Ethical Leadership

Global Challenges and Perspectives

Edited by

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and

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Virtue-based Leadership in the United Kingdom and Nigeria

Kola Abimbola and Temi Abimbola

Introduction

This chapter discusses the role of ethics in strategic leadership within competitive and dynamic markets. Using two case studies, The Body Shop and the Nigerian Stock Exchange, we examine the need for a better understanding of the ethical aspects of leadership within corporations. The argument is that not only is it imperative for market-based institutions to be socially responsible to their stakeholders, but that virtue is an essential component of strategic leadership. The interactive effects of the prevailing micro and macro economic factors require a correspondent alignment between strategic leadership at the self, organisation, and societal levels. Our justification for these two cases is that a theory of ethical leadership needs to be generalisable, and applicable to the different socio-cultural environments within which organisations and businesses are incorporated. These different environments create complexities for competition, leadership, and decision-making.

Scholars such as Bettis and Hitt (1995), D'Aveni (1994), Hitt (2000), and Ireland and Hitt (2005) assert that increasing complexity makes competing in a global economy particularly challenging. The hyper-competition of today's environment arises from the commingling of factors such as globalisation, deregulation, and technological advancement (Prahalad and Hamel, 1994; Hamel, 2001). An important consequence of this hyper-competitiveness is that previously successful methods may no longer be adequate in contemporary settings. Other important consequences include: idiosyncratic risks, the diminishing ability to accurately predict market outcomes, ambiguities in industry/market boundaries, and upheaval at the macro level. Thus, leadership requires flexibility and agility as the prerequisites for operating in conditions of uncertainty (Sirmon et al., 2007) and dynamic environments challenge the existing micro models of leadership research (Crossan et al., 2008; Waldman et al., 2006).

Strategic leadership theory maintains that organisations reflect the decisions of their leaders, who set the course for the firm (Hambrick and Mason, 1984). These leaders are responsible for crafting strategies for survival in dynamic environments (Boal and Hooijberg, 2000; Crossan et al., 2008; House and Aditya, 1997). One emerging paradigm acknowledges the need for the integration of contextual, micro, and macro influences (Waldman, 2007; Yukl, 1999), and the need for a pluralist approach to strategising (Jarzabkowski and Fenton, 2006; Whittington et al., 2006). This is essential in developing strategic leadership studies that are capable of providing managers with guidance on the complex and dynamic globally competitive landscape, which is riddled with opportunities and threats in equal measure. This call for a multidisciplinary and a multi-level approach to the study of strategic leadership provides the impetus for this study. We provide an innovative and integrative conceptualisation of strategic leadership, an approach in which we examine leadership of self, organisation, and society. Our work conceptualises the virtues as they relate to the ethical challenges that arise from the concrete decision-making of corporate leaders.

Leadership theory

Much scholarship on leadership has focused on the relationship between the leader and the follower. The notions of servant leadership, supervisory leadership, and strategic leadership (Javidan and House, 2001) reflect some key emerging schools of thought on the study of leadership. We would argue that leadership should not be viewed only in terms of the leader as an agent of the shareholders, or the leader as an individual (Waldman and Siegel, 2008). Strategic leaders should also have the capacity to lead at a societal level, where they balance the needs of their organisations against those of society in general (Crossan et al., 2008; Waldman and Siegel, 2008).

Barnard (1938) conceives of firms as social organisations whose leaders are susceptible to social cues and pressures both within and beyond the boundaries of the organisation. In an interdependent, networked and global world, the mandate to lead requires collaborative and relational cooperation with different internal and external stakeholders. There will always be conflicts of interest among the various stakeholders like management, employees, shareholders, the public, and so on. If

we factor in the dynamic roles of leaders, a new type of agency deficit ensues, because the stakeholders have to place some trust in the quality of their leaders. Leadership agency cost is the cost of monitoring the effectiveness of leaders in an effort to prevent them from prioritising their own interests above those of all other stakeholders.

