The Ethical Lacunae in Friedman's Concept of the Manager

Jonathan B. Wight
University of Richmond, jwright@richmond.edu

Martin Calkins

Follow this and additional works at: http://scholarship.richmond.edu/economics-faculty-publications

Part of the Economic Theory Commons, Ethics and Political Philosophy Commons, and the Industrial Organization Commons

Recommended Citation

This Article is brought to you for free and open access by the Economics at UR Scholarship Repository. It has been accepted for inclusion in Economics Faculty Publications by an authorized administrator of UR Scholarship Repository. For more information, please contact scholarshiprepository@richmond.edu.
The Ethical Lacunae in Friedman’s Concept of the Manager

This article challenges along two lines Milton Friedman’s injunction that the sole role of the business manager is to maximize profits for shareholders using all legal and ethical means. First, it shows how Friedman overly narrows the manager’s moral duties to consequentialist profit maximization and thereby fails to account for a wide range of values and virtues necessary for good management. Second, it illustrates how more oblique approaches to management as well as Adam Smith’s virtue-based model better capture the moral imagination and relational aspects of leadership that are critical to good management today. In the end, this article suggests that a subtler version of Friedman’s directive should be considered in which maximizing shareholder wealth provides a powerful business goal but not an exclusive one to direct or to motivate managers.

Milton Friedman promotes two doctrines in Capitalism and Freedom. The first is in regard to the proper role and use of corporate profits. The second is in regard to the moral foundations required for a stable society. Unfortunately, Friedman’s doctrine on profit is often applied without reference to his second doctrine on ethics (James and Rassekh 2000). In a similar way, Adam Smith’s economic injunctions in The Wealth of Nations are often misunderstood because the moral underpinnings for them in The Theory of Moral Sentiments are ignored. In both cases, an understanding of economic processes is weakened (Evansky 2005; Young 1997). This article analyzes the interconnections between the instrumental role of profits and the intrinsic role of morals in Friedman’s model, using for its analytical framework the moral sentiments theory of Adam Smith. The
article also examines whether Friedman’s profit-maximization goal adequately motivates managerial activity.

The key problem with Friedman’s mandate on profits is that it gives rise to a fundamental inconsistency: On one level, Friedman utilizes a largely consequentialist ethic to explain how markets and economic actors behave, yet he simultaneously relies upon managers to uphold an internal ethic based on duty and virtue. The psychological dissonance created may produce both hypocrisy and inefficiency. A subtler version of Friedman’s injunction on profits and the manager is warranted, in which virtue ethics might provide a meaningful approach to motivation within the firm.

The Manager and Profits

Fiduciary Duties and Profit Maximization

Milton Friedman’s *Capitalism and Freedom* contains one of the twentieth century’s most quoted economic passages:

> Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible (1962, 133).

He restates this claim in a widely reprinted article in the *New York Times Sunday Magazine* (1970). There, he makes two important points. First, he argues that, “(t)he corporation is an instrument of the stockholders who own it” (1962, 135). Managers are agent-employees of the owners and charged with conducting business in accordance with the owners’ wishes. This typically is interpreted to mean that managers are to make as much money as possible for the owners and to avoid other activities that reduce shareholder profits. These other activities include acts of social responsibility that funnel profits to concerns other than those approved by stockholders. To do otherwise is, in Friedman’s view, a form of unfair taxation.¹

Friedman then makes an efficiency argument based on the instrumental role that profits play in a market system. In a free and competitive market lacking externalities, profits signal the way resources ought to be used in business to best meet the preferences of consumers. In this view, managers ought not to stand in the way of the market’s free functioning and should not sidetrack the business by having it attend to social problems such as homelessness, unemployment, racial disparity, poverty, and so on. These are not the bailiwick of business nor is there anything in the manager’s training that makes him or her expert in aiding
The Ethical Lacunae in Friedman's Concept of the Manager

such causes. As Friedman notes: "If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is?" (Ibid., 133). Clearly, Friedman thinks managers cannot. Instead, they should stick to what they do best and the job they are hired to perform: maximizing wealth creation for shareholders. As we will see, however, Friedman has added an important caveat that not only limits the manager's profit seeking but also coheres with the views of an earlier free-market proponent, Adam Smith.

