

ETHICAL LEADERSHIP IN FOSTERING EMPLOYEE ENGAGEMENT AND INNOVATION THROUGH WORKPLACE WELL-BEING

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Abstract: *In the modern workplace, efforts to foster innovative employee behavior increasingly depend on leadership quality and individual psychological well-being. This study aims to examine the role of ethical leadership in fostering employee well-being, work engagement, and innovative work behavior in the financial services sector. A quantitative approach was employed by distributing questionnaires to respondents working in conventional and Islamic financial institutions, with a total of 192 respondents eligible for processing. Analysis was conducted using Structural Equation Modeling (SEM) to examine the interrelationships between variables and identify the mediating role of work engagement. The results of the study show that ethical leadership has a positive effect on employee well-being and increases work engagement. Furthermore, work engagement has been shown to act as a psychological mechanism that strengthens the influence of ethical leadership on innovative work behavior. Work well-being also supports increased innovation through more stable and positive psychological drives. This study emphasizes the importance of ethical leadership practices as a foundation for organizations in fostering a healthy work environment and encouraging continuous innovation. These findings provide opportunities for financial institutions to formulate human resource development strategies that are more oriented towards ethics and well-being.*

Keywords: *Ethical Leadership, Work Engagement, Well-Being, Innovative Work Behavior*

1. Introduction

Rapid changes in technology, consumption patterns, and business models are driving organizations to continuously innovate to remain competitive (Bagis et al., 2024). Innovation is a key factor for organizations to maintain relevance and competitiveness amidst digital disruption (Masianoga & Chakauya, 2023). Innovation is not only born from organizational policies, but also from the ability of individuals to display innovative work behavior (IWB) which is manifested through the creation, development, and implementation of new ideas in the workplace (Liu et al., 2023). Recent research confirms that ethical leadership style is able to create a psychological climate that is conducive to the emergence of innovative behavior, because ethical leaders provide moral examples, fairness, and support that strengthen employees' trust and sense of security in innovating (Jia et al., 2022; Wen et al., 2021). Empirical evidence also shows that ethical leadership has a significant influence on the innovative and creative behavior of employees across sectors, both in the education, government and service industries (Masianoga & Chakauya, 2023).

Innovation in the financial sector is a vital element because the success of a creative campaign depends on the new ideas and original solutions generated by the creative team (Tevi et al., 2025). However, work dynamics that demand high creativity, tight time constraints, and cross-departmental collaboration can cause psychological stress that impacts employee well-being and work engagement (Bagis, Adawiyah, et al., 2025). One of the best ways to become more innovative is for companies to not only rely on research and development, but also encourage all workers to innovate (Ramadhan et al., 2025). Innovation can be influenced by behavior, and behavior is one element of innovation that can be influenced by human resources. Therefore, there is a close relationship between innovation and behavior in achieving competitive advantage (Afriandika et al., 2025). Various studies show that well-being and work engagement have a positive relationship with employee productivity, job satisfaction, and innovative behavior (Riani et al., 2024; Ye et al., 2024). Well-being is an important measure of a person's overall quality of life, because those who experience abundance often live lives characterized by inner harmony, both on a personal level and in their social environment (Bagis & Adawiyah, 2024). Within the framework of Social Exchange Theory (SET), ethical leader support functions as a job resource that can increase motivation and psychological well-being, which ultimately strengthens work engagement and innovative behavior (Abuzaid et al., 2024; Liu et al., 2023). Therefore, understanding how ethical leadership styles affect well-being and work engagement is important, especially in companies operating in the financial sector, where innovation is at the heart of competitive advantage.

Theoretically, the relationship between ethical leadership, well-being, work engagement, and innovative work behavior can be explained through Social Exchange Theory (SET). SET states that positive interactions between leaders and subordinates create reciprocal obligations that encourage individuals to exhibit positive behaviors such as innovation (Blau, 1964; Jia et al., 2022; Liu et al., 2023). Ethical leaders who provide care, fairness, and trust create feelings of appreciation in employees, which then increases work engagement and emotional well-being (Bagis & Adawiyah, 2025).

