Journal of Markets & Morality
Volume 21, Number 2 (Fall 2018): 297–307

The Social Responsibility of Business

Milton Friedman Reconsidered

John Elrick
Senior Systems Analyst, Westat

Clifford F. Thies
Eldon R. Lindsey Chair of Free Enterprise and Professor of Economics
Shenandoah University

This article reviews the continuing misrepresentation of Milton Friedman's position on the social responsibility of business. Friedman qualified his support of the pursuit of profits with an ethical constraint (honest dealing); however, this qualification is repeatedly ignored by his critics. And, while Friedman specifically endorsed the stakeholder theory of the firm after it was developed, stakeholder theory continues to be presented as an alternative to value maximization. Furthermore, the magazine article, the headline of which constitutes Friedman's entire position according to his critics, is not particularly a defense of profit-seeking, but an admonition against self-aggrandizement by corporate managers.

> *[T]here 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.*
>
> —Milton Friedman, 1962[1]

Introduction

More than fifty years after he first made his argument concerning the social responsibility of business, Milton Friedman remains a convenient foil for the view that business should do more than merely maximize profits. Reduced to a headline, Friedman's argument is that "The Social Responsibility of a Business Is to Increase Its Profits."[2] To be sure, this exact wording appears only once in

Friedman's writings; as the headline of a *New York Times Magazine* article published in 1970. In the complete sentence at the conclusion of the original source, Friedman's book *Capitalism and Freedom* (1962), repeated in the magazine article, the pursuit of profit is presumed to be constrained by the law, competition, and honest dealing. The headline is certainly provocative; but, out of context, potentially a misrepresentation.

Furthermore, the thrust of the essay is not a justification of the pursuit of profit. The thrust of the article is a criticism of self-aggrandizement by corporate managers. Friedman, continuing in the tradition of Adam Smith, extolled the ability of markets to direct business to serve the common good while being suspicious of businessmen. This point—Friedman's suspiciousness of businessmen—is apparently lost on many admirers as well as critics of Friedman, who seize upon his comment on profit-maximization like a bull in an arena charging at a red cape. For many commentators in the years since Friedman's article appeared, the piece has been a prime exhibit of the amorality, if not immorality, of capitalism; an illustration of an erroneous approach to business ethics that must be marginalized. To the contrary, we propose that Friedman's view embodies much of today's mainstream approach to the ethical evaluation of business. In this article, we show that (1) Friedman's article has been misunderstood; (2) Friedman's approach is actually consistent with stakeholder theory, the approach that has become generally accepted as ethically superior in business scholarship; and (3) Friedman's observation concerning aggrandizement by businessmen was a prescient warning against an abusive business practice.

Toxic Misquotation

Milton Friedman's scholarship ranged from technical areas within monetary economics to matters of social philosophy, and his writing at times was dense in information and abrupt in language. In the case of his often-misquoted statement on the social responsibility of business, his words have been reduced to a convenient sound bite that became a straw man argument encapsulating a range of criticisms against the free market. It is not unusual for sayings to be reduced to caricatures of themselves. Lord Acton said, "Power tends to corrupt and absolute power corrupts absolutely." This saying is often shortened to "power corrupts." The clipped version gains power but at the risk of misunderstanding. Similarly, in the movie *Wall Street*, Gordon Gekko, played by Michael Douglas, says "greed, for lack of a better word, is good." This is often reduced to "greed is good." The actual words reflect the problematic aspect of "greed."

Greed is one of the seven deadly sins. But juxtaposed against each deadly sin is a heavenly virtue; greed is juxtaposed with charity. In the spirit of the Golden Mean, if we temper greed with charity, loving others as ourselves, we might be in a good place. But we have no word for this place. Hence, Gordon Gekko says, "for want of a better word." Gordon Gekko's actual words are subtle, and a veneer for his behavior that actually is greedy, and all this makes for good cinema. The clipped version of what Gordon Gekko says—"greed is good"—is simply wrong. So it is with the clipped version of Friedman.

The Critique of Friedman

No doubt the headline catches attention, but does it serve to draw attention to the complete statement or does it effectively become Friedman's statement? A Google search constrained to precise wording and restricted to educational domains returned more than ten times as many results for the headline as for the complete statement. Upon investigation, many of these results indicate that the headline does indeed substitute for the complete statement. In addition, some of the results exhibit sloppiness in quotations and references indicative of primary sources not being consulted.

