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Leading ethically

The harshness of the current economic downturn struck home recently when a friend told me the story of how her brother had just lost his business. During the 70s he had identified a niche in the fine-china market and over the last thirty years had successfully supplied larger firms with unique and short-run items. Five years ago he took out a rather large bank loan in order to finance his company's expansion.

Although Zack had reliably met the terms of the loan, at the beginning of the year the bank called in the full outstanding balance. The money could only be raised by selling his business to a larger conglomerate, which proceeded to fire his fifty staff members. Zack himself was given a managerial job in the new firm's head office, which means he now commutes into London daily, rather than enjoying the benefits of walking to work and running the company he had established and developed over the last three decades.

Of course Zack counts himself as one of the lucky ones, says my friend. At least he has a job (for the time being anyway). However, he still resents the fact that he did not lose his business as a result of his own poor management or even due to the cyclical fluctuations of the market. Instead, its demise was due to banking practices outside of his control or influence. He cannot even lay the blame on one 'evil banker' which makes the situation somehow even more frustrating. Instead, the 'system' was at fault, as suggested by Lord Turner's quote (below).

If the 'system' is at fault, is it the people within the system who are to blame? Is there something bankers and senior leaders of the financial industry could

have done differently which would have avoided so many people losing their homes and jobs? The financial crisis has led to many individuals throughout the world, innocent of any wrongdoing, to experience the pain of bankruptcy and the psychological pain that goes with it. Would things have been different had leaders of the financial industries acted ethically?

You may wonder what 'ethics' has to do with the current financial crisis. As much as we might like to blame individuals like the former Chief Executive of the Royal Bank of Scotland Sir Fred Goodwin, surely he and individuals like him, are not to blame for everything that has happened? That depends on how you think of 'ethics' and the responsibilities inherent in carrying the mantle of 'leader'.

"With hindsight, the FSA, like other authorities throughout the world, was focused too much on individual institutions, and the processes and procedures within them, and not adequately focused on the totality of the systemic risks across the whole system."

FSA Chairman Lord Turner, February 2009

The current crisis points out that leading 'ethically' may not be a question of just not committing unethical acts. Most of us would agree that falsifying documents, using others' money for personal gain or lying to shareholders constitutes unethical behaviour. Leading ethically requires leaders to go beyond making correct judgements based on obvious, readily available data. Due to the consequences resulting from their decisions, leaders have an extra responsibility to consider how those decisions might impact on others. This requires a proactive approach to the practice of ethics, rather than just a responsive one. Before pursuing these ideas further, it is important to clarify what I mean by 'ethics'.

Leadership and ethics

I am using the term 'ethics' to refer to those principles of human interaction which guide the way we relate to one another. The need for ethical standards occurs because there is often tension between what is good or beneficial for me, and what is good or beneficial for you. For instance, I may deeply desire your new silver leather-upholstered Aston Martin and owning it might greatly enhance my life. I would feel better about myself if I were driving it rather than my Smart Car. Discreetly lifting its keys from your jacket pocket and driving off with it would distinctly benefit me. However, taking your car would not be beneficial for you. In most cultures (but possibly not all) taking someone else's car as your own would be considered ethically incorrect. Although we would both benefit by owning the car, the fact that you have paid for it with your own money, or have been given it as a gift, means that your claim to its benefits outweigh mine.

Taking ethical action can be relatively straightforward when faced with options which are plainly 'right' or 'wrong'. The question of whether or not one should steal money from a till has a clear answer.

However, decisional clarity becomes less clear-cut when considering dilemmas like how much risk to expose other people's money to? The ethical duty of a financier is to invest clients' funds in ways that will produce the largest return. Yet doing so is inherently risky. In such a situation, when does being ethically entrepreneurial cross the boundary into unethical recklessness?

This is the question at the heart of the ethical dimension of the current economic crisis. Most people would agree that behaving recklessly with other people's money is unethical. However, how might the line between enterprise and recklessness be determined? A starting point is to develop the ability to 'perceive correctly'.

