

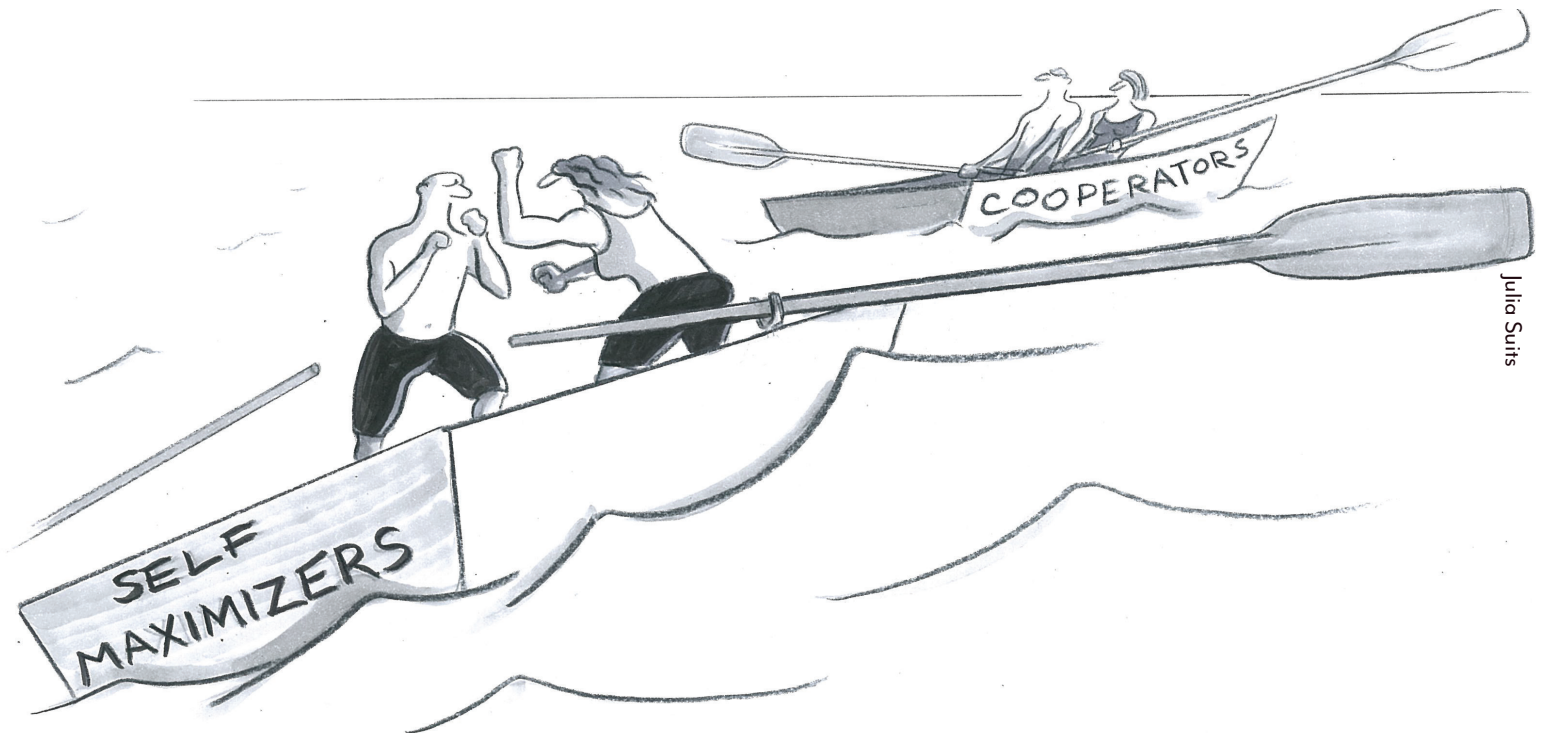


THE EVOLUTION INSTITUTE

# Doing Well By Doing Good

An Evolution Institute Report on Socially Responsible Businesses

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## Executive Summary

- A general theory of group efficacy has emerged with great practical relevance to business groups.
- The theory identifies eight core design principles needed by groups to coordinate action, avoid disruptive self-serving behaviors within groups, and cultivate appropriate relations with other groups.
- The theory explains how socially responsible business practices can also be profitable.
- A social responsibility movement spearheaded by B-Lab (B stands for Beneficial), which has resulted in over 1400 B-Corps, is used as a case study to illustrate the core design principles approach.
- Corporations are invited to join an upward virtuous spiral that rewards socially responsible business practices with success.

## What Makes an Effective Group?

The question “What makes an effective group?” is asked in dozens of different contexts—in the biological sciences, the human sciences, business, politics, sports, and many other walks of everyday life. There is no single answer to this question, insofar as groups differ in their histories, membership, social organization and purpose. However, a few basic factors apply to all groups whose members are trying to work together to achieve a common goal.

- Group members must appropriately coordinate their actions.
- They must avoid disruptive self-serving behaviors within the group.
- They must cultivate appropriate relations with other groups.

These factors are so general that they apply to animal groups such as ant colonies, fish schools, and primate troops in addition to all kinds of human groups. Recently, a general theory of group efficacy has emerged that integrates the biological and human sciences and has great practical relevance for business leaders, politicians, and anyone else who seeks to increase the efficacy of their groups. The theory identifies eight core design principles that nearly all groups need to function well. These principles are necessary, although they might not be sufficient. Each group is indeed unique in its own way and will need to be structured accordingly, but if it lacks the core design principles it is more likely to fail.

This Evolution Institute report briefly summarizes the core design principles approach and applies it to companies that attempt to be socially responsible, both in their internal organization (e.g., by providing a good working environment for employees) and their impact on the wider world (e.g., by providing a socially responsible product or minimizing their negative impact on the environment). Such companies have always existed and have always had to compete with companies that are less scrupulous. In recent decades, a

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number of efforts to support socially responsible companies have gathered steam in both the public and private sectors. This report will focus on one effort in the private sector headed by a non-profit organization called B-Lab<sup>1</sup>, but our analysis is also relevant to other Corporate Social Responsibility (CSR) initiatives<sup>2</sup>.

B-Lab certifies companies for social responsibility. Companies seeking certification voluntarily submit information to B-Lab and receive a score based on five components: environment, workers, customers, community, and governance. A company can advertise itself as a B-Corp if its B-Impact score exceeds a certain value. Over 1400 companies have become B-Corps<sup>3</sup>, including such household names as Patagonia, Ben and Jerry's, and Etsy. In addition to providing a certification service, B-Lab also works with B-Corps as a community to realize their collective vision of businesses contributing to a sustainable society.

