Institutionalization of Organizational Ethics Through Transformational Leadership

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ABSTRACT. Concerns regarding corporate ethics have grown steadily throughout the past decade. In order to remain competitive, many organizational leaders are faced with the challenge of creating an ethical environment within their organization. A model is presented showing the process and elements necessary for the institutionalization of organizational ethics. The transformational leadership style lends itself well to the creation of an ethical environment and is suggested as a means to facilitate the institutionalization of corporate ethics. Finally, the benefits of using transformational leadership are demonstrated through the components of a psychological contract, organizational commitment, and ethical culture to institutionalize organizational ethics.

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Over the last decade there has been an increasing interest in corporate ethical performance. Some reasons for this trend may be the growing lack of confidence regarding corporate activities and an increased emphasis on quality of life. Certainly concerns about protecting the environment, fair employment practices, and the distribution of unsafe products have helped to create powerful regulatory agencies such as the Environment Protection Agency, the Equal Employment Opportunity Commission and the Federal Drug Administration. Recently, however, concerns about the problems associated with breast implants, the use of fetal tissue for research and the questioning of excessive executive pay levels have become salient. Adhering to the minimum regulatory standards may not be enough to remain competitive in a world that is becoming more socially conscious.

Many of today's organizations are faced with the challenge of creating an ethical organization. Carroll argues that organizational ethics is the capacity for an organization to reflect on values in the corporate decision-making process and establish how managers can use these observations in management of the organization (Carroll, 1987). The following will present a means by which organizations can accomplish that goal. This paper will begin by looking at why an ethical emphasis may be desired by an organization. Next, the required elements for the ethical transformation process will be discussed. The transformational leadership process, consisting of its characteristics, behaviors, and outcomes, will be then described in detail. Finally, the transformational leadership process will be applied to the formation of an ethical organization, including the key components of institutionalizing organi-

Journal of Business Ethics **14**: 829–838, 1995.
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zational ethics and a demonstration of why this leadership style is effective.

The potential benefits of an ethically oriented organization are many but often indirect. Although research has found inconsistent results concerning the relationship between ethical performance and measures of financial performance (McGuire, Sundgren and Schneeweis, 1988; Aupperle, Carroll and Hatfield, 1985), more definite relationships include an increased effectiveness due to strengthened organizational culture and increased effort and lower levels of turnover resulting from greater organizational commitment (Mowday *et al.*, 1982; Steers, 1977). A strong organizational culture as well as greater organizational commitment have been linked to ethical organizations. In addition, individual satisfaction and social responsibility have been proported to be highly correlated with corporate ethical performance (Brooks, 1989). Although empirical research is somewhat limited, the benefits of an ethical organization are believed to be imperative to many organizations.

Before an organization can begin the transformation process into an ethical organization, there are some basic elements an organization must establish. These required elements and their relevance will be considered in the following section.

Elements of an ethical organization

An organization must possess certain ethical elements in order for the transformational leadership style to be effective. These elements are believed to be necessary precursors for an ethical focus as opposed to outcomes of the transformational leadership process (Sims, 1991; McDonald and Zepp, 1990; Guerrette, 1988). As can be seen in Figure 1, the required ethical elements are the ethical orientation of the leader,

