

Q: What kinds of behaviour are engendered by the hope of profit? Is such behaviour better or worse, on balance, than the behaviour we should expect if all enterprises were owned by charities or governments?

Overnight, in 1969, 14 Indian banks were nationalised, followed by six more in 1980. The move, aimed at financial inclusion, led to an 800% branch expansion in 28 years, mostly in rural areas. 40% of public bank credit was allocated to priority sectors like agriculture, enabling the Green Revolution. Amid two wars, two droughts, and major rural exclusion, it may have seemed justified. But by 1991, public banks were unviable, with non-performing-assets reaching 20% of their loan book. In the 1990s, liberalisation brought a new wave of private banks to infuse new capital and also introduce more competition into the sector. Today, HDFC Bank, launched in 1995, ranks among the world's top 10 by market cap (approximately US\$180B) ahead of the revered Goldman Sachs. (NEXT IAS Contributors). Did government ownership eventually destroy value? Did for-profit ownership, on balance, add value? Which led to better behavioural outcomes?

John Locke's labor theory of property helps frame this debate. He argued that individuals have a natural right to the fruits of their labor-profit, in this view, is just reward. But Locke also cautioned that accumulation is only fair if it leaves "enough and as good" for others. This balance-between incentive and fairness-is key to evaluating the behaviours that different ownership models create.

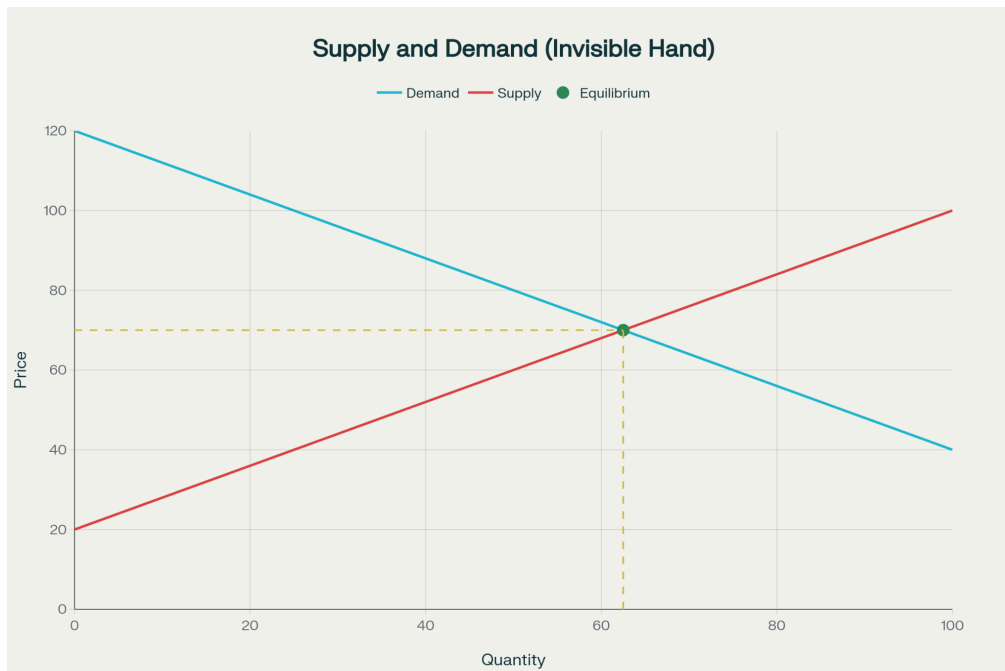
Adam Smith's invisible hand theory supports this, as for-profit ownership has and will engender behaviours that add value for all stakeholders in the long run. Specifically, people pursuing self interest leads to overall social welfare. Hope for profit drives innovation, competition, cost-efficiency and quality improvement. However, government owned enterprises have a significant role, especially in case of market failures caused by reckless pursuit of profit. Further, this essay argues that as per the Abundance Hypothesis in the post-AI world, the historical notion of 'profit or benefit' needs to be replaced with a new compelling metric of 'composite performance'. (Rahul Pratyush and Gupta). Lest we end up in a situation where profit stops being a motivator for high performance in a world of abundance.

For the purposes of this essay, I will use Indian banking examples prolifically because it gives me access to multiple years of data and an opportunity to directly compare government owned and private sector owned businesses through market cycles - periods of efficiency and inefficiency (or market failures or shocks). However, the insights shared can be extrapolated to fit any market or industry.

