



## Profit versus Social Impact and Responsibility

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**Abstract:** *The complexities of contemporary professional and business environments mandate us to discuss and then take a stance towards various issues arising in transactions between the providers of service or products and the recipients (customers, shareholders, stakeholders). Relationships include the interactions of a business with natural and man-made environments (natural resources and competition, respectively). While traditionally businesses were driven more by shareholders than stakeholders, current situation with climate change, pollution, social unrests, inequity, and globalization requires bigger stakeholders' consideration. This trend led to creation of PBC-corporations, or Public Benefit Corporations pledging for bigger environmental and societal awareness. One of the public benefit corporations that are operating within New York State and locally on Long Island is the Long Island Power Authority (LIPA). During this research, the PSEG-LIPA representatives were contacted to get some insight information about their operations and what is the role of stakeholder considerations in their planning.*

**Keywords:** *profit, social responsibility, benefit corporations, stakeholders, Long Island Power authority (LIPA)*

### 1. INTRODUCTION

In this paper we are concerned with the issues that involve applied ethics in business. In particular, this paper touches upon questions of profit maximization versus social responsibility. As it implies from the name, social responsibility is an ethical theory in which individuals are responsible for their contribution to society. Meanwhile, ethics is a set of rules or a code that one could refer to when required to make morally just decisions. Therefore, discussion on the applied ethics in business can be analyzed from at least two different perspectives. First one being the company's point of view. Companies are owned and operated by people, represented by shareholders or executives. Their major goal is to increase the profit which is crucial for the survival and growth of the company. Second point of view includes business versus society, namely point of view of stakeholders as all entities affected by company's activities, leading to questions about social impact and environmental consequences.

### 2. PROFIT

Conventional view about the purpose of business is exclusively to generate wealth and profit (Edmans, 2020, 14). Business founders are often motivated with the perspective of financial freedom and possibility of managing their own affairs. Therefore, creating a business provides excellent opportunities for those who are ambitious enough to take risks and tackle challenges where the growth potential depends mostly on the individual's personal attributes. Furthermore, entrepreneurs often find opportunities in niches or in the social problems that they seek to resolve and monetize on. Great entrepreneurs are those who were able to improve the wellbeing and productivity of society. While doing so, some of them generated tremendous profits and created the largest companies in the world.

However, it is important to mention that the methods of profit generation and distribution of profit may sometimes turn into a controversial topic. While profit is primarily used to fund the operations of the business, it is also being distributed to the shareholders of the company as a return for their investments and taxed by the government. This raises a question whether the social impact can be considered in any of the steps of the profit generation or profit distribution. In 1970 Milton Friedman published an article in the New York Times arguing that the companies are artificial individuals and

cannot have responsibility as an entity, and that only human beings can have a sense of responsibility (Friedman, 1970). He says:

*“...a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society”.*

How company structures are built is one of the ways we can understand Friedman’s doctrine. Many of the companies are structured as C-Corporations (C-corp). Every C-corp is composed of the shareholders, directors and officers and is a corporation in which the shareholders are taxed separately from the entity. Shareholders invest into the company in exchange for the portion of the ownership and voting rights. Then shareholders appoint directors to run the company on their behalf, who in their turn hire officers to engage in business activities. Since the shareholders are not involved in the day-to-day operations of the company, it is the responsibility of directors to act in the best interests of the shareholders. Therefore, maximizing profit is the only responsibility of the directors.

If the company directors prioritize social responsibility, it may be in conflict with profit maximizing business models. This aligns with the idea that businesses cannot have responsibility, because a business entity is not appropriate enough to make such commitments. Therefore, Friedman argues that companies should only pursue profit maximizing endeavors, distributing profit to shareholders, who in their turn may engage in issues concerning social impact.

Milton Friedman’s article became very influential, and its arguments are still being widely used by scholars and politicians (Hart & Zingales, 2017, 2). Supporters of the business point of view in discussing the issues concerning the topic of this paper often refer to his article as an intellectual foundation. While a company's market value and profit are important, it is not the only concern of the shareholders and executives. Because, ultimately, they are ordinary people who are, in addition to money, also concerned with societal issues. Therefore, it is fair to assume that they have social responsibilities. According to Friedman, shareholders can contribute to the welfare of society by donating to charities and establishing organizations for philanthropic purposes.

Modern days we live in a society with vast multinational corporations. Some of these corporations are larger, more complex in structure and wealthier than some of the nations combined. This puts them in position to be able to influence and deal with major global issues. Additionally, some of the issues concerning climate change, natural disasters and loss of biodiversity are often direct results of the profit seeking actions undertaken by the companies.

