

# Corporate Responsibility á la Milton Friedman

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Recent debacles have brought old debates about the obligation of business to society back into sharp relief. In his celebrated 1970 article entitled *The Social Responsibility of Business is to Increase its Profits* (NYT Magazine), Milton Friedman wrote that a corporate executive's 'responsibility is to conduct the business in accordance with [the owners'] desires, which generally will be to make as much money as possible'. That idea, and the article's title, is how people remember the Friedman logic. It has shaped received wisdom in business education and practice for over forty years.

So large is the power of simple ideas, and so sticky the authority stamp of scholars like Professor Friedman, that the wisdom tied to his name refuses to give way to a truer one ... one that he himself provided in the same article. Worth revisiting, his ideas have the power to change received wisdom once again.

Revisiting clarifies why, in fact, corporate social responsibility and exclusive pursuit of profit should not be equated, and why so many of us cringe at the suggestion. Take the quote above about making as much money as possible. Friedman's phrase does not actually end there. Rather, it ends with 'make as much money as possible *while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom* [italics added].'

Put differently, the ideal of maximizing profits is subject to a constraint that must be satisfied. If an executive stands to make \$1 billion by circumventing an ethical norm, then according to Friedman's own 'conforming' requirement, she should refrain from doing it, even though she has a responsibility to the company's owners. Why? In Friedman's eyes, respect for ethical custom takes precedence over profits. This puts a sharper point on Friedman: Yes, foregoing a dollar of profit when doing so will not compromise the law or ethical custom is, as he put it, theft against the shareholder. But when doing so compromises ethical custom, maximizing profits is not the rule. Stakeholders other than shareholders deserve consideration.

This leads to a useful definition of corporate social responsibility. Concretely, Friedman specified two constraints on the pursuit of profits: law and ethical custom. Suppose there is a firm whose profits would be \$1 billion by disregarding both law and ethical custom, \$800 million by disregarding only ethical custom, and \$600 million by abiding by both law and ethical custom. According to Friedman, the executive should choose \$600 million. We can call the company that earns \$800 million a law-abiding company, and a company that further abides by ethical custom (as mandated by Friedman) a socially responsible company. Corporate responsibility here is the morally driven exercise of profit restraint.

Though 'ethical custom' can be a tricky term, in most societies it matches principles from two schools of thought in Western moral philosophy, both of which incorporate the interests of other stakeholders. The Utilitarian school defines the moral path as one where actions promote the well-being of society at large. The Kantian school defines the moral path as one where actions preserve the autonomy of others to attain their ends.

If theft against the shareholder is wrong, as Friedman so compellingly argued, then by the same logic, theft *for* the shareholder is also wrong. Theft for the shareholder is what happens when companies deplete collectively owned resources, like clean air, clean water, animal species, or climate balance, without compensating owners. Companies that refrain from such theft out of an ethical commitment to social well-being are exercising a morally driven restraint on profit-making. They become socially responsible companies in a way that fits our definition as derived from Friedman himself.

To cite Friedman's celebrated article and adopt the view that maximizing profits in an unconstrained way is one's only responsibility is to cite him wrongly. The classic 'shareholder versus stakeholder' debate does have a resolution: To be aligned with Mr. Friedman's true wisdom, stakeholders must be part of managers' decisions so that firms internalize the wider consequences of their actions.