A Business Leader’s Guide to the Social-Financial Frontier Framework

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This article develops practical implications from the simulation model introduced in the working paper by professors Felipe Csaszar and Daniel Albert ("Searching Under Multiple Goals: Exploring the Role of Corporate Social Responsibility Heuristics"). This article presents a novel framework managers can use when making decisions which combine social and financial goals, and illuminates five types of strategic decisions involving those goals. Real-world examples are illustrated to articulate the framework's usage. The current manuscript was written under the close guidance of Prof. Csaszar.

The Confusion

Where do you stand on the debate between pursuing social goals alongside financial performance? On one hand, Milton Friedman’s declaration that “the social responsibility of business is to increase its profits” has shaped American business as it’s known today. On the other hand, some business leaders pursue social goals that are independent from financial performance. For example, J&J’s CEO Alex Gorsky integrates into his decisions the “essential role corporations can play in improving our society when CEOs are truly committed to… all stakeholders,” not only shareholders. So then, who is right?

It's fair to say that this debate is not yet settled. Though some companies have tried to philosophically align with the stakeholder view, like when the Business Roundtable “redefine(d) the purpose of a corporation to promote an economy that serves all Americans,” its leaders such as Chase CEO Jamie Dimon reject the idea to incorporate that into a legally binding strategy. We believe the answer to this debate has been hard to settle because it depends on several elements, such as the relationship between social and financial objectives. In response, we offer a novel framework, the Social-Financial Frontier, that integrates these elements and provides a map with common language for building strategy.

In addition, our framework can provide guidance around many tough decisions such as: picking a target point, moving the frontier, moving the social threshold, shaping how social performance is understood, and setting the decision process to reach the ideal point. Given the rise in employee and consumer demands for businesses to integrate social performance more fully as a measure of success, navigating these decisions will become more paramount for managers, owners, shareholders, and executives.

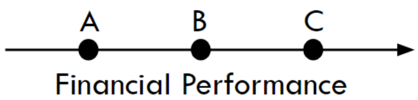

Figure 1(a)

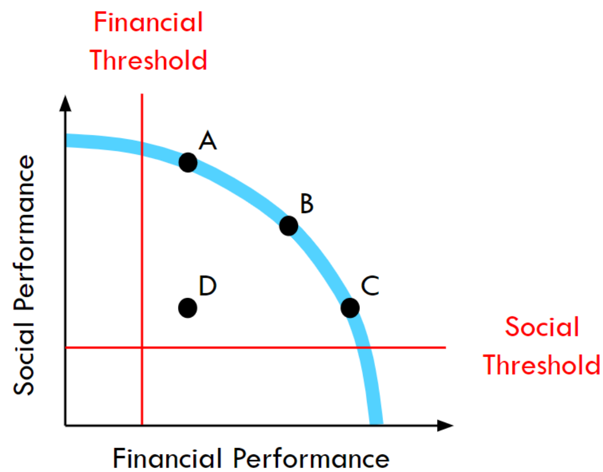

Figure 1(b): The Social-Financial Frontier Framework

The Framework

To begin to understand the framework, consider this: Friedman's focus on finances assumes that firm performance can be measured as a single number: profits. Under this view, you can place all firms on a line from less to more profitable, as illustrated in Figure 1(a). But Gorsky's remarks imply that performance is more than that– it is multidimensional. For simplicity, let's consider the most basic case that performance has two dimensions: financial (typically viewed in terms of profits) and social (usually measured in terms of impact on people or planet). Hence, performance, rather than a number on a line, is a point on a plane as seen in Figure 1(b).

But are all those points on the plane equally viable? To explore where your firm could land in this framework, consider the following elements of the figure:

1. The financial threshold is the minimum profit needed for the firm to operate. Performance below the threshold is not sustainable in the long term, as the firm would go out of business.
2. The social threshold is the minimum level of social performance that would be accepted by society at large– not just lawmakers and regulators, but consumers, employees, journalists, and activists. In other words, social perception matters; certain performance may be lawful but unethical. Similarly, performance must be above this threshold for the firm to keep operating rather than be penalized, closed down, boycotted, or canceled.
3. The frontier represents the boundary of all currently possible combinations of social and financial performance.
4. Operating outside the frontier, therefore, is currently impossible; new technologies or strategies must be researched and developed to move past this boundary.
5. Firms operating inside the frontier have attained a given combination of social and financial performance. Interestingly, firms in the frontier can improve in both dimensions– this is where most firms fall. For instance, a firm at point D can move to point B and improve both dimensions simultaneously.

