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The Virtue MATRIX

BY DEAN ROGER MARTIN

A TOOL FOR UNDERSTANDING CORPORATE SOCIAL RESPONSIBILITY

In the wake of recent corporate scandals, corporate leaders need to think more rigorously about corporate responsibility – whether they like it or not. Failure to do so, says Dean **Roger Martin***, will see options taken out of their hands. In this article he describes a tool he has developed to help executives assess opportunities for socially-responsible behavior.*

Corporations don't operate in a universe composed solely of shareholders. They exist within larger political and social entities and are subject to pressures from members of those networks, be they citizens concerned about environmental pollution, employees seeking to strike a balance between work and family, or political authorities protective of their tax bases. When the interests of shareholders and the larger community collide, management typically – and quite rationally – sides with shareholders. The almost inevitable next step is for management to come under fire for favoring the narrow interests of shareholders over the broader interests of the community.

The interests of shareholders and those of the larger community are not always opposed, of course. Corporations often willingly engage in socially-responsible behaviour precisely because it enhances shareholder value. They choose to undertake philanthropic activities such as supporting local museums or soup kitchens because they believe such activities create goodwill among customers in excess of their price tag. Likewise, companies provide daycare and exercise facilities because the improved productivity and retention rates generated by these perks outweigh their cost. And a growing number of companies such as **The Body Shop**, a global skin- and hair-care retailer, make corporate virtue part of their value proposition: buy one of our products, they tell customers, and you improve the lives of women in developing countries, promote animal rights, protect the environment, and otherwise increase the supply of social responsibility.

ILLUSTRATION: MICHAEL GIBBS

There's a second class of socially-responsible corporate conduct that generates shareholder value by keeping a business on the right side of the law. For example, company compliance with worker-safety regulations and sexual harassment statutes serve shareholders' interests by keeping a company free from legal sanctions and safeguarding its reputation.

Clearly, then, shareholder value and social responsibility are not necessarily incompatible. Whether their activities are dictated by choice – supporting charities and cultural institutions, for instance – or by compliance – adhering to laws and regulations – corporations can and do serve shareholders' interests while also serving those of the larger community. For the purposes of this article, such forms of corporate social responsibility are termed **instrumental** – that is, they explicitly serve the purpose of enhancing shareholder value. At any given moment, instrumental practices, backed by either laws and regulations or social norms and conventions, make up most of the supply of responsible corporate behavior.

