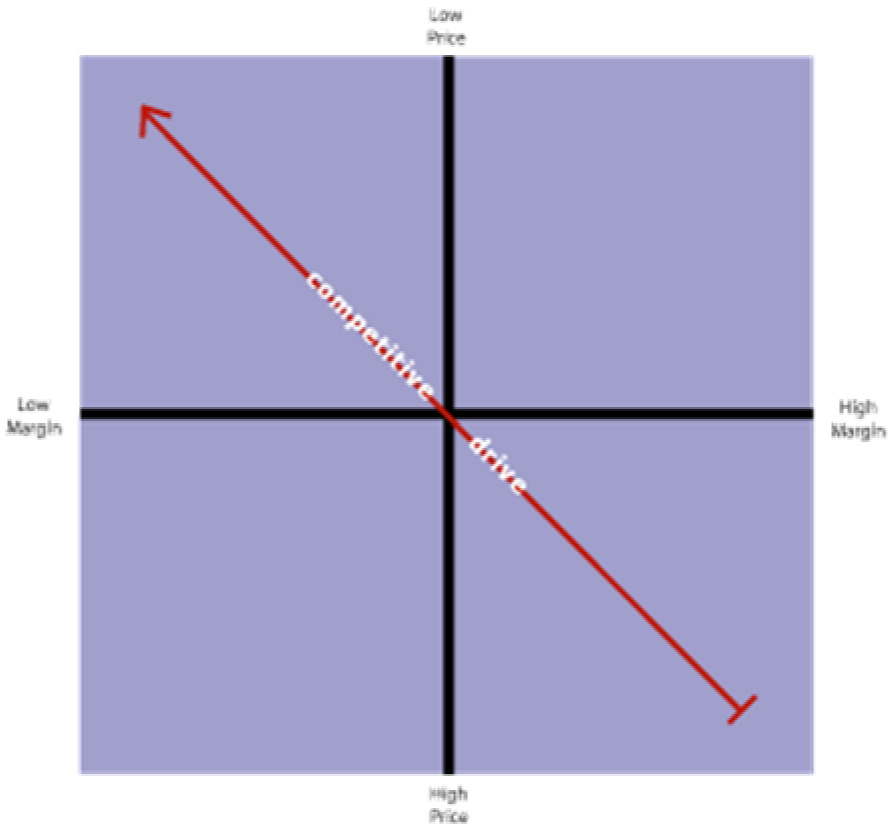
Using Moral Imagination for Irreplicable Strategic Advantage
Presented May 2003 – *"Moral Imagination" Ethics Conference*
Carlson School of Management
A White Paper by David Lapin (CEO)

Moral Imagination is a force so powerful that it empowers corporate leaders not only to dream of a competitive space unoccupied by anyone else, but to occupy that space themselves and to make their position there almost unassailable. With agility, companies with moral imagination evolve their strategies and operational practices to changing worlds while simultaneously remaining steadfastly faithful to the values and purpose that define them.[1]

To me, "moral imagination" represents a low cost strategy to de-commoditize the product you are selling, and reposition it to satisfy your customers' deepest human and even spiritual needs. This not only elevates the moral value of your business and gives meaning to your work, but it also differentiates you so that you can expand your market share, create entry barriers for your competitors, and grow your profit margins.