Various types of stakeholders place a premium on the ethical behaviours of corporations. For instance, few stakeholders want corporations to employ child labour, damage the environment, or trade unfairly. Crucially, consumers are now willing to pay premium prices for goods and services that have been produced, manufactured, or supplied by socially responsible corporations. Increased visibility means that corporations are having to become more socially responsible, because stakeholders can evaluate their actions (and inactions), and this in turn translates into increased or reduced profits. Corporate social responsibility is increasingly associated with macro organisational theories, and it has been argued that firms need to adopt this approach in order to gain legitimacy (Meyer and Rowan, 1997; DiMaggio and Powell, 1983).

As defined by the UK Department for Business, Enterprise and Regulatory Reform (BERR), corporate responsibility is 'how companies address the social, environmental and economic impacts of their operations and so help to meet our sustainable development goals'. Further, the World Business Council for Sustainable Development defines it as 'the commitment of business to contribute to sustainable development, working with employees, their families, the local community and society at large to improve their quality of life'. These and other definitions raise concerns about the relationships between corporations and the societies they impact on, the markets they operate in, and their geographical environments. Given that corporations are artificial persons whose actions are dependent on the action of their leaders, it is therefore imperative to examine the roles and functions of these leaders in this sphere.

Strategic leadership and the ethical compass

Leader behaviour has been shown to be the best predictor of behaviour at the lower level within organisations (Greenleaf, 2002; Luthans and Slocum, 2004; Pearce et al., 2008). Leaders are able to set the tone and influence behaviour within organisations because they have the ultimate accountability for the performance of the whole organisation. Mendonca argues that the behaviour and strategies of corporate leaders influence their followers and employees, thereby impacting the behaviour of the organisation as a whole (Mendonca, 2001:268). However, Baumhart (1961) and Brenner and Molander (1977) found that there is a correlation between the behaviours of the leaders of a firm and unethical decision-making. This makes the character of the leader of particularly weighty importance in any discussion on the ethical behaviour of corporations.

Kanungo and Mendonca (1996) and Mendonca (2001) have put forward a virtues-based model for the analysis and evaluation of ethical leadership. They distinguish between the 'transactional' and 'transformational' modes of influence, and the 'cardinal virtues of character formation'. In transactional modes of influence, leaders see their subordinates as something akin to robots, primarily there just to implement decisions. Control and compliance is enforced through a wide range of mechanisms that some have argued 'offend against the dignity of the human person' (Mendonca, 2001:268). In the transformational mode, followers are regarded as autonomous individuals. Desired attitudinal, belief, and value changes in followers are therefore effected through empowerment and other cognitive strategies designed to respect the personhood of followers. Leadership itself depends on the character development of the leaders. This character development is referred to as 'self-transformation for ethical leadership' (Mendonca, 2001:269). Corporate leaders require prior self-transformation in their moral strength or backbone, that is, character. This character functions as the sense of virtue, on the basis of which decisions, strategies, and actions are taken. The development and formation of virtue enables leaders to acquire an inner compass to guide their will and their strength. This helps to ensure that their decisions are based on ethical reasoning. Mendonca (2001) explains the four cardinal virtues, as identified by Plato, as follows:

> **Prudence** requires the habitual assessment, in the light of right standards, of the situation or issue on which a decision is to be made. The leader who is in the habit of practising prudence will not abdicate his or her responsibility for unethical behaviour. The prudent person will not only not resent that others disagree with his or her views but will actively seek such information to better assess the situation and exercise sound judgement.
>
> **Justice** requires the individual to strive constantly to give others what is their due. The 'due' means more than the legalistic notion of the contractual rights of others. It includes whatever others might need to fulfil their duties and exercise their rights as persons.

> **Fortitude** is the courage to take great risks for an ideal that is worthwhile. One of the underlying characteristics of fortitude is perseverance and endurance against great odds.
>
> **Temperance** involves distinguishing between what is reasonable and necessary and what is indulgent (Mendonca, 2001:269f.).