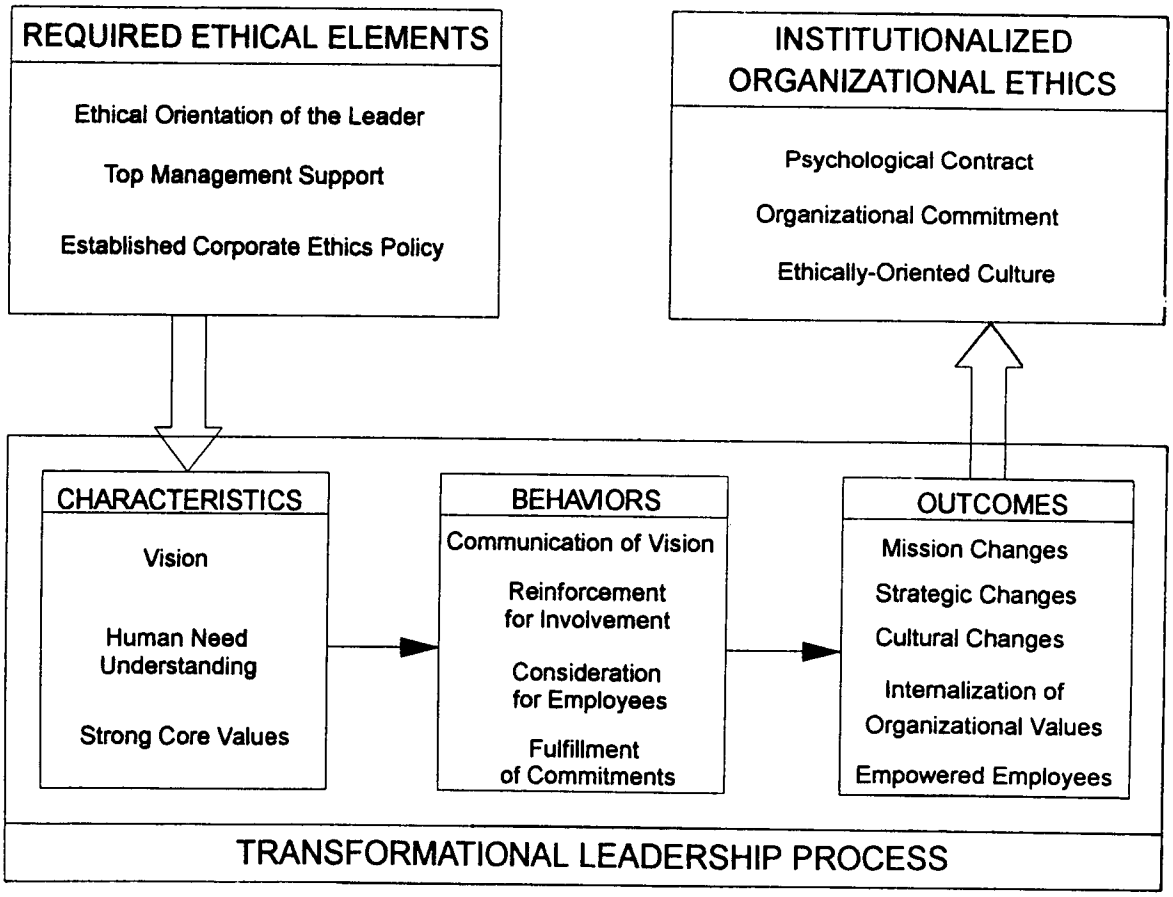

Fig. 1. Ethical transformation of an organization.

support of top management, and an established corporate ethics policy.

The ethical orientation of the leader is considered to be a key factor in promoting ethical behavior among employees. Leadership skills alone are not enough, these skills must be coupled with integrity and ethical behavior/traits. While these traits alone do not make an effective leader, traits are believed to be an important aspect of leadership as they help a leader formulate a vision and implement that vision into reality. Certain traits may be seen as a precondition for leadership, and the possession of these traits may result in a greater likelihood of desired results. In order for the goal of an ethically oriented organization to be met, the leader must have a strong ethical orientation. For example, the traits of honesty and integrity have been identified as essential for a leader to be successful in building a trusting relationship with his/her followers (Kirkpatrick and Locke, 1991).

Therefore, the values as well as the character of the leader of an organization become transparent through his/her leadership behaviors. The leader's traits will be demonstrated as he/she attempts to lead the organization. Whether or not those are ethical traits will influence the degree of ethical institutionalization. For example, a leader without an ethical orientation may be a successful transformational leader but will probably not successfully create an ethical organization as the traits exhibited by the leader are ultimately accepted by his/her followers. When a leader does not believe in what he/she is trying to inspire he/she is not as effective as when he/she personally has the ethical standards he/she is promoting. The ethical leader must take personal, ethical responsibility for his/her actions and decision making. Leaders who exhibit high ethical standards become role models for others in the organization and raise its overall level of ethical behavior. Ethical behavior must start with the leader before employees can be expected to perform accordingly (Butcher, 1991; Enderle, 1987).

The second element is top management support. A leader alone may not be able to create an ethical organization without the support of key figures around him/her. An organization's top leadership sets the ethical tone. Corporate ethics should begin in the board room and affect all major decisions regarding the organization (Bavaria, 1991). When top executives communicate their endorsement of ethical standards, employees will likely follow. Therefore, it is important to have the support and involvement of top management if an ethically oriented organization is to emerge.