A B-Corp might seem to have an inherent disadvantage in the struggle for existence in the marketplace. The resources that a B-Corp must use to be socially responsible, such as higher wages for employees or a commitment to reduce its carbon footprint, can be used by a more ruthlessly selfish company to increase its profits and share of the market. However, this reasoning ignores the powerful advantages of cooperation that can enable socially responsible agents to outcompete more selfish agents, at least under certain conditions. Cooperators can win the struggle for existence in the biological world and in the business world. Moreover, we can do more than theorize, because B-Corps and other socially responsible companies often survive very well in the marketplace as a matter of empirical fact, as we will show.

# not Greed Is Good

Many people in the business world are handicapped by a philosophy that regards “greed as good”. Individuals are assumed to be motivated entirely by self-interest, which is typically conceptualized as monetary self-interest. Maximizing profits for shareholders is thought to be the only social responsibility of a company, which the invisible hand guarantees will benefit the common good. Friedrich Hayek, Milton Friedman, and Ayn Rand are three major figures associated with this philosophy, which was eagerly adopted and promoted by business schools during the second half of the 20th century and to a large extent today. In Ayn Rand's novel *Atlas Shrugged*, the word “give” is banned from the vocabulary of the utopian community founded by John Galt.

Those who are under the sway of the “greed is good” philosophy are especially baffled by the idea that social responsibility (a form of giving) can be a successful business strategy. It is literally beyond their imagination. Fortunately, the same idea makes excellent sense against the background of the core design principles approach, which stands on a much stronger scientific foundation than the “greed is good” philosophy.

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<sup>1</sup><https://www.bcorporation.net/what-are-b-corps/about-b-lab>

<sup>2</sup>See Moon (2015) for a short introduction and Midttun (2013) for a recent edited volume on CSR initiatives.

<sup>3</sup><https://www.bcorporation.net>

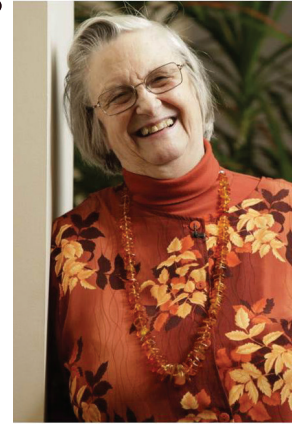
# A Brief Summary of the Core Design Principles Approach

Like the braided fibers of a rope, many lines of thought contribute to the core design principles approach. Here we will briefly describe the contributions of political science, evolutionary theory, anthropology and history, economics, and the business literature. This will set the stage for an examination of B-Corps and other socially responsible businesses.

**Political science:** The eight core design principles were first derived by Elinor Ostrom, a political scientist by training who received the Nobel Prize in economics in 2009 for her groundbreaking work<sup>4</sup>. Ostrom studied groups around the world that attempt to manage common-pool resources (CPR) such as forests, pastures, fisheries, and irrigation systems. These resources are called common-pool because they cannot easily be privatized and instead must be shared and cooperatively maintained. Conventional wisdom held that that they are vulnerable to the tragedy of overuse—famously dubbed “the tragedy of the commons” by ecologist Garrett Hardin<sup>5</sup>—and that the only solutions are privatization (if possible) or top-down regulation. Ostrom and her colleagues showed empirically that CPR groups are capable of sustainably managing their resources, sometimes for centuries, if they possess eight core design principles shown in Table 1.

**Table 1. Core Design Principles for the Efficacy of Groups**

DPI	<b>Clearly defined boundaries</b>	The identity of the group and the boundaries of the shared resource are clearly delineated.
DP2	<b>Proportional equivalence between benefits and costs</b>	Members of the group must negotiate a system that rewards members for their contributions. High status of other disproportionate benefits must be earned. Unfair inequality poisons collective efforts.
DP3	<b>Collective choice arrangements</b>	Group members must be able to create at least some of their own rules and make their own decisions by consensus. People hate being told what to do but will work hard for group goals that they have agreed upon.
DP4	<b>Monitoring</b>	Managing a commons is inherently vulnerable to free-riding and active exploitation. Unless those undermining strategies can be detected at relatively low cost by norm-abiding members of the group, the tragedy of the commons will occur.
DP5	<b>Graduated sanctions</b>	Transgressions need not require heavy-handed punishment, at least initially. Often gossip or a gentle reminder is sufficient, but more severe forms of punishment must also be waiting in the wings for use when necessary.
DP6	<b>Conflict resolution mechanisms</b>	It must be possible to resolve conflicts quickly and in ways that are perceived as fair by members of the group.
DP7	<b>Minimal recognition of rights to organize</b>	Groups must have the authority to conduct their own affairs. Externally imposed rules are unlikely to be adapted to local circumstances and violate DP3.
DP8	<b>Appropriate relations with other groups</b>	For groups that are part of larger social systems, there must be appropriate coordination among relevant groups, which reflect the same principles as relations among individuals within groups.



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<sup>4</sup>Ostrom (1990, 2010)

<sup>5</sup>Hardin (1968)

Although Ostrom concentrated on a single kind of group and employed theoretical constructs from economics and political science (such as game theory and Institutional Analysis and Development), even a glance at the design principles suggests that they are likely to apply to a broader array of groups and can be given a more general theoretical formulation because they address the three factors listed at the beginning of this report. Nearly any kind of group that implements these design principles is likely to appropriately coordinate action, avoid disruptive self-serving behaviors within the group, and forge appropriate relationships with other groups.



*Businesses have much to learn from groups that manage common-pool resources, such as this irrigation system in Bali.*

**Evolutionary theory.** Ostrom loosely framed her work in terms of evolutionary theory throughout her career. The subtitle of her most influential book, *Governing the Commons*, is *The Evolution of Institutions for Collective Action*. One of us (Wilson) was privileged to work with Ostrom and her associate Michael Cox for several years prior to her death in 2012, resulting in an academic article titled “Generalizing the Core Design Principles for the Efficacy of Groups”<sup>6</sup>. This article places the core design principles approach on an appropriately broad theoretical foundation informed by the latest developments in evolutionary science.

The process of natural selection straightforwardly results in individual organisms that are well adapted to survive and reproduce in their environments. However, the same process does not straightforwardly produce well-functioning groups. The reason is that surviving and reproducing better than other members of one’s group requires a different set of activities than working together as a group to achieve common goals. Individuals who behave as solid citizens are vulnerable to exploitation by individuals who accept social benefits without sharing the cost. In other words, the same “tragedy of the commons” that poses a problem for human CPR groups also poses a problem for all social species<sup>7</sup>.

It might seem that rewarding solid citizens and punishing cheaters would solve this problem, but a close look shows otherwise. If I reward those who provide a public good and punish those who don’t, then I am providing a public good at my own expense, compared to the non-rewarder and non-punisher within the same group. In economics, this is known as a second-order public goods problem and it leads to the dismal conclusion that natural

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<sup>6</sup>Wilson, Ostrom, and Cox (2013)

<sup>7</sup>See Wilson (2015) and Wilson and Wilson (2007) for more



selection within a social group is insensitive to the welfare of the whole group—including systems of rewards and punishments oriented toward the welfare of the group.

