

HOW BUSINESS ETHICS CAN ACCOMMODATE DISRUPTIVE INNOVATION WITHOUT DEVOLVING INTO CALVINBALL

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A COMMENTARY ON Abraham Singer (2019), “Business Ethics and Efficiency: The Market Failures Approach,” in *The Form of the Firm: A Normative Political Theory of the Corporation*, New York: Oxford University Press, 218–236,
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ABSTRACT

Abraham Singer defends the Market Failures Approach (MFA) to business ethics from the objection that the MFA cannot account for the moral value of disruptive innovation. Singer argues that critics who attack the MFA on these grounds face a dilemma: either accept the MFA, along with its general prohibition on disruptive innovation, or reject the very idea that business and market competition should be understood as rule-governed activities at all. This commentary argues that the dilemma Singer poses to MFA critics is a false one.

JOSEPH SCHUMPETER (1942) argues that an important moral virtue of the market economy is its tendency toward disruption. This conflicts with the main tenets of the Market Failures Approach (MFA) to business ethics, which holds that we should understand the achievement of Pareto efficient equilibrium as the main purpose of the market economy (Heath 2014). In chapter 11 of *The Form of the Firm*, Abraham Singer (2019) defends the MFA from Schumpeter’s objection. He argues that recognizing the value of disruption requires

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adopting the view that business is like the game Calvinball from the comic strip *Calvin and Hobbes*, “where the only rule was that you could not play the same way twice” (Singer 2019: 231). I argue that the dilemma Singer poses to Schumpeterian critics of the MFA is a false one.

The Schumpeterian Challenge to the MFA

Joseph Heath’s MFA holds that profit-seeking activity is justified, when it is justified, because competitive market processes push markets toward Pareto efficiency (Heath, 2014).²

The presence of market failures typically prevents markets from reaching Pareto efficiency. As the first fundamental theorem of welfare economics shows, under conditions of perfect competition – conditions that rule out the possibility of market failure – competitive market equilibrium is Pareto efficient. Thus, the “MFA holds that businesses have an ethical duty not to exploit ‘market failures,’ the inefficiencies and misallocations systematically and predictably effected by markets” (Singer 2019: 221).

A potent objection to the MFA takes inspiration from the ideas of Schumpeter (1942), who argued that the main virtue of the market economy is not that it achieves Pareto efficient competitive equilibrium, but rather that it *disrupts* competitive equilibrium when market actors innovate. What I will refer to here as the Schumpeterian Challenge to the MFA argues that, because of its reliance on Pareto efficiency and the conditions of perfect competition, the MFA implies that disruptive innovation is morally impermissible. But this, for the Schumpeterian, is absurd: disruptive innovation is not only permissible, it is one of the most morally important contributions that business and markets make to society.

When a firm innovates a new product, and brings that product to market, it temporarily enjoys a certain amount of market power between the time the product is brought to market and the time it takes for competitors to adopt the innovation and bring competing products to market. This qualifies as a market failure in the MFA’s sense: it is a deviation from the conditions of perfect competition that interferes

² A distribution is Pareto efficient if and only if nobody can be made better off without making someone else worse off.

with the tendency of market processes to push markets toward Pareto efficiency.

Consider the shift from analogue photography to digital photography. Prior to this disruption, there were mature markets for analogue photography goods and services. In these mature markets, competitive processes had already ironed out many inefficiencies. The immature digital photography markets that replaced them were Pareto-inefficient by comparison, at least initially. Nevertheless, the disruption caused by the introduction of digital photography represented progress from the point of view of more efficiently using resources to fulfill people's wants and needs—for many functions and tasks, digital photography is far superior to the analogue technology it replaced. However, because the MFA tries to build a theory of business ethics on the goal of attaining Pareto efficiency, it does not appear that the MFA can explain the value of this and other instances of disruptive innovation.

Singer's Response to the Schumpeterian Challenge

In *The Form of the Firm*, Singer presents his political theory of the business corporation, which takes partial inspiration from the MFA. Singer does not accept the MFA in its entirety—the final chapter of his book on 'justice failure' criticizes the MFA's emphasis on efficiency. However, Singer is sympathetic enough to the MFA to defend it from the Schumpeterian Challenge in the chapter that is the focus of this Commentary.

Singer's attempt to rebut the Schumpeterian Challenge relies on the apocryphal historical example of Webb Ellis, who is credited with inventing the sport of rugby when he picked up the ball with his hands during a soccer game. Like the Schumpeterian disruptive entrepreneur, Ellis eschewed existing norms, rules, and routines to create a new way of organizing human activity.

Ellis's decision to pick up a soccer ball with his hands was innovative—it led to the creation of a new sport. However, it is not the sort of thing that we could generally countenance people doing when they play sports. Singer (2019: 231) writes, "if everyone acted like Ellis, disregarding rules as they saw fit, all competitions would descend into Calvinball . . . where the only rule was that you could not play the same way twice." Likewise, disruptive innovation sometimes leads to

value-creating new products, production techniques, or business models, but is not something we could countenance in general (Singer 2019: 231–232).

