Journal of Business Ethics (2005) 58: 249–259
DOI 10.1007/s10551-005-1419-2

Organizational Governance and Ethical Systems: A Covenantal Approach to Building Trust

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ABSTRACT. American businesses and corporate executives are faced with a serious problem: the loss of public confidence. Public criticism, increased government controls, and growing expectations for improved financial performance and accountability have accompanied this decline in trust. Traditional approaches to corporate governance, typified by agency theory and stakeholder theory, have been expensive to direct and have focused on short-term profits and organizational systems that fail to achieve desired results. We explain why the organizational governance theories are fundamentally, inadequate to build trust. We advance a conceptual framework based on stewardship theory characterized by "covenantal relationships" and argue that design of governance mechanisms using a covenantal approach is more effective in building trust in organizations. A covenantal relationship is a specialized form of a relational contract between an employee and his or her organization. We argue that regardless of incentives and control mechanisms carefully designed through contractual mechanisms, in the absence of covenantal relationships it is extremely difficult to build trust within organizations. We propose that organizations are more likely to build trust – both at the organizational level and at the interpersonal level – when they create reinforcing and integrated systems that honor implied duties of "covenantal relationships."

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Introduction

American businesses and corporate executives are faced with a serious problem: the loss of public confidence. This lack of trust has been accompanied by profound public criticism, increased government controls, and growing expectations for not only improved financial performance, but also increased accountability for financial results (Alkhafaji, 1989). At issue is corporate governance – how a firm is managed to optimize performance and who is doing the governing. At risk is the "consequential implications of reciprocal dependence and vulnerability between participants" (Dingwall, 1983, p. 12). Put more simply, governance systems seek to balance trust and accountability, recognizing that the form of the relationship between parties directly influences the willingness to trust (Sheppard and Sherman, 1998).

This paper suggests that the organizational governance theories of traditional agency and stakeholder theory are fundamentally inadequate to build trust. We propose an alternative theory and approach based on managerial stewardship. In this paper, we briefly compare agency theory, stakeholder theory, and stewardship theory as models of organizational governance. We propose that stewardship theory offers a system of governance that is ethically consistent with the needs of organizations in today's business environ. We conclude by providing insights into the key implementation steps that are important in implementing an ethically consistent stewardship model – key steps for restoring and rebuilding public trust.

Three models of governance

The governance form selected by an organization is based on decisions to reduce any potential exchange problems created by bounded rationality, on the one hand, and the threat of opportunism, on the other hand (Barney and Hesterley, 1996). The expectation is that the manager – or agent – will maximize performance for the benefits of shareholders and other controlling interests. However, as trust erodes, an increase in organizational performance may be offset by increases in the costs of attaining it (Williamson, 1975).

Traditional approaches to corporate governance, typified by agency theory and stakeholder theory, have been expensive to direct and have focused on short-term profits and organizational systems that fail to achieve desired results (Baucus and Beck-Dudley, 2000). Agency theory assumes that humans are self-interested and prone to opportunism (Eisenhardt, 1989). Arrow (1985) notes two sources of agency problems. First, moral hazard, or hidden actions are costly to observe. Second, adverse selection, or hidden information is costly to ascertain. Monitoring and bonding agents in order to control their opportunism are two approaches that deal with these two problems. Thus, the solutions are driven by a lack of trust and increase the cost of doing business.

According to agency theory, shareholders represent the only interests that managers should be concerned with in making decisions (Jensen, 1988; Jensen and Meckling, 1976). Managers, on the other hand, are presumed to be self-interested and, unless constrained, will inevitably behave in self-interested ways (Canella and Monroe, 1997). Agents may emphasize growth over profitability, since their individual compensation typically depends upon firm size. Alternatively, they may consume excess perks, or may initiate strategies that yoke them to the firm and make it difficult for the firm to remove them.