Various previous studies have shown that ethical leadership has a positive influence on innovative work behavior (IWB). For example, Wen et al. (2021) found that ethical leadership enhances employee innovative behavior through increased trust and psychological support in technology companies in China. Similar results were also found by Jia et al. (2022), which examined the higher education sector and demonstrated that well-being and work engagement act as important mediators in the relationship. Liu et al. (2023) confirmed that ethical leadership encourages innovative behavior through increased psychological empowerment and work engagement. Meanwhile, Masianoga & Chakauya (2023) emphasizes that ethical leadership indirectly influences innovation through a work environment that supports creativity. On the other hand, Gunarso et al. (2025) showed that psychosocial well-being mediates the relationship between ethical leadership and employee innovative behavior, strengthening the argument that employee well-being is an important pathway linking ethical leadership to innovative work behavior. Similar findings are supported by Abuzaid et al. (2024), which added psychological empowerment and job crafting variables as additional mediators in a similar model.

The research gap is seen in the dual mediation mechanism (well-being and work engagement) between ethical leadership and innovative behavior which is still rarely studied. This indicates the need to test a dual mediation model that takes into account the Indonesian cultural context. This research has high urgency, both academically and practically. This study differs from previous research because it simultaneously tests the dual mediation of well-being and work engagement between ethical leadership and innovative work behavior, applied to the financial institution sector, which is highly dependent on creativity, and conducted in an Indonesian cultural context that has previously been rarely studied.

The purpose of this study is to analyze the influence of ethical leadership on innovative work behavior through the mediating role of well-being and work engagement in employees of financial sector institutions. Theoretically, this study is expected to broaden understanding of the psychological mechanisms that bridge ethical leadership and innovative behavior based on the perspective of Social Exchange Theory (Blau, 1964). Practically, the research results can provide guidance for managers and leaders in financial sector institutions to develop a leadership style that is ethical, welfare-oriented, and encourages employee involvement and innovation.

This research is expected to fill the gap in the literature regarding the dual mechanisms that bridge the influence of ethical leadership on innovative behavior while strengthening the application of Social Exchange Theory in the Indonesian cultural context (Liu et al., 2023; Ye et al., 2024). From a practical perspective, the research findings are important for financial institutions facing high pressure to continuously innovate, as ethical leadership can be a key strategy in building a work environment that supports creativity, maintains psychological well-being, and increases employee engagement and innovative behavior (Tevi et al., 2025). Moreover, in Indonesia's collectivist socio-culture, ethical leaders play an important role in creating a sense of security and shared values that strengthen innovative work behavior.

2. Literatur Review

Social Exchange Theory (SET)

Social Exchange Theory (SET) is a theoretical framework that is often used to understand the social interactions, attitudes, and behavior of individuals in organizations (Cropanzano et al., 2014). Blau (2017) emphasizes that the nature of the relationship between exchange partners influences the social exchange process, while norms of reciprocity or perceived obligations encourage goodness in many social relationships (Blau, 1964; Gouldner, 1960). According to SET, when individuals perceive leaders and organizational practices, such as ethical leadership and fair procedures, as caring and concerned about their well-being, they are more likely to reciprocate with positive behaviors. This creates trust, a sense of fairness, and higher engagement in the workplace, which in turn encourages innovative behavior. Thus, SET provides a relevant foundation for understanding how ethical leadership can influence work engagement and innovative work behavior through employee well-being mechanisms. Employees exhibit complex behaviors in generating, introducing, and implementing new ideas in the workplace (Pradana et al., 2025). This innovative work behavior becomes a source of competitive advantage and organizational sustainability (Alessa & Durugbo, 2021). Meanwhile, job

engagement reflects a psychological state that motivates individuals to participate fully in work, characterized by energy, dedication, and focus (Supriyadi et al., 2020). Employee well-being is an important factor that strengthens the relationship between ethical leadership, work engagement, and innovative behavior (Fu et al., 2020; Rasool et al., 2019). Thus, this study integrates these three variables in a SET-based research framework to explain the reciprocal mechanisms between leaders and subordinates in creating innovation in the workplace.