In Adam Smith's Invisible Hand Hypothesis as demonstrated by the supply-demand curve in figure 1, the supply curve is made of multiple individual suppliers who make independent decisions to produce the good or service depending on their cost of production and price at which they can fulfil the demand. Similarly the demand curve comprises multiple individual

consumers making self-serving rational decisions. Proponents of for-profit behavior argue that the market automatically clears at the market clearing price when the marginal cost of supplying the good or service equals the marginal price at which consumers are willing to buy in the market. This is an overall optimal outcome because any further production will be inefficient for the system at large.

Figure 1: Adam Smith's Invisible Hand Hypothesis

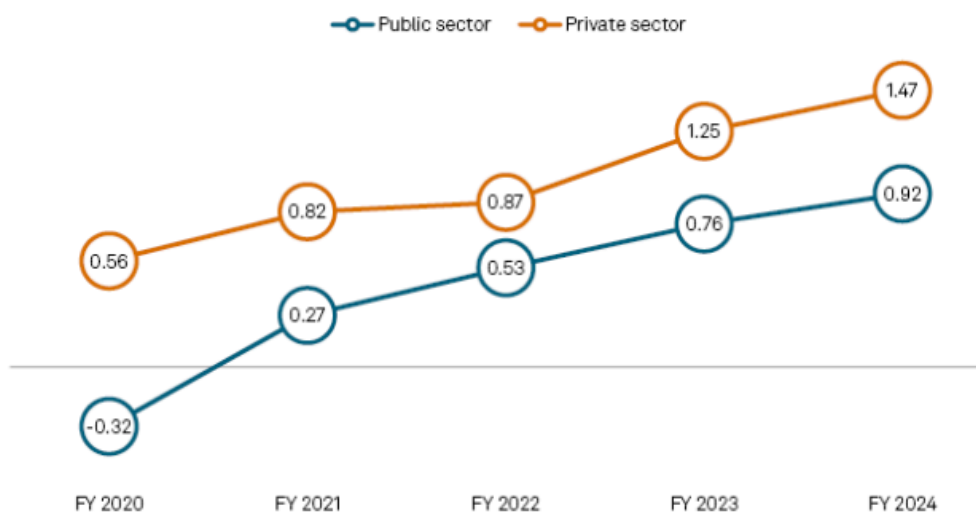


Also, proponents of free-markets argue that hope of profit incentivises producers to behave innovatively and efficiently in order to displace the less efficient producer. Enterprises optimise their business models to gain larger market share, and cut costs for increased profits. As a result of competition and innovation, consumers get higher quality at lower prices, and greater choices in goods and services. Cutting costs reduces wastage, creating more sustainable production processes, which are beneficial for society as a whole. As such pursuit of innovation and efficiency benefits consumers, investors and society.

With regards to government ownership of enterprises, the free-market proponents argue that government ownership leads to rise in inefficiencies due to lack of competition. See Figure 2 which shows the return on average assets of Indian government owned and private sector owned banks through a market cycle. (Khan et al.).

Figure 2: Return on average assets through a market cycle

Median return on average assets at Indian banks (%)



Data compiled June 20, 2024.

Analysis includes all publicly traded private sector and public sector banks as classified by the Reserve Bank of India.

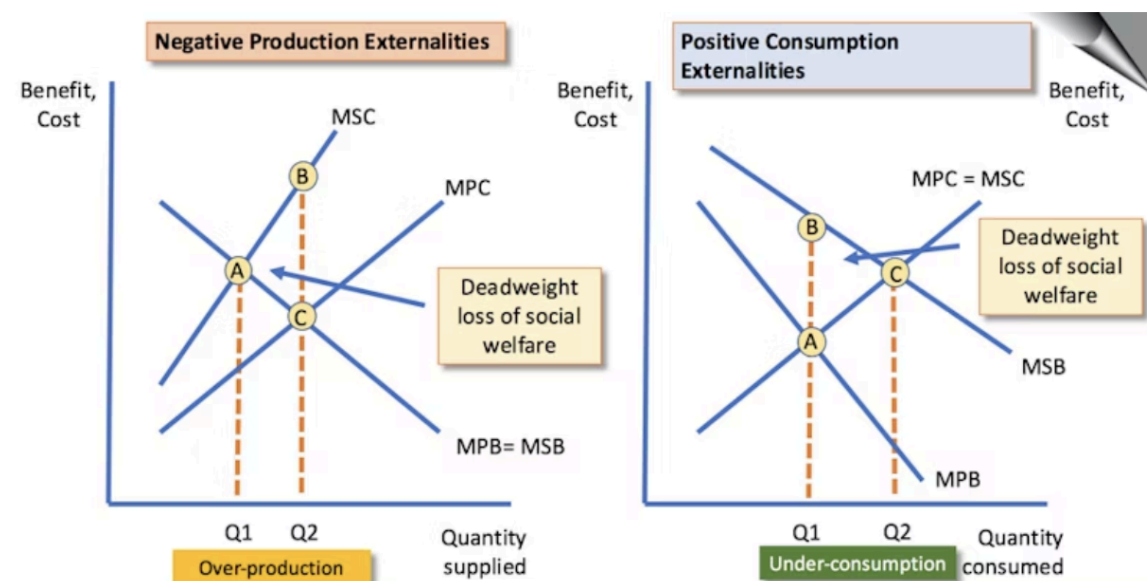
Fiscal years are for the 12 months ended March 31.