The assignment of a competent ''agent'' to manage the organization allows shareholders to diversify their portfolios and allows managers, who may lack resources for ownership, to specialize in managing. Although the separation of ownership from control has many benefits, this separation also has a number of associated costs. Prominent among these costs are agency problems, which frequently manifest in opportunistic behavior by managers (Williamson, 1975). Agency problems exist because principals (shareholders) and agents (managers) have differing risk preferences and have conflicting interests (Eisenhardt, 1989). When agents misrepresent their abilities (adverse selection) or put in less effort than required to achieve their principals' objectives (moral hazard), principals must expend resources to monitor agent performance and/or create performance-based compensation systems to incent desired behaviors (Hendry, 2002).

Stakeholder theory, a framework designed to examine situations in which executives pursue the best interests of corporate owners but that also includes the needs of other stakeholders, was proposed as an alternative theory to traditional agency theory (Donaldson and Davis, 1989, 1991). Winn and Keller (2001) posit that traditional stakeholder theories focus on the achievement of traditional corporate objectives – and the present and increasingly complexity of these objectives must be revised. The stakeholder theory concept is based on the ethical premise that ''the task of management is not only to deal with the various stakeholder groups in an ethical fashion but also to reconcile the conflicts of interest that occur between the organization and the stakeholder groups'' (Carroll, 1996, p. 23). Advocates of an expanding role of corporate social responsibility recognize that organizations must pursue both profit and service (Carroll, 1996).

Carroll notes that the traditional economic model, based on Adam Smith's notion of the invisible hand, held that society determined its needs through the marketplace. He observes that the marketplace may do a reasonable job in determining goods and services to produce but that it does ''not fare as well in ensuring that business always acted fairly and ethically (Carroll, 1996, p. 29).'' Carroll's (1996, pp. 92–93) model for moral organizational decision-making incorporates a standard of normative ethics that requires those who govern to ask ''What ought to be?'' in terms of business behavior as the standard by which business ethics might be judged. Those who are advocates of stakeholder theory argue for its virtues primarily in terms of its normative value (Donaldson and Preston, 1995).

The stakeholder relationship imposes duties that they describe as a network of implicit contracts between each stakeholder group and management; proposing a set of heuristic or social contracts based upon normative principles of human conduct. Thus, the "firm as contract" notion of Freeman and Evan (1990) obtained precedent in which the manager oversees the contractual relationship with each stakeholder. Ultimately, Freeman and Evan (1990) see stakeholder theory as redefining the purpose of the firm as serving as a vehicle for coordinating stakeholder interests. Other scholars similarly argue that the duty owed to all stakeholders is the creation of long-term wealth (c.f. Hosmer, 1986; Post, et al., 2002; Selznick, 1992).

Davis et al. (1997) describe "stewardship theory" as a relationship in which managers are stewards whose motives are aligned with the objectives of many parties. In their model, the behavior of the steward is collective or organizationally centered in terms of seeking and sustaining the objectives of the entire organization. They suggested that the role of the steward was to protect and maximize shareholder and organizational wealth and to avoid or prevent substituting individual self-serving behaviors for organizational behaviors that enhance organizational functioning and effectiveness. Advocates of the stewardship model argue that managers who are stewards are most effective when corporate governance structures give them high authority and discretion (Jones, 1995). However, this approach is likely to be viewed as dysfunctional, and possibly unrealistically naïve, under agency theory assumptions.

In describing the ethical role of the corporate steward, Davis et al. (1997, p. 26) provide clarifying detail:

> "Given a choice between self-serving behavior and pro-organizational behavior, a steward's behavior will not depart from the interests of his or her organization. A steward will not substitute or trade self-serving behaviors for cooperative behaviors . . . Because the steward perceives greater utility in cooperative behavior and behaves accordingly, his or her behavior can be considered rational."

