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Craig P. Dunn

Western Washington University, craig.dunn@wwu.edu

Brian K. Burton

Western Washington University, brian.burton@wwu.edu

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FRIEDMAN'S "THE SOCIAL RESPONSIBILITY OF BUSINESS IS TO INCREASE ITS PROFITS": A CRITIQUE FOR THE CLASSROOM

Craig P. Dunn and Brian K. Burton
Western Washington University
516 High Street
Bellingham, WA 98225-9075
360-650-2593 (Dunn)
360-650-3389 (Burton)
Craig.Dunn@wwu.edu
Brian.Burton@wwu.edu

Abstract:

Keywords:

Milton Friedman's 1970 article "The Social Responsibility of Business Is to Increase Its Profits" is likely one of the most assigned, and most debated, papers in social issues pedagogy. Written 35 years ago, it was not an academic paper (published in the *New York Times Magazine*). However, academics (especially in the field of Business & Society) have been responding to it, in print and in the classroom, since its publication (for examples, see DesJardins and McCall, 1990; Mulligan, 1986).

Friedman was attempting to debunk the notion, beginning to gain traction at the time, that corporations (and thus the managers who work for them) have a responsibility to act to increase social welfare, regardless of the law on the issue at hand (whether that issue be discrimination, pollution, or something else). In his view, managers have a moral responsibility to act always in the long-run best interest of the shareholders. He is not arguing that businesses should never engage in activities that increase the social welfare; in fact, he argues that free-market capitalism itself increases social welfare. He also notes that businesses certainly will engage in activities that will increase social welfare. However, in Friedman's view the manager's *sole* motivation for such engagement must always remain long-term increase in shareholder wealth.

Although Friedman's arguments have been examined, no such examination has satisfied an important need—to structure such an examination in a classroom situation. This paper gives such a structure, built around 10 statements made by Friedman that can be debated in class. These 'target statements' are subjected to analysis in the form of sample critiques that could be advanced, each linked to a learning objective concerning the target statement.

"Corporate social responsibility is pure and unadulterated socialism."

Learning Objective: *Articulate the advantages and disadvantages of organizing production and distribution of goods and services according to capitalistic or socialistic models.*

Sample Critique: Friedman here immediately assumes the reader is convinced, as is Friedman himself, that socialism in all its forms is necessarily evil. But it is not the case either that the reader is convinced that socialism is evil, or that socialism actually is evil (or unethical). In terms of distributive justice—an issue neither explicitly addressed nor intended as an outcome within the free-market model—in certain instances a socialistic approach to distribution of goods and services has some clear advantages. We do not generally, for example, let the market determine who receives the scarce resources of transplantable organs. Instead, we rely on a “command economy,” or at least a hybrid of capitalism and socialism. We do the same with child adoption. While the free market does a masterful job of creating aggregate wealth, a benefit each of us enjoy, the system also reinforces and in fact exacerbates wage and class distinctions that some would brand evil.

“Only people have responsibilities.”

Learning Objective: *Distinguish legal and social responsibilities from ethical and moral responsibilities, especially as applied to organizations.*

Sample Critique: In the passage preceding the above statement, Friedman speaks of social responsibilities, while in what follows he simply speaks of responsibility generically. This is not a meaningless distinction, for implied in Friedman's argument is the notion that because businesses are not moral persons, they cannot therefore have responsibilities. This is true enough if Friedman were speaking of moral responsibility: since businesses are ‘legal fictions’ and not moral persons, they can have no moral responsibility. However, Friedman's argument lacks rigor in that he never carefully distinguishes between moral and social responsibility. While it may be true enough that institutions, including business, carry no moral responsibilities, one can not conclude from their lack of moral personhood that institutions have no social responsibilities. In “The Elements of Moral Philosophy,” Rachels (2002) provides readers with a useful definition of social contract theory: “Morality consists in the set of rules, governing how people are to treat one another, that rational people will agree to accept, for their mutual benefit, on the condition that others follow those rules as well.” While seeming to deal only with the actions of persons, the notion of the social contract can easily and legitimately be extended to institutions as well (as has been done in the social issues literature [e.g., Donaldson and Dunfee, 1994]). If, for example, one of these contractual rules were that individuals not knowingly harm one another, this dimension of the social contract would be in force within society at large—and would place legitimate social (although not necessarily moral, in spite of the first word in Rachels' definition) responsibilities on the conduct of business by owners and managers alike.

