

reference 8-570-898

November 8, 2017

Paul Clyde, The William Davidson Institute at the University of Michigan; Ross School of
Business, University of Michigan

Robert E. Quinn, Ross School of Business, University of Michigan

Introduction

Within the Ross School of Business, a debate took place a few years back that continues today regarding the role of business. It was sparked by discussion surrounding a “Positive” Pillar as a part of the school strategy. More of the background can be found in the case, “Emphasizing the Positive: Forming a Strategic Identity for the Ross School of Business.” As the case points out, this pillar was distinct from a new field of study, started at Ross, on Positive Organizational Scholarship; however, a positive lens informs one part of the debate in an important way.ⁱ The debate centered around the following question: *What does “Positive” mean and does it differ from the more traditional view of profit, or in modern parlance, shareholder value maximization?*

As the two of us discussed this over lunch one day, we concluded that this was an important question and that much would be gained from a thoughtful and civil exploration of what everyone can and cannot agree upon in relation to value maximization and positive business. In introducing this, and as two individuals who see the answer differently, we feel it is important to set out what we hope to accomplish. First, we hope to clearly articulate the differences. We believe that there is much that we agree on and that the differences may be more subtle than is sometimes recognized. Second, we hope to provide a forum that could be used for other debates by providing a venue that is candid but civil. Along those lines and speaking about our colleagues we know that neither side in the debate is nefarious and both sides have extraordinarily intelligent people that subscribe to their view. Speaking just for the two of us, we have a great deal of respect for the integrity of each other and for the sincere desire we both have to learn more about how we, as educators in a business school, can increase the beneficial impact we have on our students and the business community at large. We don’t want to lose sight of that in light of some of the incivility that can be seen in social media on various topics. Those who have studied both sides are ultimately largely interested in the same goals, but have disagreements on the best way to get there. However, we also think it is important to recognize and clearly articulate the differences. This is true in other areas that we hope to pursue using a similar format in the future.

In the following articles, you will see two separate responses to the question of the role of business. One will discuss the merits of the positive lens approach to business and one will discuss the merits of focusing on shareholder value maximization in business. These are followed by an article in which all of the authors agree on the similarities and the differences.

i Roberts, L.M. 2006. Shifting the lens on organizational life: The added value of positive scholarship. *Academy of Management Review*, 31: 292-305.

Robert E. Quinn, Ross School of Business, University of Michigan
Anjan Thakor, Olin Business School, Washington University in St. Louis

Positive Business and the Inclusive Mindset: The Realization of the Principal-Agent Opportunity

Overview

This white paper presents the concept of positive business. We first define two mindsets. We specify the "conventional mindset" as one that includes the assumptions that have long driven the practice of business. These assumptions orbit around what economists call the principal-agent problem and the need to control perverse human incentives through contracting. A key assumption in this approach is that individuals are self-interested utility maximizing agents and they seek to maximize their own utility, even at the expense of others, including the principals they are contracting with. The second mindset is what we call an "inclusive mindset", which is a purpose-driven mindset that seeks to induce the pursuit of a higher, prosocial purpose that transcends the usual business goals. We suggest that this second mindset can be viewed as a reformulation of the first mindset as the principal-agent *opportunity* or the chance to transform the frailties resulting from self-interest pursuit into strengths. This shift requires managers to become leaders who wield transformative influence.

When the principal-agent opportunity is realized, an unconventional reality emerges. People flourish and perform beyond expectations. The examination of this reality of high performance produces an alternative perspective that is part of the inclusive mindset and it widens thinking around profit maximization. This mindset is sometimes acquired in the personal evolution of individuals. The inclusive mindset leads to the appreciation of failure, mediocrity and excellence as simultaneous and interrelated phenomena. The possessor of the inclusive mindset acquires the capacity to move human systems towards excellence and to create more positive forms of business.

Business

Business is a pattern of commerce or enterprise in which goods or services are provided to consumers in exchange for some other form of value. The transactional process is intended to produce profit or financial gain. An important insight of Economics is that such exchanges involve incentive frictions arising from the pursuit of strategic self-interest. The academic disciplines associated with business tend to assume self-interest and produce bodies of knowledge that focus on how contracting resolutions arise to minimize the economic losses from the strategic pursuit of self interest in transactions. The informal theories of most human actors are also based on the notions of transactional self-interest, exchange and contract. When we say, "Business is business," we mean that economic enterprise is about self-interested, objective, transactional exchange.

