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Competition, Value Creation and the Self-Understanding of Business

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A COMMENTARY ON Joseph Heath (2014), ***Morality, Competition, and the Firm: The Market Failures Approach to Business Ethics*** (New York: Oxford)

ABSTRACT

In defense of his Market Failures Approach to business ethics Joseph Heath relies on an understanding of business as essentially oriented towards competition and profit maximization. In these remarks I defend an alternative understanding of business that is centered on the creation of valuable goods and services. It is preferable because it: (a) creates less pressure to take advantage of vulnerable stakeholders, (b) can readily recognize "beyond compliance" norms that do not relate to efficiency, (c) provides a more meaningful framework for people who work in and with corporations, (d) may mitigate negative moral impacts outside the market, and (e) better captures the range of what actually counts as business activity.

JOSEPH HEATH'S MARKET Failures Approach to business ethics (MFA) holds that firms should engage in profit-oriented competition, except when the actual market fails to deliver desired efficiencies. In these cases businesses should engage in self-restraint to not take ad-

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vantage of market failures. In defense of the MFA Heath relies on an understanding of business as essentially oriented towards competition and profit maximization. In these remarks I defend an alternative understanding of business that is centered on the creation of valuable goods and services.

Heath offers two kinds of justifications for the MFA. The first justifies the market as a structured competition between firms, the point of which is to generate economic efficiencies. As he puts it, markets are "essentially special-purpose institutions designed to promote efficiency" (10).[2] The primary role of the for-profit firm within this structure is to act as a competitive profit-seeker; however, Heath argues that when market competitions fail to generate the desired efficiencies it is incumbent upon firms to refrain from taking advantage of those market failures:

> [W]hen the alignment of public and private interests is not achieved automatically by the market, some attempt must be made to do it consciously and explicitly, through moral constraint (14).

This "external" justification of the MFA stands in contrast to an "internal" justification that appeals to the self-understanding among participants in the capitalist economy. Heath deems theories that reject the "profit orientation of the firm" to be "anticapitalist" (7; 199–200). It is not enough, though, for a theory to require the pursuit of profits to be considered "profit oriented." One of Heath's primary targets is stakeholder theories which generally hold that firms should be run profitably but do not give shareholders the "special privilege" required by shareholder primacy (7). Note that Heath is deliberately making a *conceptual* point about capitalism: To reject the profit orientation of firms is to change the topic "away from the question of how economic actors should behave in a capitalist economy to whether we should have a capitalist economy at all" (7).

While I do not accept this conceptual claim about capitalism, I acknowledge that it informs the self-understanding of many businesspeople. According to this *competition*- or *profit-oriented* self-understanding firms are essentially competitors that aim to maximize profits. This self-understanding takes on normative significance since

[2] Parenthetical page references not otherwise attributed are to *Morality, Competition, and the Firm* (Heath 2014).

these are the people to whom the claims of business ethics are directed. As Heath puts it, "[a]rguing against the profit orientation of firms seemed to me . . . a perfectly respectable position to take, but probably should not be a position in *business ethics*" (7, emphasis in the original). Instead, he holds that:

> the central role of business ethics is to provide an "immanent critique" of corporate conduct. Its objective is not to bring in "outside" moral considerations to condemn the latest moral outrage, but to clarify and to correct the self-understanding of participants in the market economy . . . [from the] ultimately false suggestion that the institutions of the market free them from all forms of moral constraint (19).

Heath clarifies the competition-oriented self-understanding by informing businesspeople that efficiency provides the moral justification of the competitive system they operate within. They thereby can see the case for refraining from profit-seeking when, due to markets failures, that efficiency is not being achieved. According to Heath, this is the most that a theory of business ethics could deliver in terms of "beyond compliance" behavior.

I have two goals in these remarks. The first is to make the case for the value creation self-understanding that sees firms as organizations of people that produce valuable goods and services. The second is to show how the external justification of the MFA might also depend on the competition-oriented self-understanding of business. If this is the case then the value creation self-understanding can also undermine the external justification.

Consider how the competition-oriented self-understanding might support the external justification of the MFA. While Heath holds that the market is externally justified by the efficiencies it generates, he does not think that efficiency is the only value relevant to the design of social institutions. Other values, including distributional fairness, are also important.

A critical part of the external justification of the MFA is the positing of a division of moral labor between the market and the state (10). In this division it is the role of the market to generate efficiencies, and the role of the state to assure distributional fairness and other sorts of justice. As such the MFA is responsive to the call to provide a theory of business ethics that is unified with social and political theory (see Heath et al 2010).

This raises a concern, however, about Heath's disparate treatment of efficiency and other values relevant to the design of social institutions. If the failure of markets to deliver desired efficiencies creates a "beyond compliance" norm for businesses, then why doesn't the failure of the state to deliver on kinds of justice create one as well? This is the critique that Abraham Singer (forthcoming) makes of the MFA.

