

LITERATURE REVIEW

Corporate Finance and Shareholders vs. Stakeholder Capitalism: A Review of Milton Friedman's "The Social Responsibility of Business Is to Increase Its Profits"

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Abstract

Milton Friedman argues that the responsibility of business is to maximize profits for shareholders, and that managers should not divert company resources toward social responsibility because that role belongs to government and individuals, not the corporation. Friedman's 1970 paper became the foundation for shareholder primacy for decades and remains the default position that stakeholder-theory and ESG advocates argue against today. Since the 1970s, the business environment has changed substantially: corporate rhetoric has shifted toward stakeholder inclusion, ESG investing has grown sharply in scale, and new disclosure rules require companies to report ESG-related information. This review evaluates what these changes actually demonstrate, distinguishing evidence of changing norms and rhetoric from evidence about financial performance, and argues that Friedman's framing is too narrow for the present day even though the empirical relationship between ESG and firm value remains genuinely unsettled.

Keywords: Shareholder Primacy; Stakeholder Theory; ESG; Corporate Social Responsibility; Milton Friedman; Greenwashing

1. Introduction

This paper matters because it became one of the most influential arguments in business ethics, shaping the rules in companies around the idea of shareholder primacy. This paper was published in 1970, when environmental issues weren't widely known to affect businesses and when ignoring social issues did not hurt the image of companies. This raises the question: is a business's responsibility only to generate profit for shareholders, or do businesses also need to address social and environmental issues that affect their finances and image? The purpose of this review is to determine whether the social responsibility of corporations to only focus on generating profit for shareholders still holds fifty-six years later. This paper evaluates whether the assumptions, methodology, and conclusions remain valid in the light of

developments between 1970 and 2026, while being careful to distinguish what different kinds of evidence can and cannot establish.

2. Summary of Original Paper

Question: Is a business's responsibility only to generate profit for shareholders, or do businesses also need to address social and environmental issues that affect their finances and image?

Sample: Philosophical essay; Friedman presents a logical argument rather than an empirical study.

Method: No method. Friedman's reasoning for his argument was that managers are employees of shareholders, so spending money on social and environmental issues was spending someone else's money without their consent.

Conclusion: Businesses should focus on generating the most profit while obeying the law and following basic ethics. Social responsibility belongs to individuals and government.

Contribution: Foundation for shareholder primacy when corporations shape rules and reference points for arguments in business ethics.

3. Literature Since Publication

After Friedman's view on the social responsibility of business, his paper became one of the most referenced points when arguing business ethics. People increasingly challenged Friedman's narrow view on a business's responsibility. Freeman and McVea (2001) argue in "A Stakeholder Approach to Strategic Management" that businesses succeed by creating value for all stakeholders, and not just shareholders. Freeman believes that to make profit, you need to create value for every single person that is connected to the company, whether it's employees, community, government. They believe that businesses depend and rely on many groups, and if corporations don't have these people, the company will not have value. Jensen (2001), in "Value Maximization, Stakeholder Theory, and the Corporate Objective Function," positions himself between Friedman and Freeman. Jensen tries to combine both of their ideas in his paper. The paper's main idea is that companies should maximize long-term value, but they must pay attention to stakeholders to achieve this goal. He proposes the "enlightened value maximization," which means to maximize the long-term value of the corporation and support stakeholders who help create that value. These responses show that business is not just based on what is going on statistically or financially, but outside forces like social issues also shape a corporation's long-term performance. That is not to say that corporations should give their full attention to social or environmental causes over profit, but they should have a balance between financial goals and stakeholder relationships because that is what really creates long-term value for companies.

Beyond this theoretical debate, scholars have tested directly whether stakeholder-oriented business practices are associated with financial performance. Friede, Busch, and Bassen (2015) conducted a large-scale meta-analysis combining more than 2,000 individual empirical studies on ESG and corporate financial performance, published in the *Journal of Sustainable Finance & Investment*. Their results found a statistically significant positive association between ESG performance and financial performance overall — an empirical finding about correlation, not proof that ESG causes stronger performance, but one that lends some support to Jensen's claim that attending to stakeholders can help long-term value. Li, Tang, and Li (2024), in a study published in *Frontiers in Sustainability*, looked at 792 listed companies in environmentally significant industries between 2019 and 2021, using multiple regression analysis, and

found a positive association between ESG scores and corporate performance as measured by return on equity (ROE) and return on assets (ROA).

