

Multidisciplinary fairness and equity interpretations influencing research on fairness in interorganizational business relations

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Research on fairness and equity is linked closely to justice studies, which have academic roots in many disciplines such as philosophy, law or social psychology. In the past decades, economic theorists have attempted to incorporate fairness perceptions into their models as well. Recently, management science has been focusing on fairness and loyalty research not only in intraorganizational settings, but also among entities participating in business transactions with the objective of identifying improvement opportunities, which can increase the efficiency and effectiveness of business interactions in network operations or collaborations. Research suggests that a business relationship which is considered fair is more balanced and stable (Scheer–Kumar et al 2003). As a part of a broader research on this topic, it is essential to understand the different layers and aspects of fairness interpretations which can affect the definition and the measurement of fairness in interorganizational relationships. This paper provides a literature overview, which provides the foundation for the next stage of the study, in which we will compare fairness expressions in interorganizational relationships in a cross-cultural empirical research setting.

Keywords: fairness, equity, interorganizational relationships, management
JEL code: D63, D64, M19

1. 1. Introduction

The research on fairness and equity, closely linked to different interpretations of justice, has its academic roots in many fields of social science. The objective is to give an overview on fairness research by summarizing the different disciplines' approach to fairness. This introduction will lead the way to the managerial interpretation and research of fairness, specifically focusing on the interorganizational aspects.

We are going to review the base, dictionary-driven definitions of fairness and equity, which are often used as synonyms in the literature. The next part will review Aristotle's interpretation of justice and its link to fairness and equity definitions, which is followed by the review of the main path of philosophical interpretations of justice. We examine the fairness interpretation in different legal systems. Then, we review some economic theories incorporating the concept of fairness in their

models. At the end, we look at the applicable intraorganizational justice insights. We capture the key findings and potential implications on the definition and measurement of fairness for the management aspects specifically affecting interorganizational relationships.

As a first approach, let us review the basic dictionary definitions of fairness and equity. Out of the many meanings, fair, as an adjective, means “treating people equally without favoritism or discrimination.” It is also referred to as “just or appropriate in the given circumstances.”¹

Fairness and equity is interchangeably used in many works. Therefore, we will use them as interchangeable expressions in this review.

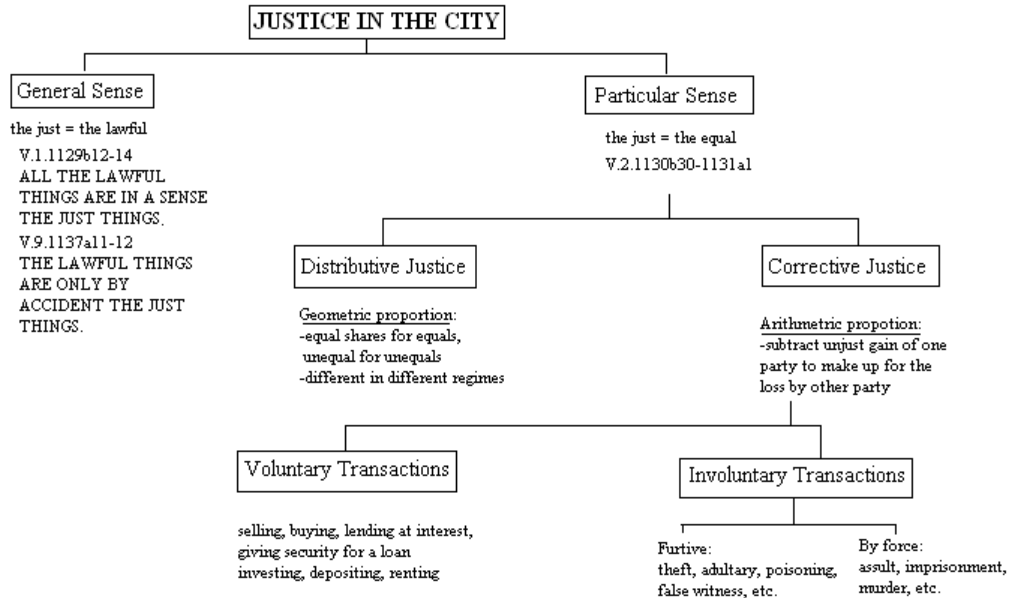
2. Aristotle’s definition of justice and equity

