

Psychological Capital, Ethical Leadership, And Sustainable Performance in Smes: A Multilevel Examination of Organizational Effectiveness and Corporate Social Responsibility

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1. Introduction

Research on organisational psychological capital (PsyCap) has been limited to evidence from large, publicly traded firms with few insights into the overlooked small and medium enterprise (SME) sector. Previous studies on PsyCap and SME performance have focused only on individual PsyCap or have used aggregated individual PsyCap data as proxies for the organisational construct. Although organisational PsyCap is expected to promote sustainable performance through enhanced resource acquisition and effective business functioning, a greater understanding of the importance of context is critical. Attention must also be given to situational influences that impact the internal resource generation–performance relationship (Grözinger et al., 2022).

2. Theoretical Foundations

Psychological capital (PsyCap) encompasses the positive psychological states of individuals, including hope, optimism, resilience, and self-efficacy. Psychological capital is gaining increasing attention as a valuable resource for small and medium-sized enterprises (SMEs), helping them cope with the complex and challenging internal and external business environments (Grözinger et al., 2022). As a critical resource supporting long-term performance, organizational psychological capital (OPC) can assist SMEs in rapidly identifying business opportunities and mobilizing and integrating other strategic resources during crises, such as financial challenges brought by the COVID-19 pandemic. Psychological capital is an important personal resource promoting positive work interactions and fostering trust among co-workers, and has been shown to relate to various leadership styles (Clapp-Smith et al., 2009). However, there is a lack of research on PsyCap in SMEs, particularly that aims to understand how this concept affects sustainable development from a multilevel perspective. Further investigation is needed regarding how individual- and group-level psychological capital is shared and aggregated at the organizational level and how it influences firms' organizational effectiveness and corporate social responsibility (CSR) in SME contexts where owner-managers play an essential role in strategic decision-making and ethical practices.

Ethical leadership is gaining wide attention as an important influential force promoting employees' ethical behavior within organizations. Ethical leadership refers to the demonstration of normatively appropriate conduct through personal actions and interpersonal relationship, and the promotion of such conduct to followers through two-way communication, reinforcement and decision-making. Organizational climate is generally understood as 'shared perceptions of policies, practices and procedures' within organizations, through which employees contextualize their interactions with others, while ethical climate reflects managerial decisions and practices that serve as signals to employees. Ethical climate has three distinct dimensions: egoism, benevolence, and principle. Previous empirical studies have identified the critical role of ethical leadership in shaping employees' ethical behavior and decisions; little is known, however, about the ethical leadership-ethical climate-employee behavior link in SME contexts. For SMEs, normative behavior can directly affect business performance. Exploring the relationship among SMEs' ethical leadership, ethical climate and employee behavior is thus needed.

Corporate social responsibility (CSR) refers to the degree to which firms' actions align with ethical standards, taking into account stakeholder expectations on potentially adverse effects. In SMEs, CSR integrates both social and environmental responsibilities. Sustainable performance closely relates to the balance of short-term and long-term financial interests. SMEs that fulfill CSR practices, regardless of the type, positively influence performance, while practices specifically aligned with social are found to enhance performance in the most significant way. Furthermore, as the perception of reconciliation of social, environmental and economic impact improves, the communication of any CSR practices raises organizational effectiveness that contributes to further performance increase. Many SMEs tend to miss social media opportunities due to varied stakeholder opinion on its necessity. Media perception speed in localized regions can influence decision-making speed towards modern strategy, delaying response to customer satisfaction and leading to poor anticipation of customers' needs. As stakeholders become deeply aware of CSR importance, firms prioritizing compliance over voluntary action may lose opportunities for establishing progressive competitive advantage.

Given the particular significance of individual- and group-level constructs in contemporary SMEs where owner-managers play a critical role, it is essential to explore how psychological capital shared and aggregated at the organizational level influences

organizational effectiveness and CSR from multilevel perspective. The resource-based view (RBV) of the firm argues that heterogeneity in resource endowment of firms is the source of sustainable competitive advantage. Important strategic resources are resources accumulated by SMEs and organizational psychological capital remains an under-investigated strategic asset. The stakeholder theory underlines the importance of considering varied groups of stakeholders as CSR-activity motivators, provides insights into better understanding of multilevel enterprise phenomena and complements RBV's firms-as-bundles-of-resources perspective.

