

Rethinking the Social Responsibility of Business

From *Reason* (October 2005)

Putting Customers Ahead of Investors

-John Mackey (Chairman and CEO, Whole Foods Market)

In 1970 Milton Friedman wrote 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." That's the orthodox view among free market economists: that the only social responsibility a law-abiding business has is to maximize profits for the shareholders.

I strongly disagree. I'm a businessman and a free market libertarian, but I believe that the enlightened corporation should try to create value for *all* of its constituencies. From an investor's perspective, the purpose of the business is to maximize profits. But that's not the purpose for other stakeholders—for customers, employees, suppliers, and the community. Each of those groups will define the purpose of the business in terms of its own needs and desires, and each perspective is valid and legitimate.

My argument should not be mistaken for a hostility to profit. I believe I know something about creating shareholder value. When I co-founded Whole Foods Market 27 years ago, we began with \$45,000 in capital; we only had \$250,000 in sales our first year. During the last 12 months we had sales of more than \$4.6 billion, net profits of more than \$160 million, and a market capitalization over \$8 billion.

But we have not achieved our tremendous increase in shareholder value by making shareholder value the primary purpose of our business. In my marriage, my wife's happiness is an end in itself, not merely a means to my own happiness; love leads me to put my wife's happiness first, but in doing so I also make myself happier. Similarly, the most successful businesses put the customer first, ahead of the investors. In the profit-centered business, customer happiness is merely a means to an end: maximizing profits. In the customer-centered business, customer happiness is an end in itself, and will be pursued with greater interest, passion, and empathy than the profit-centered business is capable of.

Not that we're only concerned with customers. At Whole Foods, we measure our success by how much value we can create for all six of our most important stakeholders: customers, team members (employees), investors, vendors, communities, and the environment. Our philosophy is graphically represented in the opposite column.

There is, of course, no magical formula to calculate how much value each stakeholder should receive from the company. It is a dynamic process that evolves with the

competitive marketplace. No stakeholder remains satisfied for long. It is the function of company leadership to develop solutions that continually work for the common good.

Many thinking people will readily accept my arguments that caring about customers and employees is good business. But they might draw the line at believing a company has any responsibility to its community and environment. To donate time and capital to philanthropy, they will argue, is to steal from the investors. After all, the corporation's assets legally belong to the investors, don't they? Management has a fiduciary responsibility to maximize shareholder value; therefore, any activities that don't maximize shareholder value are violations of this duty. If you feel altruism towards other people, you should exercise that altruism with your own money, not with the assets of a corporation that doesn't belong to you.

This position sounds reasonable. A company's assets do belong to the investors, and its management does have a duty to manage those assets responsibly. In my view, the argument is not *wrong* so much as it is too narrow.

First, there can be little doubt that a certain amount of corporate philanthropy is simply good business and works for the long-term benefit of the investors. For example: In addition to the many thousands of small donations each Whole Foods store makes each year, we also hold five 5% Days throughout the year. On those days, we donate 5 percent of a store's total sales to a nonprofit organization. While our stores select worthwhile organizations to support, they also tend to focus on groups that have large membership lists, which are contacted and encouraged to shop our store that day to support the organization. This usually brings hundreds of new or lapsed customers into our stores, many of whom then become regular shoppers. So a 5% Day not only allows us to support worthwhile causes, but is an excellent marketing strategy that has benefited Whole Foods investors immensely.

That said, I believe such programs would be completely justifiable even if they produced no profits and no P.R. This is because I believe the entrepreneurs, not the current investors in a company's stock, have the right and responsibility to define the purpose of the company. It is the entrepreneurs who create a company, who bring all the factors of production together and coordinate it into viable business. It is the entrepreneurs who set the company strategy and who negotiate the terms of trade with all of the voluntarily cooperating stakeholders—including the investors. At Whole Foods we "hired" our original investors. They didn't hire us.

We first announced that we would donate 5 percent of the company's net profits to philanthropy when we drafted our mission statement, back in 1985. Our policy has therefore been in place for over 20 years, and it predates our IPO by seven years. All seven of the private investors at the time we created the policy voted for it when they served on our board of directors. When we took in venture capital money back in 1989, none of the venture firms objected to the policy. In addition, in almost 14 years as a publicly traded company, almost no investors have ever raised objections to the policy. How can Whole Foods' philanthropy be "theft" from the current investors if the original

owners of the company unanimously approved the policy and all subsequent investors made their investments after the policy was in effect and well publicized?

The shareholders of a public company own their stock voluntarily. If they don't agree with the philosophy of the business, they can always sell their investment, just as the customers and employees can exit their relationships with the company if they don't like the terms of trade. If that is unacceptable to them, they always have the legal right to submit a resolution at our annual shareholders meeting to change the company's philanthropic philosophy. A number of our company policies have been changed over the years through successful shareholder resolutions.

Another objection to the Whole Foods philosophy is where to draw the line. If donating 5 percent of profits is good, wouldn't 10 percent be even better? Why not donate 100 percent of our profits to the betterment of society? But the fact that Whole Foods has responsibilities to our community doesn't mean that we don't have any responsibilities to our investors. It's a question of finding the appropriate balance and trying to create value for all of our stakeholders. Is 5 percent the "right amount" to donate to the community? I don't think there is a right answer to this question, except that I believe 0 percent is too little. It is an arbitrary percentage that the co-founders of the company decided was a reasonable amount and which was approved by the owners of the company at the time we made the decision. Corporate philanthropy is a good thing, but it requires the legitimacy of investor approval. In my experience, most investors understand that it can be beneficial to both the corporation and to the larger society.

That doesn't answer the question of *why* we give money to the community stakeholder. For that, you should turn to one of the fathers of free-market economics, Adam Smith. *The Wealth of Nations* was a tremendous achievement, but economists would be well served to read Smith's other great book, *The Theory of Moral Sentiments*. There he explains that human nature isn't just about self-interest. It also includes sympathy, empathy, friendship, love, and the desire for social approval. As motives for human behavior, these are at least as important as self-interest. For many people, they are more important.

When we are small children we are egocentric, concerned only about our own needs and desires. As we mature, most people grow beyond this egocentrism and begin to care about others—their families, friends, communities, and countries. Our capacity to love can expand even further: to loving people from different races, religions, and countries—potentially to unlimited love for all people and even for other sentient creatures. This is our potential as human beings, to take joy in the flourishing of people everywhere. Whole Foods gives money to our communities because we care about them and feel a responsibility to help them flourish as well as possible.

The business model that Whole Foods has embraced could represent a new form of capitalism, one that more consciously works for the common good instead of depending solely on the "invisible hand" to generate positive results for society. The "brand" of capitalism is in terrible shape throughout the world, and corporations are widely seen as

selfish, greedy, and uncaring. This is both unfortunate and unnecessary, and could be changed if businesses and economists widely adopted the business model that I have outlined here.

To extend our love and care beyond our narrow self-interest is antithetical to neither our human nature nor our financial success. Rather, it leads to the further fulfillment of both. Why do we not encourage this in our theories of business and economics? Why do we restrict our theories to such a pessimistic and crabby view of human nature? What are we afraid of?