

## CHAPTER 3

# The Role of Leaders in Influencing Unethical Behavior in the Workplace

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**A**fter years of focusing on explaining and predicting positive employee attitudes (e.g., job satisfaction, employee commitment) and behaviors (e.g., employee citizenship, work performance), organizational behavior researchers have increasingly turned their attention to understanding what drives costly misconduct in organizations (Bennett & Robinson, 2000; Giacalone & Greenberg, 1997; Robinson & Bennett, 1995; Robinson & O’Leary-Kelly, 1998; Treviño, 1986; Vardi & Wiener, 1996). Although researchers have used a variety of terms to describe such employee behavior (e.g., deviance, antisocial behavior, misbehavior, counterproductive behavior, unethical behavior), all of them share a concern with counternormative behavior intended to harm the organization or its stakeholders (O’Leary-Kelly, Duffy, & Griffin, 2000).

Unethical behavior in organizations has been widely reported in the wake of many recent high-profile corporate scandals. As researchers and practitioners consider what may be driving such behavior, leaders are coming under increasing scrutiny not only because many senior executives are accused of having committed unethical acts but also because of the role that leaders at all levels are thought to play in managing the ethical (and unethical) conduct of organization members. For example, Bernie Ebbers, the former chief executive officer of WorldCom, was hailed as a great leader for growing the company into a telecommunications superpower.

Ebbers, however, was later discredited for his failure to provide moral leadership as WorldCom became engulfed in financial scandals that resulted in the largest bankruptcy in U.S. history (for more on Ebbers, see Case 3). As Turner, Barling, Epitropaki, Butcher, and Milner (2002) suggest, organizational researchers are increasingly interested in the “moral potential of leadership” (p. 304). The assumption is that a leader who exerts moral authority should be able to influence followers’ ethical behavior.

Theory and research suggest that leaders should, and do, influence organizational ethics. The normative business ethics literature has focused on cases (e.g., Donaldson & Gini, 1996) or prescriptions regarding what leaders *should* do to provide ethical leadership (e.g., Ciulla, 1998; Freeman, Gilbert, & Hartman, 1988; Rost, 1995). The descriptive business ethics literature has reported that executive leaders set the ethical tone at the top of organizations (Murphy & Enderle, 1995) and shape their formal and informal ethical cultures (Treviño, 1990; Treviño & Nelson, 2004). Executive leaders have been found to play an important role in communicating ethical standards and using rewards and punishments to reinforce normatively appropriate conduct (Treviño, Hartman, & Brown, 2000). In addition, senior management’s concern for ethics has been shown to influence an organization’s values or compliance-oriented approach to ethics management and its integration of ethics into everyday activities such as performance appraisals (Weaver, Treviño, & Cochran, 1999a, 1999b). Leaders have also been found to influence employees’ ethical conduct. For example, employees’ perception that executives and supervisors sincerely care about ethics has been associated with the amount of unethical conduct observed in the organization (Treviño, Weaver, Gibson, & Toffler, 1999). However, despite this evidence suggesting that leaders “matter” when it comes to organizational ethics, the specific role of leadership in influencing unethical behavior in the workplace has yet to be fully explicated.

In this chapter, we explore theoretical reasons why leaders should play an important role in influencing followers’ ethical and unethical behavior. Specifically, we look at this relationship from cognitive moral development, social learning, and social exchange perspectives. Next, we consider leadership styles and how they have been linked to ethics in the leadership literature (e.g., transformational/charismatic leadership). Next, we discuss our recent research on the development of an ethical leadership construct. We conclude with recommendations for future research.

## Why Leaders Are Important: Insights From Cognitive Moral Development Theory

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To understand why leaders are important for understanding ethical and unethical behavior in organizations, we first turn to moral psychology and particularly to cognitive moral development theory (Kohlberg, 1969). Kohlberg’s theory, widely cited as the leading theory in the field of moral development, focuses on how individuals reason through ethical dilemmas and how they decide what is right.

Although Kohlberg studied the moral development of children and young adults, his students (e.g., Rest, 1986) and others have studied adults in work settings.

According to Kohlberg (1969), people reason at six stages that can be understood in terms of three broad levels: preconventional, conventional, and principled. Preconventional individuals (the lowest level) are concerned with avoiding punishment and a “one hand washes the other” kind of reciprocation. Principled individuals (the highest level) make decisions autonomously by looking inside themselves and are guided by principles of justice and rights. But we know from decades of research that the large majority of adults reason at the conventional level of cognitive moral development (for summaries of research on moral development, see Rest, 1986; Rest, Narvaez, Bebeau, & Thoma, 1999; for a summary of research on moral development in the professions, see Rest & Narvaez, 1994). Such conventional-level individuals look outside themselves to rules and laws and to the expectations of significant others in their environments for guidance when determining the ethically right thing to do. Because these conventional-level individuals represent the large majority of workers, immediate supervisors should be among the most important sources of moral guidance for these employees, and we can expect that they will look to leaders for cues about what behavior is appropriate and inappropriate.

It is also important to note that moral reasoning has been associated with ethical and unethical conduct in a number of studies. Individuals at the principled level of moral development are less likely to engage in negative behaviors such as cheating and stealing, whereas those at lower levels are more likely to engage in such behaviors and are more susceptible to outside influences (e.g., Greenberg, 2002; for a review, see Treviño, 1992). Although other outside influences, such as peers (Zey-Ferrell & Ferrell, 1982; Zey-Ferrell, Weaver, & Ferrell, 1979), and formal organizational systems, such as ethics codes and training programs (Greenberg, 2002; Treviño et al., 1999), affect ethical behavior, leaders should be a key source of ethical guidance due to the authority role they play. In fact, leaders' level of moral reasoning has been shown to influence the moral reasoning used by group members in their decision making (Dukerich, Nichols, Elm, & Vollrath, 1990), and leadership style has been shown to influence conformity in ethical decision-making frameworks in work groups (Schminke, Wells, Peyrefitte, & Sebor, 2002). The next step, then, is to attempt to better understand some of the theoretical processes by which leaders are likely to influence such behavior.

## How Leaders Influence Employee Ethical and Unethical Behavior

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We discuss several theoretical explanations for how leaders influence ethical and unethical behavior. We offer a social learning perspective to suggest that leaders influence ethical and unethical conduct through modeling processes, and we offer a social exchange perspective to suggest that subordinates are likely to reciprocate with positive behavior when they and their leaders are involved in relationships that are based on admiration and trust.

