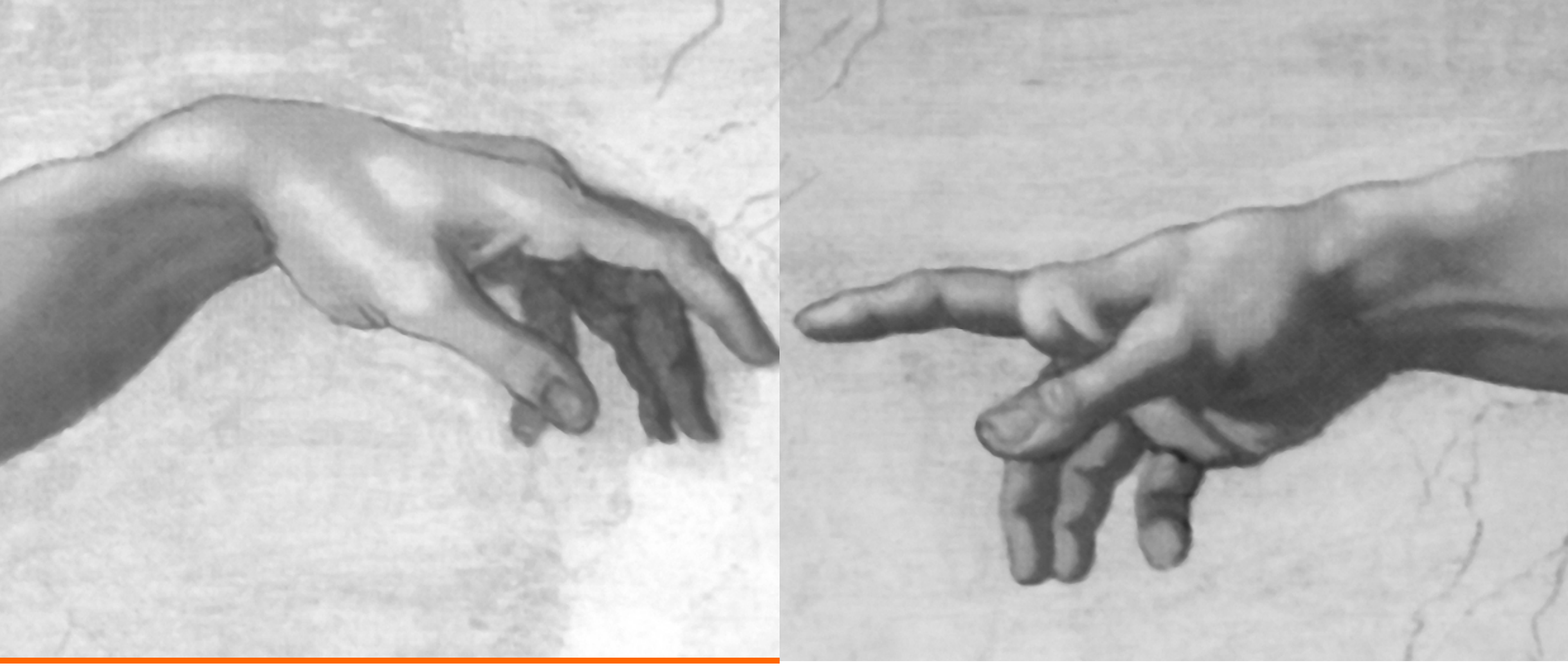

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Is Profit Maximization the Social Responsibility of Business?

Milton Friedman and Business Ethics

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Is Profit Maximization the Social Responsibility of Business?

Milton Friedman and Business Ethics

von Prof. Dr. Andreas Suchanek

I. Introduction

Although the question regarding the responsibility of corporations is certainly not new, presently the discussion around „corporate social responsibility“ (CSR) is a prominent one. Corporations, especially the large ones, face a situation, where they are held accountable for a variety of problems, from corruption to child labor. The consequences of these developments can be observed either at capital markets where the share of “ethical investments” is constantly increasing or at corporations launching “CSR-reports” etc.

But what exactly does CSR mean? A famous answer, given 35 years ago, is still much cited. It is Friedman’s assertion “The social responsibility of business is to increase its profits.” His same named essay from 1970 is still to be regarded as one of of the most published and most influential essays in Business Ethics.[1]

Friedman’s essay has grown from a discussion, though more public than scientific, dealing with the question of how far companies should take responsibility for overcoming social and ecological problems in society (cf. Silk/Vogel 1976). Friedman’s answer in this matter is clear: the concept of social responsibility is a “fundamentally subversive doctrine in a free society” (Friedman 1990, 12). The reason is that ‘agents’ (managers) receive resources from ‘principals’ (owners of companies) for a clearly defined task, i.e. profit making. But in the name of “social responsibility,” they are supposed to be entitled to use these resources not for this task but for ‘some’ social and ecological requests. Managers, however, have neither the instruction nor the necessary information and incentives to fulfill this task efficiently. Such a suggestion does not only lead to an inefficient use of scarce

[1] Cf. Fleming 1987. A brief overview over text books about “Business Ethics” proves that Friedman’s essay is to be regarded as one of the most published and most influential essays in Business Ethics. To name some examples: Adams/Maine (eds., 1998), Beauchamp/Bowie (eds., 1988), DesJardins/McCall (eds., 1990), Donaldson/Werhane (eds., 1988), Hartman (ed., 1998), Hoffman/Frederick (eds., 1989), Snoeyenbos/Almeder/Humber (eds., 1983). In the following text, Friedman’s essay will be quoted from the anthology by DesJardins and McCall.

resources but can possibly invite managers to misuse their decision-making powers due to lacking possibilities of control.