Perceiving correctly

To take sound ethical action by 'perceiving correctly' is a more complicated process than just being able to see what is apparently going on in any given circumstance. It also requires the ability to recognise the most pressing ethical demand among conflicting priorities. Creative accounting practices might fulfil the ethical virtue of 'exemplary customer service' in terms of producing the greatest return on investments. However, when such practices border on illegalities, the more important ethical requirement has not been spotted. Not being able to detect that adhering to the spirit, as well as the letter of the law is more important than maximising profits could be one example of dubious ethical shrewdness at play within the banking sector.

Identifying the most significant ethical standard is not always easy. Correct perception is often difficult because the way we see and interpret situations is affected by the context we are in, our own predispositions and pressures we might be under.

For instance, organisational cultures create norms which define business targets. In many of the financial institutions at the centre of the economic meltdown, cultures regularly rewarded individuals for their ingenuity in creating wealth. It is not surprising then that innovative, rather than prudent practices became the dominant standard people paid attention to. Standing outside this norm and acting on the basis of caution rather than creativity could easily have been interpreted as 'poor performance' within such an organisational context. Therefore just recognising the ethically correct action to pursue is not sufficient; one must also exercise courage in acting on that perception and making it known to others.

Perceiving what you don't want to perceive

Appreciating the most important ethical feature of a situation is not the only ingredient of perceiving correctly. Being able to notice signals that things are not going so well is also essential which often involves looking for signs and signals that one might not want to notice.

For instance, in his recent book *'House of cards: a tale of hubris and wretched excess on Wall Street'*, William Cohan argues that signals of the impending crash were apparent in the financial system as early as 2005 for those inclined to notice them. In particular, the implications from the Bear Stearns crash were never examined because no one wanted to see what they revealed. Being alert to such soft signals often requires actively looking for them. This is especially challenging as humans' natural inclination seems to be to look for and perceive things we want to see (such as an ever-rising stock market), rather than signs of impending troubles. Perceiving correctly requires noticing such indicators, even when their messages are unpalatable. However, the difficulty does not stop there.



Perceiving what is not there, as well as what is

A third aspect of perceiving correctly involves seeing what is not there, as much as seeing what is there. This includes the ability to anticipate the impact of the ways in which different parts of a system might interact, and the possible downsides of these interactions. The critical nature of this capability is evident when you consider how regulatory authorities around the world failed to recognise the 'risky manner' which the banking system had developed in recent years. The Financial Services Authority (FSA) based its judgments on examination of individual banking practices, rather than considering what it meant collectively for the larger banking system. This illustrates the fact that although individual acts may not pose ethical difficulties, in combination with other people's actions, scenarios might be created which have significant ethical consequences.

A second aspect of perceiving what is not there involves engaging the 'moral imagination'. The business ethicist Edwin Hartman argues that developing the capacity to imagine the possible consequences of acts and how they could impact on others is a key capability of ethical leaders. This is perhaps the most challenging aspect of perceiving correctly – the ability to exercise foresight about the impact of personal actions on people that you do not interact with or know. Bankers' inability to imagine the potential consequences of their actions for small business owners, like Zack, demonstrates how a failure of moral imagination can have disastrous (and unintended) effects on others.



Engaging foresight rather than hindsight

Undoubtedly, 'perceiving correctly' is most easily accomplished with the benefit of hindsight. However, mobilising others into new and unknown territories is the very point of leadership. Inherently then, leading requires the exercise of perceptual imagination – being able to sense the most promising markets or to have a view of how a competitor might react to product innovations. Leading ethically requires the additional perceptual skill of being able to imagine how decisions might adversely affect others, rather than just assuming that holding good intentions will alleviate negative consequences.

This is especially important because organisational systems and cultures can often obscure individuals' ethical responsibilities. There is no one, 'evil banker' culpable for the current crisis. Had leaders of the financial industry exercised proactive moral perception, Zack might still be walking to work at the company he had created and loved. ^[MF]

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