KENNESAW STATE UNIVERSITY
COLES COLLEGE OF BUSINESS
Bagwell Center for the Study of Markets and Economic Opportunity

Commentary

Title:

"Is Profit Maximization or Social Responsibility the Morally Correct Goal of Business?" (Part 2)

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October 2022

This article is the second in a four part series that is an extended comment on the moral principles of capitalism. In the first article,[1] we joined the argument about business people's moral responsibilities by quoting from the famous New York Times editorial by economist Milton Friedman who claimed that the "moral responsibility of business is to increase its profits."[2] In support of Friedman's position we made the argument that, just like individual lawyers in the legal profession, the individual players within a market system actually enhance social welfare when they pursue their own interest. This position assumes that both the legal system and the business system are operating under properly constructed rules and constraints that are appropriate for their respective systems. For business this a system of well-defined and enforced property rights, contract law, and tort law. As long as competition exists, as Adam Smith says, "By pursuing his own interest he [the business person] frequently promotes that of the society more effectually than when he really intends to promote it."[3] When business people pursue private profit they *are* doing their social responsibility.

Is it Possible for Firm to Pursue "Social Responsibility" in a Competitive Market?

In this article we make a further point that business people in a competitive system are compelled by that competition to eschew "social responsibilities" commonly understood and instead pursue profit in order to survive. Many critics of capitalism condemn businesspeople for pursuing profit and for being "greedy," but as we will make clear, most firms have no alternative to the single-minded pursuit of profit.

To illustrate the difficulty for corporations to pursue goals other than profit maximization, consider an example from the trucking industry. A new technology, the driverless truck, is poised to make a break-out from the lab onto a highway near you soon. This technology, while expected to increase safety, lower emissions, and reduce costs, will lead to job reductions on a large scale. It is estimated "that between 2 million and 4.4 million truck driving jobs in the U.S. and Europe could become "redundant" and thus be eliminated in just 13 years…."[4] On the other hand, the International Transport Forum (ITF) estimates that the new technology will reduce operating costs of road freight by 35% to 45%.[5]

Assume that those promoting "social responsibility" of business call on trucking firms to reject this technology to keep these drivers employed. Who could object to such a worthy goal? However, would it be *possible* for any trucking company to actually pursue this "socially responsible" strategy and avoid buying the new self-driving trucks? To answer this question we need to examine the levels of profit earned by trucking firms. Profit margins in trucking have averaged between 2.4% and 6% between 2011 and 2017.[6] To give those advocating "social responsibility" the greatest leeway, let's assume that the trucking industry could maintain its

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[1] "Is Profit Maximization or Social Responsibility the Morally Correct Goal of Business?" by Michael Patrono (*https://coles.kennesaw.edu/econopp/docs/Commentary-April-2022.pdf*).

[2] Milton Friedman, The Social Responsibility of Business Is to Increase Its Profits, New York Times, September 13, 1970, Section SM, Page 17, *https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html*.

[3] Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, Edwin Cannan edition, 1776, Book IV, Chapter II, pg. 423, Modern Library Edition, 1937.

[4] *https://www.fleetowner.com/technology/article/21696130/report-driverless-trucks-will-eliminate-millions-of-jobs*.

[5] Ibid.

[6] According to American Trucker, as quoted in *https://www.fastcapital360.com/blog/is-the-trucking-business-profitable/*.

highest level of profitability indefinitely. This means that for every $10 million in revenue, the average trucking company could expect to earn a profit of 6%, which is $600,000.

Now compare two trucking firms; one pursuing the "socially responsible" policy of giving up the new self-driving trucks to keep their drivers employed and the other pursuing the ostensibly "non-socially responsible" policy of profit maximization through self-driving trucks. This policy of profit maximization will be to purchase the new trucks with the lower costs of operation, but with attendant layoffs. As we can see, the profits of using the new trucks will be astounding, assuming the cost savings projected. Assuming both firms generate $10 million in revenue, the firm adopting the new technology would earn $4,360,000 while the firm eschewing the new technology would continue earning earn only $600,000.

Table 1.

	Socially Responsible Firm	Profit Maximizing Firm
Revenue	$10,000,000	$10,000,000
Costs	$9,400,000	$5,640,000[7]
Profit	$600,000	$4,360,000

At this point a person fully committed to the "social responsibility" paradigm could still insist that the morally correct thing to do is to avoid the new self-driving trucks. After all, the firm could still earn a respectable profit and keep all of its drivers employed. All the firm would have to do is avoid being "greedy" and clutching after the huge profits inherent in the new technology.

