Business Models versus Business Processes

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Much is being written and discussed lately regarding how executives should be prepared to change their business models to take advantage of new opportunities. It's important, when considering business models, to distinguish between changing an organization's business model and changing its processes

We've read several articles in the past six months that suggested that process practitioners should be concerned with changing their company's business model. There are, of course, many different uses of the term "business model." In this Article we use the term to refer to a high-level statement of what the company will do to make money and how the company will do it. Given our assumption, we suggest that the business model isn't something process practitioners should think about changing.

Defining or revising an organization's business model is the primary responsibility of thet the Board of Directors, the CEO, and the executive committee. Ordinarily, it isn't something process practitioners, or even value chain managers, are involved with. In essence, senior executives define what the organization wants to accomplish and process practitioners create or refine the processes needed to realize the goals articulated in the business model.

If we were going to describe this in terms of the BPTrends pyramid, we'd diagram it as in Figure 1.

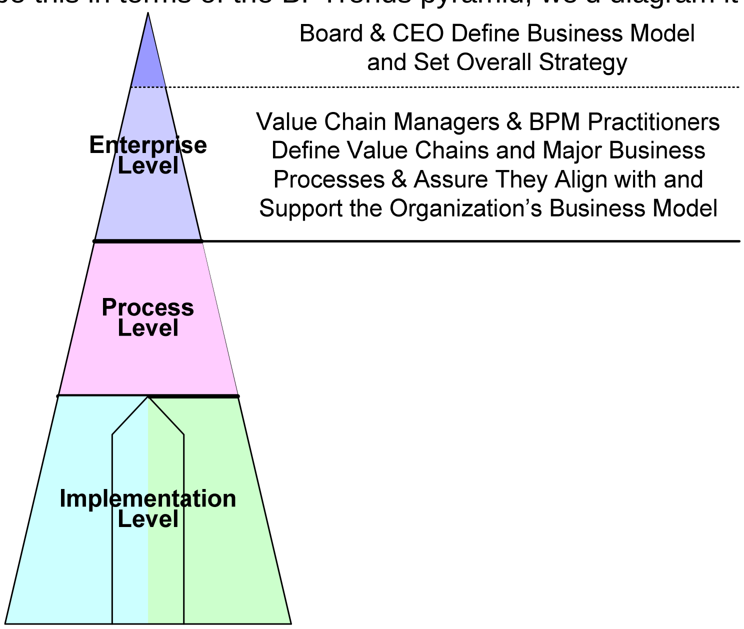

Figure 1. Divisions of responsibility within the enterprise level

The Five Forces Model for Strategy Development

Here's another way of thinking about the distinction. In 1980 Michael Porter wrote *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. This book, which has played a key role in most strategic thinking ever since, introduced, among other things, a model which is usually referred to as the "Five Forces" model. We've pictured it in Figure 2.

