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Blueprint to a Billion: From Disruption to Dominance

Turning a disruptive innovation into a billion-dollar business

BY JOE SINFIELD, DAVID G. THOMSON, AND CHRIS CARTER

One billion dollars—it's a lofty target for any business. Microsoft, Staples, Google, Nike, Genentech, Starbucks, eBay, and Harley-Davidson are just a few of the companies that have turned breakthrough ideas into such businesses. While every entrepreneur dreams of reaching that billion dollar mark, the reality is that fewer than one in 20,000 companies ever achieve the goal. What separates companies that attain this lofty status? Is there a pattern they followed to produce these results? We believe there is. In the recently released book *Blueprint to a Billion: 7 Essentials to Achieve Exponential Growth* (John Wiley & Sons), David G. Thomson identified the success pattern of these billion-dollar "Blueprint" companies.

It will come as no surprise to *Strategy & Innovation* readers that recent research conducted by Innosight indicates that more than half of the top Blueprint Companies had a strong linkage to disruptive innovation (see chart on ***page 9***). Given the rarity with which companies follow legitimately disruptive approaches, this indicates that a disruptive strategy gives you a disproportionate chance of reaching $1 billion in revenues. But as many leaders of disruptive businesses can attest, that alone is not enough.

What is needed is a combination of the principles of disruptive innovation and the 7 Essentials of Blueprint Companies. These two business-building approaches are complementary and create a process to identify,

see 'Blueprint to a Billion' on page 6

Innovating In Emerging Markets

The disruptive principles can point the way to success in developing countries

BY STEVE WUNKER

Growth is a fundamental objective of all companies. And while there are a variety of ways to grow, many large companies have realized that success in developing markets will be crucial to achieving their long-term growth objectives.

These companies have heard mountains of advice about how to penetrate these markets, yet time after time local firms with fewer resources out-perform their larger international rivals, particularly when competing for the poorest consumers. How can companies succeed in these developing markets?

see 'Emerging Markets' on page 11

INSIDE

Voices of Disruption

BY BOB BENZ

Each issue, we feature a person who is "in the trenches" of disruption. This issue, we hear from Bob Benz, who is the general manger of Interactive Media at Scripps Newspapers, a division of E.W. Scripps Company.

"Ever tried. Ever failed. No matter. Try again. Fail again. Fail better."

These words popped onto my Blackberry as my cab sped toward the airport after an innovation workshop at one of our newspapers. The quote, from Samuel Beckett's play "Worstward Ho," seemed to sum up much of what we'd just talked about, and the executive who e-mailed it to me clearly understood the mission ahead.

As absurd as it sounds, much of what we've been trying to instill in the E.W. Scripps Co.'s newspapers is a process that gives us license to try and to fail—but to fail intelligently and to leverage those failures into future successes.

In the summer of 2005, I started talking to my boss, newspaper division senior vice president Mark Contreras, about the coming budget season. Our business was (and still is) being confronted by a classic case of disruption.

Upstarts like craigslist were using the Internet to offer products that were good enough to meet buyers' and sellers' needs—and in the process were completely disrupting the classifieds business model that had been a core of our business for decades.

While we were generating a lot of revenue from our classifieds business (so much, in fact, that it seemed out of the question to match craigslist's free model), we understood

that things were changing rapidly and we had to find new ways to thrive in our 18 newspaper markets.

In short, we needed to foster disruptive innovation at our newspapers. We needed to start seeing ourselves as predator instead of prey. We had to create a channel for ideas that traditionally would be rejected because they "weren't part of our core business." That's when we came upon the idea of creating a venture fund within the division.

The fund would encourage papers to submit innovative ideas and it would invest in the ones with the most potential. It would be competitive. It would encourage innovation. And it would leverage the autonomy we grant our local publishers.

This wouldn't be a series of corporate mandates thudding down from on high. It would be a grassroots effort infused with an understanding of what's going on in the trenches.

Contreras agreed to budget $1.5 million to breathe life into the Entrepreneur Fund, and we contracted with Innosight to help us give it structure. We launched several initial projects that have helped us make the core concepts of disruptive innovation more concrete.

At the same time, we have draft-

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unlocking new market growth

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ed a charter for our Entrepreneur Fund and have worked hard to make it diverse. Of the nine members on the panel, four are from our newspaper division, one is from Scripps Networks (home of HGTV and the Food Network) and four are entrepreneurs and innovators from outside of the newspaper industry (including Freshwater Software founder Donna Auguste and former Clinton Administration official Cheryl Shavers, who also worked at Intel).

To date, we've met three times and have funded eight projects. These investments aren't big bets. They're small disbursements designed to test key assumptions in the ideas that are being submitted, and we're making the process and investments as transparent as possible to the rest of the division.

If we fail, we want to make sure everyone learns from our missteps. And when we succeed, we want to ensure that all of our papers can leverage that success into new business opportunities.

We're only seven months into the process, but we're already tweaking and adjusting course. We don't think we have all the answers, not by a long shot. But we believe we're heading in the right direction and the company intends to continue funding the initiative in 2007.

Here are a few of the key assumptions we've been testing and how we're adjusting:

1. **It's critical for someone to own the process.** We're in the midst of hiring a director for the fund who will spend 100 percent of his or her time tracking investments and helping nascent businesses get their footing.

2. **We need to expand our idea pipeline.** We conducted innovation workshops at each of our newspapers. Overall, it was a great experience and really helped people throughout the organization understand what we're striving to accomplish. But it also made it clear how difficult it is to see beyond the demands of the day-to-day business and drive innovation.

3. **A lack of human bandwidth can quickly strangle an upstart business.** Our goal was to have our corporate staff play a key role in spinning up these news businesses, but the corporate staff has a day job—supporting the online businesses of our newspapers. We're now looking at options to ensure that these businesses get the care and feeding they need. (For more on developing systems and structure to support new businesses, see "Innovators' Update," p.4.)

4. **It really is difficult to launch disruptive businesses from within your core business.** In many ways, we're wired to kill these ideas before they can grow or, at the very least, to recast them in the print frame-of-mind that our organization is comfortable with. We'll need to look for opportunities to spin off standalone businesses, and when we're taking an integrated approach, we will need to ensure that the demands of the existing business don't smother the upstart.

While the headlines still cast the future of the newspaper industry in a bleak light, we believe we are helping our employees focus on the many opportunities that are being and can be created instead of solely obsessing about the threats.◆

Reprint # 040402A

A LETTER FROM CLAYTON M. CHRISTENSEN

Each of this month's feature articles touches in some way on the importance of taking a jobs-based view of markets when developing innovative offerings. While many companies look at their customers through traditional segmentation schemes—such as demographics and psychographics—customers rarely think in these terms.

