Stewardship Governance: Fostering Ethical Work Climates and Covenantal Relationships

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Recent corrupt behavior on behalf of American businesses and corporate executives suggests that a rethinking of the relationship between corporate governance and organizational ethics is required. The dominant governance approach of agency theory has fostered an emphasis on short-term profit and self-serving behavior. This paper suggests that stewardship theory offers an attractive alternative to existing governance models and argues that a stewardship approach is likely to facilitate more ethical work climates and covenantal relationships between employers and employees, both of which have been shown in the literature to promote positive attitudes and behaviors, as well as ethical decision making.

Corporate scandals in the United States have generated criticism, along with an increased level of public distrust and accompanying loss of confidence in American businesses (Brown, 2005). Clearly, there is a need for a renewed sense of moral responsibility and subsequent ethical conduct in organizations. The literature suggests that multiple factors such as employee selection, ethics training, organizational rules and consequences, codes of ethics, and reward systems influence ethical conduct (e.g. Jones, 1991; Trevino, 1986; Valentine and Barnett, 2003; Wiley, 1995, 1998). In this paper, I suggest that a more fundamental approach to the problem of unethical behavior, rooted in the assumption of corporate governance, is needed. Stewardship theory (Davis, Schoorman, & Donaldson, 1997) shows promise as an alternative perspective on the nature of human beings, their relationships to the organizations to which they belong, and their ethical decision making processes.

Davis et al. (1997) define the stewardship approach to governance as one in which individuals are not motivated by maximizing self-interest, but whose motivations are derived from their concern for organizational objectives. Stewardship theory is founded on the assumption that employees will engage in pro-organizational actions and behaviors and act in the long-term best interest of the organization. This theory leads to a governance model opposite to that of agency theory (Jensen & Meckling, 1976), where control mechanisms are required to align the interests of managers and shareholders. Agency theory focuses almost exclusively on economic assumptions as the basis for motivation and ignores the intricacies of organizational life as a behavioral influence. As proposed by Doucouliagos (1994), additional theory is needed to explain non-economic organizational relationships.

Although stewardship theory was introduced to organizational studies nearly 10 years ago, agency theory has continued to dominate governance structures in the United States. Unfortunately, agency theory paints a negative picture of managers and organizations in which self-interest is the prevailing motivation of behavior. Just before his death, Ghoshal (2005:81) made a stirring call for a re-assessment of the assumptions underlying organizational governance where managers and organizations are positive contributors to corporate and societal welfare.

"Why do we not fundamentally rethink the corporate governance issue? Why don't we actually acknowledge in our theories that companies survive and prosper when they simultaneously pay attention to the interests of customers, employees, shareholders, and perhaps even the communities in which they operate?"
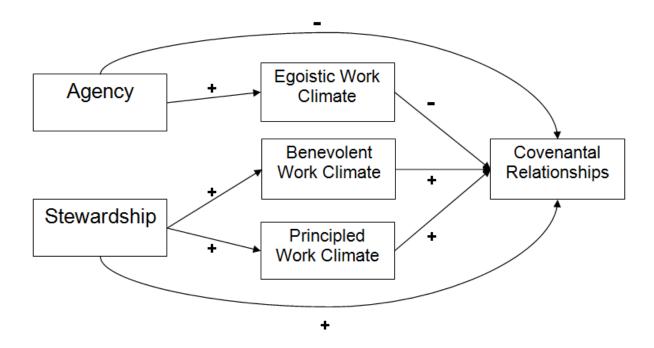
To date, stewardship has failed to gain widespread acceptance as a basis for organizational governing structures. The reason, according to Ghoshal (2005), is that stewardship theory cannot be "elegantly modeled." Therefore, there is a lack of empirical evidence for its viability. Ghoshal (2005: 81) maintains that stewardship theory does not readily yield sharp, testable propositions or provide simple, reductionist prescriptions. Donaldson (2005) disagrees to the extent of stewardship's shortcomings proposed by Ghoshal, but does recognize the need for the development and application of stewardship theory to aid in its proliferation as a viable governance approach. Although stewardship has not gained widespread acceptance in practice, it is clear that its underlying assumptions have implications for ethical decision making in business context. This paper attempts to link the notion of stewardship to issues of organizational morality through its impact on ethical work climates and strong covenantal relationships between employers and employees.

