

# Investing in Ethics

## Why boards must engage

The time is ripe for the country's top awards in ethical business behaviour to reflect the thoughts and actions of those at the top of our nation's enterprises. Rodger Spiller explains why.

**W**hen the Brookfields Business Ethics Award was unveiled at the 1999 Deloitte / *Management* magazine Top 200 Awards a significant number of the audience responded with laughter. Business ethics, some commented wryly, was an oxymoron. Such a response might have been expected at a meeting of deep green environmental activists but here were the leaders of New Zealand's business community questioning the place of ethics.

Seven years on times have changed dramatically. From investors through to regulators, business ethics has become a mainstream issue that wise businesses are taking seriously.

This year, the awards are being repositioned to reflect the growing recognition that business ethics starts with the board. The 2006 Kensington Swan Ethical Governance Award, part of the Deloitte / *Management* magazine Top 200 Awards, acknowledges the increasing recognition of business ethics at the most senior levels of business leadership.

What is driving this changing agenda for business?

- An increasing focus on ethics from leading businesses both here and overseas;
- Investor demands for ethical performance; and
- The business ethics expectations of regulators, including Securities Commissions.

### Leading businesses

Both locally and globally, the boards of leading businesses are tackling ethical challenges and elevating business ethics from the fringe to the mainstream. They are also improving stakeholder relationships and enhancing their company's reputation. The payoffs? Increased ability to attract and retain the best directors and employees, higher consumer loyalty and more robust shareholder returns.

Leading management thinker Peter Drucker reflected the importance of ethical business when talking about the new meaning of corporate responsibility: "Only if business learns that to do well it has to do good," he said, "can we hope to tackle the major social challenges facing developed societies today."

This theme was echoed in the 2005 annual review from the World Business Council for Sustainable Development, a coalition of 180 of the world's leading international companies with collective revenues of approximately US\$6 trillion. The chairman's message highlighted the challenge: "Companies must put their principles into operation, and demonstrate that they are doing this. They must also have the courage to come out of their comfort zones and provide solutions to fundamental issues such as poverty alleviation."

To date, the annual New Zealand Top 200 ethics awards programme has

provided a rich harvest of case studies of organisations "doing well by doing good". Winners include Honda New Zealand, New Zealand Aluminium Smelters, Mercury Energy, Norske Skog Tasman, Methanex, NZ Post and 3M New Zealand. Their stories, and those of finalist companies, serve as compelling and useful examples for other businesses and students. (For more information on past winners and finalists go to [www.nzcbesd.org.nz](http://www.nzcbesd.org.nz) and [www.management.co.nz/top200/ethical-governance.asp](http://www.management.co.nz/top200/ethical-governance.asp).)

The Kensington Swan Ethical Governance Award will use a 'Four Ps' model for evaluation.

- Purpose: defined in terms of creating environmental, social and financial wealth;
- Principles of honesty, fairness, caring and courage;
- Practices for the community, environment, employee, customer, supplier, shareholder and stakeholder groups; and
- Performance measurement: to account for a triple bottom line of environmental and social as well as financial performance.

### Investor demands

Investors that take full account of business ethics are an important driver of business activity. Whenever these investors assess a business as having satisfied their rigorous investment criteria, they're giving their own award for business ethics.

Expect momentum in this area to continue to build. The launch of the United Nations Principles of Responsible Investment in April this year, for example, has been described as a “historic development for global financial markets”. The Principles have the support of global financial institutions with over US\$4 trillion in assets under management. Founding signatories included the New Zealand Superannuation Fund.

In launching the Principles at the New York Stock Exchange, United Nations secretary-general Kofi Annan noted, “Today it is increasingly clear that UN objectives – peace, security and development – go hand-in-hand with prosperity and growing markets. If societies fail, so will markets.”

The six major principles include commitments to incorporate environmental, social and governance issues into investment analysis and decision-making processes, ownership policies and practices and to seek disclosure on these issues by the entities in which they invest.

In New Zealand, Asteron has created New Zealand’s first Socially Responsible Investment Trust for retail investors, which also applies the Four Ps model to its research and engagement with businesses, encouraging continuous improvement. The Australasian Ethical Investment Association has increased its activity in New Zealand with additional members, including the New Zealand Superannuation Fund, and a plan to launch a major consumer awareness campaign for sustainable and responsible investment.

### Expectations of the Securities Commission

Enron’s collapse in 2001, the accompanying demise of accountancy firm Arthur Andersen, and other large international corporate failures – Worldcom and Italy’s Parmalat to name just two – triggered

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an intense focus on corporate governance around the globe. The New Zealand Securities Commission responded by providing a principles-based framework for good corporate governance across the full spectrum of economic entities in New Zealand, from listed companies, to community-owned trusts, to Crown entities.

The Commission published ‘*Corporate Governance in New Zealand – Principles and Guidelines*’ in February 2004, primarily as a tool for boards of directors and others involved in board governance of every kind. The framework consists of nine high-level statements of principle, each supported by suggestions or guidelines as to how the principle could be implemented. Three key principles are the need for directors to observe and foster high ethical standards; the importance of constructive shareholder relations; and the significance of other stakeholders in a governance context. The *Principles and Guidelines* are obviously also compatible with those legal obligations that bear directly on governance elements of the Companies Act, stock exchange listing rules, the Securities Act and amendments, the Crown Entities Act and so on.

In a paper “Corporate Governance Post Enron”, presented last year, Securities Commission member Cathy Quinn noted that reporting and disclosure are obviously critical to ensure a principles-based approach works. “The Commission,” she said, “wants to see companies and other entities reporting how they achieved each of the nine Principles. We

want the Principles to be discussed and actioned in boardrooms everywhere and reporting and disclosure to then reflect those discussions and actions. We will all see a rising standard of governance when we see more comprehensive and timely reporting and disclosure.”

From the Commission’s monitoring of 2004 listed company annual reports it noted “a significant step up in this regard over the past two years” and that “large corporates have lifted their game and others are definitely starting to wake up to the new expectations on them”.

In Quinn’s view, NZX Listing Rule changes introduced in October 2003 had been a significant contributor. She noted, however, “two areas of distinct disappointment”. The importance, or lack of it, attached to fostering constructive relationships with shareholders; and the level of reporting attention given to companies’ interaction with other stakeholders. “Our *Principles and Guidelines* address both of these very clearly,” she said. “We think companies should have plenty of flexibility in how they work with shareholders and stakeholders, but also make more of an effort to report on what they are doing.” So the challenge remains. **M**



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