

Margin and Volume

Competitive Pressures on Basic Business Models

Executive Summary:

In the heart of every business model lurks maturation. In this article, Dr. Heuer suggests a framework that can help companies deal with their maturing markets.

The basic setup

It is beneficial to differentiate two basic extremes in business models:

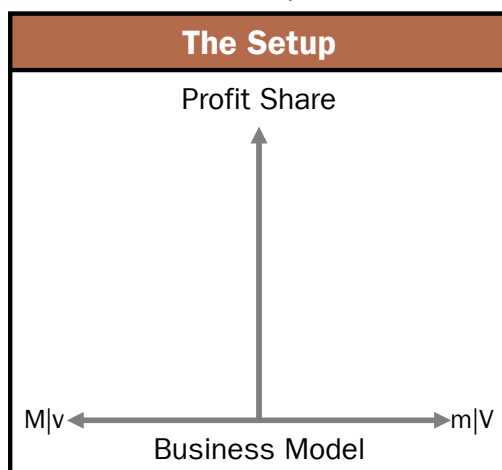
- **High Margin / Low Volume (M|v)**

The company makes money in the market by providing high margin products to special customers.

- **Low Margin / High Volume (m|V)**

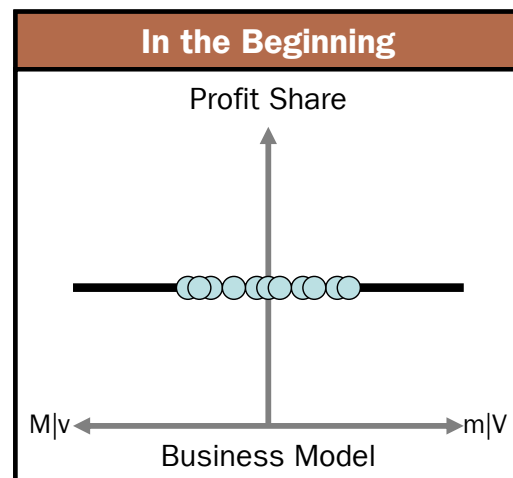
The company makes money by minimizing product cost to offer a lowest price.

The diagram below references the opportunity space between these extremes and the profit share.



Businesses compete against each other for the total profit in the market. Each company tries to maximize its share by following its investment strategy.

In the **beginning of a market**, the players (○) have a hypothetical equal share of the profit.¹ The resulting diagram is seen below. At this point in time, companies are rather **undifferentiated**. **Demand usually far outstrips supply**, which lets all kinds of business models survive.



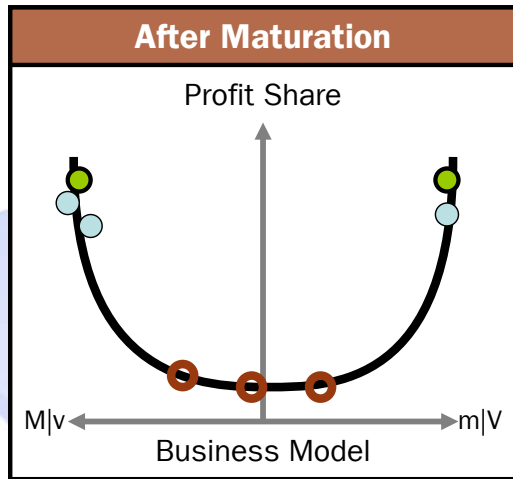
Now time will take its toll.

Participants will make investments to maximize their profit share. These investments push the participants away from the somewhat uniform

¹ This is a rather substantial assumption, but it actually only simplifies the argumentation. There is no real impact on the model if the profit shares are not equally distributed in the beginning.



initial phase into a more differentiated phase. They also increase supply past demand. At this point, commoditization sets in. The game changes.



Differentiation is taking its toll.

There are a few clear winners (●) in the market, a few runner-ups, and some clear losers (●). Notice the

way this worked out. The profit shares have shifted away from the flat distribution towards a U-shape. The companies exploiting the extremes of the business case variation are the ones that prosper; the rest is “stuck in the middle”. They do not have a clear message to their customers regarding their own value proposition.

The classic example in retail is the emergence of Big Box stores with the subsequent destruction of small foot print stores. The Big Box stores siphoned the m|V volume away and the more specialized M|v stores attracted the discerning customers on the other end. The middle was crushed. Convenience is important, but will not make a living by itself.