For example, in 2010 British Petroleum was responsible for the largest ever accidental oil spill in history (Moss, 2022). There is an ongoing natural disaster at the Niger river delta which has devastated the fishing town of Bodo, where Shell oil company has been underreporting the severity of oil spills in their pipelines (Shirbon, 2018). Company called “Ok Tedi River Mining” jointly owned by the state of Papua New Guinea and Canadian Broken Hill Proprietary Company has destroyed the lives of over 50 thousand people by dumping 90 tons of toxic waste every year into the Ok Tedi River in Papua New Guinea (Fox, 2013).

### 3. SOCIAL IMPACT

In accounting there is a procedure that calculates the total cost of the production by assessing the variable costs and fixed costs. There are also terms called *Cost of Goods Sold* (COGS) or *Cost of Production*. These procedures have been developed over the years and have been exquisitely refined to help businesses make decisions. However, in Economics there is a concept called *externalities*. It is related to the indirect effect of business activities to the third party. The difference is that people affected by externalities are not involved in the decision-making process. Natural disasters mentioned above are excellent examples of the negative externalities when the people and environment must share the negative consequences of actions undertaken by companies.

There is also a *stakeholder theory* that is closely associated with a company's responsibility to generate return for shareholders and its social responsibility. In contrast to externalities, stakeholder theory involves parties that have direct interest in the business activities of a company. Major idea of this theory is that companies must maintain a positive relationship with society and the environment.

In other words, stakeholders are customers, vendors, local communities and even employees of the company. From the perspective of practical and ethical management methods, positively treated stakeholders tend to return positive treatment back to the company. For example, vendors who have a track record of timely payments and communication are inclined to maintain the business relationship, and customers well informed about the company products and manufacturing practices will be long lasting supporters.

Public communication of British Petroleum (BP) after the 2010 oil spill is a great example of how the stakeholder relationships have a long-term effect on the company image (Achenbach, 2010). Initially BP directors attempted to put responsibility on their contractors, which only made the company appear irresponsible. Furthermore, instead of putting effort on stopping the spill and its consequences, BP bought an expensive advertising campaign in an attempt to repair its public image. If the efforts were made with ethical principles in mind, perhaps public outrage could have been diminished.

We can intuitively tell that there are situations when shareholder interests are not aligned with the stakeholder interests. In his book called “*Grow the Pie: How Great Companies Deliver Both Purpose and Profit*”, Alex Edmans describes a practice called *Pieconomics*. He touches upon the discussion concerning the profits and its distribution, as well as its implications for interested parties. Pie-splitting view of the company profit imagines pie of profit to be split between shareholders and society in form of tax, wages and product prices. One way to increase the profits is to increase shareholders’ cut of the pie at the expense of stakeholders. Another more ethical way is to increase the size of the pie while maintaining the fair stakeholder to shareholder ratio (Edmans, 2020, 9).

Taking into consideration the stakeholders’ share of profit creates challenges for companies. While healthy cash flow is crucial for the growth of the profit pie, the only way it is sustainable is by actively engaging in creation of social value. Thus, by making the creation of social value one of priorities, stakeholder consideration by design becomes part of the company objectives. In other words, objectives of a company i.e., shareholders and stakeholder interests become aligned. Additionally, following the principles of positive stakeholder relationships is associated with high financial performance (Harrison et al., 2015). There are scholarly articles and research that tested and supported this idea.

#### 4. BENEFIT CORPORATION

As a contrast to previously mentioned C-Corporation, the United States introduced a new corporate entity called *Benefit Corporation*, also known as *Public Benefit Corporation* or PBC. Its major principle is to include the positive impact to the society as a part of their functioning objective with a mission statement including a pledge for improving our habitat (Skorin-Kapov, 2018, 2). Unlike other non-profit and for-profit corporations, PBC attempts to be as socially and environmentally conscious as possible while seeking to maximize profit.

In addition to Public Benefit Corporations (PBC), there are companies with B Corp certifications. This certification is granted by B-Lab, a non-profit organization, for meeting highest standards for social and environmental performance (B Lab Global, 2022).

However, it is important to note the difference between PBCs and certified B Corps as it is quite easy to confuse them. While PBC is a new legal entity in the United States, B Corps have global reach. B-Lab certified corporations within the United States are required to be registered as PBC in their respective state’s legislation. Both types of benefit corporations have advantages to promote themselves as companies that prioritize social responsibility.

