What does business owe society?

Experts from across the globe consider the Friedman doctrine and the social responsibilities of contemporary companies.

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Fifty years ago, the late Milton Friedman, an economics professor at the University of Chicago who would go on to win the Nobel Prize in Economic Sciences, challenged the argument that businesses have obligations separate from their responsibility to make as much money as possible for shareholders.

In his op-ed for the *New York Times*, published on September 13, 1970, Friedman declared, "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."

Friedman was pushing back against the idea that businesses should avoid price increases to hold down inflation, pay more toward mitigating pollution than the law required, or hire less-qualified workers to reduce poverty. He did not say that businesses should profit by any means necessary; he wrote that corporate executives should conform "to the basic rules of the society, both those embodied in law and those embodied in ethical custom."

Today, some executives and economists reject Friedman's conception of businesses' social obligations. Last year, the Business Roundtable, which represents the CEOs of some of America's largest companies, updated its statement on the purpose of a corporation, emphasizing a "fundamental commitment to all of our stakeholders" and outlining a list of responsibilities: deliver value to customers, invest in employees, deal fairly and ethically with suppliers, support the communities in which they work, and generate long-term value for shareholders. Some have argued that global challenges such as COVID-19 and climate change are existential threats that require leadership from businesses—for the sake of their own survival, as well as that of the broader society.

At the global virtual Corporate Social Responsibility Revisited conference on September 10, 2020, Chicago Booth faculty, alumni, and guests reevaluated the Friedman doctrine for the modern era. Some emphasized the nuance often lost when discussing Friedman's argument, noting that long-term strategic thinking can benefit both shareholders and society. Others advocated moving away from Friedman's viewpoint toward a more expansive sense of social responsibility.

Several themes emerged across conference sessions, hosted by Chicago Booth's Hong Kong, London, and Chicago campuses.

ILLUSTRATION BY EDMON DE HARO

Social purpose can be good for profits . . .

- **It can create and expand markets.** In India, regulation is the biggest driver of a greater focus on sustainability, especially with respect to corporate social responsibility, said Seema Arora, deputy director general of the Confederation of Indian Industry, but "self-enlightened businesses" are involved in livelihood creation and skill building, and they generate opportunities through efforts such as educating farmers on weather forecasting and crop insurance, which increases farmers' disposable income.

- **It can help businesses mitigate risk.** As of July 1, all companies listed on Hong Kong Exchanges and Clearing must have a conversation about ESG (environmental, social, and governance) and sustainability issues at the board level. "We look at it as a risk-management exercise," said Katherine Ng, chief operating officer of the exchange's listing department.

  Investment funds that evaluate companies' ESG policies have experienced healthy growth, as COVID-19 has emphasized the need for businesses to be resilient and reduce their risks, said Calvin Chu Yee Ming, a partner at consulting firm Eden Strategy Institute. This growth has been encouraged by investor recognition that business resilience and business sustainability go hand in hand.

- **It can increase the size and improve the quality of the workforce.** The International Labour Organization projects that, with the right policies, 24 million green jobs could be created globally by 2030, in areas such as recycling services and solar-energy production, said Swee Chen Goh, the former chairman of Shell Companies in Singapore. Globally, 1.2 billion jobs depend on a stable and healthy environment.

  Mary Bush, founder of consulting firm Bush International and a longtime corporate board member, noted that training new workers in communities where businesses operate can be an investment that increases profitability in the longer run. "I think Friedman's views are quite compatible with many of the things I've seen going on in corporate America that represent stakeholder capitalism," she said.

  From the opposite perspective, ignoring social issues can harm businesses. When companies discriminate against applicants and some of their own employees, they must not be recruiting or retaining the best the labor force has to offer and, as a result, must be underperforming, said Chicago Booth's Marianne Bertrand, whose research has revealed systematic racial bias in how résumés are evaluated. "If you are focusing all recruitment on one-half of the population, because you're only looking at men, there's no way you are on the frontier in terms of the talent you can bring within your organization," she said.

How can businesses decide which social issues to prioritize? For Ng, it's a question of which challenges, if ignored, could threaten a company's future profits. For Chicago Booth's Steve Kaplan, maximizing shareholder value can be a matter of understanding customer preferences. "If you have customers that care that you are doing things for the environment, you are going to be penalized if you don't," he said.

For those who know only the most famous line of Friedman's op-ed, it might be surprising to learn that he generally agreed. "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," he wrote. "That may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects."

. . . but measuring the impact of social purpose is difficult

- There may be economic value to businesses in increasing the racial and gender diversity of corporate management, which, in theory, could produce more and better ideas, Bertrand said. Despite how often that argument is advanced, she said, **there's little rigorous evidence from research that adding diversity improves corporate profitability.**

- Because data sets are relatively new, **it may take time to understand the financial benefits of increased diversity, equity, and inclusion**, added Mekala Krishnan, a McKinsey Global Institute senior fellow. "If companies put certain diversity and inclusion practices in place, it could take some years to impact outcomes and to see shifts in the data," she said.

