＜論　　説＞

Values Realization Model of the Firm

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Abstract

The theory of the firm in economics regards a private enterprise as having a profit-maximizing function. In other words, the economic model of the firm assumes that the object of the firm is profit maximization. Although this economic model is very clear, it is so simplistic that it assumes that private firms fulfil the production function in a market. The counterpart of the firm in a market is the consumer which is hypothesized as utility maximizing entity in economics.

This economic model is useful for explaining or understanding of the market mechanism and the role of the firm as a whole. However, that model cannot explain the behaviour of each private enterprise concretely. To begin with, each private enterprise cannot actually pursue the maximization of profit because of bounded rationality[1].

In this paper, I propose the Values Realization Model of the firm, which assumes the corporate object is to realize values as widely as possible. In this model, profit is not regarded as the final goal but the means for survival or for realizing values. In summary, it is hypothesized that values realization is the final goal of each private enterprise in this model.

1. The Purpose of this Paper

The purpose of this paper is to explain the importance of the Values Realization Model of the firm. In modern industrial society, the Profit Maximization Model has been so dominant. However, many aspects of a firm's actual behaviour show the importance of the Values Realization Model. In biology, for example, we may assume every living thing's purpose is to retain its population numbers. It is roughly useful for explaining almost every living thing's behaviour. However, it is too rough a hypothesis to explain each living thing's personal behaviour. Although no living thing can survive without eating, surely eating is not the purpose of life.

In the same way, surely any private enterprise cannot survive without profits. However, profit -making is not the final goal for each private enterprise. I think profit-making is not the purpose but the means for survival. Furthermore, each private enterprise wants to survive to realize its own values as widely as possible. This perspective is more explicable than the profit maximization hypothesis for the actual behaviour of the firm

In order to explain the realistic behaviour of the firm, several theories have been constructed. For example, the Creating Customer Model which assumes the corporate objective is creating its own customers who are contributing to the expansion or maximization of its market share（P. F. Drucker）. Otherwise, there is the Revenue Maximization Model, which assumes the corporate objective is the maximization of revenue（W. Baumol）. Furthermore, there is also the Growth Maximization Model, which assumes the corporate objective is to maximize the growth rate（R. Mariss）instead of the profit.

However, we can understand that each private firm regards gaining customer, market share, revenue or growth rate as much more important than profit, because of its tendency towards realizing its own values as wide as possible.

After assessing several theories of the firm, we will discuss the Value Realization Model.

2.　Existing Business Management Models of Private Enterprises

（1）　Profit Maximization Model - The theory of the Firm in Economics

This model is so clear and simple that if one takes the differential calculus by quantity, $d\pi/dq = dpq/dq - dC/dq = 0$, the condition of the degree of the tangent slope is zero, showing profit maximization. This condition means price equals the marginal cost. If we find the most efficient company set the price very near the marginal cost, but only after the competitive action. However, no one knows the demand curve before undertaking marketing behaviour. Therefore, each private firm cannot chase the maximization of profit. Actually, any private firm cannot realize profit maximization because of the uncertainty in demand.

This Profit Maximization Model is the most classical and simplest model that is useful for understanding the total concept of the firm as a production unit. This is a part of the model of the market mechanism that realizes the most efficient distribution of social resources, as long as free competition among many small private firms exists.

However, this model cannot explain the actual corporate behaviour because of some limitations. In the first place, any private firm has only bounded rationality. Therefore, under uncertain circumstances, no private firm can accomplish profit maximization.

In second place, the modern capitalized market is controlled by a small number of large companies. Therefore, the competitive function does not work completely. We cannot discuss modern industrial society on the assumption that perfect competition exists. The oligopolistic market rather than the perfect competitive one is popular in the modern industrial society, and oligopolistic competition cannot necessarily realize the most efficient distribution of social resources.

Thirdly, some important actual behaviour of each private enterprise cannot be understood by the Profit Maximization Model. For example, some companies sometimes act in a high-risk and not so high-returning way. Moreover, in some serious situations, some companies take the difficult way rather than the easier way to obtain the profits. We can consider that each firm has its own purpose or mission besides profits.

The Profit Maximization Model is such a clear model that it ought to be useful to explain the market mechanism simply. For this reason, that model has had such big influence on various societies including business society itself. Nevertheless, the Profit Maximization Model is may be useless for explaining the realistic behaviour of each private enterprise.

