DIGITAL NATIVES: THE NETWORKFORCE
When the levee breaks

HUMAN INTERACTION with computers is becoming increasingly intimate. For the first time in history, we are beginning to spend most of our waking hours ‘plugged in’ to digital devices. American teens, for example, now devote almost eight hours a day to electronic media, encouraged by ready access to cell phones and other mobile devices. Three-quarters of them have created a profile on a social networking site. This new generation’s experience of the world—and of each other—is increasingly mediated by technology.

So, what is to be done about the looming wave of ‘digital natives’ beginning to hit the workplace—should we remove temptation by banning social media on the job, or accept defeat and begin overhauling our organisations instead?

Researchers Michael Myers and David Sundaram suggest embracing the work patterns of the social networking generation—even if that means rethinking how information systems are built and used.

Elsewhere in this issue of the Business Review, Matthew Ryan reports on the downside of innovation. He is not convinced that increasing the amount of entrepreneurial activity will automatically lift a nation’s productivity, and cautions that innovation policy must take account of adverse effects such as ‘human capital scarring’.

Brad Jackson reviews the leadership challenges posed to New Zealand by a lethal mine disaster, the rebuilding of our quake-hit second city, the restructuring of our largest metropolis to create a ‘Supercity’ and the hosting of a massive international sporting event. His conclusion: New Zealand’s small size and indigenous leadership expertise, its ‘honest broker’ status and its growing leadership infrastructure make it an ideal laboratory for new leadership practices and processes.

Susan Watson argues that the legislative response to the country’s financial sector crisis has tended to focus on increasing accountability rather than preventing wrongdoing. A better strategy, she says, might be to improve corporate governance.

Finally, Laurence Murphy notes how the Global Financial Crisis, triggered by the collapse of the subprime mortgage market in the United States, thrust property into the spotlight, implicating the humble residential mortgage in the destabilising worldwide flows of finance and credit. He argues that the dynamics of property as a global asset class has profound implications for national economics, cities, households, investors, industries and services.

There is a pattern here: finding ways to anticipate and respond to what is often pictured as a ‘tsunami’ of disruptive change.

A slice of history to end with. In 1927 the Mississippi River breached its banks, causing the most destructive flooding in US history. Its waters inundated some 70,000 sq. km, devastating the agricultural economy of the Mississippi Basin and contributing to the ‘great migration’ of African Americans to industrial cities in the North and Midwest. Kansas Joe McCoy and Memphis Minnie sang that suffering into the blues. But, over time, the farms in flood-affected, labour-deprived areas mechanised and modernised, driving regional economic development more than unaffected farms elsewhere did.

Often, it seems, there are opportunities, as well as calamities, ‘when the levee breaks’.

Vaughan Yarwood
Editor
Submission Guidelines

The University of Auckland Business Review aims to encourage insights, reflection and debate on contemporary business theory and practice. It reports on new and notable research, focusing on the implications for business professionals. The journal is published twice a year (in April and September) by The University of Auckland Business School.

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ECONOMIC growth is fuelled by successful entrepreneurs. Nevertheless, since failure is an unavoidable part of the enterprise economy, successful entrepreneurs must be resilient in the face of set-backs. The downside of this resilience is that entrepreneurs are likely to stay too long with failing enterprises. Moreover, business failure can have long-term detrimental effects on workers who are made redundant, including reduced employment prospects, lower income and poor health.

Matthew Ryan

Encouraging ‘over-confident’ entrepreneurs may do more harm than good.
In 1986, American academic Richard Roll proposed his famous ‘hubris’ theory of corporate takeovers to explain the fact that more than 50 per cent of corporate mergers fail.

He argued that, despite the evidence, most chief executives believed their own abilities would protect their mergers from the problems that beset others. More often than not, said Roll, they were wrong. His academic paper marked the start of an explosion of research into the effects of psychological biases on the functioning—and dysfunctioning—of the modern economy.

Entrepreneurs are known to be particularly susceptible to decision-making biases such as optimism and over-confidence (see sidebar), and New Zealand entrepreneurs are no exception. Research by World Bank economist Rocco Huang suggests that our entrepreneurs are fuelled by relatively high levels of optimism. Huang used the results of psychological testing conducted in 35 countries to construct an international optimism league table. New Zealand ranked 10th out of 35—ahead of Australia. More interestingly, Huang demonstrated that optimism drives innovation: more optimistic countries exhibit higher levels of entrepreneurial activity. Ranked according to their willingness to launch new businesses with uncertain prospects, New Zealanders again made the top 10 of Huang’s sample.

To the extent that optimism supports innovation, creativity and enterprise, it is no bad thing. Indeed, a recent report by New Zealand Trade and Enterprise concluded that the country’s “manufacturing and service
sector firms adopt innovations at above the OECD average [rate], and produce an abundance of novel ideas.

There is a strong tendency for the media and policy-makers to focus on these positive aspects of our entrepreneurial spirit, and to advocate policies that encourage entrepreneurship. If more entrepreneurs means more innovation, then more entrepreneurs must be better—or so the argument goes. In its briefing to the incoming Government in 2008, for example, Treasury highlighted New Zealand’s low level of labour productivity as a major economic concern and suggested that “entrepreneurship, innovation and technological change” were essential to improving productivity growth.

However, I would argue that we also need to look at the downside of entrepreneurial activity, and to ask whether New Zealand has too many entrepreneurs. By international standards, New Zealand already has a very high level of start-up activity. The Global Entrepreneurship Monitor ranks New Zealand sixth out of 36 countries for “total entrepreneurial activity” (percentage of the adult population starting a new venture or owning a business less than 42-months old). We are one of only three OECD countries to have experienced an upward trend in self-employment rates over the last half of the 20th century. Moreover, the World Bank’s Ease of Doing Business Survey ranks New Zealand first for ease of starting a new business and second for ease of doing business. The data speak very clearly: there are relatively few barriers to starting a new business in New Zealand and no shortage of people willing to take up the challenge.

The contribution of entrepreneurs to economic growth and productivity is ambiguous. The key facts are summarised in Scott Shane’s excellent book, The Illusions of Entrepreneurship. Older firms tend to be more productive than newer ones, so “increasing the rate of new firm formation is correlated with a decline in a country’s economic growth”.

Productivity is not enhanced by entrepreneurship per se. It is enhanced by the small fraction of successful and highly innovative start-ups. Shane estimates that the entrepreneurial contribution to United States growth comes predominantly from the 0.05 per cent of start-ups that are financed by venture capitalists. The bulk of entrepreneurial activity merely diverts resources from more to less productive uses.
Pollyanna capitalism?

“The chance of gain is by every man more or less over-valued, and the chance of loss is by most men under-valued, and scarce by any man, who is in tolerable health and spirits, valued more than it is worth.” (Adam Smith)

OPTIMISM, or over-confidence, has been extensively studied by psychologists and is known to be expressed most strongly in situations where people perceive themselves (rightly or wrongly) to be in control. Psychologists have also shown that optimists are susceptible to the so-called Pollyanna Principle: the less reliable the information on which a decision is based, the more optimistic they are of a favourable outcome. Optimists like being in control and are attracted to uncertainty, so it is unsurprising that they should be over-represented amongst entrepreneurs.

Indeed, numerous studies attest to the high levels of over-confidence and optimism amongst entrepreneurs. Data from the British Household Panel Survey revealed that almost five times as many self-employed people overestimated their financial position in the subsequent year as underestimated it. The study showed that employees were almost three times more likely to overestimate, than to underestimate, their financial position over the same time period. Optimism, it would seem, is ubiquitous, but is especially pronounced amongst the self-employed.

In a survey of New Zealand business founders by John Pinfold of Massey University, the average respondent reported a 75 per cent chance of still being in business in five years’ time, but assessed that a “similar venture” had only a 50 per cent chance of surviving five years. (Data from the Ministry of Economic Development show that the typical five-year survival rate for a new firm is between 40 per cent and 60 per cent). Almost all entrepreneurs regard themselves as “better than average”.

Not only are optimists more likely to start a new venture, they are also more likely to bounce back from failure. Entrepreneurs are subject to a psychological bias known as “escalation of commitment” which makes them prone to throw good money after bad, even when evidence counsels otherwise. While some studies show that business failure dents over-confidence, an over-confident entrepreneur is still more likely to start a new venture following a failure. Over-confidence is especially rampant amongst serial entrepreneurs.

Over-confident entrepreneurs are also more likely to fail. A 2007 study by European economists Philipp Koellinger, Maria Minniti and Christian Schade found a significant negative correlation between entrepreneurial confidence and the probability of firm survival. This result provides a sobering counterpoint to Huang: optimism drives failure as much as it drives innovation.
ENTREPRENEURSHIP is a process of trial and error, so failures are inevitable. Failure can even be a valuable learning experience. But failed ventures also impose significant economic costs, not all of which are borne by the unfortunate entrepreneur.