- Mark Carney, UN special envoy for climate action and finance and former governor of the Bank of England, pointed out that **financial and social shocks can push businesses toward improving their transparency and disclosure.** In the United States, for example, formalized accounting standards grew out of the Great Depression. "Out of crisis often come improvements in measurement, valuation, and understanding," he said. The effort to define sustainable growth has gathered momentum only in the past decade, he added, so the field still needs to clarify its standards and goals.

  Carney encouraged businesses to adopt "consistent, comparable, comprehensive disclosure around climate risks," following the recommendations of the Task Force on Climate-related Financial Disclosures, established by the Financial Stability Board. About 1,350 companies worldwide are disclosing data related to these metrics.

Social purpose may help preserve the capitalist system
In a different tack from Friedman, who raised concerns that expressing a business commitment to social responsibility would steer political systems toward socialism, some presenters argued that business leaders who demonstrate a social conscience help to protect the capitalist principles that have allowed their companies to thrive.

- **Businesses need to mitigate the problems that capitalism creates.** "The capitalist system as defined by Friedman is an extraordinary engine for innovation, growth, and job creation, but we all have a responsibility on our own to address the pain points created by it," such as inequality, food insecurity, and precarious health-care systems, said Jaime Augusto Zóbel de Ayala, chairman and CEO of Ayala Corporation, one of the largest and most diversified business groups in the Philippines.

- **Businesses must rebuild their reputations to promote growth.** "Emerging-markets businesses are helping lead the fight against COVID-19, which reminds us that companies can effectively pursue their objectives—shareholder profits—only if they enjoy the trust of society, and building trust sometimes entails sacrifice," said Ahmed Saeed, vice president of operations for the Asian Development Bank. A decline in the reputation of business, if not addressed, could reverse the momentum that has propelled 1 billion people worldwide out of poverty.

- **Businesses lose support if they consider only their legal duties.** "Pure shareholder value maximization actually can corrode some of the underpinnings of the system, if every relationship is contractual," Carney said. By contrast, he argued, employees, suppliers, and customers may increase their loyalty to what he described as a "purpose-driven corporation," which considers a broader set of stakeholders.

Shareholders aren't the only ones with an economic interest in a business.

The interests of shareholders and other stakeholders can be balanced
Chicago Booth's Randall S. Kroszner, a former member of the US Federal Reserve Board of Governors, pointed out that sometimes maximizing shareholder value and serving a broader social purpose align—but other times, there's an irreconcilable conflict. How can businesses respond? Presenters had suggestions.

- **Define business goals beyond profitability.** Tandean Rustandy, founder and CEO of PT Arwana Citramulia Tbk, one of the largest ceramics companies in Indonesia, rejects Friedman's strict division of responsibilities between businesses that maximize profit and governments that provide social and environmental welfare.

  "I believe the purpose of business is not profit, but to create value and impact," said Rustandy, who is a University of Chicago trustee, and for whom Chicago Booth's Rustandy Center for Social Sector Innovation was named. Companies should get more involved in addressing social needs such as education and health care, he said, not just to improve their performance, but because it's the right thing to do.

- **Recognize other stakeholders have equity.** Shareholders aren't the only ones with an economic interest in a business, said Chicago Booth's Raghuram G. Rajan, former governor of the Reserve Bank of India. Employees and suppliers also have made investments in a company that deserve consideration.

  "The missing part of Friedman is recognizing that the implicit equity stakes are sometimes as important as the explicit equity stakes," he said. "We need to maximize the sum of implicit and explicit equity stakes—that will maximize the value of the firm to society. We need a more expansive view."

  Long-time employees, for instance, "are long-term investors because their sweat equity is embedded in the firm," he explained. In many cases, these employees have committed significant human capital and should effectively be seen as partners in their companies. If they are not explicitly recognized as such, they should be.

- **Incentivize long-term thinking.** The focus on maximizing shareholder value has steered executives toward counterproductive, short-term strategies, such as gaming a company's stock price to increase the value of their options, said Vanderbilt's Margaret Blair. Meanwhile, business leaders externalize inconvenient costs, such as cleaning up pollution, onto surrounding communities. Boards can redesign incentives to encourage executives to think long term, rewarding both shareholders and society.

- **Improve shareholder democracy.** Harvard's Oliver Hart, a Nobel laureate, advocates for creating mechanisms that allow shareholders to rate their priorities. In research with University of Trento's Eleonora Broccardo and Chicago Booth's Luigi Zingales, Hart finds that shareholders can have more influence on businesses through owning shares and pressing management for change than through exit strategies such as divestment and boycotts.

  "Companies should find out what shareholders want and pursue that goal, and that is not always value maximization," Hart said. For example, shareholders could vote on whether companies reduce their carbon footprint by investing in technologies that have an up-front cost but produce broader social benefits.