



# The importance of ethical leadership

Are New Zealanders too polite to speak up when we see ethically murky behaviour at work? Are we too relaxed about formalising ethics? Dutch academic Karin Lasthuizen, who currently holds the Brian Picot Chair in Ethical Management at Victoria University's School of Management in Wellington, thinks we might be.

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Karin Lasthuizen

**L**asthuizen says ethical leadership is about cultivating organisational ethical behaviour through role modelling, communication and enforcement. Based on research she has done so far, Lasthuizen thinks New Zealanders find the enforcement angle of this the most difficult. "It's about discipline, rewarding good behaviour and addressing bad behaviour," she says. She thinks New Zealanders might be too reticent when it comes to questioning colleagues or employees if they see something that doesn't sit well with them. "In the Netherlands for instance, we are quite critical, direct, open, and this might be considered sometimes rude. Here in New Zealand, the culture is very polite. So people seem to find it more difficult to address others and say 'why are you doing this and why do I feel uncomfortable with it?'"

Lasthuizen says ethical leadership means those issues need to be addressed, and an ethical culture created "where we can have those conversations in a polite way and where we can give that feedback or have critical discussions. I don't have the answer yet as to why people here don't see that kind of question as the start of an open conversation."

Part of the reticence might come from a belief in the New Zealand business community that most people are decent and ethical, that ethics are implicitly understood and therefore aren't something that need to be specifically discussed and addressed.

Although New Zealand's public sector ranked the least corrupt in the world in Transparency International's last Corruption Perceptions Index, complacency remains a big challenge according to Suzanne Snively, the chair of Transparency International New Zealand. "Perhaps because of our high ranking, the prevention of corruption is too often a low priority. Work to enhance transparency must continue for New Zealand to maintain leadership in the fight against corruption."

Snively believes that New Zealand boards need to prioritise the policies and processes they require to manage bribery, corruption and fraud. "It is surprisingly hard to convince business to be proactive in strengthening their tone at the top, their culture, their internal prevention processes. With some rare exceptions, businesses seem to wait until they have a crisis or there is a legislative requirement before they focus on bribery, corruption and fraud."

It's not as if New Zealand is immune to corruption and fraud. One of the more high profile cases came before the courts last year, when former Ministry of Transport staffer Joanne Harrison was jailed for stealing more than \$725,000 from her employer. Her misdeeds ultimately led to the Auditor-General stepping down and a review of legislation protecting whistle-blowers. >>



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01: Suzanne Snively

02: Jane Arnott

**“Millennials expect and want to be working in an ethical company where there is fairness”**

Jane Arnott

At the time of Harrison's offending she was a senior manager at the Ministry of Transport. Her crimes included faking invoices and using the money to pay off credit cards and her mortgage. Colleagues brought Harrison's fraud to the attention of her then boss, Martin Matthews, but their concerns didn't lead to a robust investigation. Matthews later went on to become Auditor-General, but stepped down from that role after Harrison's conviction. At the time of his resignation he said he thought he had dealt appropriately with the concerns raised by the whistle-blowers. "She gave me explanations that I accepted. It turns out I was wrong, I should have been more suspicious."

The staff who spoke up about Harrison's fraud later claimed she had made their lives difficult at the ministry after they raised concerns. Some of them lost their jobs in a restructure Harrison was involved in. The State Services Commission launched an investigation into the treatment of the public servants involved. The legislation covering whistle-blowers, the Protected Disclosures Act 2000, is now being reviewed with the intention of bringing it into line with international best practice.

### EXCEPTION OR THE RULE

The Institute of Business Ethics (IBE), whose purpose is to promote high standards of business behaviour based on ethical values, released its first New Zealand publication late last year, called *Setting the Tone: A New Zealand perspective on ethical business leadership*. The report, which included interviews with 24 senior New Zealand business leaders from a range of companies and sectors, found while many companies involved supported business ethics in principle, the implementation of a business ethics programme to help guide staff to do the right thing was the exception rather than the rule. "Some organisations believe they operate ethically without ever having a conversation about what that means in practice, for example, in areas like procurement, recruitment, or engaging with customers," the report states.