Ethical Leadership and Innovative Work Behavior

Ethical leadership encourages psychological safety, a sense of trust, and positive interactions between leaders and subordinates, which can motivate employees to exhibit innovative behavior (Brown et al., 2005; Brown & Treviño, 2006). Previous research has shown that ethical leadership can increase creativity, risk taking, and individual initiative in the workplace (Ahmad, 2021; Ullah et al., 2021). In addition, ethical leadership reduces job stress and creates an environment that supports innovation (Yamoah, 2021). Human and social capital also strengthen the effect of ethical leadership on innovation, suggesting a reciprocal mechanism within organizations (Ullah et al., 2021). The indicator with the highest contribution to innovative behavior describes employees' ability to work efficiently and implement new ideas, while the lowest indicator indicates that increasing daily creativity requires consistent organizational support. These findings indicate that the efficiency and courage to implement ideas are more strongly influenced by the moral example of the leader, in line with Social Exchange Theory, which explains that ethical treatment encourages employees to reciprocate through highly valued innovative behavior. Based on this literature, it is expected that ethical leadership has a positive impact on innovative work behavior.

H1. Ethical leadership has a positive effect on innovative work behavior.

Ethical Leadership and Work Engagement

Work engagement is influenced by employees' perceptions of the leader's caring and fairness. Ethical leadership increases employees' sense of belonging, motivation, and commitment to the organization. (Alam & Gul, 2021; Fuller, 2021). With high engagement, employees show dedication and enthusiasm to complete work optimally (Supriyadi et al., 2020). Studies also show that ethical leadership can foster engagement even though specific satisfaction is not directly mediated (Buonomo et al., 2021). This positive relationship reinforces the reciprocal mechanism of SET, where leader attention motivates higher work engagement. The highest indicator's contribution to work engagement is seen through increased energy and morale, while the lowest indicator reflects employees' challenges in disengaging from work when emotional demands are high. This suggests that ethical leader behavior primarily strengthens the energy and core motivational aspects of engagement, consistent with Social Exchange Theory, which posits that ethical leadership acts as a job resource that enhances employees' psychological vitality. Therefore, this study proposes a second hypothesis:

H2. Ethical leadership has a positive effect on work engagement.

Moderation of Well-being

Employee well-being acts as a mechanism that strengthens the effect of ethical leadership on work engagement. Ethical leadership increases trust in management and psychological well-being (Rasool et al., 2019), while employee affective well-being is related to increased work motivation and focus (Xu et al., 2019). Well-being employees tend to be more engaged, take initiative, and respond to leadership initiatives. These perceptions reflect employees' ability to grow psychologically, achieve personal goals, and maintain self-confidence in life and work. (Budiharto & Pratiwi, 2025). In addition, well-being mediates or moderates the relationship between ethical leadership and work outcomes, including work engagement and innovative behavior (Huma et al., 2020; Jia et al., 2022). The indicator with the highest contribution indicates that a positive attitude toward work significantly drives engagement, while the lowest indicator indicates that enjoyment at work is still dependent on certain external conditions. These findings confirm that well-being primarily influences engagement through stable affective aspects, supporting the SET view that well-being improves employees' ability to maintain work energy and focus. Taking this literature into account, this study proposes:

H3. Well-being moderates the relationship between ethical leadership and work engagement.

Work Engagement and Innovative Work Behavior

Work engagement predicts innovative work behavior by increasing energy, focus, and motivation to generate new ideas (Hosseini et al., 2021; Sari et al., 2021). Fully engaged employees are able to optimally utilize available resources, adapt to job demands, and contribute to a learning organization. Furthermore, job engagement can mediate the relationship between workload and innovation, demonstrating the importance of psychological factors in innovation (Montani et al., 2025). The increasingly competitive nature of today's competition demands that banking institutions and microfinance institutions improve employee performance in meeting the need for high-quality services (Maghfiroh & Yusriyati Nur Farida, 2012). The strongest indicator suggests that high workplace energy drives innovative behavior, while the lowest indicator reflects that intense focus on work does not necessarily guarantee the emergence of new ideas. This supports SET and previous research findings that innovation is more influenced by vigor than by work absorption alone. Based on the literature review, work engagement is expected to have a positive effect on employee innovative behavior.

H4. Work Engagement has a positive effect on innovative work behavior.