Source: S&P Global Market Intelligence.

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However, fundamentally we all know that there are externalities that can lead to market failures causing over production or under consumption as shown in figure 3 below.

Figure 3: Over production and Under consumption scenarios. (tutor2u).



In these charts:

- MSC/B = Marginal Societal Cost / Benefit
- MPC/B = Marginal Private Cost / Benefit

Further, these graphs are particularly telling because they raise fundamental questions about the definition of ‘Benefit’ (Y-axis) in the post-AI abundance world. More on this later.

Let us now explore these market failures. For example, blind profit maximisation can cause enterprises to not account for the concern of inequality and exploitation. In pursuit of minimising costs, firms may implement unsustainable and unethical practices like wage suppression, quality dilution, collusion and mis-selling. These can exacerbate environmental degradation, societal issues and grow the disparity between the *Proletariat* (exploited workers) and *Bourgeoisie* (capital owners) as expounded by Karl Marx. Empirical evidence supports this as well: between 2000 and 2014, the global rate of surplus value (a Marxist measure of labor exploitation) grew from 91% to 115%, even as profit rates declined. In that same period, productive activity shifted rapidly from developed economies to low-wage nations like China, while unproductive capital increased in high-income countries. (Rotta and Kumar).

In fact, the Marxist theory predicts that these overlooked concerns would sharpen class divisions and eventually lead to resistance from the *Proletariat* against Capitalism. They will fight for better rights and collective FOP ownership. (RUSSELL).

Figure 4: Calculation of Marxist Values

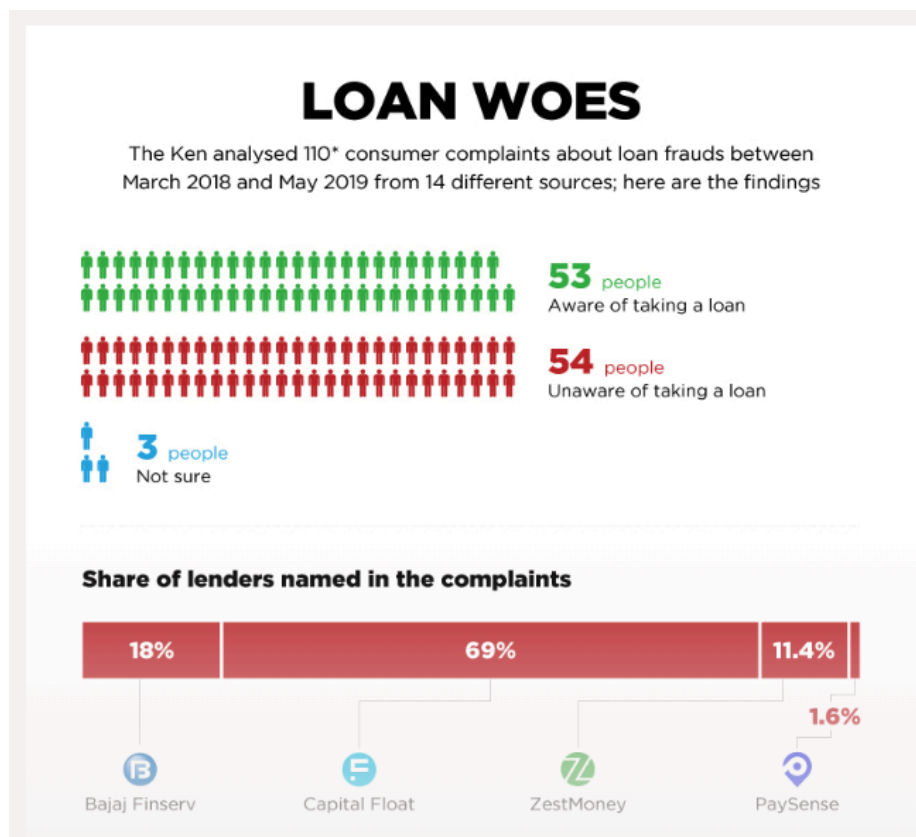
$$\begin{aligned}
& \text{SurplusValue}_{PA,i,t}^{WIOT+SEA} = \text{ValueAdded}_{PA,i,t}^{WIOT+SEA} \\
& - \text{LaborCompensation}_{PA,i,t}^{SEA} \\
& \text{Rate of SurplusValue}_{PA,i,t}^{WIOT+SEA} \\
& = \frac{\text{SurplusValue}_{PA,i,t}^{WIOT+SEA}}{\text{LaborCompensation}_{PA,i,t}^{SEA}} \\
& \text{Average Rate of Profit}_{i,t}^{WOIT+SEA} \\
& = \frac{\text{SurplusValue}_{PA,i,t}^{WIOT+SEA}}{\text{Capital Stock}_{PA,i,t}^{SEA} + \text{Capital Stock}_{UA,i,t}^{SEA}} \\
& = \frac{\text{Rate of SurplusValue}_{PA,i,t}^{WIOT+SEA}}{\text{Organic Comp. of Productive Capital}_{i,t}^{SEA} + \text{Organic Comp. of} \\
& \quad \text{Unproductive Capital}_{i,t}^{SEA}} \\
& = \frac{\text{Rate of SurplusValue}_{PA,i,t}^{WIOT+SEA}}{\text{Organic Comp. of Total Capital}_{i,t}^{SEA}}
\end{aligned}$$