Fortunately, natural selection within groups is not the only evolutionary force. Natural selection also operates between groups in a multi-group population, selecting for solid citizen behaviors and social control systems that reinforce such behaviors. As one of us (Wilson) put it in an academic article written with Harvard evolutionary biologist Edward O. Wilson, “Selfishness beats altruism within groups. Altruistic groups beat selfish groups. Everything else is commentary”. Altruism in this formulation is defined very broadly to include all activities that benefit others and one’s group as a whole at some expense to the individual.

Against this background, some of the core design principles in Table 1 (especially DP2-5) can be understood as a set of mechanisms that suppress the potential for disruptive self-serving behaviors within groups, so that succeeding as a group becomes the main pathway to success. Very simply, in a group that strongly implements these design principles, a member that wants to gain at the expense of others or the group as a whole will have a difficult time doing so. The suppression of disruptive self-serving behaviors will increase the efficacy of any kind of group, human or non-human, and there are fascinating examples of animal groups that function well by virtue of employing the core design principles<sup>8</sup>. These are cases of genetic evolution, but the same principles hold for human cultural evolution, including the evolution of institutions for collective action, as Ostrom put it in the subtitle of her book.

It is important to stress that the core design principles are needed at every rung of a multi-tier social hierarchy, which is reflected by DP7-8. To make this point in a business context, imagine that you are a new employee entering a large corporation at a relatively low level.



*Social life consists of groups within groups within groups.*

You can advance by working cooperatively with your peers or by undercutting them. If the unit that you work for strongly implements the core design principles, then the second option becomes difficult and your unit functions well as a group. Now imagine that you are promoted to become the head of your unit. Once again, you can advance by working

● In most animal societies, including most primate societies, members of groups cooperate to a degree but are also each other’s chief rivals.

<sup>8</sup>As an example, we recommend *Honeybee Democracy* by Thomas Seeley (2010)

cooperatively with other units or by undercutting them. To prevent the second option, the design principles need to be implemented between units within the corporation, in addition to between individuals within units. Now imagine that you are promoted to CEO of the corporation. By now you are thoroughly convinced about the benefits of cooperation and eager for your corporation to be a solid citizen of the world. Unfortunately, the same core design principles that operate strongly between individuals within units and between units within your corporation are absent at the level of between corporations and other relevant corporate units (e.g., nations) on the world stage. Your desire to be a solid citizen might well fail, based on the absence of the core design principles at the highest level. You might reluctantly conclude that in order for your corporation to survive, you must resort to undercutting strategies. Or, you might decide to work with other corporate units to implement the core design principles at the highest scale. Hence, we often see successful corporations forming alliances and/or partnerships with other corporations, a point to which we will return below.

**Anthropology and history.** Remarkably, not only do the core design principles inform the organization of modern groups, but they also explain how we became such a cooperative species in the first place. In most animal societies, including most primate societies, members of groups cooperate to a degree but are also each other's chief rivals. Even cooperation usually takes the form of alliances that compete with other alliances within the same group. To the best of our current knowledge, mechanisms evolved in our species that suppressed disruptive self-serving behaviors within groups, causing between-group selection to be the primary evolutionary force. Teamwork became the signature adaptation of our species.

Almost all hunter-gatherer societies that still exist or were described by anthropologists prior to their assimilation into larger societies exhibit teamwork enforced by the suppression of disruptive self-serving behaviors, as described in Christopher Boehm's *Moral Origins: The Evolution of Virtue, Altruism, and Shame*<sup>9</sup>. Bullying is not tolerated and the group as a whole has the power to thwart those who try to impose their will by creating counter-dominant coalitions.. Status must be earned and reputation is based on how much one contributes to the group (DP2). Decision-making is typically by consensus or by other processes recognized as fair by the group (DP3). It is easy to monitor agreed-upon behaviors because people are almost always in the presence of others (DP4). Mild sanctions such as gossip are usually sufficient to keep people in solid citizen mode but they are backed up by harsher sanctions such as exclusion and execution (DP5). Conflicts of interest are typically managed in a way that is recognized as fair by all parties (DP6).

In short, our species is genetically adapted to implement the core design principles in small groups and small groups are especially amenable to their implementation. The 19th century French social theorist Alexis de Tocqueville got it right when he said: "The village or township is the only association which is so perfectly natural that, wherever a number of men are collected, it seems to constitute itself."<sup>10</sup> However, this does not mean that the design principles are invariably constituted in small groups. Disruptive self-serving behaviors and their underlying psychological impulses are only suppressed, not eliminated, and are ready to surface whenever opportunities allow. All of us are like Dr. Jekyll and Mr. Hyde combined in a single person, which could be why that story by Robert Louis Stevenson has such resonance.

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<sup>9</sup>Boehm (2012)

<sup>10</sup>Tocqueville (1831)

It might seem that this portrayal of human nature is cynical and leaves no room for genuinely altruistic feelings and behaviors. On the contrary, the coercive aspects of morality make it safe to be genuinely altruistic. To see this in a business context, imagine someone who joins a company with every intention of being a genuine team player. Unfortunately, the unit that she works for is sadly lacking in the core design principles. She quickly realizes that her helpfulness will be exploited. To survive, she must turn off her own prosociality. Now imagine that she is transferred to a unit that strongly implements the core design principles. With a sigh of relief, she realizes that she can express her desire to be helpful to its fullest extent.

The core design principles are more difficult to implement in large groups than small groups for two reasons. First, our genetic adaptations evolved in the context of small groups and can break down in large groups. For example, we are not genetically equipped to keep track of relationships with more than one hundred or so people. Second, some of the design principles, such as monitoring, are intrinsically more difficult to implement in large groups. As a result, when human social groups started to increase in size with the advent of agriculture, they became less egalitarian and more prone to despotism—ironically, more like a typical primate society than a hunter-gatherer human society. They also varied in their cultural practices, however, and those that functioned best as groups were favored by between-group selection, leading to the relatively egalitarian democratic mega-societies of today. Books such as *The Spirit Level*<sup>11</sup>, *Why Nations Fail*<sup>12</sup>, *War and Peace and War*<sup>13</sup>, *The Social Conquest of Earth*<sup>14</sup>, and *Ultrasociety*<sup>15</sup> document that the core design principles are as relevant to the efficacy of nations as to the efficacy of smaller groups.

The genetic evolution of our species and the long sweep of human history might seem far removed from best business practices for a company that wants to be socially responsible. The fact that they are *not* far removed—that all three can be understood in terms of multilevel genetic and cultural evolution—is both intellectually satisfying and provides a strong scientific foundation for practical efforts to improve the efficacy of socially responsible business groups.

