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Case Study: Deutsche Bahn AG

Deutsche Bahn on the Fast Track to Fight
Corruption

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Deutsche Bahn on the Fast Track to Fight Corruption

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Executive Summary

Deutsche Bahn AG (DB) is a government-owned railway company in Germany and a leading provider of mobility, transport and logistics services in Europe. Since 1994 it has gone a long way of significant investments in modernization, expansion, acquisition, and diversification that is preparing the company for stock-listing which the German federal government agreed to take place as soon as 2007.

However, this success did not come about without overcoming serious challenges. In the ambitious run-up to modernizing its infrastructure as quickly as possible, DB launched big infrastructural programs with multi-million budgets. Not all of them were awarded in a transparent and competitive way, a business practice that led to serious corruption accusations in the beginning of the year 2000.

Bad press was combined with criticism from NGOs such as Transparency International. This made Deutsche Bahn well aware that it would need a reliable and credible partner in fighting corruption and to sell the new strategy to the public. Therefore, DB started co-operating with Transparency International and joined it as a corporative member in February 2001. Despite DB's ambitions to integrate TI in the development of the anti-corruption strategy, TI's impact was only marginal and cooperation took place on an irregular basis and most often only over telephone conversations.

Corruption is described by TI as unlawful use of an official position to gain an advantage in contravention of duty and involves both a supply side and a demand side. Companies have fallen prone to white-collar-crime in Germany and worldwide incurring significant financial and reputation losses.

Corruption became increasingly important also for policy makers. Various legislative and self-regulating programs on combating corruption and bribery have been developed on the national and inter-national level (e.g. OECD, UN) to advocate non-corrupt behavior of individuals in the public and private sector. Studies show that low corporate governance standards raise the cost of capital, lower the operating performance of industry, and impede the flow of investment. However, as long as corruption doesn't represent an endogenous phenomenon and a threat to federal public interests in Germany, the main challenge is to address it adequately in corporations.

From a public policy perspective, corruption represents a threat to the federal public interests through its spillover negative effects on domestic economic competition and growth and on German corporate competitiveness on the global market.

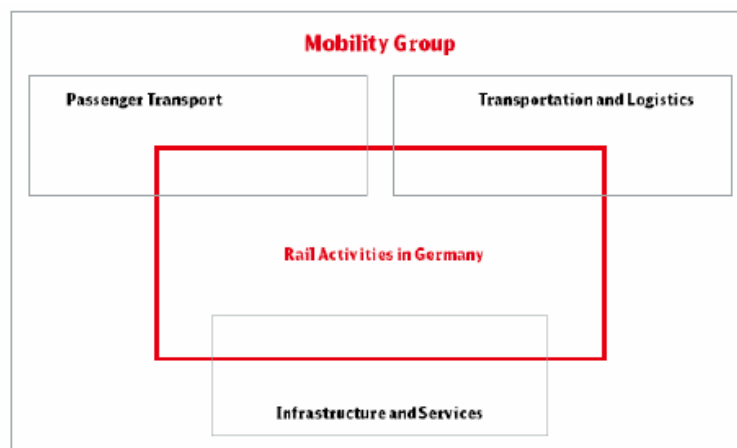
The anti-corruption strategy developed by DB represents some innovative tool for German businesses. However, its effectiveness is still to be analyzed and evaluated beyond the number of cases already discovered and punished in DB.

After 2000 the fight against corruption represented a business case for DB not only because of financial losses but mainly to reputation damages that could seriously affect the company's strategy for listing to the stock-market.

Deutsche Bahn AG and its Corporate History

Deutsche Bahn AG (DB) is a government-owned railway company in Germany and a leading provider of mobility, transport and logistics services in Europe. In Germany, DB is one of the largest employers.

The German Federal government is its sole owner, employing about 229.000 staff. Deutsche Bahn is divided into three independent from another operating business segments. The **mobility segment** includes the company's main passenger transport divisions: DB Fernverkehr (long-distance transport) and DB Regio (regional and urban transport), carry around 1.7 billion passengers annually throughout Germany and to neighboring countries. DB's **network system** manages all infrastructure and services, provides railway and craft maintenance, security and communication technology. The freight transport division or **logistics segment** moves about 280 million tons of freight annually¹ with its business units Schenker and Railion.



Source: DB Bahn Group Management Structure, 2005.

Deutsche Bahn has its headquarter in Berlin, and has offices in 150 countries. The company reported revenues of €25,055 million in 2005, which is an increase of 4.6% over the previous year. The company recorded a net profit of €610 million in 2005, which takes up to 239% compared to 2004². Despite this increase in net profit, DB faces intense competition in its passenger transport segment.

Deutsche Reichsbahn and Deutsche Bundesbahn

The Deutsche Reichsbahngesellschaft (DRG) or the German Imperial Railway Company was founded around 1920 by uniting the Staats and Länderbahnen which were operated by formerly sovereign territories and kingdoms like Bavaria, Saxony, and Prussia.

¹ DB Bahn Group Management Structure, 2005,
<http://www.db.de/site/bahn/de/unternehmen/konzern/konzern.html>

With the end of World War II and the division of Germany into four zones the DRG stopped to exist. Train service was then controlled by each of the respective zones individually. From 1949, authority over railway operations was transferred to the new governments. The DRG's successors were named Deutsche Bundesbahn (DB) [German Federal Railways] in the American, British and French sector of West German, while in the Soviet sector in the East it was renamed to Deutsche Reichsbahn (DR) [German Imperial Railways].

After the German unification in October 1990, the railway system remained separated. Both railways, Deutsche Bundesbahn and the Deutsche Reichsbahn had great deficits and investments into the railway system have long been postponed for various political reasons. Corporate structures were not in place and efficient operation of both railways was far from being realized.

In 1993 administrative and organizational problems of the German railway system were addressed by the German Bundestag who decided to unit Deutsche Bundesbahn and Deutsche Reichsbahn to form Deutsche Bahn AG. A great majority of the parliamentarians voted in favor for changing Article 87e of the German Basic Law.

This was the first step for reform of the state owned Deutsche Bahn in which the enterprise is to operate under private law. The company remains "the property of the Federation to the extent that their activities embrace the construction, maintenance, and operation of the tracks"³. The German government retains a majority of the shares.

Since 1994, DB has invested 79 billion Euros in various modernization programs, which has increased its productivity in its core business, rail operations, by more than 100%⁴. The rail reform has been a great success in which the company's earnings increased by more than 5 billion Euros.

A New Manager in DB

Hartmut Mehdorn's career in Deutsche Bahn started when he joined as chief executive in 1999, after his profession at engineering firms. A graduate engineer, he had already had a successful corporate record in effectively rationalizing business in difficulties. He held a joint function as chairman of Deutsche Airbus GmbH in Hamburg between 1989 and 1992 and, from 1992 to 1995, he was a member of the board of Deutsche Aerospace AG in Munich where he was responsible for the aviation corporate division. He was then chairman of the board of Heidelberger Druckmaschinen AG from 1997 to 1999, and, from 1998 to 1999, was also a member of the board of the large German energy supplier RWE where he was responsible for industrial holdings.

His pragmatic attitude has won him admirers such as Gerhard Schröder, former Chancellor of Germany. Despite halving of the company's workforce over the past

² <http://www.computerwire.com>

³ German Basic Law, Article 87e (3).

⁴ Datamonitor (2006): Deutsche Bahn AG: Company Profile, Reference Code 503. p. 6.

11 years, he is regarded as a boss who does care. He doesn't hide either his love for driving cars not trains and says that if it makes more sense to take the plane rather than the train, then this is what he will do.

DB's Successful Take Off

The company took off to grow as a provider of mobility, transport and logistics services by forming joint ventures with a great number of acquisitions.

The new Deutsche Bahn Chief Executive has taken a huge state-owned railway system, successfully diversified it, and made it profitable. But in order to do this, Hartmut Mehdorn needed not only strong will and political support, but also a winning vision. His goal was to turn Deutsche Bahn from a heavily subsidized, state-owned railway into a self-financing "mobility provider".