Based on the transformational theory of leadership, and the research that attests to the particular influence of leaders, the adoption by leaders of these virtues would transform their organisation from the top down. Because it is our view that the virtue theory of ethical leadership applies equally to both private and public companies, in the next section we present two case studies to illustrate the application of these virtues.

The virtues of leadership

Corporate social responsibility and The Body Shop

The Body Shop International Plc (TBS) was incorporated as a limited liability company in the United Kingdom in 1976 by Anita Roddick. The corporation has over 2,000 outlets around the world. L'Oréal acquired TBS in March 2006. Prior to its acquisition by the L'Oréal Group, TBS was known for its commitment to ethical values and corporate social responsibility (CSR). As such, one of the key concerns of TBS stakeholders was that it would lose its distinctive moral fibre by becoming acquired by L'Oréal. Our study suggests that TBS managed to retain its unique ethical orientation because of the inculcation of virtues into the character of its leaders, employees, and franchisees.

The Body Shop is founded on the philosophy that strong ethical values are compatible with corporate profitability. At the heart of the company's approach are five principles:

1. Animal protection
2. The environment
3. Community trade
4. Human rights
5. Self-esteem.

In relation to each of these principles, the company distinguishes between its vision (which it regards as its 'non-operational principles') and its policies (which are the specific actions it adopts to operationalise these principles in its corporate activities). The company presents its hierarchy of values as shown in Figure 8.1. Levels 1 to 3 of this hierarchy constitute the TBS 'vision' (that is, its non-operational values). These are the foundational values that the company inculcates into the character of its leaders, directors, employees, and franchisees. One way in which this inculcation is done is through the Corporate Values Training Programme, designed to impart these values to TBS leaders and employees. The distinction between non-operational principles and operational policies is about 'character formation' and 'practical action'. Consider, for example, the company's animal protection principle. This principle is a non-operational principle in the sense that the level at which it is introduced into the corporation is at the 'internal' level of corporate character formation. TBS directors, leaders, employees, and franchisees are expected to embody the value of animal protection in their character, thereby turning it into a virtue which informs their operational activities. The belief is that any TBS person who accepts the animal protection principle will translate this principle into action by ensuring that no animals are harmed in the production of cosmetics. Character formation is enhanced through the values training, and through values-related remuneration programmes. While the values training programme instils the virtues of the five core values into the character of its people, the values remuneration programme

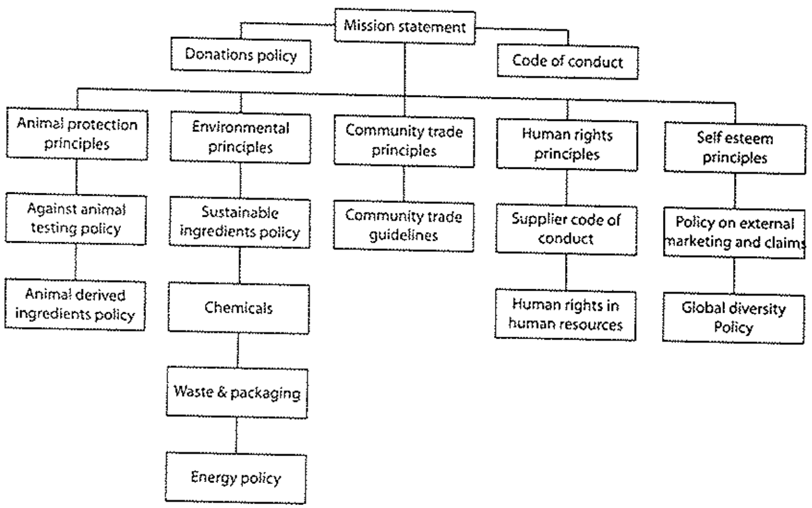

Figure 8.1 The Body Shop's Ethical Policy Hierarchy

officially includes these values as objectives in its leader, employee, and franchisee appraisal process.

