

Chapter 5

ETHICAL LEADERSHIP

Professor Robert Wood and
Dr Melissa Wheeler

Management is doing things right;
leadership is doing the right things.

Peter Drucker

Author note

Ethics was destined to loom large in any book about leadership from the Institute. It's a leadership topic that has become increasingly popular – particularly since the global financial crisis. And yet it remains a subject that tends to be somewhat academic in nature. Of course, it's absolutely true that ethics is not a leadership 'skill' in the purest sense. Perhaps that's why it's too often avoided in discussions and books about leadership. After all, how do you advise leaders on ethics or prompt them to 'be' ethical? Surely they either are ethical, or they aren't! I think that avoiding the topic and leaving it in the too hard basket is part of the problem. Leaders need to confront ethics and the need to be ethical head on. That's certainly how Professor Robert Wood and Dr Melissa Wheeler view the topic. When I heard them talk about ethics at IML's Leadership Conference I was immediately struck by the way that they approached the topic from a practical perspective.

Professor Wood's experience at the Australian Graduate School of Management (University of New South Wales) and Dr Wheeler's research at Melbourne University's School of Psychological Sciences, combined with their practical approach to the subject of ethical leadership through their joint work at the Centre for Ethical Research give me plenty of hope that ethics is finally on its way out of the lecture halls and into the boardroom and the broader workplace.

TRULY EFFECTIVE LEADERS are those who make extensive, lasting, positive impacts. These leaders respond to the challenges of their time and place through the mobilisation of people and resources, with a clear vision and commitment to leave the organisations, teams and people they lead better off.

They understand that good corporate citizens are also good citizens and that the ethical challenges of the day are not limited to organisational issues, such as the mistreatment of customers by staff and misappropriation of resources. They also include broader societal issues that affect their staff, such as the increasing gap between the wealthy and the poor, domestic violence and environmental challenges.

Ethical leadership is a fraught endeavour. Examples of unethical behaviour (often resulting in dire consequences for customers, shareholders, staff and others) are constantly reported in the media. Senior leaders who are very ethical in their own business practices can potentially lose their jobs and good reputations for unethical practices conducted by their staff, even if the senior leader is unaware of the practices until the crisis hits. In the wake of irregular trading at the foreign exchange desk in 2003, NAB chief executive Frank Cicutto and chairman Charles Allen were forced to resign due to unethical practices that took place on their watch¹. Like many leaders confronted with an ethical crisis in their organisation, Frank Cicutto and Charles Allen were known to be ethical people and, we assume, thought of themselves as ethical leaders. So, what happened?

When leaders are caught up in ethical crises involving their staff, the first response is often to identify and dismiss the ‘bad apples’ – the people who lack the necessary moral character to act ethically. However, research evidence and experience suggest many explanations, besides a lack of moral character, for the occurrence of ethical failures in organisations. For example:

- People are often overwhelmed by the complexity of situations and commit to positions that later prove to be unethical.
- When confronted with a failure to act ethically, people often rationalise their behaviour and create conditions that encourage escalation.
- Team cultures facilitate unethical behaviour by individuals through a failure to sanction unethical practices.
- Compensation, budgeting and other systems create moral hazards in which rewards, success and resources go to those who are willing to bend rules.

Many leaders make the mistake of believing that, because they have a clear set of values which they adhere to in their personal behaviour, they are ethical leaders.

Through our research and conversations with executives, we have become convinced that the greatest impediment to developing ethical leadership is not a scarcity of executives possessing personal character, but rather the lack of a framework for understanding what it means to act as an ethical

leader within organisations and in modern society.

There are several limitations to this approach. First, leaders are responsible for the actions of other people as well as their own. Second, it is not always clear what actions are best suited to particular values. Third, values can be used as rationalisations as well as reasons for action. Finally, personal action is only one of the ways in which leaders engage and influence followers. They are also responsible for the ethical impacts of the systems, processes and cultures of the teams and organisations they lead.

