Shareholder Theory (Martin Friedman)

<u>Shareholder Theory:</u> Given that businesses are moral individuals—or at least can be treated as if they were—we can now ask: What moral obligations, if any, do businesses have? This week, we will look at one answer to that question: "None!" Martin Friedman believes that businesses do not have any moral obligations or social responsibilities at all, other than to maximize their own profit. This view is called "**Shareholder Theory**".

<u>Stakeholder Theory:</u> Next week, we will look at a different view: One which states that businesses DO have social responsibilities; for instance, businesses have a responsibility to not detract from the well-being others, and perhaps they are even obligated to charitably PROMOTE the well-being of others. This view is called "**Stakeholder Theory**", and is held by philosophers such as R. Edward Freeman.

<u>What are the "Social Responsibilities" in Question?:</u> What does it mean for a business to "promote the well-being of others"? Well, this can be something obvious, such as donating money to a local charity, or soup kitchen, or orphanage, etc. But, it can also take a less obvious form: For instance, a business might spend a little more money on sturdier parts in order to guarantee that the product they're selling will last longer for their customers, and be less likely to break. Or, it might be more forthcoming about the contents of some food item, or the process by which it was made, in order to keep the customers better informed, even though this might ultimately mean that fewer customers will buy that product once they learn these things. These sorts of decisions, in addition to just simply improving the local community directly, are some examples of good things that businesses can do for the public.

<u>1. The Goal of a Business is to Profit:</u> Businesses sell products to others (e.g., goods or services). When doing so, businesses have to decide the answers to these three questions: (1) **What** product shall we make? (2) **How** shall we make it? And (3) **For whom** shall we make it? The answers to each of these questions are nearly always motivated by one, and only one thing: **Profit**.

(1) **<u>What</u>** <u>product shall we make?</u> When deciding WHAT to produce, businesses will generally base their decision on what the DEMAND is. This is because selling a product for which there is a demand is the best way to ensure a profit. If you are trying to sell something that no one wants, no one will buy it—at least, not for more than a few pennies.

(2) **<u>How</u>** <u>shall we make it?</u> Businesses generally make their decision of HOW to manufacture their product based on what would be the most efficient and cost-effective. If it costs you a fortune to manufacture your goods, you will be forced to sell them at very high prices to avoid losing money on the venture. On the other hand, goods that are made more cost-effectively will be able to be sold at a lower price and will therefore be easier to sell, and so will ensure profits.

(3) **<u>For whom</u>** <u>shall we make it?</u> When it comes to the question of WHOM one should try to sell their goods to, the answer is based on profit. Generally, a business will try to sell their goods or services in a place for which there is a NEED or DESIRE for them, and also a SHORTAGE. For instance, it would not make much sense to open a grocery store next to another grocery store. But it WOULD make sense to open one in a town that didn't already have one, but needed one badly, since this would guarantee profits.

<u>2. Shareholder Theory:</u> It is clear that the GOAL of most businesses is to profit. Put simply, a business that does not profit will not be a business for very long. Rather, they will inevitably go OUT OF business. But, we can ask this question: Are there any OTHER goals which businesses are obligated to pursue? Milton Friedman answers "No" to this question, and proposes the following view:

> **Shareholder/Stockholder Theory:** The ONLY obligation that businesses have is to profit.

Why would this be? First, let's define **shareholder**: Shareholders (in some places called "**stockholders**") are those individuals who OWN a business, or a part of a business. For instance, they might own shares of stock in a business. As owners, the shareholders of a business have employed certain managers to run their company for them; and, claims Friedman, there is but ONE goal that they have set for these managers to achieve: **Profit**. For, as we saw above, the primary purpose of a business is to profit—recall that, if a business does not profit, it inevitably fails. Therefore, since the sole PURPOSE of a business is to profit, and since the sole desire of those who OWN businesses is that their business profit, Friedman concludes that employees of any business are obligated to do one and only one thing: **Maximize that business's profit**.

3. Non-Maximization of Profit Is Wrong: So far, Friedman has stated that businesses are not **obligated** to seek anything other than the maximization of profit. But, Friedman goes even farther: He goes so far as to suggest that any employee who does anything OTHER than maximize profit for their employer is doing something wrong. Similarly, if anyone (e.g., the government) REQUIRES a business to seek something other than profit, they are also in the wrong.

