Is the Corporate Strategy of Downsizing Unethical?

YES: Larry Gross, from "Downsizing: Are Employers Reneging on Their Social Promise?" CPCU Journal (Summer 2001)


ISSUE SUMMARY

YES: Larry Gross contends that downsizing violates the psychological and social contracts implicit in the employer-employee relationship since there is an implied sense of job security afforded the employee as long as he or she is productively advancing the goals of the organization. Downsizing productive employees is a clear violation of this contract and, therefore, immoral.

NO: Professor Joseph Gilbert analyzes the ethicality of downsizing through the application of three prominent approaches to the study of ethics: utilitarianism, rights and duties, and justice and fairness. Gilbert concludes that, with one notable exception, downsizing is an ethically valid and morally responsible corporate behavior.

Corporate downsizing is the strategic action of reducing the size of an organization’s workforce in the hope of achieving greater efficiency and productivity through the reduction in labor costs. Although academic discussion of the concept can be traced back to the 1950s, it wasn’t until the early 1980s that the idea of downsizing as a strategic tool found expression in the marketplace of corporate America. The accelerated growth of international and global competition during the decade of the 1980s forced American businesses to reduce costs and focus on increasing organizational efficiency. An obvious way to quickly lower costs and trim waste is to reduce the size of the workforce. This line of thinking, coupled with the growing competitive pressures, proved irresistible to thousands of corporations of all size and financial condition. The result? Millions of employees were laid off as corporate America embraced the notion of downsizing as a valuable managerial weapon. By the time the 1990s were over, the acceptance of downsizing as an effective and dependable arrow in the corporate quiver was complete.

Although top management has expectations about the impact downsizing will have on their labor costs, they are typically much less concerned about the impact on the employees affected by the decision. An important moral question arises when we view downsizing from the perspective of the employee—namely, does the corporation have the moral right to downsize in the first place? In other words, is downsizing unethical? Most frequently, those answering "no" base their position on a stakeholder approach to business ethics. This approach argues that businesses have obligations that extend beyond merely maximizing shareholder wealth to include any entity or individual that is impacted by the organization’s activities. Consider the following statement from Larry Gross, author of the "yes" position of this Taking Sides debate: "Downsizing is driving a breach in the corporation’s social responsibility not only to the employees who lose their jobs, but also to the others who remain ... That same breach of promise on the part of these companies also affects the society where they do business" (CPCU Journal, 2001, vol. 54, no. 2, p. 113). Gross also contends that downsizing violates the psychological and social contracts implicit in the employer-employee relationship since there is an implied sense of job security afforded the employee as long as he or she is productively advancing the goals of the organization. Downsizing productive employees is a clear violation of this contract and, therefore, immoral. As you read this article, ask yourself if you would feel the sense of violation Gross refers to if you were to fall victim to downsizing at your job.

Professor Joseph Gilbert, in the "no" selection for this debate, analyzes the ethicality of downsizing through the application of three prominent approaches to the study of business ethics: utilitarianism, rights and duties, and justice and fairness. According to Gilbert, an important element in this analysis involves understanding the motivation behind the decision to downsize. He argues, for example, that a moral analysis of an organization that reduces labor costs as a last-ditch effort to avoid bankruptcy and the resultant loss of all jobs will yield a different conclusion than an analysis of a highly successful organization that downsizes in a proactive, aggressive effort to increase its profits. Gilbert further suggests that it makes sense to view the motivations for downsizing as existing on a continuum: At one end is the corporation that lays off workers to avoid closing, at the other is the profitable organization that downsizes to further increase profits, and somewhere in the middle is the company that downsizes to forestall potential problems. To further complicate the matter, the results of the analysis may differ depending on which of the three approaches are used.

After conducting this analysis, Gilbert concludes that, with the exception of successful firms that lay off employees primarily to further increase profits, downsizing is an ethically valid and morally responsible corporate behavior. Keep Gilbert’s conclusions in mind next time the media report that another major corporation has laid off thousands of its workforce. Was the company’s survival in doubt, or was the downsizing the apparent effort of top management to make a good situation even better?
Larry Gross

Downsizing: Are Employers Reneging on Their Social Promise?

...The phenomenon of downsizing, which is advertised to create financial and operational efficiencies in the modern corporate environment, has impacted millions of employees over the last several years. In the first half of 1996, the number of job cuts increased by 28 percent from the year before, resulting in 100,000 layoffs in January 1996 alone. The list of corporations that had made significant cuts included all types of industries including communications, technology, and manufacturing as well as insurance.

There was a resurgence in the number of job cuts in the last six months of 2000 due to companies looking to dilute the impact of a projected economic slowdown. In December 2000, U.S. corporations announced 133,173 layoffs, a 203 percent increase over November’s total according to a report by Challenger, Gray, and Christmas, an international outplacement firm. This number of reductions represented the highest number of job cuts ever recorded since the survey began in 1993, and this was only the fourth time that the number of layoffs totaled more than 100,000 in one month. These job reductions crossed over all industry sectors, and included a major health insurer who cut 5,000 jobs as part of restructuring plan to improve profit.

The trend in the increase of downsizing activity is predicted to continue due to companies taking action to compensate for the loss of market share and sharp drops in profitability expected from a slowing economy, according to John Challenger, chief executive of Challenger, Gray, and Christmas. He observes, “Companies are jumping in to make decisions to get their costs in line now and not wait.”