6. In contrast, firms on the frontier do face tradeoffs; for instance, at point B, the firm cannot improve upon both dimensions. The tradeoff exists between improving social performance by moving to A, or financial performance towards point C.

With this understanding of the framework, we can already answer a common question: is there a tradeoff between social and financial performance? This is true only on the frontier. For example, if your firm is performing somewhere such as Point B, improvement upon one dimension implies diminishment in the other. The good news is that there doesn't seem to exist any company that has run out of ideas for improvement. Because most firms are not maximizing their social and financial performance, they are somewhere inside the frontier. These firms don't face tradeoffs, though, as they can improve upon both dimensions at the same time.

Journey through the Framework

Having expanded Milton's line of financial performance into a plane combining social performance, we will continue illustrating the framework by walking through five common decisions you may find yourself making as a leader: each time by first visualizing a situation through the framework, then illustrating an example. These scenarios don't happen in isolation, or even just once– deciding on the balance of social and financial performance is an iterative process.

Decision 1: Picking a target point

Now we've seen which points are good – those on the frontier – but which are desirable? For example, how could a firm decide between points A, B, and C in Figure 1(b)? We can't answer this for you, as it depends on your preferences. Although each point is equally good in that no other point can surpass it along both dimensions, and in that they are both legal and profitable, they are not equally appealing to different individuals. Those who prioritize social impact gravitate towards A, those who emphasize financial performance go towards C, and those who value a balance tend towards B. As a leader, you must decide which point to pursue. There's no right or wrong answer– this is about making decisions in accordance with your team and company values.

To better understand the ideal points, consider the following examples. At point C, we may find a cigarette company whose products achieve no social good, and in fact harm the consumers who patronize the firm. On the other end of the spectrum at Point A, we see nonprofits who raise just enough money to achieve the social impact they use to measure success. In the middle, at point B, we find companies such as PepsiCo who, under the direction of former CEO Indra Nooyi, began to promote their sustainable growth agenda which includes consideration of health impact and water usage while still striving to increase consumption of "fun" but not-so-healthy products.

Decision 2: Moving the Frontier

So far, we've assumed that the frontier is fixed. That is not always true– in fact, what can you do when you're not content with the current limitations on social and financial performance? To bypass the trade-off that occurs from movement along the line, the frontier can be moved. But how? This calls for an investment in Research & Development (R&D) to increase both social and financial potential performance past the boundaries.

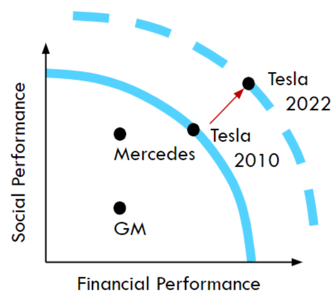

Figure 2: Moving the frontier through R&D to bypass trade-offs

Consider, as an example, a company located at point B in Figure 2 who wants to maximize both social & financial performance. Tesla did this as the first major player in the semi-autonomous electric vehicle (EV) industry by introducing a car that is both more profitable and better for the environment. From the viewpoint of Figure 2, Tesla improved performance in both dimensions. Moving the frontier is a dynamic process, as leaving competitors behind inspires them to catch up. For instance, GM CEO Mary Barra has marshaled resources to "lead in EVs, full stop."

Decision 3: Moving the Social Threshold

Moving the frontier calls for R&D which can be costly and difficult to achieve. Another, oftentimes simpler, lever suggested by our framework is to raise the social threshold. Movement here can be seen, quite literally, as "raising the bar." But why would anyone do this, if not just for altruism? Figure 3 demonstrates that it's because raising the bar can decrease the power of competitors.