Benefit corporation was first recognized in Maryland in 2010 and it has immediately spread across the nation being authorized by 35 states and the District of Columbia. However, there has been some arguments whether the PBCs are relevant and whether the new entity is actually needed in order to pursue the positive social impact.

Considering the online trend with promotion of the socially conscious trends, some companies recognized the opportunity that could help with market share and talent attraction. Survey by Nielsen conducted in 2015 shows that global respondents were “very heavily” or “heavily” influenced by the following factors (Nielsen Global Solutions, 2015):

- 62% The products are made by a brand/company that I trust.

- 59% The product is known for its health and wellness benefits.

Meanwhile, company reputation is another signifying factor when it comes to client retention and talent acquisition. Survey published by Deloitte in 2016 shows that 87% of millennials believe that “*the success of a business should be measured in terms of more than just its financial performance*” (Deloitte Touche Tohmatsu Limited, 2015).

### ADVANTAGES OF PUBLIC BENEFIT CORPORATIONS

Aside from the public relations benefit of the benefit corporation, another aspect to look at is through the business standpoint. One of the challenges every business must face is to raise the capital. While non-profit organizations face difficulties getting loans and often rely on donations, benefit corporations seek to generate profit, hence have better chances getting loans from banks with favorable interest rates. Additionally, Laureate Education (NASDAQ: LAUR) became the first PBC to go public in 2016, which is not an option for non-profit organizations.

Another advantage of PBC is regarding the legal benefits. While the directors at for-profit organizations are held to duty-of-care obligations under which they are required to prioritize the wealth of the shareholders, PBC have legal advantage which allows directors to explicitly consider stakeholder interests. This advantage also allows PBCs to avoid *Revlon rule* (Khatib, 2015). Revlon rule is the legal principle that states company would be sold to the highest bidder if the hostile takeover is imminent. This is one of the reasons why the crowdfunding platform Kickstarter decided to be reincorporated as a PBC (Clifford, 2015). The co-founder and CEO Yancey Strickler in an interview with the Entrepreneur in 2015 said: “*We see the for-profit structure as being a powerful one for aligning people around a goal*”. The legal framework protects the company from being held liable when prioritizing the social impact over the investor's wealth.

### DISADVANTAGES OF PUBLIC BENEFIT CORPORATIONS

When it comes to the disadvantages of PBCs one of them is its vague interpretation of “*general public benefit*” principle. While the legislation lists specific benefits, it does not require companies to publicly announce their goals and the benefits they seek to create (Lee, 2018). Because of this, companies get freedom of interpretation of their activities under the pretext of “*general public benefit*”. For example, company could be taking advantage of being registered as a PBC and advertising itself as socially responsible, while disguising their ambiguous business practices.

Another concern about the PBCs is their effectiveness in pursuing socially responsible goals. Since they do not enjoy tax benefits and do not rely on charitable donations like non-profits, PBC have no immediate incentive to be actively engaging in socially responsible activities.

The lack of immediate incentives raises the question whether the PBC should be enforced to pursue social mission and who is responsible for the oversight. While the regulations in the US allow shareholders to sue company directors for acting wrongfully in harm of the business and the value of its shares, stakeholders do not have similar tools.

## 5. PBC IN NEW YORK – LONG ISLAND POWER AUTHORITY (LIPA)

On December 12 of 2012 New York State passed legislation that allowed the creation of benefit corporations. However, similar entities in somewhat different forms existed prior to the legislation. In New York State public benefit corporations are closely associated with government agencies. While PBCs act as independent companies, their board of directors are appointed by the local government. In a bureaucratic sense, this allows PBCs to raise capital and issue debt without being constrained by regulations that oversee government entities (Office of the New York State Comptroller | Thomas P. DiNapoli, n.d.). For example, by assigning PBCs to operate public systems and infrastructures, they can make risky investments that are beyond the State limits and do not affect credit of New York State.

One of the public benefit corporations that are operating within New York State and locally on Long Island is the Long Island Power Authority (LIPA). It was originally created in 1985 as a municipal subdivision of New York State to operate the electric distribution system of Nassau and Suffolk counties of Long Island, NY. It became a primary service provider for over 1.1 million people on Long Island in 1998. LIPA is a for-public power authority governed by Board of Trustees with nine

members who are appointed by New York State governor. This membership is for four years period and members must reside in the communities served by LIPA. The Board of Trustees is also tasked with publicly reporting LIPA’s performance to increase transparency and integrity (LIPA, 2022).