For example, leaders who use company resources for their personal benefit, inflate their expense account, or give favored treatment to friends imply with their actions that the behavior is acceptable for their employees. Top management also plays a role in demonstrating acceptable ethical behavior by their reward and punishment practices. If individuals who behave unethically are rewarded then that behavior will be considered acceptable and will be likely to continue. On the other hand, if ethical behavior is rewarded and this is made visible in the organization then this kind of behavior is encouraged and will provide a basis for institutionalizing organizational ethics.

The last ethical element is an established corporate ethics policy which provides a statement of the norms and beliefs of an organization. This should include a code of ethics which describes the value systems of the organizations as well as guidelines for decision making. Such a policy will provide the employee with a clear understanding of the organization's position regarding employee behavior. In addition, the code of ethics provides a basis for an employee to refuse unethical actions and helps to make employees aware of ethical issues before they are faced with the situation. It is also important for the policy to be current with respect to societal and employee values, applicable to the organizational member, and readily communicated. In order for the code of ethics to be truly effective the organizational members must be aware of it and what behavioral guidelines it contains (Hunt *et al.*, 1989; Trevino, 1986).

Many organizations such as Whirlpool and Johnson & Johnson have communicated their ethical beliefs through items such as company booklets or annual reports as well as including it

in socialization programs for new employees. Also, if the code of ethics is enforced the outlined behaviors are more likely to be followed. For example, Chemical Bank has fired employees for violations of the company's code of ethics even though nothing illegal was done (McDonald and Zepp, 1991; Business Week, 1988). It is the composite of this policy and the leader's individual values which make up the corporate values. In conclusion, the corporate ethics policy is the written foundation upon which the ethical leader may build as he/she attempts to institutionalize organizational ethics.

The aforementioned elements are essential for the transformational leadership process to develop and mold an ethically oriented organization effectively. The transformation leadership process will be presented in detail in the following section.

Transformational leadership

The transformational leadership style lends itself well to the creation of an ethical environment. By appealing to the moral values of the individual, transformational leadership is a process that will allow the leader's vision to be proliferated throughout the organization. The following will describe this transforming leadership process in detail and clarify its distinction from charismatic and transactional leadership. In addition, the application of this leadership style and how it may be used to develop organizational ethics will be discussed.

Approaches to transformational leadership

Transformational leadership was first suggested in 1978 by Burns in his book, *Leadership* (Burns, 1978). Transformational leadership refers to the process of influencing major changes in the attitudes of employees so that the goals of the organization and the vision of the leader are internalized. It is a process in which leaders and followers actually raise one another to higher levels of morality and motivation. The transformational leader attempts to engage the whole person of the follower by looking for individual motivations, appealing to the individual's values, and trying to satisfy higher needs (Maslow, 1954). Transformational leadership appeals to moral values and requires the involvement of leaders at all levels of the organization. Outcomes such as dramatic changes in the organization's culture and strategies are often a result of this leadership process.

In 1985, Bass elaborated on the idea of transformational leadership in his book *Leadership and Performance Beyond Expectation*. Bass's concept of transformational leadership focuses on the raised awareness about the issues of consequences in followers. Bass argues that this heightening of awareness requires a leader with a vision, self-confidence, and inner strength to argue successfully for what he/she believes is right or good, not for what is popular or is acceptable according to established wisdom of the time (Bass, 1990; Bass, 1985). The arousal of strong emotions in followers results in their being motivated to do more than would normally be expected. With this approach, leaders transform their followers by activating higher order needs, emphasizing the value of certain outcomes, and influencing their followers to put the organization before their own self-interest.

The main difference between these two theories is that Burns restrict this type of leadership only to leaders who appeal to positive moral values. On the other hand, Bass argues that a transformational leader is one who increases commitment regardless of the final moral or ethical effect on the follower. Regardless, when transformational leadership is enacted, members of organizations no longer seek merely self-interest, but that which is beneficial to the organization as a whole.

Differentiating transformational leadership

Transformational leadership is sometimes used interchangeably with charismatic leadership in the literature. However, most authors believe there should be a distinction as transformational leadership is a more broad concept than charismatic leadership. Charisma is believed to result

from followers perceptions of leader qualities and behavior. A charismatic leader appeals to the hopes and ideals of the followers who often idolize the leader. These leaders are often only present in times of crisis. This differs from the transformational leader who appeals to the needs and values of the followers and often attempts to change entire organizations. While the transformational leader may have charismatic qualities he/she must also have much more.

