

Ethical Leadership and Employee Psychological Safety as Drivers of Organizational Innovation in Global Service Industries

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Received: 08.12.2025; Revised: 20.01.2026; Accepted: 12.02.2026; Published: 25.03.2026

Abstract

Innovation in organizations has emerged as a major source of competitive advantage in the service sector worldwide, where technological evolution is rapid, the industry is knowledge-based, and customer demands are changing dynamically. In this paper, the authors explore how ethical leadership and employee psychological safety are important determinants of organizational innovation. The study will be based on both Social Learning Theory and Social Exchange Theory, in which ethical leadership affects innovation directly or indirectly through psychological safety. The research design was a quantitative, cross-sectional study, and the sample comprised 342 employees from international service-based organizations in the IT, financial services, consulting, and hospitality sectors. The hypothesized relationships were tested using Structural Equation Modelling. The findings suggest that ethical leadership has a substantial positive impact on psychological safety ($\beta = 0.63$, $p < 0.001$) and that psychological safety has a substantial positive impact on organizational innovation ($\beta = 0.49$, $p < 0.001$). The partial mediation is also supported by showing that ethical leadership has a direct influence on innovation ($\beta = 0.32$, $p < 0.001$). The model accounts for 52% of organizational innovation variation by demonstrating the significant contributions of leadership ethics and workplace climate. These results indicate that structural investments alone do not promote innovation in service industries; rather, high rates of relational trust and facilitating psychological conditions are key contributors to innovation in service industries. The research contributes to the literature on leadership and innovation by proposing an integrated empirical framework that combines ethical leadership and psychological safety, with practical implications for organizations aiming to achieve sustainable innovation performance.

Keywords

Ethical Leadership, Psychological Safety, Organizational Innovation, Global Service Industries, Structural Equation Modelling, Leadership Behaviour.

I. Introduction

In the global service industries, which are highly dynamic due to rapid change, organizational innovation has become a critical element in maintaining competitive advantage and long-term growth. The digital transformation, worldwide competition, changing customer expectations, and technological disruption are highly dynamic environments in which service organizations operate. In contrast to manufacturing industries, innovation in service industries largely relies on human capital, teamwork in problem-solving, and knowledge sharing. Consequently, leadership behaviour is vital in shaping an organizational climate that either encourages or inhibits innovation. The lack of ethics and governance across industries has only underscored the need for leadership grounded in integrity, transparency, and accountability.

The trend of ethical leadership has come to the fore as a key ingredient in fostering trust, fairness, and responsible decision-making in organizations. Role modelling and value-based actions are the approaches leaders use to model moral behaviour and influence employees (Liu et al., 2023). Employees will develop trust and commitment to the organization when they see their leaders as ethical. Nevertheless, innovation cannot be achieved without trust alone; employees must have a culture that allows them to share ideas, challenge the status quo, and experiment

without fear of being chastised or even punished (Pauliené et al., 2026). This state of being is termed psychological safety, a shared perception that the workplace trusts interpersonal risk-taking and free communication (Abuzaid et al., 2024).

Psychological safety helps employees to transform trust into innovative behaviour. Service creation values in service industries, whereby responsiveness, creativity, and contact with the customer are important to the service delivery, demand workers to feel free to exchange novel ideas and collaborate in teams (Khan et al., 2023). Even ethical leadership might not entirely translate into innovation results without psychological safety (Chen et al., 2022; Islam et al., 2024). Thus, analyzing the joint effect of ethical leadership and psychological safety provides a clearer picture of how innovation is nurtured in global service organizations (Li & Peng, 2022).

The research questions of the study include studying the relationship between ethical leadership and psychological safety of employees, studying the relationship between psychological safety and organizational innovation, and studying whether psychological safety mediates the relationship between ethical leadership and innovation. This study, by combining leadership behaviour with psychological climate determinants, can contribute to understanding how organizations operating in the global service industries can strategically increase innovation through ethical, supportive management behaviour.

Key Contribution

- The research confirms that organizational innovation is not a strategic or technological outcome, but a behavioral outcome of ethical leadership that is based on integrity and transparency.
- It defines psychological safety as the key mediator; ethical leaders can provide a safe working environment in which employees are not afraid to take risks and present new ideas without punishment.
- It sampled 342 professionals in fields such as IT and finance, the study gives a validated model that demonstrates that the role of leadership and workplace climate explain 52 percent of the change in innovation performance.