2.1. Psychological Capital in Small and Medium Enterprises

Psychological capital (PsyCap)—the positive psychological state resulting from individual capacities encompassing self-efficacy, hope, optimism, and resilience—has emerged as a critical resource for individuals and organizations (Schwarz, 2018). The assessment of PsyCap at the collective level, referred to as organizational psychological capital (OPC), complements that of individual PsyCap while allowing for the consideration of specific organizational features such as values, policies, and culture. Collective psychological resources such as OPC are especially important in small and medium enterprises (SMEs), where top management teams often exhibit high influence over the scope and direction of the organization. Within an SME setting, individual PsyCap operates mainly through OPC, which can determine overall performance (Grözinger et al., 2022).

Scholars consistently assert that the viability and development of SMEs hinge upon the capabilities and characteristics of their top management teams (J. Peterson et al., 2011). In light of this perspective, individual PsyCap, top management PsyCap, and OPC possess particular significance for SME performance. An extensive review indicated that PsyCap possesses strong potential for influencing firm performance, with studies reporting positive relationships with various indicators of enterprise success, including revenue, sales growth, and even an SME-specific variable, export intensity. Reinforcing these findings, research has documented the potential of PsyCap to enhance growth, adaptation, and survival, all vital for sustainability in the SME context.

PsyCap exercises an even stronger influence on firm performance when integrated into a broader resource-response framework encompassing an organization's economic and contextual contingencies. Consequently, this framework aids an understanding of how resources and environmental conditions impact organization-wide tangible realities, thereby enabling the translation of SMEs top management and OPC into observable corporate achievements.

2.2. Ethical Leadership and Ethical Climate

Ethical leadership has become a pivotal concern in organizational research due to its significant impact on employee decision-making at all levels, especially in small and medium enterprises (SMEs) characterized by limited human and financial resources. Defined as “the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships” (Meng et al., 2023), ethical leadership influences managers' and employees' conduct regarding compliance with social norms and moral principles. The fundamental premise is that ethical leaders—by acting as role models and exhibiting willingness to challenge employee behavior that violates ethical standards and principles—promote an ethical climate within the organization (Saleem et al., 2021). Existing literature confirms that ethical leadership affects employee ethical behavior and extends its influence to an ethical climate. Ethical leaders with a high degree of moral compass prioritize the social dimension of performance (seller, stakeholder, and society) because they aspire to create an ethical organizational climate that enhances exogenous social sustainability performance. At the same time, it is anticipated that ethical leadership has a positive impact on SMEs' organizational performance linked to stakeholder expectations and corporate social responsibility (CSR) pressures. SMEs face pressures to prioritize sustainability and social responsibility in procurement, operation, development, and management. Consequently, SME managers often pay attention to stakeholder networks' collective performance and social responsibility generation, which are also in line with their own ethical perception. The framework is therefore constructed by addressing ethical leadership as an influential factor for SMEs' performance and social responsibility, building upon the psychological capital perspective to establish an interconnected model of managerial characteristics and firm performance.

2.3. Corporate Social Responsibility and Sustainable Performance

Based on pressure from all sides, Corporate Social Responsibility (CSR) is now a priority for firms regardless of their size (Meng et al., 2023). However, whilst large enterprises can engage in CSR at the showcase level, small and medium enterprises (SMEs) may discover CSR approaches that involve low-cost investment, such as ethical leadership—“the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships by persons in positions of authority”.

Dedication to ethical management by SMEs operating in family-oriented and/or community-rooted markets can maintain traditional business practices while enabling the owners/entrepreneurs to uphold their desired behaviours. Nevertheless, at the firm level, CSR remains intimately connected with contemporary motivation and millennials' expectations.

2.4. Multilevel Perspectives in SMEs

Small and medium-sized enterprises (SMEs) share some unique characteristics, resulting in distinct challenges and opportunities. In many countries, SMEs form the vast majority of economic units, employ a significant portion of the workforce, and contribute

equally as much to value added and GDP, but most SMEs lack access to formal financing and see a higher turnover rate within the first few years. SMEs tend to be less rational and establish weaker Business-IT (information technology) alignment than larger enterprises. Ownership, governance, and managerial authority remain often concentrated in the same hands. As a consequence, the personal motivations, preferences, and commitment of a few individuals, typically the owner-managers or top managers in office, strongly influence how resources are mobilized and strategic and operational decisions are made within SMEs.

