

Strategy as Jazz vs. Symphony

Posted by *Anthony K. Tjan* on February 3, 2010 1:19PM

I have had the privilege of spending a lot of time as a strategic advisor and investor across the size spectrum — from small early-growth companies to large Fortune 500 companies. The basic tenets of growth strategies are common: establish a clear and compelling vision; define a durable competitive advantage; and develop a clear execution plan to make it happen. But the appropriate strategic and operating philosophy should change during the phases of a company's business-building process. This week, I'm going to discuss two predominant modes for a firm to recognize: strategy as jazz and strategy as symphony.

Which of these two types of strategy is required is driven by the stage of a company. Are you in an early proof-of-concept stage or ready to scale up to the next level?

Jazz is impromptu, intimate, and improvising. Jazz musicians can create great things out of disparate inputs because of their raw individual talent and adaptive skills. Like jazz, strategy at the formation and early growth stages happens in real time, and the leader plays along with the band. It's about sensing a "vibe" and evolving as necessary. It is critical to have a big vision and directional sense of what the strategy and business model might be, rather than a perfectly premeditated plan. The "beat" of early stage companies is continuous execution with frequent adjustments. The one thing certain of early stage business plans is that they'll look quite different within a year or even within months. Creativity and intuition go a long way during the start-up stage.

As a company grows, it needs to shift into a more symphonic mode, with the leader acting as conductor. In order for the business to scale, plans need to be worked out more fully before execution gets ahead of itself. Vision is, of course, necessary at every phase of a company, but at this point it needs to be complemented with processes that can often be seen and felt as less than inspiring. This phase requires more rigorous research, more delegation (conductors don't play instruments and conduct at the same time), and a greater focus on team alignment and clear metrics. Entrepreneurs who struggle with more formal structure and process, and with letting go of things they once controlled, fail to lead at this inflection point of company growth.

Many entrepreneurs cannot make the transition from jazz to symphony; they want to continue to lead the band *and* keep playing. And the opposite is also true. People who are good at scaling a business are often not the right people to start a business. The pace of an early stage company might be seen as overly ambitious and idealistic by a big-company-CEO type who can stifle innovation and kill culture if he's not careful.

There is usually some truth in stereotypes. Meaningful differences exist between people who are more comfortable in a suit and briefcase and those who prefer jeans and a messenger bag. It's possible for the instincts for start-up and scale-up strategy to coexist in one person, but there just aren't that many Steve Jobs around.

Of course, in the real world, the alignment between company size and vintage and the type of strategy required isn't absolute. Large companies need to go through transitions and innovate, and smaller businesses need to periodically step back to structure and plan things. The key is to recognize which strategic theme is most appropriate at a given time, primarily because it's a gut check on the leadership skills and strategic plan the company needs — and whether you are the right leader at the right time.

The Three-Minute Rule

Posted by Anthony K. Tjan on January 22, 2010 8:06 AM

At our venture capital firm, [Cue Ball](#), we are pretty maniacal about understanding customers. We encourage our portfolio company CEOs to dive deep — very deep — and learn about their customers along every possible dimension. My Partner, Dick Harrington, and I developed a customer-driven approach and capability set that we put in place at [Thomson](#) which ultimately was a key driver of the company's transformation into a global media and information powerhouse. We wrote about this in a 2008 HBR article, [Transforming Strategy One Customer at a Time](#).

While there are obvious ways to gain significant customer understanding, such as surveys and focus groups, some of the most interesting insights come from less direct analyses. Take our three-minute rule as an example. You can learn a great deal about customers by studying the broader context in which they use your product or service. To do this, ask what your customer is doing three minutes immediately before and three minutes after he uses your product or service. At Thomson, one of our products provided investment analysts with financial earnings data. What we hadn't fully appreciated — until we applied the three-minute rule — was that immediately after getting our data, a large number of analysts were painstakingly importing it into Excel and reformatting it. This observation led us to prioritize developing a more seamless Excel plug-in feature with enhanced formatting capability over other product development initiatives. The result was an almost immediate and very significant uplift in sales.

