What If Corporate Governance Fostered Executive Dignity?

Geoffrey Bell  
University of Minnesota Duluth

Jannifer David  
University of Minnesota Duluth

Modern models of corporate governance are based on agency theory, which makes a number of assumptions about human nature and the behavior of executives (executive opportunism, self-interest maximization, information asymmetry, and conflicting preferences from owners) that jointly act to impair the dignity of the executives. We review the virtue theory literature, and note that it makes more generous - and, we argue, more accurate - assumptions of human behavior. Given that, we lay the foundation for a virtue theory of governance and develop a model of executive compensation based on virtue theory that will enhance the dignity of executives.

INTRODUCTION

Dignity is increasingly regarded as making critical and positive contributions to the workplace (Bolton, 2007). While we do not often consider senior executives as lacking dignity and respect (Sayer, 2007), corporate governance based on agency theory makes assumptions of human behavior that reduce and impede executive dignity. Many scholars have identified flaws in governance theory and its impact on dignity. Consequently there have been calls for organizational scholars to quit deferring to economists and to build their own theories of governance (M. H. Lubatkin, 2005). In this article, we study those flaws of agency-based governance theory that degrade dignity in executives and their organizations and offer virtue theory as an alternative for restoring dignity, specifically focusing on the role of a virtue-based model of executive compensation.

Executive compensation has been criticized as “utterly out of control,” “astronomical” (Gomez-Mejia & Wiseman, 1997), and unfair (Potts, 2006), increasing faster than both inflation and the compensation of “ordinary” workers (Potts, 2006). Executive compensation levels are rising regardless of firm performance and continued to do so throughout the recent recession (Ferracone, 2014). Some researchers have concluded that executive compensation based on agency theory has, at least in part, contributed to these concerns (Bebchuk & Fried, 2003). Yet amidst this criticism, little has been written on the ethics of executive compensation.

Our argument herein is this: Corporate governance founded on agency theory reduces or destroys the dignity of executives, by reducing trust, autonomy, meaningful work, and sense of community. While agency theory assumes executives are opportunistic, individualistic, rational utility maximizers; in fact, executives perform “rich, intrinsically-rewarding, virtue-inculcating activities” (Sinnicks, 2014: 233) in intrinsically-motivating jobs (Moriarty, 2005). Thus, there is a fundamental disconnect between the
assumptions underlying the governance theory conception of executives’ jobs and the reality. This disconnect reduces or impedes executive dignity. In response to these negative effects on dignity, we outline an alternative corporate governance model based upon virtue theory. This virtue-based model is consistent with calls to integrate agency theory with other paradigms (Barkema & Gomez-Mejia, 1998; Jensen & Murphy, 1990). We outline a model of executive compensation based on virtue and discuss how this model preserves and promotes executive dignity.

We proceed as follows: First, we review the dignity literature, particularly how it speaks to the executive. Then, we review governance and agency theory and their deficiencies with respect to dignity. We then review the virtue theory literature and show the conceptual link between virtue theory and dignity. Finally, we lay the groundwork for a virtue-based model of governance, present an alternative model of executive compensation and performance evaluation based on virtue theory, and show how it fosters dignity.

DIGNITY IN THE WORKPLACE

Dignity is emerging as an important organizational concept. Some researchers even argue that the role of the organization is the preservation and promotion of human dignity (Dierksmeier, 2011b). Incorporating dignity purposively and thoughtfully into the planning and operations of businesses may allow businesses to focus their efforts on more beneficial products and services for their customers and create an environment where all employees, suppliers, and shareholders feel themselves valued contributors to their business community. To use dignity at work as a driving principle, executives and managers must understand the term and how to implement policies and practices that would allow dignity to thrive.

The literature on dignity describes employees with dignity as people working with autonomy, doing meaningful work, who are trusted and respected by others, and working as part of a community rather than as independent actors (Ackroyd, 2007; Bolton, 2007; Hodson, 2001; McCloskey, 2010; Sayer, 2007). While broader definitions of dignity exist, these five ideas seem to capture the essence of dignity in the workplace.

Autonomy or freedom at work means that employees are able to decide how to do their work without excess interference from others (e.g., managers or owners) (Sayer, 2007). When employees make their own decisions about how work is done, they feel accomplishment and pride in their abilities and skills to complete a job. Conversely, if others constantly intervene and direct the completion of work, then employees appear little more than machines completing pre-programmed tasks. Concerns about lack of autonomy at work have focused typically on unskilled and semi-skilled employees, however, even skilled professionals face increasing pressures to work long hours and/or meet expectations of their businesses that contradict what their professional standards would dictate (Hodson, 2001). Thus, even professionals and managers face pressures that degrade dignity.

Meaningful work as a part of dignity speaks to the complexity of tasks assigned to employees and to the overarching outcomes of these tasks. Employees who believe their work contributes to the business or society at large in a measurable and positive manner find their work more dignified than work that is considered trivial or dirty (Hodson, 2001). Employees working on products or services that have a positive impact on others will likely find their work meaningful or significant, as will employees working on challenging, intrinsically-motivating tasks.