Why? Because customers' buying behaviors change much more frequently than do their membership in such groups. How often, for example, does someone walk into a store and think, "Well, what do other 50-year-old white males with children purchase?"

In reality, as customers go through their everyday lives, they are confronted with a variety of problems and they look to "hire" products that can help them accomplish these jobs. When companies identify meaningful jobs that customers encounter and then develop solutions that help more people get these jobs done more effectively, conveniently, and affordably, truly disruptive new business can result.

While understanding the importance of jobs-based segmentation is crucial, actually "doing the job of finding the job" means going out in the field and engaging customers. Currently, I am working with some colleagues to develop more specific guidelines on how to do this.

It's hard work. Purchasing databases of information and running analysis from the comfort of an office simply is not enough. It requires watching, participating, writing, and thinking. You not only have to get to know the problems your customers encounter, you have to find ways to understand problems that customers might not know they are encountering.

Our article this month on observational research (p. 14) discusses one valuable tool that can be used to decipher customers' jobs. When you read this article, remember that observational researchers are not survey takers collecting data, moderators taking opinions, or ethnographers observing people. To be successful they need to work harder, getting down in the trenches with the customers. Jobs-to-be-done researchers are like investigative reporters or detectives: They relentlessly track down the whole story behind the specific events of purchase and use.

Clayton Christensen

Innovators' Update: Sustaining the Innovation Spark

Even the best idea can fade away without the right supporting systems and structures

Each issue, we'll take a look back at a past Innovators' Insight to see how our analysis has held up. In this issue, we look at Insight #51, "Cloning Google." The Insight warned companies against blindly following Google's rule of letting engineers spend a day a week on personally interesting project. What has happened since?

Imagine you're a Google engineer, enjoying massages and fine cuisine in the luxurious GooglePlex. One of the things you love about your job is the ability to spend a day a week working on projects you find personally interesting. You have the freedom to dream and to work with other dreamers.

The approach must be working, you think, because your net worth has surged along with Google's stock. The company's powerful search solution coupled with its disruptive AdWords and AdSense advertising products are changing the media marketplace.

Other companies have taken note of this so-called "playful R&D," hoping to splice some of Google's DNA into their innovation efforts. But before allowing managers to spend time on such projects, companies need to carefully heed emerging warning signs about Google's ability to truly master the process of building new growth businesses.

Along some dimensions, Google's program has been an unqualified success. Its engineers dream up disruptive ideas by the barrelful and quickly weed out bad ones. Google launches businesses with stunning regularity. One month it is email, the next it is instant messaging, then it is payment mechanisms. All seems good.

But the initial "spark" of a new disruptive business is not enough to create real growth. Without the right kindling, oxygen, and careful tending, even the most promising sparks can quickly fade. And despite all the hype, many of Google's efforts have been duds.

In a provocative July article titled "So Much Fanfare, So Little Hits," *BusinessWeek* noted that Google has not established a market-leading position in a single area outside of search, despite two dozen major launches over the past four years. For example, the article described how Google's four-month-old financial offering (Google Finance) ranks as just the 40th most visited financial information Web site.

How can you explain Google's failure to grow seemingly disruptive businesses? It is at least conceivable that part of the blame rests on the very systems that help Google quickly launch new ideas. After all, the most "interesting" part of building a business is formulating the initial idea and launching the first version. Top-flight engineers then might quietly move on to the next "cool" project. The lack of systems and structures to help build businesses beyond launch could make it difficult for Google to sustain these sparks.

Google's struggle to grow new businesses is meaningless today because its core is so healthy. The stock has treaded water over the past nine months, but is still up close to 300 percent since its August 2004 IPO. But a company whose core business isn't growing 15 to 20 percent each quarter would be in big trouble if it similarly struggled to nurture new businesses. Markets tend not to tolerate a company with a sagging core that fails 20-some times to create a market-leading offering.

Business building is complicated. Companies often attribute their innovation woes to a lack of ideas, spending time and money on elaborate brainstorming sessions or paying outsiders to generate new ideas. One of the areas they often overlook is the processes that help nurture and cultivate new ideas.

Without the right systems and structures, the return on idea-generation will be low. Our experience suggests that there often are a lot of good ideas bouncing around. The problem is developing ways to turn sparks into roaring fires by aligning resource-allocation processes to ensure that those new businesses get the oxygen needed to thrive.

Google needs to figure out how to sustain its disruptive sparks soon. The growth of its core will inevitably slow. Yahoo!, Microsoft, and dozens of others are pouring resources into the search battle. If 18 months from now Google can not point to at least a couple of successful new growth businesses and it has to expend more resources fighting against increasingly fierce competition … well, remember a decade ago when the government wanted to break up Microsoft because it was such an unstoppable force?◆

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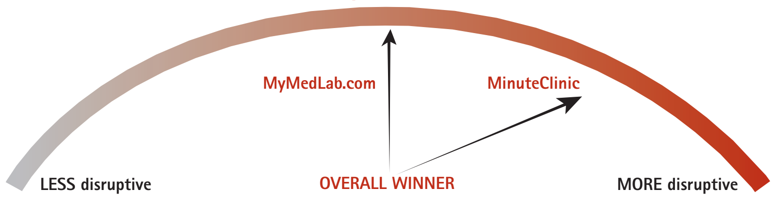
Disrupt-O-Meter

Tale of the Disruptive Tape: MinuteClinic vs. MyMedLab.com

"Is company X disruptive?" Whenever we're asked this question—and we're asked it often—we run through a simple mental checklist that looks at the target customer, the solution, the business model, and the competitive landscape. In this issue, we use our "Disrupt-O-Meter" to analyze new solutions in the medical diagnostics industry.

The promise of "consumer-driven healthcare" lies in the notion that consumers will begin to actively manage—and contain—their cost of care if those costs are transparent. Among the many companies hoping to benefit from this trend are MinuteClinic, recently purchased by CVS, and MyMedLab.com. MinuteClinic's nurse-staffed, pharmacy-based kiosks offer tests to diagnose a range of common maladies. MyMedLab.com allows patients to self-order a set of more complex diagnostic and wellness tests that normally require physician approval. Which is more disruptive?