Singer's attempt to rebut the Schumpeterian Challenge, then, takes the form of a dilemma. Either accept the MFA's general prohibition on disruptive innovation, or abandon the very idea of business firms and markets as domains of rule- and norm-governed activity.

Why Singer's Response to the Schumpeterian Challenge Fails

Escaping Singer's dilemma requires a theory of business ethics capable of justifying rules that, like those implied by the MFA, limit how firms may pursue profit, while also accounting for the value of certain disruptive innovations in spite of their tendency to undermine Pareto efficiency (at least in the short term). Ideally, such a theory would also, unlike the MFA, be able to help us distinguish 'preferred' disruptive innovations from 'non-preferred' disruptive innovations.

To show that Singer's dilemma poses a false choice to the Schumpeterian, I want to quickly introduce one consideration (not necessarily the only one) that is capable of explaining the value of (certain kinds of) disruptive innovation, while also explaining why it is typically unethical to pursue profit by exploiting market failure.

That consideration is the creation of wealth—things, both tangible and intangible, that have economic value; the all-purpose economic means that we use to satisfy our wants and needs. I like to think of the relationship between this wealth creation view and the MFA's Paretian foundations in the following way. What defines wealth creation (i.e., what it means for there to be more wealth in one state b compared to another state a) is Kaldor-Hicks improvement (Young 2021). Kaldor-Hicks improvements are potential Pareto improvements: state b is a Kaldor-Hicks improvement over state a if, and only if, agents whose utilities are higher in b than a could compensate, through wealth transfers, agents whose utilities are lower in b than a , such that b would count as a Pareto improvement over a . Like the MFA, the wealth creation approach proposes as a guiding value for business and market competition a principle derived from the idea of Pareto improvement. Unlike the MFA, the wealth creation approach understands facilitating Kaldor-Hicks improvement, rather than

achieving Pareto efficiency, as an important purpose of the market (see Young 2021).

The value of wealth creation justifies many of the same restrictions on how firms may pursue profit as the MFA. One implication of the MFA is that firms may not pursue profit by exacerbating negative externalities, such as environmental pollution, because this tactic for pursuing profit would not be available to firms competing under conditions of perfect competition. A wealth creation perspective endorses this restriction as well. Typically, negative externalities have a greater aggregate negative effect on parties whose interests they set back than the positive effect they have on benefitting parties, because the overall social cost of pollution is greater than the private cost of pollution for the polluting firm. Thus, in situations involving negative externalities, there is some price that negatively-affected parties would be willing to pay, and that positively-affected parties would be willing to accept, for polluting parties to reduce levels of pollution. Thus, considered in isolation, pursuing profit by imposing costs of pollution on third parties causes a reduction in Kaldor-Hicks efficiency, which constitutes destruction of wealth. The wealth creation perspective can justify moral rules and norms for business and market competition, including many of the rules and norms the MFA endorses. It rejects the Calvinball picture of business ethics.

The wealth creation perspective can also justify certain instances of disruptive innovation. Disruptive innovations do not involve Pareto improvement. They create (often enormous) economic and social benefit, but they also set back the interests of some people. Digital photography technology constitutes a benefit for most people, by making it much cheaper and more convenient to take and store photographs. But this disruption caused hardship for some—those whose careers or investments were tied to the fortunes of the Eastman Kodak Company, for example.

Despite causing some people hardship, however, it is virtually certain that the disruptive innovation of digital photography created wealth overall—consider the consumer welfare resulting from the marginal cost of taking and storing a photograph dropping to nearly zero. The introduction of digital photography is just the sort of economic disruption that we have *pro tanto* reason to want our economic institutions to facilitate, because it created wealth overall. Prosperity

and economic growth require economic and political systems that allow for this sort of creative destruction. Unlike the MFA, wealth creation can explain why we have reason to want disruptive innovation of this sort.

Wealth creation can also accommodate some instances of disruptive innovation without endorsing all instances of disruptive innovation. Singer (2019: 233) worries that some entrepreneurial innovations, on net, may fail to do “anything positive for society,” especially in the presence of market failure. Singer is right to worry about this. Disruptive innovation is not necessarily a good thing. Fortunately, a wealth creation perspective has the resources to distinguish between ‘preferred’ and ‘non-preferred’ instances of disruptive innovation: ‘preferred’ disruptive innovations are those that we have good reason to expect will create wealth for society overall, while non-preferred disruptive innovations are those that destroy wealth for society overall. Thus, in addition to accommodating disruptive innovation without endorsing a Calvinball conception of business ethics, a wealth creation perspective can also help us make sound normative judgments about which kinds of disruptive innovations we have reason to want.

Conclusion

Singer argues that it is only possible to justify disruptive innovation by adopting the unappealing view that business and markets are rule- and norm-free institutions akin to the game of Calvinball. In this Commentary, I have argued that Singer’s dilemma is a false one: a theory of business ethics that emphasizes wealth creation can justify certain instances of disruptive innovation, while at the same time understanding business and markets as rule- and norm-governed institutions.

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