Friedman's considerations do not only show plausibility, they also represent an insight which Business Ethics should take adequately into consideration. Nevertheless, I will claim that Friedman's thesis is one-sided and that the theory that forms the basis of it is deficient. His approach isn't sufficiently sophisticated to develop an appropriate concept for corporate responsibility as well as for the responsibility of managers. Friedman is right to criticize a notion of 'social responsibility'[2] which does not reasonably account for the conditions of business, but he leaves out the opposite problem, that certain forms of profit making are in conflict with moral norms in that they violate reasonable social or ecological standards. This side of the topic "Corporate Social Responsibility" also requires conscientious clarification. Profit and moral, to be short, can repeatedly come into conflict. Friedman admittedly has something to say about this, but, because of his restriction to only one aspect of the topic, his position gets caught in an one-sidedness that is somewhat problematic. In addition, his attempt turns out to have relatively little to offer regarding the question of how to deal appropriately with such conflicts.

Before dealing with this criticizm in more depth, I will start with a description of his position.

II. Friedman's Position

The essential reason for the fact that Friedman's essay is one of the most influential in business ethics is most likely because Friedman supports a specific position in a concise form. In this respect, his position is well suited to be used as a reference.[3] This position is directly expressed in the title, according to which companies *exclusively* have the responsibility to prove themselves on the market and to increase their profits. Friedman developed his thesis from a theoretical conception whose assumptions are to be presented in this section.

[2] At this point, as well as in the following text, the term social responsibility is put into simple quotation marks if the problematic interpretation that is criticized (with justification) by Friedman is concerned. This interpretation does not reflect the institutional conditions of the context in any way.

[3] "His position is attractive in both its clarity, simplicity, and elegance, and also in its solution of the problem of the social control of business." (Smith 1990; 61)

(1) The starting point is Friedman's basic normative premise of a liberal society as reference model for a "good" society (Friedman 1980, Friedman/Friedman 1980). This means a society whose members have on one hand fundamental economic freedoms which enable them to make decisions as buyer or seller/supplier according to their own preferences; on the other hand they have fundamental political freedoms that ensure their rights to have a say in political decisions and their protective rights against governmental intervention in their decision-making powers.

(2) Friedman assumes that individuals always follow their own interests (in a basically rational manner). He stresses that following personal interests should not be interpreted simply as selfishness or mere interest in money. "Self-interest is not myopic selfishness. It is whatever it is that interests the participants, whatever they value, whatever goals they pursue. The scientist seeking to advance the frontiers of his discipline, the missionary seeking to convert infidels to the true faith, the philanthropist seeking to bring comfort to the needy - all are pursuing their interests, as they see them, as they judge them by their own values." (Friedman/Friedman 1980; 27) At this point, as well as at others, Friedman refers to A. Smith and his statement referring to each human being seeking to improve his lot (ibid.; 144). The question is how to coordinate the corresponding efforts of every actor with those of others in such a way that a cooperation for mutual advantage becomes possible.

(3) Friedman's answer to this question includes another reference to A. Smith, namely the famous formula of the "invisible hand". This concept stands for the coordination mechanism of the market. According to Friedman, the most efficient institutional system for the development of individual freedom is the market as a system which is to be seen paradigmatically as the system of voluntary nature and the absence of pressure.[4] This is made possible by the combination of exchange and competition characterizing the market. The exchange between supply and demand is, as it were, the paradigm of voluntary interaction because exchange only takes place if the exchange partners improve their position. Nevertheless, since there can be extremely unequal relations of exchange, due to a one-sided distribution of

[4] "The political principle that underlies the market mechanism is unanimity. In an ideal free market resting on private property, no individual can coerce any other, all cooperation is voluntary, all parties to such cooperation benefit or they need not participate. There are no "social" values, no "social" responsibilities in any sense other than the shared values and responsibilities of individuals." (Friedman 1990; 12)

(economic) power, the combination with competition is quite important. Competition, among other things, opens up further alternatives or exit options to the potential trade partners. At the same time, Friedman does not fail to point out that functioning markets have many institutional preconditions and in no case can they function ‘naturally’, as it were, a fault of which he and other liberals are often accused. Friedman knows the relevance of the “rules of the game” which are to be determined in such a way that market forces are not limited but freed up if possible.[5]

(4) It is the government’s job to determine these “rules of the game” (Friedman 1980; 15, 25 and passim). According to Friedman, the goals of determining rules (and enforcing them) are to create as much room as possible for the market as a system of voluntary approval and to minimize the pressure, i.e. the necessity of “conformity”[6]. This is synonymous with the premise that the power of the government, which is definitely necessary, has to be limited. Friedman considers the concentration of power to be a fundamental threat to free society.[7] This does not only apply politically, but also to economic power as it is expressed in the form of the monopoly (Friedman 1980; 120 ff.)[8]. This assumption is of great importance to Friedman’s argumentation in that he is also centrally interested in the effective control of management power.

(5) Within the context of such a liberal society, a company is a union of free individuals, more precisely, “an instrument of the stockholders who own it” (1980; 135). Here, the classic liberal assumption is expressed that investors of capital are the owners of the company and in this respect also have the right to determine the company’s course (taking the given legal rules, social norms and terms of

[5] Friedman 1980 and Friedman/Friedman 1980 include numerous further considerations and illustrations to this point.

