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The Role of Profits – Is Profit Maximisation Tenable in the Modern Business Environment?

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Abstract

The issue of balancing business profitability and corporate social responsibility engagement is a delicate one. Whereas some people in business and academia see the two as inextricably linked and that businesses do well by doing good, others believe that using the legitimate returns of entrepreneurship for philanthropic activities is irresponsible. Modern corporations cannot exist and provide the products and services enjoyed by society if they do not make worthwhile profits for their owners who risk their wealth by investing and providing the funds necessary for their operations. Indeed the 'free enterprise' advocates have long held the view that businesses should be left to pursue the principle of profit maximisation as long as they operate within the law.

However, this paper takes the position that in an age where business sustainability is being touted across the corporate world as the panacea to achieving organizational viability, companies cannot afford to ignore their corporate social responsibility credentials in the name of profit maximisation. The article goes on to emphasize that adopting a stakeholder concept rather than the shareholder concept enables a business to enhance its competitive advantage. The article uses examples of how contemporary organizations have used their CSR policies as a differentiation strategy to separate themselves from the competition, allowing them to increase sales and market share, thereby improving their financial performance.

The article concludes by citing Michael Porter's principle of creating shared value where business and society recognize their interdependence and work together to provide products and services that meet societal needs while at the same time providing organizations and their investors with satisficing profitability.

Keywords: Profit maximization; Satisficing profits; Corporate social responsibility; Shared value; Corporate citizenship; Sustainability

Introduction

The debate about whether businesses should aim to maximise their profits regardless of the consequences to society is being had in academic and business circles. Whereas many academic writers believe that it is enough for businesses and investors to be content with satisficing profitability, there are others in academia who take the view that businesses exist to make profits for their owners and therefore must strive to achieve profit maximisation, at every cost [1]. Quoted from Anita Roddick, the founder and ex CEO of 'The Body Shop' and posited that "the business of business should not be about money. It should be about responsibility. It should be about public good, not private greed". According to [2] there is evidence of growing enthusiasm for ethical business practices and the general public are voting with their feet against organizations that ignore their responsibility towards sustainable and responsible practices in the name of profitability [2] concluded that it is in the long term interest of businesses to pursue organizational sustainability by adopting the principle of the triple bottom line, often referred to as the 3-Ps – profit, people and planet.

In spite of this, there is no denying the fact that the ultimate responsibility of businesses is to make profits for their owners. It is the return of such investment that serve as attraction to business owners, encouraging them to invest in ventures that also provide the products and services consumed by the public. These investors take the risk for their investment and deserve their rewards, regardless of their contributions to society. According to the 'Arguments Against CSR' (n. d.) [3] taking the rightfully earned money from investors without their approval is irresponsible and that businesses concerning themselves with various attempts aimed at fixing the issues of society in the name of Corporate Social Responsibility (CSR) engagement are deluding themselves. There is no argument that even in the modern business environment, any organization that does not operate in a commercially viable sense is doomed to fail, and that includes not for profit entities. There are economic and commercial pressures on CEOs and Senior Leadership Teams not just to balance the books, but also to return healthy profits in order to continue to entice shareholders to carry on with their interest and investment in businesses to ensure their long-term survival. Individuals who invest in businesses do so with the hope that they shall receive returns on their investment which is what motivates them to risk their wealth. The more returns they receive, the more attractive the proposition. This is what is argued by Adam Smith in 'The Wealth of Nations' and quoted by Baye [4]. He asserted that, "it is not out of the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest" [5]. The implication of this assertion is that by pursuing their own interests, which is profit maximisation, investors and entrepreneurs meet the needs of society. Consequently, profit maximisation is in the interest of both parties – investors and society at large.

I work for a college in the UK – an organization whose primary objective is to provide public education. However, even for an organization like this public educational institution, there are considerable financial pressures to balance the books, and budgetary constraints means that there are constant efforts being applied to budget holders to cut costs and improve the financial situation of the college.

