

PROFIT AND SOCIETY

Whether the business of business is to allocate resources in socially desirable ways or to maximize shareholder wealth?

Dah Hsian William Seetoo, Ph.D

**Associate Professor
Graduate School of Business Administration
National Chengchi University**

What is the purpose of the teams in a professional basketball playoff? Do they mean to entertain the audience, or to win the game?

I would answer that both are their purposes, but at different levels. The basketball game was designed in such a way that the efforts made and the skills shown by the players in their scoring in the game will amuse the general audience. (Some would claim that teams are composed of people, and the purpose of these people is money, reputation, etc., but if the coach and the players cannot win the game, their personal goal will not be fully attained. This point has been elaborated by Cyert and March.) In other words, the system of the game and score was created to connect the personal goals of the team members and the recreation of the audience.

For the same reason, the free enterprise system is an institution created to carry out activities the society values. In contrasting the two statements "The business of business is to allocate resources in socially desirable ways," and "The business of business is to maximize shareholder wealth", I believe that the latter should be the means to achieve the former.

This means-end relation is at least approximately true at the beginning of the story. Facilitated with the newly acquired values of "natural law" and "individualism"¹, the capitalism system was created to fully utilize the newly developed technology to obtain the wealth of the nation.

The essence of capitalism is the profit motive. Presumably, if every member of the society is free to maximize his own wealth, the welfare of the nation

would also be maximized, Adam Smith rationalized this by saying that being led by an invisible hand, an individual pursuing his own interest frequently promotes that of the society more effectually than when he really intends to promote it².

The capitalist society is a decentralized society. In such a society, the use of resources, the quantity and methods of production, and the pricing of the finished goods and services are all determined by each individual firm, based on the guideline of profit maximization. Today, the concept of profit is still the most important and useful device for the internal control of the operations of the firm. The lack of efficiency of many non-profit organizations is partly due to their lack of the "scoring system". However, because of its nature of decentralization, the capitalist system is necessarily seeking for "suboptimization", which should be easier to obtain, but can never be perfect from the standpoint of the society as a whole.

Resource allocation process in the traditional capitalist system can be summarized as follows. The price of certain goods or services reflects the consumer demand, or the "social desirability"; while the cost of certain resource represents the relative availability of that resource. Those who can transform the most available (or most idle) resources into goods and services most desired by the consumers will earn the highest profit. The optimal quantity of output will be the point where the marginal cost equals the marginal revenue. In perfect competition, optimal output quantity is also accompanied by lowest average cost. And by this simple mechanism, it is claimed that resources are allocated in the socially desirable ways.

However, we have to notice here that this model assumes that it is "socially desirable" to distribute goods and services according to personal income, and the income is determined by the value of the resources (or skill) a person can contribute.

Under the above condition, the two statements of business are consistent, and the second is the means to achieve the first,—if all the assumptions are valid.

Nevertheless, the assumptions are not totally valid, and changes in the economy and society have made this model even more obsolete. First being attacked is the perfectness of the market. The requirements of perfect competition, such as the perfect information, free entry, and lack of control of price by the suppliers, are all hard to believe in today's society. As a matter of fact, one of the major purposes of "strategic planning" is to avoid direct competition with any

other firm. When the competition is not perfect, the firm will have some degree of control over the price, and thus the quantity of output. In order to earn their "optimal" profit, the imperfectly competitive firms should restrain their output, and thus lead to higher level of production costs. In an imperfect market, the maximization of profit will not distribute the resources in the socially desirable ways, even in the traditional sense.

As the economy develops, the winners of the game become larger and stronger and more powerful. Today, a very large proportion of the western economic power is controlled by a limited number of giant corporations.³ The operations in the economic society is far beyond what the classical economics can explain. The scene becomes even more complex when the corporate power gets involved in the political system.⁴

The ever advancing technology also has some important impact upon the economic function of the resource allocation. The economies of scale brought by the new technology creates more advantages for the firms with large size, and makes the market farther away from being perfect. The technology also makes the investments less flexible,⁵ and that should include investments in both capital and human resource. The implication of this is that the decreasing adaptability of those investments has made the "unplanned" nature of the "pure" capitalism a disaster. In the traditional economics, theorists assumed that the layoffed labor could easily transfer to other prosperous industries without much difficulty, and wrong investment due to the miscalculation of the entrepreneur would not bring much harm to the society. However, with the changed economic structure and technology, the Adam Smith type of ideology and practice will be bound to bring drastical economic fluctuation and social misery.