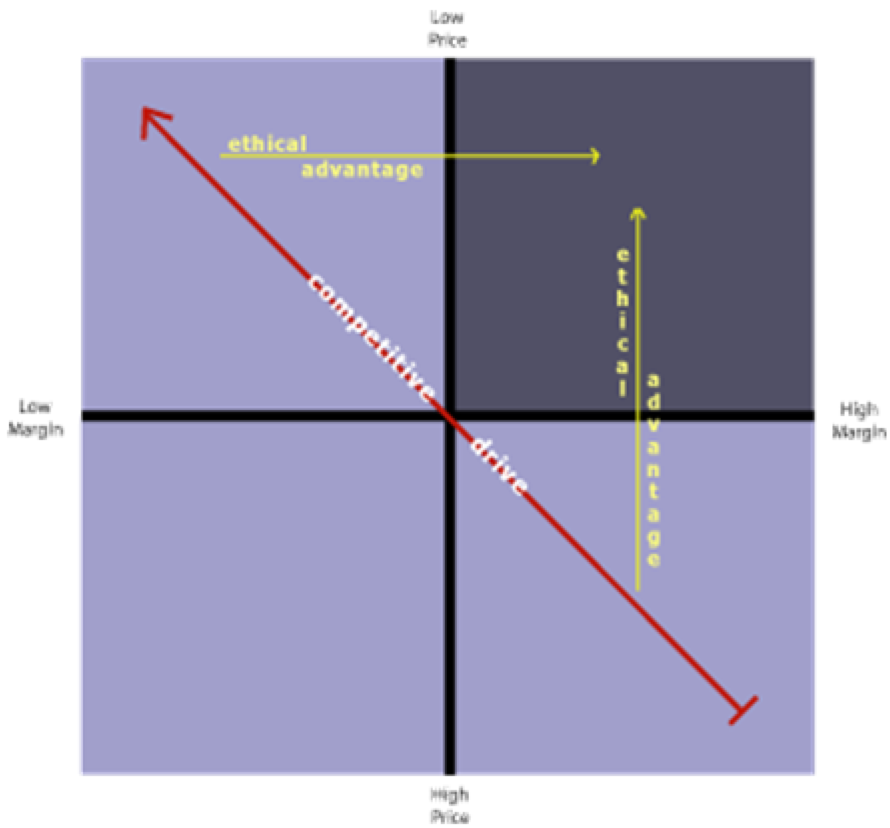
Allow me to explain the almost miraculous impact of this understanding of "moral imagination" on top line business performance. The "Moral Advantage Model," in fact, counters one of the fundamental assumptions of the father of modern business strategy, Professor Michael Porter; that there are but two "basic types of competitive advantage, a firm can possess: low cost and differentiation."[2] We shall argue the hitherto unheard of possibility of achieving both low cost and differentiation using our understanding of Moral Imagination.

The law of supply and demand dictates that the more innovative, and consequently unique, a service or product is, the lower is its supply, and therefore the higher is the price a customer can be charged for it (provided it is in demand). However, due to the high margin generated from a unique offering and the inevitable inefficiencies of a monopoly, product innovation is highly vulnerable to competitive attack. Competition will force prices down and shrink margins. The conventional strategic response to this is to achieve efficiencies through economies of scale, using volume to compensate for narrowing margins and moving competitive advantage from Porter's "differentiation" to his "low cost." Of course, as both volume and competition increase, the product loses its innovative edge, and becomes a commodity. Competitiveness then needs to be maintained through achieving competencies in operational efficiencies. In the model below, the competitive drive moves the product from innovation in the bottom right quadrant, to commoditization in the top left. The result is lower pricing and narrower margin.



The spiral towards commoditization carries with it another perilous risk, that of the Downward Performance Spiral. This spiral occurs when "a company, initially having problems with its profits, costs, or share price, takes quick action to raise profits and lower costs…Training is curtailed; pay may be frozen or cut; promotions are held up; the use of part time or temporary help increases; and people are laid off or forced to work reduced hours. These measures logically and inevitably reduce motivation, satisfaction, loyalty to the company and intentions to remain with it, and focus on the job."[3]

However, conventional strategy, in its obsession with the measurable, ignores the most prized competitive space imaginable: the top right-hand quadrant in the model, where for little cost, continuous innovation can be maintained.



The key to the top right-hand quadrant lies in using Moral Imagination to understand two dynamics. The first concerns the degree to which work satisfies the deepest human needs of employees and concerns the company's Values and Ethics. The second concerns the degree to which a company's product and service satisfies the deepest human needs of its customers and concerns the company's Strategy. We will demonstrate the link between these two dynamics, and their impact on financial performance.