Although equity and fairness research have an extensive multidisciplinary academic literature, the basic interpretation leads us back to Aristotle’s teaching and definitions. Even for a reader of today, the books of *Nicomachean Ethics* are fascinating studies. In the IVth and Vth books, Aristotle organized his interpretation of justice and fairness. In general, he considers *universal justice legal and equal for all*. However, he differentiates distinctive types of justices such as *distributive justice* (*justitia distributiva*) and *corrective justice* (*justitia correctiva*). In the recent work of Burger, a relationship map (Figure 1.) between Aristotle’s distribution justice and corrective justice is set up, which are the key guidelines organizing the life of a community or society, called city or city-state (Burger 2008). Distributive justice distributes richness, power and honor based on merits, which represents geometric proportion in the relative sense. Corrective justice compensates for inequalities, and balances loss and gain in the transactions of life in a so-called arithmetic proportion in an absolute sense. Within that, Aristotle distinguishes cases as a part of voluntary and involuntary transactions (Aristotle 350.B.C.).

In the Vth book, chapter 10, Aristotle also deals with equity as fairness in relation to justice. In his initial approach, he presents us a confusing picture of having them neither absolutely the same nor generically different. When considering them being similar, the just and the equitable, are both good; while the equitable is superior. This controversy is unlocked in the following way.

¹ Oxford Dictionaries, 2010 Oxford University Press. <http://oxforddictionaries.com>

Figure 1. Aristotle's categories of Justice



Source: Burger (2008, p. 223.)

“What creates the problem is that the equitable is just, but not the legally just, but a correction of legal justice. The reason is that all law is universal but about some things, it is not possible to make a universal statement which shall be correct. In those cases then, in which it is necessary to speak universally, but not possible to do so correctly, the law takes the usual case, though it is not ignorant of the possibility of error. In addition, it is nonetheless correct; for the error is neither in the law nor in the legislator but in the nature of the thing, since the matter of practical affairs is of this kind from the start. ... Hence the equitable is just and ... not better than absolute justice but better than the error that arises from the absoluteness of the statement. And this is the nature of the equitable, a correction of law where it is defective owing to its universality.” (Aristotle 350 B.C. V.10.). In this interpretation, therefore, when speaking about *equity and fairness*, it represents an extension of the idea and intention of the law where the law itself cannot be literally applied. That explains the superiority of equity, as it corrects the defective law, which becomes universally applicable through equity.

In V.5. *reciprocity* is detailed as well, which is linked to equality. Equality has two distinguishable forms in Aristotle's definition, which are *simple, numerical equality and proportional equality* (Aristotle 350 B.C.). Numerically equal treatment of others or distribution exists when it treats all persons identically or granting them the same quantity of a good per capita, which is not always just. In contrast,

proportionally equal treatment of others or distribution exists when it treats all relevant persons in relation to their due. Numerical equality is only just under special circumstances, when persons are equal in the relevant respects so that the relevant proportions are equal. “Proportional equality in the treatment and distribution of goods to persons involves at least the following concepts or variables: Two or more persons ($P1$, $P2$) and two or more allocations of goods to persons (G) and X and Y as the quantity in which individuals have the relevant normative quality (E). This can be represented as an equation with fractions or as a ratio. If $P1$ has E in the amount of X and if $P2$ has E in the amount Y , then $P1$ is due G in the amount of X' and $P2$ is due G in the amount of Y' , so that the ratio $X/Y = X'/Y'$ is valid” (Gosepath 2007, p. 4.).

Commutative justice (*justitia commutativa*) has been differentiated from the Distributive Justice by the Scholastics when interpreting Aristotle’s teaching and applying it for economic exchange (Farkas 1989). Commutative justice guided the exchange between equal partners serving a root for thinkers to develop the basic concepts of economics and economic transactions. Commutative justice represents a state resulting from fair and free exchange. A principle of commutative justice specifies how individuals should be treated in a given class of actions and transactions.