Ethical work climates reflect an agreed perception of ethical behavior and thus guide the decision process. Work climates are characterized along three ethical criteria of moral judgment: egoism, benevolence, and principle and three loci of analysis: individual, local, and cosmopolitan (Victor & Cullen, 1988). The ethical criteria of egoism, benevolence, and principle are derived from Kohlberg's (1984) theory of moral development and form the three basic ethical climates. The loci of analysis criteria of individual, local, and cosmopolitan identify types of referent groups used as a basis for application of ethical criteria to organizational decisions. Cullen, Victor, and Bronson (1993: 669) suggest that these two dimensions combine to form a construct depicting perceptions of how organizational members make decisions. Further, the nature of perceived ethical climate in organizations has been shown to impact organizational members' attitudes and behaviors; further, climates emphasizing benevolence or principle lead to organizationally desired outcomes (e.g. Barnett & Vaicys, 2000; Cullen, Parboteeah, & Victor, 2003; Fritzsche, 2000; Ruppel & Harrington, 2000).

Noted desired outcomes linked to ethical work climates are covenantal relationships (Van Dyne, Graham, & Dienesch, 1994), which are types of relational contracts founded in a mutual commitment to the welfare of both employee and employer. Covenantal relationships have also been linked conceptually to stewardship theory (Caldwell, Bischoff, & Karri, 2002; Caldwell & Karri, 2005). Covenantal relationships emphasize mutual values and concern for the welfare of involved parties (Barnett & Schubert, 2002). Perceptions of covenantal relationships by employees tend to engender organizational citizenship behaviors (Van Dyne et al., 1994). Employees who perceive a covenantal relationship with their employers are likely to exhibit attitudes and behaviors beneficial to their respective organizations.

I suggest in this paper that organizations adopting stewardship theory are more likely to foster environments conducive to perceptions of positive ethical climates and strong covenantal relationships. Specifically, I propose that ethical climates will mediate the relationship between stewardship governance approaches and covenantal relationships. Figure 1 illustrates the proposed relationships in this study.

CONCEPTUAL DEVELOPMENT

Stewardship theory proposes a different "model of man" than that of agency theory. This model "is based on a steward whose behavior is ordered such that pro-organizational, collectivistic behaviors have higher utility than individualistic, self-serving behaviors" (Davis, Schoorman & Donaldson, 1997: 24). Argryis (1973) describes the person depicted in stewardship theory as one who works beyond self-serving needs to behaviors directed at the needs and values of the principal. Davis and colleagues also describes governance structures conducive to success for steward behaviors. When a steward's "autonomy" is intentionally broadened, due to high levels of trust from the principal, he or she will complete tasks more effectively than when control mechanisms are put in place to monitor actions. Therefore, what works well to control or motivate an opportunistic manager may not work well to control or motivate a steward (Lee & O'Neill, 2003).

Agency theory focuses primarily on the divergence of interests between the owner and manager. Conversely, the actions of a steward are derived from and aimed at the principal's contentment and organizational successes. Stewards are trustworthy individuals and work meticulously to achieve the goals of the company and shareholder's returns (Donaldson & Davis, 1994). Drawing upon its roots in sociology and psychology, stewardship depicts individuals as having higher-order needs for self esteem, self-actualization, and affiliation (Arthurs & Busenitz, 2003). A steward's behavior can be regarded as organizationally centered. This involves a relationship of trust where the word of the steward can be taken as his or her bond (Williamson, 1975). Stewards are not motivated by self-interest, but by what is in the best interest of the group or organization.

