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## Stimulating organizational innovativeness through ethical leadership practices: the mediating role of organizational trust

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### Abstract

The paper presents the results of the research in progress that explores the interrelation between ethical leadership and organizational innovativeness, questioning the role of organizational trust in this relationship and arguing that organizational trust strengthens the effect of ethical leadership on positive organizational outcomes. The data analysis from a public organization (n=757) in Lithuania confirm partial mediation of organizational trust in the relationship between ethical leadership and organizational innovativeness.

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### 1. Introduction

Organizational innovativeness as an organizational capacity to engage in creative processes, experiment, apply new approaches and techniques, generate new knowledge and products (Lumpkin and Dess, 1996) has become critical in the context of global economy and hyper competition (Broekel and Brenner, 2011; Cho and Pucik, 2005). Moreover, it is not only business but also public organizations which are more and more required to become innovative in meeting public interest and acting by business principles. As a multidimensional construct (Wang and

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Ahmed, 2004), organizational innovativeness involves several dimensions such as product, market, process, behavioral and strategic innovativeness which may have different importance to public organizations compared to business ones. Moreover, exercising innovativeness involves a component of risk taking behaviour which may result in ideas which are innovative but violate social norms and organizational rules. Such behaviour may undermine sustainability of organizations and societies in the long run. The cases of Enron or World.com at the beginning of the 2000s, Lehman's Brothers or Goldman Sachs in the consecutive global financial crisis in 2008 highlight unethical leadership and corrupt organizational culture among the key factors which accounted for numerous illegal and unethical activities and determined the fall of seemingly glorious companies (Argandona, 2012; Sims and Brinkmann, 2003).

On the other hand, there are a number of studies indicating that ethically proper leadership positively affects employees' outcomes such as their willingness to accept change (Cadwallader and Busch, 2008), well-being in the workplace (Alimo-Metcalfe et al., 2008), organizational citizenship behaviour (Rego et al., 2010) and can develop an organizational culture that embeds ethical values and practices (Huhtala et al., 2013). However, both the concept and operationalisation of ethical leadership has been acknowledged as one of the most challenging ones. According to Brown and Treviño (2006), Brown and Mitchell (2010) many studies deal with ethical leadership from the normative perspective with little empirical evidence of the phenomenon. Moreover, leadership studies (including the ones dealing with its ethical aspect) have extensively focused on the leader's impact on followers, disregarding the dyadic influence process that exists in the relationships between leader and followers in the organizational context.

Thus, ethical leadership in this paper is considered as a relational construct between leader and followers. It rests on the theory of leader and member exchange (hereafter LMX, Graen and Uhl-Bien, 1995) that focuses on the two-way influence between leader and followers rather than just on a leader's or followers' influence on the other party. The theory departs from theories of social interrelations (e.g. social exchange theory - Blau, 1964) and holds that interrelations between leader and followers may differ depending on the quality of the relationship. LMX theory distinguishes relationships between the leader and in-group and out-group members which are termed, respectively, high and low LMX (Anand et al., 2011). High LMX can be described by loyalty, respect, high trust and liking between leader and followers while low LMX can be characterized by following employment contract, managing by autocratic methods and low trust between the parties. The academic discourse on ethical leadership has related the concept of LMX to the one of ethical leadership (Hansen, 2011), arguing that the characteristics of high LMX such as reciprocity, respect, empowering followers allow to regard this type of leadership as ethical. Such leadership may encourage employees to take risks responsibly, be open and sharing and thus contribute to organization's capability to innovate (DiLiello and Houghton, 2006). Drawing on what has been said, we formulate the following hypothesis:

H1: ethical leadership determines organizational innovativeness.

Another issue that is increasingly highlighted in the discourse of knowledge creation and innovation is the need for organizational trust. Trust is also a core component of LMX relationship. It can be considered as a binding material in team-working, cooperation, learning, knowledge sharing and creating (McAllister, 1995; Whitener et al., 1998) which account for innovativeness (Sankowska, 2013) and innovation (Ellonen et al., 2008). In this paper, organizational trust is defined as a positive attitude held by an organization's member towards another member that the other party will act by fair-play rules and will not take an advantage of one's vulnerability and dependence in a risky situation (Das and Teng, 1998). Trust usually develops when two parties regularly comply with the same ethical or/and social norms and regulations (Fukuyama, 1995; Jones and George, 1998). Leaders' ethical behaviour, consistency in following values in organizational practices can communicate to their followers that not only leaders as individuals are trustworthy but also the organization is built on ethical principles and, therefore, can be trusted (cf. Gilpeie and Mann, 2004). Hence, perceptions of an organization being ethical can motivate followers to reciprocate ethical behaviour in respect to both their leader and co-employees and develop a trusting attitude towards them. Therefore, we formulate the following hypothesis:

H2: Ethical leadership determines organizational trust.

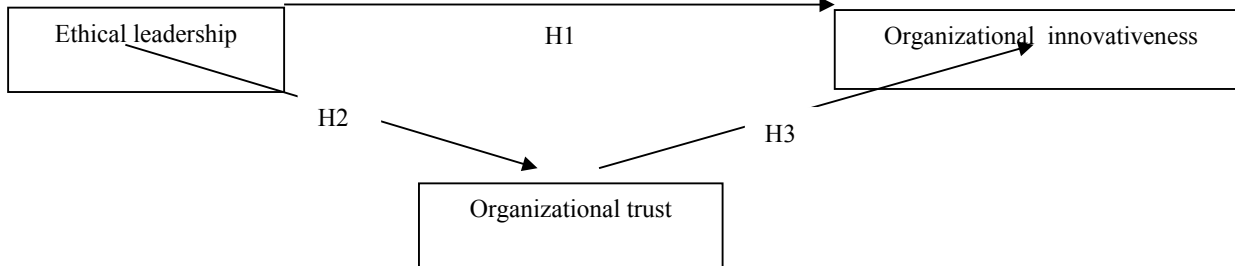
Prior research on the interrelations between different types of leadership and organizational outcomes such as transformational leadership and employee well-being (Liu et al., 2010), transformational leadership and

organizational citizenship behaviour (Podsakoff et al., 1990), authentic leadership, positive psychological capital and organizational performance (Clapp et al., 2009) has identified that trust plays a fully or partially mediating role. Consequently, we argue that organizational trust in the relationship between leadership and organizational innovativeness plays mediating role. Drawing on this, we formulate the third hypothesis to be tested:

H3: Organizational trust performs a mediating role in the relationship between ethical leadership and organizational innovativeness.

