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INTRODUCTION TO SPECIAL TOPIC FORUM

MANAGEMENT THEORY AND SOCIAL WELFARE: CONTRIBUTIONS AND CHALLENGES

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In this Introduction to the Special Topic Forum on Management Theory and Social Welfare, we first provide an overview of the motivation behind the special issue. We then highlight the contributions of the six articles that make up this forum and identify some common themes. We also suggest some reasons why social welfare issues are so difficult to address in the context of management theory. In addition, we evaluate means of assessing social welfare and urge scholars not to make (or imply) unwarranted "wealth creation" claims.

Over a decade ago, Walsh, Weber, and Margolis (2003) lamented the lack of attention to social welfare issues by management scholars. Using data ranging from the research topics of papers published in major journals to membership in various Academy divisions, they made a strong case that organizational scholarship had drifted from its roots—which had emphasized both the social and the economic objectives of organizations—to focus overwhelmingly on the economic objectives alone. This drift was regrettable, in their view, both because it limited the range of intellectual inquiry in organizational studies and because it meant that the findings of organizational scholarship were not being applied in ways that might result in better societies. Two years later, the *Academy of Management Journal* (*AMJ*, 2005) published a special forum on organizational research in the public interest, again calling for more consideration of social welfare in organizational research.

Both Walsh et al. (2003) and many of the authors in the *AMJ* special forum called for an integration of social and economic objectives. Neoclassical economists might have suggested that this call was/is unnecessary. A market-oriented economic system has been defended from a number of perspectives, including the protection of political freedom through economic freedom, the protection of property rights, and the honoring of contractual obligations. But an important foundational justification for the system is based on utilitarianism, the moral philosopher's term for

Lynn Stout, originally a special issue editor, also made contributions to this special topic forum. Judith Edwards contributed several editorial refinements.

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social welfare—sometimes expressed as the greatest good for the greatest number. More particularly, a version of market capitalism that closely approximates neoclassical microeconomic models of perfect competition—for example, competition based on price, a laissez-faire approach to governmental involvement in the economy, and a profit (or shareholder wealth) maximization objective for firms—is posited to produce high levels of social welfare because it puts society's resources to their most efficient uses. In short, social objectives could be assured if economic objectives were attained (Jensen, 2002).

Unfortunately, there are several reasons to doubt that this relationship is applicable in today's economy. First, as we discuss more fully below, the characteristics of modern market capitalism bear little resemblance to the conditions under which the perfect competition model assures social welfare. This divergence of conditions strongly suggests that the model's prescriptions—in particular, laissez-faire governmental policy and a shareholder wealth maximization objective for corporations—are unlikely to lead us to ever-increasing levels of social welfare.

A second and related point is that a substantial number of scholars, practicing managers, and entrepreneurs are actively engaged in making the perfect competition model even less applicable to the contemporary economy. A great deal of research in strategic management—that is, the search for sustainable competitive advantage—*depends on* market conditions that deviate significantly from those of perfect competition and, in some cases, involve an *intention* to carve out "mini-monopolies" in order to obviate competition based on price alone.[1] While it may make sense to explore means of exploiting market frictions to enhance firm profitability or start new ventures, determining whether social welfare improves is an empirical question; simply assuming that social welfare is enhanced in conjunction with improved profits is inappropriate.

Third, it takes a substantial leap of faith to conclude that some corporate actions taken to increase shareholder wealth actually improve social welfare. Consider the case of massive layoffs. These actions often do result in increases in shareholder wealth (via stock price increases), but they also result in substantial hardships—economic, social, and psychological—for the displaced workers and for the surviving workers who must take on the responsibilities of their former coworkers. Thus, it is not clear that all massive layoffs that enhance shareholder welfare simultaneously enhance social welfare, even in the long run. Indeed, Jones and Felps (2013b), using stakeholder happiness as their measure of social welfare, suggest that society as a whole may be made much worse off by massive layoffs, at least in the short run. A similar calculus could be applied to corporate practices at extreme ends of a "potential harm spectrum." Hiring contractors of questionable repute to dispose of hazardous wastes might anchor one end of this spectrum. Cutting costs by increasing wait times for customer service calls might anchor the other end. In both cases externality costs (to the environment and customers, respectively) are incurred and should be included in social welfare calculations.

Finally, the wisdom of relying on a model that focuses exclusively on alleviating economic scarcity no longer makes sense. Throughout much of history, economic scarcity was a pressing social problem, and an approach focused on addressing scarcity may have been defensible, despite the social welfare problems created in its wake. However, now that material abundance better describes aggregate outcomes in most developed economies, social welfare problems, new and ongoing, are less easily dismissed. Some of these problems have emerged with a vengeance, particularly in the United States—for example, scandals involving enormous sums of money, increasing inequality of wealth and income, underemployment, homelessness among former members of the middle class as well as the chronically poor, soaring health care costs, and a political system closely tied to the vested interests of corporations and wealthy individuals. Thus, although the market-oriented economic system has an enviable record of making its citizens collectively richer, it is increasingly questionable whether it is capable of addressing some other urgent social welfare problems that have emerged from the relationships between the economy and the rest of society.