Transformational leadership is also used interchangeably with transactional leadership in the literature. Kuhnert and Lewis explain the difference between transactional and transformational leadership as well as the processes by which leaders develop these styles (Kuhnert and Lewis, 1987). Transactional leaders give followers something they want in return for something the leaders want. Effective leadership depends on the leader's ability to meet and respond to the changing expectations of their followers. Kuhnert and Lewis argue that there are two levels of transactions. Lower order exchanges are based on the exchange or negotiation of goods or rights (e.g., work overtime for vacation, eight hours work for eight hours pay). Higher order exchanges are less common, and based on exchanges of trust, commitment, and respect; or tied to some emotional, non-concrete reward to maintain follower's performance.

Transformational leaders operate out of deeply held personal value systems such as justice and integrity – things that cannot be negotiated or exchanged. Transformational leaders unite followers and change followers goals and beliefs by expressing their personal standards. Although transactional leadership can be a positive force in an organization, transformational leadership is viewed as moving beyond this style of motivating for performance beyond expectations, inspiring for missions beyond self-interest, and instilling confidence to achieve superior performance. Transformational leadership is viewed as the best approach for instilling ethical behavior in organizations.

The achievement of the transformational approach requires that top management have certain prerequisite characteristics and behaviors. The details of these characteristics and behaviors as well as possible outcomes will be discussed in detail below. Once the process of transformational leadership has been established, the effectiveness of this approach will be considered in an ethical context.

Characteristics of transformational leaders

The first and perhaps most important characteristic required of a transformational leader is that of vision (Kotter, 1990; Bennis, 1989). A vision is a mental picture of a desirable and possible future state of the organization. This vision may involve a specific mission and detailed goals or may be as vague as a dream. In either case, a vision must be a source of self-esteem and reflect an appealing future for organizational members so that members develop a sense of purpose about the organization. This vision allows leaders to inspire workers by giving their work meaning and making salient the central purpose of the organization.

The second prerequisite characteristic of a transformational leader is understanding human needs (Bass, 1989; Waldman *et al.*, 1990). Leaders must be familiar with the intricacies of human motivation so they can gain the support of followers. Tapping employees' needs for recognition, a sense of belonging and self-esteem, elicits a powerful motivational response. The leader must consider personal differences and treat each employee or group of employees accordingly.

The third necessary characteristic of a transformational leader is a strong set of personal core values (Bennis, 1989; Kouzes and Posner, 1987; Bass, 1985; Burn, 1978). Transformational leaders operate out of personally held value systems that may include such values as integrity and justice. Transformational leaders can unite and change followers' goals and beliefs by expressing their personal standards. If the values are shared with the followers the effectiveness is even greater.

These are the three characteristics which appear to be most salient to the transformational leadership process regarding ethical transformation. Next, the behaviors of transformational

leaders that are most relevant to the development of an ethical orientation will be discussed.

Behaviors of transformational leaders

The first key behavior of successful transformational leaders is the communication of their vision (Kouzes and Posner, 1987; Tichy and Devanna, 1986; Bennis and Nanus, 1985; Schein, 1985). It is not enough merely to have a vision. That vision must be communicated to members of the organization. In their study of effective leaders, Bennis and Nanus found effective leaders were able to communicate a vision easily enough to be understood, were appealing enough to provoke commitment, and were credible enough to be considered real. Kouzes and Posner accentuate this point by stating that a common vision must be brought to life and must ignite human flames of passion.

The second behavior is the reinforcing of members for their involvement in the leader's vision. The involvement of the follower in support of the organization is critical and the recognition of this behavior should contribute to the following of the leader. If the personal needs of an individual are understood, the fulfillment of those needs can be used to reinforce behavior. The desired behaviors can be reinforced through a reward system which enforces what is valued by the leader. Reward systems motivate employees and influence the culture of the organization. Since intrinsic rewards are related to higher order needs, they may be the most effective in this situation (Deci, 1975; Herzberg, 1959).

The third behavior is consideration of employees. The concern for employees first in a crisis situation and constant attentiveness to employee welfare are examples of the types of behaviors that establish the desired relationship. also, by involving the followers in the planning process they will have a greater sense of involvement, resulting in a higher level of commitment. The respect of the leader by his/her followers is vital in transformational leadership and his/her following is strengthened when employees perceive their needs to be valued. Therefore, consideration of employees is a vital behavior in the transformational process.