Therefore, some other business management models are proposed.

(2) Creating Customer Model by Peter F. Drucker[2)]

P. F. Drucker considered that the most important mission of business executives is developing the potential needs or markets. These activities serve for the utility of consumers. The business executive is in a position where he could integrate various resources to make something of use and value. If the executives realize the utility of the goods or services by integrating their capital, manpower, materials, information and experiences, the potential needs of consumers would be apparent, and therefore the potential market would be a real market.

This business behaviour creates the new markets or expands the existing markets, which means creating new customers. Therefore, Drucker insists that the object of the firm is creating customers. This hypothesis which considers that the final object of the firm is creating customers is useful to some extent to explain the actual behaviour of some private entities.

However, we cannot help asking why a firm wishes to create its own customers? Is it to ensure reliable generation of profits, or for its social prestige? I assume that is because of realizing its own values or ideas as widely as possible.

(3) Revenue Maximization Model by William Baumol[3)]

W. Baumol hypothesized that each private enterprise pursues revenue maximization because the chief executives usually get increased social prestige according to the scale of revenue. This model regards the final goal of company as revenue maximization or maximizing the growth rate of revenue. This model is more realistic than the economic one.

However, this model cannot explain some business behaviour. For example, some companies in the high-tech information industry sacrifice revenue to pursue market share. Winning the dominant design of products is the crucial factor for future long-term profits.

If such companies can obtain a major market share, they can enter the mass production stage and realize rapid cost reductions through increased experience and economies of scale. The constant innovation in a high-tech industry makes any company in such industry always seek to expand its market share. Furthermore, expanding market share contributes to building up the power of their brand image directly.

（4） Growth Rate Maximization Model by Robin Marris[4)]

R. Marriss hypothesized that a private enterprise pursues the maximization of the growth rate. Mainly, he analyzed the case of Japanese companies from the 1960s to the 1970s. In this era, many Japanese companies were growing rapidly. However their equity ratio was extremely low. Roughly speaking, the equity ratio of Japanese big production companies in the 1970s was not more than 20%, which was only a half or a third of American companies at that time.

The Growth Maximization Model is a persuasive hypothesis for high leverage business behaviour, which realizes rapid growth in conditions of prosperity. However, this model cannot be accepted in a depression, because many companies attempt to survive instead of growth at such times.

Therefore, this model is not necessarily a universal hypothesis. Actually, the equity ratio of recent Japanese production companies is close to 50%. This trend shows that companies are considering that financial safety is more important than capital efficiency. It means that they regard survival as important instead of growth.

3. Proposition of the Values Realization Model

（1） The outline of the Values Realization Model

The Values Realization Model hypothesizes that any private enterprise intends to realize its values or ideology as widely as possible. In this model, making profits is not recognized as the final goal of the firm but a means to realize its values or ideology. Similarly, creating customers, obtaining the revenue, raising up the growth rate or expanding the market share, all of these activities can be recognized as means to realize the values of the firm widely.

In some excellent companies, especially their values or ideology takes on the character of public spirit such as improving common welfare, progressing technology, resolving some environmental problems and so on.

Some private enterprises sometimes slip up on moral hazards. For example, they make some seriously defective goods or harmful goods intentionally. These hazards are usually concerned with over-prioritizing profits. In other case, too cheep employment or harmful exports may arise because of prejudice against the class of worker or foreigners. In any case whether good or bad, these issues can be realized as the values or ideology of the company.

(2) Is the Model Descriptive or Normative?

The Values Realization Model that is proposed is a descriptive model. I would like to maintain that we can understand that any private enterprise has its own values or ideology that leads to certain business behaviour. Usually, almost companies have motivations for profit and growth. However, their values influences how they accomplish the obtaining of profit or growth.

Surly, any private enterprise cannot survive without profits. Therefore, any company pursues profits. However, we can observe a variety in behaviour as regard how to obtain the profit. Moreover, we can observe different behaviour after making sure of the firm's profit or position. This variety is produced by the different approaches to the firm's values or ideology. In summary, it is the values or ideology that determines the business behaviour and motivates the company.

For example, a company that puts too great an emphasis on economic profits may make excessive cost savings and that may lead to serious troubles or illegal activities. Alternatively, a company that regards growth as important may diversify its business domain aggressively.