The relationship of people with their work: "To spur high-margin growth and thereby increase their value, great organizations need only focus inward to find the wealth of unrealized capacity that resides in every single employee."[4] People engage fully in their work when they see their work as a vehicle not only for their material quests, but for their spiritual quests too. For people to become fully committed, their work should expand beyond the basic trade-off of skills for income. In their search for meaning, people need to see their work as an opportunity to use their unique talents to make a contribution to others that is valuable. The contribution they seek to make, however, is not to the coffers of shareholders, nor to satisfying the excessive indulgences of their customers! They are most satisfied when they believe that their work makes a difference to people in a much deeper way, in a way that has an almost spiritual dimension and some moral value.

It is here that the Values and Ethics component expands into the Strategic component as a company must address its offering to its customer identifying a deep human, almost spiritual, need that it can satisfy for its customers. The company's moral imagination comes into play again as it builds its strategies around the satisfying of these needs: Examining its own capabilities and the passions of its people, the companies with moral imagination probe how they can fulfill these deeper human needs of their customers through the product they offer or the way they offer it. Doing this achieves a number of strategic advantages. Firstly, it links into the loyalty of customers who find a much deeper satisfaction in their offering than in that of their competitors. Secondly, their offering, built as it is on that company's unique human capital and the inimitable "ethos" it constructs to create and deliver that offering, is hard for competitors to replicate. Thirdly, this approach entails little cost, and because it taps into employees' longings to make a meaningful difference, it stimulates higher levels of productivity than those achieved by competing companies. Richard Kovacevich, CEO of a diversified financial services organization named by *Fortune* Magazine in 1997 as the best bank for customer satisfaction and ranked 22nd on the *Business Week 50* list that same year, said that no factor was as important to his company's success as "…talented, professional, motivated people who care."[5]

Engaging in these strategies introduces a revenue-producing asset less replicable than either the material assets of the "old economy" companies (fig. 1) or the intellectual assets of the "new economy" companies (fig. 2). It is the human asset that includes intellect and innovation, but also high levels of energy and engagement in work, and using the human element to go beyond the customer convenience that technology can provide and which is fully replicable, to true customer service: making a customer feel valued not just as a source of revenue for the company, but as a dignified human being in his or her own right.[6] (fig. 3)

figure 1

figure 2

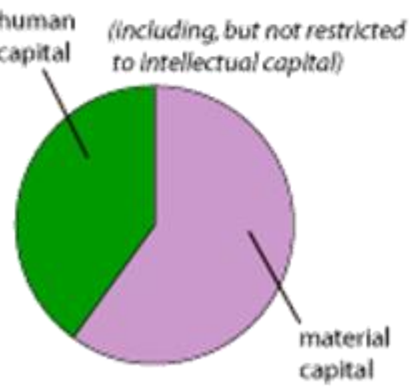


figure 3

Consider for example, Southwest Airlines. In cutting costs to a minimum in order to offer low priced air travel, Southwest realized that their offering would meet the practical, "no-frills" needs of its customers. However, the experience of the flight might be rough and somewhat undignified. No pre-assigned seating (remember United's advertisements portraying the Southwest experience as one of humiliating herding?), no meals, small aircraft. Yet providing any of those services would have destroyed their core competency and their competitiveness. So they compensated for the deprivation of dignity with warm and lively friendliness from their staff. Southwest recruits people with excellent people skills, a sense of humor, and an ability to be somewhat entertaining. Many people are willing to exchange a little dignity for a lot of fun, especially when doing so also gives them much more affordable air transportation. Southwest personnel are then helping to cheer people up during what could otherwise be a discomforting and even somewhat traumatic experience. Conceiving of this service required moral imagination. Providing the service satisfies a deeper need in customers than the need for affordable transportation, and delivering the service satisfies employees' need to make a difference on a deep human level. Southwest operates in the top right-hand quadrant of the model. By doing so, they have erected impenetrable barriers to competition as the combination of competitive pricing and irreplicable brand, low cost and differentiation, makes the competitive space represented by the top right-hand quadrant virtually unassailable.