The Mediation Effect of Work Engagement

Work engagement acts as a mediator in the relationship between leadership and job performance. (Lai et al., 2020). Li et al. (2019) argue that work engagement acts as a mediator in the relationship between leadership and innovative work behavior. Huma et al. (2020) defines work engagement as the emotional, cognitive, and physical dedication and energy exerted by employees at work. The mediating role of work engagement arises when a leader's ethical behavior creates a sense of appreciation and psychological support, which is then reciprocated by employees through increased energy, dedication, and engagement, ultimately leading them to

display innovative work behaviors as described in Social Exchange Theory. Therefore, we propose the fifth and final hypothesis as follows:

H5. Work engagement mediates between ethical leadership and innovative work behavior.

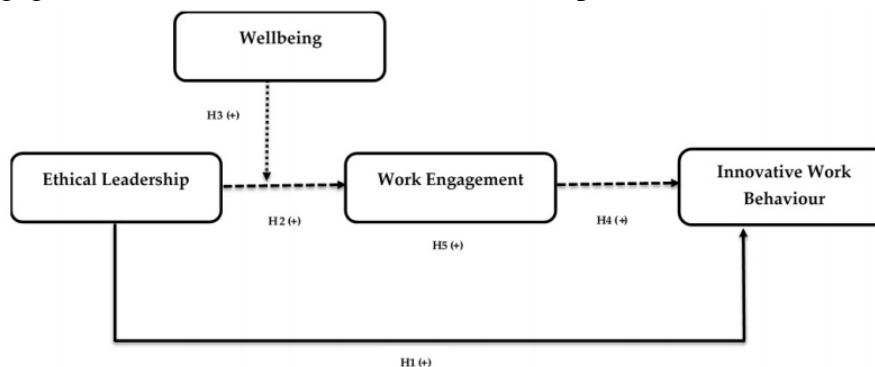


Figure 1. Research Framework

3. Research Method

This research uses a quantitative research type and is a replication of previous research conducted by (Jia et al., 2022). This study investigates several factors such as ethical leadership, work engagement, well-being, and innovative work behavior. Furthermore, it also examines the mediating role of work engagement on innovative work behavior. Therefore, this study analyzes five hypotheses. This study was applied to the banking and microfinance institutions to retest the model in a different sector, namely employees at one banking institution and five microfinance institutions in Purwokerto and Purbalingga. This allows for empirical evidence regarding the consistency of the intervariable relationships within financial institutions.

The sampling technique used a purposive sampling method. Respondents in this study were 96 employees of banking institutions 1, 16 employees of microfinance institutions 1, 28 employees of microfinance institutions 2, 35 employees of microfinance institutions 3, 29 employees of microfinance institutions 4, 38 employees of microfinance institutions 5 so that if calculated in total there were 242 people. The number of samples was determined using the Slovin formula with an error rate of 0.05 so that 192 samples were obtained. Data collection was carried out online using Google Form, with an instrument in the form of a questionnaire arranged in a 5-factor Likert scale format, starting from 1 (strongly disagree) to 5 (strongly agree).

Data analysis was conducted using the Partial Least Squares Structural Equation Modeling (PLS-SEM) approach using SmartPLS software. Each respondent's answer has its own value arranged using stages based on a five-point Likert scale with Likert values of one strongly disagree, two disagree, three neutral, four agree, and five strongly agree.

4. Results and Discussion

4.1 Results

This study uses Partial Least Square or PLS, with the aim of reducing variable variance when estimating model parameters (Hair et al., 2021). All questionnaire data was prepared for analysis and collected with a 100% return rate.

Table 1. Respondent Demographics

Identity	Information	Frequency	Percentage
Company Origin	Banking Institutions 1	96	50.0
	Microfinance Institutions 1	10	5.2
	Microfinance Institutions 2	15	7.8
	Microfinance Institutions 3	24	12.5
	Microfinance Institutions 4	22	11.5
	Microfinance Institutions 5	25	13.0
Gender	Man	106	55.2
	Woman	86	44.8
Age (years)	18 - 25	27	15.1
	25 – 30	52	24.5
	30 – 35	33	24.5
	35 – 40	36	21.9
	40 – 50	31	13.0
	> 50	13	1.0
Length of work (years)	1 - 3	51	26.6
	3 - 6	52	27.1
	6 - 9	32	16.7
	> 10	57	29.7