Trust and respect in the workplace mean that employers believe that their employees can and will do their jobs without being micro-managed. Respect means that no person is treated exclusively a means to an end for another person (Dierksmeier, 2013; Kant, 1990; Pirson & Dirksmeier, 2014; Sayer, 2007). Rather, people are treated and valued as ends in themselves (Kant, 1990; Sayer, 2007). With respect, everyone in the business understands that each person is participating in the business to achieve their personal goals and those of the organization. Further, everyone understands that all are mutually reliant on one another to attain these goals. There is recognition that every employee holds value for the business and therefore cannot be treated trivially.
Trust is reciprocal with and is cultivated by exhibiting loyalty (Heath, 2009). When both parties are committed to the organization’s goals, then trust is likely to exist. When trust exists, employees put forth their best efforts because they know that the owners/managers are striving to keep the business moving forward in a strategically wise direction, that the owners/managers are looking out for the best interest of themselves AND the employees, and that the owners/managers will not exploit the employees’ skills (Mayer, Davis, & Schoorman, 1995). When trust is present, the owners and managers know that employees will work hard, will be constantly improving the company’s products and/or services, and will not shirk their responsibilities.

The recognition of mutual interdependence that comes from having respect and trust creates a community within the business, rather than a mere nexus of self-interested persons. Dignity in this community comes from an understanding that everyone in the business is part of a team working together to achieve common goals. If everyone in a business recognizes and acts from a place where everyone is important for achieving the shared business goals AND his/her own personal goals, then everyone will be more willing to respect the skills and abilities of others and acknowledge their interdependence.

Dignity at work clearly appears beneficial for both the business and its constituents. In workplaces with dignity there is a community working on meaningful products or services with autonomy, trust, and respect. Given this backdrop, we now turn to an examination of agency-based corporate governance theory.

MODERN CORPORATE GOVERNANCE AND ITS UNDERPINNINGS

Corporate governance consists of formal and informal structures, processes, management of roles and responsibilities, and balancing power among executives, directors, and shareholders, drawing upon the disciplines of law, management, economics, and finance (Hambrick, Werder, & Zajac, 2008; Ryan, Buchholtz, & Kolb, 2010). It includes “administrative monitoring and incentive mechanisms that are intended to reduce conflict among organizational actors due to differences in incentives… It entails the structuring of rights and responsibilities of a firm’s different stakeholders” (M. Lubatkin, Lane, Collin, & Very, 2007: 43). These systems help set firm direction (Carcello, 2009).

Corporate governance draws extensively on agency theory (M. Lubatkin et al., 2007; M. H. Lubatkin, 2005). Agency theory relies on several assumptions: (1) agents are opportunistic (that is, self-interest seeking with guile - Williamson, 1979), (2) they act in a purely rational manner to maximize their own utility (Donaldson & Davis, 1991), (3) information asymmetry exists between principals and agents that, because of opportunism, agents will exploit for their own interest (M. H. Lubatkin, 2005), and (4) agents and principals have different preferences (Heath, 2009). Therefore, unless executives are monitored, they will exploit owners for their own gain (Miller & Sardais, 2011; Pirson & Turnbull, 2011).

Agency theory focuses on optimal incentive contracting and monitoring structures (Hambrick et al., 2008), but these contracts are incomplete, which produces ambiguity (Bragues, 2008; Hambrick et al., 2008; Jensen & Meckling, 1976; M. H. Lubatkin, 2005; Shleifer & Vishny, 1997; Wieland, 2001). “At its most basic level, agency theory is concerned with (a) the threats that can arise in any cooperative exchange, due to differences in incentives, when one party (the principals) contracts with another (the agents) to make decisions on behalf of the principals; and (b) the monitoring and incentive mechanisms that reduce the potency of those threats.” (M. H. Lubatkin, 2005: 214). These threats are compounded because managers owe a legal and moral fiduciary responsibility to the shareholders, but have de facto extensive control rights that the owners do not (Moriarty, 2012; Shleifer & Vishny, 1997).

Solutions to agency problems include not only close monitoring of executives by the Board and careful selection of Board members, but also effective audit and compensation committees that structure compensation to align the interests of executives with those of the shareholders (O’Reilly & Main, 2007). Firms motivate executives by appealing to their self-interest (Donaldson & Davis, 1991; Eisenhardt, 1989) through “optimal contracting” that aligns the interests of the executives with those of the shareholders, thereby “solving” the agency problem (Bebchuk & Fried, 2003; Heath, 2009).
alignment is achieved by compensating managers with long-term contingent financial incentives (Shleifer & Vishny, 1997).

CRITIQUE OF GOVERNANCE THEORY

Both the management and ethics literature pose serious critiques of the agency theory approach to governance. Tying these bodies of knowledge together is important because, ideally, governance, management, and ethics are tightly related (Wieland, 2001). In this section, we examine alleged flaws in the assumptions underlying agency theory and some of the problematic outcomes of these assumptions as they relate to executive compensation. We limit our critique to the impact of agency-based governance theory on dignity. There are many other critiques of governance, which, while important, do not relate to dignity. We do not address them here. Moreover, because executive compensation is a critical component of governance (Shleifer & Vishny, 1997), much of our critique implicitly or explicitly examines executive compensation as a function of governance.