Al-Tarawneh, Tayeh, Iskandrani, and Obeidat (2024) studied 188 non-financial firms listed in the UK from 2015 to 2023, using panel regression and Generalized Method of Moments (GMM) estimation to control for endogeneity, and found a significant negative relationship between ESG scores and Tobin's Q, suggesting that higher ESG ratings were associated with lower firm valuation in this specific sample. This directly contradicts the positive associations found by Friede, Busch, and Bassen (2015) and Li, Tang, and Li (2024), which is itself an important finding: it shows that the empirical relationship between ESG and financial performance is not settled, and likely depends on sample, time period, and how ESG is measured. Researchers studying this question have noted that using inconsistent ESG measurement systems across studies makes it difficult to compare results and draw firm conclusions about how ESG affects financial performance.

4. What Has Changed

As of 2026, several things have changed regarding the responsibilities of corporations, though each type of change demonstrates something different and should not be treated as interchangeable evidence for the same conclusion. First, there has been a clear shift in corporate rhetoric and stated purpose. In 2019, the Business Roundtable (2019) publicly redefined the purpose of a corporation to include stakeholders alongside shareholders, challenging the shareholder-primacy model Friedman described. This statement demonstrates that corporate leaders' stated values and public commitments have shifted since 1970; it does not, on its own, demonstrate that stakeholder-oriented management produces better financial outcomes than shareholder primacy did. Second, the scale of ESG-oriented investing has grown substantially. According to Bloomberg Intelligence, global ESG assets under management grew from roughly \$22.8 trillion in 2016 to around \$41 trillion in recent years, nearly doubling in less than a decade. This growth demonstrates that investors are increasingly choosing to allocate capital using ESG criteria; it does not by itself demonstrate that ESG-oriented investing produces superior returns, since investors can act on a belief or preference regardless of whether that belief is empirically justified. Third, regulatory attention to ESG has increased. The EU's Corporate Sustainability Reporting Directive and the U.S. SEC's climate risk disclosure rules now require many companies to formally report ESG-related information (though it is worth noting the SEC has since proposed rescinding its climate disclosure rules, showing this regulatory attention is not fixed or one-directional). This demonstrates that regulators increasingly treat ESG-related information as material enough to require disclosure; it does not demonstrate that the underlying ESG performance being disclosed actually predicts financial outcomes. Fourth, and separately from all of the above, empirical studies asking directly whether ESG performance is associated with financial performance have produced mixed results, as discussed in the previous section. This is the only category of evidence that speaks directly to whether attending to stakeholders improves firm value, and it remains genuinely unresolved. Together, these four types of change show that ESG has become more central to how businesses talk about themselves, how investors allocate money, and how regulators oversee disclosure, but they do not, on their own, resolve whether Friedman's core empirical assumption (that a firm best serves everyone by focusing narrowly on profit) is wrong.

5. Counter-Evidence

While the previous section shows that Friedman's separation of business and social responsibility no longer matches how markets, regulators, and corporate leaders talk about the firm, this does not mean his underlying argument has been empirically disproven. Not all studies support a positive link between ESG performance and firm value. Al-Tarawneh et al. (2024), studying 188 non-financial UK firms from 2015–2023 using panel regression with GMM estimation to control for endogeneity, found a significant negative relationship between ESG scores and Tobin's Q in that sample. This directly contradicts the positive findings from Friede, Busch, and Bassen (2015) and Li, Tang, and Li (2024) discussed earlier.

A separate challenge concerns whether ESG disclosures accurately reflect real corporate behavior in the first place. This is called greenwashing, where companies make their environmental and social efforts seem better than they really are in order to impress investors and the public (Yu, Luu, and Chen 2020). If some firms' ESG scores or disclosures do not accurately reflect their actual practices, then studies relying on those scores may be measuring perception or disclosure quality rather than genuine stakeholder-oriented performance. This matters for how the mixed empirical findings above should be interpreted. Some of the positive associations between ESG scores and financial performance could partly reflect that better-resourced companies produce more polished ESG reporting and disclosure, not necessarily that their underlying practices create more value. This review returns to greenwashing as an interpretive limitation later, since accurately measuring it is a serious methodological challenge in its own right.

