S. Social Impact

Capital has no responsibility toward humans. Capital has no responsibility toward the planet. … and customers do not fall from heaven.

ESCP Impact Paper No 2021-40-EN

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Abstract

The task of management is value creation. However, this does not imply that value creation is the purpose of the corporation. This contribution discusses Milton Friedman's piece in the *New York Times* on "The Social Responsibility of Business to Increase Its Profits" and puts forward reflections pointing to the civic responsibility of the owner (principals) and of the agents (businessmen/managers). It is the responsibility of a business to fulfill its purpose as requested by its principal(s). Managers in their role as agents cannot only pursue increases in profits and shareholder return maximization, even if the owners as principals request them to do so. Owners as principals cannot ask their managers as agents to pursue only increases in profits or shareholder return maximization. Civic responsibilities prevail. In fact, value creation is not and cannot be *per se* the purpose of the corporation. It is the responsibility of a business to engage in open and free competition without deception and fraud. It is not the responsibility of a business to use it resources and to engage in activities designed to exploit humankind and nature.

Keywords: leadership, corporate governance, civic responsibility

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Scholars who propose that "business for good" is an integral part of business purpose, and thus any business activity, are faced with a wall of skepticism and cynicism, especially among those who affirm that the "responsibility of business is to increase profits", and respectively to maximize shareholder returns. The most iconic proponent of the latter idea seems to be Milton Friedman and, in particular, his piece published in the *New York Times* in September 1970.

Milton Friedman's *New York Times* article is based on a series of argumentation lines that might not stand up to the analytical rigor that he calls on businessmen to uphold. If the thinking is flawed, the whole idea might be flawed.

Promoting a Free Society where the principal is not free to choose

Milton Friedman makes several statements that I will question. For example, Friedman writes in the concluding sentence, "This is why … in a free society, there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so longs as it stays within the rules of the game, which is to say, engages in open and free competition without deception [or] fraud." It is not clear why the only responsibility of business should be to use its resources and engage in activities designed to increase its profits. This statement in fact implies that it is not the free choice of the principal to choose what the principal wants the agent to pursue.

It dictates to the principal what the goal of the principal is to be. In a free society, the principal is free to choose its goals so long as he/she stays within the rules of society and bears the consequences of her/his choices. In a free society, a principal cannot be required to increase profits or maximize shareholder return as a goal. The principal might engage the manager "to perform some service on their behalf which involves delegating some decision making authority to the agent" (Jensen and Meckling, 1976: 308) for a very different goal than shareholder return maximization. The manager, even though pursuing the reason she/his was employed for, might very well be hired to pursue another goal, whatever it might be.

Milton Friedan writes, "[i]nsofar as his actions in accord with his 'social responsibility' reduce returns to stockholders, he is spending [the principals'] money." He might well be spending their money in line with their criterion of performance. The statement by Friedman implies that the principal, the proprietor, is seeking to maximize their financial returns. He writes that, "The short-sightedness of [businessmen] is also exemplified in speeches by [them] on social responsibility" as "it helps to strengthen the already too prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces." Friedman does not explicitly state in this sentence that the purpose of the enterprise is to pursue profits; he maintains that a view which does not state that the purpose of the enterprise is to pursue profits is to be considered incorrect. Consequently, Friedman implies that the purpose of the enterprise is to pursue profits; in fact, he posits this in his title by affirming that "the social responsibility of business is to increase profits." There is no reason why pursuing profits should be the purpose. Stockholders provide capital to the enterprise to fulfil its purpose. This does not imply that the purpose of the enterprise is set to be the pursuit of profits.

According to Milton Friedman, "[w]hat does it mean to say the corporate executive has a 'social responsibility' in his capacity as businessmen? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employer." The degree to which this statement by Friedman is correct depends on the degree to which the criterion of performance is financial. If the proprietor defines the criterion of performance as one which exhibits 'social responsibility', then the businessman is acting in the interest of his employer. Only if the criterion of performance of the proprietor is purely financial is the businessman not acting in the interest of his employer. Friedman writes, "in his capacity as a corporate executive, the manager is the agent of the individuals who own the corporation … and his primary responsibility is to them", and he adds: "Needless to say, this does not mean that it is easy to judge how well he is performing his task. But at least the criterion of performance is straightforward." It might very well be that the criterion of performance is straightforward; but this does not imply that the criterion of performance is required to be financial. The principals define the purpose of the corporation, not economists.

