Utilitarianism and Business Ethics

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Business ethics and moral theory

Direct appeals to or defenses of utilitarian moral theory are relatively rare in the business ethics literature.[1] While appeals to all comprehensive moral theories have, at least in recent years, been relatively limited, utilitarian approaches are especially underrepresented in business ethics, even in comparison to other theoretical orientations, like Kantianism and virtue ethics. There are several reasons for this.

First, like many working in other areas of applied ethics, business ethicists often aim to avoid relying on any particular comprehensive moral theory to support their normative claims. In general, an argument for any claim is stronger, and will be more broadly persuasive, if it relies on narrower and less controversial premises than if it depends on more controversial premises that are widely rejected. Since utilitarianism is, like all comprehensive moral theories, highly controversial and widely rejected, it is not surprising that its role in business ethics is limited.

In other cases, business ethics theorists avoid discussing or appealing to comprehensive moral theories because they believe that the principles that apply to conduct in business are fundamentally different from—and not ultimately explained (only) by—the moral principles that apply to us as individuals more generally. These theorists generally consider business ethics a species of professional ethics, similar to how theorists in medical and legal ethics often think of their fields. [2] Proponents of this view hold, roughly, that rather than appealing to general moral principles to determine the specific principles and obligations that apply to agents in business contexts, business ethics requires a different methodological approach. Specifically, they tend to think that defending principles for business ethics requires, first, identifying either the specific considerations that justify the existence of the relevant professional roles (e.g. corporate CEO), or those most clearly implicated by actions performed in the relevant professional roles. These considerations are then taken to determine the obligations of the professionals, at least largely to the exclusion of other considerations that play a role in determining our obligations outside of professional contexts. [3]

Finally, appeals to neoclassical economic theory—which are often made in defense of profit maximization as the appropriate aim of business decision-making—have also reduced the appeal of utilitarianism among business ethicists. Neoclassical economics can appear to be grounded in broadly utilitarian commitments, and are typically best understood either in rule-utilitarian terms, or in terms of the multi-level utilitarian approach familiar from the philosophical literature.[4] Because most philosophical business ethicists are inclined to reject the profit maximization principle, there has been a tendency among them to be skeptical of utilitarian approaches.

Economic arguments and profit maximization

Many interesting and important ethical questions fall within business ethics. However, the questions commonly treated as the field's most central, concern the principle(s) that ought to guide managers' choices in firms with a particular structure. The key feature of this structure is that the relevant firms have shareholders, who have particular legal and ethical claims in virtue of their share ownership. The questions that have figured centrally in business ethics are about how we should understand the ethical claims of shareholders, and what (if any) ethical claims non-shareholders have on managerial action.

Most philosophical business ethicists reject the view that managers are obligated to aim to maximize firm profits, or total firm value,[5] within the constraints of the law.[6] Generally, this "profit maximizing principle" is defended in two main ways. The first is clearly non-utilitarian, and appeals to the claim that firm shareholders are entitled to its managers maximizing profits, and thereby maximizing the shareholders' return on their investment, in virtue of either their property rights as share owners, or their contractual rights as the ultimate employers of the managers. This claim implies that managers ought to aim to maximize firm profits even when doing so is clearly inconsistent with utilitarian principles, and even if a general policy or practice among all managers of doing so cannot be defended in utilitarian terms.

The second defense of the profit maximizing principle appeals primarily to neoclassical economic theory. The core normative assumption of these arguments is that economic activity ought to be structured so as to maximize social welfare (understood as aggregate preference satisfaction). A common view is that the most efficient use of economic resources (that will maximize aggregate preference satisfaction) involves maximizing profits: the difference between the cost of a firm's inputs and the cost that consumers are willing to pay for its outputs. The more consumers are willing to pay for a product, it is claimed, the greater the preference satisfaction they will get from it.[7] For example, consider a firm that can invest $1 million, and is deciding whether to produce product A or product B. If consumers would pay $1.5 million for the amount of product A that could be produced, but only $1.3 million for the amount of product B that could be produced, neoclassical economic theory implies that the firm should invest in the production of product A, because this would produce greater aggregate preference satisfaction.