This rational perspective fits contextually within a principle-based and a duty-based ethical framework – sometimes called a "virtue ethics model". This duty is based upon a complex set of ethical assumptions based upon the assumed "community/citizenship" obligation of organizations and utilitarian ethics – creating the greatest good for multiple stakeholders. Solomon (1993) articulates this multifaceted ethical relationship, noting that a business has a societal duty to honor its obligation to the community – an idea dating back to the early Greeks. Manville and Ober (2003) offer additional insights about the nature of this community-based obligation, and opine that this same duty applies to modern day businesses. The steward's perspective is contextually rational as part of his or her model of how a leader serves.

Peter Block proposes a related but distinctive stewardship theory model, based upon "service over self-interest (Block, 1993, title)". Adapting Block's model, we extend the role of the steward beyond the perspective of Davis et al. (1997) but fully incorporate their view of the steward's concern for the needs of the entire organization and the creation of organizational wealth. Consistent with the perspectives of these authors, we suggest that the steward's role is to pursue organizational goals, believing that both organization and individual needs will be achieved best by pursuing collective ends (Hosmer, 1996). The fundamental assumption underlying stewardship theory is that the maximization of long-term economic wealth will ultimately serve to be in the best interests of the principals and the various stakeholders collectively, in addition to maximizing social welfare and the long-term economic benefit to society (Caldwell et al., 2002; Post et al., 2002).

Morrison and Robinson (1997) describe the employees' point of view regarding this perspective, noting that employees have perceptions and beliefs about the nature of the relationship between themselves and their employer that relate to bi-directional obligations and entitlements. Caldwell and Jeffries (2001) suggested that these perceived relationships are individually assessed. Rousseau (1995) noted that the mutual responsibilities and obligations inherent in the employee–employer relationship often differ, as perceived by employee and employee. Yet, it has been generally acknowledged that the violation of the perceived contract or covenant by employers can have a profound impact on job attitudes and behaviors (Rousseau, 1995; Turnley and Feldman, 1999).

Covenantal relationships

Rousseau (1995) notes that the duties of organizations are often perceived as implicit contracts. Other scholars also note that the ethical obligations of organizations to individuals are subjectively determined and rise to the level of an implied contract (Caldwell and Jeffries, 2001; DePree, 1989). The concept of the organization as involved in covenantal relationships has an Aristotelian base and deep ethical roots (Solomon, 1993). Ethical philosophy has pursued an integrated set of expectations in honoring the rights of others, but management theory has consistently failed to keep pace in practice with ethical duty (Selznick, 1992).

Barnett and Schubert (2002, p. 280) define a covenantal relationship as ''a specialized form of a relational contract between an employee and his or her organization''. They note that this relationship is both a transactional relationship and a psychological relationship. Smircich (1983), in her seminal discussion of organizational culture, noted that individuals interpret their organizational internal environment broadly – at the cognitive, the symbolic, and the psycho-dynamic levels. When employees are treated as complex individuals and understood in terms of their worth and value, they ''feel valued by and value their organization'' and the covenantal relationship is achieved (Barnett and Schubert, 2002). Selznick (1992, p. 479) defined a covenant as integrated with the creation of a true community – fundamentally based upon ''moral ordering'' and ''self-defining commitment''. Pava (2001: p. 86) also incorporated the concept of ''shared community'' in his definition of a covenant – noting that a covenant provides ''a stable social location for the interpretation of life's meanings in order to help foster human growth, development, and the satisfaction of legitimate human needs''.

Herman (1997, p. 39) suggests that covenants in an employement relationship are founded upon two generic commitments from both parties. First, the parties must be united around some common interest or purpose and second, in pursuit of this aim, the parties must bind themselves not to abuse the advantages they hold over each other. Herman (1997) cautions that contracting as a device to build enduring relationships is limiting in the sense that contracts provide the actors involved ''certain stipulations as a means of neutralizing the suspect contingencies they present each other''. Covenantal aspect of a contractual relationship arises from going beyond the specified contingencies and committing to the two conditions stated above.

