



INNOVATION

the five DISCIPLINES for
CREATING WHAT CUSTOMERS WANT

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It's as simple as NaBC:

HOW LIZ GOT HER BIG JOB

IF YOU CAN'T STATE YOUR VALUE PROPOSITION,
YOU DON'T UNDERSTAND YOUR JOB.

An Opportunity

Liz was the editor of nonfiction books at a top publishing house when the job of editorial director opened up. She saw it as a great opportunity, but she was worried. Liz is smart, savvy, and energetic, but normally the job would go to someone in his or her thirties or forties with ten or more years of experience. Liz was twenty-seven and looked six years younger. She thought she had the intelligence and skills to do the job, if those making the ultimate decision could look beyond her youthful appearance. But would her application be taken seriously?

Liz called her father, Art, to get some advice about what she might do. Art asked her for her value proposition. "My what?" she asked. He explained that every business transaction has at least two value propositions. In this case, one would be from the hiring manager at the organization to the job candidates, explaining why they should take the job. Another would be from her to the company, explaining why she was the best person for the job. Each side needs to persuade the other.

Remarkably, many people go into interviews without thinking of how they can add value. Some sit there expecting to be "sold," while

others cite items on their résumé. They miss the opportunity to fully describe why they will be the best person for the enterprise. Thus, Liz could distinguish herself by using her knowledge and packaging it into a compelling value proposition: her vision of how the department could create more value for its customers and the publishing house. And it would be in a form that would facilitate a productive conversation about the job.

Art acted as Liz's partner as she developed and improved her value proposition. They iterated it a dozen times. She talked to many others, continually synthesizing into her presentation the new ideas she uncovered. In the end, when she came to the interview she addressed four issues:

- *The Publisher's Need:* The nonfiction department's overall book list was not making money, although a few books on Liz's list were. Its normal customer base of libraries was purchasing 5 percent fewer books every year, setting a terrible downward cycle into motion. The department needed to keep its brand at the highest quality, yet it had authors asking for royalties that were too high to leave any profit. So it needed to maintain its brand and quality, expand its customer base, change its book portfolio to be more profitable, and somehow pay less in royalties.
- *Liz's Approach:* She proposed to change the mix of books based on an analysis of what was profitable, since 90 percent of the department's profit came from 20 percent of the books sold. She proposed new models to expand the customer base, such as introducing lower-priced books, with subject matter that was high-quality and would appeal to a broader readership. She suggested ways of enlisting more emerging authors in addition to the established ones, thereby lowering royalties. She also described new ways to combine previously published material into new books.
- *Benefits per Costs for the Publisher:* Liz produced a spreadsheet of the current revenue and earnings, and she forecast 10 percent per year revenue growth and 15 percent profit based on her suggestions. She also showed how the publisher's brand would be en-

hanced, causing a “virtuous cycle,” attracting more authors and therefore more books and more profit as well. Her approach would not cost more than the publisher’s current approach.

- The Publisher’s *Alternatives*: Doing business as usual was causing a slow and inevitable decline. Her approach was the only one presented that offered the publishing house a way to revamp its approach and grow. She was also the only candidate who quantified, in a realistic way, the financial advantages of the changes she suggested.

Partly because of her value proposition, Liz was unanimously chosen as the top candidate and given the position. In her first yearly review, her manager gave her a double-digit raise and said that she exceeded all targets and was a “blessing” to the publishing house. When we talked to Liz she said, “There was no way I could have won this job without creating a value proposition. The format was perfect. You start off reviewing the company’s needs, and they agree with you where you get it right. You can then have a deeper discussion with them about their needs and learn more before you go to your approach. It was perfect, just perfect.”

If you are like Liz, or most of us, when you start a new project it seems impossible. It is scary. We are often asked, “How do you take a vague, incoherent idea and turn it into one that creates compelling new customer value?”

The process Liz used provides the answer. It has been developed, tested, distilled, and refined for years by us and our colleagues. It is the origin of hundreds of projects, more than fifteen new companies, and two broadcasting Emmys, including one for developing the U.S. standard for digital high-definition television.

As you read this chapter some of you may say that you already do these things. Yes, you probably do some of them. Because of the effectiveness of this process, many other creative professions, such as music teaching, moviemaking, journalism, and public relations use variations of these ideas.¹ The celebrated dancer and choreographer Twyla Tharp wrote a book called *The Creative Habit*.² Her view is that achievement—

whether in dance, business, or restaurant cuisine—is the result of preparation, effort, and proven practices, all disciplines that can be learned. She emphasizes closely observing the world and starting by getting your ideas down on paper. As you read this chapter, you will think of your own examples about how these ideas apply to other activities.