What is the role of profit

The point has been made earlier that there is nothing wrong in incentivizing today's entrepreneurs to increase investments which create wealth for society, provide jobs for the population, serve as a source of revenue for governments and ultimately increase the wealth of nations and raise the standards of living for the masses [6] asserted that profit maximisation which increases shareholder wealth is the appropriate goal of a business in a capitalist society. "When a firm applies profit maximization, it is basically saying that its primary focus is on profits, and it will use its resources solely to get the biggest profits possible, regardless of the consequences or the risks involved". By taking the risk and investing in a business, the rewards associated with the risk should not be denied the investor. This is the spirit of entrepreneurship which drives business ventures in a capitalist economy. Tough times mean that everyone, competitors and customers alike, are looking to strike the best deal they can. You only have to look at the volume of high street casualties in recent months to realize that there is absolutely no room for sentiment when it comes to survival. If businesses are not operating to their maximum potential, they will fall by the wayside.

Business failure means losses to investors to the tune of their investment and with a volatile and often unforgiving business environment, it behaves on managers and directors to seek to maximise the return on investment to shareholders as a way of compensating them for the risk of failure and consequently, indebtedness. There is no point in winning lots of business and landing deals if the margins are too tight and the business cannot make a decent profit. It is my view that taking on too much activity can affect a business, especially in the early years of its development especially if there is not much by way of margins to show for it. In regard to this, the primary concern of business leaders is to explore the avenues that increase the bottom line regardless of sentimental 'do good' activities that divert shareholder returns away from them [7] posited that, profit maximization is the most important objective of a business entity. Every business, in addition to striving for the attainment of other objectives, does its best with special importance to make profits. Profit is to be regarded as a yardstick against which are assessed or measured the quality and value and the success of a business. If this argument is to form the basis of a business' strategic approach, then profit becomes the benchmark against which the efficiency and other key performance indicators of any business are measured. It becomes the over-riding motivation that pre-occupies the thinking of management and drives the policies and decisions within the business. The inference here is that while a business may survive and continue with its operations with satisficing profitability in the short to medium term, the long term objective is to strive to achieve maximum profitability.

Finally, the 'free enterprise' advocates have long held the view that businesses should be left to pursue the principle of profit maximisation as long as they operate within the law. In pursuance of this ideology, [8] and is quoted as stating that, the first counter-view of the CSR debate is that, there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud [9].

The neoliberal journalist Janet Albrechtsen who, writing in an opinion piece for the Australian newspaper recently quoted from Professor Bryan Horrigan to support Friedman's views that the fundamental flaw with corporate social responsibility, and why it is a backward step, is the underlying premise that capitalism and companies have something to be embarrassed about that they must justify their existence by going in search of some higher moral purpose. This shame-faced capitalism is an unfortunate development. The idea pushed by advocates that the pursuit of private profit is inconsistent with the public good does not stack up. How quickly we forget that Adam Smith knew a thing or two about human nature ... Smith pointed out, also quoted earlier that, "it is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their self-interest [10]. Although when Friedman argued that 'the business of business is business', he was in no way suggesting that businesses could act without regard to society. However, the shareholder value theory explains that provided a business acts legally and ethically, only shareholder interests' matter [11] quoted Friedman's article in the New York Times which argued that any business executives who pursued a goal other than making money were, "unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades". He argued that these executives are guilty of analytical looseness, lacking rigor and commercial discipline, and may have turned themselves into unelected government officials who are illegally taxing investors and denying them of what is their rightful recompense.

In spite of the precarious position adopted by the free enterprise community, it is my view that such values are no longer tenable in modern societies where increased consumer awareness has made the general public extremely powerful, often dictating corporate behaviour by putting pressure on businesses to behave in an ethical manner.