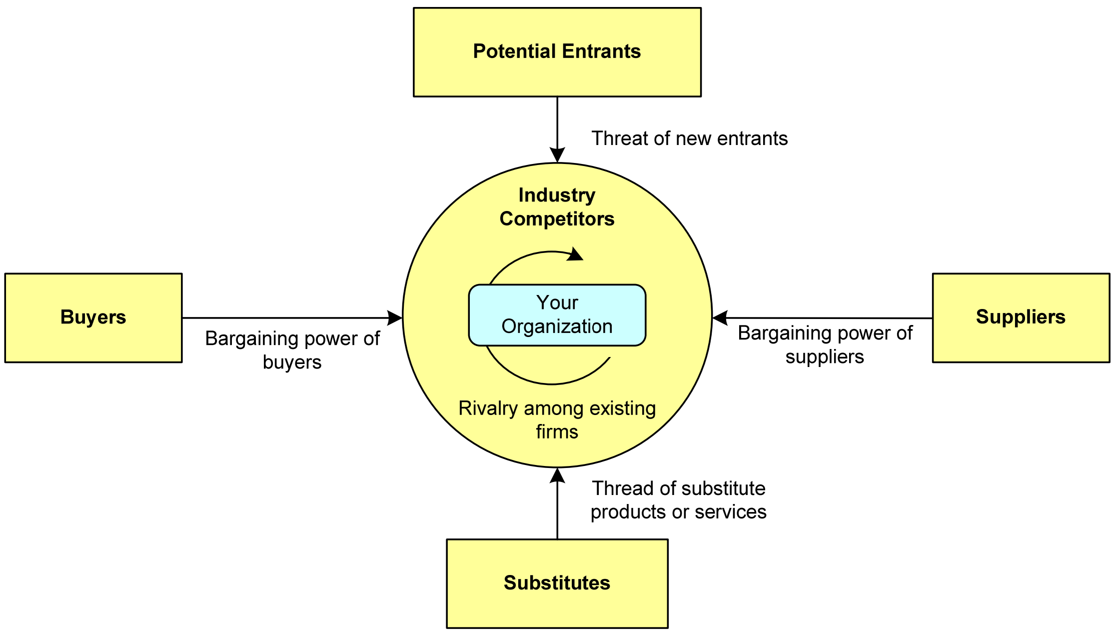

Figure 2. Porter's model of the five forces driving competition

In essence, the Five Forces model looks at the environment that lies outside your organization. It considers the product or service the organization produces for its customers and asks if the organization can continue to produce it, profitably, in the future. The five forces are each examined to determine how they might affect the organization's current business model assumptions and its future profitability. The executive strategy team asks about other firms in the same marketplace and determines how their products compare with its own. Is the organization well positioned to take customers away from rivals, or vice versa?

Industry Competitors. Porter pictures your competitors at the center of the model, surrounding your firm. As rival companies make moves, the company must respond. Similarly, the company may opt to make changes itself, in order to place its rivals at a disadvantage. Porter spends several chapters analyzing the ways companies compete within an industry.

Beyond the rivalry among the companies that make up the industry, there are changes in the environment that can potentially affect the entire industry. Porter classifies these changes into four groups: (1) buyers, (2) suppliers, (3) potential new companies that might enter the field, and (4) the threat that new products or services will become desirable substitutes for the company's existing products and services.

Buyers. Buyers or customers will tend to want to acquire the company's products or services as inexpensively as possible. Certain factors give the seller an advantage: If the product is scarce, if the company is the only source of the product, or the only local source of the product, or if the company is already selling the product for less than its competitors, then the seller will tend to have better control of its prices. The inverse of factors like these give the customer more bargaining power and tend to force the company to reduce its prices. If there are lots of suppliers competing with each other, or if it is easy for customers to shop around, prices will tend to fall.

Suppliers. In a similar way, Suppliers would always like to sell their products or services for a higher price. If the suppliers are the only source of a needed product, if they can deliver it more quickly than their rivals, or if there is lots of demand for a relatively scarce product, then suppliers will tend to have more bargaining power and will increase their prices. Conversely, if the supplier's product is widely available, or available for less from someone else, the company (buyer) will tend to have the upper hand and will try to force the supplier's price down.

Substitutes. Companies in every industry also need to be aware of potential new products or services that might function as substitutes for the products or services the company sells. At a minimum, a substitute product can drive down the company's prices. In the worst case, a new product can render the company's current products obsolete. The manufacturers of buggy whips were driven into bankruptcy when internal combustion automobiles replaced horse-drawn carriages in the early years of the Twentieth Century. Similarly, the availability of plastic products has forced the manufacturers of metal, glass, paper and wood products to reposition their products in various ways.

Potential Entrants. Finally, there is the threat that new companies will enter the market and thereby increase the competition. More companies pursuing the same customers and trying to purchase the same raw materials tends to give both the suppliers and the customers more bargaining power, driving up the cost of goods and lowering each company's profit margins.