Many companies in the insurance community, both large and small, adopt downsizing as a business strategy. Downsizing, which may be proposed for any number of objectives, including cost management, always results in reduced staff. This is critical because reducing staff is downsizing’s real objective, contrary to any of the stated objectives that attempt to rationalize it. One irony about the downsizing trend is that those released are not the newest employees. Long-term employees, especially middle managers who may have given 10 to 30 years in service to the company, are often discharged. Many of those who fall into that category are unable to find employment that allows them to use their current skill sets or to maintain their lifestyle. A study by the American Society for Training and Development indicated that one-third of the displaced managers over 35 years old find jobs that pay less than they previously earned. These victims of downsizing often need five years to get back to their former pay level.

Corporate downsizing has posed an even more serious dilemma than the individual situations suggest. Downsizing is driving a breach in the corporation’s social responsibility not only to the employees who lose their jobs, but also to the others who remain either as an employee or with a vested interest in the company’s future. That same breach of promise on the part of these companies also affects the society where they do business.

There is a fallacy inherent in downsizing. Organizations that undergo this type of change do not appear to be better off than they were before they implemented the process.

Downsizing does not appear to be in the best long-term interest of the corporation, its employees, or its shareholders. In fact, there is considerable evidence in this regard.

As a result, it is important to understand downsizing’s key objectives in order to evaluate whether its stated goals are met. One definition states that downsizing is “a set of activities ... undertaken on the part of management, designed to improve organizational efficiency, productivity, and or competitiveness. It represents a strategy that affects the size of the firm’s workforce and its work processes.”

Atwood cites that existing research describes the attributes of downsizing as intentional; it usually involves, although is not limited to, reductions in personnel; it focuses on improving efficiency of the organization; and it also affects work processes intentionally or unintentionally.

Reviewing the financial results for companies engaged in significant downsizing during the early 1990s, one study cited that the massive job cuts rarely lead to strong sustained gains in the affected company’s stock over the long term. Where median share prices initially rose six months after downsizing by 8 percent, they slid to a 26 percent loss within three years. In another study, only 21 percent of the firms surveyed reported that they achieved satisfactory shareholder return on investment as a result of downsizing, and 46 percent found that reducing head count did not reduce expenses to the degree that had been anticipated. In the same study, only 32 percent increased profits to anticipated levels and only 22 percent of the downsized companies saw the increase in productivity they expected.

In some cases, no effective increase in stock prices occurred even in the short term. In 1995 the Times Mirror Company reported third and fourth quarter losses coincident with the elimination of more than 2,000 jobs. It blamed the losses on the cost of huge layoffs, downsizing, and closures aimed at saving money in the long run.

A report by the Wyatt Company, a national management consultant firm, stated that only 12 percent of downsized companies increased market share, 9 percent improved product quality, and just 7 percent increased innovation.
Despite various actions taken by management at these firms to downsize, the data indicated that many had experienced unexpected and undesirable outcomes.

In a four-year study examining 30 firms in the automotive industry, the data revealed "very few organizations in the study implemented downsizing in a way that improved their effectiveness. Most deteriorated in terms of pre-downsizing levels of quality, productivity, effectiveness, and the 'dirty dozen,' e.g., conflict, low morale, loss of trust, rigidity, scapegoating." Ellen Bayer, global human resources chief for the American Management Association, states, "We've found that in both the long and short term, growing companies tend to outperform downsized firms-especially in such areas as employee morale and turnover rates." These financial effects of downsizing are directly impacted by the fact that the downsizing process is the wrong choice from an ethical perspective. Downsizing is in direct conflict with the Stakeholder Approach to corporate social responsibility. This approach emphasizes accountability to a larger constituency that has significant interest in the corporation's well-being and long-term survival. This infers that purely market-driven ethical decision-making can only capture a short-term benefit without regard for the viability of the organization in the environment it operates.

In fact, the short-term benefits of downsizing only benefit a very small segment of the organization, if at all. The downsizing process indicates a rationalization of action based on a corporate application of psychological egoism. Employees are sacrificed for the apparent benefit or survival of the larger corporation, which is considered an entity in itself that is worthy and capable of self-interest. This "culture of narcissism" represents the acceptance of a business environment where corporations have only one objective, profit, which is in contrast to the need to keep the triangular interests of shareholders, management, and employees in balance.

In a 1999 case study of downsizing that was used by a hospital to address a $16 million budget shortfall, the report cited that within two years almost every reduced position was back in place. The study suggested that the organization never asked whether the projected cost savings was worth the turmoil and impact on productivity and whether better options should have been evaluated by the organization instead.

The fact that downsizing is a bad decision for all affected is coupled with a level of responsibility that the corporation has to two key environments—the employees affected and the society in which the corporation operates. People who are productive employees with years of tenure and education lose their jobs, with seemingly little regard for the disruption of their lives by the corporations that employed them. The financial impact is obvious, but what about the psychological and social implications this action caused?

Despite the absence of a written contract, employees have an implied agreement from their employers in return for their effort to advance the corporation's goals. This includes a promise of protection and safety through wages, benefits, and good working conditions. While the assumption of the implicit psychological contract that assured lifetime job security may no longer hold, a new contract in which employees are more autonomous and self-reliant has taken its place. In the new employment relationship, trust is established through this contract that represents the obligations between the employee and the organization and is based on a normative approach of trust. In this approach employees see trust as an ethical relationship explained in terms of shared ideals and values. This obligation matches Lawrence Kohlberg's Social Contract Legalistic Orientation, a stage of moral reasoning that creates a sociolegal obligation that exists without statutory support. Downsizing violates the promise this relationship creates.

