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# IS YOUR BUSINESS MODEL RIGHT FOR TOMORROW'S MARKET?

## OR EVEN FOR TODAY'S?

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**Y**our business model is the component of your strategy that determines How you execute to serve your market(s). While the internet did not "change everything," the frenetic pace of today's world and the dynamics of new distribution, sales, service, support, and manufacturing methods have rendered many business models less than optimal. This paper discusses the concept of a business model and looks at how to determine if yours needs review.

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**Do you have the  
right business  
model for today's  
market?**

**What about  
tomorrow's?**

**How can you tell?**

**If not, what can  
you do about it?**

Who has the greatest impact on a ship's performance? *The Captain? The Navigator? The Engineer?* Actually none of the above. The person with the greatest impact on a ship's performance is the designer of the ship! No matter what the Captain directs the ship to do, no matter what course the navigator specifies, and no matter what the processes in operations, the ship can do no more than it was designed to do.

Likewise, the performance of your company is dictated by the design of your business model. No matter how effective your people or management are, trying to produce results with an inappropriate business model is futile.

Operationally, your business model is the set of processes, procedures and capabilities that define performance limits and profitability levels of your

business. At a higher level, your business model is the element of your strategy that determines How you execute to serve your market(s). As an element of strategy, your business model is something that you therefore actively decide; it is something over which you have complete control.

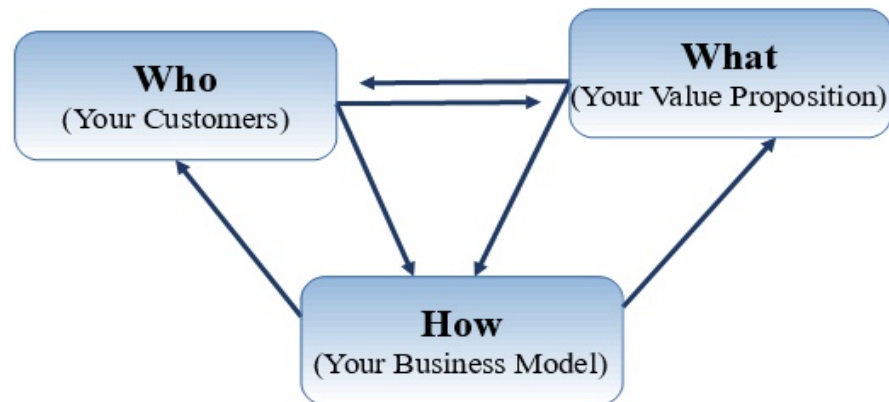
### **What is a Business Model?**

Your business model is the component of your strategy that determines How you execute to serve your market(s). At a high strategy level, you make three crucial choices:

- Your *WHO* – that is, which customers (or markets) you choose to serve
- Your *WHAT* – the products or services that you choose to serve those customers with. This is your value proposition.
- Your *HOW* – the ways in which you bring your *What* to your *Who*. Your *How* is essentially your business model.

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A business model consists of How you deliver your value proposition to your target customers.



A business model consists of How you deliver your value proposition to your target customers. It consists of a multitude of things including, and not limited to:

- Elements of the whole product that are included or not included
- Channels
- Product mix
- Brand strategy
- Services offered
- Sales process and means
- Promotional process and means
- Manufacturing/operations process
- Market segments targeted
- Product development process
- Tie-in products and how they are tied in
- Distribution/order fulfillment mechanisms
- Strategic alliances
- Pricing strategies
- Financing Options
- Capital structure
- Profit criteria

Your choices in these above areas – and others – define the capabilities of your organization to perform its mission, which is delivering your *What* to your *Who*. No matter how attractive the customers you have targeted, and no matter how compelling your value proposition, without an effective way of getting the latter to the former, you cannot succeed.

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When the characteristics of your business, your industry, your customers' industry, or your environment change, it is just common sense that you will have to adapt to those changes.

This should be clear by inspection. Assume you have the world's greatest widget or service, and it's just perfect for a set of customers who truly need and want it. You still need to go through the appropriate channels to reach that customer base; you may need strategic alliances to be of true value to your customers; you may lack the proper cash-flow structure to fund your customer acquisition efforts; the cyclicality of your product development process must mesh with the periodicity of your customer's new product needs . . . and soon.

While your business model – your company's delivery capabilities – is the result of high level strategic decisions, your income statement – including Gross Margin, Overhead, Sales, CoGS, and Marketing expenses, etc. – is a reflection of it . . . and the net profit figure is your report card on how well you execute it.

For example, if you sell directly to end customers, then typically your sales expense will be higher than if you sell through distribution, and your gross margin will be higher, too. If you choose to deliver your *What* to your *Who* with a high service-add, then your marketing expenses or overhead expenses will reflect that business model choice. And so on. Every industry has a set of income statement ratios that are typical for that industry . . . and these ratios are nothing more than algebraic shorthand for that industry's typical business model.

