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The Role of Unethical Leadership and Culture in FTX Collapse

Kaushik Dutta-Bhowmik

Belk College of Business, University of North Carolina, Charlotte, 9209 Mary Alexander Rd, Charlotte, NC 28262, USA

Abstract: ***The leadership of a company plays a significant role in influencing its culture. It determines the long-term success or failure of the organization. Ethical leadership is crucial in establishing a healthy organizational culture. Unethical leadership may lead to the downfall of promising or even successful businesses. This paper examines the case of Sam Bankman-Fried, whose unethical leadership and Machiavellian behavior contributed to the collapse of FTX and Alameda Research, leading to bankruptcy and legal consequences. The study also highlights the importance of fostering an ethical culture through strong leadership, a robust ethics and compliance program, and sound business practices by analyzing the culture and leadership failures in these companies. The insights from this study can guide business leaders to avoid legal and reputational damage caused by unethical leadership and ensure sustainable success for their organizations.***

Keywords: Unethical Leadership, FTX, Sam Bankman-Fried, Unethical Culture, Organizational Failure

1. Introduction

Leadership of an organization plays an essential role in shaping its culture, directly influencing its success or failure. Ethical leadership helps to build trust and brings transparency and accountability, which is critical to the long-term success of a business. Conversely, unethical leadership can create a toxic environment that undermines these values, leading to organizational failure. The recent collapse of FTX and Alameda Research provides an excellent example of the devastating consequences of poor leadership and an unethical company culture. The cryptocurrency entrepreneur, Sam Bankman-Fried, was sentenced to 25 years in prison [1] following his conviction on charges of fraud [2]. Once hailed as a visionary leader in the cryptocurrency world, Sam Bankman-Fried led his companies into financial ruin through unethical behaviors, including deceptive practices, mismanagement of resources, and a culture of favoritism and discrimination.

The purpose of this paper is to analyze the role of unethical leadership and culture in the collapse of a company and suggest actions to improve the ethical environment of a company facing a similar situation.

The study is significant because it offers insights into the role of ethics in leadership and company culture in preventing a company's collapse. It also provides practical lessons for other companies looking to create an ethical environment for their employees.

2. Sam Bankman-Fried: Unethical Leadership

Let us analyze the unethical aspects of Sam Bankman-Fried's personality and behavior. He deliberately cultivated a 'Boy Genius' image, presenting himself as a laid-back, youthful figure who disregarded formal attire. This image was created strategically to instill confidence among investors by taking them back to the early days of Silicon Valley start-ups, where founders often dressed in a similar casual style [3]. This behavior can be considered deceptive, with the benefit of hindsight. He disregarded professionalism, often conducting business meetings, even with investors, in casual attire while playing video games [4]. This could be interpreted as an exhibition of the illusion of control bias [5, p. 65], where he overestimated his ability to control events. The illusion of control bias can also explain his big risk appetite. He was primarily focused on making money and often disregarded unethical behavior while acquiring capital [6]. His risky behavior was also evident from his buying habits when he committed money that he did not yet have [6]. In hindsight, his risky behavior could be seen as a reflection of the self-serving and opportunistic aspect of his personality. This is further supported by the fact that he was known to bribe officials in foreign countries to further his interests [7].

He was perceived as altruistic, frequently making charitable donations, enhancing his appeal to investors [6]. He has admitted that his altruistic behavior helped him gain the trust of the financial investors and the FTX users [8]. His charitable donations also gained him political favors [9]. His altruistic and philanthropic behavior could have given him a 'moral license' to engage in unethical behavior [5, p. 197].

He reportedly made significant donations to the political campaigns of mainly liberal-leaning politicians [10]. He also lobbied for crypto-friendly legislation in Washington, D.C. [11], which helped him gain political influence. This, in turn, could have further fueled his illusion of control bias. The act of lobbying and donating to politicians in hopes of gaining favor displays the manipulative aspect of his personality.

The behavior and traits shown by Sam Bankman-Fried can be summed up as 'Machiavellianism' which is characterized by being deceptive, manipulative, self-interested, and opportunistic [5, p. 62]. This argument is further supported by the fact that he used to keep the company's financial information in a closed group and kept it out of investors' reach [6], overlooking unethical behavior in achieving his goals and creating a disruptive persona to attract investors [14]. A person displaying 'Machiavellian' behavior, his engagement in unethical behavior was somewhat predictable [5, p. 62]. This meant that his sole focus was on 'ends,' and he was not much concerned with the 'means.'

He is also known to have a romantic relationship with his employee, Caroline Ellison [12], who was also made the co-CEO of Alameda Research. This nepotistic behavior also highlights the conflict of interest [5, p. 92] he had. This contributed to the perception of injustice and discrimination [13] felt by some employees, further endorsing unethical behavior.