An important social cost of business failure—and one that has been largely neglected in the business literature—is human capital scarring. This is the loss in productivity that results from workers being displaced from employment. Traditionally, economists have supposed that labour should be mobile so it can seek its most productive use. But we now know that moving workers from one firm to another is not a frictionless process: human capital is eroded along the way, and to a surprising degree.

According to a Statistics New Zealand study, workers displaced by firm closures between 2001 and 2004 earned 22 per cent less income one year later (relative to comparable workers who were not displaced) and 16 per cent less after four years. The displaced workers were also 12 per cent less likely to be employed four years later. In other words, losing your job, even through no fault of your own, casts a long shadow over your labour market prospects.

It can even damage your health. A remarkable study by US economists Daniel Sullivan and Till von Wachter found that workers who lose their jobs from firm closures have, on average, a 15-20 per cent increase in mortality rate over the subsequent 20 years. For a 40 year old male, this amounts to an 18-month reduction in life expectancy.

The leading explanation for this sustained deterioration in labour market outcomes is that displaced workers lose what economists call “firm-specific skills”—human capital acquired through experience working within the same organisation. Workers with long tenure in their current positions suffer most from displacement. Analysis of US data suggests that workers with at least six years tenure experience a 25 per cent reduction in income even six years after displacement, relative to their non-displaced counterparts. The Statistics New Zealand study estimated that workers who lost their jobs due to restructuring, and who were re-deployed within the same organisation, suffered much less deterioration in long-term earnings and employment prospects than workers who were displaced by a firm closure.

Of course, we all know it takes time for a new worker to become fully productive, but the magnitude and persistence of productivity losses from displaced workers are not well appreciated. Some startling figures were revealed in research by economist Tom Krebs from the University of Mannheim. He conducted a numerical simulation to determine the effects of human capital scarring during recessions on the US economy. To do so, he calculated the productivity improvement that would be obtained by removing the cycles around mean GDP. Assuming that cycles cause 4 per cent of workers to be displaced in an average year (over the long run), Krebs calculated that eliminating cycles would be equivalent to raising per capita GDP by between 0.5 per cent and 4 per cent in perpetuity. Just to be clear, that is a 0.5-4 per cent increase in the income of everyone in the United States, just from preventing the annual displacement of only 4 per cent of the working population.

Business failures that result in displaced workers are detrimental to productivity. Since over-confidence contributes to the high failure rates amongst new businesses, over-confident entrepreneurs are a luxury we cannot afford to create to excess.
THE foregoing analysis raises two important policy questions.

First, are there too many entrepreneurs, rather than too few? I do not have an answer to the question, but it is important to observe that New Zealand already has a high level of labour market turnover (or “churn”, as labour economists prefer to call it). A 2004 study by the US-based, New Zealand economist John McMillan found that “New Zealand’s job creation and destruction is somewhat more rapid than in the United States and considerably more rapid than in Europe”, and that most of the country’s job destruction is concentrated amongst firms with 1-5 employees. New firms are much more likely to shed labour than older, more established firms. Given our high rates of entrepreneurship and worker displacement, we need to think carefully about the productivity costs of human capital scarring.

We should be cautious about policies
that aim to increase the general level of start-up activity. Not only will few of these enterprises be growth-enhancing, but most will fail. Many more would fail if not for the life-support provided by the ‘sweat equity’ of tenacious entrepreneurs, who typically earn far less than if they had remained in the paid workforce—around 35 per cent less after 10 years in business according to US data cited by Shane.

Second, how do we design innovation policies that guard against the worst excesses of over-confidence—policies that select for successful entrepreneurs?

Consider programmes that promote an enterprise culture and the turning of ideas into businesses. To the extent that these encourage the not-so-confident into entrepreneurship, or educate budding entrepreneurs on how to employ more rational decision-making, they serve a useful purpose. Similarly, mentoring programmes that provide new
business owners with a more objective perspective on their businesses are especially valuable in the context of over-optimistic entrepreneurs.

But programmes that give further encouragement to the already over-confident, and especially programmes targeted at young entrepreneurs with little experience, may be counter-productive. Data from Shane are again instructive. The typical profile of a successful US entrepreneur is a person between 45 and 55, with a University degree—often at postgraduate level, and several years’ experience working in the same industry as his (they are also usually male!) new firm.

Of course, selecting for success is a tricky, though not impossible, exercise – venture capitalists seem to do it quite well. As Shane argues, the first step is to understand the profile of the successful entrepreneur and to know which sectors have the highest success rates for new start-ups. The latter, of course, is country-specific, so careful research on the experience of New Zealand entrepreneurs is needed.

We should also be wary of programmes that lower barriers to entry. Respected British economist David de Meza has written (with various co-authors) a series of influential papers on policies to combat the social costs of over-optimistic entrepreneurs. He advocates that government schemes which subsidise new start-ups be abolished, and proposes that loans to new businesses be taxed.

Clearly, these are controversial suggestions. Business people and researchers typically argue that a ‘finance gap’ hinders new start-ups, and that policies should improve access to finance, not impede it. However, not all credit rationing indicates a market failure. Conservative lenders may correctly perceive that an entrepreneur has unrealistic expectations. Denying finance—or imposing high collateral requirements—is precisely the sort of screening that well-functioning credit and capital markets are expected to perform.
De Meza’s data from the UK and US show that credit markets perform it quite well. The businesses for which lenders require higher levels of collateral—and hence the ones for which they perceive the highest risk—do indeed fail with greater regularity. Markets raise the finance hurdle for over-confident entrepreneurs, for which society should be grateful.

But they do not, according to de Meza, raise it high enough. Markets do not eliminate all of the economic risks of over-confidence. High collateral requirements, for example, protect lenders’ interests against over-optimistic borrowers, but they do not protect the economy from the productivity costs of failed ventures. De Meza concludes that there is ‘over-lending’ to entrepreneurs—the marginal entrepreneur adds more economic cost than economic benefit. By de Meza’s logic, having fewer entrepreneurs would give the economy a more efficient engine for driving innovation.

This is a radical inversion of conventional wisdom – the finance ‘gap’ has become a finance ‘glut’. While it would be premature to advocate de Meza’s policy prescription for New Zealand, the ideas behind it should be incorporated into our thinking about innovation policy.

Treasury’s own analysis suggests that a lack of managerial talent is much more significant in explaining New Zealand’s poor productivity than deficiencies in our enterprise culture. Encouraging more entrepreneurship may not be the best way to address our slow-growing small and medium enterprises (SMEs), and the risks of ‘excessive’ entrepreneurship are very real.

It is common, when observing someone tackle a risky endeavour, to remark that the person must be “either brave or foolish”. Successful innovation policy should not only support our courageous entrepreneurs; it should also protect us from foolhardy adventurers.

KEY TAKE-OUTS

- New Zealand already has a high rate of entrepreneurial activity, and the nexus between the general level of entrepreneurship and improved productivity is tenuous at best.

- Entrepreneurs have a tendency to over-confidence (the over-confident are attracted to entrepreneurship), which contributes to the high failure rates for new businesses.

- Workers displaced by business failures suffer long-term reductions in health, wealth and well-being.

- Innovation policy must balance the costs of inefficient resource allocation—including lost productivity from “human capital scarring”—against the benefits of innovation.
A TESTING GROUND
FOR
GLOBAL
LEADERSHIP

Why we should become a leadership laboratory

Brad Jackson

NEW ZEALAND has the potential to become a global ‘testing ground’ for the new leadership practices, models and processes that the world desperately needs in order to effectively respond to the natural and man-made challenges that we increasingly face.
THE PAST two years have been the most challenging time for New Zealanders since the Second World War.

In common with other nations, we have attempted to navigate through the uncertainty and anxiety imposed by the Global Financial Crisis, and more recently by the Eurozone debt crisis. If that were not challenging enough, the nation continues to be rocked by the aftershocks of a devastating natural disaster, as unexpected as it was severe. The leadership challenges that the Canterbury earthquakes have posed—from coping with the initial catastrophe to re-building New Zealand’s second city, Christchurch—are alone sufficient to preoccupy the entire nation for the next decade. But we do not have that luxury. The lethal accident at the Pike River mine in November 2010 galvanised the nation, then plunged it into despair. The event sorely tested national- and local-government leaders already stretched by the Christchurch earthquake, as well as the mining industry, the police and the international search-and-rescue community.

On a more positive note, at the other end of the country a new municipal entity was brought to life after many false starts. With the unitary governance structure of the ‘Supercity’ finally in place, it is a now-or-never moment for Auckland to finally live up to the potential that has been widely touted since its inception in 1840.

