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MANAGING AN ETHICAL PORTFOLIO

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Track: Governance/ethics/society

THE ETHICAL PORTFOLIO MATRIX

The concept of portfolio analysis has existed for several decades (Drucker, 1964) and is designed to evaluate the performance and potential of a strategic business unit. Recent developments within portfolio analysis have introduced a three-dimensional approach to portfolio analysis (Illinitch and Schaltegger, 1995), designed to answer both the criticism of the two-dimensional approach and allow a greater dimensionality in analysis.

Central to the popular Boston Consulting Group growth-share matrix is the simplicity of approach to analysis. However, with the simplicity of its creation comes the inherent drawback of the BCG Matrix; the rigidity of the framework means that it is unable to be adapted to differing situations, producing simple strategic directions for an ever-more complicated world. Other criticisms have been levied at the matrix, including:

- There is no consideration of risk (Wind & Mahajan, 1981). Therefore the firm does not know the level of risk involved in each strategic option.
- The model only operates in growth markets – it is not able to consider negative rates of growth (Lancaster & Massingham, 2001). With many markets being in decline, the model cannot take this into account.
- No guidelines exist for the 'correct' portfolio (Wind & Mahajan, 1981). The correct balance for one firm may be very different to another.
- Companies may invest too heavily in Dogs, hoping that an already failing position will improve (Wilson & Gilligan, 1997). Displaying a resemblance to

Drucker's 'Investments in Managerial Ego'; managers will not want to lose face and therefore waste investment in an already failed product.

- Market attractiveness is measured by the use of growth rates, which may not be a robust enough measure on its own (Capon & Hulbert, 2001). Growth rates vary, and these alone do not show future potential within the market.
- Competitive strength cannot simply be shown by relative market share (Boyd et al, 2002). Other factors come into play such as efficiency, margin and profitability, with market share only playing a small role.
- Cash flow is the performance criterion used (Lancaster & Massingham, 2001). This is helpful in short-term actions, but long-run profitability is a better measure of performance.
- The results are very sensitive to variations in how both growth and market share are measured (Wind, Mahajan & Swire, 1983). Therefore, the model is open to personal interpretation, causing inaccuracies to be evident.

Despite these criticisms, the methodology itself still has a role to play within management circles as an indicator of position and potential strategic direction. The model is important due to its emphasis on a portfolio of products, balancing mature and declining products with those essential for future success. In addition, undertaking the method means that thought has been placed on the current situation facing the SBU or product – the simplicity itself means that it is often a first methodology to be used. Finally, it brings into consideration both competition and the inevitability of change within the market-place. This ensures that it is not a static matrix, but one which is ever-changing due to activities by competitors and the product life-cycle. The first of these is detailed below in the form of the Green Portfolio Matrix –

incorporating environmental aspects within portfolio analysis. The second; the Ethical Matrix utilises a holistic approach to portfolio analysis, brought into play by the European Foundation for Quality Management Excellence Model.

Green Portfolio Matrix

In the latter half of the 1990's and on into the 21st century the focus on environmental and 'green' issues has grown. The green business portfolio matrix, developed by Illinitch and Schaltegger (1995), incorporated the environmental impact of the firms' business activities. Adding a vertical dimension to the BCG Matrix, this measures environmental impact. Products which are ecologically sound are termed 'green' and those which are not are 'dirty'.

The concept brings into consideration of whether the firm is operating in a 'dirty' or 'green' manner, together with the portfolio of the products it offers. Where the firm is operating in a 'dirty' manner, the negative publicity and penalties that are applied may make it an unviable strategy in the longer-term. However, for short-term profits, there is potential in using this methodology. Making the 'green' route is beneficial in terms of PR and image, however it may not necessarily be as profitable as taking a 'dirty' direction. A green cash cow will still produce a positive cash flow, yet a green dog may not.

Adapting the Green Business Portfolio - the Ethical Business Portfolio

As with the growth in environmental awareness, there has been a similar growth in the ethical approach to business – taking into account corporate responsibility. As such, firms now are recommended or required to publish corporate responsibility figures