Analysis

In regards to the above arguments, it is quite ironic that most businesses - small to big multinationals, are now all eager to engage in deeds that are not necessarily part of their core business activities, and in so doing, diverting significant amounts of money towards ventures that use up substantial parts of their profits with the objective of being seen as good corporate citizens. The current business position confirms that organizations now accept the fact that the corporate world now relies on trust and goodwill of the general public to flourish and improve their chances of long term survival. Thus businesses today will do whatever it takes to win the trust of a demanding public who will not accept anything less than genuine attempts by businesses to contribute to society and adopt sustainable practices by investing some of their profits towards endeavours that promote the good and well-being of communities where they operate and protecting the environment.

In the business world today, it is expected that the responsibilities of a business are now much wider than just serving the interest of their shareholders [12] argued that all business organizations have multiple stakeholders and must consider their needs to achieve sustainable success. In regards to the stakeholder concept, it is believed that businesses today are so interdependent with the wider society that it must serve the interest of all parties, and thereby gain commercial advantage too. Anita Roddick famously said that in business 'doing good is good business' and that behaving ethically and looking after the interest of the wider society also makes good business sense.

Good business examples

Research published by Ethisphere about the world's most responsible businesses regularly features companies like Unilever, Marks and Spencer and Google. According to their criteria, these companies truly go beyond making statements about doing business ethically and translate those words into action. The companies that are honoured in the articles every year are those businesses who don't only promote ethical business standards and practices internally, but who exceed legal compliance minimums and shape future industry standards by introducing best practices today [13]. One can argue that the successes of these major companies have not been due sorely to their profitability but that their core values of responsible behaviour has contributed significantly to their rapid growth and global success. It therefore goes to show that profit making must not constitute the be all and end all scenario for all businesses and care needs to be taken not to sacrifice everything in the name of maximising profits.

Another reason why the interest of society should be prioritised by business is that it is possible to earn higher returns by acting in a socially responsible manner. There is evidence in the business world that this is the case [14]. Many organizations have reaped and are still reaping the rewards of active engagement in CSR programmes. Below are a few examples from the UK.

Marks and Spencer's Plan A which is a corporate-wide initiative aimed at helping to protect the planet–by sourcing responsibly, reducing waste and helping communities. This led to an estimated £50 m extra profit by cutting packaging cost by 20% and increase energy efficiency by 19% (Figure 1).

Figure 1: About Plan A.

GE's ecomagination initiative which sets out the company's commitment to technology solutions that save money and reduce environmental impact for its customers and GE's own operations has generated more than US$160 billion in revenue. Their website claims that GE's own operations have seen a 32 percent reduction in GHG emissions since 2004 and a 45 percent reduction in freshwater use since 2006, realizing $300 million in savings.

Unilever (Project Shakti): The project has the purpose of making sustainable living commonplace. The company develops new business practices that that achieves the company's expansion plans while at the same time developing the communities. As a result, the company claims to be meeting people's ever-increasing desire for more sustainable products and creating a brighter future for everyone. "The Unilever Sustainable Living Plan will help us double the size of our business while reducing our environmental footprint and increasing our positive social impact' [15]. This has led to a $100 m extra sales by selling to rural Indian communities

Recent examples of practical engagement in socially responsible manner in the US include the following: Cummins, Inc., of Columbus, Indiana, has reduced diesel engine emissions by 90% and expects that within 10 years the company will be at zero or close to zero emissions. Xerox Corporation, Stamford, Connecticut, is a multinational corporation that places high value on its communities. One of its well-known development traditions has been its Social Service Leave Program. Employees selected for the program may take a year off with full pay and work for a community non-profit organization of their choice. Green Mountain Coffee Roasters, Waterbury, Vermont, was a pioneer in an innovative program designed to help struggling coffee growers by paying them "fair trade" prices, which exceed regular market prices. Recognition is given to the company for offering microloans to coffee-growing families and underwriting business ventures that diversify agricultural economies.

Chick-fil-A restaurant chain based in Atlanta, Georgia: Founder and CEO Truett Cathy has earned an outstanding reputation as a businessman deeply concerned with his employees and communities. Through the Win Shape Centre Foundation, funded by Chick-fil-A, the company operates foster homes for more than 120 children, sponsors a summer camp, and has hosted more than 21,000 children since 1985. Chick-fil-A has also sponsored major charity golf tournaments.