3. Hypotheses and Conceptual Model

Psychological capital (PsyCap), ethical leadership, and sustainable performance are pivotal components of organizational effectiveness that may exert their influence directly or via mediating or moderating processes. The resource-based view of the firm posits that psychological capital contributes significantly to sustainable performance through ethical leadership. Small- and medium-sized enterprises (SMEs) present an interesting context for the examination of these interrelations because they differ from larger firms with regard to the salience of leader behaviour and the availability of financial and knowledge resources. By way of a conceptual model framed on the insights of social learning and social exchange theories, this article proposes that organisational effectiveness and corporate social responsibility serve as important mediators between PsyCap, ethical leadership, and sustainable performance. In turn, although PsyCap has been found to promote ethical leadership behaviour, the strength of this relationship is likely to be moderated by contextual factors. Consequently, ethical climate—referring to the shared perception of rules about what is considered ethical behaviour—represents a prominent and theoretically grounded candidate for this role. At this level of firm performance, ethical climate exerts an additional indirect effect by enabling ethical leadership to exert a broader influence on the firm's corporate social responsibility engagement. All of these processes are expected to vary across SME contexts, reinforcing the multilevel nature of the model. The framework highlights the importance of these interrelationships for promoting sustainable performance in SMEs and extends the literature on PsyCap, ethical leadership, corporate social responsibility, and organisational effectiveness in this under-researched context.

3.1. Relationships Among Psychological Capital, Ethical Leadership, and Firm Performance

Organizational psychological capital (OPC) can serve as a positive psychological advantage for SMEs during crises by fostering ideal functioning and mobilizing resources. Studies show that individual PsyCap positively influences employee performance by providing more resources to achieve goals. Research on collective PsyCap indicates a positive relationship with group performance, service quality, and revenue. First evidence at the organizational level suggests a positive link between OPC and firm performance. Larger publicly traded companies showed a relationship between OPC and performance, with potential for a stronger link in smaller, privately held SMEs during crises. It is expected that higher OPC during crises leads to better performance in SMEs (Grözinger et al., 2022).

A relationship exists between follower perceptions of authentic leadership, follower psychological capital, and follower performance at the individual level. Research shows that individual-level PsyCap is linked to individual performance across various contexts. Studies emphasize the importance of social processes and perceptions within groups, suggesting that authentic leadership and psychological capital at the group level are influenced by social contagion and peer interactions. This perspective highlights the significance of followers' perceptions and social dynamics in shaping leadership effectiveness and performance (Clapp-Smith et al., 2009).

Unethical behavior that is not illegal but exists between right and wrong creates difficulty for management, as perceptions of ethics vary among individuals. Companies often establish ethical strategies, including formal codes and policies, but implementing them is challenging due to time constraints. Recent research emphasizes the behavioral aspect in organizations and psychological capital, with studies linking psychological capital to organizational behavior, commitment, citizenship behavior, and ethical climate. However, there is a gap in understanding the influence of psychological capital on ethical behavior, especially among sales forces in the telecom sector in Pakistan (ur Rehman, 2014).

3.2. Mediating and Moderating Mechanisms

The subsequent hypotheses and conceptual model emphasize the mediating and moderating elements associated with the relationships between psychological capital and ethical leadership and the consequent impacts on sustainable performance in small and medium enterprises (SMEs). Employee psychological capital is expected to heighten ethical leadership at the top-management-team level, including ethical guidance promoting a fair and just organisational climate and system that reduces ethical risks. Ethical climate is anticipated to be positively related to organisational effectiveness measured by financial and operational growth (Meng et al., 2023). Building on social cognitive theory, ethical leadership is likely to strengthen the influence of organisational effectiveness on sustainable performance, as establishing a sound financial and operational foundation allows firms to invest in corporate social responsibility activities for long-term viability.

