Available online at http://cadmusjournal.org/
Cadmus
Promoting Leadership in Thought that Leads to Action
Volume 4, Issue 4 - June 2021

Transdisciplinary Theory of the Firm

Garry Jacobs
President & CEO, World Academy of Art & Science;
President, The Mother's Service Society

Abstract

There is an imperative need to reconceptualize the role of the firm in modern society based on a holistic perspective in order to correct the imbalances and excesses generated by a too narrow conception of purpose and the inadequacies of current theory to explain and reveal the underlying process by which firms, stakeholders and society at large grow, develop and evolve in a synergistic, mutually reinforcing and beneficial manner. The concept of the firm as a separate independent entity striving to maximize its own individual benefit in competition with other firms needs to be replaced by a conception of the firm as a nodal element in a comprehensive commercial system and social organization designed to deliver maximum benefits to society as a whole and to distribute those benefits rationally for the welfare of all. The concept of efficiency narrowly defined in terms of shareholder value needs to be replaced by the concept of effectiveness broadly defined as the total value generated to all stakeholders and society at-large. The unique role of the firm as an agent for free expression of individual initiative, innovation and creativity can best be preserved and enhanced only in a commercial, regulatory and social environment which safeguards the welfare of the collective, while providing maximum opportunity for individual choice and action. This article views the firm from the perspective of an integrated transdisciplinary science of society, examines the relationship between the individual firm, business community and the wider society, and considers the concept of value from the perspective of impact and overall benefit on society and human wellbeing.

1. Origins of the Firm

The roots of the modern firm run far into the past, a past which reveals much about the origins of the corporation and its inherent socioeconomic nature. The 'company' as it is known today first developed in medieval Italy, where individuals pooled capital together and jointly invested it by establishing a permanent partnership. At first this arrangement included only family members, but later was extended to include others. The earliest known record of such partnership was by a group of merchants in Genoa in the 12th century ("The Genoa Connection", 2009).

The form of company known as 'corporation' was born in medieval England. Early corporations were established by issuance of a royal charter by the British crown. The original corporations were not-for-profit organizations such as universities, schools, churches, hospitals, etc. (Woodland, 2014). If the corporation's acts violated the terms of its charter, the court had the power to declare the offending actions unlawful. Profit-making was not legal under these early charters. This changed with the reconstitution of the East India Company in 1612. The charter of EIC distributed the company's liability among the stockholders and limited it to the total capital pooled by the firm. In the granting of charters and rights to firms as a 'corporate' entity, applicants were known to offer monetary and other benefits to public officials or the crown itself in order to obtain monopoly powers (Hodgson, 2002).

"This article examines the theory of the firm from the perspective of society and looks for a theory that is consistent with the fundamental principles of social reality. It views the firm from the perspective of an integrated transdisciplinary science of society. It examines the relationship between the individual firm, business community and the wider society, and considers the concept of value from the perspective of its social impact and overall benefit to human wellbeing."

Adam Smith became an outspoken critic of the mercantile system which benefitted the government and selected domestic corporates at the expense of the public-at-large by imposing high tariff barriers on foreign goods, thereby effectively raising domestic prices for consumers. This was perhaps the principal reason for his advocacy of the 'invisible hand' as an impartial, impersonal mechanism to prevent bias and collusion between the government and big business. His intention was not to liberate business from regulation but rather to liberate the general public from victimization by rent-seeking officials and influential businesses. His objective was to promote public interest rather than to maximize private profit. Smith (1827, p. 107) says,

The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public. To widen the market and to narrow the competition, is always the interest of the dealers… The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.

2. Legal Theory of the Firm in USA

During the colonial era, British corporations were chartered by the crown to do business in North America and the practice continued in the early United States both at the state and federal level. These corporations were often granted monopolies by charter. In the late 18^{th} and early 19^{th} centuries, corporations began to be chartered in greater numbers by the states under general laws allowing for incorporation at the initiative of citizens, rather than by specific acts of the legislature.

In the 1886 case Santa Clara County v. Southern Pacific Railroad Co., the US Supreme Court recognized the corporation as a 'natural person' under law with at least some of the rights of other citizens, except those specifically barred. This included protection under the 14^{th} Amendment of the Constitution, 'No state shall deprive any person of life, liberty or property.' The ruling served as the initial legal basis to defend unchecked capitalism, limits on regulation of firms, including their enormous financial influence on political processes (New Internationalist, 2002). The 1886 judgement and subsequent interpretations and adjustments remain highly controversial issues for legal debate even today. It is noteworthy that the American legal position is an exception to prevailing global law on this issue.

Law is one of the fundamental constructs on which society is founded and in a constitutional democracy the constitution is held to be sacrosanct. The constitution represents the principles and universal values upon which the nation's founders have formed the government and legal framework for the governance of the society. In some instances, when the constitution has been found to be inconsistent with fundamental human rights, it has been amended by an arduous process. It was well known at the time the US constitution was adopted in 1789 that its failure to prohibit slavery was in direct contradiction to the principles on equality and social justice on which the nation was founded. Due to the expediency of framing a constitution acceptable to all 13 of the original colonies, slavery remained legal for another seven decades until the passage of the 13^{th} Amendment in 1865, but it was from the outset in violation of natural law as a "codification of the public conscience of society," as widely interpreted by global society even a century earlier (Jacobs, Nagan and Zucconi, 2014). The same obviously applies to its failure to grant voting rights to women.