Finally, for three glorious months at the end of 2011 we welcomed and hosted the world (at least, the rugby-mad portion of it) to celebrate a great sporting event in our “Stadium of Four Million”. This posed significant leadership challenges that the New Zealand Rugby Union, event organiser Rugby New Zealand 2011 and a myriad of government, business and not-for-profit organisations can attest to. It was with
equal parts pleasure and relief for the country that we were able to win both on and off the pitch.

These are just four of the major leadership challenges that this country has faced recently. We might add others, including the Rena environmental disaster and the vine-killing PSA kiwifruit disease, along with the perennial and seemingly intractable problems of global warming, child poverty, the cost of housing and youth unemployment.

As for how well we responded to these challenges, who would fail to be impressed by the resolve, courage and ingenuity demonstrated by so many of our compatriots in this troubling year? However, in my role as critic, I will argue that, with respect to the state and conduct of leadership in New Zealand, the glass is most definitely half–full. This article follows on from ‘Why Leadership Matters’, by Lester Levy (with whom I co-direct the New Zealand Leadership Institute), published in the previous issue of the Business Review. Lester showed that while leadership continues to be a priority not only here but throughout the world, it remains an elusive concept to fully comprehend, let alone practise with confidence and consistency. As he noted, much is said about the importance of leadership and how it should be practised but it is all too rarely acted upon.

I would like to make the case that, partly because of the types of leadership challenges that it has recently had to face, this country could become a global ‘testing ground’ for the new leadership that the world so desperately needs.

The definition of a ‘testing ground’ is “a region resembling a laboratory inasmuch as it offers opportunities for observation and practice and experimentation”. My contention, based on twelve years’ experience in New Zealand, is that it can provide a singularly valuable laboratory in which to observe and practise leadership and to experiment with new leadership models and philosophies.

The allusion to a ‘test’ can be interpreted either as a challenge to be taken on from time to time (for example, a cricket test) or as a conscious attempt to experiment. I have already indicated that, as a nation, we have had more than our share of tests of late, to which we have responded relatively well. However, there is still much to learn from these various events. The Royal Commission inquiries into both the Christchurch earthquake and the Pike River mining disaster will hopefully prove instructive in this regard, particularly if a broad ‘leadership lens’ is applied to their analyses. A number of scholars are also deeply engaged in sifting and analysing these events, which certainly make for first-rate leadership and management case studies.

For the remainder of the discussion I want to focus on the second meaning of ‘test’: to consciously experiment with new models of leadership. I will argue that we need not only to be more conscious and deliberate in finding new ways to respond to issues, but also more proactive in selecting the issues that we take on and the means by which we address them. It is always tempting to resort to tried-and-trusted approaches, especially if they have been relatively successful in the past. It takes a far-sighted group of leaders to tackle seemingly intractable problems in the spirit of discovery.
WHEN I FIRST arrived in New Zealand twelve years ago I was told by many as a point of pride that this country was frequently selected by transnational corporations as a test market in which to try out new products and services—especially in the information technology and telecommunications sectors. The optimists asserted that this was because of the country’s penchant for innovation and its technological sophistication. The skeptics suggested that, in large measure, it was because we were so far from the rest of the world that if the tests resulted in failure, damage would be minimal.

Whatever the truth, it strikes me that there is no reason why we could not apply the same logic to softer human technologies such as leadership and team processes. Those who have worked in high-performance environments will appreciate how ‘hard’ the softer people issues can be to address and resolve. The world places great value on this kind of knowledge. There is no reason why New Zealand could not begin to export its leadership know-how the way it does with primary products and aspires to do with hard technologies.

We have several advantages. Our bicultural heritage, underpinned by the Treaty of Waitangi, has already provided a testing ground for the operation and reconciliation of very different governance and leadership practices. Perhaps we should have learned more from this unique nation-building experiment.
Our Maori scholars have established a leadership position in indigenous development that could provide a great base for indigenous leadership research.

The relatively small size of the country’s population, coupled with the relatively fewer degrees of separation (everyone seems to know everyone), gives us the potential to work swiftly, more informally and with more agility than larger nations. Given this, it is perhaps ironic that we still tend to mimic the complex bureaucratic structures of larger Western countries. Because of the way we have navigated the shifting sands of international relations—and because we are not a military threat—we have managed to preserve an ‘honest-broker’ role that would be helpful in promoting and operating a leadership laboratory. Our geographical position in the Pacific provides us with a unique vantage point to observe the pressure that a new generation is exerting on deeply entrenched autocratic leadership practices in much of Asia—most notably in China.

If we can make the case for New Zealand as a testing ground for new leadership and governance processes, what are the kinds of things that we should begin actively testing through research and development efforts? In what follows, I have singled out five areas that we might profitably begin working on. These are high-yield issues that are attracting considerable interest from some of the more progressive leadership thinkers in the world—many of whom have visited us in the past three years. Because they are all related, there are likely to be considerable synergies in pursuing a multi-pronged agenda.
Create leadership practices fit for the age of complexity

WE NEED to recognise that we are operating in an environment of continuing complexity that demands new forms of leadership and governance in the private, public and not-for-profit sectors. The past few years have certainly been an exceptionally challenging time in New Zealand, but it may be wise to assume that this is the context within which we will be working and living from now on. Things are not going to get back to ‘normal’. Not that conditions ever were particularly easy—a deeper reading of history reveals that effective leaders have always intuitively understood that they were operating in complex environments.

We also need to recognise that we are not the only country in this situation. One promising way forward is the notion of ‘complexity leadership’ being refined by Mary Uhl-Bien, a leadership scholar from the University of Lincoln-Nebraska. Mary’s work was inspired by the pioneering research of Margaret Wheatley who noted that change does not result from preconceived, top-down strategic plans but from local actions that occur simultaneously and link together to produce powerful emergent phenomena. The Arab Spring is a compelling example of this type of leadership process.

In her theory of complexity leadership, Uhl-Bien distinguishes between ‘administrative leadership’ (top-down) and ‘adaptive leadership’ (bottom-up) processes, and highlights how in many organisations these processes frequently fail to connect. ‘Enabling leadership’ is what is required to connect these two leadership processes. This is very hard to identify, let alone promote, and yet it is the crux of effective leadership.

For the reasons outlined in the previous section, New Zealand would be an ideal place to gain a better understanding, through direct observation and active experimentation, of how these enabling leadership processes function: Who is responsible for them? How and why do they make them happen? What do we do to encourage and promote them in the community, the organisation, the city and the nation?

Foster a willingness to tackle ‘wicked’ problems

THANKS in part to media hyperbole, leadership has come to be seen as the all-encompassing source of, and solution to, most of the world’s problems—to the point where the term has become somewhat meaningless. Keith Grint, of the University of Warwick, has developed a helpful framework to distinguish between the functions of leadership, management and command processes.

To gain clarity about what leadership is and what it is for and, ultimately, to make it useful again, he distinguishes between ‘critical’ problems (those that are self-evident, crisis-driven and urgent) that need to be tackled by a ‘command’ process to provide fast and ready answers; ‘tame’ problems (those that are complicated but ultimately resolvable through unilinear logic) that should be tackled by a ‘management’ process which leads to better organisation; and ‘wicked’ problems (complex problems with no right or wrong answers) that are to be tackled by ‘leadership’. Leadership is distinguished by its preoccupation with asking questions, not by providing short and snappy answers with heroic decisiveness, as is commonly believed.

By way of illustration, we could look at the Canterbury earthquakes. In the period immediately following each major
shock, ‘command’ was the most appropriate response to the crisis, as was generally recognised. Once the search and rescue mission was completed, it was important to move into ‘management’ mode to become methodical and equitable in addressing who should receive support, when and how much—a tame problem. Now, as we move into the long and arduous re-building phase, according to Grint’s framework we should be entering the ‘leadership’ realm. The $2 billion draft plan for the Christchurch CBD purportedly drew on over 100,000 public submissions. Have the leaders been asking the right questions in order to forge a sustainable and productive future for the country’s second-largest city?

The problem with leadership problems is that followers quite naturally want instant answers and solutions. Every problem tends to be viewed by them as either a critical or a tame one. But leaders need to resist the temptation to stick to the familiar and simpler command or management modes. It takes a courageous, yet enlightened leader to ask the bold and frequently unpopular questions that need to be asked. To find a way through this conundrum, we will all need to revisit our assumptions about how leadership is created—which takes us to the next leadership test.

Seek to develop leadership not just leaders

IN A WORLD full of confusing and conflicting leadership definitions, Ken Parry and I, in our book A Very Short, Fairly Interesting and Reasonably Cheap Book About Studying Leadership, humbly added our own, defining leadership as “an interactive process between leaders and followers within a distinctive context to pursue mutually important goals”. This definition emphasises leadership as an interactive process that is constantly being created through communication. It also privileges the relationship between leaders and followers and emphasises the central role of purpose and context. In The Leadership Challenge, James Kouzes and Barry Posner go further, arguing that “leadership is a reciprocal relationship between those who choose to lead and those who decide to follow”. We generally worry about the former when perhaps we should become more aware and concerned about the latter.

