The Leadership Quarterly 26 (2015) 1034–1050

Contents lists available at ScienceDirect

The Leadership Quarterly

journal homepage: www.elsevier.com/locate/leaqua

Prophets vs. profits: How market competition influences leaders' disciplining behavior towards ethical transgressions

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ARTICLE INFO

Article history:
Received 2 April 2014
Received in revised form 15 July 2015
Accepted 16 July 2015
Available online 19 August 2015

Handling Editor: William Gardner

Keywords:
Market competition
Unethical behavior
Disciplining behavior
Punishment
Ethical decision-making

ABSTRACT

We investigate how market competition influences the way leaders discipline employees' ethical transgressions. A cross-sectional study among organizational leaders (Study 1) revealed that strong market competition is related to an instrumental decision frame (business practices are more focused on serving the organization's interest). This decision frame explains why strong market competition is related to leaders' perceptions of the evaluation of wrongdoing in terms of instrumental rather than moral concerns. Two experiments (Studies 2 and 3) show that increased market competition makes leaders' disciplining of ethical transgressions more contingent upon the transgression's instrumentality to the organization: the same ethical transgression is punished less when it resulted in profit than when it resulted in loss. This research is among the first to identify conditions that determine disciplinary responses of organization leaders to ethical transgressions, and it feeds the debate on whether market competition promotes the display of unethical behavior within organizations.

Introduction

Market competition is a fundamental principle of capitalist economies (Blaug, 2001), making it a ubiquitous aspect of the context in which organizations and their leaders operate. To obtain competitive advantage, organizations rely strongly on leadership for at least two reasons (Yukl, 2008). First, leaders are responsible for making sense of the environment, identifying threats and opportunities, and for making strategic decisions to positively influence firm performance (Bourgeois & Eisenhardt, 1988; Thomas, Clark, & Gioia, 1993). Second, leaders can stimulate subordinates to contribute to organizational performance, as is shown by a variety of research programs devoted to leadership styles and actions such as transformational leadership (e.g., Lowe, Kroeck, & Sivasubramaniam, 1996; Piccolo & Colquitt, 2006), servant leadership (e.g., Van Dierendonck, 2011), leader–member exchange (e.g., Gerstner & Day, 1997), and leader reward and punishment behaviors (e.g., Podsakoff, Bommer, Podsakoff, & Mackenzie, 2006).

In addition to motivating followers to maintain or increase performance, leaders also have moral obligations that include stimulating ethical behavior among employees and disciplining employees who transgress ethical norms (Brown & Trevino, 2006; Chonko & Hunt, 1985; Van Houwelingen, Van Dijke, & De Cremer, 2014). Disciplining ethical transgressions may not directly contribute to organizational performance, yet it helps establish an ethical climate and prevents future occurrences of unethical practice (Brown & Trevino, 2006; Chonko & Hunt, 1985; Mayer, Kuenzi, & Greenbaum, 2010). Unfortunately, reality provides numerous instances of leaders failing to discipline employees who engage in ethical transgressions, especially in organizations operating in

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http://dx.doi.org/10.1016/j.leaqua.2015.07.004
1048-9843/

strongly competitive markets. For example, the UK newspaper *News of the World* illegally hacked the telephones of celebrities, relatives of dead soldiers, and crime victims to run exclusive news or scoops. Another example is the illegal rigging of benchmark interest rates (Libor and Eurobor) by major banks like UBS, Barclays, and RBS to boost their trade profits and creditworthiness. How can such widespread and longstanding unethical practices persist without any disciplinary reactions within a company? The extant literature offers only few insights on the factors that predict when and why leaders will discipline ethical transgressions.

In the present paper, we argue that an essential element of the external environment in which organizations and its leaders operate (i.e. market competition), may explain why many leaders fail to discipline ethical transgressions committed by employees. More specifically, we argue that when strong market competition is present, leaders will be stimulated to view employees' ethical transgressions purely from the perspective of whether the transgression is instrumental to the company. We build our argument on the two-stage signaling-processing model developed by Tenbrunsel and Messick (1999). Rather than focusing on individual differences between leaders in ethical focus, this model proposes that the context influences the type of frame (i.e., instrumental or ethical) through which an individual perceives the decision (i.e., signaling stage). The type of decision frame that is evoked subsequently determines the decision-making process and outcome (i.e., processing stage). We conducted three studies where we applied this model to leaders' use of discipline (in response to employees' ethical transgressions) as a function of market competition.