Disrupt-O-Meter



MYMEDLAB		MinuteClinic	
Consumers wanting to bypass lengthy doctors' office visits for diagnostic wellness tests	CUSTOMER	Consumers seeking cheap, simple, and convenient help for everyday maladies	WINNER
Website allows test scheduling at a medical clinic without a doctor's prescription	SOLUTION	A nurse runs tests and writes prescriptions that can be filled on-site	WINNER
While insurers don't pay, the tests are a fraction of what doctor's charge	BUSINESS MODEL	A McDonalds-like, low-cost, simple business model that has insurers' support	WINNER
Doctors might feel removed from patient care and risk losing some lucrative tests	COMPETITIVE LANDSCAPE	Allows doctors to focus on higher-margin, more specialized patient services	WINNER

More Disruptive: MinuteClinic. While both companies offer innovative ways for consumers to more actively manage their care at a lower cost, MinuteClinic's solution is much simpler and more convenient to use: Consumers get the test in a local store, shop while the results are determined, and pick up the medication on the way out. The service is cheap, lowering costs for consumers and insurers that otherwise would have to pay for a visit to a doctor's office. More important, doctors—who don't exactly wake up hoping to treat colds and ear aches—have less motivation to fight MinuteClinic's service. MyMedLab, however, not only targets higher margin lab tests, but also inserts itself between the patient and the doctor in potentially meaningful medical situations, such as diagnoses of sexually transmitted diseases or presence of abnormally high cholesterol levels. ◆

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EMERGING TECHNOLOGY WATCH

Flying below the satellite

Ninety kilometers above the surface of the earth sits the bottom edge of an atmospheric region—called the ionosphere—that obtains an electrical charge as it shields the Earth from solar radiation. This charge allows the ionosphere to carry radio waves, as shortwave radio owners who pick up signals from around the world know. Now Samsung has filed a patent seeking to use this atmospheric layer to send and receive cellular signals over long distances without investing in satellites. Quality of service is likely to be lower and subject to electromagnetic storms and other factors, but it may someday be possible to send text messages well beyond line of sight by bouncing them directly across the sky.

Increasing the sample size

When drug manufacturers compete for the attention of physicians, free drug samples play a major role. While the prevalence of free samples can benefit patients, drug manufacturers, and physicians, sample selection often depends on the sales associates that visit a doctor's office, leading to variation from one physician to the next. Medmanage Systems seeks to reduce this variation by augmenting the salesperson with an online distribution agent that specializes in sample delivery. The distribution system—the equivalent of an online kiosk for order and delivery—has the potential to reach more than 90 percent of health care prescribers in the U.S., allowing them to diversify their sample portfolio while encouraging sales associates to focus on higher–end drugs.

Another type of housing disruption?

While the war between real estate valuation sites Zillow.com and Realtor.com has been gaining attention in the press, a third startup company, Redfin, has been building an online brokerage, so far providing services for homes in the Seattle and Bay areas. Redfin claims that it is the first online service that allows users to purchase MLS-listed homes online. Redfin further claims that its service saves consumers roughly $11,000 per transaction in agent fees. At the same time, Redfin executives have been providing congressional testimony intended to challenge some of the traditional blocks to Internet real estate businesses, such as minimum service requirements and equal access to MLS listings. If this happens, expect to see a host of Internet sites, from eBay to Yahoo enter the real estate market. Five years from now, brokers may be forced to struggle with the same challenges facing travel agents today.

By John Boddie. For submissions please, email jboddie@strategyandinnovation.com

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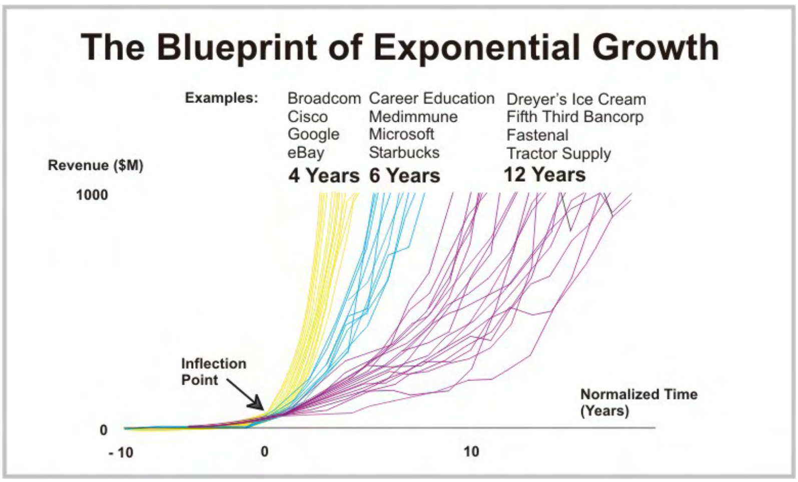
develop, and grow an idea into a potential billion-dollar business: prioritize new growth opportunities that follow the patterns of disruptive success in the early stages and then incorporate the 7 Essentials of Blueprint Companies as the path to success takes shape and the company matures. With all of these pieces in place, executives can drive unprecedented growth.

What are 'Blueprint Companies'?

"Blueprint Companies" are companies that have achieved the billion-dollar revenue mark. While these companies represent just five percent of American public offerings since 1980 (387 out of 7,454 IPOs), they have had a disproportionate impact on the economy, accounting for 56 percent of the employment and 64 percent of the market value created by that total set of new companies. BlueprintCompanies, in other words, are the core of America's economic innovation and growth.



It is almost impossible to avoid using their products. When did you last use Microsoft software; surf the Internet (running largely on Cisco equipment); search on Google; drink a latte at Starbucks; shop on eBay or Amazon; purchase products at Williams-Sonoma, Staples, or Home Depot; take medicine made by Amgen, Genentech, or MedImmune; or use financial services from Charles Schwab?

Blueprint Companies don't just grow fast, they grow *exponentially*. Exponential revenue growth is super-compounding: It describes companies that can double revenue every year, for example. In contrast, non-Blueprint Companies exhibit random or linear growth—or worse, no growth at all.

At first blush, Blueprint Companies seem to have little in common beyond having reached $1 billion in revenues. Some companies took many years to achieve $1 billion; others hit the milestone quickly. Interestingly, these companies share a unique revenue trajectory that can be divided into three parts: 1) a variable runway, 2) an inflection point where revenue breaks onto an exponential growth path (typically around $50 million), and 3) an exponential trajectory to $1 billion in revenue.

What makes comparison of the revenue trajectories difficult is the variable runway. Some companies reach the inflection point in only a few years. Others take decades to reach the point. However, lining up all of the companies' inflection points at the $50 million mark where companies break into exponential growth to $1 billion revenue reveals an interesting pattern.