But the problems of the capitalist ideology are still more than that. Capitalism is by nature a form or method of economic change and is never stationary. Schumpeter⁶ pointed out that capitalism is an evolutionary process, a process of Creative Destruction, which incessantly revolutionizes the economic structure from within, incessantly destroying the old one, and incessantly creating a new one. In other words, the aim of any competition is to put an end to that competition. When the game is over, only the winner survives, there is no more competition. Although Schumpeter's prediction is not likely to come true in the near future, his analysis of the nature of capitalism provides some valuable insights into the economic scene today.

The value of the society always interacts with the development of the eco-

mony.⁷ The changed values together with the changed economy and technology have at least two effects upon the profit-maximization's role in the social resource allocation.

The first one is that today's consumers need not only goods and services, but also the "quality of life"⁸. In other words, some of the social desirability cannot be attained through the traditional way of business practice. The second effect of the changed value is the changed ideology of "who should decide the social desirability". According to the traditional capitalist economics, those who provide the most needed resources will enjoy the highest income, and thus are entitled to the lion's share of the produced goods and services. That is, the "consumer sovereignty" is based upon "money vote"—one dollar one vote, no more no less. Recently, there is a trend among people to claim their rights on a "per head" basis, that is to say, everybody should be entitled to some basic right of the social resources. This trend is inconsistent with the profit motive, because the profit seekers only care about people with purchasing power.

So far, we have examined the logic of the profit maximization, and the changing underlying assumptions which used to support the "means-end" relation between the two possible business of business. Our conclusion is that under the present situation, the profit maximization doctrine can no longer allocate resources in socially desirable ways. Some remedies are needed.

To meet the problems of imperfect competition, the traditional solution is the legislation of antitrust laws, and the legal system also regulates the labor practice, consumer protection, etc.⁹

Besides the institutionalized laws, there are many other suggested ways to rebuild the means-end relation between the profit goal and the social resource allocation.

The opinions can be roughly divided into two camps. their disagreement is mainly due to the fact that they make their assertions from different vantage points.

The first camp take their view from the position of business management, Their general opinion is to increase the power of the existing institution of business and management. The most frequently used term is the "corporate social responsibility". Recently, some businessmen as well as scholars claim that business should bear some additional social responsibilities besides profit seeking. Among many others, Steiner¹⁰ states that modern business ideology no longer clings to the classical concept of profits as being the sole objective, and business

should take responsibilities to help society achieve its basic goals. However, some other scholars consider the "social responsibility" claimed here is only a new means to the profit end. Friedman¹¹ pointed out that "... the doctrine of social responsibility is frequently a cloak for actions that are justified on other grounds rather than a reason for those action. To illustrate, it may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government." Heilbroner¹² is even more cynical about the term social responsibility, when he criticizes that "the stress on the 'newness' of capitalism carefully avoid a recitation of those facts, such as the distribution of wealth or income, that testify to profound structural continuities rather than change; the 'frank' confrontation of bigness in business does not extend to a public discussion of the concentration of business power; and the repeated stress on 'professionalism' . . ."

In short, those who claim the importance of social responsibility really mean to strengthen the current capitalist system and extend the power of the existing management and big business.

Drucker also belongs to this camp. He explicitly points out that the social problems can be good profit opportunities for business, and the newly-created social demand—"quality of life", should become the business of business.¹³ This idea has been presented by Braybrooke as "private production of public goods", which means that corporations diversify their output and sales efforts in the direction of seeking out contracts with various levels of government for the supply of goods for collective consumption.¹⁴

If I were a sophisticated businessman, or if I were to teach students aiming at business career, I would take the viewpoint of the first camp.