It is not the purpose of this article to enter into extended legal debate and controversy over issues on which prevailing legal theories of the firm are based. It is sufficient to emphasize the obvious fact that a valid legal theory, whether in democratic USA, communist China or any authoritarian state, may be valid according to the constitution of the nation but contrary to universal principles of law and justice. It can also be contrary to the conscience and will of the public-at-large, which is impeded by a cumbersome constitutional process from interpreting or modifying the constitution to reflect the national public conscience and that of humanity as a whole.

Instead, this article examines the theory of the firm from the perspective of society and looks for a theory that is consistent with the fundamental principles of social reality. It views the firm from the perspective of an integrated transdisciplinary science of society. It examines the relationship between the individual firm, business community and the wider society, and considers the concept of value from the perspective of its social impact and overall benefit to human wellbeing.

3. Theory in the Social Sciences

A discussion regarding the theory of the firm raises fundamental questions regarding the nature of theory in the social sciences. Valid theory needs to be founded on concepts and premises regarding reality that are clear and well-defined. The mere capacity to predict results is not in itself sufficient to confirm the validity of a theory, any more than the accuracy of the Julian calendar based on the conception of a heliocentric universe proved the validity of that conception.

Moreover, the theories expounded in the social sciences are of a distinctly different type than those formulated in the quest to uncover the universal, invariable and eternal verities of reality in the physical realm of the natural sciences. For the social reality, which is the field of study in the social sciences, is a human-made reality, not a product of physical nature, and the principles governing its functioning are founded on modes of consciousness—conceptions, perceptions, ideas, beliefs and values—which vary in space and time, differ from one culture to another, mutate and develop with the development of the society, and evolve with the progressive evolution of the consciousness, knowledge, values, organization and technological capabilities of the society.

Theory is a scientific explanation (Jones, 2001). It is not an ideological statement of beliefs or preferences. Theory is an attempt to represent reality in a manner that is a consistent close approximation to what actually exists. A scientific theory seeks to present a reliable account of the real world. The real world studied by the social sciences, including Economics and Management, is the world of human society. Theories put forth in these and other fields of social science must be consistent with what is known about social reality as a whole. On these points, theory in the natural and social sciences seems comparable.

The problems arise when we consider the nature of social reality and the consequences of dividing it into disciplinary fragments. All the natural sciences are constructed on the same fundamental principles of Physics and Chemistry. Although the subjects are organized as different fields of knowledge, these fields are all based on the same primary assumptions and are interlinked with one another. The laws of Physics applied in Astronomy and Meteorology are the same as those that apply in Botany and Soil Science. Natural reality is an integrated whole and there must be self-consistency between the premises and principles applied in all these fields. So too, society is an integrated whole and its study is incompatible with attempts to describe it differently in different fields of social science as if these fields exist independently or without reference to what is pertaining in other fields with which it is related.

Controversies no doubt exist in the social sciences between different assumptions regarding the fundamental reality of society. The contract theory of society first set forth by Hobbes and Rousseau conceives of society as dependent on establishing contracts by which parties agree to forego their dominant interests and independence. Rousseau's (1950) *The Social Contract* prepared the way for the notion of people and government acting in a coalition of interdependent partners. Adam Smith considered society as an artificial creation for the maintenance of mutual economy and benefit between people and government. But regardless of whether society is a social construct or a natural reality, the theory supports the view that the purpose of society and that of the firm is for the mutual benefit of its members. The alternative social organic theory regards society as a kind of organism, similar to a biological system, as conceived by Emile Durkheim (1998). This view gives prominence to the organism as a whole and conceives of individuals and organizations merely as constituent parts, its associations and institutions. But here too, it is the mutual benefit accruing to the collective which is of paramount rationale for the existence and functioning of society. Our view integrates both perspectives and grants fundamental legitimacy and real existence to both the society and its individual members and other constituent elements. But in all three cases we are led to the same conclusion. The society and its elements, including the firm, exist for the purpose of mutual welfare.

> *"A social theory of the firm is one that examines the role and functioning of business entities as a specialized category of social institution created and sanctioned to serve a social purpose. Like all social institutions established and protected by law, they are intended to promote the welfare and wellbeing of society."*

The boundaries separating social, political, economic, psychological and management activity are conceptual rather than actual. The social reality they seek to describe cannot be divided or arbitrarily segregated into separate airtight, independent theoretical compartments. Thus, for example, assumptions regarding human rationality and decision-making processes in Economics must necessarily be consistent with those in Psychology, unless they refer to two different species of humanity or a clear case can be made for the variation. The separation of disciplines is an intellectual device to facilitate study rather than an actual division of social reality. Social reality is transdisciplinary and its components form aspects of a single, indivisible reality, just as the metabolic, respiratory, muscular, nervous and hormonal systems in the human body form inseparable elements that do not exist independently of one another.