However, the term justice is a constantly disputed concept, whose meaning is never final or fixed. Aristotle called justice representing a middle point between conflicting aims. Based on that, each society or group within a society will have its own definition of justice which cannot be reconciled given the special local circumstances. Each society will have its own ideas about justice and fairness, and its own practices for implementing them. These concepts are inevitably conflictual and can be politically charged.

3. Fairness in philosophy

The philosophical doctrines continuously emphasize the importance of applying ethical aspects when defining fairness, which is linked and related to defining justice as well. The concepts briefly described in these paragraphs are to give a broader view of the ongoing justice debate without the attempt of making a full review. The reason why we feel it is critical to mention these concepts is that when developing any economic or business model, the base assumptions are leading us back to the philosophical principles of what is considered to be just or fair. Different social justice concepts create various approaches dependent on the range of society members affected, the projected dimensions and other parameters of the model such as the level of acceptance of human disparity (Tóth 1991).

Based on the *utilitarian approach*, social welfare is to be determined by the aggregate of individual utilities, which results in total social utility. The social

welfare function maximizes the aggregate social utility by looking for a Pareto-optimal situation, in which the aggregate social utility is the largest in such a way that any change does not deteriorate any individual utility (Tóth 1991). However, it is insensitive to any additional problems related to the distribution of wealth among the individuals within the society. In all cases, the greater aggregate utility is preferred regardless of the potential of distribution inequalities.

John Rawls was associated with the concept of *liberal egalitarianism* relying on the social contract concept and modern decision-making approaches (Tóth 1991). Rawls's approach to justice represents the central theme of decision-making. Distributing equally is the starting point in his concept. Unequal distribution is only considered acceptable if it serves the common good (Rawls 1971). The first priority rule refers to the principle of freedom, which does not allow conversion between economic benefits and freedoms when the social distribution is determined. The second priority rule emphasizes the primacy of exchange between justice versus prosperity and efficiency. Based on this, he considers an institution just which improves the situation of the most disadvantaged ones first.

Friedrich August Hayek, an Austrian *empirical libertarian* economist and philosopher, lays down the following arguments when navigating through the issues of justice. In his interpretation, freedom is considered a fundamental pillar, which is interpreted as a potential to choose among alternative options (Tóth 1991). Freedom exists when there is a lack of compulsion. The second pillar represents limited cognoscibility, as due to its limitations, the human mind cannot embrace fully the complexity of the society. The third pillar is methodological individualism. In a society, individuals represent the entity of a society of individuals. Hayek distinguishes between two social idealistic states of orders. One is the established order, which is the result of human design, organized in a hierarchy of goals, operating principles and structures (Tóth 1991). Based on his above-mentioned principles, such an order cannot be optimal. The other is spontaneous order, which can be captured only in an abstract way due to its complexities. Hayek raises the question whether there is any sense of social justice applicable to an order. Just or unjust can be applied only to human behavior. In a spontaneous order, there is *no entity to be accountable for justice*. Therefore, we cannot speak of the just or unjust nature of distribution in that case.

Robert Nozick, a representative of *natural rights liberalism*, makes a distinction between the justice of acquiring and the justice of the transfer. *Property acquisition* and transfer are the only legitimate ways of *transfer*. However, that is not always the case. Therefore, he introduces *the principle of compensation* to make up for the unjustly impacted party (Tóth 1991). These three principles constitute Nozick's concept of justice.

Philosophy offers us a variety of approaches when considering social justice. They work as a basic framework for different concepts of fairness. When looking at

fairness interpretations and models, we will be able to link back basic assumptions of different social justice concepts to the different philosophical routes.

4. The legal interpretation of fairness related to justice

The key philosophical concepts are materialized through the ways of working of a society. The key element of this are the legal systems, which eventually provide a framework for individuals and business entities to operate. The law, with a collection of structured rules, provides a base and contractual framework of operations for an individual, a business or any other entities and organizations of a society. When looking at the different legal frameworks, we immediately face a colorful varieties of approaches.

