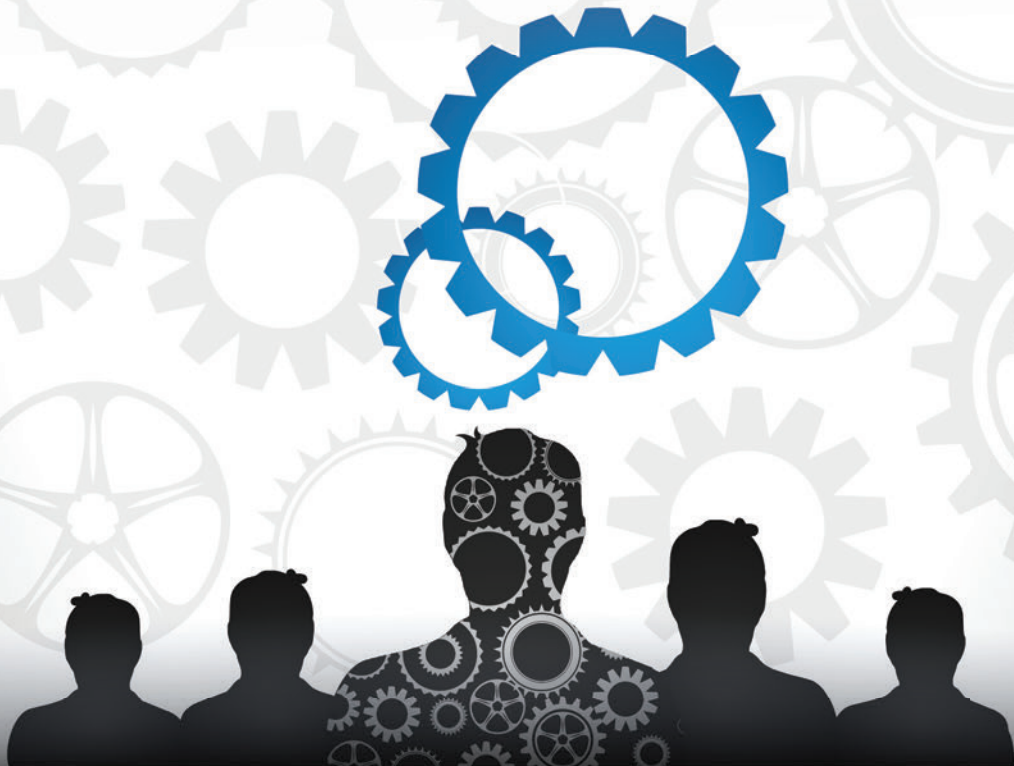




RESEARCH REPORT

ETHICAL LEADERSHIP

Every leader sets a tone.



A Research Report from the National Business Ethics Survey® (NBES®)



The Ethics Resource Center (ERC) is America's oldest nonprofit organization devoted to independent research and the advancement of high ethical standards and practices in public and private institutions. Since 1922, ERC has been a resource for organizations committed to strong ethics cultures. ERC's expertise informs the public dialogue on ethics and ethical behavior. ERC researchers analyze current and emerging issues and produce new ideas and benchmarks that matter for the public trust.

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ABOUT THIS STUDY

ETHICAL LEADERSHIP

A Research Report from the National Business Ethics Survey® (NBES®)

The National Business Ethics Survey® (NBES®) generates the U.S. benchmark on ethical behavior in corporations. Findings represent the views of the American workforce in the private sector. Since 1994, the NBES and its supplemental reports have provided business leaders a snapshot of trends in workplace ethics and an identification of the drivers that improve ethical workforce behavior. With every report, ERC researchers identify the strategies that business leaders can adopt to strengthen ethics cultures.

To view past issues of the NBES, please visit our website at www.ethics.org/nbes.

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The report was made possible in part by the generous contribution from our sponsor,
the Raytheon Company.