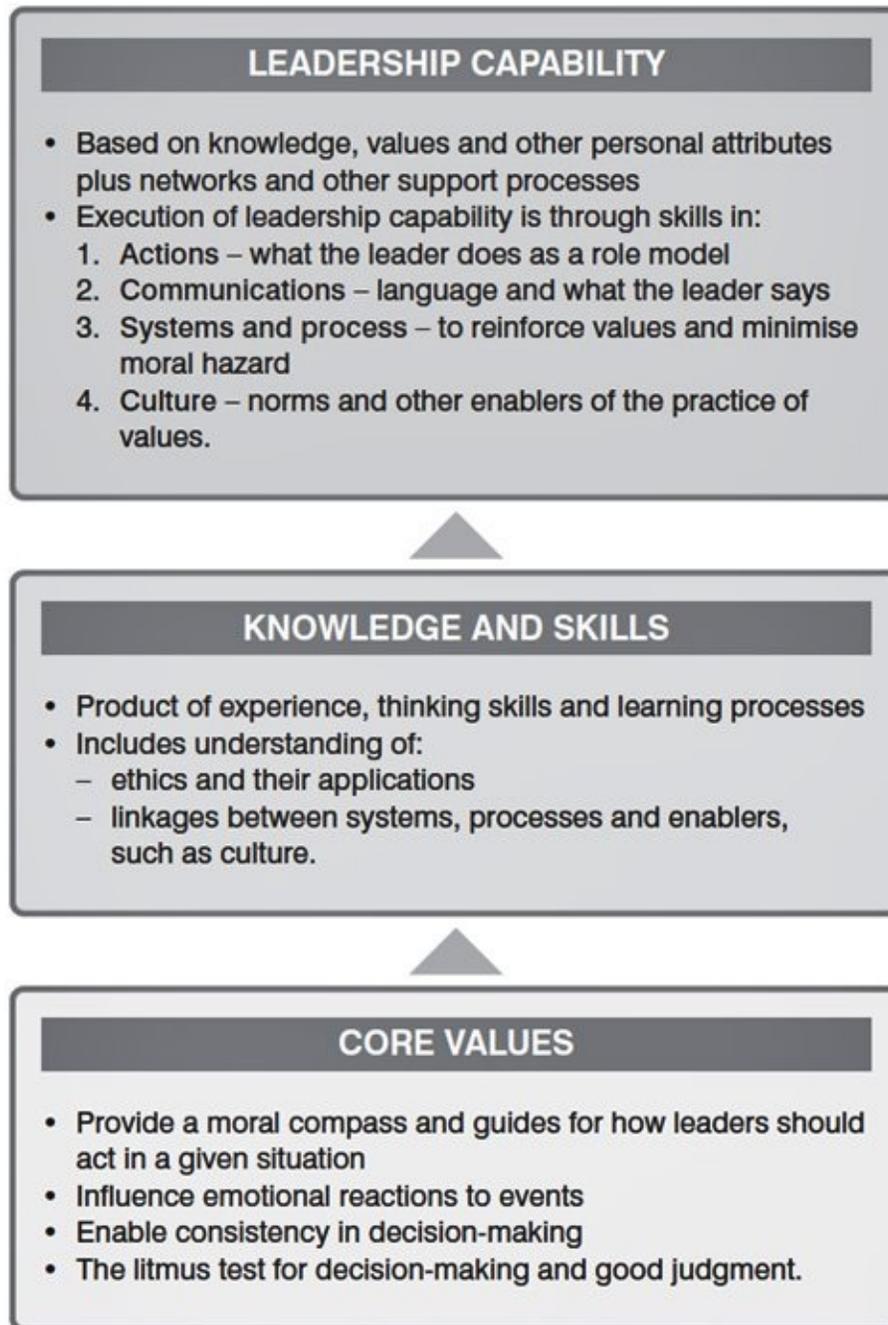
A FRAMEWORK FOR ETHICAL LEADERSHIP

Our framework for analysing ethical leadership, shown in Figure 5.1, is based on the Knowledge Based Model of Leadership². Key components of the framework are outlined in this chapter, including the mechanisms for engaging and influencing people, core values and ethical reasoning, plus some practical recommendations for ethical leadership.

Leaders can engage and influence others through the following four mechanisms and their application to ethical leadership:

1. **Actions:** What the leader does. Ethical leadership requires a capacity to identify and solve ethical problems and to act as a role model in the display of ethical virtues. Critically, ethical leaders ask the unasked questions about standards and common practices in their communities and industries, challenging the status quo. They have the courage to act when the answers they find don't accord with the expectations of the day.
2. **Communication:** What the leader says. Communication is a critical mechanism for engaging and influencing people, particularly in persuading them to undertake ethical actions that may run contrary to their self-interest. Leadership requires communication of purpose and vision for sustained ethical action.
3. **Systems and processes:** The structures the leader creates and maintains. Much of what happens in social organisations is the product of systems and processes, plus the associated rules. These include systems and processes for selection, recognition and rewards, punishments, access, accountability and participation. Systems and processes that create moral hazard or encourage unethical action in followers are counter to the requirements of ethical leadership.
4. **Culture:** The environment the leader creates and supports. There are many enablers, including resources, structure and goals, but the widespread and subtle effects of norms and language make culture a particularly influential enabler.

Figure 5.1 – Leadership Capability Framework



These four mechanisms can be used to highlight the differences between the acts of a person of good character and the acts of an ethical leader. They also aid in understanding the complexity of ethical leadership in modern society. When a person recognises ethical issues and acts ethically in the presence of others, they may serve as a role model, and therefore, as a leader. Leaders also have to communicate the need for ethical action, to persuade others to follow the correct course and to hold difficult conversations when standards are not met. However, there are many situations in which the personal actions of the leader are not the mechanism that is engaging and influencing their staff. Many of the expectations, rewards and guidelines that shape behaviour are embedded in the systems, processes and cultures of organisations and teams. Ethical leaders understand that they are also responsible for the impacts of these

impersonal mechanisms on the ethical actions of their staff.