Caveats to Restrain Greed

Although Friedman does claim that managers ought to strive to maximize profits for shareholders, he also maintains that doing so should not be divorced from the ethical foundations on which business activity takes place. Managers, he asserts, ought to maximize profits for owners while conforming to the "basic rules of the society, both those embodied in law and those embodied in ethical custom" (1970). Unbridled profit seeking is simply unacceptable behavior if such behavior is outside the mainstream of ethical norms. Managers may neither opt out nor excuse themselves from laws and customs. Instead, they must abide by what used to be called the basic "rules of justice."

In adding this caveat, Friedman follows the lead of Adam Smith who argued forcefully against the notion that private vices are public virtues and against the belief that greed, avarice, and selfishness can contribute to public well-being (Calkins and Werhane 1998). In Smith's view, people engaged in competitive commerce can be virtuous because their virtues—in particular, their habits of prudence, justice, and self-command—are crucial to a well-functioning society (ibid.). Virtuous people, Smith believed, will uphold "religiously the sacred rules of justice in spite both of the greatest interests which might tempt, and the greatest injuries which might provoke [them] to violate them" (1982, 241). In short, they will exercise self-command, Smith's preeminent individual virtue.

For Smith, as for Friedman, self-interest is subsumed within an ethical framework (James and Rasskeh 2000). Smith states clearly that "in the race for wealth, and honours, and preferments, he may run as hard as he can, and strain every nerve and every muscle, in order to outstrip all his competitors. But if he should justle, or throw down any of them, the indulgence of the spectators is entirely at an end. It is a violation of fair play, which they cannot admit of" (1982, 83).

This ethical framework, which includes the notion of justice as fair play, is a social and ethical, not a legal, construct. It is the platform on which character and reputation are forged: "To be anxious, or to be laying a plot either to gain or to save a single shilling, would degrade the most vulgar tradesman in the opinion
of all his neighbors" (ibid., 173). For Smith, therefore, regulating oneself—exercising self-command—is of paramount importance. Not surprisingly, he regards self-command as the preeminent individual moral virtue, one from which "all the other virtues seem to derive their principal lustre" (1982, 241).

Friedman echoes the Stoic character of Smith's views when he admonishes managers to exercise self-restraint while running businesses for shareholders. He challenges them to be unselfish agents of the owners and to refrain from diverting business resources toward activities that earn economic rent for managers—such as endeavors that boost short-term profits and executive bonuses at the expense of long-term productivity and profit (Grant 1991, 911). Friedman thus espouses profit seeking but does not advocate greed. Rather, consistent with Smith, Friedman enjoins managers to stand firm against passions that would tempt them away from fulfilling the fundamental fiduciary duties associated with the principal-agent agreement and from conforming to society's legal and ethical norms.

Asymmetric Information and the Subtlety of Ethical Custom

While Friedman's manager is consistent with Smith's virtuous man at the abstract level of duties, is Friedman's thesis consistent at a practical level? Are there times when managers ought not to maximize profits? To answer this question, consider as an example the CEO of a health maintenance organization (HMO). This company receives the bulk of its receipts from a third party, such as an insurance company, so that consumers and payments are separated by a semitransparent penumbra. Suppose a patient visits one of these HMO doctors complaining of a backache. The doctor in this situation has many treatment options, each entailing a different level of treatment and potential profit for the HMO. What should the doctor do?