In the immediate aftermath of Hurricane Katrina in 2005, judged to be the worst and most expensive ever in terms of destruction, hundreds of companies made significant contributions to the victims and to the cities of New Orleans, Biloxi, Gulfport, and the entire Gulf Coast.

Strategic Business Practices

In addition to the above examples, organizations use ethical and sustainability practices as a strategic marketing tool which enhances the reputation of the business. Research shows that, for decades research has suggested that businesses that invest in sustainable and ethical practices have improved their corporate financial performance. More recently, in 2014, a report by University of Oxford's Smith School of Enterprise found that companies that pursue corporate sustainability policies are more likely to receive a boost to their share price [16]. The research found that corporate sustainability helps boost a company's operating performance, whereas firms that violate environmental regulations experience a significant drop in share price. The report concluded that sustainability and profitability can go hand in hand.

Undeniably, in an age where sustainability is being touted across the business world as the panacea to achieving organizational viability, business organizations cannot afford to ignore their corporate social responsibility credentials in the name of profit maximisation. Friedman's notion of free market enterprise focuses on a responsibility to shareholders alone, but the stakeholder concept and the principle of the triple bottom-line is based on the notion that businesses, especially large public corporations, have a responsibility to a range of stakeholders, not just shareholders. Indeed, Friedman might point out that by simply pursuing its commercial interests, businesses generate a longer term social dividend of higher private pensions, employment, corporate taxes, and economic growth. Nonetheless, it seems to me that these societal benefits, good as they are, may not be legitimate reasons for organizations to exploit resources and cause damage to the very factors of production that will be used for the benefit of future generations. Society will not accept it and the present generation will reject any organization that ignores its responsibility to the environment and acts in seemingly oblivious manner to the detriment of society and to the expectations of its own customers.

This is why many organizations now see CSR as businesses doing well by doing good. A BBC article written by [17] highlighted the notion of CSR thus; "It means a company has moved beyond profit maximisation and the best insular interests of the company, its staff and its shareholders, to include a wider commitment to helping to build a better society in general". Like most things in life, there are good and bad examples of CSR. Some good examples include Salesforce.com, a leader in pioneering, evangelizing and implementing the unique 1/1/1 model which is based on a simple idea of Leveraging salesforce.com's people, technology, and resources to help improve communities around the world. Salesforce.com Foundation was created to apply the core strengths of the company to help organizations further their social mission and improve their corporate citizenship credentials. Others include Starbucks who offer access to credit to their farmers with the view to helping them avoid taking loans from loan sharks and high interest bank loans that cut into their profits with the inevitable consequence of the cyclical pattern of poverty within these communities. It ought to be noted that, in spite of the above; Starbucks has recently been involved in tax avoidance scandal in the UK which has dented its CSR reputation. These companies and many others have built good names for them and are reaping the benefits of good reputation leading to customer loyalty and profitability.

Poor ethical practices

However, many of the small scale mining companies operating in Ghana have been driven out of business due to their poor environmental records and the dangers they pose to the communities around the mining towns. Action Aid research highlights that poor people in Obuasi in Ghana are suffering huge social and environmental costs and alleged human rights abuses as a result of gold mining by a subsidiary of UK-listed mining giant Anglo American. It is claimed that due to their poor environmental practices, these small scale mining companies have rendered dozens of rivers which were previously used by thousands of villagers for drinking water, fishing and irrigation, dozens of rivers are now unusable [18]. Many of these businesses have now been driven out of business by pressure from the chiefs and citizens of the communities which forced the government to crack down on these unethical and sometimes dangerous practices. In their attempt to maximise profits by cutting corners, they put the long term survival in jeopardy (Figure 2).

Figure 2: Locals claim this gold mining waste dump leaches into the water table.