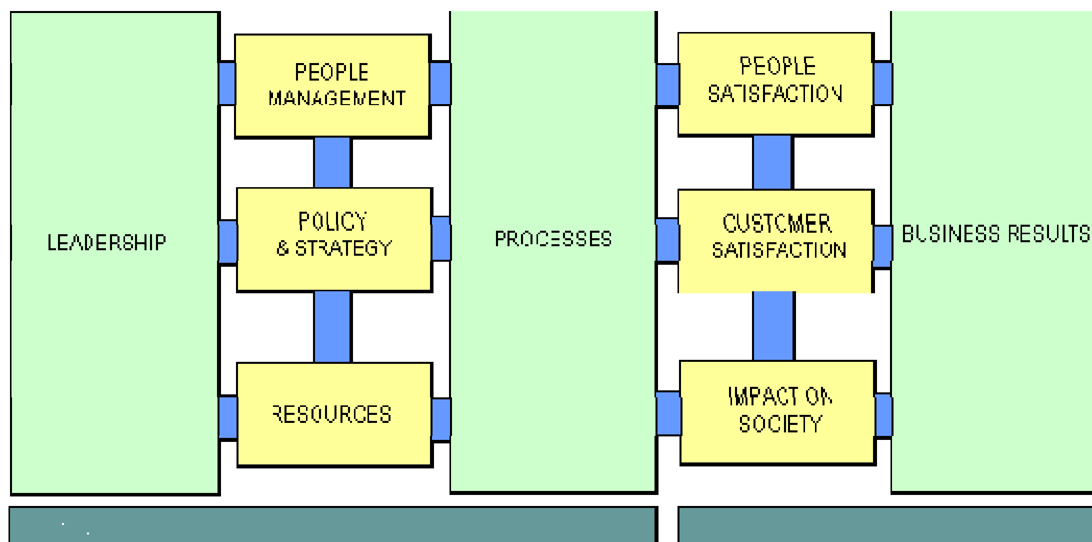
alongside those of financial aspects. The focus taken on the 'correct' approach to business is growing – amplified by the increasing availability of information and in the UK the use of the FTSE4good index of socially responsible firms. Therefore firms can no longer ignore the social and ethical impact of their operations. Taking the framework developed by Illinitch and Schaltegger, it is clear that the term 'green' can apply to more than environmental issues. In addition, Lantos (2002) argues that the use of a corporate social responsibility approach to strategic portfolio planning presents a range of significant opportunities including the improvement of corporate image and marketing communications.

In terms of social accountability, a range of models have been formulated to allow firms to incorporate corporate social responsibility into their operations. The most common of these is termed the EFQM Excellence Model, which brings together a range of aspects relating to the financial and non-financial business areas. These include internal and external actions, with firms operating a self-assessment approach. Unlike other quality methods, this model does not lead directly to an award, thereby removing the 'plaque collecting' approach to befall Investors in People and ISO 9000. Firms can however, if they wish, submit their scores and be externally audited. This leads to an entry into the European Foundation for Quality Management Award for excellence in quality. However, only one firm each year can win the award, with past winners including Siemens Netherlands (2003), Brisa (1998), Runshaw College, UK (2003) and St. Mary's College, Northern Ireland (2001).

The EFQM Excellence Model shown in **Figure 1** below, developed from the Malcolm Baldrige National Quality Award, includes a range of criteria which can be

incorporated into an adaptation of the green business portfolio model. These include leadership, the firm's policy and strategy and people satisfaction - introducing a wider range of aspects (Dale & Bunney, 1999). Once aimed at only large corporate organisations, this model has now been widened to include the public sector and small firms. Typical factors which form and ethical corporate social responsibility approach include the 'impact on society', resource management and people management, drawing on additional elements from the Turnbull report (Vinten, 2000). These require firms to take a holistic approach to management, being driven by far much more than business results. Depending on the country this may not be popular (Singhakapdi et al, 2001) leading to complications of culture affecting any ethical approach to strategic planning.

Figure 1: The EFQM Excellence Model



Taking a stakeholder management approach to marketing planning and social responsibility (Maighnan & Ferrell, 2001) a series of strategic opportunities present themselves (Lantos, 2001). Here the term 'green' is better renamed 'ethical' and 'dirty'

