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BAD LEADERSHIP AND THE EROSION OF CORPORATE GOVERNANCE

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Abstract: *Despite extensive governance reforms and leadership training initiatives, bad leadership continues to undermine corporate accountability and institutional trust. This article critically examines how bad leadership erodes corporate governance structures by weakening board oversight and accountability, as well as by normalizing governance failure. Drawing on illustrative case studies and interdisciplinary literature, the analysis develops a typology of consequences, while also exploring the symbolic and political construction of governance failure. Special attention is paid to stakeholder trust, reputational collapse, and the limitations of compliance-based ethics. The article concludes with recommendations for future research and the importance of ethical leadership as a cornerstone for institutional legitimacy.*

Key words: *bad leadership, corporate governance, organizational failure, ethical misconduct, institutional trust*

1. Introduction

Despite extensive leadership training, development, and academic education programs, bad leadership persists in corporate, political, and societal contexts (Örtenblad, 2021). Using deception, charm, and intimidation, bad leaders, or sometimes even corporate psychopaths, advance their own interests at the expense of their employees and organisations by frequently violating ethical standards (Cunha et al., 2024).

Poor leadership severely compromises corporate governance through weakened oversight mechanisms and diminished accountability. Executive unethical practices, normalised into reinforcing cycles of systemic dysfunction (Cohan, 2002; Zandstra, 2002), enabled by passive or complicit boards, lead to reputational damage, regulatory scrutiny, and substantial financial instability (Gandz et al., 2013; Larcker & Tayan, 2012).

This article critically examines the organisational, ethical, and societal consequences of bad leadership, especially in terms of governance failures. For scholars, policymakers, and business leaders, understanding these consequences is essential for designing better leadership education, fostering ethical decision-making, and developing strong institutional accountability, while failure to address them will only result in continued organisational, economic, and societal decline.

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2. The Mechanisms through which Bad Leadership Undermines Corporate Governance

Corporate governance involves institutional frameworks and collaborative processes (Aguilera et al., 2018), influenced by ownership configurations (Udin et al., 2017), and local challenges or the demands of the international market (Mulili & Wong, 2011), meant to ensure that companies operate in an accountable manner by continuously mitigating risks (Amede & Ilaboya, 2024) and that the interests of all stakeholders are aligned towards sustainable profit generation (Hossain et al., 2018). By manipulating, weakening, or bypassing governance mechanisms, bad leadership erodes corporate governance and fosters systemic dysfunction, which can have detrimental regulatory, financial, and reputational consequences for organisations.

Despite corporate governance's protections for transparency, accountability, and ethical decision-making, bad leadership can undermine board oversight, reduce accountability, and normalize unethical practices, allowing powerful CEOs' misconduct and corruption to flourish.

2.1. Weak board oversight enables executive misconduct

Even though boards of directors should act as mechanisms of corporate control over executive power (Cohan, 2002; J. Roberts et al., 2005), as ethical stewards of corporate identity (Zandstra, 2002) and as upholders of stakeholders' interests, often bad leaders can weaken governance structures, which leads not only to financial crises through fraud, but also to ethical crises.

Bad leaders manipulate board processes, influence corporate policies, evade accountability, and resist regulatory oversight by consolidating power in the CEO position (Adams et al., 2005; Larcker & Tayan, 2012). Therefore, board independence is reduced because it becomes complicit in bad leadership (Zandstra, 2002), by not challenging strategic decisions due to a lack of information or risk assessment expertise (Cohan, 2002). Holding both CEO and board chairman positions generates overconfidence, leading to riskier strategies, speculative acquisitions, unwarranted compensation, and appointing similar successors, consequently reducing adaptation to changing business environments (Larcker & Tayan, 2012; Li & Tang, 2010). Bad leadership, board passivity, and ethical lapses create a culture of deference and unchecked power, leading to systemic corporate fraud.