The final behavior necessary for transformational leadership is the fulfillment of commitments. When followers see the leader keeping promises and doing what is expected, they perceive him/her as being trustworthy and credible. The leader gains influence by demonstrating important personal characteristics, which are usually byproducts of his/her strong core value system. Without the perception of a credible leader, it is difficult for members to internalize the values of the organization. Therefore, commitments made by a leader must be kept in order to maintain a following.

Outcomes of transformational leadership

The outcomes of the previously discussed behaviors are many and complexly intertwined (Yukl, 1989; Bass, 1985; Burns, 1978). The more effectively these behaviors are carried out the greater the strength of the outcomes.

Two outcomes of this leadership process are likely to be major changes in the organization's mission and its strategies. The mission statement and subsequent strategies for fulfillment of the mission statement are both reflections of the major themes and values in the vision. Also, by allowing the followers to take part in the development of strategies they will have a greater commitment toward those strategies.

The reshaping of the organization's culture is also influenced by all of these leader behaviors. Schein (1985), in his research on culture and leadership, found that there are five primary mechanisms leaders use to influence culture. He argues that the most powerful mechanisms for transmitting and embedding culture are (1) what leaders pay attention to, what they measure, and what they control; (2) the leaders reactions to critical incidents and crises within the organization; (3) their deliberate role modeling, teaching and coaching; (4) the criteria leaders use for allocation of rewards and status; and (5) the criteria utilized for recruitment, selection, promotion, and retirement. Each of these five mechanisms are subsumed under transformational

leadership behavior. Thus, the transformational leader behaviors in combination with the previously established elements are drawn upon and, subsequently, the culture of the organization is greatly shaped by the transformation process.

In summary, the organizational values, as established by the leader in his/her vision, are often internalized by the followers. The perceived strength of the leader's values and his/her subsequent credibility also lead employees to view their own values as those of the organization. In addition, by using an intrinsic reward system to reinforce involvement in the organization, the internalization of values and subsequent organizational commitment are likely to follow.

As leaders transform followers, the followers begin to trust and respect the leader, and they are motivated to do more than originally expected. Kouzes and Posner suggest that through the understanding of employees and subsequent concern for them, they are strengthened and empowered. According to Burns, when the transformational process occurs, the members of the organization become transformational leaders themselves.

The transformational leadership process results in outcomes that are essential for implementing ethics in an organization. The following discussion will address how this leadership process, along with the foundation of ethical elements, will support the institutionalization of organization ethics.

Institutionalized organizational ethics

Institutionalization of ethics means that ethics are formally and explicitly incorporated into business life on a daily basis. Sims has found in his work regarding ethics in the organization that the key elements to achieve this institutionalization are a psychological contract, organizational commitment, and an ethically oriented culture (Sims, 1991).

Psychological contract

A psychological contract is a set of unwritten, reciprocal expectations between an individual and an organization which specifies what each is expected to give and receive in the relationship (Kotter, 1990; Rosseau, 1990; Schein, 1985; Kotter, 1973). This type of contract commits both sides to the relationship. The greater the match between the individual and the organization's expectations regarding ethical behavior in organizations, the greater institutionalization of ethics, ethical employee behavior, and more persistence toward the institutionalization of ethics.

The transformational leader fosters this psychological contract. The leader clearly expresses his/her own ethics through his/her vision and influences both the mission statement and strategies of the organization. The transformational leader will encourage moral involvement of the individual so that the individual intrinsically values the organization's mission as well as his/her work. This involvement will lead to a stronger contract between the individual and the organization. In addition, by showing consideration toward employees and their needs and reinforcing ethical behavior in the organization, the grounds of the psychological contract should be well understood for both parties.

The psychological contract contains expectations of behavior which if broken may result in strong emotional behavior. The required element of top management support is significant here to demonstrate the commitment toward ethical behavior. The top management team will confirm what behavior is acceptable and what ethical behavior is encouraged. The reward and punishment practices established by top management also help clarify the ethical expectations. Thus, top management communicate their endorsement of ethical behavior which provide for a strengthened psychological contract.

Therefore, the first ethical element, a psychological contract, is one way to get both the individual and the organization working together to make ethical behavior part of the daily functioning of an organization.

Organization commitment

The second factor, organizational commitment, occurs when individuals identify with and work toward organizational goals and values. There are a number of elements that will help increase organizational commitment and ultimately the commitment to ethical behavior. Each of these elements is encouraged by the transformational leadership process and will be discussed below (Stumpf and Harment, 1984; Angle and Perry, 1981; Mowday *et. al.* 1982; Salancik, 1977).