The new **DB strategy of expansion, acquisition and diversification** transformed a national railway into a multinational business group, which is Europe's biggest rail-freight operator, Germany's biggest bus operator, and the world's number two in airfreight and number three in sea-freight.

The purchase in January 2006 of the US-based logistics firm BAX Global for \$1.1 billion brought to DB access to new logistics markets in America but especially in Asia. It added to and complemented the trading operations of Schenker and Stinnes, two German logistics firms which Hartmut Mehdorn acquired in 2002.

In 2000 Railion Nederland has been acquired followed by Railion Denmark in 2001 and Alexandria-based Railion Italia in 2005 to form what is today known as DB Railion, the company's rail freight subsidiary.

The railway's **long term success** depends on whether it has sufficient access to European and global customers on various complementary market segments. DB's strategy has no alternative to diversification beyond rail, given the looming global competitive pressure and the high protectionism in Europe that threatens to slow down Deutsche Bahn's expansion.

Only because of its diversification was Deutsche Bahn able to turn its first **profit**, of €154 million in 2002, 11 years after it became a (state-owned) joint-stock company. The following years, the company strengthened its spiraling growth. In order to unfold its growth and rationalization potential, Hartmut Mehdorn consistently built upon the DB's strengths and tried to reduce its weaknesses.

However, the significant annual **cuts in the federal subsidies** (from €3.5 billion in 2004 to an expected €2.86 billion until 2008), the high level of indebtedness (down to 305% in 2004 compared to 320% in 2003) and the undercapitalization due to the postponement of DB floating are poised to endanger the DB expansionist strategy towards overseas markets.

In addition to this a DB faced a decline in passenger transportation, increased competition in long distance passenger transportation and stiff competition and price pressures in the freight market. In order to benefit from Germany's economic recovery in 2006 and 2007 and from the global booming rail/sea and air freight transport market, DB had to find a quick solution to its privatization plans.⁵ The success of Hartmut Mehdorn's grand strategy hinges on a fast and sustainable DB private capitalization.

Together with his management team he spent the last few years preparing the railway for the next strategic move – the **stock listing**.

A decision on floating DB was agreed upon by the German government on November 10, 2006. "Lawmakers agreed to sell the railway without its track. We may go ahead with a sale of as much as 49 per cent in 2008 and 2009."⁶ The German Constitution requires the government to keep a controlling stake.

How the Corruption Scandal Came all About

„The best means to fight corruption is by being observed by the public“, says Hartmut Mehdorn in 2005 when he presented the company's Corruption Report and the work of the compliance department at a press conference⁷. However, openness to inquiries from the media on corruption allegations in DB was not always welcomed. The German magazine DER SPIEGEL has portrayed DB as the most corruption prone enterprise in Germany⁸.

Until some years ago, corruption was a taboo in Germany and Germans were viewed as particularly resistant to corruption. However, the image of having a clean slate vanished with increasing corruption scandals and allegations of big German companies such as Volkswagen, DaimlerChrysler and Deutsche Bahn AG.

According to DB's deputy spokesperson Norbert Giersdorff, corruption allegations in DB were first voiced by DB employees internally⁹. These events were then followed-up by an internal investigation task force accompanied by an internal audit process. In summer 2000 they discovered irregularities and handed the case over to the Office of Public Prosecutor in Frankfurt/Main. In the months that followed, undercover investigations took place in which a special police task force of the Hessian state office of criminal investigation was involved.

According to Dr. Michael Wiehen, member of the board of Transparency International Germany and cooperation partner of DB admitted that corruption is most likely to "occur in departments that negotiate building contracts with private firms"¹⁰.

⁵ Datamonitor (2006): Deutsche Bahn AG: Company Profile, Reference Code 503. www.datamonitor.com

⁶ Wolfgang Tiefensee in Financial Times, November 10 2006, p.4.

⁷ Deutsche Bahn AG (2005): Korruptionsbericht.

⁸ Der Spiegel (2005), Nr.8, p. 92ff..

⁹ Interview Norbert Giersdorff, chief deputy spokesperson DB, 6.11.2006.

¹⁰ Interview with Dr. Michael Wiehen, TI, 24.11.2006.

On 30 October 2001, upon search order by the senior prosecutor Mr. Schilling in Frankfurt/Main a country wide corruption network of DB was discovered. During the search 17 offices and apartments as well as two companies were examined by the police that arrested four business men, which were doing business with DB. Among the arrested was a former DB purchasing manager, who had been laid off from DB for unrelated reasons. He was accused of having accepted ready money and presents with a value of 3.4 million Deutsch Mark (€1,7 million) ¹¹. In exchange he was accused of having arranged special DB contracts with a value of more than 100 million DM (€51.3 million) with his partners.

Only after these incidents it was obvious to the public and to DB top management that this was only the tip of the iceberg on corruption in the company¹². Most severe cases of corruption occurred in departments that had strong working relations with the private sector, e.g. the construction and building business.

In the course of the reconstruction period in East Germany, big infrastructural programs with multi-million budgets were set up to reconstruct railway tracks, stations and other railway related facilities. In 2000 and 2001 when corruption incidents were discovered countrywide, these infrastructural projects and in particular, the allocation of building and construction contracts were closely scrutinized.

In many cases, DB regional managers in East Germany and business men were accused of having demanded bribe money and where granted great sums in exchange for convenient business deals between contractors and Deutsche Bahn. For example, in November 2001, the project manager of the DB subsidiary *DB Projekt Verkehrsbau GmbH*, was arrested under allegations of bribery and extortion in which he demanded 700.000 DM (€358.000) from a construction company from Bavaria. In case of non compliance, the project manager threatened the company to exclude it from future contracts¹³.

Such incidents have occurred many times and the exact number of persons affiliated with taking bribes, allocating contracts to firms with dubious management personnel is very difficult to reveal. According to DB, there are numerous individuals and firms as well as connections abroad such as off-shore bank accounts. DB's head of the legal department, Margit Suckale announced in November 2001 that DB is "currently working actively and fearlessly to uncover corruption within the company"¹⁴. At this point in time, 180 internal incidents have been investigated of which 25 have led to prosecution.

In a big company such as DB with over 229.000 employees as well as contractors worldwide, fighting corruption is a difficult and long process that requires dedicated management, analysis of existing transparency procedures, expertise to combat corruption effectively as well as mechanism to sanctioning corrupt behavior.

¹¹ Conversion rate 1.95583.

¹² http://www.wdr.de/online/wirtschaft/bahn_korruption/index.phtml

¹³ http://www.zugchefa.de/beruf/seiten/1_presse/2001/11-01.htm

¹⁴ http://www.zugchefa.de/beruf/seiten/1_presse/2001/11-01.htm

Role of Civil Society: Transparency International

Transparency International (TI) is a global civil society organization that is the leading international organization addressing corruption. It was founded in 1993 and is headquartered in Berlin, Germany.

TI's mission is to create change towards a world free of corruption. The organisation describes itself as a "global network including about 100 locally established national chapters and chapters-in-information"¹⁵. For almost two decades these bodies have been successfully fighting corruption in the national arena in a number of ways: they bring together relevant players from government, civil society, business and the media to promote transparency in elections, in public administration, in procurement and in business. TI's global network of chapters and contacts also use advocacy campaigns to lobby governments to implement anti-corruption reforms.

TI itself does not undertake investigations of alleged corruption or expose individual cases, but at times will work in coalition with companies such as Deutsche Bahn.

The NGO has become known as a reliable and trustworthy partner in the national and supranational arena to combat corruption. It has developed a set of indicators to measure corruption as well as tools and instruments that it makes available for all stakeholders:

1. **Corruption Measurement:** Provision of reliable quantitative diagnostic tools regarding levels of transparency and corruption, both at global and local levels.
2. **Integrity Pacts:** This tool is to prevent corruption in public contracting.
3. **Preventing Corruption on Construction Projects:** TI has launched an international initiative aimed at preventing corruption on construction projects.
4. **Business Principles for Countering Bribery:** This tool aims to provide a tool for companies to look for comprehensive reference to good practice to counter bribery.
5. **Anti-Corruption Handbook:** This guide is to assist in the process of designing and applying anti-corruption measures.

