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The Social Benefits of Profit Maximizing Firms vs Social Enterprises

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Introduction

This is the second in an occasional debate series focused on critical topics shaping the curriculum and of many business schools as well as the direction of many corporations. (The first debate articles may be found here.)

The goal behind this series, which is hosted by the William Davidson Institute at the University of Michigan, is to identify issues currently under discussion in both business schools and the business community as a whole. Unlike other debates, this series focuses not only on points of disagreement, but also where the authors have staked out common ground. As a result, this series contains three separate essays: one written by researchers taking one side on the issue, one written by researchers taking the other side and a third jointly written by all of the authors that clearly lays out the areas of agreement and disagreement. In this way, both sides have the opportunity to present their case, but are also forced to recognize areas of agreement and clarify areas of disagreement. The goal of the series is to provide a venue for “a thoughtful and civil exploration of what everyone can and cannot agree upon,” as noted in the previous debate.

This particular debate centers on the following question: *To what extent do social enterprises that do not maximize profits provide a solution to the many challenges facing the world today?* In the essays that follow, two different views are presented. Professor Michael Gordon argues they can play an important role: “Social entrepreneurs, and the enterprises they create, combine business perspectives and discipline with a passion for a cause to create organizations intent on changing the world. In so doing, they can overcome market failures and remake systems that dramatically improve the world.”

Taking the other side, Paul Clyde, Jagadeesh Sivadasan, Aneel Karnani, Puneet Manchanda and MP Narayanan agree that “there are significant problems the world is facing—income disparities, environmental concerns, human trafficking” but state that “many claim that profit-seeking businesses are not only not helping, they are exacerbating some of these problems. Thus, social enterprises that do not maximize profits are seen as the solution. We disagree.” The final essay shows where there is agreement and disagreement.

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The Social Impact of Profit-maximizing Firms

The recent ascent of social enterprise into the lexicon of business schools and, more importantly, businesses themselves, reflects a growing concern that profit-maximizing firms don't address all of the world's problems. Profit seeking businesses are not viewed as inherently bad and there is a recognition that many provide considerable benefits. However, there are significant problems the world is facing—income disparities, environmental concerns, human trafficking—and many claim that profit seeking businesses are not only not helping, they are exacerbating some of these problems.[1] Thus, social enterprises that do not maximize profits are seen as the solution. We disagree.

We agree that profit-maximizing[2] firms by themselves will not address all of the global challenges. There is a vital role for governments in dealing with externalities, providing public goods and addressing income redistribution, to name a few areas. However, we submit that discouraging firms from behaving as profit maximizers threatens to undermine our ability to address those and other social challenges. Our argument is not with the ultimate goals. We share the concern about negative social effects of income disparity, environmental degradation, and human trafficking among others. Our worry is that this sentiment runs the risk of eliminating our most powerful weapon for positive social impact: the profit-maximizing firm (and may undermine the role of government in addressing these issues). We hold this view because of an understanding of the potential positive impact of economic systems in which firms are free to maximize profit (and considerable evidence to support the view that this potential has been realized); however, we recognize that there are a number of legitimate concerns with this position. Nonetheless, after wrestling with at least some of these, and conceding readily that profit maximization by private firms cannot be expected to cure all the world's ills, we believe that Milton Friedman's position of almost 50 years ago remains valid and that profit maximization will, in most cases, be the most socially beneficial approach to business.[3]

1. Profit maximization involves societal value maximization

Firms that maximize profits provide social benefits to consumers and producers (including shareholders, managers and workers). Firms can only maximize their profits to the extent that they provide goods and services

1 See, for example, Bhattacharjee, Amit and Jason Dana "People Think Companies Can't Do Good and Make Money. Can Companies Prove them Wrong?" *Harvard Business Review,* November 28, 2017. https://hbr.org/2017/11/people-think-companies-cant-do-good-and-make-money-can-companies-prove-them-wrong

2 We use the term profit maximizing throughout, but we do not mean to draw a distinction between this and shareholder value maximization.

3 Milton Friedman, Sept 13 1970, *"A Friedman Doctrine: The Social Responsibility of Business is to Increase its Profits" The New York Times.* https://timesmachine.nytimes.com/timesmachine/1970/09/13/223535702.pdf

that consumers value, and do so at a cost below that which consumers are willing to pay. The gap between the price paid by the consumer and the consumer's value for the product—consumer surplus—represents a social gain, and in free markets, every single business transaction creates this value for the consumer. Because the consumer surplus is not directly measured in national or corporate accounts, this component of the firm's contribution to social welfare is often overlooked. Profit-maximizing firms must also employ people, purchase from suppliers and deploy capital in ways that are superior to their alternatives. This generates value to all of those producers above and beyond their alternatives; i.e., producer surplus. Producer surplus combined with consumer surplus constitutes social value. The firm in a free and competitive marketplace acts to maximize societal value not because it wants to benefit others, but because—as Adam Smith noted long ago—it wants to create profit for itself.

The creation of profit also encourages successful firms to expand what they are doing, and it encourages others to imitate their behavior. As long as profits are correlated with social benefit as described above, the generation of profit will lead to the creation of more social value. Alternatively, if the product or service isn't profitable, that suggests consumers do not value it as much as it costs to produce it and therefore society would be better off devoting resources elsewhere. The inability to profit gives the firm the incentive to produce less of the good, or even to stop the production of the good or service entirely. With the exception of certain situations discussed below, the incentives of the firm are aligned with those of society. The profit-maximizing firm is programmed and incentivized by markets to generate social value.

While one critique of market economies is that goods are allocated to those with the highest purchasing power, free-enterprise systems have played a vital role in reducing poverty around the world. In fact, the movement away from centrally-planned economy (discussed below), to a more market-based economy with a dominant role for profit-maximizing private enterprises, succeeded in moving millions of people out of poverty, particularly in China and India.[4]

2. Alternatives to profit maximization in a free market

This is not the first time alternatives to the profit-maximizing firm operating in a free market have been considered, and the alternatives don't have the same desirable properties.

A. Limitations of a centrally planned economy

Thirty years ago (and for decades before that), the most likely alternative was the state-run firm as part of a centrally planned and directed economy. A significant challenge with this approach is that decisions about what to produce and how much to produce are made by a central authority based on the invariably limited and imperfect information that the authority has. Even if the authority has the interests of society at heart—and there were many instances in which it was clear the central authority had only its own interests and not the society's at heart—the central authority would have to have all relevant information at hand to determine the socially optimal output. A significant benefit of a profit-maximizing firm operating in a free market is that no individual decision maker needs to have all of the information. Market participants, each acting in their own interest, act on the information they possess and this moves prices, which in turn send signals to buyers and sellers about where to direct society's scarce resources. As Nobel Prize-winning economist Frederic von Hayek put it:

> *Fundamentally, in a system in which the knowledge of the relevant facts is dispersed among many people, prices can act to coordinate the separate actions of different people in the same way as subjective values help the individual to coordinate the parts of his plan.... The marvel is that in a case like that of a scarcity of*

4 https://www.economist.com/news/leaders/21578665-nearly-1-billion-people-have-been-taken-out-extreme-poverty-20-years-world-should-aim. And as highlighted by Prahalad (2006) and in the related literature, there are numerous examples of firms contributing to poverty reductions though innovations designed to both serve the poor and increase firm profits (C.K. Prahalad, *"Fortune at the Bottom of the Pyramid: Eradicating Poverty Through Profits",* 2006, Prentice Hall).

one raw material, without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly; i.e., they move in the right direction. This is enough of a marvel even if, in a constantly changing world, not all will hit it off so perfectly that their profit rates will always be maintained at the same constant or "normal" level.[5]

B. Limitations of adding social objectives as alternatives or additions to profit-maximization

The more recent proposed alternative to profit maximization is activity designed explicitly to pursue some social goal in addition to profits. The objectives of these firms go by names such as social enterprise, base of the pyramid, not-for-loss businesses or triple bottom line.[6] Activities within firms that pursue other goals are also encouraged as with corporate social responsibility, impact investing, or corporate philanthropy.[7] Some discussions about these firms or activities seem to suggest that profit-maximizing and social goals are mutually exclusive. We disagree.[8] For reasons stated above, we believe profit-maximizing firms often have the greatest social impact. Thus, we will consider the firm that pursues a social goal in addition to profits.