In common with other individualistic Western countries, New Zealand has taken a narrow, leader-centric focus with its leadership development. The country has virtually ignored the role of the follower in creating good leadership. Indeed we are quite reluctant to acknowledge—and feel generally uncomfortable with—the notion of being a ‘follower’. This is unfortunate, as it is only when we start to actively promote smart followership that we will be begin to put the ‘ship’ back into leadership.

Our leadership development strategy needs to become more widely encompassing and considerably less elitist. It needs to kick in much earlier in a person’s life – not just as they are about to assume senior leadership roles. And it needs to focus on developing collective capacity as much as individual capacity.

Promote inter-group, place-based leadership

IN ADDITION to being overly preoccupied with the development of individual leaders, most of our current leadership development has focused on improving the quality of leadership within existing teams, departments or organisations—what Todd Pittinsky, from the Center for Public Lead-
Leadership at Harvard University, describes as “intra-group leadership”. Pittinsky argues that the next phase of leadership development should make inter-group leadership the top priority. Inter-group leadership addresses the leadership of disparate, frequently competitive and occasionally hostile groups and organisations in order to create long-term sustainable change.

New Zealand has an unhealthy penchant for spawning new organisations charged with creating new programmes every time a fresh problem emerges. We are not taking the time to assess the possibility of reinvigorating or closing down existing organisations. Collaboration and partnerships are often talked about, but rarely practiced, in a full and sustainable way. The net result is that many well-intentioned efforts to tackle large, globally-induced problems are dissipated through fragmentation and an inability and unwillingness to build scale, due to competing positions and interests. We often fail to capitalise on our small population size, seeking instead to gain legitimacy by being organised in a similar manner to Australia, Canada and the United Kingdom.

We can readily observe the power of inter-group leadership in action when we see how well New Zealanders can collectively respond to natural or human-induced disasters. We need to see more of that capacity being developed and deployed to tackle the longer term, less dramatic—but equally urgent—economic and social problems.

One potentially powerful way to foster inter-group leadership is to focus leadership development initiatives on place rather than organisation. Place can provide far greater unifying force for leadership than a single organisation or industry. Four years ago the New Zealand Leadership Institute engaged in an unusual programme aimed at developing the collective leadership capacity in the North Island’s economically-challenged Kaipara region. Sponsored by the Northland Corporation, the programme brought together 20 emergent leaders from the business, iwi, government and community sectors over an eighteen-month period to tackle some of the region’s most pressing problems. This group continues to work together to promote effective leadership by organising special learning events and informally working on community issues.

Celebrate leadership not just leaders

IN A COUNTRY supposedly afflicted by the ‘Tall Poppy Syndrome’ we do not appear too shy to celebrate and reward success, if the number and frequency of award dinners is anything to go by. While, as a leadership scholar, I would be the last person to argue that we should not celebrate success, I do think we need to question what exactly these awards are achieving and promoting in the long term. Indeed it may a good time to rationalise the number of awards and ceremonies in this country. That being said, I would be quite willing to promote an award that recognises and celebrates leadership that is genuinely distributed and enabling, and which succeeds in bringing disparate groups together rather than preserving the existing well-intentioned, but highly fragmented, status quo.

Along these lines, it was gratifying to see Sam Johnson, the widely-acknowledged leader of the 10,000-strong University of Canterbury Student Volunteer Army, given a special award by the Sir Peter Blake Trust. I believe that this movement presents a graphic example of the power of distributed and enabling leadership, assisted to positive effect by social media.
We have the opportunity to become an international centre for leadership development.

New Zealand: a key destination for ‘leadership tourism’?

HOW WILL we know we have been successful in becoming a testing ground for leadership? One powerful indicator might be the number of people who begin to visit these shores, either physically or virtually, specifically to observe and understand the leadership practices we have developed to effect sustainable change. By way of initial focus, we might consider the following contexts within which to concentrate our efforts, given our track record in entrepreneurial business, health, indigenous, sport and youth leadership.

Building on New Zealand’s emerging capacity to host global sporting events, we could create leadership events in which to observe, practice and experiment with leadership. For years many of the world’s leaders—including many from New Zealand—have made leadership-development pilgrimages to the hallowed halls of Harvard, Yale or Stanford. There is no reason why New Zealand could not find a place on future leadership-development itineraries.

Much has been made of the importance of promoting ecotourism to attract a new and environmentally-conscious type of visitor. What about spawning a new field of ‘leadership tourism’? Most talk regarding innovation in New Zealand hinges on inventing and selling ‘hard’ technologies in the biotechnology, information technology, telecommunications or healthcare sectors. What about the export potential for inventing and selling ‘soft’ human technologies that can lead to development of more effective and responsive leadership?

For those who insist on a business case for this strategy, it is very difficult to define let alone quantify the scale of the leadership industry—that is, all those who engage in developing, educating and researching leadership. One estimate has placed it at well over $100 billion in revenues, globally. In addition to being a lot larger than most people imagine, it is also one of the few industries that is continuing to grow, as people and institutions seek solutions to seemingly insurmountable problems.

When I first arrived in New Zealand in 1999, there was relatively little in place for fostering leadership. It has been exciting, therefore, to witness the growth of an impressive leadership development infrastructure throughout the country in the past decade. The New Zealand Leadership Institute, Leadership New Zealand and the Leadership Development Centre, together with an elaborate web of leadership development consultancies and community-based programmes, have done a great deal to develop New Zealand’s collective leadership capacity.

In view of this infrastructure and our special context, we have the opportunity to become an international centre for leadership development. Leadership practitioners, scholars, developers and educators can visit New Zealand to observe and participate in innovative leadership processes.
The key will be in forging a durable two-way connection between the research undertaken, the practices introduced into leadership development programmes and other sectoral and organisational initiatives.

This is something that the New Zealand Leadership Institute has been committed to since its inception. Inspired by the interest in our work shown by leadership scholars in other countries we have been actively working with the International Leadership Association (ILA) to launch a regional network across Oceania that can serve as a model for Asia, Africa and Latin America—parts of the world that are just beginning to invest in leadership research and development. We will be hosting an ILA Oceania regional conference in Auckland in April 2013.

I invite you to contact me if you are keen to learn more about this idea or would like to work with us. We will need to engage in inter-group leadership of our own with individuals and organisations who are willing to pursue leadership research and development in the spirit of open inquiry and active experimentation, but with the determination to find new and viable ways forward. The stakes are too high for us not to begin this important work.

### KEY TAKE-OUTS

- New Zealand is an ideal testing ground for new leadership practices and processes due to its small size and indigenous leadership expertise, its ‘honest broker’ status and its growing leadership infrastructure.

- Prime areas for experimentation are: complexity leadership, leadership development, inter-group and place—based leadership.

- New Zealand has the potential to attract both physical and virtual visitors to not only observe but also engage with us in experimentation with novel and sustainable leadership practices.
DIGITAL NATIVES

Rise of the Social Networking Generation

Michael D. Myers
David Sundaram

A WAVE of ‘digital natives’—those who have spent their entire lives surrounded by digital technologies—is about to hit organisations in developed countries. But how will companies cope with the habits and assumptions of this new workforce? Will they ban Facebook at work, as Television New Zealand did? Or will managers—most of whom are digital immigrants—instead try to accommodate them?
DIGITAL NATIVES have grown up in a world where the use of information and communications technology is all-pervasive. They expect their digital devices to be always on and connected via ubiquitous information systems. And they expect to be able to take mobile phones, tablets and personal digital assistants with them wherever go.

IT HAS become the norm for digital natives to use digital devices that are connected to ubiquitous systems such as Facebook, YouTube and Twitter, for both personal and professional purposes.

However, almost all managers today—like the vast majority of their employees—are ‘digital immigrants’. Most of us were not born into the digital world; rather, we learnt to use computers at some stage in our adult life.

If we look at current management theory and practice—particularly theories and methods used by management consultants, managers and IT professionals regarding the design and implementation of information systems – one feature stands out: all are based on our experience with digital immigrants.

This means that many of the underlying assumptions of these current theories and methods may already be out of date. More to the point, some current management practices may be counter-productive for digital natives. For example, a traditional assumption of information systems research and practice is that users resist new information technology. This assumption, regarded as general law by most information systems researchers and practitioners, is really just a derivative of a more general assumption in management that people resist change.

The idea of user resistance drives many of the activities carried out in major information systems development projects. For example, it is considered best practice to have ‘user involvement’ and ‘user participation’ during a project so as to minimise ‘user resistance.’ One user (normally a senior manager) is nominated as a ‘project sponsor’ and is usually asked to ‘sign off’ at various stages of the project. It is assumed that all this effort is needed to avoid project failure.