The three-minute rule also helps highlight unique cross-selling opportunities. Many years ago, I remember doing some ethnographic research on female drug-store shoppers. One fascinating pattern we saw was that a significant number of women picked up a disposable camera after putting newborn diapers into their shopping carts. Follow-up interviews confirmed that snap-happy moms were often new moms. Placing disposable diapers close to inexpensive disposable cameras furthered this purchase pattern and would not have otherwise been an intuitive merchandising or cross-selling strategy.

One final retail example is described beautifully by my friend Paco Underhill, a shopping-pattern guru. In his book, *Why We Buy*, he describes how shoppers who do not have a shopping basket or shopping cart go quickly to the checkout when their arms get full. Okay...so what? A casual observer says that is obvious. A savvier approach might be to interview people in a checkout line with an armful of goods to ask where they were three minutes earlier and if they would have considered buying anything else if it hadn't been so difficult to carry so many items. Underhill concludes that more establishments should consider putting shopping baskets in the middle of the store to keep customers in shopping mode longer (since research showed that few would go back to the front of the store to get a cart once engaged with shopping).

These situations illustrate the narrow-mindedness to which it is easy to fall prey. In the Thomson example, we were thinking of ourselves as a data provider, though we were really part of a broader workflow solution. We failed to realize the importance of customer context over our own product capability. In the cross-selling and shopping-basket examples, the three-minute rule reminds us that rearranging the context of a shopping experience to better meet customer patterns can be extremely effective. Customers seek solutions, but it is likely that your offering is only part of one. The three-minute rule is a forcing mechanism to see the bigger picture and adjacent opportunities.

So what are you doing three minutes after reading this?

Don't Wait for the Right Deal to Come Along

Posted by *Anthony K. Tjan* on November 30th, 2009 8:00 am

Perhaps the most important success factor for a venture firm is to ensure that it has a strong, high-quality deal flow. Deal flow is like getting "at bats" in baseball. If you get enough pitches, eventually you'll learn when to swing and hopefully knock one out of the park. But the best deals sometimes arise from situations where the opportunity had to be created.

I hear too often from people that they are waiting until the right deal or idea comes along and when it comes they'll be ready to strike. This is a rather passive approach. Successful business leaders and investors are proactive hunters, creating ideas where they did not necessarily exist. They can handle some ambiguity, believe deeply in themselves, and understand that the starting point may not be perfect. If it's approximately correct as it can serve as a means to a bigger goal. Let me illustrate with a few simple examples:

1. My partner John Hamel is a great example of finding value in yet-to-be-identified opportunities. I love telling the story of how he found his house. He found a condo complex he loved, but the unit that was available was not ideal. He decided that it would be a good fallback option, but only after he wrote a letter to every tenant in the building asking if they were interested in selling. The result was that he found one of the very best units at a more attractive price than the unit he was originally considering.
2. One of our first venture investments came about at a time when the company we wanted to invest in was not seeking money as much as it was looking for advice. We did advisory work in exchange for equity, developed a trusted relationship, and then finally had an opportunity for significant investment.
3. I've been plain inspired by people who have created their own job opportunities. The downturn has forced many job seekers to be a little more creative. One example is a gentleman who shared with me how he was willing to work for deferred comp that would only be due if he performed against tangible metrics. I loved the chutzpah and was happy to hear that he has succeeded in a position that now pays more than his previous one. In a similar story, a co-founder of my former company landed himself a top executive post by offering to serve on special projects for a couple of years. By working first in a less desirable but available position, he demonstrated his capabilities and achieved real results. He earned respect and then the position he wanted.

What do these stories have in common? They're about negotiating with imperfect situations as opposed to letting those situations control you. If you're creative, positive, and proactive, good things have a way of coming along.