Surplus value formula approximates the economic value appropriated by capitalists from workers. Secondly, the rate of surplus value measures the degree of exploitation. Average rate of profit declines as capital intensity increases.

Together, these equations quantify the contradiction at the center of Marx's critique on Capitalism: it's a system that sustains itself by widening inequality, even as internal efficiency deteriorates.

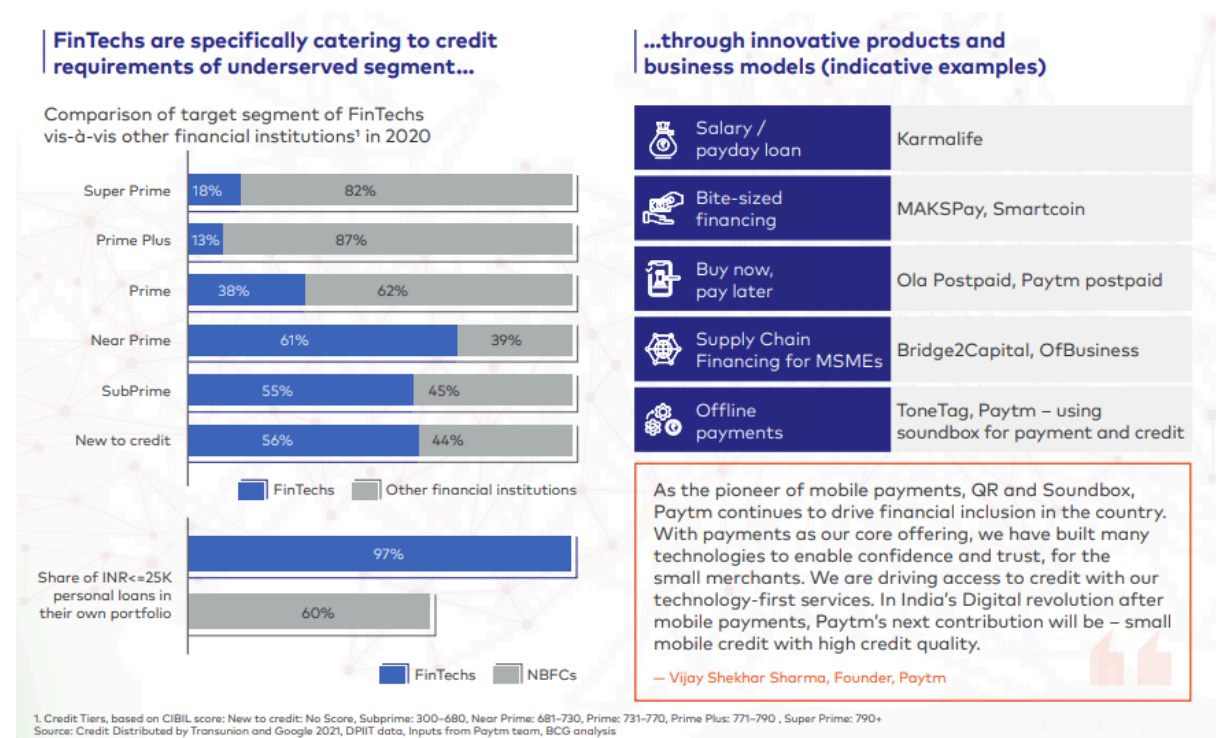
Indeed there are gut-wrenching examples of mis-selling and reckless profiteering in the real world as well. For example, an ed-tech startup in India Byju's mis-sold loans to the parents of their students which created a major uproar and large-scale crisis with lenders that had exposure to Byju's students. (Banerji). See Figure 5 below.