To be sure, there are some products or services that will not be provided or will be provided in too-limited a quantity (or conversely, will be provided in too great a quantity relative to optimal) and for those situations the unregulated or free market profit-maximizing firms will not suffice. For instance, providing health care in a rural market in a low-income country is not likely to be profitable; if such care is to be provided, either the government or a non-profit firm (social enterprise) will need to step in. However, it is a mistake to think that adding a corporate social responsibility objective is a magic elixir that will necessarily increase social welfare. Firms with multiple shareholders that pursue goals in addition to, or instead of, profits are saddled with a few significant burdens.[9]

First, there is a separation of ownership and management for publicly traded firms and private firms with multiple owners. In such cases, the owners must develop a mechanism to measure and monitor manager's performance on the social goal. Profits are a relatively clear and easily quantified metric on which all owners can agree. Measuring progress toward a social goal is far more difficult and is particularly troubling for firms with many owners, each of whom may have a different idea of how to measure progress.

Second, and related to the first point, adding a second objective in addition to profit without an explicit weighted scorecard or well-defined specification for trade-offs among the objectives entails a rationally infeasible optimization problem, as pointed out by Jensen (2000).[10] In practice, as Jensen (2000) argues, allowing managers discretion over a vaguely defined set of "stakeholder" objectives lead managers to pursue their own interests, thereby increasing agency costs in the economic system. This danger was recognized long ago by Dodd (1932)

5 P 526–7 from Hayek, F.A., "The Use of Knowledge in Society," *American Economic Review,* 35 (4), 1945, 519-530.

6 Base of the pyramid started out being described in ways that were consistent with profit maximization. However, more recent writings suggest that is not what is contemplated: "Another distinguishing feature of BoP ventures is the goal of becoming economically self-sustaining, meaning that at the least they expect to recover their ongoing operating costs" (p 10, London, Ted and Stuart Hart, *Next Generation Business Strategies for the Base of the Pyramid,* Pearson Education, 2011).

7 In this paper, we make no distinction between the different types. When we refer to social ventures or social firms we are including all of them.

8 Karnani (2011) provides a more complete discussion of this argument (Karnani, Aneel, "Doing well by doing good: the grand illusion," *California Management Review,* 53(2), 69-84.

9 As discussed in section 3, corporations could explicitly include social goals in their charter before raising equity, so that shareholders with interests aligned with those goals choose to invest in the company. However, the discussion in this section, and the experience of state-owned firms (Megginson and Netter 2000), and the historical convergence away from alternative models of corporate governance (see Section III of Hansmann and Kraakman 2001), suggest significant challenges in maximizing social welfare while also optimizing firm productivity to compete in the marketplace.

10 Michael C Jensen, 2000, Value Maximization, Stakeholder Theory and the Corporate Objective Function, SSRN Working Paper. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=220671

who, while arguing for providing discretion to managers to take on "social responsibility," acknowledged the possibility that "to expect managers to conduct an institution for the combined benefit of classes whose interests are largely conflicting is to impose upon them an impossible task and to endow them with dangerous powers."[11] Hansmann and Kraakman (2001) conclude that despite the early calls for corporate social responsibility and managerial discretion going back to an early debate between Dodd (1932) and Berle (1931) and a period of prominence for the "manager-oriented model," "it is now conventional wisdom that when managers are given great discretion over corporate investment policies, they tend to serve disproportionately their own interests, however well-intentioned managers may be" so that "the price paid in inefficiency" from a system allowing managers discretion to serve non-shareholder interests was too great.[12]

Third, as Friedman notes, any social responsibility restrictions that force corporations to deviate from profit-maximizing behavior and reduce their profits, is essentially equivalent to a corporate tax, imposed in an undemocratic manner. When the social responsibility is vague, it allows wide discretion to the managers of the firm to determine which "social" objectives to pursue. In contrast, revenues from corporate taxes imposed by the Congress are spent based on budgets drafted by elected legislators, prioritizing the collective objectives of the electorate. As Friedman argues, imperfect as this system may be, this is the agreed on institutional process for taking a share of the corporate profit to be spent for collective social welfare of the citizenry. Adding an additional tax to be spent at the discretion of the firm's manager is unlikely to be superior to this existing taxation system. Lobbying Congress or electing legislators aligned with particular social goals who would devote tax revenues towards the pursuit of those goals could be a more effective and feasible alternative to pressuring specific companies, especially if more socially responsible and receptive firms are likely to be undercut by competition from the less socially responsible (Dodd 1932), as we discuss next.[13]

Fourth, social ventures, by providing goods and services at prices that do not cover all of their costs, effectively subsidize the products and services they provide. Local providers of the same good or service don't have that luxury. Social enterprises therefore run the risk of undermining local businesses and the development of that economy. Frazer (2008) set out to investigate the reasons for the decline in garment production in Africa between 1981 and 2000. He found that used clothes donations explained 40% of the decrease in production and 50% of the decrease in employment.[14] A study of the TOMS shoes donation program found the program undermined the business environment by increasing the recipients' reliance on outsiders for provision of basic needs.[15]

Fifth, there is the danger Dodd (1932) noted—"the competition of the socially irresponsible makes it impracticable for the more public-spirited managers to act as they would like to do." In a competitive marketplace, any firm that does not minimize its costs will be driven out of business, so that any costly steps to achieve social goals will be infeasible. However, profit-maximizing entails a positive feedback loop, as the firm has a strong incentive to continue and expand activities that increase profits and to cut back or eliminate activities that decrease profits. The search for profits also generates the capital to expand many socially beneficial activities and starve those privately and socially costly activities. Successful pursuit of social goals other than profits arguably provides less incentive to increase the activity and definitely provides less capital to expand the activity.

11 E Merrick Dodd, Jr., 1932, For Whom Are Corporate Managers Trustees? *Harvard Law Review,* Vol.45, No 7, pp. 1145-1163.

12 Henry Hansmann and Reinier Kraakman, 2001, The End of History for Corporate Law, 89 *Geo. L.J.* 439.

13 Total government spending plus transfers as a share of GDP, which could be viewed as the piece of the economic pie that is taken for "social" purposes, was 37.8% in the US in 2016. https://data.oecd.org/gga/general-government-spending.htm. Any additional social responsibility constraints could be effectively increasing this share, and hence should be thought of in the context of the optimal level of aggregate taxes.