This implies not only that firms should use their available resources to produce the outputs for which consumer willingness to pay is highest, but also that they should charge the maximum amount they can get from consumers for those outputs. This is because willingness to pay is treated as the best available indicator of the strength of individuals' preferences. On this view, if person 1 is willing to pay more than person 2 for a particular product, we should think that obtaining the product will do more to promote the satisfaction of person 1's preferences than it would do to promote the satisfaction of person 2's preferences. Because of this, charging the profit maximizing price for all products will result in greater aggregate preference satisfaction than charging any lower price, since at lower prices those with weaker preferences for particular products may obtain some of the scarce supply, which would leave at least some of those with stronger preferences for the product without access to it. And when those with stronger preferences for a product do not obtain it because those with weaker preferences do, this lowers aggregate preference satisfaction.

On this view, profit maximizing by firms is required because it is the best available means to maximizing aggregate preference satisfaction. While some economists treat the claim that profit maximizing by firms will generate maximum aggregate preference satisfaction as at least close to a conceptual claim, it is surely properly understood as an empirical claim. Some think that the evidence for this empirical claim is quite strong. For example, Michael Jensen claims that "200 years worth of work in economics and finance indicate that social welfare is maximized when all firms in an economy maximize total firm value".[8]

The view that firm managers ought to aim to maximize firm profits because this is the best means to achieving maximum aggregate preference satisfaction shares important structural features with at least certain forms of utilitarianism. First, and most obviously, it takes maximizing social welfare as the ultimate criterion that justifies the normative guidance offered to human decision-makers.

The view seems inconsistent, however, with familiar forms of act-utilitarianism, according to which each action ought to be assessed in terms of its contribution to aggregate well-being. This is because it is surely not the case that every individual profit maximizing choice by a manager of a firm contributes maximally to aggregate preference satisfaction. And, unsurprisingly, no defender of the profit maximizing principle makes this claim, or defends the principle in act-utilitarian terms.

Instead, to the extent that the precise structure of the view is articulated, it is generally presented in terms that are at least roughly analogous to either rule-utilitarian or multi-level utilitarian views in moral theory. For example, Jensen's claim is, in effect, that because social welfare would be maximized if all firms maximize total firm value, any individual manager of any particular firm ought to aim to maximize the total value of her firm. This looks like a rule-utilitarian justification of the profit maximizing principle.[9] An implicit claim, which Jensen does not articulate directly, is that each firm ought to follow the principle that is such that, if all firms followed it, social welfare would be maximized. And that is the direct analog, at the level of firms, to the rule-utilitarian claim that individuals ought to follow the rules that are such that, if everyone followed them, social utility would be higher than it would be under any alternative set of rules.

An alternative defense of the profit maximizing principle claims that for any individual manager, deliberating with a focus on maximizing firm profits will tend to result in decisions that are best for social welfare. Even if maximizing social welfare is the proper ultimate criterion for assessing actions performed in business contexts, it is not necessarily the case that individual agents ought to aim directly at, and deliberate in terms of, maximizing social welfare. Instead, it might be better for social welfare for individual agents to aim at, and deliberate in terms of, a different goal or set of goals. This line of reasoning is analogous to multi-level utilitarian arguments in favor of individuals aiming at and deliberating in terms of certain non-utilitarian considerations or goals. For example, Peter Railton argues that an individual would plausibly do more to promote social utility over the course of their life if they are disposed to aim at, and deliberate in terms of, being a loving partner or a good friend, rather than always aiming directly at, and deliberating in terms of maximizing social welfare.[10]

The multi-level utilitarian claim that managers aiming directly at maximizing social utility might not be best for achieving that goal, and the associated justification of the profit maximizing principle, is not always clearly distinguished from the rule-utilitarian line of reasoning described above.[11] It is, however, distinct in important ways, just as rule-utilitarianism is importantly distinct from multi-level utilitarianism. Perhaps the most important distinction is that while the rule-utilitarian defense of profit maximizing claims that social utility would be maximized if all firm managers aimed at maximizing their firm's profits, and implies that any particular firm manager ought to aim to maximize the profits of her firm regardless of what others do, the multi-level utilitarian argument can, in principle, allow that there are circumstances in which individual managers ought not aim at, and deliberate in terms of maximizing firm profits. This is because the relevant underlying principle is that any particular individual ought to aim at, and deliberate in terms of, whatever considerations or goals will lead that individual to do more to promote social welfare than any alternative considerations or goals. On this view, while there can be cases in which alternative aims and modes of deliberation would be best for an individual's contribution to social welfare, in most actual cases managers aiming at and deliberating in terms of maximizing firm profits will best promote social welfare.