Proponents of agency theory often adopt a very negative perspective of human behavior that is antithetical to and corrupting of dignity. One question asked by agency theorists is, “How do [principals] ensure that managers do not steal the capital they supply?” (Shleifer & Vishny, 1997: 737). To answer this question many see the Board as a “policeman protecting the shareholders from theft by the CEO” (O'Reilly & Main, 2007: 9). The predicted outcome of this is that “in the absence of a vigilant and responsible board, the CEO and other top management team members enrich themselves at the expense of the shareholder, whose rightful company profits are diverted into ever larger executive compensation packages” (O'Reilly & Main, 2007: 2). (Italics added in all quotes.)

Agency theory assumes that self-interested and opportunistic executives engage in vice to achieve their personal desires (Heath, 2009). This poor executive behavior leads to widespread distrust and suspicion amongst the executives, which drives the development of elaborate monitoring schemes, often in the form of annual, performance-based incentives based upon the firm’s financial performance that make up the majority of executives’ pay for the year. These individual incentives preclude the development of trust and respect for the executives and a sense of community, which lie at the heart of dignity (Heath, 2009; Sison & Fontrodona, 2012).

Agency theory presents an undersocialized model of the economic world (Gedajlovic, Lubatkin, & Schulze, 2004; Granovetter, 1985; M. Lubatkin, 2007), which renders it incapable of capturing the complexities of modern organizations (M. Lubatkin, 2007). The under-socialized model results from the assumption that employees act self-interestedly, opportunistically, and independently of each other, and so ignore the social ties that link them (M. Lubatkin et al., 2007). Agency theory goes so far as to characterize cooperative behavior as “irrational” and opportunistic behavior as “rational,” which encourages actors to begin acting in accordance with the model (and hence more opportunistically and less cooperatively).

Executives’ compensation and career progression often rely on a “tournament” wherein junior executives compete for the CEO’s position (Anabtawi, 2005). These tournaments stem from this agency theory assumption that social relationships in organizations are merely “simple dyad relationships between economically rational and motivated actors” (M. Lubatkin, 2007: 59). They generate competition, jealousy, and frustration that impedes communication and cooperation (Moriarty, 2005). Thus, the model is antagonistic to dignity because it belittles cooperation that fosters the community, trust, and respect - all components of dignity.

Whether or not agents act self-interestedly or cooperatively is partly a function of the social context of the relationship, so it is not appropriate always to assume self-interest (M. Lubatkin, 2007). Research has shown that opportunism describes no more than one third of the population (Geoff Moore, 2012). Organizational culture provides cues for employees about the appropriate behaviors in a given organization and people rely on these cues to determine a preference for opportunistic or cooperative behaviors (Heath, 2009). Thus, under what conditions will an agent act self-interestedly, and what conditions are likely to generate cooperation? (M. Lubatkin, 2007). If one always assumes that agents will
a more complex social reality (M. Lubatkin, 2007), then principals will overinvest in monitoring and control behaviors and underinvest in building trust and developing loyalty, dedication, and professionalism (Boatright, 1999; Heath, 2009), wasting firm resources and diminishing dignity by unnecessarily reducing trust and executive autonomy.

In addition to reducing executive autonomy, excessive monitoring through external controls (e.g., performance-based individual incentives) crowds out an individual’s intrinsic desire to cooperate with others or to consider decisions from a moral perspective. Heath (2009: 515) states that actors “no longer consider the question [of cooperation] from the moral point of view, but rather examine it from the standpoint of their self-interest.” Moore (2012) is concerned that a controlling external environment - a hallmark of governance - crowds out an individual’s intrinsic motivation to contribute to the common good. Further, a reliance on external incentives as motivators may signal to employees that they are not trusted (Heath, 2009). So in addition to reducing autonomy, reliance on external controls will limit trust or, worse, suggest to executives that they are distrusted.