Nonetheless, despite calls from scholars representing a range of disciplines (*AMJ*, 2005; Walsh et al., 2003) and the noble vision of the Academy of Management—"We inspire and enable a better world through our scholarship and teaching about management and organizations"—the management literature has been remarkably quiet on the role of managers and corporations in first creating and now solving the problems that threaten social

[1] While lower prices have conventionally been associated with social welfare, product variety can also be a source of social welfare benefits (Dixit & Stiglitz, 1977; Spence, 1976).

welfare. Indeed, little appears to have changed since Walsh et al. lamented an "eerie silence" in the management literature with respect to issues of human welfare at the societal level and urged management scholars to "bring social welfare back in" to their research agendas, most importantly by integrating social and economic objectives (2003: 860; 875). In this special topic forum our objective is to help fill this void by encouraging theoretical work that addresses important social welfare issues related to the activities of large corporations in the economy and of those who manage them. In a later section we will address the "eerie silence" issue.

NEW APPROACHES TO MANAGEMENT THEORY AND SOCIAL WELFARE: THEMES AND CONTRIBUTIONS

In examining the various perspectives taken by our contributing authors, two themes emerge. First, fairness and justice are argued to be important elements of social welfare; in other words, utilitarian measures of aggregate well-being—either economic (e.g., GDP) or human happiness (e.g., stakeholder happiness)—are not adequate metrics for social welfare.

In two of the included articles—Marti and Scherer (2016) and Mitchell, Weaver, Agle, Bailey, and Carlson (2016)—the authors argue that social welfare should not be understood in terms of economic welfare alone, at least not in terms of aggregate economic wealth (e.g., GDP). Marti and Scherer address the issue of financial regulation, beginning with an argument that social welfare is best seen in terms of three elements: efficiency (with a long scholarly history), stability (with a much shorter history), and justice (their main theme). Mitchell and colleagues make a case for a pluralistic view of social welfare. In the process, they find flaws in both economic welfare maximization (through shareholder wealth maximization; e.g., Jensen, 2002) and stakeholder happiness enhancement (Jones & Felps, 2013b).

Justice, Fairness, and "Many Objectives"

Marti and Scherer (2016) begin by elaborating on the argument that social science theories not only describe social reality but also shape it. With this insight in mind, they raise the vital normative question, "How *should* these theories shape our world?" In their illustrative example these authors show how financial regulation has, up to the present, focused primarily on economic efficiency, with an occasional nod to economic stability. Building on the work of Habermas (1971), they argue that social welfare has three major components: efficiency, stability, and justice. While stability has clearly taken a back seat to efficiency (witness the financial meltdown of 2008), in the perspectives of both scholars and regulators, justice has been given no seat at all. Marti and Scherer submit that a very important question should be added to the list of regulatory concerns: Does the proposed regulation make the economy more just? For management theorists this question could be distilled to how the proposed regulation of financial innovations—high-frequency trading in their example—affects top incomes and income inequality. In essence, the authors question whether social welfare is actually enhanced, irrespective of efficiency improvements and stability preservation, if the great bulk of the benefits flow to those already well off. Ultimately, they advocate an *inclusive* (as opposed to a technocratic) approach to financial regulation, one that focuses on both the ends and the means of promoting social welfare. Distributive justice, in the form of income inequality, also plays a prominent role in Cobb's (2016) contribution, discussed below.

Bosse and Phillips (2016) argue that if in our dominant theory of corporate governance— agency theory—we replaced the assumption of narrow self-interest with one of *self-interest bounded by norms of fairness*, then positive reciprocal behaviors on the part of managers could be increased and negative reciprocal behaviors could be reduced. This change in assumptions could not only enhance our ability to understand some anomalous agency theory–based empirical results but also could inspire corporate boards to base executive contracts on a well-documented human behavioral tendency—a quest for reciprocity and fairness—and achieve social welfare gains through *agency benefits,* as well as through the avoidance of destructive agency costs based on "revenge."

Finally, Mitchell and colleagues (2016) address the metaphysical specter that haunts discussions of economic welfare—namely, the question of "one" versus "many." Having more than one objective aggravates complexity in decision making, and it is not surprising that a major strength of traditional neoclassical economic theory resides in its use of a single-valued metric—that is, "happiness" in nineteenth-century utility theory

and its twin concept, "marginal utility" (measured through preference rankings and indifference concepts), later on.

How about the corporation? Do we need a single yardstick or many yardsticks to evaluate its contribution to social welfare? Jones and Felps (2013a,b) have argued that corporate action requires a single-valued objective that allows managers to make principled choices among policy alternatives and that functions as an analog to the normative maxim that managers should optimize value for the firm's equity owners. In contrast, Mitchell and colleagues maintain that adopting a multi-objective approach to managerial decision making permits the engagement of a broader array of market-enhancing preferences and market signals and allows a more inclusive process that enhances multidimensional social welfare. The authors envision an intracorporate "marketplace" in which managers engage competing objectives. They argue that invoking a single-valued corporate objective would only hamstring the virtuous process of social welfare enhancement made possible by the existence of intracorporate markets among stakeholders.