Utilitarian objections to profit maximization

There are a number of objections that can be raised against the utilitarian arguments for the profit maximization principle described above. Unsurprisingly, many of the objections that have been developed by business ethicists appeal to non-utilitarian considerations, and suggest that utilitarian approaches to business ethics (and, typically, to ethics more generally) are fundamentally mistaken. There are, however, also many utilitarian objections.[12] These objections, if successful, would show that endorsing a utilitarian approach to business ethics need not, and indeed does not, commit one to accepting the profit maximizing principle.

Some of the objections are primarily empirical, and raise doubts about whether having managers aim at maximizing firm profits is in fact the best means to promoting social welfare. Others, however, suggest that at a more fundamental level, neoclassical economic theory cannot account for considerations that any plausible utilitarian view will imply are morally significant. If any of these latter objections are compelling, then the notion that appeals to neoclassical economic theory might generate a recognizably utilitarian approach to business ethics represents a deep error. This error, we might think, is at least partially explained by the fact that the proponents of ostensibly utilitarian arguments for the profit maximization principle are often trained in economics and related fields rather than in philosophy, and therefore are not experts in moral theory, including utilitarianism. As a result, they tend to operate with a fairly simple, stipulated account of social welfare as aggregate preference satisfaction, and to accept that willingness to pay is at least a reasonable proxy for preference strength. In addition, they tend not to engage with questions about whether there might be considerations that their own normative commitments suggest are important, but which are given no weight within the principles that they claim should guide managerial decision-making.

Preference satisfaction and alternative accounts of welfare

The utilitarian arguments for the profit maximizing principle can be challenged by objecting to the preference satisfaction account of welfare they rely on. Arguments against this account of welfare suggest that the arguments fail, even in utilitarian terms.

If, for example, welfare is best understood in hedonistic rather than preference satisfaction terms, then we would need to ask whether compliance with the profit maximizing principle would tend to produce the most happiness (i.e. the highest net sum of positive over negative experiences). And it is difficult to see what reasons we might have to think that it would. Many of the ways that firms seek to produce profits seem unlikely to generate a significant net sum of positive over negative experiences, let alone the maximum available net sum. Indeed, many of the relevant strategies plausibly do very little to produce positive experiences, or even result in more suffering than happiness.

Consider, for example, advertising strategies that work by causing feelings of insecurity or inadequacy, or rely on preexisting dispositions to these feelings, exacerbate them, and then persuade consumers that their products can relieve them. These are often effective ways of generating firm revenue, but since products can only rarely relieve these negative feelings for more than a brief period, these strategies for generating profit are likely to be net negative on hedonic accounts of welfare. And this is just one example — surely there are many others that are subject to a similar analysis.

These cases also cast doubt on the preference satisfaction account of welfare that the utilitarian arguments for the profit maximization principle rely on. Specifically, these arguments often depend on the revealed preference account widely employed in economics. On this account, our preferences are revealed by our behavior, and so it is assumed that we always act in ways that will maximally satisfy our preferences. If we in fact purchase a product, then, it is assumed that purchasing that product will satisfy our preferences more than any alternative use of the same resources.

This account ignores the possibility that we can, for example, be misled by certain advertising strategies to purchase products that will not in fact contribute (much) to satisfying the preferences to which the relevant ads appealed. It also ignores concerns about whether there is any moral value in actions that, first, create a preference that a person would not otherwise have had, and then proceed to provide the means to satisfy that preference, at some cost to the person (e.g. the cost of purchasing a product). It is far from clear, then, that even preference satisfaction accounts of welfare will favor the profit maximization principle.