## Social Learning

Social learning has been used to understand how leaders influence followers more generally. House (1977), Bass (1985), and Kouzes and Posner (1987) all have referred to role modeling as essential leader behavior. In particular, charismatic or transformational leaders (discussed in detail later) are thought to influence followers, at least in part, through modeling and identification processes (Avolio, 1999; Avolio, Bass, & Jung, 1999; Kelman, 1958).

A social learning perspective (Bandura, 1977) suggests that leaders influence their followers by way of modeling processes. Modeling is acknowledged to be one of the most powerful means for transmitting values, attitudes, and behaviors. Employees learn what to do, as well as what not to do, by observing their leaders' behavior and its consequences. Leaders are likely to be models by virtue of their assigned role, their status and success in the organization, and their power to affect the behavior and outcomes of followers.

Clearly, modeling by leaders can influence followers to be ethical or unethical. Leaders who engage in unethical behaviors create a context supporting parallel deviance (Kemper, 1966), meaning that employees observe and are likely to imitate the inappropriate conduct. If leaders are observed "cooking the books," enriching themselves at the expense of others, or lying to customers or suppliers, followers learn that such behavior is expected. If leaders are rewarded for unethical conduct, the lesson for followers becomes particularly strong. Consider some chief executive officers, such as WorldCom's Bernie Ebbers and Enron's Ken Lay, who were celebrated by financial analysts and the media as exceptional executive leaders who defied conventional wisdom as they continually surpassed Wall Street's short-term financial expectations. They were publicly hailed and financially rewarded for achieving extraordinary financial outcomes, and no one seemed to care what means they used to achieve those outcomes. We should not be surprised to find that their subordinates followed their leads and became increasingly adept at inventing new (and sometimes unethical) ways in which to contribute to these outcomes.

Employees can also learn to be ethical by observing leaders who stand up for doing what is right, especially if the leaders are successful in doing so. For example, a chief executive who communicates with employees about a decision not to invest in a highly corrupt foreign country because it would require employees to engage in inappropriate behavior such as bribery is sending an important signal about what is appropriate and expected of followers. Similarly, an executive who shuts down machinery to ensure employee or product safety makes it clear that doing the right thing is expected even if it means short-term losses.

Leaders' power to influence may be particularly effective because leaders make decisions about the rewards and punishments that are imposed on employees, and followers learn vicariously by observing what happens to others. People in organizations pay close attention to rewards and punishments (Arvey & Jones, 1985; Kanfer, 1990; Treviño, 1992), and these contribute to modeling effectiveness because they are socially salient. Modeling theory argues that consequences

(rewards and punishments) facilitate learning in an anticipatory and vicarious manner. Consequences inform observers about the benefits of modeled ethical behavior as well as about the negative effects of modeled inappropriate behavior. So, not only are leaders role models themselves, but they also make others into models by rewarding appropriate conduct and disciplining inappropriate conduct (Gini, 1998; Treviño, Brown, & Hartman, 2003). This seems especially important to the management of unethical conduct. We would not want every employee to have to personally experience punishment for inappropriate conduct so as to learn that such behavior is unacceptable. By observing how other employees are rewarded and punished, many employees can learn these important lessons vicariously.

Relying on justice and social learning theories, Treviño (1992) emphasized the key social implications of punishment in organizations. Discipline sends powerful signals about the value of organizational norms and leaders' willingness to stand behind them. Employees who are trying to do the right thing expect misconduct to be punished harshly, and they are disappointed if it is not. For example, if an employee who downloads pornography to his office computer is quickly terminated, other employees will get the clear message that such behavior will not be tolerated and that rules against it are being enforced in the organization. Employees' sense of retributive justice (Hogan & Emler, 1981) will be satisfied (Treviño, 1992; Treviño & Ball, 1992), and they will be less likely to engage in such behavior themselves. However, if such behavior is allowed to continue, employees will question management's sincerity and whether the organization's rules mean what they say.

Similarly, vicarious rewards can send powerful messages supporting ethical or unethical conduct. If an employee who pulled the handle to stop a potentially dangerous machine from harming a coworker is celebrated for his or her caring, observers learn that such behavior is appropriate, expected, and appreciated in the organization. Alternatively, if that same employee is punished because stopping the machine means missing short-term production quotas, employees will learn that short-term production quotas are more important than employee safety and that they are expected to behave accordingly. Finally, if a salesperson who is known to lie to customers is made "Salesperson of the Year," given a fat bonus, and sent on a Hawaiian vacation, employees will learn that lying to customers is rewarded, making such behavior more likely. Thus, employees are susceptible to leaders' influence to engage in appropriate or inappropriate behavior by learning from the leaders' own modeling of such behavior and by learning vicariously from how other employees' behavior is rewarded and punished.

The social learning approach suggests a mostly instrumental understanding of what drives unethical behavior in organizations. It argues that because of leaders' authority role and the power to reward and punish, employees will pay attention to and mimic leaders' behavior, and they will do what is rewarded and avoid doing what is punished in the organization. The rewards and punishments need not be direct but also can be learned vicariously by observing how others in the organization are rewarded and disciplined.

## Social Exchange

Instrumental exchange is not the only way in which leaders can influence followers' ethical and unethical behavior. The quality of the interpersonal treatment that employees receive from leaders is also likely to be an important factor. Typically, high-quality leader–employee relationships are characterized as social exchanges as opposed to transactional ones. According to Blau (1964), transactional exchanges are characterized by quid pro quo logic and are governed by contract so that all terms and obligations are specified in advance and are enforceable by third parties. As a result, obligations governed by transactional exchange have a contractual tone and do not depend on trust between the parties. In a transactional exchange relationship, a supervisor relies on legitimate power to influence employees through the use of rewards or punishments, and employees can be expected to perform their duties as directed but to do little more.

