Shaping Behaviour and Engagement: The Role of Ethical Leadership in India's SME Ecosystem.

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Abstract

Ethical leadership has emerged as a pivotal driver of sustainable performance, stakeholder trust, and responsible business conduct among Indian Small and Medium Enterprises (SME). Drawing insights from recent empirical and qualitative studies across diverse sectors, this paper examines how ethical leadership shapes organizational behavior, Corporate Social Responsibility (CSR) effectiveness, and employee engagement within India's SME ecosystem. Findings indicate that leaders who demonstrate integrity, fairness, and transparency not only enhance CSR credibility but also foster ethical organizational cultures that reduce employee turnover and work-related stress. Moreover, ethical leadership acts as a bridge between strategic CSR initiatives and tangible social and environmental outcomes, promoting accountability and long-term sustainability. However, many Indian SMEs continue to exhibit fragmented and reactive ethical practices due to limited structural frameworks and awareness. The analysis emphasizes the need for leadership development programs focused on ethical competence, value-based decision-making, and stakeholder-oriented management systems. Strengthening these ethical foundations can enable Indian SMEs to align business growth with social responsibility and contribute meaningfully to national sustainable development goals (SDGs)

Keywords: Ethical leadership, Leadership Effectiveness, SME, CSR

1. Introduction:

SMEs form the backbone of India's economy, contributing significantly to employment generation, innovation, and GDP growth. However, beyond their economic contributions, SMEs increasingly face pressure to act responsibly and ethically in their operations. In recent years, leadership within Indian SMEs has gained attention not only for its role in driving profitability but also for shaping organizational ethics, corporate social responsibility (CSR), and sustainable development practices. As India progresses toward inclusive and sustainable growth, the ethical orientation of SME leaders has become a central factor influencing the social legitimacy and long-term success of these enterprises.

Ethical leadership, characterized by integrity, transparency, fairness, and accountability, establishes the moral framework that guides employee behavior and organizational decision-making. Empirical studies across the Indian context (Basavaraj & Bala, 2022; Dohroo et al., 2023; Joseph, 2024) reveal that leaders' ethical conduct enhances employee trust, CSR effectiveness, and overall organizational performance. Moreover, leadership practices rooted in ethical values promote a positive work culture, reduce job stress and turnover intentions, and improve stakeholder relationships. Despite these benefits, many Indian SMEs continue to operate without formal ethical structures, relying instead on personal morality and reactive CSR efforts, which often lack strategic alignment and continuity (Srinivasan, 2024).

Existing research highlights both the potential and the challenges of integrating ethics into SME leadership. While larger corporations have established formal CSR and compliance frameworks, SMEs often face constraints such as limited resources, lack of awareness, and inadequate leadership training (Rathod et al., 2023). Nevertheless, studies indicate that when SME leaders actively embed ethics into business strategy—through transparent communication, fair decision-making, and community engagement—they can build sustainable enterprises that align with national and global sustainability goals (Joseph, 2024).

This study, therefore, seeks to explore the critical role of ethical leadership in strengthening CSR practices, organizational culture, and sustainable development among Indian SMEs. By synthesizing existing evidence and identifying gaps, it aims to establish how ethical leadership can serve as a strategic tool for enhancing competitiveness while ensuring social and environmental accountability

Role of SMEs in India:

Small and Medium Enterprises (SMEs) play a crucial role in India's economic and social development. They contribute around 30% of the country's GDP and provide employment to over 110 million people, especially in rural and semi-urban areas. SMEs are key drivers of entrepreneurship and innovation, often introducing niche products and new technologies. They support large industries by acting as suppliers and help diversify the industrial base. By establishing operations in smaller towns and rural regions, SMEs promote balanced regional growth and reduce urban migration. They also foster inclusive development by providing opportunities to women and marginalized communities. SMEs are flexible and adaptive, quickly responding to market demands and technological changes. Despite their importance, they face challenges such as limited access to finance, skill shortages, and regulatory hurdles. Strengthening SMEs through policy support and capacity building can significantly enhance India's economic growth and social well-being

Ethical leadership and Leadership Effectiveness

Ethical leadership has emerged as a pivotal factor influencing leadership effectiveness across diverse organizational settings. A meta-analytic review by Brown, Treviño, and Harrison (2005) underscores that ethical leadership positively correlates with various follower outcomes, including perceptions of leader fairness and ethical behavior. This ethical orientation fosters a work environment characterized by trust, fairness, and integrity, which in turn enhances team performance and cohesion. For instance, ethical

leaders can bolster a team's belief in its efficacy and social integration, particularly following poor performance, facilitating a recovery and sustained motivation.

Further empirical studies corroborate these findings. Madanchian (2018) demonstrated that ethical leadership has a direct and positive effect on leadership effectiveness, emphasizing its importance in organizational success. Similarly, research by Zhang (2018) reveals that ethical leadership invokes followers' other-praising moral emotions, such as awe and inspiration, leading to enhanced moral actions and reduced unethical behaviors.