Unfortunately, the argument does not stop here. We know from both economic theory and years of practical experience that in the long-run in a competitive market a firm cannot expect to earn the huge profits implied in the bottom row of Table 1. While the early adopters of the new technology will earn above normal profits, in time firms will compete the price of trucking services down until the remaining firms earn the competitive rate of profit (i.e., 6% of revenue).[8] In the long-run the profit comparison between the two firms will look quite different.

In Table 2 we see that following a "price war" in the industry, caused by the lower costs of operating the new self-driving trucks, firms bring in much lower revenues.[9] Once the firms using the new self-driving trucks set the new lower rate for hauling freight, all firms, whether they use the new trucks or not, will have to meet the new competitive price since they are all delivering the same service. In long-run equilibrium the firms using the new technology will earn the competitive profit rate (assumed to be 6% for trucking).[10] Since the firms sticking to the older trucking technology will have to charge the same price as the firms using the new technology to get any business – but will have much higher operating costs – they would suffer massive losses. At the new lower prices, we assume our profit maximizing firm brings in $6 million in revenue for

[7] The costs of the firms adopting the new self-driving trucks are assumed to be 40% lower than the firm not adopting the new technology. The 40% figure is the average of the predicted range of cost savings estimates.

[8] For a fuller discussion of this point see Chapter 14, Firms in Competitive Markets, *in Principles of Microeconomics, 9th edition* by N. Gregory Mankiw, Cengage Learning, 2021.

[9] In order to keep the math in the example simple, we are assuming the number of miles driven per year remains the same. In reality, we would expect that the entire trucking industry would expand due to the lower costs of shipping by truck. However, the scale of the comparison between firms using the old and new trucking technology will be similar.

[10] For a fuller explanation of the impact of technology on the prices and profits of competitive firms see *Principles of Economics,* 9th edition, by N. Gregory Mankiw, Cengage Publishing, 2021, pgs. 263-281.

hauling the same amount of freight and earns the competitive profit rate of 6%, or $360,000. The "socially responsible" firm also brings in $6 million in revenue but still has its initial costs of $9.4 million, since it has not adopted the lower cost technology. This choice results in a negative profit (i.e., a loss) of $3.4 million.[11]

Table 2.

	Socially Responsible Firm	Profit Maximizing Firm
Revenue	$6,000,000	$6,000,000
Costs	$9,400,000	$5,640,000
Profit	– $3,400,000	$360,000

The problem the "socially responsible" firm now faces is not a choice between a "reasonable" profit and the protection of their worker's jobs, versus a "greedy" profit and the layoff of their workers, but rather, a choice between massive losses leading to bankruptcy or adopting the new labor saving self-driving trucks themselves. Given this choice we see that there is really no choice at all. No firm sticking to the old trucking technology could compete and stay in business unless it too switched to the self-driving trucks and laid-off it's now redundant workers. Contrary to popular myth, most firms do not make a profit level so high that they are in a position to choose between "social responsibility" and profit maximization.

This example illustrates a general problem for those who suggest that individual business owners need to develop a social conscience and "do the right thing," even assuming we all agree what the "right thing" is. No firm in a competitive capitalist system can afford to pursue any other goal than profit maximization in a meaningful way (or by implication, cost minimization), even if it wanted to. This general principle means that firms cannot pursue climate change amelioration, environmentalism, unemployment amelioration, urban renewal, wages above productivity for our least skilled workers, or any other "social good" at scale. This argument implies that asking privately owned firms to develop a "social conscience" and become more "moral"[12] to solve social problems is asking for the impossible.

If society needs to solve a social problem, it needs another alternative. As Milton Friedman pointed out, the alternative in a democracy is getting laws passed through our legislature, and funding the necessary agencies with taxes levied on people with their support in the voting booth, as opposed to berating business owners for their supposed moral failings.

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[11] The figures used in this hypothetical example are the author's calculations using publicly available data that were referenced above. The purpose of the example is not to prove what the actual revenue or profits of any particular firm will be, but to illustrate the general scale of the impact of new technologies on costs of production and the resulting pressures that will result for firms refusing to adapt the new technology.

[12] One of the problems of dealing with the subject of business ethics is that opponents of capitalism define morality in such a way that profit seeking is ruled out of court. However, business owners are acting morally when they maximize their profits as long as they follow the moral principles embodied in the rules of property rights, contracts, and torts.