It is here that Heath could turn to the self-understanding of the firm. He could argue that the "beyond compliance" expectations of businesses must be limited to market failures because those are the only ones that are compatible with the competition-oriented self-understanding of business. This self-understanding can recognize limits on competitive behavior, but only those that directly relate to the moral "point of the competition" (5).

Absent any other more purely external justification of why "beyond compliance" norms are restricted to matters of efficiency, the "external" justification of the MFA depends on the competition-oriented self-understanding of business.

The Value Creation Self-Understanding

The MFA is vulnerable because there is an alternative understanding of business that participants in the market economy already possess, or could readily be brought to possess. This value creation understanding sees businesses as organizations of people that create valuable goods and services. Market participants who have this self-understanding see themselves primarily as creators of value rather than essentially as competitive profit-seekers.

The existence of competing self-understandings of business broadens the role of business ethics from providing an immanent critique to determining which self-understanding to cultivate among market participants. We should nurture the value creation self-understanding for the following reasons:

First, it creates less pressure to take advantage of vulnerable people.[3] Consider the Volkswagen emissions rigging scandal. By focusing on competitive success – and in particular the desire to be the

[3] Heath anticipates this point when he notes that many business ethicists resist "the suggestion that markets are competitive . . . based largely on the intuition that if we want businesspeople to behave themselves, putting too much emphasis on the competitiveness of market interactions is counterproductive" (6).

top carmaker in the world – Volkswagen faced internal pressure to cut moral corners. In contrast there is no inherent tension between the value creation self-understanding and the recognition that one has obligations to not take advantage of vulnerable people. Under this understanding Volkswagen could recognize that it has obligations to people with compromised health to not cheat on pollution emissions tests. It could then set itself the task of finding a way to deliver valuable products to their customers while respecting the emissions control regime.

Second, the value-creation self-understanding does not limit the call for corporate self-restraint to cases of market failure. It could also call for self-restraint when the state failed, say, to provide employees with a basic living wage or customers with adequate product safety.

Third, the value-creation understanding provides a more meaningful framework for people who work with and for the firm; it is generally more meaningful to see oneself as creating things of value for other people than to be solely driven by a concern for profits and competitive success.

Fourth, there may be negative moral consequences outside the market as a result of overly emphasizing competition within it. This may include the inappropriate extension of competitive behavior into areas such as personal relationships. (See Allen Buchanan's [1985: 110ff] discussion of the "expansionist tendency of the market.") It may also lead people to confuse the competitive success that a person has in the market with her value as a person. An understanding of business that de-emphasizes competition would mitigate these possible negative effects.

Fifth, the value creation self-understanding is analytically superior to the competition-oriented self-understanding since not all for-profit firms are engaged in competition. Consider utilities that hold legal monopolies over water or electricity. It is not really meaningful to see these companies as engaged in competition; but it does make sense to think of them as businesses. This also holds for companies that hold intellectual property. Sometimes various bits of intellectual property are in direct competition with others; however, sometimes they are not. Consider a company with a patent over a life-saving drug. If no other company has a comparable alternative drug then there is no meaningful sense in which it is in competition. This point generalizes. Businesses often seek to make profits by *avoiding* competition through product differentiation and other strategies. Companies that successfully avoid competition are often held up as examples of business success, rather than as marginal cases.

The value creation self-understanding correctly recognizes monopolies, the holders of intellectual property, and the product differentiators all as engaged in business activity since they all create valuable goods and services. The value creation self-understanding can also see companies in highly competitive environments as engaged in business activity. Each company can see itself as in the business of profitably creating things of value in a *competitive environment*. This acknowledges a place for competition in business without making it central to its normative understanding.

The value creation self-understanding also can recognize the moral importance of seeking profits—and is thus compatible with capitalism—without requiring firms to *maximize* profits. Generally speaking shareholders invest in firms with the reasonable expectation that managers will exercise due care in achieving a reasonable return. Managers of for-profit firms can and should aim to create things of value while honoring this moral obligation to shareholders.

To summarize, businesspeople generally have, or readily could have, two self-understandings of business that rival for their attention and acceptance; and, it is the task of the business ethicist to help businesspeople cultivate the value creation self-understanding over the competition-oriented one since it:

(a) creates less pressure to take advantage of vulnerable stakeholders,
(b) can readily recognize "beyond compliance" norms that do not relate to efficiency,
(c) provides a more meaningful framework for people who work in and with corporations,
(d) may mitigate negative impacts outside the market, and
(e) better captures the range of what actually counts as business activity.

If these points are correct the value creation self-understanding of business directly undermines the internal justification for the MFA, and possibly undermines the external justification as well. At the very least, one could not appeal to market participants' self-understanding to explain why "beyond compliance" norms are restricted to the avoidance of taking advantage of market failures.

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