So too, to be valid social theories must take into account not only factors and changes taking place within disciplinary boundaries but also those that are taken as externalities. It is perfectly valid to seek to formulate a specialized legal theory of the firm that strives to explain its status under the laws of the nation in which it operates or an economic theory of the firm which seeks to explain its status and functioning under whatever are the prevailing conditions of the economic system in which it operates. But it is essential to realize that neither the legal environment nor the economic system in which it operates offers static, passive, immutable conditions. Unlike the laws of nature governing the behavior of atoms and molecules in the physical universe, social laws and determinants evolve over time along with the changes that occur in government policies, technologies, organizational practices, social attitudes, cultural values, international relations, global context and environmental conditions. All of these factors constitute dimensions of an ever-changing global social environment. A social conception that ignores these changes may serve as a model, but it cannot be said to represent the underlying social reality it seeks to represent.

When President Franklin D. Roosevelt (FDR) assumed office in 1933, he confronted the worst banking crisis in American history. Thousands of banks had already failed as depositors rushed to their banks to withdraw funds before theirs too collapsed. Over the previous three years, the crisis had defied remedy by conventional economic policy under the previous administration. FDR realized that nothing he had studied in Economics at Harvard had prepared him to deal with the situation, because the economic theory he had learned did not consider the wider social context and underlying social, political and psychological forces impacting on the situation. In response he implemented a spectrum of actions that spanned many disciplines, including new public policies and new laws, including the first federal deposit insurance program. But the most important of these actions was neither legal nor overtly political. Instead he directly addressed the American public in the first of his famous fireside chats. The President explained to them that the crisis stemmed from a loss of public confidence by the American people in their government, institutions and national heritage. He appealed to national pride in the heritage and destiny of their nation. He called on the people to reject the emotions of fear that drove so many to the bank to withdraw their savings. He appealed to Americans to stop the panic by ceasing to withdraw their savings from the banking system with the famous words, "We have nothing to fear but fear itself." When the banks reopened, Americans heeded his call to courage and many went back to the banks to redeposit their hard-earned savings. The panic subsided (Johnson and Jacobs, 2012). FDR's remedy for the financial crisis illustrates the obvious fact that economy and business are inseparable aspects of a wider political, legal, social, cultural and psychological reality and can only be fully understood in the context of society as a whole.

A social theory of the firm is one that examines the role and functioning of business entities as a specialized category of social institution created and sanctioned to serve a social purpose. Like all social institutions established and protected by law, they are intended to promote the welfare and wellbeing of society and any abrogation of that purpose must be considered in theory and practice as an aberration or departure from that intended purpose.

But social theory differs from natural theory in yet another important respect. Theory in the natural sciences often strives to approximate the way things actually work in the real world by constructing models. The assumptions on which those models are based are an attempt to reproduce the way nature actually works. Theory in the social sciences is often constructed to represent the way theorists think social reality *should* work. Here the line is crossed between ideology and reality, often without making the distinction explicit. The statement that the purpose of firms is to maximize profitability is an ideology rather than a statement of fact. Unfortunately, in the social sciences, especially in economics, the concept of theory and economic law is often founded on implicit theoretical assumptions, philosophical premises and cultural values that far more closely resemble dogma than scientific thesis.

4. Social Nature of the Firm

This perspective compels us to examine the fundamental premises on which a social theory of the firm must be based. A firm is a child of the society born out of its needs, nurtured and supported by its resources and capabilities, and sustained by mutually beneficial interchange with the social whole of which it constitutes an inseparable element. It is born of the existing and emerging needs of society, draws its sustenance and substance from the present resources of the society, grows by productively harnessing these resources to provide value to the society, and evolves by contributing to the evolution of the social organism as a whole. Society includes the totality of all human relationships between its members and the groups to which they belong.

Human relationship is the basis for all forms of productive social activity and all creation of social value. Economic relations are founded on the capacity of individuals and groups to produce surpluses beyond what is required for their own sustenance and their capacity for specialization of function in order to expand the range of products and services available for exchange and consumption. Firms are organized groupings of individuals designed to maximize the effectiveness of their interrelationships with other individuals, firms and groups.

The relationship between these three levels of reality—individuals, firms and society—is self-evident from an examination of history. The development of steam-powered tractors, farm machinery and processing plants brought unprecedented prosperity to America during the late 19th century. Perceiving an unmet social need as a business opportunity, a perceptive railway stationmaster in the American Midwest named Richard Sears established a mail-order company in 1892 to sell household products to consumers in outlying rural areas far from urban commercial markets. Within a decade, his mail-order business extended far and wide in rural America. Around 1900 he brought in a business partner named Julius Rosenwald who questioned the quality and reliability of the products being offered to distant rural customers, at a time when the prevailing philosophy in American commerce could be summed up as *caveat emptor, 'buyer beware'.* So the company introduced what a half-century later became the ubiquitous promise of retailers to American consumers 'Satisfaction guaranteed or your money back.' The company's business multiplied until it was unable to efficiently handle the volume and complexity of its business. Then just around the time Henry Ford was introducing the moving assembly line in his first mass production, automotive factory for the Model-T, a German engineer named Otto Doering applied the same technology to streamline order fulfillment in the expanding warehouses of the mail order company. Business boomed further until by 1920 Sears Roebuck had become the largest retailer in the world.

