

# Promotion of Development of Institutions: A Task for Global Corporations?

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## Abstract

In this paper, I show how Milton Friedman – who usually is taken to be interested in shareholders only - nevertheless can be said to support a positive duty for global corporations to promote the development of institutions in countries in which they operate. The argument is strengthened by rejecting two objections, first that shareholder interest is all that matters and second, that corporations do not have a mandate to take such positive actions. My argument has implications for both practical management in global corporations and traditional scholars of Friedman's.

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In this paper, I argue that global corporations have a positive duty to promote the development of basic background institutions in countries in which they operate. I adopt Milton Friedman's neoclassical economic argument as the basis for this contention. First, I make a short delimitation and define core concepts. Second, I present Friedman's argument about the role of institutions to protect the individual's right to freedom from coercion. Focussing on the crucial point that Friedman assumes that institutions already exist, I show how

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corporations have a moral duty to promote the development of such institutions in countries which they operate. Third, I expand the argument by considering two objections.

Based on Friedman, I define *basic background institutions* as those which promotes and enforce the fundamental right to freedom from coercion through for instance property rights, environmental protection and enforcement of contracts.<sup>1</sup> I use the term *institutions* to refer to these conditions. As Friedman assumes that corporations have no obligations, where I propose responsibilities for corporations, I posit that these reside with the corporation's CEO as an individual. I will not discuss the practicalities of institution building but will merely consider the philosophical aspects and normative conclusions.

Friedman begins from the view that when individuals pursue their self-interest they benefit society and thereby justify the existence of both market and corporations.<sup>2</sup> A corporation's self-interest is equal to the interest of its shareholders. Thus, a corporation should aim to maximize profits for shareholders; in short, there is no such thing as corporate social responsibility.<sup>3</sup> However, the pursuit of self-interest is not without limits. The overriding principle governing Friedman's interpretation of self-interest is the need for freedom from coercion.<sup>4</sup> While Friedman does not use the word himself, justice in his view is to create benefits for all by benefitting oneself while not harming others. To secure this, a society needs a framework of institutions. In this way, fraud, deception or externalities,<sup>5</sup> where economic activity makes a person worse off and not fully compensated are prevented.

This highlights a crucial point in Friedman's argument: He assumes that

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<sup>1</sup> Friedman, *Capitalism and freedom*.

<sup>2</sup> Smith, *An inquiry into the nature and causes of the wealth of nations*.

<sup>3</sup> Friedman, 'The Social Responsibility of Business is to Increase its Profit'.

<sup>4</sup> James and Rassekh, *Smith, Friedman, and self-interest in ethical society*.

<sup>5</sup> Friedman calls these 'neighborhood' or 'external' effects, and defines them as 'arbitrary obstacles' that prevent others 'from using [their] capacities to pursue [their] own objectives'.

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institutions already exists. An example illustrates this. Suppose that a global chemical corporation views a foreign country Z favourable for business. It builds a chemical plant in country Z which is close to a stream, but subsequently discovers that the production of chemicals will pollute the stream. As there are no legal institutions in country Z to make or enforce laws in relation to chemical pollution, the company will not commit any illegal activity. Nonetheless, the corporation's activities will effectively force the locals relying on the stream to exchange good water for bad. They may be willing to do so if they were paid accordingly but it is not feasible for them, acting individually, to either demand or enforce proper compensation. Without institutions, voluntary exchange is impossible because individuals affect others and cannot charge or compensate them. Thus, the corporation and the market will impede the freedom of others. The responsibility to create institutions that prevent such incidents falls, in Friedman's view, on individual citizens. However, due to injustices such as oppression or deprivation, individuals in country Z cannot build those institutions themselves. What then should corporations do? As I see it, there are three options.

The first is simply never to enter country Z or, having discovered the lack of institutions, leave and wait until individuals have promoted the development of these institutions.<sup>6</sup> That, however, is not a suitable solution. It would effectively mean that many emerging markets would never be developed, both reducing the corporation's options for expansion and representing a cost to country Z's economy. By doing so, the corporation foregoes a beneficial business opportunity and thereby harm the shareholders, which is of primary importance for the corporation.