Among TI's active advocacy campaigns against corruption, the organization issues an annual Corruption Perception Index (CPI) and publishes an annual Global Corruption Report, a Global Corruption Barometer and a Bribe Payers Index.

TI Germany has attracted a large number of corporate members such as SAP AG, German Federal Employment Office, Deutsche Lufthansa, Schering AG etc¹⁶. Since February 2001 Deutsche Bahn AG is a corporate member of TI.

¹⁵ <http://www.transparency.org>

¹⁶ For an extensive list of corporate members see Annex 1.

Cooperation between Transparency International and Deutsche Bahn AG

TI became aware of corruption incidents in DB only through the media in spring 2000. In fall, DB's ombudsman Dr. Rainer Buchert from Frankfurt/Main approached TI and brought the organization and DB together on one table. "Dr. Buchert knew us and introduced us to the legal department of DB¹⁷", says Dr. Michael Wiehen, Member of the Board of TI and cooperation partner for DB.

Deutsche Bahn was well aware that it would need a reliable and credible partner in fighting corruption and to sell the new strategy to the public. Therefore, DB was cooperating well with Transparency International and soon joined TI as a corporative member in February 2001. Corporative membership with TI includes regular biannual meetings with all corporative members (see annex). In these meetings tools and measures to curb corruption are being discussed and members exchange experiences and takes on corruption.

"Deutsche Bahn was eager to get positive news in the press and hence was very cooperative in working with us. [...] For example, we have developed rules for the allocation of building contracts with DB."¹⁸

In regular meetings with DB's head of the legal department, Dr. Wiehen was consulting on possible means to develop the anti-corruption strategy. "We did not directly cooperate with DB's managing board but we knew that they were informed about our activities and consultations by the head of the legal department¹⁹". Margit Suckale, who at the time was heading the legal department and who was identified as the contact point for TI was responsible for working on an internal strategy.

According to Dr. Wiehen, cooperation with DB took place on an irregular basis and most often over telephone conversations with Mrs. Suckale. Dr. Wiehen was describing TI's function in this process as a "checking tool" rather than that of an integrated partner for DB.

Despite DB's ambitions to integrate TI in the development of the anti-corruption strategy, the impact of TI's influence seemed only marginal. TI was not directly involved in the analysis of the corruption problem neither in DB, nor in strategic development of the anti-corruption strategy but was rather consulted once parts of the strategy had already been developed.

TI's reputation as a credible organization fighting corruption was strategically facilitated and publicly used by DB e.g. by publishing TI articles in DB's customer magazine, *DB mobil*. A TI proposal such as the full implementation of the Integrity Pact²⁰ which applies

¹⁷ Interview with Dr. Michael Wiehen, TI, 24.11.2006.

¹⁸ Interview with Dr. Michael Wiehen, TI, 24.11.2006.

¹⁹ Interview with Dr. Michael Wiehen, TI, 24.11.2006.

²⁰ Eigen, Peter/ Wiehen, Michael (2003): Wenn der Ehrliche nicht der Dumme ist - Der Integritätspakt von Transparency International ein Ausweg aus dem Gefangenendilemma?

sanctions in cases of violation of contracts was only included in a lighter version as DB's 'integrity clause' in building contracts.

Moreover, TI is not monitoring DB's strategy after implementation. It maintains contacts to the ombudsmen: "We cannot assure that there has been an internal learning and regular evaluation process in DB. [...] we monitor the current events at DB from a distance. We are only observers."²¹ The current status of cooperation between DB and TI are the regular meetings of corporate members.

Today, TI and DB continue to cooperate with each other on the corporate membership level. Many big German firms such as Deutsche Lufthansa and Schering AG cooperate with TI on this level and hence make use of the NGO as a cachet for their alleged active corporate behaviour towards corruption.

On the other hand, TI Germany depends on corporate membership as membership fees from companies make up 40% of TI's annual budget²². According to Spiegel Online, other international NGOs such as Greenpeace deny any donations by companies while TI accepted about 52.000 Euros in fees and donations from companies in 2002. Corporate membership fee in TI is restricted to 5.000 Euros annual.

Business Crime Control, a German NGO dedicated to disclose white-collar crime criticizes TI for treating its corporate members too gentle when it comes to fight corruption in big German firms.

In the case of corruption allegations of corporate members, TI has no means of sanctioning despite suspending and later excluding members from TI²³.

What is Corruption?

Corruption is described by TI as unlawful use of an official position to gain an advantage in contravention of duty. This can involve the promise of an economic benefit or other advantage, the use of intimidation or blackmail. It can also refer to the acceptance of such inducements.

Corruption involves both a **supply side** and a **demand side**. While much attention of the global anticorruption literature and campaign in the last years has been directed toward the demand side of corruption (e.g. corrupt government officials), the supply side of corruption is just as significant, and the role of the corporations as the main contributors of bribe payment is highly important²⁴.

Rules of corporate governance including accountability and transparency have profound impacts on the behaviours of both the bribe takers and bribe payers involved in corrupt practices.

²¹ Interview with Dr. Michael Wiehen, TI, 24.11.2006.

²² Eltermann, Claudia (2003): Feigenblatt der Großindustrie, in: Spiegel online, 4.11.2003.

²³ One example is Siemens AG that has been suspended from TI's corporate membership list in 2004 and has been excluded on 15 December 2006.

²⁴ TI starts its Bribe Payer Index only in 2002.

Globalization can spur the convergence of corporate governance to international standards. However, it can also increase competition for a large number of inefficient domestic firms, and thus may create high pressure for them to bribe in order to survive.

Additionally, by some multinationals bribery is used as a marketing strategy to penetrate into emerging markets. Transparency International's Bribe Payers Index indicates that companies from some of the leading exporting nations in the world, including Germany, still pay bribes in foreign countries to gain unfair advantages over their competitors²⁵.

In an era of globalization, bad corporate governance leads to the export of bribery practices across the borders and thus undermines the effectiveness of the global anticorruption campaigns.

According to the 10th principle of the UN Global Compact²⁶, the private sector has ethical and business reasons to refrain from corrupt behaviour. Companies whose policies and practices fail to meet high ethical standards face trust and reputation losses while staff motivation and loyalty erodes. Beyond additional legal risks and financial damages, firms expose themselves to blackmail and long-term lack of sustainability of their businesses. Resources are inefficiently managed and the quality of services and materials used, seriously distort companies' regional or global competitiveness.

The graphs below show the 2005 PriceWaterhouseCoopers Global Economic Crime Survey²⁷ shows for example that 45% of companies worldwide have become prone to economic crime in the past two years. Despite the growing confidence that the corporations surveyed have in their risk management systems, most fraud (34%) is still detected by chance (e.g. through tip-offs). No industry is safe – whether regulated or not - and the larger the company, the higher the likelihood that it will experience and detect acts of fraud.

In the past two years, the average financial damage to companies from tangible frauds (e.g. asset misappropriation, false pretences, and counterfeiting) was US\$ 1.7 million (1.289 million Euros)²⁸.

47% of the companies that suffered fraud managed to recover at least some of their assets. Preventing corruption is complex as the phenomenon of corruption itself and combinations of interrelated mechanisms, including sound ethics management systems, specific prevention techniques and effective law and law enforcement, are needed for successful prevention of corruption.

²⁵ TI Bribe Payer Index 2006, p. 7

²⁶ <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle10.html>

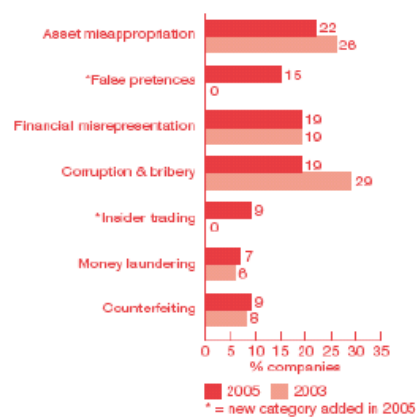
²⁷ PriceWaterhouseCoopers Global Economic Crime Survey 2005.