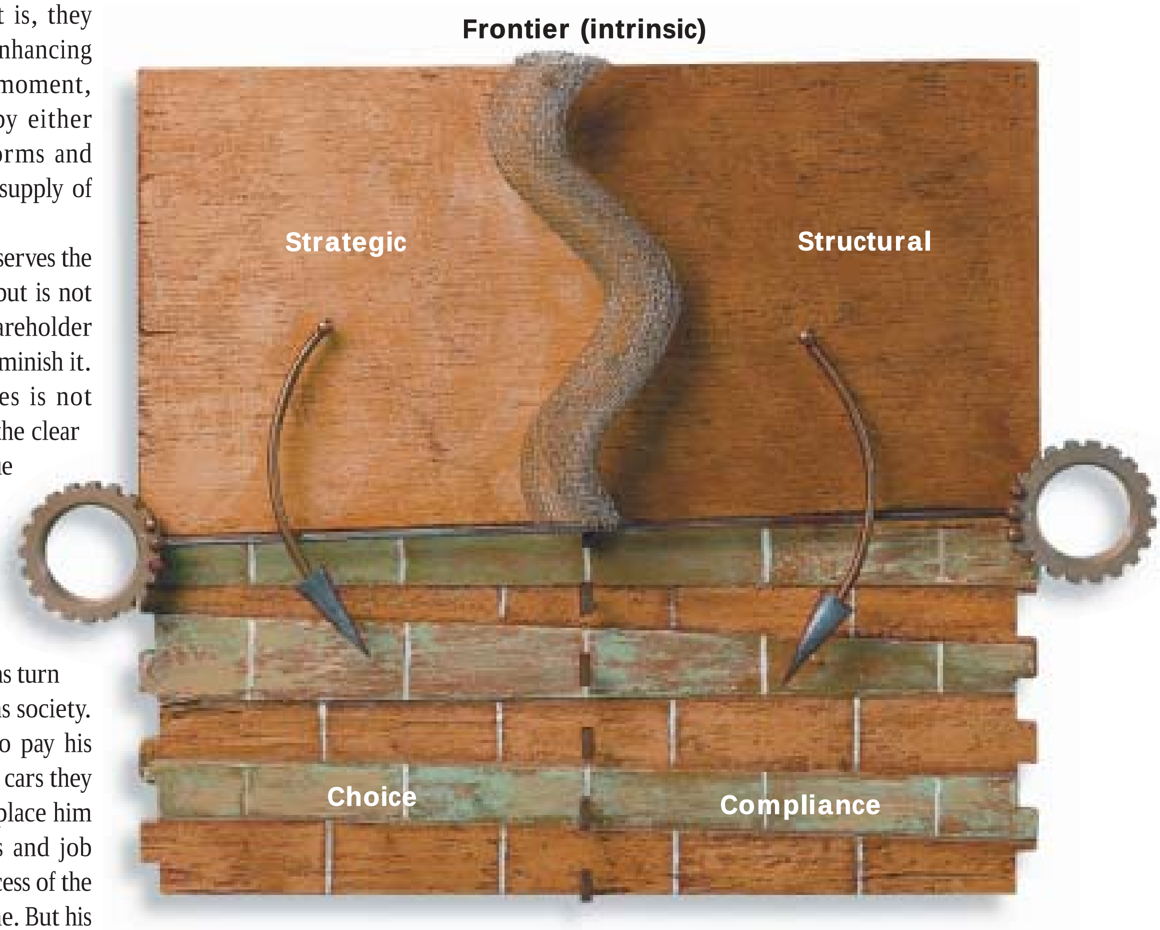
Another set of activities, however, serves the interests of the larger community, but is not guaranteed to do the same for shareholder value; in fact, these activities may diminish it. The motivation for such activities is not instrumental – that is, impelled by the clear purpose of enhancing shareholder value – but **intrinsic**: A company's leaders embark on a course of action simply because they think it's the right thing to do, whether or not shareholder interests are served.

Some intrinsically-motivated actions turn out to benefit shareholders as well as society. **Henry Ford** believed he ought to pay his workers enough to afford to buy the cars they produced. That policy appeared to place him at a disadvantage, since the wages and job security at his plants were well in excess of the norms in the auto industry at the time. But his decision ultimately benefited **Ford Motor Company** by making it an attractive employer and by stimulating demand for its products. At the same time, Ford's move benefited society by raising the bar for pay and labor practices across the auto industry.

Some intrinsic activities, like the renowned **Malden Mills** case – whereby a 1995 fire destroyed a textile plant in northern Massachusetts, and owner **Aaron Feuerstein** used his $300-million insurance settlement to not only rebuild the plant, but also pay his workers while it was under construction – benefit society at the shareholders' expense. Others, however, unless widely adopted, are both detrimental to shareholders and ineffectual in establishing socially beneficial norms. For instance, the leaders of a chemical producer may believe that investing heavily in greenhouse-gas reduction is the right thing to do. But if the producer's rivals refuse to follow suit, the company may undermine its own cost-competitiveness without significantly lowering overall greenhouse-gas emissions.

In retrospect, of course, it is fairly easy to determine whether a particular corporate action benefited shareholders, society, both, or neither. But corporate leaders don't have the aid of hindsight when making their decisions. They can, however, use the **Virtue Matrix** as a framework for assessing opportunities for socially-responsible behavior.