**Economics.** Economics is a diverse subject that originated a century before Darwin's theory of evolution. Nevertheless, one school of economic thought has become so dominant that it is called "orthodox", overshadowing so-called "heterodox" schools of thought in influence<sup>16</sup>. The orthodox school originated with 19th century economists such as Leon Walras, who wanted to create a "physics of social behavior" comparable to Newton's laws of motion<sup>17</sup>. This required making a long list of assumptions about human abilities and preferences that has become known as *Homo economicus*. It also required making a long list of assumptions about the human social environment, including perfect markets that are at equilibrium. These assumptions allowed a body of formal mathematical theory to develop that is incomprehensible to all but a few people. However, the intuition that flows from the equations is all too familiar: People are entirely self-regarding utility maximizers. "Self-regarding" can be approximated by monetary self-interest. The unregulated pursuit of self-interest robustly benefits the common good. The only social responsibility of a corporation is to maximize the profits of its shareholders.

No matter how solidly entrenched and dressed up in mathematics, a theory is only as

• The core design principles are as relevant to the efficacy of nations as to the efficacy of smaller groups.

• The orthodox school of economics is an emperor with no clothes.

<sup>11</sup>Pickett and Wilkinson (2009)

<sup>12</sup>Acemoglu and Robinson (2012)

<sup>13</sup>Turchin (2005)

<sup>14</sup>E.O. Wilson (2012)

<sup>15</sup>Turchin (2015)

<sup>16</sup>The vocabulary surrounding the orthodox school of thought is confusing. It is also called both "neoliberal" and "neoclassical".

<sup>17</sup>Beinhocker (2006)



good as its assumptions and orthodox economic theory is a case of “garbage in, garbage out.” *Homo economicus* and its imaginary social environment are such a far cry from *Homo sapiens* and



real social environments that there is no theoretical justification for the orthodox school of thought. The argument that the predictions of a theory can be right even though its assumptions are wrong, which was advanced by Milton Friedman in the 1950's, sounds silly after the failure of orthodox economics to predict or cope with the economic crises facing us today<sup>18</sup>. Very simply, the orthodox school of economics is an emperor with no clothes and the sooner this is widely appreciated the better.<sup>19</sup>

So-called heterodox schools of thought include the Keynesian tradition and newer schools such as evolutionary economics, ecological economics, and behavioral economics. These traditions are not well integrated with each other and some of them lack a general theoretical framework of their own. For example, behavioral economists Richard Thaler and Cass Sunstein call for an economics based on “*Homo sapiens*, not *Homo economicus*” in their book *Nudge*<sup>20</sup>, but so far the field of behavioral economics has only resulted in a long list of results that are conceptualized as anomalies and paradoxes. These results are indeed anomalous and paradoxical against the background of orthodox economic theory, but need to be organized into an alternative theoretical framework that gives them coherence. In retrospect it will seem obvious that if we want an economics based on *Homo sapiens*, then it will need to be based on evolutionary theory, which includes a thorough understanding of ecology as the environment in which evolution takes place. At that point, evolutionary, ecological, and behavioral economics will become integrated with each other.<sup>21</sup>

Some of the basic assumptions of the new theoretical framework are clear enough, even if their implications are only starting to be worked out. The unregulated pursuit of self-interest emphatically does not robustly benefit the common good. A group that functions well must have mechanisms that coordinate action, prevent disruptive self-serving behaviors, and creates appropriate relations with other groups. Human preferences cannot be boiled down to self-interest, much less monetary self-interest. We evolved to function as teams in small groups and a proper understanding of our innate psychology can go a long way toward the design of modern groups. At the same time, we are not genetically adapted for life in large groups. At best we are culturally adapted and even our cultural adaptations can fail in fast-changing modern environments. This requires us to become “wise managers of evolutionary processes” to solve the problems of modern existence<sup>22</sup>. These assumptions and their implications are far more conducive to the cultural evolution of sustainable business practices than orthodox economic theory, as we shall see.

**The business literature.** In 2013 the Evolution Institute partnered with Jonathan Haidt, a professor at New York University's Stern School of Business, to organize a conference titled “Darwin's Business: New Evolutionary Thinking About Cooperation, Groups, Firms, and Societies”.<sup>23</sup> One of the speakers was economist Herbert Gintis, who said this about the

We evolved to function as teams in small groups

<sup>18</sup>Friedman (1953); see Wilson (2012) for more

<sup>19</sup>This does not mean that market processes are irrelevant or that monetary self-interest is absent. Other approaches include these in more sensible ways than the orthodox school.

<sup>20</sup>Thaler and Sunstein (2008)

<sup>21</sup>Wilson and Gowdy (2013). Visit [Evonomics.com](http://Evonomics.com) for a lively presentation of the new economic paradigm.

<sup>22</sup>Wilson, Hayes, Biglan, and Embry (2014)

formation of business schools in America.

After World War II, business schools blossomed all over the United States. All the major universities set up business schools. Before that, businessmen were just businessmen. They didn't go to college, or if they did they didn't learn anything about business. But these new business schools were very professional. When they wanted to teach economics, they simply borrowed from the economics discipline. In economics it's called *Homo economicus*. *Homo economicus* is not that popular any more but it certainly was after World War II. *Homo economicus* has no emotions. He's totally interested in maximizing his wealth and income. He really doesn't care about other people, although he does care about leisure. Leisure, income, and wealth are the only things. When they taught this to business school students it obviously followed that if you're a good businessman you should just maximize your material wealth. This is greedy. Being greedy is human, it's good to do, and the more greedy you are the more successful you'll be.

In other words, orthodox economic theory became the predominant worldview in the business world through the influence of business schools. We are aware that business schools include other worldviews, that some of them emphasize teamwork, that business ethics programs counsel that greed is not good, and so on. However, the orthodox worldview is the only one that seems to stand on an authoritative theoretical foundation, with the others lacking unity.

What happened when this "Greed is Good" worldview was actually put into practice? Some people became fabulously wealthy, of course, which is the typical outcome of greedy social strategies when they are unopposed. But there is precious little evidence that the "greed is good" worldview causes single companies to work well, much less entire economies.

Once we see the "greed is good" worldview for what it is, then we can consult the voluminous business literature to identify the practices that actually cause single businesses and multi-business economies to function well. In general, the new theoretical framework outlined above does a far better job explaining best business practices than the "greed is good" worldview. Unsurprisingly in retrospect, business groups are like any other human social group with a set of goals that can only be achieved by collective action. Cooperation is essential but must be protected against disruptive self-serving behaviors. Monetary incentives are important but cannot entirely substitute for other social incentives. An effective company has a strong sense of identity and purpose (DP1). Monetary and other rewards are proportional to one's contribution to the group effort. Competition among employees can be highly motivating and need not be disruptive as long as it is appropriately refereed so that the best person wins (DP2). Decision-making is sufficiently inclusive and transparent so that employees know that decisions are being made for the collective good (DP3). Performance is monitored (DP4) and shortcomings are initially addressed in a sympathetic matter before stronger sanctions are employed (DP5). Conflicts are resolved quickly and in a manner that is regarded as fair by all parties (DP6). Even if a company has perfected its internal social organization, it can still fail if it inhabits a larger cultural ecosystem that does not provide sufficient safeguards against unscrupulous business practices (DP 7 and 8).