But what if the traditional assumption about users resisting new information technology no longer applies? What if digital natives not only do not resist new technology, but instead get frustrated when the IT policies of the organisation for which they work prevent them from using new technology?

If our argument is correct, we now have the curious situation where it is not the young digital natives who are resisting new technology, but rather their digital immigrant managers. A significant percentage of organisations have banned social networking sites and have even disabled features of smart phones and tablets in an attempt to keep their digital natives under control.

We suggest that this response has about as much chance of success as King Canute's attempt to stop the tide from coming in.
WHAT ARE the differences between digital natives and digital immigrants?

A survey by Project Tomorrow of 200,000 students in the United States (www.tomorrow.org) concluded that digital natives are not merely using technology differently; rather, their lives are being moulded by technology in a new way. They are digitally literate, highly connected, experiential, social, and in need of instant gratification. By age 20, they will have spent an estimated 20,000 hours online using a host of systems, from transaction and decision-support systems to collaboration support for personal and professional purposes. They typically use these information systems to explore their place and identity in the world. Unlike their digital-immigrant counterparts, they tend to be more comfortable with extensive peer-to-peer collaboration and the resultant disclosure of personal data.

Although many digital immigrants have become proficient users of technology, their use of it differs significantly from that of their digital-native counterparts. Communication via new technology is one such area—digital immigrants prefer to use email for online communication whereas digital natives prefer the more synchronous forms of instant messaging. With mobile phones, digital immigrants favour speaking to people whereas digital natives prefer texting. Digital natives also tend to share differently. Blogging is increasingly gaining currency for both immigrants and natives but, once again, for different reasons. Digital natives blog to share personal experiences and they treat personal blogging websites as forms of online journals. By contrast, digital immigrants tend to use blogging sites as an intellectual tool to share and discuss ideas with their peers.

Whereas digital immigrants are regarded by IS scholars and practitioners as users of IT (hence the extensive IS research and practitioner literature on user involvement and user acceptance), digital natives are creators of online content. Digital natives are adept at uploading videos to YouTube, building websites and communicating texting or Twitter. Hence, digital natives are not passive users of information systems; rather, they are creators and active participants in a new digital media culture, sometimes even launching their own online enterprises. More so than their digital immigrant counterparts, digital natives have meshed the digital world and its numerous technologies with their daily lives.

Although we believe there are significant differences between natives and immigrants in their use of, and attitudes towards, technology, our research indicates that there is no hard and fast distinction between the two. In other words, we suggest that digital nativeness is best seen as a continuum. Depending on their experiences, some people are likely to be more native than others. To what extent, then, can digital immigrants become digital natives, and vice versa? The phrase “You can’t teach an old dog new tricks” is perhaps relevant here. While people may place themselves at different points along the continuum, we suggest that learning a new language and becoming comfortable with a new culture is not easy and that ‘digital fluency’, like fluency in English, can only be achieved after genuine immersion in the culture.
THE RISE of the digital native is being accompanied by the increasing popularity of a related phenomenon: that of ubiquitous information systems (UIS).

The word ‘ubiquitous’ is derived from the Latin ‘ubique’, meaning ‘that which exists everywhere’. In the context of information technologies, ubiquitous digital connectivity can be seen in the indispensability of the internet for digital natives, and the rapid uptake of mobile phones, laptop computers, and personal digital assistants. An increasing number of these devices and environments tend to be hybrid and smart (cars and buildings), enabling rich and flexible ways of interacting. In this article, when we talk about ubiquitous technologies we are including hardware such as tabs, pads, boards, dust, skins, and clay interconnected and interwoven into the very fabric of our lives through ubiquitous networks—often made available through ‘cloud’ computing. When we use the word ‘system’, we mean in it in the broadest sense of being made up of people, processes, information and communication systems and technologies. Ubiquitous information systems bring all these things together to impact on all facets and phases of human living.

We suggest that the rise of the digital native, along with the growth of ubiquitous information systems, has profound implications for management research and practice and, in particular, for how organisations manage the development and use of information systems.

We propose a model for understanding digital natives in the context of UIS (see Figure 1). Our model has four dimensions: Users (Digital Immigrants versus Digital Natives), Systems (Traditional Information Systems versus Ubiquitous Information Systems), Activity (Professional versus Personal), and Context (Office versus Home).

When these four intertwined dimensions are charted, a clear pattern emerges. Most research and practice in information systems has focused on the inner/central regions of
the chart: namely, the traditional information systems used by digital immigrants for professional purposes at the office. However, little effort has been spent at the mid-to-outer regions of the chart, which looks at ubiquitous information systems used by digital natives for professional and personal purposes at the office and at home.

Traditional information systems help to improve the efficiency and effectiveness of organisations. The users of these systems in the past have been digital immigrants for whom functionality has been of paramount importance. For digital natives, however, interactivity, usability, flexibility, and connectivity are as important as functionality. Most aspects of traditional information systems, and the types of users associated with them, have been well researched. However, there is limited knowledge about the design, implementation, and use of UIS by digital natives and many organisations are struggling to develop the best policies and practices for this new audience.

Activities and context have also tended to be taken for granted. Implicitly, most IS research and practice has focused on the use of information systems for professional purposes in the context of the workplace. The use of information systems for personal purposes in non-office contexts, such as the home, has tended to be ignored. This is perhaps understandable, given that most IS researchers are currently based in business schools and most IT professionals work for large companies or public sector organisations. Nowadays, however, digital natives seamlessly transition between the use of traditional and ubiquitous information systems for both personal and professional purposes. Hence the boundaries and contexts are no longer very clear.
How do we design and implement UIS for digital natives?

The way forward

AT THE University of Auckland Business School we are currently engaged in a research project that focuses on how digital natives are interacting with and transforming UIS. How UIS can be designed and implemented for digital natives is an issue related to the use of UIS by digital natives. In this design stage, we suggest a set of five interrelated dimensions, namely, personalised, interactive, intuitive, attractive, and social (Figure 2). Traditional information systems design has, for the most part, focused on functionality at the expense of the five usability-oriented design criteria identified above. However, we believe that while functionality is important, these five interrelated design dimensions are crucial when considering UIS and digital natives.

As discussed earlier in this paper, personalisation allows users to adjust the difficulty of the interface according to their skills. Common examples of this are applications that offer an “expert mode”, enabling more complex functions. Personalisation helps to match user expectations and perceptions of the web space. In terms of flow, personalisation allows users to adjust the personalisation dimension to suit their needs by automatically adapting the design of a UIS. A good example of this is the Google start page and the homepage of bbc.co.uk, which are examples of such usability-oriented design criteria identified above. The personalisation dimension is important, these five interrelated design dimensions are crucial when considering UIS and digital natives.

For digital natives, the design of a UIS for digital natives should be considered in the design stage of personalisation and interactivity. In a 2005 study of American and Australian teenagers, researchers Jacob Nielsen found that they preferred to be active “as opposed to just sitting and reading”. In an earlier piece of work, researchers Sandra Hughes-Hassell and Erika Miller had suggested that they preferred to be active “as opposed to just sitting and reading”. In an earlier piece of work, researchers Sandra Hughes-Hassell and Erika Miller had suggested that they preferred to be active “as opposed to just sitting and reading”.

The way forward

Figure 2: Ubiquitous Information Systems Design Dimensions for Digital Natives

PERSONALISED

SOCIAL

ATTRACTIVE

INTERACTIVE

INTUITIVE
gested that the visual appeal of information systems, ease of navigation, currency and accuracy of information were all key elements in creating an interactive UIS for digital natives.

The intuitive dimension is rooted in the requirement to allow users to navigate easily. Intuitiveness is an attribute for interfaces that can be used ‘without recourse to manuals or tutorials. The button in word-processing software that is indicated by a ‘B’, and which allows making selected text in a document bold, is an example of an intuitive interface element. And Yahoo mail is a web 2.0 application that is mostly intuitive for users with some basic computer knowledge.

The attractive dimension refers to the need to make the UIS specific to digital natives by incorporating ‘cool’ and up-to-date designs. The nature of such designs is, of course, difficult to specify. One way to address this challenge is to empower the users to contribute to the design of the UIS just as they can contribute to the content. Elements of this dimension can be seen in Facebook.

The social dimension captures the requirement to show who contributed what and to allow users to express their own virtual identity. Discussion boards are one manifestation of this concept. In discussion boards, every ‘post’ is attributed to a user and many platforms allow the maintenance of individual ‘user pages’ or customised personal messages below each post. Users are able to summarise their contributions in terms of their most popular posts or other resources they have created on the web.

Being connected is not only a part of what digital natives do, it is who they are.
How do UISs affect digital natives, organisations, and society?