The Raytheon logo is displayed in a bold, red, sans-serif font. The background of the entire page is a light gray gradient with a pattern of various-sized gears. In the lower center, there is a cluster of three interlocking gears in a medium blue color. At the bottom of the page, there are silhouettes of five people. The central silhouette is filled with a pattern of small gears, while the others are solid gray.

EXECUTIVE SUMMARY

In every human endeavor, including ethics, leadership can make the difference between success and failure. As part of its National Business Ethics Survey[®], ERC set out to learn what's required for successful ethical leadership and what leaders can do to set an ethical tone at the top and inspire employees to do the right thing. With data from the survey, we explored the relationship between management behaviors and employee conduct.

Among the most notable findings: the most significant factor in ethical leadership is employees' perception of their leaders' personal character. Leaders who *demonstrate* they are ethical people with strong character have a much greater impact on worker behavior than deliberate and visible efforts to promote ethics.

Workers Judge Leaders on Three Factors

Employees at all sizes of companies draw conclusions about their leaders' character primarily on three factors:

- The overall character of their leaders as experienced through personal interactions;
- How senior managers handle crises; and
- The policies and procedures adopted by senior leaders to manage the company.

Employees want to know, for example, whether leaders treat lower level employees with dignity and respect, share credit when good things happen, and uphold standards even if it reduces revenues and profits. They watch to see whether leaders are steady in crisis, hold themselves accountable or, alternatively, shift blame to others. Workers also look at day-to-day management decisions to gauge whether ethical behavior is recognized and rewarded, or whether praise and promotions go to workers who bend the rules.

Supervisors Can Impact Ethics as Much as CEOs

We also found that tone at the top doesn't just come from the C-suite. When it comes to modeling good behavior, keeping promises, or upholding company standards, direct supervisors may matter just as much or more than CEOs and other senior executives. In fact, two in five workers we surveyed pointed to their immediate supervisor when asked who they consider senior leadership. However "senior leadership" is defined, workplaces in which leaders display ethical leadership tend to have lower rates of misconduct, less pressure to break rules, and greater employee engagement.

Ethical Leadership Is a 24-7 Job

Finally, ethical leadership is increasingly a round-the-clock job. When it comes to ethics, everything a leader does sets a tone. In a world where old distinctions between public and private are increasingly blurred, leaders' private behavior can matter just as much as what they do at work. When leaders practice 24-7 integrity, workers' own commitment to ethical conduct tends to be stronger. In matters of ethics, leaders are always setting a tone.

Recommendations for Strengthening Ethical Leadership

Companies can build on leaders' personal strengths to increase the odds that managers and employees will do the right thing. Based on findings, ERC recommends companies:

- Pay attention to personal character when hiring and make 24-7 integrity a job expectation.
- Educate managers about the way employees evaluate leaders, including the impact of "private" behavior in the age of social media.
- Encourage leaders to share credit for success and seek honest feedback from employees.
- Annually review business objectives and policies to ensure they promote ethical performance.

ETHICAL LEADERSHIP

In every human endeavor, leadership matters. In matters large and small, from sports to business to politics and war, the quality of a group's leaders often makes the difference between success and failure. Research and intuition alike suggest that leadership makes a difference in ethics, too. Assessing "tone at the top" is critical for boards of directors, auditors, and regulators as they try to gauge the risks of fraud or mismanagement.

To better understand the implications of ethical leadership and how tone at the top is transmitted, ERC included several targeted questions as a part of our National Business Ethics Survey[®] 2013 research. We included items to understand the relative importance of several factors that shape employees' beliefs about senior leadership. We also asked respondents about numerous leadership traits to explore the relationships between management behaviors and desired ethics and compliance outcomes. Because of the kinds of analysis conducted (e.g., means testing and multivariate regression

modeling) many of the findings in this report are presented in text explanations, rather than specific percentages or charts.