Table 1

Number of Hits of a Google Search Restricted to Academic Institutions

"The social responsibility of a business is to increase its profits."	4,980
"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."	416

Representative of the cases that simply substitute the headline for the complete statement is Chandler and Werther. They state, "Friedman believed that the only 'social responsibility of business is to increase its profits.'"[3] This passage quotes the headline of the *New York Times Magazine* essay as if it were a complete summary of Friedman's position. In particular, it leaves out Friedman's ethical constraints.

Scott Tong writes, "At the University of Chicago, economist Milton Friedman (who would later win the Nobel Prize) wrote this in the *New York Times Magazine* in 1970: 'There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits.'"[4] Note that there is a period immediately after the word "profits" and that the period is enclosed in quotation marks, indicating that Tong is stating that Friedman's statement ends there. While Tong quotes part of the statement, it is clear that Tong's understanding of Friedman's social responsibility argument derives from the headline.

In a textbook of business ethics, Ferrell, Fraedrich, and Ferrell state, "Milton Friedman has been quoted as saying that 'the basic mission of business [is] thus to produce goods and services at a profit, and in doing this, business [is] making its maximum contribution to society and, in fact, being socially responsible.'"[5] The cited reference for their quotation of Friedman is the 1970 *New York Times Magazine* essay. Yet that essay does not contain the quoted words, and as is often the case among Friedman's critics, the authors leave off Friedman's ethical constraints.

Carroll and Shabana say, "The case against the concept of [corporate social responsibility] typically begins with the classical economic argument articulated most forcefully by the late Milton Friedman (1962). Friedman held that management has one responsibility and that is to maximize the profits of its owners or shareholders."[6] This article references the *New York Times Magazine* essay, giving its date as 1962, which is the date of the publication of *Capitalism and Freedom*.

Robert Solomon presents this interpretation of Friedman bluntly: "Perhaps the most famous of these [bad or misleading arguments] is the diatribe by Nobel-winning economist Milton Friedman."[7] Solomon continues, "[M]anagers of corporations have obligations to their shareholders, but they have obligations to other stakeholders as well. In particular, they have obligations to consumers and to the surrounding community as well as to their own employees."[8]

Among the consequences of relying only on the headline is that the ethical constraints are not only ignored; violations of the ethical constraints might be said to be justified. Ken Silverstein says, "Economist Milton Friedman has argued that it is the social responsibility of corporations to increase profits.… But business ethicists caution against a myopic pursuit toward earnings. The quarterly reporting syndrome that pressures companies to meet earnings expectations promotes temptation that can push some to distort the truth."[9]

To be sure, we are not the first to notice that many critics partially quote Friedman's actual statement or rely exclusively on the headline of his 1970 essay. John Friedman, himself critical of Friedman, says, "In fact they are misquoting and simplifying just one part of Mr. Friedman's more than four decades' old statement. The complete statement is rather broader and brings in a few elements of what is today considered to be integral parts of corporate responsibility—ethics and integrity."[10] Hamid Bouchikhi (2015) succinctly points out that "Friedman's critics often forget the second part of his thesis."[11]

Stakeholder Theory

Among the arguments put forward by Ferrell, Fraedrich, and Ferrell supporting stakeholder theory is its juxtaposition against Friedman's social responsibility argument. Since the publication of R. Edward Freeman's landmark book, the idea that firms have stakeholders, and that these stakeholders range beyond those considered by Friedman's theories, has become commonplace.[12] Stakeholder theory posits that large and complex enterprises rely on more than the purchase of commodities and labor in spot markets for the production of goods that are similarly sold in spot markets. Contemporary corporations rely on relationships with consumers, suppliers, and employees, with those who supply credit and equity capital, and with the communities in which they operate. Accordingly, among the things firms do is offer implicit contracts, develop internal markets, form and deliver upon expectations of quality and fairness, and induce loyalty and others kinds of commitment. Although it has become routine to contrast this position against Friedman, it is possible to argue that Friedman's complete statement encompasses the needs of these stakeholders in the context of the long-term profitability of the enterprise. But this argument was not strong until relatively recently.