Why Small Companies are Better at Customer Service

Posted by *Anthony K. Tjan* on September 21, 2009 10:00 AM

Many of my posts have focused on big company lessons for smaller, high-growth, entrepreneurial companies. But two recent experiences reminded me that sometimes big businesses need to look more carefully at what the little guy is doing. I believe that a small business is likely to deliver better customer service than a large company because of its innate common sense and understanding of the power of empathy.

Here are two personal examples of outstanding customer service: one outstandingly great and the other outstandingly bad.

I'll start with the bad. Last year, on the day we were hosting a dinner party planned months in advance, I received an urgent call at the office that two men with a police officer had entered our home (by picking our lock) and proceeded to go into our basement to shut off and lock our gas. No warrant, no explanation. After calling our large national utility provider and waiting for a live rep to replace the automated "Silicon Sally," I was told that we had not paid our bills. After another hour on the phone, I learned that the new post-merger parent company servicing our gas line had been sending our bills to a street with the same name in another town. We were responsible for the bills, even if we did not receive them.

I asked for the amount due and things went from bad to worse. I could no longer pay over the phone and could not pay online because my account was viewed as delinquent. Exasperated, I arranged for a money order and went to the service location only to be told that they could not take a money order for that large an amount. I would need to come back with cash. When I returned, it was late afternoon and no one was available to turn the gas back on. When I pleaded that we were hosting a dinner event and needed the gas to cook, I was told that that was why I should have paid my bills on time.

Contrast that to a local party supply company that delivered our china and glass rentals for a different event. An hour before the guests arrived, I realized that plates and glasses lay broken in several crates. When I called the company, they did not question the fact that they were broken, but apologized and offered to immediately send replacements. When I said that the timing was too tight and so we would make do, one of the owners came to the phone to apologize again. About 30 minutes later, I received a call on my cell. It was an employee from the rental company saying that he arrived with replacements but did not want to ring the bell and cause any distractions. The next business day, I received another message from the owner apologizing for the stress and inconvenience and letting me know that I would not be charged for any of the rentals.

The key difference in these experiences is the common sense and empathy of the small local company. Too much customer service — especially in large companies — has devolved to standard operating procedures and scripted answers delivered with artificial calmness. To an upset customer, these automated responses often seem inappropriate or absurd. When I interviewed my friend Mehmet Oz in a prior post, he said that the opposite of anger is not calmness but empathy. While I appreciate the challenges of cost-effectively scaling customer service, empathy training might help service employees calm angry customers more effectively, increasing their long-term loyalty, and perhaps even changing them into referring fans.

Of course there are examples of large companies with high-touch customer service, such as the well-documented case of Nordstrom. My guess, though, is that Nordstrom and other big companies known for excellent customer service have studied more best practices from small firms than from large ones.

For my money, the two best customer-service practices are **sincere empathy over indifferent calmness** and **common sense over standard operating procedure**. These two simple guiding



principles remind us how easy it can be to transform the customer experience, and how unfortunate it is that more businesses have not done so.

Value Propositions That Work

Posted by Anthony K. Tjan on Wednesday September 14th, 2009 at 8:15 AM.

In my last post, I highlighted the fact that [most people can't explain what their company does](#) — its value proposition. The best way to start getting employees and management aligned is to understand the benefit the company is trying to deliver to its customers. Consider that there are only four types of consumer benefits that matter and by extension only four categories of value propositions that work.

1. Best quality. Richard Branson once said that being the best at something is a pretty good business model, and I agree. Think of brands that set a standard, like [Louisville baseball bats](#), [Benjamin Moore paints](#), and [Stradivarius violins](#). You don't have to be a sports nut to have heard of the 125-year history of the Louisville Slugger, nor do you have to be a classical music aficionado to have heard of the legendary Stradivarius violins. Brands that set standards are sometimes luxury brands, but not necessarily. You don't need luxury to set a best-in-class standard. Brands like Benjamin Moore define quality in their categories. That's an enviable position and a value proposition that works.