Stewardship and agency theories lead to very different views of organizational governance. Various means are employed to represent the respective assumptions of each theory. Agency theory is founded on the motivational assumption of man as a self-serving individual who seeks the maximization of his own personal utility (Jensen & Meckling, 1976). In order to align interests of both principal and agent in these relationships, principals attempt to limit departure from their interests by offering monetary incentives

and by instituting control mechanisms to monitor actions of the agent. As noted earlier, stewardship theory embraces a different model of individual motivation. This view revolves around organizationally-centered motivations which transcend self-serving behaviors. When applied to a governance model, the organization is structured in such a way to maximize the long term health of the company, as well create a culture that fosters reciprocal trust and moral development (Pava, 2003).

A chief issue delineating the two theories of stewardship and agency is trust. Agency theory assumes minimal vested trust in managers, as agents are regarded as self-interest seeking and thus must be constantly monitored. Stewardship presumes greater trust, as agents are assumed to be motivated by higher order needs of growth, achievement, self-actualization and place considerable value on sustained organizational health.

Basing a governance system on reciprocal trust and moral development provides the avenue for the institutionalization of ethics within an organization. As shown in this paper, the underlying philosophy of a stewardship governance structure provides the context for positive ethical work climates and covenantal relationships to flourish, which can guide ethical behavior and decision making.

Ethical Work Climates

Victor and Cullen (1987: 51-52) define ethical climate as the "the shared perceptions of what is ethically correct behavior and how ethical issues should be handled." An organizational ethical climate is a normative construct of the mutual appraisal of policies, procedures, and behaviors in an organizational context that direct employee ethical actions and decisions (Agarwal and Malloy, 1999; Wyld and Jones, 1997; Key, 1999).

Victor and Cullen (1987) developed a two-dimensional typology of organizational ethical climates and theorize that these climates can be placed in "maps" to depict reality in organizational settings. The first dimension is based on Kohlberg's (1984) three levels of moral reasoning. Victor and Cullen (1987) label these: egoism, benevolence, and principle. The focus of egoism is for individuals to maximize positive outcomes for him or herself. Benevolence refers to achieving favorable outcomes for a relevant collective, which extends beyond motivation to maximize self-interest. Distinct from the two teleological centered orientations is the principled view which emphasizes actions reflecting accordance with generalized beliefs or standards. People applying the principled criterion rely on established laws, rules, policies, and procedures when dealing with ethical issues.

The second dimension distinguishes three possible loci of analysis an organization can assume in making ethical decisions. Victor and Cullen (1987) label these three loci: individual, local, and cosmopolitan. The individual locus refers to the self as a basis for ethical reasoning. The local referent is derived from immediate social or work groups, with the most common being the organization (Cullen, Parboteeah, & Victor, 2003). Finally, the cosmopolitan extends to sources of moral reasoning beyond the immediate organization (e.g. the profession). The two dimensions combine in a three by three matrix, resulting in nine cells representing a different theoretical ethical climate type (Victor & Cullen, 1987, 1988).

Subsequent empirical research has demonstrated that not all nine theoretical climates regularly emerge. For example, Victor and Cullen (1988) found that the original nine climates reduced to five. Wimbush, Shepard and Markham (1997) found three, and Fritzsche (2000) found only two. As a result, some researchers have recommended collapsing climate types across loci of analysis (e.g. Agarwal & Malloy, 1999; Deshpande, 1996). For the purposes of this paper, the climate types are collapsed across loci of analysis into three levels of organizational climate (egoism, benevolence, and principle) that correspond with the presence of covenantal relationships as well as develop from the presence of stewardship ideals.

Governance and Ethical Work Climates

Davis and colleagues (1997) suggest situational factors such as management philosophy (involvement oriented/control oriented), organizational culture (individualistic/collectivist), and power distance relationships (low/high) that are likely to develop principal-steward relationships. An organizational

governance structure predicated on such situational factors of stewardship can lead to the fostering and development of ethical work climates.

Ethical work climates are the shared perceptions of customary organizational policies and procedures based on ethical content that determine what constitutes ethical behavior at work (Victor & Cullen, 1998: 101). Individuals' perceptions of the nature of these climates have shown to affect organizational attitudes and behaviors. Cullen and colleagues (2003) found that egoistic climates were negatively related to organizational commitment, as benevolent and principled climates held positive associations with commitment. Ruppel and Harringtorn (2000) found the nature of ethical climate to associate with organizational communication and trust. Climates emphasizing individual interests held negative relationships with both communication and trust. Barnett and Vaicys (2000) found in their study of marketers that perceived ethical climate dimensions had a moderating effect on the ethical judgment - behavioral intentions relationship. They found the perception of a benevolent or principled climate reduced the propensity for organizational members to engage in ethically questionable acts, even as the individuals do not perceive the acts as unethical.