Finally, on objective list accounts of welfare, according to which individuals are better off the more they enjoy certain objectively valuable goods (e.g. pleasure, knowledge, loving relationships, etc.), there is little reason to think that compliance by managers with the profit maximizing principle will tend to maximize welfare. This is, among other reasons, because the kinds of choices that consumers are typically induced to make by profit maximizing business activities very often do not promote their enjoyment of the goods that most commonly appear on the lists endorsed by objective list theorists. The tensions between consumerist values and lifestyles and the enjoyment of, for example, deep and meaningful human relationships, are familiar and widely discussed.

Resource distribution, willingness to pay, and social utility

Another reason to doubt that profit maximization will tend to maximize social welfare is that the metric falsely implies that people with more money typically have stronger interests at stake. The utilitarian arguments for profit maximization assume that where there is greater willingness to pay for product A than for product B, there are stronger preferences for A than for B, and so producing A will generate more welfare than producing B, assuming that the cost of producing each would be the same. In a world in which some people possess significantly more wealth than others, however, it is clearly false that greater willingness to pay is a reliable indication of stronger preferences. If I am deciding whether to spend $100 to produce 25 high quality, inexpensive meals that would be purchased by badly off people for no more than $5 each, or else one luxurious meal that would be purchased by a wealthy person for $150, it seems clear that I am likely to do more to promote social welfare by choosing the former option that would generate $25 in profit for me, rather than the latter option that would generate $50 in profit.[13] On a plausible preference satisfaction account of welfare, this is because the preferences of the badly off people for a high quality, inexpensive meal are surely, at least in the aggregate, stronger than the preference of the one wealthy person for the luxurious meal. It is only because they lack resources that an account that relies on willingness to pay will count the aggregated preferences of the badly off as weaker than the preference of the single wealthy person.

In a world with significant resource inequality, then, it will not be the case that profit maximization tends to maximize social welfare. Indeed, the greater resource inequality is, the more profit maximization will tend to frustrate, rather than promote, the maximization of social welfare.

Externalities and other deviations from perfectly competitive markets

A third reason to be skeptical of the utilitarian arguments for profit maximization is that they do not account for negative externalities that are often generated by profit maximizing business activity. Negative externalities are costs that are imposed via economic activity on people who are not participants in that economic activity, either as producers, sellers, or consumers. For example, if part of a firm's strategy for maximizing profits includes cheaply dumping carcinogenic by-products of its production processes in the local river, then the cancers suffered by people who are exposed to the toxins, and in particular the economic costs of those cancers (e.g. medical bills, lost income from missing work, etc.) are negative externalities.

The utilitarian arguments for profit maximization do not account for negative externalities because they assume perfectly competitive markets. Perfectly competitive markets are characterized by a number of idealized conditions: all market participants are assumed to act rationally (understood as maximizing the actor's preference satisfaction); there are many buyers and sellers, with sellers offering homogenous products; all market participants have all of the information relevant to their choices; and there are no externalities or transaction costs. In perfectly competitive markets, it is argued, profit maximization by all firms will maximize social welfare.

The presence of substantial negative externalities from profit maximizing business activity in the actual world is likely the most significant reason why the utilitarian arguments for the profit maximizing principle fail. But there are other deviations from perfectly competitive markets in the actual world that are also worth noting. For example, Jensen acknowledges that monopolies, in addition to externalities, break the connection between profit maximization and the maximization of social utility that he claims exists in perfectly competitive markets.[14] This is because, among other reasons, in the absence of competition, firms can extract greater resources from consumers, which diminishes the gains to social utility from economic transactions. Importantly, it is not only monopoly conditions that significantly limit the gains to social utility in comparison to conditions of perfect competition. If firms have greater market power than they would have in conditions of perfect competition (where they, like all market actors, would have none) they can affect the terms of market transactions in ways that will tend to limit the gains in social utility produced. In the actual world many firms have a great deal of market power, so maximizing profits will not maximize social utility.

Similar points can be made about, for example, the lack of perfect information in actual markets, where consumers often lack access to relevant information. Here again, deviations from conditions of perfect competition seem likely to severely undermine the case for thinking that maximizing profits will tend to maximize social utility.