Moreover, since directors have personal or positional interests, procedural and moral failures occur (Ciepley, 2013; Kirkpatrick, 2009; Zandstra, 2002) promoting a culture of deception and intimidation that either demotivates employees to speak up and question bad leadership, or ignore employees altogether (Cohan, 2002; Shleifer & Vishny, 1997; Westphal & Zajac, 1998). Thus, governance becomes a symbolic exercise due to structural factors like internal fragmentation and isolation of senior managers, creating knowledge silos and a culture of deception (Cohan, 2002; Shleifer & Vishny, 1997; Westphal & Zajac, 1998). Psychologically, cognitive biases such as overconfidence and groupthink lead to dismissing red flags and reinforcing corporate blind spots (Cohan, 2002; Tversky & Kahneman, 1974).

The inevitability of corporate failures is not solely due to bad leadership, but appears to be constructed in the interaction between executive misconduct and board inaction, in a wider context of ethical negligence, failures in communication, and cognitive biases (Cohan, 2002; Zandstra, 2002).

2.2. Lack of accountability encourages bad leadership

Governance failures often result from the inability to hold leaders accountable for reckless or unethical behaviour, due to board loyalty or structures designed to protect powerful leaders (Brown & Treviño, 2006). Financial fraud cases, such as Enron (Cohan, 2002; Zandstra, 2002), environmental fraud, as seen with Volkswagen (Jung & Sharon, 2019; Mujkic & and Klingner, 2019; Rhodes, 2016), and customer fraud, exemplified by Wells Fargo (Elson & Ingram, 2018), have become increasingly common.

Some studies highlight excessive CEO compensation and a lack of performance-based accountability, eroding shareholders' trust and increasing scrutiny from investors and regulators (Gandz et al., 2013; Larcker & Tayan, 2012). Others point to leaders' lack of integrity, humility, and sound judgment, leading to reckless risk-taking (Gandz et al., 2013). Additionally, an unbalanced relationship with stakeholders and a focus solely on shareholders exacerbate the double agency problem (Child & Rodrigues, 2004; Freeman & Reed, 1983).

Leadership actions like downsizing, outsourcing, and aggressive restructuring undermine employees' trust and commitment, affecting productivity and operational effectiveness (Child & Rodrigues, 2004). In times of crises, balancing stakeholder interests is crucial over prioritizing short-term damage (James & Wooten, 2005).

2.3. Normalizing governance failures

When bad leadership becomes institutionalized, it reshapes corporate cultures and identities, embedding unethical governance practices and failures that persist long after individual leaders exit the organization.

Bad leadership persists due to manipulation, weak accountability structures, and a lack of regulatory oversight. It translates into leaders promoting unethical, illegal, and harmful goals to serve their own interests. In a self-perpetuating cycle of toxicity, not only will employees internalize and replicate these behaviours, but bad leaders will actively discourage trust, leading to workplace fragmentation and deviance, increased conflict, and a culture of hostility, fear, and manipulation (Avolio et al., 2009; Doğan & Aslan, 2024; Krasikova et al., 2013; Prochazka et al., 2017). In crises, common leadership failures include denial and deception, worsening scandals when the truth emerges.

Normalizing governance failures occurs as a result of ignoring warning signs, engaging only in reactive crisis management, and being unable to learn from past crises, which lead to repeated mistakes, weak resilience, and increased long-term risk (James & Wooten, 2005). Normalizing governance failures affects ethical decision-making and increases the likelihood of fraud, regulatory violations, and reputational damage (Gandz et al., 2013).

If unethical behaviours are accepted as normal business practices, the organizational culture develops blind spots (Cohan, 2002; Zandstra, 2002) which further accentuates governance failure.

3. Consequences of Governance Failure

Systemic governance failure as a result of bad leadership can have reputational, financial, and legal repercussions for organizations, employees, and markets (Huaman-Ñope et al., 2022; P. W. Roberts & Dowling, 2002).

3.1. Reputational Damage and Loss of Stakeholder Trust

Stakeholder perceptions, investor decisions, customer trust, and market stability are shaped and influenced by the most crucial intangible asset - corporate reputation capital – which is built through ethical behaviour and transparent leadership (Barnett et al., 2006; Bear et al., 2010; Fombrun et al., 2000; Fredriksson et al., 2020).