Soon afterwards, retired army officer Robert Wood took over at Sears. Wood observed the revolutionary social changes wrought by the rapid spread of low cost automobiles, including the migration of middle class families out of the congested urban centers to the freshly sprouting suburbia. Recognizing an unfilled social need, he established the first of what became Sears' department stores and suburban shopping malls. Over the next six decades, Sears continued to grow rapidly, retaining its title as the largest retailer in America and the world, even during the Great Depression years when department store business was down by more than 40%. Sears won and maintained the loyalty and trust of the American Middle Class, controlling 50% or more of total sales in many product categories, until it lost touch with the rapid evolution of American retailing and lost its dominant market position and title to Walmart, which proved able to meet the needs of American society more effectively and efficiently.

Sears' phenomenal success as a commercial business was inextricably tied to the growth, development and evolution of American society. The company grew on the strength of rising national aspirations and levels of education, changing social expectations and cultural values, rapid technological and organizational developments, and demographic forces. It thrived for nine decades due to its ability to perceive, understand and serve changing social needs effectively and efficiently. The profits it earned during that period were impressive, but they were only a residual benefit for the invaluable service it provided to American households. It thrived because it served the needs of the people better than other firms did.

The Sears story is a dramatic historic example of a ubiquitous phenomenon. Today Airbnb, Amazon, Apple, Facebook, Google, FedEx, Marriott, Microsoft, Uber, Visa International are outstanding instances of this fact. These and countless other companies of the past and present support the same conclusion. A firm is a form of social organization sanctioned and supported by the society, given a legal status and protection under the law in order to meet the needs of society (Roberts, 2004). Its purpose is to provide goods and services, employment and incomes to meet the economic needs of the society and its members in a manner that is consistent with the policies of the government, laws of the nation, health and welfare of the people, and preservation of the natural environment (Lawson, 2019).

It performs this function by drawing upon the resources of the whole society and utilizing them in a manner which is socially beneficial. It does so by utilizing the cumulative knowledge, know-how and skills developed by society over countless generations which are made available for its use. It utilizes the services of members of the society raised, educated and trained for the purpose. It functions based on the physical and social infrastructure provided by society, including energy generation, communication, transportation, education, scientific research, healthcare facilities, and many other types. It is granted temporary proprietary rights to benefit from the incremental technological innovations it generates based on the vast reservoir of existing knowledge and practice. It exists and grows by drawing upon the accumulation of the society's existing capital resources—human, social, financial, intellectual, manufactured and natural.

This view is self-evident when it comes to the list of massive global firms mentioned above. In these cases, the very definition and conception of the firm no longer seem adequate to explain their nature and functioning. Companies such as Google, Amazon and FedEx have become part and parcel of the global social system. Their presence extends far beyond the limits of their physical properties and operations or the workplace of their employees. They connect, relate to and integrate so many aspects and functions of the society that it is inseparable from them. Therefore, Google and Facebook are held accountable by a standard for unbiased presentation of information which few national governments and politicians can meet.

And this fundamental principle holds true even for the smallest local firm as well—the local restaurant, hotel, doctor or dentist, barber, electrician, builder, taxi or bus service. The moment it poses threats to the health, safety, welfare and well-being of its customers, employees or society at large, it can be compelled to correct itself or be dissolved. The operation of any business is a privilege extended in return for service rendered to society and that privilege is always conditional. As Thomas J. Watson, Jr., the founder and CEO of IBM, expressed it, "We acknowledge our obligation as a business institution to help improve the quality of the society we are part of."

"The firm is an intermediate agent between society and the individual. It has no independent existence of its own, any more than the respiratory and circulatory system of the human body exist independent of the whole of which they are inseparable components."

Thus, any valid theory of the firm must rest on the foundations of this social reality. When for any reason a firm ceases to serve this purpose, it is subject to strictures either by the customers who reject it, the employees who operate it, the shareholders who invest in it, the bankers who finance it, or the government that has the right and responsibility to regulate its activities. If its products are found to be faulty or dangerous, it may be subject to lawsuits by the state or private parties. If its activities damage the environment, it may be punished or prohibited from continued operations. If its domination of the market exceeds prevailing norms to the extent that it is no longer in the public interest, it may be broken up into smaller entities under antitrust laws or subject in rare cases to special legislation.

Founded in 1880, the American Telephone and Telegraph Company, AT&T, was declared a public utility in 1907 and subject to strict regulation to ensure optimal service to the American people. When advances in telecommunications technology no longer necessitated public management, in 1982 the company was broken up into seven smaller regional entities for the very same reason—to ensure optimal service to the American people.

5. Social Macrocosm and Individual Microcosm

Full understanding of the nature of the firm depends on full understanding of the nature of the macrocosm we call Society. Society is a living organization, an evolving organism, which includes but is not limited to the sum of its individual members and intermediate formations. It includes both objective and subjective elements and both organized and unorganized structures and activities. Its formal objective structures include family, government, law, systems, national and international organizations, enterprises and formally organized activities such as governance, defense, production, distribution, finance, etc. Its informal relationships include recurring interactions between individuals, organizations and activities, which operate within and outside the formal structures. Its intangible subjective factors include prevailing values, knowledge, ideas, attitudes and beliefs, which constitute its culture.