Organizational Processes

Second, several of the authors focus on the processes by which the twin objectives of economic and social welfare are enacted. Sonenshein (2016) explains how the perceived illegitimacy and equivocality of social issues act as deterrents to increased corporate attention to activities that enhance social welfare (beyond economic). Issue illegitimacy refers to perceptions that allocating resources to a particular issue falls outside of a justifiable basis for firm action, whereas issue equivocality deals with disagreement regarding the meaning of an issue, including its purpose, scope, and implications for the firm. In addition, Sonenshein's article offers a meaning-making perspective that unpacks how social change agents can overcome these impediments through linking specific tactics (framing, labeling, importing, and maintaining) to different types of social issues (convertible, blurry, risky, or safe). The author also explores the multiple levels of meanings that shape a social issue, including very macro levels, such as economic philosophies, and very micro levels, such as individuals' beliefs. One of the many novel ideas advanced in the article is that although issue equivocality is often perceived as an impediment to action, it can also provide an opportunity for social change agents to favorably shape the meaning of a social issue, thus leading to corporate actions that enhance social welfare.

At the firm level, process is also a focus of Bridoux and Stoelhorst (2016), particularly with regard to a firm's relationships with stakeholders. These authors employ relational models theory to create a hierarchy of relational modes based on their joint value creation capacity. In the context of knowledge-based firm/stakeholder endeavors, communal sharing relationships are shown to be superior to equality matching, authority ranking, and market pricing relationships. The choice among these relational modes is influenced by stakeholder perceptions of the model that are made salient by the firm's behavior. The authors also argue that there is a tendency toward market pricing when the behavioral standards of the other modes are not met.

Finally, Cobb (2016) examines employment processes and how they contribute to, or undermine, social welfare. A central social welfare concern has been the growth in income inequality throughout the world. Heretofore, most commentators seeking to understand income inequality have focused on government policy, technology, or economic explanations to try to understand the growth in income inequality. Cobb demonstrates how scholars of organization and management can contribute to our understanding of this challenge. He argues that the way managers structure the employment relationships in their organizations is a key factor in producing relative societal income inequality. His theory contains several insights suggesting fruitful further research in management, as well as public policy recommendations. For example, he demonstrates how the spread of nominally market-focused compensation practices such as pay-for-performance, external hiring, and pay benchmarking lead to greater inequality within occupations, and most starkly within organizations. While management researchers have long documented the damage such systems can do to the collaboration on which organizational performance depends (e.g., Lawler, 1971; Pearce, 1987), Cobb draws our attention to the larger social welfare costs of such systems. Similarly, he documents how different ownership forms (e.g., private equity ownership) drive the management external orientation that exacerbates income inequality. His work opens a promising new avenue of management

research and brings our understanding of organizations to bear on a central public policy concern in many countries.

We were somewhat surprised that none of the submissions addressed (1) the role that religion could play in the relationship between management and social welfare, particularly in view of the recently created Management, Spirituality, & Religion Interest Group of the Academy of Management, or (2) possible single-valued corporate objectives that include a stronger social welfare orientation (under the assumption that shareholder wealth maximization [e.g., Jensen, 2002] and stakeholder happiness enhancement [Jones & Felps, 2013b] do not exhaust the possibilities). In the former case, social welfare is inherently values based, and religions are inseparably connected to values. In addition, some religious organizations pursue social welfare through many types of programs in local communities and often worldwide, providing potential models for other organizations, including businesses. In the latter case, Walsh once called the corporate objective issue "arguably the most important theoretical and practical issue confronting us today" (2004: 349). In addition, whatever their shortcomings, single-valued objectives do have the benefit of radically simplifying both management practice and management scholarship. Furthermore, multiple corporate objectives could be interpreted to mean that the pursuit of any one of them is acceptable or, more cynically, that there is no objective at all. Given the impetus of this special topic forum, perhaps future management scholarship will address these neglected themes.

WHY THE EERIE SILENCE?

As noted above, Walsh et al. (2003) claimed that there was an "eerie silence" among management scholars with respect to issues involving social welfare. If this is still true (and we believe it is), an important question emerges: *Why* have management scholars made so little progress in addressing social welfare problems and, more specifically, integrating social and economic objectives? Here we suggest some reasons why this silence exists and, by extension, why it may emerge again, even in the wake of this special issue.

First, it is entirely possible that many individual scholars who populate our discipline believe that shareholder wealth maximization on the part of corporations does indeed lead to optimal social welfare. Although not all of these scholars are likely to be familiar with the details of the logic(s) behind this theorized relationship (e.g., Jensen & Meckling, 1976; Jones & Felps, 2013a), the shareholder wealth maximization objective remains appealing for a number of other reasons. First, as a single-valued objective, it is simple to articulate and, in theory, possible to implement (because multiple objectives cannot be maximized simultaneously). Second, it has a long history of acceptance by managers and management scholars. Third, it conforms to the mandates of financial markets—that is, "Wall Street." Fourth, social welfare issues are often thought to be the concern of government, not business. Fifth, in theory, it renders profit-motivated activity morally legitimate in utilitarian/social welfare terms.