The current paper is divided into seven parts that provide a structure and a coherent framework for analyzing the relationship among ethical leadership, psychological safety, and organizational innovation in the global service industries. Section I presents the research issue, explains the importance of ethical leadership and psychological safety, and outlines the study objectives. Section II is a literature review that identifies gaps in both theories and empirical evidence. Section III presents the theoretical background and gives the research hypotheses. Section IV describes the research methodology, that is, research design, data collection, measurement and analysis procedures. Section V presents the results of the empirical findings and statistical results, and Section VI explains the findings in relation to the available theories and their implications in practice. Finally, Section VII will cover a conclusion of the study by discussing the key findings and the future research plan.

II. Literature Review

The most common definition of ethical leadership is a leadership behaviour based on integrity, fairness, accountability, and morality. Ethical leaders are role models because they are honest, transparent, and considerate of the stakeholders, hence establishing a clear standard of acceptable behavior in organizations. They promote candid communication, develop upon ethical expectations, and balance between words and actions. Ethical leadership within companies enhances confidence and respect between the leaders and employees and sets the stage of positive behaviour in the workplace environment (Zhao et al., 2023; Iqbal et al., 2022). Service industries are sensitive to ethical leadership in influencing the attitude and performance results among employees since interaction and reputation are the major variables (Hoang et al., 2023; Su et al., 2022).

Based on the literature available, ethical leadership has a positive influence on the innovation process within an organization in the sense that it enhances the process of knowledge sharing, teamwork, and taking responsibility in risk taking. Workers tend to think that their leaders are

ethical, thus more inclined to think of their significance and encouragement, which is why they are more ready to introduce new ideas. The ethical leaders have erased the fear of failure and have created a culture of fairness that helps in solving the creative issues. Ethical climates have been found to promote engagement, commitment, and discretionary behaviour among employees and through this, innovation is generated (Imran et al., 2025). However, regardless of the effectiveness of the leadership behaviour, innovative results might not be obtained directly unless a favorable psychological work environment is provided (Jin et al., 2022).

Psychological safety is a collective conviction among the employees that the working environment is conducive to interpersonal risk-taking (Vakira et al., 2023). It gives people an opportunity to say what they think, confess, ask questions, and share new ideas without fear of adverse repercussions. Learning behaviour, creativity, and group innovation have been closely linked with psychological safety (Ahmad et al., 2023; Saeed et al., 2022). Employees in innovative organizations should be able to take risks and feel comfortable putting the current processes to the test (Yang & Liu, 2022; Ye et al., 2023). Empirical studies have evidenced that in psychologically safe teams, there is increased collaboration, adaptability, and performance. Therefore, psychological safety is an important process that connects leadership behaviour with the results of innovation (Burhan et al., 2023; Khairy et al., 2023).

Despite the results of previous research, which has focused on the analysis of ethical leadership and psychological safety separately, there is very little literature that has combined the two factors in the framework of the global service industry. According to the available literature, the hypothesis is that there could be a mediating role where ethical leadership leads to psychological safety, which subsequently boosts innovation in the organization. Nevertheless, there is still the necessity of empirical research to confirm this integrative framework. The present study helps fill this gap as it will aid the understanding of leadership and innovation by researching the integrated impact of ethical leadership and psychological safety on organizational innovation using global service contexts.

III. Theoretical Framework

The work contains a proposed integrative theory that connects the concepts of ethical leadership, psychological safety, and organizational innovation in the global service sectors. Ethical leadership is theorized as the independent variable, which influences the climate in the organization, and psychological safety is one of the mediating variables through which leadership behaviour affects the outcomes of innovation. The dependent variable is organizational innovation, which is the capability of the organization to produce and apply new ideas, processes, and services. The model presupposes that the leadership behaviour has an impact on the employee perceptions, which in turn impact the innovative actions and performance.

The theoretical perspectives support the proposed relationships. According to the Social Learning Theory, employees monitor and emulate the behaviour of ethical leaders who act as role models of integrity and fairness. Employees embrace ethical norms through a series of interactions and build trust in the leadership. Social Exchange Theory also states that in cases where leaders are ethical and supportive, employees will follow suit by behaving positively, such as through engagement, sharing of ideas, and discretionary effort. Another theory that supports the given framework is the Leader-Member Exchange Theory, which emphasizes the significance of good relationships between leaders and employees, which increases mutual trust and open communication. All of these theories collectively explain the route between ethical leadership and psychological safety and, later on, to innovation.