The steward's duty is to create this covenantal relationship (Caldwell et al., 2002). The long-term impact of a stewardship approach maximizes shareholder profits, achieves balanced professional growth and job security for employees, and honors corporate social responsibility relationships (Hosmer, 1996). Solomon (1993) articulates the importance of organizational duty, noting that duties are defined by one's role in the organization carry a moral weight. In pursuing long-term organizational wealth rather than just short-term objectives, stewards serve the best interests of society, stakeholders, customers, and shareholders (Hosmer, 1996).

Covenantal duties operate within a framework of virtue ethics in which there is congruence between business, the public good, and the individual interest (Solomon, 1992, 1993). Organizational leaders operating from a covenantal perspective recognize that stakeholder interests are often syncretic or dynamically balanced and are sometimes not perfectly aligned (Lado and Zhang, 1998). This syncretic balance allows stakeholders to recognize that not every decision can benefit all parties equally – but that the nature of the relationship is such that the parties recognize that they seek to maintain a long-term interdependent relationship even if individual decisions may not result in a short-term maximization of benefits. Pava's (2001, p. 86) insights about the open-ended, long-term, and interest preserving nature of covenants are instructive here – allowing parties to be ''simultaneously both free agents and members of a living community''.

Solomon created a framework of six contemporary virtues for ethics in business: Community, Excellence, Role Identity, Holism, Integrity, and Judgment (Solomon, 1993). He defines these terms as follows:

Community – A corporation is more than a collection of self-interested individuals. A sense of community helps define individual identities. Communities focus internally on cooperation rather than competition.

Excellence – Corporations must both "do well" and "do good". Corporations must improve their ability to fully recognize and reward merit within and to thus inspire ongoing improvement.

Role Identity – Individual affiliation occurs best when personal and organizational values fit. Duties and virtue, rightly applied to the individual, enable each person to align and integrate that fit.

Holism – Holism is synonymous with aligned context with the big picture, rather than an incremental focus. It demands a synergistic approach and a recognition of long-term priorities.

Integrity – Integrity is the integration of virtues into a consistent character. It encompasses moral courage and the will and willingness to do what one ought to do.

Judgment – The ability to balance conflicts in roles without compromising principle is the essence of judgment (Solomon, 1993, pp. 145–186).

Solomon's six virtues provide a foundation that is conceptually consistent with the factors of the covenantal relationship defined by both Selznick (1992) and Pava (2003). Other scholars, (Cameron et al., 2003) suggest that this virtuous approach to organizational governance has not only an inherent connection with the interdependent duties of a community but is strong applicability to the modern business organization. The heart of the covenantal approach is its dependence upon values – to provide for "the interpretation of life's meanings in order to help foster human growth, development, and the satisfaction of legitimate human needs" (Pava, 2003, p. 2).

The covenantal model

In an effort to clarify the elements of the covenantal model of stewardship theory, we provide a summary of its implicit assumptions and duties at the organizational level and contrast those assumptions with our view of parallel assumptions of both agency and stakeholder theories (Table 1).

In distinguishing the stewardship framework from either an agency theory or stakeholder theory approach, we present the stewardship model as ethically superior because it honors the societal obligations and the duties to all stakeholders. The strength of the covenantal approach of the stewardship model is that it incorporates the ability to look internally (within both self and the organization) and toward the external environment in assessing organizational needs within a full context. Argyris and Schon (1978) described this process of simultaneous assessment internally and externally as a double-loop model for learning, a concept that is well accepted in the management literature (Senge, 1990).