The hypotheses and research framework are depicted in Figure 1.

Figure 1. Hypothesized relationships among ethical leadership, organizational trust and organizational innovativeness



In sum, our paper focuses on the interrelation between ethical leadership and organizational innovativeness, and the role of organizational trust in this interrelation. These relations have been little empirically explored (cf. Huhtala et al., 2012), and our study addresses this gap making a respective contribution to the related academic literature.

## 2. Method

The empirical data were collected by a standardized questionnaire from a public sector organization in Lithuania (N=1221, n=757, a response rate of 62 %) in autumn 2013. The questionnaire in Lithuania has been distributed as an electronic survey, having contacted the top management and posting the link to the communication department for further dissemination to the employees. Participation in the survey was voluntary, undermining the factor of fear to be punished for “wrong” answers.

The questionnaire consists of three thematic blocks (i.e. ethical leadership, organizational innovativeness and organizational trust) and socio-demographic characteristics of the respondents. Ethical leadership is measured by an LMX questionnaire (Graen and Uhl-Bien, 1995) which consists of 7 statements measured in a 5-item Likert scale (1 denoting “totally disagree” and 5 “totally agree”). Organizational innovativeness was measured with a 20-item questionnaire by Wang and Ahmed (2004) that consists of 5 thematic blocks related to product, market, behavioral, process and strategy innovation. A 7-item Likert scale was used with 1 meaning “strongly disagree” and 7 “strongly agree”. Organizational trust was measured by McAllister (1995) 11-item questionnaire with an analogous 7-item grading scale. Some items originally were reverse coded and were adequately transformed for analysis.

The data were analyzed using SPSS 22.0 software. Reliability tests of all the scales of ethical leadership, organizational innovativeness and organizational trust has yielded Cronbach alphas of 0.9, allowing us to conclude that internal consistency of the statements was sufficient to measure the explored phenomena. Effects of theoretically presumed interrelations between a predicting variable (i.e. ethical leadership), a mediating variable (i.e. organizational trust) and the outcome (i.e. organizational innovativeness) were tested following the sequence described by Baron and Kenny (1986) and Frazier et al. (2004) performing multiple regression analysis. According to them, a mediating relationship is tested in 3 stages, i.e. 1) checking whether there is a significant relation between the predictor (i.e. ethical leadership) and the outcome (i.e. organizational innovativeness); 2) checking whether the predictor (i.e. ethical leadership) is related to the mediator (i.e. organizational trust) and 3) checking whether the mediator (i.e. organizational trust) is related to the outcome variable (i.e. organizational innovativeness) and whether the strength of the relationship between the predictor (i.e. ethical leadership) and the

outcome (i.e. organizational innovativeness) is significantly reduced when the mediator (i.e. organizational trust) is added to the model.

### 3. Findings

Based on the data from the public sector organization, 32% of the respondents were male, 68% female. 97% were with higher education. 86% were in an expert/ specialist position, 3% in an administrative and 10% in a managerial one. The average number of years in the company was 14 (SD = 8.5). A major age group among the respondents was above 51 years old (45%), followed by a group of 41-50 years (29%).

Regression analysis following Frazier et al. (2004) steps has yielded the following results:

1) Regression analysis between ethical leadership as the predictor and organizational innovativeness as the outcome yielded statistically significant relation ( $p < 0.001$ ) with adjusted  $R^2$  of 0.3 and standardized coefficient  $\beta$  of 0.530. This result confirms H1.

2) Regression analysis of ethical leadership on organizational trust resulted in a statistically significant relation ( $p < 0.001$ ) with adjusted  $R^2$  of 0.2 and  $\beta$  of 0.482. This finding confirms H2.

3) Regression analysis of ethical leadership and organizational trust on organizational innovativeness loaded a statistically significant relation ( $p < 0.001$ ) with adjusted  $R^2$  of 0.4 and respective  $\beta$  of 0.311 and 0.382. This finding rejects the possibility of a fully mediating relationship but accepts the one of partial mediation. Hence, H3 is accepted.

### 4. Discussion and Conclusions

The study adds knowledge to organizational outcomes of ethical leadership and the impact of organizational trust on this interrelation. It argues the importance of the relational perspective between leader and followers in stimulating organizational innovativeness and, potentially, innovation development. Partial mediation of organizational trust in the relationship between ethical leadership and organizational innovativeness suggests that other indirect factors may be involved in the studied interrelation, which calls for further research. Further study of the statistically significant relations between ethical leadership and different dimensions of organizational innovativeness (product, market, process, behaviour and strategy) should be carried out to gain more in-depth knowledge in the effects of ethical leadership. Based on prior study by Riivari et al. (2012), it can be assumed that potentially affected dimensions in public organizations will be the dimensions of process and behaviour as public organizations do not usually produce a marketable product. The referred study was carried out in a different socio-cultural context, therefore, testing the effects in Lithuania may render interesting implications to the literature of outcomes of leadership and organizational culture and to management of public organizations.

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