A comprehensive review of the business literature is beyond the scope of this report, but

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<sup>23</sup><https://evolution-institute.org/article/darwinian-business-conference-at-nyu-stern-school/?source=tvol>

a few examples will be helpful before focusing on B-Corps and other companies that are committed to social responsibility in today's economic environment.

- In his 2013 book *Give and Take: A Revolutionary Approach to Success*<sup>24</sup>, the University of Pennsylvania's Wharton Business School professor Adam Grant identifies three broad social strategies—giving, matching, and taking. Givers freely help others, matchers give only when they expect to get, and takers try to get without giving whenever possible. The “greed is good” mentality suggests that givers can't possibly survive in the business world—remember that the very word was banned from John Galt's utopian community! Grant blends authoritative studies with entertaining biographical sketches to show that givers do the best *and* the worst. They are spectacularly successful when they manage to combine forces with other givers, but they become chumps when surrounded by takers. A company that implements the core design principles is likely to be a Mecca for giving, while taking is likely to accumulate in companies lacking the core design principles.
- Sociologist Robert Jackall provides a fascinating ethnography of a large business corporation in his book *Moral Mazes: The World of Corporate Managers*<sup>25</sup>, which was first published in 1988 and reissued in 2009 with an afterward that describes how “organized irresponsibility” contributed to the Great Recession. As the jacket description puts it: “This classic study of ethics in business presents an eye-opening account of how corporate managers think the world works, and how big organizations shape moral consciousness. Robert Jackall takes the reader inside a topsy-turvy world where hard work does not necessary lead to success, but sharp talk, self-promotion, powerful patrons, and sheer luck might.” The corporate social environment described by Jackall is sadly lacking in the core design principles and therefore becomes a breeding ground for social strategies that benefit individuals and factions within the corporation while undermining the performance of the whole. Employees with higher ethical standards are either washed out of the system or learn to change their ways. Fortunately, this is not a statement about all corporations but only corporations lacking in the core design principles. As NYU's Stern Business School professor Jonathan Haidt has stressed, the entire business system must be ethical for individuals to be ethical within the system.<sup>26</sup>
- In his 1998 book *The Human Equation: Building Profits By Putting People First*<sup>27</sup>, Stanford Business School professor Jeffrey Pfeffer amasses a mountain of evidence that businesses can be profitable by taking good care of their employees. One study<sup>28</sup> reported by Pfeffer followed the fate of 136 companies over a five-year period, starting from the time that they initiated their public offering on the U.S. Stock Market. The management practices of the companies were coded using information from their offering prospectuses, which was publicly available. Statistically controlling for other factors, companies that placed a high value on human resources and shared profits with employees (DP2) had a much higher survival rate over a five-year period than companies that treated their employees as expendable.
- A 2012 British government report<sup>29</sup> documented that employee-owned companies compared very favorably to conventional companies, especially during the 2008-9 economic downturn. Advantages of employee-owned companies include a higher

• Businesses can be profitable by taking good care of their employees.

<sup>24</sup>Grant (2013)

<sup>25</sup>Jackall (2009)

<sup>26</sup><http://ethicalsystems.org>

<sup>27</sup>Pfeffer (1998)

<sup>28</sup>Welbourne and Andrews (1996)

<sup>29</sup>Nuttall (2012)

degree of engagement and commitment, greater psychological well-being, and lower staff turnover, all of which make sense in terms of the core design principles. The report also identified barriers to employee ownership. These included: a) lack of awareness of the concept of employee ownership; b) lack of resources available to support employee ownership; and c) legal, tax, and other regulatory barriers to employee ownership.

To summarize, the business literature offers compelling evidence that business groups need the core design principles to succeed, just like any other human social group. This fact is so obvious in retrospect and is so well supported by evidence that one has to wonder why it has not been obvious all along. One part of the answer is that the “greed is good” worldview has eclipsed common sense. The subtitle of Adam Grant’s book is not hype. Giving really is a revolutionary approach to business success against the background of what is taught in business schools. Grant recounts that Wharton School students frequently express a desire to help others, which they plan to do by becoming philanthropists after making a fortune in business. It never occurs to them that they might not need to wait. According to the British report, employee-owned businesses aren’t even on the radar screen of legal, tax, accountancy, and other business advisors.

In one sense it is discouraging that the economic and business worlds are so deluded by the “greed is good” worldview. In another sense, it is exciting to contemplate the improvements in business performance that can potentially be achieved by employing the core design principles approach.

## B-Corps and Other Socially Responsible Businesses

B-Corps are part of a vibrant Corporate Social Responsibility movement that is taking place worldwide<sup>30</sup>. B-Corps are committed to doing the right thing and B-Lab provides an honest signal that they are walking the walk and not merely talking the talk. B-Lab does more than this, as we will outline in more detail below. The “greed is good” worldview leads to the expectation that doing the right thing detracts from the most competitive business practices, turning B-Corps into losers in the marketplace. The core design principles approach leads to a set of expectations that is more optimistic, while remaining realistic. Corporations that are organized according to the “greed is good” worldview are likely to suffer from parasitic social strategies similar to the ones described by Robert Jackall in *Moral Mazes*. In addition, the entire worldview offends moral sensibilities and makes it difficult for employees to believe in the mission of their company. The result is likely to be a corporation that functions poorly as a corporate unit.

In contrast, a corporation that is committed to social responsibility and implements the core design principles is likely to function well as a corporate unit and therefore to be competitive in the marketplace. Employees are likely to have a strong sense of purpose (DP1) and willingness to give, knowing that they are protected against parasitic social strategies (DP2-6). Decisions are likely to be better and even hard decisions such as employee layoffs are easier to make when the decision-making process is known to be fair (DP3). While a B-Corp has strong control over its internal social organization (DP1-6), its

<sup>30</sup>See Moon (2015) for a short introduction and Midttun (2013) for an edited volume that offers a Nordic perspective.

relationship with other groups in a multi-group ecosystem (DP7-8) can be more problematic. If the core design principles are lacking at the ecosystem level, then cooperative corporations can indeed lose in competition with more predatory and parasitic corporations. Even here there are grounds for optimism, however, by cooperative corporations clustering together to aid each other, through the court of public opinion, and through government regulations.