²⁸ Exchange rate 22.12.2006, <http://www.oanda.com>

Figure 1: Companies reporting fraud (worldwide)



Figure 5: Perceived prevalence of fraud (among all companies interviewed)



Source: PWC Survey 2005

The Regulatory Framework on Corruption and Bribery

In the second half of the 1990s, fighting corruption and bribery became increasingly important for policy makers on the national and supranational level. Today, corruption is being addressed worldwide in politics, administration, civil society and the private sector.

Various programs on combating corruption and bribery have been developed to advocate non-corruption of individuals, companies and institutions. Increasingly, emphasis has been placed on the effects of corruption by the **United Nations** (Global Programme Against Corruption), the **OECD** (OECD Guidelines for Multinational Enterprises; OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions), **EU**, and **IMF** (Guidelines Regarding Governance Issues).

Some of these regulations have specific impact on national legislation and place new responsibilities upon national decision-makers to fight corruption. For example, the OECD Guidelines for Multinational Enterprises are recommendations providing voluntary principles and standards for responsible business conduct for multinational enterprises operating in or from a country adhered to the Declaration. The German government along with all other OECD member states has signed a binding decision in June 2000 to participate in the implementation of the guidelines and to promote their observance of the recommendations by companies operating from Germany²⁹. As an interface, the German government has set up a National Contact Point in the Ministry of Economics and Technology. The NCP is a government office that is responsible for the promotion of the OECD Guidelines on the national level.

Another OECD instrument is the Anti-Bribery Convention which aims at reducing corruption in developing countries by sanctioning bribery in international business

²⁹ Gordon Kathryn (2001): The OECD Guidelines and Other Corporate Responsibility Instruments: A Comparison. Working Papers on International Investment.

transactions carried out by companies based in the convention member countries, such as Germany.

The convention came into effect in February 1999 and requires countries that have signed the convention to pass legislation that criminalizes bribing of foreign public officials. The OECD has no authority to implement the convention. However, it monitors the implementation by participating countries in a two-phased examination process. Phase I consists of a review of legislation implementation of the convention in the member country. Phase II assesses the effectiveness with which the legislation is applied.

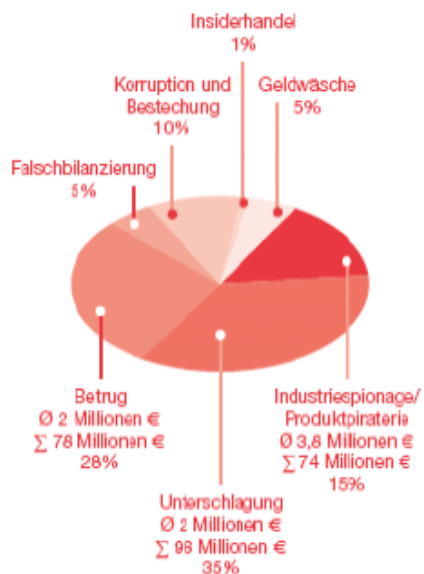
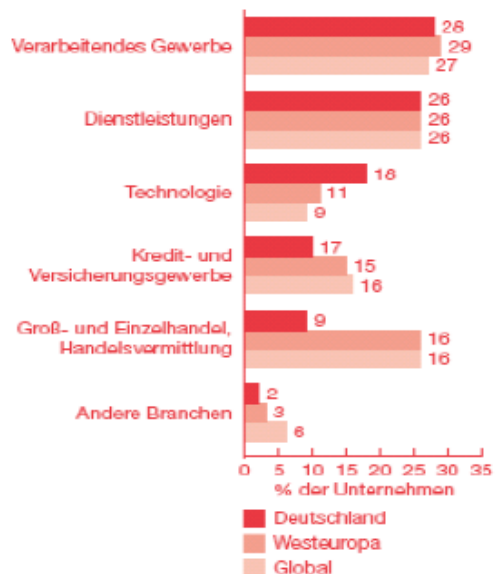
On the international level, combating corruption in international business is widely recognized as an essential step in maintaining a sound international trading system and assuring the viability of market economies. This requires a comprehensive program, directed at bribe payers as well as bribe takers. Corporate codes of conduct are a key part of such a program.

For example, in the U.S., corporate codes of conduct have been used for many years as a way to achieve compliance with legal and ethical rules. The bribery scandals of the 1970s, and the enactment of the Foreign Corrupt Practices Act (FCPA) in 1977, resulted in the adoption of anti-bribery codes by many U.S. companies. On the international level, the International Chamber of Commerce (ICC) in Paris published Rules of Conduct to Combat Extortion and Bribery in 1977. According to TI USA, a number of non-U.S. companies have adopted codes modeled on the ICC Rules. Many other companies were reluctant to adopt anti-bribery codes because they believed that their competitors would continue to pay bribes³⁰.

Corruption in Germany

According to the 2005 PWC Survey, 62% of the German companies with more than 5,000 employees were prone to corruption and experienced economic fraud. The German companies lost altogether between 2003 and 2005 over 250 million Euro. Only 43% managed to recover their financial losses partially.

³⁰ <http://www.transparency-usa.org>

Abb. 8: Finanzielle Schäden ausgewählter Delikte in Deutschland**Abb. 37: Wirtschaftszweige**

Source: PWC Survey 2005

German Legal Framework in the Context of Corruption

In 2000 the German penal code (*Strafgesetzbuch*) was reformed to respond to increasing corruption and bribery of officials in the public sector. Laws were passed to prohibit and sanction this behaviour to set off penal advantages against tax liabilities. Furthermore, finance administration is obliged to report bribes according to the German Income Tax Act (§ 4 EStG)³¹. However, in practice there is no coherent pattern of implementation.

The German legal framework provides for measures to sanction corrupt behavior of individuals in the context of a firm or the public sector. Employment law provides for admonition to instant dismissal from the workplace.

In Germany, there is no centralized coordination or supervision system that takes care of corruption. In legal terms the federal states are responsible for prosecution. Among those several have established specialized corruption prosecution offices at state-, regional- or municipal-level³². However, numerous rules and directives on corruption exist in federal and state laws as well as in municipal administrative regulations that make up a highly imprecise regulatory framework with many interdependencies.

Publicly financed institutions and enterprises such as Deutsche Bundeswehr and Deutsche Bahn are obliged by law to report corruption to the Office of the Public

³¹ Schauensteiner, Wolfgang (2006): *Erfolge und Blockaden bei der Korruptionsbekämpfung*, in Netzwerkrecherche, nr-Werkstatt: Dunkelfeld Korruption – Mehr Qualität durch Recherche – Vonder Kür zur Pflicht, Jahreskonferenz netzwerk recherche 19. und 20. Mai 2006, Hamburg, p. 42.

³² TI Progress Report (2005): *Enforcement of the OECD Convention on Combating Bribery of Foreign Public Officials*, p. 7ff.

Prosecutor. However, without criminal investigations and proceedings, corruption cases will not be followed up.

Germany still lacks a countrywide corruption register. Furthermore, a comprehensive business criminal law (*Unternehmensstrafrecht*) with flexible sanctioning mechanisms would enhance the incentives for enterprises to develop anti-corruption strategies and set-up effective compliance departments for preventive control mechanisms within firms.

In practice it is fairly easy for companies to conduct corporate business behaviour without legal consequences. Insufficient control mechanism by the federal government has to be replaced by effective and highly qualified control procedures for public administration as well as for private enterprises³³.