It turns out that once a company hits the inflection point, there are three definitive trajectories to $1 billion revenue: a 4-year, 6-year, or 12-year trajectory. The nature of the curves shows that after reaching the inflection point, Blueprint Companies demonstrate consistent exponential revenue growth. And this growth is substantial: Going from $50 million to $1 billion in four years is a 111 percent compound annual growth rate; in 6 years it is 65 percent, and in 12 years it is 28 percent.

Blueprint Companies can grow in any sector. Given the recent success of Google, eBay, Microsoft, and Cisco, it is not hard to understand why people associate information technology with high growth rates. But IT accounts for only 18 percent of the Blueprint Companies.

The consumer discretionary sector—retail stores, internet retail, and the like—actually outranks the tech sector: Staples, AutoZone, Williams-Sonoma, and Abercrombie & Fitch are but a few. Above both IT and consumer discretionary, is financial services—and inside this sector is the insurance industry with the highest number of Blueprint Companies. Down the list are healthcare, materials, and industrials.

Disruptive innovation played an important role in the evolution of more than half of the top Blueprint Companies, a substantial percentage considering the relatively low ratio of disruptive ideas to sustaining ideas in any given marketplace.

So building on a disruptive idea appears to be a very good start on the path to a billion. But it is not enough. When executives begin to transition a business from an emergent strategy process to a more deliberate approach as the "right" strategy takes shape, they need to begin implementing the 7 Essentials of Blueprint Companies.

Taking a disruption to a billion

To launch a company on a speedy and rapid growth trajectory, a company must first navigate the two-part phase of idea generation and prioritization and then business model development to form the seed of a great disruptive business. As *S&I* readers know, the concepts of disruptive innovation provide a process and set of tools to guide executives through these early stages (see sidebar below, "Planting and Nurturing a Disruptive Seed"), starting with the identification of offerings that will satisfy a customer job, then defining a foothold strategy that is aligned with the patterns of disruptive success, and ultimately, pursuing an emergent approach to optimize the strategy.

This process forms the foundation for a strong, profitable, and very successful business. But what if we want more than just a "successful" business? How do we cross

PLANTING AND NURTURING A DISRUPTIVE SEED

Before a business can achieve scale, it needs to go through the often challenging process of honing a successful business model. In fact, research has indicated that the typical successful business changes business models four times before finally hitting upon a winning model.

Consequently, one of the keys, of course, is to remain solvent during this early phase. Based upon our experience helping clients navigate this difficult period, we see three critical steps that enable a company to earn the right to grow.

Step 1 - Satisfy Customer Jobs:

At the core of every great disruptive business lies an offering that satisfies a "job" in the marketplace that had previously been unsatisfied. Whether touting the benefits of a new technology or service or seeking to serve an untapped customer segment with a yet-to-be-defined offering, it is critical to identify a connection between the jobs that customers are trying to get done and the specific characteristics of your offering that satisfy those jobs.

Many times this means offering a product that is "good enough" along the current measure of performance, but substantially better on another dimension—a dimension tied to a currently unsatisfied job. Disruptive innovations are successful because they actively address this unmet job. Incumbents, in contrast, are often unwilling or unable to address customer jobs in a new, non-traditional, performance dimension and, thus, this approach creates opportunity for new businesses.

(To learn more about the jobs-to-be-done framework, see "Get the Job Done," *S&I* July-August 2005. To learn more about how to identify jobs, see "Observational Research," p.14.)

Step 2 - Define a Foothold Strategy:

With an offering in mind and a clearly identified market need, the next step is to develop an approach to market that builds on the patterns of successful disruptive innovations. There are two primary disruptive strategies:

The *low-end* strategy targets some of an industry's least attractive customers—those who are overshot by existing offerings. By providing "good enough" solutions at a lower price with a low-cost business model, the low-end of a market can become an attractive opportunity.

The *new market* strategy allows customers to take advantage of products or services that they were previously unable to utilize due to factors such as a lack of skill, wealth, or access. By overcoming barriers to consumption, nonconsumers can be brought into the market, growing the pie rather than taking from it.

(To learn more about disruptive strategies, see "Do You Really Know What You are Talking About," *S&I* May-June 2005.)

Step 3 - Use an Emergent Strategy Process:

A company's ability to evaluate how well an opportunity fits the disruptive patterns is actually a function of how much it truly *knows*—not assumes—about the opportunity. When a new venture is conceptualized, we say that the "knowledge-to-assumption ratio" is low—that is, there are only a few facts that we can confidently assert about the opportunity, but there are a lot of assumptions being made.

A flexible, emergent strategy processes allows a company to adapt its perspective and change course as an optimal strategy becomes clear without having spent too much money pursuing deadends.

At the core of this emergent management philosophy is accepting the fact that you cannot know everything at the onset about a new opportunity. As a result, you must proactively call attention to aspects of the proposed business model that involve unknowns that cannot be conclusively determined to fit a pattern of success. In essence the goal is to "invest a little to learn a lot", thereby pursuing the opportunity while preserving the ability to adapt to factors that cannot be known at the outset.

(To learn more about emergent strategy, see "Mastering the Emergent Strategy Process," *S&I* March-April 2006.)

Using the approach outlined above for identifying and developing new growth opportunities enables an organization to stay solvent while iterating its product offering and business model. The process increases the chances a company will gain a foothold that can provide the foundation for longer-term growth. With increased certainty about the opportunity and the business model needed to capitalize upon it, the entrepreneur or manager is in a more informed position to ramp-up investment and drive the business toward a billion dollar goal.

the inflection point on the revenue trajectory and achieve exponential growth? It is our belief that the answer to such a question should be "implement the Seven Essentials of Blueprint Companies."

The trajectory a company pursues to $1 billion is a complex function of multiple factors. Examination of the Blueprint Companies demonstrates that the time to identify, launch, and shape a business based on a disruptive innovation is highly variable and can range from months to years. For example, the average time for IT companies is 5 years from founding to $50 million revenue. During this time, the teams not only shaped their innovation, they launched a business and achieved early and rapid exponential revenue growth on the order of 100 percent per year. In contrast, in sectors such as financial services the path can be much longer.

However, transitioning from building and launching a business model to exponential growth occurs as companies gain comfort that they have found the right strategy and commit to the relationships and management approach that is embodied in the 7 Essentials. To achieve exponential growth as a whole, a company really needs exponential revenue growth per customer. In other words, the overall macro dynamics of compounding growth translate to the micro dynamics on a per customer basis.

The quicker the per-customer revenue grows, the quicker the company reaches a billion. For example, Microsoft grew on the 6-year trajectory as PC users bought not only the operating system but Microsoft Office for hundreds of dollars. In contrast, Dreyer's Ice Cream went up the slower 12-year trajectory, as per customer revenue growth increased more slowly (though still at a rapid rate).

