

## NAVIGATING ETHICAL AND MORAL CHALLENGES LEADERS FACE IN STAKEHOLDER CAPITALISM

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### **Abstract**

*One can assume that the ethical business leader of the 21st century will need to become a leader of community in which they operate, answering to all stakeholders, guiding all stakeholders, mediating all stakeholders' concerns. A virtuous position at first glance and one leader wants to aspire to in theory but frequently fail at in practice.*

*The current paper strives to underline the need of ethical conduct at both leader and stakeholders' level and proposes the introduction of a code of ethical principles to be followed and introduced by the leader and all stakeholders in an organization. Such a code should promote a set of well-established principles to be agreed and followed by the parties involved. A five criteria set is proposed for the development of further codes of conduct, that will lead to more appropriate judgements and findings.*

**Keywords:** Leadership, Moral challenges, Ethical Decisions, Stakeholder capitalism, Sustainable Development

**JEL Classification:** A10, A13, A14, C83, D74, D81, C91, D93

### **I. INTRODUCTION**

Stakeholder capitalism is firmly replacing the cutthroat business environment that non-capitalist economies have leveraged in their narratives against western economies for decades. Enhanced by political support, investor support and Environmental Social and Governance movements dictating the flow of capital, the newfound moral and ethical characteristics of conducting business are reshaping corporations, their approach, their investments and ultimately their leadership.

Corporations and companies are expected to serve the interests of all of their stakeholders, not just shareholders. This extends ethical and moral responsibility for the leaders of these organizations to owners, employees, vendors, customers, and society. Long-term value creation is becoming nuanced, and leaders are expected to navigate a range of outcomes that far exceeds the traditional quarterly earnings reports and the success of these leaders can and are measured by achievements or lack thereof across a spectrum of areas.

Leaders are therefore faced with relentless pressure to perform against all standards. Ethical leadership is becoming indistinguishable from moral leadership. While ethics is a set of principles of right conduct, moral leadership

is ethical decision making with the right moral values. Moral leadership is defined as “a leader’s behavior that demonstrates superior virtues, self-discipline, and unselfishness” (Cheng et al., 2004, p. 91). It entails “setting an example for others about the rightness or wrongness of particular actions” (Fairholm and Fairholm, 2009, p. 132).

## **II. LITERATURE REVIEW**

The commonly accepted guidelines within which a leader was expected to act have become more complex. Leading by example in the workplace has evolved into requiring leaders to become the most inclusive, most tolerant that our society has ever seen. However, stakeholder capitalism takes the evolution of ethical and moral leadership at the very edge of unobtainability as we’ll elaborate on in this article via examples.

### **Ethical and moral leadership**

Akdogan et al. (2016) have noted that different definitions of what ethical leader means exist, but it is generally considered as the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships and the promotion of the same type of conduct to followers by double-sided communication, reinforcement and the process of decision making. An ethical leader should be a promoter of well-being.

Corporate and political scandals have accentuated the need of moral based leadership, while it is more and more recognized that organizations should ensure positive outcomes not only for the shareholders, but for all the stakeholders (Banks et al., 2021).

Ethics is often defined as "doing good" and interrelated to responsibility towards society (Ferrell et al., 2019). The role of the ethical leader goes further, by introducing the dimension of role model, underlined by Bandura (1977, 1986, quoted by Stouten et al., 2013 pp.681) through the social learning theory. This theory argues that people learn specific behavior by observing a person who is perceived as legitimate in their actions, more specifically the followers observe leaders and take their behavior as a reference. More than this, leaders serve not only as models, but as barometers that allow the followers to calibrate their own behavior and reaction in front of unethical situations.