As mentioned earlier, state related PBC allows companies to independently issue debt. Thus, New York State formed a Utility Debt Securitization Authority to manage LIPA’s finances and issues debt on LIPA’s behalf (LIPOWER.ORG, 2015). In 2015 Utility Debt Securitization Authority issued \$1,002,115,000 worth of restructuring bonds in order to retire previous debts of LIPA (UDSA, 2015). Some of the previous debts were the consequences of Hurricane Sandy in 2012. LIPA also received heavy criticism for their management of the hurricane, 160 thousand Long Island resident were left without electricity (Hakim et al. 2012).

After much criticism, key people at LIPA have resigned. Starting January 2014, LIPA has entered a 12-year contract with PSEG to operate electric infrastructure on Long Island. LIPA has also approved reformed management contract with PSEG in December 2021 which gives New York State Department of Public Service greater oversight as well as additional \$30 million to repair communication systems on the island (LIPA, 2021).

In December 2011 PSEG vice president Scott Jennings announced that LIPA Board of Trustees approved the PSEG to be selected to manage LIPA’s electric transmission system (PSEG, 2011). It comes following the damages caused by the tropical storm Irene and PSEG’s extensive experience was expected to be effective in managing such disasters in future. While PSEG is taking over the day-to-day operations, LIPA remains as the owner of the power grid and holder of its debts.

When it comes to environmental concerns, New York State puts very ambitious objective to cut greenhouse emissions by 100% by the year 2050. Climate Leadership and Community Protection Act (CLCPA) of 2019 commits to generate zero-emission electricity by 2040 and carbon free economy by 2050.<sup>1</sup>

Long Island is most densely populated area of the New York State, therefore LIPA is an essential part of this plan. LIPA is actively working on transitioning from generating electricity from fossil fuels. Successful transition involves developing new sources of clean energy while effectively retiring older energy plants that work on fossil fuel. Here is the information from (Monroe, 2021) on the LIPA 2022 proposed budget:

**Table 1.** Clean Energy Plants in service and in development on Long Island, NY

<b>Solar</b>	<b>Size (MW)</b>	<b>Effective</b>
Riverhead Solar	20	2019
LI Solar Calverton	23	2021
Riverhead Solar II	36	2022
Community Solar Program	21.5	2022
<b>Offshore Wind</b>	<b>Size (MW)</b>	<b>Effective</b>
South Fork Wind Farm	130	2023
Sunrise Wind	880	2024
Sunrise Wind 2	1260	2026

During this research, the PSEG-LIPA representatives were contacted to get some insight information about their operations and what is the role of stakeholder considerations in their planning. Some of the findings, as well as LIPA’s plans to reduce carbon footprint by more than 7 million of tons, are discussed in following paragraphs.

In addition to the projects shown on the Table 1, LIPA is working together with New York State Energy Research and Development Authority in order to combine efforts with other projects across the State. While some of the clean energy will be used for needs on Long Island, excess energy will be transported to other parts of the State and will be used to meet clean energy objectives.

<sup>1</sup> The link is available at [https://www1.nyc.gov/site/sustainability/our-programs/climate-leadership-and-community-protection-act.page#:~:text=New%20York%20State%20is%20taking\\_level%20GHG%20emissions%20by%202050](https://www1.nyc.gov/site/sustainability/our-programs/climate-leadership-and-community-protection-act.page#:~:text=New%20York%20State%20is%20taking_level%20GHG%20emissions%20by%202050).

In light of new electric plant developments, LIPA is also closely working with the State agencies like New York State Independent System Operator to improve energy transmission and distribution system. These improvements will require batteries with additional capacity. Therefore, LIPA is planning to install 175 MW of battery storage by 2030. According to estimates, investments into infrastructure could add up to \$1.5 billion.

Understandably these improvements require large investments. Since the stakeholder interests are one of major priorities of PBCs, in June 2021 LIPA announced the launch of Integrated Resource Plan (IRP) (PSEGLI, 2021). Objectives of this plan include assessing LIPA's resources, its electric transmission assets and maintaining the affordability for the customers. The IRP will make asset comparisons to find best options that meets reliability, environmental and affordability requirements.

## 6. CONCLUSION

Recognition of stakeholder rights on a corporate level and legal recognition of benefit corporations is a great progress towards addressing the societal issues. Companies acting upon the mission of positive social impact and responsibility will have their social reputation and profit generating models enhanced. Despite the ambiguity of the benefit corporations and the clarity in managerial purposes, society has an opportunity to benefit from the resources and talents channeled into the corporate world.

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