Historically, there are a number of factors that tend to function as barriers to the entry of new firms. If success in a given industry requires a large capital investment, then potential entrants will have to have a lot of money before they can consider trying to enter the industry. The capital investment could take different forms. In some cases, a new entrant might need to build large factories and buy expensive machinery. The cost of setting up a new computer chip plant, for example, runs to billions of dollars, and only a very large company could consider entering the chip manufacturing field. In other cases, the existing companies in an industry may spend huge amounts on advertising and have well-known brand names. Any new company would be forced to spend at least as much to even get its product noticed. Similarly, access to established distribution channels, proprietary knowledge possessed by existing firms, or government policies can all serve as barriers to new companies that might otherwise consider entering an established industry.

Until recently, the barriers to entry in most mature industries were so great that the leading firms in each industry had a secure hold on their positions and new entries were very rare. As companies have become more international, geography is no longer a barrier and industry leaders in one country find themselves in competition with industry leaders everywhere.

In our discussion here, however, these aren't really process concerns. The organization's executives create a business model to describe how the company will make money. The model specifies a product or service and customers. It makes assumptions about the cost at which the product or service can be brought to market and the price customers will pay for the product. Executives analyze these variables until they identify a strategy that will result in the profits the organization requires.

If a company decides to get out of the business of selling insurance, deciding instead that it can make more money advising other insurance companies on how to price their products, then it has made a major change in its business model. Similarly, if a computer manufacturer outsources the actual manufacturing of computers and focuses only on marketing its computers, it has radically changed its business model.

Obviously a changed business model has major implications for the processes used at a company, but the basic decision about the nature of the business and the overall strategy for making a profit are usually made independent of those involved in creating or redesigning processes.

The Value Chain Model for Process Integration

In 1985 Michael Porter wrote a second important book, *Competitive Advantage: Creating and Sustaining Superior Performance*. In this book, Porter introduced a number of new ideas, including the concept of the Value Chain. Competitive advantage, Porter concluded, depended on all of the specific activities needed to create products and services and on the way the company organized those activities together into processes and ultimately into value chains.

Figure 3 provides an overview of Porter's value chain concept. (In Figure 3 we are actually using an organization diagram created by Geary Rummler, but it emphasizes both Porter's value chain concept and the context in which a value chain operates.)