Finally, adopting a stakeholder concept approach rather than the shareholder concept enables a business to enhance its competitive advantage. Many organizations have used their sustainability policies as a differentiation strategy to separate themselves from the competition, allowing them to increase sales and market share, thereby improving their financial performance. In this context, stakeholder demands are seen as opportunities rather than constraints. Firms strategically manage their resources to meet these demands and exploit the opportunities associated with them for the benefit of the firm. Body Shop, before the takeover by L'Oréal used its ethical principles of not testing its products on animals as a competitive advantage which enhanced the company's reputation and helped its brand loyalty, and its consumer patronage. Apple, now the world's most profitable business invests billions of dollars in renewable energy projects where the returns on investment are driven by two key motives; it reduces future costs and also sees it as the 'right thing to do'. The seemingly price inelastic nature of demand for Apple's products is partly due to their reputation built on the principle of shared value. Many institutional investors avoid companies or industries that violate their organizational mission, values, or principles but take interest in companies with good records on employee relations, environmental stewardship, community involvement, and corporate governance.

Conclusion

In a world where consumers are becoming increasingly conscious of the environment and sustainable production, any organization that ignores its responsibility to the environment and treats communities as irrelevant does so at its own peril. The interdependence of business and society is a force that businesses cannot afford to ignore. Society needs business but businesses also need society to create demand and to make available public assets and infrastructure that allow them to operate and thrive. This is in line with Porter's principle of creating shared value where business and society recognize their interdependence and work together to provide products and services that meet societal needs. The importance of profitability must not diminish the significance of CSR engagement. In fact, by accepting that CSR means doing well by doing good, it pays to engage in the CSR philosophy. It seems to me that modern consumerism will ultimately force businesses to behave in an ethical fashion; and social responsibility on the part of big corporate organizations as well as

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SMEs may be the road to profit maximisation. In this regard, profit maximisation may have been fashionable in the era of Smith, but the world has moved on from this era and it behaves on businesses to change with it.

Secondly, the competitive forces that operates in nearly all industries make the profit maximization objective a null proposition. The power of consumers as well as competitors will always drain away part of the profit potential in most industries. This is what Michael Porter describes as the 5 generic forces, illustrated below (Figure 3).

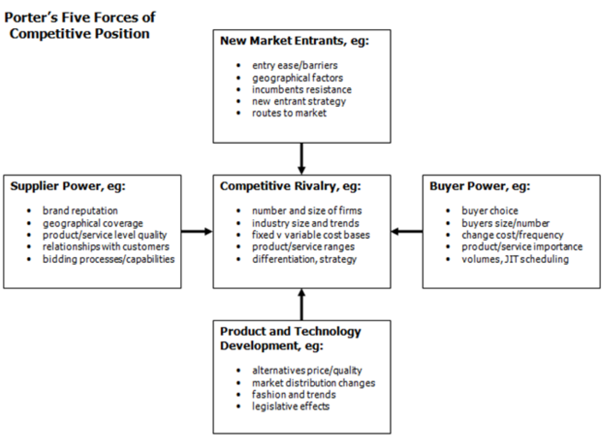

Figure 3: porter's five forces model.

The model explains how the various forces that operate within any particular industry have the potential to drain away business profitability, thereby making profit maximization a nigh impossibility.

Finally, market transparency diminishes the chance of any business aiming to maximise its profitability. There is no loyalty between any business and its customers in today's competitive business environment. For example, price comparison websites means that customers are able to check and compare prices among various competitors. Customers will therefore choose the products or services that offer the most value for money without any sentimental consideration. Businesses will therefore have to offer competitive prices to attract today's savvy customers who will sit in the comfort of their homes and make purchasing decisions that make economic sense to them, regardless of brand.

In response to the question about whether profit maximization is tenable in the modern business environment, I conclude that the various forces that interplay to determine the profitability of businesses are varied and complex. In the long term, businesses must be focused on what gives them an edge over their competitors rather than the desire to achieve profit maximization.

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