THE VIRTUE MATRIX



How The Virtue Matrix Works

The Virtue Matrix is composed of four quadrants. The bottom two make up the 'foundation' of the matrix, the top two its 'frontier'. The lower two quadrants are what I call the **civil foundation.** Akin to the 'common law' of responsible corporate behavior, the civil foundation is an accumulation of customs, norms, laws and regulations. It promotes conduct that is socially responsible and enhances shareholder value.

In the left quadrant is conduct that corporations engage in by choice, in accordance with norms and customs. The right quadrant represents compliance – responsible conduct mandated by law or regulation. A dotted line divides the choice side of the civil foundation from the compliance side, indicating that the boundary between the two is porous.

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Some activities that enter the civil foundation through the left quadrant eventually become so widespread that the norms are enshrined in laws or regulations. For example, only a handful of companies once offered health care benefits to employees' dependents. Because the goodwill engendered among employees and customers exceeded the cost of the benefits, more companies copied the practice. Eventually, government regulations required most companies offering health benefits to extend them to employees' dependents as well.

The civil foundation is not drawn to scale. It is deep and robust in prosperous, advanced economies, whereas in less-developed economies it is likely to be shallow and fragile. Perhaps the most significant aspect of the civil foundation is its upper limit – that is, the line separating it from the frontier quadrants. It is not fixed. Rather, in robust economies, it tends to move upward over time, as new social benefits become norms or even legal requirements. But the civil foundation can shrink as well as expand. Pressures on less-healthy economies can weaken the norms – and in some cases, even the legal enforcement – that support the civil foundation.

For a case in point, consider Russia immediately following the collapse of Soviet rule: regulations governing working conditions, child labor, and the like were largely not enforced, and legal authorities – far from protecting state assets – participated in their wholesale looting. As a result, commercial enterprises – which had been subject to at least minimal discipline by Soviet authorities – became vehicles for the enrichment of a handful of plutocrats. Only in the past few years, as foreign financiers have conditioned their investments on a modicum of responsible corporate behavior, has Russia re-established the semblance of a civil foundation.

The top two quadrants of the matrix, the *strategic* and *structural* frontiers, encompass activities whose motivation tends to be intrinsic and whose value to shareholders is either clearly negative or not immediately apparent. The **strategic frontier** includes activities that may add to shareholder value – and become instrumental – by generating positive reactions from customers, employees, or legal authorities. Actions that fit in this quadrant -- though risky – are generated by the conscious choice of the corporation's senior management, as part of their profit-making strategy.

Socially-responsible corporate practices in the strategic frontier tend to migrate to the civil foundation as other companies 'imitate the innovator' until the practice becomes the norm. An example is **Prudential Insurance**'s 1990 introduction of viatical settlements – contracts that allow people with AIDS to tap into the death benefits in their life insurance policies to pay for medical and related expenses. The move generated so much goodwill that competing insurers soon began offering this as well. Very quickly, corporate behavior that had seemed radical became 'business as usual' throughout the insurance industry.

The upper right quadrant of the matrix, the **structural frontier**, houses activities that are both intrinsically motivated and turn out to be *contrary* to the interests of shareholders. The benefits of corporate conduct in this quadrant accrue principally to society rather than to the corporation, creating a fundamental structural barrier to corporate action. The Malden Mills example is a classic case of conduct on the structural frontier. By continuing to pay his employees, the mill's owner spared them considerable hardship and relieved the state and city of the costs of unemployment insurance and welfare payments. But his generous act decreased his own wealth and that of his fellow shareholders. Unlike Prudential's actions, Aaron Feuerstein's conduct will probably not become the norm in corporate America.

The strategic and structural frontiers are separated by a wavy line, which is intended to suggest that some actions are not clearly *beneficial* or *detrimental* to shareholders. For instance, **Procter & Gamble** had a strict policy of refusing to pay bribes to win foreign business long before the *Foreign Corrupt Practices Act* banned such conduct. While this may have placed the company at a disadvantage compared to its rivals, P&G's improved reputation among consumers in the U.S. and elsewhere likely offset that harm.

