

Ethical Leadership and Its Relationship with Organizational Performance: Organizational Trust as a Mediator

ABSTRACT

This article examines the influence of ethical leadership (based on leaders and followers reports) and their impact on organizational performance. It also examines organizational trust and its role as a mediator in ethical leadership and its performance using partial least square (PLS-SEM) analysis.. The findings show that ethical leadership (leaders and followers reports) can predict 17.6% of organizational trust while ethical leadership and organizational trust can predict organizational performance by as much as 20.4%. In addition, organizational trust is seen to act as a full mediation between ethical leadership and organizational performance (leaders' reports) and as a partial mediation in the case of ethical leadership based on followers' reports. This research can contribute to the development of a leadership profile especially for the civil service in Malaysia.

Keywords: Ethical leadership, organizational trust, organizational performance, PLS-SEM

1. Introduction

Effective leadership is critical as it can enhance organizational and employee performance. On the other hand, weak leadership and management can negatively impact financial bottom-lines and contribute to organizational failure. It has been found that 56% of organizational breakdowns can be attributed to weak leadership (Wilton, Woodman, Rudiger, Pardey, & Tamkin, 2012). From a moral perspective, unethical leaders will have a negative impact on individuals under their supervision (Hogan & Kaiser, 2005). This is because leadership attributes contribute almost 25% towards an employee's level of productivity, motivation, energy, competency, and commitment in the workplace (Holloway, 2012; Kouzes & Posner, 2012). However, ethics-related issues are not exclusive to the corporate world as they transgress groups and individual.

In the context of the Malaysian civil service, unethical leadership and management practices have given rise to various issues relating to corruption, misconduct, and an increase in the number of client complaints. In addition to practical issues such as malpractice and non-compliance, the theoretical aspects of leadership, which are a relatively new area, need to be investigated (Brown & Treviño, 2006; Stouten, Van Dijke & De Cremer, 2012). Also, there is a need to assess all the predictors of ethical leadership on organizational performance from different sources (Walumbwa et al., 2011). Jordan, Brown, Trevino and Finkelstein (2011) and Mayer (2012) also point out that studies related to such predictors are limited and need to be further undertaken as the concept of what constitutes ethical leadership is still unclear.

There is also a need to focus on potential mediators that can influence ethical leadership (Kalshoven, Den Hartog & De Hoogh, 2011). In this context, trust will serve as a potential mediator as it is a core aspect of leadership (Solomon 2004) and one of the elements that affects the relationship between leaders and followers, and the quality, performance, efficiency, and effectiveness of the organization (Rezaei, Salehi, Shafiei & Sabet, 2012)

Research on the impact of ethical leadership on organizational performance is still limited compared to that on the influence of organizational leaders and environments (Yukl, 2013). As such, it is important to focus on

the elements of organizational performance in ethical leadership studies. As Packard (2009), Mayer (2012), and Sheraz et al. (2012) note, there is a need for a more in-depth investigation on the relationship between ethical leadership and leadership and organizational performance. Accordingly, the main objective of this study is to examine the influence of ethical leadership (leaders and followers) on organizational trust and organizational performance.

2. Background

Researchers have provided various definitions of ethical leadership. According to Treviño et al. (2000) ethical leadership requires a leader to build a reputation as an ethical person in the public (employee) view while Kanungo (2001) states that it involves acts and behaviours that generate benefits while not harming others.

Some well-known contemporary theories on leadership in the literature place strong emphasis on ethical leadership. They include transforming leadership, servant leadership, and charismatic leadership (Yukl, 2013). In addition, the studies note that the theories on the authoritative, transformational, and spiritual styles of leadership are closely related to ethical leadership theory especially in the moral dimensions (Brown & Treviño, 2006). However, the researchers found that the ethical leadership model presented by Brown et al. (2005) provides strong basis for a more comprehensive study on ethical leadership as most of the follow-up studies on such leadership apply the concepts and definitions proposed by them such as Northouse (2010), De Hoogh and Den Hartog (2008), Kalshoven et al. (2011), and Yukl, Mahsud, Hassan and Prussia (2011). As such, this study will also use the definition by Brown et al. (2005) that is, “the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships and the promotion of such conduct to followers through two-way communication, reinforcement and decision making”.