Once we free ourselves of the “greed is good” delusion, the theoretical argument for B-Corps succeeding in the marketplace is strong. It isn’t necessary to speculate, however, because there is data. Two of us (Chen and Kelly) compared the average revenue growth rate of a sample of B-Corps with a matched sample<sup>31</sup> of public companies and non-B-Corp private firms during the period 2007–2011<sup>32</sup>. B-Corps matched the growth rate of small-to-medium private firms and exceeded the growth rate of public companies.

It is gratifying to know that B-Corps can do well by doing good, but it is also important to realize that this result adds to an extensive body of evidence that already exists for the efficacy of socially responsible business practices, as described in the previous section. To proceed further, it is necessary to take a closer look at B-Corps and other socially responsible businesses from the core design principles perspective.

Once we free ourselves of the “greed is good” delusion, the theoretical argument for B-Corps succeeding in the marketplace is strong.

## A Closer Look at B-Corps

After learning about Chen and Kelly’s study, EI President David Sloan Wilson and his graduate student Melvin Philip teamed up with Kelly and Chen to study B-Corps in more detail. Our goal was to see if the core design principles can explain the success of B-Corps and perhaps help them achieve their business and social responsibility goals even better. We did this in three ways: 1) Site visits to five B-Corps in the New York City area that were arranged with the help of B-Lab CEO Jay Coen Gilbert; 2) A qualitative analysis of 50 B-Corps and 50 conventional companies matched for size and business sector; and 3) A quantitative analysis of B-Corps using data that B-Lab makes available to researchers with the help of Duke University’s Center for the Advancement of Social Entrepreneurship.<sup>33</sup> The quantitative analysis is still in progress and this report will focus on the site visits and qualitative analysis.

Each site visit included a meeting with a representative group of employees and a separate meeting with the CEO of the company. A workbook was provided beforehand that followed a description of each design principle with three questions:

- How important is this design principle for your company?
- How well aware is your company of this design principle?
- How well does your company currently implement this design principle?

Verbal answers were encouraged in addition to numerical ratings and the workbook ended with a request to nominate important auxiliary design principles in addition to the core design principles. The CEO and employees were asked to complete the workbooks before the site visit, which would provide the basis for discussion during the meetings.

<sup>31</sup>The samples were matched according to size and 4-digit Standard Industrial Classification (SIC) Code.

<sup>32</sup>Chen and Kelly (2015)

<sup>33</sup><https://centers.fuqua.duke.edu/case/>



Most of the employees and CEOs managed to peruse the workbooks prior to the meetings but few managed to complete the rating scales. This might seem like a mundane observation but it illustrates an important problem that needs to be addressed. A proper understanding of business practices requires a scientific approach, such as Chen and Kelly's analysis of financial performance, our attempt at quantitative analysis that is still in progress, and our effort to gather quantitative data during our site visits. Many business people are unaccustomed to a scientific approach and find it difficult to incorporate careful data gathering into their busy work routines. The final section of this report will suggest ways that this problem can be overcome.

Even though the workbooks did not result in quantitative information, they did provide the basis for lively discussion during the meetings with employees and CEOs, which we used to provide our own ratings. The conclusion that emerged from nearly every meeting was that the core design principles approach was insightful, nicely described why the company was already succeeding, and also suggested ways that the company could perform even better. On our part, we were inspired by how these companies had implemented some of the design principles but we also saw failures of implementation and therefore room for improvement. A common theme was that the company was experiencing problems associated with growth. The unity of purpose and spirit of cooperation that seemed to come naturally at the beginning was proving difficult to sustain as the number of employees increased above 50 or more. This is exactly to be expected and one benefit of becoming more mindful about the design principles is to plan for growth.

We will now provide examples of how B-Corps implement the core design principles and why there is still room for improvement, based on our five site visits and the qualitative analysis of a larger sample.

**DPI: Clearly defined boundaries.** For the common-pool resource groups studied by Ostrom, clearly defined boundaries meant the physical boundaries of the resource and the membership of the group entitled to manage it. In a broader business context, clearly defined boundaries means having a strong sense of group identity and purpose. The more that employees think of themselves as members of a cooperative group and believe in its mission, the more efficacious the company is likely to be. This might seem like an obvious point but it is ignored by the "greed is good" worldview, which pretends that employees can be motivated solely by individual monetary incentives. To the contrary, in his classic article titled "What Price the Moral High Ground?", the economist Robert H. Frank shows that many employees will accept a substantially lower wage to work for a company that does the right thing.<sup>32</sup>

B-Corps have an intrinsic advantage over many other companies for DPI because their goals are more laudable. Other than someone misled by the "greed is good" worldview, who wouldn't feel more proud to belong to a company that is attempting to make the world a better place than to a company that is merely trying to maximize profits for its shareholders? All five of the B-Corps that we visited were striking in the degree to which employees believed in the mission of their company and were proud to be identified with it. Several of the CEOs went out of their way to say that their mission was not to make money but to accomplish a

● A proper understanding of business practices requires a scientific approach.

● The conclusion that emerged from nearly every meeting was that the core design principles approach was insightful.

<sup>34</sup> Frank (1996)

given socially responsible goal. They knew that their corporation must be competitive in the marketplace to survive. As one CEO put it, B-Corp does not stand for “Beautiful Corpse”. But they did not regard their social responsibility goals or becoming a B-Corp as a business strategy. The fact that this stance can be a successful business strategy might sound strange, but it is little different than the success of individuals who demonstrate true integrity, based on their attractiveness to other people who know that they can be trusted<sup>35</sup>. Becoming certified as a B-Corp provides an honest signal not only to customers willing to patronize a socially responsible company, but also to employees who want to work for a socially responsible company.



bcorporation.net

Nevertheless, a strong sense of group identity and purpose does not come automatically to a B-Corp, especially when it grows beyond its founder stage. Work is required to cultivate a sense of group identity and purpose, especially for employees with peripheral jobs such as working in a warehouse, a remote sales force, or temporary employees working during periods of peak sales. Some of the B-Corps did a good job implementing DPI, building upon the intrinsic advantage of their socially responsible mission, but there was still plenty of room for improvement.

**DP2: Proportional equivalence between benefits and costs.** No matter how laudable the mission of a group, it will not retain the allegiance of its members unless they share the benefits and are credited for their contributions. As with DPI, B-Corps have an intrinsic advantage over most other companies for DP2 because employee welfare is part of their mission and a component of the B-Impact Score. Employee benefits often went beyond a decent salary and health insurance to include an aesthetically pleasing work environment, accommodating childcare needs, work at home options, and being paid for hours spent volunteering for good causes. In other words, at least some of the B-Corps helped their employees achieve a work-life balance, which was at least as important as monetary incentives.