BENEFITS¹ OF LEADERSHIP COMMITMENT TO ETHICS

- Fewer employees feel pressure to compromise standards.
- Observations of misconduct are rare.
- When misconduct is observed, employees report it to management.
- Those employees who report misconduct they observed are less likely to experience retaliation.
- Employees are engaged and intend to stay with the company.

WHAT IS ETHICAL LEADERSHIP?

Ethical leadership involves not only doing what is right, but doing so in a way that encourages others to follow suit. There are many factors involved in ethical leadership: communicating the importance of ethics, abiding by company standards, supporting employees in doing the right thing, and holding accountable those who don't to name a few.

Recognizing that these factors are not equally influential, ERC investigated the relative importance of leadership attributes to learn how different management behaviors are tied to the ethical health of an organization. As part of the National Business Ethics Survey[®], we asked employees about 34 management behaviors and attributes, including the Ethical Leadership Scale developed by Brown, Treviño, and Harrison (2005).

Some of the behaviors we investigated are explicitly about ethics (e.g., talking about the importance of and setting a good example of ethical conduct), while others are more about workplace relationships (e.g., listening to what employees have to say), or involve perceptions of leaders' personal lives and behavior outside the workplace.

1. Ethics Resource Center (2013). *Ethics Resource Center's National Business Ethics Survey*. Arlington, VA: Ethics Resource Center. Ethics Resource Center and The Hay Group (2010). *Ethics and Employee Engagement*. Arlington, VA: Ethics Resource Center.

What Sets the Tone?

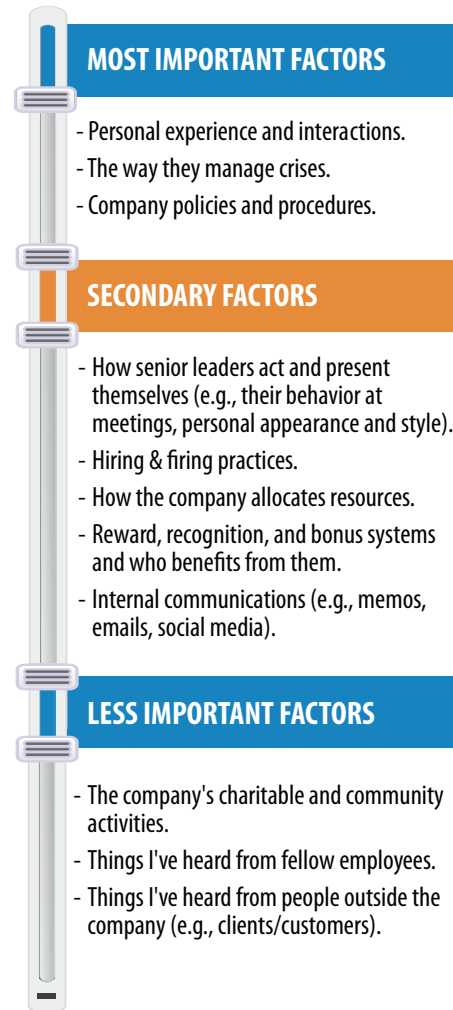
Within the ethics community, we know that tone at the top makes a profound difference and we often speak with leaders about the importance of intentionally setting the right tone. But there is little empirical data about what actually drives employees' beliefs about senior management, how tone at the top is communicated, and how employees determine what truly matters to management.

To address this knowledge gap, we surveyed thousands of private sector employees to find out how they formed their impressions of company leaders and tone at the top. We asked employees to tell us how important each of 11 different factors are to forming their beliefs about senior management. We were surprised to discover that the responses were the same regardless of company size and even strength of culture. Across the board, employees judge leaders primarily on three different factors.

First, workers care about the overall character of their leaders as experienced through **personal interactions**. Workers make up their minds about senior leaders based on what they personally have seen and experienced. Do leaders treat lower-level workers with dignity and respect? Will they compromise safety in order to make a profit? Do they attribute success to the efforts of employees, take sole credit when good things happen, or only see and value the contributions of those closest to them?