Conventional Mindset

The word conventional means normal, common or standard. In the social sciences there is a conventional perspective. Organizations are hierarchies of authority, and people are self-interested actors who work for

money, minimize costs, seek the status quo, compete for scarce resources, become alienated, stagnate in their work, miss opportunities, and tend to underperform expectations.

Principal-Agent Problem

These gloomy but realistic assumptions come from the extensive observations of social scientists. When people are observed in social life, the observed patterns reflect the above assumptions. The assumptions are consistent with the widely recognized principal-agent problem at the heart of microeconomics. The principal or manager hires the agent or employee. There is a contract, transaction or exchange. For a certain amount of money the agent provides a certain amount of work. When the principal is present to observe or measure effort, all is well—this is called the “first best”. When the principal is not present, the self-interested agent begins to shirk, exhibiting underperformance. In what is called the “second best” case.

The conventional perspective tends to be self-reproductive and self-sealing, i.e. it is a Nash equilibrium in the sense that the principal expects the agent to behave in a certain way faced with the employment contract and the agent behaves the way the principal expects. If a manager makes the conventional assumptions listed above, the manager tends to see the employee as a problem to be controlled through the employment (incentive) contract.

In this objective approach, the employee becomes an object. As indirect control is increased through the explicit features of the incentive contract, resistance tends to increase, and the resistance verifies the original assumptions of the manager. The application of the conventional logic tends to lead to a further increase in control and then more resistance.

Here there is a vicious cycle that prevents high performance, i.e. prevents the second-best outcome from approaching the first-best outcome. In the conventional mindset, the principal-agent problem is solved through the design of a contract that assumes second-best behavior by both the principal and the agent. The problem cannot be altered if one relies on the same behavioral assumptions that produced it. The only way out is a transformative learning experience that alters the belief system of the manager and turns the manager into a leader who can see, understand and elevate human systems.

The Principal-Agent Opportunity

The existence of the principal-agent problem also implies that there is a principal-agent opportunity. In the conventional mindset, the principal-agent problem is centered in the self-interested agent. The employee’s presumed self-interest is the objective problem to be solved.

In what we call the inclusive mindset a radical transformation occurs. The problem is no longer in the self-interested agent, the problem is now an opportunity and the opportunity lies with the principal as a form of high accountability. The principal must become a leader who transcends conventional self-interest and finds his or her self-interest in the common good of the relationship and the organization. The leader must exert a form of influence that attracts the employee to come out of conventional defenses to join with the leader in mutual learning and the co-creation of a better future. One way to do this is for the principal to sacrifice her self-interest to pursue a higher purpose that the agent can associate with the principal, one that transcends the principal’s business goals and from which the agent derives positive utility (or satisfaction) from.

By offering a purpose or vision that inspires the imagination and courage of the agent, the principal transforms the agent. The principal's visible self-sacrifice signals authenticity of purpose to the agent. When a leader of transformational influence encounters underperformance in a person, they do not see a problem person, they see a relational opportunity.

The Inclusive Mindset

The conventional mindset tends to be exclusive. Given the assumptions of self-interest which it is based on, it unconsciously moves human attention away from the emergence of excellence and often leads to the conscious denial of the possibility of excellence in the sense of the attainability of the first best in the presence of incentive frictions. The focus on self-interest may slow the development of the cognitive and emotional complexity in the principal/leader that is necessary for the leader to see and nurture relational opportunity.

In contrast, the inclusive mindset recognizes decay, convention and excellence. It accepts the reality of constraint and the reality of possibility. It is based on grounded optimism or constructive skepticism. When the inclusive mindset is acquired, nothing is lost. The leader still has the capacity to confront the incentive frictions arising from the pursuit of self-interest, but the pursuit of a higher purpose changes the principal-agent relationship and incents the agent to provide higher effort in the second-best case (in which the principal cannot directly observe the agent's effort) than in the conventional mindset case .

The Assumptions of the Inclusive Mindset

The inclusive mindset is reflected in the following kinds of assumptions.

- While it is true that organizations are hierarchies of authority, it is also true that they are dynamic human networks.
- While it is true that people work for money, it is also true that they will work for meaning provided by higher purpose.
- While it is true that people become alienated by control, it is also true that they become inspired by meaningful possibilities.
- While it is true that people seek the status quo, it is also true that they accept challenges.
- While it is true that people fail to see opportunities, it is also true that they embrace vision and live in hope.
- While it is true that people are self-interested, it is also true that they become selfless servants of a higher purpose.
- While it is true that people seek to minimize costs, it is also true that they spontaneously contribute.
- While it is true that people compete for scarce resources, it is also true that they collaborate and co-create.
- While it is true that people often stagnate, it is also true that they flourish as they learn to love what they do.
- While it is true that people tend to underperform expectations, it is also true that they excel and exceed expectations.