Even though these ideas are not complicated, very few people and even fewer enterprises systematically apply them. After learning about and meeting with senior managers from hundreds of organizations, we have found only a handful that do. These few companies tend to be leaders in their fields, like GE, P&G, Baldor, Toyota, 3M, and W. L. Gore.

Value Propositions: NABC

Every important innovation opportunity requires a value proposition. When it's missing, the result is confusion, poor communication between employees and management, a lack of focus on the customers' actual needs, and wasted organizational resources.

The goal of every innovation is to create and deliver customer value that is clearly greater than the competition's. The difference has to be compelling to the customer, which is expressed as:

“Our New Customer Value is *much greater* than the
Competition's Value.”

But how do you, like Liz, start to develop new value for the customer? Begin with your value proposition. It is the nucleus for value creation, because it addresses the four fundamental questions that must *always* be answered when you start to create new customer value. These questions are:

1. What is the important customer and market *Need*?
2. What is the unique *Approach* for addressing this need?
3. What are the specific *Benefits per costs* that result from this approach?
4. How are these benefits per costs superior to the *Competition's and the alternatives*?

In an essential way, these ideas are not unfamiliar. You create value propositions as a matter of course in everyday life. For example, if you have a visitor and it is time for lunch, a typical conversation might be, “June, I understand you are as hungry as I am [Need]. Let’s go have lunch at the Company Café [Approach], instead of McDonald’s [Competition] because, for the cost of McDonald’s, it has great food, it’s quiet, and we can continue our conversation [Benefits per costs].”

Who determines the worth of this value proposition? Do you as the host? No, it is your visitor, June. And June might say, “Thank you, but I promised my children that we would go to McDonald’s today, so I would prefer going there. My children will be happy playing on the slide, and we will be better able to continue our conversation.”

This simple example demonstrates several other important points. First, the order of the questions—need, approach, benefits per costs, and competition—does not matter. What is important is answering all of them. Second, there are many different approaches for addressing a particular need. Your goal is to develop an approach that provides superior customer value—benefits per costs—when compared with the competition and alternatives. To be effective, value propositions must be quantitative and easily understood. A picture, image, or mock-up greatly facilitates communication of your ideas. When it’s appropriate, always create one.

Value propositions are difficult to develop in business, because initially you don’t know enough about any of the four questions. In addition, these four key questions interact with one another. One must repeatedly improve or “iterate” value propositions by getting feedback from others to make them complete and compelling. As we discussed in Chapter 2, you must repeatedly go back and forth between the unmet needs of your customers and your sources of new ideas to create new innovations. Without a process to help, answering the four questions in a value proposition tends to be either elusive or impossible.

One reason value propositions are hard to develop is that we all love talking about our “approach,” to the exclusion of the other components. We have listened to many hundreds of business presentations during our careers, and in the beginning they always sound like this:

Need, **Approach**, Benefits per costs, Competition.

They are all about “approach.” For example:

“What the world *needs* is a little red wagon.

Our *approach* is to build a little red wagon.

The *benefits* are that we will have a little red wagon.

There is no *competition*, since our wagon is a nice shade of red.”

It’s all approach, with no need, benefits per costs, or competition. You might think that this example is an exaggeration, but it isn’t. People are always consumed with *their* approach—after all, they thought it up. They want to tell you about it and they want you to appreciate it. If you don’t, they often assume it is your problem, not theirs.

When you begin developing your value proposition, it should initially look more like this:

Need, Approach, Benefits per costs, **Competition**

In this case the focus is on understanding the customers and the potential competition. That is, it is all about understanding the market ecosystem—the customer and market needs and the current and potential future players. Over time, you can create an approach, or refine an existing one, with compelling benefits per costs when compared with those of the competition.

When it comes to innovation, most enterprises are a Tower of Babel. The staff and decision makers literally speak a different language. The staff will initially talk about “nAbc,” because they are focused on their approach. There is no need, benefits per costs, and competition. But the decision makers will be initially interested in “NabC,” because they want to address their customers’ unmet needs and beat the competition. They assume the staff can figure out the approach and benefits per costs once the needs and competition are understood. With no process in place to put all the pieces together, the staff and decision makers are at loggerheads. The staff will say things like “The decision makers don’t get it” or “They don’t support us.” When you talk to the

decision makers they also will say things like “The staff doesn’t get it” or “We’re unable to get the staff to do useful things.” Remarkably, both groups say the same things about the other and both feel powerless. The solution is to have a value-creation process in place where everyone speaks the language of customer value, including all elements of a value proposition, NABC.