DB Anti-Corruption Strategy

Launched in 2000, at the initiative of Hartmut Mehdorn, the DB anti-corruption program has a unique systematic structure and model character³⁴ which has meanwhile attracted immense national and international attention. Soon after his appointment as the new DB's CEO, Hartmut Mehdorn demonstrated his leadership by urging the chiefs of Law, Corporate Security and Revision Department to set up the **Compliance Steering Committee**, which was eventually supplemented by **two ombudsmen** and representatives of the Human Resources Department.

Mehdorn declared compliance activities a strategic matter and urgently called for full support from the supervisory and management board, managers and employees. By means of a top-down approach he laid the foundation for a completely new corporate culture shaped by transparency, loyalty and integrity: "The best remedy against corruption always has been and always will be the public limelight." declared Mehdorn. Through the financial, reputation and motivational losses, the corruption represented a threat to the business profitability of DB.

Compliance Steering Committee

The core institutions of the fight against corruption at Deutsche Bahn are the **Ombudsmen**, lawyers to whom information can be reported in confidence, and the **Compliance Steering Committee (CSC)**, which examines all information in detail and initiates internal investigations. Additional punitive and preventive measures are aimed at making the DB fight against internal corruption a success story.

³³ Ibid. Pragal, Oliver (2006), p. 63ff.

³⁴ According to the DB deputy chief spokesman there was no company at the beginning of 2000 in Germany with an established anti-corruption management system. Online interview with Norbert Giersdorff, November 2006.

Started in 2000, “the objective of compliance work at the DB Group is to protect honest employees, uphold the ethical values of the company and do “clean” business with law-abiding partners.”³⁵

The mission of the CSC includes both punitive and preventive measures to tackle corrupt behaviour of the company’s employees. The CSC examines all information in detail and initiates internal investigations through its two specialized units, Corporate Security and Corporate Revision.

It operates after self-designed procedures and is obliged to thoroughly document any case of suspected mismanagement. Based on clear evidence of the investigation, CSC then recommends to the superiors of the suspected employee disciplinary steps to be taken.

They range from warnings or transfer onto other positions until definitive dismissals. Moreover, the CSC closely cooperates with and assists the German public prosecutors and the police with their investigations by documenting the suspected cases. Over the last years, the CSC activity was ameliorated and streamlined through the creation of a Compliance Officer position.

The Compliance Officer

It is important for employees to know who is in charge of handling potential ethical violations. A compliance/ethics officer manages a company’s ethics policies and makes sure that every employee is well-informed of company values and standards. The officer guarantees that employees who violate the codes of conduct are held accountable and disciplined for unethical behavior. They also maintain confidentiality when a whistle blower reports a possible violation.

According to DB publications the first DB Compliance Officer is Regina Puls³⁶. She is responsible for the management of the CSC, leads the Contract Awarding Ban Committee, and checks the penal, civil and work law relevant whistle-blown cases. She took over the key job in January 2005 after one year of professional experience in German *Bundeskriminalamt* and after acting as chief of the unit “Investigation and Special Tasks” within the DB Corporate Security department. “Fraud and bribery are not just petty offences. They harm our company and pose a threat to jobs”, says Mrs. Puls.

Her role is not to only to manage everyday activities of the CSC, but also to create momentum for a new corporate culture and identity that increases the trust between employees and managers, between DB and its political, business and community share-and stakeholders. A 2004 GlobeScan survey of 1,000 employees in European large companies found 84 percent of the respondents agreed with the phrase, ‘CSR increases my motivation and loyalty.’ However, only 64 percent felt their company had done a good job informing them about its social responsibility commitments.

³⁵ Deutsche Bahn AG (2005): Korruptionsbericht, p. 4.

³⁶ All quotes in this paragraph are taken from Deutsche Bahn AG (2005): Korruptionsbericht, p.4.

Ombudsmen and Whistle Blowing System

Ombudsmen are independent lawyers to whom DB's employees and business partners can report in confidence their mismanagement suspicions. They are also part of the Deutsche Bahn's CSC and assure a direct, personal and more effective whistle-blowing system with input both from within and from outside the company.

Whistle blowers are people who often at great personal risk choose to disclose information about improper government or industry actions that are harmful to public health, the environment, the economy or others.³⁷ It is crucial for companies to protect the rights of its employees and provide an anonymous "open line" of communication for those that have been exposed or witnessed infringements upon company principles or government laws. The reporting steps should be clearly laid out for all employees and easily accessible at any time. The system is known in Anglo-Saxon countries since the end of 1970s.

The system was introduced by DB for the first time in the German corporate world in 2000. In order to create trust among the potential whistle-blowers, DB's priority was to structure the process in such a way that whistle-blowers' identity remain fully confidential and their interests protected. In the absence of any legal incentive or rewarding mechanisms³⁸, the protection and confidentiality were the only mechanisms to make people come out of the darkness. "Whistleblowers-Hotlines and Voicemails" were created and used along with special software that guarantee a full anonymous correspondence.

However, the lack of personal contact hindered the rapid emergence of a trust-based relationship. For this reason, DB hired in 2000 Dr. Edgar Joussen and Dr. Rainer Buchert, two experienced and independent lawyers as Ombudsmen with the mission to encourage, take up and cultivate personal and confidential contact with whistle-blowers.

They act as information screener and abide by an absolute silence with regard to the identity of the people that approach them. Not even DB can find out who they are, without their consent. Ombudsmen are however closely cooperating with the Compliance Officer to whom they are subordinated. The ombudsmen as well as the Compliance Officer can be approached at any moment. Clear contact details are available on the DB website, in its activity, management reports and employees newsletters.

The "objectivity and searching for incriminating and exonerating evidence are the guarantee which encourages an increasing number of whistleblowers to inform the internal contacts at DB," says Mrs. Puls. This corruption detection mechanism is the first

³⁷ Dworkin, T. /Near, J. (1992). *Blowing the Whistle: The Organizational and Legal Implications for Companies and Their Employees*. Maryland: Lexington Books.

³⁸ The German TI expert reports that there is no specific whistleblower protection for foreign bribery complaints and that whistleblower protection in Germany is generally weak. There are currently plans to introduce a regulation in the German Civil Code (BGB) to protect employees in the private sector who blow the whistle. See TI Report on Progress in Enforcement of the OECD Convention on Combating Bribery, p.10, June 2006.

but not the only necessary step in effectively addressing corruption. Punitive and preventive measures play a crucial role.

From Punishment to Prevention

“We want everyone to know that DB AG does not view corruption merely as a necessary evil or concomitant phenomenon, but as something it is determined to fight. We believe that this attitude alone acts as an effective deterrent,” declared Hartmut Mehdorn.

Indeed, his “no tolerance policy” was rewarded. Over the past five years the DB has designed and implemented both punitive and preventive mechanisms that turned out to be very effective in the fight against corruption.

Corruption Punishment

In some of the cases, DB’s former employees and also external parties who benefited from corrupt practice received heavy prison sentences. Further steps were taken under labor legislation that ranged from letters of caution to dismissal without notice.

“The Federal Railway Property Office also had to take action, as the employees concerned also included civil servants from the era of the state-owned *Deutsche Bundesbahn*, who - in addition to sanctions under criminal and civil law – also risked disciplinary steps by the competent public authority.”³⁹

However, DB punitive strategy depends to a great extent on the implementation by the German federal government of the OECD Convention on Combating Bribery that was already ratified by 36 countries and has to be enforced by national governments. Since many major companies have their headquarters in Germany an effective enforcement would significantly reduce the supply side of corruption.

Corruption Prevention

Corruption prevention is to be distinguished between **internal** (within the company) and **external** (with business partners) mechanisms.