Organizational trust involves an overall assessment by employees as to the extent to which an organization can be trusted (Tan & Tan, 2000). It also refers to the level of trust among individuals, groups, or organizations that will create organizational preparedness based on cultural and behavioural communications in relationships and transactions (Shockley-Zalabak et al., 2000). In the context of organizations, low levels of trust result in a lack of discipline at work and open communications, and weak relationships within the entity. Employees will also avoid expressing ideas as they fear failure (Gopinath & Becker, 2000). In addition, the level of trust in an organization can determine its characteristics as well as influence its structure, control mechanisms, employee job satisfaction, work design, commitment, communication, and the behaviour of its members (Zeffane & Connell, 2003).

The domain and organizational performance concept can only be specified when it is linked to the organization's effective constructs. Richard, Devinney, Timothy, Yip, and Johnson (2009) and Hamann et al. (2013) note that the construct of an organization's effectiveness includes its performance and various internal achievements usually associated with more effective or efficient operations. Whereas Poister, Aristigueta, and Hall (2015) state that overall performance is synonymous with productivity. At the macro level, it is a composite of efficiency, effectiveness, and cost-effectiveness of the organization's delivery services while, at the micro level, it refers to factors or inputs that affect productivity or yield.

3. Methodology

3.1 Participant Profile

The sample for this study comprised public service officers in Malaysia (officers and their subordinates) in ministries and state governments. A total of 220 superior staff officers were senior and upper-level civil servants and had served for two years and more. Officers included those from management and professional levels and in top management while 456 were support staff and management and professional officers.

3.2 Sampling Procedures

The research design employed a cross sectional survey using a questionnaire as a test tool for obtaining data from respondents. The sample selection from the ministries and state government offices used stratified random sampling.

This study used three endogenous variables to obtain 80% statistical power to identify an R^2 value of at least 0.10 (with a probability of 5% error) thus requiring at least 124 samples (Hair, Hult, Ringle, & Sarstedt, 2014). A total of 220 officers (leaders) and 456 subordinates (followers) are involved in this study.

3.3 Instruments

This study employed the *Ethical Leadership at Work* questionnaire (ELW) by Kalshoven et al. (2011) and the organization trust from the Organizational Trust Index or OTI (Shockley-Zalabak, Ellis, & Cesaria, 1999). The organizational performance in this study adapted two instruments: (a) organizational performance perception by Delaney and Huselid (1996), and (b) the public sector agencies' star rating report (Malaysian Administrative Modernization and Management Planning Unit 2012).

3.4 Data Analysis

The data for this study was analyzed using the IBM SPSS Statistic Version 21 and Structural Equation Modeling (SEM) using SmartPLS version 2.0 (Ringle, Wende & Will 2005). The SEM analysis was divided into two stages: (a) a measurement model involving an assessment of the validity and reliability of the item, and (b) a structural model that included an assessment of the relationship between the latent constructs. In general, this validation aimed to determine whether the measurement and structural model met the quality criteria of empirical studies (Urbach & Ahlemann, 2010; Ramayah, 2014). To measure intermediate values, this study used the intermediate analysis procedures in PLS-SEM, and the Variance Accounted For (VAF) formula by Hair, Hult, Ringle, and Sarstedt (2014).

4. Results

The SEM analysis was divided into two stages: (a) a measurement model involving an assessment of the validity and reliability of the item, and (b) a structural model which included an assessment of the relationship between the hidden constructs. Based on previous studies and according to Ramayah (2014), the measurement model needs to examine both convergent and discriminant validity.