In contrast, social exchange relationships entail future obligations that are unspecified and are enforced by norms of reciprocity (Gouldner, 1960). Without the protection of contractually specified obligations, the perceived trustworthiness of the partners and the fairness of the exchange become important for developing and maintaining lasting relationships. With social exchange, the obligation to reciprocate is voluntary (i.e., not contractually specified), and the benefits obtained may be nonmonetary. The rewards exchanged may be spontaneous (e.g., attraction, gratitude, respect). In addition, individuals in social exchange relationships tend to identify with the other parties in the exchange relationships. Parties engage in social exchange willingly, and reputation plays an important role in ensuring that the norms of fairness governing the exchange are not violated. Although the risks of exploitation and one-sidedness are high, a social exchange relationship develops over time with increased trust (Whitener, Brodt, Korsgaard, & Werner, 1998) and can be mutually beneficial for the parties involved as well as for the larger organization in which they work. Typically, leaders engage in both social and transactional exchanges with subordinates (Bass, 1985). Studies have shown that these two dimensions are strongly correlated (Avolio, 1999), although the dimensions can lead to different outcomes.

### *Perceived Fairness*

Perceived fairness is particularly important for the development of a social exchange relationship (Konovsky & Pugh, 1994), especially in the context of a leader–subordinate relationship (Pillai, Schriesheim, & Williams, 1999). When employees believe that they are treated fairly in a social exchange relationship (Konovsky & Pugh, 1994), they are motivated to give more of themselves— affectively, cognitively, and/or behaviorally—in support of their supervisor and the group or organization that he or she represents. Fair treatment engenders satisfaction and loyalty among employees, making it less likely they will be motivated to harm their supervisor, group, or organization.

Social exchange is closely linked to both procedural and interactional fairness (Moorman, Blakely & Niehoff, 1998; Pillai et al., 1999). Interactional fairness refers

to employees' perceptions of the degree to which they are treated with respect and dignity by authority figures (Bies & Moag, 1986). Perceived interactional justice should be particularly important to the development of a social exchange relationship between supervisors and subordinates because supervisors interact with their subordinates and make decisions that affect them every day. Although immediate supervisors may have little impact on the development of organizational procedures (procedural justice), they are likely the most important influence on employees' perceptions of whether the employees are treated with dignity and respect in the organization. When leaders treat employees well, they initiate social exchange processes, creating a sense of obligation among subordinates and motivating them to reciprocate. Subordinates may reciprocate by way of organizational citizenship behaviors, particularly those aimed at their supervisor (Malatesta & Byrne, 1997; Masterson, Lewis-McClea, Goldman, & Taylor, 2000; Niehoff & Moorman, 1993; Wayne, Shore, Bommer, & Tetrick, 2002), or by refraining from behaviors aimed at harming their leader, work group, or organization.

Alternatively, perceived unfair treatment can provoke strong negative reactions from employees. Greenberg (1990) found that employees reacted to perceived unfair pay cuts and interpersonally insensitive explanations from management by stealing from the organization, just one of many studies that have linked perceived unfairness with counterproductive employee behaviors (Konovsky, 2000). In response to perceived injustice, employees may engage in interpersonal and organizationally directed retaliation, including sabotage (Ambrose, Seabright, & Schminke, 2002; Bennett & Robinson, 2000; Robinson & Bennett, 1997; Treviño & Weaver, 2001) in an attempt to rebalance the scales of justice. One might expect an employee to target the source of the injustice, but an employee will be unlikely to retaliate against a leader overtly because such retaliation will most likely lead to formal sanction or punishment. Instead, we expect that employee retaliation will be covert and broader, including behaviors such as falsifying expense reports, abusing sick time, lying to the supervisor, and misusing company time and other resources. Research has found that unfair treatment by an individual, especially by a supervisor, can result in retaliation against either the person or the organization as a whole (Ambrose et al., 2002; Rupp & Cropanzano, 2002).

### *Trust in Supervisor*

Social exchange relationships between leaders and followers are built on trust. Trust in leaders is especially important for employees due to their weak and subordinate positions relative to their supervisors (Kramer, 1999). Furthermore, leaders influence important outcomes such as pay, promotion, and satisfying work conditions. Employees face uncertainty about these outcomes and whether their leaders will allocate them fairly (Kramer, 1996). Furthermore, employees are dependent on their supervisors as representatives of higher organizational authority. When employees trust their leaders, the employees are more willing to engage in voluntary behaviors that benefit the organization (Podsakoff, MacKenzie, Paine, & Bachrach, 2000). A recent meta-analysis found that employees' trust in their leaders was associated with many positive outcomes (Dirks & Ferrin, 2002), including

citizenship behaviors (Konovsky & Pugh, 1994) such as altruism, civic virtue, conscientiousness, courtesy, and sportsmanship as well as job satisfaction and satisfaction with their leaders. We can think of citizenship behaviors (which help the work group and organization) as representing the opposite of organizationally and interpersonally harmful behaviors. Therefore, as citizenship behaviors increase, unethical behaviors should decrease. Negative outcomes should be lower if employees trust their leaders because, as argued earlier, the leaders represent the organization to direct reports. Furthermore, although trust has been found to be more strongly related to work attitudes than to job performance (Dirks & Ferrin, 2002), the relationship of trust with unethical employee behaviors is likely to be strong because, theoretically, trust is more closely related to such behaviors than to more general job performance.

### *Liking and Affection for Supervisor*

The leader-member exchange literature has focused on the importance of high-quality relationships between employees and their leader (Dansereau, Graen, & Haga, 1975; Graen & Cashman, 1975). In this literature, high-quality relationships are frequently characterized by employee liking and admiration of their leader (Schriesheim, Castro, & Cogliser, 1999). When employees have a high-quality relationship with their manager, they have been found to be less likely to engage in retaliation (Liden, Sparrowe, & Wayne, 1997). Alternatively, when employees have a poor exchange relationship with their supervisor, negative outcomes can result (Fairhurst, 1993). Some have argued that if employees dislike or are frustrated with a supervisor, they will retaliate in surreptitious ways by harming the organization through sabotage or by being aggressive with coworkers (Fairhurst, 1993; Liden et al., 1997; Zahn & Wolf, 1981). Again, we expect that employees will be less likely to engage in overt retaliation against a supervisor who they dislike because doing so would most likely lead to formal sanction or punishment. Rather, such frustration and dislike for a supervisor is likely to lead to covert (i.e., “behind-the-back”) harmful behaviors aimed at coworkers or the organization (Bennett & Robinson, 2000).

## **Leadership Styles and Employee Ethical/Unethical Behavior**

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Now that we know something about the theoretical processes that are important to leaders' influence on followers' ethical and unethical behavior, we turn to the leadership literature to see what it can tell us about this relationship.

