Corporate Purpose, Managerial Autonomy, and Performance

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Purpose Center, Society & Organizations Institute – HEC Paris

Harrison Munro-Clark is an HEC PhD student, who studies the influence of organizational context and structure on decision-making and organizational performance. He develops his research in collaboration with the S&O Institute.

Rodolphe Durand is a professor of strategy at HEC Paris, founder and academic director of the Society & Organizations Institute, and he holds the Joly Family Chair in Purposeful Leadership.

The Society & Organizations (S&O) Institute

The Society & Organizations Institute is an interdisciplinary institute at HEC Paris which unites over 60 professors and researchers. Its purpose is to reinvent business through promoting sustainability and unleashing human potential. The S&O Institute with its three centers: Purpose, Inclusive Economy and Climate & Earth, addresses the key challenges of the social and ecological transition, following the THINK, TEACH, ACT approach.

The Purpose Center and its Joly Family Chair in Purposeful Leadership

The objective of the Purpose Center is to contribute to reforming businesses to focus on their mission and the values of social and environmental sustainability, through responsible leadership hinged on a shared “raison d’être”. Its Joly Family Chair in Purposeful Leadership co-created in 2018 with Hubert Joly, former CEO of Best Buy, aims at placing purpose at the heart of leadership and focuses on the search of meaning for individuals.

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Purpose adds goals to profit making

Corporate purpose - the raison d'être of a company beyond pure profit-making - has made a comeback in the business world. Despite its origins in the early 20th century, where it was believed that top executives' role was to foster a common purpose amongst employees[1], this concept lay largely dormant in the following years. Today, as we see its resurgence, important questions arise: Can a purpose-based company outperform its competitors? If so, under what conditions?

Purpose cannot be just an ethereal idea or an objective characteristic of a firm. It needs incarnation – which connects strategy back to its roots, to strategic execution.[2] The articulation of the purpose in terms of goals serves to translate the abstract purpose into an organizational reality. Pursuing a purpose does not come without complications. Purpose-based firms pursue multi-dimensional performance goals that reflect their broader purpose. For instance, a firm with corporate purpose linked with environmental sustainability may pursue goals relating to carbon emissions and access to clean water as well as financial objectives[3]. In this manner, the corporate purpose uniquely configures the goals in a purpose-based firm.

More goals, lowered performance, and the role of management

From an economics viewpoint, these extra 'purpose goals' add complexity to strategic decision-making and on average weaken firm performance[4]. Since a single decision can have effects on performance on multiple goals, managers struggle to find ways to make decisions to improve performance on one goal without undermining performance on the other goals they simultaneously consider. Consider, for example, a manager who is tasked with finding ways to improve EBITDA and carbon efficiency. Intuitively, it is easier for the manager to find strategies to improve performance on just EBITDA or just carbon efficiency rather than both together. As a result, a firm pursuing both EBITDA and carbon efficiency is likely to underperform a firm pursuing just EBITDA. In aggregate, then, firms that pursue a purpose should underperform their competitors.

Recent studies, however, suggest that purpose-based firms can have a performance edge over their non-purpose-based counterparts. This is consistent with anecdotal evidence. Many top-

[1] Barnard, C.I., 1938. *The functions of the executive* (Vol. 11). Harvard university press. Selznick, P. 1957, *Leadership in Administration: A sociological interpretation,* Quid Pro books (2011)
[2] Durand, R., 2023. From the boardroom: Making purpose research relevant for practice. *Strategy Science*. Forthcoming
[3] Frérot, A. and Durand, R., 2022. *A Broader Vision for Business: Toward a New Narrative*.
[4] Ethiraj, S.K. and Levinthal, D., 2009. Hoping for A to Z while rewarding only A: Complex organizations and multiple goals. *Organization Science*, *20*(1), pp.4-21.

performing companies like Best Buy, Unilever, and Nestlé, for instance, have multiple non-financial goals tied to their corporate purpose. Firms characterized by both high purpose and clarity amongst management exhibit higher future accounting and stock market performance.[5]

This suggests that managers could be a vital link through which purpose impacts a company's financial performance. The key here is that this positive relationship between purpose and performance relied on managers and employees genuinely understanding and experiencing this alignment of purpose and clarity with their strategic role. Managers are not just passive implementers of objectives and orders from senior management but could actively drive performance improvements through their strategic decision-making and exemplarity. This idea is supported by recent research showing that managers can be instrumental in creating value within a company.[6] Hence, the relationship between purpose and performance could be understood by the notion of managers playing a more proactive role in driving company performance.