[6] “The political principle that underlies the political mechanism is conformity. The individual must serve a more general social interest - whether that be determined by a church or a dictator or a majority. The individual may have a vote and a say in what is to be done, but if he is overruled, he must conform.” (Friedman 1990; 12)

[7] “The greatest threat to human freedom is the concentration of power, whether in the hands of government or anyone else.” (Friedman/Friedman 1980; 309; also see Friedman 1980; 2 and passim)

[8] At this point, one can already find a systematic incoherence in Friedman’s attempt. It is obviously possible that also in the market there is pressure of “conformity”, i.e. acceptance of monopoly prices, exactly like one can rediscover “voluntary nature” in democracy that is characterized by political competition – what , by the way, Friedman knows well (cf. Friedman/Friedman 1980; 27 f.). It should be added that the “voluntary nature” of actors who have to act under competitive conditions, differs strongly from daily comprehension of the term. These short remarks point out that Friedman uses the terms “unanimity” or “voluntary nature” and “conformity” in their common, somewhat elusive meaning. Especially, he fails to recognize the *systematic* relevance of the distinction between rules and action which is expressed in the fact that one can voluntarily approve of rules that force oneself to act in conformity; cf. Buchanan 1975.

competition adequately into account). At the same time, it has to be taken into consideration that, according to Friedman's opinion, companies as such, are not able to take responsibility; "the only entities who can have responsibilities are individuals" (Friedman, as quoted in Entine 2002; 75). Thus, according to Friedman, social responsibility can neither reasonably be assigned to "the economy" nor to the companies but only to persons as actual decision-makers.

(6) Managers who are employed by companies have a contractual relationship with the owners of the company, the shareholders; they are their "agents". According to Friedman, they have concrete responsibility only to these shareholders. Their further responsibility to other stakeholders is settled by obeying legal and moral rules like the avoidance of deception and fraud.[9] However, Friedman knows that responsibility is to be organized in an incentive compatible way (see above (2)). The fundamental solution for this problem is to tie managers down to the objective of increasing profits. This has a double advantage for two reasons: First, this criterion is easy to observe.[10] Second, a company that makes profit at the same time contributes to social cooperation for a mutual advantage because this profit making indicates efficient performance or increase in value.[11] In this respect managers fulfill their responsibility to society by acting in a profit making manner – in the same way as this applies to " the butcher, the brewer, or the baker".[12]

(7) Friedman uses these considerations to fiercely criticize the catchphrase of 'social responsibility' pertaining to the economy or individual companies.[13] In his eyes, this concept is vague and indefinite: "The discussions of the "social responsibilities of business" are notable for their analytical looseness and lack of rigor". (Friedman 1990; 9). More precisely, Friedman opposes any idea in which managers, as the

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[9] Friedman 1990; 12. Here Friedman quotes himself from Friedman 1980; 133. Carson (1993) points out that that there are inconsistencies between Friedman's essay from 1970 and the respective passages in his book from 1962 in so far as in 1970 Friedman strictly links the responsibility of managers to the interests of the owners without the necessary additional condition that this has to be a matter of legal or legitimate interests.

[10] The importance of this quality with respect to the possibility of social control can hardly be overestimated.

[11] It should be noted, however, that Friedman assumes the working of the "rules of the game" as well as of markets.

[12] Compare Friedman's repeated reference to the "invisible hand" already mentioned, e.g. Friedman/Friedman 1980; 2, 189 ff. and passim.

[13] The term "business" is not clear here. This will play a part later on in so far as companies as corporate players can definitely be assigned responsibility. However, 'the economy' that is not a player cannot sensibly be assigned any responsibility.

relevant economic decision-makers, should use the resources made available to them for other objectives than profit making. Their essential duty is a fiduciary one regarding the capital entrusted to them (cf. Coelho et al. 2003). Friedman mentions three examples for misunderstood fulfillment of social responsibility (Friedman 1990; 9): (1) Managers could refrain from pushing through price increases in order not to contribute to (socially unwelcome) inflation; (2) they could take costly measures, extending beyond legal regulations, to make a contribution to the objective of environmental protection in this way; (3) and lastly, they could (again at the expense of business profits) employ long-term unemployed instead of more qualified employees as a contribution to the fight against poverty. Friedman's criticism, at this point, is not directed at the demand to stop such measures themselves. Rather his criticism is that the managers do 'something good' here with money that does not belong to them and that was entrusted to them by the owners of the money for other purposes.[14]

The real problem here is not expressed by the question of whether or not the resources could have been supplied to a more efficient use in the individual case. It rather lies in the impending undermining of functional contexts that form the basis of a free society. "Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate official of a social responsibility other than to make as much money for their stockholders as possible. This is a fundamentally subversive doctrine." (Friedman 1980; 133) The "subversive" character of this idea of social responsibility is to be seen in the undermining of property rights, in which managers are encouraged to do 'something good' according to diffuse social and ecological criteria, instead of fulfilling their duty to use the property of others entrusted to them strictly in the interest of the owners, precisely for profit making.

In this context, Friedman points out that managers do not only lack the necessary information about which use of resources would really serve the public welfare in the best way ("How is he to know how to spend it?" Friedman 1990; 10). There are also problems of incentives because of the yet unsolved problem of how the misuse of this power can be controlled effectively.[15] Especially this last point is

[14] This can easily be made clear on the basis of the following consideration: It would be more than strange if one is informed by the investment manager to which one has entrusted one's money that he (the manager) spent a part of it – as a realization of his 'social responsibility' – for the financing of the local clinic because it had needed money so urgently. This undermining of property rights is what Friedman's criticism is directed at.