Rather than just expecting people to behave ethically, boards need to spell out ethical expectations and guidelines, and have ethical values sitting alongside business values when it comes to strategy, governance and decision making. "Those values should be embedded into organisational culture through a code of ethics supported by communication, engagement, training and reinforcement, leadership and an environment that supports speaking up, and risk assessment, monitoring and accountability," IBE's report says.

### RISING EXPECTATIONS

Regulators are making it clear that taking a more formalised approach to business ethics is now an expectation. Having a code of ethics is expected for companies listed on the New Zealand Stock Exchange and it is also principle 1 in the Financial Markets Authority's *Corporate Governance Handbook*. The Institute of Directors has a Code of Practice for Directors that all members sign up to, and the IoD also covers ethics and culture in its *Four Pillars of Governance Best Practice for New Zealand Directors*.

It's not just regulators and membership bodies that expect high ethical standards. Employees also want assurances that they are working with and for ethical people. "There's a new generation of people coming along who want it. Millennials expect and want to be working in an ethical company where there is fairness, where supply chains are considered, where work practices are less about greed and more about integrity," says Jane Arnott, IBE's representative in New Zealand.

External stakeholders also expect businesses to be able to demonstrate a commitment to ethical values, says Transparency International's Snively. "Shareholders are increasingly looking for responsible businesses to place their investments, staff prefer to work somewhere ethical, customers prefer to buy from them, suppliers and distributors prefer to deal with them. With global, networked communications, society is better informed about the structure of sustainable investments, so they know when profits are only short-term and when a business is failing to do things to be sustainable and viable." >>



Snively believes there are opportunities for New Zealand businesses if they can demonstrate high ethical standards. "Corruption is a huge international problem, so if we were to grasp the nettle, so to speak, and decide to provide leadership at the top through board chairs, we could outpace the world very quickly."

She believes if New Zealand directors demonstrated more of a commitment to ethical leadership and values it would lead to more listings on the New Zealand share market and increased activity and interest from ethical investors, from overseas as well as New Zealanders. "There are just so many positive things that would flow on from it were boards to make ethical leadership the centre of their strategic planning, instead of a 'nice to have' or something to delegate to their human resources team. Human resources teams play an important role too, don't get me wrong, but the thing is, ethical leadership should be core to everything an organisation does." >>

## What is ethical leadership?

### IT GOES BEYOND COMPLIANCE WITH THE LAW

Business success cannot be achieved through a culture of fear or control, or ticking boxes for regulatory requirements. It has to be grounded in core values and an ethical culture.