Let me give you a more detailed success story with which I was intimately involved: Until nearly ten years ago, Truworths International, a fashion retailer with over 300 branches, dominated its market among fashionable and youthful females. Then, quite suddenly, the "wheels came off." Inexplicably, Truworths began to lose market share. Customers surveyed referred to Truworths' fashion as "low class." They complained about poor customer service, the difficulty in finding merchandise, unattractive dressing rooms, and more. But Truworths could not understand their comments: They had not changed anything; they were doing business the way they always had. Why were their customers abandoning them?

Truworths' revenue and profits were dwindling despite a buoyant market. CEO Michael Mark, internationally renowned fashion merchant, began to study changing conditions and the success of their competitors. No matter how they tried to catch up to their customers' expectations and to imitate their competitors' strategies, their downward spiral continued. Morale began to fail, and productivity sagged as Truworths feared that they might even begin to face the flight of their valued intellectual capital.

Michael asked my associate, Desi Rosenfield and me, to take Truworths' top management on a strategy retreat. We helped them access their "moral imagination" and apply it to the soul of Truworths' business. We sought to understand some of the deeper human needs that are satisfied when a woman buys fashion. We showed how fashion is unique to the human being-while animals also need protection from cold and rain, they do not relate to fashion! There is a uniquely human quality about fashion, a quality that touches some deep emotion, one that appeals to some quasi-spiritual need. We debated and probed how Truworths could satisfy those deep human needs in ways that no other competitor could. With great candor we asked the challenging "why?" question: Why do women spend more money on fashionable clothing and accessories even though cheaper alternatives are available that are at least as functional and often of better quality?

Michael and his team identified youthful women's desire for confidence as the core driver of their fashion buying. These women want to know that they are trendy, aligned with international style, and that their clothes and accessories are fashionably blended. Often insecure in their own knowledge of the international fashion world and the latest trends in style, fabric, and color, these women rely on Truworths' buyers and merchandisers to inform them and guide their fashion choices.

Truworths then, is not only in the business of fashion clothing; it is also in the business of supplying youthful, fashionable women with confidence. Clothing, in fact, is the vehicle for delivering that confidence.

It is in this non-material, "intellectual" value of clothing where Truworths found its margin. Truworths' uniqueness was now not only restricted to clothing. A world of opportunity opened up to the organization as it began to focus on its non-material offering. Truworths could find advantage by understanding and responding to its customers' deepest needs. It could re-engineer itself as a provider of confidence to youthful women by means of fashionable clothing and accessories, rather than competing for clothing dollars like other retailers. By creating and nurturing unique competencies in this arena, Truworths repositioned itself in the unique competitive space of the top left-hand quadrant.

With imagination and energy, Michael and his management team examined every aspect of their organization. What other vehicles do they have with which to enthuse customers with confidence? How effectively were they currently doing so? Were they recruiting and training staff who have the skills and the attitudes to enthuse customers with confidence? This process led the executive team to change every part of their business.

They articulated a new business philosophy and used it to guide the changes. They institutionalized their philosophy in the way they purchased and merchandised their product. They redesigned their stores, adapted the music being played, revamped the dressing rooms, and changed the way they recruited, trained, and managed their employees. They revisited their marketing material and the management of their customer database. They recreated their web site and modified their internal communications.

However, most important of all was Truworths' recognition that they needed to design and faithfully implement a unique value system, tailored specifically to create and nourish a culture that supported their new strategic focus. This they did with astonishing effectiveness. Truworths' moral imagination was applied not only to satisfying the deep human needs of their customers, but also to being sensitive to the human needs and motivators of their own staff and management. They discovered how to gain maximum productivity, customer focus, and innovation from their people, while building their pride and reinforcing their job fulfillment.