Society is a reservoir of social resources and potentials which individuals, firms and other social organizations draw upon for their sustenance, growth, development and evolution. These resources can be classified under five major heads: the needs and aspirations of the society, which form the basis for the Market; the sum of society's knowledge, skill and know-how, which form the basis for Technology; all forms of Capital—natural, financial, human-made—which enhance its capacity for productive activities; the knowledge, skills, energies, aspirations, values and attitudes of its People; and the activities, systems and formal structures that constitute elements of social organization (Jacobs and Macfarlane, 1990). All the accomplishments of firms are based on the utilization of these five types of social resources to produce products and services designed to serve the wider society of which they form a part.

The individual members of society represent the other pole of social existence, the Microcosm on which the firm bases itself. The individual too is an inexhaustible source of energy, aspiration, ideas, invention, innovation, initiative and creativity who bases his or her actions on the resources of society for the growth and development of both the individual and the collective in a mutually beneficial manner. Social macrocosm and individual microcosm exist in a symbiotic relationship which governs the existence, growth, development and evolution of the society and all the intermediate elements between them. The individual acquires the energy, knowledge and capacities for growth and development by drawing upon the resources of the society. At the same time, the conscious individual in the form of leader, pioneer, inventor, discoverer, creator and original thinker is the source and catalyst for all social innovation, creativity and evolution. In a well-governed society, development of these two poles is mutually reinforcing.

6. Intermediate Status of the Firm

A company lives and grows as a significant intermediary in symbiotic relationship between the two fundamental poles of social existence: the social macrocosm of which it is a part and the microcosm of individuals which are members of that macrocosm. The firm is an intermediate agent between society and the individual. It has no independent existence of its own, any more than the respiratory and circulatory system of the human body exist independent of the whole of which they are inseparable components.

According to Greenwood (2005, p. xxvi), "To reduce the firm to its constituent parts is no more reasonable than is treating a human being as no more than the chemicals that make her up." Maitland (1900) writes that Otto von Gierke's theory says of the corporation "that it is no fiction, no symbol ... no collective name for individuals, but a living organism and a real person, with body and members and a will of its own. Itself can will, itself can act ... It is not a fictitious person ... It is a group-person, and its will is a group-will… the personality of the corporation ... is in no sense ... artificial or fictitious, but is every whit as real and natural as is the personality of man."

Firms grow, develop and evolve by drawing upon and harnessing the five types of social resources in productive and creative ways to meet the needs and aspirations of the society. They draw upon the individuals with whom they relate as the source and catalysts for its growth, development, innovation, creativity and evolution.

"There is an imperative need to reconceptualize the role of the firm in modern society based on a holistic perspective in order to correct the imbalances and excesses generated by a too narrow conception of purpose and the inadequacies of current theory to explain and reveal the underlying process by which firms, stakeholders and society at large grow, develop and evolve in a synergistic, mutually reinforcing and beneficial manner."

The effectiveness of the firm depends on its capacity to identify and organically integrate itself with the wider society of which it is a part; on its capacity to coordinate and integrate the actions of the individuals, structures, systems and activities of which the firm is constituted; and on its capacity to align and integrate itself with the unique capacities of each of its individual members.

Society, individual and firm are organizations which carry out activities for their survival, growth, development and evolution in systematic, recurring ways. The extent of their organization determines the effectiveness with which they transform resources into social value. At the same time, society, individual and firm are also living organisms which thrive, grow and develop by a process of generating, releasing, focusing and converting energy into productive forms of activity. The process of energy generation and conversion governs their growth, development and evolution. The intensity of the energy generated and the effectiveness with which it is utilized for productive purposes determine their overall capacity for growth, development and evolution (Harmon and Jacobs, 1987).

The primary mode of relationship between the firm, society, other firms and social organizations and members of society is cooperative, symbiotic and mutually beneficial. The law of the jungle dictating survival of the fittest is no more apt for firms than it is for physical nature. For the law of the jungle is also based primarily on symbiosis and mutuality. Each being and species plays a part in the survival and growth of the whole and even their competitive behaviors help to sustain the overall balance and health of the ecosystem as a whole. Competition between firms is a reality, but for every competitor it seeks to supplant, a firm depends for its very survival on cooperation and mutually beneficial relations with countless others which provide the raw materials, component elements, processing, transport, energy, communication, financial services, storage, educational, research, knowledge, skills, research and auxiliary services it requires for its functioning.

7. Purpose of the Firm

The purpose of a firm is to maximize value to society as a whole and all its individual members. Social value includes physical, organizational, social, ecological, mental and psychological dimensions, such as quality, accuracy, speed, punctuality, safety, hygiene, maximum utilization of physical resources, space and time, exchange, communication, systematic functioning, cooperation, coordination, integration, courtesy, teamwork and harmonious relationships, service, satisfaction, freedom, equality, trust, honesty, comfort, convenience, integrity, innovation, creativity, goodwill, self-giving, security, enjoyment, beauty, wellbeing and delight.