Employees expect that all parties will honor their explicit and implicit obligations. Disturbance occurs when these obligations are not met or when the parties have different expectations regarding the obligations. When downsizing is employed as an organizational strategy, it focuses on economic goals over the promotion of commitment, and, as a result, the employees view the strategy with distrust.

The further impact of this breach of the promise is evident anecdotally. John A. Challenger notes, "It may be unrealistic to expect intense loyalty on the part of the worker when in many instances the employer cannot promise in return. The current spate of mergers in the banking, media, utilities, and other industries, major re-engineering efforts, and downsizings all have weakened the ties that spur employee commitment and productivity."

The lack of the corporation's initiative to protect its employees causes the individual workers to suffer. Employees are devastated by the emotional aspect of downsizing, which rocks their self-esteem and self-confidence. They see themselves valued solely as an expense item of the corporation and believe that if that's the way it is, why bother? Frederick Reichheld, a corporate strategy consultant and expert in loyalty practice states, "The great betrayal of American workers is the failure of companies to let them know how much value they are creating, versus how much they are costing."

A 1996 survey commissioned by the American Management Association demonstrated the physical toll to employees by downsizing and restructuring through evidence that the number of both occupational and nonoccupational disability claims increased significantly during these periods. These increases were also found to occur not only to employees whose jobs were being eliminated but also among those who remained employed. These remaining employees suffered distress from several sources: threat of job loss, job description changes, added responsibility due to the layoff of co-workers, salary freezes or cutbacks, and forced relocation, among others. In a 1997 European study, the authors found a significant association between downsizing and medically certified sick leave where the rate of absenteeism was 2.3 times greater after major downsizing.

Downsizing also causes a conflict for those managers who are charged with the decisions of who to let go and the implementation of the downsizing process when they recognize the implied agreement exists. Based on the ethics standard that is applied, the individual manager is forced to decide between what is his or her responsibility to the corporation's will and survival and the promise of security that he or she offers on behalf of the corporation in return for the employee's productivity. Because downsizing often results in almost explosive change, there is little time for the manager to come to terms with this inconsistency or to distance him- or herself from the result. When faced
with this task, many decide to leave the company rather than deal with the stress of the conflict. Other managers defer the dilemma to upper management instead of implicating themselves.

The breach of promise to society is perhaps the most serious implication of all because everyone is hurt as a result. The rationale that corporations use to describe the benefits of a particular “cost management” effort appear to be flawed—not only in terms of its return to the corporation, but to the society in which it operates as well. The continuous implementation of restructuring efforts that did not appear to have focus are evidence of this rationale, which continues to cause damage to employees' lives and the corporation itself. The reduction of the work force for the singular purpose of reduced costs/more profits breaches the integrity the corporation has in relation to the quality of its contribution to the overall health of society. A profit-oriented approach simply leads to a restriction of the corporation's definition of a goal and an indifference to the means by which these goals are pursued.

Loss of perspective hinders a corporation's ability to compete in the marketplace because it diminishes the corporation's sensitivity to the needs and preferences of customers. Nash writes, "One cannot achieve market sensitivity or organizational cooperation by working on the assumption that your own way of doing things and your profit are necessarily more compelling than anything else."

Feldman and Liou in their article "Downsizing Trust," indicate that the call for principled implementation of downsizing strategies has become a current theme in management literature. They state that the term leadership based on the ideals of trust and power has replaced the word management. Trust has become the new foundation of leadership, replacing authority, and focusing on the reciprocal relationship between leaders and followers. Reciprocity in this relationship refers to a mutual loyalty and commitment between leaders and followers based on trust and honesty. This accounts for the fact that organizational leaders acknowledge that the social contract exists between the employee and the organization and that the organization must honor the contract.

This concept points to new strategies for staff reduction based on organizations approaching it with a quality focus, which requires them to change their fundamental assumptions about people, organizations, and management. This strategy embodies the issue of trust between the employee and the organization. It recognizes the need for empowerment of the individuals who work there and their need to strive to maintain pride in their work and the continuous improvement of all aspects of work within the organization. In this scenario, the organization is responsible for providing training, opportunity, and responsibility for decision making in tandem with accountability, mutual respect, and trust.

In the future, companies must do everything in their power to provide training or placement for employees who may lose their jobs because of the normal dynamics of change that is inherent in any system that requires a destabilizing element to allow organizations to shift away from the status quo. Companies must also pay serious attention to the transition experienced by employees remaining within the organization. This is necessary to provide the protection factor that is implied in the employee/employer relationship.

A well-designed and consistent communications plan is key to any effort designed to successfully assist an organization through change. Communication must be provided, and it should be proactive so that information can be shared early in the process. In a 1995 survey, 65 percent of the responding organizations ranked "gaps in communication channels" as the number one negative factor experienced after restructuring. A well-designed communication plan breaks down barriers and helps people accept the change. An additional study found that insufficient communication from top management might result in middle managers not supporting or even sabotaging new initiatives.

T. Quinn Spitzer, CEO of Keppel-Tregoe, an international consulting firm, states, "There is no new social contract. The companies that always had one still do; the companies that never had one are more inclined to talk about it." Spitzer contends there are four dimensions to this responsibility that have been misapplied over the years:

1. Culture—Organizations will run their businesses with the idea that an employee is at least as important as the investor and the customer.
2. Skill building—Organizations will give employees the skill sets needed to do their jobs; workers have the reciprocal responsibility of self-reliance.
3. High performance work environment—Organizations will offer a hospitable workplace and reward systems that allow opportunity for excellence. For their part, workers must have some control over their destiny and must perform.
4. Employment security—This is considered as a paramount concern rather than employment for life. Organizations will be mindful of job security in decision making, instead of laying off as an initial strategic response to business downturns.