The second option is to operate justly but without institutions. Here, this

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<sup>6</sup> This is what Joseph Heath calls the 'market failures approach.' To profit from market failures (where activities on a market generates for instance externalities) is to 'to undermine the social benefits that justify the profit orientation in the first place.' See Heath, 'Business ethics without stakeholders'.

would mean taking further environmental precautions or moving the factory to prevent pollution, which is equal to a negative duty not to do harm. To argue this would not be controversial;<sup>7</sup> however, this option is also not feasible. In Friedman's view, institutions do something that the market cannot do for itself, namely to determine, arbitrate and enforce the law of society. Friedman simply does not believe that corporations can adhere to rules without enforcement. Specifically, he believes that even if some corporations can, not all can. If it was possible to act justly without institutions, then the reason for creating them in the first place would disappear. They are needed, both to create acceptance of the law and to interpret and enforce it.

This leaves a third option: To promote the development of institutions itself. By doing so, the corporation creates profits for shareholders by expanding the business and both the market and the corporation avoid creating externalities. Thus, in the situation where the corporation cannot act without creating externalities that harm individuals, and where institutions are lacking, the corporation not only has a negative duty to refrain from doing harm but also a positive one to promote development of such institutions that prevent harms in the future.

By considering two objections, I develop this argument further. The first objection that Friedman could put forward himself is that corporations have another aim that is more important: To further the interest of the shareholders.<sup>8</sup> Promoting institutions will make this harder to pursue as they limit the corporation's conduct and reduce potential profits. One response could be that by promoting institutions, the corporation indirectly benefits itself, because it creates a framework under which other corporations are required to respect the law. Thus, the corporation benefits shareholder by securing that all corporations

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<sup>7</sup> See, for instance, Donaldson, 'Moral Minimums for Multinationals' or Ruggie, 'Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework' for such arguments.

<sup>8</sup> Friedman, 'The Social Responsibility of Business is to Increase its Profit'.

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compete equally. This response, however, does not entail that the corporation should promote institutions *per se* but rather that they ought to do so if in their own interest. Therefore, I rather reply that the best society in Friedman's view not is one without institutions - even though the corporation here fully could pursue its self-interest without limits. Rather, it is one where social benefits are achieved but without expense to individual freedom. Thus, Friedman is concerned with *more* than merely shareholder profits; his primary focus is to secure the greatest amount of freedom for each individual. Therefore, the institutions are not only for the benefit of corporations but also for the benefit of citizens.

The second objection presented by Nien-hê Hsieh is that because the corporation is not accountable in the way that governments are, it should not be involved in activities traditionally associated with political institutions.<sup>9</sup> True, Friedman himself argues that if employees promotes social responsibility, they act as public officials but without the mandate to do so. I however find that this objection ignores the crucial difference between direct and indirect measures. If the corporation decided the content of the law or enforced the law itself, it would be highly problematic. However, the corporation merely promotes the means to establish the institutions. The content will still be determined by others. In my view, when Friedman opposes social responsibility, he aims at direct measures while promotion of institutions merely is an indirect measure. Thus, there is no contradiction when Friedman supports the promotion of institutions and at the same time argue against public officials' social responsibility.

I have above presented an argument for corporative duties that are not founded in a cosmopolitan<sup>10</sup> or liberalist<sup>11</sup> tradition. Instead, by considering three options for corporations operating in countries where institutions are lacking, I

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<sup>9</sup> Hsieh, 'Does Global Business Have a Responsibility to Promote Just Institutions?'.  
<sup>10</sup> Ruggie, 'Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework'.  
<sup>11</sup> Hsieh, 'Does Global Business Have a Responsibility to Promote Just Institutions?'.  
<sup>11</sup> Hsieh, 'Does Global Business Have a Responsibility to Promote Just Institutions?'.

have argued not only for a negative duty to refrain from harm, but also by endorsing and expanding Friedman's view, I have also argued for a positive duty for corporations to promote development of institutions. Because Friedman considers freedom from coercion to be of intrinsic value, corporation must do more than just benefit its shareholders. This conclusion has both practical implications, for global corporations pursuing new frontiers, and theoretical ones, for those arguing that Friedman's focus is shareholders and shareholders alone.<sup>12</sup>

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<sup>12</sup>See for instance Camenisch, 'Business ethics: On getting to the heart of the matter' or Englehardt and Schmeltekopf, 'Ethics and life: An interdisciplinary approach to moral problems' for such an argument.

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