ESG and stakeholder capitalism have also faced political opposition in the United States. Since 2021, Republican-led state legislatures have introduced many anti-ESG bills that limit the use of ESG factors in public pension funds and state contracts. In 2023, about 165 anti-ESG bills were introduced across 37 states, and 14 states passed new laws (Lichtenstein et al. 2024). These laws mainly require public pension funds to make investment decisions based only on financial considerations, echoing Friedman's argument that investment decisions should focus only on financial returns. This shows that Friedman's shareholder-primacy theory still has real political and institutional support today, and that the shift away from his framework is contested rather than settled.

6. Critical Evaluation

Milton Friedman's paper has many strengths, but the biggest one is its influence. It became one of the most-referenced points in business ethics and is still used and responded to decades later, as shown by Freeman and McVea (2001) and Jensen (2001) each building their own theories partly in response to it. Friedman's argument is also internally logical: he treats managers as employees of shareholders and assigns them a single, measurable objective (profit) rather than the more complex, harder-to-evaluate set of obligations that stakeholder theory can create.

Friedman's paper also has clear limitations when evaluated against today's evidence, though these limitations are narrower than "Friedman has been proven wrong." Jensen (2001) criticizes Friedman's narrow framing directly, arguing that ignoring stakeholder relationships can destroy long-term profit rather than protect it. This is a theoretical critique, not an empirical refutation, since the empirical evidence on this exact question remains mixed, as shown above. Separately, Friedman's assumption that social and environmental issues are wholly separate from firm value is harder to defend today given that markets, through the scale of ESG investing, and regulators, through mandatory disclosure rules, now treat these issues as financially material rather than as external concerns. Friedman's paper also does not anticipate

today's social media environment, where corporate behavior is visible and judged quickly, which plausibly changes the reputational and financial stakes of social and environmental conduct in ways his 1970 argument could not have accounted for.

7. If This Paper Were Written Today

The studies reviewed in this paper show mixed results. Some large reviews and recent studies (Friede, Busch, and Bassen 2015; Ho, Nguyen, and Dang 2024; Biju et al. 2025) found that ESG is associated with better firm performance. Other studies, including Al-Tarawneh et al. (2024), found ESG has little or even a negative association with firm value. One reason for these mixed findings is that many studies use a single overall ESG score, even though the environmental, social, and governance factors may affect firms differently. This study proposes examining that possibility directly, while treating greenwashing as an important interpretive caution rather than as a variable the study attempts to directly measure.

Research Question

Among S&P 500 firms from 2015–2026, does the environmental (E) dimension of ESG performance predict long-term firm valuation (Tobin's Q) more strongly than the social (S) or governance (G) dimensions?

Hypotheses

H1: Firms with higher ESG performance will have higher firm value, measured by Tobin's Q, among S&P 500 firms.

H2: The environmental (E) pillar will have a stronger positive association with firm value than the social (S) or governance (G) pillars.

Sample

S&P 500 firms, 2015–2026 (panel dataset).

Data

ESG pillar scores (environmental, social, and governance) from MSCI ESG Ratings. Financial performance measures: Tobin's Q (main measure), with ROA, ROE, and stock returns as additional measures, using data from Compustat and CRSP. Control variables: firm size, industry, leverage, and R&D intensity.

Methodology

Panel regression with firm and year fixed effects, to account for differences between firms that do not change over time (such as industry or reputation) and events that affect all firms in a given year (such as the COVID-19 pandemic or interest rate changes). System GMM estimation to address reverse causality and endogeneity, specifically, the possibility that firms with higher Tobin's Q or stronger financial performance have more resources available to invest in ESG, rather than ESG performance causing higher firm value. System GMM uses lagged variables as instruments to help identify the direction of the relationship, following the approach used by Al-Tarawneh et al. (2024) and Zhang, Kong, and Hu (2024).