The claims in the first half of each statement are based on conventional observations of reality. The claims in the second half of each statement are also based on observations of reality but they are the less frequently occurring patterns that emerge in times of high performance. Conventional patterns and patterns of excellence are both patterns of reality. The monistic perspective tends to see only one. The inclusive mindset allows the actor to integrate the realities of constraint with the realities of possibility.

The inclusive mindset accepts the assets such as objectivity, analysis, expertise and control at the heart of the conventional mindset. Problem solving will always be necessary. When a person gains the inclusive mindset, there is no loss of capacity to solve technical incentive contracting problems. They instead acquire additional capacities. Cognitive and emotional functioning becomes more complex.

Objectivity is wedded with appreciation, analysis is wedded with empathy, expertise is wedded with humility, and control is wedded with mutual learning and co-creation. The technical manager becomes a fully human leader, using a rigorous, analytical mind wrapped in moral power and the capacity to elevate relational dynamics.

Profit Maximization

The conventional mindset tends to be monistic. The array of all positive values is reduced to the selection of a single positive value and it is pursued with a narrow focus. The shortcoming of this approach is that it does not focus on the drivers of sustainable excellence. Initially this brings progress but over time the positive value becomes an excess and a natural transformation occurs. The positive becomes a negative. The pursuit of the positive begins to destroy the larger ecology of which the strategist is a part and tragedy follows. In questioning the notion of narrow profit maximization, some version of the this argument is often employed.

In the inclusive mindset, it is recognized that the pursuit of higher purpose can sometimes conflict with profit maximization. Yet profit maximization and purpose can also be complementary. A leader with an inclusive perspective has the potential to create a system of intrinsic motivation and unleash resources not available to the normal organization. In the former case people compete for scarce resources. In the latter case, a fully engaged workforce, that is exceeding contractual expectations, is a generative resource-producing ecology.

The Acquisition of the Inclusive Mindset

While the inclusive mindset comes to us from positive psychology and positive organizational scholarship, it should be recognized that people have always been acquiring it, not from scholarship and instruction, but from personal transformations that often start with discontinuities and trauma. If a person transcends the natural fight or flight reactions and persists, they often reconstruct their personal narratives. In the process of personal evolution, people discover the power of transformational dynamics. They begin to attend to the realization of potential in both self and others.

People of the inclusive mindset make more complex assumptions like the ones listed above. They become bilingual. They can speak and operate from the conventional mindset and thus communicate with conventionally oriented people. They can also speak and operate from the inclusive mindset and attract conventionally oriented people to higher levels of thinking and performance.

They particularly help people to transcend the assumptions of self-interested exchange. In conventional reasoning the purpose of a contract is to eliminate the need for trust. In the inclusive mindset contracts are helpful tools but there is always a need for trust. Trust reduces transaction costs and it gives rise to the collective intelligence necessary to excellence.

Complex, adaptive, social systems are like the human body in that they have the capacity to be self-healing. In organizations of higher purpose there is still a need for stability and control, but it is minimized because self-interest becomes the collective interest and leadership moves away from a single individual. It becomes spontaneous and decentralized. None of these ideas are natural to the conventional mindset.

People of the inclusive mindset are distributed across the planet. There have always been a few parents, teachers, coaches and bosses who learn to operate beyond convention and acquire the capacity to wield transformative influence. When we encounter them, we never forget them. They leave an unforgettable positive legacy.

People of the inclusive mindset are very much realists who understand the constraints and the challenges of life, including the frictions arising from the pursuit of self-interest. Yet they attract us to possibility through their articulation of a higher purpose. They see the potential in us and challenge us. As a result, we become more than we are. While acquisition of the inclusive mindset has always been elusive, understanding and articulating it opens the door for accelerated human growth and for a more complex understanding of business.

Positive Business

Positive business is a pattern of enterprise in which actors compete to be the best in the world by being best for the world. Efforts are organized to a higher purpose, and the higher purpose is the arbitrator of decisions. Self-interest declines and moral power escalates. Cultures of self-interested reciprocity become cultures of generalized reciprocity. People give help to one knowing they will receive help from another.

Here the conventional pattern of negative peer pressure becomes positive peer pressure, employees begin to expect each other to give their best. The need for hierarchical policing as well as direct control through monitoring and indirect control through contracts declines. Conventional mechanisms continue to be of value because they are aligned with the higher purpose and not with political self-interests. They provide the modicum of stability necessary to individual and collective growth. Collective learning accelerates and both collective and individual capacity expands. The people both flourish and exceed expectations. The power of purpose and the quality of product or service becomes a natural attractor of external support. Growth is a natural consequence of collective learning.

