When Management Is not Self-Centered

Where Peter Drucker and Milton Friedman Agree on the Business of Business

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Management, What is it good for?

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Abstract: Peter Drucker (1978) holds that managers must take responsibility for the common weal. This notion seems to contradict Milton Friedman's (1970) famous observation according to which, "the social responsibility of business is to increase its profits." Yet, as the essay demonstrates, Friedman (1970) does not deduce this claim in terms of economic reasoning. Rather, in his determination of managerial obligations, he refers to the institutions of private property and the act of contracting. He thus evokes the classical *doux-commerce doctrine* according to which the pursuit of profits is a socially desirable activity. Consequently, Friedman's (1970) dogma of shareholder value maximization as sole responsibility of managers is inherently linked to societal and ethical considerations that are also present in the argument of Drucker (1978). Jointly read, the works of Friedman (1970) and Drucker (1978) allow for definitions of "good management" as liberal art as proposed by Drucker (1989, 2008) that resolve tensions between the works of two giants of management thinking.

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(1) What constitutes good management?

Since Aristotle wrote the *Nicomachean Ethics* in 350 BC, questions concerning the moral quality of human actions have been driving philosophic and scientific enquiry. For more than four decades, management scholars have been answering the question “What Constitutes Good Management” by quoting Milton Friedman’s (1970) famous observation that “the social responsibility of business is to increase its profits” (compare: Davis, 2005). According to standard interpretations, this observation “implies that social issues are peripheral to the challenges of corporate management” (Davis, 2005, p.105), i.e. that “good management” is measured exclusively in terms of shareholder value.

If understood as proposed by Davis (2005), Friedman’s (1970) definition of management is at odds with Peter Drucker’s (1978, p.293) *dictum* according to which “organizations – and that means the ‘professionals’ who manage them – must surely take responsibility for the common weal” (in: Maciariello & Linkletter, 2011, p.59; compare: Cooperrider and Fry, 2009). Neither does Friedman’s (1970) notion seem to fit Drucker’s (1946, p.141f) observation that the “large corporation must offer equal opportunities of advancement” so as to comply with “human concepts of dignity” (in: Meynhardt, 2010, p.617). Yet, authors have claimed that Drucker was “sympathetic to Friedman’s profit maximization position believing, ‘that business should stick to its business” Drucker, 1973, p.348, in: Schwartz, 1998, p. 1687). Are the dual positions of Drucker (1978), and Drucker (1973) a “self-contradiction” of which Drucker has been accused frequently (Schwartz, 1998, p.1687)? Or are they alternative readings that explain Drucker’s (1978) care for social responsibility on the one hand, and his sympathy for Friedman’s (1970) profit maximization hypothesis on the other? And what do alternative readings of Friedman’s (1970) argument imply for answers to questions of “good management”?

As this essay will demonstrate, it is possible to interpret the aforementioned quotes of Drucker (1973; 1978) as complementary statements that represent two sides of the same coin. The subsequent paragraphs will show that this interpretation is the result of a careful reading of Friedman’s (1970) argument that will lead to observations alternative to those of Davis (2005). As these observations allow for taking account of societal aspects within Friedman’s (1970) shareholder value maximizing doctrine, they comply with

Drucker's (1978, p.293) acknowledgement of social responsibilities as elements of good management. Also, they resolve assumed tensions between this acknowledgement, and Drucker's (1973) appreciation of Friedman's (1970) shareholder value maxim. Resulting conclusions stress the ability of managers to understand "the human condition and the social role and nature of organizations" (Maciariello & Linkletter, 2011, p.93) as precondition for successful shareholder value maximization. They hence support the notion of "good management" as liberal art as proposed by Drucker (2008), and reformulated by Maciariello & Linkletter (2011).

(2) Shareholder value maximization as objective of the firm and societal act

At the core of Friedman's (1970) definition of managerial objectives stands the observation that "in a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business." His task is to "conduct the business in accordance with their desires, which generally will be to make as much money as possible…." This observation implies that once the corporate executive "for example, … is to refrain from increasing the price of the product … to contribute to the social objective of preventing inflation, even though a price increase would be in the best interest of the corporation" he would be "spending someone else's money for a general social interest." Friedman (1970) refers to this kind of behavior as in-effect "imposition of taxes and expenditure of tax proceeds." As Friedman (1970) notes, modern democracies reserve the collection of taxes to governments only. Hence, corporate managers do not have the right to "tax" the property of shareholders by using them for means other than the latters' interests.