The key to implementing the 7 Essentials successfully is having the patience and discipline to pursue them only once you have defined and appropriately validated your strategy. Locking-in customer relationships too early or committing to the design or features of a product or service before adequately testing their market appeal can lead to the missteps characteristic of classic innovation blunders.

Once a robust strategy is identified, the 7 Essentials should be put in place as quickly as possible. By the time the Blueprint Companies reached the inflection point, many if not all of the 7 Essentials were in place, earning it the right to quickly reach $1 billion in revenue. Naturally, growth rates slow with size, so it is important to achieve high growth rates as early in a company's life as possible. If you fail to do so, you still can create a growth company, but not one that will achieve exponential growth.

Executing the 7 Essentials to achieve exponential growth

With a sound business model in place, leaders need to build out the 7 Essentials. Just as the patterns of disruptive innovation define a path of increased probability of success in launching new growth efforts, the 7 Essentials are common characteristics of companies that achieved the outstanding growth that defines Blueprint Companies.

These essentials are independent of industry and, in fact, five or more of them showed up in more than 90 percent of the Blueprint Companies studied. By keeping these essentials in mind as a business moves through its early stages, executives can maximize the chances of building a billion dollar business—and can get there more quickly.

1. Create and sustain a breakthrough value proposition. The best Blueprint Companies not only created but sustained breakthrough value propositions. In the terminology of disruptive innovation, these companies identified an important unmet job and delivered a new and better solution to accomplish that job—a solution that created a new dimension of performance valued by customers.

Importantly, companies need to clearly convey their value proposition to customers. For example, PC commercials focus on processors, memory, and display features—important attributes to computer buyers. If Starbucks took a similar approach, their advertising would tout coffee beans and, especially, water, which makes up 98 percent of coffee. But Starbucks' value proposition is based on friendly and experienced staff who customize an experience. And every store promotes an environment that is an extension of home and work: Internet access, comfortable seating, and music. Customers pay for the total Starbucks experience.

And, just as we suggest an iterative approach to refining disruptive ideas, blueprint companies continually refined their business models to sustain the breakthrough value proposition that was at their core, taking the disruption to a broader and broader set of customers and driving exponential growth.

2. Exploit a high-growth market segment. While opportunities for new growth businesses exist in many industries, some provide more opportunity than others. This is equally true for disruptive innovations and Blueprint Companies. Finding disruptive opportunities in industries undergoing rapid change is typically easier than finding them in slow growth markets.

In the same way, the odds of building a billion dollar business improve when the underlying industry is experiencing rapid growth and offers a range of ways to exploit that growth.

Looking at the list of Blueprint Companies reveals that the specialty store industry generated the highest number of billion dollar businesses: 18 firms including Autozone, Staples, Tractor Supply, Williams-Sonoma, and PETsMART. This occurred because there were multiple high-growth market segments to address (office supplies, cookware, pet supplies). In contrast, slower growth markets are likely to support only one or two billion dollar businesses—witness Harley-Davidson in the motorcycle manufacturing industry.

3. Shape a revenue powerhouse with Marquee Customers. Your best customers can serve as a valuable extension of your sales force These *Marquee Customers* shape the company by testing and deploying the product, recommending the company to their peers, and providing the backbone of exponential revenue growth (per-customer exponential revenue growth). For example, eBay's top customers are part of a feedback system that helps shape eBay's new services. As evangelizers, they are also a powerful word-of-mouth sales force to attract other customers.

Marquee Customers are key components of the continued iterative approach to building a new growth business. They provide the company with fast, responsive and honest feedback regarding products and services. And by making the Marquee Customers part of the development process, a potential Blueprint Company can test a number of different business models and product options.

4. Secure Big Brother Alliances for breaking into new markets. The complement to Marquee Customers is a Big Brother–Little Brother alliance relationship. These alliances, in which a bigger company helps a smaller one, provide credibility to the Little Brother, give it market intelligence, and lead it to Marquee Customers. Microsoft's early alliance with IBM is a perfect example.

These relationships also can prove valuable when the Big Brother helps the potential Blueprint Company evaluate specific assumptions about customers, markets, and industry dynamics.

LEADING BLUEPRINT COMPANIES WITH A DISRUPTIVE FOUNDATION

- AES Corp.
- The Altera Corp.
- Amazon.com, Inc.
- Ambac Financial
- Apollo Group, Inc.
- AutoZone, Inc.
- Biomet, Inc.
- Boston Scientific Corp.
- Broadcom Corp.
- Chiron Corp.
- Cisco Systems, Inc.
- eBay, Inc.
- Genentech, Inc.
- Google, Inc.
- LSI Logic Corp.
- Medco Health Solutions, Inc.
- Microsoft Corp.
- Moodys Corp
- Network Appliance, Inc.
- Novell, Inc.
- Sun Microsystems, Inc.
- United Health Group, Inc.
- Veritas Software Co.
- Xilinx, Inc.
- YAHOO! Inc.

5. Become the masters of exponential returns. Conventional wisdom suggests that companies should over invest to grow. In contrast to conventional wisdom, Blueprint Companies are cash flow positive early in their life and sustain this positive cash flow to $1 billion in revenue. In the technology industry, where the market values were highest, companies were cash flow positive as early as the inflection point.

Just as we advocate starting small and focusing on profits in the early stages of business development, maintaining this philosophy throughout the growth trajectory appears to be a core success factor for Blueprint Companies.

Over-spending was not the path to success. The shareholder returns for being a top performing Blueprint Company can be shocking: Those on the four-year trajectory delivered an average of 87 percent returns to their shareholders.

6. Practice Inside-Outside Leadership. A pivotal quality that enables the execution of the other essentials is a dynamic leadership pairing: One leader (or team) faces outward toward markets, customers, alliances, and the community, while another leader (or team) focuses inward on optimizing operations. Contrary to the popular belief that one leader is *the* leader, this Inside-Outside leadership pair is highly prevalent among Blueprint Companies.

Think of Microsoft, eBay, Yahoo!, and Network Appliance, among others. In the early 1990's Jon Shirley served as the Mr. Inside to Bill Gates, who became Mr. Outside as Microsoft ascended from $50 to $800 million in revenue. Today, Meg Whitman is the icon of an outside-facing leader. She focuses on eBay's value proposition, customer satisfaction, and alliances. Maynard Webb is eBay's Mr. Inside, concentrating on operations. Having a lower profile executive is critical to maintaining a focus on operations and profitability.

7. The board is comprised of essentials experts. Blueprint boards are not packed with investors. These companies recruited customers, alliance partners, and other Blueprint CEOs to the board. It makes a big difference. We call these members *Essentials Experts* because their role is linked to the shaping and execution of one or more of the essentials.