Remember Frank from Chapter 1. When he came into the room he brought a “nAbc” presentation. He was frustrated because no one would take him seriously. Actually that wasn’t the problem—no one could understand him. In most organizations this is a common problem. If you are a decision maker with no value-creation process in place, you too will probably be befuddled when a Frank walks in, because you don’t have the time to figure out what he is saying in order to determine whether it has value for the enterprise. At that point you have two poor choices: 1) You can politely ignore him or 2) you can send him off, saying “Do more homework” in the hope that something will happen to help you make sense out of what you just heard. These choices demoralize the staff and leave the decision maker feeling ineffective. Absent a way to engage the staff member, they may eventually walk out the door. Steve Wozniak, cofounder of Apple with Steve Jobs, left HP, a company he loved, because he couldn’t get management to pay attention to the potential of personal computers. This outcome is not unique. Hundreds of talented employees, carrying billions of dollars of new value in their heads, leave companies they love each year. As a champion, you must make sure value-creation processes are in place to engage your Wozniaks in order to capture their important innovations.

The next time someone gives you a presentation, keep the four ingredients—need, approach, benefits per costs, and competition—in mind and see if they are all included. If they are, you are talking to a very rare and special person. But if they aren’t, be tolerant—developing a good value proposition is extremely difficult. That is why it must be part of a thoughtful improvement process with your team and organization, not an ad hoc activity.



Below are some short, effective value propositions. The first one is from Paul Cook, a Silicon Valley Hall of Fame entrepreneur. It is the value proposition presented to a cable company executive for a video-on-demand system. We have labeled the four key ingredients—need, approach, benefits per costs, and competition—so you can see how they all fit together.

—————{ *VIDEO-ON-DEMAND VALUE PROPOSITION* }—————

“I understand that you are looking to expand your business. I think we might be able to help.

- **(Need)** Movie rentals represent a \$5 billion business opportunity that you currently cannot access. The only parts of rentals that people really dislike are the obligation to return the tapes plus the late fees. Customers find that it is inconvenient and wastes time.
- **(Approach)** We have developed a system that allows you to provide videos on demand to your customers using your cable system, with access to all the movies of Blockbuster. Our approach makes use of one of your currently unused channels, with no changes to your system. In addition, you do not need to invest any capital. Each movie costs your customers \$6.99, the same cost as a rental at a video store.
- **(Benefits per costs)** You will receive \$5 of new revenue per movie rented, with a margin of 20 percent after paying for the movie costs. Your customers will have all the pause and fast forward functions of a VCR when watching the movie, and they do not have to return the movie when done. Late fees are gone. We estimate you could capture a market share of 20 percent.
- **(Competition)** Our system is patented, and it is the only one to include all of these features. Online rentals represent new

competition for both you and us, but they have a handling-cost disadvantage of 75 cents per tape. Sending videos back is inconvenient, plus they cannot provide spontaneous purchases.

Would you like a follow-up meeting to see how we could help you increase your revenue and profit?”

Writing down your initial answers to these questions is the beginning of a proposal or innovation plan for your project. The power of the NABC value proposition is that it is concise and to the point. As we will describe in Chapter 8, it is also the basis for your Elevator Pitch, which is a short, pithy summary of your value proposition; and then, in Chapter 9, we describe your full innovation plan.

Note that earlier we wrote competition *and* alternatives. In many situations there is direct competition, such as Corvette versus BMW. But in other cases there are alternatives that we might not consider at first. For example, for those interested in an exciting driving experience, the comparison might be between a sports car and a motorcycle. In this case motorcycles are a serious alternative with sales growing rapidly.

When someone comes up with a new idea, ask the person to answer these four questions: need, approach, benefits per costs, and competition and alternatives. Communication about an innovation is facilitated through a *common language*, including value propositions. And if the value proposition is not persuasive, the simple NABC template enables you to develop a compelling, persuasive one that will help sell your innovation to your peers, supervisors, and, eventually, customers.

Multiple Value Propositions Are Required

In every situation, *at least* two value propositions are required. The first is to your prospective customers, the people who might buy your product or service. The metrics for them are benefits per costs and how those benefits per costs compare with those of the competition and alternatives.