So, how do we reconcile the idea that having multiple goals weakens performance with the emergent notion that purpose-based firms can, under certain circumstances, outperform their peers?

One key result, two studies

Our study, synthesized here, proceeds in two complementary steps, with one core result: <u>granting managers greater autonomy can actually mitigate the negative impact of pursuing multiple goals</u>. We defined autonomy as a manager's freedom to formulate tasks and see them through without interference from senior management. In practice, this means that as a manager's decision-making autonomy grows, there are more scenarios where a purpose-based company outperforms its competitors with fewer goals.

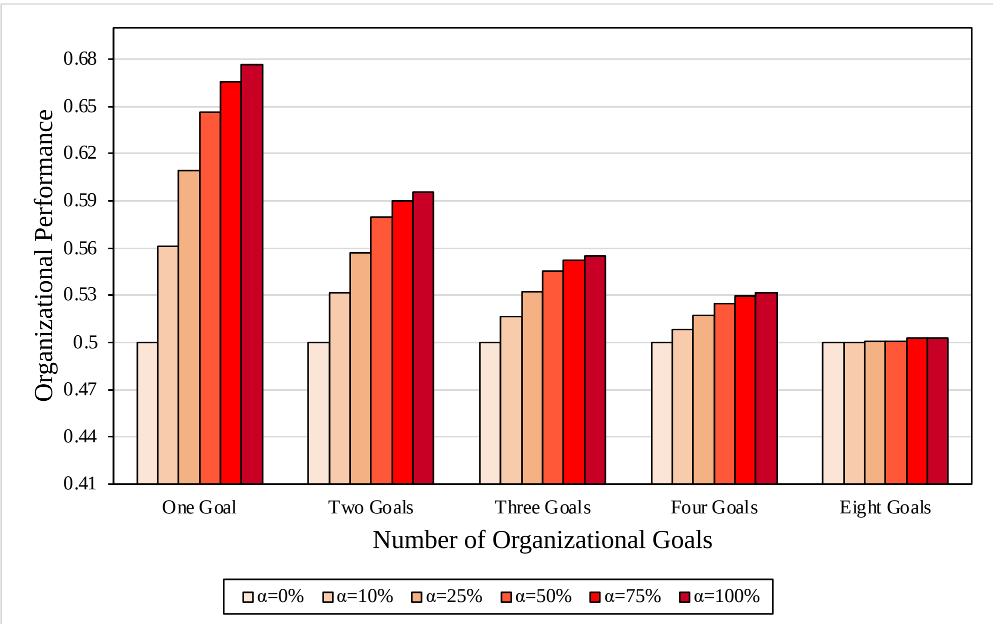
1 We replicate the "NK model" used by Ethiraj and Levinthal (2009) (see footnote 4) that mimics the complexity of managerial decision-making in organizations. The NK model is a mathematical framework that represents a complex system's interdependencies and explores how they impact the system's ability to adapt and evolve. The central notion of the NK model is the concept of a performance landscape. Each possible combination of the N decisions in an organization represents a point on this landscape, with the height of the point determined by the performance (Ω) associated with that particular combination of decisions. The more interdependencies between decisions (higher K), the more rugged the landscape becomes, meaning it has more hills (local peaks) and valleys (low-performing areas).

[5] Gartenberg, C., Prat, A. and Serafeim, G., 2019. Corporate purpose and financial performance. *Organization Science*, 30(1), pp.1-18.
[6] Kryscynski, David, Russ Coff, and Benjamin Campbell. "Charting a path between firm-specific incentives and human capital-based competitive advantage." *Strategic Management Journal* 42, no. 2 (2021): 386-412.

In our case, N represents the number of decisions a manager makes, and K represents the level of interdependency between these decisions. This creates a rugged performance landscape, which we can imagine like the Alps. The emphasis of strategy is, then, changing the set of N decisions to try to get to a higher point on the performance landscape, i.e., Mont Blanc. This involves a process of searching through the landscape by iteratively modifying the decisions and seeing if the changes lead to higher performance. Due to the rugged nature of the landscape, however, the manager can easily get stuck on a local peak - a point where any small change to the decisions would decrease performance, even though it is not the absolute highest point in the landscape (global peak).