According to Friedman's injunction, the CEO's imperative is to advance the wishes of the company's shareholders. If profit maximization is the goal, the CEO has a moral obligation to make as much profit as possible so long as no fraud is committed. Accordingly, the CEO should command that doctors prescribe the procedures, tests, and surgeries that will generate the most profit for the HMO. Because backache symptoms indicate a number of possible causes, some of which could be serious, the doctor could select the priciest treatment options while still not violating the law or ethical customs. Doctors who overtreat can argue that they are being risk-averse to provide better care or to avoid lawsuits. The patient would be inclined to go along with the doctor's treatment regimen.
because she lacks the doctor’s sophisticated knowledge. In doing so, however, she and her insurance company will pay an inflated price for treatment of her backache. Even so, no laws are broken, and the doctor conforms to society’s expectation that doctors alleviate patient suffering.

Exploring the situation further, however, it becomes apparent that the CEO’s promotion of profit maximization is not wholly appropriate. For one, the CEO is taking advantage of the patient’s ignorance and likely violates the fiduciary trust grounding the doctor-patient relationship. The doctor is able to prescribe the most expensive course of treatment precisely because of information and financial asymmetry and because the patient trusts that the doctor has her best interests in mind. Because it is often difficult for buyers to obtain competing information in some health-care situations, and the consequences for failing to buy may be life-or-death, this transaction can be seen as coercive (Sandel 1998). Had the patient the same information and experience as the doctor, and were the patient paying directly for the treatment, she would not be as inclined to accept the doctor’s expensive treatment option. Lacking such knowledge and incentives, however, she is exploited by the health-care providers’ dictum to maximize profits.

Nobel Laureate Kenneth Arrow discussed the problem of doctors, asymmetric information, and ethics in an early book (1974). Doctors who own medical labs or testing equipment have an economic incentive to order tests, and many do so at a rate much higher than average (Armstrong 2005). When such moral hazards exist, the medical community demands—through an ethical code dating back twenty-four hundred years—that its members put patient interests ahead of other interests, including those of corporate shareholders. Such a hierarchy of interests is ambiguous in practice, of course, and so the characters of the CEO and the doctor matter a great deal. In particular, we might examine the CEO motives as a basis for analysis. In the case of our backache patient, the CEO must accept that doctors—and hence the CEO as well—have fundamentally competing duties. Both the doctor and the CEO as business manager must restrain themselves in light of the expectations that society has of doctors, whether they are free agents or employees of health-care enterprises.

These two things, the presence of the need of individuals to adhere to duty and the necessity of individuals and their employers to acknowledge the expectations of society, illustrate how Friedman’s caveats apply in practical situations. They reveal, too, the subjective dimension of what would seem to be an absolute application of a free-market requirement to maximize profits. Finally, they show how the need to limit profit seeking arises in settings where laws are not at issue and where the ethical customs of society are open to interpretation.
Analogous situations to the doctor can be found in other disciplines. Accountants, lawyers, engineers, journalists, religious leaders, and others have similar but distinctly particular fiduciary standards associated with their vocations. In these and other endeavors, professionals are duty-bound to relegate profit seeking to secondary status. As with the doctor, managers in these disciplines must recognize the presence of asymmetric information and hold certain important core values above the absolutes of the market. Even econometricians have been called upon to develop a code of ethics in response to numerous problems of asymmetric information in data collection and analysis (Levy and Peart 2008).

One can surmise that social norms and codes for certain professions arose precisely because of issues of client vulnerability. Yet, there are many instances of customer vulnerability where professional codes of conduct are absent. Take, for example, the situation of a traveler in need of urgent car repair to an isolated town with only one service station. A nationwide corporation owns the repair station, and the shop manager faces a decision of whether to maximize profits for the owners (corporate shareholders) or follow a perceived moral duty to put the customer’s interests ahead of the company’s. To some degree, this problem can be handled adequately by enlightened self-interest in the marketplace. The car repair shop manager might decide to be honest and not take advantage of the customer to thereby promote the corporation’s reputation for honesty. In this way, the manager could justify favoring the customer’s interests on the grounds that doing so creates a relationship resulting in greater profits in the long run (Novak 1990). Accordingly, absent a professional code of conduct, the institution of competitive markets itself—through repeat business—can create incentives for behavior that conform to ethical standards, even if the motives for action are avaricious (Smith 1981; McCloskey 2006).