Traditional management thinking is critical of approaches that do not pursue short-term bottom line results (McCoy, 1985). McCoy notes that corporations are increasingly recognizing that their obligations are not one-dimensional. We concur with McCoy's conclusion that the "paramount task" of leadership in organizations is the management of instrumental organizational objectives and normative values (McCoy, 1985, p. 13). As Hosmer (1996) has suggested, the managerial dilemma of governance represents the conflict between economic and social performance. He notes that extending the stewardship responsibility of management to long-term issues and to all stakeholders is essential because the moral problems of management (1) have extended consequences, (2) multiple alternatives, (3) mixed outcomes, (4) uncertain consequences, and (5) personal implications for the parties involved (Hosmer, 1996, pp. 10–11).

Although many scholars focus on pursuing short-term profit and profit maximization as the primary mission of the firm, institutional microeconomic theory encompasses "ethical as well as economic precepts" (Hosmer, 1996, p. 33). Although profit maximization is a part of the theory of the firm, "it is only a part, and certainly not the central focus" (Hosmer, 1996, p. 33). The covenantal model is fundamentally committed to the ongoing process of managing change, recognizing that the governance role necessitates creating a culture that guides moral development while simultaneously meeting the legitimate needs of organizational stakeholders (Pava, 2003, p. 13).

Systemic implementation

Pava (2003, pp. 18–19) emphasized that "the idea of covenant implies that our theory of being human is inextricably related to how we construct organizations". Lawrence and Lorsch (1967) suggested a systems approach to understanding how organiza-

TABLE I
Organizational assumptions of covenantal duties

	Agency Theory	Stakeholder Theory	Stewardship Theory
Overall Ethical Focus	Teleological or goal oriented and deontological or duty oriented	Focused on the utilitarian needs of all stakeholders with an ethics of balance	Virtue ethics based upon a commitment to society based virtues and rights
Manager Role	Maximize short-term wealth for the Principal	Balancer of demands and advocate of collective interests	Integrator of shared interests
Time Focus	Often short-term	Both short-term and long-term	Primary concern is long-term
Manager Motivation	Serving principals and preserving self-interests	Equalizing benefits to all parties	Virtues and values and society
Use of Information	Maximizes profitability	Creates understanding about interests and needs and identifies trade-offs	Achieves synergies
Basis of Trust	Competence	Equity	Integrity
Moral Position	Conditional	Situational	Principled
Function of Rules	Control	Clarify process	Define opportunity
Key Value	Results	Balance	Authenticity
Manager's Primary Function	Profit producer	System maintainer	Steward
Organization Goal	Create highest possible short-term wealth	Create wealth and preserve relationships	Create long-term wealth and achieve best interests of all
Manager's Personal Goal	Preserve self-interest	Serve all parties fairly	Achieve potential
Motivational Model	Economic model with extrinsic motivators	Mixed model with mixed motivators	Self-actualizing model with intrinsic motivators
Vision/ Focus	Protection of self-interest while	Integrating shareholder and organizational interests	Increasing organizational wealth to serve all interests
Assumptions about People	People seek rewards in an exchange relationship and are individualistic utility maximizers	Peope are concerned with equity and fairness and want to be dealt with justly. Utility is measured distributively	People are collective self-actualizers who achieve utility through organizational achievement

tions can manage change. Although their model of organizational development and change does not address covenantal concepts specifically, they clearly understand the importance of a systems theory approach to integration and differentiation. Similarly, Schein (1992) articulates the importance of external adaptation and internal integration in aligning behaviors, values, and core assumptions. This systemic integration of values and behavior, Schein notes (1992, pp. 374–383), is the duty of the leader and the key to creating organizational trust. As Pava (2003, p. 21) emphasized, the way in which an organization is organized is ''an inherently ethical activity'' and ''ethical issues intersect with organizational concerns at every turn''.

The ethical foundation of a covenantal approach parallels the thinking of practitioner studies that have begun to receive increased acceptance in the management literature. Pfeffer (1998) focused on the importance of valuing people while simultaneously pursuing the instrumental objectives of the organization. Collins (2001) and Collins and Porras (1997) found that organizations that outperformed their competitors were value-based and relied heavily on core values advocated by highly committed leaders. Cameron et al. (2003) have articulated the importance of a virtue-based role in guiding organizations, and Cameron (2003, p. 190) has noted that virtuous firms outperformed those led by leaders with low scores in virtuousness in ''profitability, productivity, innovation, quality, customer retention, and employer loyalty.'' Stewardship leaders provide an integrated and congruent set of organizational systems that reflect an aligned set of priorities and that focus on contextual fit.