Why is this? As we have just seen, Friedman points out that the managers and executives within businesses have been hired by the shareholders or stockholders who own a company for one and only one purpose: To acquire **profit** for that business. These shareholders OWN that business, and when IT does well, THEY do well; i.e., the owners PROFIT when the business profits. But, any instance of an employee of some company seeking something other than profit (such as common goods for society) will require that employee to **take away from that business's profit**. In other words, in order to promote the common good in society, a business must SPEND some of its profit in order to give back to the public—but **this is stealing**. The profit rightfully belongs to those who own the company. Promoting the public good therefore requires **stealing from the shareholders who own the company**.

Alternatively, taking money from the company in order to make others better off can be seen as a form of TAXATION. By forcing a company to give some of its earnings to the public, we are essentially imposing a TAX on that company, and then using that tax money to help others, improve the community, etc. But, businesses are ENTITLED to their earnings. They rightfully earned their profit, so any case of taking some of that profit away is THEFT. So, taxation is unjust. Furthermore, the earnings of businesses are ALREADY taxed by the government to fund public goods—so they have already fulfilled their social responsibilities. Requiring that businesses fulfill ADDITIONAL social responsibilities is essentially DOUBLE theft; and this is even more wrong.

4. Other Reasons to Adopt Shareholder Theory: There are some other reasons to think that businesses are not responsible for taking moral reasons into account when making decisions. Here are a few of them:

(a) Selfish Businesses Actually Promote Overall Well-Being: As it turns out, a business acting PURELY out of self-interest WILL end up promoting the overall well-being of the community around them. For instance, businesses have self-interested reasons to **not harm** others, since a business which mistreats its employees, or is rude to customers, or sells them harmful defective products is a business that is unlikely to do very well. But, businesses might even have further reasons to **benefit** others around them, since a business that improves the local community is more likely to attract better employees from around the country, and more customers to the area. This thesis is known as **The Invisible Hand** argument, since it proposes that some "invisible hand" will guide even a completely unregulated market for the betterment of society as a whole.

(For instance, consider the downtown initiative in Columbus, MS, to improve Main Street, build the riverwalk, preserve historic sites, organize the farmer's market, and arts events, etc. This is the sort of thing a local business might fund in order to make the area a more attractive place to live, which in turn ultimately brings more customers and a bigger pool of potential employees to the area.)

In short, Friedman's claim is that most businesses, if left completely unrestricted and allowed to pursue ONLY profit, would inevitably end up making the community around them better and WOULD serve the interests of others, for one simple reason: **It pays to be generous!**

(b) <u>That is the Government's Job:</u> Others suggest that it is not a business's job to curtail its own actions. Businesses are out for profit, and profit alone, and they will **pursue profit by any legal means that they can**—so, if there is something we think that a business should or should not do, the government should make a law to enforce it. But the business itself should not be responsible for enforcing rules (for which there are no laws in place) upon itself.

(c) <u>Business-People are Not Moral Authorities:</u> Some suggest that the social responsibilities we have in mind are MORAL issues, but **business-people are not moral authorities**. Since business-people have not really studied ethics in detail, we cannot rely on them to make sound moral decisions about what they should or should not do. Additionally, if we force businesses to start enforcing morality, this power of moral authority will inevitably be abused by those who seek profits, and these selfish moral values will eventually be imposed upon society.

<u>Objections to (a):</u> Though it IS a step in the right direction when a business takes some of its earnings in order to promote the public good, notice that, ultimately, the MOTIVE for this seemingly "beneficent" or "altruistic" behavior is actually

selfishness. According to reason (a), businesses ONLY ever end up doing good things for the public because it is ultimately in their own **self-interest**. In other words, they are only doing good things for the public because it will "come back around" to them, such that the business will be more likely to profit even MORE. But, many people think that seemingly "virtuous" behavior is not TRULY virtuous unless it is motivated by selflessness. Only when we do good things for others MERELY because it is good are our actions truly praiseworthy. Therefore, a business being "good" or "kind" purely based on selfish motives and reasons is NOT morally praiseworthy.

<u>Objections to (b):</u> First, it is unclear that the government COULD successfully implement laws that would sufficiently regulate businesses. Since laws tend to be very general, a lot of specific cases of doing bad things will still be "legal" unless we create a LOT of laws. In turn, this would require huge, controlling, paternalistic government. But even liberals, who generally favor big government, do not want SO many laws that EVERY action is surrounded by red tape and is governed by some law or other.

But, more importantly, the shareholder theorist seems to be assuming here that, in the absence of a law against it, any action is morally permissible. This assumption is clearly false, however. Imagine, for instance, that there were no law against murder (i.e., imagine that murder were legal). It would an egregious mistake to assume that murder would, in that case, be **morally permissible** simply because there is no **law** against it. We would still have an obligation not to kill, and we would still be doing something morally wrong by murdering, even if it were legal. It would be completely wrong-headed for anyone to say, "Hey, it's not MY job to regulate my own immoral behavior. That's the **government's** job. If I really had an obligation not to kill, there should have been a law against it." That would be absurd. **We would still have moral obligations, even in the absence of laws**.