14 Frazer, Garth, 2008, "Used-clothing donations and apparel production in Africa," *The Economic Journal,* 118 (532), October, 1764-1784.

15 Wydick, Bruce, Elizabeth Katz, Flor Calvo, Felipe Gutierrez and Brendan Janet, 2016, "Shoeing the Children: The Impact of the TOMS Shoe Donation Program in Rural El Salvador", Policy Research Working Paper 7822, World Bank Group, September.

This is the heart of the problem. Social goals, other than profits, are far less likely to multiply their effects than profitable goals.[16] In encouraging such behavior, investors and business schools are encouraging a commitment of resources (including highly capable business students) to activities that—regardless of their good intentions—are often wasteful and ineffective in serving the intended beneficiaries.

C. Potential Limitations of Profit-Maximization

There are a number of limitations or qualifications to the argument for profit maximization, many of which are explicitly acknowledged in Friedman's article.

i. Welfare loss when there is market power, which can be addressed by antitrust enforcement and competition

There have been strong arguments recently, that the market power exercised by some firms runs counter to the idea that profit-maximizing firms generate social value.[17] Much of the concern relates to industries with network externalities such as Google, Facebook and Amazon. In each of these cases, the value of the service offered increases as more customers use the service. This has the potential to create a demand-based natural monopoly. This is a real concern and the antitrust authorities (Federal Trade Commission and Antitrust Division of the U.S. Department of Justice) have the authority to address it when the firm's market power has been obtained illegitimately, or is being exercised in a way that impedes competition from others. We do not purport to analyze all of the details related to this, but do want to point out that we have a case study of sorts to learn from: Microsoft.

In 2000, a U.S. District Court ruled that Microsoft had market power and that it had abused that power, after a decade-long investigation that began at the FTC and moved to the U.S. Department of Justice. Microsoft also benefited from network effects: users preferred to use operating systems and products that other consumers used because a) it made it easier to share documents, and b) more products were developed for those systems. The ruling against it, however, led to little in the way of concrete intervention. Options, including breaking the company up, were considered in the U.S. but ultimately abandoned. (European authorities took the opportunity to fine Microsoft hundreds of millions of dollars in 2004, 2006, 2008 and 2013.) It wasn't clear how breaking Microsoft up would benefit customers and there was clear potential for harm so that option was dropped. The Department of Justice did, however, stop Microsoft from purchasing other companies. In 1995, Microsoft tried to enter the financial industry by purchasing Intuit (owner of Quicken) and offered to give away its own competing product, Money, in order to eliminate anticompetitive concerns. The Department of Justice challenged the acquisition claiming, in essence, that Microsoft was the most likely competitor to other software markets even if they didn't currently operate in them. Whether their reasoning was right or wrong can be debated, but it did stop Microsoft from entering that market.[18]

Throughout the Microsoft trial and since, it was clear that Microsoft did not view itself as free from competition. To the extent that the network externalities are strong, a single player may win out thereby eliminating competition within the field. But that doesn't eliminate what Demsetz called competition for the field.[19] Competition may be very strong to be the single player that sells to the entire market and that competition can persist even after one player temporarily wins. In Microsoft's case, other organizations continued to develop products and

16 For example, recent research suggests that a highly effective way to fight poverty is through unconditional cash transfers; this suggests that any entity with an added social goal of fighting poverty faces a difficult trade-off for deploying additional resources to expand its own activities at the expense of cash transfers. Kenny, Charles, Give Poor People Cash, *The Atlantic,* September 25, 2015. https://www.theatlantic.com/international/archive/2015/09/welfare-reform-direct-cash-poor/407236/

17 See, for example, "How to Tame the Tech Titans," Economist, January 18, 2018, https://www.economist.com/news/leaders/21735021-dominance-google-facebook-and-amazon-bad-consumers-and-competition-how-tame or "Big Profits Drove a Stock Boom. Did the Economy Pay a Price?," Eduardo Porter, The New York Times, Feb 13, 2018. https://www.nytimes.com/2018/02/13/business/economy/profits-economy.html

18 http://articles.latimes.com/1995-05-21/news/mn-4463_1_microsoft-money

19 Demsetz, Harold, "Why Regulate Utilities," Journal of Law and Economics, 11, 55–66, 1968.

services that could compete with different parts of Microsoft and in some cases, succeeded. Every generation has its large companies that seem indestructible—this generation's include Google and Facebook—but thus far competition, either within the field or for the field, has continued its disciplinary role when allowed to do so.

The Microsoft case shows that a) antitrust authorities have options (though perhaps more limited) even in the case of industries with strong network effects, and b) even in industries with strong network effects, competition plays an important role. In the context of the present discussion, the question is whether a socially-minded monopolist in an industry with strong network effects is preferable to a profit-maximizing firm subject to the checks of antitrust authorities and competition described above. There are a few reasons to believe the answer is: no. First, there is no reason to think that a social enterprise could reach that position in the first place. Firms that succeed in capturing the market in industries with such strong network externalities are aggressive in their pursuit of increasing market share while keeping costs low.[20] Second, even if one did reach that position, there is no reason to believe that they continue to optimize social welfare rather than profits even if they started out doing so. The market for corporate control is likely to dictate reversion to profit maximization. Finally, Dodd's (1931) concern about endowing managers with "dangerous powers" hold here as well—how comfortable will society be in trusting a private organization to optimize something that is virtually impossible to measure and monitor from the outside? For all of these reasons, it is unlikely that a social enterprise will be preferable to (or perhaps, different from) a profit-maximizing firm subject to the constraints of antitrust authorities and competition.

Microsoft is informative here as well. While at the helm of Microsoft, Bill Gates behaved in a way that was consistent with profit maximization. This behavior invited significant antitrust scrutiny, but it also enabled him to earn a fortune that has given him the ability to affect social issues in a way that rivals even the largest governments (e.g. the Gates Foundation is the second largest contributor to the World Health Organization, behind the United States).[21] Friedman could have been describing Gates when he argued that it was more efficient to maximize profits and then let individual shareholders invest in social causes of their choosing. It is impossible to know, but it seems unlikely Microsoft would have been in the position it was had Bill Gates been pursuing other goals in addition to or instead of profits.

ii. Externalities, which justifies a role for targeted government intervention

Private benefits will reflect social benefits as long as there are no "externalities." Externalities are, by definition, costs and benefits that are not realized by either the producer or consumer. The easiest example, and one that appropriately causes much concern, is pollution. If carbon emissions have a social impact beyond the cost to the firm of the fuel that produces the emissions, which is almost certainly the case, anything that involves the use of those fuels will be overproduced, imposing an inefficiently high cost on society. The classic response is government policy intervention. In the case of carbon emissions, a tax that accounts for the social cost of the pollutants will cause buyers and sellers of carbon fuels to make decisions based on the social costs.

What happens when there is no such tax? If all firms agreed to appropriately higher prices, it could—by reducing production and thus pollution—imitate that outcome. This is unlikely to happen or be sustained voluntarily in a competitive market, however. The incentive to compete on lower prices will be too strong and encourage cheating on an implicit agreement to keep the price of fossil fuels high. Further, if oil companies were to reach an agreement to keep the price artificially high, the public is unlikely to look favorably on it and government could be expected to bring action under antitrust laws. There is no good substitute in these cases for appropriately targeted government intervention. The appropriate response for individuals is to play their role as citizens

20 Liebowitz and Margolis (Liebowitz, Stan and Stephen Margolis, *Winners, Losers and Microsoft,* The Independent Institute 1999.) argue that the dominance of Microsoft's IBM compatible operating system in the 1990s was largely because the IBM compatible computers (with MS DOS) were able to provide the basic functions customers desired (e.g., word processing) at a cost that was much lower than the apparently superior Apple alternative.