[15] It is to be called to mind one more time (cf. above (4)) that for Friedman the control of power is the central problem of a liberal society.

essential for Friedman's mistrust since he knows as an economist that the problem of the concentration of power must also be taken very seriously, because the possibility of misuse of power for gain is a very strong incentive for certain individuals to seek this power. That is why he supports the maximization of profits as strict guideline for managers because – assuming there are suitable government and moral norms as well as functioning markets – unlike 'good deeds,' this criterion is not only easy to observe but also indicates that managers perform efficiently in the exact way they should.

(8) Friedman uses the following argument in support of his position: He presents the use of business resources for 'good deeds' as a form of taxation that is illegitimate because it has not, as in the state, developed in accordance with the regulations and the corresponding "checks and balances" (Friedman 1990; 10).[16] Put differently: As much as social and ecological problems really need to be solved, it is not the task of business, but that of the government which has the resources as well as the institutional procedures for coordinating occurring conflicts of interests. The manager, however, is all but a "civil servant," but he is "an agent serving the interests of his principal", i.e. the owner of the company (ibid.).

(9) In the course of the following argumentation Friedman points out again where he sees the real danger: in the semantics, i.e. the way of speaking about "social responsibility of business." Even supported by entrepreneurs and managers themselves, this is dangerous because "it helps to strengthen the already prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces" (ibid. 12). On one hand, this results in directly offering managers the possibility of misusing the resources (entrusted to them) for own purposes – at the expense of the stockholders – in the name of 'social responsibility'. On the other hand, it increases the dimension of the politicization of decisions, and at the same time paves the way for collectivism.[17] This can happen for example, when the "iron fist" of government (ibid.) further limits the freedom of business, because in time it will become clear that managers are by no means the most suitable players to

[16] That is the reason why in the literature it is spoken of the "tax (or taxation) argument".

[17] At this point at the latest, parallels to Hayek's argumentation and his criticism of 'social justice' become quite clear; cf. Hayek 1976, especially chapter IX. Hayek's criticism is directed above all at the fact that with regard to certain social conditions worth striving for – i.e. more material equality – measures of redistribution are taken that undermine 'deeper' institutional structures.

perform ‘good deeds’. In this way, all those who demand that the business’ fulfillment of ‘social responsibility’ should exceed beyond the maximization of profit contribute to undermine the foundations of free society, namely the rules of private property, of competitive markets and of the companies acting on them. Regrettably, there are also some managers who borrow this way of speaking about ‘social responsibility’ if they comment something in public (ibid.)

III. The One-sidedness of Friedman’s Position

If one takes a closer look at Friedman’s argumentation, an interesting question arises: Why does Friedman consider it necessary at all to criticize the concept of social responsibility with the background premise of his market-orientated, liberal position? This question is by no means trivial. The obvious answer seems to be that the assertion, that economy, business or managers are assigned responsibility in an inappropriate way, is to be criticized. But then, one can ask further as to why this criticizm needs to be emphasized if functioning markets are implied. Expressed differently: Friedman seems to think it possible that a “market failure” can occur due to moral demands on business.

To clarify this point, the “tax argument” is to be observed more closely (cf. point (8) in the previous section). According to this, Friedman criticizes the idea that the manager spends the money available to him for social or ecological purposes with the remark: “they can do well – but only at their own expenses” (Friedman 1990; 11); managers should not, however, use the shareholders’ money to fulfil dubious social or ecological responsibilities. But this “tax argument” is weak for several reasons.[18] The most important reason is the following counterargument which can be derived from Friedman’s own concept. Accordingly, operative markets efficiently perform a social supervisory function also and especially with regard to the decision-making behaviour of managers: If customers are “taxed” in the form of prices that are above the competitive price in order to use the difference for ‘good deeds’, then these customers will leave if they do not accept the socially or ecologically motivated expenses of the company as compensation for the higher price; if the wages of the employees should be below the equilibrium wage for the same reason, the employees will – a functioning market implied – leave the company; if the

[18] Cf. for example DesJardins/McCall 1990, 16 ff.; Liechty 1990; Boatright 1993; 398 ff.

stockholders receive lower dividends because the profits are used for 'good deeds', they will sell their shares – or fire the managers.[19] That is to say, under the conditions of functioning markets for goods and services, for labor, and for capital, a manager, *according to the concept implied by Friedman himself*, should not be left any leeway to misuse the resources entrusted to him in the way feared by Friedman.

If Friedman, nonetheless, considers it to be necessary to criticize the usual notion of social responsibility, then he obviously assigns possible effects to this kind of public communication that can contribute to destroying these market forces; even worse: Friedman fears explicitly that the foundations of liberal society could be undermined in the name of responsibility and morality (cf. above (7)). The danger results from the fact that, due to "shared mental models" (Denzau/North 1994) of relevant stakeholders, pressure can be put on the decision-making behavior of managers that differs substantially from profit-maximizing behavior. Business activities might become legitimate that can have unintended and socially undesirable consequences. Thus, Friedman states the fact that public ideas of morals and responsibility may have a considerable influence on the markets' ability to function.

