THE B CORPORATION:
ECONOMIC THOUGHT ON 'DOING GOOD' AND THE PROFIT MOTIVE

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In a recent op-ed in the New York Times, David Brooks stated, "B corporations are a way to transcend the contradictions between the ineffective parts of the social sector and myopic capitalism." Since "myopic capitalism" is often assumed to be asserted by mainstream economists, I will explore in this paper the history of economic thought on this potential transcendence.

Legal definitions of benefit corporations (or B corporations) are very recent, although there have always been corporations whose primary purpose was more community-minded than shareholder value (private hospitals, for example). Maryland was the first state to pass legislation, in 2010, allowing for the establishment of B corporations. Since then, 26 other states have also pass such laws, and many others states have organizations that are writing and supporting such legislation (B Lab, 2014). Since the laws have been passed by states rather than centrally, there is no one definition of a B corporation, but the general idea is that such companies are legally justified in pursuing social or environmental goals, even at the expense of shareholders' profit.

Anyone even slightly familiar with economic thought (including my colleague who brought a recent NY Times article about B Corporations written by David Brooks (Brooks, 2014) to my attention) knows Milton Friedman argued in *Capitalism and Freedom* (Friedman, 1962) (and later expanded in a New York Times Magazine article) that "The Social Responsibility of Business is to Increase its Profits" (Friedman, 1970). And this is generally the assumption made regarding economic thought on "doing good" versus pursuing profit—that economists reject the notion of it being the businessperson's responsibility to worry about "doing good" and believe s/he should concern him/herself only with profit.

But is this true? In the branch of economic thought that is generally supportive of capitalism and markets, would economists scoff at the idea of a B corporation? How important has the profit motive been in this train of thought? What is the history of the tension between "doing good" and the profit motive? In the interest of brevity, I will concentrate on four thinkers who are generally considered important influences on today's mainstream economic theory: Adam Smith, J.S. Mill, Alfred Marshall, and Milton Friedman. My general argument is that economists are and have been misunderstood on this issue, and that they have never been as myopic as some people assume.

Adam Smith

Adam Smith argued capital accumulation by businesspeople was a necessary driver of economic growth, which he sought to promote, but he had little love for businesspeople themselves. A few of the best-known quotes on the subject from *The Wealth of Nations* (1980 [1776]) follow as evidence: "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices" (p. 145); "The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public" (p. 266); and, "[T]he mean rapacity, the monopolizing spirit, of merchants and manufacturers, who neither are, nor ought to be, the rulers of mankind…." (p. 493). It was, of course, the capitalist system, rather than capitalists, that Smith championed.

Smith was explicitly skeptical regarding both of the claim of, and perhaps any benefit from, trading for the social good. "By pursuing his own interest, [the individual] frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. It is an affectation, indeed, not very common among merchants, and very few words need be employed in dissuading them from it" (p. 456). Here, of course, Smith is referring the part each economic actor plays in his analysis of the capitalist system. The capitalist seeks profits, the consumer seeks low prices, the laborer seeks high wages, and so on. These motives, combined with competition, make for a largely self-regulating system that results in economic growth, Smith asserts.

One therefore might think Smith would be suspicious of the B corporation, and perhaps he might even think that such corporations would be doing a disservice to the public by not prioritizing profits. However, a look into what Smith had to say regarding the effects of prosperity and adversity on sympathy in *The Theory of Moral Sentiments,* 6th ed., (2005 [1790]), along with his ideas in *The Wealth of Nations* regarding institutions necessary for the public good, imply something else. In a world in which "doing good" is underprovided by the market, I would argue Smith would have supported the idea of institutions, partly supported by benefactors and partly supported by the market, whose goals would be the social good rather than profit. Smith's views of the profit-seeking behavior of capitalists would probably lead him to assume B corporations would never become as common as firms that prioritize profits, but there seems to be ample evidence that he would have supported the missions of B corporations.

In *The Theory of Moral Sentiments* Smith discusses our "disposition to admire the rich and great, and to despise or neglect persons of poor and mean condition," which he calls "the great and most universal cause of the corruption of our moral sentiments" (p. 53). He attributes this disposition to our reluctance to sympathize with grief. It is simply unpleasant to do so, he says (p. 40). And because a person who suffers realizes our reluctance to sympathize, "[he] proposes his grief to us with fear and hesitation: he even smothers the half of it, and is ashamed…" (p. 41). Moreover, we admire those who bear their misfortunes stoically (p. 42). "It is because mankind are disposed to sympathize more entirely with our joy than with our sorrow, that we make parade of our riches, and conceal our poverty," Smith concludes (p. 44). On the other hand, we are made happy by witnessing other people's generosity. "When we see one man assisted, protected, relieved by another, our sympathy with the joy of the person who receives the benefit serves only to animate our fellow-feeling with his gratitude toward him who bestows it" (p. 61).