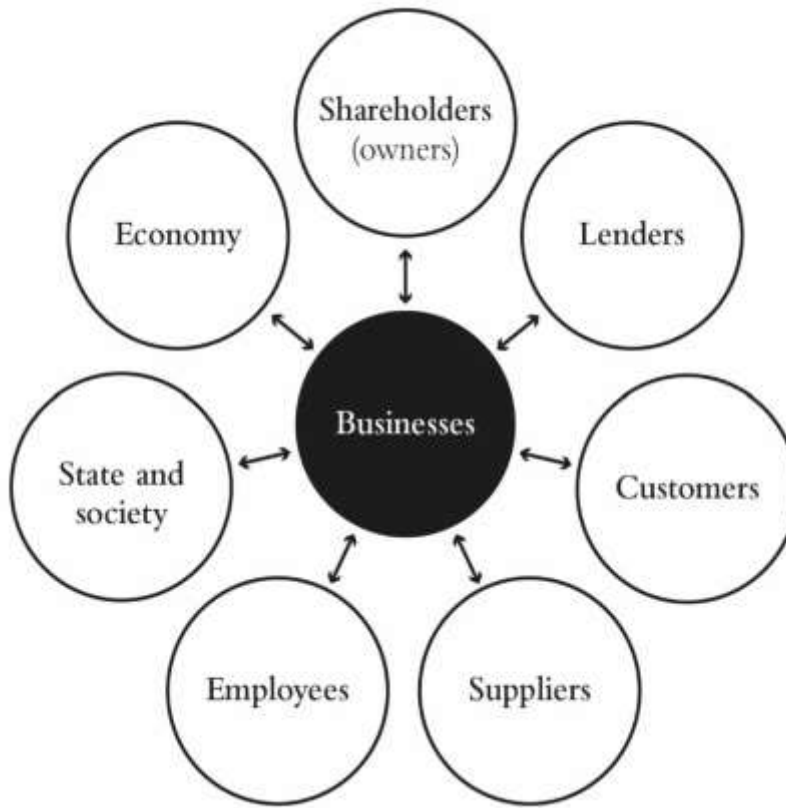
Ethical leadership has been linked to important follower attitudes and behaviors beyond ethics, such as: job satisfaction, voice behavior, personal initiative, trust in leader, organizational commitment, work engagement, in-role performance, work withdrawal behaviors, deviant behaviors, employee emotions or OCBs (drawn from previous literature by Velez et al., 2018).

Dust et al. (2018) have shown that employees who work for leaders engaging in ethical leadership are confident in their capacities and perceive high level of meaning, impact and control over their work. The accent on psychological empowerment provides the motivational drive and antecedent of success.

Moreover, Walumbwa et al. (2017) have noted that employees that are treated ethically may be more apt to behave in a manner that is beneficial to the group’s long-term development and success by taking part in group learning. While Chen et al. (2016) have underlined that voice behavior, which includes expressing viewpoints inconsistent with the status and willingness to report relevant problems is specific to employees that discern inappropriate or unethical actions, and they tend to express their opinions or ideas when they perceive the encouragement demonstrated by ethical leaders.

Apart from this, ethical leaders are willing to insure a healthy, safe and fair working environment for their workers as they are morally inclined to provide safe products and services for their customers to offer organizational legitimacy that afford business sustainability (Lin et al., 2020).

Related to those individuals that practice ethical leadership, they are highly connected to principled decision, honesty, trustworthiness, caring and fairness. (Brown et al., 2006). They also possess personal traits consistent with normative ethical principles, such as integrity and concern for others.



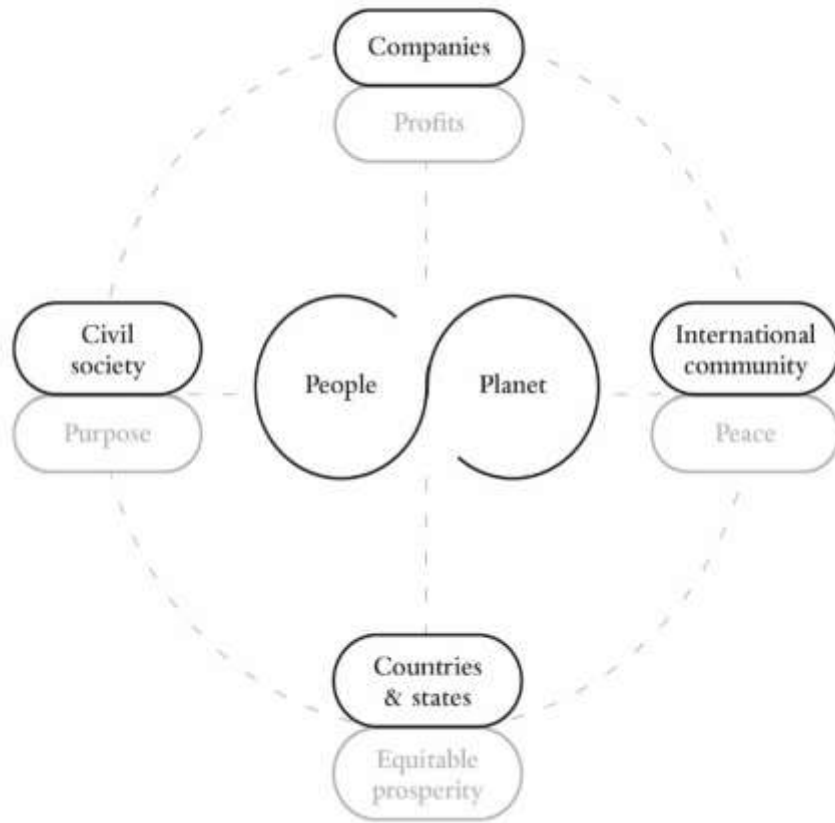
**Figure 1. Modern Company Management in Mechanical Engineering (Schwab, 1971)**