### **Transformational and Charismatic Leadership**

The organizational leadership literature has addressed leadership's moral dimension primarily through the transformational and charismatic leadership dimensions (Kanungo & Mendonca, 1996). In the broader leadership literature,

Burns (1978) distinguished transformational leadership from transactional approaches. He argued that transformational leaders encourage followers to embrace moral values and to act in the interest of the collective rather than self-interest. He cited Kohlberg's (1969) theory of cognitive moral development, Maslow's (1954) hierarchy of human needs, and Rokeach's (1973) theory of values to explain transformational leaders' influence. Transformational leaders are thought to raise followers' level of moral development and to focus followers' attention on higher level needs and values.

In contrast, transactional leaders rely on rewards and punishments to direct followers' behavior. Kanungo and Mendonca (1996) argued that transactional approaches are inconsistent with moral leadership because transactional approaches ignore followers' needs and aspirations and that transactional leaders focus on the status quo rather than on an inspiring vision of the future and may be motivated by their own achievement and power rather than followers' needs.

Bass (1985) translated Burns's (1978) work on transformational leadership for the organizational behavior literature and, with Avolio (Bass & Avolio, 2000), developed a multidimensional transformational leadership construct with the following dimensions: individualized consideration, intellectual stimulation, idealized influence, and inspirational motivation. The idealized influence dimension is the most clearly "moral" dimension, with its focus on setting a good example, communicating moral values, and sacrificing self-interest for the benefit of the group.

Transformational leadership has been associated with many positive outcomes such as workers' satisfaction with work and the leader, organizational commitment, citizenship behaviors, and job performance (Fuller, Patterson, Hester, & Stringer, 1996; Lowe, Kroeck, & Sivasubramaniam, 1996; Yukl, 2002). However, researchers have just begun to study the influential mechanisms that mediate between leader behavior and these outcomes. Transformational leaders, by way of the idealized influence component, are thought to influence followers to develop a collectivistic orientation rather than a selfish one, to internalize moral values transmitted by the leader, and to increase followers' self-efficacy (Shamir, House, & Arthur, 1993).

The inspirational motivation component of transformational leadership combines with idealized influence to represent the "charismatic" aspect of transformational leadership. With inspirational motivation, leaders use symbols to present an attractive and optimistic vision of the future. Conger and Kanungo (1998) proposed that charismatic leaders would influence followers by arousing their personal identification with the leaders (Pratt, 1998). The charismatic leadership literature (House, 1977) argues that charismatic leaders link the organization's mission with followers' self-concept, including a sense of moral virtue (Gecas, 1982). Similar to transformational leaders, charismatic leaders are thought to emphasize the collective and the value of being part of something larger than themselves.

Thus far, the research to document these mediating mechanisms has produced mixed results. For example, Kark, Shamir, and Chen (2003) found that transformational leadership was related to personal identification with the leader and to social identification with the work unit, although personal identification with the leader had the stronger effect. But Dvir, Eden, Avolio, and Shamir (2002) failed to support their hypothesis that transformational leaders influence followers to develop a

collectivistic orientation or to internalize moral values. Similarly, Shamir, Zakay, Breinin, and Popper (1998) found a negative relationship between leader charisma and follower self-efficacy, and their research provided only weak support for the proposition that charismatic leaders influence followers by inspiring them to work for the collective interests of the group. Furthermore, although a recent study found that transformational leaders are higher in moral reasoning (Turner et al., 2002), we do not yet have evidence that transformational leaders transmit this higher moral reasoning to their followers.

Clearly, more theoretical and empirical work will be needed to fully understand the processes by which transformational and charismatic leaders influence followers and any relationship between these leadership styles and ethics-related outcomes. One problem with understanding the relationship with ethics-related outcomes may be that transformational and charismatic leadership approaches presume “charismatic” appeal and/or “transformative” processes that may or may not be necessary to influence followers’ ethical conduct (Treviño et al., 2003).

Another problem concerns the potential darker manifestations of transformational and charismatic leaders. Bass (1985) acknowledged that transformational leaders can wear “white hats or black hats.” In addition, others have argued that both transformational and charismatic leaders can be self-centered and manipulative in the means they use to achieve their goals (Parry & Proctor-Thomson, 2002). Bass and Steidlmeier (1999) distinguished between pseudo-transformational leaders, who are self-interested and lack moral virtue, and “authentic” transformational leaders, who are more clearly “moral” leaders.

Others have coined the term “authentic leadership” to refer to a broad leadership construct that they propose to be the “root concept underlying all positive approaches to leadership and its development” (May, Chan, Hodges, & Avolio, 2003, p. 2). May and colleagues (2003) argued that authentic leaders have the ability to judge ethical dilemmas from multiple stakeholder perspectives and see their leadership role as including ethical responsibility. In addition, authentic leaders are self-aware and transparent in their decision making as well as in their intentions to act ethically. Authentic leaders can be, but are not necessarily, charismatic and/or transformational, but they are courageous enough to act on their ethical intentions and to sustain ethical action despite countervailing pressures.

## Ethical Leadership

Because we sought to establish empirical grounding for further research on an ethical dimension of leadership, we have focused our attention on the development of a construct we call “ethical leadership.” We conducted interviews with 20 senior executives (mostly chief executives) and 20 ethics officers in large business organizations. We asked them to describe the characteristics and behaviors of an ethical leader with whom they had worked closely during their careers. The good news is that all of them quickly thought of someone, suggesting that ethical leadership is not a rare phenomenon in today’s business organizations. Similarly, a majority of

respondents to the National Business Ethics Survey agreed that their supervisors and executive leaders model ethical behavior (Joseph, 2000).

Systematic content analysis of our interview data suggested that ethical leaders are both “moral persons” and “moral managers” (Treviño et al., 2000). We think of the “moral person” as representing the “ethical” part of the term “ethical leadership,” and we think of the “moral manager” as representing the “leadership” part of that term.

Ethical leaders are thought to be moral persons because they are honest and trustworthy, take good care of their people, and do the right things in both their personal and professional lives. They make decisions based on values and ethical decision rules, and they are fair and concerned about stakeholders’ interests and long-term outcomes.

