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Is There Room for Ethical Leadership in Today's Business Environment?

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Introduction: The Need for Ethical Leadership

As the Occupy movement signifies, there is a growing demand around the world that corporate leaders must behave more responsibly, and that more equality is required in the distribution of societal benefits. The slogan of movement members—“We are the 99 percent”—signifies the frustration felt by the ‘ordinary’ majority, which has seen a long-term slide in their economic well-being at the same time as the top 1 percent of society’s wealthiest individuals has experienced significant increases in net worth. Furthermore, the anger experienced by those suffering from the many ill effects of the global financial crisis, which began in 2008, has been fueled by fury over the apparent lack of penalties for the architects of the financial crisis. Indeed, several of the firms who took government bailouts continued to pay exorbitant bonuses to the very executives that guided the firms into trouble, while hundreds of thousands lost their jobs around the world. The Occupy movement quickly became an international phenomenon, as 82 countries experienced protests and over 600 communities experienced protests in the US alone.¹

While the financial crisis galvanized public cynicism and disgust with corporate immorality, demands for ethical leadership, defined as “the demonstration of normatively appropriate conduct . . . and the promotion of such conduct to followers” (Brown, Treviño, and Harrison 2005, 120), have been building for some time (Mendonca and Kanungo 2007). Scandals and blatant corporate greed at the expense of society have been revealed in recent years at firms such as Enron, WorldCom, Arthur Anderson, AIG, Lehman Brothers, Bre-X, Barings Bank, and tobacco companies. Unethical behavior by executives does not appear to be limited to “a few bad apples” (Bakan 2004); experi-

ments with 179 top executives and 203 financial controllers in the US found that 47 percent and 41 percent of them, respectively, would artificially inflate profits (fraudulently) to increase their odds of promotion (Brief, Dukerich, Brown and Brett 1996). When *Harvard Business Review* surveyed its readers, 80 percent of them indicated the companies they worked for had unethical practices (Morgenson 2004, A-12). Unethical leadership is widespread, even outside of business: three dozen school officials and teachers in Atlanta were indicted for helping children cheat in standardized test scores in order to improve their schools’ performance on the tests, earning bonuses as a result (Brumback 2013). A program of research by McCabe and colleagues over a number of years has found that across academic disciplines in universities and colleges cheating is widespread, but business students cheat more than others (McCabe and Treviño 1993; 1997; McCabe, Treviño, and Butterfield, 2001). Even among graduate students, the percentage of cheaters remains high: 56 percent of business students and 47 percent of nonbusiness students admitted to cheating in the prior year, usually perceiving that others were doing it, so they should too (McCabe, Butterfield, and Treviño 2006, 298).

Why do we see such unethical behavior in general, and in business in particular? After all, businesses are designed to create societal value by enabling the efficient production and distribution of goods and services. A business that creates value for its customers is a business that will continue to have customers in the long run.

**Economic Self-interest Seeking as a Damaging Focus of Attention**

Yankelovich (2007) and others claim that problems with business ethics make visible broader cultural problems associated with the rise in power of free market capitalism or market liberalism since the 1960s and 1970s, and the assumption, based in economics, that self-interest seeking is normatively good because it is economically efficient. Changes in values “have promoted a strikingly self-centered form of individualism that encourages people to look out for themselves even at the expense of others” (Yankelovich 2007, 14). While Adam Smith’s version of capitalism had an explicitly moral component, this morality has faded into the background as the guiding capitalist logic seems to be more rooted in the directives of Milton Friedman, which focus simply on the business of business as profit-seeking within the confines of the law (Friedman 1970). Most business decision making models taught by business schools and used in companies focus purely on profit seeking (Bauer
and Derwall 2011). In North America, business executives owe fiduciary duties to shareholders, which have been interpreted broadly as requiring executives to maximize profits. However, as Yankelovich argues, “The typical shareholder is a thirty-two-year-old fund manager who couldn’t care less about your stock and will dump it in a nano-second if your quarterly profits fall by pennies a share” (2007, 15).

Many studies have shown how this economic logic, focused on business efficiency if not profit maximization, has been applied to multiple sectors, including health care (Arndt and Bigelow 2000; Reay and Hinings 2005), arts and culture organizations (Allmendiger and Hackman 1996), and previously nonprofit activities (Tracey, Phillips and Jarvis 2011), as a matter of survival. When this logic, based on economic self-interest, has become pervasive within society, is it any wonder that individuals feel it is only rational to pursue narrow economic self-interest themselves? Self-interested behavior, given its valorization in the media, popular culture, business schools, and elsewhere, seems to be the only rational way to avoid being a sucker when others are likely to take advantage of you when seeking their own self-interest.