Relying upon the consequentialist incentive of enlightened self-interest to handle all problems of moral hazard is problematical. This is the case, for example, when sellers do not anticipate repeat business, when buyers themselves are not responsible for paying (e.g., third-party insurance payers), and when providers can sustain asymmetric information and lack of transparency. It can also occur when managers’ bonuses are tied to short-term rather than long-term goals. In such situations, greed can lead to free riding and inefficiency that can be substantial in certain industries (health care, for one). Resolving such problems is not easy, but Friedman and Smith provide fairly consistent arguments at both the theoretical and the practical levels to advocate for market principles restricted by compelling individual duties and social customs.

Smith and Friedman differ greatly, however, in their attempts to explain the complex human behaviors that provide a rationale for moral duties. For his part,
Smith offers a nuanced account in *The Theory of Moral Sentiments* (1982) for how society inculcates young people in concepts of duty and virtue so that, as adults, they might come to acquire self-control. This socialization process relies upon the cultivation of mutual sympathy ("fellow-feeling") that is genuinely felt. It demands that self-interest be constrained and often superseded by other motives.

In many ways, Smith's model individual is similar to Friedman's, but a key distinction is with Friedman's ethical framework. Smith is a virtue ethicist who argues (with Hume) that although ethical behavior produces good consequences, the foundation for ethical behavior lies in the emotional connections of individuals rather than in rational calculations of enlightened self-interest.

Not unlike Aristotle and other of his predecessors, Smith holds virtue to be its own reward. Smith states, "Sympathy ... cannot, in any sense, be regarded as a selfish principle" (1982, 317). Smith's moral sentiments model can then readily explain how and why an economic actor could behave with duty to customers, even in cases of one-time interactions and with pervasive asymmetric information, that is, in cases in which enlightened self-interest breaks down.

Friedman's model cannot do the same, and his ideal manager, we will see, is logically inconsistent. According to Friedman, business executives are bound by the principal-agent relationship to operate in a deontological or duty-based ethical manner up the chain of command with their superiors and shareholders. Simultaneously, they are to pursue a purely consequentialist striving to maximize profits and to disallow intrusions into their conduct such as Smith's moral sympathy. Managers thereby face a moral dilemma. If they accept the notion that deontological moral duties should guide behavior, and if deontological moral duties require that everyone be treated in the same manner, then preferring one group (shareholders) over other stakeholders on purely consequentialist grounds is morally untenable. How can this be resolved? Terry Price (2008) addresses the question using Kantian logic, but the result may be difficult to generalize and apply in practical situations.

In addition, it is also unclear in Friedman's argument how and why managers come to acquire fidelity to the concept of moral duty in the first place. Friedman does not provide an adequate answer and so the logical fallacy in his argument is this: that capitalism clearly requires duty-bound managers, but capitalist institutions cannot create or sustain the concept of duty. Paul Heyne (1995), an advocate of markets, succinctly argues this point:
The market requires moral foundations which cannot be created by market transactions themselves. Moral foundations are nurtured in communities—in families, neighborhoods, religious fellowships, local political associations, and other voluntary groups. By fostering the steady disintegration of these communities, market transactions may tend over time to undermine the moral foundations upon which they rest.

This is the first lacuna in Friedman’s concept of the manager—that managers must be duty-bound to shareholders but cannot be duty-bound to customers, workers, suppliers, and other stakeholders. The important exception is if profits can be enhanced by appearing to be duty-bound to other stakeholders, that is, to appear morally committed to social concerns if doing so enhances community relations, worker efforts, and so on. Managers thus have a dualistic ethical personality.