21 https://www.npr.org/sections/goatsandsoda/2018/02/13/585346426/bill-gates-addresses-tough-questions-on-poverty-and-power

in encouraging the appropriate policy response. Importantly in the present discussion, most markets do not have such significant externalities.[22] Thus, the existence of externalities in some markets does not diminish the benefits of teaching students to maximize profits in most.

iii. Market failure when there is asymmetric information

As pointed out by Akerlof (1970) and others, certain markets where there is significant asymmetric information may fail without appropriate market design or government intervention.[23] Healthcare is one sector where such issues are most salient, and many western countries have adopted systems that are not entirely free-market based. There is an intense and ongoing debate in the literature about alternative approaches to improving effectiveness and reducing costs in the US healthcare sector. We do not wish to wade into the details of this debate, but acknowledge that settings with significant asymmetric information could call for legal/government interventions (e.g., mandatory auto insurance). However, it is worth emphasizing that to an extent information is also a product that can be traded like any other good or service, and hence there will be a useful role for profit-maximizing firms engaged in the business of collecting and providing information, to reduce information asymmetries (for example, Carfax in the used car market, or credit bureaus in financial markets).

iv. Using laws to codify social ethics and compel ethical firm behavior

Friedman advocates maximizing profits subject to the laws and ethics of society. This presents an important qualification and we want to emphasize that profit maximization does not absolve individuals engaging in unethical behavior. Individuals at all levels of an organization make choices, including the choice to follow a directive from superiors. Those choices have consequences and the individual has an obligation to determine whether the choice violates the person's ethics. This does not mean they get to choose which things to do and not to do at will; however, it does mean that each individual must develop his or her own set of principles by which he or she will live. There is not a set of ethics on which everyone would agree. However, businesses and schools can and should encourage deliberate and conscious consideration of ethics.

Complying with ethics presents a challenge. If ethical behavior imposes a cost, competition is going to force firms to behave in ways that lead to the least costly ethics. There could be a race to the bottom. This is a key argument highlighting the potential benefits of laws (and regulations) that reflect the ethics of the society. Laws that impose sufficiently high costs on those who do not comply will force firms to abide by the ethics of society as embodied in the laws. All competing firms will be compelled to take society's ethics (through compliance with laws) into account. Because laws will need to aggregate up individual preferences, it presents a similar challenge as for companies with disparate shareholders deciding on common social goals. As Friedman notes in his article, the democratic system adopted by most countries to develop laws is not without flaws, but it may be better than any alternative. In fact, U.S. history is replete with examples of societal ethics and community preferences being codified in laws that distinctly impose costs and constraints on firm behavior, including among others the civil rights legislation prohibiting discrimination, workplace safety regulations, and the Americans with Disabilities Act. To the extent that individual firms observe industry practices that are unethical

22 One important exception is primary and secondary education, which arguably has significant externalities. Even in this case, suitably designed market-based systems that provide choice to parents could potentially be efficient and effective, at least in some contexts. Angrist, Pathak and Walters, Angrist, Pathak and Walters, 2013, Explaining Charter School Effectiveness, *American Economic Journal: Applied Economics,* American Economic Association, vol. 5(4), pages 1–27, October). http://www.nber.org/papers/w17332

23 Akerlof, George, "The Market for Lemons: Quality Uncertainty and the Market Mechanism," *The Quarterly Journal of Economics,* 84 (3), Aug, 1970, 488-500.

(or generate negative externalities as discussed in point ii above), and are constrained by competition from unilateral ethical behavior, lobbying for regulations or publicizing the issue in a way that prods the legislature to action may be the ethical and practical course of action.

v. Individual proprietors, benefit corporations and charities

An important qualification is that Friedman's argument applies to publicly traded firms and private firms with multiple owners. If a firm is owned by a single individual, that individual is and should be free to pursue whatever goal the individual chooses.

A similar qualification applies for corporations that explicitly set out social objectives (e.g., benefit corporations) so investors understand and agree with these objectives before becoming shareholders. Arguably, investors in such corporations obtain non-pecuniary utility from contributing to social goals and hence rationally accept lower financial returns. Many states have passed legislation to recognize such benefit or B corporations. We have no quarrel with such corporations; however, the challenges discussed in Section 2b above suggest that even for such corporations, maximizing profits and then deploying the dividends to meet social goals may be more effective than trying to simultaneously address multiple objectives within a firm.

Further, as Friedman also acknowledges, there is a distinct role for non-profit corporations and charities, which aim to promote specific (non-profit-maximizing objectives). Instead, the question that is to be debated is whether the prominent form of stock-holder corporations (i.e., firms with multiple shareholders), which appears to have won the competition between alternative corporate forms (Hansmann and Kraakman 2001), should be pressured to change its singular focus on shareholder value maximization.

vi. Situations where firm activities more efficient than individual shareholder actions

While we agree that a firm that clearly states alternative objectives before taking on investments can and should be allowed to pursue goals instead of or in addition to profit maximization, it is not clear that will be an efficient solution. Hart and Zingales argue that in certain cases, it will be.[24] They agree with Friedman that in the case of charity, it is more efficient to maximize profits, return the money to shareholders and let them choose which charities to invest in. However, they argue that in some cases in which profits are related to the social cause, it may be less costly for the corporation to change its action (and thus increase shareholder welfare, even though profits suffer). They use guns as an example: "Think about the shareholders of a company such as Walmart, who are concerned about mass killings in the United States. Walmart's ability to restrict the sale of high-capacity magazines or assault rifles in its stores would be more effective than if it took the extra profits from those sales, returned them to shareholders, and let shareholders donate to gun control advocacy." But would it? A reduction in sales of guns at Walmart does not necessarily mean fewer guns are sold. It means Walmart isn't selling them and another gun seller is probably happy about that. If the goal is stopping the sale of guns, a binding law on all potential sellers of guns will arguably be much more effective than individual and voluntary corporate action.[25]

Perhaps a more compelling example would be life-saving pharmaceutical products in low-income countries. In this case, the argument would be that it is more efficient for the pharmaceutical companies to provide the products than for individuals to make donations that would provide the same amount. We will limit this discussion to products that are not valued sufficiently in high-income markets and thus wouldn't be developed at

24 Hart, Oliver and Luigi Zingales, "Serving Shareholders Doesn't Mean Putting Profits above All Else," *Harvard Business Review,* October 12, 2017.