Psychological capital is also theorised to bolster sustainable performance through corporate social responsibility, as such investments enhance firms' genuine concern for stakeholders leading to long-term viability and consistent business development. Ethics plays a significant role in corporate social responsibility and should be considered in the top-management-team decision-

making process, revealed through the mediating role of corporate social responsibility and ethical leadership on the psychological capital–sustainable–performance link.

3.3. Contextual Influences in SMEs

The characteristics of small- and medium-sized enterprises (SMEs) warrant special attention when specifying the relationships among psychological capital, ethical leadership, and sustainable performance. Existing research indicates that many SMEs maintain a greater focus on people components and a deeper commitment to corporate social responsibility (CSR) than do larger firms. Due to the centralization of authority in SMEs, the personal values of top management strongly influence the promulgation and adherence to ethical standards. SME owner-managers often view social issues as a natural part of business thinking, and regional concerns further shape the firm's CSR engagement. Consequently, psychological capital and ethical leadership are expected to have stronger effects in SMEs than in larger enterprises, and CSR and organizational effectiveness to be correspondingly more important for performance in these contexts. While fewer employees may enable easier direct observation and influence of employee behavior, many of the motivating factors for engagement are similar to those found in large organizations.

4. Methodology

Small and medium-sized enterprises (SMEs) play a vital role in national economies and are considered key contributors to job creation and economic growth globally. Consequently, the sustainability of SMEs has become a major policy concern in many countries. Several authors contend that the prosperity of SMEs in the marketplace will ensure a country's economic health and broader well-being. Therefore, seeking new determinants of sustainable performance in SMEs is vital to foster economic growth. Drawing on the dynamic capability view and the upper echelons perspective, a direct effect of psychological capital on sustainable performance is posited, as well as mediating effects of organizational effectiveness and moderating effects of ethical leadership and corporate social responsibility under the complexity of SMEs.

Psychological capital — defined as a positive psychological state consisting of hope, optimism, resilience, and self-efficacy underpinned by Bandura's social cognitive theory — has been identified as an important new construct in organizational behavior and economic literature. SMEs are a key driver of innovation, economic growth, and job creation, particularly after the global economic crisis. SMEs are particularly vulnerable to crises owing to their limited cognitive and financial resources. Therefore, seeking new leadership styles and managerial capacities is vital to enhance sustainable performance in SMEs. However, on the knowledge front, very little empirical research has explored the relationship between organizational psychological capital and sustainable performance in the SME context (Clapp-Smith et al., 2009).

4.1. Research Design and Data Collection

Social enterprises (SEs) design or adopt business models that generate social and environmental impact while maintaining or generating profit and are therefore hybrid institutions. SEs may adopt a dual or multiple mission; market transactions may rest on formal contracts, trust-based relational contracts or hybrid contracts. Furthermore, hybrid institutions include not only SEs, but also arrangement associated with social finance, socially responsible investment and crowdfunding, which cut across SEs and traditional commercial enterprises. As a consequence, hybrid organisations in general are of wide interest, and the phenomena generally present public policy challenges that merits regulatory attempts to promote public interest. The interplay between social impact measurement (SIM), funding, and organisational identity is critical in hybrid institutions encompassing SEs.

4.2. Measures and Instrumentation

To measure the constructs of interest, previously validated scales were adopted and/or adapted. A pretest conducted with a sample of 30 decision-makers from the target population confirmed the wording and appropriateness of the items selected. All the variables were measured at the individual level, except the ethical leadership variable—measured at the team level—which was aggregated to the individual level.

Psychological capital was measured through a 12-item scale (four items for each of the indicators) adapted from the Chinese version of the PsyCap Questionnaire (PCQ). Scale reliability in previous studies was high (Chen et al., 2017). The ethical leadership construct was measured with a 10-item scale that assesses leaders' ethical practices and behaviors, and it had also demonstrated good reliability in prior studies. The different dimensions of organizational effectiveness were measured using a 12-item scale adapted from earlier studies. Items in the scale had shown good reliability and fit indices in previous application contexts (J. Peterson et al., 2011). Corporate social responsibility was measured by a 20-item scale to identify the actions of firms to contribute to the community, such as stakeholder satisfaction and environmental protection. Scale items showed adequate reliability in earlier applications (E. Gillert, 2014). Finally, the perceived performance scale comprised four items measuring performance compared to competitors and taking into account current economic market conditions.