2. Best bang for the buck. Recessionary woes have amplified the fact that some consumers will always buy on price. Best-in-class value doesn't always mean lowest price, however, but rather the best quality-to-price ratio. Jet Blue is a good example of a company that, though it may not offer the cheapest or best in comfort travel, does a good job of communicating its value relative to its price point. Dell, Chipotle, Ikea, and Toyota are other good examples of best-in-class value, and their value propositions have been sustainable through the years. Incidentally, the founder of Ikea, [Ingvar Kamprad](#), has regularly traded places with Bill Gates on various world's richest lists.

3. Luxury and aspiration. On the other end of the spectrum from bang-for-buck players are luxury providers that promise the experience of a wealthy lifestyle to aspirational consumers. Ralph Lauren is one of the masters of a lifestyle luxury brand; others are Rolex, BMW, and Hermes. While the luxury segment was hurt during the downturn, it is almost certain that as the economy rebounds that customers will return to luxury goods as their discretionary spending increases.

4. Must-have. One of the most attractive value propositions we have seen and studied are the "must-haves." These include basic goods — certain foods, for instance. During my prior work with Thomson Reuters, we often talked about "must-have" content that business professionals could not do their jobs without. The critical legal information and tools [WestLaw](#) provides to lawyers are an example. As long as there are legal cases, there will be a need for legal information. It does not mean there will not be competition, but if the category you are pursuing is must-have, then the market leaders will have a great prize to share.

Does your company's value proposition fit in one or more of the categories above? If not, it is time to adjust. Figure out how to reposition your offering. Stop being stuck in the middle and aim to set a new standard.

Your Employees Have No Clue What Your Company Does

Posted by Anthony K. Tjan on Thursday September 3rd, 2009 at 9:25 AM.

Here's a test. Ask five to 20 of your employees to explain what your company's customer value proposition is. How many different answers do you guess you'll get? Answer: somewhere between five and 20. This is, of course, in addition to the response, "What the heck do you mean by a value proposition?"

This is slightly exaggerated to illustrate a point. But, in the many years with which we have advised on and written about [customer-driven strategies](#), there has been a common pattern: massive inconsistency in people's ability to clearly articulate their company's value proposition. To test this in your own organization, do what we do with our own firm and with the firms we advise by asking the questions below to a sample of five to 20 employees. These questions form the core of describing your value to a customer. Whether you call it a value proposition, a brand promise, a mantra, a USP (unique selling proposition), or any other consulting euphemism, guru term, or blogger moniker, the guts of being able to clearly describe what you do boils down to answering these three important questions:

What product or service is your company selling?

Who is your target customer for this product or service?

What makes your offering unique and different?

Sometimes the answers are 180 degrees counter to one another even among people working on the same team. Your employees have no clue what you do, or they have a damn hard time explaining it. Either way, it is a problem.

Not enough value propositions start with authentic meaning and purpose. With purpose comes belief, and with belief comes an easier ability to articulate the customer pitch. In one of my most recent blogs, my partner Mats Lederhausen described the need to begin with a [purpose bigger than the product](#). The goal is not to have employees mindlessly memorize the answers to the questions above like a multiplication table. People need to feel that the customer proposition is true and intuitively believe in it. I remember a meeting in a prior company with my partner Dick Harrington who said, "We are not simply a database of medical data. We are in the business of saving lives; that is our purpose." It resonated with everyone there and I bet few have forgotten that moment.

With a clear purpose as the starting point, these four points will further clarify your message to customers, align your team's goals with it, and improve your team's ability to articulate it.

Clarity, consistency, and frequency of the customer message points from the top.

Forums for others' to articulate the value proposition. We have done exercises in which we listen to our own elevator pitch from fellow employees. At times we've even video-taped these for learning.

Get people from different divisions to go through the exercise of answering the questions described above. Share with the group the biggest disconnects and try to resolve them. Half of the battle is understanding that you have a problem.