The purpose of the firm is no more to make profit than it is the purpose of human beings to breathe and eat. Profit is an essential condition for the survival and growth of the firm as breathing and eating are essential for human survival and growth. But they are not its purpose. Its purpose is to meet the needs of society and it does that by providing goods and services, generating employment and generating incomes for members of the society, providing markets for suppliers, providing loans and investment opportunities for financial institutions, generating tax revenues to support the requirements of the local community and national government, and also to generate returns to its shareholders as an incentive for them to invest in it. In performing these functions, it is governed by a variety of other requirements—to conform with the nations' laws; to protect the health and safety of consumers, employees and the general public; to protect the natural and social environment; and to conduct itself in all ways as a good corporate citizen. The right to create a firm as an artificial entity recognized and protected by law is bestowed by the government so that it may carry out its beneficial social functions. That right carries with it specific obligations and responsibilities. The fundamental system flaw in prevailing corporate and financial law is the failure to hold companies fully responsible for harm arising from failure to fully implement the rule of law and pursue the welfare of society. Frank Dixon (2017) rightly argues that

Failing to hold companies fully responsible for negative impacts is a primary overarching economic and political system flaw. It places businesses in conflict with society… Flawed systems make it impossible for companies to mitigate about 80 percent of negative environmental and social impacts and remain in business.

There is an imperative need to reconceptualize the role of the firm in modern society based on a holistic perspective in order to correct the imbalances and excesses generated by a too narrow conception of purpose and the inadequacies of current theory to explain and reveal the underlying process by which firms, stakeholders and society at large grow, develop and evolve in a synergistic, mutually reinforcing and beneficial manner. This redefinition is consistent with the growing recognition of the vital importance of CSR (corporate social responsibility) and ESG (Environmental, Social, and Governance) for the future of viable, equitable and sustainable market economies. This recognition has come so far that ESG is becoming a very important criterion for investment in global financial markets and even hedge funds are applying ESG criteria (Fletcher, 2019). The adherence of firms to stringent environmental, legal and other standards is not a secondary or subsidiary factor. It is a fundamental social as well as a legal condition on which the very existence of the society depends.

The concept of the firm as a separate independent entity striving to maximize its own individual benefit in competition with all others needs to be replaced by a conception of the firm as a nodal element in comprehensive commercial system and social organization designed to deliver maximum benefits to society as a whole and to distribute those benefits rationally for the welfare of all. The concept of efficiency narrowly defined in terms of shareholder value needs to be replaced by the concept of effectiveness broadly defined as the total value generated to all stakeholders and society at-large. The unique role of the firm as an agent for free expression of individual initiative, innovation and creativity can best be preserved and enhanced only in a commercial, regulatory and social environment which safeguards the welfare of the collective, while providing maximum opportunity for individual choice and action.

The article argues that the firm fulfills its role most effectively and generates the maximum of social value when it harmonizes its activities with those of the wider society, its individual members and all other stakeholders. In the measure the total social system is aligned with this wider view, profit can constitute one measure of that value generated and maximizing total social value is compatible with maximizing the effectiveness of the firm. Under present circumstances the perverse incentive system and distribution of power encourages other strategies that are detrimental to social welfare and often to the sustained corporate success as well.

These views are based on 40 years of case studies and consulting for businesses and historical research on the evolution of the current legal environment for business in the USA as documented in several books and articles (Harmon and Jacobs, 1987). This research confirms the view that sustained corporate success is achieved by firms which are best able to identify the needs and aspirations of society—physical, social, psychological and cultural—and to shape their activities to most effectively meet those needs.

Given the considerable gap between sustainable social theory and current practice, the article will close with a discussion of policy measures and systemic solutions designed to realign corporate behavior and investment practices. Holding companies fully responsible is the overarching systemic solution. It changes the incentives. "Protecting business and society," Dixon (2017) stresses, "requires that systems be evolved in ways that hold companies fully responsible. This eliminates conflicts between business and society. It makes acting in a fully responsible manner the profit-maximizing strategy."

Achieving this requires addressing the specific system flaws mentioned above. Emphasis needs to be placed on incorporating environmental, social and other externalities within the pricing structure in order to remove perverse incentives for unsustainable corporate behavior, and reducing the perverse impact of limited liability, time value of money, over-emphasis on economic growth and shareholder returns, inadequate measurement of social well-being, and inappropriate business influence of government (Dixon, 2019).

8. 'Value' in a Social Context

The problem of economic theory in general and the theory of the firm in particular is complicated by the absence of adequate theory regarding other principal elements in economic science. Two obvious examples are the interrelated concepts of value and money which form the basis for most economic theory yet lack satisfactory definition. Value is commonly defined in monetary terms and vice versa, but neither exists in and of itself apart from the aspirations, values, perceptions and behavior of human beings in a social context.

> *"Economic theory is founded on implicit assumptions regarding the playing field and rules for economic transactions that completely and intentionally ignore the larger fundamental question of social power. Social power is the elephant in the room ignored by economic theory."*

The standard description of money found in economic textbooks focuses on its multiple forms and economic functions that it performs, but does not explain its essential basis or reality. Regardless of the early material forms which money assumed in the distant past, money is not a material thing at all. It is a purely social conception and a symbolic representation of human relationships. It is a device formulated by human consciousness to facilitate mutually productive relationships among people (Jacobs and Slaus, 2012). Like the sounds and symbols of which language is composed, it is based on human conventions with no inherent value of their own. Money has no more value or utility than a telephone or email account of one living on a desert island without communication with the wider world. It has value to foster relations between human beings. Money is a networking tool or instrument designed to facilitate productive exchanges in space and time. It is founded on the subjective human perception of trust or confidence. When that trust is declining or absent for any reason, money has less or no residual value.