The first step to address corruption internally was the issuance of a clear code of **conduct** for all DB employees, which contains specific instructions in the form of behaviour directives or the directive regarding the conflict of interests. During their employment in the company, the employees “may not, in connection with their work, demand or accept from third parties payments or other advantages for themselves or for any other person or grant third parties unlawful advantages.”⁴⁰

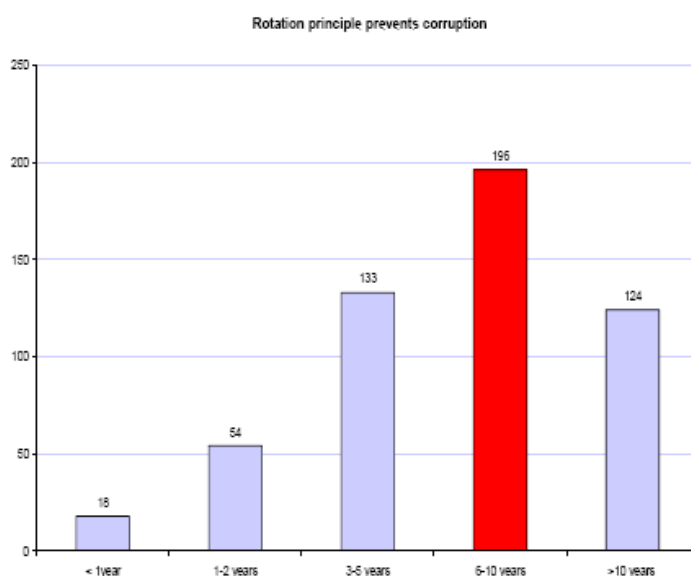
³⁹ Deutsche Bahn AG (2005): Korruptionsbericht. p 7.

⁴⁰ Deutsche Bahn, Corporate Governance Principles 2003, p.4/5-8/9.

Moreover, internal control instruments have been set up such as the **dual control principle**, the **rotation system** and **independent audit procedures**.

The dual control principle (*Vier-Augen-Prinzip*) aims at reducing corruption by the countersigning of contracts and payments.

The rotation system on the other side tries to reduce the corruption by transferring regularly the personnel occupying positions with a high corruption risk. The corruption exposure increases direct proportionally with the period spent in a particular position as shown in the following graph.



Source: Bundeslagebild Korruption 2004, Bundeskriminalamt

DB's books are checked by the Federal Court of Auditors (*Bundesrechnungshof*), which produces regular financial reports on the use of financial resources, by the Federal Railway Authority (*Eisenbahnbundesamt*) and the German Association of Taxpayers (*Bund der Steuerzahler*).

At present no independent external auditor checks the books of DB. TI experts believe that substantial improvements are needed in Germany's accounting and auditing requirements to prevent the concealment of bribery⁴¹. According to a confidential statement by a DB employee from the strategic department, the company intends to introduce an output- instead of an input oriented audit system that is currently used. This would focus

⁴¹ TI experts note that "German auditors are legally obliged to notify legal representative or supervisory board of the audited company of any irregularities and violations of statutory provisions or facts that constitute serious violation of law. However, neither auditors nor statutory bodies have an obligation to report suspicion of corruption to prosecutorial authorities" in TI Report on Progress in Enforcement of the OECD Convention on Combating Bribery, p.13, June 2006.

more on quality verification of the services and the infrastructure. Considering the future privatization of DB this aspect is highly relevant.

Despite some internal presentation and briefings, there is still no systematic education program for DB employees but appropriate steps were under close consideration according to Regina Puls⁴².

Deutsche Bahn developed **external prevention** instruments as part of its relations with the business partners. To this purpose an **integrity clause** was introduced in the DB's "General Terms and Conditions of Purchase", which specify severe consequences applied without reservation in case of corrupt conduct on the part of companies working with DB. These sanctions range from a 10% reduction of the contractual payment to contract cancellation without notice or a gradual ban (*Vergabesperre*) between 3 and 7 years on bidding for DB contracts.

Under pressure from the German business community, DB has taken up TI's developed "**integrity pact**" only partially⁴³. The integrity pact, opposed to the integrity clause described above, has the form of a legal contract between suppliers and providers to give up any hidden deals that could lead to financial or competition losses and to allow for independent external monitoring. It covers planning, preparation, publication and development of big projects such as construction, service provision, privatization, licensing or concessions) and provides for clear sanctions for any non-compliance.

Additional guidelines for DB business partners stipulate mutual recognition of corporate value management:

1. Common guidelines for relations between contractors and suppliers;
2. Common guidelines for contractors and suppliers of engineering and architectural services and
3. Common guidelines for contractors and suppliers of security and construction related services.

Although important in the current form, DB understands the fight against corruption not as a fixed approach but as a "dynamic process" that adapts to the constant innovations in corruption techniques. Sometimes it is not necessary to design or implement new instruments, but to refine or upgrade the current effective ones even more.

Effectiveness

The 2006 Transparency International Report on OECD Progress evaluates the German **corporate anti-bribery compliance** and **whistleblower protection programmes** as ineffective. The **financial and staff resources** for foreign bribery enforcement that enable public prosecutors to launch investigations is unsatisfactory. So far, Germany is

⁴² Deutsche Bahn (2005): Korruptionsbericht, p.4.

⁴³ Interview with Dr. Michael Wiehen, TI, 22.11.2006.

also lacking a law for criminal liability for corporations. Although not an OECD Convention requirement, criminal liability of corporations is regarded as important because it provides a stronger deterrent than personal liability⁴⁴.

According to DB **effectiveness indicators** of the company's anti-corruption strategy include the number of detected, investigated and sanctioned cases. However, measurement of the degree of employee acceptance and trust in the new system, of the financial and reputational damage recovery, the degree of business partners' recognition and compliance with the DB anti-corruption instruments need to be evaluated. External data such as surveys and evaluations of NGOs on effectiveness of the anti-corruption strategy is not available. "We do not have the resources to conduct an encompassing survey on how well the strategy was implemented in DB" says Dr. Wiehen of TI⁴⁵.

According to DB publications⁴⁶, most of the cases which were brought to attention turned out to be indictable offenses. This shows that **high quality of information** is acquired through the whistle blowing system. The initial fear that the system could lead to denunciations did not materialized. About 430 cases have been dealt with by the CSC between 2000 and 2005.

At the time of the 2005 DB Report on Corruption, 221 cases were solved and in 124 cases DB pressed criminal charges or assisted the German public prosecutor and the police with their investigations⁴⁷. The number of anonymous letters decreased and no case of self-denunciation occurred.

Despite the supposed success, it is not always easy to detect and prove true corruption accusations. Depending on the complexity of the corruption practices, the investigation could span from weeks to some months. It is difficult to assess the employee's trust and acceptance of the new anti-corruption system. Questions arise such as: Is the number of detected cases a strong evidence for this confidence? How much corruption is going undetected?

Moreover, no precise data exist on how much money has been recovered by DB after corrupt cases were confirmed and suited, nor how much money would have been lost if corruption had not been fought at all.

How much is and how can one assess the losses in reputation? Since most of the cases seem to be located in acquisition, services and construction contracting or in standard compliance⁴⁸, further steps and instruments have to be carefully considered by DB especially in the perspective of soon being a listed company.

⁴⁴ TI Report on Progress in Enforcement of the OECD Convention on Combating Bribery, 2006, p.14.

⁴⁵ Interview with Dr. Michael Wiehen, TI, 24.11.2006.

⁴⁶ All quotes in this paragraph are taken from Deutsche Bahn AG (2005): Korruptionsbericht, p.7.

⁴⁷ Ibid.

⁴⁸ *Gnadenlos unterschätzt*. Interview with Dr. Edgar Joussen, Ombudsmann of the Deutsche Bahn AG realized by Dieter John, Managing Partner Forensic bei KPMG in Spring 2006.