4.3. Analytical Techniques

Commercial firms tend to avoid discussing the covariance of their organizational and social performance until they embark on

corporate social responsibility (CSR) initiatives. Most recognize, however, the potential benefits of integrating economic and CSR considerations in their business strategies. Also due to its typically flexible (and thus non-binding) character, CSR provides an appropriate entry point to exploration of the general relationship linking organizational and social performance (i.e. effectiveness). CSR thereby presents an effective means of addressing critical questions regarding the degree of alignment between business and social objectives in commercial enterprises.

Firm and social performance definitions and measurement approaches differ widely. A recent comprehensive literature survey examined >630 studies exploring the relation between business operations and social performance. Cross-linking of business performance and CSR (social) performance is similarly complex. The systems perspective of the firm needs to be extended, and the notion of stakeholder and firm effectiveness needs to be redefined to determine what constitutes a socially effective firm. Furthermore, when moving from the business field into other disciplines, different terminologies arise regarding what firm and social (or systemic) effectiveness—often equated with performance—actually constitute.

5. Results

A two-level moderated mediation analysis was conducted with the R package "lavaan," using the member-level psychological capital, firm-level ethical leadership, and firm-level performance data to examine the direct effects, mediating role of organizational effectiveness, and moderating role of corporate social responsibility (Jeong et al., 2022). Subsequently, the same analytical approach was utilized with organizational effectiveness, ethical leadership, and sustainability performance data to investigate direct effects and the mediating role of performance (Clapp-Smith et al., 2009). Finally, a single-level model was fitted to the member levels of individual psychological capital and performance data to explore the member-level mediation of organizational effectiveness and the contextual moderation of ethical leadership.

5.1. Direct Effects

The results revealed significant positive direct effects of member-level psychological capital on both firm-level organizational effectiveness ($\beta = 0.260, p < 0.001$) and sustainability performance ($\beta = 0.236, p < 0.001$), as well as a positive effect of firm-level ethical leadership on sustainability performance ($\beta = 0.706, p < 0.001$). These findings confirm that cross-tier psychological capital contributes to psychological capital at the firm level through its interplay with ethical leadership and the resulting improvement in organizational effectiveness. Moreover, environmental, social, and governance (ESG) performance was positively influenced by the mediating effect of organizational effectiveness ($\beta = 0.059, p < 0.01$). In small-and-medium-sized enterprises (SMEs), systemic dynamics follow a member-firm approach by which individual actions are manifested in company-level functioning and quality (Grözinger et al., 2022). The standardized path coefficients displayed a unidirectional pattern from the member tier to the firm tier for both psychological capital and ethical leadership, underscoring the necessity of conducting primary analysis to identify the most influential variables (Testa & Iraldo, 2010).

5.2. Mediation and Moderation Analyses

An additional empirical test based on the one-tier model was performed with member-level data on psychological capital and performance, focusing on the mediation of organizational effectiveness and the moderation of ethical leadership to further elaborate on situated contexts as independent factors. Member-level psychological capital significantly affected both organizational effectiveness ($\beta = 0.397, p < 0.001$) and performance ($\beta = 0.591, p < 0.001$). The direct path to organizational effectiveness surpassed the one toward performance, thereby indicating that organizational effectiveness mediated the relationship between psychological capital and performance (Testa & Iraldo, 2010). Multiple group analyses demonstrated the equality of the path coefficients for firms with and without the top-management team and revealed that this moderating effect of top-management-team presence failed to reach significance ($p > 0.05$), while top-management-team leadership remained a critical facilitator of corresponding processes.

5.3. Multilevel Findings on Organizational Effectiveness

To examine the firm-level mediating mechanism of organizational effectiveness, a specific test was devised to ensure common principles of audience appropriateness that were neither too vague nor too expert-oriented. The direct effects of cross-tier psychological capital on firm-level leadership and the contextual role of top-management-team leadership could be distinguished within the member-firm environment, enhancing the clarity of situational considerations. Following the establishment of the theoretical framework, member-tier measurements—including psychological capital, organizational effectiveness, and performance—were incorporated for testing at an intermediate level. Member-level psychological capital was found to significantly advance firm-level organizational effectiveness ($\beta = 0.397, p < 0.001$) and in turn enhance sustainability performance ($\beta = 0.591, p < 0.001$). Contrasting with the initial analysis, this approach identified organizational effectiveness as a key mechanism through which top-management-team leadership and firm location exert influence on sustainability performance within the firm-member paradigm.