First, the more visible the ethical contributions the more likely they will act as incentives for future ethical performance thus institutionalizing ethics. This reinforcement through visibility may be seen in the leader's reinforcement of desired organizational behaviors. For example, if an employee is publicly rewarded for their behavior through awards ceremonies or in-house publications the individual is likely to increase their commitment to ethical behavior.

Second, the expected behavior must be explicit. The required element of a corporate ethics policy can help with this factor due to the fact that it shows visibly the organization's position, as well as explicitly stating what is expected. Also, clear expectations of behavior are seen in the leader's vision and ethical behaviors such as honesty can be demonstrated and encouraged through the leader actions of honesty.

The third element that contributes to commitment is the enhancement of personal responsibility. By having personal responsibility for one's actions, individuals are tied to the consequences of those behaviors. Thus, ethical behavior is more likely to follow as individuals are not allowed to distance themselves from the consequences of unethical actions. This personal responsibility is important to institutionalizing ethical behavior in the organization and can be seen through the transformational leadership process as employees are empowered and have control over their own actions. Therefore, the visibility of ethical contributions, clear expectations of behavior and the enhancement of personal responsibility all lead to greater commitment toward ethical behavior.

Also, by having a common vision that appeals to the needs, values and dreams of employees, the transformational leader can elicit commitment. The transformational leadership process is effective because it builds commitment of the followers and involves them in the movement toward the desired directions (in this case, ethical behavior). Enhancing organizational commitment to ethical behavior is an ongoing process and is encouraged through the behaviors of a transformational leader.

Ethically oriented culture

In Trevino's model of ethical decision making in organizations, organizational culture is considered a key component when looking at ethical behavior (Trevino, 1986). The core of the corporate culture is in the value system. The corporate values, as established by leadership, will affect all aspects of the organization. They will indicate to the employees what is important, create a sense of identity, enhance social stability, and give direction as to what behavior is accepted. To the extent that an organization has a strong ethical culture, the guiding philosophy of its leaders will be widely shared among its employees. The culture of an organization has a profound influence on the employees. To the extent that culture strongly supports ethical behavior the institutionalization of an ethical organization will be supported.

In addition, the organization's culture socializes individuals in the organization. The culture conveys that certain behaviors are acceptable or unacceptable. A culture could encourage unethical behavior by considering acceptable certain forms of illegal activities. For example, in the early 1960's executives at General Electric, Westinghouse, and other manufacturers of electrical equipment conspired to set prices. Individuals in the organization lost sight of the fact that it was illegal as it became common place. When employees were questioned they said that they found price-fixing to be an established way of life, and simply entered into it as they did into other aspects of their job (Yeager, 1990). A culture could similarly socialize individuals in

ethical behavior established by an ethically-oriented culture.

The behaviors of the leader were previously shown to contribute greatly to the shaping of the culture of the organization. Thus, it is important that the leader has an ethical orientation as the values of the leader play a key role in the shaping of the organization's culture. In conclusion, leadership behaviors that promote and encourage ethical behavior will result in an ethically oriented culture.

Can transformational leaders really make a difference?

We believe that transformational leaders can make a positive impact on the ethical performance of organizations. It is imperative, however, that the organizational mission, policies, and reward system encourage ethical behaviors. For example, some large organizations may intentionally screen dynamic, transformational leaders from unethical events so the outward appearances of strong ethical conduct is maintained. In order to truly create and develop ethical leaders, top management must be committed to a clear code of ethical conduct; recruit, select, and promote managers with high ethical standards; develop performance standards that reward ethical conduct; and encourage training in ethical leadership skills (Howell and Avolio, 1992).

In addition, it is important for an organization to evaluate the ethical performance of its organizational members. This requires that ethical behaviors be assessed against standards or norms of acceptability. Standards can be captured through federal and state laws and organizational standards, as well as professional standards of ethical behavior (Gatewood and Carroll, 1991).

The institutionalization of organizational ethics helps to create a mutual understanding among organizational members about what is appropriate behavior. An effective process by which this desirable goal may be obtained is through the use of a transformational leader. The leader is an integral part of the organization, and this style provides many of the necessary elements in having an ethically oriented organization. By effectively utilizing the transformational leadership process, the organization's culture can be transformed into one which fosters and encourages ethical behavior by its members.

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