It is true that we commonly perceive the value of money to depend on physical objects, resources and productive capabilities, and these things do indeed support the trust vested by people in the value of money. But the real source of the value is still subjective, rather than objective. That is why $8 trillion in value could so suddenly vanish from the American economy during the 2008 financial crisis, when the nation's material assets remained fully intact or why the US Federal Reserve could by an act of wizardry create trillions of dollars of new value out of apparent nothingness, like a magician out of an empty hat, to restore trust in the system.

But the problem of value in economics and the value of money with which it is linked is further complicated by the fact that money is a very limited measure or index for value creation which excludes far more than it includes. Measures of monetary value may and often do exclude and even act to the detriment of other values depending on the political, legal, regulatory, economic, commercial, social and cultural environment in which they operate. The most obvious example is the fact that the economic notion of wealth creation is so narrowly defined that it excludes the detrimental impact of economic activity on the physical environment and resources on which it is based and depends for its existence. The notion that shareholders are entitled to the residual value of economic activity undertaken by firms is based on this narrow conception. It can and often does distribute residual value to shareholders when there is actually no residual value to the society to be distributed. This example illustrates the problem of separating an economic theory of the firm or of value from a wider social theory.

But the problem lies still deeper. Economic theory is founded on implicit assumptions regarding the playing field and rules for economic transactions that completely and intentionally ignore the larger fundamental question of social power. Social power is the elephant in the room ignored by economic theory. For much of what is regarded as economic value generated by effort and efficiency is largely and sometimes wholly the result of the unequal distribution and access to various forms of social power and may not depend on any form of productive economic activity at all. This fact is tangentially addressed by the economic concept of rent-seeking. But it goes much deeper. For rent-seeking is viewed as an exceptional factor which intrudes on the free workings of the market, whereas social power is an ever present, ever active agent in determining social outcomes. No valid economic theory or theory of the firm can be formulated without addressing this issue explicitly.

The issue of power is not confined to either economy or politics. It is a fundamental construct of all social theory. Power is the capacity to accomplish any goal. The generation of power is one of the principal reasons why groups of individuals acting in coordination with one another can accomplish what none can achieve by themselves. The basis of power in society is collaborative human relationships. That power takes a multitude of forms—the capacity for self-defense or aggression, governance, safety, security, communication, transportation, production, trade, education, healthcare, research, technology, innovation, invention, entertainment and so forth. All of these powers support human accomplishment and all are forms of social power made possible by collaborative human relations. All these forms of social are interchangeable. Political power can be used to acquire wealth and economic power. So too, economic power can be exercised to acquire political influence and power. Education, science and technology are productive powers that are readily converted into wealth. The strategic location of Dubai as a global transportation hub has been converted into wealth comparable to that of some oil-rich countries.

9. Money, Value and Social Power

Money is one form of social power. But it is also a symbol for all other forms of social power due to its capacity for rapid convertibility, mobility, storage and exchange. A complete theory of the firm needs to be founded on a comprehensive theory of the money as a convertible and transferable form of social power and capacity (Jacobs, 2016). In principle, profit is intended as a measure of the efficiency with which a firm utilizes the available social resources and individual capacities to maximize overall value to society. But to a large extent it is a measure of the differential in power exercised by individuals and firms due to their size, financial power, access to information, political influence, legal resources, etc.

> *"The development of a transdisciplinary science of society which encompasses economy and business would be a significant and substantial contribution to framing the theoretical foundations for the future evolution of global economy and society."*

A theory of the firm that ignores the power dimension of economy and society does not reflect social reality. A few years ago, *The Economist* published a cover story on the role of patent and copyright laws in contemporary economy. They argued that the original purpose of these laws was to encourage innovation, so that firms can recover the costs of innovation and be encouraged to invest further in it. In other words, the social intention is to promote the welfare of society through the innovation of firms. Their research found that extending protection beyond a period of 20 years (which applies only to the pharma industry. For others, the period is even less) actually has the opposite effect. Extended patent and copyright laws are a form of rent-seeking ("Question of Utility", 2015). *A Patent System for the 21st Century* recommends significant changes in the way the patent system operates (Merrill, Levin and Myers, 2004). Countless other laws bestow benefits that do not reflect the real efficiency of firms, not their real contribution to society.

In current practice, profit reflects the efficiency with which a firm maximizes value in a power-biased system that gives excessive importance to some resources and some values at the expense of others. To cite an obvious example, the government incentives for continued investment in fossil fuels is a power-based decision to support a politically and economically influential sector, to reduce the cost of oil production and pass on the cost of remediation and environmental pollution to society-at-large. This bias results from and contributes to inherent inequalities in relative importance attributed to different social values and the rent-seeking behavior which it permits and reinforces. Both result from the unequal distribution of social power. Value as currently measured reflects the present disposition of power in society as much or more than it reflects the real value to the individual and its members. Thus, the effective behavior of firms is strongly influenced by the total social system in which it operates. Optimal social welfare and effectiveness can only be achieved under social conditions that promote the equitable distribution of power and benefits to all members.