It should be emphasized that this consideration of Friedman is to be agreed with explicitly, and some of his other arguments also offer important insights that should be taken into consideration with regard to the question of determining the (social) responsibility of business. This especially requires an understanding of the functional connection of the institutional arrangements of the 'market' and the 'state under the rule of law' and the insight that these institutional arrangements' ability to function can be reduced by 'well-meant' interventions, whether that be by politicians, by managers or – thus it is to be added today – by non-governmental organizations. Undesirable, unintended consequences are the result. In a discussion about the question of corporate social responsibility, one also has to consider the problem mentioned by Friedman, which is how managers can be controlled appropriately with regard to the task they have been assigned.[20]

Thus, the problem of Friedman's argumentation is not that it is incorrect but that it is one-sided. Especially because Friedman recognizes – although implicitly for

[19] Interestingly enough, Friedman himself refers briefly to this connection at some point (Friedman 1990;10) without dealing with it in more detail and resolving the tension between this fact and his own statements, which have been mentioned previously.

[20] It is a deficit of several Business Ethics positions to give no satisfactory answer to this and to avoid the problem largely by demanding an appropriate moral behavior; cf. for example Ulrich 1998; 431.

the most part – that the moral ideas of citizens can have an immense impact on the markets' ability to function, it is important to be able to grasp these moral ideas adequately. But exactly at this point, Friedman's approach is deficient. His position differentiates between two forms of (fulfilling) social responsibility: an inappropriate one which can lead to an endangering of the free society and an appropriate one that Friedman equates with profit maximization. What he fails to do though, is to apply this differentiation to the imperative of profit maximization, i.e. to differentiate between an inappropriate and an appropriate form here as well. In this way his position receives that one-sidedness of which it is often accused.

Expressed differently, there is a further threat to the foundations of a free society that Friedman does *not* mention: Not only does the inappropriate form of fulfilling social responsibility endanger these foundations, there are also inappropriate forms of profit maximization that – metaphorically speaking – live off the conditions that a free society offers and thereby use it up or undermine it.

Essentially, this difficulty arises if the strategies by which the increase of profits is striven for hurt the (legitimate) interests of a third party. This type of situations can be called a *conflict between (the increase of) profits and morals*.

IV. The Conflict Between Profit and Morals

"Morals" is a complex concept. But it may be sufficient at this point to understand it by the appropriate explicit or implicit consideration of the legitimate interest of all stakeholders concerned by business decisions[21]. As far as suitable general regulations exist and the prevailing markets function, one can assume that these interests are already taken into consideration institutionally – above all by laws and market prices. But there are enough examples showing that situations keep arising as well which contain variants of the basic conflict. Some examples may be sufficient for illustration at this point[22]:

- A building contractor is confronted with the problem that she has only a chance to get a major contract urgently needed by means of bribery.

[21] Without doubt some of the concepts in this definition such as "appropriate" or "legitimate" have to be explained. But at this point it may be enough to refer to typical examples in order to gain a sufficient understanding for the following considerations. For more extensive considerations cf. Suchanek 2001.

[22] Further examples and their relevance for a revision of Friedman's position can be found in Carson 1993.

- A fashion store sells fabrics – at a profit – that have been made by children under poor working-conditions for low wages.
- In an industrial enterprise, costly security standards are not met due to missing governmental regulations or the knowledge that there is no control.
- Because of the costs, a pharma concern decides against producing a drug that may be urgently needed, but those in need of it do not have the willingness – or rather: ability – to pay required.
- A large enterprise can lower costs by delaying the payment of invoices from small suppliers for whom the prosecution for punctual payment might be almost prohibitively expensive.

Numerous other possible (or real) cases could be mentioned but these examples may suffice to point out the relevance of the assertion that business or managers can keep getting into situations where they can increase profits in a way that is inappropriately disadvantagous for a third party.

These conflicts of profit and morals are usually not rooted in some inappropriate ideas of intellectuals who lack any knowledge of market processes; instead, the conflicts often have a real basis in that business action actually may lead directly or indirectly to disadvantages for a third party which many people consider to be unreasonable and morally outrageous. It would be inappropriate to only refer to the criterion of profit maximization in the face of such a situation. This would be synonymous with a one-sided solution to the conflict – namely to the advantage of the profit and to the disadvantage of morals – that would be problematic in the same degree as the one-sided solution to the disadvantage of profit and in the name of 'social responsibility'. Because companies are dependent on public acceptance, they only receive their "license to operate" under the condition that they do not act illegitimately. In this respect a one-sided solution to the conflict to the advantage of profit and to the disadvantage of morals would harm the market economy no less than a misinterpreted concept of 'social responsibility'.

To this line of argument one could reply that profit maximization always means the 'right' way of increasing profits which solves these conflicts most efficiently (and if managers cannot solve them it is the task of the government to change the rules of the game). But this purely semantic solution to the underlying problem would be unsatisfactory. In the same way, one could reply to Friedman's criticism of 'social responsibility' that basically always the 'right' kind of fulfilling social responsibility is meant and that it is in the (enlightened) interest of business to act accordingly. Then, Friedman's argument becomes irrelevant.

Put differently: There is a right and a wrong understanding of the concept of social responsibility and there is also a right and a wrong way to maximize profits. Asserting, that profit maximization *always* leads to socially desired outcomes is either wrong or argues away the underlying problem and fails to clarify how a *responsible* form of profit-making is characterized.

V. Freedom and responsibility

How can one describe the problem that a misinterpreted concept of profit maximization may undermine the foundations of the free society? In a nutshell the answer is: successfully striving for profit depends on (institutional) preconditions that are not completely independent of the way in which this pursuit of profit is put into practice; this can also happen in such a way that the (institutional) preconditions of successful – and socially welcome – business activity deteriorate and with them the possibilities of future profit-making.