Furthermore, after the success of their business behaviour, their values or ideology influences how they spend their money and exploit their position and how they utilize their resources. In summary, a values or an ideology influences for both the process of how to attain the objectives and what those objectives actually are. Therefore, We can understand that private enterprises attempt to realize their values or ideology by both these process.

On the other hand, it is part of the normative discussion that a company has to hold a sound values or ideology. For example, any company must have a service spirit or a public spirit, any company must behave as a social stakeholder and so on. To put it another way, a company should not hold too selfish an ideology, nor emphasize profits too much. These discussions arise from values judgement. We can consider these normative models of the firm's Ethical Model which are introduced by normative judgement to be the social responsibility of the firm or stakeholder discussion.

4. Existing Discussions about Business Ethics

(1) Negative Theory for Business Ethical Behaviour

The most famous theory that insists that the firm must pursue only business profits without any other ethical purpose is the theory by Milton Friedman[5]. He said that a private corporate executive has responsibility only to stockholders as owners of the company. Therefore, in a free enterprise, private-property system, the social responsibility of a business firm is to increase its profits.

Surely, in a free competitive market, a more profitable company may contribute more to society. Because consumers prefer higher utility goods to lower ones, a company that can produce the higher utility can obtain more profits.

The profits pursuing activities of competitive companies may progress effective or efficient production systems, effective or efficient distribution systems and so on. If a company cuts down its costs by fraudulent methods, that may result in defects or faults with products and decrease its future profits. Therefore, a desire to increase its profits is compatible with the social responsibility.

Moreover, M. Friedman insisted that if a corporate executive pursued any other ethical purpose than increasing profits, for example the improvement of culture or the environment, he reduces returns to stockholders, and he is spending their money.

（2） Positive Theory for Business Ethical Behaviour

The representative theory on the opposite side of M. Friedman, which is constructed by Kenneth J. Arrow, explains that individual ethical activities progress economic efficiency as a whole[6]. K. J. Arrow mentions several reasons for social inefficiency of unrestricted profit maximization behaviour by each private business entity.

The first reason is the oligopolistic condition of the modern market. In this condition, as a small number of companies occupy the market, consumer options are narrow. In such a bound competitive condition, inefficient or injurious company is able to survive to some extent. Arrow also implies that free competition soon brings about an oligopolistic condition. Therefore, we cannot expect that profit-maximizing behaviour realize the social efficiency.

The second reason is external diseconomies. Although vigorous competition may bring about pollution or congestion, no one will pay for such a social cost. Therefore, profit maximization does not necessarily realize efficiency.

The third reason is asymmetrical distribution of information between the parties to an exchange. Arrow explains that the firm is frequently in a better position to know about the conditions or consequences of various goods or service than the buyer. This inequality of information is apt to induce injurious activity, for example hiding some risk of use or being deceptive about harmful effects and so on. In this condition, profit maximization is not socially desirable.

Moreover, Oliver E. Williamson also points out that the small numbers of transactions and asymmetrical distribution of information is apt to induce opportunistic behaviour[7)].

These social losses or opportunistic behaviour that are derived from profit maximization, can be surely restricted by government administration or legal regulation. However, the cost of observation or administration is inevitably accompanied by governmental restrictions. In addition, frequent litigation must be recognized as other social cost.

Arrow insists that recognized ethical codes can make a great contribution to economic efficiency. If ethical codes or rules are widely accepted, any firm or individual could obtain sound materials, goods or services at a reasonable price, and consequently the social efficiency would be greatly enhanced. These phenomena have already been pointed out by Max Weber in his book, The Protestant Ethics and Sprits of Capitalism[8)].

5. Case Studies of Excellent Japanese Companies

(1) Mitsubishi Corporation

We can confirm the existence of a desire for corporate values as well as profit making at the time the company was founded by investigating the case of the Mitsubishi Corporation.

The Mitsubishi Corporation was founded by Mr. Iwasaki in Japan in 1873 and clearly intended to exclude foreign shipping companies in those founding days. Iwasaki believed that Japanese modern industries could never progress if Japan depended on the mailing system of the foreign shipping companies. Therefore, Mitsubishi entered into keen competition with the Pacific Mail Company (U.S.) and P&O Company (U.K.). After two years of competition, Mitsubishi dominated every Japanese coasting service, moreover it occupied a part of China sea lines.