The nature of the ethical climate guides the decision making process for individuals in the organizational setting. According to Victor and Cullen (1988), in an organization characterized by an egoistic climate, self-interest is the dominant consideration for reasoning and resolution of ethical problems. Benevolent climates are typified by teleological considerations of the welfare of others. Finally, principled climates engage the application and interpretation of agreed principles of morality in the ethical decision making process.

The delineation of ethical climates parallels the three classifications of personal preferences noted by Ben-Ner and Putterman (1988: 7) as self-regarding, other-regarding, and process regarding.

> "self-regarding preferences concern the individual's own consumption and other outcomes, other regarding preferences concern the consumption and outcomes of others, and process regarding preferences concern the manner in which the individual in questions and others behave, including the ways in which they attain outcomes of interest."

Based on the research of Barnett and Vaicys (2000), organizations that develop ethical climates may encourage employees to look outside themselves for guidance on whether or not to engage in behaviors that may be morally questionable. As the nature of the climate is able to moderate behavioral intentions, and subsequent behavior, an organizational environment fostering stewardship can drive the perception of this respective work climate.

Egoistic work climates involve the maximization of self interests in decision making processes. Individuals within the organization perceive they are expected to make ethical decisions based on what maximizes their personal interests. "As such, the decision-maker usually seeks the alternative with the consequences that most satisfies his/her needs, ignoring/neglecting the needs or interest of others" (Parboteeah and Cullen, 2003: 140).

Obviously, this conflicts with a stewardship approach to governance, as stewards forgo self-serving behaviors in favor of protecting organizational interests. Such climates may compel employees to perceive greatest benefit, or least ethical repercussions, when a decision outcome favors individual welfare. Mechanisms that promote stewardship are unlikely to foster the perceptions of a climate emphasizing self interest in any decision process. Alternatively, an agency perspective may appropriately lead to the perception of an egoistic climate.

Agency theory describes the relationship in which one party (principal – owner) delegates work to another (agent - manager), who performs that work (Ross, 1973). The model of man fundamental to the theory is that of the rational, self-serving individual who seeks the maximization of his own personal utility (Jensen & Meckling, 1976).

Proposition 1: The existence of agency governance will be positively associated with the existence of egoistic work climates.

Benevolent work climates emphasize the interests of other parties in the decision making process. Block (1993) describes the role of the steward as committed to the welfare of others. Climates emphasizing the welfare of others align with the theoretical underpinnings of stewardship, as to value long-term relationships and overall health of the organization.

Proposition 2: The existence of stewardship governance will be positively associated with the existence of benevolent work climates.

Principled (or deontological) work climates guide individual ethical decision processes through the evaluation of universal principles of right and wrong (Ferrell & Fraedrich, 1997). Actions are deemed ethical as they comply with these universal principles. Deontological work climates accentuate compliance with organizational policies and procedures, professional code, societal regulations, and laws (Barnett & Vaicys, 2000). Such climates are likely to facilitate collective agreement on acceptable organizational behaviors (Barnett & Schubert, 2002). Stewards believe their interests are aligned with that of the organization, and engage in collective behaviors (Davis et al., 1997).

Proposition 3: The existence of stewardship governance will be positively associated with the existence of principled work climates.

Covenantal Relationships

Mutual obligations are the fundamental nature of employment contracts (Rousseau, 1989) that delineate the relationship between employees and employers. Differing from the formal written contract of employment is the psychological contract, described by Robinson and Rousseau (1994) as an individual's belief regarding the terms and conditions of a reciprocal exchange agreement between that person and the employing party. The concept of the psychological contract may be differentiated and categorized as being of a transactional or relational nature (MacNeil, 1985). Transactional contracts are usually short-term and performance related, involving set monetary exchanges. Relational contracts are based on emotional involvement beyond mere financial reward. They tend to be far more long-term and involve significant investment by both the employer and employee.