According to this integrative framework, the study comes up with the following hypotheses. The adoption of ethical leadership will have a positive impact on psychological safety, where rightful and open-minded leaders will provide an atmosphere of confidence. It is also hoped that psychological safety would have a positive effect on organizational innovation, as more secure employees would be ready to experiment and inject new creative ideas into the company. Innovation in an organization is also supposed to be directly affected positively by ethical leadership. Lastly, psychological safety is hypothesized to mediate the association between ethical leadership and innovation, enhancing the indirect channel, whereby leadership behaviour leads to

innovative results. This is the theoretical model that will form the basis on which practical testing is carried out in the following sections.

IV. Research Methodology

The research design of the study is a quantitative design based on a deductive research approach to investigate the relationships that exist between ethical leadership, psychological safety, and organizational innovation in global service industries. The cross-sectional survey strategy was used because it allows obtaining perceptual information about employees in different service industries in a particular period of time. The quantitative design is suitable since the study will seek to formulate hypotheses, which have been derived theoretically, and then test them through statistical modelling.

The conceptualization of the research is that ethical leadership is an independent variable, psychological safety is a mediating variable, and organizational innovation is a dependent variable. The main analytical method was chosen as Structural Equation Modelling (SEM) since it enables the study of more than one relationship and mediation effect to be used at the same time, with a correction of measurement error.

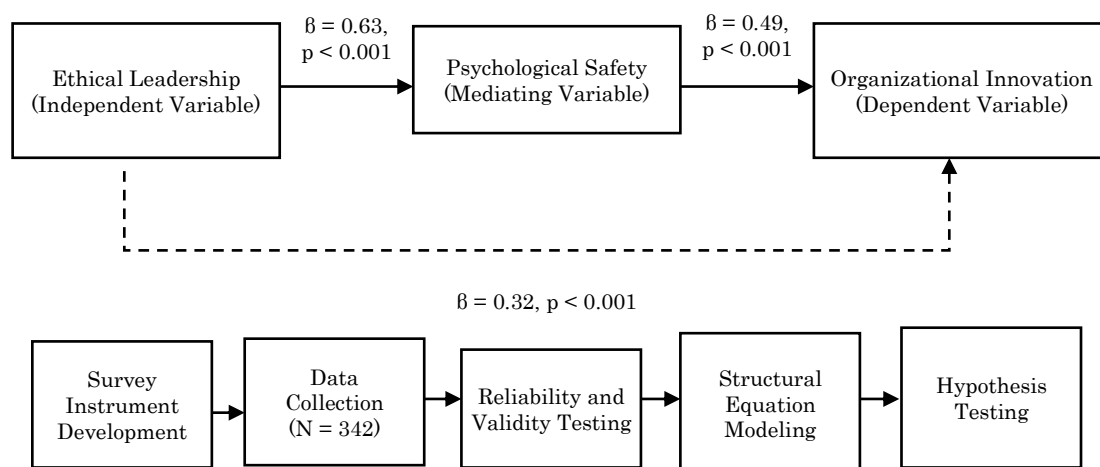


Figure 1. Integrated research framework and methodological process in the global service industry context

The interconnected research model in figure 1 is designed to associate Ethical Leadership (independent variable), Psychological Safety (mediating variable), and Organizational Innovation (dependent variable) in the context of the global service industry. The upper part illustrates the standardized relationships between the ethical leadership and psychological safety ($\beta = 0.63$, $p < 0.001$), and organizational innovation, both directly ($\beta = 0.32$, $p < 0.001$), and indirectly by means of psychological safety ($\beta = 0.49$, $p < 0.001$), which proves the existence of partial mediation. The bottom section gives the chronological steps in the methodology used in designing the instrument of the survey, data collection ($N = 342$), reliability and validity, structural equation modelling, and hypothesis testing.

A. Instrument Development and Measurement

The survey tool was constructed on the basis of validated scales of the previous research in the field of leadership and organizational behaviour. Moderate changes of wording were introduced to the global service context, keeping the conceptual integrity intact. Everything was measured on a five-point Likert scale, with the scale starting with 1 (Strongly Disagree) to 5 (Strongly Agree).

The ethical leadership measure was tested using questions that evaluated the integrity of leaders, fairness, transparency, and moral guidance. The concept of psychological safety was evaluated based on openness-related statements, risk tolerance, and freedom to express ideas. Measures of organizational innovation were based on pointers to new idea creation, introducing new processes, and increasing service improvement programs.

Table 1 presents the descriptive statistics of the constructs of the study.