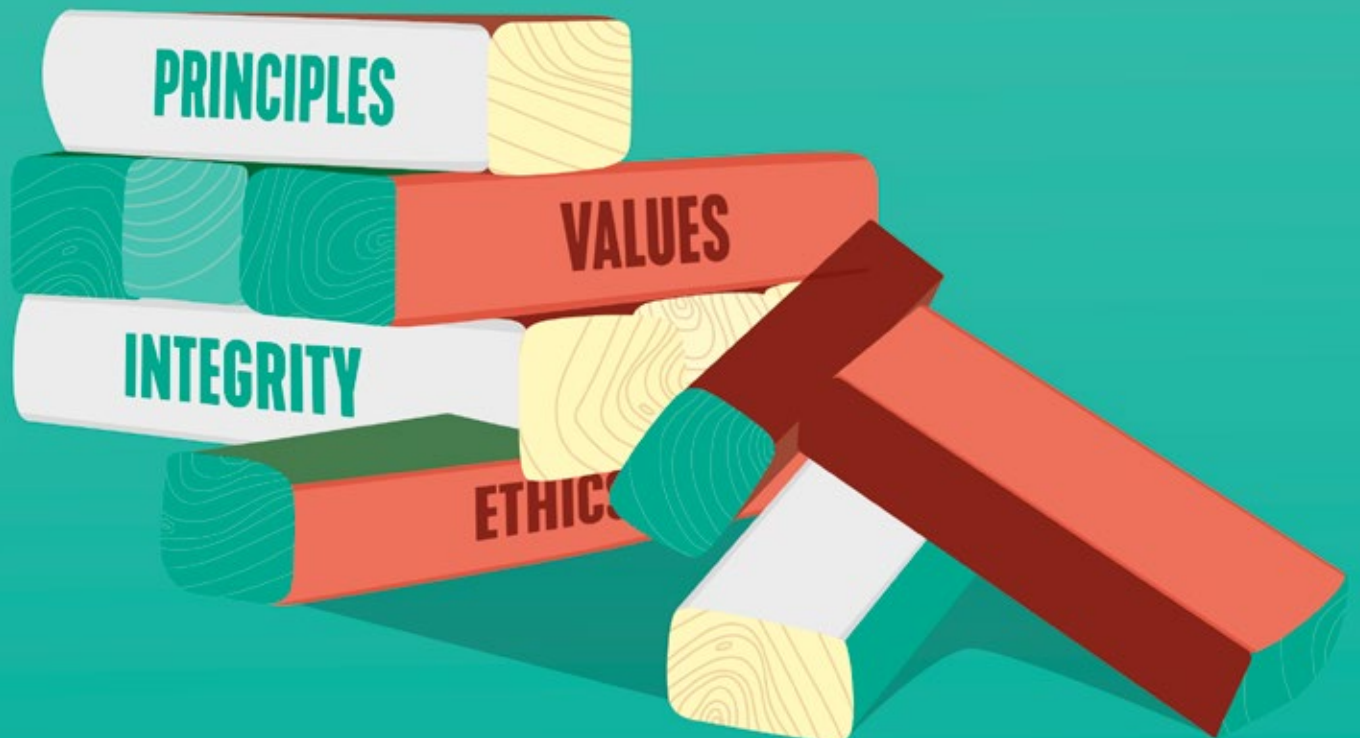
### IT SUPPORTS INDIVIDUAL DECISION-MAKING

Empowering people to make their own decisions while taking into account organisational values. Creative problem solving, reasoning and discretionary judgement based on ethical values needs to replace blind obedience. This gives employees the confidence to deal with situations that are not specifically covered in the 'rulebook' and encourages them that 'doing the right thing' is the right thing to do.

### IT PROMOTES AN OPEN CULTURE

Where employees can ask questions and raise issues without fear or retaliation. This ensures that poor, unwise or non-compliant behaviour is reported and dealt with. Speaking up is seen as positive and encouraged. It enables early intervention and prevention and helps to protect a company's reputation.

*Source: IBE Setting the Tone: A New Zealand perspective on ethical business leadership*





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Karin Lasthuizen



## PROVIDING ETHICAL LEADERSHIP

There is no one-size-fits-all approach when it comes to ethical leadership, no single checklist that can be applied to all organisations to tick off. What board members can do is create an ethical framework that encapsulates the values of their organisation and allows them to feed that ethos through the business.

There are key practical steps boards and their chairs can lead and oversee to make sure ethics are a core component of the way business is conducted throughout the organisations they work with, says Snively. “The fastest way to get up to speed would be for board chairs to take a real interest in this and put in regularly measured preventative measures. For example, the code of conduct is something that connects all divisions of the organisation. The values are something that everyone can sign up to. It takes tone at the top to say that this is important, and it takes tone at the top to actually be leading it, exhibiting it and illustrating that this is what they believe.

“The reality is, it’s very easy to do,” says Snively. “None of these things are hard. We’re not asking for anything like rocket science, what is important is commitment.”

One step a board can take is making sure it is getting all relevant information fed back from management. Snively says boards will enhance value if they empower their Audit and Risk Committee to start from the premise that business sustainability is its greatest risk, but that it can also be its biggest opportunity.

“Based on this, it then can build the framework for monitoring risk adapted to its business priorities. The information required for this more business-focused approach to risk, requires information from senior management that goes wider than what is provided through monthly accounting reports. The board has a role in motivating the chief executive to be engaged in generating knowledge about this and reporting about this.”