Make sure the articulation is consistent across all marketing collateral to allow on-going evolution. Whenever the message is edited, apply the change across all channels. Understand which materials customers see most frequently and periodically check consistency across all materials. Articulating a message that management, employees, and customers all understand is one of the most critical priorities for any effective organization, from an entrepreneurial upstart to a Fortune 500 company. The value proposition is the connection between product development and selling. If your own people do not believe in it and cannot consistently articulate it, what are the chances that customers will get it?

Purpose Bigger Than Product

Posted by Anthony K. Tjan on Wednesday August 26th, 2009 at 5:30 PM.

I recently sat down with my BlackBerry voice recorder and Mats Lederhausen to ask him to share his philosophy of "purpose bigger than product." Mats is a great entrepreneur and also had one of the most successful careers at McDonald's where he was a [driving force for its turnaround](#). He currently runs his private investment vehicle [Be-Cause](#) and is a Special Partner at our firm, [Cue Ball](#).

What is your philosophy of "purpose bigger than product" all about?

At its core, it is about being real and idea-driven. Trust is perhaps the most important currency in business, and big ideas may be the only true source of competitive advantage. Lack of trust is a form of tax. And that tax rate has increased in the past number of years. Customers simply don't trust institutions as much today. Particularly large businesses. The main reason is that we now live in an "information everywhere" and more transparent world. Every customer has a camera in their cell phone, a Facebook in their pocket and Twitter at their fingertips. This means we hear and see evidence of businesses not walking their talk. Their products don't match their promise. In order to regain this trust you must simply make sure that all your products, your merchandising, your advertising, your people and the totality of your touch points with consumers sing from the same hymn. And that hymn is what I call purpose. Some people call it vision. Others call it focus. It is the same thing. It is source of your promise. It answers the question: Why are you here?

Talk a little more on the notion of "big ideas."

I often talk about "altitude creates attitude". When you meet people that have a big idea it is almost impossible to be unaffected. It is like a perfume. You can smell it miles away. I firmly believe that the source of human energy and creativity can be found in the distance between where we are and where we'd like to be. It is that creative dissonance that is the entrepreneurial rocket fuel. If human beings could have walked everywhere on the planet I don't believe we would have invented trains, planes and automobiles. So, if you really want to build great companies you need big ideas.

Certainly, not all big ideas may be viable in all incarnations. What about the reality of these ideas?

Of course they have to be believable. They can't be pipedreams. Or as [John Naisbitt](#) once said: You can't get so far ahead of the parade that no one knows you're in it. From an execution perspective, you have to think big, start small, and scale fast. You can't think big and start big, that's almost impossible. You need miniature versions of your grand idea so you can validate its parts, and then iterate and tweak constantly. There's nothing wrong with having a really big idea and launching only aspects of that idea. Rome wasn't built in a day. Take [Chipotle](#), for example. Steve Eills had a very big idea about food, but he didn't start by executing 100% of his vision; he gradually did what he could towards that theme. It is also important to remember that your purpose is not what you "tell" customers, but what you do. The best way to disappoint everyone is to over-promise and under-deliver. Therefore you must be humble AND committed at the same time. In fact, customers are more forgiving when you make mistakes if those mistakes are honest efforts in trying to improve towards a known and worthwhile direction.

How can a purpose be instrumental in leading an organization?

I look at purpose as the guiding star. The compass. The soul. Steve Jobs once said "Design is the fundamental soul of a man-made creation". And everything we do is design in one form or the other. And if you have a fuzzy idea of your own soul, your design will suffer. On the other hand, like Steve Jobs does, if you have a sharp idea of your soul and what footprints you want to leave, all your design will complement and reinforce that soul of yours.

How did you come to have this philosophy?

There are a few parts of the answer. First, to be honest, it's hard to know the answers to the bigger questions in life, like why we believe what we believe. To a certain extent it's the result of the sum of all of our experiences since birth. Second, I've been influenced by seeing what really works. I think strong conviction and a sense of purpose enables focus, and the biggest culprit of bad performance in a company is lack of focus. It's hard to set direction if you don't know who you are. Thirdly, I've decided that I only want to work with companies that are trying to do something important. It's about human progress and adding value to society.