As companies increasingly chase profitability in a self-interest seeking world, a vicious competitive spiral to the bottom occurs in many sectors. Many consumers, seeking their own interests, focus on purchasing at the lowest price, which favors retailers and suppliers with scale economies. As these retailers and suppliers gain more business, they increase their scale further, driving out smaller competitors and creating a set of goods that are increasingly homogeneous and commodity-like (Shell 2009). As retailers gain power, they increasingly squeeze suppliers to reduce the wholesale prices of their goods each year. Because retailers are facing ‘hypercompetitive’ environments with other retailers, they pass savings onto consumers (and pay their own employees low wages to keep their prices low) in order to maintain their growth through volume.

As pricing pressures increase, suppliers cheapen the quality of their goods and pay their employees less in order to meet the price points that the powerful, hypercompetitive retailers are demanding. As the quality and price of goods go down, consumers buy the same items more often, replacing items that break or that are so cheap they are virtually disposable. In addition, as the quality of goods goes down, consumers experience satiation from getting a good deal, rather than from the products themselves. In order to experience satiation, they must continue to get good deals, and because they are experiencing declines or stagnation in their real purchasing power (due
to wage pressures), they continue to focus on low-priced goods, but must engage in buying more often in order to feel satiated. On the consumer side, we end up with overconsumption of cheap goods—goods which overfill landfills and don’t make people happier. The television show *Hoarders* shows the ridiculous extreme to which this overconsumption can go.

On the business side, there is another dark consequence to this cycle. The concentration of power in the hands of the megaretailers and their megasuppliers creates a political force that subverts the democratic process. These large firms donate to political candidates, lobby politicians, and control so much economic activity that passing regulations that curtail these firms’ activities is next to impossible. Indeed, Noam Chomsky has suggested that democracy is radically incompatible with our existing form of capitalism, as “control of government is narrowly concentrated at the peak of the income scale, while the large majority ‘down below’ has been virtually disenfranchised.”

What this means is that Friedman’s profit-maximization within the law is practically and ethically hollow. There are very limited opportunities to create laws that protect societal interests.

Is There Room for Ethical Leadership in a Highly Competitive Business Environment?

While the paradigm of profit maximization dominates, there are countervailing trends in today’s business environment that favor more ethical leadership of companies. When considering a firm’s external environment, trends that support ethical leadership include the increasing effectiveness of social activism, market incentives associated with socially responsible positioning, the impact of ethical or socially responsible investment, and the nascent but growing trend for companies to actively discourage investment from investors who focus on quarterly profits above all else.

The Trend Toward Increasing Social Activism

Easier access to information means that corporate behavior is now more visible than ever. Reductions in the cost of communications, and the democratization of communication through the internet and social networking, means that activists are able to share the job of monitoring companies and spread the news of transgressions to a larger audience. For example, when CNN recently covered the Steubenville, Ohio, rape trial in a way that was

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perceived to be excessively supportive of the rapists and dismissive of the victim, activists created an online petition demanding an apology that attracted over a quarter of a million signatures within a few days.3

Because of increasing transparency and activist targeting, there are more likely to be substantial reputational penalties for unethical or socially undesirable behavior, especially for firms that are large and generally have strong brand images, as these are the firms that are disproportionately targeted. Activist targeting can have an impact in several ways. First, it can increase managers’ awareness of the moral content of issues, a first step in applying ethical leadership (Mendonca and Kanungo 2007). Second, it can create market sanctions: moral misconduct may preclude access to certain markets or may damage a carefully cultivated brand image. For example, mining companies with poor reputations for dealing with communities or environmental concerns may be unable to obtain rights to mine in certain countries. Third, because the managers of targeted firms often have very positive views of the firm’s identity (and by reflection, their own), they may be distressed by public critique and may work to reduce it. Fourth, when these large firms change their behavior by, for example, adopting new supply chain standards or stakeholder engagement practices, other firms tend to follow, either because other firms are benchmarking best practices, or because the targeted firms later pressure the industry association or the government to change practices and/or regulations to level the playing field (Winn, Zietsma, and McDonald 2008).