This duality at the level of theory suggests a second and practical feature of Friedman’s argument: Managers are morally authentic when responding up the chain of command but possibly deliberately inauthentic when manipulating down the corporate hierarchy (as long as no moral norms are broken). The second lacuna in Friedman’s concept of the manager then reveals how Smith and he diverge at an instrumental level. While both see ethics as achieving some beneficial outcomes, Smith’s concept of the ethical person is fundamentally nonconsequentialist. Smith uses a virtue-based behavioral model, incorporating intuitions and emotions to study human motivations, while Friedman relies more upon consequentialist calculations of self-interest and a loose deontology to establish the duties of managers to corporate shareholders.

Profits and Motivation

In his Nobel Prize address, Douglass North (1994) argued that neoclassical economics is a poor vehicle for understanding the development of markets because it generally ignores the role of institutions and path dependencies over time. Similarly, Kenneth Arrow observed of doctors, institutions, and ethics that, “one might regard professional ethics as an example of an institution which fills in some measure the gap created by the corresponding failure of the price system” (Arrow 1974, 36–37). Both comments illustrate aspects of Friedman’s model, which is that it is arguably helpful in identifying the instrumental role of managers but inadequate for understanding the motives and full range of managers’ duties.
Friedman’s model is limited for one because he argues that maximizing profits should direct the manager’s activities without explaining the reasons for profit maximizing being the single and best motivator for managers and entrepreneurs. The notion that profit is or should be the overarching motivator is problematic for several reasons. First, it contradicts a common understanding and empirical research about the ways successful business leaders actually motivate in practice. A slew of management and leadership literature indicates that managers and entrepreneurs are not motivated primarily by profit maximizing (Adams 1984; Hawken 1987; Österberg 1993; Ray and Rinzler 1993; Ray and Renesch 1994; Peale, Blanchard, and Peale 1996; Harmen and Porter 1997; Blanchard 1997; and Pfeffer 1998). Rather, they are inspired by ideas and ideals related to an enterprise.

Second and following from the first point, Friedman’s model fails as an explanation for manager motivation because it relies on a neoclassical economic model ill-designed to provide such explanation. The neoclassical economic model is a black box containing virtually no behavioral information about the psychological sources of meaning. It explains well how businesses become efficient at generating profits but does not account for the motives that drive individuals to produce those profits. It can explain, for example, how F. W. Taylor’s scientific management’s time studies, standardization, and mechanical view of management can increase efficiency to generate higher profits in business, but it cannot account for the drive, creativity, and circumspection that impel individuals to build successful institutions. Moreover, it does not explain the fundamental reasons for engaging the process in the first place. It simply explains process without reflecting on the merit of the activity. It is vulnerable therefore to criticisms such as Peter Drucker’s, who reputedly said, “There is nothing so useless as doing efficiently that which should not be done at all” (Office of Federal Procurement Policy, 2004, 16).

Third, Friedman’s model is inadequate because there are so many better alternatives to it. A more helpful approach, for example, can be found in the recent intellectual history of entrepreneurship, which explains a wide range of managerial motivations (Kalantaridis 2004). Here, we find how profit is a central concern for managers (especially entrepreneurs) but not the only or even main source of meaning and motivation. Rather, managers and risk-taking mavericks tend to be motivated by the desire to achieve, build, overtake competitors, produce the best, be first to market, or attain some self-actualizing goal or set of goals. Rivalry, for one, is a potent motivator. As Adam Smith noted, rivalry and emulation, spurred by competition, is usually sufficient to induce “the very greatest exertions” (1981, 760). Such rivalry, as David McClelland argues in *The Achieving Society* (1961),
is spurred by the desire to excel and is a psychological process and not simply a desire for a specific outcome, such as maximizing profits.

Other, more anecdotal observations support Smith's and McCleland's arguments. For example, John Kay's sample of twentieth-century innovations—DNA, computing, antibiotics, television, and the green revolution in agriculture—illustrates how "financial incentives play ... only a small part [in their discovery], and the financial rewards for the discoverers were not great.... The principal motives appear to be the excitement of the process of discovery, and the social rewards offered to the renowned scientist" (2004a, 268). Even Donald Trump admits that, "Money was never a big motivator for me, except as a way to keep score. The real excitement is playing the game" (BrainyQuote). Motivating goals can even relate to transpersonal or altruistic objectives. Frank (2004, 79), for example, found that workers in companies with "socially responsible" profiles were willing to accept wages far below firms that did not. In the end then, a wide range of other explanations supersede Friedman's model as an explanation of manager motivation.

