

These are times of crisis for the business community, and the crisis is about trust. There was a time when the public believed in corporations—really. In the late 1960s, surveys showed that 70 percent of Americans felt that corporations generally could be trusted to act responsibly. But even after the economic boom of the past two decades, the figure has fallen to the mid-40s. Given the discouraging news of the past few months—indeed, almost all business news since the tech meltdown—it’s hard to be optimistic about improvement.

vate sectors, relates to how business leaders define success. Specifically, it relates to how they use the most socially weighted term in the business lexicon: *profit*.

Not all profits are equal, but business leaders often talk and act as if they are. A more careful use of the term would acknowledge three different categories: *social profits*, *neutral profits*,

to black-and-white attitudes. In the business community, leaders encourage “profit maximization,” pay hard attention to “the bottom line,” seek “profitable growth” for their business enterprises, and build “profitable and successful” careers for themselves. There is a strong connection in the psyches of many businesspeople between *profit* and *goodness*, between *profit* and *success*.

This could hardly be more different from the emotions evoked by the term *profit* among those who are distrustful of the business community, such

Not All Profits Are Equal

How Corporate America can regain the public’s trust.

By Vijay Govindarajan
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Restoring trust will involve some difficult and complex reevaluations of the rules and accepted practices that shape the relationships among auditors, analysts, and executives. But business leaders can make one simple but powerful change immediately. The change, which would reshape the ongoing dialogue between the public and pri-

and *debatable profits*. This distinction can improve the business community’s transparency, trustworthiness, and commitment to responsible action.

The problem with *profit* as it is used today is that it all too readily panders

as environmentalists, labor unions, consumer groups, and, unfortunately, the majority of the voting public. While profit may be equated with success and progress in the culture of business, it is equated with greed and irresponsibility in the culture of the opposition. Environmentalists, for example, rally around the notion that the business community

is willing to sacrifice natural treasures for corporate profits. The tradeoff could be described as natural treasures for useful goods and services, or natural treasures for economic development. But neither description is as evocative of immorality, and neither is as galvanizing, as the notion of sacrificing natural treasures for profit.

In too many minds, there are two camps: “greed is good” vs. “corpora-

Often it seems that the only way to make progress in a political struggle is to take an extreme stance. When confronted with absurd and provocative statements like, “You are either on the side of social progress or on the side of profits,” perhaps it is only natural for business leaders to counter with reflexive, implausible denials that there is ever any conflict between the two.

safety. A power plant could find a “loophole” in regulations that allowed for greater efficiency but also increased pollution.

Causing further damage to their credibility, business leaders sometimes dismiss the opposition as lacking a basic understanding of the merits of the market economy. This only insults their critics and creates further ill will.

To improve the atmosphere, business leaders must contribute to an improved understanding of both the vast promise and the problematic flaws of the market system. They must always seek to help the general public understand that—yes!—profits and social well-being are sometimes in conflict. But only sometimes.

Some avenues to increased profits make a distinct social contribution, some make no direct contribution, and some potentially diminish societal well-being. These three categories—social profits, neutral profits, and debatable profits—are quite distinct.

Corporations are understandably hesitant to be transparent about anything.

tions are evil,” “free enterprise” vs. “social responsibility,” or simply “profit is good” vs. “profit is wicked.” Such polarization cannot be mitigated without first building trust, and trust will not come without transparency.

Unfortunately, in such a poisoned and contentious atmosphere of public sentiment, corporations are understandably hesitant to be transparent about anything. What possible incentive is there for anyone to be open in the face of such hardened viewpoints?

Corporate Responsibility Is Good Business—Sometimes

The relationship between the corporate community and the public could be much healthier, with a more nuanced attitude toward profits. While business leaders clearly have the ability to reshape the dialogue, they tend instead to augment the antagonism.

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The original and best-known denial may be economist Milton Friedman’s 1970 article “The Social Responsibility of Business Is to Increase Its Profits.” Many executives would contend that the notions of social responsibility espoused by the business community have evolved substantially since then. Maybe, but few are anxious to discuss the details. At a recent conference on the topic, comments from business leaders included such abstract aphorisms as, “Corporate responsibility is good business” and, “By definition, socially responsible companies are well-run companies.”

Statements like these, which equate social responsibility with profitability, undermine corporate credibility, since it is easy to see that corporate *irresponsibility* can also be profitable. The tobacco industry’s choice to be less than forthcoming about the hazards of smoking (until it was forced to do so) stands as the most vivid recent example, but there are similar situations in almost every industry. An auto manufacturer could quietly make a subtle, cost-reducing design choice that, while not clearly negligent, had a measurable impact on

The Two Avenues to Social Profit

There are many ways to improve the bottom line but only two avenues to social profits, through which a corporation and society as a whole mutually benefit. The first is to increase productivity; the second is to create and commercialize new and useful products and services. Indeed, these are the two social benefits that the business sector is uniquely capable of delivering.