Recent management literature reviews the evolution of a work/life initiative, where action to benefit the individual is directly linked to business strategy such as flexible work scheduling. This results in a change in perspective from a human-cost to a human—investment approach when evaluating the benefit to the organization. Specifically, it allows a corporation to measure the value of a work/life procedure and balance it in terms of organizational efficiencies. As part of the process, the intervention and related investments are defined in terms of the broadest group of stakeholders and its measurable return in terms of the company's business strategy.

Lee Perry, professor of strategy and organizational behavior at the Marriott School of Management, believes that by using technology and redeploying people based on comprehensive process analysis, the reduction-in-staff aspect of restructuring may be mitigated. He states, "Managers are using a machete when they should be using a scalpel." He suggests, "If organizations could bring the goals of business and society together, what would it look like?"

There is a definite correlation between the need to do what is "right" and a successful business enterprise. From my observations about downsizing, I also see that the definition of that term is the result of a cooperative understanding of the employer, employee, and the other stakeholders to make sure all interests are addressed. The reality is that although we cannot escape the dynamics of
change, we cannot allow it to serve as an excuse to act unethically. As Edward B. Rust Jr., chairman and CEO of State Farm Insurance Company, stated, “Mutuality of trust makes it far less difficult to go through the changes that the marketplace places on us.” We must confirm our responsibility to each other through how we face these types of situations, whether we act as individuals or as the conscience of our corporations.

NO

Joseph T. Gilbert

Sorrow and Guilt: An Ethical Analysis of Layoffs

Closing the office door, looking straight into an employee's face, and telling him that he no longer has a job is not an easy task. When that employee's performance has been satisfactory or even exemplary, it is even more difficult for a manager to terminate him or her. Yet, this happens hundreds of thousands of times when companies decide to reduce the size of their workforce by layoffs. From the stock market's point of view, such a decision is usually a good thing—a company's stock price often rises on the day that a layoff decision is announced. From top management's point of view, such a decision can seem to be the best, or even the only one, available to solve serious problems that top managers must address. From the point of view of the managers or supervisors assigned to deliver the news to individuals about to be terminated, the decision often produces sorrow or guilt, or both. From the point of view of the terminated employees, shock, disbelief, and anger are among the typical reactions.

Since layoffs cause suffering, sorrow is an appropriate emotion. Is guilt appropriate, and if so on whose part? In other words, is moral or ethical wrong involved in layoffs?

This article focuses on the decision to conduct layoffs and the subsequent decision about which employees will be laid off. . . . We will argue that in some circumstances, laying off some employees is the ethical thing to do, and managers who fail to do so are guilty of unethical conduct. In other circumstances, no ethical defense of layoffs can be found, and managers who decide on layoffs in these circumstances are guilty of unethical acts. In a wide range of circumstances in between, there are ethical arguments for and against layoffs. For these cases, we show how ethical reasoning can be applied to assist managers in determining the morally right thing to do.

One common definition of an act with ethical or moral consequences is that such an act involves decisions freely taken that will have positive or negative consequences for others. Layoff decisions clearly fall within this definition. Our analysis will employ the three major approaches often used in writing and teaching about managerial ethics: utilitarianism (the greatest good for the greatest number), rights and duties, and justice and fairness. . . .

Ethical Analysis: The Basic Tools

To determine whether a decision, such as downsizing, or an action, such as laying off an employee, is ethical, managers have certain analytical techniques available to them. While these techniques are not as widely known as statistical analysis or flow charting, they are gradually becoming part of a manager’s standard tool kit. Business schools are placing more emphasis on ethics, partly because of the large number of clearly unethical business practices exposed during the 1980s.

Most business school textbooks and courses on ethics take the same basic approach to analyzing the morality or ethics (we use the words interchangeably in this article) of business decisions. The three most commonly accepted approaches draw on the work of moral philosophers dating back more than two thousand years to Plato and Aristotle. While these philosophers were not familiar with corporations or computers, they did think long and deeply about issues of morality. The fact that their writings are still read and discussed indicates that they have something worthwhile to say.

Ethics is the branch of philosophy that deals with the morality of human decisions and actions, and business ethics deals with them in a business setting. These dry-sounding definitions point to the link between the best work of some deep moral thinkers and particular decisions or actions taken by managers in a contemporary business setting.

Utilitarianism. One approach to determining the morality of a decision or action is utilitarianism, which holds that a moral decision or action is one that results in the greatest good for the greatest number of people. The philosophers most commonly identified with this view are two nineteenth century Englishmen, Jeremy Bentham and John Stuart Mill. The assumption behind this approach is that pleasure causes happiness and pain takes it away. Since pleasure and the happiness it causes are the ultimate good for humans, the act that causes the greatest pleasure or happiness for the greatest number of people is the morally good act. This view also assumes that people live in communities and must take this fact into account in deciding on the moral rightness of what they do. While this view may sound simplistic, it is often called upon in business settings to justify or condemn certain actions. We will examine the issue further, but it is common to justify layoff on the basis that terminating 500 people will save the company from bankruptcy and hence preserve the jobs of 2,500 others.