25 An alternative argument for Walmart's action would be that such actions by prominent corporates can alter public opinion and social norms, and potentially help lead to changes in individual and corporate behavior. Walmart itself described its decision to stop selling assault rifles as based on "declining consumer demand", rather than on political reasons. The New York Time editorial dismisses as "foolish" the hope that this could lead lawmakers to introduce regulations on assault rifles (New York Times, Aug 30 2015, "Walmart Decides to Drop Sale of AR-15 Assault Rifles").

all as part of a profit-maximizing strategy.[26] In such cases, the firms might well be more efficient at developing and selling in the subsidized markets. However, if the company faces financial constraints (for example, during a recession), the subsidized product will be one of the first line items to be cut. And for good reason. If the company does not stop subsidizing the product in those markets, it runs the risk of going bankrupt and stopping sales of all of their goods, potentially a very socially costly outcome. However, while competition is likely to discipline production of unprofitable products, this does not mean we are left with the alternative that Hart and Zingales suggest: individuals independently trying to fill the void. Again, governments or quasi-government organizations (like Gavi or the Global Fund) can, and do, fill the gap. For example, Gavi, the vaccine alliance, was established by an initial investment from the Bill and Melinda Gates Foundation, and is funded by government and private donations "to leverage not just financial resources but expertise too, to help make vaccines more affordable, more available and their provision more sustainable, by working towards a point where developing countries can pay for them themselves."[27] Gavi spends well over $1 billion annually to increase access to vaccines. Some of that money does come from the private sector but about 80% comes from governments (and almost all of the private sector participation comes from foundations). Global Fund targets tuberculosis, HIV/AIDS and malaria but operates in a similar way. These programs do not rely on the contributions from the private sector. Instead, Gavi and the Global Fund provide the financial incentives for pharmaceutical companies to do what they do best: develop and manufacture products.

3. Conclusion

We recognize that there are limitations and qualifications to the profit-maximizing model, most of which can be addressed most effectively by appropriate government action. But these qualifications do not undermine the basic argument that firms trying to maximize profits are generally socially beneficial. To repeat, we don't believe we have a fundamental disagreement on the goals, such as environmental protection, advanced by proponents of corporate social responsibility. In fact, it is precisely because we believe these are so important that we are making the arguments above. Our concern is that some of these issues and related discussions are leading businesses and students of business to believe that the profit-maximizing firm is no longer beneficial to society. Some recent public opinion surveys reflect this view.[28] Our goal here is to articulate the argument for profit maximization while clearly addressing some of the major concerns—and appropriate policy responses—related to it.[29]

26 Profit maximizing firms can sell products at low prices in some markets as part of a price discriminating strategy when they are developed for markets that are willing to pay a much higher price.

27 From the Gavi mission webpage as accessed on January 24, 2018 (http://www.gavi.org/about/mission/).

28 Socialism, Capitalism Seen in New Light by Younger Americans, *Wall Street Journal,* 12/7/2017.

29 Government regulation obviously has its limitations too. The negative effects of regulatory capture pervade governments. For this reason, we are only advocating a role for government under very specific circumstances where there is a widely recognized market failure. Also, whenever market-related mechanisms (e.g., assigning property rights to address externalities) are available, we advocate their use in preference to bureaucratic solutions.

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We Need Social Enterprises

Private foundations in the United States are required by the IRS to contribute an amount equal to 5% of their net assets each year to charitable causes they support. They invest the other 95%, seeking financial—not social—returns. In fact, the grant-making side and the investment side of foundations are typically completely separate.

We see in this arrangement how economic activity neatly separates making money (which is prioritized) from addressing societal problems—even among organizations whose stated purpose is to address societal ills. Among for-profit corporations, making money is emphasized more strongly, often to the exclusion of any other stated non-financial ends.

And yet the world cries out for help. Ten percent of the world population lives in extreme poverty,[30] nearly a million people go hungry each day,[31] and we face environmental challenges of the worst kind. These are just the tip of the iceberg (which, unfortunately, are melting).

Who should step up to fix societal problems? Sadly, nonprofits and governments are inadequate for the task. The United States is the most charitable nation in absolute terms.[32] Still contributions, which were at an all-time high of $410 billion in 2017, amount to only about 2% of US GDP. This sum includes money from all sources: individuals (70%), foundations (16%), bequests (9%), and corporations (5%). There is broad latitude in what counts as charitable giving, and more than one-third of these charitable dollars was contributed to religious organizations or towards the arts, culture, and humanities, rather than addressing dire needs.

Nonprofits provide important social benefits, but their efforts are diluted by a constant need to fundraise, operating with overhead rates of nearly 37%,[33] and they may find themselves drifting in their missions so that they fit in with funders' changing requirements. On top of this, while charitable organizations may provide vital, direct services to those in need, these efforts often address symptoms rather than rooting out underlying causes.

If there is too little money among nonprofits to address societal problems, then perhaps we should look to governments or multilateral institutions to address them. Here, too, the sums are paltry relative to the need. Official development assistance reached $142.6 billion worldwide in 2016,[34] or less than one-half the level of US charitable giving. From the data I can put together, charitable giving and development aid combined amounts to considerably less than 1% of world GDP. Around the world, governments are losing their appetite for spending on their own country's social problems. The poorest among them spend paltry sums to support the most needy, let alone make investments necessary to lift up the entire population. All told, there is far too little money from governments, development assistance organizations, and nonprofits to address the enormity of our societal problems.

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30 The World Bank. 2018. "Poverty." https://www.worldbank.org/en/topic/poverty/overview.

31 World Hunger Education Services. 2018. "2018 World Hunger and Poverty Facts and Statistics." 2018. https://www.worldhunger.org/world-hunger-and-poverty-facts-and-statistics/.

32 World Economic Forum. 2016. "Foreign Aid: These Countries Are the Most Generous." https://www.weforum.org/agenda/2016/08/foreign-aid-these-countries-are-the-most-generous/.

33 Sullivan, Patrick. 2012. "Survey: Charities Should Spend 23% on Overhead." The NonProfit Times. http://www.thenonprofittimes.com/news-articles/survey-charities-should-spend-23-on-overhead/.

34 Organization for Economic Co-operating and Development. 2017. "Development Adi Rises Again in 2016 but Flows to Poorest Countries Dip." http://www.oecd.org/dac/development-aid-rises-again-in-2016-but-flows-to-poorest-countries-dip.htm.

Then, of course, there is the "real" economy—the "business" economy—which operates on a profit-first (profit only?) basis. Can business be relied on to address societal problems? We have seen a dramatic lessening in extreme poverty over the last 25 years: from nearly 2 billion people (37.1%) in 1990 to 700 million (9.6%) in 2015. The great bulk of this decline occurred in China, where infrastructure investments combined with a low-wage (and literate) workforce attracted foreign investment in factories, creating millions of jobs. And today, China is pouring vast sums into Africa through loans, aid, trade, and export credits.[35] But is this really enough?

The facts listed above obscure other truths. Though the number of those living on $1.90 or less (the definition of "extreme poverty") has dropped significantly, half the planet (an estimated 48.7%) remains very, very poor—living on just $5.50 a day or less.[36] Half of the world's population can't obtain essential health services, especially those living in Sub-Saharan Africa and South Asia.[37] And there are wide within-country disparities in access to health care as well. More than 250 million children—one in ten—are denied an education.[38] The IPCC warns that, by the end of the next decade, we may lose our opportunity to curtail the most devastating effects of climate change. Its 2018 report states: "With clear benefits to people and natural ecosystems, limiting global warming to 1.5°C compared to 2°C could go hand in hand with ensuring a more sustainable and equitable society." Yet, it warns, this "would require rapid, far-reaching and unprecedented changes in all aspects of society. . . ."[39]

The vast resources controlled by business hint at its potential to heal, but business-as-usual does not appear up to the task of healing the world's wounds. There are several reasons, aside from the purely philosophical—market failures being the main one. Markets fail when transactions that could improve overall economic or social welfare fail to take place; when transactions that do take place destroy overall welfare; or when transactions allocate resources unjustly or unfairly.[40]

Transactions may fail to take place—even when there is profit to be made and value for consumers—when markets need to be created. Market creation is often necessary when entrenched habits get in the way of new behavior, even if that new behavior can lead to better nutrition, improved food production, healthier lives, or many other unarguable benefits—even improved livelihoods. In wealthy countries, companies selling "status" goods (think of early smart phones) can count on early-adopters to pay exorbitant prices that support further product development and, eventually, lower prices and greater adoption. But market creation of this sort is exceedingly difficult in low-income markets. Transactions may fail to occur as well when governments are unable to provide necessary infrastructure—say, roads to distribute goods; or clinics where medicines and care can be administered.