The stakeholder concept goes back more than 50 years ago, when it referred to anyone who was important for the successful outcomes of the company, take in academic literature in 1971 when Klaus Schwab visualized in his book “Modern Company Management in Mechanical Engineering for the “constellation” of parties of interests (Figure 1).

Applied in various forms in modern democracies, came in contradiction with the Milton Friedman (1970) firstly mentioned the “shareholder primacy”, were profits for them was the main goal, an increasingly powerful concept at that time as the globalization was growing and the short-term.

Contrary, the stakeholder capitalism raises the preoccupation for long-term value creation, equally for the company and all its interest’s parties, including society at large, in synergy both in good and bad times, having at center the Planet and the People, and later adding the Purpose (Rupert Younger, McKinsey, 2020) while keeping the Profit.

Nowadays we realize more than ever after 2020’s pandemic and 2021’s war ignition between Ukraine-Russia and all the consequences that followed on multiple crisis raised (e.g.: energy, inflation) added to the existing ones (e.g. demographics) should reshape the stakeholders’ goals for Profits, Purpose, Prosperity and Peace (Schwab and Vanham, 2021), a claim for consensus to pay attention for all, from governments (prosperity), civil society (purpose), companies (profits and long-term value creation) and international community (peace) as shown in Figure 2.



**Figure 2. *The Global Stakeholder Model***  
 (“Stakeholder Capitalism”, Klaus Schwab and Peter Vanham, Wiley 2021)

The updated stakeholder capitalism it’s about eliminating the rising income inequalities in countries where the economies’ progress decreased, to increase the impact of innovation and thus productivity gains while diminishing the big corporates monopole and mitigate the short-term gains of natural resources exploitation.

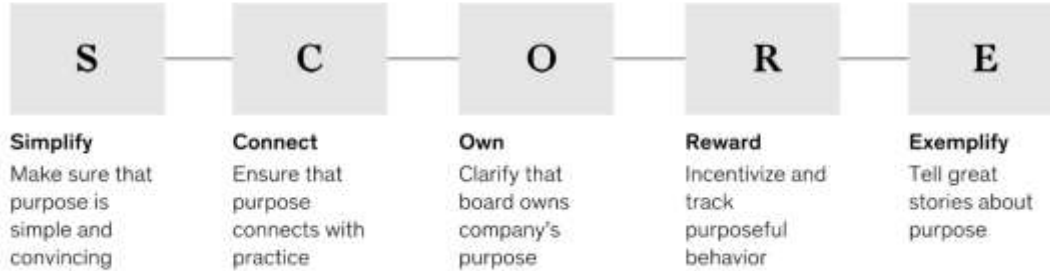
The authors (Schwab and Vanham, 2021) propose a analysis of countries reaction to external powers, a review of the social contract and plans for future generations, and new economic type of measure.

A method to achieve all the above is offered by McKinsey (2020) as shown in Figure 3, the SCORE Model issue by the Enacting Purpose Initiative that assists top leaders to address the right questions and then to draw a relevant roadmap that fuels the business changes, with an improvement trajectory.

Leaders should look at the materiality and the values at stake, at the focus of measure to be taken when addressing the sustainability at company, sectorial level, that impacts all internal and external stakeholders.

**Boards can adopt the SCORE framework to link purpose to actions and outcomes.**

**SCORE framework**



Source: Enacting purpose within the modern corporation: A framework for boards of directors, Enacting Purpose Initiative, 2020

**Figure 3. SCORE framework (McKinsey, 2020)**

**Challenges of ethical leaders in stakeholder capitalism**

In the 21<sup>st</sup> century, the assumption of the ethical business leader is that he or she will need to become a leader of their entire community in which they will operate, promptly answer to all stakeholders, guide all stakeholders and mediate all stakeholders' concerns. A virtuous position at first glance and one leader wants to aspire to in theory but frequently fail at in practice. It is what has led to ever more complex, all-encompassing mission statements being issued by companies who aspire to being pillars of the community, of the economy, of innovation while serving their shareholder and employee bases simultaneously. At the same time leaders of these organizations need to manage the conflicts of interest between these stakeholders.