Abb. 29: Maßnahmen zur Ermittlung und Bekämpfung von Wirtschaftskriminalität

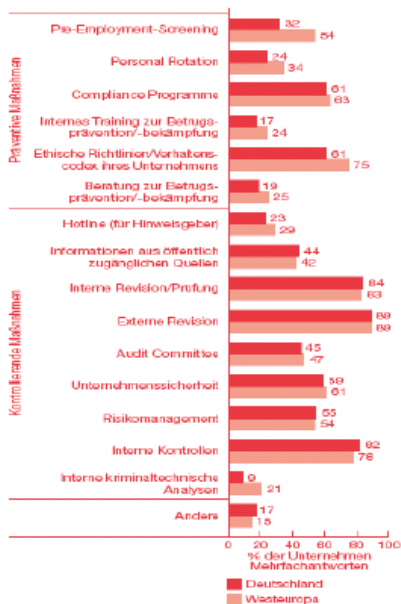
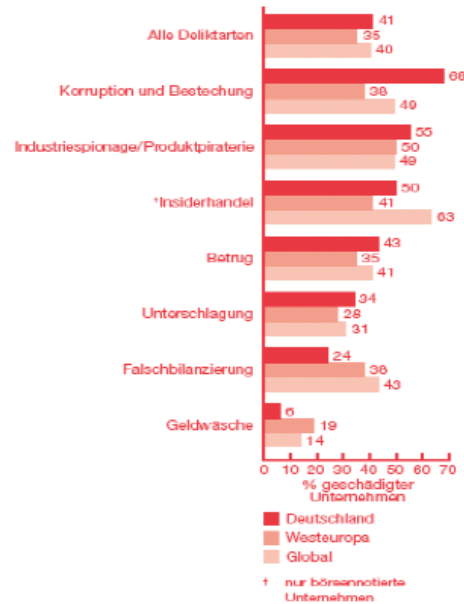


Abb. 9: Immaterielle Schäden der Wirtschaftskriminalität



Source: PWC Survey 2005

The License to Operate of DB: A Business Case

Deutsche Bahn AG has a great variety of social activities⁴⁹. The company's portfolio includes a reading and language skills program for children (*Stiftung Lesen*), anti-racist initiative (*Bahn Azubis gegen Hass und Gewalt*), program to support street workers (*Off Road Kids*) as well as cultural and sport activities.

Corruption allegations in DB and the public dissatisfaction with the company's performance have become a major problem for the company and its management since 2000. At this point the company itself has set out a clear signal to its stakeholders that it is committed to fight corruption by developing an anti-corruption strategy and institutionalize the relevant instruments.

However, the decision to fight corruption and to make it a management priority by the newly designated chief executive Hartmut Mehdorn was not coincidence. Mehdorn joined the company in 1999, at a time when most of the big budget infrastructural projects were about to be finished. Since 1994 DB invested 79 billion Euros in a variety of infrastructural and modernization programs⁵⁰. The interest if the company was now to restructure the DB to prepare it strategically for privatization. Hartmut Mehdorn was perceived as the man who was able to transform DB into an efficient and internationally successful company.

⁴⁹ <http://www.db.de/site/bahn/de/unternehmen/engagement/engagement.html>

⁵⁰ Datamonitor (2006): Deutsche Bahn AG: Company Profile, Reference Code 503, p.6.

In this fragile business environment, public corruption allegations with the potential to harm the privatization process negatively revealed a shift in interests. Corruption and bribery was not a new phenomenon in DB, particularly with the reconstruction and modernization of large parts of Eastern Germany. At this time infrastructural projects under time constraints and of high political relevance were conducted without close scrutiny for corruption and bribery. This seemed to change when the scandal arose in 2000. Making privatization a top priority DB strategically sought support from partners which whom to work towards socially responsible corporate behavior.

One example is Transparency International as a reputable and highly credible partner in fighting corruption. Moreover, DB has become a member of various organizations and networks that demonstrate corporate social responsibility among those TI corporate membership (2001) and ECONSENSE – Forum für Nachhaltige Entwicklung in der Deutschen Wirtschaft (2004)⁵¹.

DB's commitment to include the anti-corruption strategy in the company' strategic planning led to development of the Corporate Governance Principles⁵². They were approved by DB's Management Board and Supervisory Board in March 2003 and state the duties and responsibilities of DB management board and supervisory board as well as DB's relationship towards its shareholders.

These Principles anticipate prevention of corruption in respect of aspects such as transparency as well as reporting and audit of the annual finances. Although Deutsche Bahn is not yet listed on the stock exchange, it has already introduced a code of practice for the management and supervision of the company, which is intended to signal improvement of transparency within the company to the national and international capital markets. Unlisted companies can subscribe to these German corporate governance principles on a voluntary basis.

Regular presentation of DB's corruption reports and the work of the compliance department at press conferences signal DB's commitment to fight corruption.

These developments indicate that DB's corporate culture was about to change to the extent that corruption was no longer tolerated and that the management of DB was committed to make corruption a business case for the enterprise. Corporate Governance was to become a new benchmark for corporate socially responsible behaviour in auditing, allocation of building contracts, relationships with customers, suppliers and subsidiaries.

The extent to which corporate governance principles are being implemented and adhered to in DB's management and among its contractors is still to be seen.

According to DB, one component of its success on the anti-corruption campaign was the organized communication strategy. Both, within and outside the company, the message was clear: fighting corruption was to reach employees, business partners and the public opinion. They had to become aware of the company's commitment to fight corporate

⁵¹ <http://www.econsense.de>

⁵² http://www.db.de/site/shared/en/file_attachments/reports/corporate_government_principles.pdf

corruption. The strategy was claimed a success by DB. Put into perspective, DB indeed was the forerunner in dealing with corporate corruption in Germany. However, compared to the international level, corporate risk management was not new at all. In the USA, for example, corporate codes of conduct have been implemented by companies since the 1970s.

The current degree of DB's announced success to deal with corruption made other German companies to ask specific consultancy from DB on how to approach the problem in their businesses. However, the transferability of the model is limited.⁵³

The specific nature of the company being a government owned enterprise and its sheer size make it difficult to transfer the model to other companies. A lot depends on the top leadership, the management structure and transparency instruments within the firm.

A key question still remains: in the absence of a coherent legal system in Germany that effectively detects and sanctions corruption and against the background of the pending privatization of DB, how much in the anti-corruption strategy is window-dressing and how much is actually authenticity?

⁵³ Interview with Dr. Michael Wiehen, TI, 22.11.2006.