In addition to providing material benefits, B-Corps also tended to do a good job at social recognition. Employees felt that they were known and liked as individuals and that their efforts were appreciated. They frequently referred to each other without prompting as family. Unsurprisingly for those who are not blinded by the “greed is good” worldview, they frequently went beyond the call of duty to help each other meet company goals. Little wonder that treating employees well can be a decisive factor in a company’s survival, as the study reported in *The Human Equation* described earlier documents.

As with DPI, for companies that appreciate the importance of DP2, implementation is relatively easy when the company is small but requires more structure as it grows. One B-Corp that we visited created a mentoring system that assigned each new employee to an experienced employee. Another company that hired a large number of temporary

The more that employees think of themselves as members of a cooperative group and believe in its mission, the more efficacious the company is likely to be.

<sup>35</sup> Economist Robert Frank explores this theme in his 1988 book *Passions within Reason*.

employees on a seasonal basis to handle peak sales made sure that each was known and referred to by their name and that good work performance would be rewarded by an invitation to return next year or to become a full time employee when positions became available. These efforts were good as far as they went, but there was still room for improvement in the implementation of DP2 by paying explicit attention to it as an important design principle.

**DP3: Collective Choice Arrangements.** Even when employees are well treated, they will justifiably feel left out if they don't play a role in decision-making. In addition, employees often have vital information for making good decisions that is lost when they are not consulted. That's why famously successful corporations such as Toyota make sure to include all employees, including the assembly line workers, in their decision-making processes<sup>36</sup>.

Decision-making can be inclusive without requiring everyone taking part in every decision. What's important is for the process to be regarded as fair, even when not everyone is involved. For example, many decisions can be made by a trusted individual who consults with relevant others as needed. The decision-making circle might need to be widened for some issues and a full-blown consensus process might be required for others. A sizeable literature on group decision-making shows that different problems call for different solutions.<sup>37</sup> DP3 allows for flexibility in decision-making processes, as long as all of them are recognized as fair. Otherwise the company becomes vulnerable to decisions that benefit some individuals or factions at the expense of others and the company as a whole. Knowing that unfair decisions *can* be made undermines employee commitment, even before unfair decisions *are* made.

By our estimation, B-Corps are more variable in their implementation of DP3 than DPI or

In addition to providing material benefits, B-Corps also tended to do a good job at social recognition.



DP2. In some cases a general ethos of fairness extends to decision-making, but other cases conform to a standard corporate model in which decisions are made by the CEO and a small inner circle. The same CEO who has a strong vision of a socially responsible company can be reluctant to share decision-making power with others. The result can be an “I know what's right for us” atmosphere that poisons otherwise excellent employee relations.

**DP4: Monitoring.** A capable business already knows how to monitor its operations, employee

<sup>36</sup>Rother (2009)

<sup>37</sup>Wilson(1997)

performance, and financial performance. B-corps easily extend monitoring to include their social responsibility goals. One that we visited used their B-score as a monitoring tool, seeking to drive it up in the same way as driving up a financial index. The same company calculated a gross happiness index for its employees and used it to improve employee satisfaction. Another B-Corp that we visited had the special mission of employing people who otherwise would have no chance of finding a good job, due to a lack of education, a prison record, and so on. These employees were monitored extremely closely, with weekly performance evaluations to make sure that they were learning and conforming to workplace norms.

Despite generally high marks for DP4, we also found room for improvement. One B-Corp that we visited asked its employees to set their own achievement goals, which sounds like an enlightened policy. According to some of the employees that we met with, however, the pressure to declare ambitious goals was so great that the goals became unrealistic and reflected poorly on the employee during the next performance review.

**DP5: Graduated Sanctions.** Most employees are well meaning, especially if they believe in the mission of their company and feel that they are being treated well. If they fail to meet agreed-upon expectations, then it is because of extenuating circumstances and not mal-intent. A friendly, sympathetic response is called for to address the problem and a harsher response can be interpreted as a lack of trust on the part of the corporation. Nevertheless, chronic lapses cannot be tolerated and some employees do actively try to game the system. Stronger sanctions are therefore required when milder sanctions fail.

B-Corps tend to understand this principle as part of their general trusting relationship with their employees. The B-Corp with a special mission to employ people who otherwise would have no chance of finding a good job was especially exemplary in this regard. It is understood that these employees face extraordinary challenges that must be dealt with sympathetically but also without compromising performance standards. The intense loyalty of the employees is based largely on the fact that they feel understood.

**DP6: Conflict Resolution Mechanisms.** We were unable to glean much information about conflict resolution procedures during our site visits or examination of other B-Corps based on publicly available information. The CEO of one B-Corp that we visited said “we talk shit out”, suggesting that he was relying upon informal conflict resolution mechanisms appropriate for very small groups but unlikely to suffice for larger groups. We suspect that if better information was available, B-Corps might not score higher than conventional companies for DP6 and might even be handicapped by their emphasis on cooperation and trust, which makes it seem as if conflicts will not occur.

As with decision-making, the perception of an inadequate or unfair conflict resolution procedure can erode trust and commitment, even before conflicts arise. Another important point is that conflict resolution mechanisms are sometimes not used even when they are in place. It is therefore important to implement mechanisms that encourage employees to “speak or hold your peace” so that grievances can be aired. Implementing fast and fair conflict resolution mechanisms and making sure that they are used might allow B-Corps to perform even better than they currently do.

**DP7 & DP8: Minimal Recognition of Rights to Organize and Appropriate Relations**

• The intense loyalty of the employees is based largely on the fact that they feel understood.

**with Other Groups.** The last two design principles mark a shift from the internal social organization of a company to the company as an agent in an ecosystem of other agents, including suppliers, customers, competitors, shareholders, governmental agencies, and so on. These other agents can infringe upon the ability of a company to govern its own affairs, which compromises DP7. An obvious example is legislation that requires a company to maximize profits for its shareholders.

Even if a company is allowed to manage its internal affairs, it still must form relationships with other agents in the economic ecosystem (DP8). The most important point to make about this level of interactions is that it reflects the same design principles as interactions among individuals and subunits within a corporation. The design principles are *scale-independent*. This poses both a danger and a challenge for a company that wants to be socially responsible. It can find itself in the same situation as an employee working for a unit or a unit head working for a corporation that lacks the design principles. No matter what the scale, socially responsible strategies will have difficulty surviving unless the design principles are in place.

In his book *The Darwin Economy*<sup>38</sup>, economist Robert Frank describes a social dilemma confronting hockey players that serves as a parable for businesses. Playing hockey without a helmet can lead to dangerous injuries, including permanent brain damage from concussions. But playing without a helmet gives a competitive advantage over playing with a helmet in any particular game. All hockey players would be better off playing with helmets, but none of them can afford to do so if some players are allowed to play without helmets. The solution, of course, is to make and enforce a regulation requiring hockey players to wear helmets. As for helmets, so also for myriad other infractions that are monitored and called out by referees in sports competitions. Is there a single sport that does not require referees?