For example, short-term hit-and-run strategies of a company are an obvious example for forms of profit-making that are socially undesirable insofar as they often cause costs in the long run. Obviously, Friedman does not consider such short-term strategies to be a real problem and the reason for this is probably his trust on the market which sorts out such irresponsible behavior. But especially the market or the competition can lead to the result that socially undesirable behaviour is stopped due to the pressure that the restrictions of the market put on the decision-makers in a business.

Thus, it can happen, to name an example, that toxic substances whose disposal according to regulations can cause immense costs are tipped into nearby stretches of water, in the normal garbage or the like without further precautions and in an environmentally harmful way because the pressure to lower costs caused by competition is so immense.[23]

[23] It should be mentioned in passing that there doesn't exist any economic system in modern society in which situations do not keep arising in which individuals are put under severe pressure and then take undesirable measures; therefore a complete elimination of such behavior is impossible. Therefore, the task is to compare different institutional arrangements in relation to the question how and to what extend they cause such behavior on the one hand and sanction it on the other hand.

Without doubt, Friedman is aware of such problems and sees two forms of incentives that can get managers to act responsibly: a) the incentives of the market on which clients, employees and investors as the most important groups of stakeholders assert their claims and punish ‘irresponsible’ decisions by migration; b) the incentives that are defined by general regulations of the government and that are supposed to take effect if market forces e.g. due to negative external effects[24] do not provide for the correction necessary themselves. In the end, it is the government’s task to solve all those conflicts of profit and morals, that cannot be solved by the market itself, by adjusting the “rules of the game”.

But exactly with regard to the possibilities mentioned at last a problem arises that is obviously underestimated by Friedman: On the one hand he assumes the ‘strong’ sovereign state that provides a ‘good’ and reliable set of general guidelines, on the other hand a major part of his publications aim at opposing the increase of governmental activities – including different regulations. Thus, his reasoning leads to a dilemma: Either the government is assigned the responsibility to solve all those conflicts between profit and morals that the market does not provide – and this leads undoubtedly to an immense increase of governmental activity and regulation. Or one pleads for a limitation of governmental activities and regulations and a granting of more entrepreneurial freedom and competition, but then the question arises as to whether the unspecified guideline of profit maximization will be sufficient to solve the prevailing conflicts in a satisfactory way.

Exactly at this point, a precise definition of corporate or management responsibility is needed. Expressed as a thesis: The responsibility of economic decision-makers is not only to be seen in making profits in compliance with the “rules of the game”, they also have a responsibility to *preserve and if possible improve the (future) conditions of their own freedom of decision-making in that they themselves strive to avoid or solve current or potential conflicts of profit and morals as well as to improve the (institutional) preconditions for the solution to those conflicts.*

To explain this thesis, a simple game-theoretical form of argumentation may be used. Starting point of this explanation is the well-known prisoners’ dilemma that can be interpreted as a paradigmatic example of the conflict between profit and morals[25] at this point:

[24] Friedman talks about “neighborhood effects”, cf. for example 1980, 28 ff.

[25] Of course, this is a drastic simplification because real forms of this conflict are much more complex. But to bring out the basic way of thinking it will be refrained from further differenciations at this point. A possible interpretation

			B	
			k_B	nk_B
A	k_A		I *2, 2*	II *0, 3*
	nk_A		III *3, 0*	IV ***1, 1***

The individual rational strategy *nk* which shall stand here for profit-orientated action leads to a disadvantage of the parties involved (and perhaps that of a third party) which could be avoided if the parties involved could agree credibly on the strategy *k*.

A well-known solution to this problem is to introduce suitable rules that change the pay-offs in the desired way:

			B	
			k_B	nk_B
A	k_A		I *2, 2*	II *0, 3-p*
	nk_A		III *3-p, 0*	IV *1-p, 1-p*

Thus, may *p* be a parameter that represents the costs incurred going to the expense of the player who chooses the strategy *nk*. In so far as its expectation value is high enough a change to strategy *k* becomes attractive from the players' point of view. As outlined before, Friedman considers it to be the government's task to define suitable rules which ensure that *p* reaches a high enough expectation value.

However, it would be a misunderstanding – that possibly might suggest itself with regard to the strongly simplifying depiction – to think that these rules are to strictly determine the room for maneuver of the players[26]; this would, in fact, contradict the basic idea of a free society. Institutions are rather to be understood as an "infrastructure of freedom". That means that institutions do not determine actions down to the last detail, but they set a frame for individual behavior in a way, that the freedom of one is compatible with the freedom of others. Seen in this way, institutions

of the dilemma described in the text is a situation where two firms have to use bribes as one means of competition and both would be better off if both wouldn't have to use this means.

[26] Thus, the model could suggest that the players are to be tied down to a specific way of acting, i.e. *k*.

are always "incomplete"[27] in a certain sense or, properly speaking: *open* in as much as they open up freedom to choose.[28]

This characteristic of openness is of central importance in this context because the possible degree of the institutions' openness depends to a great extend on the behavior of the players: The more reliable one can assume that the people stick to the rules – even without being told down to the detail what to do and what to refrain from and without a surveillance authority keeping watch on every single action –, the more open the institutional arrangement can be designed. However, should mutual mistrust prevail or should there be more intense conflicts of interest, it will be necessary to pay attention to stronger institutional protection of the mutual reliability of behaviour by suitable control mechanisms and sanctions – and this will cause costs.