WRITER Don Tapscott says that the 80 million digital natives coming into the workplace will want to be part of an organisation in which engagement and collaboration are the norm, rather than one that relies on command and control. This is because the workplace values and expectations of digital natives differ from those of older generations. For example, they tend to have expectations of rapid career growth, greater demands for work-life balance, and the need for clear and frequent performance feedback. This has important ramifications for management in organisations.

However, familiarity with computers, and their ease of use, also means that digital natives are less cautious with their personal information and so are potentially more vulnerable to the threats and risks that the internet poses. Proficiency with certain technologies does not necessarily translate into an understanding about personal security and privacy.

But simply blocking channels such as YouTube and Facebook to address governance and security concerns, as some organisations have done, is a poor solution. They may be missing an opportunity to empower digital natives to connect with one another and collaborate. Organisations often take a conservative stance with any new technology. However, being connected is not only a part of what digital natives do, it is who they are. They consider their digital world to be part of their personality. Not being constantly connected is the equivalent of telling digital immigrants that they cannot use the phone or talk to their peers during office hours. Digital natives expect that at work they will continue to be connected—to collaborate, share and have fun.

The rise of the digital native, along with the proliferation of ubiquitous information systems, calls for an entirely new paradigm for IS research and practice. Those organisations in which the digital immigrant managers seek to control and contain digital natives within fixed organisational boundaries will simply stagnate, whereas those organizations that welcome digital natives into their workforce and indeed take advantage of their ‘cultural capital’ will survive and prosper.

KEY TAKE-OUTS

- A tsunami of employees who have lived their entire lives surrounded by digital technologies is about to hit organisations.

- Ubiquitous information systems need to leverage the strengths—and address the weaknesses—of these ‘digital natives’.

- Personalisation, intuitiveness, attractiveness and social interactivity are of paramount importance in designing ubiquitous information systems for digital natives.
GOOD CORPORATE governance is rather like good health: we may all be guilty of neglecting it until its absence causes us actual harm and then it starts to matter to us rather a lot. During the economic boom over the past decade, corporate governance was treated by some as the compliance tick-the-box aspect of running a company. Others saw it as window dressing, with the most egregiously rapacious entities trumpeting their compliance with codes of good governance, along with socially responsible practices that often allowed iron fists to be concealed in green velvet gloves.
THE THING about cycles is that they revolve, and the Global Financial Crisis—and New Zealand’s related, but unique, crisis in the finance sector—have highlighted grievous governance failures.

IN HINDSIGHT it seems remarkable that those failures went undetected. The legislative response, both internationally and within New Zealand, has been (relatively) swift. In New Zealand, the focus has been on creating a single, well-resourced regulator of the financial markets so that action against transgressors will not continue to fall in the gaps between existing regulators. Also, the Securities Act 1978, which regulates offers of securities to the public, will get an overdue overhaul. And breaches of some directors’ duties will become criminal offences.

But, although the Financial Markets Authority intends to improve its market-intelligence capabilities, many of the legislative responses are ex post mechanisms—improving the ways in which wrongdoers are held accountable rather than preventing the wrong doing in the first place. For example, no explicit protection exists for corporate whistleblowers who report breaches of directors’ duties, (something I have written on elsewhere with Rebecca Hirsch.) Whistleblower protection might at least allow wrongdoing to be detected at an earlier stage.

The legislative responses are also reactive in that they identify existing holes in financial market enforcement and seek to plug them. Reactive legislation in this area is not new. The Securities Markets Act 1988 was a response to the sharemarket crash of 1987 and the resulting exposure of insider breaches; the Securities Act 1978 was a response to the 1977 Securitibank crash. At that time, securities legislation was contained in the Companies Act 1955; those who sought to avoid it needed only to offer securities to the public using entities other than companies. Earlier examples exist. In fact, the first piece of investor-protection legislation in New Zealand—the Promotions and Directors’ Liability Act 1891—was a response to an English case, Derry v Peek (1889) 14 App Cas 337, where it was held that a plaintiff in an action for deceit based on a false representation in a prospectus must prove actual fraud.

What this history tells us is that, whatever the legislative response, determined wrongdoers—those who actively set out to fleece the public—eventually find a way around the law.

What to do? The solution may lie within the companies themselves—by improving corporate governance and board accountability in some fundamental way. One approach, advocated by some North American commentators, is to increase the powers of shareholders. It is assumed that empowered shareholders would be able to monitor management and remove those who were malfeasant or incompetent. If shareholders really could control directors, this approach would be sound. Shareholders would have the opportunity to limit their loss or, at the very least, make such directors responsible for corporate failure. However, I believe that it will become increasingly...
accepted that this approach is flawed. The idea that individual shareholders can monitor and control management has existed since the inception of the modern company in the mid-19th century, and it continues to persist despite all evidence to the contrary. In fact it is very rare for diverse groups of shareholders to act to appoint or remove directors or to reign in management abuses. The exception is when shareholders derive power from holding a significant or controlling stake in a company. In closely held companies, for example in many family-controlled European companies, shareholders exercise that power. The classic conception of the company expounded by Berle and Means highlights the separation of ownership (in shareholders) from control (in management) as the defining characteristic of the corporate form. Once that gap is bridged by controlling shareholders, the separation between ownership and control narrows. In the classic conception of the corporation, shareholders acting in that capacity should not instruct and control directors. Separation of ownership and control is one of the fundamental tenets of company law and when it does not exist companies become, in substance but not form, a type of partnerships. Also, if shareholders do bridge the gap between ownership and control to too great an extent, they risk being deemed directors, and therefore subject to many of the obligations of directors. The ability of majority shareholders to control management is not an example of the company model working but rather of it being bypassed.

The 19th-century theory that underpins the long-held belief that shareholders can monitor management and reign in abuses is that shareholders (as principals) appoint directors (as their agents) to operate companies on their behalf. Directors have certain fiduciary obligations of loyalty and care that prevent them from acting in self interest or performing inadequately. Stripped down, modern law and the economic theory of agency, which has dominated thinking about firms in recent decades, mirrors this dominant strand of corporate law theory. Shareholders appoint managers as their agents to run the firm. Agency costs arise through the necessity of monitoring mechanisms to prevent self-interested behavior. Ultimately, under both versions of the theory, shareholders as principals can exercise the ultimate sanction by removing directors or managers from their positions. Thus, it seems logical to empower shareholders.

Why, then, is the corporate form so easily abused? The answer lies in recognising the flaws in the theories and understanding the pathology of companies. Boards do not actually derive their powers from shareholders, but rather from an enabling statute such as the Companies Act 1993. In a legal sense, directors are not the agents of the shareholders. As a matter of practice, the selection of directors is carried out by, or under the direction of, existing board members. If shareholders are not the principals of directors and are not the source of their powers, the consequence is that it becomes legitimate for boards of directors to consider the interests of other stakeholders when those interests arise. The most obvious instance of this would be the interests of creditors when...
a company nears insolvency. But the inability of shareholders who have not aggregated their shares to exercise control over management means that the opportunities for management abuses are great. Correctly understood, the role of the board is not to ‘manage’ the company, in the contemporary understanding of the word, but to supervise. It is the board that is the monitor of management, not the shareholders. The use of the term ‘manage’ in the statutory provisions that empower boards is unfortunate and historical—it had a different meaning until the evolution of management science at the beginning of the 20th century. The tendency of some law and economics theorists to conflate the board with management ignores the fact that the board has an important supervisory and monitoring role to play that is not a management function. The harsh reality is that boards of directors and management control corporations. In a fundamental structural sense, shareholders cannot constrain the exercise of those powers, and attempts to bolster shareholder powers as a mechanism to control management are thus doomed to failure.

So, how can corporate management be controlled? The long title to the Companies Act 1993 in part states that the Act is intended to “reaffirm the value of the company as a means of achieving economic and social benefits through the aggregation of capital for productive purposes, the spreading of economic risk, and the taking of business risks.” The Act is also intended to “encourage efficient and responsible management of companies by allowing directors a wide discretion in matters of business judgment while at the same time providing protection for shareholders and creditors against the abuse of management powers.” And therein lies the tension for future corporate governance regulation. Can we control the beast without destroying it? On one hand we must seek to nurture and incentivise enterprise through a vehicle—the limited liability company—that is so effective as a means of aggregating capital for productive purposes that it has been described as the greatest invention of the modern era. On the other hand it is essential that we provide adequate protection against a dominant and powerful institution that is potentially devoid of scruple or conscience. How do we get rid of the bathwater without the baby going out with it? My argument is that it can only be achieved through boards functioning as monitors of good corporate governance.