We note, as did Lawrence and Lorsch (1967) that a well-founded systems approach that integrates organizational governance principles and values will impact organizations at the organization-to-environment, organization-to-organization, and individual-to-organization levels.

Building trust

The stewardship model is neither unique to ethics nor to management theory. It assumes a commitment to the welfare, growth and wholeness of others that Kouzes and Posner (1994) find in their studies to be critical to the establishment of organizational credibility. Although trust has been acknowledged to be an elusive construct at both the individual and organizational levels (Mayer et al., 1995; Hosmer, 1995), trust is also acknowledged as the glue that holds organizational culture together and the basis of interpersonal and organizational success (Reina and Reina, 1999).

Block defined stewardship as ''to hold something in trust for another.'' (Block, 1993). In a true covenantal relationship governance occurs by pursuing long-term, wealth producing interests for all stakeholders. Block explained that choosing service over self-interest occurred when leaders were willing to be accountable without choosing to control or manipulate others. Block's approach was to treat stakeholders ''as owners and partners'' without creating conditions of dependency or control – by creating conditions of empowerment that ''offers choice and spirit'' to core workers (Block, 1993, p. 22). At the same time, Block recognized that the stewardship approach was respected by practitioners and academics when it passed ''the test of the marketplace''.

Similarly, Pfeffer (1998) endorsed an approach to developing within employees a commitment to the organization and its purposes. Consistent with a systems approach, Pfeffer (1998) advocates creating a culture of high involvement and ownership. Pfeffer is sharply critical of governance techniques and menus that seek success by imitating other organizations without understanding the conditions under which governance principles are based. Pfeffer explains: ''success frequently entails implementation rather than coming up with great ideas'' (Pfeffer, 1998, p. 13). It is not enough to find or define answers – implementation that occurs with the cooperation and buy-in of fully involved employees is the key to successful organizations. Both Pfeffer and Block wrote eloquently about the importance of employees at the lowest level being involved in developing and implementing solutions that serve both internal and external customers.

Pfeffer observes that there is ''a substantial and rapidly expanding body of evidence, some of it quite methodologically sophisticated, that speaks to the strong connection between how firms manage their people and the economic results achieved ''(Pfeffer, 1996, p. 31). The key catalyst for achieving this result is a faithful adherence to principles, duties, and core values. Block (1996) advocated that the key to releasing this energy in people came by redistributing the role of management organization-wide through the process of clearly articulating employee roles, establishing new social contracts in relationships, and empowering employees by supporting them in their positions and redefining the role of bosses. He acknowledged that creating a new social contract ''based on partnership and empowerment is the difficult emotional work of stewardship'' but declares it to be an important step in creating a stewardship culture (Block, 1996, pp. 84–85).

The process by which stewardship governance – a covenantal relationship – occurs most easily in what Senge calls a ''learning organization'' (Senge, 1990). Both Senge and Block emphasize the importance of open dialogue in creating such a culture. Block puts this process of dialogue into cultural context:

> Moving from parent to partner comes down to a series of conversations. Dialogue is the solution. The conversation is about purpose, ownership and responsibility. Shifting these concerns from the exclusive province of the management class and distributing them among people doing the core work. We do this for the sake of the institution, not because the load is too heavy. The boss says in effect, ''I want you to share in the felt ownership of this franchise. I plan to share with you the power and privilege of ownership, as long is it is used in service of the larger unit. This is the partnership agreement that I want to manage by.'' This

> conversation accompanies the definition of the stewardship contract … which defines the playing field. (Block, 1996, p. 86)