When an organization has multiple goals, it is like having multiple distinct landscapes to search on simultaneously. Finding the highest peak in all these landscapes concurrently is a significantly less complex task than if the firm has fewer goals. With respect to this task, the capacity of management to take autonomous, performance-enhancing actions appears critical to the way in which purpose-based firms could outperform competitors. The introduction of corporate purpose can alter the social context within a firm, possibly enabling managers to better understand their value creation scope, thereby easing superior control, increasing autonomy, and facilitating more alert performance-enhancing solutions. We therefore introduced a parameter in Ethiraj and Levinthal's model to modulate managerial autonomy, and compared how multi-goal firms performed with and without managerial autonomy.

Figure 1. Performance in firms with multiple goals and varying levels of managerial autonomy



This figure represents average performance in firms pursuing different numbers of goals with varying managerial autonomy levels. The variable α captures the probability that a performance improvement effort is implemented by the firm. Larger values of α are synonymous with greater levels of managerial autonomy. Figure 1 shows that, keeping all else constant, as an organization pursues more and more goals, its overall performance tends to decrease.

Figure 1 also demonstrates that the managerial autonomy positively moderates the relationship between the number of organizational goals and firm performance. When a firm sets between one to four goals, there is a clear link: the more autonomy managers have, the better the business performs. For instance, in a firm with a single goal, performance reaches a plateau at 0.50 when there is no managerial autonomy. This plateau increases to 0.58, 0.63, 0.66, 0.68, and 0.69 as autonomy grows to 10%, 25%, 50%, 75%, and 100% respectively. Similar outcomes can be seen in companies with two, three, or four goals. This shows that managerial autonomy can have a positive impact on the relationship between goal setting and performance.

When an organization has as many as eight goals, however, the degree of managerial autonomy makes no noticeable difference in performance. Regardless of whether autonomy is 0% or 100% (or anywhere in between), the organization's performance plateaus at 0.50. This is logical – the prospect of performance improvement becomes irrelevant if managers cannot identify suitable enhancements. The takeaway here is that beyond a certain goal threshold, managerial autonomy no longer plays a moderating role. Additionally, if no improvements can be implemented (i.e., autonomy is 0%), the firm's performance stays the same over time. In repeated simulations, the average performance settles at 0.5, regardless of the number of goals.

Furthermore, this figure shows that the moderating effect is sufficiently strong such that there are instances in which a firm that pursues a greater plurality of goals and has greater levels of managerial autonomy outperforms a firm that pursues fewer goals. For example, a firm with a single goal and 10% autonomy will only plateau at a performance level of 0.56. Yet a firm with two goals and managerial autonomy of 50%, 75%, or 100%, can achieve performance plateaus of 0.58, 0.59, and 0.60 respectively. So, a company with more goals and higher autonomy can surpass a firm with fewer goals and less autonomy. This highlights the powerful influence that managerial autonomy can have on goal setting and performance. Managerial autonomy can offset the negative impact of setting a large number of goals on organization performance. It is important to note, however, that the positive effect of autonomy starts to diminish as the number of goals approaches eight. In these cases, it is unlikely that managers can identify and implement an improvement action that will enhance performance across all goals in a short period.

The key takeaway is that managerial autonomy can powerfully counteract the negative impact of pursuing multiple goals on performance. Yet, the positive impact of managerial autonomy has its limits. If an organization is juggling too many goals – about eight in our model - the performance benefit of autonomy begins to wear off. The manager simply does not have enough capacity to find and implement improvements for every goal. As a result, the firm falls back into the "status-quo trap" of failing to improve performance, regardless of its managerial autonomy.