As the role of the board of directors in a legal sense is better understood, the importance of good corporate governance will become clearer. Broad consensus exists around practices that determine good governance. The Securities Commission produced guidelines also adopted by the Financial Markets Authority, and codes such as the UK Combined Code and the OECD Principles of Corporate Governance have been adopted in most jurisdictions. Less consensus exists over how important good corporate governance is to a company’s financial bottom line. An increasing number of studies show that good governance does in fact have a positive effect on profitability, but to focus on this as the sole arbiter of the importance of good governance is to miss the point. Limited liability companies are not really, or not completely, an example of private ordering. Limited liability and, more significantly, the right to incorporate, are privileges used to create companies that are not necessarily private or owned by a single individual.
granted by the State. Many of the principles of public law were derived from corporations’ law, especially the law of municipal corporations. In corporate law history the public and private are intertwined. Once the public law aspect of corporations is accepted, the idea that corporations can be regulated by the State should become less repugnant. In fact, if it is accepted that incorporation carries with it complete control by management over the assets of the investors of the company, a failure to constrain that power through regulation would be a dereliction of duty by the State. Controls exist, through the imposition of directors’ duties, that impose on boards monitoring obligations and accountability. *Ex ante* mechanisms to ensure observance are important. But many of the principles in corporate governance guidelines remain soft law, ultimately able to be rejected by the boards of companies that are probably most in need of them. The advantage of corporate governance principles is that they tend not to constrain management in the advancement of the enterprise. Rather, they clarify the monitoring and oversight role of the board. Implemented correctly, they may allow us to keep the baby and lose the bath water.

Mistakes of the past are often not repeated. Instead, new ones arise that may be manifestations of an underlying systemic problem. The history of corporate and securities law is a record of mistakes and responses; holes exposed and then plugged. But new problems always emerge as the incompetent get it disastrously wrong and as determined wrongdoers find new and more creative ways to fleece the gullible public. The spokes in the wheel of this cycle may be, first, a greater insight into the pathology of companies and, second, a truer understanding by boards of their role, through the imposition of good corporate governance requirements.

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**KEY TAKE-OUTS**

- The legislative response to the financial sector crisis has tended to focus on increasing accountability rather than preventing wrongdoing, but improving corporate governance might be a better strategy.

- Shareholders should not be relied on to monitor and control management—that is the function of the board of directors.

- Implemented correctly, corporate governance principles protect shareholders and creditors while boosting company profitability.
THE GLOBAL Financial Crisis, arising from the post-2007 meltdown of the subprime mortgage market in the United States, firmly positioned ‘property’ within discourses of economic crises and macro-economic change. In a dramatic turn of events, the humble residential mortgage had become implicated in destabilising global flows of finance and credit.
WHILE THE root causes of this particular financial crisis can be traced to issues of poor governance, information asymmetry and moral hazard in the US mortgage market, the unfolding crisis has highlighted the role of property markets in the global economy.

In contrast to economic discussions that have emphasised globalisation and hyper-mobile flows of capital, it is somewhat ironic that an internationally ‘non-tradable’ and locally-embedded asset—residential property—was at the centre of the financial maelstrom. Yet, the relative surprise in policy and academic circles at the contribution of property to the Global Financial Crisis needs to be seen in the context of a significant reconfiguring of property markets over the past 50 years and the increasing significance of cities and urban space in the global economy.

Now, for the first time in human history, more than half of the world’s population lives in urban centres. Cities operate as the strategic loci of economic, social and cultural processes and are essentially vast built environments consisting of various forms of functional spaces (houses, offices, factories, warehouses, roads and so on) that are built, owned and managed over long time horizons. Given the scale of global urbanisation, it is unsurprising that property markets represent a significant component of national economies.

Indeed, the sheer size of the property market is truly impressive. In 2011 the Economist newspaper estimated that the
combined value of residential and commercial property in rich countries alone, following the Global Financial Crisis, stood at US$80 trillion (US$ 80,000,000,000,000). By comparison, the value of equity markets was US$20 trillion. Property services company DTZ put the total value of the global ‘investable’ commercial property market in 2009 at US$11 trillion. In addition, home ownership has expanded globally over the past 50 years to the point where in 2008 there were 75 million home owners in the United States and more than 130 million in the European Union. It has been argued that the EU, a quintessential economic union of sovereign states, could be legitimately termed a ‘Union of Homeowners’. Underpinning the growth of home ownership has been the increasing availability of mortgage finance. Annual residential mortgage originations in the US alone amounted to US$ 4 trillion in 2004. Locally, even though New Zealand has witnessed a significant decline in its home ownership rate—from 73 per cent to 66 per cent—the total value of residential assets was estimated to be NZ$600 billion in 2010, which is more than three times the country’s GDP. While a house is a small investment in terms of the total investment domain, housing is the largest asset class in the global economy.

Given the scale of property assets in the global economy and the myriad ways in which property processes affect economic, social and cultural practices, there is a clear need to better understand its role in business and economic processes. In what follows, I would like to address five property market myths and to identify five looming issues.

**Five Property Myths**

**MYTH: Housing markets are fundamentally the same**

Notwithstanding the real estate mantra of ‘location, location, location’, most commentaries on residential markets (both academic and industry) tend to treat such markets as relatively homogeneous. In this context, the concept of ‘average house price’ exerts considerable psychological and market power. Announcements regarding year-on-year house price increases are media events that have significant meaning for individual home owners and for the financial institutions that originate and/or securitise residential mortgages. Yet, housing markets are characterised by heterogeneity and locational fixity. Within national housing markets there are clear regional disparities in house price performance and even individual cities contain distinct sub-markets. While hedonic price models are premised on the notion of the ‘law of one price’, research has repeatedly demonstrated that markets consist of these clearly defined sub-markets.

While recognising the fragmented and differentiated nature of housing markets, it is also necessary to acknowledge the legal and institutional differences that exist across national jurisdictions. Home ownership in the US differs from home ownership in the UK, Australia or China, because it is produced and exchanged through very different institutional structures and agents. Given this, it needs to be recognised that the financial benefits of home ownership are not intrinsic to the tenure, but rather are a product of the geographical and physical attributes of a property, combined with the institutional arrangements that support the tenure. Significantly, international studies confirm that the financial benefits of home ownership are disproportionally skewed toward higher-income households.
MYTH: There is a simple relationship between residential rents and house prices

IN THE WAKE of the global property boom, and ensuing debates about the true value of property markets, considerable attention has been given to the explanatory power of the house price-to-rent ratio. This simple ratio represents an attempt to value housing as an investment asset. Popularised by the Economist, house price-to-rent ratios have increasingly been used to assess the overvaluation of housing markets. As house prices have tended to increase faster than rents, this ratio has been used to identify ‘speculative bubbles’.

However, the price-to-rent ratio is problematic at a number of levels. It assumes a constant discount rate (or yield), which may or may not hold. Researchers from both Harvard and the University of Reading suggest that, in reality, the user cost of capital is influenced by a range of factors, including house price expectations, credit market constraints (both real and nominal interest rates), tax provisions and transaction costs. In addition, the price-to-rent ratio downplays the role of housing as a necessary consumption item (it is hard to avoid the need to be housed) and the fact that house buyers may not be primarily concerned with the investment characteristics of property when purchasing a house.

MYTH: What goes up must come down

IN MANY popular accounts of the possible impacts of the Global Financial Crisis on housing markets, considerable attention has been given to the likelihood of significant house price declines. For example, the Reserve Bank initially suggested a possible 30 per cent decline in New Zealand house prices. Underpinning this argument is the notion that during the boom prices got out of line with fundamentals and that in the succeeding slump prices will return to an appropriate level, determined by fundamentals. However, in the absence of a significant oversupply, house prices are characterised by a ‘ratchet effect’ in nominal (if not real) prices. This ratchet effect reflects home owners’ behaviour during a slump. Under full-recourse mortgage systems (as in the UK, Australia and New Zealand), when prices begin to fall households are reluctant to sell. This reluctance becomes evident in the increased time taken to sell a property and in a decrease in the number of properties for sale. As the supply of housing on the market declines, prices tend to stabilise. If home owners are able to service their mortgages and therefore do not need to sell, then they are not under pressure to go to the market and take a capital loss.

In econometric modelling of housing markets, this ratchet effect is described in terms of a price asymmetry between upturns and downturns. Significantly, this modelling suggests that during a boom, house price expectations are autoregressive (as house prices go up, we expect them to go up more), but during a slump negative price expectations do not affect current prices to the same extent. This asymmetry in price behaviour over a boom-slump cycle suggests that the price effects of a boom can be long-term.

MYTH: Rationality rules the market

GIVEN THE enormity of the global property market and the relative size of individual housing transactions compared to a household’s income, markets could be expected to operate rationally. Indeed, many accounts of the recent global property boom emphasise what Yale economist Robert Shiller terms ‘irrational exuberance’. Implicit in this phrase is the idea that property markets are fundamentally rational but subject to bouts of irrational behaviour. Research on how households search for, and choose, housing indicates that they adopt logical search criteria in response to sets of ‘push’ and ‘pull’ factors.
Moreover, credit constraints and conservative lending criteria also ensure that households are rational in their housing choices.