Even where markets might be created, transactions may fail to take place when companies decide there is not enough profit to be had. Although standard economic theory suggests that, if a buck can be made, someone will find a way to make it, for some companies that "buck" may need to be many millions of dollars before they take the opportunity seriously.

Additional arguments are made that business activity can destroy value (though not necessarily immediately or by design). Examples would include: large chain stores out-competing locally owned and controlled business, thus hollowing out communities; or businesses that cause environmental damage. Other business practices

35 Pham, J. Peter, Abdoul Salam Bello, and Boubacar-Sid Barry. 2018. "Chinese Aid and Investment Are Good for Africa." Foreign Policy August 31.

36 Lakner, Christoph, Joao Pedro Azvedo, Daniel Mahler, and Espen Beer Prydz. 2018. "April 2018 Global Poverty Update from the World Bank."

37 World Health Organization, and The World Bank. 2017. "Tracking Universal Health Coverage: 2017 Global Monitoring Report."

38 United Nations Educational, Scientific, and Cultural Organization. 2017. "Accountability in Education: Meeting Our Commitments." http://unesdoc.unesco.org/images/0025/002593/259338e.pdf.

39 Intergovernmental Panel on Climate Change. 2018. "Summary for Policymakers of IPCC Special Report on Global Warming of 1.5 Degree Celsius Approved by Governments." https://www.ipcc.ch/pdf/session48/pr_181008_P48_spm_en.pdf.

40 Phills, James, and Lyn Denend. 2005. "Social Entrepreneurs: Correcting Market Failures (A)."

can be viewed as unjustly allocating rewards, as exemplified by the “race to the bottom,” in which companies continually seek new locales where they can pay workers ever shrinking wages, despite the hardship for other workers put out of work or the meager lives such minuscule wages support.

Together, these issues mean that the nearly $200 trillion circulating in the global economy is largely being directed not toward the common good but, rather, toward fattening the uncommon wallet.

Still, the fact that there is so much money swirling through the world economy—even though so little goes toward addressing dire problems—means that maybe there’s another way to organize business. Historically, this would not seem strange at all. Initially, incorporation was only granted for the purpose of building a port or a road, or providing some other public benefit. Corporate charters were limited to the time necessary to complete these tasks, and corporations were only permitted to perform activities to fulfill their charter. Although stockholders could benefit, this, too, was seen as a means to the end of providing a common good. Corporate charters were revoked for causing public harm.

Today’s corporations could not be more different. They may endure forever. There is no restriction on what they can do and few restrictions on their relationships with other corporations. Now viewed as “people,” they may actively contribute to political campaigns. None of this was permissible at the outset.

We have moved dramatically away from the time when incorporation was a privilege to serve the common good, to one where the only responsibility of a corporation is to itself. Corporations have begun to act as if their only interest is to shareholders (it’s not; even if we in business schools tell our students the same thing). To benefit their shareholders, most companies barely look beyond their financial noses. A McKinsey survey in 2017 showed that 87% of executives and directors felt pressure to produce results in two years or less[41]—a horizon far too near even if companies wanted to address difficult societal problems.

More troubling, not only does business as usual appear less able to address entrenched societal problems, it may be complicit in causing them. Even as organizations such as those in attendance at the World Economic Forum proclaim their desire to “do good,” others argue that they have too much at stake to radically change their behavior; and that if they make only modest changes, they will actually be perpetuating the same systems, with the same built-in advantages, which already dramatically separate the 1% (10%) from the 99% (90%).[42]

Far too many have not only been left out by the forces creating this sorting of wealth, but put in a position nearly impossible to recover from, often by laws, regulations, and decrees that reinforce their plight. Structural barriers arise in different guises, each of which privileges business interests over societal interests: the Latin American debt crisis and debt restructuring that favored foreign banks and investors over the ability of local governments even to support citizens’ need for food and health care; redlining neighbors in the United States after World War II, which prevented many blacks from buying a home—an act considered fundamental to wealth accumulation; the dissolution of labor unions, which were once a backstop against poverty and a guarantor of a middle-class wage; the legacy of slavery, which built wealth for one group at the terrible, and continuing, expense of another; the extraction of natural resources, which, when done injudiciously, devastates both economies and the environment.

Current criticisms of business range from the relatively benign (businesses act without sufficient awareness of the needs of anyone but shareholders) to the hostile (some businesses knowingly act to undermine the rights and opportunities of their workers and the communities in which they operate when it is expedient). In the United States we see reaction to such criticisms in the forms of B-Corp certification as well as many new legal

41 Barton, Dominic, James Manyika, Timothy Koller, Robert Palter, Jonathan Godsall, and Joshua Zoffer. 2017. “Measuring the Economic Impact of Short-Termism.” https://www.mckinsey.com/~/media/McKinsey/Featured Insights/Long term Capitalism/Where companies with a long term view outperform their peers/MGI-Measuring-the-economic-impact-of-short-termism.ashx.

42 Giridharadas, Anand. 2018. Winners Take All: The Elite Charade of Changing the World. New York: Alfred A. Knopf.

forms that have recently arisen, including benefit corporations, L3C's, and social purpose corporations. We see similar reactions around the world including Muhammad Yunus's urging that the true nature of business is as a social business—"a business with a social mission at its core, 100% dedicated to solving human problems." Each of these can be viewed as a manifestation of a social enterprise, as can companies created as ordinary for-profit businesses, co-operatives, and even nonprofits. Greg Dees, one of the earliest scholars in the area of social entrepreneurship, listed other traits of the idealized social entrepreneur (and thus, implicitly, social enterprises), including being innovative, bold, and being focused on constituencies served and outcomes created.[43] Social entrepreneurs, and the enterprises they create, combine business perspectives and discipline with a passion for a cause to create organizations intent on changing the world. In so doing, they can overcome market failures and remake systems that dramatically improve the world

How Social Enterprises Address Market Failure

KickStart International began in 1991. Its mission is to develop and sell money-making tools that poor people in Africa can buy and use to lift themselves out of poverty. Its best known product is an irrigation pump, which allows smallholder farmers to farm more efficiently and grow cash crops (even during the dry season), which can be sold for profit. A nonprofit itself, KickStart establishes a supply chain in which all parties make money: manufacturers, suppliers, shopkeepers, and certainly farmers. KickStart, too, makes money on each sale. Yet, in its nearly thirty years of existence, it still must rely on outside subsidies.

Why? Because changing people's behavior is so difficult, and KickStart must continually do marketing (in time-consuming, hands-on ways) to convince people to buy its product—even though it is extremely effective, saves time, and pays for itself within a year. There are no "early adopters" champing at the bit to show off their flashy, new purchase (and pay associated price premiums). Indeed they tend to hide their newly gained wealth from friends and family lest they come for it. The need for a long-term subsidy is quite typical for an organization producing goods for which there is a true need but for which the market is still being created.

