Executive Summary

Summary

Ethical acumen is a key competence for business leadership. This view has been reinforced by the recent wave of corporate scandals originating in the boardroom, often as a consequence of personal greed or ambition. Furthermore, leadership and proficient business management are distinct skills. **This report explores the role of ethical leadership in building and reinforcing a culture of trust in business.**

Why is ethical leadership so important?

The quality and style of leadership in a company will influence the tone of the entire business. That tone will affect the internal processes through which the company operates and, in turn, how, and to some extent, what, it communicates to its external stakeholders. If a leader's style is one of openness and transparency in dealing with colleagues and staff, this attitude will be reflected in the company's communications with its external stakeholders. **A leader's influence thus extends beyond the company itself.**

At the same time, the values and expectations of a company's stakeholders and wider society will influence a business leader's priorities and occasionally put pressure, positive and negative, on their ethical commitment. A leader will need to balance any tension between generating profits and doing business ethically.

Influence on internal tone

Tone in this context means the qualities and style that characterise business behaviour. In the immediacy of the organisation a leader is seeking to run, he or she needs to be aware of the example they are personally setting for their employees. In a meritocracy this is often overlooked, but the tone of how to behave, how to react to others and how to dress is on display and will be absorbed by those being led. On a tribal level followers try to emulate their leaders as a means of advancement.

Leadership in an organisation is often viewed as emanating from one person: the chairman or the CEO. But it is usually the collective tone set from the top that is of primary importance to employees. The board exists to set the strategic direction of an organisation, and under the UK unitary board structure, the board is collectively responsible for that strategy. The way that the board members work together reinforces leadership - particularly in the area of business ethics.

It is also important to recognise that there are 'leaders' at every level in an organisation; for instance divisional leaders, team leaders, project leaders and so on. Each leader will, by example, have an effect on the performance of the team being led. **So the tone set from the top will almost certainly cascade down the organisation and be played out at many different levels and in many different situations.**

An organisation needs to remain viable in order to be sustainable. Part of that viability is the practical matter of the customer's willingness to continue purchasing a company's products or services. In other words, do the customers continue to trust the company to provide products that demonstrate quality and value for money? But in today's business environment, the customer's interest in how the goods or services are produced, not in a technical sense but in an ethical and social sense, can be critical to their loyalty too.

This emphasises the need to communicate the internal tone of the company to its external stakeholders. **By clearly stating how it does its business, the company may begin to increase trust on the part of its stakeholders and society.**

Influence of stakeholders and society

The values and expectations of stakeholders and society may in turn influence a business leader's actions and behaviours. This is shown in many ways.

The first influence is the **institutional investor community**. Shareholders and shareholders' representatives want the companies they invest in to maximise returns. In the main, they expect companies to do business and to abide by the law but not to go the extra mile in producing costly reports on their corporate citizenship projects and so forth. This majority view has yet to turn significantly.

Over the past four years MORI has conducted a poll of investors and analysts on the factors they take into account in making judgements about investing in or recommending a particular company. The trends show that when prompted only 42% of investors mentioned honesty/integrity in 2004 - in contrast to 53% in 2002, which may have been an immediate post-Enron (2001) effect. However, when investors were not prompted the figures dropped to 6% in 2004 and 10% in 2002. For corporate social responsibility issues, the prompted figure was 8% in 2004 versus 10% in 2001: the unprompted figures were 3% and 4% respectively. The inference is that 'soft' issues, as they are often regarded, do not feature very strongly in the deliberations of institutional investors. However, there is a minority view held by ethical investors recognising the importance of corporate responsibility to long-term shareholder returns. This 'ethical minority' have UK funds of approximately £4.5-4.7bn invested, representing about 2% of the market as of November 2004.

Another pressure on leaders occurs when a company's stance on how it does its business is not matched by its **competitors**. Indeed the competitors may see a positive advantage in cutting corners to help the business win custom. Ethical business leaders know that doing business ethically may cost their company in the short term. But they are prepared and able to explain their choices to their management teams and shareholders, and even to the customers with whom they may decline to do business.

Another form of pressure is through individual or collective behaviour channelled through **non-governmental organisations** (NGOs). Such organisations are an effective voice in seeking change in business behaviour. Their tactics range from arranging mass boycotts of a company's products to seeking to disrupt company meetings. At one extreme, some single-issue groups are unwilling, unlike the majority of NGOs, to engage in dialogue. They resort to violent behaviour on company property and, at the worst, against company staff and their friends and family.

The democratic process is intended to reflect **society's expectations**. If companies do not 'behave' in society's eyes, then laws will be introduced to engender good behaviour. The law, however, can act only at a minimum level. It will never be drawn wide enough to deal with all behaviours. **It is by following good practice when operating in the grey areas not covered by the law that business leaders demonstrate their capabilities and ethical acumen.**

An ethical leader will demonstrate moral courage. Doing something because it is the right thing to do inspires others to do the same. This implies flexibility in leadership, particularly when expecting targets to be met or the 'right' kind of business to be done. In these instances employees know that when choosing to decline business rather than to break one of the company's ethical tenets, they are supported by the company's management. An ethical leader therefore leads by example, but also knows that from time to time leadership is about providing a supportive environment for individuals in the organisation.

This report

This report explores the importance of ethical leadership in *Setting the Tone* of a business.

Chapter 1 sets the context for ethical leadership by looking at the wider issue of restoring public trust in business. It explores the influence leaders can bring to bear in their organisation and on its external communications, and the influence exerted on leaders by their shareholders and other stakeholders.

Chapter 2 discusses, by way of illustrative ethical dilemmas the importance of a leader being sensitive to ethical issues.

Chapter 3 examines the characteristics considered essential for ethical leadership.

Chapter 4 looks at the ethical leader's need to earn trust. It reviews five attributes and five behaviours of leadership and suggests how leaders can set an ethical tone throughout their company.