Ethical lapses or incompetence, in other words, bad leadership, can affect stakeholder trust and undermine their engagement and support (Gandz et al., 2013; Krasikova et al., 2013). For example, Exxon's delayed and arrogant response to the 1989 Valdez oil spill increased reputational harm and public distrust (Child & Rodrigues, 2004).

In times of crisis, bad leadership reveals incompetence and ethical negligence, which increases public scepticism (James & Wooten, 2005; Krasikova et al., 2013). Ineffective leadership during crises affects the entire governance system, raising market volatility and sector-wide vulnerability (Zandstra, 2002). Bad leadership practices such as misaligned compensation, poor communication, and a lack of transparency indicate systemic ethical and governance issues, eroding reputation capital, diminishing resilience, and undermining stakeholder trust, impacting long-term recovery (Gandz et al., 2013; Larcker & Tayan, 2012).

Repeated ethical breaches and governance failures amplify reputational losses, which lead to reduced market value and competitive position, as well as stakeholder distrust and increased scrutiny from authorities (Larcker & Tayan, 2012; Zandstra, 2002).

3.2. Increased regulatory scrutiny and compliance burdens

The dynamics between high-profile scandals due to bad leadership and the subsequent institutional pressures that drive increased regulations aimed at restoring public confidence and corporate legitimacy are analysed by institutional theory (Agrawal & Chadha, 2004; Hail et al., 2017; Kuhn & Lee Ashcraft, 2003; Meyer & Rowan, 1977; Suddaby, 2010).

For example, the fraudulent financial reporting and deliberate deception by Enron's leaders directly led to the Sarbanes-Oxley Act of 2002, which increased transparency and internal control requirements, imposed considerable compliance costs, and restricted corporate autonomy (Cohan, 2002; Larcker & Tayan, 2012). Similarly, the Volkswagen emissions scandal, which implied leadership deception, prompted stricter compliance and monitoring standards across the automotive industry (Krasikova et al., 2013; Mujkic & and Klingner, 2019).

While persistent governance failures may lead to overly restrictive regulatory environments, potentially limiting strategic flexibility, innovation, and competitive advantage (Child & Rodrigues, 2004; Zandstra, 2002), and raising operational complexity and financial costs for organizations, it also presents critical opportunities for organizational renewal, encouraging corporations to strengthen internal ethical standards, governance systems, and risk management practices, fostering a more resilient and trustworthy corporate environment in the long run (Gandz et al., 2013).

Recognizing and navigating this duality is crucial for organizations seeking to regain stakeholder trust and maintain long-term legitimacy in increasingly regulated markets.

3.3. Negative impacts on leadership effectiveness and employee morale

Bad leadership, characterized by an illusion of control, as exemplified by Enron's executives (Cohan, 2002), or by insufficient succession planning (Larcker & Tayan, 2012) leads to financial risks, poor strategic decisions, weak investor confidence and organizational resilience, as well as the erosion of corporate governance structures.

Bad leadership leads to a culture of silence that demotivates employees from speaking up about misconduct or questionable practices (Child & Rodrigues, 2004; Moaşa, 2011), which further diminishes psychological safety (Edmondson & Lei, 2014; Frazier et al., 2017; Hirak et al., 2012). In this context, employees experience high levels of stress, a loss of trust, reduced cognitive capacity, tunnel vision, and risk-averse behaviour aimed at self-preservation (Krasikova et al., 2013).

However, the severity and longevity of these negative consequences depend heavily on moderating factors such as organizational culture, structural accountability mechanisms, and existing levels of employee empowerment (Child & Rodrigues, 2004).

3.4. Financial instability and increased risk exposure

Corporate governance failure as a result of bad leadership is co-constructed and leads to excessive financial risk exposure and instability.