Although L'Oréal has its own values and mission statement, these do not necessarily cohere with those of TBS. For example, one of the five cardinal values of TBS is that it supports the protection of animals, and this translates into its practice of not manufacturing and retailing cosmetics that have been tested on animals. L'Oréal, its parent company, does not subscribe to this principle, so how can TBS maintain its values, virtues and practices within this context? The practical solution adopted is that TBS is run and managed independently of the L'Oréal Group. It has not been folded into any of L'Oréal's business divisions; it retains its own unique brand; and it remains a separate business unit with its own separate management team. Only time will tell whether this will protect TBS, but preliminary indications show that TBS still retains its own unique virtues. As an example, since its acquisition by L'Oréal Group, TBS has moved from being mostly to 100 per cent 'vegetarian'. Prior to its acquisition, TBS sold two products that violated its animal protection values. Its men's shaving brush was made from hogs' hair, and its bath beads contained gelatin. Since its acquisition, TBS has found an alternative to hogs' hair, and has discontinued the sale of the bath beads that contain gelatin.

Corporate governance and the Nigerian Stock Exchange

The current global financial crisis began in 2007 as a result of the subprime mortgage lending crisis in the United States. The resulting collapse of a variety of financial institutions can be viewed as the result of inadequate inculcation of social responsibility in the banking and financial markets sectors. In an effort to avert financial crisis, US and European governments adopted extraordinary measures (including the provision of substantial financial bailout packages to stabilise banking systems; the cutting of interest rates by Central Banks; and market interventions such as the buying of large amounts of corporate short-term debt by governments). Nigeria was not exempt from this global turbulence, and the crisis in the Nigerian Stock Exchange serves as a good counter-foil to the case of The Body Shop. Although the two corporations are from two very different environments, in two very different sectors, and have very different goals and objectives, their differences crystallise the indispensable roles of virtues and character in ethical leadership and corporate social responsibility.

The Nigerian Stock Exchange (NSE) was established as the Lagos Stock Exchange (LSE) in 1960. It functioned as the LSE until 1977 when its name was changed to the NSE. The NSE is an integral part of the Nigerian Financial System, a system that has the Central Bank of Nigeria (CBN) at its apex. The CBN regulates the country's financial system through monetary policies that are formulated to create a stable economic condition. The CBN has direct control of government regulatory agencies including the Securities and Exchange Commission (SEC). The SEC focuses on non-banking institutions and regulates capital markets. The primary objective of the SEC is that of the protection of investors and capital market development. The SEC is granted a number of powers to assist it in the achievement of this objective. These include: the regulation of the capital market to prevent malpractice in security trading; the regulation of capital market trading information; regulation of the issue of new shares; the registration of individuals and institutions involved in the capital market; and the power to fine, suspend or de-list firms and individuals for securities rule violations. The NSE is a self-regulated organisation that reports to the SEC. NSE requires its market operators to subscribe to an ethical code which it describes as: 'our word is our bond'.

While integrity therefore appears to be the primary value that the NSE requires of its market operators, this value was undermined by events in February and March 2009, which show the limits of a reliance on regulation and policing as the primary framework for the supervision of financial markets. Between February and March 2009, shares in African Petroleum (AP) crashed from 293.00 Nigerian naira to 54.00 Nigerian naira, wiping 240 billion naira off the value of AP. Because the shares of AP had for many years been one of the most stable shares in Nigeria, this collapse within just eight weeks was extremely baffling. An investigation was launched, which discovered that AP had been the victim of 'share crossing', which is an illegal practice within the Nigerian securities market. As a result of the investigation, the SEC fined and suspended Nova Finance and Securities Ltd and one of its directors from trading on the Nigerian Stock Exchange. However, the records show that the then Vice President of the Nigerian Stock Exchange was the sole subscriber to Nova Finance and Securities Ltd, yet the SEC passed no comment on this (*Nigerian Muse*, 2009).