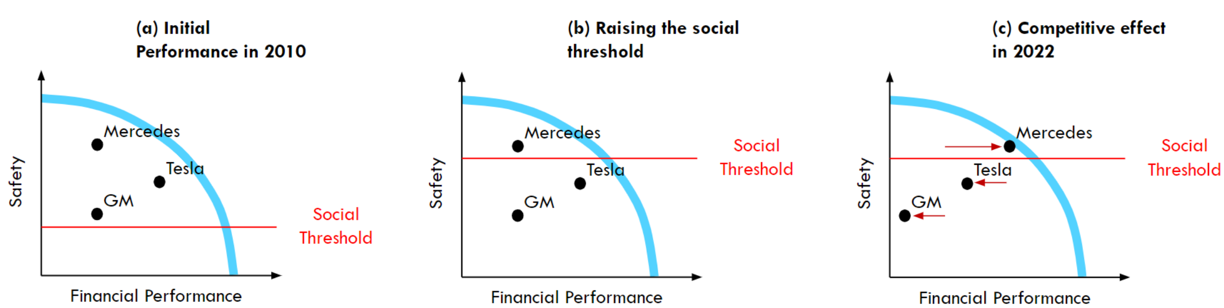

Figure 3: Moving the social threshold to decrease power of competitors

For example, take Mercedes' recent move to influence regulators by accepting legal responsibility for any accidents made while its semi-autonomous vehicles are in "Drive Pilot" mode. Doing so may seem attractive to consumers who seek additional assurance of physical safety, legal protections, and fewer fines, but the main advantage here is in regard to competitors. Raising the bar from Figure 3(a) to Figure 3(b) leaves Tesla and GM behind. By reducing the number of perceived competitors, Mercedes taps into a new market segment of more risk-averse consumers and increases its profits as seen in Figure 3(c).

Decision 4: Shaping how Social Performance is Understood

In a more extreme move, leaders also shape how social performance is defined in the first place. In other words, what will the label of the y-axis be? Determining how the frontier is perceived will impact how stakeholders view your performance.

One example is the ongoing battle in tech to shape social performance in terms of privacy versus connectivity. Facebook, now known as Meta, communicates that social performance should be measured by enhancing connectivity between individuals and communities. As company policy reads, "To provide the Meta Products, we must process information about you." With a y-axis defined in terms of "connectivity," Meta inherently trades off personal privacy to dominate Apple in terms of social performance, as seen in Figure 4(a).

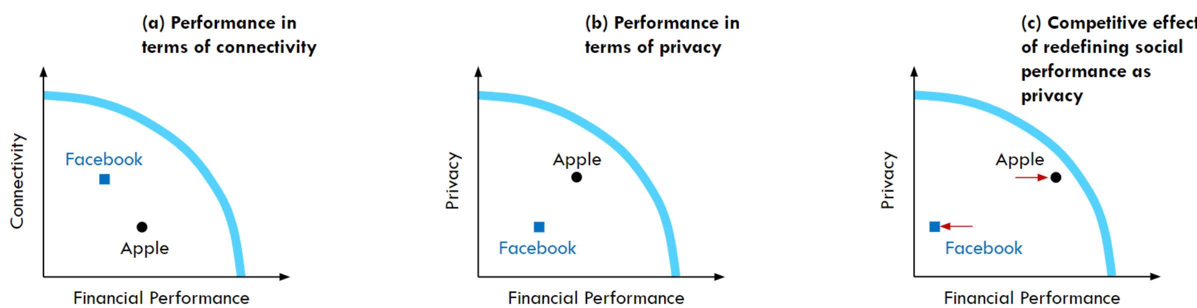

Figure 4: Movements resulting from public understanding of social performance

On the contrary, Apple wants the public to measure social performance in terms of personal privacy. Differentiating itself from Meta, Apple believes "that you can have great products and great privacy." If Apple successfully redefines the y-axis as such, then their competitive advantage over Meta as illustrated in Figure 4(b) will create a self-fulfilling prophecy of success: drawing in better employee talent, developing better tech, and luring in customers ultimately leads to financial gains demonstrated in Figure 4(c). Shaping this perception is critical to success and lends fuel for further iterations.

Decision 5: Setting the decision process to reach the ideal point

So far, we have discussed what point you may lead your company to. But how can you reach that point? The traditional way companies have thought about achieving social performance is by earning profits and then donating to achieve their ideal point. That is one way of thinking, but that may mean you will get stuck at obstacles along the way. There is another decision process more likely to get closer to a firm's ideal point: rather than leaving social performance as an afterthought, consider both financial and social performance when making each business decision along every step of the road. Doing so enables you to discover new ways of being profitable that you couldn't have realized if you just cared about financial performance because you will have more opportunities to think about tradeoffs; in each decision such as hiring, moving, supply chain purchasing, and more, considering all options makes it more likely you will innovate. Ultimately, if all decision-makers in your team are empowered to align their strategies accordingly, this iterative process is how you shape evolution and maintain authority around social performance in your industry.