What do mean when you say "important?"

While we have significant global issues to be concerned about, an important business doesn't have to be grandiose or socially driven in order to be important. General contribution to the well-being of another human being is worthwhile. It could be a restaurant that's creating jobs and leaving customers just a tad bit happier than when they arrived. Or a concept such as [MiniLuxe](#), our Cue Ball investment that is trying to "Starbuck" the nail salon, which has innovated a lot around hygiene and customer experience. It is an example of a business with a clear purpose that is trying to do something remarkably better than the industry norm.

What companies really celebrate this philosophy?

Nike is a company that understands it. They have always had this idea that it's more than a sneaker. They are about getting into the game, being more than a spectator in life, and embracing activity. In their words, "Just do it." If you go to their headquarters in Oregon, it's like being in a gym: it breathes "active lifestyle." That's what they're about and they have consistently executed around it.

Southwest Airlines is about giving people the freedom to fly. They are about seeking and loving freedom, and they enjoy being a bit nutty about celebrating that notion. And there are many others as well. Apple, Berkshire Hathaway, Microsoft, Google, Patagonia, IKEA, and a host of others. There is one thing that is interesting to me to note about all these companies. They are very different in so many ways. But they are also very similar in one way. They all have their founders alive and kicking. When the source of the original idea is still around it is harder to lose why you came to this world in the first place.

Cult Culture as a Competitive Advantage

Posted by Anthony K. Tjan on Monday August 24th, 2009 at 9:24 AM

There are few things as powerful as genuine culture in a company. In the venture business we are in, we thrill vicariously in the joy and passion of young companies who are trying to change the world. Start-ups have one great advantage in that they have a better shot at creating and cultivating the magical culture that most large businesses have lost along the way. Having that culture is a little like youth — you know while you still have it, but you are not quite sure of the exact moment you lost it.

Scaling culture or perhaps more accurately preserving a special culture is tough for "successful" big businesses. This is because at some point in a firm's evolution the importance of big usually overtakes the importance of quality, values, and founding principles. Most large businesses also fall prey to over-processing, over-codifying, and over-PowerPointing their story, strategy, and yes, culture, to employees. Herein lies the difference between real employee cult cultures such as lululemon and Apple, versus, say, any of the companies who went to the bailout coffers. Go to the two retail stores mentioned and you just feel that the people who work there are happier. Ask them why they are satisfied and they say they believe in the company's mission, love the products, and the company understands their professional goals. There is a thin line between cult and culture as competitive advantage. The businesses that can create a cultural movement amongst their employees are few and far between, but those who do have an incredible advantage that they should recognize and do everything possible to celebrate and preserve.

How to Align Employee and Company Interests

Posted by Anthony K. Tjan on Tuesday August 4th, 2009 at 10:07 AM

I spent time with each of my team members recently to focus on the top priorities for our firm Cue Ball and to make sure we were all on the same page. I asked each person to prepare a list of their top five priorities. In our individual review sessions, I asked them to look at those top five priorities and asked three questions:

- 1) Which of these priorities do you think will have greatest impact for our firm?
- 2) Which of these priorities interests you the most?
- 3) Which of these priorities are you most likely to be successful with?

In asking these questions, I realized that real magic for an employee happens when these three questions produce the same answer. When the item someone is most passionate and capable at achieving success with aligns with the item that has the most impact for a firm. The problem, of course, is that many times it does not.

You can correct this with three principles: Communication, confidence, and aligning interests:

Consistently communicate the top three-to-five priorities for the firm and make sure people get it. A starting point is asking people to reshape what they plan to do each week, month and year into goals that match those top buckets. If it isn't contributing to one of those top priorities, then that's a bigger issue, something you can start to address with this approach.

Promote confidence in people. I recently heard a great story of an executive mentor who told a junior manager that one of their goals had to be to fail at least twice in the coming year. The willingness to take risks, succeed at them sometimes, but accepting and learning from failure is key to building confidence.