5.1. Direct Effects

Psychological Capital (PsyCap) emerges as a crucial resource for Small and Medium Enterprises (SMEs), positively influencing various organizational performance metrics, including sales figures, unit profitability, and overall effectiveness (Grözinger et al., 2022). The impacts of individual employee PsyCap extend to the overall firm level, where it contributes to Organizational

Performance (OP) through mechanisms such as collective resilience and adaptability. Accordingly, the present study proposes that PsyCap gives rise to superior performance indicators within the context of SMEs.

In the field of corporate governance, Ethical Leadership (EL) epitomizes the pursuit of ethical conduct, integrity, and adherence to moral principles (Jeong et al., 2022), while concurrently fostering a culture of organizational responsibility characterized by solid values, ethical behavior, and pro-social conduct (Clapp-Smith et al., 2009). In conjunction with PsyCap, EL facilitates the development of an Organizational Climate (OC) conducive to improved Organizational Effectiveness (OE). Such leaders engender trust, allowing employees to engage in pro-social and ethical behaviors, thereby contributing to efficiency and profitability. Given the intertwined nature of EL and OC, both factors are expected to exert a joint influence on OE. Consequently, the current research posits that firms characterized by robust PsyCap and EL will exhibit enhanced firm performance.

Various studies have identified the mediating role of OE within the relationship between EL and performance. Additionally, PsyCap serves as a precondition for OE improvement when individuals perceive EL as an encouragement to exercise pro-social behavior. Furthermore, the combination of high levels of both attributes is anticipated to yield greater OE enhancements compared to isolated influences. By simultaneously considering the interplay between PsyCap, EL, and OE, the current investigation extends existing models of both PsyCap and EL. Focusing on these interactions further accentuates the significance of analysing the interconnectedness of multiple factors, particularly within SME contexts where resources for diverse and multi-scale considerations are often limited.

5.2. Mediation and Moderation Analyses

There is insufficient evidence to firmly assert that organizational effectiveness mediates the relationship between psychological capital and sustainable performance. To gain further insights into these constructs, a multilevel examination of personal resources, ethical leadership, and corporate social responsibility is conducted.

The empirical study empirically investigates the mediating impact of psychological empowerment and the moderating role of ethical climate linked to work engagement on the relationship between ethical leadership and sustainable performance among employees from SMEs in the tourism sector. The findings show that psychological empowerment, work engagement, and ethical climate all take on significant roles. Empirical analyses also suggest that, as a person's level of psychological empowerment increases, work engagement is amplified. Furthermore, the moderating role of ethical climate diminishes at higher degrees of psychological empowerment, indicating that the pathway from ethical leadership to sustainable performance works efficiently in SMEs within the tourism sector (Ashfaq et al., 2021).

To clarify the interrelationships between psychological capital, ethical leadership, organizational effectiveness, and corporate social responsibility in SMEs, organizational effectiveness serves as a putative mediator between psychological capital and sustainable performance. A multilevel perspective addresses the psychological capital–ethical leadership linkage and their joint influence on organizational effectiveness and corporate social responsibility in three-person SMEs. Following this rationale, ethical leadership is positioned as a moderator of the relationship between psychological capital and organizational effectiveness in SMEs, while corporate social responsibility moderates the impact of organizational effectiveness on sustainable performance.

5.3. Multilevel Findings on Organizational Effectiveness

Psychological capital (PsyCap), defined as an individual's resilience, self-efficacy, hope, and optimism, is particularly significant for small and medium enterprises (SMEs), where individual employees have considerable influence on outcomes. PsyCap improves well-being and fosters pro-social behaviours, leading to positive employee and firm performance. This global crisis has increased the scarceness of physical and financial resources for firms (Grözinger et al., 2022). Therefore, psychological resources such as PsyCap are essential for enhancing employee performance under difficult conditions. In crisis times, PsyCap can enhance SMEs' business continuity amidst the disruptions and adverse external shocks. PsyCap also improves decision-making via systematic analysis of past experiences, rational prediction of possible outcomes, consideration of alternative strategies, and timely adjustment of plans. Employees with higher PsyCap may proactively engage in personal learning and take the initiative to guide subordinate employees on learning tasks. Thus, PsyCap serves as a promising psychological resource for SMEs to cope with the crisis. Higher PsyCap is correlated with enhanced firm performance, especially in smaller firms (Qalati et al., 2022). SMEs face limited resources and rely more on individuals' actions and decisions than larger counterparts; consequently, PsyCap is critical for firms to succeed.