Because most investors have not scaled companies to $1 billion revenue, CEOs from existing Blueprint Companies often were recruited onto the boards of up-and-comers to provide insight into exponential growth. For example, Howard Schultz from Starbucks was on the board at eBay during its exponential phase. In contrast, boards with only investors and insiders tended to be associated with struggling companies.

Bringing it all together

So, do you have to do it all? Yes. Research has repeatedly shown that new growth companies that fail to pursue an emergent strategy more frequently run out of resources or lose the faith of their supporters and thus cannot adapt to unknowns—leading to their demise.

Similarly, companies on the Blueprint journey must execute the 7 Essentials at average-or-above levels of performance when compared to their counterparts that did not make it to $1 billion.

In the end, increasing the likelihood of creating a billion dollar business from a great idea is a matter of discipline and method. It's about how you can use the pattern of disruptive innovation and the 7 Essentials to better your business, organization, and team to screen new ideas, foster their development, and produce exponential growth.

This necessarily is a proactive approach to growth. The disruptive innovation pattern and the 7 Essentials are not artifacts; they are characteristics that are created by thoughtful, action-based management decisions. Adopting one or more of these concepts presented here will enhance your growth—both personally and professionally. Executing all of them will enable your company to achieve extraordinary exponential growth.

Joe Sinfield is a partner at Innosight and an Assistant Professor at Purdue University. Chris Carter is a principal at Innosight. David Thomson is the chairman of and a consultant with the Blueprint Growth Institute. He is the author of *Blueprint to a Billion: 7 Essentials to Achieve Exponential Growth* (Wiley). Visit www.blueprinttoabillion.com.

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The theories of disruption that explain the creation of new markets in developed countries can help established players break into emerging markets as well. Specifically, companies first need to carefully think through the unique "jobs" their customers are trying to get done in these countries.

A deep understanding of these jobs shows that firms often should buck the conventional wisdom: Customers in these markets don't always opt for the cheapest offering. Based on these insights, companies need to begin the difficult task of redesigning their entire business model—not just their product offering—to suit the market. Finally, emerging markets often demand entirely new distribution systems and channels to market.

Understand the customers' jobs

Unless a firm truly comprehends the jobs that developing country customers want to get done, it risks importing assumptions from abroad that can sink the local business. Achieving this understanding does not require massive market research, but does demand attentive listening (see related article, p.14).

The mistake to avoid is assuming the jobs of people in developing countries are similar to those of developed nation consumers. The result is fruitless efforts and frustration.

General Motors, for example, has had great success in China with its Wuling Sunshine minivan, a small vehicle with a tiny engine, a top speed of 81 mph, and seats one-third as thick as those in U.S. models. Why has this offering worked as other vans have failed to gain traction? For small distributors in congested cities, the Wuling accomplishes the job of getting goods cheaply from point A to B. They aren't concerned with power, speed, comfort, or capacity. They do, however, care about price. And here GM has a major advantage: The vehicle costs $5,000. Because the Wuling Sunshine is affordable and gets the job done, it has quickly expanded the minivan market.

In developing its offering, Indian software firm Empower Works rethought the jobs of corporate clients in the enterprise software space. The company recognized that 80 percent of eligible firms were not using any kind of purchased system. Nonconsumption stemmed from the fact that existing packaged offerings came from U.S. vendors such as PeopleSoft that dramatically overshot (and overpriced) Indian firms that just wanted to keep track of vacation time, attendance, and travel.

So Empower developed a simple web-based application that provided these functions cheaply—but more reliably—than the unbranded, often internally produced software that firms had come to rely upon. The system helped Empower gain 72 clients in one year. The company is moving upmarket, but keeping a sharp focus on a low-cost business model that nonetheless offers quality to its target market.

Firms must think creatively about how to identify nonconsumers and how to discover their needs, for instance, encouraging employees to question their extended families and having managers ride along in delivery trucks to see the challenges that customers face. It is essential when employing these strategies to get beyond the the words that customers believe you want to hear to get an unvarnished picture of demand.

Being cheapest isn't always best

To most executives, a person subsisting on $2 a day is unimaginably poor. How can they survive, never mind buy our products, companies might wonder? Clearly, the poor economize in many ways. Yet some companies and nonprofit organizations realize that these consumers care about quality and will pay a premium for valued brands.

Zambia's non-profit Society for Family Health (SFH) promotes the use of health-related goods such as anti-malarial mosquito nets and condoms by selling the products commercially. (*Editor's Note: This article uses many examples from Zambia, a democratic and relatively free-market African economy since 1991. In several ways, Zambia is representative of many developing countries: It is poor, but stable, and is opening its markets.*)

SFH's products are not necessarily cheap; a mosquito net might cost $5. However, consumers pay these sums at a local grocery store, rather than access programs that give away a similar net for free. Why? Because, like all consumers, they value convenience and quality.

SFH's commerce-oriented model has made the products widespread because distributors profit from sales. SFH has also created a brand for the nets, complete with a fictional spokeswoman, "Mama Safenight," to convey the product's quality. SFH recognizes that consumers only go through the bother and expense of using a mosquito net if they trust its effectiveness.

Cellular operators have learned a similar lesson. Nokia has long dominated cellphone sales in Zambia, in spite of relatively high prices. One manufacturer, Sendo, recently introduced a new phone, selling it for about 20 percent less than Nokia's cheapest model, but consumers overwhelmingly preferred the Nokia handsets.

It turned out that consumers who spend a large portion of their income on cellphones care deeply about the impression that their handset makes. Conveying status is a key job. Given the cost, consumers are also deeply concerned about a handset's longevity and reliability and they did not trust the unfamiliar brand's quality.

The lesson: What is basic in Western markets can be a conspicuous luxury elsewhere. This is true even in packaged goods.

The introduction of Castle, South Africa's leading beer brand, to the Zambian market by SABMiller is a classic example of how relatively costly products can gain rapid acceptance when managed correctly. The brand quickly zoomed to pass the local (and quite tasty) brand Mosi in spite of selling at a price premium.

For beer, the emotional appeal of the brand is important. SABMiller effectively differentiated the jobs of Mosi and Castle (which the smaller brewer purchased prior to the launch). Mosi expressed national pride; Castle expressed prestige. While Castle was more expensive, it conveyed status, an important job for people who have few ways to broadcast such a message.

Price is obviously an issue. Firms have frequently struggled when they have imported sophisticated, costly products from developed countries, intent on targeting a small middle and upper class. But being cheapest is by no means being best. If a firm can accomplish other important jobs for its customers, even at a price premium, it will often find success.