4.1.1 Measurement Model: Convergent Validity

Factor loading, Composite Reliability (CR) or the consistency of internal reliability and average variance Extracted-AVE, can be used to access the validity of the focus by taking into account the following conditions i.e., weighted values > 0.7 , $CR > 0.7$, and $AVE > 0.5$ (Hair, Sarstedt, Hopkins, & Kuppelwieser, 2014). The values are described in Table 1.

Table 1 Weighted factor loadings, average variance extracted and composite reliability for the study variables

| | No of Items | Loadings | Average Variance Extracted (AVE) | Composite Reliability (CR) |
|--|-------------|--------------|----------------------------------|----------------------------|
| Ethical leadership (Leaders' Report) | 27 | 0.70 to 0.84 | between 0.52 to 0.67 | between 0.75 to 0.85 |
| Ethical leadership (Followers' Report) | 29 | 0.64 to 0.86 | between 0.52 to 0.64 | between 0.76 to 0.88 |

| | | | | |
|----------------------------|----|---------------|----------------------|----------------------|
| Organizational Trust | 29 | 0.63 to 0.88 | between 0.53 to 0.63 | between 0.82 to 0.90 |
| Organizational Performance | 9 | 0.64 to 0.824 | 0.600 | 0.84 |

4.1.2 Measurement Model: Discriminant Validity

The verification of discrimination requires the value of AVE for each latent variable to be higher than the variable coefficient with other latent variables (Hair, Hult, Ringle, & Sarstedt, 2014). The value of AVE and the correlation between variables is explained in Table 2.

Table 2 The AVE discriminant validity value for each study variable

| Research variables | ELLR | ELFR | OT | OP |
|---|--------------|--------------|--------------|--------------|
| Ethical Leadership (Leaders' Report-ELLR) | 0.590 | | | |
| Ethical Leadership (Leaders' Report-ELFR) | 0.099 | 0.562 | | |
| Organizational Trust (OT) | 0.406 | 0.148 | 0.662 | |
| Organizational Performance (OP) | 0.199 | 0.099 | 0.449 | 0.761 |

Note: Bold diagonal represents the square root of the AVE value while the non-bold value represents the correlation

4.2.1 Structural Model: Coefficient of determination R^2

The R^2 value refers to the total variance of the dependent variable described by the fixed variable. A larger R^2 value increases the predictability of a structural model. This study used the Smart-PLS algorithm to determine the value of R^2 while the bootstrapping function was applied to generate t statistical values. This study generated 500 bootstrapping items from the 220 samples, and the results of the structural model are described in Fig. 1.