When *Reason* magazine sponsored a symposium on Milton Friedman's article on the social responsibility of business, John Mackey, cofounder and long-time CEO of Whole Foods Market, said he disagreed with Friedman. "I believe," Mackey said,

> that the enlightened corporation should try to create value for all of its constituencies. From an investor's perspective, the purpose of the business is to maximize profits. But that's not the purpose for other stakeholders—for customers, employees, suppliers, and the community. Each of those groups will define the purpose of the business in terms of its own needs and desires, and each perspective is valid and legitimate.[13]

Mackey was describing stakeholder theory.

Milton Friedman, commenting on Mackey, said, "The differences between John Mackey and me regarding the social responsibility of business are for the most part rhetorical. Strip off the camouflage, and it turns out we are in essential agreement. Moreover, his company, Whole Foods Market, behaves in accordance with the principles I spelled out in my 1970 *New York Times Magazine* article."[14]

In particular, Friedman pointed out that Whole Foods' expenditures on stakeholders are focused on the bottom line of the company and its many relations.

T. J. Rodgers, CEO of Cypress Semiconducter, considered the matter obvious: "It is also simply good business for a company to cater to its customers, train and retain its employees, build long-term positive relationships with its suppliers, and become a good citizen in its community, including performing some philanthropic activity."[15]

When stakeholder theory was developed, it was considered to be an alternative to value maximization as a theory of the firm. In part, this reflected a turf war between the management and finance faculties of business schools. But, in part, this was because stakeholder theory lacked rigorous definition. In a series of articles, Michael Jensen and Walking and Jensen have argued that maximizing the market value of the firm is consistent with stakeholder theory.[16] Gouldey et al. provide a fairly general proof.[17]

There is plenty of evidence that social reasonability is consistent with profit maximization. For some examples, companies with unique or specialized products (such as durable goods manufacturers and R&D) that cultivate strong bilateral supplier relationships have lower debt ratios.[18] Similarly, Bae et al. find that firms with high employee-friendly ratings also tend to have lower debt ratios.[19] Edmans finds that a value-weighted portfolio of the common stock of the "100 Best Companies to Work For in America" earned a premium return of 3.5 percent annually.[20] Ertugrul finds that acquisitions by firms with higher employee friendliness ratings result in higher employee productivity, return on assets, and excess stock returns.[21]

Furthermore, not all corporate social expenditures are valued by the market. Rather, it appears that only those expenditures that are tied to stakeholders in the manner described by stakeholder theory are valued. Hillman and Keim find that while good stakeholder management increases shareholder wealth, participation in social issues does not.[22] Also, Benson and Davidson find that CEOs are paid to increase long-term value.[23] While market values are positively correlated with higher aggregate stakeholder management scores, CEOs are not compensated for providing benefits to non-investor stakeholders above what is needed to maximize firm value. Benson et al. define expected stakeholder management as the level of stakeholder benefits that maximizes firm value.[24] Expenditures beyond this level decrease a firm's long-term market value.

Even some critics of Friedman recognize that he is clear, part of the mainstream, and persuasive. Pava and Krausz recognize that firms can engage in expenditures that appear both to fulfill the obligations of firms to their stakeholders and strengthen shareholder value. In their review of many studies of the relationship between firms that are judged—by various criteria—to be socially responsible, and their financial performance, their "single most important observation" is that only one of twenty-one studies found a negative relation. In contrast, twelve studies found a positive relation.[25] Thus, it can be said, these firms pursue social responsibility while maximizing shareholder value.

Management Self-Aggrandizement

Friedman's argument was not a defense of profitability at any price; rather, it was an indictment of self-serving aggrandizement and social engineering experiments by corporate executives using shareholder funds without explicit consent. At the time, the corporations were largely immune to competition. As described by John Kenneth Galbraith in *The New Industrial State*, US industry was still largely unrivaled, much of it oligopolistic, controlling markets through mass marketing as well as through mass production.[26] Furthermore, the top personal income tax was 90 percent and the nearly flat corporate income tax rate was 46 percent. Corporations were therefore not only used to amassing capital so as to exploit available economies of scale but also managing cash flow so as to minimize the impact of taxes. Through fringe benefits including pensions, and through perquisites ("perks"), corporations deferred income from peak earning years to years of lower income (and lower personal tax rates) and effectively delivered compensation to employees and earnings to owners in ways that avoided taxation.