How the Murdochs handled the Leveson Inquiry

In 2011, Rupert Murdoch and his son, James, were summoned to give evidence at the Leveson Inquiry into phone hacking by staff at the *News of the World* newspaper. At the time, questions were raised about what the Murdochs knew and for how long. For many people, this knowledge was the basis for judging whether the Murdochs had behaved unethically. This is a reasonable test when judging personal ethicality, but it does not suffice when judging the ethics of a leader. As the leader of the *News of the World*, James Murdoch was responsible for the values communicated through the systems, processes and culture of the newspaper. Investigations conducted from 2005 to 2007 and subsequent prosecutions had established that the practice of phone-hacking existed at *News of the World* long before the Leveson Inquiry and that the history of paying hackers was well established. Over the course of his testimony, Rupert Murdoch admitted that a cover-up had taken place within the *News of the World* to hide the scope of the phone-hacking. On 1 May 2012, a parliamentary select committee report concluded that Murdoch ‘exhibited willful blindness to what was going on in his companies and publications’ and stated that he was ‘not a fit person to exercise the stewardship of a major international company’. However, Channel 4 News later broadcast a secret tape in which Murdoch dismissively claims that investigators were ‘totally incompetent’ and acted over ‘next to nothing’ and excuses his newspaper’s actions as ‘part of the culture of Fleet Street’.

Whatever views you have about the personal ethics and integrity of the Murdochs and other leaders at *News of the World*, their actions are not those of an ethical leader because of the systemic lack of ethical values and integrity in the culture, systems and processes of the newspaper.

TWO TESTS OF ETHICAL LEADERSHIP

We propose that there are two tests of ethical leadership. The first is one of *personal integrity*, which asks if what the leader says and does is consistent with their values. The second is a test of *systemic integrity*, which asks if the systems, processes, norms and accepted practices of the unit or organisation are aligned with ethical values and practice. For example, if rewards are structured so that mis-selling, over-billing or other questionable practices are required to earn competitive salaries or bonuses, then the system has moral hazard built in, and the leader should be accountable³.

Blaming ‘bad apples’ and other forms of scapegoating is an avoidance of a leader’s responsibility. Revelations following the 2016 tragedy at Dreamworld theme park in which four people died suggest that there was a lack of rigour in safety and maintenance systems at the park before the accident. According to reports in the *Financial Review (AFR)* (28 October 2016), ‘A stack of documents show accredited inspectors have raised concerns about the Dreamworld safety regime for years and claim management targeted employees who spoke out about safety issues’. It appears that the systems at Dreamworld, like those at *News of the*

World, lacked systemic integrity, which is a failure of ethical leadership, irrespective of the personal integrity of the leaders involved.

Of course, everyone – including leaders – makes mistakes. The world is complex and not totally controllable, which makes integrity, both personal and systemic, a dynamic process. It is something we should constantly strive for, while accepting that there will be times when what we do and say or our systems, processes and culture will become misaligned with our values. The critical issue is what we do when misalignment occurs. Murdoch's claims that investigators were 'totally incompetent' and acted over 'next to nothing' and the way he excuses his paper's actions as 'part of the culture of Fleet Street' is not the response of a leader seeking to re-establish alignment with an ethical set of values.

CORE VALUES – THE RAW MATERIAL OF ETHICAL ACTION

Every individual has a set of values against which they evaluate their own and others' actions. These values may be gleaned from what a person says about who they are, or through observations of what they believe to be right or wrong, important or unimportant, and good or bad. When they are taken into account, values act as guides for how one ought to act in a given situation. They also influence our emotional reactions to events.

Ethical leadership cannot be achieved without a set of values against which to judge action. But which values? In philosophical approaches to ethics, a fundamental question in identifying the values or decision criteria we are to follow is 'what values do we base our ethical standards on?'. There are many different approaches to this question; some are more absolutist – such as the Ten Commandments – while others, such as the utilitarian approach (see later in the chapter), are more relativistic.

Our position is that all leaders should identify a personal set of core values or principles that they believe in and they should strive to adhere to those principles in their own contexts, within available resources and constraints. These core values should reflect their life experiences and be applied consistently across all phases of life, including family, friendships, community and personal relationships, as well as work. It is a common mistake to believe that one can pursue different values across different contexts; consistency of action, integrity and learning how to be true to one's values requires focus.

Ethical leadership is a dynamic process – one that must be guided by 'endpoints' or moral standards. A leader's core values cannot be negotiated away or ignored. The process of learning to live by these principles in modern organisations and society, particularly as a leader facing value conflicts, is complex.

The Johnson & Johnson Tylenol poisoning incident

The response from the late chief executive of Johnson & Johnson, James Burke, to the 1982 Tylenol poisoning incident is an example of core values in action. In 1979, less than five years after taking the reins at Johnson & Johnson, Burke had challenged his senior executives to live by their credo to serve the needs of their customers – 'the doctors, nurses and patients, mothers

and fathers' – first and foremost⁴. This revived commitment to the company's values was tested in 1982 when a number of people died after taking Tylenol that was intentionally laced with cyanide and strychnine. Burke immediately ordered the removal of all 31 million bottles of Tylenol then on American store shelves, despite opposition from the FBI and FDA, who considered it an overreaction. He went even further by sending hundreds of thousands of messages to doctors' offices, hospitals and trade groups and immediately suspending all advertising of the product⁵.

In the case study above, Burke was sensitive to the fact that the Johnson & Johnson executives were not living the company credo, because the Johnson & Johnson values were aligned to his own core values. His personal beliefs about good versus bad and right versus wrong had been shaped by his life experiences, reaching back to his childhood. His choices, which many saw as an overreaction and potentially undermining the company's reputation and profitability, were guided by his belief that, as leader, he should strive to protect the community from harm as well as to act in a way that would make his staff proud. Burke did not use his core values as a scorecard for showing that he was a good person.