Fourth, Friedman's model does not account for the inspirational sentiments underlying managerial motives to maximize profits. Although he suggests that enlightened self-interest motivates managers to maximize profits, managers might just as easily adopt a pretense of such sentiments to mask their greed. In such circumstances, a savvy (but cynical) manager might even promote the goals of corporate social responsibility in the hope that these might increase productivity, customer loyalty, and ultimately ... profits. This sort of approach is not farfetched. It befits the modus operandi of many "opportunistic pseudo-transformational leader(s)" observed by Terry Price (2003, 72).

Adam Smith's model of behavioral psychology, in contrast, provides a clearer rationale for the moral sentiments empowering responsible business practices. For Smith, the natural sentiment of sympathy (fellow-feeling) is the source of moral virtue that "cannot, in any sense, be regarded as a selfish principle" (1982, 317). In practice, it engenders caution and truthfulness. The reason for this is simple—because people are adept at discerning the feelings of others similar to themselves, they can detect deceit. Accordingly, "the prudent man is always sincere, and feels horror at the very thought of exposing himself to the disgrace which attends upon the detection of falsehood" (Smith 1982, 214). Although exceptions in the form of superb emotional fakers do exist, it is difficult for most people to sustain emotional fictions. Most can intuit when another (for our purposes, a manager) says something he or she does not really believe, and the resulting punishment of alienation and disgust when individuals are caught in deception is usually sufficient to minimize widespread hypocrisy.
Having established the reasons and support for fellow-feeling and honesty, Smith goes on to note that ambitious people frequently do not know for certain what they are pursuing. Their objectives are bound up within a social context so that acceptance and status among their peers becomes their strongest desire (1982, 213). As Smith notes: “It is not ease or pleasure, but always honour, of one kind or another, though frequently an honour very ill understood, that the ambitious man really pursues” (1982, 65, emphasis added). When placed in the context of business, this means that managers learn to generate profit for the sake of survival (their own and their firm’s), but this is not to say that they are motivated by profit per se or that they operate best from a psychological perspective in which profit maximization is at the center.

Fifth and finally, Friedman’s model not only fails to account for certain inspirational sentiments, it also fails to recognize the importance of intuition in motivation. Here, Frank Knight’s Risk, Uncertainty, and Profit (1921) is particularly helpful to an understanding of the role of intuition in management and, in particular, to transformational leadership. In Knight’s view, risk is an attribute of a business project for which reasonably well-known probabilities exist. If insurance markets are deep enough, for example, one can buy policies to protect against virtually any risk. Uncertainty, on the other hand, is a situation in which not enough information exists to make reasonable assessments of probability. No amount of planning or logical assessment can resolve the uncertainty and so no insurance can be bought to offset its hazards. In environments of uncertainty, intuition may be a vital input in production (Kay 2004a, 2004b). As Trump reflects: “Experience taught me a few things. One is to listen to your gut, no matter how good something sounds on paper” (BrainyQuote).

If it is true that intuition and emotion (right-brain functions) are sometimes of greater use to managers than logical, cost-benefit calculations (left-brain functions), then managers may need to develop imagination, spontaneity, curiosity, creativity, and connectivity—all forms of moral imagination—a topic to be addressed next (Goleman 1995, Elster 1998).

**Obliquity and Organizational Transformation**

While most contemporary management theorists acknowledge Smith’s and Friedman’s theories as helpful, these and other early microeconomic theories are thought to be overly narrow and limited. They consequently have been largely replaced with approaches that are more expansive and holistic.