10. Conclusion

This article is not intended to challenge the virtues of the market economy system or the contribution of business entities to social welfare and development. For millennia economic exchange has been a principal instrument for social evolution. It has broken down the physical, social and cultural barriers that separate groups of people from one another. It has provided an incentive and a means to relate with other human beings for mutual benefit over wider and wider areas until it covers the entire globe. It has encouraged people to develop specialized skills to capitalize on their comparative advantages and benefit by exchange with others who possess different skills and advantages. Since the mid-1950s and, especially since the end of the Cold War, business has been at the forefront of global social evolution. Companies like Google, Apple, Amazon and Facebook may have done more to bring human beings in collaborative relations with one another than the combined efforts of all the world's governments.

This article is rather intended as a challenge to the ideologies of economic orthodoxies masquerading as scientific theory, which retard social evolution by ignoring or concealing inconsistencies and fallacies in theory that serve as the basis for perpetuating inefficient, ineffective, and inequitable policies and practices, which in turn prevent global society from fulfilling its fundamental objective of maximizing human wellbeing. In this sense much of prevailing mainstream economic theory is the handmaiden of an inequitable system.

It is not the intention of this article to pursue this subject in depth, but a few examples may illustrate the fundamental importance of the issues that they raise. One example is the fallacy of regarding environmental costs as an externality which undermines the very claim that firms maximize profit by efficiency. In the measure they do not absorb the true costs of their activities, they maximize profit at the expense of present or future generations of the society-at-large. Another fundamental flaw is the failure to distinguish between productive investments in the real economy and speculative investments in financial markets. Current tax policies incentivize capital investments by depreciation allowances and low tax rates regardless of whether they are socially beneficial or socially destructive. The growing divorce between financial markets and the real economy has led to rising levels of inequality and financial instability, which are polarizing society and undermining democratic processes.

The development of a transdisciplinary science of society which encompasses economy and business would be a significant and substantial contribution to framing the theoretical foundations for the future evolution of global economy and society.

Author Contact Information
Email: garryjacobs@gmail.com

Bibliography

1. A question of utility (2015, August 8). *The Economist* Retrieved from https://www.economist.com/international/2015/08/08/a-question-of-utility
2. Dixon, F. (2017). High-Level System Change: Protecting Business and Society. *Cadmus, 3*, 3, 98-112.
3. Dixon. F. (2019). System Change Investing and the Sustainable Development Goals. *6*, 3, 98-117
4. Durkheim, E. (1998). *The division of labour in society*. Basingstoke: Macmillan.
5. Fletcher, L. (2019). Hedge funds join the hunt for the ESG 'factor'. *The Financial Times*.
6. Gierke, O. and Maitland, F. (1900). *Political Theories of the Middle Age ... Translated, with an introduction, by F.W. Maitland [from Das deutsche Genossenschaftsrecht]*. University Press: Cambridge

7. Greenwood, D. (2005), Introduction to the Metaphors of Corporate Law, *Seattle Journal for Social Justice 4*, 1: 1-31
8. Hodgson, G. (2002). The Legal Nature of the Firm and the Myth of the Firm-Market Hybrid. *International Journal of the Economics of Business*, 9(1), pp.37-60.
9. Harmon, F. G., & Jacobs, G. (1987). *The vital difference: Unleashing the powers of sustained corporate success*. New York: AMACOM.
10. Jacobs, G., & Macfarlane, R. (1990). *The Vital Corporation: How American Businesses--Large And Small--Double Profits In Two Years Or Less*. Englewood Cliffs: Prentice Hall.
11. Johnson, I. & Jacobs. G. (2012). Crises and Opportunities: A Manifesto for Change. *Cadmus, 1,* 5, 11-25.
12. Jacobs, G. & Slaus, I. (2012). The Power of Money. *Cadmus 1*, 5, 68-73
13. Jacobs, G., Nagan, W. & Zucconi, A, (2014). Unification in the Social Sciences: Search for a Science of Society. *Cadmus Journal*, *2*, 3, 1-22
14. Jacobs, G. (2016). Money, markets and social power *Cadmus 2,* 6, 20-42.
15. Jones, R. (2001). *Encyclopedia of international political economy*. London: Routledge.
16. Lawson, T. (2019). *The nature of social reality: Issues in social ontology*.
17. Merrill, S., Levin, R. and Myers, M. (2004). *A patent system for the 21st century*. Washington, D.C.: National Academies Press.
18. New Internationalist. (2002). *A Short History Of Corporations*. [online] Retrieved from: https://newint.org/features/2002/07/05/history
19. Roberts, J. (2004). *The modern firm: Organizational design for performance and growth*. Oxford: Oxford University Press.
20. Rousseau, J.-J. (1950). *The social contract, and Discourses*. New York: Dutton.Bottom of Form
21. Smith, A. (1827). *An inquiry into the nature and causes of the wealth of nations*. Edinburgh: Printed at the University Press for T. Nelson and P. Brown.
22. The Genoa connection (2009, January 8). *The Economist,* Retrieved from https://www.economist.com/books-and-arts/2009/01/08/the-genoa-connection
23. Woodland, J. (2014). *Money Pits: British Mining Companies in the Californian and Australian Gold Rushes of the 1850s (Modern Economic and Social History)*. Ashgate Publishing Group.