But, if PEOPLE have moral obligations even when there are no laws, then it seems that BUSINESSES ALSO have moral obligations even when there are no laws. Put simply, we are all morally responsible for our own actions. If we do something wrong, WE are the ones at fault—not the government.

<u>Obections to (c):</u> Again, imagine that an individual PERSON gave the excuse offered in part (c) for their immoral behavior: They say, "Hey, I'm not an ethicist, so I cannot be held responsible for considering the moral repercussions of my actions." That would be utterly absurd. Of course we DO hold people morally responsible for their actions, **even if they are not ethicists**.

One does not have to be a moral authority in order to recognize that certain things are morally wrong (e.g., murder, rape, theft, lying, cheating, and so on). So, one does not have to be a moral authority in order to be held accountable for their actions. But, if PEOPLE cannot use the excuse of moral ignorance to justify their immoral behavior, or escape blameworthiness, then businesses cannot use this excuse either.

5. Objections to Shareholder Theory in General: Below are some objections to the Shareholder Theory, generally speaking:

Objection #1: This is Ethical Egoism: When Friedman advances the view that businesses are obligated to maximize their own profits, he is essentially advancing **ethical egoism**, but for businesses rather than people. Recall that ethical egoism is the view which states that the morally right action is the one that best promotes one's own self-interest. But, "best promotes one's own self-interest" is just what "maximizes their own profits" means in business terminology. So, shareholder theory is a form of ethical egoism.

But, ethical egoism has a number of problems. For instance, if the morally right action is to maximize profit, then businesses will inevitably be obligated to engage in behavior that is morally permissible according to egoism, but which is obviously (to most of us) IN FACT **morally wrong**. For instance, recall the case of selling baby pajamas full of carcinogenic chemicals to mothers overseas. This was legal, and served to maximize the company's profits. …But it was wrong! Egoism does not recognize the fact that some actions performed in the name of maximizing self-interest (or profit) can be morally wrong. It would RECOMMEND selling these pajamas. True, objective morality, however, would not.

Recall another problem with egoism: Most agree that the function of morality is to curtail or restrict selfish desires. But egoism is the view that we should PURSUE our selfish desires. As such, ethical egoism is completely morally deficient.

Objection #2: Abiding by the "Rules of the Game": Interestingly, Friedman states that, while businesses may have no obligations, they DO have to abide by "the rules of the game". He says that business-people have only one responsibility:

> That responsibility is to conduct the business in accordance with their [employer's] desires, which generally will be to 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. (pg. 4)

Later, he adds:

> There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud. (pg. 9)

Friedman states here that businesses must not break laws in their pursuit of self-interest. But, curiously, he also states here that businesses must conform to "ethical custom" and avoid "deception or fraud". These appear to be MORAL constraints on what a business should or should not do. One might ask Friedman, "What ARE these 'ethical customs' you speak of?" For, it almost sounds as if Friedman IS suggesting that businesses DO have an obligation to adhere to the basic principles of morality. But, in that case, perhaps businesses DO have obligations to others—since one of the basic principles of morality seems to be that it is not just OURSELVES that matter morally. OTHERS matter morally as well, and we have a basic moral obligation to consider how our actions affect the well-being of others when making decisions.

Topic Suggestion: Shareholder Theory #1: Recall the **Invisible Hand** argument, which proposes that business, if left to pursue selfish goals, will inevitably end up doing good things for the public. This is because, ultimately, a business that has a good reputation stands to profit even MORE.

But, notice what this implies: It implies that businesses ONLY end up doing good things for the public because it is ultimately in their own **self-interest**. In other words, they are only doing good things for the public because it will "come back around" to them, such that the business will be more likely to profit even MORE. However, many people think that seemingly "virtuous" behavior is not truly virtuousness unless it is motivated by selflessness. Only when we do good things for others MERELY because it is good are our actions truly praiseworthy.

What do you think? Can someone still be a morally good person, even when the only reason they do nice things for other people is because they are hoping to be rewarded for it in the future, and NOT just for the sake of being nice to others? In other words, does it matter what the **motivations** behind our actions are? Is a kind deed ONLY morally praiseworthy when it is done selflessly, or can it also be praiseworthy when the motive is a selfish one?

Note: Please complete "Reading Quiz for Week 6" at this time if you have not already done so.