We can conclude that Mitsubishi certainly held the values of its business that was supporting to national independence through its corporate activities.

(2) Hitachi Corporation

The Hitachi Corporation, which was founded by Mr. Odaira in Japan in 1920, made heavy electric machines. Odaira held the ideology of creating original Japanese technology. Hitachi took the risky way, instead of the easy profitable way. They made big efforts to build up their original technology without co-operation with foreign companies.

In the period of the Great Kanto Earthquake of 1923, Odaira decided that Hitachi must devote all its energies to the reconstruction of the Kanto area, including Tokyo city. Tokyo Shibaura electric company (Toshiba at present), in the Tokyo-Yokohama area was one of the largest companies to suffer serious damage from the earthquake. Seriously damaged companies in these areas could almost not order necessary machinery at the normal price. On the contrary, the orders from the Osaka-Kobe area were at a high price. However, Odaira kept refusing all of the profitable orders from the Osaka-Kobe area throughout the reconstruction of the Tokyo-Yokohama area, because of concentration on the reconstructing.

Through this period, original technologies by Hitachi were widely accepted by the government and many companies. Surely, we can confirm the existence of the ideology or values of the firm besides profits-making in this case. Even now, Hitachi regards fundamental research as important to build up their original technologies. Nowadays, Hitachi is one of the most creative companies in the high-tech industry in the world.

(3) Panasonic (former brand of Matsushita Electric Company)

Panasonic (Matsushita Electric Company) was founded by Mr. Matsushita in Japan in 1918, and has been made various electric instruments. Matsushita had the ideology of improving public welfare by developing home electric goods.

In the 1950s, as an electric refrigerator was very expensive, the average Japanese family seldom had an electric refrigerator. Therefore, some unlucky children were poisoned by perished foods every summertime.

After serious efforts, Matsushita developed reasonable priced refrigerators by using the mass production system learned from the Moving Assembly Line of the Ford Motor Company. The production system which is famous as the Ford system, could obtain economies of scale by setting up the large-scale standardized parts in a short time. This mass production system could cut down the considerable cost of manufacturing and accomplished cheaply priced refrigerators. These refrigerators were widely adopted by average families. Of course, Matsushita obtained great profits. However, Matsushita held the clear sense of saving many children who would construct the future nation.

6. How to cope with Both Social Responsibility and Profit Making ?

(1) Comprehending the Values Realization Model as a Descriptive Hypothesis

In the first place, it is necessary that we recognize that the Values Realization Model is a descriptive hypothesis. Although we can usually observe any firm pursuing profits, we cannot conclude that pursuing profits is the final goal of the firm.

We can understand that the ultimate or real goal of the firm is realizing its values or ideology by considering profit and profit-making activity from two perspectives. First profit-making activity itself is a reflection of its values. The values or ideology reflects how to obtain profits. For example, from the selection of a business domain to which way to cut costs, reduce the workforce, increase investment or diversify, the company takes decisions that seek to increase profits.

The second perspective is how to expend its profits after the firm has obtained them. The values of the corporation relates to how it spends its profits. For example, how much it expends on stockholder dividends, workers‘ wages, equipment investment, R&D costs and charities.

Of course, as business management is a going concern activity, the two perspectives circulate mutually. However, we can guess what values or ideology a company holds by considering its approach in these two areas.

(2) Diffusing the Sound Values of the Firm

In order to make profit-making activity compatible with social responsibility, it is important that the sound values or ideology is diffused widely. The Profit Maximization Model is apt to make the firm slip down to the unsound values of overemphasizing profits, because of its legitimization of unreserved profit-pursuing activity.

The argument for the firm's additional responsibility for society does not win over the superficial, momentary or evasive resolution, until the firm realizes its position as a stakeholder of society. In this sense, the Values Realization Model is so useful as a tool for infiltrating stakeholder consciousness into the firm, combined with the case that a corporate values or ideology usually reflects on its behaviour, performance and survival.

In summary, we can consider that inadequate business activity, such as an overemphasis on pursuing profits to the detriment of sound social responsibility, just comes from valuing the overemphasis of profit. Moreover, several cases of long-surviving excellent companies suggest that an anti-social values such as over-emphasis on profits will break its own business and the profit itself.

Therefore, the Values Realization Model will be able to progress the social responsibility of the firm.

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