Align interests to responsibilities where possible. Know the core interests of your top employees. What naturally drives someone and what is innately rewarding to them is so powerful. As a manager, it's your job to identify those interests and channel that employee's intensity to the right priority to create a frictionless output opportunity.

It boils down to a simple three-step plan. Step one: get the right focus and relentlessly communicate it. Step two: align the priorities to areas. Step three: Build employee confidence and exploit natural interests. Result: happier, harder working, and more loyal employees.

Want to understand Your Customers? Go Psycho.

Posted by Anthony Tjan on Thursday May 28, 2009 9:41 AM

Customer research tends to be demographically-biased in its design. But it is time for us to go a little psycho on customers — psychographic, that is.

When it comes to purchasing behavior, it is obvious that personalities matter. So why is it that we so often look at detailed website usage or customer data along impersonal demographic dimensions like age and gender? While useful, those characteristics don't describe attitudinal trends which may be more important — and need to be a critical complement to other data.

Psychographics are the data points that describe a user's values, opinions and lifestyle.

Think of psychographics as the kind of data a psychologist or anthropologist would use to profile someone, as opposed to the demographic data that a census surveyor wants to collect.

Or consider what information you might want to collect for a blind date. Demographics may be useful to narrow the pool down to, say 30-year old males in Chicago, but would that be enough? To choose your partner, you likely want to consider personality, interests, and values. Similarly, for customers to fall in love with your product or brand, you need to understand their personality and passions and see how those connect with your product or service.

While there's no standard psychographic profile, we can borrow some ideas from psychology. A psychographic profile should tell us about how a person interacts with the world (are they extroverted or introverted? analytical or emotional?) and what they value most (security? family? the environment?). You can combine more "classical" survey methods with questions that are personality or association-based. For example, ask the question: If you (or this product, or this service) were a car, what kind of car would it be? A Mini, a Mercedes, a Range Rover, or a Prius? Each of these cars connotes a different personality and you can use such responses to infer desired personality traits.

In the pre-digital world, gleaning sufficient information to constitute a psychographic profile would often require prohibitively expensive customer anthropology. Imagine researchers observing and following customers as they interact with a product. Now, however, as consumers spend increasingly more time online, a level of digital anthropology is more feasible because consumer data can be better aggregated and analyzed — cheaply.

Cameras within stores can also share tremendous insight. Video anthropologist and consumer researcher Paco Underhill has filmed thousands of hours in retail settings. One discovery: customers buy less when their arms are full of products; shopping baskets in the middle of the store can help increase sales. In an intense retail customer research assignment I once did, we discovered that new mothers were significant purchasers of both diapers and digital cameras — placing these two seemingly disparate product categories closer together helped drive cross-selling.

So, how can you use psychographic data? Suppose you wanted to market a new brand of organic, flaxseed-infused cereal. While there is no clear demographic group for that product, there may be a well-defined psychographic one. You could target anyone who identified Whole Foods and Eastern Mountain Sports as favorite brands, expressed a concern about health and fitness, and is environmentally conscious. You can also use psychographics to inform *how* you market to a particular group. You could market to "analytical and research-oriented" folks by talking about the cereal's unique formula, while you could reference case studies and endorsements when marketing to people who value expert opinion.

The task for next-generation online audience measurement and sentiment tools, then, is to start understanding traffic along psychographic axes. There are a few ways to do this.

First, members of an audience measurement firm's user panels could complete a psychographic questionnaire: What are their three favorite brands? What kind of car would they like to be? On a Friday night, would they rather stay in and watch a movie or go out on the town?

The second way is to understand what your users are doing before and after they interact with your company and profile the content and audience of those sites. In my HBR piece on customer

strategy, we discuss a technique we used at Thomson Reuters called the three-minute rule; we observed what users were doing three minutes before and three minutes after each interaction with the product.