Second, employees are affected by **how senior managers handle crises**, which are by their nature, urgent, challenging, and emotionally-charged situations. Such moments are powerful teaching tools, helping employees see their leaders with clear eyes and revealing which values the leaders prioritize. During times of great stress, do senior leaders shift blame, compromise values, or keep employees in the dark? Or, instead, do they take responsibility; look after the well-being of employees; hold firmly to company values; and ensure employees feel cared about, informed, and safe?

FACTORS THAT SHAPE EMPLOYEES' BELIEFS ABOUT TOP MANAGEMENT



Finally, workers consider the **policies and procedures** that senior leaders adopt in order to manage the company. Leadership sets the overall vision for the organization, but, day-to-day management determines how that vision will be carried out. Policies and procedures establish the way in which work gets done, which behaviors are rewarded, and what actions will draw discipline. Does senior leadership give bonuses to top performers who bend the rules? Does the company actively work to protect whistleblowers? Are employees given the time and support they need to do their job effectively and ethically?

Top Management and the Behaviors of Ethical Leaders

The data provide us with a clear picture of the ideal ethical leader who consistently does the right thing and inspires others to do so as well. When we consider the behaviors that matter most in setting an ethical tone at the top, we see a selfless leader with strong character and personal fortitude as well as the ability to navigate through crisis while adhering to the company's ethics standards. The positive behaviors such ethical leaders exhibit result from consistent decisions to act in a respectful, responsible, and principled fashion.

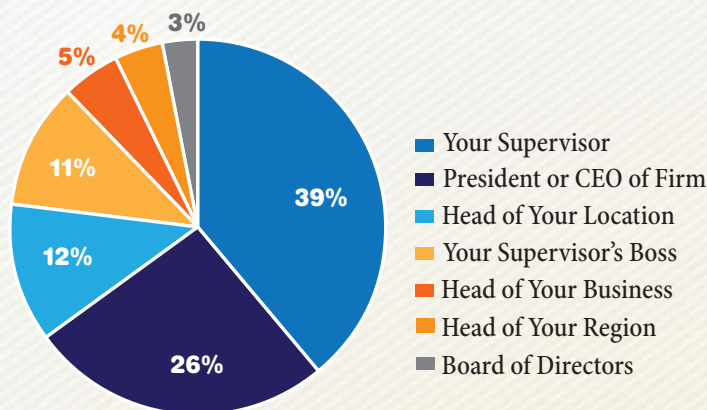
Our research identified 10 behaviors that employees look for from top management:

- Accepting blame when things go wrong, rather than blaming others;

- Sharing credit for successes;
- Doing the right thing, even if it means sacrificing profits or losing business;
- Putting the good of the company ahead of personal interests;
- Showing concern for the best interests of employees;
- Treating all employees with respect and dignity;
- Setting a good example of ethical conduct;
- Keeping promises and commitments;
- Providing employees with sufficient information about situations and decisions that affect them; and
- Holding themselves accountable for violations of ethical standards.

WHO SETS THE TONE?

ACCORDING TO EMPLOYEES, WHO IS "TOP MANAGEMENT"?



Every level of leadership makes a difference in setting the tone for employees. When talking about tone at the top, it is common to think of senior leaders – CEOs, CFOs, general counsels and other members of the executive suite.

But when it comes to modeling good behavior, keeping promises, or upholding company standards, employees' direct supervisors can be just as important as the leaders in the C-suite. In fact, when asked who they think of as senior leadership, nearly two in five people we surveyed (39 percent) pointed to their immediate supervisor. Others identified middle managers with whom they have regular contact. So, to a significant degree, our findings about senior leaders also reflect employees' thoughts about their day-to-day supervisors as well.

The behaviors and attributes of top management correspond to positive outcomes in different ways. For example, when top management gives credit to employees, employees are less likely to feel pressure to compromise ethics standards. However, employee engagement is more closely linked with top managers setting a good example of ethical conduct. The table below summarizes how positive top management behaviors and attributes correspond to desired outcomes.