Examples of core values⁶ that have been shown to lead to a greater consistency of ethical action plus the ongoing learning and development of ethical leadership capabilities of the type demonstrated by Burke include:

- **Virtue** – constantly striving to develop in oneself and others the virtues of charity, compassion, forbearance, humility and recognition of the essential dignity of other people.
- **Care** – acting to ensure the welfare of others, nature and the environment.
- **Justice** – ensuring just decisions through open and informed decision-making.
- **Integrity** – being consistently honest and trustworthy in all activities.
- **Respect** – having regard for self and others, nature and the environment.

A common misconception of ethical leadership is that values alone make a person ethical. The misconception is reflected in the use of the compass as a metaphor for ethical action. The points on the compass are used to represent the core values. However, the compass is of little use in the hands of someone who lacks the knowledge or the manual dexterity and vision to operate it. Even among those who can use a compass effectively, there will be differences in performance. Some will be highly adaptive and able to use the compass effectively in different terrains with different maps and under different conditions. Others will be more limited in their application and only able to use the compass effectively with detailed maps, relatively simple terrain and otherwise favourable conditions. These differing levels of skill are also evident in how individuals convert their values into ethical action. Some individuals rely solely on established social and legal expectations to determine the right course of action, while others are able to use ethical reasoning frameworks to identify solutions to ethical problems that align with their core values.

ETHICAL REASONING – THE PRODUCTION PROCESS OF ETHICAL ACTION

Psychological research tells us that people tend to think of themselves as ethical because they have a strong set of values; in fact, most people think of themselves as more ethical than the average person⁷. Values, however, are just the raw material of ethical action and, without a production process, they can be used as either reasons for ethical behaviour or as rationalisations for unethical behaviour.

The production process for converting values into ethical action is ethical reasoning.

Unfortunately, most individuals have limited knowledge about different ethical frameworks or how they might lead to different decisions. A greater understanding of ethical frameworks will enable individuals to better incorporate ethical considerations into their judgments and decisions and to evaluate the ethicality of their actions.

The question of what makes an action ethical has engaged moral philosophers for centuries and has produced many different forms of ethical reasoning. Two of the more common forms of ethical reasoning that are used in business are outlined below. Leaders who consciously apply ethical reasoning frameworks are more conscientious and more consistent in the pursuit of their values, and they are more likely to be trusted by their followers.

1. **The utilitarian approach.** The moral doctrine of consequentialism asserts that the ethical status of an action or decision should be based on its outcomes alone. Utilitarianism is a specific form of consequentialism that ascribes moral rightness to actions that maximise general human wellbeing and utility. An ethical decision is made by first predicting all the potential consequences of an action and then impartially weighing the harms against the benefits.
2. **Kantian approach.** Kantianism is a form of principle-based reasoning in which actions are morally correct based on their alignment with rules and duties (core values), regardless of outcome. A Kantian approach involves the evaluation of a proposed course of action against identified values, rules and duties.

In the world of work, consequences matter and, for this reason, the utilitarian approach is the most commonly applied form of ethical reasoning. The utilitarian approach is employed in economic models of decision-making, including portfolio investments and expected values because it is the most effective form of moral reasoning for making choices when resources are scarce and outcomes matter. A second common form of reasoning employed in work organisations is a form of Kantian reasoning in which broad principles or values are to be upheld, irrespective of the consequences.

A combination of the two forms of ethical reasoning is illustrated by the approach to the review of projects by some companies for whom safety of their people is a non-negotiable core value. In order to avoid the inevitable trade-offs between outcomes, such as safety, technical standards and return on investment (ROI), which occur in utilitarian calculations, competing projects are first assessed on whether they meet the required safety standards, and

those that don't are excluded from further consideration. Under this process, projects excluded may have a higher ROI and better technical standards than those that are compared using utilitarian calculations in the second phase of the assessment process.

Johnson & Johnson CEO James Burke's decision to remove all 31 million bottles of Tylenol on American store shelves, despite opposition from the FBI and FDA, is another example of principle reasoning. A utilitarian calculation of the consequences would have concluded that the potential harm was minimal and therefore outweighed the consequences. This was the advice that Burke received. However, he chose to be guided by his core value of 'do no harm to my fellow human beings', irrespective of the consequences for the company.

AUTHENTIC LEADERSHIP AND VALUES ALIGNMENT

A key feature of authentic leaders is that they display *personal integrity* by being true to their values, which is also true of ethical leaders. Particular attention is paid to the behaviour and communications of leaders because of their credibility as role models and their organisational status and power. However, as we have argued, without clear ethical reasoning frameworks, even strongly held values may not protect leaders from unethical action.

Followers will forgive personal failures when a leader is seen to be striving to be true to their values and is willing to acknowledge and learn from mistakes. In a complex and changing world, the alignment of actions with values is a dynamic process. The risks of repeated misalignments are greater when a leader does not apply ethical reasoning in his or her analysis of issues.