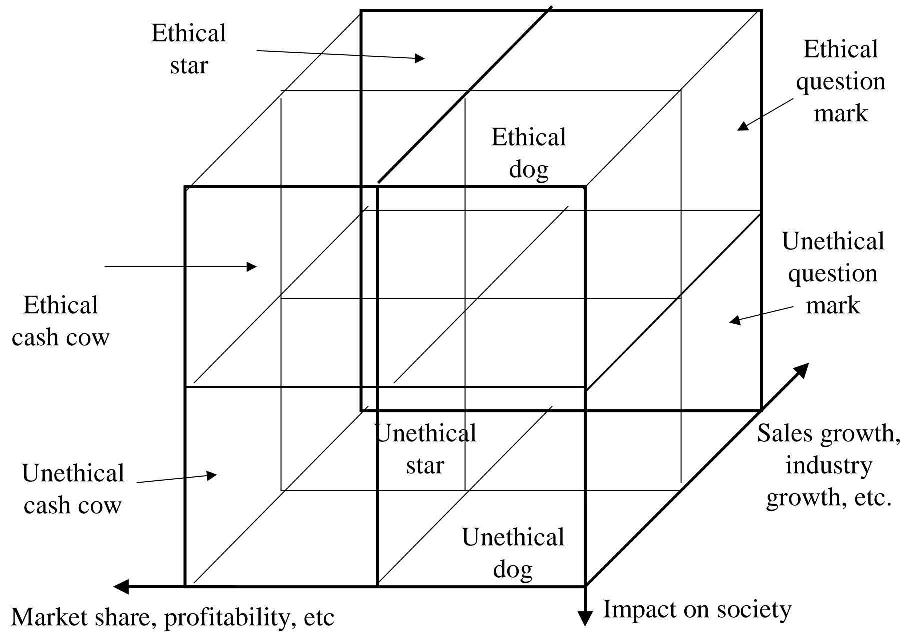
renamed as 'unethical' due to the additional factors involved in the adaptation. A re-drawn version of the diagram is shown below in **Figure 2** below. The segments within the model are:

- ***Ethical Question Mark*** - products introduced aimed specifically at the emerging needs of society. These may or may not be successful. The recent launch of electric and fuel-cell cars are currently in this position.
- ***Unethical Question Mark*** - having been introduced, these products find themselves facing criticism or damaging publicity at the start of their lives. Such products have a lessened chance of survival unless the negative impact can be minimised. Products in this category include the new-style baby milk formulas which are marketed as being healthy yet are still less healthy than breast milk.
- ***Ethical Star*** - benefiting from helpful publicity, these products capture the mood of the nation and build the market share from the ensuing goodwill. Such products include Benecol which draws on the current public fad for food which offers medicinal benefits.
- ***Unethical Star*** - products in this category are in a leadership position in a high-growth market. Needing to manage the negative publicity carefully, the cash input required to build the star into a cash cow has to be converted in a sustainable manner, belying the anti-social approach to the product. Examples of this type of product include Sunny Delight receiving negative publicity regarding its chemical contents, the brand being recently sold following a failed re-branding to Sunny D.
- ***Ethical Cash Cow*** - products which have succeeded in capturing the consumers' interests and are seen as being beneficial. These products have the

ability to price skim - utilising the positive perception towards the product. In 2001, Shredded Wheat increased its sales by 17% when re-branded as for a healthy heart enhancing its cash cow position into an ethical stance.

- ***Unethical Cash Cow*** - these are products which are environmentally or socially unacceptable yet create a considerable positive cash flow. Examples of these include cigarettes and petrol.
- ***Ethical Dog*** - products which are both socially and environmentally acceptable yet have a very small market share in a low growth market. These are likely to result in a low positive or negative cash flow, and are unlikely to become mainstream products without considerable investment. For example, the strategic decision by Iceland to sell only organic frozen vegetables at the same price as non-organic backfired when the expected increase in sales did not occur.
- ***Unethical Dog*** - often the last remnants of 'old industry', these are the unwanted yet often essential elements that are too expensive to replace with innovations. Examples of unethical dogs include such products as paint containing solvents or Nescafé's self-heating coffee can which drew criticism from motoring organisations for encouraging tired drivers to continue driving.

Figure 2: The Ethical Portfolio Matrix



Strategically, the organization has to decide its ethical position. An unethical stance is an acceptable strategic option yet it will attract negative publicity which must be managed carefully. Ethical organisations have an opportunity to use consumers' goodwill to build brand reputations - organisations such as the Body Shop and Ben & Jerry's have taken just such a stance. Despite this approach, some marketers believe that taking a socially responsible perspective of planning is detrimental to the firm and society itself (Miles & White, 1998), preferring a market-based approach. However, an increasing reliance on internal governance will be reflected in external activities (Zaman, 2001). In addition, this process allows for integrity – an increasing area in current markets (Kotler et al, 2002).