Table 1. Descriptive statistics of key constructs

Construct	No. of Items	Mean	Standard Deviation
Ethical Leadership	8	4.12	0.68
Psychological Safety	6	4.05	0.72
Organizational Innovation	7	4.18	0.65

According to table 1, the respondents tend to agree with high scores related to ethical leadership (Mean = 4.12) and organizational innovation (Mean = 4.18). Standard deviations are relatively low, which indicates uniformity in responses, indicating a stable opinion in the sample.

B. Sample and Data Collection

The target group was composed of the employees in global service organizations such as the IT services, financial services, consulting, and hospitality services. The questionnaire was provided to the professional networks and organizational contacts through the use of a structured online questionnaire. Following the checking on completeness and response validity, 342 useful responses were left to be analyzed. Table 2 provides the demographic distribution of the respondents.

Table 2. Demographic profile of respondents (N = 342)

Variable	Category	Frequency	Percentage
Gender	Male	186	54.4%
	Female	156	45.6%
Age	21-30	124	36.3%
	31-40	148	43.3%
	41+	70	20.4%
Experience	<5 years	132	38.6%
	5–10 years	126	36.8%
	>10 years	84	24.6%
Sector	IT Services	122	35.7%
	Financial Services	88	25.7%
	Consulting	74	21.6%
	Hospitality	58	17.0%

The balanced representation is seen in table 2 in terms of gender, age, and industry sectors. Most of the respondents are aged 31 to 40, which means that they are seasoned professionals who are able to assess the leadership and innovation practices.

C. Reliability and Validity Test

Measurement reliability and validity were determined prior to the testing of the hypotheses to ensure that they are robust. The alpha and Composite Reliability (CR) were used to establish internal consistency reliability. The evaluation of convergent validity was conducted in terms of Average Variance Extracted (AVE). Table 3 summarizes the findings.

Table 3. Reliability and convergent validity results

Construct	Cronbach's Alpha	Composite Reliability	AVE
Ethical Leadership	0.91	0.93	0.67
Psychological Safety	0.88	0.90	0.60
Organizational Innovation	0.89	0.92	0.64

The alpha value of all Cronbach's alphas is higher than the recommended alpha of 0.70, which proves high internal consistency. The value of AVE greater than 0.50 represents sufficient convergent validity.

Table 4 shows the Fornell-Larcker criterion used in assessing discriminant validity.

Table 4. Discriminant validity matrix

Construct	EL	PS	OI
Ethical Leadership (EL)	0.82		
Psychological Safety (PS)	0.61	0.77	
Organizational Innovation (OI)	0.58	0.69	0.80

AVE square root is denoted by the diagonal values. The fact that these values are greater than inter-construct correlations means that discriminant validity is achieved, and thus each construct is statistically different.

D. Structural Model and Hypothesis Testing

Structural Equation Modelling was conducted to test the hypothesized relationships. The model fit indices indicate acceptable model adequacy (CFI = 0.94, TLI = 0.93, RMSEA = 0.052, $\chi^2/df = 2.41$).

The structural path results are presented in table 5.

Table 5. Structural model results and hypothesis testing

Hypothesis	Path	β	t-value	p-value	Decision
H1	EL $\rightarrow$ PS	0.63	11.84	<0.001	Supported
H2	PS $\rightarrow$ OI	0.49	8.72	<0.001	Supported
H3	EL $\rightarrow$ OI	0.32	5.14	<0.001	Supported
H4	EL $\rightarrow$ PS $\rightarrow$ OI	0.31	6.98	<0.001	Supported

The findings demonstrate that the role of ethical leadership is substantial in psychological safety ($\beta = 0.63$). Organizational innovation is greatly predicted by psychological safety ($\beta = 0.49$). The indirect effect supports the fact that ethical leadership has a direct and indirect impact on innovation by means of psychological safety.

V. Results And Findings

This section gives a detailed discussion of the empirical findings derived using Structural Equation Modelling. The results are presented in the form of descriptive analysis, correlation, structural model analysis, mediation, and the graphical representation of the relations between ethical leadership, psychological safety, and organizational innovation.

A. Descriptive and Correlation Analysis

The descriptive statistics show that the respondents view the relatively high levels of ethical leadership ($M = 4.12$), psychological safety ($M = 4.05$), and organizational innovation ($M = 4.18$). The mean scores indicate that there is an overall positive leadership climate and innovation-supportive environment in the sampled organizations. The values of the standard deviation are very low (0.65 to 0.72), and they suggest uniformity in the perceptions of the employees in the sample.