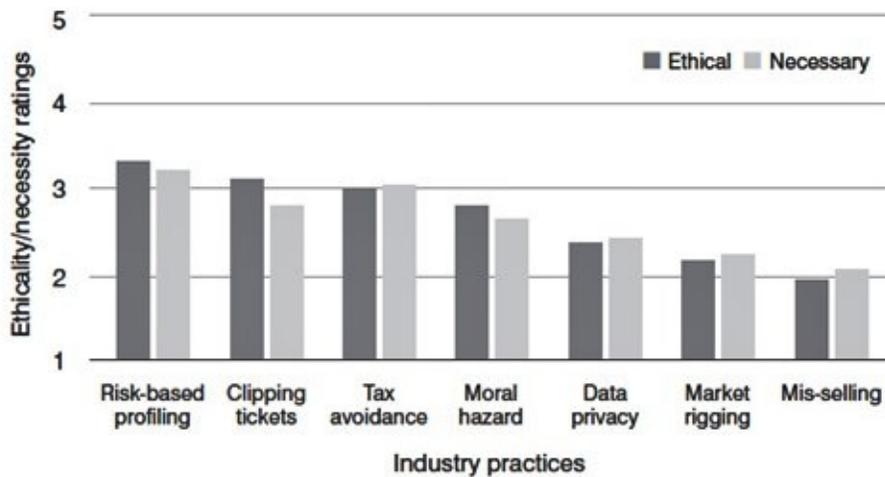
Sometimes a leader's misaligned personal values lead to the use of *post-hoc* rationalisations that seek to convert unethical acts into justifiably moral ones, as was illustrated with Murdoch's rationalisation that phone-hacking was part of the culture of Fleet Street. Other examples of rationalisations can be seen in the use of euphemistic language such as 'equity retreat' meaning a stock market crash and 'externalities' when referring to harms done to customers. Euphemistic language relabels harmful behaviour in innocuous or convoluted language that makes it seem acceptable. Jargon allows individuals to distance themselves from the repercussions of their actions and continue to engage in practices without having to acknowledge their ethical implications⁸. The risk is that these rationalisations support norms of unethical action that then become part of the culture of teams and organisations.

When unethical practices become cultural norms

Once unethical practices are supported by cultural norms, they may no longer seem unethical. In the finance industry, for example, competitive pressures often result in practices that provide a predictable and sustainable flow of earnings that are considered essential, even if they are unethical. This cultural effect was evident in a recent survey we conducted looking at ethics in the banking and financial services industry for the Chartered Accountants of Australia and New Zealand⁹, where we found that the more necessary questionable practices were, the more likely they were to be seen as ethical (see Figure 5.2). As noted in the report, 'A person who believes that a practice is necessary for themselves and their organisation to succeed has

vested interest in framing that practice as ethical’.

Figure 5.2 – Perceived ethicality and necessity of finance industry practices



1 = very unethical/unnecessary and 5 = very ethical/crucial

Source: Wood *et al* (2016)

When leaders talk about ethical issues with their staff and peers and call out the use of jargon, euphemisms and other rationalisations, they are less likely to behave unethically. Ethics-based conversations among team members lead to more ethical decisions¹⁰. Simply asking whether or not unethical behaviour was acceptable has been shown to result in less cheating¹¹.

The responsibilities of the ethical leader do not stop at personal action. As social systems become larger and more complex, leaders must reach wider audiences over longer time periods and be able to achieve ongoing engagement and influence in the handling of dynamic problems. To do this, the leader must ensure that the systems, processes and cultures of the social organisations that they lead, represent, support and reward ethical values. Leaders may signal their behavioural expectations by what they reward and what they ignore, in addition to the way they, themselves, behave. When the leader’s personal values are reflected in the rules, norms, behaviours and outcomes of the systems, processes and culture, the social organisation will have greater reliability of ethical outcomes. We refer to this as *systemic integrity*. While ethical behaviour can be influenced by any number of systems and processes, including performance management processes and budgeting systems, research evidence has demonstrated the impacts of codes of conduct and incentive systems.

Codes of conduct that are properly communicated and enforced have been shown to reduce the incidence of unethical behaviour¹². Ethical organisations have processes that make people aware, informed and accountable for (un)ethical conduct, including the communication of norms that recognise and reinforce personal accountability against values, particularly when transgressions occur.

Why incentive systems can have unethical outcomes

Recent research has established that incentive structures are one of the most potent mechanisms for maintaining systemic integrity; however, often they unintendedly reinforce unethical outcomes. Compensation and large bonuses are predominantly structured to deliver specific outcomes, such as growth in sales, without taking into account the means by which these outcomes are achieved. A survey of more than 1,200 financial professionals in the United States and United Kingdom found that 32% of respondents believed compensation structures and bonus plans in place at their company could incentivise employees to ‘compromise their ethics’ or break the law¹³. As shown in Figure 5.2, the combination of incentive systems and the forces of competition in the banking and financial services industry has led to a culture in which questionable practices are seen as both necessary and ethical.

While most people are aware of the role that incentives, rules and regulations play in deterring unethical behaviour, the powerful influences of individual and social factors often go unnoticed¹⁴. For example, when banking and financial services practitioners were asked to rate the factors that guide ethical behaviour in the workplace, the majority of respondents ranked external factors such as codes of conduct, regulations, and laws in their top five (see Figure 5.3). Ethical leadership requires attention across the full range of mechanisms for engaging and influencing staff to act ethically.