OneWorld Health, an affiliate of nonprofit PATH.org, focuses on the tropical diseases of the poor. These diseases—including malaria, TB, dengue fever, and others—are almost entirely off the radar of most pharmaceutical companies, even though they affect 1.4 billion people a year, causing $10 billion dollars in lost productivity.[44] Because of the extremely high costs associated with developing new drugs and the lack of customers' ability to pay very much (if anything) for them, OneWorld Health decided to become a nonprofit pharmacy. This opened the door for other pharmacies to donate their drug "discards,"—including those that were older, out of patent, or produced side effects—so they could receive tax advantages.

Consider visceral leishmaniasis (VL): the second most deadly parasitic disease in the world. It is drug-resistant, requiring $100 to treat, and, often, hospitalization. OneWorld Health determined that a drug developed in the 1970s by the for-profit company Pharmacia (since bought by Pfizer) was effective against the disease. Pharmacia had given the rights to the drug to the World Health Organization because the antibiotic required a patient to receive an injection on twenty-one consecutive days, rendering it "obsolete" given newer, oral antibiotics. To OneWorld Health, this seemed to be an inconvenience at most, and certainly one well worth it for patients in Bihar, India, who otherwise faced a range of much more "inconvenient" symptoms, including death, without treatment. OneWorld partnered with Gland Pharma, an Indian firm, who produced, at cost, a $10 lifetime cure for VL. The nonprofit Janani administered the drug through its health clinics.

Today, due to OneWorld's efforts in securing this drug, paromomycin, from the World Health Organization and bringing it to market affordably, it is on WHO's List of Essential Medicines, thereby providing an effective tool to

43 Dees, J. Gregory. 1998. "The Meaning of Social Entrepreneurship." https://entrepreneurship.duke.edu/news-item/the-meaning-of-social-entrepreneurship/.

44 Health Poverty Action. 2018. "Neglected Tropical Diseases." Accessed October 10. was the world's first nonprofit pharmacy.

combat VL around the world. As this example exemplifies, even a life-saving drug for which there is demand and a cost-efficient means of production may require the ingenuity of a social enterprise to overcome the market failures that can mean the difference between life and death. Recently, and years after OneWorld Health's founding, a consortium of about 500 American hospitals has banded together to form Civica Rx, a nonprofit generic drug company. Its goal is to ensure an adequate supply of affordable generic drugs, just as severe price hikes and drug shortages are badly hampering hospitals. As can often occur, the innovation spawned by one social enterprise is adopted (and adapted) by another—often with the knowledge and full approval of the originator, which recognizes the potential for additional good.

In a similar vein, products to treat serious diseases often are not developed because profits are deemed to be too small. This is what David Green discovered when he worked with the Aravind Eye hospital in India. In that country, blindness can be a death sentence, since one can no longer work. Green's research led to the conclusion that intraocular lenses, artificial lenses that replace natural lenses during cataract surgery, could be manufactured for less than $4, a nearly 50-fold reduction over their selling price to hospitals by major medical manufacturers, with patients paying considerably more. Green developed Aurolab, a nonprofit manufacturing company, to manufacture intraocular lenses (and subsequently other medical supplies). His approach was to ruthlessly cut costs (but not quality), bringing badly needed medical supplies to the poor in the developing world at affordable prices. His model—high quality, low cost, to tens of millions of poor people—stood on its head the model advocated by "modern" medical supply firms, which seek large profit margins from far fewer patients.

Redressing Structural Flaws

Modern day hospice care can be traced back to London just after World War II. Nearly a decade later, the practice was transplanted to the United States and, during the intervening decades, legislation in this country was introduced and voted down, hospice care was more rigorously studied, the idea of palliative end-of-life care crept into mainstream consciousness, until finally, in 1983, Medicare established a Hospice Benefit to cover the costs for those in hospices. Since then, the number of patients receiving hospice care has risen above 1 million per year (nearing one-half of all end-of-life patients today).

From this abbreviated history, we can see how the efforts of a social activist (Dr. Cicely Saunders, of St. Christopher's Hospital near London) eventually influenced the very fabric of how we can care for those nearing the end of their lives: with compassion, dignity, more cost-effectively, and, perhaps curiously, in ways that often both improve the quality and prolong the length of their lives. What was begun as the effort of a compassionate social entrepreneur blossomed into institutionalized support for hospice care through Medicare and certain states' Medicaid programs. This shift to a more de-medicalized view of end of life care has also produced significant financial savings within the health care system.

We may be seeing something similar in health care itself. For half a century, doctors have been frustrated by their inability to attend to their patients' "social determinants" of health—such as malnutrition, being homeless or extremely transitory in their housing, not having reliable and even slightly convenient transportation, and other factors. Health Leads, a revenue-generating nonprofit, has been working for over two decades to fill such "social prescriptions," which the doctors they support can now write. Health Leads' own efforts resembled those undertaken by Dr. Jack Geiger thirty years earlier. Few in the health system now doubt that attending to social determinants leads to better health outcomes, but Health Leads is showing that it also reduces system costs. The World Health Organization has issued an in-depth report on the importance of social determinants. The efforts of Health Leads and similar organizations have led to the Declaration of Alma-Ata, which called for "Health for All," defining health as "a state of complete physical, mental, and social well-being…" and insisting it is a human right. In the United States, programs like Comprehensive Primary Care Plus, Accountable Health Communities, and 1115 Medicaid Waivers are enabling health systems across to country to address social needs as an essential part of care. A movement to reform health care, begun by social entrepreneurs, is afoot.

Social entrepreneurs and their enterprises are equally engaged in rooting out and eliminating systemic problems in other areas, including criminal justice reform, human trafficking, lack of access to effective education, and the destruction of the environment. They can be exquisite in fashioning solutions tailored to highly specific local problems. Yet many seek also to redress an underlying, unjust economic system that favors the wealthy over the poor, directors over employees, profit over people. They aim to transform business for societal good—in ways that more equitably share profits and re-consider the very nature of ownership and control of business.

Moving Forward

The ideas presented in this paper reflect emerging practice. Making businesses' focus on societal problems become commonplace will take shifts in financial and human capital. On the financial side, we see the advent and rise in acceptance and importance over the last decade of impact investing. Its foundational principle is to create investment opportunities where societal concerns rank at least as high as financial considerations. Investors seek out these investments, even investments with sub-market-rate returns. Institutions such as private wealth management practices in most major banks are rushing to meet the demand. Many early-stage impact investments are in social enterprises. New products such as socially-directed exchange traded funds are creating new options for everyone to participate in the "impact economy." These new developments in financing business should spur the creation of more social enterprises.

Impact investors are awakening to the need to provide "patient capital" necessary for longer-term impact from socially desirable business activity. RSF Social Finance facilitates investments in, among other areas, environmental sustainability, sustainable food systems, and local social change. Among its non-standard practices, RSF brings together lenders and loan recipients to negotiate mutually acceptable interest rates; and it has, on occasion, looked favorably at very long-term business plans, including one 50-year business plan of a Yerba Mate beverage company. That time horizon helped convince RSF that the company was not engaging in "casino capitalism"—looking for investment now in order to quickly flip the company—but rather growing the business as the owners' life's work.