Corporations are the world’s foremost experts at increasing productivity. Out of self-interest, corporations constantly seek more efficient ways to produce—for example, by using the Internet to automate information flows, or inventing new industrial equipment that reduces the need for manual labor.

Unfortunately, *productivity* is an abstract term, one that many people have trouble disentangling from other macroeconomic indicators mentioned on the evening news. Simply put, the more productive we are as a society, the more goods and services we can collectively consume. Productivity is the total goods and services that the average person produces in one day. Consumption is the total goods and services that the average person consumes in one day. Clearly, in the long run, we can consume only as much as we produce. So productivity and consumption are equivalent.

Many question whether increased consumption is really a social benefit. In the United States, some contend, we already consume far beyond our basic needs. But from a global perspective, billions of people still lack adequate food and shelter, and the social benefit of increased production and consumption under these circumstances is uncontested.

And even in the United States, one of the world's wealthiest countries, almost all would agree that there are many social problems that could be alleviated with more spending. Without increases in productivity, this can be accomplished only through the contentious political process of redirecting funds from other uses.

Over time, however, productivity increases alleviate the conflict by giving society as a whole more resources to utilize. By improving productivity, businesses literally create something out of nothing. They create new income that did not previously exist. They create new possibilities.

Creating greater potential for consumption would be much less interesting if it meant simply consuming greater and greater quantities of the same stuff! Therefore, the second and equally important avenue to social profits is innovation. In addition to

finding ways to increase productivity, corporations are the world's experts at developing and commercializing new products and services that improve lives. They provide a constantly expanding menu of options for consumption and well-being.

In the last couple of decades alone, the business community has introduced ubiquitous new innovations as diverse as cellular telephones and

by transferring existing income or wealth from somewhere else, they pursue neutral or debatable profits. If the target is another corporation or an individual, the profit is neutral. But when the target is social wealth, then the profit is debatable.

Increases in neutral profits come through routine business negotiations. When corporations seek to receive better terms from suppliers,

Not all new products and services created by the business community are of equal value.

Post-it Notes. It has also introduced the convenience of e-mail, the awesome healing power of a slew of new wonder drugs, and—at least in the opinion of one author of this article—the magic of the carbon-fiber bicycle frame.

Of course, not all new products and services created by the business community are of equal value. It would be absurd, for example, to compare the social benefit of a new medical-imaging technology with that of a new video game.

Still, when fully informed consumers choose to purchase new products and services, they can only be better off than when the choice didn't exist. When businesses seek to give society more options, they are pursuing social profits.

Neutral Profits: A Zero-Sum Game

Neutral and debatable profits are quite distinct from social profits. When pursuing social profits, corporations are literally attempting to create new income and new possibilities for consumption. In direct contrast, when corporations seek to increase profits

attempt to limit raises for employees, or demand increased prices from customers, they are playing a zero-sum game. One party wins, the other loses, and the net direct benefit to society is zero.

It is important to note, however, that without the pursuit of neutral profits, markets would fail to operate effectively. It is through the energetic pursuit of neutral profits that competitive prices are established, and without a well-functioning pricing mechanism, resources are misallocated. Neutral profits are important even if they don't have a direct social benefit.

Are Debatable Profits Immoral?

In the case of debatable profits, the transfer of wealth is not between a business and another private entity but between business and society as a whole. Specifically, when corporations pursue debatable profits, they seek to enrich themselves at the expense of a publicly owned asset—most often public health, public safety, or the environment.

Of social, neutral, and debatable

A Letter to Shareholders

In its annual report, a company can distinguish between the three categories of profits. Though based loosely on an actual company, this letter is fictitious.

For over a century, American Breweries Inc. (ABI) has stood for quality and great taste. 2001 was a fantastic year for ABI. Earnings per share grew by 10 percent in a year that saw an average EPS decrease of 15 percent for companies in the S&P 500. Though our stock price was down slightly, we handily outperformed the market.

We were successful in 2001 because we pursued a wide variety of initiatives for increasing our profits. Following what has become a standard, these initiatives are categorized as social, neutral, and debatable profit initiatives.

Initiatives for Social Profits

New product development has always been an important focus of our business. We continue to invest heavily in research and development processes, and have contributed to the wide variety of beverages that are now available in supermarkets. Our greatest success in 2001 was the introduction of Bachman's Gold, a flavored alcohol beverage. Appealing to a wide variety of responsible consumers who want a beverage that is light, refreshing, and decidedly different from beer, this product has already achieved a higher growth rate than any other product in our portfolio.