Friedman touches on tax considerations in his 1970 essay: "[I]t may be that, given the laws about the deductibility of corporate charitable contributions, the stockholders can contribute more to charities they favor by having the corporation make the gift than by doing it themselves." But except for this brief consideration of the use of the corporation to minimize the impact of taxation, Friedman argues that it is for the owners and other stakeholders of the firm, rather than its managers and directors, to decide what to do with the wealth created through the firm.

Today, we find ourselves in a much different world. The global economy is very competitive, forcing companies to be more focused on cost. Tax rates are much lower, reducing the use of the corporation to minimize the impact of taxes. To some extent, these changes are the result of Friedman's great influence, whether we are speaking of the spread of free markets and democratic governments in the world, free trade and floating exchange rates, an all-volunteer military, the legalization of drugs, or the flattening of the tax code. There is a lot more in *Capitalism and Freedom* than the chapter that provided the genesis of Friedman's essay on the social responsibility of business.

Conclusion and Future Research

The risk in reducing a fully developed idea, such as Friedman's position on the social responsibility of business, to a pithy catchphrase should be obvious. At best, attention can be gained at the expense of precision. At worst, an opposite idea is communicated. Hence, we describe the characterization of Friedman's position as a "toxic misquotation." However convenient it might be to describe a caricature of Friedman's position as his position, it is incorrect. If a reading of his actual statement isn't clear enough, Friedman himself provided the corrective in his comment on Mackey.

Well before the contemporary concept of the social responsibility of business was developed, Friedman appended certain legal and ethical constraints to the pursuit of profit. After the social responsibility of business crystallized as the stakeholder theory of the firm, Friedman embraced it. Indeed, in the long run, ethical behavior is consistent with the pursuit of profit. And just as Friedman said business should constrain itself by honesty, so too should scholarship.

For too long, commentators and scholars have muddied the waters of corporate social responsibility, failing to distinguish between actual theft and fraud, short-run profiteering, and long-run profit maximization. Confusing the pursuit of profit with succumbing to short-run temptations and engaging in theft and fraud effectively amounts to a critique of the market economy and a different topic. Seeing the difference invites an exciting new research paradigm: how to best discipline business and businessmen to their long-run self-interest, and how to best monitor and police business and businessmen when self-discipline fails. Society and many members of society have suffered at the hands of corporatism masquerading as capitalism. Enron, WorldCom, Madoff, the collapse of the S&L industry during the 1980s, and the housing bubble during the 2000s are among the many cases and episodes that can be reexamined. To reference Friedman, were these instances where business "stay[ed] within the rules of the game, which is to say, engage[d] in open and free competition without deception or fraud"? The actual quotation, as opposed to the toxic misquotation, suggests a very different line of inquiry.

Notes

1. Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), 133.
2. Milton Friedman, "The Social Responsibility of a Business Is to Increase Its Profits," *New York Times Magazine*, May 13, 1970.
3. David Chandler and William B. Werther, Jr., *Strategic Corporate Responsibility*, 3rd ed. (Los Angeles; London; New Delhi; Singapore; Washington, DC: SAGE Publications, 2014), 394.
4. Scott Tong, "How Shareholders Jumped to First in Line for Profits," *Business Insider*, June 14, 2016, https://www.marketplace.org/2016/06/08/world/profit-shareholder-value.
5. O. C. Ferrell, John Fraedrich, and Linda Ferrell, *Business Ethics: Ethical Decision Making and Cases*, 9th ed. (Mason, OH: South-Western; CENGAGE Learning, 2011), 37.
6. Archie B. Carroll and Kareem M. Shabana, "The Business Case for Corporate Social Responsibility: A Review of Concepts, Research and Practice," *International Journal of Management Reviews* 12, no. 1 (2010): 88.
7. Robert Solomon, *Applied Ethics*, vol. 5: Business Ethics, ed. Ruth Chadwick and Doris Schroeder (New York: Routledge, 2002), 9.
8. Solomon, *Applied Ethics*, vol. 5, 10.
9. Ken Silverstein, "Enron, Ethics, and Today's Corporate Values," *Forbes*, May 14, 2013, https://www.forbes.com/sites/kensilverstein/2013/05/14/enron-ethics-and-todays-corporate-values/#a8dae595ab81.
10. John Friedman, "Milton Friedman Was Wrong about Corporate Social Responsibility," *Huffington Post*, August 12, 2013, http://www.huffingtonpost.com/john-friedman/milton-friedman-waswrong_b_3417866.html.
11. Hamid Bouchikhi, "When CSR Must Begin with Observing the Rule of Law," *The Council Community*, February 12, 2015, https://councilcommunity.com/2015/02/12/when-csr-must-begin-with-observing-the-rule-of-law/.
12. R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Boston: Pitman, 1984). See also R. Edward Freeman and John McVea, "A Stakeholder Approach to Strategic Management," Darden Business School Working Paper no. 01-02 (2001), available at SSRN: http://ssrn.com/abstract=263511 or doi:10.2139/ssrn.263511.