The second value proposition is to the investors. In an established organization, that might be the manager of the company, the principal

of a school, or a contract officer at a government agency. In other cases, it might be to outside investors, such as venture capitalists. In that case, the metrics for success include market size, profit, revenue growth, and return on investment (ROI).

In most situations, more than two value propositions will be required, because you may have business partners in addition to your customers and investors. In the Paul Cook video-on-demand example, the owner of a cable distribution system was a necessary partner in addition to Paul's investors. The value proposition to the cable owner emphasized revenue and profit growth for his company. But you will also see that this brief value proposition included benefits per costs for the cable owner's customers, such as the benefit that at the same price, there is no need to return rented tapes. The cable owner would only be interested if he was sure his customers would be getting additional value too. Typically, in any new initiative, value propositions must be developed for suppliers, distributors, staff, and other partners, if they are all to join the initiative.

Below is an early draft of a hands-free car phone value proposition. It is in outline form, which is the best way to get started. Note that it includes benefits per costs to both customers and investors.

——{ *HANDS-FREE CAR PHONE VALUE PROPOSITION* }——

NEED

- Cell phones are difficult and dangerous to use when you are driving.
- There are more than 500 million cell phones in use around the world.
- Because of the driving risks, many U.S. states and other foreign governments are legislating against the use of cell phones by drivers of moving cars, which would limit cell phone usage in cars.
- Consumers want to continue to be able to use their phones while driving.

APPROACH

- Use voice-activated dialing with a headset.
- Provide additional software for existing phones.

- Make the software “downloadable” to existing phones with a \$10-per-year subscription for the “in-car service.”

CUSTOMER BENEFITS PER COSTS

- Convenience
 - *Allows increased phone usage.*
 - *Safe, comfortable, and easy to use: does not require a new phone.*
- Quality
 - *Excellent speech recognition for voice-activated dialing: 99 percent accuracy with untrained users.*
 - *Supports twelve different languages.*
 - *Robust performance in noisy environments—better than human performance.*
- New applications: the speech interface allows access to the Internet and other services.
- Cost: \$10 per phone per year.

INVESTOR BENEFITS PER COSTS

- New product = increased sales.
 - *Assume our available market share is 10 percent of the 500 million total market.*
 - *At \$10 each, then 50 million \times \$10 = \$500 million per year total revenue potential.*
 - *Initial investment needed: \$5,000,000*
 - *After three years, achieve revenue of \$50 million per year with a return on investment of 5:1.*
- Other sources of revenue are available, because of the speech interface.
 - *Initial discussions under way with other service providers.*
 - *Applications include: navigation, auto service, food.*
 - *Business model TBD.*
- Hands-free auto use can reduce litigation, which may be another revenue opportunity.
 - *Today the average cell phone car lawsuit is around \$50,000.*
 - *Opportunity for reduced auto insurance to the consumer*
 - *Business model TBD.*
- Low product risk = prototype developed and demonstrated.

COMPETITION AND ALTERNATIVES

- Existing phones, which must be used outside the car.
- Speech-activated phones built into the car.
 - *More expensive at more than \$100 per car.*
 - *Less convenient for the consumer who wants to use a regular cell phone.*
- Possible competitors: Intel, IBM, and Microsoft.
 - *Our demonstrated 10 percent better speech quality and car noise insensitivity enables this application.*
 - *Intellectual property protection: we are protected by a family of fourteen patents.*

This early draft was written after just a few hours of thought. It left many questions unanswered, and some of the early assumptions turned out to be incorrect. But that didn't matter. It was a start, and this initial draft convinced us that the opportunity was important enough to pursue. Therefore we began the iteration process to improve the value proposition and determine whether we could create a compelling business opportunity.

Specific, Quantitative, and Illustrative

Good value propositions are specific, quantitative, and illustrative; they tell a story. When people present their first value proposition to us, we usually give them one to four minutes to present it. We have listened to hundreds of these presentations, and only a few have been passable. Many are unintelligible. But we are sympathetic; we have never gotten one right the first time either. Even with the NABC template in your mind, it takes numerous rounds of improvements to be effective.

For example, the hands-free-phone value proposition says, "Many U.S. states and other foreign governments are legislating against the use of cell phones by drivers in moving cars." This is not good enough. We need to know the dates when the new laws will come into effect and exactly what they will mandate. We also assume that 10 percent of

the 500 million phones will want our service. We need much more specific evidence about the number of potential customers and how we will engage them.