Lastly, so-called "single sign on" services will make associating user behavior on different sites much easier. Google, Microsoft, and Yahoo! all participate in the OpenID project, and Facebook has a competing platform called Connect, which allows a user to log into many sites with one set of credentials. A central database could contain everything from blog comments and self-descriptions on social networking sites to purchasing data and search history.

Psychographics offer us an ability to understand current and potential customers in terms of the beliefs and values that drive their purchasing behavior. In our more voyeuristic and measurable digital world, psychographics will increasingly drive customer understanding.

Do You Really Know Where You Make Your Money?

Posted by [Anthony K. Tjan](#) on Friday April 3, 2009 4:22 PM

This second conversation with former Thomson Corporation CEO Dick Harrington looks at why small businesses need to understand their product line profitability. When Harrington was CEO of Thomson Corporation, now Thomson Reuters, cash flow grew by 4x.

Tony Tjan (TT): This is one of those common sense, not commonly done things...but remind readers why it's so important to understand exactly where their profits come from?

Dick Harrington (DH): You need to understand exactly where you make your money because that means you understand your business model well, and that's going to let you make the best decisions for growth.

TT: Could you use Thomson as an example?

DH: At Thomson, we had a **business model** with high fixed cost and very low marginal costs, so once you covered that fixed cost, every additional dollar of revenue was highly profitable. At that point you have as much an "EBITDA model" as a "revenue model" - and that is a good day. Understanding that what we were about was fixed cost leverage combined with recurring revenue that ultimately created very strong cash flow growth, was key to our success.

In terms of determining exactly which businesses were doing this well and where we were really making our money, we did a portfolio break down of income by product lines. If one wasn't making money, we wanted to know why. Perhaps it was just a loss leader, driving some other product, but we could also be underpricing it. On the flip side, for the ones that were really making money you wanted to be careful to make the right on-going investments and not be overpricing them.

TT: How would a small business act on this kind of information?

DH: For small businesses, you should know the cost structure for top products and be able to know if you made money or not just by looking at the revenue for each every month.

TT: So, do you think that most people today know that?

DH: I don't, because most small businesses bundle all the products into one big ball. Very few people are looking at product line profitability.

TT: But isn't that because product line profitability is hellish to measure? Do you really need to measure every SKU's revenue and profit and work through allocating fixed costs?

DH: Not quite; you can categorize products. And if you're small, you can estimate and be approximately correct. For example, if one product is consuming all your customer support resources, you want to account for it. But for small changes in floor space usage, for example, you probably don't need to factor that in. Being approximately correct is good enough; you don't need to have perfect information to make the right decision.

TT: How about a concrete example of how a small shop could apply this lesson? If they allocate a lot of time to product X or Y, should they account for that?

DH: Break down operating income or EBITDA by product line, and allocate any fixed costs that are consumed in different degrees. So if 50% of the floor space is for one product line, charge that product line the appropriate cost. If one product is a few more square feet than another, though, don't worry about it.

TT: How frequently should a small business be doing this?

DH: If you have sophisticated systems, you want to look at this quarterly. If not, do this kind of report every four to six months in order to confirm your own thoughts about where profit it is.

TT: Why do you think small businesses have a hard time with this?

DH: Small businesses start with a good idea, but eventually the business gets more sophisticated. The entrepreneur then tries to focus on what he knows best. So the engineer looks at engineering costs, the sales guy at sales costs, etc. No one is looking at the operation holistically.

You need to continuously think and assess if you are getting the right profitability information, especially in the context of competitors.

TT: How can you get profitability data for competitors at the product line level?

DH: Well, if you are a small business, the best you may be able to do is price comparisons. And be smart about this. If you think you get business because you charge 10% less, but everyone else is still busy, then you're probably leaving 10 cents of every dollar on the table.

TT: How much do you prioritize the cost side over the revenue size?

DH: Looking at costs should be a continuous process, but it's not going to drive profitability. If you are in the early stages of a business, focus out demand generation - the revenue side -- and then focus on optimizing costs. The first priority for a small business is always, always, always to get customers. Never forget that.

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