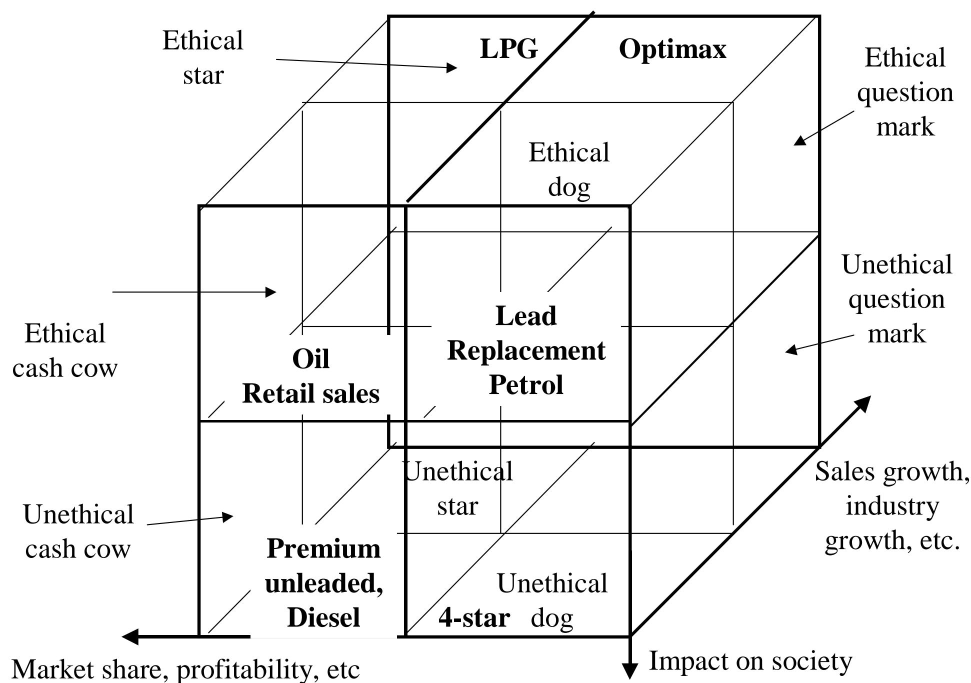
Applying the Ethical Portfolio Matrix

In order to test an adaptation of the Ilinitch, and Schaltegger model two organisations were selected to provide an evaluation of their portfolios. The organisations were selected primarily for their involvement in industries which were both ethically

complex and of significant national and/or international interest. In addition, the organisations were selected due to the ability of identifying relevant strategic business units.

The first of these was that of Royal Dutch Shell, using an evaluation of their retail forecourt petroleum sales. A completed example of the matrix applied to Shell Petroleum – their Petrol Stations is shown below in **Figure 3**:

Figure 3: The Shell Ethical Matrix



Here there are a range of ethical and unethical products; the Ethical Cash Cow is oil and forecourt retail sales, which are seen as essential by the public. The growth in the 'clean' fuel LPG is an Ethical Star, as this is a recent phenomenon although now in the mainstream. In addition, there is an Ethical Dog, in the form of Lead Replacement Petrol which accounts for a decreasing level of sales and an Ethical Question Mark in the form of Optimax – a recently introduced variant of Super Unleaded petrol. In early

2004 a decision was taken by many petrol retailers to remove their Ethical Dog – Lead Replacement Petrol accounted for less than 1% of most forecourt's sales.

On the unethical side, the Unethical Cash Cows are diesel and premium unleaded sales – which will account for the majority of sales. As these fuels pollute the environment, they are unethical – and would also be considered dirty in the green matrix. Finally, the Unethical Dog is the sale of 4-star leaded fuel, where available. Some 4-star is sold, although this is minimal. This Unethical Dog is now being phased out during 2004.

The second selection was that of Nestlé. Of particular interest was the use of their infant feeds, both for their approach to marketing of infant formula internationally throughout Africa and Asia plus their European approach of curd-based formula in addition to whey-based formulas. Their approach to infant formula can be classified as being an Ethical Cash Cow in the more developed countries (MDCs) whilst an Unethical Cash Cow in the lesser developed countries (LDCs). Nestlé have come under significant criticism from the World Health Organisation for their approach to the promotion of infant feeding. The sale of ready-mixed infant formula has increased in recent years but are still relatively small when compared to both infant formula as a whole and for Nestlé itself and is therefore classified as an Ethical Question Mark. The traditional whey-based infant formulas have been joined in recent years by a curd-based formula which is marketed as being for the hungrier baby. This is not considered suitable for infants, although the market share is increasing, and is therefore classified as an Unethical Star.

Further work

This development of the model is the first stage in the testing process. The next stage is for a methodology involving an examination of organisational portfolios across for-profit and non-profit boundaries. The proposed methodology covers the following activities:

- Selection of twelve organisations; eight for-profit and four not-for-profit.
- In-depth examination of a strategic business unit within each of these organisations.
- An evaluation of the "ethical" and "unethical" nature of their activities together with a consideration of the cash flow and profit impact of each.

The intention of the research process, which is planned for 2005, is to test the applicability of a framework for mapping ethical and unethical activities. This process will then test the suitability of an ethical portfolio framework to manage both strategic actions and social responsibility activities for the strategic business unit.

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