Try this simple experiment. Imagine that someone just came into your office and asked for the value proposition for your most important project. What would you say? Try it.

N: My customer's needs are . . .

A: My approach to satisfy that need is . . .

B: The benefits per costs of my approach are . . .

C: My benefits per costs are superior to the competition and alternatives because . . .

Your value proposition template gives you a more powerful world-view, which also applies to everyday business tasks. Recently, we were with a colleague preparing a presentation. He is an expert in understanding customer value, but he was like everyone else in that the first time he practiced his presentation it was about him. That is, he talked about the topics with which he felt comfortable—his approach. We all do this, but presentations like this just exasperate your audience. We asked him to put on his “customer value hat” for each slide he showed. That is, to think about what the audience needed, why the points on the slide represented value for them, and why this value was superior to the alternatives. When he gave the final presentation, he got rave reviews, and a few months later he won a huge contract.

Finally, where possible, you should create a detailed picture of the product or service in use, so the concept of the innovation becomes evident. Below are some tips for creating compelling value propositions.

- Customers
 - *Talk to and interact with your prospective customers: Deeply understand your market space.*
 - *Create a first Value Factor Analysis to make sure you are considering all elements of potential value, from tangible features, to convenience, to the overall experience, and to intangible issues, such as security and identity.*

- *Create a prototype, if possible, or at least a picture or mock-up of your product or service.*
- *Watch and study your prospective customers using your prototype.*
- Competition
 - *Study your competition: know the competitors by name.*
 - *Understand all the alternatives.*
- Look to the future: anticipate new competitors and market disruptions.
- Be quantitative: if you are not sure, take a SWAG (Scientific Wild A—Guess).
- Iterate.
 - *Fail often to succeed early.*
 - *Form a “Watering Hole” (Chapter 6).*

Innovation Plans

Value propositions are not complete innovation plans. But they address the *fundamentals* of a plan. It doesn’t make sense to develop a more extensive plan until these basic questions are answered in a clear, concise, and compelling way. We use the term *innovation plan* rather than business plan, because this phrase emphasizes the urgent, dynamic imperatives of value creation.

In many situations, a short value proposition is sufficient information to decide what to do. But where substantial resources are to be invested, the value proposition must eventually gather and include all the components of a full plan, whether it is a government proposal or a new venture. In Chapter 9 we will show how value propositions naturally evolve into full-blown innovation plans, and other ingredients and tips for success will be described.

All Activities Need a Value Proposition

A value proposition should be developed for all your organization’s innovation activities, whether incremental or transformational. That includes the

formation of new products and businesses, product improvements, management productivity tools, government policies, education reforms, basic scientific research, and enterprise-wide programs from the finance and human resources departments. It's also an invaluable tool for your personal career development, as we showed in Liz's story.

Steve Obsitnik was a founder of Discern Communications, an SRI International company. Steve learned about NABC value propositions and value creation during the formation of Discern at SRI. Several years later, he said how much he appreciated learning about these concepts, which he uses all the time. He told us that his talks to employees were in the NABC format, since it helped him focus on what his audience needed. He even does performance reviews using NABCs. He gives his value proposition to each employee, and the employee gives one to him. He said it was a remarkably efficient way to develop goals and achieve organizational alignment.

Innovations can be incremental (the development of a new website) or transformational (the creation of a new drug to control diabetes). In most organizations, the value creation process is a series of ad hoc, inefficient steps. But innovations never occur out of whole cloth. Innovations must be developed in a value-creation process. The value proposition is your most important value-creation tool. It allows you and the entire organization to focus on answering the core questions for each initiative. It also provides a tool to allow the compounding of ideas, one upon the other. Without such a tool, exponential improvement, as described in Chapter 2, is not possible.

Discover the power that Liz used to win her new job. The next time you give a presentation, put it into the NABC format. Make it as specific and quantitative as you can. Add a picture or sketch of your approach, if appropriate. Then find a partner, and others, and ask them to critique your content and presentation multiple times. We'll bet that when you give your presentation, your colleagues will notice a positive difference. Your value proposition is the starting point. Eventually, it will become the core of your Elevator Pitch and your complete innovation plan.

These ideas have been used at SRI International for all organizational activities, including presentations to customers, formation of

new companies, requests for capital equipment, and changes in human resources policies. Since every activity within an organization has a customer and a need for resources, every new activity requires a value proposition to demonstrate why it is the best use of the organization's time and money.