Redesign the business model not just the product offering

While companies will often seek to adjust their product offering when catering to the poor, they often face great difficulty altering their underlying business model. This is understandable. The way a firm does business is the result of a complicated mix of processes and priorities that cannot be easily changed by a handful of edicts.

Yet adopting an innovative approach can be vital to a firm's success. Wal-Mart, for instance, first succeeded due to a unique business model, not because of proprietary technology. The same principle applies to the developing world.

Consider banking. Citibank has operated in Zambia since 1979, opening three branches in the country. As elsewhere, Citibank offers both consumer and business banking services, but has struggled in the consumer sector. Why? Few consumers value the unique job that Citibank does: Protect money in a rock-solid, global institution. The few Zambians with substantial savings tend to invest abroad and those with more meager savings need frequent access to their money, something difficult to do at a bank with three branches.

In response, Citibank has simply emphasized corporate banking, reasoning that corporate customers do not need widespread branches. While Citibank has had some success with large multinationals, which value a global banking relationship, it has struggled to attract Zambian companies. These companies tend not to value Citibank's long-term investment and lending services because local firms try to optimize use of cash-on-hand.

These companies also benefit little from Citibank's sophisticated reporting systems, as many transactions occur in cash. Cash transactions could be facilitated through local branches, but Citibank's emphasis on the corporate market—and its resultant conclusion from developed country experience that branches are of limited value to such customers—severely limits its ability to offer such a service. Citibank is overshooting the needs of its corporate customers with unnecessarily complex services.

In contrast, local player Finance Bank has grown rapidly with an entirely different model. The firm has 14 times as many branches as Citibank. It embraces the consumer market, drawing queues of customers transacting as little as $5 and winning customers simply by being close to them. Understanding its customers' cash needs, it invested in a state-of-the-art ATM system. The company makes money on service fees, benefiting from a high volume of transactions and serving the retail market profitably.

Finance Bank then recognized that its branch network could be of immense value to business customers, given their unique jobs.

The bank offers safekeeping for cellular operators' pre-paid airtime "scratchcards," for instance, gaining entry into one of the fastest-growing industries in the country.

It also enables wholesalers of consumer goods to pay their suppliers through its bank branches, avoiding cash transactions in busy public markets. This service gained the bank a foothold with some of Zambia's largest corporate customers. Finance Bank has a quickly growing share of the corporate banking market, bucking the conventional wisdom of the industry.

While many of Citibank's financial products are quite similar to Finance Bank's, Citibank's business model was not appropriate for the local environment, where success required emphasizing a large number of small transactions and diversified revenue streams. What's important to remember is that the needs of poor markets can create new dimensions of performance. Frequently, one of these dimensions is simplicity and companies that develop straightforward solutions can succeed in new ways.

Distribution needs to work locally

Most developed-country firms have an inadequate understanding of one of the most important factors in penetrating these markets: distribution. No matter what the firm's competencies are in understanding jobs, creating products, and developing business models, a company will have little impact if consumers can't find the offering.

In launching the Castle beer brand discussed above, SABMiller took the radical, but effective, step of purchasing Mosi—and its distribution network—thereby ensuring timely and reliable distribution, a necessity for a perishable such as beer. While a significant expense, the move paid off: By controlling both brands, SABMiller achieved scale economies that enable reliable deliveries.

Purchasing the largest incumbent is not always possible of course, so entrants need to carefully think through the challenges they will face in getting their products in front of consumers. Even large

multi-nationals with well-established brands are likely to suffer if their distribution strategy does not take local realities into account.

When PepsiCo, for example, entered the Zambia market, it tried to launch its product using an independent distributor that carried a variety of products. Unprepared to make a long-term commitment, the relationship predictably went flat. Product did not get to stores reliably and grocers eventually choose not to prioritize, or even stock, the brand.

Success often requires finding novel ways to deliver products. Celtel, an Amsterdam-based pan-African cellular operator (*Editor's Note: the author worked at Celtel*), faced a similar problem in Zambia when it had to quickly establish distribution of scratchcards. Realizing the differences between a ddevloped market and one like Zambia, Celtel gained reach partly by employing "super-dealers," individuals who each could create a salesforce. One such super-dealer was Friday Tembo, a man in his 20s operating out of a tiny shack.

Despite the non-traditional appearance of his store, Mr. Tembo controls a sizeable percentage of Celtel's total airtime distribution. He does this partly through providing credit himself to independent dealers who work on commissions. Because he is rooted in the community, his personal knowledge of these people and their social networks enables Mr. Tembo to assess creditworthiness quickly. A consumer can therefore buy Celtel airtime in the tiniest market stalls in remote towns—where very few consumer products are found.

Not all products are as small and easy to distribute as scratchcards, of course. When Colgate decided to enter the same market, it could have tried the "Pepsi approach" discussed above. Instead, however, the company took a much more measured approach, allowing it to learn about the market, build partnerships, and introduce its brand.

Rather than launching in the capital, Colgate introduced its products in a small, geographically removed region of the country. Here, an on-the-ground team learned about the market and tested distributors. Instead of taking a loose, arms-length approach to its relationships, Colgate used a small handful of captive distributors to slowly expand its footprint while maintaining the solid distribution needed for market penetration.

Managing the parent company

Finally, it is important to be aware of and actively manage the complex relationship between a developed nation parent company and a subsidiary in an emerging market. Generally, business units or subsidiaries in emerging markets that are bound by the strategy and close operational supervision of their parent companies stand little chance of blazing fundamentally new paths to growth. To succeed, companies must devolve substantial authority to staff on the ground who understand the unique challenges and opportunities of developing country environments.

One of the most harmful things parent firms can do to developing country subsidiaries is tell them, "We need you to grow. Just tell us what you need to get there." Particularly when a firm is trying to experiment with a new business model, it may take time to judge whether a strategy is correct. Therefore, in developing countries, it is crucial to follow the "impatient for profits, patient for growth" model of disruptive innovation.

The good news is that competition is unlikely to follow as fast as it does in developed nations, at least where low-cost knock-offs are hard to create. The bad news is that managers—particularly those new to this context—may need to go through a few iterations before they get the business model right. Impatience for profits serves to keep a rein on subsidiaries' actions even while operational autonomy is devolved. Managers can adjust their business model many times, but there is a limit to how badly things can go astray if profitability is mandated.

Together, these steps can help a company create a business that recognizes the innumerable inefficiencies and difficulties of developing economies and uses those problems to its advantage. By resolving issues that customers have long faced, firms can win the loyalty of frustrated consumers, and they can turn nonconsumers into important new sources of revenue.