Performance-based incentives are supposed to reduce or eliminate agency problems. Ironically, the combination of the information asymmetry and performance-based compensation means that executives have an opportunity and incentive to misstate financial statements to increase their compensation (Carcello, 2009). High powered incentives “create enormous opportunities for self-dealing for the managers” (Shleifer & Vishny, 1997: 745). These compensation models may in fact exacerbate agency issues and compromise executive integrity by placing large pressure on executives to compromise their integrity with the promise of large financial gain for doing so, which may further reduce trust and dignity. Federal agency theory fails to account for the possibility that agents have non-financial needs for achievement, responsibility, recognition, and intrinsically-motivating work tasks (M. H. Lubatkin, 2005: 214). Executives may like their jobs/firms, and they may feel a sense of loyalty/identity to their firms (Boivie, Lange, McDonald, & Westphal, 2011; Heath, 2009; Pepper & Gore, 2015). People make decisions for many non-financial reasons (Dierksmeier, 2011a; Dierksmeier & Celano, 2012; Dierksmeier & Pirson, 2009; Giovanola, 2009; Ulrich, 2009). Other motivators, such as prestige, challenge, and power might be as or more important to executives than financial compensation (Finkelstein & Hambrick, 1988). Executives are motivated both extrinsically and intrinsically (Geoff Moore, 2012), so governance models that assume that pay is their only motivator will likely err because whether intrinsic or extrinsic motivators dominate may be situationally determined (Geoff Moore, 2012). “There is considerable evidence that CEOs are very highly motivated to begin with in part because of the challenging nature of the job, the intrinsic value of the work, … and a desire to appear successful in the business community” (Finkelstein & Hambrick, 1988: 550). Money is rarely the primary reason people work hard (Moriarty, 2005) and a focus on money may inadvertently reduce executives’ intrinsic motivation for a job well done (Deci & Ryan, 1980; Kasser, 2003; Kerr, 1995; Pepper & Gore, 2015). Thus, by focusing on extrinsic rather than intrinsic motivation, governance theory will reduce executive self-actualization, autonomy and meaningfulness of work, all sources of executive dignity.

Summarizing, we observe that governance based on agency theory exerts multiple negative influences on executive dignity. It inherently assumes opportunistic behavior, which reduces reliance on trust. It leads to excessive reliance on controls, reducing executive autonomy. It focuses on extrinsic - financial - rewards rather than intrinsic ones, reducing autonomy and the meaningfulness of the executives’ work. Thus elements of the modern governance system work together to reduce multiple dimensions of executive dignity.

Given the increasing importance of dignity in the workplace (Bolton, 2007), we now look for solutions. Are there alternative theories that may produce effective governance without having these negative effects on dignity? To answer that question, we turn to virtue theory. We believe that many elements of virtue theory make it amenable to corporate governance in a manner that will foster rather than impair executive dignity.
AN OVERVIEW OF VIRTUE THEORY

We have shown that modern corporate governance theory founded in agency theory acts to diminish executive dignity. Therefore, we need to consider a different underlying theory that may produce desired governance outcomes without reducing dignity. We believe that virtue theory may provide such a foundation. Therefore, in this section, we briefly summarize the virtue theory concepts.

Virtue theory originates in the writings of Aristotle (Arjoon, 2000; Solomon, 1992). It focuses on promoting integrity and excellence (Flynn, 2008) in the context of community. The ultimate goal of virtuous activity or living a “good life” is happiness (Gavin & Mason, 2004) or eudaimonia (Flynn, 2008; Koehn, 1998). When a person achieves excellence in virtues s/he should have a “good life” (Sinnicks, 2014). Further, people’s human freedom and agency (Dierksmeier & Pirson, 2009; Solomon, 1992) allow them to choose whether or not to be virtuous in their lives. While virtue theory was not developed originally with the firm as a unit of analysis, virtue theorists have examined its firm level implications (MacIntyre, 2008; Sison & Fontrodona, 2012; Solomon, 1992). In these writings, virtue theory addresses virtue at both the firm and individual levels. People come together in a firm to accomplish jointly that which they are unable to attain by themselves (Sison & Fontrodona, 2012). The common good does not lie primarily in the production of goods and services, but rather in the community efforts for their production (Sison & Fontrodona, 2012).

There are four “cardinal” virtues: “prudence or practical wisdom, courage or fortitude, self-mastery or temperance, and justice or fairness” (Arjoon, 2000: 163) from which all other virtues are derived (Bright, Alzola, Stansbury, & Stavros, 2011). The moral virtues of courage and temperance each lie on a continuum where both extremes (either deficiency or excess) constitute a vice, and the virtue falls at the “golden mean” (Arjoon, 2000; Mintz, 1996). Bright et al. (2011) portrays the effect of this golden mean as an inverse-U-shaped relationship between virtue and behavioral excellence. That is, as a person moves from a deficiency of a virtue to the “golden mean,” behavioral excellence increases, but after attaining the golden mean, if the actor passes into excess behavioral excellence decreases. Conversely, wisdom and justice lie on continuums where more is better.

“Community” is another important dimension of virtue theory (Arjoon, 2000). Individuals strive to achieve a good life through the development of virtues in the context of community. Community fosters the collaborative pursuit of common goods (Sinnicks, 2014). Community members should act in accordance with the common good of society (Arjoon, 2000; Pirson, 2011). The “common good” of the firm is “collaborative work, insofar as it provides, first, an opportunity to develop knowledge, skills, virtues and meaning (work as praxis), and second, inasmuch as it produces goods and services to satisfy society’s needs and wants (work as poiesis)” (Sison & Fontrodona, 2013: 611).

Within firms, the common good is achieved through the development of practices. Practices are social in nature, create community-determined level standards of excellence, and are protected by their communities through traditions and institutions (Geoff Moore, 2012). Scholars who consider management as a practice argue that business is a highly social activity that creates goods and services that make life better for individuals and society (Potts, 2006; Solomon, 1993).