As moral managers, ethical leaders are clear about their expectations of followers. They are visible role models of ethical behavior, communicate with their people about their ethical and values-based expectations, and use the reward system to hold followers accountable for ethical conduct.

Ethical leaders are also socially salient in their organizations. Ethical leaders stand out from what can be described as an “ethically neutral” background in many business organizations where the intent focus on the financial bottom line can easily drown out other messages (Treviño et al., 2003).

It is important to note that the executives we interviewed rarely described ethical leaders as either transformative or visionary, terms that are consistent with the transformational and charismatic leadership literatures. In addition, ethical leaders clearly use the reward system to support ethical conduct, suggesting that ethical leadership includes a dimension more consistent with transactional leadership approaches. Thus, although overlap certainly exists between ethical leadership and the transformational and charismatic leadership constructs, some important differences remain.

Understanding ethical leadership in this way makes sense if we consider the proposed theoretical processes underlying the relationship between leadership and employee ethical conduct: social learning and social exchange. In accordance with a social learning perspective, ethical leaders are described as being visible ethical role models who stand out from an ethically neutral landscape. They behave ethically in their personal and professional lives, and they make decisions based on ethical principles and the long-term interest of multiple stakeholders. Followers are likely to personally identify with such a visible role model of ethical conduct and to pattern their own behavior after that of the leader.

In addition, ethical leaders send clear messages to organizational members about expected behavior and use the reward system to hold everyone accountable to those expectations. By clearly rewarding ethical conduct and disciplining unethical conduct, they allow for vicarious learning to take place. This aspect of ethical leadership depends on social learning and can be viewed as more transactional (than transformational) because followers behave ethically and refrain from unethical conduct largely due to the observed consequences.

However, ethical leadership is also consistent with a social exchange perspective. Ethical leaders were described as being trustworthy and as treating their people

with care, concern, and fairness. As such, they are likely to create social exchange relationships with their subordinates, who can be expected to reciprocate this care and fair treatment by engaging in citizenship behaviors and by refraining from unethical conduct. In addition, using the reward system to support ethical conduct is consistent with followers' perceptions of organizational justice. By disciplining unethical conduct, the leaders are upholding organizational norms and supporting the values of those who obey the rules. Thus, ethical leaders are likely to influence their followers to engage in ethical conduct and to refrain from unethical conduct by way of multiple processes that rely on both transformational and transactional approaches to leadership. This finding is contrary to the view that transactional approaches are inconsistent with ethical leadership (Kanungo & Mendonca, 1996).

## Discussion

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In this chapter, we have focused on the role of leadership in influencing employees' ethical and unethical conduct. We argued that because most employees are at the conventional level of cognitive moral development, they are looking outside themselves for guidance in ethical dilemma situations. Leaders, especially first-line supervisors, should be a key source of such guidance due to their proximity to their followers and their power to influence subordinate outcomes. We then outlined a number of theoretical processes, particularly social learning and social exchange, that are proposed to underlie this relationship between leader and follower ethical outcomes. We also reviewed the leadership literature for insight into relevant leadership styles and found that although transformational/charismatic leaders are proposed to be moral leaders, the empirical evidence for their influence on ethics-related outcomes remains scanty. Finally, we reviewed our own work on an ethical leadership construct that more tightly links leadership characteristics and practices to ethics-related outcomes.

### Potential Limitations on the Role of Leadership

We hope that we have convinced the reader that leadership is enormously important and deserves more attention in our attempts to understand employee ethical and unethical behavior. However, we should also put the role of leaders in a broader context and understand its potential limitations, all of which are open to empirical testing.

We expect that some employees will be less influenced by leaders than will others. For example, employees who are at the principled level of cognitive moral development are expected to behave in accordance with internally held principles of justice and rights. Therefore, their ethical conduct should be less influenced by what specific leaders do or say. If faced with "unethical" leadership, principled individuals are more likely than others to try to change the situation, blow the whistle, or leave.

Employees at the lowest levels of cognitive moral development (preconventional) should be less influenced by leaders than by reward system contingencies.

When thinking about right and wrong, preconventional individuals think mostly about obedience and punishment avoidance or instrumental exchange (i.e., a “one hand washes the other” kind of relationship). Therefore, preconventional individuals will likely pay more attention to what will happen to them if they engage in a particular behavior than they will attend to leaders’ behavior or expectations. Still, to the extent that leader expectations are tied to reinforcement contingencies, preconventional individuals can be expected to do what is expected of them by leaders.

Leader and follower demographics may also be significant. We suspect that ethical leadership may be less influential in homogeneous settings where leaders and their followers share values based on age and cultural similarity. Yet with the development of an increasingly diverse workforce in the United States, ethical leadership should become even more important.

Supervisory leaders may be more or less influential depending on characteristics of their work group such as size and type of work. For example, the larger the span of control, the more difficult it may be to communicate ethical standards and to hold work group members accountable. Furthermore, if employees work in the field and not under a leader’s direct supervision (e.g., sales representatives), a leader’s ability to influence them may be diminished simply because the leader is less visible or salient due to less frequent communication.

Individual leaders may also be less influential to the extent that the organization has a strong ethical climate and culture that incorporates formal and informal systems to support ethical conduct (Treviño, 1990; Treviño, Butterfield, & McCabe, 1998; Victor & Cullen, 1988). For example, since the implementation of the U.S. Sentencing Guidelines in 1991 (see [www.uscc.gov](http://www.uscc.gov)), the majority of large business organizations have developed formal systems such as codes of conduct, ethics and legal compliance training programs, and telephone advice and reporting lines that answer employees’ questions about appropriate conduct in ambiguous situations and that allow employees to anonymously report misconduct they observe (Joseph, 2000). To the extent that these formal systems are supported by other formal organizational systems such as performance management systems and norms of daily business practice, unethical conduct should be lower (Joseph, 2000; Treviño et al., 1999). On the one hand, a strong ethical context can be thought of as providing a kind of substitute for ethical leadership; thus, individual leaders may have less influence on their direct reports in such settings. On the other hand, in a strong ethical context, leaders are expected to provide ethical guidance. So, their efforts simply become part of the larger ethical environment that supports and encourages ethical conduct.