The results have been nearly ten years of market leadership. Truworths has consistently delivered financial results that exceed the expectations of investors and analysts. They have defied negative trends and shown phenomenal bottom line growth. Michael explains the consistent growth: Truworths profit rests on the human and intellectual component of what they are selling, not on a commoditized material product similar to that sold by their competitors. The nature of that human component, allows for continuous innovation and the protection of Truworths' premium margins and the growth of its market share. Truworths enjoys competitive advantage in the true sense of the term.

What is True Competitive Advantage?

Many vectors drive customer choice. The most common are price, convenience, and quality. But the greatest advantage occurs when customers have little or no choice because the total customer experience offered, in addition to being well priced and convenient, is unlike anything else available to them. Then, provided your offering is desirable and cannot easily by imitated, your advantage is absolute. The premium your customer will pay expands your margins. The uniqueness of your offering presents you with an almost unlimited opportunity to expand your market. "If you provide clients with the best possible experience, then profits and growth should naturally follow, almost regardless of what's going on in the economy."[7]

In the fifteen years that I have been helping companies develop strategies for success that cannot be imitated, I have used an organization's own internal talent, belief systems and creative brilliance. This leads its "Moral Imagination," expanding the discipline of strategic thinking into the arena of human values and ethics.

Values & Ethics in Strategy: True Moral Imagination

The word "value" has both an economic and a moral meaning. Value exists when there is a willingness to pay a price. In economic terms, value exists when a market is willing to pay a price for a product or service. In the moral sense, a value exists when the individual who possesses that value is willing to pay a price for it. For example "honesty" is only truly a value when an individual who believes in honesty, is willing to suffer loss or forgo a gain to uphold that belief. We call the belief the value, and the price an individual will "pay" to uphold that belief, the ethic.

Financial excellence results when a corporation's values and its ethics support its strategy. Ethics is a component of strategy because every business secures its future by making a contribution. The act of making a contribution is fundamentally an ethical activity. Identifying that contribution and maximizing its value is the field of strategy. Profit is the value the market attaches to an organization's contribution and the efficiency with which it makes that contribution.

Employees who experience their company's purpose as making a valued contribution (with profits as the outcome) rather than merely generating shareholder wealth, commit to their work with greater passion. This leads to a partnership between employees and corporate leadership that boosts innovation and uplifts performance. Ethics play a vital role in the preservation of this priceless partnership, which can thrive only in an atmosphere of trust and integrity.

Truworths is one of many companies that have redefined their purpose in terms of the human contributions they make, designed a strategy to optimize the financial value of that contribution, and institutionalized a corporate ethic to ensure that their people trust in the integrity of the company's values and the supremacy of its purpose in its strategic thinking.

Accessing the Unique: A Formula for Success

A company's own Human Asset is the most powerful resource for uniqueness and innovation. This results from both the uniqueness of the compendium of talents that comprise a company's human asset and the uniqueness of each individual in that compendium.

Since the great French detective, Alfonse Bertillon, solved a murder in Paris in 1902 using fingerprint technology, science has become increasingly aware of the differences between people. This knowledge was not new to the Japanese culture, which for centuries had used a fingerprint pressed into clay to identify the potter. The solution of another murder in the small British village of Narborough in 1985 using DNA technology taught the world that not only are no two individuals alike, but no individual is identical to any other human being who has ever lived.

Individual diversity is not the product of the present but rather of that individual's history. "Each gene is a message from our forebears and together they contain the whole story of human evolution. Everyone is a living fossil, carrying within themselves a record which goes back to the beginnings of humanity and far beyond."[8]

Genetics affects not only how people appear, but also often how the world appears to them. A minute DNA difference results in nearly half of the people of Europe seeing the world a shade more red than the other half does! When people use their unique qualities to mold the way they think and the contributions they make, those contributions are as unique the people themselves. Those contributions cannot be replicated.