“The manager is the agent of the individuals who own the corporation...and his primary responsibility is to them.”

Learning Objective: *Discuss whether the manager's duty to shareholders can be overridden by the manager's more fundamental duty to other stakeholder(s).*

Sample Critique: Friedman notes that the corporate executive has direct responsibility to his employers, the shareholders. He is also careful to argue that this is not necessarily the manager's sole responsibility; there is, after all, the duty to conform to the basic rules of the society.

Nonetheless, Friedman emphasizes the concept of agency in arguing that the manager's most direct obligation is to conduct business in accordance with the desires of shareholders. Friedman is here reinforcing the libertarian view that “desires” are not the appropriate subject of moral scrutiny. If shareholders “desire” profit, so be it. If consumers “desire” high-fat foods, or environmentally-destructive products, or sex-for-hire, so be it. It should be noted that agency has historically been invoked as an excuse for a number of questionable moral practices—including at the margin such atrocities as the extermination of Jews by Nazis. We as a society are increasingly dissatisfied with the claim often proffered in such circumstances that the individual(s) most directly involved in such atrocities were merely following orders. Are not orders appropriately questioned? A more sophisticated analysis would give some clearer direction as to the circumstances which might permit—or even require—managers to override their fiduciary responsibility to shareholders. For example, with respect to a classic business ethics case—that of the Ford Pinto—it is apparent to even the most jaded devotee of free-market capitalism that the right of the customer to life is more foundational than a shareholder’s right to profit, and that therefore the relatively costly fix is the morally correct action.

“To say that the corporate executive has a ‘social responsibility’ ...must mean that he is to act in some way that is not in the interest of his employers.”

Learning Objective: *Explain the relationship between economic and social returns from a managerial perspective.*

Sample Critique: Friedman makes an interesting claim here: that social responsibility necessarily comes at the expense of the interests of employers, or shareholders. This is a fairly common belief—essentially that economic returns and social returns are inherently at odds with one another from a manager’s perspective. But is this always and everywhere the case? Numerous examples might be offered of companies which simultaneously pursue profit while respecting their social responsibilities; the Business Enterprise Trust has documented a host of these (e.g., Bollier, 1996). To cite only one example, 3M has saved more than \$100 million through its 3-P (Pollution Prevention Pays) program. None of the efforts were either legislatively mandated nor a matter of social custom or contract. Yet 3M raised the bar, and is finding both economic and ecological benefits in the process. We would also argue that Friedman has chosen the easy examples here by using price increases, reducing pollution below the legal limit, and hiring hard-core unemployed instead of better-qualified workers. He is apparently hesitant to address the toughest issues, such as the responsibility American companies might have for the health impacts on Taiwanese employees related to the exportation of toxic and/or hazardous waste such as lead-acid batteries. Issues of modest price raises or hard-core unemployment pale in comparison to the tragedy of international human rights violations. The former are easily explained in a free-market system; the latter become more difficult, and the solution is more long-term in nature, leaving a troublesome (for the free-market advocate) sense that more can and should be done.

“The [socially responsible] executive is in effect imposing taxes.”

Learning Objective: *Discuss the distinction between treating stakeholders as means to the end of maximizing shareholder wealth and treating stakeholders as ends in themselves.*

Sample Critique: Friedman here invokes an interesting metaphor, which is used throughout the remainder of his treatise. It is a metaphor of private taxation, carried out at the behest of corporate managers. It is correctly acknowledged that the spending of corporate assets by managers is only a problem to the extent that managers exercise their discretion in a manner which is at odds with the interests of those constituencies which the manager represents—just as the spending of public monies by bureaucrats is only a problem to the extent that bureaucrats exercise their discretion in a manner which is at odds with the interests of citizens. But who are the constituencies to whom managers owe some duty? One would think Friedman would argue they are shareholders, since he has previously stated managers have a direct or primary obligation to owners. However, Friedman is not content to stop here; he mentions the interests of customers and employees as well. A careful reading of the passage suggests that Friedman goes so far as to explicitly state—not merely suggest by implication—that managers are agents of customers and employees as well as of shareholders. What is the source of this agency? Is it through conformance to the "basic rules of the society, both those embodied in law and those embodied in ethical custom"? It does not seem so. Is it through a more generalized notion of social responsibility? This appears to be what Friedman is arguing; after all, he has invoked a social—and peculiarly public policy—metaphor to develop his position on managerial responsibility. However, Friedman could mean that customers and employees have interests of importance to the manager only insofar as those interests affect shareholder wealth. This distinction is subtle and difficult to explain to some students, but it is vital in getting them to understand the differences in behavior that can result from differences in fundamental philosophies.