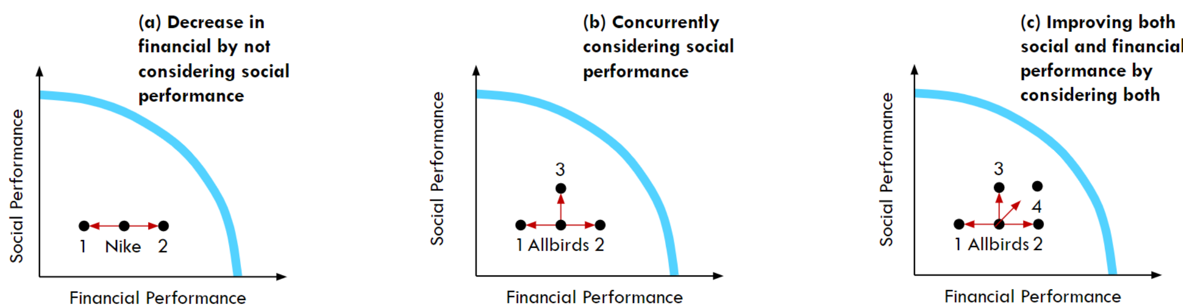

Figure 5: Movements possible in different decision processes

Compare the examples of Allbirds and Nike. When Nike tried to bolster their bottom line to point 2 in Figure 5(a) by outsourcing work to countries with weak labor laws, many consumers boycotted the company for the worker abuse that took place in those factories. This diminished financial performance to point 1. Allbirds, on the other hand, decided to pursue a social goal on top of financial performance. The founders sought to have a positive environmental impact and hired Sustainability Lead Hana Kajimura who measured success in terms of a zero-carbon emissions target, as demonstrated by attempting to move to point 3 in Figure 5(b). This led to a discovery of a new material for soles, which the company shared with competitors for free. While bettering their social performance, this also bolsters their bottom line as seen by a movement to point 4 in Figure 5(c) by potentially creating economies of scale to lower costs and increasing purchases from consumers who recognize Allbirds as a sustainability leader now.

Now what? A roadmap for decision making

We now conclude by introducing a roadmap with five guiding questions to repeat over the course of implementing a strategy process that includes social and financial considerations. As mentioned before, this is an iterative process– one that can follow the steps below, and as illustrated in Figure 6.

1. New to this strategy but want to begin? This is a time for introspection and to define, along with key stakeholders, how your firm measures social performance from a wide range of options. Apple is an example of a firm who started here to lay the foundation for what came next.
2. Already have an idea of how you want to perform? Target the most relevant strategy to achieve that desired performance. Allbirds demonstrate how this looks in action.
3. Ready to put your ideals in action? Empower everyone internally to work towards that point by providing communication and training. Gaining internal commitment is critical here; GM illustrates this through their work in EV.
4. Feeling good about what you're achieving? It's not enough to do things, we must tell others we are doing it; communicate to those you're affecting. Pepsi is an example of a firm who is attempting this currently.
5. Want to keep evolving? Go through this dynamic cycle again! Continue to think outside the box about what you can change– Mercedes has done this and will need to keep up by monitoring trends and continuing to invest in R&D.

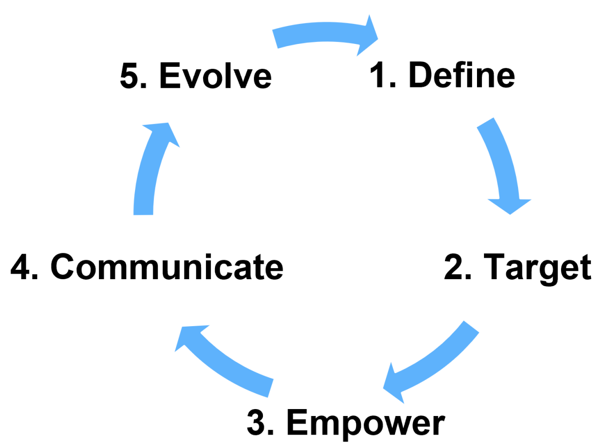

Figure 6: Roadmap of the social-financial performance strategy journey

Conclusion

During this journey through the framework, we demonstrate that by considering a second objective of maximizing social performance, firms can be more profitable than firms who just care about profits. While Friedman emphasized a singular focus on profit, represented as a number on a line, this framework puts current belief into practice – focusing on social and financial performance can create synergies rather than be a distraction. It is time to move past the debate and take action.

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