What is the Purpose of a Corporation?

Justice Question: Shareholders or Stakeholders?

Adam Smith said, "It is from not the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."[1] In 1776, Smith's *Wealth of Nations* stated that the reason the butcher curates, cuts and sells good meat is to make money to feed himself and his family. The same is true for the brewer and baker. Some might view this as greed. Smith viewed this as an invisible hand that yielded unintended social benefits when the pursuit of self-interest cultivated collaboration and mutual benefit. "Enlightened self-interest" means we help others, which ultimately serves our self-interest.

In 1962, Milton Friedman, a Nobel Prize winner in economics, created the Friedman Doctrine. Friedman was heavily influenced by Smith's ideas when he wrote, "There 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."[2]

For the last half century, most business leaders and business educators relied on the Friedman Doctrine to define the purpose of a corporation. Today, it comes as no surprise that anti-business voices are challenging the Friedman Doctrine. But here is what is surprising. It's not opponents, but proponents of capitalism that are calling for reform. Increasingly, business leaders and business educators are advocating that companies redefine their purposes from an exclusive focus on profit to one which includes people.[3]

So often, organizational principles about justice are governed by what is legal, rather than by what is virtuous. As financial performance declines and pressure to perform increases. For example, the Business Roundtable, comprised of the CEOs of America's largest companies, stated that long-term shareholder value isn't a company's only purpose. Corporations also need to invest in and train employees, create value for customers, develop ethical supplier relationships, and take care of the environment.

Prior to the Business Roundtable statement, Laurence Fink, the CEO of BlackRock, made clear that if a company lacked a sense of purpose and failed to engage with the community, "... it will ultimately lose the license to operate from key stakeholders."[4] Mr. Fink's

concerns are that “widespread aversion” to capitalism requires companies do more than focus on profit. As the world’s largest investor managing $6 trillion in 401(k) plans, exchange-traded funds and mutual funds, BlackRock has the financial muscle to hold companies accountable for delivering social value, not just economic value.

Michael Porter, among the world’s most influential thinkers and educators in competitiveness, said, “The purpose of the corporation must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity growth in the global economy.” In addition, Porter believes that creating shared value will favorably motivate and attract employees, customers, partners, shareholders and society at large.[5]

Friedman may not have been that far from Porter’s perspective when he stated, “It may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government.”[6] Friedman added this could attract talented people along with “other worthwhile effects.”

To be clear, creating social value doesn’t mean that profitability takes a back seat. Companies still need to create wealth for shareholders to generate and deploy capital that makes it possible to hire and invest in people and to deliver value to customers and business partners.

The broader justice point is this. When society’s sense of justice shifts, behavior and laws follow, not the other way around. If enough people believe it is “just” that companies adopt a broader purpose than profit, then this might shift a narrow focus on quarterly earnings to a broader focus on stakeholders.

We started with Adam Smith’s *Wealth of Nations*, which focused on enlightened self-interest. We will end with his treatise *The Theory of Moral Sentiments*. Smith was not just the founder of economics, but also a moral philosopher who thought deeply about self-interest and sympathy. Today, we would more likely use the word empathy to capture what Smith meant by the word sympathy.

Smith concluded that it is prudent that we look out for our own interests. At the same time, we have empathy for others and others have empathy for us. He was clear that we demand that business leaders adhere to the law; otherwise society would break apart. Justice and the rule of law limits the harm we cause others. This doesn’t mean we punish people who are uncharitable or ungrateful.[7]

Smith thought our conscience reminds us that other people matter. He stated that we welcome business leaders who are benevolent but that we can't demand they be so. In other words, we can cultivate compassion, but cannot command it. Clearly, Smith's two-century-old insights about self-interest and empathy are still with us today. This is why we can count on an endless debate about how to best create value for both shareholders and for stakeholders.

Ultimately, a meaningful and just purpose is about committing our life to something bigger than ourselves. Applying this ideal to a company's purpose means that we make life better for people – employees, customers, business partners, and communities—in addition to making profit. To do so is just. And to do so earns a company's "social license" to profit. However, like all justice issues, making life better for all company stakeholders is complex and challenging. This is a noble purpose, not because it is easy, but because it is worthy.

1. Adam Smith Institute (2019). "Wealth of Nations." https://www.adamsmith.org/the-theory-of-moral-sentiments.
2. Friedman, Milton (1962). Capitalism and Freedom. University of Chicago Press. ISBN 0-226-26421-1
3. "Big business, shareholders and society. What are companies for?" The Economist. August 22, 2019.
4. Fink, Larry (2019). Larry Fink's Annual Letter to CEOs. A Sense of Purpose. https://www.blackrock.com/hk/en/insights/larry-fink-ceo-letter
5. Porter, Michael (February 2011). "Creating Shared Value," Harvard Business Review.
6. Friedman, Milton (1962). *Capitalism and Freedom.* University of Chicago Press. ISBN 0-226-26421-1.
7. O'Rourke, P. J. (October 2018). "On 'The Wealth of Nations.'" New York Times.