In addition, the single-valued shareholder wealth maximization objective renders management theory–based research much more tractable and, therefore, more attractive to management scholars. Theories based on economics are certainly not "value free," as was once claimed, but the values that underpin them are widely accepted, meaning that scholars employing them rarely have to address thorny questions involving values in their theoretical and empirical work. Indeed, studies based on economics are highly amenable to the "scientific method" that conveys a great deal of legitimacy and prestige to many disciplines, including management. The assumptions of economics may not be as realistic as we might want them to be, but they render the research process much more manageable, a matter of no small concern to those of us whose careers depend on doing management research. Finally, figuring out how to assure that social welfare is improved in the context of management theory is very difficult, a topic to which we now turn.

Enhancing Social Welfare in the Economy[2]

Social welfare is broadly defined in terms of the well-being of a society as a whole, encompassing economic, social, physical, and spiritual health. Although the term *social welfare* is often defined

[2] Some of what follows is based on a utilitarian view of morality. This view evaluates acts and policies on the basis of whether they maximize certain kinds of consequences, usually couched in terms of "happiness." Utilitarianism has been criticized on several grounds, the most prominent of which is its apparent failure to account for justice—that is, its apparent willingness to allow the ends to justify the means.

more narrowly to refer to government programs that provide assistance to needy individuals and families, here our reach is longer and comports with recent efforts to gauge social welfare more broadly. For example, UN-sponsored rankings of well-being rate countries on a range of factors, including economic (e.g., GDP per capita), health (e.g., healthy life expectancy), social (e.g., social support), and moral (e.g., generosity and corruption) dimensions (Helliwell, Layard, & Sachs, 2013). Gallup[3] similarly ranks regions by well-being based on perceived social, financial, community, and physical health. Our task in this special topic forum is filling out our understanding of social welfare writ large by focusing on the role of the corporate sector.

In theory, there is an array of net benefits—benefits less costs for each individual—that is socially optimal. Indeed, there is no reason that such an optimum could not include concerns about stability and justice as well as efficiency (Marti & Scherer, 2016), or even several other dimensions of welfare (Mitchell et al., 2016). Practically, however, such an optimum would be enormously difficult to achieve even in a static world. In a dynamic world the slightest disturbance would require a new optimal array of net benefits, rendering its achievement impossible in all but a theoretical sense.

If we narrow our focus to economic variables alone, microeconomic theory (specifically, the first fundamental theorem of welfare economics) maintains that such an optimum can be achieved when a competitive equilibrium is reached. Such an equilibrium is possible only under conditions of perfect competition—for example, markets consisting of many buyers and many sellers, competition based on price alone, markets undistorted by government policies, perfect information, undifferentiated products, and zero externalities. In equilibrium, a state of Pareto optimality obtains; that is, no one can be made better off without making someone else worse off. The role of the firm in this scenario, from both practical and moral perspectives, is simple: firms should attempt to maximize profits. From a practical perspective, profits are the measure of firm efficiency and assure firm survival. From a moral perspective, profit-maximizing firms play their designated role in a "rule utilitarian" moral system that assures maximal social welfare (Jones & Felps, 2013a). Thus, the primary objective of managers is to maximize firm profits.

Unfortunately, many of the assumptions of perfect competition—many buyers, many sellers, and so forth—are violated in contemporary market capitalism and, according to the theory of the second best (Lipsey & Lancaster, 1956–1957), *all* of the assumptions must be met for optimality to be achieved. Importantly, moving closer to any one assumption (making it "more true")—for example, breaking a large firm into several smaller firms through antitrust action—does not necessarily increase, and may actually decrease, aggregate social welfare. This means that management cannot simply maximize shareholder returns and expect social welfare gains to emerge; improving social welfare has become a much more complex and less well-understood undertaking.

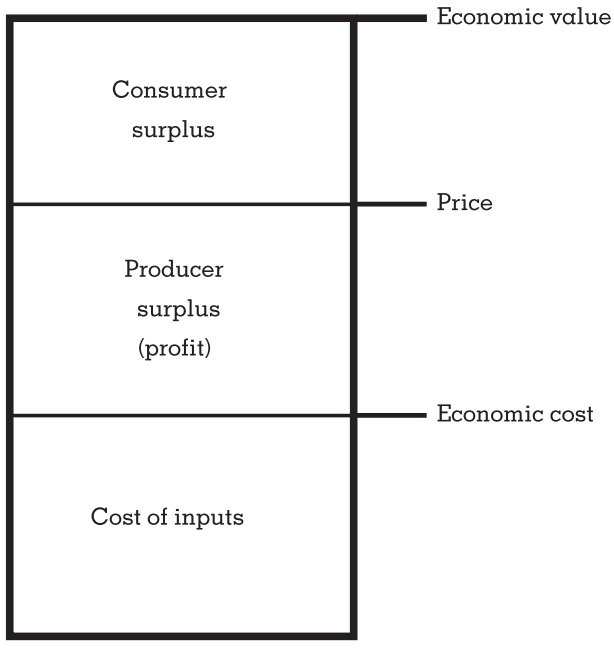
From the perspective of the principal-agent model taught to most business school students, complete contracting is assumed and shareholders are (by construction) the only residual claimants. However, in our world of incomplete and implicit contracts, there can be multiple residual claimants—that is, stakeholders (Klein, Mahoney, McGahan, & Pitelis, 2012). From this perspective as well, because managerial decisions can have an impact on multiple stakeholders, improving social welfare becomes far more complex than simply maximizing shareholder wealth.