On the whole, though, actions that fall between the strategic and structural frontiers tend to gravitate, by default, toward the structural frontier. If the corporate consensus is that a particular activity will not accrue to shareholders' benefit, no one corporation is likely to take the initiative to disprove that assumption. Thus, executives' commendable concern for their shareholders' wealth can sometimes stifle innovations in corporate social responsibility.

Having toured the Virtue Matrix, let's use it to analyze the issues confronting senior executives when they consider their corporations' social responsibilities. The first to tackle is why the public clamor for more responsible corporate conduct never seems to abate.

Why Good Deeds Get Punished

Some companies are near-paragons of socially-responsible behavior. They support worthy causes in the communities in which they operate, their workforces are diverse, their workplaces family-friendly. They go well beyond the minimum safeguards required by environmental regulations. Yet many citizens, interest groups, and media commentators complain that these very companies are insufficiently attentive to the common good. What explains the public's perception that, at any given time, there is an under-supply of corporate social responsibility?

In a sense, companies are victims of their own good deeds. Consider the civil foundation again. The corporate behavior that falls into the lower quadrants of the Virtue Matrix may have originated on the strategic frontier, but today it is either mandated by law or enforced by custom and tradition. Thus, complying with environmental law or providing on-site daycare wins corporations little credit in the public mind today. Such conduct is less a responsibility than a duty.

For a company to earn public credit for its behavior, it has to engage in activities that reside in the frontier. This is where the public sees obvious social or environmental benefits to be gained, but little corporate willingness to realize them. At any given time, only a few companies are operating on the strategic frontier.

The picture is even worse on the structural frontier. No consortium of energy producers has come together to formulate and execute a strategy to reduce greenhouse-gas emissions.

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Pharmaceutical manufacturers have not yet crafted a plan to halt the worldwide spread of HIV infection. Media companies have failed to take concerted action to stem the tide of vulgar trash that too often passes for children's entertainment. There are compelling commercial, scientific, and political reasons why these initiatives have not come to pass, but the inability or unwillingness to deliver these obvious benefits creates a powerful public sense that corporations are not doing enough.

The Vision Shortage

The most significant impediment to the growth of corporate virtue is a dearth of vision among business leaders. Opportunities abound to devise programs and processes that benefit society as they enrich shareholders. What seems lacking is imagination and intrinsic motivation on the part of corporations and executives. This is by no means an insurmountable obstacle. Fundamental economics are on the side of innovation in the strategic frontier. What's needed is support for the companies and business leaders who undertake bold initiatives. This support is essential, since the benefits of innovation on the strategic frontier are speculative until action is taken.

Consumer agitation can help executives weigh the risks of action. For example, Scandinavian consumers have long pressed for more environmentally-friendly paper products, such as toilet tissue and disposable diapers. This pressure helped convince Scandinavian paper producers to take a chance on innovations such as using unbleached pulp in their products.

Perhaps even more effective than consumer agitation is peer encouragement. By publicizing their successes on the strategic frontier, business leaders can encourage further innovation by other companies. Prudential made a point of trumpeting the enthusiastic market acceptance of viatical settlements. Favorable newspaper articles and TV spots about the settlements convinced rival insurers that the risk of introducing similar products was negligible compared with the potential benefits.

Far more troublesome and difficult to dislodge are barriers to action on the structural frontier. As a result, the solutions I propose are provisional, and I encourage readers to challenge and extend my thinking on this question. The greatest barrier to corporate action on the structural frontier is the lack of economic incentives. Agitation from consumers won't sway companies, since, by definition, if consumers were enthusiastic and likely to reward corporations for a particular innovation, that innovation would be located on the strategic frontier. Nonetheless, there are ways to overcome this bias toward the status quo. The most effective weapon against inertia is collective action, either on the part of governments, non-governmental organizations, or corporate leaders themselves.