We have also taken on numerous initiatives to increase the efficiency of our production and sales processes. For example:

- We invested heavily in new, modernized capital equipment in three of our largest breweries.
- We began the installation of a new Enterprise Resources Planning system, which will reduce the need for paperwork and increase productivity throughout our operation.

profits, only the pursuit of debatable profits results in a conflict between the public and private sectors. This is where transparency is most needed.

If a company is going to sell alcohol, it ought to be aggressively forthright about the dangers associated with alcohol consumption. If a company is going to promote an experimental medical procedure, it ought to be aggressively forthright about what can go wrong. If a company is going to drive oil tankers along treasured shorelines, it ought to be aggressively forthright about the related risks and how they are being man-

aged. Until business leaders proactively disseminate information about their activities associated with the pursuit of debatable profits, there will be no trust.

It is also important for the public to understand, however, that almost all production and consumption has side effects related to social wealth. In many cases, these side effects are widely accepted. For example, production of almost any tangible product requires the extraction of raw materials from the environment. (The few products that can be produced entirely from recycled materials are

- We continued to invest in our strong brand, which efficiently and effectively communicates our product attributes and now affords us the lowest cost per sale in the industry.
- We increased the percentage of our product that flows through our exclusive wholesaler network, which is more cost-effective than distributors, which handle multiple brands.
- We opened a new glass plant adjacent to a brewery, substantially reducing the cost of transporting glass bottles.

Through these initiatives, we have contributed to the overall social well-being of Americans as a whole by increasing productivity—and therefore income—and also by creating new options for consumption by responsible users of our products.

Initiatives for Neutral Profits

This year, our market share increased to nearly 50 percent, more than double that of our nearest competitor. This powerful industry position has increased our negotiating position with some raw-material suppliers. We were able to avoid price increases in all of our non-commodity supply lines, and achieved price reductions in a few key supply categories.

Initiatives for Debatable Profits

Running an alcoholic-beverage operation is about more than just the bottom line—it is about public trust. There are obvious public-health and -safety implications of the way we choose to run our business, and we take this responsibility extremely seriously. We are actively engaged in the ongoing debate about how to balance the enjoyment of alcohol consumption with the dangers of underage drinking and drunk driving.

Having said this, we have opposed existing initiatives to increase taxation on alcoholic-beverage sales. In fact, we are attempting to increase our profitability by lobbying heavily for a decrease in these taxes. Extra sales taxes penalize all users

the exceptions to the rule.) Furthermore, much of modern life involves risks. For example, no form of transportation, whether by air, car, or scooter, is 100 percent safe. And many of the products that people most enjoy consuming, such as fatty foods and tobacco, also contribute to long-term health problems.

Therefore, *businesses are not in the wrong just because they pursue debatable profits*. They are called *debatable* as opposed to *immoral* for a reason. What determines morality in the pursuit of debatable profits is the level of disclosure.

of alcoholic beverages, whether they are responsible or irresponsible, and regardless of their ability to pay the tax. We feel that this is unfair, and that educating the public on responsible consumption is a far more productive method for reducing the dangers of underage drinking and drunk driving.

Accordingly, responding to voices of concern from the public, we have also taken some actions that have had a negative impact on our bottom line. We have accepted what might be called debatable losses. This year, we invested more than \$500 million in media efforts designed to promote responsible consumption. In addition, in the coming year, we will be funding programs at many universities that educate students about responsible consumption. Through our ongoing, open engagement with the public on this important issue, we have concluded that this is the appropriate action for our company, and for all in our industry, despite its obvious impact on overall sales volume and therefore the bottom line.

We continue to engage the public openly and actively on this issue, and welcome your comments at responsible.consumption@americanbreweries.com. Also, in partnership with a consortium of public-activism groups, we fund an independent nonprofit initiative, Responsible Consumption for All. Our Website, www.consume-responsibly.org, is a tremendous starting point for learning about a wide variety of perspectives on this issue. It also lists dates and locations for public forums and panel discussions on this critical issue, all sponsored by the initiative.

Beyond the Bottom Line

While we believe that our profit-seeking activities make important social contributions, we have also sought to involve ourselves directly in community activities. This year, we have funded these activities primarily through the ABI Trust, which has donated over \$250 million to charitable organizations in education, health care, the arts, and environmental conservation.

—V.G. and C.T.

Would Business Leaders Be Comfortable With Candor?

Business leaders must go beyond simply accepting scrutiny of their efforts to increase debatable profits. They must invite and even lead public debate, offering their own expertise as a resource. With such a commitment to transparency, the public will be empowered to make informed judgments weighing social benefits against social costs. They will make reasonable decisions regarding industrywide regulation. They will identify sensible

edges both the positive and problematic contributions that the other makes, rather than strictly focusing on the negatives.