John Kay, corporate consultant and former business school dean at Oxford University, proffers one such new approach that emphasizes “obliquity.” Here, Kay argues that the best way to reach a profit objective is not always to head directly
for it but to approach it from the side, that is, obliquely. Such an approach is preferable in dynamic situations where systems are “complex, imperfectly understood, and change their nature as we engage with them” (Kay 2004b). The approach is especially helpful in multifaceted, interdependent business organizations where, typically, there is no single, simple, and correct strategy for running operations. In these dynamic situations—whether the industry is new or mature, has adopted technology slowly or quickly, is publicly or privately held, has extensive or weak government regulations, is led by a founding entrepreneur or hired managers, has low or high margins—managers must balance a variety of competing internal and external demands to resolve problems. While Friedman’s simple admonishment to maximize profits has an important place in this environment, it is certainly not an exclusive prescription for business development.

Kay recognizes the limits of traditional direct approaches to management problems and goes on to explain that managers who focus on the simple, well-defined objective of profit maximization often fail miserably. They make the mistake, in his view, of “underestimating the complexity of the system with which they (deal) and the value of the traditional knowledge they (inherit)” (ibid.). A better approach, he believes, is one that provides managers with a holistic perspective of the corporation; that is, one that enables managers to adapt to and succeed in a changing world. To buttress his point, Kay observes how few neoclassical microeconomists are hired by businesses. This, he suggests, is partly because microeconomic theorists rely on simplistically direct, ahistorical approaches that do not account for the path-dependent nature of evolutionary business enterprises. Further, the standard model fails to portray adequately the complex psychological incentives that motivate today’s managers.

The paucity of the standard model that Kay describes highlights not just the limits of microeconomic theory but also the failure of economists to account for one of the theory’s central tenets—Smith’s notion of sympathy. Sympathy or fellow-feeling is critical to good management, for by it, “we place ourselves in [another’s] situation, we conceive ourselves enduring all the same torments, we enter as it were into his body, and become in some measure the same person with him” (1982, 9). Sympathy forms the basis of moral imagination and enables managers to deeply understand and appreciate the employees, investors, suppliers, customers, and other stakeholders crucial to the success of commercial enterprises (Werhane 1999; Moberg and Seabright 2000). While number crunching skills and consequentialist approaches that emphasize profit maximization are important, these alone are insufficient for good management as both today’s management theorists and Adam Smith recognized.
The Ethical Lacunae in Friedman's Concept of the Manager

The key points raised here are first, that Smith's concept of human motivation does allow for a dominant role to be played by nonpecuniary motives; and second, that Smith's approach is based on a nonconsequentialist model of moral sentiments that inspires good management. Smith lays out the biological and psychological case for human instincts that lead to the formation of moral rules and norms (Wight 2007; Evensky 2005). While these moral rules serve useful instrumental purposes, they arise from an intuitive psychology that operates through virtue ethics. Given this and within Smith's moral framework, a company might come to represent the best aspirations of its stakeholders, not just financial rewards for its shareholders. Decision-making might reflect a concern for creating a process and generating outcomes that uphold self-actualizing interests (Hawken 1987). Not unlike Michael Porter and Mark Kramer's notion of "building shared values" as an approach to corporate social responsibility, managers might generate loyalty and efficiency that more than compensate for the company's costs (Porter and Kramer 2006, 13).

Conclusion

This article challenges Friedman's doctrine that the pursuit of profit is and should be the manager's exclusive duty. As shown here, Friedman's thesis based on arguments of commutative justice, freedom, and economic efficiency does not claim that managers are relieved from the constraints of civil and moral laws. To the contrary, his argument maintains that ethical precepts delimit and create the foundation for ethical business practices and markets. Friedman's notion of profit maximization, in short, is not synonymous with selfish individualism. Rather, it advocates consideration of others and self-restraint or, in Adam Smith's terminology, sympathy (fellow-feeling) and self-command.