Figure 5.3 – Proportion of respondents who ranked the item in the top 5 most influential factors in ethical decision-making



Source: Wood *et al* (2016)

VALUE CONFLICTS AND MORAL COURAGE

The pursuit of core values in many organisations will be juxtaposed against efficiency goals, such as productivity and return on capital, and may sometimes conflict with such goals. We believe that an ethical leader’s approach to this potential conflict should include at least the following.

First, not to fall into the judgment trap that solutions must focus on either ethics *or* efficiency. When apparent conflicts appear, the role of the ethical leader is to seek solutions that combine

ethics *and* efficiency and to convince others of the viability of those solutions. The reconciliation of apparent value conflicts is one of the markers of human progress. For example, quality and quantity, which were once seen as alternative goals in manufacturing, are now recognised as products of the same reliable systems.

Second, ethical leaders need the skill to analyse the nature of the conflict and to identify whether it is a disagreement about the goals that have been selected or the means to pursue them.

Third, ethical leaders need to think beyond the specific issue to the impacts of the broader culture, systems and processes that influence value and perspectives. Leaders need to search for and discover integrative solutions to value conflicts in their own roles and those that affect their staff. It is through such acts of leadership that social codes and behavioural conventions arise to benefit the community.

Finally, when there is an irreconcilable conflict between the personal values of the leader and the efficiency demands of the organisation, then the leader must find a personal strategy that is consistent with his or her values. Too often transgressions are overlooked or rationalised in order to protect oneself or one's peers, and so as not to be seen as disloyal. The costs of failing to address ethical breakdowns increase the longer the issue is unchallenged. Leaders need to establish mechanisms of early intervention where people can challenge the behaviour of their peers and their supervisors without fear of retaliation. Localised accountability of this nature will act as a much stronger brake on unethical action than external whistleblowing and often will avoid the crises where personal and organisational values seem irreconcilable¹⁵.

OTHER KNOWLEDGE AND SKILLS OF AN ETHICAL LEADER

While an ethical reasoning framework is essential for ethical leaders, they must also be able to bring the relative knowledge and skills to bear on problems. Based on evidence from the last 30 years of research in cognitive psychology and neuroscience, the Knowledge Based Leadership model states that:

- all behaviour, including ethical problem-solving and leadership, is based on knowledge that is stored in long-term memory; and
- deep knowledge in a subject such as ethics is the product of diversity of experience and mindful reflection on that experience.

These two premises have important implications for developing or changing behaviours. First, when seeking to change or develop a behaviour, such as ethical leadership, it is necessary to identify the sets of knowledge that are most directly relevant to the behaviour and to target those as part of the learning process. Second, the learning process will be more successful if it provides participants with diverse experiences and teaches them the skill of mindful reflection and how to apply that skill to, for example, ethical leadership.

Making good ethical choices and the leadership of ethical issues requires a well-developed understanding of the practical realities of the situation. The knowledge required for effective

ethical leadership can be divided into several categories. These include general knowledge, like values and ethical reasoning frameworks, which can be applied across different ethical problems and issues, plus some categories of more specific knowledge required to solve specific problems and issues, such as those relating to the environment, land rights or compensation systems.

The application of different ethical frameworks can be used to illustrate this point. A person who has good knowledge of ethical frameworks such as the utilitarian approach and Kant's principled reasoning, may understand that these can be applied in a particular situation through questions such as, 'Which option will produce the most good and do the least harm?' (the utilitarian approach) or 'Does this action respect the rights of individuals and not treat them simply as a means?' (Kantian approach).

While asking such questions is a big step forward from not considering them at all, the quality of ethical action will be greatly influenced by the ability to answer the questions for the specific circumstances in which they are raised. The quality of answers will vary widely as a function of the knowledge, personal attributes and experience, or the skill levels, of individuals.

Beyond values and an ethical reasoning framework, ethical leadership requires knowledge and skills that provide the necessary grounding in practical realities, including:

- self-knowledge of one's own values, and of how one is perceived by employees; and
- knowledge of how systems and processes of the organisation and of other enablers – such as culture – shape the behaviour of employees for specific issues.

Many of the ethical challenges confronted by leaders are dynamic, involve multiple stakeholders and have feedback effects so that current actions affect future options.

4 specific leadership skills necessary to solve dynamic problems

1. **Flexibility** – in thinking and communicating: you have to be an adaptable problem-solver and agile learner.
2. **Ability to cope with disappointments** and make tough decisions under pressure and in conditions of uncertainty – you need to manage anxiety, to deal with ambivalence and make courageous, unpopular decisions.
3. **Ability to communicate effectively** – you need to explain issues clearly; persuade and support others by explaining how to follow a path of action; and use appropriate language, stories and examples.
4. **Ability to think systemically** and strategically: you need to anticipate second order effects, feedback and impact of history; look into the future across multiple horizons; stand outside issues and be mindful.

RECOMMENDATIONS FOR ACTION

Before leaving you to ponder our discussion on ethical leadership, we would like to give you some practical suggestions you can use to strengthen your ethical leadership skills:

Introduce reasoning that places non-negotiable principles ahead of cost-benefit calculations

Organisational decision-making often occurs in a context that is dominated by a short-term utilitarian (or consequence-based) approach in which estimates of risk and outcomes are combined to identify a preferred option based on expected profit. The application of this short-term utilitarian approach poses several problems for ethical reasoning. First, it often fails to take account of outcomes that are less immediate. Psychologists question our capacity to accurately predict all possible harms and benefits from a course of action¹⁶, and the complexity of products and outcomes make this even more problematic. A second concern is that some outcomes that are difficult to represent in the common metric of dollars, such as client dissatisfaction, are often ignored or devalued.

