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Toward a Common Good Model of the Firm with Suppliers, Labor and Consumers

Luisito C. Abueg¹, Mariel Monica R. Sauler¹ and Benito L. Teehankee^{2,*}

¹ *School of Economics, De La Salle University*

² *Management and Organization Department, De La Salle University*

**Corresponding Author: benito.teehankee@dlsu.edu.ph*

Abstract: Recurrent business scandals culminating in the recent subprime mortgage crisis have caused substantial harms to various corporate stakeholders and entire economies. As a result of this alarming phenomenon, business schools have joined the United Nations Principles for Responsible Management Education (PRME) movement and have committed to develop teaching tools and to research on frameworks that can help orient business students towards becoming more socially responsible. The tendency of self-interested models of economics, such as the standard textbook profit maximizing model of the firm, in promoting imprudent self-interested behavior among business students has been revealed by research and lamented by business management scholars. Standard theory suggests that firms that maximize profit simply take an action when the marginal revenue of that action is equal to the marginal cost of that action, and whether those actions are beneficial or not to its stakeholders is not made explicit in basic expositions of the model found in textbooks. It becomes important, therefore, to develop models of the firm which are more socially oriented. The paper refines previous work on a baseline formal model of the firm which incorporates the provision of living wages and benefits for the employees of the firm and those of its suppliers, while pursuing maximum profit. The baseline model is extended to include customers who have information on and may value the firm's labor practices.

Key Words: model of the firm; living wage; common good; profit maximization