Steve Wunker is a partner at Innosight. His previous experience includes serving as managing director of Celtel in Zambia. He can be reached at swunker@innosight.com Reprint # 040401B

Observational Research: A Valuable Tool for Identifying Jobs

Getting close to the customer can reveal important insights about their problems

BY DAVID DUNCAN

As a *Strategy & Innovation* reader, you know the importance of creating solutions that help customers get important jobs done. Maybe you even have an idea that seems disruptive, but are unsure how to learn more about the jobs customers are tying to get done.

When trying to understand customers, companies typically draw upon a variety of market-research techniques to better create winning offerings. But if you are focused on uncovering information about customer jobs, observational research is a particularly helpful technique to have in your disruptive toolbox.

This article explains what observational research is, outlines the best techniques for gathering such information, and describes how to use those results to gain insights that can help you produce innovative products and services.

Why observational research?

Generally, observational research aims to get beyond what customers merely *say* they do to uncover what they *actually* do and *how* they do it. More traditional techniques, such as focus groups and surveys, while still quite valuable, tend to reflect only what customers *say* they do or how they *say* they feel. This gives an incomplete picture: There are many things that customer narratives omit due to forgetfulness, deliberate distortion, or simple lack of awareness.

Think, for example, about the development of Personal Digital Assistants (PDAs), such as the Palm Pilot, which many focus groups dubbed unnecessary and too complex. Having never seen or used such a device, consumers were unaware of its benefits and didn't see how it could be of use. In other words, they didn't understand how it could help them get important jobs done. Observational research can fill these gaps by gathering clues to consumers' true needs and motivations, revealing jobs that customers are unable to express.

There are two types of observational clues: *material* clues and *behavioral* clues. Material clues are the physical things that surround us in our lives and can often be more revealing than the things people say.

For example, in one recent client situation a consumer had claimed to be very health conscious and attentive to diet and exercise. Upon examining the consumer's home, however, our observational researcher noticed a dirty ashtray in the dishwasher and a variety of unhealthy foods in the kitchen. This observation led to a discussion of the need to span the gap between good intentions and actual behavior, a critical job for developing products in the health category.

Behavioral clues come from observing how consumers interact with products. For example, one recent in-home observational research exercise for a newspaper company focused on an avid purchaser of the Sunday paper. Through observation, the researcher learned that as soon as the consumer picked up her paper, she threw out everything but the coupon section. This insight reveals an important customer job that could help the company develop innovative online savings-focused products like CoolSavings.com. These kinds of insights have significant consequences for product design, marketing, and new business development.

Two research techniques

There are two main categories of observational techniques: *point-of-purchase* observation and *point-of-use* observation. Whether to use point-of-purchase or point-of-use observation—or both—depends on the objectives of the research.

If the purpose is to gain insight into consumer needs for better products or for new products, point-of-use observations are best. If the purpose is to understand how to better deliver and market existing products to consumers, point-of-purchase observations can be helpful.

Point-of-purchase observation

These are observations that take place where the consumer is purchasing a product and typically happen in stores, but can be done in other contexts as well.

To conduct this type of observational research, the researcher watches consumers examine product alternatives and make selections. The exercise can be purely observational—involving no interaction with the consumer—or it can be a combination of observation and interview. The latter is usually more helpful, as it allows the researcher to probe the motivations behind the selection process, the selection criteria, and gaps in existing product solutions.

The decisions that precipitate purchase provide important clues to areas of consumer dissatisfaction—unmet jobs—that inspire ideas for new products and services. Consider asking some of the following questions:

What led to you deciding to make this purchase? Which options did you consider? What process did you follow when you explored each option? What research did you conduct? Why did you make the decision(s) you did?

Information gained by point-of-purchase observation is usually more helpful for understanding aspects of merchandising, such as product placement and display design. You can gain valuable insights about how consumers compare brands, read labels, respond to packaging, and sequence shopping.

Point-of-use observation

Even more useful than point-of-purchase observations are observations that take place when the consumer is using the product or, as discussed below, when the consumer *could* be using the product but chooses not to.

When choosing a venue to observe, think broadly about how a product is consumed. For example, for a newspaper, observations might take place in someone's home, on public transportation lines, at an airport terminal, in a line, or at the office.

Point-of-use observation provides insight into three main areas:

1: The circumstances in which the product is consumed: when, where, how frequently, with whom, and while doing what. This information is used to understand barriers consumers might have to using a product, frustration with existing products, and ways products could better accomplish consumers' jobs in discrete circumstances.

2. The mode of use of the product: how the consumer is using the product. Is the consumer making use of all the product's features or just some of them? Is the consumer using the product in the way it was intended? Is the consumer using the product in conjunction with other products in important ways?

3. Indicators of nonconsumption and compensating behaviors: whether consumers are unable to solve a particular problem because of a lack of existing solutions. Observing consumers' compensating behaviors—ways that they attempt to get important jobs done with existing but inadequate solutions—can give clues about how these solutions fall short and, therefore, dimensions for improvement.

A theory to filter information

Making use of observational techniques requires more than just a talented researcher—although this is important. It requires a guiding theory that provides structure to the observational exercise and facilitates the development of actual ideas and solutions.

We believe the jobs framework is a great approach and should be explicitly articulated to the researchers. Without such a guiding theory, market research often leads to confusing or generic conclusions that lack practical guidance. The jobs theory helps identify:

What you are looking for: Important problems that consumers can't solve conveniently with today's products and services.

How to spot the signals: Look for visible consumer frustration, compensating behaviors, and gaps between what a consumer says and what he or she does to find addressable frustration points.

What questions you ask: In what circumstances is a customer trying to get a job done? Why has the consumer chosen a given solution over others for the job? What are the barriers to getting the job done with existing solutions? What are the shortcomings of existing solutions? Could existing solutions be improved? How often is the consumer trying to get the job done?

Who you select as a subject: Companies often choose consumers of their products as subjects. This can help identify ways to make current products better, but can hide opportunities to create new products. Make sure to also focus on "nonconsumers." Understanding what inhibits these people from consuming can point to opportunities for innovation.

One of the more compelling case studies in *The Innovator's Solution* describes how one fast food company discovered that some customers hire its milkshakes for unanticipated reasons, such as killing time during boring commutes or appeasing small children. The key to generating this insight? Observational research, coupled with a mental model guiding the researcher to unearth the problem the customer was trying to solve. Putting those two pieces together can similarly lead you and your company to powerful insights. ◆

David Duncan is a manager at Innosight. He can be reached at dduncan@innosight.com.

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