Figure 5: Mis-selling by Byju's with private sector lenders.



Notwithstanding such instances, the long-term experience from Indian fintechs is quite contrary to what Marx theorised. The data clearly shows that venture capital and private equity funded for-profit fintechs have done more to further financial inclusion in India than the rest of the sector as shown in figure 6. Fintechs in India drove product and distribution innovation to serve the segments that were not being served by the mainstream financial institutions. This can be seen in the market share of fintechs in financially underserved segments and the product innovation they introduced to the market to make finance accessible to the masses.

Figure 6: fintechs driving innovation to extend credit to the new-to-credit and sub-prime customer segments. (DPIIT and BCG).



The last two examples show that profit maximisation behavior can indeed lead to distortions in the short term but over the long term it fosters innovation and efficiency.

Historically, profit-seeking enterprises have harnessed competitive pressures to drive innovation and efficiency, contributing significantly to societal progress. For instance, the development of electric vehicles by private firms illustrates how market incentives can align with environmental goals. At their core, such enterprises often improve quality of life through scalable, market-driven solutions.

Conversely, not-for-profit enterprises have addressed complex, long-term, or high-risk challenges beyond the reach of simple free markets. For example, India's government-affiliated vaccine production-such as COVAXIN-demonstrated this vividly. While private COVID-19 vaccines ranged from \$10 to \$37 per dose (₹730-₹2,700), the Indian government procured COVAXIN at just ₹150 per dose-approximately one-tenth the international private cost. (Bharat Biotech). Similarly, the Indian Space Research Organisation (ISRO) has achieved remarkable space exploration milestones, with missions like Chandrayaan-3 costing around USD 75 million (₹615 crore)-significantly lower than typical Hollywood film budgets of USD 150-\$165 million. (Naudiyal).

Yet both models suffer when poorly executed. The profit motive can skew incentives, as seen in the military-industrial complex's propensity to perpetuate conflict. (Ritter and McLauchlan). Not-for-profit organisations, meanwhile, can succumb to governance

failures-such as corruption leading to inadequate infrastructure despite substantial public spending.

Conventionally, the self-correcting mechanisms of profit-driven enterprises have been viewed as superior in the long term. However, I propose a fresh hypothesis as we enter an era of artificial intelligence, quantum computing, and abundance, the traditional divide between for-profit and not-for-profit may need to be redefined.

Individuals and enterprises seek profit with the ultimate goal of improving the standard of living. In a future where AI technologies elevate baseline living standards, the marginal value of additional profit may decline. Profit could still have signal-value for performance of a company, but may no longer serve as a prerequisite for societal advancement. At the same time, not-for-profit organisations' limitations-inefficiency and corruption-could be substantially reduced through AI-enabled operating models and governance. Systems with embedded transparency and objective-aligned protocols could manage public services and funds with rigorous accountability. A great example is this is visible in the Digital Public Infrastructure (DPI) in India. For example the Account Aggregator (AA) framework which allows customers data to be available to all financial institutions basis user consent is conceived as techno-legal architecture. (Rutvik Paikine). In this framework, the governance standards are incorporated into the lines of code that defines the AA itself. Thus it obviates the possibility of corruption or inefficiency altogether as long as the governance rules are well defined.

This pivot suggests that future institutions could be judged less by their ownership structure but more by their effectiveness, ethical alignment, and adaptability to a new definition of 'Benefit' which is more composite. Indeed, at this stage the hypothesis may seem speculative. However, this hypothesis integrates historical lessons with forward-looking insights and allows us to conceive a world where the lessons of for-profit enterprises are married with the long term and public good nature of government owned enterprises enabled by a new definition of 'Benefit' in a post-AI abundant world. People who argue on historical metrics without taking into account the context within which profit maximisation occurs are missing a crucial inflection point in human history.

To conclude, Milton Friedman said in his famous speech in 1970, "The social responsibility of business is to increase profits". While this is indeed correct, I recommend we redefine 'profit' to include wider composite metrics of performance and productivity in a post-AI abundance world.

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