Practices produce two types of outcomes: internal and external goods. Internal goods are those derived from engaging in a relevant practice and are valuable both for their outcomes and for their own sake (Sinnicks, 2014). They are the individual skills and abilities developed through engaging in an activity. Every community member who participates in the activity can gain internal goods (Potts, 2006). As community members develop internal goods, they also develop virtues (Sinnicks, 2014) and virtues are required to obtain internal goods (Potts, 2006). Internal goods lead to the ability to do a job well, which produces meaningful work and autonomy. External goods are property and other tangible outcomes (Geoff Moore, 2012; Sinnicks, 2014) including money, prestige and power (Sinnicks, 2014). They may be unequally distributed among members of the community (Potts, 2006).

At the individual level, the common good means that all community members share or take part in the work (Sison & Fontrodona, 2013). Each community member is responsible for and trusted to develop his/her skills to support the common good. To achieve this individuals will need to be intrinsically
motivated to attain a level of skill necessary to meet the community-determined standard. Such skill is acquired by participating in the practice. Perfecting a practice requires at a minimum for a person to acquire practical wisdom about that activity and temperance to conform to the standards set by the community rather than setting his/her own individual standards. To encourage this intrinsic motivation, jobs should be designed to incorporate aspects of dignity such as autonomy, trust, respect, community, and meaningful work (Beadle & Knight, 2012).

**RELATING VIRTUE THEORY AND DIGNITY**

We now consider how virtue theory and dignity relate to each other. Dignity and virtue theory address many similar ideas; therefore virtue theory seems a natural companion theory to the dignity construct. We use the four cardinal virtues together with community to explain how an executive can foster dignity in his or her life and in the work place. Table 1 outlines the connections between dignity and virtue theory, which are described below.

**TABLE 1**

<table>
<thead>
<tr>
<th>Components of Dignity at Work</th>
<th>Virtue Theory Equivalents and Applications</th>
</tr>
</thead>
</table>
| **Respect** - Each person is an end unto his/herself and not a means to an end and therefore must be treated with respect by others (Dierksmeier, 2013; Kant, 1990; McCloskey, 2010; Pirson & Dirksmeier, 2014; Sayer, 2007) | **Justice** - a sense of fairness where “all members of the organization and everyone connected to it getting their due” (Dyck & Kleysen, 2001: 563)  
- Executives will need justice to make strategic decision for the company while considering the ramifications of these decisions for everyone.  
- Employees will need justice to work for the betterment of themselves, but also the business and its customers. |
| **Trust** - Employees and other community members need to be committed to the organization and know that others in the business are similarly committed (Ackroyd, 2007; Bolton, 2007; Hodson, 2001; Sayer, 2007) | **Courage** - Taking risks that may cause harm to oneself in the pursuit of the overall community good (Dyck & Kleysen, 2001). Courage represents the virtuous middle of the continuum between cowardice and recklessness (Mintz, 1996).  
- Executives will need courage to trust that employees will complete their work well.  
- Employees will need courage to trust that managers will not exploit them. |
| **Autonomy** - thinking rationally and having the freedom to act on those thoughts (Ackroyd, 2007; Bolton, 2007; Dierksmeier, 2011b; Hodson, 2001; Sayer, 2007) | **Temperance/Self-Control** - the internal regulation of emotions and/or impulses in order to keep a focus on the whole, rather than over-reacting to details (Dyck & Kleysen, 2001: 564)  
- Executives will need temperance will to avoid trying to control everything within the business.  
- Employees will need temperance to not shirk responsibilities because freedom has been given. |
| **Meaningful work** - Work that contributes to the self-development | **Practical Wisdom** - “a capacity for deliberation and action by individuals to obtain what is good for
of employees (Fox, 1994) and employees’ abilities to act creatively and with purpose in the world (Hodson, 2001) themselves and others in general.” Dyck and Kleysen (2001: 563)
- Executives need wisdom to understand the best manner to make the business successful and to foster meaningful work not only for themselves, but also for employees.
- Employees need wisdom to understand the best ways to develop themselves and forward the purpose of the business.

<table>
<thead>
<tr>
<th>Community</th>
<th>Community</th>
</tr>
</thead>
</table>
| - Work is a social endeavor (McCloskey, 2010) and businesses function best when all their members have a shared collective conscious (Durkheim, 1984) | - Members acting in accordance with and to promote the common good (Arjoon, 2000). 
- Executives need a clear vision of the common good and actively seek to promote it (Arjoon, 2000). 
- Employees should strive to understand the business vision and how their efforts contribute to it. |

Respect: From a virtue theory perspective, respect can be achieved by ensuring justice throughout the business. Justice is present in an organization when all members of the organizational community receive fair outcomes (Solomon, 1992). An executive who deliberately considers fair outcomes for all members of the business community is showing respect for these members. Further, recipients of this respect should appreciate this recognition and respond similarly. Executives who focus on justice will be able to “walk the tightrope” of treating others as ends in themselves (Kant, 1990) while working for the critical provision of external goods.