The continental *civil law* system is a widely used legal system in more than seventy countries around the world. As a legal framework, it represents a complete set of rules and regulations about determining what is right and what is wrong (McFarlin–Sweeney 2006). The historical roots of the civil laws date back to the Roman times, and were later used as a base when establishing the Code Napoleon. Today it is widely spread in Continental Europe and in those non-European countries where the colonization of Europeans left its marks. In the civil law system, the judge takes a great part in proceedings including decisions about what evidence is presented to the court (Pokol 2001). The legal cases are decided under the strict rule of law. *A contract, even it may prove to be unfair, will be normally upheld and enforced by the legal system.* When the written law is not applied strictly to a specific case, then it is to be decided *ex aequo et bono*, which means that the case to be decided by principles of what is fair and just. However, a case to be decided *ex aequo et bono* on its merits, when the strict rule of law is overridden, requiring a decision based on what is fair and just in given circumstances (McFarlin–Sweeney 2006).

The Anglo-Saxon *common law* system is practiced in more than thirty countries including the United Kingdom and most of its former colonies, the United States, Canada, Australia, and Ireland (McFarlin–Sweeney 2006). The common law uses the rulings and outcomes of previous cases or precedents to resolve legal disputes. The focus is put on the specific case and its similarities to previously resolved cases and its outcomes instead of applying general principles. Great importance is put on the procedure of legal dispute resolution in which the judge in a common law system is relatively passive, typically functioning as a neutral referee. The lawyers of the plaintiff and defendant are expected to present evidence and develop a legal case to resolve the dispute. *Common law does not have an interpretation of fairness.* The statue of Prohibition of abuse of rights exists in the UK, which prohibits engaging in any activity or performing any act aimed at the

destruction of any of the rights and freedoms set forth herein or at their limitation to a greater extent than is provided by the law.²

Beyond the different interpretation of civil and common law system, there are other systems such as religious law, customary law and mixed or pluralistic systems with each of them having a different interpretation and guidelines on fairness, which are locally influencing and influenced by the local interaction among individuals and entities.

European Union Law had developed as a sub-discipline of international law, now being a “sui generis” law system known as “supranational law”, in which the rights of sovereign nations are limited in relation to one another. International law, on the other hand, is the law of the international community, or the body of customary rules and treaty rules accepted as legally binding by states in their relations with each other. International law differs from other legal systems in that it primarily concerns sovereign political entities (Shaw 2003). Both on the international and supranational level, general guidelines are laid on top of the local systems to mitigate the interactions between nations without serving as solid globally accepted approach.

Therefore, from our point of view it can be observed that different sizes of legal spaces exist for practicing fairness within the legal framework, which are embedded in the legal systems. However, dependent on the historical development of a country, the legal system and the local national culture shape the practical ways of working locally creating greatly different local business environments.

5. Fairness in economic models

Neoclassical economic concepts date back to economists such as Jevons, Menger and Walras, who independently formulated and published the principle of diminishing marginal utility at the beginning of the 1870s. A commodity requiring twice the work hours is not twice as valuable as another as the customers' willingness to pay twice as much is independent from the work hours needed (Polónyi 2002). Utility is a considered subjective, consumer-related category having a value of being useful in meeting consumer needs. The consumer assesses the goods based on the marginal utility of each unit of goods, evaluating the adequate market price (Polónyi 2002). Neoclassical economics worked with mathematical models in which utility determines value. The objective of a Pareto-efficient solution drives the optimization process until there is no other allocation in which any individual is better off, while no individual is worse off. This model builds on a stylized reality in which perfect competition is assumed without external economic

² Convention for the Protection of Human Rights and Fundamental Freedoms as amended by Protocols Nos. 11 and 14.

effects. The neoclassical approach considers individuals to be selfish and rational players maximizing their own benefits. The models does not consider the discussion of equity issues to be the task of economics, therefore it does not deal with equity and fairness issues.