The summary of Friedman's (1970) argument illustrates how the former deduces the managerial objective of shareholder value maximization from political considerations. For, the two main concepts through which Friedman (1970) identifies this objective are (1) the notion of contracts, i.e. the idea that business owners mandate managers to fulfill tasks and duties defined in the latters' employment contracts, and (2) the concept of private property that protects individuals against theft and usurpation from third parties. According to this line of reasoning, the notions of profit maximization and shareholder value creation are not only expressions of individual economic interests. They also reflect political institutions that are essential for modern society.

This reading of Friedman's (1970) argument constitutes management as task that receives its ultimate legitimization through its contribution to both private *and* public interests. Read under this presumption, Friedman's (1970) focus on the profit motive as adequate goal of management rests on a centuries-long discourse on commerce as civilizing and therefore socially desirable moment, as a quote by Samuel Johnson illustrates:

> "Dangerous human proclivities can be canalized into comparatively harmless channels by the existence of opportunity for money-making and private wealth, which, if they cannot be satisfied in this way, may find their outlet in cruelty, the reckless pursuit of personal power and authority, …. It is better that a man should tyrannize over his bank balance than over his fellow citizens…. (in: Hirschman, 1977, p.134).

Under these premises it is no longer possible to identify the tasks and responsibilities of managers as categories that are separate to society.

(3) Shareholder value maximization – Its legitimizations and limitations

By deducing the principles of shareholder value oriented management from the institutions of property rights and the concept of legal contracting, Friedman (1970) imposes non-economic limits to the profit objective of the firm. For, in cases where the pursuit of shareholder value creation undermines the stability of societal institutions, profit oriented management looses its legitimacy according to Friedman's (1970) argument. It is hence the task of managers to stay "within the rules of the game" (Friedman, 1970), while these rules consist of both legal and ethical principles (ibid.). These principles broaden the responsibilities of managers by incorporating qualities such as trustworthiness, due diligence, and other fiduciary duties into Friedman's (1970) definition of "good management".

There are ample cases in which managers failed to account for the limits to the notion of shareholder value maximization that Friedman (1970) himself had identified. The list of examples includes situations were the respective consequences were either borne internally by the managed organizations themselves, or externally by other parts of society. The demise of Enron which "failed because its pursuit of immediate shareholder value maximization caused it to misapply the economics, mistaken its own inflated stock market capitalization for fundamental value" (Bratton, 2002, p.1275), is an example of the first group of cases. Cases of the latter category can be illustrated by the example of overprized telecommunication firms the share prices of which were driven by the stock market boom of the 1990s "which lifted the Standard and Poor's 500 index from 542 on average in 1995 to a high of 1,533 in August 2000" (Friedman, 2010, p.13). The "fact that the stock prices were too high meant that the cost of capital to the firms issuing shares was too low", which resulted in firms expanding "more than they should have" (ibid.). While market exuberances allowed telecom insiders, venture capitalists, executives, and holders of private investment vehicles "to cash out roughly … $18 billion" in shares by selling out stakes before the bubble burst (Beerman, 2002), "firms laid hundreds of millions of miles of fiber-optic cable that have never been lit and probably never will be" (Friedman, 2010, p.13). Both examples show that misapprehensions of the shareholder value objective can cause considerable damages to both the owners of a firm, as well as the broader society and economy.

Last but not least, Friedman's (1970) limitations to the shareholder value doctrine evoke Joseph Schumpeter's (1943 [1994]) notion of the "capitalist order … [resting] on props made of extra-capitalist material" (p.162). Schumpeter's (1943 [1994]) argument reflects the earlier statement of Frank Knight (1939 [1982]) that

> "It is a commonplace that in no society do its members obey the laws from sheer self-interest …. They must be believed to be 'right', in principle, and in the main. And personal rulers are followed, or officials obeyed because their position is accepted as, first, legal, and secondly, in accord with a law which itself is fundamentally 'right'" (p.59).