Trust: In businesses with dignity, members trust each other and are committed to the business (Hodson, 2001). Trust results from actions driven by courage. Courageous people take actions that will be good for the business, but not necessarily for themselves (Dyck & Kleysen, 2001). A Board cannot know if executives will do what they are supposed to do, but to develop trust with these executives, it must allow them to work on their own. The ability to work without monitoring at least partly reflects the executives’ internal goods. The more skilled executives are at successfully running the business, the more the Board can reduce its monitoring schemes. However, agency theory predicts that even if the executives have the necessary skills, they may choose to shirk. Over time, the social relationship between the Board and the executives should help the Board better evaluate executives’ abilities and tendencies to shirk (M. Lubatkin, 2007). Thus, over time, trust can be substituted for monitoring and control. From the executives’ perspectives, putting forth the best work they can requires them to trust that their Board values the needs of the broader organizational community and will not demand unrealistic outcomes such as exorbitant growth/profits.

Autonomy: Autonomy means “being trusted to act responsibly” (Sayer, 2007: 18) and comes from the ability to think rationally and to act accordingly (Dierksmeier, 2011a). For the employees and the managers to act responsibly, they must have self-control. Taking advantage of autonomy to shirk responsibilities displays a lack of self-control. In a business where managers and employees regularly exhibit self-control, autonomy becomes possible because the managers and employees know that they will not use this freedom to shirk or exploit the other.

Meaningful work: From the executive’s perspective, wisdom is necessary to understand how to structure the business in a manner that provides meaningful work through job design and opportunities for growth and employee self-actualization. Businesses are complex and the capacity to understand and create a structure that meets this high-level need for all employees will necessitate an in-depth understanding of the working of the business and how different employees interact with each other, customers, suppliers, and others.
Community: Finally, dignity requires community in which trust and respect can flourish. A community operates best when there are shared values and beliefs. Virtue theory speaks directly to this as it focuses on achieving the common good (Arjoon, 2000), making the organization a moral community rather than simply an assembly of partially overlapping and partially competing interests. Common goals foster cooperation among members of the community, and that cooperation is critical for organizational success (Mele, 2003), so one of the critical tasks of top management is the development of those goals: “If business firms were a mere collection of self-interested individuals continually competing to achieve their personal goals, without any concern for common goals and with an absolute lack of cooperation, they could not survive” (Mele, 2003: 84).

Thus, virtue theory and dignity are conceptually kindred spirits. Virtue theory provides executives and employees with the means to restore and develop dignity in the workplace. We now examine how virtue theory overcomes the challenges agency theory presents to dignity and how that moves us one step toward a virtue-based theory of governance.

TOWARDS A VIRTUE THEORY OF GOVERNANCE

Agency theory reduces the dignity of executives by assuming they will act opportunistically whenever possible, thereby reducing trust in the executives. It relies extensively on external controls through incentives, reducing executive autonomy. Finally, assumptions of self-interest and opportunism lead to little or no sense of community. Developing a governance theory based upon virtue theory enhances trust, autonomy, community, and meaningful work, thereby fostering executive dignity.

Because virtue theory draws on a more positive view of human nature (Cameron, Dutton, & Quinn, 2003) than agency theory, it does not confront the negative motivational issues faced by agency theory. Governance based on virtue will not assume opportunistic behavior nor will it degrade the intrinsic motivation of executives. One key goal of virtue theory is to foster a morally good life. It calls for executives to develop internal as well as external goods and to practice justice, wisdom, and other virtues that should enhance his or her well-being and motivation.

Virtue theory assumes executives are part of a community, not independent actors (Dyck & Kleysen, 2001). The executive serves a key role in this community as a figurehead in community development (Mintzberg, 1973) and fostering the common good. Setting a tone for the community (Schwartz, Dunfee, & Kline, 2005) based on virtue and calling for the best in oneself and others is far more likely to lead to dignity than always trying to prevent people from acting on their worst impulses. Our expectations of others are self-fulfilling prophecies (Ferraro, Pfeffer, & Sutton, 2005; Ghoshal, 2005; Ghoshal & Moran, 1996) so assuming the worst in people may produce the worst. Conversely, virtue theory may create self-fulfilling prophecies that lead executives and employees to higher levels of virtues, while also increasing dignity.

Agency theory focuses on external goods (Sinnicks, 2014) and relies extensively on control and incentive alignment. Virtue theory recognizes that external goods are important, but views internal goods as necessary for both the creation of external goods and living the good life (G. Moore, 2005). The fundamental need for firms to produce both internal and external goods leads to tension over their relative importance (Beadle & Knight, 2012). An overarching focus on external goods, such as is common in agency-based governance, leads to decay in or destruction of virtue (G. Moore, 2005). Governance based on virtue theory leads to a more balanced valuing of internal and external goods, and the development of practice.