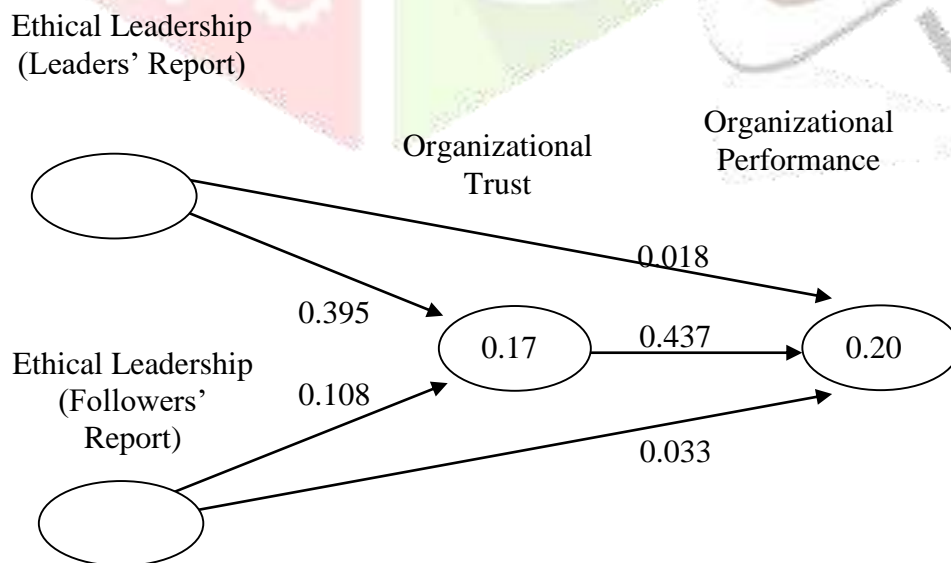


Figure 1 Framework and results of the structural model of the study

4.2.2 Structural Model: Path Coefficient

In each structural model, each latent variable is capable of relating to and being explained in the study's hypothesis. It is also able to provide accurate results for each hypothesis and explain the strength of a relationship between the independent and fixed variables.

Table 3 Path coefficient, t-value, and significance level of each

| | Variable | Path coefficient(β) | t-value | Significance level |
|---|---|-----------------------------|---------|--------------------|
| Organizational Performance ($R^2=0.204$) | ← Ethical Leadership (Leaders' Report) | 0.081 | 1.176 | $P>0.05$ |
| | ← Ethical Leadership (Followers' Report) | 0.033 | 2.302 | $P<0.05$ |
| Organizational Trust ($R^2=0.176$) | ← Organizational Trust | 0.437 | 25.783 | $P<0.05$ |
| | ← Ethical Leadership (Leaders' Report) | 0.395 | 26.961 | $P<0.05$ |
| | ← Ethical Leadership (Followers' Report) | 0.108 | 9.837 | $P<0.05$ |

An evaluation of the structural model (R^2 determination coefficient) found that ethical leadership (leaders and followers reports) and organizational trust explained 20.4% of organizational performance. For the coefficients, ethical leadership (leaders' report) had no significant relationship to organizational performance with a value of β 0.08, $t = 1.176$, and $P > 0.05$ while it (followers' report) had a significant relationship to organizational performance at β 0.33, $t = 2.302$, and $P < 0.05$. Organizational trust was also found to have significant relationships with organizational performance at β 0.44, $t = 25.783$, and $P < 0.05$.

Ethical leadership (leaders and followers reports) is also able to explain 17.6% of organizational trust. For the coefficients, ethical leadership had a significant relationship to organizational trust with values of β 0.40, $t = 26.961$, and $P < 0.05$ (leaders' report) and β 0.11, $t = 9.837$, and $P < 0.05$ (followers' report).

4.3 Mediating Analysis

The VAF formula = $(P12 \times P23) / ((P12 \times P23) + (P13))$ was applied to determine whether organizational trust variables could act as an intermediary between ethical leadership and organizational performance. The leader

reports showed that organizational trust had a VAF > 91% value indicating that it acts as a full mediator between ethical leadership and organizational performance. The computations are as follows:

$$P_{12} = 0.395, P_{13} = 0.018, P_{23} = 0.437$$

$$(0.395 \times 0.437) / ((0.395 \times 0.437) + 0.018)$$

$$\text{VAF} = 0.91 \text{ (91\%)}$$

For the followers report, the structural models using followers' reports found that the intermediate variables i.e., organizational trust had a VAF value of 59% indicating that they act as partial mediators between ethical leadership and organizational performance. The computations are as follows:

$$P_{12} = 0.108, P_{13} = 0.033, P_{23} = 0.437$$

$$(0.108 \times 0.437) / ((0.108 \times 0.437) + 0.033)$$

$$\text{VAF} = 0.59 \text{ (59\%)}$$

5. Discussion

Most studies on value based leadership perspective are based on authoritative, transformational, and spiritual theories as it is closely related to the theory of ethical leadership especially in the moral dimensions. In this regard, there is a need to examine Brown's perspective on ethical leadership as a basis for discussing and reviewing such leadership issues. Further, no comprehensive study has been conducted to-date on the contributory factors and effects of ethical leadership in Malaysia. The variables representing the situational elements and the criteria for success should also be explored as such studies are still limited in Malaysia.