Rights and duties. A second approach to ethical analysis is to examine the issues of rights and duties. The basic position here is that individuals have rights, either as humans, as citizens of a given country or state, or as occupants of a particular position. These rights confer duties on others, and the morality of a given decision or act can be determined by an analysis of these rights and duties. The philosopher most commonly associated with this view is Immanuel Kant. While issues of rights and duties may sound more philosophical and less mathematical than that of determining the greatest good for the greatest number, it is not necessarily so. My right to personal comfort may be outweighed by your right to live. My duty to my family may be outweighed by my duty to serve my country in time of war. Once again, calculation enters into many, but not all, ethical decisions. Few people would question that humans have a basic right to life, and that random killing is morally wrong. A somewhat different question, related to layoffs, is whether workers have a right to their jobs, and therefore, managers have a duty not to lay them off.

Justice and fairness. The third basic approach involves issues of justice and fairness. While some would treat justice and fairness as issues within the first two approaches, others maintain that they constitute a third approach. Both utilitarianism and rights and duties have been criticized for being unfair in certain cases. In some situations, you may not have a clear right to your job, and it may not be clear that maintaining your job serves the greatest good of the greatest number, but does not seem fair to you to be terminated when you have been performing well and earning both praises and raises. In the United States, we tend to equate justice with legality, but there are situations where an action that is legal does not seem fair or just. As with the previous two approaches, calculation sometimes enters into considerations of justice and fairness, because it may be impossible in a given situation to be fully fair to everyone involved. The philosopher whose work is most often cited on issues of justice and fairness is John Rawls, a professor at Harvard University.

With this brief summary of the three most common approaches to analyzing issues of managerial ethics, we now turn to the issue of layoffs. . . . There are a variety of reasons why managers may choose to layoff employees. An ethical or moral analysis of layoffs requires that we identify some of these reasons.

At one extreme is the situation where a company ceases operation, either at the choice of its owners or because of bankruptcy. In this case, obviously, all employees lose their jobs, but this is not usually referred to as a layoff. A similar situation, but not as drastic, occurs when a company is in serious danger of going out of business, and reducing labor costs through layoffs is the only apparent alternative. We will refer to such situations as layoffs to save the company. In other situations, layoffs are a preventative measure. In such cases, managers analyze their company’s competitive situation, see that it is deteriorating and that labor costs are a significant factor, and move to reduce these costs before the company reaches the life or death stage. We will refer to this category as layoffs to improve the company.

In still other situations, layoffs are conducted to improve an already good situation. Here it is the judgment of managers that while the company is not deteriorating, greater profits could be achieved by reducing labor costs. Such layoffs may come about in mergers or acquisitions. Here two companies become one, and frequently plants or offices are closed and their employees laid off to reduce duplication. These layoffs are also conducted to reduce labor costs, but the motivating factor (or at least the precipitating factor) is the merger or acquisition.

Another circumstance in which layoffs are conducted to improve an already good situation involves outsourcing. The theory of core competency, popular in current strategy literature, suggests that a company can perform best
by identifying its core competency, concentrating its efforts and its employees on performing core functions, and contracting with other companies to perform other functions. In practice, this can lead to layoffs if a company decides to stop performing certain functions and not to employ those people who formerly carried them out. We will categorize these situations (mergers, acquisitions, and outsourcing) as layoffs to change the company. The three categories of layoffs that we have identified (to save, to change, or to improve the company) are not mutually exclusive, but they are sufficiently different to provide a basis for further discussion.

**Utilitarianism and Layoffs**

On the face of it, deciding the morality of a decision or action by counting may seem strange. Yet it is an approach to decision-making that is frequent in everyday life and in the business world. . .

When a manager terminates an employee who has done nothing wrong, it can scarcely be argued that this is good for the employee. Whether the action is called downsizing, rightsizing, outplacement, or some other term, the terminated employee had a job yesterday and now does not . . .

The utilitarian argument focuses on obtaining the greatest happiness or good of the greatest number. Happiness is also the goal in other systems of ethics, dating back to Aristotle in the fourth century, B.C. This basis for deciding on moral acts makes some intuitive sense. Most people would probably agree that it is morally better, in general, to make people happy than to make the unhappy, to bring them pleasure rather than to bring them grief. What the utilitarian argument maintains is that it is not enough to consider the happiness or unhappiness of a single individual. Attention must be focused on the sum of happiness or grief resulting from a decision or action. Thus, the terminated employee receives pain rather than pleasure from his termination. The manager who conducts the face-to-face interview terminating the employee is likely to suffer grief rather than happiness as a result of the termination interview. If there is any moral justification for this action, it must lie in a greater sum of happiness coming to a larger number of others. An echo of this approach can be heard in the stakeholder analysis approach to issues of business strategy.

This line of reasoning is strengthened if the company, and hence the jobs of employees who are not laid off, can only be saved by reducing the labor force. If this is the case, then the happiness or pleasure of employment for all those who remain justifies the pain of those laid off and those managers who conduct the termination interviews. Further justification can be found in the happiness of stockholders, bondholders, and others who would be hurt by the company’s bankruptcy. Given this situation, the utilitarian approach would clearly condone the layoffs as the moral thing to do. But how can we be sure that we are dealing with layoffs to save the company rather than to improve it.