Figure 2 provides the mean scores of the three major constructs and their corresponding values of standard deviation as error bars. The findings showed that the mean score of Organizational Innovation ($M = 4.18$) is the highest, followed by Ethical Leadership ($M = 4.12$) and Psychological Safety ($M = 4.05$). Although it has relatively small error bars, as it indicates low variability in the responses, which means that there is consistency in the way employees see the situation within the sample. The graphical image confirms that there is a general perception among the respondents that there are strong ethical leadership and innovation-oriented practices in their organizations, and psychological safety, though slightly less, is at a high rate. The visualization offers a better insight into central tendency and dispersion than a simple bar chart, which increases the level of statistical interpretation.

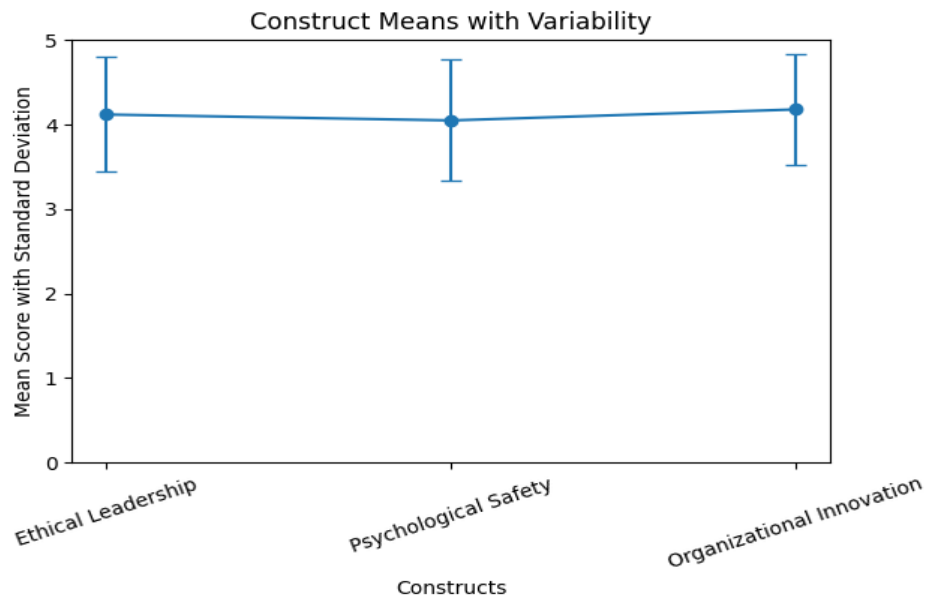


Figure 2. Construct means with standard deviation error bars

Pearson correlation was used to test the strength and the direction of relationships between constructs. The findings are presented in table 6.

Table 6. Correlation matrix of study variables

Construct	EL	PS	OI
Ethical Leadership (EL)	1		
Psychological Safety (PS)	0.61	1	
Organizational Innovation (OI)	0.58	0.69	1

Note: $p < 0.01$

The findings indicate that all constructs have statistically significant positive relationships. Ethical leadership correlates highly ($r = 0.61$) with psychological safety, which implies that ethical managerial behaviour positively impacts the perception of employees about the existence of a safe working environment. The psychological safety has the highest level of correlation with organizational innovation ($r = 0.69$), which underscores its importance in promoting innovative and creative behaviour. These correlations give some initial empirical evidence for the model that is being postulated.



Figure 3. Regression relationship between ethical leadership and organizational innovation

Figure 3 shows the scatter plot and the obtained regression line to describe the relationship between Organizational Innovation and Ethical Leadership. Each of the points stands out as the score of a particular respondent, whereas the regression line reflects the positive linear relationship between the two variables. The positive gradient of the regression line proves that increasing the level of perceived ethical leadership correlates with increasing the level of organizational innovation. This data is in line with the structural model results ($\beta = 0.32$, $p < 0.001$), which indicate that ethical leadership is a significant predictor of the innovation results. The spread of the data points in the regression line indicates a moderate variability, which is aligned with the reported R^2 value that denotes a significant explanatory capability of the model.

C. Mediation Analysis

Bootstrapping (5000 resamples) was used to test the mediating effect of psychological safety. Indirect influence of ethical leadership on organizational innovation via psychological safety was substantial ($\beta = 0.31$, $p < 0.001$). The fact that both direct and indirect effects are important proves the presence of partial mediation.

This result implies that ethical leadership can boost innovation by not only directly acting on leadership behaviour, but also indirectly by establishing a psychologically safe work environment. Workers in an ethical setting are more inclined to free communication, communicate their new ideas, and take risks without being afraid of any punishment or adverse effects. Psychological safety thus acts as a vital process that connects the leadership behaviour with the results of innovation.

