



KEY DEBATE

Three views on the purpose of a business

Since there is no one categoric view of the overarching purpose of a business, stakeholders, including managers, have to decide.

Milton Friedman and profit maximisation

Milton Friedman,¹ the renowned economist, wrote:

In a free enterprise, private property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society. . . . What does it mean to say that the corporate executive has a 'social responsibility'? . . . If the statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interests of his employers. . . . Insofar as his actions in accord with his 'social responsibility' reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some employees he is spending their money.

Milton Friedman's maxim was that 'the business of business is business', that the 'only social responsibility of business is to increase its profit'. Market mechanisms are then adequate in themselves. If customers are not satisfied, they take their business elsewhere. If employees are not satisfied they work elsewhere. It is the job of government to ensure that there is a free market to allow those conditions to take effect.

Charles Handy's stakeholder view

Citing the corporate scandals of the last decade, Charles Handy² argues that the driving for shareholder value linked to stock options for executives, especially in the USA, has resulted in the system 'creating value where none existed'. He accepts

that there is, first, a clear and important need to meet the expectations of a company's theoretical owners: the shareholders. It would, however, be more accurate to call them investors, perhaps even gamblers. They have none of the pride or responsibility of ownership and are . . . only there for the money. . . . But to turn shareholders' needs into a purpose is to be guilty of a logical confusion. To mistake a necessary condition for a sufficient one. We need to eat to live; food is a necessary condition of life. But if we lived mainly to eat, making food a sufficient or sole purpose of life, we would become gross. The purpose of a business, in other words, is not to make a profit. It is to make a profit so that the business can do something more or better. That 'something' becomes the real justification for the business.

The new capitalists' argument: 'Society and share owners are becoming one and the same'

In their book *The New Capitalists*,³ the authors also recognise that 'a corporation is the property of its stock owners and should serve their interests'. However, it is the 'millions of pension holders and other savers . . . [who] . . . own the world's giant corporations'. These 'new capitalists are likely to be highly diversified in their investments'. Investment funds, such as pension funds, are their representatives and 'hold a tiny share in hundreds, perhaps even thousands, of companies around the world'. They then argue:

Imagine that all your savings were invested in one company. The success of that company alone would be your only interest. You would want it to survive, prosper and grow, even if that did damage to the economic system as a whole. But your perspective would change if you had investments in lots of companies. [Then] it is to your disadvantage that any business should seek to behave socially irresponsibly towards other businesses, the customers, employees or society generally. By so doing they will damage the interests of other firms in which you have an interest. The new capitalist has an interest in all the firms in which he or she is investing behaving responsibly: 'in creating rules that lead to the success of the economic system as a whole, even if, in particular circumstances, those rules may tie the hands of an individual company' . . . managers of a business should quite properly 'concentrate single mindedly on the success of their own organisations . . . however they will not be serving their share owners' interest if they undertake activities that may be good for them individually, but damaging to the larger economic system.

References:

1. M. Friedman, 'The social responsibility of business is to increase its profits', *New York Times Magazine*, 13 September (1970).
2. C. Handy, 'What's a business for?', *Harvard Business Review*, vol. 80, no. 12, December (2002), pp. 49–55.
3. S. Davies, J. Lukommik and D. Pitt-Watson, *The New Capitalists*, Harvard Business School Press, 2006.

Questions

- 1 Which view do you hold:
(a) as a manager? (b) as a shareholder?
- 2 What are the implications of the different views for managers' development of organisational strategy?