Resolving this issue is not easy. When a company is in serious trouble, there is usually a perceived need to act quickly. Thoughtful consideration of all available alternatives is not likely to occur. Competing by price reductions only worsens a company’s financial situation unless there are accompanying cost reductions. Competing by improving the present products or services, or introducing new and better ones, is often not a short-term possibility. Competing by greatly increased marketing efforts is costly, and if the company is already in financial trouble, costly solutions do not appear practical. Reducing staff can be done quickly, and there is ample precedent for such a decision. . .

While not an attractive alternative, a U.S. company in financial trouble can seek protecting by entering Chapter 11 bankruptcy, reorganizing its finances, and continuing as a going concern. As an alternative to layoffs, this solution may postpone the action, but often companies in Chapter 11 bankruptcy reduce staff as part of their reorganization before emerging from bankruptcy. So layoffs are still carried out, and the negative consequences of bankruptcy are added to the mix. In a utilitarian analysis, such a scenario is apt to result in greater unhappiness for more people (suppliers, creditors, shareholders) than would occur with layoffs alone.

In the final analysis, the only way to know for sure whether a company was in a situation of either conducting layoffs or going out of business is to wait and see. Yet it is cold comfort to managers or employees to find out after the fact that layoffs were needed to save the company and that, as a result of inaction, all jobs have been lost. Some uncertainty is inevitable regarding the question of whether the situation involves saving or improving the company. The luxury of waiting for definite answers is simply not available. Hence, we suggest a decision rule which says that if, in the judgment of senior management at the time the layoff decision is made, the situation was one of saving the company, it should be treated as such for purposes of ethical analysis.

Another possibility is that layoffs are not the only step between the present situation and a company’s closing, but are seen as a way of dealing with deteriorating performance (layoffs to improve the company). In this case, it is more difficult to conclude that the unhappiness of those laid off and of managers who conduct the terminations is outweighed by a greater good for a greater number of people as a result of the company’s improved performance. The unhappiness is clear, the greater good and those who benefit from it is less clear. In this category of layoffs, the further the situation deviates from a clearcut choice between layoffs and the company’s closing, the less compelling the utilitarian argument becomes. However, top managers, by their positions, are charged with the future as well as the present well-being of the company. They are responsible for being proactive as well as reactive. In a situation where layoffs now can prevent a crisis later, choosing layoffs can be the best decision for the greatest number.

In the case of layoffs to improve already adequate performance (layoffs to change the company), the decision might bring happiness to managers whose compensation is tied to company performance through stock options or bonus plans, and to stockholders if the resulting improvements in performance cause the stock price to rise. However, in many cases companies conducting layoffs to improve performance do not attain the hoped-for results. Even if the results are achieved, unhappiness comes not only to the workers laid off and their managers, but also to many of the workers who remain. They face increased workloads and uncertainty about their own future with the company. Further, the families of those laid off also suffer pain. Workers at competing companies, observing
the layoffs carried out by their rival may well suffer pain at the prospect that their own company will lay them off to maintain competitive. Thus, by a utilitarian analysis, it is by no means clear that layoffs to improve a company’s position are always moral. 

The second question concerns how many and which employees are to be laid off. A utilitarian analysis emphasizes the impact of these choices (how many and who) on the results to be obtained. For the choices to be moral, the unhappiness caused must be offset by a greater sum of happiness for others resulting from the company’s improved performance. 

If the reason for layoffs is to reduce labor costs, then it seems clear that laying off highly paid employees will reduce cost most. Older employees with greater seniority are normally more highly paid than newer and younger employees. A utilitarian analysis would note that older employees may suffer a greater degree of pain, since they often have a more difficult time finding new jobs than younger employees. Where negotiated contracts between labor and management prevail, unions typically negotiate as part of the contract that any layoffs occurring during the contract period will be based on reverse seniority, with the newest workers being laid off first. Another factor to be considered in a utilitarian analysis is that employees who perform their jobs best provide the most good to the company. Following this approach, the poorest performers should be laid off. However, many companies do not document performance in a way that can serve as a ground for determining layoffs on merit. Others do not choose to follow such an approach, even if they are able to.

A utilitarian approach concludes that layoffs are sometimes ethical, but some circumstances involving the desire to change a company, this approach finds that layoffs are not ethical. This approach emphasizes a consideration of human as well as financial factors and a concern for balancing the unhappiness which such actions bring to some participants with the benefits that result to others. The utilitarian approach does not assume that the company’s financial situation is paramount, but does consider that greater good may come to a larger number of people, and that the unhappiness resulting from layoffs, might be morally justified by an analysis of the whole situation. It further considers that, if layoffs are to occur, the basis for deciding who will be laid off is also open to moral analysis.

Of the three approaches to ethical analysis used in this article, utilitarianism is the least abstract. Because major corporate decisions are so often based on impersonal analysis of financial considerations, the utilitarian approach adds an important perspective to those decisions.

Rights, Duties, and Layoffs

Much of philosophy deals with what it means to be human. There is general agreement that humans have a right to live, and that they have this right not because of their citizenship in one or another country, or because of their membership in a religion, or because of their occupation or position in life. If humans have a right to live, then they have a duty not to randomly take each other’s lives. In general, rights imply duties. This is obvious with a little thought. If I have a right to privacy, you have a duty not to invade my privacy. If I have a right to free speech, you have a duty not to silence me.

In addition to rights that people may have simply by reason of being human, other rights are conveyed to all or some citizens of a country. In the United States, citizens who are at least 18 and are not felons have a right to vote. Not all humans have this right, but citizens of some countries have it. Rights can also be granted to citizens of a state or province. Citizens can also have duties by virtue of their status as citizens. 