The usefulness of the distinction between social, neutral, and debatable profits, then, is clear. It focuses the scope of public concern on the issues where there reasonably should be concern. To the extent that business leaders succeed in energizing open debate about the appropriate limits to the pursuit of debatable profits—and show their willingness to engage in the debate in a balanced and fair way—they will have much stronger credibil-

limits to the pursuit of debatable profits.

Unfortunately, open and honest debates are far from likely in the current environment. Businesses have little incentive to make their operations more transparent. This is because business leaders quite reasonably believe that they are likely to be judged unfairly.

Instinctively, they know that it is likely that all public attention will focus on areas of perceived or actual conflict, while little attention will be given to positive contributions. Trust and compromise cannot be achieved among adversaries unless each acknowl-

ity in announcing the contributions their corporations have made through the pursuit of social profits.

Corporate executives must lead the campaign to reshape the dialogue between the public and private sectors. They have the resources and opportunities to do so. Ideally, the distinctions between types of profits can become a framework used instinctively by both sides to guide discussions.

The campaign can start inside the walls of the corporation. Employees of corporations can be powerful word-of-mouth advocates for more enlightened attitudes toward profits. CEOs also have numerous opportunities to speak to external audiences, including journalists, analysts, and the general public. Furthermore, corporations could help create nonprofit organizations that are solely dedicated to energizing fair and balanced discussions about the proper limits to the pursuit of debatable profits. Such organizations could be jointly funded with consortia of opposing activist or lobbying groups.

Finally, CEOs can use any number of opportunities to publish information about their operations, organized by the three categories of profits. The annual report is the most obvious publication, and the letter to shareholders—the most-read section—is a critical outlet for the new approach to describing corporate activities.

“A Letter to Shareholders” (left) is an example of such a letter. It includes extraordinarily frank and candid language. It plainly acknowledges the existence of debatable profits, and even admits that the company has accepted diminished earnings in order to lead the effort to set standards related to the pursuit of debatable profits.

No doubt many business leaders would be instinctively uncomfortable with such transparency and candor. But trust implies vulnerability. Leading

transparent dialogue is ultimately a sign of strength, not weakness. If leaders can help the public understand and embrace the distinction between social, neutral, and debatable profits, the public will appreciate the increased honesty and will be far more likely to judge corporations fairly, recognizing contributions made through the pursuit of social profits.

Companies that have responded to extreme crises with candor, such as Johnson & Johnson during the Tylenol scare, have memorably won strong public accolades. Now the challenge is to make such candor part of everyday operations, not just a strategy for crisis management.

Before Taking Initiative, Classify It

Identifying three categories of profit has the potential to provide an additional benefit: a new approach to making comparative judgments of social responsibility among corporations. The existing approach, in which corporations are urged to earn profits *plus* make social contributions, should be replaced with a more meaningful approach that might be called “prioritizing profits.” In other words, what matters most is not what a company does outside of the pursuit of profit but the emphasis placed on different types of profit-seeking initiatives.

The distinction between social, neutral, and debatable profits does not quite allow for a quantitative approach to what might be called “social accounting.” For technical reasons, it is impossible to divide a company’s bottom line into three portions—e.g., ABC Inc. earned \$10 total profit, of which \$5 is social, \$3 is neutral, and \$2 is debatable. But it is possible to classify *initiatives taken in pursuit of increased profits* as either social, neutral, or debatable, and it is tremendously worthwhile to do so.

CEOs can judge their own efforts based on questions such as the following: Has the overwhelming focus been on productivity and innovation? Bravo, the company has emphasized social profits. Has the focus been on increasing leverage over suppliers? Well, that’s fine—but less exciting from a social perspective. Has the company emphasized cost-cutting measures that reduce safety or potentially damage the environment? Decidedly less impressive, and potentially immoral, unless accompanied by a proactive effort to support an ongoing dialogue with the public that invites reasonable debate and regulation.

Cleaning Up the Dirty Word

The world turns on simplifications. Casting abstract concepts, or even entire groups of people, in the simple language of good and evil often motivates and inspires. But it also contributes to an environment dominated by tense and unproductive conflict.

Profit has become a term that can hardly be spoken without immediately summoning extreme preconceived notions. It has become a dirty word. But it is hardly going away. By creating succinct and crisp distinctions among social, neutral, and debatable profits, business leaders can unload some of the word’s baggage.

The distinction can help create an atmosphere of trust. Business leaders cannot ignore the significance of this issue; without trust, every relationship with customers becomes more complex and more legalistic. Furthermore, lost trust increases the likelihood that businesses will be subject to additional regulation, some or most of which will be costly and unnecessary. More fundamentally, freedom, opportunity, and the promise of increasing standards of living are all threatened when trust is broken.

Regaining trust will create an atmosphere in which the public and private sectors can work in partnership to place sensible limits on activities that may harm treasured public assets, an atmosphere in which each sector values and respects the efforts and contributions of the other.