Top management behaviors & attributes	CORRESPONDING POSITIVE OUTCOMES ²			
	Employees are less likely to feel pressure to compromise standards	Employees are less likely to observe misconduct	Employees are more likely to perceive environment promotes candor and is not retaliatory	Employees are more likely to be engaged and intend to stay with company
Top management gives credit to employees				
Employees believe top management is selfless ³				
Top management does NOT put self-interest above the good of the company				
Top management considers best interests of employees				
Top management does NOT blame others when things go wrong				
Top management would do the right thing, even if it meant lost business/profits				
Top management treats all employees well				
Top management sets a good example				
Top management keeps promises and commitments				
Misconduct was NOT committed by senior leader				
Employees are satisfied with info from top management				
Top management is held accountable for violating company's ethics standards				

LEGEND:

- ORANGE boxes indicate a significant positive relationship between this attribute and the corresponding ethics outcome.
- GRAY boxes indicate the attribute was included in the regression for the corresponding outcomes, but modeling did not reveal a significant positive relationship.
- WHITE boxes indicate that attribute was not included in regression modeling for the corresponding outcome because preliminary analysis revealed it was less likely to yield results.

For information about additional leadership behaviors which were included in the regression model, but not in the table because they did not have a significant, positive relationship to any of the outcomes, please contact ERC.

2. Increased reporting and decreased retaliation against whistleblowers are not included in this chart because the strength of the relationship between ethical leadership emerged from some analyses, but was unclear in others. ERC will be exploring reporting and retaliation in greater depth in an upcoming research report.

3. This was measured using an index of multiple leadership attributes.

Supervisors Can Matter as Much or More than Top Management

Discussions of leadership and tone at the top often focus on the executive suite and the board room, but other managers, especially supervisors who interact with employees every day, have a significant impact as well. Top management’s commitment to ethics won’t make a practical difference unless it’s matched by supervisors and employees throughout the company.

Our data show that employees look for many of the same attributes in direct supervisors as they do in senior leadership (and, as noted in the box on page 3, many employees think of supervisors as their senior leaders). Workers set rigorous standards when assessing supervisors’ ethical character and they view their bosses holistically – considering not just behavior at work or supervisors’ interactions with direct reports, but what kind of people employees believe they are. Even managers who treat workers fairly and with respect can fall short in

workers’ eyes if out-of-office behavior suggests they may not be truly trustworthy.

When it comes to ethical leadership three elements stand out for supervisors:

- Setting a good example of ethical conduct;
- Conducting one’s personal life in an ethical manner; and
- Being accountable for violations of ethical standards.

Employees also are influenced by whether supervisors:

- Listen to employees;
- Support employees’ efforts to uphold the company’s ethics standards;
- Keep promises and commitments; and
- Define success by how it is achieved, not just by business results.

FORMS OF MISCONDUCT COMMITTED MOST OFTEN BY SENIOR LEADERS (COMPARED TO OTHER EMPLOYEES)

SPECIFIC FORM OF MISCONDUCT	PERCENTAGE OF THIS FORM OF MISCONDUCT COMMITTED BY SENIOR LEADERS
Making improper political contributions to officials or organizations	53%
Offering anything of value (e.g., cash, gifts, entertainment) to influence a public official	41%
Improper hiring practices	39%
Lying to employees	39%
Falsifying and/or manipulating financial reporting information	36%

Although any incidence of misconduct is troubling, our analysis revealed that misconduct committed by senior leaders has a strong connection to employees’ intent to leave the company.

The behaviors and attributes of supervisors correspond to positive outcomes in different ways. For example, when supervisors set a good example of ethical conduct, their direct reports are less likely to feel pressure to compromise ethical standards. Additionally, employees are less likely to observe misconduct if they believe their supervisors can be trusted to keep promises and commitments. The table below summarizes how positive supervisor behaviors and attributes correspond to desired outcomes.

