

On The Promise
Abstract
Scott Adams

Maximizing Shareholder wealth is a foundational principle of financial management. This leads to an implied ethic that as long as stockholders are making money, then the ethical things is being done. The issue of layoffs is explored using utilitarian, rights and duties, and justice and fairness criteria. The type of layoffs explored are those involving a company that is doing well, but believes layoffs will further improve their situation. It will be shown that layoffs are sometime unethical.

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The temptation in financial management is to boil everything down to numbers and not consider other issues. A primary foundation of finance is that management should maximize shareholder wealth (Scott, 1999, p. 3-4). Shareholders have a wide variety of interests, but share a single goal of having their wealth increase. However, this principle has an implied ethic which indicates that as long as money is being made for shareholders the ethical thing is being done.

Historical Dilemma

Ethical thought should be given when layoffs are contemplated. The ethical issues surrounding layoffs are many because there is a wide range of circumstances where layoffs are involved. Sometimes laying off workers is the moral thing to do and sometimes it is unethical. The criteria for deciding this are much more complicated than whether or not shareholder wealth is maximized.

Companies use layoffs to reduce their workforce. This decreasing of workforce is quite different than firing. In a layoff, people are let go through no direct fault of their own. Firing implies termination for cause. An employee let go for stealing or continual tardiness is not laid off. Further, layoffs will not include the choice to simply not fill a position and let the workforce shrink through attrition. In this case, an employee leaves by choice and is not replaced by a new worker.

In a layoff, people who are good workers one day are simply let go the next. For example, a common reason for laying off workers has been the core competence theory (Prahalad, 1990). This theory suggests that companies can perform best if they only focus on one thing while having all other activities outsourced. In this case, all

accountants could be laid off and the duties given to a different company entirely. These accountants were performing their job, but have been let go because of a change in the way the company desires to operate.

Often, layoffs are done with the promise that increases in shareholder wealth will follow. In this analysis, layoffs done to keep a company from going out of business will not be considered. A company that lays off workers as a means of survival has different ethical issues surrounding it. This analysis will look at companies that are performing well and have little to no risk of going out of business, but desire to increase shareholder wealth through shrinking of the workforce. A smaller workforce means lower costs. More often than not, these cost reductions do not lead to increases in shareholder wealth (DeMeuse, 1997). It will be shown that it is not always ethical to lay off employees on the promise that shareholder wealth will increase in the future.

Ethical Considerations

Ethics deals with the morality of human decisions. Many people have obtained their sense of rightness and wrongness from religion. A religion determines what is ethical from divinely inspired teachings. However, a more philosophical approach is desirable in this instance because layoffs happen to people of many different religions. A conclusion needs to be made about the correctness of laying off humans, not Protestants, Muslims, or Hindus. Therefore, theology will not be explored for this model.

Further, ethics should not assume that laws are morally correct. An act will not be justified for the sole reason that it is legal. Most political jurisdictions have different laws, so some outside model would be needed anyway to conclude which geographical areas actually have the correct moral laws. It is not difficult for most people to think of

some laws somewhere on earth that they find morally troubling. Therefore, legal issues will not be explored in developing this ethical model.

As stated earlier, maximizing shareholder wealth is the goal of financial management. However, the response was made that just because something makes stockholders wealth does not mean that it is, by definition, ethical. Microeconomic theory has a similar principle that profit maximization is the goal of all entities. Marginal benefits are compared to marginal costs and if the marginal benefits are greater than the marginal costs, then economic theory suggests the action is morally correct (Hosmer, 1987, pg. 35).

Further, economic theory holds that the scarce resources in an economy can be allocated in such a way as to reach Pareto Optimality. This is the condition where no one person could be made better off without hurting somebody else. This position is considered the ethical position in normative economics.

Just like with maximizing shareholder wealth, the ethic is implied that because benefits outweigh costs or Pareto Optimality is reached then the position is ethical. A more philosophical approach is needed to evaluate whether an action is ethical.

Ethical decisions have been discussed around three major philosophical approaches. The oldest approach would be the use of utilitarianism which blends economic theory with philosophy. John Stuart Mill and Jeremy Bentham are the persons who are identified with developing utilitarian thinking (Beauchamp, 1983, p. 21). Mill's assumption was that pleasure leads to happiness and that pain takes away happiness. Utilitarianism states that the most ethical thing to do is bring the greatest amount of happiness and pleasure to the greatest number of people. Moral decisions are based on

what is best for the entire community (Velasquez, 1998, p.73). For example, 1,000 people were laid off, but the company is saved from bankruptcy and 12,000 people kept their jobs. The happiness and pleasure of the group of 12,000 is greater than the pain suffered by the 1000 who lost their jobs.

Utilitarianism is the basis for cost-benefit analysis (Mishan, 1997). Figuring out if the present and future economic benefit outweigh the present and future economic cost is typical cost-benefit analysis. However, this type of analysis is usually restricted to monetary measurement (Velasquez, 1982, p.75).