Alternatively, some organizations have a strong culture and climate that supports unethical conduct. In such an environment, it is unclear how much a single supervisory-level leader can do to change the situation. Anecdotal evidence suggests that only a chief executive may have the power to change such an unethical culture. Take the example of Douglas Durand. Durand had worked for 20 years at Merck & Company, where he was a senior regional director in 1995. Merck had a strong ethical culture where ethics and social responsibility were taken seriously. Durand accepted a lucrative offer to become the vice president of sales at TAP

Pharmaceuticals. Once he arrived, he quickly discovered a culture where sales representatives bribed doctors, did not account appropriately for free samples, and engaged in Medicare fraud. Durand tried to change the culture first by appealing to the sales representatives' ethics and by using the reward system to reinforce ethical conduct. However, his efforts were not supported by senior management, and he began to feel increasingly marginalized. In desperation and fear that he too would be implicated in the fraud, he finally determined that he had no choice but to blow the whistle on the company and leave. After years of investigation, the company was convicted and paid a record \$875 million fine, and Durand collected a large part of the fine under the federal whistle-blower statute. Even at his fairly high executive level in the organization, he was unable to change a culture that focused exclusively on the bottom line and supported unethical and illegal conduct (Treviño & Nelson, 2004).

### Levels of Leadership

Another question for future research relates to levels of leadership. Much leadership research does not distinguish between the executive and supervisory levels, although such a distinction is likely to be important for leaders' influence on ethics-related outcomes. Our published qualitative research focused on characteristics of executive-level ethical leaders. We conducted follow-up interviews with M.B.A. students that focused on supervisory ethical leadership, and we found that these informants characterized supervisory ethical leaders in similar ways. But some differences do stand out. Based on our executive ethical leadership data, we inferred four types of executive leader: ethical leader (high on the moral person and moral manager dimensions), unethical leader (low on both dimensions), hypocritical leader (high on the communication of an ethics agenda but not perceived to be a strong moral person), and ethically neutral leader (low on the moral manager dimension and not clearly high or low on the moral person dimension) (Treviño et al., 2000).

Executives are perceived from a distance. As a result, ethical leadership is largely a reputational phenomenon whereby the social salience of their "ethical" leadership is particularly important (Treviño et al., 2003). Executives must work to stand out from a background filled with other messages. If they are not visible ethical role models who communicate a strong ethics and values message and hold followers accountable for ethical conduct, executives are likely to be perceived as ethically neutral. Followers simply do not know where such executives stand. However, supervisory leaders are seen quite differently. Most employees work closely with their supervisors every day and have a clearer understanding of the ethical dimension of their leadership based on direct observation and experience. As a result, supervisory ethical leaders are likely to be seen in more black-and-white terms as either ethical or unethical leaders.

It is also unclear whether executive or supervisory leadership is more important in influencing ethical and unethical conduct. We suspect that both are required, but for different complementary reasons. For example, senior executives set the tone "at the top" and create and maintain organizational culture, including an organization's

ethical culture and climate (Treviño, 1990; Victor & Cullen, 1988). Through their impact on the performance management system and their support (or lack of support) for ethics-related resources, organizational members—including supervisors—receive powerful messages about the importance of ethical conduct in the organization. Supervisors translate those messages and make them real through their daily treatment of followers and by setting daily expectations. When supervisory leaders reinforce the messages from the top, the positive influence on ethical conduct should be strongest. However, if supervisors contradict these messages, followers are forced to make a difficult choice. We suspect that most followers will choose to do what is expected by their supervisors unless the ethical culture is so strong that the followers believe that reporting unethical supervisors will be supported.

## Conclusion

Leaders receive much of the credit for success and also shoulder most of the blame for ethical failures in organizations. Given their visible positions of authority, responsibility for shaping formal organizational policies, ongoing interactions with employees, and control over important rewards and punishments, leaders should play an important role in influencing employees' ethical and unethical conduct. In this chapter, we have proposed that leaders influence such conduct primarily by way of social learning and social exchange processes. Through modeling, leaders influence followers by demonstrating high ethical standards in their own conduct and by using the reward system to teach employees vicariously about the outcomes of ethical and unethical behavior in the organization. Furthermore, admired leaders who are seen as trustworthy, and who treat employees fairly and considerately, will develop social exchange relationships that result in employees reciprocating in positive ways. We hope that these insights will help to guide future research.

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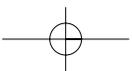
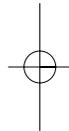
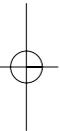
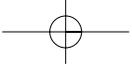
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## CASE 3

# Bernard Ebbers: Innovative Leader or Reckless Risk Taker

In 1998, Bernard Ebbers, then chief executive officer of WorldCom, was named one of *Network World's* 25 most powerful people in the telecommunications industry. Through the 1990s, Ebbers's WorldCom had acquired many companies and merged with others in a quest to build a worldwide telecommunications giant from a headquarters based in Mississippi.

As Ebbers became a major player in a rapidly growing industry, he cultivated a maverick image as an industry outsider in cowboy boots leading his troops to the top of the mountain. Although he was not seen as an Internet prophet who foretold of the inevitable dominance of cyberspace, Ebbers displayed a simple charm that led key staff members to describe him as a charismatic leader who inspired extraordinary levels of personal loyalty and high employee performance.

"When he enters a room, he is like a rock star," one WorldCom employee said. "People wanted to touch him, shake his hand. He created tremendous wealth, at least on paper. People revered him."

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AUTHOR'S NOTE: This case was prepared by Roland Kidwell (Niagara University) as the basis for classroom discussion. It was developed from accounts that are listed in the bibliography at the end of the case. All names of individuals and the organization are real.

Within a few years of achieving industry prominence, the WorldCom bubble burst. A man who challenged the status quo in worldwide telecommunications through more than 70 mergers and acquisitions, including a multibillion-dollar deal to take over the much larger MCI, Ebbers was unceremoniously removed by his company's board of directors in 2002. That summer, allegations of accounting fraud surfaced, WorldCom entered into what was then the largest bankruptcy in the United States, and within a few months the company name became MCI.

## From Small Beginnings to Industry Powerhouse

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The story of Bernie Ebbers was once described by author George Gilder as "one of the most fascinating, improbable, and inspiring in North American business." To Gilder, who examined networking and telecommunications in his 2000 book *Telecosm*, Ebbers displayed "the magic of entrepreneurial vision and temerity." Ebbers quickly moved from motel chain owner to fiber-optic network magnate, leading commentators to dub him the "Ted Turner of the Internet."