In the context of the civil service, the elements of leadership are among the priorities and this is reflected in the first strategic thrust of the Malaysia Public Service Transformation Framework (KKTPA). Thus, there is a need to conduct this leadership study in the current context as it will aid the implementation of the KKTPA and, over the long run, promote the development of leadership theory especially in the context of the public service.

References

- Brown, M.E. & Treviño, L.K. (2006). Ethical leadership: a review and future directions. *The Leadership Quarterly* 17(6): 595–616.
- Brown, M. E., Trevino, L. K., & Harrison, D. A. (2005). Ethical leadership: A social learning perspective for construct development and testing. *Organizational Behavior and Human Decision Processes*, <http://doi:10.1016/j.obhdp.2005.03.002>
- Brown, M.E., Treviño, L.K. & Harrison, D.A. (2005). Ethical leadership: a social learning perspective for construct development and testing. *Organizational Behavior and Human Decision Processes*, 97(2), 117-134.
- De Hoogh, A.H. & Den Hartog, D.N. (2008). Ethical and despotic leadership, relationships with leader's social responsibility, top management team effectiveness and subordinates' optimism: a multi-method study. *The Leadership Quarterly*, 19(3), 297–311.
- Delaney, J.T. & Huselid, M.A. (1996). The impact of human resource management practices on perceptions of organizational performance. *The Academy of Management*, 39(4), 949–969.
- Gopinath, C. & Becker, T.E. (2000). Communication, procedural justice, and employee attitudes: relationships under conditions of divestiture. *Journal of Management*, 26(1), 63–83.
- Hair, J.F., Hult, G.T., Ringle, C.M. & Sarstedt, M. (2014). *A Primer on Partial Least Squares Structural Equation Modeling (PLS-SEM)*. London: Sage Publications.
- Hamann, P.M., Schiemann, F., Bellora, L. & Guenther, T.W. (2013). Exploring the dimensions of organizational performance: a construct validity study. *Organizational Research Methods* 16(1): 67–87
- Hogan, R., & Kaiser, R. B. (2005). What We Know About Leadership. *Review of General Psychology*, <http://doi:10.1037/1089-2680.9.2.169>