The willingness of organization leaders to reframe their mental models and to create an empowering dialogue with employees is consistent with DePree's thoughts about the obligations of the servant leader. He also describes the leader's duty as a "covenantal relationship" in which the leader and the organization owe a broad array of obligations to employees at all levels (DePree, 1989, p. 53). In addition to defining expectations about the organization, leaders owe employees the opportunity to grow and to make a contribution to organizational objectives. Defining the new reality is "the first task of the leader" according to DePree – including identifying boundaries and ground rules both internally and in the external environment (DePree, 1989, p. 11).

The critical role of the leader in the covenant relationship model is not an autocrat coach – although the transitional role of coach may be necessary for the short-term (Block, 1996). Block explained that the coaching role carried the same limitations as benevolent patriarchy. "Turning supervisors into coaches keeps the managing and the doing of the work separate" but managing the organization must become a part of each employee's duty (Block, 1996, pp. 105–106). In the model we propose, the leader fulfills his/her role by securing funds for unit operations, communicating results and requirements for continued financial support, and brokering services and other supports that enable the work unit to succeed – tasks that make leaders vital to teams while reinforcing the fact that governance is a function that is integrated throughout the organization (Block, 1996, p. 107).

Implementing systemic covenantal approach has a variety of human resource applications. For example, a covenantal approach instead of focusing on performance appraisal – criticized by many as organizationally dysfunctional (c.f. Deming, 1986; McGregor, 1960) – is team-based and customer-focused. Block (1996, p. 97) noted that the key focus on performance must begin with knowing what the customer values "and how the unit is doing in living up to those values". Both internal customers and end-users of organizational goods and services are the determiners of unit effectiveness and "each person should be engaged in this discovery process" (Block, 1996, p. 97). Rather than the boss being the customer of the employee, the stewardship model reverses this relationship and "the subordinate is the customer of the boss" (Block, 1996, p. 107). In honoring the covenantal duty "the leader must become a servant and a debtor" to employees (DePree, 1990, p. 11).

In a similar vein, compensation systems congruent with a covenantal model must be team-based and systemically reinforcing. Baucus and Beck-Dudley (2000) noted that traditional compensation systems result in outcomes that tend to divide organizational loyalties and produce the wrong results. Kerr's (1975) famous article about the "folly of rewarding A while hoping for B" similarly acknowledged the dysfunction of traditional human resource compensation systems. Among Pfeffer's seven practices of successful organizations is his recommendation that organizations establish contingent compensation systems, such as gainsharing, based upon organizational performance outcomes (Pfeffer, 1998, pp. 64–65). Effective organizational leadership requires establishing congruent and well-conceived organizational systems that demonstrate a commitment to all of stakeholders – and a commitment to governance that transcends short-term outcomes at the expense of long-term success.

Implementation is the key

The challenge of implementing a covenantal model of organizational governance is that its successful adoption requires much more than an understanding of its concepts and principles. Pfeffer (1998) and Block (1996) note that successful organizations recognize that the design of improved organizational systems must "ultimately get beyond the issues of philosophy, architecture, and mind set – even though these are absolutely critical and fundamental" (Pfeffer, 1998, pp. 99–100). Pfeffer noted that the alignment of system elements is "easier described than accomplished, because few organizations have developed a set of consistent practices" (Pfeffer, 1998, p. 100). As a result, managers make the mistaken assumption that "because they recognize the need for alignment and state the concept on paper and make one or two changes – at one point in time – that everything is suddenly in alignment" (Pfeffer, 1998, p. 104).

Collins and Porras (1997) also emphasized that the key to successful implementation of change is in understanding change as an evolutionary process that takes time and extended effort. Changing traditional mental models and developing a driving core ideology – inherent in a covenantal approach – was the critical first step. They emphasized that a short-term "build it quickly, make a lot of money, cash out, and retire" approach is not consistent with long-term success. Nonetheless, the systemic and aligned approach that they advocated has been the method of great companies in the past fifty years.