As compelling as the arguments of Marti and Scherer (2016) and Mitchell and colleagues (2016) may be with respect to multiple dimensions of social welfare, they further complicate the task of identifying improvements (let alone optima) in social welfare. Since the components of social welfare writ large—for example, efficiency, stability, and justice (Marti & Scherer, 2106)—are incommensurable (i.e., lacking a means of making principled trade-offs), we cannot deal with multiple dimensions of social welfare *simultaneously*, making a *social* optimum a destination beyond our reach. Combined with the futility of pursuing an *economic* optimum—equilibrium under perfect competition—as discussed here, focusing on *Pareto improvements* in aggregate economic welfare becomes a reasonable approach, albeit

[3] Available at http://info.healthways.com/hubfs/Well-Being_Index/2014_Data/Gallup-Healthways_State_of_Global_Well-Being_2014_Country_Rankings.pdf?t=1449866045324.

an incomplete one since it ignores questions of justice (Marti & Scherer, 2016) and intrinsic values (Donaldson & Walsh, 2015), among others (Mitchell et al., 2016). We can make *someone* economically better off without making anyone else worse off. Therefore, in the analysis that follows, incomplete though it may be, we focus on *improvements* in aggregate *economic* outcomes—Pareto improvements—as our standard for the improvement of social welfare, as well as on improvements in firm profitability, the driving force behind many corporate actions. We will return to the issue of multiple measures of social welfare at a later point in the discussion.

FIGURE 1
The Economics of Profit Making (from Peteraf & Barney, 2003)



Pareto Improvements and Firm Profitability

As noted above, the term Pareto improvements applies to exchanges/relationships wherein one or more parties are made better off without making any other party (parties) worse off. Because one party's gain does not involve another party's loss, there is always a net gain, resulting in unambiguous improvements in economic welfare. There are three generic ways to increase firm profits (along with various combinations of the three types), each with implications for social welfare.[4] As derived from Figure 1, firms can (1) increase economic value and price while holding input costs constant, (2) reduce input costs while holding economic value and price constant, and (3) increase/reduce price while holding economic value and input costs constant. Under certain conditions, each of these profit-enhancing actions also enhances (or at least does not harm) nonshareholder stakeholders.

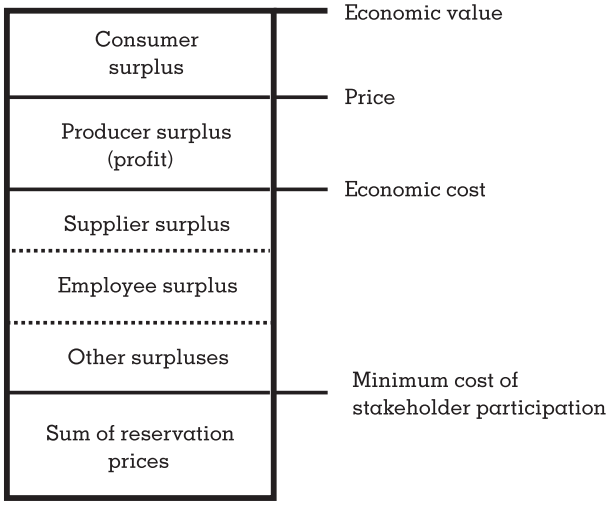
Figure 2 presents the components of economic cost in somewhat greater detail and makes explicit the participation of corporate stakeholders—for example, employees, suppliers, creditors, neighboring communities—in addition to customers (as recipients of consumer surpluses) and shareholders (as recipients of producer surplus). A reservation price is either (a) the most that a buyer is willing to pay for a good or service or (b) the least that a seller is willing to accept for a good or service. When these prices overlap, voluntary exchange can occur and, since few exchanges are made *at* the reservation price of either the buyer or the seller, both parties usually receive surpluses.

Under category 1, firms meet the Pareto improvement standard if they (1) develop new products/services or improve or differentiate existing products/services (thereby assuring market *dis*equilibrium) without increasing costs, (2) raise prices no more than the incremental economic value added, and (3) appropriate/capture no more than the incremental surplus created by price increases and/or increased volume. New wealth is created and no one is made worse off. However, if the firm, assumed to have some market power under conditions of disequilibrium, raises prices *more* than the incremental economic value created, then surpluses for continuing customers will decline, violating the Pareto improvement standard.

In addition, Priem (2007) outlines a number of ways that go beyond new or improved products/services and that allow firms to grow the

[4] Note that under equilibrium conditions, firms are *price takers*; they have no power to raise or lower their prices. Since we are dealing exclusively with conditions of economic *dis*equilibrium, firms can raise or lower their prices and will presumably do so in accordance with the price/quantity relationship of the product/service in question.

FIGURE 2
The Components of Economic Value



"top line." Noting that value creation involves the willingness of consumers to pay more for a product/service, he describes means of increasing the *use value* of a product/service so that the *exchange value* (price) can be increased, calling this the "consumer benefit experienced (CBE)" approach.