The Trend Toward Market Incentives Associated with Socially Responsible Positioning

While market incentives, such as price premia associated with good ethical behavior, may also be available, there is evidence that many consumers will not pay a substantial premium for ethical or green goods (see, e.g., Devinney 2011; Gershooff and Irwin 2011). Because investing in highly ethical practices takes time and energy, it may be seen as irrational to invest heavily in ethical leadership. Yet, anecdotal evidence suggests that ethical leadership helps to build a positive brand image for differentiated companies, and there are numerous examples of firms that have taken an ethical stand and have strong financial performance, even if customers don’t explicitly acknowledge they are buying because of ethics. Companies like Tom’s of Maine, Timberland,

3. Two high school football players in Steubenville, Ohio, were found guilty in an incident where they repeatedly raped an unconscious girl and posted footage of the assault on the internet. The petition was found at: http://www.change.org/petitions/cnn-apologize-for-your-disgusting-coverage-of-the-steubenville-rapists. Accessed March 29, 2013.
Starbucks, Apple, Ben & Jerry’s, and Trader Joe’s (Hawthorne 2012) obtain substantial price premia because of their strong brand images, part of which is based on their ethical stance. Furthermore, when ethical companies like these change hands, acquirers seem to pay a significant acquisition premium (Hawthorne 2012). Many of these firms earn superior returns.

The Trend Toward Increasing Ethical/Socially Responsible Investment

As of 2010, approximately 12 percent of professionally managed investments in the United States were invested in ethical or socially responsible investments. Socially responsible investment specialists select investments based on social and environmental screens, file shareholder resolutions to attempt to influence firms’ social performance, engage in policy work, and invest directly in high impact community development initiatives. While the performance of investment funds varies widely, a number of ethical or socially responsible investment vehicles perform at the top of the industry, and it appears one can invest with one’s conscience and not pay a significant financial penalty. Given that societal expectations for social and environmental performance seem to be growing over time, increasing the risk associated with irresponsible or unethical corporate behavior, investment returns for socially responsible investments are likely to improve relative to investments in irresponsible firms in the future. The availability of capital that is actively supporting ethical leadership should increase the supply of ethically-led firms.

The Trend Toward Seeking Investor Alignment

There is a nascent but growing trend for companies to actively state that they will be making decisions based on longer term criteria more consistent with their social values, rather than focusing on short term profits. In doing so, they are actively warning short term investors to sell their stock or not invest in the first place. Unilever is a high profile example of a firm that eschews company-provided earnings guidance, and that warned investors that the company would be managing to the mission rather than for short term results. Unilever’s profitability has been very strong. When a Starbucks investor expressed concern that the firm’s support of gay marriage would hurt its sales at its annual general meeting, CEO Howard Schultz stated “Not every decision is an economic decision... The lens in which we are

6.  Keynote address on responsible capitalism by Unilever CEO Paul Polman at Schulich School of Business, February 15, 2013.
making that decision is through the lens of our people. We employ over 200,000 people in this company and we want to embrace diversity of all kinds.” Pointing to the 38 percent return on investment that Starbucks was earning, Schultz encouraged the investor to sell his shares if he felt he could do better elsewhere.7 Stories like this one, and like Unilever’s Lifebuoy soap campaign to reduce childhood deaths due to diarrhea in developing countries, are promoted virally through social media by supporters not affiliated with the companies.

Beyond these high profile examples, a broader trend is taking shape in the form of Benefit Corporations, or B-Corps, or their like in other countries, as well as a variety of mission–driven social and sustainable enterprises. A B-Corp is a firm which is required by law to create societal value along with shareholder value, by considering how its decisions affect employees, the community, and the environment.8 The relatively new organizational form is growing, with approximately 670 B-Corps certified in 24 countries by early 2013.9 Investors in B-Corps are explicitly aware that the social mission is important, and profits will not dominate the organization’s purpose. Indeed, Hart (2011), in describing what he calls third-generation (sustainable) corporations, claims that profit maximization is not a purpose at all, but an outcome.

It is now becoming clear that the best way to maximize profits over the long term is not to make them the primary goal (Mackey 2009). Profits are like happiness: a by–product of other things like having a strong sense of purpose, meaningful work, and deep relationships. Those who focus obsessively on their own happiness are usually narcissists—and end up miserable. Third–generation corporations, therefore, understand that you make money by doing good things rather than the other way around. (Hart 2011, 653–54)

Effects of Ethical Leadership on Employees

While external trends provide avenues and rationales for engaging in ethical leadership, it is clear that employees also benefit from their involvement in firms practicing ethical leadership. In line with the quotation above, and summarizing positive–psychology research, McGonigle (2011) notes that having

a guiding and meaningful purpose, the chance of success, satisfying work, and social connection is intrinsically motivating and leads to happiness. A significant contributor to the meaning employees experience comes from helping others.