The unethical leadership shown by Sam Bankman-Fried, and his close confidants seems to have significantly impacted the unethical culture of his two firms. This is more relevant for a company run by its founder, who is responsible for defining the culture for the rest of the employees to follow. Similarly, the leaders are responsible for maintaining an ethical or unethical culture. Social learning theory [5, p. 201] suggests that employees are likely to learn from the behavior of their leader. Therefore, Sam Bankman-Fried's unethical behavior is most likely responsible for the series of unethical behaviors that ultimately led to the collapse of FTX.

3. The Culture in FTX and Alameda Research

Sam Bankman-Fried founded two organizations, FTX and Alameda Research. The company culture at both firms was similar. Employee allegations in social media and congressional hearings provide critical insights into the company culture. An employee described the culture in FTX as toxic [13]. The employees often had to work seven days a week, without time off and holidays. Dissent was allegedly met with backlash [15]. This suggests that the employees were under severe stress and were experiencing burnout. Employees under stress are likely to engage in unethical behavior due to the depletion of their self-regulatory resources [5, p. 218].

The practice of nepotism, favoritism, and systemic discrimination against women employees was also commonplace [13]. Such sexual discrimination is unethical and illegal as per US federal law [5, p. 224]. Together, they contributed to health issues for employees and created a stressful environment [16], which increased the chances of employees engaging in unethical behavior. Further, discrimination in the workplace is unethical as it fails to meet its duties towards the employees and fails to adhere to the Kantian imperative [5, p. 86].

FTX also had a culture of lavish spending [13]. Lavish parties were funded by the company. The executives were provided luxury apartments with private chefs. Employees were allowed to stay at expensive luxury hotels and resorts, and free food was provided on the office campus 24/7. Employee perks included free groceries, hairstyling, and spa services. FTX spent over 256 million [17] to purchase 35 properties in The Bahamas, where it was based. This indicates that the company unethically misused corporate resources [5, p. 101].

Power in the company was concentrated within a small group of employees [18], who often had conflicts of interest. The company did not have robust accounting practices, where invoices and receipts were circulated through 'Slack', an instant messaging application [19]. Being a privately held company, FTX did not have to comply with the Sarbanes-Oxley Act, which requires public companies to have internal auditing and reporting. Lack of this oversight led to employees misappropriating company benefits, resulting in the loss of substantial assets [20].

FTX had an ethics and compliance office. However, instead of addressing ethical issues, its primary function, reportedly, was to pay large sums of money to potential whistleblowers to keep the company's internal practices [21] out of public view. Eventually, FTX sued Daniel Friedberg for his failure as its former ethics and compliance officer under Sam Bankman-Fried. This paints the picture of an organization that lacked a robust ethics and compliance program, which is necessary for businesses to comply with the US federal sentencing guidelines [5, p. 164]. The requirements of due diligence of an effective compliance program, as outlined in US federal sentencing guidelines, state that a company needs to have a way to detect criminal conduct, take appropriate disciplinary action against the violators, and take steps to prevent such occurrences in the future [5, p. 164] It should not be surprising that an organization with such a poor ethics and compliance program would fail to prevent unethical and illegal activities.

Similarly, long working days were also a feature of the other firm, Alameda Research [22]. Employees were severely burnt out and stressed. This organization also had a lack of internal controls in business practices [14]. Sam Bankman-Fried allegedly lacked integrity, engaged in inappropriate sexual conduct with subordinates, and was caught lying on occasions [22]. These instances highlight the unethical nature of Alameda Research.

As mentioned above, the culture shows that unethical behavior in the organization was tolerated and sometimes rewarded (executives with luxury apartments and services). As social learning theory suggests, in the absence of punishment, the employees are likely to engage in unethical behavior repeatedly, and results in the cementing of an unethical culture in the firm [5, p. 201]. The culture in these companies was unethical in numerous ways. It was essentially a ticking time bomb destined to erupt into a scandal, one way or another.

4. Correcting the Ethical Problems

The companies had numerous ethical problems. For them to turn around ethically, radical change must be implemented in the leadership, company culture, and ethics and compliance program.

4.1 Ethical Leadership

A company in FTX's position with its former leader convicted and imprisoned [1], need to get a new leadership. The task of the new leadership would be to focus on bringing ethics and compliance culture to the organization. The role of leadership in creating and maintaining an ethical culture in the organization is paramount [5, p. 120]. Its new leadership must start by communicating ethics through their voice, action, and support. Leadership should formalize ethical culture by creating robust ethics and compliance policies. They need to put their weight behind the policies and ensure all employees know the vision of their ethical leadership. They need to allocate appropriate resources and time to create a formal culture in the organization effectively. This needs to be complimented by the practice of exemplary ethical conduct by the leadership to cement the new culture informally. Once the culture is established, they need to maintain the new culture by paying attention, measuring, and controlling ethical behavior, hiring people

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who fit their vision, and finally, holding people accountable for their actions [5, p. 121].