Ebbers was born in Edmonton, in western Canada, during the early 1940s. After flunking out of two other colleges, the 6-foot-4-inch Ebbers was offered a basketball scholarship at Mississippi College, where he eventually graduated with a physical education degree. At the small liberal arts school, Ebbers learned a valuable lesson from his coach: "With hard work, dedication, a commitment to principles, and a commitment to Jesus Christ, life can be worthwhile."

After graduation, Ebbers married a local woman and decided to stay in Mississippi. He got his start in business by purchasing rural motels, financing the purchases with large helpings of money borrowed from friends. In 1982, the breakup of telecommunications giant AT&T offered an important opportunity to Ebbers and his business associates. Ebbers became an original investor in LDDS, a company that purchased long-distance service wholesale from AT&T and resold it to individual customers at retail prices.

The company was not immediately successful. It lost money and racked up debt for the first 2 years. At that point, in 1985, Ebbers gained control of LDDS by using equity from his motel chain. Shortly afterward, he was named chief executive officer and began to seek new sources of capital and to cut the costs of operations. Along the way, large amounts of debt financing caused him little concern.

Murray Waldron, one of Ebbers's original partners, described him as "the most focused leader I'd ever seen."

Ebbers, who saw himself as a marketing expert, hired engineering and accounting expertise to assist in his efforts to make LDDS profitable. Part of that turnaround effort involved rapid expansion. According to Gilder, Ebbers

adopted economies of scale as a means to success; Ebbers purchased or rented larger volumes of bandwidth, thereby reducing unit costs. This strategy was accomplished through rapid expansion—purchasing regional long-distance resellers and integrating them into the system. In 1989, LDDS merged with Advantage, a publicly traded company that held a small long-distance business. The newly acquired public status of LDDS allowed the company to expand by trading its stock for assets. More acquisitions followed.

Eventually, Ebbers's growth strategy led to vertical integration. In 1994, LDDS purchased its key network supplier, Wiltel, the nation's fourth-largest fiber-optic network. This purchase allowed Ebbers to obtain the name WorldCom, which was the moniker of Wiltel's European subsidiary. Wiltel was purchased for LDDS stock and paid for by cuts in operating costs that resulted from the merger.

Expansion did not end there. The new WorldCom made additional network purchases that allowed the company to start building a fiber-optic network across Europe and to boast of owning one of the largest Internet service providers in the world. In 1998, the multibillion-dollar purchase of MCI, which was three times the size of WorldCom, gave the company additional industry clout and resources.

"It's actually a very, very enjoyable exercise," Ebbers once said of his rash of acquisitions. "After you do enough of them, it kind of becomes part of your culture."

In WorldCom's heyday, Ebbers controlled "the world's most menacing business challenge to the world's telecom industry," according to Gilder's account. That industry included corporations such as AT&T, British Telecom, Sprint, GTE Communications, and the Bell regional operating companies.

WorldCom's stock surged in 1999, reaching \$75 a share. After the MCI acquisition, the company, led by Ebbers, continued its efforts to create a lean and mean amalgamation, selling off two of MCI's five corporate jets, cutting expense accounts of former MCI people, and (most significantly) axing 2,000 of the company's 75,000 jobs.

As his industry status increased, Ebbers was viewed by colleagues and members of the local community in Mississippi as a responsible business leader who was willing to give back to the community. He taught Sunday school at his local Baptist church, served meals to the needy at a Jackson restaurant, and lived modestly in a prefabricated home. He invested most of his wealth in company stock.

"He is absolutely one of the most incredible human beings I have come in contact with," said Diana Day, who worked with Ebbers for nearly 20 years. "The Lord was his CEO, as (He) is all of ours."

"Bernie Ebbers is my mentor," LeRoy Walker, Jr., a businessman and community leader, once told Jesse Jackson, according to an account in *Time* magazine. Jackson had attacked Ebbers during a speech at historically black Tougaloo College, accusing him of failing to provide money for Mississippi's

black students while spending billions to buy MCI. Walker, a Tougaloo board member, explained to the social activist that Ebbers had given the college more than \$1 million, new information technology, and computers to be used by disadvantaged black youth in the local community.

## Another View of Ebbers's Leadership

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Not everyone was thrilled about Ebbers's capabilities and priorities. Although Ebbers's professed hatred of corporate bureaucracy led to significant reductions in staff as new companies were acquired, the company chief executive purchased a 164,000-acre ranch and 20,000 head of cattle in British Columbia.

As new companies were absorbed, critics argued, WorldCom did not effectively realize the savings that had been suggested as the reason why the takeovers made business sense in the first place. Acquisitions occurred so quickly that there was no time to properly integrate new companies into WorldCom. Employees at WorldCom meetings would often introduce themselves by the company where they had originally worked, for example, "Happy to meet you. I'm legacy-MCI."

While WorldCom moved to make its largest proposed acquisition of all—that of Sprint—Ebbers did not endear himself to international competitors when he attacked the European telecommunications players that he claimed were lagging behind North America: "Most of the companies in Europe would not be survivors in a transaction" between U.S. and European telecommunications companies, he said. Ebbers expressed impatience with, and disdain for, those who questioned WorldCom's direction.

Based on stories that were related to the media about Ebbers, his management philosophy focused obsessively on keeping down costs. He questioned why expensive bagels, rather than cheaper food, were served at company meetings. He replaced the coffee supplier with vending machines when he discovered that the company was spending \$3 million a year on coffee. He announced that he would videotape employees' walks on an exercise track at company headquarters to document whether they were taking too many breaks. He banned color copies because he deemed them too expensive. He personally turned off lights to shave energy bills and adjusted thermostats in WorldCom's offices, putting them 2 degrees higher during the summer and 2 degrees lower during the winter.

These cost-cutting tales conflicted with Ebbers's alleged generosity in loaning money for the purchase of company stock; he provided personal loans to key senior executives for that purpose. One former senior manager told the *Financial Times* that Ebbers offered \$80,000 to \$300,000 loans to as many as 50 top executives. These loans were not put in writing, but it was understood that they would be repaid.

"All those guys drank Bernie's Kool-Aid," one anonymous WorldCom source said in a *Financial Times* analysis of the company. The source likened

the situation to the infamous Jim Jones's religious cult mass suicide of the 1970s.