Typically, utilitarians add the cost and subtract the value of all things, not just monetary issues (Beauchamp, 1983, pp. 28–29). Utilitarians would find a way to measure work environment and beauty of land. The measurement unit is called utilities. An action is deemed ethical if, and only if, the utilities produced by an action are greater than the sum total of utilities produced by another action. The utility for just one person is not counted, but the utilities for all people are considered.

It is also important to understand that only one action is right. Cost-benefit analysis is often used for a single situation. However, utilitarianism holds that all possible alternatives are to be evaluated, and the one that brings the greatest net benefit to all people is correct (Velasquez, 1982, p. 73).

The second method for discussing ethics originated with Immanuel Kant. Kant encouraged examining the issues of duties and rights (Velasquez, 1983, p. 93). Essentially, people have rights as humans, citizens, and as employees of a company. The rights of these people confer duties on themselves and others, and the morality of a decision can be determined by evaluating these rights and duties. For example, a person

may have a right to personal comfort. However, during war, it becomes their duty to serve the country.

Kant's ideas are based on categorical imperatives, which is the idea that all people are equally free with one another (Velasquez, 1983, p. 93). This idea is similar to the golden rule, that we are to treat others how we would like to be treated. An action is right if the person's reason for carrying out the activity is the reason that he or she would be willing to have other people act in a similar situation. In essence, a person who does an action should be willing to have the similar action done to them.

Finally, Kant would add that people should never be used as a means to an end (Velasquez, 1993, p. 95). Kant would say that an action should be carried out in a way that enhances freedom for all people. A person is free to take on risks, but they must know they are at risk. An example might be a firefighter. The job is risky, but as long as the person is willing to accept the pay and risks that have been disclosed, then a free decision has been made which is considered morally right. However, if a person is hired for a job and is suddenly sent to put out a fire that was never communicated as part of his or her job, a free choice was never made, and this would be considered unethical.

Whereas the last method revolves around rights and duties, the final method deals with justice and fairness. The primary goal under this method is to produce the greatest amount of justice. It is similar thinking to utilitarianism, except that justice is to be maximized instead of pleasure. John Rawls would be the most famous supporter of this method (1999).

The ideas of justice and fairness contain some rules that are applied across multiple situations. Plato believed that justice must be proportional (Gilbert, 2000, p.11).

The punishment for murder should be greater than the punishment for stealing a stick of gum. Consistency must, also, be applied to situations (Gilbert, 2000, p.11). If two different people do the same act, then their reward or punishment should be equal.

John Rawls believed that analysis should be done by looking at the society from the outside without knowing a person's position in that society. This is referred to as being behind a veil of ignorance (Rawls, 1971). In this case, a person does not know if he is king or peasant, manager or worker, rich or poor. Now a person looking at a society without being in it and knowing his or her position can make a judgment that is not biased by living in that society.

An Ethical Model

Each of the above systems of determining justice has positive aspects, but each has its share of criticism. These methods can be blended in such a way to highlight the positive while eliminating some of the weaknesses. The goal of the model as a whole is to bring the greatest amount of good to the greatest number of people, determine the rights and duties of people and see that they are being honored, and to bring the greatest amount of justice to society.

The first criterion for decision making in this model is to use the utilitarian approach. Each of the approaches has a different angle through which they look at ethical issues. Utilitarianism has the widest view. The greatest amount of good for the greatest number of people is the key. In this model, utilitarianism will be used to determine the greatest good for the most people. Once this is done, the next level of analysis will follow. This will help keep the big picture in view.

The rights and duties approach is not as concerned with the big picture. Its strengths lie in the fact that it focuses on individuals. A situation should not develop where somebody's rights have been violated. Even if others are made happier, an individual's right should never be violated. When a situation is viewed for analysis, the rights that a person has must be clearly defined. Further, once rights are defined, the duties that go along with those rights must be identified. A person not performing the duties associated with his or her rights is subject to the loss of those rights. The situation must be clarified when these decisions are being made. For example, a person of age 18 is granted the right to vote. However, this right is taken away when a person is convicted of a felony. It is necessary that both rights and duties be examined, and it must be realized that they are a set.

So far, the model has determined what would produce the greatest amount of good for the greatest number of people. Next, an examination has been done to determine if any rights have been violated or any duties neglected. If so, a recalculation needs to be done to determine the next alternative that produces the greatest amount of good for the largest number of people. This must be done until a solution is found that does not violate any rights or neglect any duties. Next, issues of fairness and justice can be examined.

One advantage of the fairness and justice approach is that it considers the individual while viewing the social system in which the individual functions. What needs to be examined at this point is whether the action being performed is fair and just. Two questions need to be answered at this point. First, is the action consistent? Second, is the action proportional?

First, consistency is examined. Are all people involved receiving the same rewards and punishments for actions that are similar? At this point, it is known that rights and duties are being fulfilled. What is important is that equal reward and punishment have been given in relation to the fulfilling of rights and duties.

The second issue is proportion. Do the results of the actions seem proportional to what a person has done or will do? This will be looked at and answered from behind the veil of ignorance. Likely, new issues will arise when proportion and consistency are considered. These new issues will have to be examined. Is it still true that the greatest amount of good has been done for the largest number of people? If the decision seems proportional and consistent, then the correct decision has been made.