Nonhuman animals

An especially powerful utilitarian reason to reject the above case for the profit maximization principle, is that the view gives no weight whatsoever to the interests of nonhuman animals.[15] Since utilitarians virtually unanimously believe that nonhuman animal interests are morally significant,[16] the fact that the profit maximizing principle does not, and indeed cannot, count the interests of nonhuman animals *at all* should be viewed as a very serious problem by utilitarians.

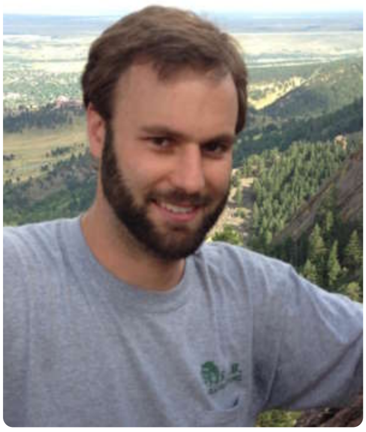
The reason that the profit maximizing principle cannot count the interests of nonhuman animals is straightforward. Because they have no willingness to pay that can be responded to by market actors aiming to maximize profits, their preferences (e.g. the preference to avoid suffering) cannot be counted by a formula that measures strength of preference in terms of willingness to pay. So, while those humans with limited economic resources (e.g. the global poor) have their preferences, in effect, counted for less than those of people with greater resources, the preferences of those who cannot, in principle, be market actors cannot be counted at all.

This means that proponents of the profit maximizing principle are committed to accepting that if a firm can maximize its profits by, for example, subjecting billions of nonhuman animals to conditions that amount to torture in order to produce meat or other products that human consumers are willing to pay for, then they ought to do it. In addition, if they endorse the profit maximizing principle on utilitarian grounds, then they are committed to holding that doing this can be expected to maximize social utility. Utilitarians, however, will rightly find this implication absurd.

Conclusion

The utilitarian objections to profit maximization show that utilitarian managers and entrepreneurs must focus on more than profits. Most fundamentally, they must ensure that their business strategies reflect a willingness to accept less than maximal profits when this would be better for social welfare. Accepting that there can be significant conflicts between profits and social welfare, and that ethically, social welfare should be prioritized, conflicts with dominant norms in much of the business world. But utilitarianism, properly understood, surely requires it.

About the Author



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1. For exceptions, see Gustafson, 'In defense of a utilitarian business ethic' and Jones & Felps, 'Stakeholder happiness enhancement'. ↩
2. For example, Heath, 'Business ethics without stakeholders' and Donaldson & Walsh, 'Toward a theory of business'. ↩
3. For criticism of this approach, see Berkey, 'What should business ethics be?'. ↩
4. For example, Railton, 'Alienation, consequentialism, and the demands of morality'. ↩
5. Maximizing profits and maximizing total firm value are, on at least most views, treated as equivalent. ↩
6. For a defense of profit maximizing, see Friedman, 'The social responsibility of business is to increase its profits'. Friedman adds that managers' pursuit of profits should be constrained by 'ethical custom' as well, though he does not explain how he understands the content of this constraint. ↩
7. This claim is widely challenged because the rich will typically be willing to pay more for the products that they want than the poor can pay for things that would benefit them at least as much. ↩

8. Jensen, 'Value maximization, stakeholder theory, and the corporate objective function', p. 239. ↩
9. Jones & Felps, 'Shareholder wealth maximization and social welfare', p. 213. ↩
10. Railton, 'Alienation, consequentialism, and the demands of morality'. ↩
11. For example, Jensen, 'Value maximization, stakeholder theory, and the corporate objective function'; Boatright, 'Fiduciary duties and the shareholder-management relation'. ↩
12. Jones & Felps, 'Shareholder wealth maximization and social welfare'. ↩
13. For a similar example, see Jones & Felps, 'Shareholder wealth maximization and social welfare', pp. 222-3. ↩
14. Jensen, 'Value maximization, stakeholder theory, and the corporate objective function,' p. 239. ↩
15. Berkey, 'Prospects for an animal-friendly business ethics'. ↩
16. Indeed, utilitarianism implies that equivalent interests (e.g. in avoiding suffering) must count equally, regardless of species membership. ↩