Examples of conflicting stakeholder interests are becoming more relevant during times of economic turmoil. The leaders of basic material producing companies can benefit, even speculate during times of major shortages and disruptions to supply chains as has been a frequent accusation during the 2022 shortages of petroleum products. A CEO is faced with the choice of investing in additional production, therefore contributing to drops in prices and possibly impacting their own company's profits down the line or can maintain a disciplined, even restrictive stance and contribute to maintaining high profit margins which can be used to strengthen the balance sheet of the company they are leading. The former approach serves society and those impacted by high costs of daily life directly and indirectly, given that increased energy costs lead to increases in all goods and services. The latter serves the shareholders and likely the employees of the company, providing increased income, a less leveraged balance sheet and better job security, possibly better working conditions. The hypothetical leader in our example is faced with a binary choice (yes or no) that he or she must navigate and add nuance to. Their ethical and moral integrity will eventually be questioned by one stakeholder group.

In stakeholder capitalism, assessing whether a leader is ethical becomes a factor of the observer. It will be rare that all stakeholder's views on whether a leader's choices are ethical, or morally aligned. While striving to adhere to ethical and moral obligations towards a stakeholder group, a leader may fail another, at times their actions can be filtered through conflicting viewpoints within the same stakeholder group. A struggling manufacturing plant owner may choose to reduce the workforce at his company to save the business. That decision may be cheered by shareholders but not the community or workforce however this too is nuanced. Those who remain employed may remain employed because of the business surviving, those who have been terminated may no longer be able to afford to live in the same community. The community may continue to prosper or at least survive because of the decision. However, different elements of the community will view the decision as morally right or wrong depending on how it affects them.

Avoiding conflict of interest sits at the very top of ethical leadership. However, that is frequently viewed as personal conflict of interest. The ethical and moral leader of stakeholder capitalism must navigate the conflict of interest amongst their stakeholder groups, some of which are on opposing sides.

The current paper strives to underline the need of ethical conduct at both leader and stakeholders' level and proposes the introduction of a code of ethical principles to be followed and introduced by the leader and all stakeholders in an organization. Such a code should promote a set of well-established principles to be agreed and followed by the parties involved.

### III. DISCUSSIONS

The authors started the article with a critical analysis of the existing worldwide relevant literature in the field. Having in mind the relatively few empirical data, together with the descriptive character of the paper, the authors focus on a qualitative analysis. Consequently, the main research tool focus on drawing upon recent literature to highlight the influence of corporate code of conducts and widely accepted moral and ethical values to the new generation of leaders who need to not only follow the interests of the shareholders, but also the ones of their stakeholders.

The keywords used were “leadership”, “moral challenges” “ethical decisions”, “stakeholders’ capitalism” and “sustainable development”. The abstracts were read, and we focused on those papers that were directly showing characteristics or impacts of the evolution of stakeholder capitalism and its influence on leadership style resulting in a total of 15 articles.

Furthermore, the authors categorized the information gathered in the number of articles explained in a research method chosen for its usefulness for seeking to develop a hypothesis. By addressing the concept of stakeholders’ capitalism and its influence to the new leadership style, the articles highlight the impact of moral values, ethical decisions, sustainable development to the adoption of a new set of rules which should be validated by a larger spectrum. The new leadership style helps not only to produce added value to business, but also to satisfy the interest of stakeholders and to represent a gain for the entire society as a whole.

The second hypothesis points out that following the new leadership style, the companies, and their people can produce even more because they are part of a win – win scenario.

Therefore, it will be possible to build future case studies relevant to the impact of stakeholder capitalism and new leadership style on a sustainable economy.

Finally, the authors will present their own observations and conclusions regarding the contextualization of the proposed 5 criteria to validate the ethical leader’s behavior.

Ethical leaders are expected to be virtuous, fair, and trustworthy, knowing how to effectively communicate the importance of right and correct choices and behaviors, becoming themselves credible and positive sources to model behaviors at work (Ahmad, 2018).