Source: SmartPLS Algorithm Process Results, 2026

Table 1 shows the demographic results of the respondents. The total respondents of this study came from one Banking Institutions and five Banking Institutions, namely Banking Institutions with 96 respondents (50.0%), Microfinance Institutions 1 with 10 respondents (5.2%), and Microfinance Institutions 2 with 15 respondents (7.8%). Microfinance Institutions 3 with 24 respondents (12.5%), Microfinance Institutions 4 with 22 respondents (11.5%), and Microfinance Institutions 5 with 25 respondents (13.0%). Based on gender, the respondents were dominated by male respondents with 106 people (55.2%), while female respondents were recorded at 86 people (44.8%). In terms of age, the majority of respondents were aged 26-30 years, amounting to 47 respondents (24.5%), followed by 35-40 years old with 36 respondents (18.1%), indicating that many respondents were at the productive working age stage who generally had stable work experience. The work period was dominated by respondents with experience > 10 years, amounting to 57 respondents (29.7%).

Data management in this study was conducted using the PLS version 4 approach. The PLS method aims to gain a more comprehensive understanding of the relationships between variables in the model. Furthermore, PLS analysis can provide additional information that can be interpreted through relatively simple analysis procedures (Hair et al., 2021).

Table. 2 Outer Loading

Variabel	Statement Items	Outer Loading
EL 1	My boss sanctions employees who violate ethical standards.	0.777
EL 2	My boss sets an example of how to do things ethically right.	0.802
EL 3	My boss listens to what employees say.	0.748
EL 4	My boss sets an example of how to do things ethically and correctly.	0.771
EL 5	My boss makes decisions fairly.	0.847
IWB 1	I am often looking for new methods, techniques and work tools.	0.768
IWB 2	I feel that I am more efficient than my boss/coworkers/subordinates.	0.841
IWB 3	Over the past six months, my work creativity has increased every day.	0.724
IWB 4	I can explain my ideas systematically to leaders and other employees.	0.770
IWB 5	I have implemented the new ideas I have come up with as part of my daily life at work.	0.793
WB 1	I am satisfied with my job.	0.757
WB 2	I feel happy to be at work.	0.727
WB 3	I have a positive attitude towards my work.	0.798
WB 4	I enjoy my daily work tasks.	0.798
WB 5	I feel my work gives me satisfaction.	0.799
WE 1	I am excited to start work in the morning.	0.762
WE 2	When I work, I forget everything around me.	0.737
WE 3	It's hard for me to break away from my work.	0.722
WE 4	At my workplace, I feel full of energy.	0.682
WE 5	I can continue working for a very long time.	0.729

Table 2 displays the outer loading results in the analysis, indicating that there is one indicator with a value below 0.70. However, because the analysis was conducted in one round, this indicator was not removed, which is in line with the research (Hair, G. Tomas M. Hult, et al., 2021). Indicators with outer loading values between 0.40 and 0.70 can still be maintained if their deletion does not provide a significant improvement in model quality.

Table 3. Construct Reliability and Validity

	Cronbach's alpha	Rho_A	Composite reliability	Average variance extracted (AVE)
EL	0.849	0.855	0.892	0.624
IWB	0.839	0.847	0.886	0.609
WB	0.836	0.845	0.883	0.602
WE	0.777	0.780	0.848	0.529

Referring to Table 3. From the description above, it is known that the variables of ethical leadership, work engagement and well-being on innovative work behavior are more than 0.7. The Average Variance Extracted (AVE) value shows that the overall construct value is more than 0.5, thus indicating that all variables in this study are stated to be reliable.

Tabel 4. Model Fit

	Saturated Model	Estimated Model
SRMR	0,082	0,081
d_ ULS	1,406	1,393
d_ G	0,530	0,528
Chi-Square	727,307	723,753
NFI	0,734	0,735

Based on Table 4, the results of the mode suitability test show an SRMR value of 0.081. This result is lower than the threshold of 0.80 recommended by (Hair, Hult, et al., 2021). Thus, it can be concluded that this research model generally has a good level of model suitability and is suitable for use in future analyses.

The Adjusted R-Square value for Innovative Work Behavior is 0.590. This value indicates that ethical leadership, work engagement, and well-being are able to explain the innovative work behavior variable by 59.0%. Thus, it can be concluded that the Adjusted R-Square value is quite adequate. The Adjusted R-Square value for the work engagement variable is 0.446. This value indicates that the ethical leadership and well-being variables are able to explain the work engagement variable by 44.6%. Thus, it can be concluded that the Adjusted R-Square value is quite adequate.