Principled reasoning addresses these concerns by reasoning from a clear set of agreed principles, rather than the relative costs and benefits. These principles are most effectively established and conveyed as a set of ‘non-negotiables’ by the leader. Organisational leaders should establish a clear set of non-negotiable principles and integrate them into the daily practices of their teams. Non-negotiables might include:

- ‘We should not win at our clients’ expense’.
- ‘We should listen and encourage discussions and challenges regarding the ethicality of our actions’.
- ‘We’ll never undertake an action that is demonstrated to be unethical’.

Principled reasoning may circumscribe the choice of some profitable actions and will challenge the strategic imagination of leaders and their teams to identify options that are both ethical and profitable.

Increase diversity of people and ideas

The lack of diversity in many organisations contributes to the culture of loyalty and ‘groupthink’ that can stifle discussion of complex, often abstract topics like ethics and suppress the reporting of misconduct by colleagues. Increasing diversity is a long-term, dynamic challenge, but the starting point for that change is the review and redesign of recruitment, selection and career-planning practices to allow a diverse group of workers to enter and progress through the organisational hierarchy.

In the more immediate future, teams need to develop processes that enable the inclusion of divergent views, including ethical considerations, in their everyday interactions and discussions. Inclusive teams that tolerate different views enable members to call out violations

of standards and support colleagues in ethical decision-making. This helps stop unethical conduct early and before it escalates to crisis proportions¹⁷. Teams that can discuss divergent ideas and converge on agreed priorities without conflict are more innovative and more productive than homogenous teams that agree quickly at the expense of constructive discussion.

Create an ethical culture through ethical actions and communications

Leaders need to bring ethical considerations into discussions of tasks and performance with their staff. Good ethical leaders in high-pressure, fast-moving environments are those who have clear non-negotiables (as mentioned above) that they communicate regularly to their staff to enable a better understanding of what cannot be traded off in the pursuit of financial performance. Those who fail to communicate and enforce ethical standards and fail to model good ethical behaviour will increase the risks of ethical failures leading to crises for their organisations.

Therefore, through what they say and what they do, leaders should set the tone and create cultures where ethical considerations are the norm. This requires leaders to ensure that the following are valued and endorsed:

- Employees' understanding of what it means to be ethical in different situations and for different tasks.
- Stating a clear expectation that employees must never act unethically.
- Employees' understanding of the client's interests and an expectation that they not be compromised in the pursuit of company or personal gain.
- An expectation that employees challenge peers and leaders whose actions appear to violate the non-negotiables.

Use team charters to shape team culture

Team charters are an established management tool for clarifying team direction and setting boundaries. They are developed collaboratively by the team and frequently identify its purpose, resources, reporting structure and deliverables. Leaders can shape the culture of their team by incorporating ethical elements into their team charter, such as non-negotiable ethical behaviours, conflict-resolution procedures, contributions and accountability for violations of the team charter. These team-level agreements can also be used to reinforce and further explore the policy positions set forth by boards.

Use ethical moments to create an ethical mindset

Decision-framing can be used to support ethical behaviour. A simple technique is to have 'ethical moments' at the beginning of all meetings. An ethical moment is a short conversation about ethical issues, which may relate to the specific decisions to be considered in the meeting or refer to examples of ethical/unethical action from other sources, such as newspapers or industry contacts. Ethical moments are based on 'safety moments', which have been used successfully and extensively in mining and other heavy industries. Numerous resources exist

providing guidance to the effective use of safety moments, many of which could be adapted to implement ethical moments in most settings.

Ethical moments are a simple tool that implemented genuinely and in concert with the other measures outlined go a long way towards instilling an ethical culture in organisations.

Ensure buy-in at the top

Boards of directors need to provide leadership on ethical considerations. Company boards need to take a more proactive approach to recognising – and taking action to minimise – the ethical risks of the practices that generate much of their earnings. Too often, the senior leadership only engages with ethical considerations when a crisis arises, at which time their responses are confounded by attempts to manage potential reputational damage. This approach places the burden of balancing ethics against profit on the staff, who, when trouble arises, can be labelled as ‘bad apples’ and dismissed as a cathartic solution to the crisis. Boards of directors should provide clear leadership on ethical considerations in two key ways.

The first is by ensuring that detailed policies and procedures are setting unambiguous ethical standards for practice. They should take responsibility for ensuring not only that those ethical standards are being met, but that they are, in fact, able to be met in the company’s culture and structure.

Boards should also take explicit ethical positions on practices such as those we have targeted in this chapter. These positions should provide guidance to staff in how to balance considerations of both ethics and profit.

Create ways of measuring and rewarding performance that include ethical considerations

It is widely accepted in the design of reward systems that what gets measured gets done. Leaders and their staff may experience conflicts between maximising their own rewards, maximising financial returns for the organisation in the long term, and acting ethically. For example, the trade-offs required in the resolution of these conflicts create the potential for shareholders’ interests and clients’ needs to be neglected. The risk for clients is greatest when there is strong pressure for short-term profits and financial incentives are contingent upon profit or other financial indicators.