In short, Smith suggests in *The Moral Sentiments* that people will naturally underreport their suffering, and that there is a positive externality associated with the alleviation of such suffering. And this positive externality is not only because the third parties are happy for the person who is relieved, but also because they enjoy witnessing the generosity involved. These two observations

would likely lead Smith to the conclusion that “doing good” would be underprovided by the private market.

In *The Wealth of Nations*, Smith addresses the need for institutions to provide services important for the public good that would not be adequately provided by profit-seeking individuals. Services such as defense and justice, Smith says, must be funded by society at large, as everyone benefits from these services and their costs cannot be assigned to particular people. More directly relevant to this discussion, however, is his example of public education for the young. Smith suggests that students (or their families) be charged at least some fee for instruction. He argues that when teachers receive all of their salaries from the public or private endowments, they no longer feel responsible to the students or their families. For the teacher to have the proper incentive to teach the most useful subjects, then, the teacher must depend on the fees of his students (pp. 759-61). However, Smith also says some part of expense of schooling will come from public or private endowment, especially in the case of educating “the common people” (p. 784-85).

The type of institution that Smith describes, one in which the good or service exhibits sizable positive externalities, and is partly supported by the users of the product and partly supported by charitable contribution, is a prototypical B corporation. Today’s B corporations, with goals such as good working conditions and environmental protection, often forgo some (or all) profit in the name of “doing good.” The shareholders are, in effect, partly supporting the institution with their private contributions, and the firm also has incentive to compete in the marketplace for the majority of its support. In this way, more resources are allocated to the production of these goods or services than would be in a purely profit-driven market, and more “good” is done than when funded only by charitable contributions.

J.S. Mill

While also a supporter of the capitalist system, it is clear J.S. Mill would have supported the notion of corporations with goals of “doing good.” In his *Principles of Political Economy,* 7th ed. (1987 [1871]), Mill returns several times to the topic of experiments in productive associations. For example, in his chapter on private property, Mill describes utopian socialist experiments,

such as those suggested by St. Simon and Fourier. These early socialists proposed communities in which productive assets were held in common, and production and distribution decisions were to be made by various schemes. Mill concludes "it would be extremely rash to pronounce [Fourierism] incapable of success, or unfitted to realize a great part of the hopes founded on it by its partisans. With regard to this, as to all other varieties of Socialism, the thing to be desired, and to which they have a just claim, is opportunity of trial" (p. 216).

Mill turns again to experimental productive associations in his chapter on the future of the laboring class, and again he suggests that experiments in "co-operation" (in which workers are at least partial owners of their firms) be encouraged. Mill sees no reason why such firms would not be as successful or profitable as firms not owned by workers (p. 789), but in any case, he would reject the notion that progress depends on the profit motive. He states, "Mankind are capable of a far greater amount of public spirit than the present age is accustomed to suppose possible. History bears witness to the success with which large bodies of human beings may be trained to feel the public interest their own" (p. 206).

Mill's awareness of capitalism's drawbacks, and his hope for a system that could reap its benefits and leave its problems behind, combined with his empirical orientation, leads one to quickly conclude he would support the idea of corporations with goals other than profit maximization. Mill was also obviously more optimistic that people could move beyond the profit motive than Smith. In fact, considering his view of the stationary state, it seems Mill hoped the profit motive would soon simply wither away. "But the best state for human nature is that in which, while no one is poor, no one desires to be richer, nor has any reason to fear being thrust back by the efforts of others to push themselves forward" (p. 749). He also asserts, "It is scarcely necessary to remark that a stationary condition of capital and population implies no stationary state of human improvement. There would be as much scope as ever for all kinds of mental culture, and moral and social progress; as much room for improving the Art of Living, and much more likelihood of its being improved, when minds ceased to be engrossed by the art of getting on" (p. 751).

Alfred Marshall

Alfred Marshall, while more skeptical of socialism than Mill, was also optimistic about the potential for people to behave altruistically. In fact, in his *Principles of Economics,* 9th ed. (1920), Marshall asserts, "No doubt men, even now, are capable of much more unselfish service than they generally render, and the supreme aim of the economist is to discover how this latent social asset can be developed most quickly, and turned to account most wisely" (p. 9). So, to Marshall, not only do people have the ability to behave generously, but this topic is of primary importance in the discipline of economics.

