Why Managers Need to Think Beyond Profits

In 1970, Milton Friedman’s essay “The Social Responsibility of Business is to Increase its Profits” was published in the *New York Times Magazine*. Over the course of his influential essay, Friedman comes to the conclusion that businesses shall only seek to increase their profits. Furthermore, Friedman claims that corporations should not be hold accountable for fighting poverty, racism, or environmental pollution. Essentially, he arrives at this standpoint via two different arguments: the so-called *agency argument* on the one hand, and the *taxation argument* on the other hand. While Friedman uses completely different points in these two argument chains, both have in common that they each rely on certain key assumptions in order to come to the conclusion mentioned above. Throughout this essay, we will concentrate our efforts on the *agency argument*. More specifically, we will outline two major weaknesses of Friedman’sargument chain. However, before we can address these issues, we first have to outline Friedman’s *agency argument* chain in its entirety in order to support our counter arguments.

Friedman starts off his argumentation related to agency by stating that in a business setting, managers are fiduciary agents of the equity investors. Thus, managers always have the obligation to act in the interest of their beneficiary (in this case the equity investors). Additionally, Friedman claims that equity investors do have one main interest: seeing increased company profits. Therefore, the corporate executives must make decisions which are aimed at increasing the earnings of the corporation. Concluding from that, Friedman argues that by spending money on social issues, managers would not serve their inherent obligation. Instead, managers would deliberately reduce company profits in order to fight social issues. Since these expenses however are not aligned with the interests (increased profits) of their shareholders, Friedman claims that executives have the responsibility to not spend corporate money on social endeavors. Lastly, Friedman adds that managers are risking to get fired if they decide to allocate company funds to projects which are not directly related to boosting corporate earnings. Because these managers would be acting in violation to the principles of their beneficiary, Friedman concludes that the managers can indeed expect to be laid off, if profits do not increase, stay stagnant, or even tremble. Hence, it is in the managers best interest to not divert assets to spend on social endeavors and exclusively serve the interests of their beneficiaries.

Even though this is a brief summary of Friedman’s *agency argument* chain, it helps us to lay out two criticisms of Friedman’s view that the only role of business is to increase profits. First, we note that Friedman’s conclusion is based on the assumption that investors generally “want to make as much money as possible”. In other words, all they care about is profits. Therefore, managers have to follow suit and base their decisions on the question of whether a certain project will be profitable or not. We believe this underlying hypothesis was not true in 1970, and still is not true today. While we agree with Friedman that there are many investors in the market who are using their money solely to grow their wealth, increase their pension funds, or save for other personal reasons, there are also many other investors who are not joining companies for financial but for ideological reasons. For instance, business magnates like Elon Musk, Rupert Murdoch, or Bill Gates often invest in ideas and not purely in profit machines. Elon Musk, for example is invested in multiple high-tech companies which are trying to push the limits of science and technology for the sake of the common good. Besides companies like *Tesla* and *SpaceX*, Musk was and still is part of other promising projects like *Solar-City* or *Neuralink*. On the other hand, Bill Gates is known for his foundation which supports companies and organizations around the globe in order to reduce extreme poverty, and increase educational opportunities. Obviously, these are two very special cases, but they demonstrate how investors are often times looking beyond profits. Themes like social justice, climate change, or ethics more often than not influence investors in their decision making. *Socially conscious funds, sustainable ETFs*, or the urge to *divest* from companies which rely heavily on fossil energy sources are all further examples which demonstrate how the broad public is interested in more than pure monetary results. Therefore, corporate managers should not purely focus on increasing profits. Since dealing with certain social or environmental issues is more often than not in the interest of their equity investors, managers need to act upon the demands of their beneficiaries and allocate company money to social issues. For most executives, that means finding the correct balance between increasing profits and fulfilling their *social responsibility*. Hence, we come to the conclusion that if we reject the hypothesis that all investors care exclusively about profits, we have to reject Friedman’s belief that businesses should only seek to increase profits.

Secondly, we can also look at Friedman’s thesis that spending money on social endeavors is automatically decreasing company profit. For the sake of the argument, we take on the hypothesis we rejected above and assume here that all investors indeed purely care about increased profits and thus it is the responsibility of every corporate executive to make decisions which will ultimately lead to increased company earnings. The question we then have to ask is whether allocating money to social or environmental problems always reduces the earnings of the company. We believe that we have to negate this question for a single reason. There are various companies for which making profits is related to having a certain public image. For example, we can look at *Starbucks*. The world’s largest coffee house chain has stores all around the world and is known for leading the second wave of the US coffee culture. However, *Starbucks*’ success story is not purely based on the taste of the products they serve. Moreover, people are buying the brand, the experience, or a certain feeling when they purchase a coffee at Starbucks. This unquantifiable experience is strongly influenced by the public picture of the company. To uplift their social and public image, *Starbucks* has started a variety of programs over the past decades. Waste reduction initiatives, sourcing resources from sustainable and ethical places, or strengthening communities through civic engagement are all examples of how *Starbucks* attempts to nurture a positive public image. Of course, these projects all need financing and therefore might reduce profits in the short run. However, in the long-run *Starbucks*’ positive public perception has been crucial to the success of the company. Of course, the *Starbucks* example can be applied to many other industries and companies. We could point out airlines which are investing in environmental programs, fast food chains that are supporting projects to fight world hunger, or tech companies that are trying to solve issues created by their own social networks. In general, all the examples have in common that businesses invest in social projects because doing so can uplift their public image and thus help to increase company profits. Going back to Friedman’s agency argument, we therefore conclude that spending money on social or environmental endeavors does not automatically reduce company profits. Instead, we showed that investing money for the sake of the common good, can actually boost company profits. Hence, managers are often better off, if they devote a certain amount of money to social and environmental issues.