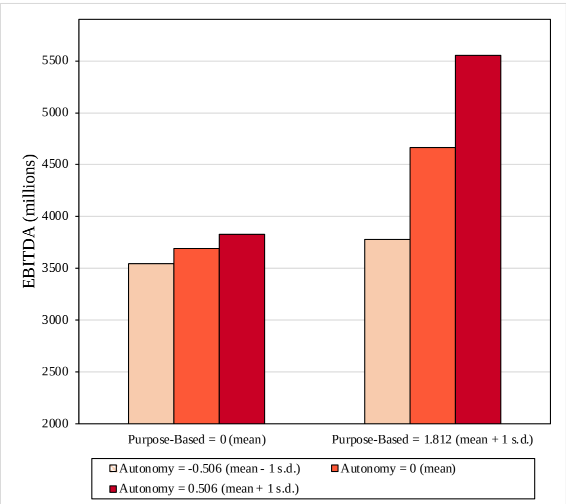
2 We corroborated the main result of our simulation by analyzing the financial performance of 289 firms in the period 2015-2021, using a unique dataset that included around 50,000 managerial responses to a company culture survey, annual reports (to see if the companies pursued a purpose), and corresponding financial performance data.

The key measure of a firm's financial performance was its EBITDA, which reflects the outcome of operating decisions. We categorized firms as more purpose-based if they associated themselves with the concept of a corporate purpose and had a common sense of purpose amongst the employees. To measure managerial autonomy, we averaged the responses of managers to a survey question concerning their need to check with leadership before taking action.

What we found consistent across all models was the positive impact of purpose-based management. A company centered around a clear purpose consistently displayed a positive correlation with profitability, aligning with the emergent results in strategy (see footnote 5). Our analysis suggests that being purpose-based could lead to increased profitability (of about 16% for a one standard deviation increase in purpose-based management), in line with our initial hypothesis. When we incorporated managerial autonomy into our models, the results became even more compelling. Although managerial autonomy by itself did not significantly impact performance, it did play a decisive role when interacting with purpose.

Figure 2 graphically illustrates the moderation effect of a firm's managerial autonomy on the relationship between the pursuit of a corporate purpose and EBITDA in our sample firms.

Figure 2. Effect of managerial autonomy on the relationship between purpose and performance.



This figure demonstrates that both an increase in autonomy and purpose are associated with superior performance in the case that the values are above the mean. This result suggests that the firm's managerial autonomy positively influences the correlation between the pursuit of a corporate purpose and EBITDA performance (of about 30% when both purpose-based management and autonomy are increased by one standard deviation). This outcome corroborates our mathematical model, strengthening the claim that managerial autonomy can enhance the impact of a purpose-based approach on financial performance.

Implications

In this study, we examined the performance implications of multiple goals for purpose-based companies, which pursue objectives beyond the traditional pursuit of profit. We found that when managers have the autonomy to implement performance-enhancing decisions, companies with multiple goals can outperform those with a single goal focus. We also found that companies that pursue multiple goals, but give their managers significant autonomy, can outperform those with a narrower focus. The positive relationship between corporate purpose and financial performance is moderated by managerial autonomy. Therefore, companies aiming to achieve both social and environmental goals, as well as profitability, need to give their managers the freedom to make performance-enhancing decisions. Hence, it is imperative for organizations to foster a culture that empowers managerial discretion, enabling proactive decision-making and offering opportunities for performance improvement.

Autonomous managers are seen to be more capable of navigating the rugged landscape of multiple objectives, identifying and implementing performance-enhancing solutions. There is, however, a limit to this advantage. The more goals a company pursues, the less impact managerial autonomy has on performance. If the goal count becomes too high (e.g. eight, in our simulations), the positive effect of autonomy fades away. These findings suggest a potential balancing act for purpose-based companies. Thus, executives should strive to maintain a balance that optimizes performance outcomes, considering both the strategic ambition (i.e., the instantiation of purpose-based goals) and the level of managerial autonomy within the organization.

Perhaps the most compelling finding lies in the powerful synergy between corporate purpose and managerial autonomy. The empirical evidence presents a clear narrative: organizations guided by a clear purpose, coupled with high levels of managerial autonomy, enjoy significantly improved financial performance. While this relationship is simply correlational, it is incumbent upon executives to create a management framework that encourages both a strong corporate purpose and high managerial autonomy. By strategically leveraging these two factors, firms can potentially unlock significant performance enhancements and achieve competitive advantage.

HEC PARIS | SnO PURPOSE center

1, rue de la libération
78351 Jouy-en-Josas
www.hec.edu/sno
@HECParisSnO