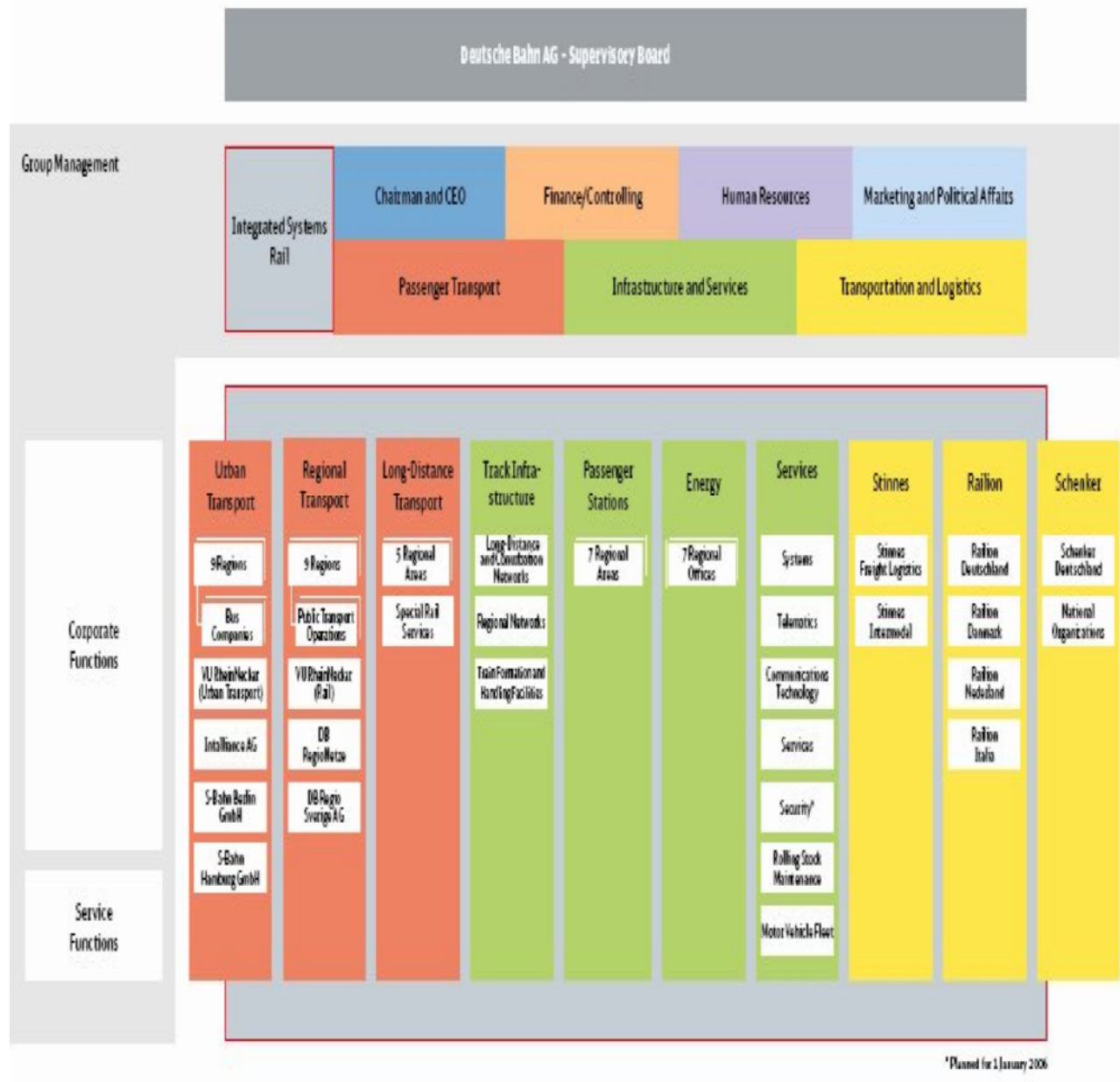
Annex

Transparency International, Germany: List of Corporate Members

- ABB AG, Mannheim
- akzente Kommunikationsberatung GbR, München
- Allianz AG, Frankfurt
- BASF AG, Ludwigshafen
- Berliner Volksbank eG
- Bundesagentur für Arbeit (BA), Nürnberg
- Business Keeper AG, Potsdam
- Control Risks Deutschland GmbH, Berlin
- DaimlerChrysler AG, Stuttgart *Die Mitgliedschaft ruht gemäß §6 der Satzung.*
- DEG (Deutsche Investitions- und Entwicklungsgesellschaft mbH), Köln
- **Deutsche Bahn AG, Berlin**
- Deutsche Lufthansa AG, Frankfurt am Main
- Dr. Buchert Rechtsanwaltsgesellschaft mbH, Frankfurt am Main
- Dr. Kleinfeld & Partner, Hamburg
- FRAPORT AG, Frankfurt/Main
- GFA Consulting Group GmbH, Hamburg
- GOPA-Consultants, Bad Homburg
- GTECH GmbH, Frankfurt am Main
- GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit), Eschborn
- HOCHTIEF AG, Essen
- KfW Bankengruppe, Frankfurt am Main
- Ochsenfeld Rechtsanwälte, Hildesheim
- Pfalzkrankenhaus für Psychiatrie und Neurologie, Klingenmünster
- PricewaterhouseCoopers AG Wirtschaftsprüfungsgesellschaft, Frankfurt am Main
- ROBERT BOSCH GmbH, Stuttgart
- SAP AG, Walldorf
- SCHERING AG, Berlin
- Siemens AG, München *Die Mitgliedschaft ist seit dem 15. 12.2006 beendet.*
- Stadt Halle (Saale), Halle
- Stadt Hilden, Hilden
- Stadtwerke Bonn GmbH, Bonn
- Stiftung Evolutionsfonds Apfelbaum, Köln
- Vivico Real Estate, Frankfurt/Main
- Wirtschaftsgilde e.V., Weinheim

Deutsche Bahn Group Management Structure

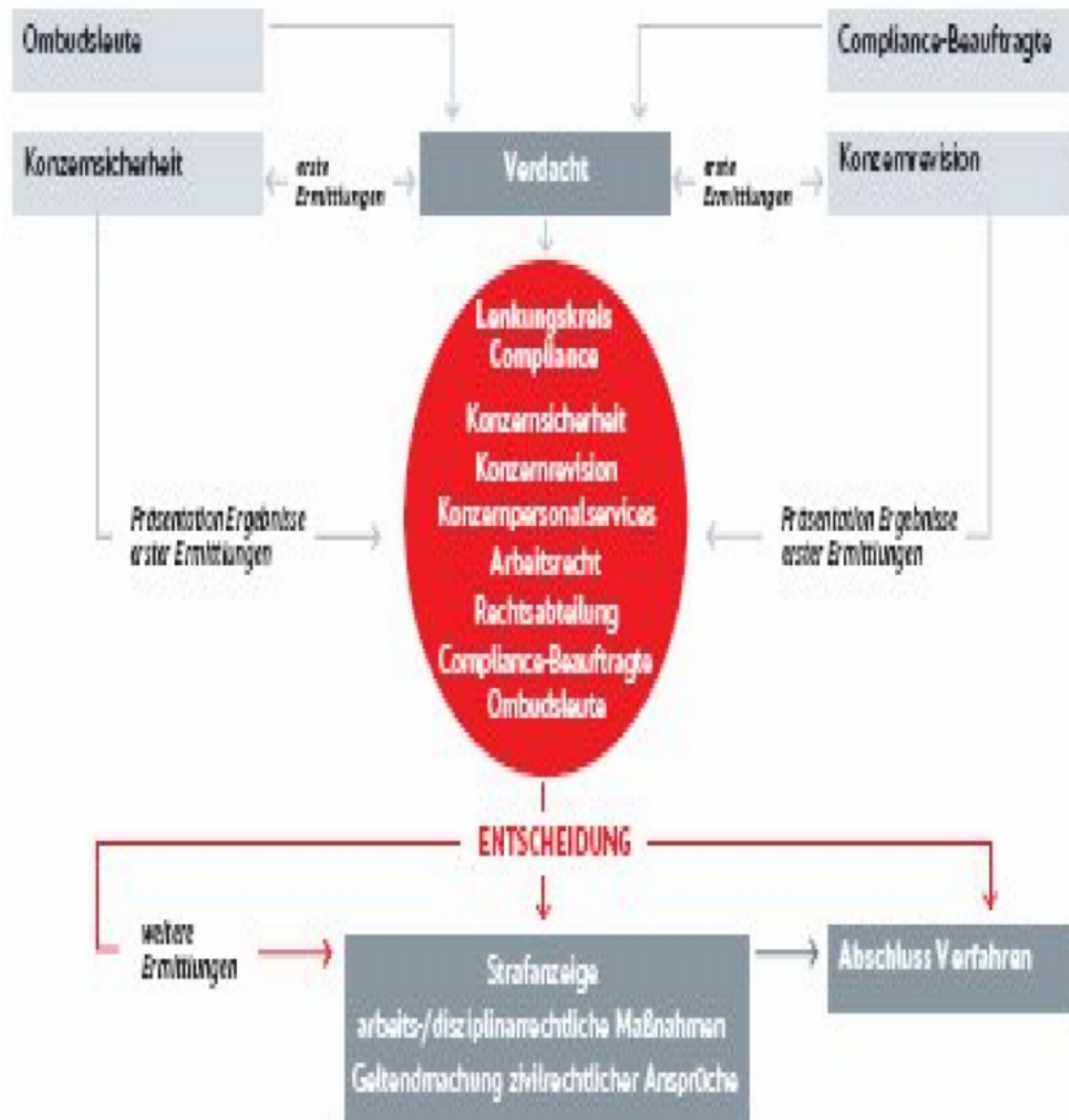
The Basic Group Structure



DB Compliance Steering Committee Structure (Korruptionsbericht 2005)

Der Lenungskreis Compliance

Aufgabe des Gremiums ist es, korruptes Verhalten im Unternehmen mit repressiven und präventiven Maßnahmen zu bekämpfen.



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