A third group of rights consists of those a person may have by virtue of their positions in a company or agency. A supervisor may have the right to sign company checks for up to $5,000, while the chief financial officer may have the right to sign for up to $5 million. A police officer has the right to apprehend and jail a suspect, while ordinary citizens do not. These rights can be very powerful in practice. The central point is that a person has these rights not as a human or as a citizen, but by virtue of occupying a certain position.

It is important in conducting an ethical analysis to distinguish legal rights and duties from moral rights and duties. They often overlap: most people agree that random killing is both legally and morally wrong. However, they are not always identical. In the not-so-distant past, it was illegal to drive over 55 miles per hour in the U.S., but one could argue that it was not morally wrong. If legal and moral rights and duties are always identical, then a change in the legal speed limit results in a change in the moral rightness of driving at a certain speed. A further argument against the identity of legal and moral rights and duties lies in the source of laws. In the U.S., federal laws that apply to all citizens are made by Congress. Many people are uneasy with the idea of Congress as their source of moral right and wrong.

The law in the U.S. as to whether an employer can terminate an employee at will (for any reason or no reason) varies from state to state. Federal law prohibits termination for some reasons (age, gender, disability). In cases where a labor-management contract determine wages and conditions of work, grounds for termination are usually specific and limited. Whatever rights a job an employee has under such agreements come from the employee's membership in a group covered by the negotiated contract. Applying a rights and duties approach to the ethical analysis of layoffs, it appears that the central question is whether an employee has a moral right to his or her job, and whether supervisors then have a corresponding moral duty not to determine that employee until he or she forfeits that right.

Upon reflection, it is clear that an employee does not have an absolute right to retain a job. An employee who shoots his boss or is caught embezzling large amounts of money does not have a right to keep a job. A more limited question involves the right of an employee to keep a job as long as he or she is performing it satisfactorily. It is difficult to see the basis of such a right. As indicated, some rights come from our status as humans. 

With some few exceptions, U.S. employees do not have legal rights (rights as a citizen) to keep their jobs as long as they perform well. Some countries do provide such rights; others provide less legal job protection than the U.S. The third source of rights is from status in an organization, but the general
status of employee does not in and of itself seem to confer the right to keep a job.

The moral analysis of layoffs in terms of rights and duties requires an emphasis on the individual. What a manager may or may not morally do is determined by examining the rights of the individual employee. If the manager has a duty to retain the employee the duty results from the employee’s right. If the manager is free to determine whether the employee keeps or loses a job, and can morally make either decision, in terms of this analysis the manager has that freedom because the employee does not have a right which constrains the manager’s freedom. This part of the analysis, then, concludes that under a rights and duties approach, managers are not morally prohibited from conducting layoffs.

Managers have duties by virtue of their positions as manager. Top managers have a duty to act in the best interests of their company and its stakeholders; a wealth of literature on agency theory analyzes the manager’s role as an agent for the owners or stockholders of a company. In the extreme case that characterizes our first category, where layoffs provide the only means to save the company, one could argue that top managers have a duty to do what is best for the company, and that in this case conducting layoffs is best. This approach leads to the conclusion that managers sometimes have a duty to conduct layoffs, and that failure to act on this duty would be unethical.

It is considerably less clear whether managers have a duty to conduct layoffs to improve or to change their company. Because such attempts in the past have often failed to improve performance, it makes sense to ask whether managers have a duty to take steps that might fail. The discussion of rights and duties leads to the conclusion that managers have a right to conduct layoffs in these situations (since employees do not have an overriding right to keep their jobs); it is much harder to prove that they have a duty to do so. If they have a right to conduct layoffs to improve or change the company, then under this method of analysis, it would not be unethical to do so. Particularly in the case of layoffs to change the company, when performance is already good, it does not appear that a credible arguments can be made for a managerial duty to conduct lay-offs.

**Fairness, Justice, and Layoffs**

... A philosophical approach tries to remove the level of analysis from what an individual perceives to be fair and just, and to prescribe some rules and guidelines that can be applied across many situations. Many philosophers, beginning with Plato discuss justice as involving a sense of proportion. The just reward for a heroic deed is greater than for a minor, inconsequential action. The punishment for murder is greater than for petty theft. An unjust consequence (reward or punishment) is one that is out of proportion to the action that triggers it. Justice, in most philosophical analyses, also involves a sense of consistency. If certain actions are judged worthy of reward or punishment, each person who performs the action should, in justice, receive the same reward or punishment. This idea is sometimes expressed in the statement that those similarly situated should receive similar treatment. ...

Applying this analysis to the question of layoffs, it appears that a central question is that of the fairness to the laid-off employee. Since the employee has, by our earlier definition of the situation, performed well and done nothing to trigger termination, it does not appear that there is a proportion between the action (termination) and the preceding behavior (satisfactory performance). It also does not appear that the principle of consistency is followed, since some employees who have performed well lost their jobs, while others who have performed similarly remain employed.

An approach that is sometimes taken in the name of fairness is to lay off a certain percentage of employees “across the board.” In practice, this means that each division or department or region must lay off some percentage of its employees. This does not solve the problem of fairness or consistency but merely shifts it to a lower level of decision-maker. Under this approach, the head of each unit must still decide which employees will keep their jobs and which will lose them. A disadvantage of this approach is that it disconnects the decisions from improving the company’s performance, since it is rare that all units are equally overstaffed or equally important in their contribution to the company’s overall performance.