This consideration has important consequences for the determination of corporate responsibility (and more general: the responsibility of citizens). *Institutions are not free of charge, and the costs of their maintenance depend on the behavior of individual as well as corporate actors*. These costs can arise e.g. in the form of taxes for the government that imposes these institutions, in the form of notarial contract costs or similar expenses directly incurred. But most important are those costs that show a certain similarity to the concept of opportunity costs: the *costs of missed options to act owing to institutional restrictions*, in which these restrictions have to be considered as being necessary due to the missing confidence in the fact that actors use their freedom in a responsible way. If it should turn out that institutions which have only pre-structured the action of the actors with general guidelines at first, are evaded by these due to a lack of detailed regulations, then it is to be expected that such detailed regulations will further limit the actors' rooms for maneuver in time, and that they will not only stop undesired but also possible desired ways of acting. This might also imply that the gains from cooperation made possible by the introduction of institutions are overcompensated with their costs. A consequence might be to refrain to realize potential gains from cooperation because of the anticipated costs of necessary institutions, that arise due to a lack of mutual confidence in the reliability of the partners interacting.

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[27] The term "incomplete" derives from the discussion in "New Institutional Economics" about the concept of incomplete contracts; cf. e.g. Tirole 1999.

[28] For the idea of "openness" of institutions cf. Suchanek/Waldkirch 1999. It should be mentioned that at this point and in the following text, the concept of openness has a positive connotation; one could also think of a problematic form of openness, that is exactly not accompanied by that establishing of mutual reliability of behavior that is indispensable for a "freedom under the law".

To explain the basic idea according to the scheme already used before:

		B	
		k_B	nk_B
A	k_A	I *2-x, 2-x*	II *0-x, 3-x-p*
	nk_A	III *3-x-p, 0-x*	IV *1-x-p, 1-x-p*

Here, *x* stands for the direct and indirect costs that are caused by the establishing of institutions and that have to be carried by the players. If *x* should exceed a certain value, the gains from cooperation (cell I) will be overcompensated with the costs.[29]

Now, a crucial fact is that the parameter *x* always depends on the players' behavior. If, for example, the player stick to the rules, monitoring and enforcement costs will decrease. In this sense, a rule-observing behavior can be seen as a kind of investment in a condition that enhances cooperation for mutual advantage.

Put differently: Institutions represent *assets* in so far as the possible value of individual actions – and often enough: the fact that they are made possible – depends to a large extent on the availability of suitable institutions, and this is especially valid for all kinds of business investments because the benefits here will not arise until an uncertain future, whose uncertainty can most often be reduced sufficiently by institutions in a way that actors will be willing to take these risks. But these assets depend, as said before, on the actions of individuals who act under these institutions. Thus, it could be said that the actions, at the same time, always also represent an investment (reinvestment, disinvestment) in current systems of regulations, however marginal this investment may be in the individual case; the respect of the rules strengthens them, their violation undermines their validity.

To sum up: *institutions*[30] *are collective goods that need (re-)investment and the worth of which depends to a large extent on these (re-)investments*. It should be noted, that the sole respect of a rule can already be interpreted as such a (re-)investment.

[29] If the numbers in the matrix are interpreted cardinally, then $x < 1$ ought to be valid, so that the establishing of the institution is worthwhile. Here, it has to be taken into account that the institutions are valid for a number of corresponding (situations of) actions, causing the value to get very small in the individual case in contrast to *p*, whose value is related to the individual action.

[30] To be sure, not all kinds of institutions are really assets. Some may be ill-designed, anachronistic, or overly complex. But, in principle, institutions – be it formal or informal ones – are a necessary prerequisite for every successful cooperation.

With regard to the context discussed here, considerations can be stated more precisely to the effect that managers always have a share of responsibility for the preservation (and improvement) of rules under which they act and which enable them to make permanently entrepreneurial decisions with the prospect of future revenues. Thus, companies or managers have a vital interest in not being suffocated by governmental regulations. But the corresponding rooms for maneuver can only be granted to companies by society if these rooms are not misused, that is, if one can *trust in the integrity of the firm*[31]. Institutions are still necessary for many solutions of conflicts between profit and morals but the arrangement of these institutions can be either more detailed – and therefore generally more costly and more unpleasant for business –, or more open and liberal, and this depends on the ways and means that are used while trying to make profits.

Summing up: *Manager (also) have a ("social") responsibility to contribute to the preservation and the extension of future possibilities for legitimate profit-making by participating in the construction, preservation and extension of those arrangements that form the preconditions for exactly this*.

V. Companies as Corporate Actors

The explanations of the last section are to show that Friedman's argumentation suffers from being too one-sided: he underestimates the the challenge to strive for profits in a way that doesn't undermine the (institutional) conditions for the firm's license to operate. Possibly, Friedman took this aspect as obvious and not worthy to be mentioned, but the many stories of Enron, WorldCom, and so on demonstrate how important it is to understand clearly the necessity for investment in these kinds of assets as institutions, trust, and integrity.