A Company's ethos, created by the synthesis of every unique member of its human asset, is as unique to that company as DNA or fingerprints are to an individual. When companies use that ethos, their deepest moral resource, to create their customer experience, the outcome is as unique as their very souls, and as impossible to imitate. It is only when companies lose their authenticity in their quest to be the same, that they forgo their true competitive advantage and begin the process of commoditizing their offerings. This drives down their pricing, erodes their margins and destroys their brands.

When a company's brand has an ethos that can be identified and articulated, it provides an experience that no customer will forget, one that no competitor could imitate.

Moral Imagination vs. Moral Illusion

It is surprising how frequently business leaders live in a state of illusion about the values that operate in and drive their organizations. This is because, often unbeknownst to them, at least three separate and usually non-aligned value systems could be at work in their companies. The existence of these different value systems undermines trust as employees and the public experience management's deeds as incongruent with their stated values. It damages brand reputation and erodes morale.

It is, at times, difficult for an organization's leadership to acknowledge the existence of divergent value systems and to understand the implications of the divergence. It is even more difficult for leaders to confront the truth of what values really drive their organization. Yet this confrontation with the truth is a vital step in crafting an integrated value system that can transform an organization. For an organizational ethos to evolve with integrity, these three systems must be unified into one. The three value systems are:

1. *The Espoused Value System*: The Values that management communicates both orally and in writing.
2. *The Perceived Value System*: The Values that employees believe drive management's conduct.

3. *The Actual Value System*: The values that actually underpin the interpersonal dynamics of the organization. Management may have never previously articulated these values and employees may never have identified them.

Using Moral Imagination to Align Values with Strategy

The people in an organization who develop its strategy are not usually the same people tasked to develop the organization's values. Even when the same people undertake both of these tasks, they do not often appreciate the intricate relationship between values and strategy, nor do they have the expertise to translate values into ethics.

We shall describe three cases where organizational values actually or potentially undermined organizational strategy and describe how we used moral imagination to resolve these conflicts and propel the organizations forward. The first case is in the Health Care Industry, the second is in the Banking Industry, and the third is a case of Mergers and Acquisitions.

Case Study 1: The Healthcare Industry

Conflicting Values Priorities

The Vice-President of Human Resources of a large Health Care Organization was energetically imparting the value of caring in the organization. All of the staff espoused this value and the Chief Executive supported it. However, the Vice-president of Operations was driving a relentless strategy of cost reduction to ensure the survival of the organization in a tumultuous phase of the Health Care industry's evolution. Both leaders are people of impressive intellectual and moral stature, and drove their campaigns hard. Both initiatives were vital for the organization. Their two departments enjoyed excellent relations. Yet the value of caring undermined the efficiency strategy. Staff could not align the need to reduce patient/nurse ratios with the value of caring. They could not relate to the downsizing of certain departments in an organization that claimed to care not only for its patients but also for its staff. Not only did the organization fail to achieve its cost-cutting goals, but it was also experiencing reductions in standards of caring. More serious however was employees' loss of respect for leadership's integrity. The values initiative lost credibility, and employees saw the cost focus as the only thing that really counted. Patients were not the only ones who suffered from this deterioration. Everyone suffered, including the organization's capacity to sustain its dominant competitive position.

An Integrated Solution

We changed cost-consciousness from a survival tactic to a value that integrated with patient caring. Nursing staff began to seek their own ways to cut costs as part of their patient caring, realizing that doing so would extend quality medical care to more people. Staff reductions initiated by the nursing staff themselves, did not cause resentment and did not impact negatively on the quality of patient caring. We translated these and other supporting values (beliefs) into an ethic (conduct) that management began to live by. Even senior personnel responsible for large amounts of revenue were counseled when they transgressed organizational values. No longer was rainmaking seen to be more important than quality in interpersonal conduct. Very soon this work began to impact achieving astonishing results in employee commitment to both cost efficiency and excellence of care.