On the microeconomic level, attempts were made to incorporate the question of fairness. We will review Baumol's model, who worked with the assumption that there is a possible trade-off between fairness and efficiency goals and objectives. This meets the utilitarian approach, but contradicts Rawls and Hayek's interpretation of justice just as a reference. Foley defined the *envy-free principal*, which was built into Varian's fair distribution definition. Varian determines that an equitable distribution exists if it is envy-free, *which means that no individual prefers anyone else's share of the distribution more than his own. Varian calls the distribution fair when it is equitable and Pareto optimal* (Varian 2008).

Baumol argues that Varian's definition of fairness invites confusion between issues of the allocation efficiency and equity, which is clarified in Baumol's approach of fairness and superfairness theory (Baumol 1987).

Baumol's definition of fairness states that "a distribution is called superfair, if each class of participants prefers its own share to the share received by other group, that is, if no participant envies the other" (Baumol 1987, p. 15.).

There is a fairness boundary line which separates the combinations deemed unfair to the group from the fair combination. The Edgeworth box is equal distribution, expressing concern at the heart of any individual's fairness boundary passing through the same indifference curve, and therefore equal distribution is always preferred over any fair distribution. The area of superfair distribution is considered those points which are fair or more than fair from both actors' points of view. We look for a distribution, which is superfair distribution, which is better than the equal distribution of non-homogeneous products (Bara 1998).

6. Fairness from the intraorganizational perspective

When looking at the *management application of fairness theories*, we find that many areas of management are impacted by the findings of social psychology. Areas of Human Resource Management have specifically built a number of practical applications in hiring, performance management, compensation and benefit management in order to build a genuine and adherent business culture (Brockner 2006).

Social psychology made a major effort in theorizing on fairness in Organizational Justice studies. Homan published first about the *social exchange theory* proposing that an individuals' objective is achieving the maximum benefits with the minimal cost which is also used for evaluating relationships (Homans 1961). Further theorizing on Homans' work, Adam published the well-known *Equity*

Theory (Adams 1965). The theory suggests that people compare the ratio of inputs and outputs, which is being used to determine the equitable state and drives their satisfaction level. Here we can identify the link to Aristotle's proportionate equality definition. Adams' works generated a wave of debates resulting in the so-called *Distributive Justice* research in social psychology. Later on scientists started to examine the way in which a decision is made to arrive to a certain outcome. In this approach, called the *Procedural Justice*, researchers find that the distribution of outcomes cannot be fair without a fair procedure. Procedural justice examines aspects of an individual's fairness perception of the outcome of the allocation process, for which a number of procedural justice models, for example the Group Value model, were developed (Tyler–Lind 1992). *Interactional Justice* is the third dimension of the organizational justice research. It "refers to the perceived fairness of the enactment or implementation of procedures and has two sub-facets. Interpersonal justice captures the sincerity and respectfulness of authority communication, while informational justice concerns the use of honest and adequate explanations for decisions" (Colquitt et al 2006, p. 111.). *Integrative Justice* theory embraces all the three (distributive, procedural and interactional) approaches. Folger's *Referent Cognitions Theory* was among the first integrative models, soon followed by others such as the *Fairness Theory* or the *Fairness Heuristic Theory* (Lind 2001, Cropanzano et al 2001).

Organizational Justice focuses on intra-organization fairness issues. With the increasing number of interorganization and international co-operations, it is relevant to ask how organizations interpret fairness in business to business relationships. An empirical study was done on this topic with the objective to investigate perceived inequity in interorganizational relationships between automobile producers and dealers in the Netherlands and the US, which revealed that different cultures interpret fairness differently during their business interactions (Sheer–Kumar et al 2003).

7. Conclusion

The reviews above clearly showed that there is a striking difference when looking at fairness concepts on the theoretical level compared to elements of practical life. Aristotle documented this observation as well, who made a clear differentiation between justice and equity theories. We see a path formulated on distributive and procedural justice leading to an integrative approach through the intra-organizational research. Therefore, fairness is practically linked to the objectives and procedures as well, whether applied to a life of a society or an organization. We cannot ignore the local, legal environment and the cultural features of the business environment in which business entities are operating. However, how far fairness can be interpreted universally in an interorganizational business setting can be a question of an empirical cross-cultural comparison, which is the next stage of our research agenda.

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