Block noted that the implementation of stewardship concepts provides "no safe path" although the change in mental models is decidedly difficult (Block, 1996, p. 237). The question of "How?" – the implementation issue, he noted, "becomes more interesting than the answer" (Block, 1996, p. 233). But Block also noted that the implementation process is as much a "letting go" of old thinking as it is an adoption of new ideas.

The challenge

A covenantal approach to governance suggested by the stewardship model is a profound challenge for corporate leaders because it presumes to share control, reframe the traditional leadership model, and focus on values rather than techniques. Despite nearly fifty years of acknowledgement of the duties of corporate social responsibility, agency theory is still the predominant mental model for corporate governance (Carroll, 1996). Notwithstanding the track record of great companies identified by Pfeffer (1998), Cameron (2003). Collins (2001) and Collins and Porras (1997) organizational leaders are unwilling to relinquish models of self-interest that are acknowledged to be morally and, possibly, economically limited (Hosmer, 1996; Carroll, 1996).

The ethical implications of pursuing long-term organizational wealth, multiple stakeholder interests, socially beneficial outcomes, and morally beneficial purposes are perceived by some to be in conflict with the profit-focused thinking of corporate traditionalists. As W. Michael Hoffman (1989) noted in his article, "The Cost of a Corporate Conscience", ethical behavior can "cost dearly", because, in the words of Andrew Stark, "ethics and interests can and do conflict" when short-term economic objectives are given primacy (Stark, 1993, p. 40). Nonetheless, evidence from many successful organizations makes it clear that long-term economic growth and profit can be achieved by organizations that operate within a framework consistent with the stewardship model.

Contributions of our model

In this paper we suggest that stewardship theory's covenantal model of corporate governance offers the following contributions:

(1) It provides a meaningful alternative to agency theory and stakeholder theory that is not inconsistent with instrumental goals of long-term profitability for organizations.
(2) It offers a normatively superior approach to corporate governance based upon qualitative virtues that have worth in and of themselves.
(3) It is a model of governance consistent with management theories that have both a practical and a theoretical base.
(4) It is systemically holistic and founded in well-established management theory and organizational development principles.
(5) It is intuitively acceptable as ethically virtuous. Its commitment is fundamentally centered on optimal solutions and the growth and thriving of a community of participants.

We acknowledge that a covenantal approach is fraught with challenges for many corporate leaders – particularly because those leaders possess a control-focused paradigm for corporate governance that tends to treat employees either paternalistically or with little regard for their long-term welfare. Clearly, acceptance of our proposed model will not be undertaken without a significant reframing of the mental models of corporate executives, managers, boards of directors, and academicians.

Conclusion

In light of the fact that corporate America is struggling to gain increased public confidence, the principles upon which corporations are governed seem to merit close examination and possible reform. The model of covenantal relationships presented in this paper offers an ethically solid alternative to agency theory and stakeholder theory. Although a covenantal governance model is unlikely to be accepted quickly, its assumptions and principles merit both careful review and practical testing. As a paradigm for ethical governance, covenantal theory is founded upon an ethical base that is theoretically sound and that has a realistic practical foundation as well. Further testing of this model seems merited in light of the demand for a more socially responsible ethical and moral framework for American business.

The model of covenantal leadership presented and described in this paper contains opportunities for a wide variety of future research. One potentially fruitful area to test is the continuing research being done that identifies outstanding and financially successful organizations (c.f. Cameron et al., 2003). Another potentially rich area of research is the exploration of the ethical mental models of corporate executives, boards of directors, managers and employees. Studying those models in the context of understanding the underlying theories of governance inherent therein can provide insights into what might be necessary to sustain comprehensive stewardship theory as a new system of corporate governance. Additional research opportunities exist through qualitative research in work units or organizations on an experimental or applied basis.

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