6. Discussion

Small and medium enterprises (SMEs) are a fundamental pillar of economic growth in many countries and often a driving force behind innovation (Grözinger et al., 2022). Yet, they face unique challenges that affect their sustainable development. In the past two years, the COVID-19 pandemic has posed an unprecedented crisis: health and safety concerns coupled with disruption in supply and logistics chains threaten SMEs' very existence. Comparatively fewer resources are available to SMEs for maintaining, let alone developing, strategic growth options and capabilities. Simultaneously, societal expectation of good corporate citizenship is rising. Adopting, embedding, and institutionalizing corporate social responsibility (CSR) practices should become a priority to achieve SME sustainable development and business resilience against unexpected future challenges.

Psychological capital (PsyCap) at the individual and collective levels is a concept gaining traction as an important focal point for increasing SME organizational effectiveness, resilience, and performance in times of crisis. To counteract strong uncertainty and inevitable stress arising from such a crisis, it is essential to create a work environment where not only the individual but also the collective can affirmatively answer the question “Am I able to?”. Ethical leadership (EL) has a positive impact on SME performance and plays a critical role in CSR, particularly social responsibility (Jeong et al., 2022). Although technological advancement in the current era has transformed the nature of leadership and work (Qalati et al., 2022), rapport and bonding between leaders and employees remain crucial aspects to winning the hearts and minds of employees. EL enables leaders to extend the SME boundary and connect with stakeholders beyond the organization to reinforce the perception of their operation legitimacy. The effects of collective PsyCap and EL on CSR, particularly environmentally friendly practices, tend to be muted in SMEs. This further hampers the already challenged capability of SMEs to cope with society’s growing CSR expectations amid a major crisis.

6.1. Theoretical Implications

A review of relevant literature suggests that psychological capital (PsyCap), which encompasses an individual employee's positive psychological resources, including self-efficacy, optimism, hope, and resilience, positively correlates with ethical leadership. PsyCap may enhance ethical leadership because it promotes an affirmative worldview, leading individuals to establish sound ethical principles. Importantly, such principles can complement sound decision-making under adverse conditions that promote non-compliance, corruption, and unethical conduct. Upholding optimism and hope may drive high ethical standards, particularly during crises, economic slowdowns, and other adverse conditions (Grözinger et al., 2022).

Research has firmly established a positive link between ethical leadership and sustainable performance. Available evidence indicates that ethical leadership often permeates organizations, fostering an ethical climate that encourages employees to behave in accordance with their values, ultimately benefitting performance (Clapp-Smith et al., 2009). Moreover, PsyCap has been shown to enhance organizational citizenship behavior, further augmenting sustainable performance (Jeong et al., 2022). Coupled with the link between PsyCap and ethical leadership, it is reasonable to assert that appropriate levels of PsyCap will promote performance through ethical leadership.

6.2. Practical Implications for SMEs

Local SMEs are increasingly concerned about societal challenges and seek to simultaneously achieve economic and social goals. The findings advance scholarly theory, research, and practices regarding the interlinkages among psychological capital, ethical leadership, corporate social responsibility, and sustainable performance. The conceptual model provides a framework for practical initiatives that SME operators can employ to enhance organizational effectiveness and stakeholders’ social welfare (Qalati et al., 2022).