Under category 2, with economic value and price held constant, reductions in input costs that result from production cost and/or transaction cost efficiencies will result in Pareto improvements as long as the firm does not appropriate more than the savings created. However, assuming that it has power resulting from *dis*equilibrium conditions, a firm can also increase its profits by reducing the prices paid to its input suppliers, resulting in wealth *transfers* from the firm's input suppliers. No new wealth is created, suppliers suffer losses, and the Pareto improvement standard is not met. Thus, the nature of input cost reductions is critical to the link between profit seeking and wealth creation.

Under category 3, Pareto improvements can also be achieved by firms that can increase profits by reducing prices—an outcome dependent on the price/quantity relationship—while holding economic value and input costs constant, thus increasing the consumer surplus of existing customers and adding new customers. However, firms with power resulting from disequilibrium conditions may also attempt to increase profits by increasing prices. Even if profits do increase, the losses incurred by customers result in a failure to meet the Pareto improvement standard.

Recall that we elaborate on the role of Pareto improvements because, at the level of discrete economic transactions/relationships, they represent the only actions that can be definitively tied to improved social welfare. Pareto improvements *do not* represent a robust and exhaustive representation of social welfare. They do, however, reveal problems with the shareholder wealth maximization model and with the use of the term *wealth creation* in the strategic management literature, as discussed below. Since we are not able to identify an ideal criterion for improving social welfare, we use one that yields a particular form of *better* outcomes.

Externalities

Profitable actions taken by the firms that either (1) create *positive* externalities or (2) create *no* negative externalities also result in Pareto improvements. In economic analyses of social welfare in the context of shareholder wealth maximization, the caveat "no negative externalities" is usually invoked. Negative externalities result when losses are incurred by parties not involved in a given (mutually beneficial) transaction/relationship. The production of untreated toxic waste as a by-product of manufacturing processes is an obvious example of a negative externality. However, if a reasonably broad definition of stakeholder is used—one that includes *those affected by* corporate actions (Freeman, 1984)—the caveat involving negative externalities becomes redundant. Actions involving Pareto improvements will, by definition, not harm (and may benefit) those affected by the firm's actions—that is, stakeholders.

Pareto Inferior Actions

In our analysis thus far, we have focused on Pareto improvements—corporate actions that result in Pareto *superior* outcomes. The other side of the coin is Pareto *inferior* actions—those that result in losses for one or more corporate stakeholders. A short list of Pareto inferior actions should facilitate an understanding of what we regard as actions that, at a minimum, are not

unambiguously socially beneficial and, in some cases, may be socially harmful:

- employee layoffs or salary/wage cuts;
- reductions in employee benefits—e.g., health care coverage, pensions, sick leave;
- allowing "normal attrition" to overburden remaining employees;
- price concessions imposed on suppliers;
- non-price concessions imposed on suppliers—e.g., delivery schedules, payment terms;
- reduced customer service—e.g., lengthy waits for poorly trained customer service representatives, reduced warranty coverage;
- product/service price increases unsupported by cost increases;
- tax exemptions, zoning relaxation, or infrastructure improvements extracted from local communities;
- environmentally risky resource extraction practices—e.g., BP's operations in the Gulf of Mexico; and
- careless disposal of toxic wastes—e.g., tannery wastes in Woburn, Massachusetts, disposal in countries without protective regulations.

In short, a number of common corporate actions intended to increase profits certainly do not meet the Pareto improvement standard and may not improve *net* social welfare. Simply equating improvements in shareholder wealth with social welfare improvements (wealth creation), as is often done in the strategic management literature (for explicit exceptions see Klein et al., 2012, and Peteraf & Barney, 2003), is not justifiable. Unless the profit-improving action can be shown to actually improve social welfare—that is, create new *net* wealth—no conclusion to that effect should be drawn or implied.

Pareto Improvements and Other Elements of Social Welfare

While the Pareto criterion is assumed to be applied in a world in which economic exchanges are voluntary—if one party does not benefit, he or she does not make the exchange—power differentials between exchange partners make it likely that, even if no one loses, the gains of the powerful will be greater, perhaps far greater, than the gains of the less powerful. Thus, repeated applications of the Pareto criterion could result in increased concentrations of wealth, which re-raises the issue of multiple measures of social welfare.

Marti and Scherer (2016) deal specifically with the (distributive) justice aspect of social welfare. In terms of financial regulation, they argue, scholars and regulators put far too much emphasis on efficiency, too little on stability, and almost none at all on justice. In fact, a criterion based on Pareto improvements could be applied to economic policy writ large; that is, efficiency (or stability or justice) should not be improved at the expense of the other two. For example, regulatory changes intended to improve efficiency in financial markets could not be implemented if they resulted in less stability in financial markets or an increase in the Gini coefficient,[5] a measure of equality—for example, income, wealth—in the population. However, given the economic collapse of 2008 and ongoing increases in concentrations of wealth, we suspect that many citizens of Western democracies would sacrifice a fair amount of efficiency for improved stability. Those in the United States would probably prefer more egalitarian distributions of wealth and income as well.