Transparency International believes there are seven key actions to prevent bribery, corruption and fraud that all boards should enable. They are: setting the tone at the top; creating and communicating a code of conduct; up-to-date knowledge of relevant legislation and regulation; avenues for reporting breaches in ethical standards; due diligence of distributors, agents and joint ventures; corruption prevention, communication and training; and regular risk assessments.

## PERSONAL VS BUSINESS ETHICS

Part of a board’s role in providing ethical leadership is making sure that everyone is working under common guidelines, towards common goals. Lasthuizen says people tend to be passionate about their personal ethics, but everyone’s personal ethics are different. “There are different ways to be a good person and there are different takes on ethics. Boards need to make sure there are ongoing discussions to make sure that those differing personal ethics can work together to become cohesive workplace ethics.”

The first step is identifying the values that an organisation finds important. “The board has to be specific about the values they find important and how they can make sure there are discussions about them,” Lasthuizen says. “Board members need to think about what other people need in order to get ethics more at the forefront of decision making. It’s about how to discuss different kinds of values. That’s maybe a different kind of approach.”

The board also needs to make sure that its code of ethics, its core values, are part of an ongoing discussion throughout the organisation, about what those core >>





values actually mean – and not in a ‘tick the box’ kind of way. “It’s about having an ethical dimension in all decisions. It’s not just about how to avoid bad behaviour, but also how are people doing good things? For instance, being low on corruption doesn’t mean you are high on ethics,” says Lasthuizen.

She says that drafting an organisational code of ethics together with employees can be a strong instrument to create or strengthen an ethical climate. “But as they say ‘a code is nothing, coding is everything’, which means that it is all about discussing the relevant moral values and norms, and including specific moral dilemmas and approaches, even per unit or role, which makes it effective in raising ethical awareness and decision-making throughout the organisation. Also for boards, these discussions are relevant: ‘what are our guiding principles and which ethical dilemmas occur within this board or as board members?’”


Including specific questions or examples in a code of conduct can be an effective way to make it come to life. In IBE’s report, Z Energy CEO Mike Bennetts said the organisation had included an ‘ethical test’ in its code of conduct. “Three questions that people should answer when they face a difficult decision are: Does it feel right? Can I tell my grandmother? If it’s in the paper, will I mind?” Bennetts said.

## THE DANGERS OF ‘DEAL FEVER’

Board members also need to be aware of how remuneration and bonus structures could influence the ethical behaviour of employees.

Arnott says directors need to understand that what is incentivised will be pursued. “People will seek to achieve, so directors need to be very, very in touch with what the unintended consequences can be of certain types of incentives. They need to look at where the effort is going into ensuring that the company’s values are being honoured within the framework of what’s being incentivised. It’s trying to ensure there’s a connection between ‘here are our values’ and ‘this is what we are incentivising or building our bonuses around’. That’s really important.”

She says people are likely to put aside their personal moral standards at work if they think that is what is expected from their role. “It may be that a sales manager is incentivised on winning, so will operate at a level of almost moral blindness, because that person is hell-bent on winning.”

Bruce Plested, the Executive Chairman and founding owner of Mainfreight, talked in the IBE report about the steps he took to minimise the risk of incentivised workers. He decided to scrap sales targets and replace them with a weekly profit report “that allows the board to maintain the watch over performance without creating pressure on people to compromise ethical standards.” 



## Building board culture

The Institute of Directors’ *Four Pillars* says a functional culture is essential to a high-performing board. “Within the corporate structure, the board has the highest standards of accountability and liability while operating with the least amount of time and almost no day-to-day control. Sound board architecture and processes provide a platform for good governance but do not guarantee it. The key is to build and nurture a healthy operating culture with effective interaction between skilled and experienced people.”

To read more from the *Four Pillars* go to [iod.org.nz/FourPillars](http://iod.org.nz/FourPillars).

SOURCE: *THE FOUR PILLARS OF GOVERNANCE BEST PRACTICE FOR NEW ZEALAND DIRECTORS*.

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