With this research we aim to address several gaps in the literature. First, in spite of substantial academic interest in leader discipline, the overwhelming majority of studies examined consequences rather than determinants of disciplinary action (see Podsakoff et al., 2006). Furthermore, almost all of these studies focused on the disciplining of poorly performing employees (e.g., low productivity) and overlooked the disciplining of ethical norm transgressions. Second, although several studies have examined leadership in competitive environments, they did not consider its effects on ethical decision-making but focused primarily on strategic decision-making linked to the economic performance of organizations (e.g., Baum & Wally, 2003; Eisenhardt, 1989; Judge & Miller, 1991; Khatri & Ng, 2000; Waldman, Ramirez, House, & Puranam, 2001). This lack of attention to the ethical decision-making of leaders is surprising given that market competition has been strongly linked, both anecdotally and theoretically, to unethical conduct in organizations (e.g., Sethi & Sama, 1998; Shleifer, 2004). To date, empirical studies that have examined the effects of market competition on ethical decision-making remain very limited and reveal conflicting findings (Dubinsky & Ingram, 1984; Falk & Szech, 2013; Nill, Schibrowsky, & Peltier, 2004; Verbeke, Ouwerkerk, & Peelen, 1996). In contrast to these studies, we focus exclusively on organizational leaders, who are hierarchically and psychologically closer to the organization's goals (Kaiser, Hogan, & Craig, 2008; Overbeck & Park, 2006) and therefore potentially more susceptible to contextual variables that challenge these goals, like market competition. In this way, we hope to resolve some of the ambiguity that has resulted from prior works on how market competition shapes ethical decision-making.

Why market competition matters to leaders

Competition can be defined as different parties pursuing scarce and contested resources, such that one party's goal attainment makes the other party's goal attainment either impossible or less likely (Deutsch, 1949). Competition can either have either a zero-sum form (where one party's gain is matched by a loss for the competing parties) or a nonzero-sum form (where one party's gain does not necessarily result in loss but perhaps only in less gains for the others). In both forms, the parties have at least some conflicting interests (Hunt, 2000).

Competition can operate at different levels of analysis. It has been studied and operationalized not only as an interpersonal (or intra-organizational) variable (for a meta-analysis, see Stanne, Johnson, & Johnson, 1999), but also as a phenomenon that operates between organizations, i.e., market competition (Blaug, 2001; Nickell, 1996). Although the concepts of interpersonal competition and market competition share the basic assumption that agents try to be better off than each other, we argue that there are some important differences between them that make market competition especially relevant as a predictor of leader behavior.

The relation between *interpersonal* competition and organizational behavior has been studied extensively. An illustration of a competitive intra-organizational environment is Enron, which created strong competition among its employees by giving top performers performance-based bonuses and by using appraisal systems whereby poor performers were quickly expelled (Kulik, O'Fallon, & Salimath, 2008). In such environments, competition is highly salient to the members of organization because it is directly linked to self-relevant outcomes (e.g., salary). As a consequence, employees will be motivated to put more effort into their work (Schwepker & Ingram, 1994), but they may also engage in unethical acts in an effort to outperform their coworkers. Several studies provide empirical evidence for a negative effect of intra-organizational competition on ethical behavior. For instance, Robertson and Rymon (2001) showed that purchasing agents who face high pressure to perform are more likely to use deception. Hegarty and Sims (1978) found that participants in a marketing experiment were more likely to accept kickbacks (i.e., bribery) when faced with more competition.

Just as intra-organizational competition may be particularly relevant for employees because of the direct link to self-relevant outcomes, market competition may be especially relevant to organizational leaders because of their positional closeness to the organization's goals and strategy. In the strategic management literature, leaders are ascribed an important role in assessing the external environment, in making strategic choices to obtain competitive advantages, and in creating a viable future for the organization (e.g., Hambrick & Mason, 1984; Ireland & Hitt, 1999). In fact, research has shown that the decision-making of leaders particularly matters to organizational performance when the external environment is highly unpredictable (*dynamism* or *turbulence*: Baum & Wally, 2003), is characterized by quick changes in demand, competition, and technology (*high velocity*: Judge & Miller, 1991), or has rapidly intensifying levels of competition and diminished periods of competitive advantage (*hypercompetition*: Bogner & Barr, 2000). For instance, faster and more intuitive decision-making of leaders is positively related to firm performance primarily in dynamic or high-velocity environments (Baum & Wally, 2003; Eisenhardt, 1989; Judge & Miller, 1991; Khatri & Ng, 2000). As another example,