A VIRTUOUS MODEL OF EXECUTIVE PERFORMANCE EVALUATION AND COMPENSATION

Because governance based upon virtue may resolve many of the dignity-reducing issues associated with governance based on agency theory, we now outline executive performance evaluation and compensation models based on virtue. These performance evaluation and compensation models use the
cardinal virtues and community to encourage executives and reward their achievements. Our focus on cardinal virtues is illustrative. It ensures a well-grounded virtue theory approach while leaving firms free to tailor their executive compensation plans to include other virtues that might be important to them. This model requires executives to balance internal and external goods (MacIntyre, 2008; Geoff Moore, 2012) for themselves and for their business communities. For internal goods, the executive will seek to develop her own practices and to foster the development of meaningful work for employees and respectful relationships with employees, suppliers, shareholders, and customers. Regarding external goods, the executive will receive financial and non-financial compensation, and will ensure adequate financial and non-financial rewards for employees, suppliers, and shareholders, and products/services that benefit society.

One might wonder whether, in the presence of autonomy and trust, do we still need to measure performance at all? However, without measurement and consequence for poor performance there is a risk that free-riding would become the predominant mode of operation (Moriarty, 2012). Virtue seeks the golden mean of courage; not the excess of recklessness. Therefore a balance between autonomy and trust and accountability must be maintained. Trust the executive to do the job well, but measure their performance so that it may be acknowledged and rewarded appropriately.

The Cardinal Virtues in Executive Performance Evaluation

Fundamental to a virtue-based executive compensation system would be the fostering of the cardinal virtues and the organizational community through performance evaluation. Criteria for assessing executive performance would include their use of justice, wisdom, courage, temperance, and consideration of community. The following paragraphs suggest manners in which this could be accomplished.

Justice considers fair outcomes for all community members. Executives’ performances could be assessed by looking at how they treat all organizational community members. For example, does the executive promote an employee compensation system that fairly rewards both external and internal goods? Are opportunities for training and career progression equally available to all employees regardless of rank or any non-work related signals? If so, these are signals that the executives are treating employees fairly. One existing measure that may capture justice for employees is a quality of workplace assessment (for example, see the Great Place to Work Institute, 2014).

With respect to other community members, justice towards customers, shareholders, and suppliers also should be considered in the performance evaluation of executives. Are products and services sold at fair prices and do they improve customers’ lives? Improving the lives of customers can be measured by assessing the extent to which the firm’s goods and services enhance fundamental human needs (Max-Neef, 1992) and societal welfare (Porter & Kramer, 2006, 2011). And are customers treated respectfully? Fair outcomes (e.g., justice) for suppliers may be measured by assessing the long-term nature of their relationships, the quality of communications, such as working on order forecasting to reduce supplier uncertainty, and working jointly on improving product quality management to benefit the suppliers, the firm, and its customers.

Justice for the shareholders requires that they receive a reasonable return on their investments (Drucker, 2001), that they are kept informed about the activities of the business, and that they are given an opportunity to voice their opinions about business matters. These outcomes could be measured using our traditional assessments of financial performance plus an assessment of Board-executive communications.

Justice for the wider community might begin by assessing environmental responsibility using data from the Toxic Release Inventory or carbon emissions. This community-based justice should also include an assessment of business attempts to improve the community and opportunities provided to community members to voice their ideas and concerns about business operations as they affect the community, such as corporate philanthropy.

Practical wisdom reflects the executives’ abilities to balance stakeholders’ interests, and to ensure that whenever possible, corporate actions increase joint value to multiple stakeholders (Freeman, 2010).
Practical wisdom means that the executives understand the working of the business and move the company forward with high quality internal and external goods. To assess this wisdom a combination of measures will be needed. First an assessment of financial performance will be needed. As much as the virtue theory of compensation will encourage non-financial outcomes, financial outcomes as an external good cannot be ignored. Additionally, all of the organizational community members should be asked about their perceptions of executive performance in an expanded form of 360-degree feedback.

Courage will be seen as executives direct their organizations in manners deemed unpopular by firm outsiders (e.g., such as not managing the firm to meet quarterly income or stock price targets) or when their decisions place the needs of one stakeholder over another. While the later decisions may seem counter to virtue, it seems inevitable that such decisions will need to happen for the good of the whole community. At these times executives must consider the whole, but commit to redressing the aggrieved group’s needs in the future. As stakeholders may see these action from their perspectives, the compensation committee will need to collect information from all stakeholders and then use its own wisdom to determine if the executive has acted courageously.

Temperance will be assessed on whether executives strive for the long-term sustainability of the community over short-term gains and personally seeking servant rather than star status (Greenleaf, 1977). Temperance can be assessed by how well the executives focus on long-term business objectives that benefit the entire community; not just themselves. Again, multiple stakeholders would assess these questions, leaving the final evaluation to the compensation committee.