Supervisor behaviors & attributes	CORRESPONDING POSITIVE OUTCOMES ⁴			
	Employees are less likely to feel pressure to compromise standards	Employees are less likely to observe misconduct	Employees are more likely to perceive environment promotes candor and is not retaliatory	Employees are more likely to be engaged and intend to stay with company
Supervisor sets a good example				
Supervisor listens to employees				
Supervisor is held accountable for violating co. ethics standards				
Supervisor's personal life is ethical				
Misconduct was NOT committed by a first-line supervisor				
Supervisor supports employees				
Supervisor keeps promises				
Supervisor defines success by how achieved				

LEGEND:

- ORANGE boxes indicate a significant positive relationship between this attribute and the corresponding ethics outcome.
- GRAY boxes indicate the attribute was included in the regression for the corresponding outcomes, but modeling did not reveal a significant positive relationship.
- WHITE boxes indicate that attribute was not included in regression modeling for the corresponding outcome because preliminary analysis revealed it was less likely to yield results.

4. Increased reporting and decreased retaliation against whistleblowers are not included in this chart because the strength of the relationship between ethical leadership emerged from some analyses, but was unclear in others. ERC will be exploring reporting and retaliation in greater depth in an upcoming research report.

What Ethical Leadership Means for Companies

Our efforts to understand which leadership behaviors most effectively foster an ethical workplace led us to an important conclusion: the most profound impact is character. Surprisingly, being an ethical person and principled leader with strong character is far more important than deliberate and visible efforts to promote ethics.

Being an ethical person and principled leader with strong character is far more important than deliberate and visible efforts to explicitly promote ethics.

Whether they recognize it or not, every leader is continuously communicating whether ethical conduct really matters. Employees are constantly watching leaders: how they make decisions, how they treat workers at lower levels of the organization, how they handle challenges and crises, what they do to share and celebrate successes, what policies they put into place and how they enforce them, and even the way they conduct their personal life. Bottom line: companies need to think about leaders in ethics terms – because employees already are.

Bottom line: Companies “need to think about leaders in ethics terms – because employees already are.”

This last truth has some important, perhaps uncomfortable, implications. Like it or not, leaders’ personal lives can have repercussions. In a few high-profile cases, sexual affairs, ostentatious lifestyles, or other personal choices have captured headlines, caused turmoil inside companies, and cost senior leaders their jobs. Even when questionable behavior remains inside the company, our data show that employees notice and react, losing respect for leaders and,

sometimes, weakening their own commitment to their company’s stated values.

Employees take a holistic view of their leaders. Whether considering the company’s top management or their immediate supervisor, employees look to see if leaders “practice what they preach” and behave ethically outside the workplace as well as at work. When leaders practice 24-7 integrity, workers’ own commitment to ethical conduct tends to be stronger. But when there’s a disconnect between managers’ workplace behavior and their private conduct, companies’ ethical health declines.

Historically, leaders’ private lives have been viewed as beyond the company’s purview. But our findings suggest that this dichotomy may be unsustainable, especially in an age when technology is blurring the old distinctions by putting more of the “private” into the public domain. Leaders must accept that their ethical responsibilities no longer end when they leave the office. Workers are attuned to whether leaders’ commitment to ethics is integrated and pervasive, and drives their conduct both inside and outside the workplace.

When it comes to ethics, everything a leader does sets the tone.

This reality has profound implications for company decisions about hiring, retention, and promotion. For leaders themselves, it should be a reminder of how public their lives are. Effective ethical leadership has become a round-the-clock job. Not only must leaders act with integrity, but they must do so both privately and publicly. And, they must be mindful of managing expectations and perceptions in situations where their actions could be misconstrued. Whether at the head of the organization or many levels below, leaders’ behaviors are always teaching employees about ethics as a value. When it comes to ethics, leaders are always setting a tone.