636-239-0582
hank@thequalitycoach.com

Case Study 2: The Banking Industry

Loyalty vs. Excellence
Throughout its long history, a prominent banking institution entrenched the values of fairness and loyalty among its managers and employees. When globalization and technology transformed the Financial Services industry, these values began to inhibit the Bank's drive for efficiency and excellence. The Bank downsized and started to reward peoples' performance rather than their loyalty. Employees felt alienated from the organizations' traditional ethics and began to passively sabotage the company's objectives.

An Honest Integration of Values
We redefined the implications of loyalty and explained it as 100% mutual commitment during an employee's career at the Bank, but not lifetime employment. We taught the reasons why lifetime employment was neither strategically nor ethically appropriate. We explained fairness as treating all people according to the same value system rather than as treating all people the same. The value system dictated that greater contributors be treated more favorably than smaller contributors. This was not unfair. The impact on morale and employee retention during the changes was remarkable. It enabled management to focus on the Banks pressing strategic needs rather than pacifying disgruntle but key employees.

Case Study 3: Mergers and Acquisitions

Growing Value by Merging Values
The pressure to "close the deal" in mergers and acquisitions should never undermine the greatest imperative - delivering shareholder value. Often the most critical cause of failure is the clash of cultures and incompatible strategic thinking. Successful merging requires synchronizing the diverse skills of all employees into a vision for a new company that is greater than the sum of its parts. Architects of successful mergers and acquisitions should always diagnose the ethical dynamics of both companies and qualitatively evaluate the strategic thinking of each of them. This forewarns them of the potential pitfalls of the merger and assists them to design a merger strategy that extends beyond structure; a strategy to build an integrated ethic for the new corporate entity. When employees see this process of incorporating ethics into strategy they gain faith in the direction of the new entity, the integrity of its leadership and the brilliance of its future.

A Merger of Values
In a recent merger, two successful banks were struggling to convince each other of the merits of their respective strategies in an attempt to truly merge rather than merely "take over." Our ethical and strategic diagnosis clarified to the combined management team why each strategy served the cultures of each bank in the past, but neither could serve the culture of the new entity. After understanding the value system of the new entity and we designed a strategy different to either of the original two but tailored to the new organization. In harsh conditions this accelerated revenue generation beyond expectation.

In Conclusion

As we have stated, organizations optimize their productivity when employees view their work as much more than the mere trading of skills for money. To achieve this heightened commitment, organizations should integrate their values and translate them into a single ethic that spans all management decisions and employee conduct. Then the company should align that ethic with its strategies. When an organization achieves this, its employees see their work as a vehicle with which to fulfill their own higher spiritual quests to make rare and needed contributions. The money they earn reflects the value of their contribution and provides them with both economic security and emotional self-esteem. This leads employees to invest their intellects and their passion in the work they do, driving their organizations' thinking to the very edge of competitiveness, and their performance… beyond that.

Footnotes:
1 - For one of the most significant studies of companies that live by this synthesis of moral principle with strategic agility, see James C. Collins and Jerry I. Pooras, *Built to Last* (New York, NY: HarperCollins Publishers, 2002), 102-103.
2 - Quoted by Henry Mintzberg, Bruce Ahlstrand, and Joseph Lampel, *Strategy Safari* (New York, NY: The Free Press, 1998).
3 - Jeffrey Pfeffer, *The Human Equation* (Boston, MA: Harvard Business School Press, 1998), 27.
4 - Markus Buckingham and Donald O. Clifton, Ph.D., *Now, Discover Your Strengths* (New York, NY: The Free Press, 2001), 6.
5 - Pfeffer, *Human Equation*, 16.
6 - See David Lapin, *Transaction World Magazine*, "Service is Not a Strategy; It's an Ethic," August 2001.
7 - Michael Dell, *Business 2.0*, December 2002/January 2003.
8 - S. Jones, *The Language of the Genes* (London: HarperCollins, 1993), 1.