- Holloway, J. B. (2012). Leadership Behavior and Organizational Climate: An Empirical Study in a Non-profit Organization. *Emerging Leadership Journeys*, 5, 9–35.
- Jordan, J., Brown, M.E., Treviño, L.K. & Finkelstein, S. (2011). Someone to look up to: executive-follower ethical reasoning and perceptions of ethical leadership. *Journal of Management*, 39(3), 660–683.
- Kalshoven, K., Den Hartog, D. N., & De Hoogh, A. H. B. (2011). Ethical leadership at work questionnaire (ELW): Development and validation of a multidimensional measure. *The Leadership Quarterly*, 22(1), 51–69. <http://doi:10.1016/j.leaqua.2010.12.007>
- Kalshoven, Karienne & Hartog, D. N. Den. (2009). Ethical Leader Behavior and Leader Effectiveness : The Role of Prototypicality and Trust. *International Journal of Leadership Studies*, 5(2), 102–118.
- Kanungo, R.N. (2001). Ethical values of transactional and transformational leaders. *Canadian Journal of Administrative Sciences*, 18(4), 257–265.
- Kouzes, J., & Posner, B. (2012). Leadership Challenge. *Leadership Excellence*, 29, 3–4. <http://doi:10.1177/1742715010394733>
- Mayer, D.M. (2012). Who displays ethical leadership, and why does it matter? An examination of antecedents and consequences of ethical leadership. *Academy of Management Journal*, 55(1), 151–171.
- Northouse, P. (2010). *Leadership: Theory and Practice*. Edisi Ke-5. California: Sage Publication.
- Poister, T.H., Aristigueta, M.P. & Hall, J.L. (2015). *Managing and Measuring Performance in Public and Nonprofit Organization: An Integrated Approach*. United States: John Wiley and Son.
- Ramayah, T. (2014). *SmartPLS 2.0*. Pulau Pinang: Universiti Sains Malaysia.
- Rezaei, M., Salehi, S., Shafiei, M. & Sabet, S. (2012). Servant leadership and organizational trust: the mediating effect of the leader trust and organizational communication. *Emerging Markets Journal*, 2(1), 70–78.
- Richard, P.J., Devinney, T.M., Yip, G.S. & Johnson, G. (2009). Measuring organizational performance as a dependent variable: towards methodological best practice. *Journal of Management*, 35(3), 718–804.
- Ringle, C.M., Wende, S. & Will, A. (2005). *SmartPLS 2.0 (beta)*.
- Sheraz, A., Zaheer, A. & Nadeem, M. (2012). Enhancing employee performance through ethical leadership, transformational leadership and organizational culture in development sector of Pakistan. *African Journal of Business Management* 6(4): 1244–1251.
- Shockley-Zalabak, P., Ellis, K., & Winograd, G. (2000). Organizational trust: What it means, why it matters. *Organization Development Journal*, 18, 35–48. <http://psycnet.apa.org/psycinfo/2001-14037-002>
- Shockley-Zalabak, P., Ellis, K. & Winograd, G. (2000). Organizational trust: what it means, why it matters. *Organization Development Journal*, 18(4), 35–48.
- Shockley-Zalabak, P., Ellis, K. & Cesaria, R. (1999). Measuring organizational trust: trust and distrust across culture: the organizational trust index. In *Feedback Manual*. Colorado Spring: University of Colorado.
- Solomon, R. C. (2004). Ethical leadership, emotion and trust: beyond “charisma.” Dlm. Ciulla, J.B. (pnyt.). *Ethics, the Heart of Leadership*, hlm.83–102. United States: Praeger Publishers.
- Stouten, J., Van Dijke, M. & De Cremer, D. (2012). Ethical leadership: an overview and future perspectives. *Journal of Personnel Psychology* 11(1): 1–6.
- Treviño, L. K. & Brown, M. E. (2005). The role of leaders in influencing unethical behavior in the workplace. *Managing Organizational Deviance*, 69–87.
- Tan, H.H. & Tan, C.S. (2000). Toward the differentiation of trust in supervisor and trust in organization. *Genetic, Social, and General Psychology Monographs*, 126, 241–260.
- Treviño, L.K., Hartman, L.P. & Brown, M. (2000). Moral person and moral manager: how executives develop a reputation for ethical leadership. *California Management Review*, 42, 128–142.

- Unit Pemodenan Tadbiran dan Perancangan Pengurusan Malaysia. (2012). *Panduan Penafaran Bintang Agensi Sektor Awam*. <http://www.mampu.gov.my/starrating>.
- Urbach, N. & Ahlemann, F. 2010. Structural equation modeling in information systems research using partial least squares. *Journal of Information Technology Theory and Application*, 11(2), 5.
- Walumbwa, F.O., Mayer, D.M., Wang, P., Wang, H., Workman, K. & Christensen, A.L. (2011). Linking ethical leadership to employee performance: the roles of leader–member exchange, self-efficacy, and organizational identification. *Organizational Behavior and Human Decision Processes*, 115(2), 204–213.
- Wilton, P., Woodman, P., Rudiger K., Pardey, D. & Tamkin, P. (2012). *A Summary of the evidence for the value of investing in leadership and management development*. London: Department for business Inovation and Skills.
- Yukl, G. (2013). *Leadership in organization*. United States: Pearson Education Limited.
- Yukl, G., Mahsud, R., Hassan, S. & Prussia, G. E. (2011). An improved measure of ethical leadership. *Journal of Leadership and Organizational Studies*, 20(1), 38–48.
- Zeffane, R. & Connell, J. (2003). Trust and HRM in the new millennium. *The International Journal of Human Resource Management*, 14(1), 3-11.