Research indicates that the more powerful the CEO is, the greater the variance in stock performance becomes, illustrating that power amplifies both ambitious strategic decisions and significant miscalculations, heightening overall market volatility and risk exposure depending on contextual factors (Larcker & Tayan, 2012; Lewellyn & Muller-Kahle, 2012; Li & Tang, 2010).

Additionally, executives exhibiting overconfidence and illusions of control may dismiss financial warnings, pursue excessively risky strategies, or misrepresent corporate profitability. Such behaviours intensify the organization's exposure to severe financial crises and eventual collapse, as investor confidence deteriorates in response to revelations of governance misconduct (Cohan, 2002; Gandz et al., 2013).

Misaligned incentives and conflicting interests between leaders and shareholders exacerbate financial instability (Bebchuk & Fried, 2003; Jensen & Meckling, 1976; Larcker & Tayan, 2012; Shleifer & Vishny, 1997; Young et al., 2008). Without strong governance mechanisms, boards may fail to act independently, becoming complicit in executive misconduct. This dynamic was demonstrated by the Enron scandal, where board members with financial interests aligned with executive gains turned a blind eye to unethical financial reporting and concealment of significant corporate losses (Cohan, 2002; Zandstra, 2002). Investor trust consequently eroded and precipitated massive financial instability, market panic, and costly shareholder litigation.

4. Conclusions and Future Research Directions

There is wide support for the idea that bad leadership weakens corporate governance. However, studies diverge on whether governance failures are primarily a function of individual misconduct or systemic weaknesses, whether strong governance mechanisms can mitigate bad leadership, and what the most severe consequences of governance failure are.

It is in these divergences that authors can find new questions that can guide future research. For example, authors could, among others, look at the weaknesses of categorizations of bad leadership consequences on corporate governance, critically investigate the method/s used to conclude which consequences on corporate governance arise from bad leadership, and rank the impact of each consequence.

Finally, I will present the divergences present in the literature, aiming to open the discussion for future research. The first disagreement is on whether governance breakdowns result from individual ethical failures or systemic weaknesses in governance structures. Some authors see governance failures as individual ethical failures that come from moral deficiencies at the leadership level (Cohan, 2002; Zandstra, 2002), from a lack of ethical judgment leading to reckless decision-making (Gandz et al., 2013), or from bad leadership cultures that reinforce unethical behaviours (Krasikova et al., 2013). Other authors see governance failures as structural weaknesses and highlight either the traditional models that focus solely on shareholder interests (Child & Rodrigues, 2004) – which are affected by bad leaders holding excessive power (Larcker & Tayan, 2012), or bad leadership and decision-making under pressure in times of crisis (James & Wooten, 2005).

The second disagreement is on whether governance reforms can effectively prevent bad leadership. Those who argue that strong governance mechanisms can mitigate leadership failures highlight expanding governance beyond shareholders to include employee trust (Child & Rodrigues, 2004), or training programs in crisis management (James & Wooten, 2005) and ethical leadership (Gandz et al., 2013). Over time, organizations implementing authentic reform, transparency, and accountability can partially rebuild stakeholder trust (Gandz et al., 2013). In contrast, some research has shown that destructive leaders will always exploit governance weaknesses because leaders act in bad faith (Cohan, 2002; Zandstra, 2002), powerful CEOs manipulate governance mechanisms to maintain control (Larcker & Tayan, 2012), and toxic leadership cultures cannot be changed through structural reforms alone (Krasikova et al., 2013).

Research shows that bad leadership has serious consequences, but there is a divergence in which consequences are the most severe, with some authors claiming that the greatest consequence is financial and market instability (Cohan, 2002; Larcker & Tayan, 2012; Zandstra, 2002). In contrast, other authors highlight organizational dysfunctions (Child & Rodrigues, 2004; Krasikova et al., 2013) or ethical and reputational damage (Gandz et al., 2013; James & Wooten, 2005).

Ultimately, corporate governance is only as strong as the leadership that enforces it - without ethical and accountable leadership, governance structures remain vulnerable to manipulation and failure.

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