Although the business community frequently derides government regulators, pressure from these sources can help responsible corporate behavior migrate from the structural frontier to the civil foundation. Consider, for instance, the case of mandatory air bags in automobiles. If only one manufacturer had decided to equip its vehicles with air bags, it would likely have had to raise sticker prices by an average of $500 to $800. Without similar price increases by its rivals, the manufacturer would have lost sales without creating an offsetting societal benefit. But by mandating air bags on all passenger cars, U.S. regulators reduced traffic fatalities while they eliminated the transfer of purchases from one manufacturer to another.

Too bad so few regulations produce such happy outcomes. Some U.S. pollution-control guidelines, for instance, have been estimated to cost society $1 billion per life saved. Were such inefficiencies to occur on the strategic frontier, they would be quickly disciplined by the marketplace. But erroneous judgements in the structural frontier often face less scrutiny and can therefore remain in force indefinitely, creating a societal cost that ultimately diminishes the civil foundation. For that reason, before they impose a requirement on business, regulators should be sure to establish metrics that enable them to assess whether a regulation's value exceeds its cost. Failure to do so can have the wholly unintended effect of shrinking the civil foundation by causing a dramatic slowdown in economic progress.

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That's precisely what has happened in British Columbia over the past two decades. Regulators – in their attempt to compel corporations to increase their production of socially responsible behavior – imposed so many costs and administrative burdens on businesses that many simply decamped for friendlier climes. As a result, B.C. has suffered a marked slowing in the improvement of living standards, working conditions, and real income – hardly the outcome sought by regulators.

NGOs that wish to exert effective pressure on corporations can learn an important lesson from this example: they must be careful not to tip over into extremism or to advance agendas that lack popular support. Those cautions aside, the successes of NGOs can't be denied. It was primarily pressure from NGOs that convinced oil companies to withdraw their support of the corrupt and despotic Abacha regime in Nigeria, and that helped improve working conditions in Southeast Asia.

But perhaps the most effective pressure on corporate leaders will be the pressure they impose on themselves. To date, the U.S. government has given no sign that it will force energy producers, utilities, and heavy industries to reduce their output of greenhouse gases. And no single corporation can be expected to do so alone, since the attendant costs would dwarf any marginal improvement in public health and safety. If any action is to be taken, it will have to come from a corporate coalition assembled by an intrinsically motivated leader with the energy, vision, and communication skills necessary to convince other corporate leaders to take a sizable risk.

Such leadership is also required to address globalization's most troublesome dilemma – that is, the inconsistency among the world's civil foundations. The lack of global standards can hobble attempts at collective action on the structural frontier. Consider the *Foreign Corrupt Practices Act*, for example. The act attempts to universalize a feature of the U.S. civil foundation by prohibiting bribery overseas by this country's corporations. For the most part, the act has maintained a level playing field for U.S. corporations as they go after foreign business. But many complain that the act puts them at a disadvantage compared with corporations from countries where bribes are considered 'just another cost of doing business'.

Imagine the difficulty corporations and countries will encounter as they grapple with the question of global warming. Already, countries with relatively undeveloped civil foundations protest that they're being held to the environmental standards of advanced economies, which in turn complain that companies in countries with shallow civil foundations enjoy an unfair cost advantage over their more socially-responsible rivals. And while this squabbling goes on, the threat posed by global warming only increases. Ultimately, I believe the logjam will be broken only when courageous and intrinsically-motivated corporate leaders promote the notion of a global civil foundation that businesses, together with governments and NGOs, work constantly to upgrade.

Conclusion

Public demands that business show a conscience as well as a profit are nothing new. In 19th century England, William Blake and Charles Dickens made such demands central to their writing. Of course, there's also nothing new in the claim that business' sole obligation is to enrich its owners.

Rather than attempt to settle a debate that can never be settled, I would point out that in either case, a widespread expectation exists today that companies conduct themselves with at least a minimal degree of social responsibility. I'm convinced that most business leaders sincerely wish to meet that expectation, if not exceed it, and the Virtue Matrix is designed to aid them in their efforts. While it cannot resolve or eliminate the competing claims of shareholders, society and the government, the matrix offers a framework for evaluating those claims and encourages business leaders to be as bold and innovative in enriching society as they are in enriching their shareholders. RM