An ethical leader will firstly be expected to adhere to a generally accepted code of conduct which governs the norms and practices of their ongoing activity. An ethical leader in the stakeholder economy must informally build a code of conduct as it applies to their stakeholder, define the principles by which they’ll lead and act and telegraph these to their stakeholders. As needed, they’ll need to understand the conflicts of interest between stakeholders and build a strategy around those.

Although basic principles that apply to ethical leaders have been identified within the existing literature (as reviewed above, in the Literature review section), no specific conduct has been promoted in order to ensure that a leader’s behavior is “ethical”. One reason could be the subjectivity of the term and the well accepted, but very wide definition of “doing good” that the ethical leader adheres to.

The “normative appropriate” (Akdogan et al., 2016) sense should be complemented with specific requirements that imply mandatory attention to social responsibility, future sustainability, and people empowerment. The reason for such a need is the fact that both an individual and a company can act in a “normative appropriate” way, but at the same time in an unethical or unfair manner.

Assessing whether a leader is ethical or not shouldn’t be only a subjective act that allows the viewer to decide through their own lens, but a requirement that touches specific criteria and can be well explained through numbers and argumentation.

The authors propose a set of 5 criteria that such a code of conduct should contain the following:

1. The ethical leader should be involved in actions that ensure that in-group sustainability doesn’t hinder or promotes out-group sustainability.
2. The ethical leader should ensure involvement and positive outcome through social responsibility initiatives that promote well-being.
3. The ethical leader should promote a safe and positive working environment that fosters communication, growth, and self-expression.
4. The ethical leader should ensure fairness and equality of chances within the organization.

5. The ethical leader should act in a transparent, correct, and normative appropriate manner.

Specific criteria and measurements should be defined in order to cover the above conduct principles. The data should be filled in annually by the company's leader, as well as the stakeholders and the outcomes to be made public, in order to transparently showcase the organizational stakeholders, as well as the company in its own morality.

In stakeholder capitalism era, a leader cannot afford to be only reactive, they need to anticipate how a decision reverberates across the groups and what implications and consequences that may have. Stakeholders wield more influence than even three decades ago and stakeholder groups will seek (and often obtain) the power to prioritize their agenda via the mechanisms of traditional capitalism. Activism in the 21st century is conducted in the boardroom more often than in the past, stakeholder groups have successfully obtained seats on the board of multiple publicly traded companies. Therefore, leaders that are labeled as unethical or immoral by one stakeholder group, while praised and supported by another, may find themselves facing repercussions that traditional capitalism has spared the leaders of the past.

It is therefore critical that leaders become mindful of the lenses through which their ethical and moral standing is being viewed and build their own code of conduct that seeks to align with the expectations of modern society.

#### **IV. CONCLUSION - WHAT HAPPENS WHEN LEADERSHIP FAILS?**

Through the conducted research, we have validated several hypotheses regarding the new ethical leadership style and consequently a set of five principles was proposed.

The first hypothesis regards the sustainable benefits of ethical leadership acting to all existing internal and external stakeholders in the value chain of each business, when exceeding the shareholders' primary interests. The second hypothesis reflects the business value added produced when ethical leaders are interested in their employees' well-being. The third hypothesis regards the positive impact in the community when ethical leaders care about societal impact of their company's activity. Fourthly, by simply being a role model, they informally and involuntarily implement a code of conduct among employees and stakeholders that could mark a desirable business and societal behavior in time.

The leaders' responsibilities are being enhanced in a changing world that is continuously complexifying. Ethical leadership contributes to unfortunate and undesired events' prevention, although it cannot completely avoid mistakes, ethical dilemmas. It is a fiduciary duty of an ethical leader not only to be at the level of stakeholders' expectations, but also to develop ethical and moral succession, caring for employees, customers, suppliers, community, building a positive ethical culture that last on long-term.

As the ethical leadership style includes subjective appreciations, a kit of principles is useful for assessments' objectivizing. Thus, a five criteria set is proposed for the development of further codes of conduct, that will lead to more appropriate judgements. Accordingly, an ethical leader must promote sustainability, consider social responsibility through actions in this direction, ensure a safe and productive work environment, act transparently and ensure equal opportunities within the organization. The above-mentioned principles can only be evaluated if specific and measurable criteria are established, which can be checked, evaluated, and published at the disposal of all interested parties.

The present research has several limitations, that can be addressed further by quantitative and qualitative studies, for example, by specific research on industries that have their own specificities, by type of dilemmas that may reveal various issues to be argued or by type of populations or cultures.

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