This pattern is never permanent. Patterns of excellence like patterns of decay are dynamic, complex, fragile and vulnerable. They are ever under internal and external threat. Positive business requires people who recognize that they most prosper when their individual interest and the collective interest are one. When they understand that maintaining synergistic conditions is an avenue to their highest purpose, they find the energy to pursue them.

Conventional Reactions

There is a common reaction to the notion of positive organizations. It goes something like this; "The idea of a positive organization is unrealistic, it does not occur in the real world."

The reaction is very important, not because it is correct, positive organizing does occur in the real world, but because it demonstrates that the conventional mindset is sometimes exclusive. In these instances, it rejects the possibility of excellence. Conventional leaders tend not to aspire to create systems of high performance. They tend to see culture as a constraint, outside their zone of control, and not as a lever for change inside their zone of control. They expect people to be self-interested, they expect themselves to be self-interested. They expect to exert conventional efforts and they expect to reap conventional responses. Business is thus a function of conventional analysis conducted with a left-brained bias.

Embracing the inclusive mindset requires learning, it requires the continuous revision of fundamental beliefs and the facilitation of learning in others. Most leaders do not know how to build trust or create belief in a higher purpose. Most leaders recognize the conventional culture and they recognize that any attempt to create a more positive culture puts them outside expectations and into the danger of losing credibility and influence. What if the articulation of higher purpose does not change the agent's behavior? Will the resulting underperformance make the leader look inefficient, not smart enough to design incentive contracts to effectively deal with the agent's self-interested behavior in the second best? Given the reality of self-interest and fear, we all tend to design our lives to avoid failure.

Research and Education

The use of the inclusive mindset is expanding in both scholarship and in practice. In the first case it is moving from positive psychology and positive organizational scholarship into the other social sciences. In the second case many practitioners are embracing the notion of positive business and moving forward on their own. The internalization of the inclusive mindset will bring advantages to both students and employees. Such people can engage in technical problem solving while they can also create cultures of excellence. They will have power not available to conventional managers. Schools that can integrate their curriculum around the inclusive mindset will have a strategic advantage that is not easy to imitate.

Paul Clyde, The William Davidson Institute at the University of Michigan; Ross School of Business, University of Michigan

Aneel Karnani, Ross School of Business, University of Michigan

Venky Nagar, Ross School of Business, University of Michigan

MP Narayanan, Ross School of Business, University of Michigan

Positive Pillar and the Role of Businesses

Over the past few years we have seen more businesses and business schools wrestle with the relationship between a corporation's responsibility to increase profits and its responsibility to pursue (other) social responsibilities. Within the Ross School of Business at the University of Michigan, this took the form of a debate about the strategy for the school that includes a Positive pillar consisting of three elements: (i) generating economic value, (ii) creating great places to work, and (iii) creating social impact and sustainability. Specifically, the question is whether the three elements are mutually compatible.

Much of the debate revolves around the idea articulated by Friedman almost 50 years ago that the responsibility of corporations, and he is clear that he is talking about publicly traded corporations, "is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."ⁱⁱ We believe Friedman's argument remains, in essence, valid today.

The most important argument in favor of this position is simple: social value is most effectively generated by corporations that maximize shareholder value (modern parlance for profit maximizationⁱⁱⁱ) subject to legal and ethical constraints. Creating a great place to work is good for the bottom line. Providing customers with products at a price that is both below the value the customer places on it and above the cost to the company has a social impact and is profitable. And the most effective way to ensure that these activities take place and are sustained is to reward the ultimate decision makers with profits. Thus, we hold this position not because we have a fundamental disagreement with the ultimate goal – maximizing social welfare – but because we believe this goal is more likely to be realized through shareholder value maximization. Treating workers well is more likely to happen if it is shown to increase share value. Improving the lot of consumers is more likely to happen if the producers realize that it increases shareholder value. Arguing that corporations should do these things at the expense of shareholder value is counterproductive.

As Friedman points out, requiring corporations to pursue goals other than profits is problematic because the management of a corporation is unlikely to be able to identify and support social causes that all shareholders of a diffusely-held public company care about. Here there is a distinction between the role of corporations and the role of governments. Government has a role in establishing and protecting property rights that reflect society's values and corporations should abide by those laws. This includes, for example, laws designed to address externalities such as pollution. Once established, the firms will find the most effective way to operate within those laws. Asking the corporations, instead of governments, to take on the role of determining which social goals to pursue other than increasing share value puts too much power in the hands of (unelected) executives. If executives do have such broad responsibility for societal

ii Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits," New York Times Magazine, September 13, 1970

iii The term "shareholder value" simply recognizes that both long term and short term profits are valuable.

welfare, there is no mechanism (and there cannot be) to hold executives accountable for achieving these broad goals. Shareholders can appoint and fire executives; other stakeholders cannot.