Kaldor Improvements

Situations in which profit-generating corporate actions do not harm any nonshareholder stakeholders—Pareto improvements—far from exhaust the social welfare possibilities, however. Indeed, opportunities for Pareto improvements are likely to constitute a relatively small proportion of potential corporate actions. Nicholas Kaldor (1939) offered one means of extending Pareto improvements to include actions for which trade-offs between shareholders and other stakeholders are required.[6] If the benefits anticipated by one party are great enough to allow compensation adequate to "make whole" those who would be harmed, the policy in question would be regarded as an improvement in welfare

[5] Higher Gini coefficients connote less equal distributions of wealth or income; lower coefficients connote greater equality. Among national economies, most Gini coefficients fall in a range of 0.20 to 0.50. For example, for OECD countries, over the 2008–2009 time period, after-tax Gini coefficients ranged between 0.25 and 0.48, with Denmark the lowest and Mexico the highest. For the United States, the country with the largest population in OECD countries, the after-tax Gini coefficient was 0.38 in 2008–2009.

[6] Some economists believe that Kaldor's extension of the Pareto criterion should be applied only at the macro level (e.g., governmental regulations). We see no reason that it cannot be applied at the corporate policy level as well.

and desirable under Kaldor's criterion.[7] Although Kaldor's formulation involves only *hypothetical* compensation, it is sufficient to meet the standards of many forms of utilitarianism—that is, those that focus solely on aggregate economic welfare, without regard for the distribution of harms and benefits. As long as the "winners'" gains exceed the "losers'" losses, utilitarian standards are met. Those whose wealth/income is dependent on shareholder returns would become richer owing to "efficient" (but uncompensated) wealth transfers from nonshareholder stakeholders, who would become progressively poorer.[8]

Indeed, repeated applications of the Kaldor criterion could result in even more rapid increases in concentrations of wealth/income than repeated applications of the Pareto criterion. Under Pareto, there are no losers; under Kaldor, not only are there losers but they are uncompensated. In addition, the Pareto approach has the advantage of being based on voluntary exchanges, while the Kaldor approach could be highly coercive. Although the Kaldor criterion would seem to be an improvement on the apparent current "social welfare" criterion (i.e., shareholder wealth creation *is* wealth creation) because corporate actions resulting in reductions in net social welfare are not allowed, the distributive justice implications remain very significant. For these reasons we do not endorse Kaldor improvements as an alternative to Pareto improvements.

Perhaps because Kaldor was concerned only with hypothetical compensation, *actual compensation* of those harmed by corporate policies—that is, wealth transfers, externalities—has never been seriously considered. Nor is it surprising that such harms do not play a role in attributions of economic efficiency that accrue to profit-maximizing corporate behavior. However, the fact that we rarely calculate the extent of harms caused by specific corporate policies, let alone compensate those harmed, does not diminish the harms themselves. And because the Kaldor criterion is itself fraught with thorny problems both theoretical and practical (e.g., Layard & Walters, 1978; Sidak & Spulber, 1996; Williamson, 1996), we cannot endorse a criterion such as *Kaldor improvements with compensation*.[9] We do, however, suggest that, given the problems with other options—equating shareholder wealth creation with wealth creation/social welfare improvement, Pareto improvements, and Kaldor improvements—such a criterion might represent an intriguing line of inquiry for future exploration,[10] but one that is far too complex to examine with any thoroughness here. To sum up, the assessment and measurement of social welfare and, by extension, the relationship of social welfare to management theory are not problems for which easy solutions are apparent.

CONCLUSIONS AND IMPLICATIONS

The most striking conclusion that can be drawn from the six excellent articles that make up this special topic forum and our own examination of the role of social welfare in management theory is that assessing and measuring social welfare is a very complex and difficult undertaking. One theme that emerges from the included articles is that social welfare cannot be understood in terms of economic efficiency alone. Two articles (Marti & Scherer, 2016; Mitchell et al., 2016) directly address this issue, and a third (Cobb, 2016) addresses it implicitly. Marti and Scherer (2016) and Cobb

[7] What we have called the Kaldor criterion is often referred to in the economics literature as *Kaldor-Hicks efficiency* after Kaldor and John Hicks (1939), who added the provision that those potentially harmed by an action could (in theory) pay the potential actor not to proceed with the action.

[8] Some commentators (e.g., Hartman, 2006; Smith, 2012) believe that this process is already well underway.

[9] On its face, compensating nonshareholder stakeholders for wealth transferred to producer surplus (Figure 2) makes no sense. If producer surplus is used to compensate nonshareholders for their losses, there is no net gain in producer surplus. Indeed, this sort of wealth transfer is a zero-sum game; that is, producer surplus increases (approximately) equal (nonshareholder) stakeholder surplus decreases. It appears that no new wealth is created. However, when producer surplus (profit) is translated into shareholder wealth, this is no longer true. Because price/earnings (P/E) ratios for corporate shares are almost universally greater than 1 to 1 (among S&P 500 firms, P/E ratios averaged from 13.01 to 16.66 in the period from September 2011 through December 2012 [ycharts.com, 2013]), shareholder *wealth* gains—share price increases—are likely to be greater than stakeholder losses, leaving resources available to compensate harmed stakeholders. *Importantly, compensation must be paid in company stock*. An unpublished working paper authored by two of the special issue editors of this special topic forum, entitled "Sustainable Wealth Creation" (Jones & Freeman, 2013), begins an exploration of this possibility.