Table 5. Discriminant Validity

	EL	IWB	WB	WE
EL	0.790			
IWB	0.619	0.780		
WB	0.707	0.590	0.776	
WE	0.539	0.720	0.643	0.727

Discriminant validity testing in this study was analyzed using the Fornell-Larcker criteria. This approach is used to ensure that each construct in the model is clearly distinct and does not overlap with one another (Hair, Hult, et al., 2021). A construct is said to have good discriminant validity if the square root of the AVE value is higher than the correlation value of the construct with other constructs. Based on the evaluation results in the table, it can be seen that the AVE value of each variable Ethical Leadership (EL) is 0.790, Innovative Work Behavior (IWB) is 0.780, Well-Being (WB) is 0.776, and Work Engagement (WE) is 0.727 has a square root of AVE value that is greater than the correlation value between variables. Thus, these results

indicate that all constructs in the study have met the criteria for discriminant validity. This proves that each variable, whether Ethical Leadership, Innovative Work Behavior, Well-Being, or Work Engagement, has different conceptual characteristics and can stand alone without overlapping measurements between constructs.

Table 6. Path Coefficients

	Original sample (O)	Sample mean (M)	Standard deviation (STDEV)	T statistics (O/STDEV)	P values	Result
EL -> IWB	0.325	0.325	0.057	5.707	0.000	Accepted
EL -> WE	0.215	0.217	0.072	2.974	0.003	Accepted
EL -> WE -> IWB	0.117	0.118	0.041	2.854	0.004	Accepted
WB x EL-> WE	-0.118	-0.118	0.033	3.525	0.000	Accepted
WE -> IWB	0,545	0.547	0.054	10.131	0.000	Accepted

Based on the test results in the table, the acceptance and rejection of the hypothesis are determined through the p-value. If the p-value <0.05, then the hypothesis is accepted and considered significant. The research findings on the first hypothesis show positive results based on the original sample value of 0.325, with a p-value <0.05. This confirms that ethical leadership has a significant effect on innovative performance behavior, so the first hypothesis is accepted. In the second hypothesis, the research results also show a positive original sample value of 0.215 and a p-value <0.05, so it can be stated that ethical leadership has a significant effect on work engagement. Thus, the second hypothesis is accepted. Furthermore, the third hypothesis is accepted because the p-value <0.05 with an original sample value of -0.118.

These results indicate that well-being negatively moderates the relationship between ethical leadership and work engagement. The fourth hypothesis found that work engagement significantly influences innovative performance with an original sample value of 0.545 and a p-value <0.05. Therefore, the fourth hypothesis is accepted. The fifth hypothesis found that attitudes toward work engagement negatively mediate the relationship between ethical leadership and innovative performance behavior with an original sample value of 0.117 and a p-value <0.05. This means that the fifth hypothesis is accepted.

4.2 Discussion

Ethical Leadership and Innovative Work Behavior

The results of the study indicate that ethical leadership has a significant influence on innovative work behavior. These findings indicate that when leaders display fairness, consistency, and provide moral examples, employees feel psychologically safe to try new ideas.

This sense of security makes it easier for employees to explore ideas, propose improvements, and take constructive risks. This aligns with SET theory, which explains that positive treatment from leaders is reciprocated by positive employee behavior in the form of innovation initiatives. These findings confirm the results of the study Masianoga & Chakauya (2023), Wen et al. (2021) and Aswad et al. (2023) which found that ethical leadership strengthens intrinsic motivation and increases employees' courage to innovate. The consistency of these research findings illustrates the importance of moral leadership in the financial services sector, which faces high compliance demands but still requires creativity in service and operations. Thus, ethical leadership can be considered a catalyst that strengthens employees' innovative capabilities in banking and microfinance institutions.