Friedman's argument does, however, raise a logical contradiction. Because moral tenets come as bundles of duties and obligations—often impossible to untangle—they cannot be resolved through simple formulae or defined in terms of profit motivation. Some motive or set of motives other than profit maximization is necessary, and sometimes these other motives can conflict with the profit motive. A business manager, for example, who believes it is her duty to be loyal to the owners' interests, might also believe it is her moral duty to tell the truth—even if doing so might lower profits. James and Rassekh (2000, 671, 12) report that Friedman, in a personal communication, agreed that in such a situation, truth telling to outsiders was a moral obligation of the business manager even if this lowered shareholders' profits. This particular example arose in the
specific context of threatened third-party property rights that, to Friedman, might represent a core human right on par with freedom.

For Friedman, the fiduciary aspect of the principal-agent agreement is paramount; hence, honesty is a critical virtue. Honesty is not, however, the only moral virtue relevant to managers, and these other moral virtues become apparent in practice. A manager might easily find him or herself in a position of having to decide, for example, whether or not to uphold shareholder interests when doing so threatens the selfish personal interests of the manager. He or she might also have to decide about whether or not to tell the truth (a form of honesty) when doing so could jeopardize the interests of employees, suppliers, and other stakeholders. In these sorts of situations, relying exclusively upon the principal-agent agreement, the moral virtue of honesty, and profit maximization is unhelpful. Other values and virtues are necessary. Friedman's formula does not account for these and effectively boxes-in managers, forcing them to be only consequentialist in their dealings with stakeholders. This is Friedman's first major gap or lacuna.

Friedman's second lacuna involves his insistence on profit maximization at the expense of important motivational issues in management. While the pursuit of self-actualizing incentives that increase worker loyalty, motivation, and efficiency would be accepted by Friedman under the rubric of enlightened self-interest, his requirement that managers calculate the expected gains and losses from having such nonpecuniary drives and then pretend to possess them undermines the strength and efficacy of the approach. Such a consequentialist reckoning ultimately fails to recognize the genuine relationships of managers as well as the authentic sympathy and passion (Smith's fellow-feeling) that inspire managers, workers, and customers. Hence, this tactic fails to account for moral imagination—a construct that cannot be conjured up along narrowly rational and self-interested grounds.

Given these shortcomings and to offset these lacunae, this article supports a subtler version of Friedman's directive. It acknowledges that profit maximization using all legal and ethical means remains an insightful model of resource allocation. It proffers, however, that this metagoal can at times be achieved obliquely by placing other objectives ahead of profit. For example, cultivating a genuine virtue ethic (as in Adam Smith) may achieve this goal, but not in a purely consequentialist manner. In this way, it is hoped, the manager might have a focused, yet more consistently authentic and humane, moral framework to guide his or her behavior.
Notes

1. Friedman observes that tax laws may mitigate against this because of the double taxation of corporate profits.

2. Adam Smith is equally cynical: “I have never known much good done by those who affected to trade for the public good” (1981, 456). Smith is referring here to merchants who profess to care for society’s interests when they are really lobbying for legislation that would earn them economic rent (e.g., through protectionism). Friedman’s point is analogous.

3. Here, *vocation* is regarded as a response to a calling.

4. What exactly are these absolute laws or institutional rules? Friedman provides only one example, that of the widespread acceptance of wages in a market system based on individual productivity. One can think of many others, such as the widespread acceptance of the legitimacy of fairly elected governments and the widespread adherence to moral injunctions against theft. It should be clear that transaction costs in exchange would be much higher in the absence of widespread acceptance of basic social norms of morality.

5. Michael Novak makes this distinction: “[T]here is a difference between maximization of profit and optimization of profit. To aim at maximizing profit—that is, to obtain the greatest profit possible out of every opportunity—is to be greedy in the present at the expense of the future.... By contrast, to optimize profit is to take many other factors besides profit into account, including long-term investment, consumer loyalty, and the sense of a fair service for a fair price” (1990, 51).


References


The Ethical Lacunae in Friedman's Concept of the Manager