“[T]he doctrine of ‘social responsibility’ involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses.”

Learning Objective: *Distinguish between relevant forms of corporate governance; also, discuss the role of the corporate manager in the broader political environment.*

Sample Critique: Friedman seems to be arguing here that we can't rely on managers to make political decisions, because there are no countervailing powers to restrict the exercise of managerial discretion. Let us remember that Friedman, as with others holding to conservative libertarian moorings, is mistrustful of government. This makes the argument here presented especially curious, for a logical extension of Friedman's logic would lead to the conclusion that public bureaucratic decision-making, with its accountability (eventually and indirectly) to the voters, is to be preferred to decision processes implemented in the political sphere but by managers operating within the unregulated private sector and thereby having no accountability. He certainly wants managers to concentrate on business decisions and leave political decisions to their elected representatives and the appointees of those representatives. Inherent in this is the notion that managers should stay out of the political process, let others make the rules of the game, run their firms, and abide by those rules after they have been made. Friedman advances as a reason for this that managers cannot know the consequences of their actions in the political realm for the society at large. However, the basic position of his political orientation is that no one knows the broader consequences of an action for society (Sowell, 1987). Friedman does not make clear why managers should be less able than others to make such decisions, or at least

participate in the process. Indeed, it can be argued that as people educated in the analytic decision process, managers could have much to contribute to the political decision process.

Friedman is correct that the social responsibility doctrine takes explicit recognition of the political nature of business decision making, even if we are looking at the narrow view of decision making within a business. Berle and Means (1933) recommended that organizational decision processes evolve into a “purely neutral technocracy.” This conclusion was based upon their argument that under conditions of separation of ownership from control managers can not be relied upon to faithfully discharge their duties to shareholders. Neo-classical economists and agency theorists alike have extended this reasoning, but all hold in common the belief that managers are not trustworthy. One remedy for such 'moral hazard' is to explicitly involve affected stakeholders in managerial decision-making at the highest levels of the organization, likely making the decision process more political than otherwise. Many German companies, for example, subscribe to the principle of co-determination, which requires employee representation on corporate boards. Regardless of whether it is socialism, the pertinent question is whether this is a good policy. Does it have the effect of leading to a good society, rather than merely a wealthy one?

“The great virtue of private competitive enterprise [is that] it forces people to be responsible for their own actions and makes it difficult for them to ‘exploit’ other people for either selfish or unselfish purposes.”

Learning Objective: *Explain the controls, or lack thereof, placed on managerial behavior by the free-market system.*

Sample Critique: There is ample evidence in the managerial, neo-classical and agency literature that private competitive enterprise does not make it difficult for managers to “exploit” other people for their selfish purposes. In fact, the very people who are the easiest to exploit are those individuals to whom Friedman argues managers have the most direct and primary duty—the shareholders. And by using an agency argument earlier in his article, Friedman shows he must be aware of this line of thinking and the resultant possibility of moral hazard. Managerialists speak of breaches of trust; neo-classical economists speak of managerial shirking; agency theorists speak of opportunism. In all cases, some explanation is offered as to why the corporate form persists when it allows for managerial inefficiency—representing an expense to corporate owners. It is well known that managers appropriate corporate resources for their own selfish ends through engaging in on-the-job consumption. CEOs have been roundly criticized for exacting excessive salaries from Boards of Directors—boards whose membership in very many cases has been carefully orchestrated by corporate managers. In theory these managers could be fired for such actions, bringing in some measure of accountability, but in practice this would lead to a revolving door and relatively high transaction costs for the firm and its shareholders. If control of managerial discretion is “the great virtue of private competitive enterprise” we are left to wonder what the lesser virtues of the system might be.