A covenantal relationship is a more concentrated type of relational contract between and employee and his or her organization (Van Dyne et al., 1994). The relationship is predicated by a joint dedication to the welfare of both parties and perpetuation of organizational values. Covenantal relationships are founded in mutual commitment where behaviors mandatory for preservation of the relationship are not always known in advance (DePree, 1989). Van Dyne, and colleagues (1994) describe this type of relationship as existential, focusing on a state of being and involving intrinsically motivated effort rather than earning. This in turn creates an environment where the employee will feel valued by, and value for the organization (Barnett and Schubert, 2002).

Covenantal relationships are significant in organizational environments, as they have shown impact on organizational behaviors. The perception of covenantal relationships can influence employee performance, such as organizational citizenship behaviors (Graham & Organ, 1993; Van Dyne et al., 1994).

Governance and Covenantal Relationships

As discussed earlier, psychological contracts can be differentiated into two types, transactional and relational contracts. Transactional employment contracts are embedded in economic exchange describing terms of service, compensation, and rights of both parties (Graham & Organ, 1993). The focus of both parties (employer/employee) in transactional relationships is of maximizing self-interest (Barnett & Schubert, 2002).

As noted earlier in the literature, opponents of stewardship theory (agency theorists) are wary of lacking control features and bestowed trust upon employees in this governance ideal (Davis et al., 1997). The separation of ownership and control within the firm causes the interests and objectives of the principal (owner) and the agent (manager) to differ. As long term interests of the principal conflict with short term interests of the agent, divergences may occur. Since the manager is not the owner of the firm, he lacks the disincentive associated with a loss in equity value due to actions not in the best interest of the firm. Principals attempt to limit departure from their interests by offering monetary incentives and by instituting control mechanisms to monitor actions of the agent. More simply put, in many instances the focus of agency theory is reliant upon transactional employment contracts.

> *Proposition 4: Agency governance will be negatively associated with the existence of covenantal relationships between employees and employers.*

Relational contracts, on the other hand, are not based solely on economic benefit, but more on long-term maintenance of relationships. A covenantal relationship is a special type of relational contract built on mutual commitment of both the employer and employee and an allegiance to shared values (Graham & Organ, 1993). The bond of this association requires involved parties behave in whatever fashion necessary to uphold values and preserve the long-term health of the relationship (Barnett & Schubert, 2002). According to Donaldson and Dunfee (1994), a founding assumption of stewardship theory is that the steward is driven by an underlying social contract. Stewardship theory defines situations where employees are not motivated by self interest, but by organizationally centered interests. Caldwell, Bischoff, and Karri (2002) note that a duty of the steward is to create covenantal relationships.

The presence of covenantal relationships alleviates these concerns as interests of employee and organization are aligned and a mutual commitment to the proliferation of this relationship guides behaviors. Further, Caldwell and Karri (2005) argue that employing a governance design of stewardship based on covenantal relationships is an effective method for building trust in organizations. Caldwell and Karri (2005) emphasize stewardship as a covenantal approach, focusing on individuals and establishing long term relationships. Much of the same theoretical approach proposed by Caldwell and Karri (2005) is agreed except for the use of terms (stewardship and covenantal relationships) almost interchangeably, this paper asserts that the stewardship model provides the contextual setting for fostering of covenantal relationships.

> *Proposition 5: Stewardship governance will be positively associated with the existence of covenantal relationships between employees and employers.*

Mediating Influence of Ethical Work Climates

This research posits that stewardship governance can lead to the development of both covenantal relationships and ethical work climates. It has been shown in the literature that a relationship exists between ethical work climates and perceived covenantal relationships. Therefore I propose that ethical work climates may partially mediate the relationship between stewardship and perceptions of covenantal relationships.