Schumpeter's (1943 [1994]) and Knight's (1939 [1982]) observations illustrate that societies and their organizations are not alone formed and preserved by the profit motive and its civilizatory character outlined by Samuel Johnson (cf. above). Rather, firms live on institutions such as trust (Fukuyama, 1995), cultural achievements (Tabellini, 2007) and norms (Donaldson & Dunfee, 1999) that are not directly reflected in share prices. Yet, managers can only pursue their tasks and maximize firms' financial values, if they account for these institutions in their reasoning and behavior.

(4) Negative and positive obligations of management

The previous section demonstrated how Friedman (1970) defines the objectives of shareholder value oriented management through the institutions of private property and contracts, thus inevitably linking aspects of "good management" to societal considerations. If corporate management objectives and societal aspects cannot be separated, questions arrive with regard to the nature and degree of societal obligations of the firm and their respective consequences for managers.

In reply to these questions, many authors refer to the dualism of mandating firms either to minimize negative impacts (Kilcullen & Kooistra, 1999), or to maximize net social impacts (Norman & MacDonald, 2004). According to Friedman (1970), managerial obligations external to the interests of the shareholders of the firm primarily exist in negative terms, as managers must act "conforming to the basic rules of society" (ibid.). According to this obligation, managers' societal responsibilities are predominantly limited to the task of ***not*** engaging into certain actions such as "deception or fraud" (ibid.).

Block (2004, p.275) identifies the absence of positive obligations as "basic premise of libertarianism." Even "Good Samaritan laws, which demand "that people come to the aid of those in trouble … are incompatible" with the doctrine of libertarianism (ibid.). For example, the absence of "legitimate interpersonal comparisons of utility" (ibid., p.276) in libertarian thought implies that there is no "law against refusing to toss a life preserver to a drowning man" (ibid., p.275). For, it is not possible to conclude "that the interest of the drowning man in staying alive is more important than that of the passerby who refuses to spend but a moment on saving him" (ibid., p.276).

Despite its fundamental impact on societies and economies of the 20th century (compare: Doherty, 2007), the libertarian premise concerning the non-existence of positive obligations is only of limited value as guideline for managerial behavior as it does not take account of external confinements that managers face. This can be exemplified by returning to the drowning example. In context of the latter, it is to note that many continental European jurisdictions foresee a legal duty to rescue another person in danger (Agulnick & Rivkin, 1998). Moreover, the obligation to rescue has gained increasing ground outside Europe as the common law rule against criminalizing omissions has been weakened over the last 40 years (ibid.). In addition to legal considerations, consensus exist with regard to the existence of moral obligations that make bystanders who let a child drown in a pool "without taking the trouble to ascertain the depth of the pond ... no doubt, shameful cowards" (Stephen, 1883, p.10, in: Agulnick & Rivkin, 1998, p.95). Hence, managers who would stick to the libertarian principle of absent positive obligations as absolute plan of action, would not only be likely to break the law in numerous jurisdictions, but would also cause reputational damage to the firm.

Ascertaining the inability of the libertarian premise to account for existing juridical and ethical obligations, Friedman (1970) demands that managers act “conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom.” He thus limits the principle of absent positive obligations to cases where managers are not constricted by legal or ethical considerations in their behavior. His argument therefore opens up gateways for positive obligations as elements of management and managerial responsibility.

As the previous argument has shown, Friedman (1970) both explicitly and implicitly asserts different managerial responsibilities that are beyond the goals of shareholder value maximization. This explains how Drucker (1973) could agree with Friedman’s (1970) argument while also acknowledging responsibilities of managers toward the common weal (Drucker 1978, cf. above). A careful reading of Friedman’s (1970) argument thus resolves tensions that authors claim to subsist between the former and observations regarding the societal responsibilities of managers as identified by Drucker (1978).

(5) Business ethics – An element of good management?

While Drucker (1973, 1978) and Friedman (1970) agree upon financial and societal objectives of managers, Drucker’s (1981) positions on managerial ethics are different to those of Friedman (1970). A comparison of the approaches of Drucker (1981) and Friedman (1970) will help to elucidate main points of distinction thus allowing to form final conclusions with regard to consequences, that result from Friedman’s (1970) and Drucker’s (1973, 1978, 1981) arguments for definitions of “good management.”