Friedman also recognized important caveats to this argument. First, no one is advocating illegal or unethical activity. Second, these arguments apply to publicly traded firms that have diffuse shareholders and not to privately held firms. Individuals who control privately held firms are welcome, as is anyone in a free market, to pursue any objective they wish with their own money within the confines of the law. Similarly, some organizations such as non-profits are established from the beginning to pursue other objectives. "The manager of such a corporation will not have money profit as his objective but the rendering of certain services."^{iv}

Thus, the goal of shareholder value maximization is not an argument against social causes. Indeed, we see it as a way to increase resources available to social causes. Each shareholder will have a variety of purchases and investments he or she would like to make, some of which may be donations to causes that are of particular interest to them. By maximizing share value, the board, CEO and other employees have increased the individual shareholders' ability to make those purchases, investments and donations.

If, by Positive, we mean that business practices can be used to improve the operation of non-profit organizations, we agree. If, by Positive, we mean that privately held companies can use business principles to improve their pursuit of objectives that the individual owner(s) agree on, we agree. If, by Positive, we mean that corporations can have a beneficial effect on shareholders, employees, consumers, suppliers and any other stakeholders, we agree. However, if by Positive, we mean that publicly traded companies should pursue social objectives other than shareholder value, we are concerned that such actions by managers of publicly traded firms will only decrease social welfare.

^{iv} Friedman, *ibid.*

Paul Clyde, The William Davidson Institute at the University of Michigan; Ross School of Business, University of Michigan
Aneel Karnani, Ross School of Business, University of Michigan
Venky Nagar, Ross School of Business, University of Michigan
MP Narayanan, Ross School of Business, University of Michigan
Robert E. Quinn, Ross School of Business, University of Michigan
Anjan Thakor, Olin Business School, Washington University in St. Louis

We agree that . . .

The purpose of this summary is to highlight the areas of agreement between the Positive Lens (PL) position and the profit maximizing (PM) position as articulated in the previous articles. As stated in the article on positive business, "profit maximization and positive business can be complementary." Indeed, there is much the two positions hold in common. Specifically, we agree that

1. Firms that are not publicly traded appropriately pursue their own goals that maximize the utility of their owner(s).
2. Non-profit ventures will have missions other than profits and appropriately pursue those missions
3. The objective of a public firm should be to maximize shareholder value. Indeed, the risk with other objectives is that CEOs may pursue value-destroying pet projects that are dressed up as serving some amorphous social purpose.
4. With many dispersed shareholders in a public firm, it will be difficult to get unanimity on the "right" higher purpose.
5. Value maximization is a long-term concept. Those with longer time horizons will make short-term profit sacrifices in order to increase long term value.

The areas in which there is not agreement, or at least not complete agreement, have to do with the (existence of?) tradeoff between motivation and profit maximization.

The PL position holds that a firm that chooses to adopt an authentic prosocial higher purpose and in which the leader is able to persuasively communicate it to the organization may be able to energize its employees to exceed normal expectations in terms of the effort they provide. They will behave more like principals than agents. This can actually benefit shareholders in the long run. But this is not guaranteed, and we recognize that there is a risk that the pursuit of higher purpose will actually have no long-term benefits for the shareholders. For this reason, not every CEO will articulate higher purpose pursuit as part of the goal of the firm.

The PM position agrees that HR practices that motivate employees are beneficial and positively impact a firm's profitability. The PM position also agrees that not all principal agent relationships are or should be adversarial and that efforts to align the interests of principals and agents will be beneficial. The distinction is that the PM position holds that decision-making must choose one thing to maximize.



Established at the University of Michigan in 1992, the **William Davidson Institute** (WDI) is an independent, non-profit research and educational organization focused on providing private-sector solutions in emerging markets. Through a unique structure that integrates research, field-based collaborations, education/training, publishing, and University of Michigan student opportunities, WDI creates long-term value for academic institutions, partner organizations, and donor agencies active in emerging markets. WDI also provides a forum for academics, policy makers, business leaders, and development experts to enhance their understanding of these economies. WDI is one of the few institutions of higher learning in the United States that is fully dedicated to understanding, testing, and implementing actionable, private-sector business models addressing the challenges and opportunities in emerging markets.