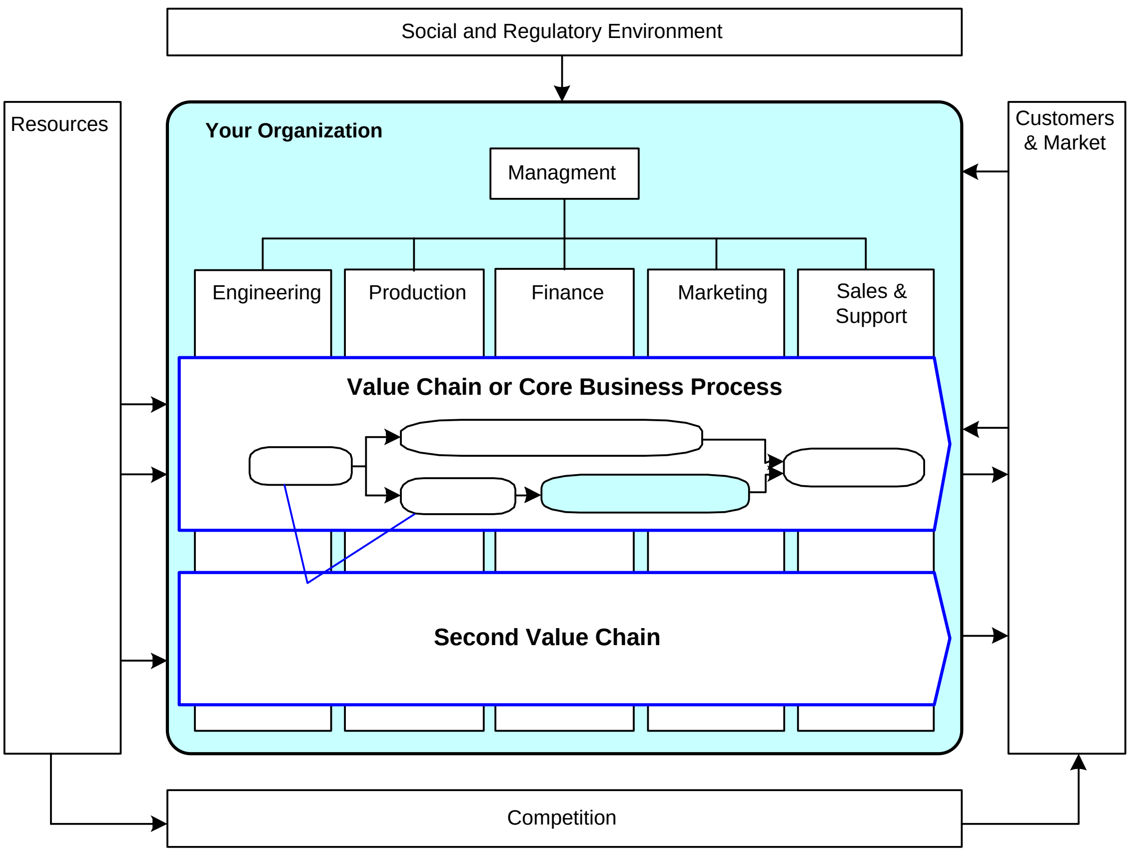

Figure 3. Porter's value chain concept

The value chain describes all of the activities or processes that are required to produce a specific product or service for a given market. Small companies usually have only one value chain, while larger organizations commonly support multiple value chains. In essence, the value chain is a very large process. It begins with the Inputs from outside the organization and goes thorugh to the outputs that are sold to customers. Value chains and the processes, subprocesses, and activities that comprise a value chain are very much the concern of process practitioners.

Reviewing the two books, it is as if Porter recognized that there were two different elements at work. Executives scan the environment and look for opportunities. They create business models that suggest how a firm can create value and make profits. Operations and process practitioners create and manage the specific value chains and processes that the firm relies on. They provide the wherewithal to realize a specific business model.

The best business model will fail if the company can't execute it. The best value chain or process will fail if it produces products and services that are inappropriate for the market.

Between the two lies the task of aligning the firm's business model (and its goals and strategies) with the firm's processes. In today's economy, each has to be dynamic. A company's senior executives must constantly reexamine the company's business model, and the process people must constantly look for ways to improve business processes. And both need to consider how to change their respective models to accommodate the needs and limitations of the other.

Considered in this way, the business model isn't something that process practitioners need to create, but it's something they need to understand. Any enterprise process architecture effort should begin by determining the business model and the goals of the organization. The KPI's for a value chain's performance should be carefully aligned to the assumptions and goals established by the business model.

BPM practitioners ought to be respectful of the organization's business model. They ought not get carried away and imagine that they can create or change it. At best they can make major improvements in the way a business model is realized.

Till next time,
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ABOUT PAUL HARMON

Paul is a Co-Founder, Executive Editor and Market Analyst at BPTrends, (Business Process Trends), the most trusted source of information and analysis on trends, directions and best practices in business process management, (www.bptrends.com). He is also a Co-Founder, Chief Methodologist and Principal Consultant of BPTrends Associates, a professional services company providing executive education, training and consulting services for organizations interested in understanding and implementing business process management. He has worked on major process improvement programs at Bank of America, Wells Fargo, Prudential and Citibank, to name a few.

Paul is the Co-Author and Editor of the *BPTrends Product Reports*, the most widely read reports available on BPM software products and the author of the best selling book, *Business Process Change*: *A Manager's Guide to Improving, Redesigning and Automating Processes.* He is an acknowledged BPM thought leader and noted consultant, educator, author and market analyst concerned with applying new technologies and methodologies to real-world business problems. He is a widely respected keynote speaker and has developed and delivered executive seminars, workshops, briefings and keynote addresses on all aspects of BPM to conferences and major organizations throughout the world. BPTrends Associates is partnered with Boston University to develop and deliver the BUCEC BPM Curriculum and Certification Program.