Impact investing is also an antidote to finance that creates no actual value. Lawrence J. Lau, professor of economics at Stanford, puts it starkly: "Today, the overwhelming bulk of foreign exchange transactions in the world, which total about US $1,250 trillion a year, compared to the total value of world trade of less than US $50 trillion (less than 4 per cent), is for speculative purposes." [45]

In sum, impact investing seems to be "on the money" when it comes to directing financial resources to address societal problems, or at least it's getting there. What about human resources? Young people crave careers infused with social purpose. Their energy, innovation, and intention to change the world align with the ideas of social enterprise and social entrepreneurship. But business education is letting them down.

Business schools provide students with a powerful set of tools and resources to start, run, and lead organizations. But there is a monolithic form these organizations assume. Any entrepreneur starting an organization will seek venture capital. If the organization (a for-profit) hits gold, it will either become a public company or be acquired. (Of course, the company will be in tech the blockchainier, the better). Between startup and exit, it will demonstrate a ferocious commitment to…itself.

Larger, established organizations, including public companies, share this ethos, directing their efforts to grow bigger, more profitable, and be better positioned for any threat or opportunity. Those in the broader ecosystem operate in equally self-reinforcing and self-protecting ways. Venture capitalists, for instance, mostly fund

45 Lau, Lawrence J. 2016. "Why a Tobin Tax Could Help to Stablise the Renminbi." South China Morning Post, June 27. https://www.scmp.com/comment/insight-opinion/article/1930586/why-tobin-tax-could-help-stabilise-renminbi.

others who look like them (white, male), are educated at a tiny group of select schools (Stanford, Harvard, a few Ivies), and live in California, New York, or Massachusetts. If you're a woman, are of color, or don't have the right pedigree, good luck!

Might business education be different? Of course. As Davis[46] explains, we can start by directing businesses' focus outward—to serve human needs before corporate interests. This means thinking about social impact ahead of, or at least along side, financial performance; and giving as serious attention to metrics of societal impact as we do return on investment. It means holding up as examples in our teaching successful for-profit and nonprofit social enterprises. And most important it means acknowledging that we are at a moment in history when the world can no longer endure the effects of any type of activity that further threatens the planet or further divides us, economically or socially. Business, with its massive influence, must be directed toward the social good, as must the way we teach it.

46 Davis, Jerry. 2018. "Management Education for Sustainable Development." Stanford Social Innovation Review. http://ssir.org/articles/entry/management_education_for_sustainable_development.

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We Agree that…

The purpose of this summary is to highlight the areas of agreement between the Social Enterprise (SE) position and the profit maximizing (PM) position as articulated in the previous articles and clearly demarcate the differences:

Areas of agreement:

1. Traditional profit-maximizing businesses have raised the standard of living for those living around the world.

2. Not everyone will be served by profit-maximizing businesses because for some products or services, willingness (or ability) to pay isn't sufficient to cover costs (including a fair/expected market return on capital). In those cases, if those products or services are to be provided, either an enterprise that does not cover all of its costs (including a market return on capital—e.g., non-profit, social enterprise, etc.) or the government will have to provide the product (or provide sufficient subsidy) if it is to be provided at all.

3. The government has an important role to play, especially with respect to externalities. Negative externalities such as pollution will not be incorporated in the profit maximizing firm's decision making because that firm does not bear all of the cost.

4. Firms established as non-profit or established as entities that pursue something in addition to or instead of profits, have the right to pursue whatever goals they identify, so long as capital providers are made aware of the goals of the firm at the outset.

5. In maximizing profits, firms must serve many stakeholders:

   a. customers, who do not have to buy and presumably won't if the value of the product is less than the price charged;

   b. employees who will generally have other options for work and whose productivity affects the profitability;

   c. suppliers who also have alternatives; and

d. providers of capital such as shareholders who also have alternative places to invest.

In short, all of these constituencies have choices and a profit maximizing firm must at least satisfy all of them in order to remain their choice.

6. If consumers value social goals and are willing to pay for them, a profit maximizing solution could include a product or service that reflects those goals. For instance, if consumers are willing to pay X more for a product produced solely with renewable energy, then a profit-maximizing firm could successfully provide such a product as long as the extra cost of producing it solely with non-renewable energy sources was less than X . A profit-oriented, but not profit-maximizing, organization might accept additional costs, even without increasing prices to fully recover these costs.

7. Market economies result in an unequal distribution of income and wealth, partly reflecting variation across individuals in talent and effort, but partly also from random/exogenous and historical, structural factors.

8. Some social enterprises and some profit maximizing firms have a negative impact on overall welfare.

9. Profit maximizing firms are an, if not the, essential driver for the development of economies around the world.

10. Profit maximizing firms are agnostic about social concerns or issues; if a social issue gains traction in the market or receives governmental support, the free market system can be very effective in channeling the efforts of profit seeking entrepreneurs in providing efficient solutions to solve the issue. Profit maximizing firms are not interested in maintaining the status quo; in industry after industry (e.g., Netflix in the TV entertainment, Uber in the taxi sector, Apple in the cellphone industry in 2008), entrepreneurs in fact seek to destroy the status quo, to provide better or lower cost services to customers.

11. Even in the case of negative externalities, as Coase and others have argued, the key underlying problem is not the failure of markets, but the lack of markets or property rights. For example, assigning rights over local water sources to local governments could force companies to internalize costs imposed on local communities.

Where we disagree:

Profit Maximizing:

1. Firms that pursue objectives other than profits run the risk of enabling management to pursue its own objectives at the cost of society even if in the name of a difficult to define and measure social goal. The experience of state-owned enterprises across the world suggests that organization provided multiple mandates are unable to be efficient and lead to significant drain of resources for the capital providers (i.e., tax payers), which then lead to privatization in almost every country. The underlying difficulties posed by multiple objectives is very likely to persist even when private shareholders are providing the capital.

2. We recognize that individuals have the right to pursue whatever individual objective they choose, within the legal and ethical constraints of society. However, any assertion that the profit maximizing firm is less socially beneficial must be compared with some real alternative institutional arrangement. There is no evidence that social enterprises are systematically a more innovative or a socially beneficial alternative.

3. Profit maximizing firms provide products and services that address social issues. As long as there is customer to cover the costs (including a return on equity capital), they can be expected to continue to do so. That customer may be private individuals and companies or it could be the government. Social goals such as HIV/AIDS treatments, cancer treatments, development of solar energy, and housing for

low-income populations have been addressed by profit maximizing firms, even if in many cases these efforts are funded or supported by the government. Modern medical advances that have increased human lifespans around the globe have been underpinned by innovations spurred by profit seeking firms incentivized by the patent system. Even here, the role of government in establishing and maintaining institutions to protect private property rights play a crucial role; but ultimately significant innovation and growth in most industries have been financed and executed by profit maximizing firms and entrepreneurs.

4. The market system systematically rewards profit seeking firms that enhance overall value, either by enhancing customers' willingness to pay, or by reducing costs.

Social Enterprise:

1. Profit maximization underpins the belief that economic outputs, especially as measured by aggregated indicators such as GDP, are more important than concerns about social issues, including poverty, access to health care, and a healthy planet. This reinforces structural barriers to broader, more inclusive well-being.

2. Social enterprises are more likely to devise innovative solutions to societal problems than are profit-maximizing enterprises. Once established, more traditional for-profits might help bring these to scale.

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