Moreover, ethical leadership has been associated with increased employee readiness to change, as it fosters an organizational culture that values ethical behavior and adaptability. Metwally (2019) found that ethical leadership enhances employees' readiness to change, partially mediated by an organizational culture of trust and fairness. These findings collectively suggest that ethical leadership is not merely a moral imperative but a strategic approach that significantly enhances leadership effectiveness and organizational performance.

Measurement of Ethical Leadership in the Indian Context

In India, ethical leadership is measured using context-specific tools that reflect the country's unique cultural and organizational dynamics. A seminal study by Khuntia (2004) developed a 22-item scale assessing ethical leadership among middle-level managers in Indian private and public sector manufacturing companies. Through factor analysis, two primary dimensions emerged: (1) empowerment and (2) motive and character. These dimensions capture the essence of ethical leadership in India, emphasizing leaders' roles in empowering subordinates and demonstrating moral integrity. The scale exhibited high reliability and validity, making it a robust instrument for assessing ethical leadership in Indian organizations.

Further research has expanded on this foundation. A study by Nguyen (2025) reconceptualized ethical leadership in the Global South, including India, highlighting the importance of cultural nuances in leadership practices. This research suggests that ethical leadership in India is deeply intertwined with societal values such as respect for hierarchy, community well-being, and moral duty, necessitating measurement tools that account for these cultural dimensions.

Measurement of Leadership Effectiveness in the Indian Context

In the Indian context, the measurement of ethical leadership and leadership effectiveness is typically conducted using a combination of culturally adapted questionnaires, behavioral observations, and performance indicators. Ethical leadership is often assessed through self-reported scales such as Khuntia's (2004) 22-item Ethical Leadership Scale, which emphasizes dimensions of empowerment and moral character, as well as 360-degree feedback tools that gather evaluations from subordinates, peers, and supervisors to capture multiple perspectives. Behavioral observation methods are also used, focusing on leaders' day-to-day actions in decision-making, fairness, and team support. Leadership effectiveness, on the other hand, is measured using scales like the Leadership Effectiveness Scale by Dhar and Pethe (2003) or LESALU for academic leaders, which assess interpersonal relations, communication skills, emotional

stability, and moral strength. Additionally, practical indicators such as team productivity, goal achievement, employee satisfaction, and turnover rates are incorporated to provide objective evidence of effectiveness. In Indian organizations, combining perception-based methods (questionnaires, 360-degree feedback) with behavior-based approaches (observations and key performance indicators) ensures a comprehensive and culturally relevant evaluation. These methods account for India's hierarchical structures, social norms, and emphasis on ethical conduct, providing a reliable framework for assessing both ethical leadership and overall leadership effectiveness in varied organizational contexts

Research Framework:

The research framework on leadership and ethical practices in SMEs aims to systematically explore how leadership styles influence ethical decision-making, organizational culture, and overall business performance. At the core of this framework is the relationship between ethical leadership—characterized by integrity, transparency, fairness, and accountability—and the adoption of ethical practices within SMEs. The framework considers both independent variables, such as leadership styles (transformational, transactional, servant, and authentic leadership), and dependent variables, including ethical behavior, employee engagement, CSR effectiveness, and firm reputation. Mediating variables like organizational culture, trust, and employee commitment are also integrated, as they help explain how leadership impacts ethical practices. Moderating factors such as firm size, industry type, and regulatory environment are considered to account for contextual differences among SMEs.

The framework proposes that leaders who actively model ethical behavior foster a culture where employees internalize values and norms, resulting in reduced unethical practices and enhanced social responsibility. Data collection is envisaged through surveys across diverse SMEs,. Ethical practices are assessed through adherence to regulatory standards, CSR initiatives, stakeholder engagement, and internal ethical policies. Leadership effectiveness is evaluated based on employee perception, ethical climate, and organizational performance outcomes. Furthermore, it integrates insights from Indian SME contexts to highlight culturally specific ethical challenges and leadership responses. It also incorporates stakeholder theory, recognizing the role of employees, customers, suppliers, and community in shaping ethical outcomes. The approach is multidisciplinary, drawing from management, ethics, and organizational behavior literature. The framework aims to guide SMEs in designing policies, training programs, and leadership development initiatives that promote ethical conduct. It also serves as a basis for evaluating the impact of ethical leadership on sustainability and long-term competitiveness. By linking leadership behaviors to measurable ethical outcomes, the framework provides a roadmap for both academic research and practical application. Overall, it underscores the premise that ethical leadership is not just a moral imperative but a strategic advantage in the SME ecosystem. This structured approach ensures comprehensive understanding, actionable insights, and a foundation for policy recommendations to enhance ethical standards in SMEs

Methodology:

The research methodology for analyzing leadership and ethical practices in SMEs begins with a literature review and careful selection of key variables. Based on the literature a model would be developed and data would be collected , further analyzing the vaiables and testing the model Fit using Structural Equation Modelling (SEM). The sample would include the SMEs from Karnataka. The data collection would be done using the structured questionnaire drawn from the established scales.

Findings

Findings would indicate that leaders who demonstrate integrity, fairness, and transparency not only enhance CSR credibility but also foster ethical organizational cultures that reduce employee turnover and work-related stress. Moreover, ethical leadership acts as a bridge between strategic CSR initiatives and tangible social and environmental outcomes, promoting accountability and long-term sustainability.

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