

Incentives

Structuring incentives to bring about productive behavior without adverse unintended consequences is challenging. Proper incentives must not only motivate employees to create value and signal what is valued, they must also motivate employees to create that value in a principled manner. To design effective incentives, we must first have an understanding of human action.

Ludwig von Mises posits three requirements must be present for individuals to take action. These are: (1) unease or dissatisfaction with the present state of affairs, (2) a vision of a better state, and (3) belief that they can reach the better state.

We mow our lawns only when we are dissatisfied with their present condition, believe they will look better and know how to mow them. Customers switch when they become dissatisfied with their current supplier, believe another supplier will serve them better and are able to switch. When just one of these requirements is missing, people will not act.

Companies that fail to provide conditions that meet all three requirements create a culture of inaction. Companies that encourage creative destruction, provide a vision of how to create value and facilitate decision making, create a culture of Principled Entrepreneurship.

What any individual employee values is highly subjective and includes both financial and non-financial components. Possible non-financial incentives include belief in what we are doing, challenge, competition, pride, recognition, satisfaction, enjoyment, helping others succeed and being part of a successful team. Our Beaverhead Ranch in Montana provides an example of incentives that are a mixture of financial and non-financial. Recognizing that people don't go into ranching for the money but for the lifestyle, of which a big part is working with their families, the policy of not allowing family members to work on the ranch was changed. Further, houses were built on the ranch for each family. The ranch immediately attracted a far superior work force.

Private Property

Private property is essential for both a market economy and prosperity. There cannot be a market economy without private property, and a society without private property cannot have prosperity. To ensure ongoing innovation in satisfying people's needs, there must be a robust and evolving system of private property rights.

Without a market system based on private property, no one can know how to effectively allocate resources. This is because they lack the information that comes from market prices. Those prices depend on voluntary exchanges by owners of private property. Prices and the resulting profit and loss guide entrepreneurs toward satisfying the needs of consumers. Through this system, consumers are able to direct entrepreneurs in efficiently allocating resources through knowledge and incentives in a way no central authority can.

Countries that clearly define and protect individual private property rights stimulate investment and grow. Those that threaten and confiscate private property lose capital and decline. They also lose the capability and efforts of the individuals who would be the greatest contributors to economic growth.

Problems also arise when property rights are unclear or ill-defined. In such cases, owners don't benefit from all the value they create and don't bear the full cost from whatever value they destroy. Their use of the property will not be optimally focused on creating value in society. In the past, when owners were not liable for injury to person or property caused by pollution, noise or accidents, they made less effort to prevent them. When rent controls have prevented landlords from charging market prices, buildings have been allowed to deteriorate.

The biggest problems in society have occurred in those areas thought to be best controlled in common: the atmosphere, bodies of water, air, streets, the body politic and human virtue. They all reflect aspects of the "tragedy of the commons" and function much better when methods are devised to give them characteristics of private property.

Value Creation

Successful companies create value by providing products or services their customers value more highly than available alternatives. They do this while consuming fewer resources, leaving more resources available to satisfy other needs in society. Value creation involves making people's lives better. It is contributing to prosperity in society.

Value creation is the role of business in a market economy. Businesses that don't create value are not enhancing people's lives. In fact, businesses that destroy value are detrimental to our lives. When businesses make unprofitable products, they are drawing resources away from higher-valued uses, and when businesses waste resources they prevent them from being beneficially used at all. In either case, a business with unattractive returns should be restructured, sold to a better owner or shut down.

The long-term success of a business is determined by how much it is contributing to improving people's lives and prosperity through value creation.

In a true free market, with beneficial rules and property rights, the appropriate measure of the enterprise's value creation is long-term profitability.

A Culture of Virtue

The ability to create real value depends on a principled, entrepreneurial culture in which the members are passionate about discovery. Although employees are selected and retained on the basis of their values and beliefs, they must also have the necessary talent to produce results. Virtue without the required talent does not create value. But talent without virtue is dangerous and can put the company and other employees at risk. Employees with insufficient virtue have done far more damage to companies than those with insufficient talent. Several years ago, a supervisor in one of our plants decided – even after training – that a new government requirement wasn't beneficial. He saw no need to comply with it. We self-reported his violation and also terminated the employee. Both virtue (that is, living by our shared values and beliefs) and talent (the specific skills and knowledge required to excel in a specific role) must be present.