[10] To paraphrase Williamson (1996: 1014), to argue that an approach is flawed does not establish that there is a superior feasible alternative. All feasible options may be flawed, and choices must be made from the feasible alternatives (Williamson, 1996).

(2016) focus on issues of distributive justice, while Mitchell et al. (2016) make it clear that there are multiple values worth preserving. Unfortunately, assessing social welfare in terms of multiple incommensurable measures is well beyond our current capabilities. As a result, we focused on economic welfare first and took distributive justice into account after the fact.

In terms of economic welfare—that is, wealth creation—alone, we examined three possible approaches to improving social welfare and speculated on a fourth. First, we concluded that the current practice of equating shareholder wealth improvement with social welfare improvement—explicitly or implicitly—should be abandoned in both management theory and management practice. The assumptions on which the model that supports this conclusion is based bear no resemblance to the realities of twenty-first-century market capitalism. Furthermore, many actions taken by corporate managers to improve company profits harm nonshareholder stakeholders of the firm. The losses must simply be absorbed by these stakeholders. Indeed, they are rarely, if ever, measured or counted in calculations of economic efficiency. For this reason it is likely that some of these actions do not result in net improvements in social welfare, and some may actually result in social welfare losses. Furthermore, in many cases, because shareholders gain at the expense of other stakeholders, distributions of incomes and wealth become increasingly unequal, a distributive justice concern. Finally, actions taken under the banner of shareholder wealth improvement are fundamentally coercive; that is, the losses of nonshareholders are not voluntarily accepted.

The one approach that yields unambiguous improvement in social welfare, at least with respect to the discrete action under consideration, is the Pareto improvement criterion. Making someone better off without making anyone else worse off does improve social welfare. However, corporate actions for which there are winners but no losers make up a relatively small proportion of all such actions, meaning that the Pareto criterion cannot be widely applied. Furthermore, although voluntary economic exchanges, by definition, improve the welfare of both parties, differences in bargaining power may mean that repeated Pareto improving exchanges lead to increasingly unequal distributions of income and wealth. Nonetheless, no coercion is involved in the voluntary exchanges that underpin Pareto improvements.

Employment of the Kaldor improvement criterion holds the possibility of obtaining actual social welfare improvements for a full range of corporate decisions. If winners could (hypothetically) compensate losers for their losses and still register gains, social welfare would be improved. The hypothetical nature of this criterion is a key element here. As long as no actual compensation is involved and the gains of the winners exceed the losses of the losers, the Kaldor criterion is satisfied. And although greater economic efficiency is achieved, distributions of income and wealth are likely to become substantially more unequal. In addition to this distributive justice concern, Kaldor improvements clearly involve coercion; losers do not accept their losses voluntarily.

An approach that we represented as an "intriguing line of inquiry for future exploration" might be called Kaldor improvements with compensation. Because this approach is laden with thorny theoretical and practical problems, a full exploration of the prospects for this criterion would involve an analysis well beyond the scope of this article. However, other scholars might give this possibility further consideration, particularly in view of the fact that shareholder wealth gains are measured in share price increases, which grow in proportion to the P/E ratio of the firm's stock (usually 10-1 or more) rather than in direct proportion to stakeholder losses. If this relationship holds, ample resources could be made available to compensate (in company stock) those harmed by actions taken to increase shareholder wealth.

We note that two of the articles included in this special topic forum appear to be based on Pareto improvements, the one social welfare criterion that can be unambiguously linked to social welfare improvement. Bridoux and Stoelhorst (2016) show that communal sharing firm/stakeholder relationships are more efficient than other relational modes. Since no other stakeholders appear to be harmed, the Pareto criterion is met. The same conclusion can be reached with respect to the Bosse and Phillips (2016) article. Introducing notions of fairness and reciprocity into the contracting process involving the firm's board and its top executives could result in reduced agency losses and possible agency benefits in corporate governance. No stakeholder group appears to be

harmed in this revised process, again meeting the Pareto improvement criterion.

In terms of the implications of this special topic forum in general, and of this introduction in particular, we offer the following. With respect to management scholarship, Marti and Scherer (2016) remind us that our theories not only describe social reality but also shape it. With this caveat in mind, we strongly urge management scholars to take social welfare considerations into account in their theorizing and empirical research. This consideration could take the form of a thoughtful assessment of the social welfare implications of their work; relying on the assumption that increasing shareholder wealth invariably leads to social welfare advances can no longer be justified. The same recommendation applies to practicing managers as well; Friedman's (1970: 124) claim that "the social responsibility of business is to increase its profits" cannot be taken as gospel any longer. In addition, we hope that management scholars will be inspired to directly address social welfare concerns in their theory building and empirical studies. If they do, we need not experience another "eerie silence" with regard to social welfare issues in management research once the dust settles on this special topic forum. And if theories do shape social reality, as we believe they do, the "better world" envisioned by the Academy of Management may begin to take shape.

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