Viewed from the perspective of the social system or the whole company, the discussion of fairness changes. In the extreme case, where failure to reduce labor costs by conducting layoffs results in the company’s closing, all employees lose their jobs.

As the cause for layoffs deviates from the clearcut case where they represent the only way to avoid the company’s closing, the argument from fairness when the system is viewed as a whole becomes weaker. Layoffs taken as a proactive step to forestall problems management foresees are less clearcut but still defensible. If layoffs are conducted to increase the profits of an already profitable firm, it is unlikely that a person behind Rawls’ veil of ignorance would consider the system allowing this to be just.

Would the analysis hold if the employees laid off were those with the least seniority or those who, while performing adequately, did not perform as well as those who retain their jobs? From the point of view of the system, seniority or merit present arguably consistent bases for deciding who loses their job and who keeps it. We should note, however, that relative seniority is much easier to establish than relative merit in performance. From the point of view of the individual, although these approaches attain some consistency, the problem of lack of proportion remains.

Of the two approaches, merit would appear to be more defensible, since it ties the goal of layoffs (improved company performance) to the judgment of which individuals should suffer layoffs (those who contribute least to the company’s performance). Seniority might be defensible if there is not sufficient evidence to use merit. The defense of seniority would lie in the fact that it is measurable and might be seen as a proxy for individual performance in the sense that employees with more experience will, in general, contribute more to the company’s performance than those with less experience.

The fairness and justice approach requires an emphasis on more than just the individual, who is the center of the rights and duties approach. Questions
of fairness and justice address issues of proportion and consistency, but within a narrower setting than that addressed by the utilitarian approach. Of the three methods for ethical analysis, then, utilitarianism takes the widest view, considering the greatest good of the greatest number, whoever and wherever they might be. A major criticism of this approach is that it neglects important individual concerns. The rights and duties approach, as we have noted, centers on the individual, and looks out from the individual’s rights to those on whom these rights impose duties. The fairness and justice approach considers both the individual and the social system within which he or she operates. The major focus of this approach is limited to a company or agency or possibly a community.

Comments and Conclusion

We have applied the three basic theories commonly used in managerial ethics to analyze the issue of the morality of layoffs. The views of these three basic theories generally coincide. In the extreme case where layoffs are the only way to save a company, the utilitarian approach finds the decision to conduct layoffs to be moral, because the layoffs generate the greatest good for the greatest number. The rights and duties approach sees the action of layoffs in the same situation to be moral because employees do not have absolute rights to their jobs. However, this view also requires that layoffs be conducted in a fair and just manner, because employees do have a right to be treated fairly. Finally, the justice and fairness approach, does not find layoffs to be moral, because they lack proportionality between the individual’s behavior (good performance) and the resulting action (termination of employment). However, when the focus is changed from fairness to each individual to fairness in the total system, layoffs are justified—at least when the alternative is that all employees lose their jobs. Since all the individuals involved are part of the system, a reasonable argument can be made that the system view is the more appropriate one to be used here. Given that layoffs are to be conducted, this approach finds seniority or merit to be moral bases for determining who will lose jobs and who will keep them.

In the opposite extreme case, where layoffs are proposed in an attempt to change a company that is already performing well and does not appear to be in danger, none of the three approaches supports the conclusion that such layoffs are ethical. In this situation, the greatest good for the greatest number is not achieved. While employees do not have rights to their jobs, managers do not have a duty to conduct such layoffs. Finally, justice and fairness are not served...

POSTSCRIPT

Is the Corporate Strategy of Downsizing Unethical?

Predicting the future is always difficult. However, when it comes to business, one thing seems certain: Global competition is here to stay and is likely to become even more intense in the foreseeable future. As a result, U.S. firms will continue to be exposed to intense competitive pressures from both domestic and international businesses. As a means of reacting to these pressures, we also expect downsizing to remain a popular strategic initiative for reducing labor costs and increasing organizational efficiency. But as the two articles in this debate make clear, the popularity of downsizing does nothing to address the basic moral question of whether or not downsizing is immoral.

Larry Gross argues that downsizing—under all conditions—is immoral. The basis of his view is that laying-off workers violates important aspects of the employer–employee relationship as well as ultimately harming society itself. There may be trouble with this view, however. Consider this observation by Frank Navran: “The truth is that unless an organization was designed expressly and overtly for the purpose, it is not in business to provide employment. Jobs are the by-product of successful organizational endeavors, not their intended output” (“The Ethics of Downsizing,” The Ethics Resource Center, 1996). The first responsibility of an organization is, like that of an individual, to act in a manner that is life-sustaining. From this perspective, downsizing is not inherently unethical, despite Gross’s protestations.

John Gilbert argues downsizing is not immoral in most instances, depending on the health of the organization at the time of the layoffs. According to Dr. Gilbert, the only time downsizing is unequivocally immoral is when the organization is profitable, its prospects for the future bright, and it chooses to reduce its workforce primarily to increase immediate profit levels. Critics might assert that this is the motivation behind the majority of layoffs by huge U.S. firms over the last twenty or so years. After all, giant corporations such as GE, IBM, and Merrill Lynch have never really been in danger of going out of business, but each has engaged in aggressive, large-scale downsizing initiatives. It’s hard to believe that these actions were motivated by much more than keeping stock prices high and increasing overall shareholder wealth.

This is a topic that invites passionate responses on both sides of the debate. Hopefully, the articles presented here provided you with some insight about the topic and alternative ways in which to view and think about the morality of downsizing.
Suggested Readings