Acknowledging that “the corporate executive is also a person in his own right” Friedman (1970) aims at differentiating between moral obligations experienced by the corporate executive “as a person”, and ethical demands that are relevant to the executive as employee and agent of the owners of the firm. Only the latter matter for the tasks and duties of managers, according to Friedman (1970).

Philosophical arguments such as the so-called “Buridan moral dilemma” (O’Neill, 2000, p. 58) illustrate limits to Friedman’s (1970) preposition of a separate sphere of business ethics. Michael Sandel (2009) offers a distinctive version of the Buridan dilemma that illustrates how shared identities make it impossible for executives to disregard personal moral obligations when making corporate decisions. His example assumes the wreckage of a ship where “the captain has to make a choice. He can either escape with his own son, or he can let his son drown but save several hundreds of the ship’s passengers.” Sandel’s (2009) account of the Buridan dilemma illustrates – admittedly in drastic colors - why the assumption according to which personal values can be excluded from the work place is not convincing. Similarly to the captain in the quoted example, who can hardly be imagined to form his decision void of fatherly instincts, managers will not be able to disregard personal values in their daily jobs (Rokeach, 1973). The shipwreck example hence helps to explain why Drucker (1981, p.x) dismissed separate concepts of business ethics arguing that “there is only one ethics, one set of rules of morality, one code – that of individual behavior, in which the same rules apply to everyone alike” (quoted in: Meynhardt, 2010, p.622).

Sandel’s (2009) version of the Buridan dilemma rejects Friedman’s (1970) hypothesis of two discrete spheres of moral reasoning. However, the underlying assumption of Friedman’s (1970) hypothesis according to which managers experience multiple and potentially contradicting moral obligations, is supported by current findings of psychologists and management scholars (Meynhardt, 2004). The ability of managers to balance these obligations is hence another part of the answer to the question of “what constitutes good management.”

(6) Management as liberal art

There are two lessons to be drawn from the present argument. First, both Friedman (1970) and Drucker (1973, 1978) identify corporate management as profit oriented task that takes place within the context of society. Consequently, their notions of “good management” entail the objective of profitability, but within limitations resulting from the very institutions that enable firms to pursue this objective. Since these institutions comprise of economic as well as “extra-capitalist material” (Schumpeter, 1943 [2003]), managerial tasks are not defined in financial terms only. In contradiction to the libertarian doctrine of the absence of positive obligations (Block, 2004), these tasks can also entail non-negative obligations defined by law or ethical custom that precondition the legitimacy of management outcomes as observed by Knight (1930 [1982]). Being legally accountable to the owners of the firm while also being subject to formal and informal rules of society, "good managers" have to be able to balance diverse obligations in complex environments.

The second lesson is that Friedman's (1970) reflections on the objectives and qualities of "good management" display innate similarities to the works of Peter Drucker by complying with categorizations of management as liberal art. According to Martha Nussbaum (1998, p.86) the liberal arts "cultivate capacities of judgments and sensitivity". These qualities hence play a vital role for the management-definitions of Friedman (1970). For, Friedman (1970) identifies the pursuit of shareholder value maximization as objective that managers can only realize in line with the formal and informal institutions of society as the present argument has shown. Since these institutions imply both negative as well as positive obligations of the firm, Friedman (1970) expects managers to make decisions that are effective, legitimate, and applicable as well as sensitive to the various internal and external constraints and conditions under which the firm operates. This mixture of effectiveness, legitimacy, sensitivity, and responsibility is an integral element of "good management" as defined by Drucker's (1973, 1978). Analogous characteristics led to Drucker's (1989) recognition of management as liberal art (Maciariello & Linkletter, 2011, pp. 95 – 132).

The financial crisis has undermined the reputation of the corporate sector. It will be hard to redeem management as a profession as long as debates about good management fail to provide satisfying answers to contemporary audiences. By studying intellectual principles on which two towering management thinkers have built their observations, the present essay has attempted to give an outline on what these answers could look like. Since its argument rests only on a fraction of the writings of Peter Drucker and Milton Friedman, the essay does not want to be more – but also neither less - than a call for further dialogue.

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