The second camp looks at the problem from the standpoint of the society as a whole. Their opinion is that there is limitation to the capacity of the business and the free enterprise system in solving the societal problems. Schumpeter would be the extremist in this camp. He believed that eventually the whole free enterprise system will be replaced by socialism because as the evolutionary process of capitalism proceeds, the profit motive will become less and less effective in allocating resources according to the social desirability.¹⁵ Heilbroner reasons along the same line, but states that the existing power structure will prevent the capitalist system from drastical change.¹⁶ Keynes can be marginally considered to be a member of this camp. His thesis¹⁷ points out the insufficiency

of the laissez faire economics, and finally led to the government intervention of the national economic affair. Shonfield argues that in order to obtain the stability of economic development and employment, a more extensive governmental economic planning and a closer government-business cooperation are needed.¹⁸ In short, Schumpeter, Keynes and Shonfield are among those who acknowledged the insufficiency of the free enterprise system (or the profit motive) in obtaining social goals, and were trying to suggest some other institution to replace, or to supplement the existing capitalist system.

Other members of the second camp assert to impose limit upon the power of the corporate management. Hayek pointed out that "... Policy guided by 'social consideration' is likely to produce most undesirable results, ... Management desires to be able to pursue values which they think are important and that they need little encouragement from public opinion to indulge in these 'idealistic' aims. But it is just in this that the danger rests of their acquiring real and uncontrollable power."¹⁹ Friedman also claims that corporate management is not supposed to decide value for the society. And if it does so, "the businessman, ... is to be simultaneously legislator, executive and jurist."²⁰ They believe that under the present, socially accepted rule of the game, the corporate's only responsibility is to make profit, and the performance of management can be evaluated by the firm's profitability. If the management were granted the power to allocate the corporate resources according to their own values, or the "social values" as they subjectively perceived, it could be a misallocation of the resources. Plus, there is no way for the society, or the shareholders to evaluate what the management has done. More than forty years ago, Berle made this point by saying, "You cannot abandon emphasis on the view that business corporations exist for the sole purpose of making profits for their stockholders until such time as you are prepared to offer a clear and reasonable scheme of responsibility to someone else."²¹

Above are the major assertions of these two camps. Now in what way should they be compromised? When the profit maximization principle cannot help allocating resources in socially desirable ways, should corporate management set aside the profit goal and discharge their social responsibility by allocating the corporate resources as they see fit? Or should the management stick to the profit maximization doctrine, regardless of the societal problems directly or indirectly created by their profit-seeking? One way to supplement the insufficiency of profit doctrine in allocating resources is to let the private sector dwindle in

proportion to the whole economy. Hower, the inefficiency of the government-controlled enterprise is well known, Drucker has pointed out the growing disbelief in government's ability to solve major problems, and "the liberals and progressives who, a generation ago, rallied under the banner of 'more government', now increasingly look to other leadership group, other institutions, and above to business, to take on the problems which the government should but is not able to solve."²² What Drucker says is very likely to be true. One possible resolution to this "private vs. public" problem can be the idea of "private production of public goods" as mentioned earlier. However, to fully utilize the capacity of private enterprise and their profit motive in attaining the social goals, some additional social devices are needed.

This social device should be *a new set of working rules*, institutionalized to facilitate the attainment of the above objective. According to Commons, the working rule is a framework of customs, habits, and precedents, in which the firms operate.²³ And in practice, the working rule is enforced by law and government. Johnson describes some business behavior in a decentralized economy as a situation of "prisoners' dilemma", and "some kind of coercion will probably be necessary to shift the solution to the 'mutually beneficial' cell'"²⁴. In other words, to make the profit-making as means to the social ends again, some additional regulations and criteria must be established through the political process. Theoretically, the power and right in the political process are founded on a "per capita" basis—one person one vote, no more, no less, which is more consistent with the value of the modern society. Only through a well-working political system, the real social value can be reflected.

Besides the efficient operation of their business, probably the most important social responsibility of business is to obey the law, and to keep the political system, mass media, etc., free from their influence. The new working rule should be then set up with the truly free choice of the people in the society. And only under that set of working rules, with the "socially desirable ways" being defined, can the profit motive lead to the socially desirable resource allocation.

Under this situation, firms work for for their profit maximization, subject to the constraints imposed by the society.

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Now the score of the winning team leads far ahead, the game is no more

exciting. Plus, the audience is no longer satisfied with the traditional way of B-ball playing. It is time for the Professional Basketball Association to design some new rules of the game to entertain the audience so that they won't switch to other sports.

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