For example, in the case of FTX, we know there was a lack of transparency in the company. Investors were routinely kept in the dark about the financial health [6] of the business. New leadership should start by creating policies that require them to disclose their financial health routinely to the investors, declare all assets, and explain financial decisions to them. Then, they need to support this policy through routine communication with the employees through various platforms. This should help to create a formal ethical culture in the company. Finally, leaders need to ‘walk the talk’ by bringing transparency through their actions. They can do this by routinely following the policy and showcasing the company's financial health through investor meetings. This would send the right message to the employees by showing leadership participation in ethical behavior and encouraging employees to show transparency at their levels. Further, leaders can reward ethical behavior by recognizing employees who champion transparency and hold the employees who lack transparency accountable. This should help to establish an informal culture that encourages ethical behavior. This can be achieved quickly in a company with a small number of employees, like FTX [23].

4.2 Culture

Creating a new ethical culture is paramount for a company in a similar position as FTX, as the behavior of its employees is shaped by its culture [5, p. 119]. To maximize its impact, there needs to be an alignment of the formal and informal culture. New policies need to be implemented that encourage ethical behavior. Employees need to receive appropriate levels of training and communication to set the formal culture. The informal culture must be aligned with the formal culture through rewards and punishment [5, p. 119], i.e., celebrate heroes and punish offenders.

For example, in the case of FTX, misappropriation of company assets in the past has led to huge expenditures. Policies must be put in place to limit spending to the desired level. Employees need to be trained to use company resources efficiently and responsibly. Leadership needs to show commitment by cutting back on the lavish perks they receive and parties they fund. Finally, employees who can reduce expenditure must be celebrated as heroes to align formal and informal cultures, and those who increase expenditure must be held accountable [5, p. 118]**.** This should send the right message to the employees, encouraging them to engage in ethical conduct.

4.3 Ethics and Compliance Program

Companies must implement ethics and compliance programs as per the US federal sentencing guidelines [5, p. 163]. A robust program with a known ethical leader at the helm as an ethics and compliance officer should be the first order of business in a company in a similar position as FTX. This should pave the way to bringing ethical culture to the organization. The program needs to be capable of detecting and preventing criminal conduct. Individuals who have been known to, or are prone to, engage in unethical activities need to be removed from decision-making. Proper training and communication systems must be in place to keep the employees aware of and engaged in ethical conduct. Mechanisms designed to receive and investigate employee-reported misconduct need to be in place. The program should be able to protect and reward informants and should be able to punish perpetrators and people who fail to detect misconduct. Finally, the program needs to be capable of preventing the recurrence of misconduct.

In addition, further processes need to be set up to properly distribute all the power previously concentrated with few people in the organization. The company accounts must be kept properly, along with sufficient internal oversight and controls. Expenditures need to be monitored and regulated. All forms of discrimination and nepotism need to be prevented, and working conditions must be improved to alleviate employee stress. This would also create the right conditions for pushing an ethical culture in the organization.

5. Conclusion

The collapse of FTX and Alameda Research, once again, highlights the critical role played by the leadership in shaping the ethical landscape of a company. The unethical actions and poor leadership decisions by Sam Bankman-Fried created a toxic culture that led to financial mismanagement, legal troubles, and, ultimately, the collapse of both of the companies. His failure to foster transparency, accountability, and a robust compliance framework damaged his personal reputation, got him incarcerated, and ruined both of the companies.

This case highlights the significance of ethical leadership and the need for companies to prioritize a culture that values integrity, accountability, and respect. Business leaders must recognize that their behavior sets the tone for the entire organization. By aligning leadership practices with ethical standards, establishing strong compliance programs, and maintaining an open and transparent culture, companies can mitigate risks and avoid costly consequences like lawsuits and reputational damage. The lessons learned from the FTX debacle should guide current and future leaders in building sustainable, ethically sound businesses that can thrive in the long term.

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Author Profile

Kaushik Dutta-Bhowmik is a certified SAFe 6 POPM and CSPO management professional. He specializes in Agile coaching and Scrum and has successfully led application development and operation teams. With extensive experience in managing globally distributed teams, vendors, and consultants, he has also overseen various projects during his professional career. He has worked as a technology leader in the integration and collaboration space. He received his B.Tech. degree in Mechanical Engineering from Asansol Engineering College in 2012. Since 2023, he has been pursuing his MBA with a concentration in management at the University of North Carolina, Charlotte, United States. His areas of interest and understanding include business strategy, AI, and organizational management.