Less easily measured outcomes, such as the ethicality of actions, are considered – if at all – as fuzzy, nice-to-have outcomes but not essential. It is unlikely that ethical considerations will be integrated into decision-making if these are not measured and taken into account when deciding bonuses and other incentives.

We recommend that organisations use client surveys and ratings of staff by leaders and peers to assess if the manner in which employees achieve outcomes is: (a) ethical; (b) includes effective treatment of clients and staff; and (c) contributes to the long-term benefits of the organisation.

Practices such as: (a) compensation disclosure, making sure that shareholders have a say about the compensation structure; (b) factoring in the management of risk in the

compensation decision-making process; and (c) including clawback provisions in the contracts of managers to discourage unethical behaviour may also alleviate some of the unintended negative consequences of current compensation practices.

THE LAST WORD ON ETHICAL LEADERSHIP

- Be ethical and promote ethical behaviour, always. It is not enough for leaders to be ethical themselves. As leaders we are responsible for the actions of other people across the entire organisation, as well as their own.
- Ethical leadership can be learned and developed. Use the ethical framework in this chapter as the basis for the development of your own personal approach to ethical leadership.
- Ethical leaders display a set of core values for the basis of their leadership that they never ignore.
- Ethical leaders are self-aware. They ‘check in’ regularly with their colleagues, mentors and confidantes.

¹ AAP. (March, 2016). ASIC chair criticises ‘bad apples’ defence, *news.com.au*. Retrieved 14 April, 2016, from <http://www.news.com.au/finance/business/breaking-news/asic-chairman-slams-bad-apples-defence/news-story/2029329bfed586a6da681b42106780ab>

² Wood, R. E. (2009). *Knowledge Based Leadership*. Unpublished manuscript.

³ Wood, R. E., Wheeler, M. A., & McGrath, M. (2016). A question of ethics: Navigating ethical failure in the banking and financial services industry. Retrieved from the Chartered Accountants website, https://www.charteredaccountantsanz.com/~media/FutureInc/Pdfs/2016/0416-28LA_FutureIncEthicsinBankingandFinancial%20Services.ashx

⁴ Useem, J. (Jan/Feb, 2016). What was Volkswagen thinking? On the origins of corporate evil – and idiocy, *The Atlantic*. Retrieved from The Atlantic Website, <http://www.theatlantic.com/magazine/archive/2016/01/what-was-volkswagen-thinking/419127/>

⁵ Brown, D. (October, 2012). Led J & J during Tylenol Crisis, *The Washington Post*. Retrieved from <https://sites.psu.edu/brendanfeiferfye/2015/07/26/case-study-tylenol-1982/>

⁶ Armstrong, J. (2011). *In Search of Civilization: Remaking a Tarnished Idea*. Graywolf Press.

⁷ Epley, N., & Dunning, D. (2000). Feeling “holier than thou”: are self-serving assessments produced by errors in self- or social prediction? *Journal of Personality and Social Psychology*, 79(6), 861-875.

⁸ Tenbrunsel, A. E., & Messick, D. M. (2004). Ethical Fading: The Role of Self-Deception in Unethical Behavior. *Social Justice Research*, 17(2), 223-236. doi: <http://dx.doi.org/10.1023/B:SORE.0000027411.35832.53>

⁹ Wood, R. E., Wheeler, M. A., & McGrath, M. (2016). A question of ethics: Navigating ethical failure in the banking and financial services industry. Retrieved from the Chartered Accountants website, https://www.charteredaccountantsanz.com/~media/FutureInc/Pdfs/2016/0416-28LA_FutureIncEthicsinBankingandFinancial%20Services.ashx

¹⁰ Gunia, B. C., Wang, L., Human, L., Wang, J., & Murnighan, J. K. (2012). Contemplation and conversation: subtle influences on moral decision making. *Academy of Management Journal*, 55(1), 13-33.

¹¹ Gino, F., Ayal, S., & Ariely, D. A. N. (2009). Contagion and differentiation in unethical behaviour: the effect of one bad apple on the barrel. *Psychological Science*, 20, 393-398.

¹² Kish-Gephart, J. J., Harrison, D. A., & Trevino, L. K. (2010). Bad apples, bad cases, and bad barrels: Meta-analytic evidence about sources of unethical decisions at work. *Journal of Applied Psychology*, 95(1), 1-31.

doi: <http://dx.doi.org/10.1037/a0017103>

[13](#) Tenbrunsel, A. E., & Thomas, J. (2015). *The street, the bull and the crisis: a survey of the US & UK financial services industry*: University of Notre Dame: Labaton Sucharow LLP.

[14](#) Bandura, A. (2016). *Moral disengagement: how good people can do harm and feel good about themselves*. New York, NY: Worth Publishers.

[15](#) Wood, R. E., Wheeler, M. A., & McGrath, M. (2016). A question of ethics: Navigating ethical failure in the banking and financial services industry. Retrieved from the Chartered Accountants website, https://www.charteredaccountantsanz.com/~media/FutureInc/Pdfs/2016/0416-28LA_FutureIncEthicsinBankingandFinancial%20Services.ashx

[16](#) Bandura, A. (2016). *Moral disengagement: how good people can do harm and feel good about themselves*. New York, NY: Worth Publishers.

[17](#) Ibid.