A stream of work by Adam Grant and colleagues provides tangible evidence of this effect (c.f., Grant 2012; 2007; 2008). Grant studied employees at a call center whose purpose was to obtain funding for scholarships. A student who had benefited from a scholarship funded through the call center’s efforts gave a 10 minute presentation to call center employees, talking about the difference the scholarship had made in his life. As reported by the *New York Times Magazine*, a month later, “workers were spending 142 percent more time on the phone and bringing in 171 percent more revenue, even though they were using the same script. In a subsequent study, the revenues soared by more than 400 percent” (Dominus 2013). This contact with beneficiaries made employees realize the prosocial nature of their work, which helped them see the meaning associated with their jobs (Grant 2007; Grant, Campbell, Chen, Cottone, Lapedis and Lee 2007). Their perceived prosocial impact was associated with more effort, more persistence, and better job performance (Grant et al. 2007; Grant 2008). In another study, Grant and colleagues found that employees at Borders who contributed to a fund for the support of other employees in need showed higher increased commitment to their employer than the recipients of the fund. They stated: “when employees act on the opportunity to give, they are able to see themselves and the organization as more caring, which is likely to strengthen their commitment to the organization that manages the program” (Grant, Dutton, and Russo 2008, 913).

This work highlights that employees are motivated by relational aspects of their jobs and they gain psychic benefits from helping others. A recurring theme in work on improving ethical decision making in companies is that adopting an ethic of care (Gilligan 1982), with its inherently relational focus, would improve ethical decision making (Maver and West 2012). A care ethic approach to business conceptualizes mutual interdependency and cooperative relationships as givens, and “challenges the assumption that an individualistic, competitive or aggressive marketplace is inevitable” (Sander-Staudt and Hamington 2011, x). The virtues of attention, respect, response, completion, compassion, empathy, and concern for others comprise the care ethic (ibid.).

The care ethic is inherently sympathetic with sustainable companies that exhibit more inclusive capitalism, as described by Hart (2011, 648):

Third-generation corporations are developing fully contextualized solutions to real problems in ways that respect local culture and
natural diversity. This means engaging in ‘deep dialogue’ with local communities to cocreate businesses that are truly ‘embedded’ in the local context. Such companies will come to view the communities they serve as partners and colleagues, rather than merely as ‘consumers.’ (Hart 2011, 653)

In doing so, employees will have direct contact with stakeholders, understand their issues, and develop innovative solutions to interdependent problems.

Employees and managers working in companies that exhibit an ethic of care for their stakeholders are thus more likely to experience greater meaning in their work, which is associated with higher job performance, stronger organizational commitment (Grant 2012; Piccolo, Greenbaum, den Hartog, and Folger 2010), greater tendency to go above and beyond the call of duty, and reduced deviance (Mayer, Kuenzi, Greenbaum, Bardes, and Salvador 2009).

How Do We Ensure Ethics is Reflected Within the Firm?

An important cautionary note is in order, however. To maintain a consistent commitment to ethical leadership, ethical behavior must be exhibited and promoted by those at the top of the organization, but it must also trickle down through extensive modeling by immediate supervisors (Mayer et al. 2009). A clear ethical code of conduct is required, but it is insufficient. Consistent and repetitive communication of the code of conduct, along with cultural symbols and stories to make it real, will help embed ethical conduct into the culture. Accountability for ethics at all levels before accountability for profits is necessary—it must be understood that ethical conduct is nonnegotiable, and consideration of profits comes only once a firm can be assured that its actions fit its code.

Conclusion

I have argued that ethical leadership is increasingly being called for by members of society feeling disgusted by corporate scandals and abused by income inequality. I located the seeds of corporate misconduct in a focus on profit maximization and narrow self-interest seeking, and argued that Friedman’s directive for businesses to maximize profits within the law is insufficient when the law can be subverted by powerful corporate interests. I have argued that there is increasingly room for ethical leadership, even within a highly competitive business environment, and that there are benefits for companies and their employees in pursuing ethical leadership, particularly as informed by an ethic of care. While the journey toward a more ethical corporation is
unlikely to be an easy one, and the need is strong to maintain a consistent focus once a choice is made to pursue ethical leadership, the potential benefits to society, the firm, its employees, and its other stakeholders are substantial.

References