The case illustrates two very important points. First, in addition to regulation, there needs to be an ethical framework for the development of values to which institutions and individuals within the financial market will adhere. These values are needed to augment regulatory regimes in an effort to ensure that consumers are better protected and that financial crime is reduced. Secondly, principles, standards, and values have

FRAMEWORK FOR THE DEVELOPMENT OF VALUES	
Values and culture of firms	**Regulatory relationship**
Minimum standards • Unthinking, mechanical compliance • Does as little as can get away with • Culture of dependency • Tries to abdicate decisions and responsibilities	**Policing** • Monitoring boundaries • Detecting and responding to crises • Enforcement 'lessons' • Basic training
Compliance culture • Reliant on guidance • By the book • Unaware of some risks • Bureaucratic	**Supervising / educating** • Developing ethics and competence • Looking for early warning signs • Early action to bounce firms back on track • Themed / focused visits
Beyond compliance • Risk focused, self policing • 'Buying in' at senior level • Ethos integrated into most business processes • Ethos seen as assisting business	**Educating / consulting** • Facilitating the development of competence and culture • Values scorecard • Lighter touch
Values-led business • Internalise ethos of core values • Spirit not just letter • Values focused, goes beyond rules, not just compliance • Well developed individual responsibility and a sense of involvement by all staff • Focus on prevention • Continued reassessment and improvement of approach • Awareness and discussion of ethical consideration at senior and all levels • Open relationships • Strong learning culture	**Mature relationship / benchmarking** • Reinforce good practice • Lead by example • Re-allocate resources to problem firms • Sustainable regulation

Figure 8.2 The FSA Framework

to be integrated and diffused into all aspects of the 'business as usual' activities of corporations. The case study of The Body Shop is an example of such a successful integration, while the case of the Nigerian Stock Exchange is an example of poor integration. This integration need not be complex. The United Kingdom's Financial Services Authority (FSA) Discussion Paper on Ethics proposes one such integrative model, based on three core values. These require individuals and institutions within the financial sectors to be open, honest, responsive, and accountable; to act responsibly and reliably; and to relate to colleagues and customers fairly and with respect. The FSA's integration of values and regulation is shown in Figure 8.2.

An evaluation of the NSE crisis shows that regulation alone is not enough to remove unethical behaviour, and the FSA framework shows how a regulated body might evolve into a more truly ethical organisation over time.

Conclusion

This discussion has suggested that embedded virtues form the backbone of ethical leadership behaviour. The policies, strategies, and decisions adopted by corporate leaders in the exercise of their leadership will have a ripple effect throughout corporations. The decisions of leaders influence their followers and employees, thereby impacting the organisation as a whole. Some have argued that what is really needed is better corporate governance (Amao and Amaeshi, 2008). As Sternberg observed, 'properly understood, corporate governance refers simply to ways of ensuring that a corporation's actions, agents and assets are directed at the definitive corporate ends set by the corporation's shareholders' (Sternberg, 2004:25). On this definition, corporate governance is about ensuring that directors and managers are accountable to shareholders, and that their actions are not *ultra vires*. This is particularly important in modern-day corporations where management is typically detached from ownership. As an artificial entity, corporations of necessity require directors and managers to carry out their aims and objectives. This inevitably requires the shareholders to grant certain powers and obligations to directors and managers to serve as trustees of the shareholders' interests. If we approach the discussion of corporate ethics solely from the point of view of 'corporate social responsibility', the focus tends to be on the ethical qualities of corporate leaders, because it is the decisions of these leaders, and not the decisions of the shareholders, that impact on society. If we approach the discussion of corporate

ethics from the point of view of 'corporate governance', the shareholders also become involved, because of their role, through the Board, in attending to the character of the leaders acting as their agents in the execution of their roles and functions. Either way, the embedding of the virtues, from the shareholders through the Board to the leaders and employees, is indispensable if an organisation wishes to become truly ethical.

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