This is also expressed in another aspect that Friedman briefly touches upon: the understanding of firms. As already mentioned above (cf. section II., point (5)), Friedman considers firms to be solely an instrument of the owners without any further specified status; he stresses especially that only individuals are in a position to be assigned responsibility. In doing this, however, he fails to recognize a fundamental aspect of organizations or companies: They are *"corporate actors"*[32] in a way that it is

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[31] For the concept of a firm's integrity cf. the following section.
[32] Fundamental for this is Coleman 1990; for the relevance of this concept in the context of Business Ethics cf. Waldkirch 2002, Wieland 2001.

possible to assign responsibility to them. Companies as institutional arrangements are a unit that, by other actors, customers, shareholders, politicians, representatives of the media etc., is considered to be capable of acting. This has already become evident in the face of the legal status that companies have as “legal persons”. As such, they are “fiktive Zurechnungssubjekte” (“fictive objects of attribution“) (Waldkirch 2002; 164 ff.) which can also be held responsible for events that result from ‘their’ actions. Consequently, one needs to clarify what the responsibility assigned to them consists of – and what not – and how they reasonably take it. Conceptually, there are no new questions that arise: Just as before, an inappropriate form of assigning responsibility can be distinguished from a ‘right’ one, and the same holds true for the corresponding forms of profit-making. In the same way, it can be argued that companies have a share in the responsibility for the rules under which they act, and this is especially valid in a time when traditional control systems and the conditions under which they can be enforced break away or need adjustment due to globalization. Here, it becomes even more evident than before that Friedman’s assumptions according to which the (‘sovereign’) state has the responsibility and the means to set and enforce the “rules of the game” needs to be differentiated under today’s conditions. Expressed differently: In today’s world society, companies inevitably belong to those significant players that have to contribute to functioning institutions.

Thus, with regard to rules that only exist or are only enforced rudimentarily, companies are confronted with the need to provide the conditions for a successful market transaction not only by establishing an appropriate reputation as a reliable partner but also by investing in those (institutional) conditions which allow them to operate successfully.[33] On the part of different groups of stakeholders, dealing with moral requirements, thus, becomes a task of management that is all but trivial; and it is the task of the corresponding scientific discipline, of business ethics, to generate and communicate systematically relevant insights for this problem area.

VI. The Role of Business Ethics

After the previous considerations, the task of Business Ethics can be specified to such a point that it is supposed to make theoretical contributions to solve conflicts

[33] In Business Ethics, the importance of the “integrity” of companies is lately referred to at this point as that characteristic that, with regard to incomplete contracts, signals the own reliability as cooperation partner; cf. Paine 1994.

between profit and morals. These contributions can be further categorized (1) as criticism and (2) as heuristics.

(1) With regard to criticism it can be differentiated once again with regard to the two sides that determine the conflict. Thus, on the one hand the different moral demands that are put forward by diverse groups of stakeholders – including intellectuals[34] – have to be analyzed critically regarding their compatibility with the institutional conditions of market economies founded on the rules of law. This has to be done in order to avoid that existing standards are undercut. As shown, M. Friedman makes an important contribution to this aspect.

However, it has been argued here that the other side of the coin has to be discussed as well, i.e. the problem of an economic or economical reductionism – as it could be called – that leaves out relevant dimensions and e.g. is solely oriented towards measurable results. Therefore, if one focusses only on measurable profits one might be in danger of losing track of relevant factors such as e.g. integrity as well as the possibility to connect with the moral institutions of numerous people whose perception is not primarily defined by the social subsystem of economy.[35] At this point Friedman's position turns out to be deficient, and this is problematic not at last because for this reason correct insights have less impact due to the – in the critics' eyes – lacking or inappropriate ethical foundation.

(2) The task of business ethics does not only consist of criticism. It should rather be able to develop at least conceptionally constructive suggestions for solving the fundamental conflict of profit and morals. And also at this point Friedman's approach turns out to be deficient. Because with regard to the problem mentioned before, Business Ethics would be superfluous, as it were, due to the fact that Friedman discusses and defines away the conflict of profit and morals since profit making is principally considered to be done responsibly, and if problems occur, it is the responsibility of the government to ensure the conditions for the compatibility of profit and morals. In this way, Friedman forgoes the opportunity to be able to systematically discuss and analyze this conflict. But especially in a free competitive society – all the more under the conditions of globalization – it has to be expected that conflicts

[34] This means that Business Ethics also has to be self-critical regarding its own possibilities and limits.
[35] This understanding is often at the center of philosophically based Business Ethics. Exemplary for this see Ulrich 1998.

between profit and morals will keep arising, not at last because the dynamics of competition will keep creating new situations that are not yet regulated in a satisfying way and that contain different potentials of taking advantages on the costs of a third party. And under the conditions of competition, one will have to expect systematically that these potentials are made use of.

Acting responsibly in a way that is compatible with the objective of profit making is all but trivial; it is a task of management in the same way as the planning of new products, the choice of suitable financing instruments etc. The moral ideas of relevant groups of stakeholders form a constraint for business. Managers have to take this constraint into account, and this holds all the more true since they can definitely influence the (moral) perceptions of stakeholders with their actions and their communication. But especially with regard to the high complexity of business action and its contexts, both the fulfilling and the assignment of responsibility require considerably much of all those involved. It is especially important to specify all those assets that contribute to defuse potential or current conflicts of profit and morals or to avoid them completely. And it is important to consider incentives under which managers and other decision-makers are willing to invest assets.

VII. Conclusion

Generally, one can agree with Friedman’s thesis that companies – or the managers running them – should systematically aim at increasing profits. But this thesis proves itself to be in need of being stated in a more differentiating way: inappropriate forms of pursuing profits can become a danger to the foundations of the free society to the same degree as inappropriate moral demands for corporate social responsibility which were criticized by Friedman. Due to this reason it is necessary – more than ever in the age of globalization – to examine the possibilities and their preconditions under which business can make profits in a responsible way.

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