13. John Mackey, "Rethinking the Social Responsibility of Business," *Reason*, October 2005. See also John Mackey and Raj Sisodia, *Conscious Capitalism* (Boston: Harvard Business Review Press, 2013).

14. Mackey, "Rethinking the Social Responsibility of Business."

15. Mackey, "Rethinking the Social Responsibility of Business."

16. Michael C. Jensen, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function," *Business Ethics Quarterly* 12, no. 2 (2002): 235–56; idem, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function," *Journal of Applied Corporate Finance* 14 (2001): 8–21; idem, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function," *Journal of Applied Corporate Finance* 22 (2010): 32–42; Ralph Walking and Michael C. Jensen, "Pioneers in Finance: Part 2 of an Interview with Michael C. Jensen, Jesse Isidor Professor of Business Administration, Emeritus, Harvard Business School," *Journal of Applied Finance* 21, no. 1 (2011): 6–17.

17. Bruce K. Gouldey et al., "Stakeholder Theory and the Market Value Rule," *Financial Decisions* 28, no. 1 (2016): 1–20.

18. See Shantanu Banerjee, Sudipto Dasgupta, and Yungsan Kim, "Buyer–Supplier Relationships and the Stakeholder Theory of Capital Structure," *Journal of Finance* 63, no. 5 (October 2008): 2507–52; Jayant R. Kale and Husayn Shahrur, "Corporate Capital Structure and the Characteristics of Suppliers and Customers," *Journal of Financial Economics* 83, no. 2 (February 2007): 321–65; Sheridan Titman and Roberto Wessels, "The Determinants of Capital Structure Choice," *Journal of Finance* 43, no. 1 (March 1988): 1–19.

19. Kee-Hong Bae, Jun-Koo Kang, and Jin Wang, "Employee Treatment and Firm Leverage: A Test of the Stakeholder Theory of Capital Structure," *Journal of Financial Economics* 100, no. 1 (2011): 130–53.

20. Alex Edmans, "Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices," *Journal of Financial Economics* 101, no. 3 (September 2011): 621–40.

21. Mine Ertugrul, "Employee-Friendly Acquirers and Acquisition Performance," *Journal of Financial Research* 36 (2013): 347–70.

22. Amy J. Hillman and Gerald D. Keim, "Shareholder Value, Stakeholder Management, and Social Issues: What's the Bottom Line?" *Strategic Management Journal* 22 (2001): 125–39.

23. Bradley W. Bensen and Wallace N. Davidson, III, "The Relation between Stakeholder Management, Firm Value, and CEO Compensation: A Test of Enlightened Value Maximization," *Financial Management* 39, no. 3 (Autumn 2010): 929–63.

24. Bradley W. Bensen et al., "Deviations from Expected Stakeholder Management, Firm Value, and Corporate Governance," *Financial Management* 40, no. 1 (Spring 2011): 39–81.
25. Moses Pava and Joshua Krausz, "The Association between Corporate Social-Responsibility and Financial Performance: The Paradox of Social Cost," *Journal of Business Ethics* 15 (1996): 324.
26. John Kenneth Galbraith, *The New Industrial State* (Princeton: Princeton University Press, 2007 [1967]).