Recommendations for Strengthening Ethical Leadership

Our analysis demonstrates that ethical leadership delivers significant organizational benefits by inspiring both managers and employees to do the right thing. For companies, ethical leadership begins with selecting leaders of strong character and a keen sense of right and wrong. Companies also can and should build on leaders' personal strengths by encouraging management actions and behaviors that correlate with ethical conduct by employees. ERC has identified measures that the data indicate are likely to result in a workplace with reduced misconduct and less pressure to break the rules.

1. Incorporate personal character as criteria in the company's hiring process, especially for senior executives.
2. Establish 24-7 integrity as an expectation for senior managers and make it part of annual performance reviews.
3. Educate managers about trends in technology and social media and their impact on leadership responsibilities; emphasize the blurring of traditional division between public and private activities.
4. Provide guidance to senior managers about the way employees form perceptions about and evaluate their managers.
5. Review crisis management plans and training programs to emphasize corporate values and ethical performance in the face of stress and to account for the impact of social media.
6. Encourage leaders to recognize employee contributions to organizational success and to seek honest feedback from employees about company standards and policies.
7. Annually review company business objectives, policies, and procedures to ensure that they are consistent with company values and promote ethical performance.

DATA COLLECTION & METHODOLOGY

All data used for this report was collected as part of ERC's National Business Ethics Survey[®] (NBES[®]) 2013, which captures the views of private sector workers in the United States. It provides a comprehensive look at trends in workplace ethics and compliance and also offers the most exacting longitudinal cross-sectional data about conduct at work.

In order to examine the concept of ethical leadership, ERC included several targeted questions in the NBES 2013. Many of the questions were asked of all NBES 2013 respondents, while others were given to only a randomly-selected subset of 1,200 respondents (600 of whom responded to in-depth questions about management behaviors and an additional 600 who were asked about communication vehicles employed by senior leadership). This report includes data collected from both the full set of NBES 2013 participants, as well as the subsets who answered the supplemental ethical leadership series.

ERC recognizes David A. Harrison, Linda K. Treviño, and Michael E. Brown, whose ethical leadership scale was included in the NBES 2013 question set. Also, we would like to express our gratitude to Linda K. Treviño for her contributions and feedback during the analysis and report process.

The NBES 2013 dataset reflects responses from 6,420 private sector workers. Participants were 18 years of age or older; currently employed at least 20 hours per week for their primary employer; and working for a company that employs at least two people. All participants were assured that their individual responses to survey questions would be confidential. Participants were randomly selected to attain a representative national distribution. About one-quarter of survey participants were interviewed by telephone. Of these, approximately 33 percent were interviewed over landlines and 67 percent over cell phones. The remaining three-quarters of the survey population participated through an online survey (using online panels and communities).

The survey opened September 30, 2013, and closed November 15, 2013. Survey questions and sampling methodology were established by ERC.

Data collection was managed by Survey Sampling International (SSI). The sampling error of the findings presented in this report is +/- 1.2 percent at the 95 percent confidence level. Data were weighted by age, gender, and education. Data were additionally weighted by phone type (cell/landline), survey mode (telephone/online), and organization size. The proportion of the cell phone group to the landline group in the sample was weighted to a 40/60 ratio.¹ The proportion of telephone respondents to online respondents was weighted to be equal.²

To request a detailed explanation of methodology and the methodological limitations of this report and demographic information on survey participants, please email the Ethics Resource Center at ethics@ethics.org.

1. The cell 40 / landline 60 ratio is an estimation of the proportion of working individuals living in households with cell-only service versus households with landlines.

2. The equal-weight strategy was implemented because survey results from the two groups tended to differ, and it matched the methodology used in 2011. It is part of an ongoing transition from a landline telephone-only survey to a mixed telephone/online survey, and eventually to an online-only survey. The weighting equalized the influence of each group and provided comparability to the 2011 iteration of the study.



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