Confusing the task of management with the job of management

The thinking that maximizing shareholder returns is the purpose of business confuses the task of managers with the job of managers. It is to confuse the piece of work that managers need to get done with the duty of managers. Managers need to generate more revenues than produce costs; this does not have to imply that the reason for which managers are employed is to increase profits or maximize shareholder returns. There is no reason, or hardly any reason, from a conceptual point of view, to hire a manager if the resultant activities performed by the hired manager produce more costs than revenues or generate (discounted) negative cash flows. Thus, the task of management is to create value, whether the managers work for a non-profit organization or for a profit seeking entity, unless the principal explicitly states that this is not the case. The fact that the task of management is to create value does not have to imply that managers are employed to pursue the goal of profit maximization or shareholder return maximization. Jensen and Meckling (1976: 314), in their groundbreaking contribution, made the assumption that "no owner gains utility from ownership in a firm in any other way than through its effect on his wealth or cash flows"; this assumption was made in the design of the mathematical model they put forward. There is no logic in assuming that the input variables considered in a mathematical model are input variables for businessmen to use resources and engage in the activities of managerial practice. The task of managers (managers as agents) is to create value. This does not imply that the job of managers (managers as agents) is to create value.

It is to be noted, though, that the assumption that the responsibility of businessmen is to increase profits or to maximize shareholder returns might hold true for some owners. There is no reason to assume that this supposition is correct for all owners. This statement does not mean that Jensen and Meckling (1976: 314) were not right in making the assumptions they made to demonstrate what they set out to demonstrate. In fact, they did a service to the academic community through their work. Their work was the most cited article in corporate governance research over certain periods (Durisin and Puzone, 2009) and, over a period of three decades, even among the most cited contributions to Business Ethics (Calabretta, Durisin, and Ogliengo, 2011). Then again, it is not because Jensen and Meckling (1976: 314) made those assumptions that owners also need to make such assumptions. It is not because Jensen and Meckling (1976), for reasons of theoretical modelling, do not include the manager's civic responsibility to society that a manager does not have a civic responsibility to society.

Capital has no responsibility toward humans. Capital has no responsibility toward the planet.

It is the principal who makes the monetary investment in the corporation of which the businessman is the agent. Even though it is clear that any investment is fraught with risk, it is not clear why individuals (and consequently principals as individuals) are required to seek a return on the investments they make. They are not. Individuals do not do so on so many occasions in their daily lives. Individuals make many monetary investments in many activities and in many relationships without seeking a financial return on the investment. Many investments in social relationships, many investments in cultural and sporting activities do not seek a (financial) return. Some individuals might seek a return on an investment; other individuals might not seek a return. In a free society it is up to individuals to choose whether they seek a return or not.

It is not clear why the scope of a monetary investment in a corporation has to be to reward the risk, whatever the kind of risk taken on. This is not to question *per se* the assumption that an investment is fraught with risks, that different investments exhibit different risks and that therefore differences in risk profile are to be rewarded differently if this is what the investor is seeking. At the same time, it is not clear why this argument has to imply that each monetary investment made is required to have as a goal a maximization of the financial return given the investment's risk profile.

Hart and Zingales (2017: 263) note that "[t]here is considerable confusion … [and] that part of the confusion is that the academic literature itself is confused." Consequently, there is academic literature noting that maximizing shareholder returns or market value is not the same as maximizing shareholder welfare and analyzing conditions under which corporations rather than political institutions should enact political change (e.g., Elhauge, 2005; Bénabou and Tirole, 2010; Hart and Zingals, 2017). The argument put forward here is not to distinguish between shareholder welfare and shareholder value asserting that shareholder welfare should be pursued. The argument put forward here is that individuals as principals and as agents cannot put a responsibility on capital that capital does not have. Principals cannot claim they are required to reward the risk of the investment. Agents cannot claim that the capital investment made by the principals requires them to maximize shareholder returns *per se*.

Human beings have responsibility, capital does not. Money is the foundational medium of exchange in our developed societies. Capital in the form of money as a medium of exchange or of value storage does not exhibit any responsibility. Principals as human beings have responsibilities. Agents as human beings have responsibilities. The very fact that money has no responsibility implies that humans are required to take on their responsibilities. Arguing that humans (as agents or as principals) have the responsibility to reward to the greatest extent the risk of a monetary investment (in a corporation) implies giving responsibility to money that money does not have. Money (or a monetary investment) does not require reward. No principal has the obligation *per se* to maximize returns on the capital invested. Individuals may choose to want to reward money (or a monetary investment). It is a human choice; it is not an obligation. It is a choice; it is not a responsibility. Individuals cannot logically claim that their individual choices become an obligation.

Humans have responsibilities toward other humans and they have responsibilities toward the planet. It is their duty in society to take on those responsibilities "conforming to the basic rules, both those embodied in law and those embodied in ethical custom." This implies that even if the principal were to ask the agent to only pursue an increase in profits or shareholder return maximization as a goal, the agent would be unable to pursue only this goal given her/his civic responsibilities. Further, it implies that principals cannot ask the agent to only pursue an increase in profits or shareholder return maximization as a goal, given her/his civic responsibilities. Individuals can make choices and individuals have responsibilities toward other humans and toward the planet.