The business world is awash with social dilemmas similar to the ones confronted in sports. This fact is obscured by the “greed is good” worldview, which pretends that the unregulated pursuit of self-interest is always good and that regulations only get in the way—as if business is the only sport that does not need to be refereed!

Implementing the core design principles is more difficult at the level of an economic ecosystem than within a corporation, but still possible, especially when the nature of the problem is clearly seen. One important point is that the regulations need not be formal and need not be universally applied. Consider how social regulation takes place in small groups. The process is almost entirely informal. Cooperators find each other and band together, avoiding the depredations of non-cooperators. The simple ability to choose one’s social partners is often enough to provide a competitive advantage for cooperators. Non-cooperators aren’t punished; they are simply shunned.

Norms and reputations are key factors in the informal regulation of small groups. A norm establishes agreed-upon behaviors and a reputation establishes compliance to norms. Thanks to norms and reputations, cooperators can find each other and avoid non-cooperators without needing to gain direct experience beforehand.

Moralistic attitudes also play a key role in the informal regulation that takes place in

● Even if a company is allowed to manage its internal affairs, it still must form relationships with other agents in the economic ecosystem.

<sup>38</sup>Frank (2011)



small groups. People are not dispassionate about good and bad behavior. They are strongly drawn to good actors and contemptuous of bad actors. Meting out rewards and punishments become personal pleasures and establishing a good reputation becomes an obsession. In this fashion, small groups tend to run on an even keel without anything resembling formal regulations. The legal scholar Robert Ellickson explores this theme in his provocatively titled book *Order Without Law*<sup>39</sup>.

In principle, this panoply of informal mechanisms can operate at a larger scale. Indeed, they have probably always operated at a larger scale to a degree, another fact that is obscured by the “greed is good” delusion. *Of course* corporations need to cultivate a good reputation to survive in the marketplace. However, the informal mechanisms operate to a lesser degree at the scale of an economic ecosystem than the scale of a small group. Also, when “greed is good” becomes the morally accepted norm, it isn’t even recognized as deviant behavior.

We think that the high performance of B-Corps and other socially responsible businesses can be attributed not only to their internal social organization, but also to the cooperative arrangements and norms that they are establishing at the level of the economic ecosystem, resulting in an upward virtuous spiral. First, they are redefining norms of good behavior in the business world. Second, they are committed to upholding the norms to the best of their ability without becoming beautiful corpses. Third, they are choosing to interact with other agents in the economic ecosystem that uphold the norms. Fourth, they are seeking to establish regulations that force all agents to comply with the norms, whether they want to or not. Organizations such as B-Lab are catalyzing the process by helping to establish the norms, providing an honest reputational signal, facilitating cooperative interactions among B-Corps, and lobbying for legislation. It is encouraging to think that this virtuous upward spiral might already be in progress, accounting for the demonstrated success of B-Corps and other socially responsible businesses in competition with less scrupulous businesses. A clear understanding of the core design principles can make it happen even faster.

Norms and reputations are key factors in the informal regulation of small groups.

Brad Hammonds



<sup>39</sup>Ellickson (1991)

# Moving Forward

The Evolution Institute is playing a leading role in rethinking economics<sup>40</sup> and applying the core design principle approach to a variety of groups, including but not restricted to business groups. We are grateful to B-Lab CEO Jay Coen Gilbert for providing access to B-Corps and to the CEOs and employees of the five B-Corps that met with us. Moving forward, we are interested to partner with single businesses and consortia of businesses to further develop the design principles approach as a way of promoting socially responsible business practices. We end this report by outlining three steps that can be taken right away.

**Step One: Adopt the better theory.** Albert Einstein said: “It is the theory that decides what we can observe”. The world is so complex that we cannot attend to everything, so a theory—broadly defined as a way of interpreting the world around us—is required to tell us what to pay attention to and what to ignore. There is no such thing as a single “common sense”. Every theory has its own “common sense” that makes some things appear obvious, others far-fetched, and others invisible.

For decades, “common sense” in the business world has been dominated by the “greed is good” worldview that emanates from orthodox economic theory and disseminates through business school education. There is now ample evidence that orthodox economic theory has no basis in reality (i.e., its assumptions are hopelessly unrealistic), is incapable of disconfirming itself, and leads to toxic outcomes in the real world. The emperor has no clothes and the sooner this is widely recognized the better.<sup>41</sup>

No one can function without a theory, so rejecting one requires accepting another. The core design principles approach has a much stronger basis in reality (i.e., its assumptions are more realistic), is truly scientific (capable of disconfirming itself), and is far more likely to lead to benign outcomes in the real world. A common response to adopting a better theory is to say “How stupid of me not to have thought of that!” This is what Thomas Huxley said about Darwin’s theory of evolution after learning it for the first time. We hope that the reader might have had a similar response to this report. If so, then step one is to accelerate the rejection of the “greed is good” worldview and the adoption of the core design principles approach as the working theory in the business community. This will be a huge step forward, even before a single new proposition is tested.

**Step Two: Gather data.** The predictions of the core design principles approach are eminently testable. The degree to which a company implements the core design principles can be measured and related to the company’s success at achieving its financial and social responsibility goals. We are encouraged by our review of the business literature, Chen and Kelly’s quantitative analysis of the financial performance of B-Corps, and our qualitative analysis of B-Corps. We also know that much more is needed by way of quantitative analysis. In addition to our ongoing quantitative analysis based on data gathered by B-Lab, we will be creating our own survey based on the core design principles approach that we hope will become widely used.

The degree to which a company implements the core design principles can be measured and related to the company’s success at achieving its financial and social responsibility goals.

<sup>40</sup>See [www.economics.com](http://www.economics.com)

<sup>41</sup>Again, this does not mean that market forces are irrelevant or that monetary self-interest is absent as a motivation. There is a legitimate concept of the invisible hand, but it is very different from the orthodox version (Wilson and Gowdy 2014).

**Step Three: Experiment.** The Evolution Institute has created its own framework for working with groups (including but not restricted to businesses) called PROSOCIAL ([www.prosocialgroups.org](http://www.prosocialgroups.org)). It is an internet platform that can be joined by an unlimited number of groups. Each group receives a home page and an online training course that group members (or a representative subgroup) step through together to learn about, assess, and better implement the design principles. The training course can be repeated at regular intervals to monitor progress. Groups can communicate with other groups and the internet platform provides a scientific database in addition to a practical framework for improving the efficacy of groups. Businesses with a serious interest in learning about and adopting the core design principles approach are encouraged to visit the PROSOCIAL website to learn more. We are also looking for investors to help develop the potential of PROSOCIAL, since we think that it can become an important tool for increasing prosociality and the efficacy of groups worldwide.

“It is the theory that decides what we can observe”.



**PROSOCIAL**  
*the science of working better together*

## About the Evolution Institute



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