Yet, notwithstanding this, there is also clear evidence that emotion and sentiment are important in property decisions. In contrast to sharemarket investment decisions, the word ‘love’ is often used by house buyers to describe why they chose a particular property. Moreover, in a rising market, buyers are willing to pay a premium on a property because of the ‘fear’ of losing out. These emotions are not irrational and they point to the importance of geographies of affect. Moreover, in contrast to share portfolios and bank deposits, people have memories and experiences invested in properties and this affects their understanding and valuation of them.

**MYTH: Property is deadweight on the real economy**

IN THE context of property booms, considerable policy attention has been directed toward what is viewed as the unproductive nature of property investment. Implicit in these discussions is the view that owners are receiving an unearned ‘economic rent’. The policy prescription arising from this perspective is either to promote consumer restraint—by raising interest rates—or to wait for a cyclical slump.

While this view has some merit, it tends to downplay the real benefits of property to the national economy. The building sector is an important source of both direct and indirect employment. Home owners’ ‘do-it-yourself’ enthusiasm directly supports jobs and profits for hardware chains and garden centres. Property transactions generate considerable benefits for a range of professions including legal, insurance, real estate, banking and exchange services. As a counterweight to the rather negative perception of housing as a problem sector, PricewaterhouseCoopers partner Suzanne Snively argued in a presentation to a 2009 Reserve Bank workshop that housing was a consumption and investment good, an industry, and an important component of New Zealand’s infrastructure. Snively highlighted the tangible and intangible benefits of homes and the extent to which they influence house prices and economic stability. She also pointed to the non-housing outcomes of good housing—namely, its positive effects on “health, education, labourforce participation and productivity”.

In addition to the housing sector, the commercial property sector plays a pivotal role in facilitating economic activities. The physical infrastructure of cities affects their economic performance, while the availability of high-quality buildings has a significant effect on the locational decisions of global financial services firms. Indeed, property-led urban regeneration programmes are at the heart of many cities’ attempts to become globally competitive.
Five Emerging Issues

Property and sustainability

INCREASINGLY, cities face major sustainability issues and property processes are a key component of both the problem and the solution. A study commissioned by the Royal Institution of Chartered Surveyors has found that the global construction industry produces significant waste and greenhouse gas emissions. In response to this concern, governments around the world are promoting urban intensification and pressing for zero-carbon property development. In addition, large pension funds and global investors, in tandem with large corporate tenants, are demanding ‘green buildings’. These drivers of change will not only shape how we provide buildings but will also transform the way we live and work. In searching for new and more sustainable development practices there is a need to reflect on the existing building stock. The appetite for new, environmentally-sound buildings creates strong redevelopment pressures, particularly in the commercial core of cities. But demolishing existing buildings has significant energy and
emissions implications. In seeking to meet the needs of the future we must balance the demand for new green buildings with effective retrofits of existing ones.

**Property and the macro-economy**

NOTWITHSTANDING the Global Financial Crisis, property will continue to be an important component in national economies and will pose significant challenges for economic policymakers. For example, reflecting on the role of housing investment in the US economy, the *Economist* argues that new house construction contributes significantly to the “volatile bit” of the economy and that housing has had an important role in driving economic recoveries.

While property booms are potentially inflationary, with a likelihood of becoming speculative bubbles, property downturns can exert a significant drag on GDP growth and prolong economic recessions. The International Monetary Fund recommends that, for
economies with more advanced mortgage markets, economic stabilisation requires a monetary policy approach that “responds to house price developments in addition to consumer price inflation and output developments”. It is noteworthy that since the Global Financial Crisis New Zealand’s Reserve Bank has sought to further regulate the activities of the banks in the mortgage market.

**Property Insecurities**

HOME OWNERSHIP is viewed by many as an enduring source of financial and psychological security. Yet, as the fallout from the US subprime mortgage crisis has demonstrated, the benefits of home ownership are not immutable. Home ownership is characterised by fragmentation and differentiation. The growth of home ownership necessarily involves the incorporation of lower income groups into the tenure—and in terms of housing costs, capital appreciation and security of tenure, their experience varies significantly from that of wealthy home owners.

Given evolving mortgage markets and changing building practices, the experience of housing will undoubtedly change. In New Zealand, the rise of ‘leaky building syndrome’ following implementation of the Building Act (1991) has had serious consequences for owners of houses with monolithic cladding. Michael Rehm, of The University of Auckland Business School’s Department of Property, has calculated that the stigma associated with leaky building syndrome has stripped $1,000 million from the market value of such houses. In the future, we are likely to see greater diversity and risk associated with housing markets and tenures.

**The limits of asset-based welfare**

AROUND THE world, the expansion of home ownership has been facilitated by favourable housing policies. Underpinning this political support is a set of beliefs regarding the benefits to such tenure. In addition, governments have increasingly viewed property ownership as a component of welfare policies. It is argued that, irrespective of the
rate of capital appreciation, outright home ownership reduces poverty among older households — and can lower the demand for pensions — by reducing housing expenditures. This possible effect on pensions is important. As the global population ages, future pension demands are likely to put increased pressure on countries’ resources. In the face of a potential pension tsunami, governments have increasingly considered the possibility of ‘asset-based’ welfare.

Proponents of asset-based welfare view home ownership as a form of pension, arguing that the wealth stored in housing can be released in old age to pay for essential services such as health care and residential care. However, research on the practices of home owners highlights the fact that home owners are generally resistant to reverse-equity mortgages and instead seek to preserve their assets. Countries everywhere are grappling with the implications of aging populations, age-specific differential home ownership rates, uneven wealth distributions
and the illiquid nature of housing assets, and these issues are likely to intensify in the coming years.

**Property and business**

**ENTIRE SECTORS** of the economy rely on the provision of specialised buildings. For example, tourism relies on an infrastructure of hotels, motels and backpacker accommodation. Financial services, by contrast, demand buildings ranging from suburban offices to downtown office towers with large floor plates. The ways in which such space is developed, owned, invested in, managed and leased has significant implications for individual industrial sectors and for the wider economy. In the context of rising urban competition, and an increasing policy awareness of the importance of ‘competitive cities’, the built environment can act as both a facilitator of change and an impediment to it.

At the level of individual firms, the nature and quality of occupied space can have a significant impact on productivity, particularly in the services sector. Recent research suggests that the behavioural, rather than the physical, aspects of the workplace have a significant bearing on productivity, and that businesses will increasingly need to address the balance between office interactions and distractions.

In addition, property has long been a strategic asset in the development of small and medium enterprises (SMEs). Whereas banks are reluctant to finance ‘ideas’, real property is often used as security for business loans to support small businesses and entrepreneurs in cases where finance would otherwise not be available. Moreover, in the shadow of the Global Financial Crisis, secured lending linked to property is likely to continue to feature prominently.
Laurence Murphy is professor of property at the University of Auckland Business School and was Head of the Department of property from 2003-2009. He was a Visiting professor at Trinity College Dublin in 2009, and in 2010 was appointed Acting-Director of ‘Transforming Auckland: Institutional, Technological and Cultural Innovations for Sustainable Cities’—one of three Thematic Research Initiatives established by the University of Auckland. In May 2010 he was elected an Eminent Fellow of the Royal Institution of Chartered Surveyors (RICS).

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**Conclusion**

THE UBIQUITOUSNESS and familiarity of the built environment has tended to foster a perception that land and buildings are merely a passive backdrop to economic activity. However, the sheer scale of property (both commercial and residential) as an asset, its role in business cycles, individual consumption and savings, and the operations of corporations and small businesses, means that property matters.

New Zealanders have been reproached for their love of property, yet they are not unique in this respect. Singapore, a high-tech knowledge economy, has a home ownership rate of over 90 per cent and the booming Chinese economy has a home ownership rate, in urban areas, of 80 per cent. Though the love of property is not the root of all evil, property booms and slumps are implicated in significant global and local crises. In the aftermath of the Global Financial Crisis, there is a clear imperative to understand the complex interdependencies that shape property dynamics and to move beyond general myths that inform policy prescriptions. This requires a twin agenda. First, there needs to be more research into the specificities of property markets, their dynamics, institutional structures and evolving agents and actors. Second, property markets and processes need to be placed in wider business and social science debates. Property is too big to be ignored, and too important to be marginalised, in either government policy or business practice.

**KEY TAKE-OUTS**

- The dynamics of property as a global asset class has profound implications for national economies, cities, households, investors, industries and services.

- Governments, businesses, households and city managers must incorporate more complex interpretations of property processes in their decisionmaking.

- Property is too big to be ignored, and too important to be marginalised, in either government policy or business practice.
MEETING OF THE BORED OR BOARD MEETING?