Company observers said that power became concentrated among a few people in the upper echelon, including Scott Sullivan, chief financial officer; Ron Beaumont, chief operating officer; and Diana Day, senior vice president of customer service. Other executives who joined the company through its acquisitions were shunted to the background. These "outsiders" viewed the company as lacking the professional management and operating systems that would be expected in an organization of its size. They claimed that the mammoth company ran like an entrepreneurial start-up.

## Regulatory Problems, Deflated Stock, and Disgrace

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Because of the use of company stock to finance most of WorldCom's continuing run of acquisitions, it was crucial for the company to keep the stock price high. Thus, company officials found it extremely important to meet Wall Street's expectations of what the company earnings should be. Ebbers and Sullivan frequently attended industry analyst conferences, where they made presentations touting the company and its rising stock price. When the stock price declined during the general telecommunications stock downturn, it was inevitable to some that the company would go bust.

"Everybody always felt like there was no room for error," a former executive told the *Financial Times*. "Once, we missed [earnings] by 1 cent, and the stock nearly [collapsed]. That was an error that lived with 'the Bern' for a long time. He went on a rampage. He would be completely nasty, condescending, and arrogant."

In 1999, WorldCom moved to take over Sprint, making a \$115 billion bid to acquire the rival carrier. The bid exceeded the \$80 billion proposed merger of the Exxon and Mobil oil companies. Ebbers's long-term strategy in acquiring Sprint, along with MCI in 1998, was to upgrade their Internet facilities and engage larger competitors on a worldwide basis with a streamlined Internet capability. However, in both cases, U.S. regulatory agencies stepped in, claiming that WorldCom was attempting to monopolize the industry. Regulators forced WorldCom to sell MCI's Internet facilities to Cable & Wireless of Britain and barred acquisition of the Sprint network. Some observers, including Gilder, said that the government's failure to allow WorldCom to pursue its strategy led to the company's downfall.

At the least, such regulatory actions did not aid Ebbers in turning his organization into a strong company that would be able to cope with economic fluctuations and a stock market downturn that would make additional acquisitions unfeasible. By April 2002, calls for Ebbers's dismissal increased as the company stock slid from a market value of \$180 billion in 1999 to \$8 billion 3 years later, and a Securities and Exchange Commission investigation into WorldCom's accounting practices began. Ebbers was also questioned about

\$400 million in low-interest loans that he had secured earlier from the company's board of directors, ostensibly to buy more stock.

"With Bernie, it was live by the sword, die by the sword," said Alex Peters, manager of Franklin Global Communications Fund. "He has certainly assembled a valuable set of assets. The question is, will he be able to get a fair price for them in the end?"

When Ebbers was finally forced out by the board's outside directors, he still refused to concede that the company had significant problems. At that point, WorldCom stock was selling for approximately \$2.50 a share.

## Fraud, Bankruptcy, and Recriminations

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Within 2 months of Ebbers's departure, allegations of financial fraud surfaced and led to the firing of Sullivan. An internal audit found that the company had fabricated profitable numbers to ensure that its stock price stayed high. In June 2002, John Sidgmore, who took over as chief executive officer for Ebbers, announced that an "irregularity" had been found in the way in which the company had been accounting for its capital expenses. An ensuing investigation by accountants for WorldCom found that \$3.8 billion in operating costs had been incorrectly classified as capital expenditures over a 15-month period that began in 2001. The inaccuracy increased reported cash flow and profits, leading the company to falsely report a \$1.4 billion profit in 2001 and a \$130 million profit for the first 3 months of 2002.

As the investigation continued, more reporting problems were uncovered, leading the company to admit that it had overstated its earnings by more than \$9 billion since 1999. Five company officials, including Sullivan, were charged with criminal fraud, but for many months investigators' efforts to link Ebbers to illegal activity were unsuccessful. Despite WorldCom's high-tech nature, Ebbers did not use e-mail and usually responded to e-mails from his staff with phone calls.

Within a month of disclosing its accounting misdeeds, WorldCom, faced with \$41 billion in debt, filed for reorganization in federal bankruptcy court. The largest bankruptcy in U.S. history affected creditors, business clients, 20 million consumers, and 80,000 employees around the world. Lawsuits related to the company's downfall continue, as do investigators' attempts to implicate Ebbers in the accounting fraud.

WorldCom's board voted in September 2002 to ask the bankruptcy court to rescind Ebbers's severance agreement, which awarded him \$1.5 million a year for life. Lawyers for the board argued that the agreement was void because Ebbers knew the company was insolvent at the time the agreement was reached.

In June 2003, a report prepared by an independent law firm with the aid of MCI (formerly WorldCom) board members cited tremendous pressure at WorldCom to keep revenues up so as to meet Wall Street's expectations.

Although the company was legitimately growing at 5 to 10% each quarter, one MCI board member said, that figure was boosted to 10 to 15% to meet analysts' expectations. The report asserted that only a few top executives at WorldCom directed the fraudulent accounting, but it identified Ebbers as the creator of a culture that gave birth to the fraud.

On March 2, 2004, federal authorities charged Ebbers with conspiracy, securities fraud, and filing false financial statements. Sullivan agreed to plead guilty to similar charges and to testify against Ebbers in exchange for receiving a less severe sentence. Two months later, Ebbers was accused of falsifying six regulatory filings just before WorldCom's collapse.

### Discussion Questions

1. To what extent were the actions of Bernard Ebbers indicative of leadership, and to what extent did Ebbers display destructive deviant behavior? Provide examples of leadership and deviant behavior from the case.
2. How did Ebbers influence his managers and employees to engage in deviant unethical behavior? How could he have used his influence and leadership style to avoid deviant behavior among subordinates?
3. Identify some theoretical linkages between Ebbers's leadership style as practiced and the behavior that occurred within WorldCom.
4. The law firm report identified Ebbers as the source of a culture that resulted in the company's accounting fraud. How did Ebbers's leadership style contribute to the values and actions of key managers? How could key managers perform their jobs effectively and ethically in the WorldCom culture?
5. Consider the characteristics of the ethical leader described in Chapter 3. How does such a leader encourage ethical behavior among managers and employees and, at the same time, obtain successful organizational results? Could Ebbers have used these characteristics to accomplish his goals at WorldCom? Explain.

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