Corporate Social Responsibility and Milton Friedman:

Has Business Turned Its Back on Profit?

Gabriel Ng

> **"There is one and only one social responsibility of business—to use its resources and engage in activities designed to improve 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 and fraud."**
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> **—Milton Friedman, *Capitalism and Freedom*, 1962**

Death of Friedman?

This quote from Friedman is from his 1962 book *Capitalism and Freedom* and was repeated in a 1970 article for the *New York Times Magazine*. In that article, Friedman argued that any notion of corporate social responsibility represented an undemocratic tax imposed by company executives. In the intervening years, Friedman appears to have lost the debate. For example, Apple CEO Tim Cook states: "My belief is that companies should have values, like people do." and Hugh Lawson, head of environmental, social and governance at Goldman Sachs notes: "We think ESG [Environmental, Social and Governance] investing has gone, in essence, mainstream."

Friedman's premise is that the only way a company can be said to be socially responsible is if it does so contrary to the wishes of its stockholders. Executives, while free to spend their own money and time how they wish, are, qua executives, acting as agents for stockholders. Thus, if the company simply acts in accordance with the will of its shareholders, the executive is not being "socially responsible," he is just being responsible. This view excludes one category of corporate social responsibility (CSR)(this term is used throughout this essay in an expansive sense, rather than as a narrow technical definition): those measures that are cheap and net present value (NPV) positive. For example, replacing light bulbs in the company's headquarters with long-lasting, energy-efficient bulbs or not washing the towels of your hotel's customers unless they indicate they want fresh towels. These are just measures which clearly save money—operational no-brainers—that stockholders would expect the executive to execute.

Friedman goes on to state that true corporate social responsibility, contrary to the wishes of stockholders, is a tax. This may be on stockholders (in the form of lower returns), on customers (higher prices), or on employees (lower wages). This represents a usurpation of the function of government and places a responsibility—that of spending the proceeds of this tax—on executives who are unqualified to handle it. In doing so, the tax imports the coercive element of majority rule from the political arena to the markets, where all participation should be voluntary. The only thing all participants can agree upon, Friedman implies, is on the pursuit of profit.

Everywhere you look, Friedman's views seem to be in retreat. Starbucks voluntarily paid £20 million in tax more than it was legally required to. Valeant agreed to lower the price of certain drugs. Apple built fields of solar panels and formed an energy company to sell clean power. ExxonMobil donated

$268 million in 2015 in charitable contributions. Hundreds of American companies signed a letter to President Trump urging action on climate change. Others flock to join multi-stakeholder initiatives, such as the Fair Labor Association. Corporations boast about their CSR programs with no hint of hesitation.

> **"It would be inconsistent of me to call on corporate executives to refrain from this hypocritical window-dressing because it harms the foundations of a free society. That would be to call on them to exercise a 'social responsibility'!"**
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> **—Milton Friedman, *Capitalism and Freedom*, 1962**

The Rewards of Widow-Dressing

Before we praise or bury Friedman and pass judgement, note the all-important proviso in his conclusion: "so long as it stays within the rules of the game." Ask any lawyer (or conscientious businessman) and they will tell you that there has been an unprecedented proliferation of "rules of the game." Even such topics more naturally falling within the domain of CSR have become the subject of regulation, such as section 1502 of the Dodd- Frank Act on disclosure rules regarding conflict minerals. We are now seeing a global reaction to this accumulation of law, from President Trump's promised bonfire of financial regulations to the Brexit reaction against Brussels red tape. If the primacy of profits has been replaced by a doctrine of social responsibility, we would expect fewer constraints on companies, not more.

Clearly there is something else going on. Profits remain central to corporate decision-making; CSR measures are best understood as a driver to profitability. Central to this is the public nature of the CSR measures. Friedman decried executives' rhetoric on social responsibility as "hypocritical window-dressing" for self- interested, profit-driven actions. This nevertheless represents the most accurate lens by which to view the current world. The Sermon on the Mount notes that hypocrites who "sound a trumpet before" themselves when they give to charity have "their reward." What is this reward? How does a public CSR program create value?

Preempting Costly Government Regulation

Notwithstanding the accumulation of laws discussed above, one of the most important corporate rationales for CSR is to forestall regulatory intervention. While the mills of government may grind slowly, they can grind exceedingly small. News of corporate malfeasance and the accompanying voting public's outrage can lead to dramatic action. Policy analysts refer to "the issue-attention cycle," where a crisis pushes a topic up the policy agenda and opens windows for activists to push for a government solution. Thus, we can understand Starbucks' voluntary tax payment as an investment against more onerous tax rules, and we can understand Valeant's action on drug prices as an attempt to head off price controls. It cannot be an accident that Ford discovered the benefits of manufacturing in the U.S. over Mexico just as President Trump was about to be sworn in. CSR in this case is public relations, crisis management, and political lobbying rolled into one.

Insurance

Of course, it is better to prevent crises before they happen. Closely linked to this is the concept of CSR as insurance. Rigorous compliance, or even super-compliance, with the law means a company is less likely to be caught out by a scandal. To take a simplistic example, an apparel retailer could boost profits by being willfully blind as to whether their suppliers used child labor. However, if the news leaked, it could face a large consumer backlash and accompanying destruction in the value of the company. "Corporate oracles," is a term *The Economist* coined in a 2017 article for companies that cater to public opinion and adopt practices now that they may be required to do by law later on, voluntarily do the things today that may be required tomorrow. For example, oil majors, anticipating the evolution of public expectations on environmentalism, have diversified into renewables.

Recruitment and Retention

According to a 2015 study by PR agency Cone Communications, 64% of millennials (who will make up 50% of the U.S. workforce by 2020) consider a potential employer's CSR commitments before deciding whether to sign on. Further, 83% say that they would be more loyal to an employer who makes a positive social impact; for the wider U.S. population, the figure is 70%. Companies with a credible, public CSR program develop a competitive edge in hiring and keeping talent.

> **"The discussions of the 'social responsibilities of business' are notable for their analytical looseness and lack of rigor."**
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> **—Milton Friedman,**

A New Model?

The common thread with all these rewards is that they are exceedingly hard to measure with traditional financial accounting models. While the costs are very clear line items on the books, where does one account for the ability to attract motivated and intelligent employees? Indeed, if certain CSR measures are analogous to insurance, then they would be NPV negative. But that does not make them any less important to a business: imagine a CEO telling his stockholders that he did not insure the vital assets of their company.

Friedman's view that the profit motive should drive the thinking of executives remains correct. Indeed, the proliferation of CSR measures are not a repudiation of his view. Sound business reasons exist for most CSR. Some CSR will succeed and some will fail *in their business goals*.

In short, CSR should be conceptualized as a rebuke to antiquated financial metrics that fail, in their narrowness, to capture the profitability of CSR measures. We do not need a new model of executive decision-making, we need a new model of accounting.

ABOUT THE AUTHOR

Gabriel Ng is a first-year dual degree MBA/MPA student at New York University. Previously, he worked as a lawyer at Shearman & Sterling in London, where he advised on tax law matters such as Intercontinental Exchange's takeover of NYSE, Qatar Investment Authority's acquisition of Canary Wharf Group, and GE's sale of its Indian commercial lending and leasing business. He also completed several pro bono projects, in conjunction with Lawyers Without Borders. Now, he works as a research assistant at the Stern Center for Business and Human Rights. Gabriel grew up in Hong Kong before moving to the U.K. to study law, and obtained his B.A. in Law at the University of Cambridge, Trinity Hall

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