8. Findings and Discussion

Expected Results

Based on the mixed findings in previous research, the overall relationship between ESG and firm value is expected to be positive but relatively weak (partially supporting H1). When the ESG pillars are examined separately, the environmental pillar is expected to have the strongest positive association with

firm value, since climate-related risks are increasingly reflected in market valuations through mechanisms like insurance costs, supply chain disruption, and regulatory exposure (supporting H2).

Expected Contribution

This would be among the first studies to test the ESG–performance relationship at the pillar level within a single, high-profile index (S&P 500), which could help clarify why prior studies using aggregate ESG scores have produced such inconsistent results.

9. Limitations

ESG pillar scores differ across rating agencies (such as MSCI, Sustainalytics, and Refinitiv), which means results could vary depending on which agency's scores are used. Correlation between ESG and financial performance does not establish causation, even with GMM estimation, which addresses reverse causality but cannot rule out every alternative explanation. Changes in ESG regulations and political attitudes, including anti-ESG legislation and the SEC's proposed rescission of its climate disclosure rules, may affect ESG reporting and data availability during the study period in ways that are difficult to fully control for.

A further limitation concerns greenwashing, which this study treats as an interpretive caution rather than a directly measured variable. If some firms' ESG disclosures overstate their actual practices, then the ESG scores used in this study, and in the broader literature reviewed above, may partly reflect disclosure quality or public relations effort rather than genuine underlying performance. Reliably distinguishing greenwashing from simply incomplete or imprecise reporting is a serious measurement challenge: it would require a clear definition of what counts as an ESG claim, an independent and validated benchmark of actual firm performance to compare it against, and a validated method for quantifying the gap between the two. Existing attempts to do this using NLP-based textual analysis of corporate disclosures are still developing and have not been widely validated against independent ground truth. Rather than propose an unvalidated measurement approach, this study treats greenwashing as a plausible explanation for why the ESG–performance relationship remains mixed across the literature, and future research using validated greenwashing measures would be a valuable extension of the pillar-level analysis proposed here.

10. Conclusion

Milton Friedman believed that the responsibility of businesses is only to maximize profits for shareholders, not to get involved with social and environmental concerns, because he saw those as the responsibilities of government and individuals rather than corporations. This review finds that Friedman's argument is partially right rather than fully correct or fully wrong. His paper still holds up in one respect: a single, measurable objective gives managers clear accountability, a point Jensen (2001) raises in critiquing Freeman's broader stakeholder theory, since trying to satisfy every stakeholder at once can leave managers without a clear priority.

At the same time, several forms of evidence show that Friedman's clean separation between business and social responsibility no longer matches how markets, corporate leaders, and regulators actually operate. Corporate purpose statements like the 2019 Business Roundtable statement show a rhetorical shift toward stakeholders. ESG-oriented investing has grown to roughly \$41 trillion globally, showing a major shift in how capital is allocated. New disclosure rules, such as the EU's CSRD and the SEC's climate disclosure rules (now themselves facing proposed rescission), show that regulators increasingly treat

ESG information as material. None of these three facts, however, proves that ESG performance actually improves financial outcomes. That question depends specifically on the empirical literature reviewed above, which remains genuinely mixed. Friede, Busch, and Bassen's (2015) meta-analysis of over 2,000 studies found a positive association between ESG and financial performance, while Al-Tarawneh et al.'s (2024) GMM-based study of UK firms found the opposite.

Greenwashing further complicates this picture, since some of the reported positive associations between ESG and financial performance may partly reflect disclosure quality rather than genuine differences in underlying practice, though reliably measuring greenwashing remains a significant methodological challenge. Meanwhile, the anti-ESG movement in the United States, with more than 165 bills introduced across 37 states in 2023, shows that Friedman's shareholder-primacy view still carries real political and institutional support today rather than being simply an outdated idea from the 1970s. Friedman's paper remains important for its argument that businesses need a clear and accountable objective. However, his assumption that social and environmental issues can be treated as fully separate from financial performance no longer matches a business environment shaped by ESG-oriented capital, mandatory disclosure, and public scrutiny, even though whether attending to stakeholders actually improves financial performance, rather than simply reflecting a changed set of expectations, remains an open empirical question.

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