### **Do You Need a New Business Model?**

When the characteristics of your business, your industry, your customers' industry, or your environment change, it is just common sense that you will have to adapt to those changes. If any of those changes indicate a significant way in which you can, must, or are expected to deliver your *What* to your *Who*, then a fundamental change in your business – a change in your business model itself – is likely in order.

For example, if your existing sales process or choice of channels is no longer relevant to your customers, than you need to re-design them. If the capital structure of your business is no longer sufficient to fund your product development to a competitive level, than you need to realign your *Who*, *What* and therefore your *How* (which links the two of them) so as to match your capital capabilities. And perhaps the most famous example of the necessity of new business model thinking is the way in which the internet changed customer's expectations of how they interact with vendors.

### **Examples From the Present**

A client of ours, a leader in their industry, built that leadership position on two pillars: a powerful distribution channel using independent dealers and leading edge products. These two pillars held them in good stead for many years.

However, new competitors, looking to find a leverage point used these two pillars against the leader. By creating products that could not effectively be distributed through the existing distribution channels, new competitors put pressure on the leaders to choose between their

channel and competitive products. Rather than make the choice, the company chose instead to change their business model.

The new model envisioned new distribution (adding a field sales organization and a direct order channel), product (licensing products from other companies and forming strategic alliances), and capital strategy (using prepaid services to create substantial cash flow) that leveraged the existing strengths while blunting the newcomers' new methods. While none of these changes are revolutionary to the world of business, their combination is a sea change for their industry and will "change the rules of the game" for their new and existing competitors.

A number of years ago the semiconductor industry was comprised of vertically integrated companies that had their own factories to make semiconductor devices. This resulted in competition based on process technology, design expertise, sales and marketing. Additionally, factory capacity was an issue because the demand for semiconductors is cyclical and the lead time to build a new factory is long.

The capital needs to compete in this industry have always been substantial. (There was a time when it took \$1 of capital to create \$1 of sales.) But, as Jerry Sanders, then CEO of Advanced Micro Devices (AMD), was known to say, "Real men have fabs."

Over the last 25+ years this business model has made way for an alternative model that uses out-sourced wafer fabrication companies and created so-called "fab-less" semiconductor companies that are effectively design, marketing, and sales focused firms.

Semiconductor factories that sell manufacturing capacity to "all comers" have always been available, but these factories had generally been small and/or used trailing edge technology. The advent of modern, large-scale factories that use leading-edge technology available to "all-comers" has changed the industry. It no longer takes billions of dollars of capital to be an effective competitor in the semiconductor industry.

There are obviously still trade-offs between the two models and whether both of these models can co-exist, or one will prove superior to the other, time will tell.

### Life From the Model

Your *Who*, *What* and *How* are the three crucial elements of your strategy. Therefore, they should be under constant review during your strategic planning cycle. The following situations, for example, always warrant a re-evaluation of your business model:

- When your *Who* (your customers) or your *What* (your value proposition) change (or need to change to keep you competitive)
- When any of your existing *How* elements have to change significantly
- When you aren't making your desired goals (profit, share, etc.)
- When a sea change in your business occurs (or you believe it could occur)

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- When your competitive landscape changes significantly (or has the real possibility of doing so)
- When an external influence (such as a regulation or social factor) changes significantly

Yet business models are particularly resistant to change. Why? Because your business model is instantiated in your company's operations – your people's skills, your processes, your capital equipment . . . and most important, "in the way things are done around here". People's skills change only with training or new people – and both are slow processes. Corporate processes take on a life of their own and, as human phenomenon, are notoriously resistant to change. And new or different equipment is expensive. All this and more conspire to make changing "the way we do things around here" a frightening task to contemplate and a difficult one to execute.

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### Final Thoughts

Do you have the right business model for today's market? What about tomorrow's? How can you tell, and what can you do about it? You can only tell by undertaking a thorough examination of the assumptions that form the basis of your existing business model. One way to do this as a first pass is to look at each line in your going-forward income statement and genuinely ask yourself, "What assumptions are we making when we project this number? Are they really still true, and will they be?"

### More Information

If you would like more information about how to apply a process to improve your marketing/sales function, simply contact us and we'd be happy to help you get started. From sweeping marketing/sales management process strategies to specific branding or product launch services, Customer Manufacturing Group can help.

If you'd like to learn more about Customer Manufacturing Group, or for a complimentary subscription to *Customer Manufacturing Updates*, give us a call at (800) 947-0140, fax us at (408) 727-3949, visit our website at [www.customermanufacturing.com](http://www.customermanufacturing.com), or e-mail us at [info@customermfg.com](mailto:info@customermfg.com).

We have offices in major cities in the United States, and our experts travel extensively throughout the world. If you'd like to schedule a meeting when we're in your area, just let us know.