Customers do not fall from heaven

Corporations cannot lay a claim to their existence because their owners are seeking shareholder return maximization and are only gaining "utility from ownership in a firm in [no] other way than through its effect on his wealth or cash flows" (Jensen and Meckling, 1976: 314). Given civic responsibilities, it is not logical of investors as principles to hold businessman responsible only for shareholder return maximization. It is not logical to ask the agent to be responsible only for shareholder return maximization; they have civic responsibilities, too. Further, it is not clear why customers should spend their money on the offerings of companies whose leaders they perceive as aiming at exploiting them and as being agents that do not fulfill their civic responsibilities.

Milton Friedman states that "[i]nsofar as [the businessman's social responsibility] actions raise the price to customers, he is spending the customers' money." The reasoning behind this statement is unclear: the businessman is not spending the customers' money; the businessman is spending money that belongs to the corporation. It is the free choice of the customers to spend their money on the offering of the corporation and to pay the price(s) that the corporation charges. It is rather the other way around: it is not clear why companies should take it for granted that customers would reward companies that seek to maximize shareholder returns with their business.

The reason for any corporation to exist in a competitive marketplace must be earned and re-earned. Corporations need to earn the customer's business. Customers are the only reason to engage in business activity, or, paraphrasing Peter Drucker (1973), the purpose of business is to acquire, keep, and grow customers. Customers do not fall from heaven; they need to be acquired, kept, and grown in the competitive marketplace through the conduct of the corporation and the activities it engages in. Business can only exist if customers do not object to their conduct and reward them with their purchases or usage.

Isn't it enough for my local bar to seek income through serving a good cup of coffee or for my local baker to provide me with bread simply in order to earn revenue? Of course, principals might deploy capital to increase profits. The argument here is not to state what principals are required to pursue. Yet, proponents of the shareholder return maximization doctrine require principals to deploy capital with the sole objective to increase profits. The principal of the local bar might seek income by serving coffee. The principal of another bar might aim at being recognized as offering sustainably grown, harvested, and delivered coffee while seeking an income. The proponents of the shareholder return maximization doctrine require principals to build relationship with customers with the only scope of exploiting customers to the maximum extent. Any relationships with customers are built with the aim of extracting as much cash flow as possible from them. Individuals build relationships with other individuals to exploit them.

Of course, it is the choice of customers to reward companies with their business. Some individuals given their preference set might reward corporations maximizing shareholder returns; others might not. As our societies evolve, laws, customs, and etiquette evolve with them. Ultimately, individuals cannot claim to be legitimate when they replicate a behavior that previously went unquestioned. Citizens alter their conduct as the state of affairs evolves, and conduct once considered authoritative might no longer be deemed acceptable (Arendt, 1958). For proponents of the shareholder return maximization doctrine, the social responsibility of business is to exploit customers; ultimately, it is to exploit humankind for their private profits. “And we have only for a moment to imagine what would happen to [the doctrine (of shareholder return maximization)] if enough people would … refuse support, even without active resistance or rebellion, to see how effective … this would be” (Arendt, 1964: 47). Companies claiming that they are in business to maximize shareholder returns might no longer be considered “worthy” of the customer’s money, as expressed by customers in their choices.

The proponents of the shareholder return maximization doctrine regard the customer only as a means to an end. Accordingly, corporations are not in business to obtain a return from offering a superior benefit to their target customers; corporations are in business to build a portfolio of customers generating the highest obtainable cash flows, either directly through their cash flow contributions or indirectly through their customers’ knowledge, influence, and referral value, which in turn maximizes cash flow generation. Capital is no longer regarded as a means for the enterprise to serve customers; customers are there to serve capital, to maximize shareholder returns. Customers might well object to reward companies that seek to maximize shareholder returns with their business. It is not clear why companies should take it for granted that customers would reward companies with their business if the only reason for companies to build relationships with them is to exploit them.

Concluding comment

Managers in their role as agents cannot only pursue increases in profits and shareholder return maximization, even if the owners as principals request them to do so. Owners as principals cannot ask their managers as agents to pursue only increases in profits or shareholder return maximization. Civic responsibilities prevail. It is the responsibility of a business to engage in open and free competition without deception and fraud. It is not the responsibility of a business to use it resources and to engage in activities designed to exploit humankind and nature. It is the responsibility of a business to fulfill its purpose as requested by its principal(s). The Responsibility of a Business is Not and Cannot *per se* Be to Increase Its Profits.

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