Ethical Leadership and Work Engagement

The research findings show that ethical leadership has a significant influence on work engagement. These results indicate that when leaders pay attention to employee aspirations, act fairly, and maintain integrity, employees feel valued and subsequently demonstrate higher levels of dedication. In the context of the financial institution being studied, the presence of ethical leaders creates a work environment that supports employee commitment and focus. These findings reinforce the research findings Alam & Gul (2021) Buonomo et al. (2021) dan Endang Prihatin et al. (2021) which states that ethical leader behavior increases employee motivation and psychological energy. Furthermore, these results align with SET theory, which states that a positive reciprocal relationship between leaders and subordinates encourages increased affective commitment and engagement. Thus, ethical leadership functions not only as a job resource but also as a psychological factor that increases engagement in daily work.

The Moderating Role of Well-Being between Ethical Leadership and Work Engagement

The results of the study indicate that well-being negatively moderates the relationship between ethical leadership and work engagement.

This suggests that when employee well-being is already at a high level, the direct effect of ethical leadership on engagement tends to weaken. This phenomenon may occur because employees who already have high well-being may be less reliant on their leader's ethical behavior to maintain their work engagement. This finding reinforces the view (Huma et al., 2020) The findings suggest that the influence of ethical leadership can vary depending on the employee's psychological state. Furthermore, these results demonstrate that well-being serves as a strong independent factor in shaping engagement, so that under certain conditions it can reduce employee dependence on leaders. Thus, organizations need to consider that the effects of ethical leadership are not always linear, but can interact with employee psychological states.

Work Engagement and Innovative Work Behavior

The research results show that job engagement has a significant influence on innovative work behavior. This finding confirms that employees with high energy, deep dedication, and full concentration on their work tend to be more capable of generating new ideas and implementing

them. In the financial services industry, banking institutions or microfinance institutions, which were the object of this research, job engagement is a crucial aspect because innovation often arises from employee initiatives that interact closely with customers. This finding aligns with research Hosseini et al. (2021) Sari et al. (2021) and Noerchoidah et al. (2023). which states that work engagement is one of the most powerful psychological factors driving creativity and innovative behavior. Theoretically, this finding supports the SET model, which explains that engagement is an outcome that motivates positive behavior. Therefore, increasing work engagement is an important strategy that organizations can use to strengthen an innovative culture.

The Mediating Role of Work Engagement in the Relationship between Ethical Leadership and Innovative Behavior

This study also found that job engagement positively mediated the relationship between ethical leadership and innovative work behavior. This means that leaders' ethical behavior not only directly influences innovation but also works through increasing employee engagement levels. When leaders demonstrate integrity and caring, employees feel strong support, leading to greater engagement and subsequent innovative behavior. This finding is consistent with research Lai et al. (2020), Li et al. (2019) and Saddique et al. (2023) which states that work engagement is an important mediator in the relationship between leadership and innovation. These results further reinforce the SET model, which emphasizes the importance of reciprocity in creating positive behavior. Thus, enhancing engagement is a strategic psychological pathway linking ethical leadership behavior to employee innovation in organizations.

5. Conclusion

This study shows that ethical leadership plays a significant role in increasing innovative work behavior and work engagement, while employee well-being also influences engagement levels and moderates the relationship between ethical leadership and work engagement negatively, indicating that the influence of ethical leaders is not always dominant when employee well-being is high. These findings confirm that innovative behavior is not only triggered by the moral example of leaders, but also by employees' psychological conditions, which are strengthened through work engagement as a key mediator. Therefore, companies need to systematically develop ethical leadership practices through training in integrity, transparency, and fair decision-making to create an environment that supports innovation. When innovative work behavior increases, employees become more effective in completing tasks, more responsive to work issues, and are able to make better contributions to the company's quality. On the other hand, improving employee well-being through humane work policies, harmonious work relationships, and rewards based on contributions are important for maintaining high work engagement.

6. Suggestions

Financial institutions, both banks and microfinance institutions, need to prioritize ethical leadership development through integrity, transparency, and fairness training to create psychological safety that supports employee innovation. Strengthening work engagement is a primary focus because it serves as a key mechanism linking ethical leadership to innovative

work behavior. Furthermore, improving employee well-being through humane work policies and fair rewards is crucial for maintaining optimal work engagement. Managers are expected to consistently demonstrate concern and fairness to build positive reciprocal relationships (Social Exchange Theory) that encourage dedication and innovation. With the right strategy, organizations can strengthen a culture of innovation and achieve sustainable competitive advantage.

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