Finally, it must be realized that some ambiguity will be present in situations. A clear-cut conclusion will likely not be found in all cases. However, the ability to make judgments should be enhanced and a more ethical decision may be derived.

Application of the Model

The model is now applied to a situation when layoffs are done to improve a well performing company. The question that needs to be answered is if managers have a duty to do something that might fail and cause lost jobs in the process. In this case, the company is doing well, but a situation has arisen where people are to be let go; in doing so, a promise for increased shareholder wealth is to be fulfilled.

If everyone would keep their jobs without layoffs and only stockholders would be made happier, then the utilitarian position would be that layoffs to just improve performance would be unethical. This position is extremely tenuous when the desired improvements never occur, which is often the case (DeMeuse, 1997). Looking at all the

possible people affected, the workers are happy because they kept their jobs; managers are happy because they do not have to tell somebody they no longer have a job; the people of the city are happy because employees remains to eat in restaurants, shop, and pay taxes. Shareholders have less pleasure. They have not lost money; but do not gain any more shareholder wealth from the layoffs. Some managers whose pay is tied to stock may be less happy. In both of these cases, they are not hurt, just not realizing increased happiness.

It is important to realize those managers and workers who keep their jobs suffer. Post-Downsizing Stress Syndrome (Shore, 1996) involves the psychological damage that managers and workers who keep their jobs suffer. Much stress surrounds layoffs. Workers who keep their jobs often wonder if they will be let go in a later round of layoffs. Managers suffer stress because they have to make difficult decisions about who should be let go. Further, the organization itself suffers from a demoralized workforce and cost savings that never seem to really occur (Shore, 1996, p. 5). According to utilitarianism, layoffs on the promise of future gains are unethical.

Next, the rights and duties analysis needs to be fulfilled. In layoffs this is somewhat tricky, because few would argue that workers have a right to a job and that managers have a duty not to lay them off (Gilbert, 2000, p.11). This question is more difficult, because this question is whether an employee has a right to keep his job as long as he is performing his tasks satisfactorily. Rights and duties analysis is focused on the individual, and in this case should be examined from the management side. "What a manager may or may not do is determined by the rights of the employed individual" (Gilbert, 2000, p. 11). Managers are actually employed by owners, and agency theory

would argue that managers actually have a sole duty to stockholders (Eisenhardt, 1989). This leads to the conclusion that managers indeed sometimes have a duty to conduct layoffs, and in fact it would be unethical not to lay off workers in some instances.

Since research shows (DeMeuse, 1997) that attempts to conduct layoffs that increase shareholder wealth more often than not fail, it is necessary to answer whether or not managers have a duty to take steps that are more likely than not to fail. Managers would seem to have the right to conduct a layoff because no overriding right exists for employees to have a job. However, it is difficult to prove that managers have a duty to do a layoff in the case of an already well performing company.

So far, utilitarianism leads to the conclusion that a layoff should not be performed on the promise of future shareholder wealth increases. The rights and duties approach leads to the conclusion that workers do not have a right to a job, but that managers have duties to stockholders. However, it seems that the duty would only apply if in fact the increases in wealth from a layoff were actually going to follow. Finally, the issue of justice and fairness needs to be examined in this situation.

The duties of management were previously examined, but in this case the fairness of laid-off workers needs to be examined. Since layoffs are defined differently from firing, it seems unfair that those who lost their jobs were performing the job adequately. The termination was not based on the employee's performance. Thus, looking at the issue of proportion, it would seem that the action of termination is not proportional with the reaction of laying off the worker. Worse yet, the unfairness is seen when workers who lost their jobs are performing equally well to those who kept their positions in the company. This would violate the idea of consistency. Two employees are performing

equally well; one is let go and the other stays. Therefore, the ideas of justice and fairness are violated when layoffs are done on the promise of future gains in shareholder wealth. "It is unlikely that a person behind Rawls' veil of ignorance would consider the system allowing this to be just" (Gilbert, 2000, p. 12).

Conclusion

Layoffs make big headlines in today's business world. A part of the headline is the implication that there is something morally wrong with dismissing workers. However, the maximization of shareholder wealth is a primary goal of financial management. The question that is addressed is if it is appropriate to lay off workers for a promise of increases in shareholder wealth. Utilitarianism concludes that the greatest good for the greatest number of people is not to lay off workers in the case of a well performing company. The rights and duties analysis shows that workers have no real right to a job and the owners have a duty to shareholders. However, since this is a promise of future increases in wealth, the duty for a manager to lay someone off on a promise does not exist. The justice and fairness issue fails because no matter how you lay off a portion of the workers, it is not proportional and consistent. A worker who is doing well, yet is fired is not treated in a proportionate way. Laying-off some workers and not other similar workers is not consistent. Therefore, laying off a worker on the promise of increases in shareholder wealth is unethical.

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Scott Adams Biography

Scott Adams has his BA in Economics from Otterbein College and his MA in Economics from the University of Toledo.

He spent 10 years in the financial services industry, including three years with Merrill Lynch, before joining the faculty at Taylor University where he teaches Finance classes and oversees the University's Series 7 program.

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