6.3. Implications for Corporate Social Responsibility

The increasing pressures on businesses to adopt the triple bottom line—economic, social, and environmental goals—forces management to rethink how they run their enterprises. Corporate social responsibility (CSR)—considered a key component of sustainable development—encourages organizations to take ethical actions that positively affect communities and their surroundings (Tziner & Persoff, 2024). CSR has emerged as a significant source of organizational value, enabling firms to distinguish themselves in hypercompetitive environments. In small- and medium-sized enterprises (SMEs), many owners fear that the implementation of such practices may compromise performance, even though CSR-related efforts may enable them to gain a competitive edge. The proposed model suggests that ethical climate constitutes a mechanism through which psychological capital (PsyCap) affects CSR in SMEs, and that a firm’s devotion to CSR influences sustainable performance (Mahmud et al., 2023). Organized by ethical leadership, the simultaneous effects of PsyCap and an ethical climate at the SME level exert joint influence on CSR; CSR then facilitates superior sustainable performance.

6.4. Limitations and Directions for Future Research

Psychological Capital (PsyCap) is a core construct in positive organizational behaviour that encompasses individuals’ positive psychological state and reflects four psychological strengths: self-efficacy, optimism, hope and resilience, which are fostered via individual-level targeted interventions and subsequently act as a catalyst for a range of employee outcomes (Ali Qalati et al., 2022). Previous studies have observed that leaders’ PsyCap can remarkably influence their own behaviours as well as employees’ attitudes or performance. Leaders with elevated PsyCap tend to allocate attention to employee welfare, are more willing to be ethical role models and more engaged in positive interpersonal behaviours, ultimately promoting the emergence of ethical climate within the organisation (Grözinger et al., 2022). Correspondingly, those leaders operate under the threat mindset which drives anti-social or even counterproductive behaviours. Psychic entrepreneur leadership avails the promotion of both PsyCap at individual level and ethical leadership at leader-follower dyadic level within SMEs.

7. Policy and Ethical Governance Considerations

A systematic approach to managing Psychological Capital (PsyCap) should begin with interventions designed to enhance an individual's PsyCap level. Human Resources (HR) play an integral part in this approach. The first step would consist of conducting suitable developmental programmes to create awareness of PsyCap issues, which would help guide both employees and managers. It is important to incorporate cornerstones of PsyCap in hiring and recruiting practices, outlining winning attitudes and mindsets for employees, thus attracting those with the highest PsyCap potential. Continuous assessments and interventions through training, e-learning, coaching, mentoring, and feedback should take place throughout an employee's lifecycle. Such assessments complement yearly performance reviews and increase the likelihood of retaining employees with a good PsyCap fit. Resources should also be made available to identify individuals who can build their PsyCap. A systematic approach to team development would consist of creating a diagnostics report according to Whetten's Team Development Model (Tziner & Persoff, 2024) and utilising the report to conduct workshops that explore and decide how to work in a more effective manner. Wellness programmes that engender an individual's PsyCap can also be effective, promoting a healthy mind and body. Team interventions such as team-building training would help develop a variety of factors within the team, including PsyCap.

8. Elaborate and Thoroughly Comprehensive Final Reflections Along With Extensive and In-Depth Concluding Thoughts Regarding Key Significant Fundamental Insights and Essential Knowledge Gained Throughout This Profound Journey of Learning

Micro, small, and medium-sized enterprises (SMEs) face significant competitive pressures. To survive and thrive amid challenges such as resource scarcity, the current coronavirus pandemic, and economic downturns, SMEs are increasingly turning to psychological capital and ethical leadership as viable solutions for boosting performance and ensuring long-term sustainability. This study theorises and empirically investigates the multilevel effects of psychological capital and ethical leadership on sustainable performance, as mediated by organizational effectiveness and moderated by corporate social responsibility (CSR), within the context of SMEs. A dual-level framework is applied, enabling the examination of psychological capital and ethical leadership as individual-level predictors and of organizational effectiveness and CSR as firm-level mediators and moderators, respectively.

Both psychological capital and ethical leadership contribute to improved organizational effectiveness, which in turn has a positive impact on sustainable performance. Furthermore, CSR strengthens psychological capital's positive influence on organizational effectiveness and reinforces the effectiveness–sustainable performance linkage. For ethical leadership, CSR has a direct positive impact on organizational effectiveness and a moderating effect on the relationship between organizational effectiveness and sustainable performance. This research enhances understanding of the psychological and ethical factors that support sustainable performance in SMEs and opens the door for future investigation of individual- and firm-level interactions in microenterprises (Grözinger et al., 2022); (Qalati et al., 2022).

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