As covenants are predicated by mutual value and concern for the involved parties, established workplace values may be an attributing factor to the development of covenantal relationships. Further, as proposed by Barnett and Schubert (2002) the nature of the perceived ethical work climate associates with the presence of covenantal relationships. The varying nature of the ethical work climate (egoistic, benevolent, or principal) affects the development and perception of covenantal relationships between employee and employer. Barnett and Schubert (2002) found evidence in their study of 194 department store employees that there was a negative relationship between egoistic climates and covenantal relationships, and positive relationships between both benevolent and principled climates and covenantal relationships.

Egoistic Work Climates and Covenantal Relationships

Egoistic climates are focused on maximizing 'self-interest' without regard to how relevant decisions may affect others. Fundamentally, egoistic climates parallel agency governance in theoretical foundation. Therefore the perceptions of egoistic climates are likely to propagate in governance structures built on agency theory. Further, it is proposed that agency governance will have a negative association with covenantal relationships, mirroring research findings on the relationship of egoistic climates and covenantal relationships (Barnett & Schubert, 2002). The combination of these theoretical and empirical linkages provides for the partial mediation of egoistic work climates.

> *Proposition 6: Egoistic work climates will partially mediate the relationship between agency governance and covenantal relationships.*

Benevolent Work Climates and Covenantal Relationships

In organizations characterized by benevolent climates, consideration of the well being of others dominates employee reasoning (Victor & Cullen, 1988). Alternative to the egoistic climate, individuals immersed in a benevolent climate do not merely seek to maximize self interest; rather they make distinctions between the subject and the object of ethical behavior and consider the consequences of their behavior on the welfare of others. Along the notion of utilitarianism, decisions made should produce net positive results for others.

Barnett and Schubert (2002) draw two consistencies with benevolent ethical climates and covenantal relationships. First, benevolent climates necessitate decision processes beyond the scope of individual interest. Covenantal relationships thrive on mutual sacrifices for long-term interest of the relationship. Second, benevolent climates concentrate attention on others welfare, as covenantal relationships are founded on the commitment to welfare of the involved parties.

> *Proposition 7: Benevolent work climates will partially mediate the relationship between stewardship governance and covenantal relationships.*

Principle Work Climates and Covenantal Relationships

Climates based in the principle criteria embody deontological consideration of laws, rules and principles when considering ethical issues. Absolute adherence to agreed principles of morality characterize these climates. Norms and rules are rooted in strong organizational values, and their respective application and interpretation guide reasoning (Victor & Cullen, 1988).

Principle climates, predicated on shared acceptance and understanding of organizational values, parallel the formation of covenantal relationships. Covenantal relationships foster a key component of mutual commitment, which is also reflected in the ideals of principle climates.

> *Proposition 8: Principled work climates will partially mediate the relationship between stewardship governance and covenantal relationships.*

DISCUSSION AND FUTURE RESEARCH

This research aims to further legitimize the notion of stewardship theory as a governance model. Organizational governance issues persist in the media and academia. As agency theory has dominated governance issues in management theory combined with the perceived lack of ethics in corporate America and public mistrust of companies, stewardship theory is slowly gaining support. Prior theoretical work on stewardship specific to organizational governance has had minimal integration of ethical variables of work climate and covenantal relationships into the theoretical framework, which is the contribution of this paper.

Davis and colleagues (1997) suggest research for both situational and individual factors relating to the choice between agency and stewardship organizational models. The authors suggest that neither model is

optimal for every organization. For individual organizations an interaction effect of situational and individual variables may lead to optimal governance structures (agency or stewardship). Mutual stewardship relationships maximize firm performance, whereas mutual agent relationships minimize potential firm costs. A mismatch between the two elements allows for one of the involved parties to act opportunistically.

A future study should examine individual variables such as personality characteristics that would lead to steward behaviors. Of primary interest in personality would be the traits of conscientiousness and agreeableness. Conscientious individuals are ambitious, practical, persistent, scrupulous, and careful (Costa & McCrae, 1992). Agreeable individuals are altruistic, generous, trustworthy, and cooperative (Costa & McCrae, 1992). In a study of workplace deviance conducted by Colbert, Mount, Harter, Witt, and Barrick (2004) it was found that employees who are conscientious and agreeable were less likely to engage in deviant workplace behaviors.

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