Marshall suggests that people are motivated mostly by things other than wealth, even in reference to their work lives, however, material reward is the "steadiest" motive in business (p. 14). This is, of course, quite a bit different than arguing that people, in their business lives, are primarily motivated by wealth (or income, or profit), or that they seek to maximize it. In fact, he goes so far as to say, "Everyone who is worth anything carries his higher nature with him into business; and, there as elsewhere, he is influenced by his personal affections, by his conceptions of duty and his reverence for high ideals" (p. 14).

Regarding the economic analysis of philanthropy, Marshall rejects the idea that economists are not concerned with charitable activities. He argues, "It is then not the want of will but the want of power, that prevents economists from reckoning in the action of [altruistic] motives such as these; and they welcome the fact that some kinds of philanthropic action can be described in statistical returns, and can to a certain extent be reduced to law, if sufficiently broad averages are taken…. It will however probably be always true that the greater part of those actions, which are due to a feeling of duty and loves of one's neighbor, cannot be classed, reduced to law and measured; and it is for this reason, and not because they are not based on self-interest, that the machinery of economics cannot be brought to bear on them" (p. 24).

Perhaps ironically, Marshall's supply and demand model allows for consumer and producer motives other than those of self-interest. On the supply side, Marshall was among the first to consider the nuances of opportunity costs and economic profits. He clearly states the potential return to capital must be considered in a firm's costs, but he does not assume shareholders

necessarily will pursue maximum profits. That a saver with preferences toward companies with environmental or social goals might choose to invest in these even at the expense of returns s/he could earn in another type of corporation is consistent with Marshall's model. On the demand side, the marginal utility derived from the good is of importance, but this is completely subjective. Estimating the return that is sacrificed by financial investors to pursue goals other than profit maximization does not seem to be particularly daunting in our modern data-driven age, nor does it seem an impossible task to explore the extent to which consumers are willing to pay higher prices for goods or services from socially responsible companies. Once included in supply and demand functions, there is no reason to think the resulting equilibrium would be inefficient.

Milton Friedman

Because the title of Friedman's 1970 *New York Times Magazine* article was "The Social Responsibility of Business is to Increase its Profits" (Friedman, 1970), it would be folly to argue he did not say it. However, one must not judge an article by its title. A very few quotes will suffice to illustrate that what Friedman meant by this statement was much less strident than it appears. Friedman clearly prioritizes economic freedom over any particular goal of a corporation. There is nothing in his argument that precludes corporate goals other than profit maximization.

Early in the article, Friedman acknowledges, "Of course, in some cases his employers may have a different objective [than profit maximization]. A group of persons might establish a corporation for an eleemosynary purpose, for example—a hospital or a school. The manager of such a corporation will not have money profit as his objectives but the rendering of certain services." He argues that in either case (a goal of profit maximization or of something else), the primary responsibility of the managers is to the owners of the firm. Friedman's main point is that for a manager to pursue a goal other than that which is the stated purpose of the corporation, s/he is spending someone else's money for his/her *own* social goals. If the purpose of the corporation *is* a social goal, then Friedman would clearly not just support the manager's pursuit of that goal, he would say the manager *must* pursue that goal to be behaving ethically.

Friedman also makes the point that what often is claimed to be corporate social responsibility is actually just profit maximizing behavior, such as the managers of an outdoor apparel company donating corporate funds to conservation causes as a way of advertising. Another example might be Starbuck's recent decision to pay for their employees to attend college, which may make customers happy to think their expensive coffee drinks are helping someone go to college, and may also draw and retain better employees. In this case, Friedman says, the term "corporate responsibility" is "pure rhetoric." Only in the case of a firm's management actually acting "in some way that is not in the interest of his employers" does Friedman argue the behavior is unethical. Again, if the interests of his/her employers *are* social or environmental, it is obviously ethical for the manager to pursue them.

Conclusion

It is perhaps not surprising that economists have been misunderstood on the issue of the necessity or desirability of the profit motive. All of the thinkers mentioned in this paper prioritize economic freedom. To the extent individuals choose to pursue profits (within legal limits), these economists would undoubtedly argue that is their right. However, there can be little doubt these thinkers would also support the pursuit of other, more socially conscious, goals.

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