D. Explained Variance and Model Strength

The model describes the 40% variance in psychological safety and the 52% variance in organizational innovation. The R^2 values suggest moderate and strong explanatory power, which proves that the combination of ethical leadership and psychological safety can have a significant impact on the performance of innovation within global service sectors.

E. Summary of Empirical Findings

In general, the findings are highly empirically solid in support of the integrative theoretical framework. Ethical leadership has a positive impact on psychological safety and innovation in an organization. Psychological safety is a significant contributor to innovation and mediates the correlation between ethical leadership and innovation to some extent. The findings of this research prove that innovation in the service sector is not just a strategic project, but a behavioral consequence of ethical leadership and a favorable psychological environment.

VI. Discussion

The results of the present research give strong reasons to believe that ethical leadership has a fundamental role in psychological safety development in global service organizations. The correlation between ethical leadership and psychological safety is quite high and this means that leaders who are perceived as ethical, and who are always perceived to maintain integrity, fairness and transparency in their leadership style create an atmosphere of trust and openness. When they believe they are respected and feel safe at their posts, the employees will consider their leaders as responsible and morally upright. This further builds up the concepts of the Social Learning Theory because employees watch and internalize behaviour portrayed by ethical leaders. Ethical leadership in service sectors is very important to set the behavioral standards that help minimize uncertainty and promote positive discussion within the team, as interpersonal connections and teamwork are the key components of the work.

The high correlation between psychological safety and organizational innovation shows that the favorable working environment is relevant in shaping creative thinking and bringing about ideas. Employee engagement, sharing of knowledge, and problem-solving are important in innovation in service sectors. The findings point to the fact that employees who feel free to share atypical ideas, make mistakes, and challenge the current practices are likely to deliver results related to innovation more. Psychological safety lessens fear of negative assessment, which tends

to prevent experimentation and innovative thinking. Thus, the existence of a psychologically secure environment will turn the potential of employees into real innovation performance.

The mediation analysis gives a more theoretical interpretation of how the leadership behaviour is translated into the outcomes of innovation. The partial mediation effect indicates that ethical leadership positively influences organizational innovation through a direct but indirect relationship through psychological safety. This implies that leadership ethics not only generates innovative thinking but also provides the needed psychological environment for such thinking to become a reality. Ethical leaders also build mutual trust, and this will improve open communication and collaborative learning, thus increasing innovation capability. Such a combined insight contributes to the research of leadership by clarifying that it is not only strategic directives that lead to innovation, but also relational and psychological processes in organizations.

Moreover, the described organizational innovation elaboration shows that both leadership ethics and psychological climate explain a significant percentage of innovation performance. These results support the perception that innovation is entrenched in organizational culture and behavior systems. In the case of global service industries experiencing high rates of technological change and competition, ethical leadership and psychological safety development are not a moral requirement, but a strategic one. The research thus contributes to the theory of ethical leadership and the innovation management literature to provide a holistic clarification of how trust environments created through leadership contribute to sustainable innovation results.

VII. Conclusion

This paper supports the fact that psychological safety and ethical leadership are influential and interdependent determinants of organizational innovation in the global service sector. The empirical results prove that ethical leadership has a strong positive impact on the perception of psychological safety among employees, which contributes to the creation of a culture of creativity, knowledge sharing, and innovative performance. The partial mediation evidence suggests that ethical leadership has a direct impact on the innovation results, besides being indirect and contributing to the improvement of innovation by establishing a climate of trust, openness, and interpersonal security. These findings indicate that innovation is not merely an attempt at strategy or technology, but instead, it is at the core of the relational and behavioral structures of an organization. Leadership integrity, fairness, and transparency in global service spheres where value is created mainly through human interaction and collaboration, and intellectual capital are instrumental in motivating innovative capacity. Psychologically confident employees are better placed to give innovations, question established ways of doing things, and conduct healthy experimentation. In turn, the promotion of ethical leadership practices and the enhancement of psychological safety mechanisms may also become the long-term solutions to the improvement of innovation performance. On the whole, this research paper has added to the literature on leadership and innovation in the sense that it has combined ethical governance and psychological climate theory into a single empirical model. The results can be used by managers and policymakers to facilitate long-term competitiveness. The ability to build resilient, innovation-driven working environments through ethical standards in leadership development and organizational culture allows firms to operate in a highly dynamic and complicated global service setting.

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