“In a free society, it is hard for ‘evil’ people to do ‘evil’.”

Learning Objective: *Evaluate the state of society in two cases: where majority rules absolutely, and where the will of the majority is checked by an institution applying objective standards of human behavior.*

Sample Critique: Let us look at the assumptions undergirding Friedman's argument leading to this phrase. Both democracy and capitalism respect personal liberty; therefore, these organizational schema are to be preferred to other available alternatives. Within a democratic system, the majority set the rules—or so Friedman argues. But democracy is more than majority rule. Democracy is majority rule coupled with respect for minority rights. The exclusive focus on the collective will of the majority would as easily allow for the dismissal of the entire judicial branch of government as it would allow for the dismissal of corporate social responsibility. We would hope that in a democratic society judicial action, prompted by the minority and taken by judges, would be used to prohibit unjust employment discrimination, to use just one example, even if the majority of the populace favored such bias. Simply stated, the majority are sometimes wrong. As to the statement itself, it does not seem particularly difficult for "evil" people to do "evil" in a free society. We see examples of it every day. What is most curious is the use of quotation marks around both of the times "evil" appears in the sentence. The implication is that Friedman believes there is no such thing as objectively evil behavior. To claim (as Friedman also does, in the continuation of that sentence) that one man's good is another's evil emphasizes that implication—in fact, it comes very close to stating that view explicitly. Friedman fairly clearly implies that might makes right in this statement. It is well worth exploring what that implication means for citizens and managers in a democratic society, if it is followed by members of that society.

“Once this view [of social responsibility] is adopted, the external forces that curb the market...will be the iron fist of Government bureaucrats.

Learning Objective: *Explore the likely outcomes of socially responsible behavior in terms of government action versus the likely outcomes of irresponsible managerial actions.*

Sample Critique: When all else fails, resort to an ad hominem argument. This is as blatant a breach in logic as one is likely to find, and needs no further denunciation. With respect to the claim that corporate socially responsible behavior is likely to be a lightning rod for governmental regulators, one could more persuasively argue to a conclusion exactly the opposite of that arrived at by Friedman. Corporate misbehavior tends to impose costs on society—negative externalities which are borne by ordinary citizens. Public agencies often seek reparations for these unintended consequences of corporate activity; in fact, beyond seeking a remedy for past harms the motivation for much governmental regulation has been the prevention of future corporate malfeasance. The passage of the Sarbanes-Oxley Act, a legislative action that might be considered less than an unmitigated good, is an example such behavior by public agencies. Corporate socially responsible activity as a form of self-regulation is more likely to result in avoidance of government regulation, rather than to provide the impetus for such regulation. If managers at Enron, WorldCom, and their corporate brethren would have behaved in a socially responsible manner—under any definition of the term—Sarbanes-Oxley would never have existed.

“The doctrine of ‘social responsibility’ taken seriously would extend the scope of the political mechanism to every human activity.”

Learning Objective: *Discuss the implications of corporate social responsibility for managerial and political decision making.*

Sample Critique: It is not clear that the social responsibility doctrine would reduce every decision to a political decision, any more than would the logical extension of Friedman’s argument regarding democracy and capitalism discussed above. But if by this Friedman means that in all our affairs, as moral persons, we ought to be concerned with the collective good and the well-being of others, this would not be a bad thing. What it means to be moral is to live one's life with explicit reference to a concept of the good. Absent such a concept, life itself loses both purpose and thereby meaning. Ultimately, pursuit of the good society is an individual quest with personal meaning for each of us. It may be that it is only in the search for the collective good that we liberate ourselves...

TEACHING SUGGESTIONS

Many approaches could be used in a classroom setting. For example, groups of students could debate the issue. Students could be forced to argue one side, then the other. A more general conceptual discussion could take place with the entire class. A case situation could be used to ground the discussion. What we have chosen to do is to have students work in pairs to take a position on whether or not they *agree* or *disagree* with each statement, and more importantly present the *logical rationale* for their position. Following this critique, the entire class is engaged in a collective discussion of each statement.

We believe such an important piece of writing as Friedman’s “The Social Responsibility of Business Is to Increase Its Profits” should be subjected to strict scrutiny in classes—especially those concerned with the general topic of Business & Society—to ensure that students have a nuanced view of the arguments for and against its stance.

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