A Virtue-Based Executive Compensation Model

One major concern we identified with agency-based compensation is the deleterious effects of relying on extrinsic motivators. Freeman et al. (2007) provides a partial solution. They develop two alternative models of compensation, which they call “Model I” (for “incentives”) and “Model V” (for “values”). The incentive-based model reflects agency-based executive compensation based upon extrinsic incentives driving behavior. It presumes that people act solely because of external incentives. In contrast, their values-based model presumes that people are motivated by key internally held values and principles (similar to virtues) rather than external incentives. External incentives play a much-reduced role. The job of the incentive-designer is to ensure that incentives reflect desired principles and values so that they do not detract from desired behaviors (Kerr, 1995). Behaviors are intrinsically-based as employees have “bought in” to the firm’s espoused values, and their behaviors reflect these shared values. Incentives are add-ons, rather than drivers.

Our executive compensation system would follow more closely the Model V relying extensively on intrinsic motivators reflecting virtues. Virtue-based governance does not assume executives are opportunistic whenever possible, so there is less need to “tie” compensation to shareholder interests and more trust and respect for the internal goods and virtues of the executives and their ability to foster the common good. Therefore, executives are paid primarily in base salary rather than incentives. Because the Board trusts and respects the executive’s decisions and compensates her accordingly, the executive has a higher level of dignity in his/her work.

Under this plan, executives would be rewarded primarily through the use of base salaries with annual merit increases derived from performance evaluations based on the virtues. Because these evaluations assess performance on multiple dimensions, they differ greatly from the agency-based model, which relies greatly on stock price. Beyond a generous, but not exorbitant, base salary, executives could receive true bonuses for high achievements. Not coincidentally, such relatively “weak” incentives reflect the advice of some proponents of behavioral agency theory (Pepper & Gore, 2015; Roberts, 2010).

Incentives are not completely ruled out in this plan, but firms’ compensation committees must decide the extent to which incentives will be a part of their executive compensation plan. Agency-based executive compensation typically consists of a relatively small base pay plus much larger incentives paid in stock options. A virtue theory model of compensation would reverse that mix with far less reliance on stock options. This move away from incentives signals the Board’s trust that executives do not need to be “incented” to be virtuous, and so signals the Board’s respect and social esteem for the executives and
provides them with autonomy in their work. Additionally, “In humanistic organizations, incentive systems include monetary and symbolic incentives tied to holistic organizational goals” (Pirson & Lawrence, 2010: 558), so it is likely that executive incentives will combine financial and non-financial rewards, and that monetary rewards may be deemphasized to prevent extrinsic rewards crowding out intrinsic rewards and moral incentives (Heath, 2009). Rewards such as regular communication of the Board’s satisfaction with executive performance and/or feedback from other stakeholders may be highly important here.

**Outcomes of a Virtue-Based Compensation System**

A by-product of this approach to compensation is that by eliminating incentives based on limited criteria (i.e., stock options), companies will reduce the motivation to focus on just one thing (e.g., stock price). Much of what our model does is simply take away motivators that encourage poor behavior (Carcello, 2009) and then rely upon the excellence already present in most executives (Geoff Moore, 2012) to run their organizations as they would want without the extrinsic motivators pushing them in undesirable directions (Carcello, 2009).

The question might be asked, “Are we compensating the executive to be virtuous or to develop virtue in the organization?” The answer to this is really, “both,” as is suggested by Sison & Fontrodona (2012: 230) who defined a virtuous organization in part as: “in the ‘excellent corporation,’ the virtues are practiced not only at the personal level, but also, and jointly, as in a biconditional relation, at the institutional or firm level, in terms of ‘corporate character.’” Moore (2005: 661) further defines a virtuous corporate character as “the seat of the virtues necessary for a corporation to engage in practices with excellence, focusing on the internal goods thereby obtainable, while warding off threats from its own inordinate pursuit of external goods and from the corrupting power of other institutions with which it engages.” Moore (2005: 663) argues that the creation of corporate character is a critical task of the executive. Therefore, the compensation system would seek not only to reward the executive for the development of his/her personal virtue, but also for developing virtue in the firm and a virtuous corporate character.

This proposed model addresses our concerns about the agency theory executive compensation model. First, the virtue theory model would allow organizations to step away from a model that does not adequately address true human behaviors. Second, the virtue theory model clearly places the executive in the organizational community and encourages her to understand its complexities and make decisions for the common good. Finally, by backing away from narrowly defined incentives, it frees the executive to make the best decisions possible.

**CONCLUSION**

The goal of our paper is to examine how the prevailing governance theory erodes executive dignity and provide an alternative using virtue theory to restore this lost dignity. Assumptions of opportunism and self-interest lead to a heavy reliance on external controls primarily in the form of financial incentives. These assumptions and the incentives used to minimize their negative outcomes lead to lower levels of trust, respect, autonomy, meaningful work, and a sense of community for executives. Moreover, while these models of executive compensation founded on the principles of agency theory harm executive dignity, they oft-times also fail to accomplish the goals they set out to achieve (tying the interests of the executive to the shareholders) (Devers, Canella, Reilly, & Yoder, 2007; Gomez-Mejia & Wiseman, 1997). Because of these deficiencies in agency-based governance theory, we laid the foundations for an alternative model of governance based on virtue ethics and applied this to executive compensation. We found that such a model may enhance rather than reduce executive dignity.
REFERENCES