Comparing the two business model extremes:

	Low Volume High Price	High Volume Low Price
Focus	Customer Experience	Supply Chain Efficiencies
Product Choices	<ul style="list-style-type: none"> Specialized and Deep “We can get that for you” 	<ul style="list-style-type: none"> Generic and Broad “We have something close”
Demand	Many micro spikes	Active Smoothing
Customer Acquisition	Narrowcasting <ul style="list-style-type: none"> Word of Mouth 	Broadcasting <ul style="list-style-type: none"> Best Deal in Town
Experience	Entering a different world	A Clean Warehouse
Service	“But of course, Madame”	“Cleanup Aisle 3”
Exclusivity	Customer-Exclusive <ul style="list-style-type: none"> Specialty Items One only for you 	Store-Exclusive <ul style="list-style-type: none"> Store Brands Only from us
Slogan	The Best Anywhere	Good Value for a Great Price



Using the Framework

What is the value of this framework?

Awareness

Firstly, you have a basic dimension on which business is measured. This helps clarify strategies and ultimately investments. If you are heading into the foray trying to be both a M|v and a m|V at the same time, get ready for disaster. I am not aware of any business in a commoditized market that could survive in the middle for long.

You will not be able to generate a high enough profit share against your more specialized competitors to make your operation perform world-class on *both* sides of the spectrum.

The real Achilles heel is the incompatibility of the two operations. Imagine the discussion between the head of Marketing and the head of procurement. The first is being compensated to create exciting new product offerings with very short shelf lives. The other has every incentive to smooth out the supply chain operations by buying in bulk and predicting large volumes of demand far ahead.

It's DOA.

*Pretty much,
Apple and Dell
are the only ones
in this industry
making money.
They make it by
being Wal-Mart.
We make it by
innovation.*

Steve Jobs

K*Mart and SEARS failed, DEC failed, EuroTunnel is failing, Maytag failed, Sainsbury almost failed (and survived by re-focusing), Karstadt failed, Quelle failed.

Guidance

Secondly, you can use this framework to make your strategic choices.

Entering a Market

When you enter a market, know whether it is already commoditized or still fluid. If commoditized, use your core skills from other operations to hit the same sweet spot again. If things are still fluid, you can bring that experience to bear and *accelerate commoditization*. That is right, commoditize faster. If your operation is superior some-

where else, it will have a good shot at being superior in a new market (if you are branching out smartly, see "Beyond the Core"). There is a good chance that this move will kill off most of the incumbent competitors.

That's what Wal*Mart does when it enters a new market. It is the king of m|V.

That's what IBM did when it moved from high-end computing platforms to high-end consulting services. It is the kind of M|v computing. Nothing else.



If you are a little more curious about the other side of the world, you can use the new market to experiment with the other way of doing business. For that, you need a new operation (your current one is not going to cut it) and stamina. All your battle-honed instincts will point the wrong way (since you have flip-sided the strategy you are implementing). You will need help. The advantage of this rollercoaster: a new leg to stand on, a new way to make profits.

Dominating a Market

If you want to dominate a market you are in, you now know where your investments have to be made. If you are a m|V player, operational efficiencies and a relentless cost pressure is key. Invest in the back room. *Think Toyota. Think Target.*

If you are a m|V player, make your supply chain more fractal, that is increase the number of participants so that you can find even more exciting products. Invest in the front room. *Think WholeFoods.*

If you cannot do that, or if you are beating to the punch by competitors, it is time to leave. Otherwise, you will turn this market into a sink hole.

Leaving a Market

When your competitors consistently outstrip your own efficiency efforts or deepen their supply network

much faster than you do, you should think about turning the key for the last time. Can you move your resources to a market where their capabilities make them top dogs? You now know what to look for!

We don't have a monopoly. We have market share. There's a difference.

Steve Ballmer

Resources

Beyond the Core, Chris Zook, 2005
ISBN 1578519519

About Jay Heuer

Dr. Heuer is co-founder and CEO of SarJay GmbH, the Germany-based consulting outfit focused on **Innovation Management**, **Finance Management**, and **Talent Development**.



Jay has spoken on numerous occasions at conference and in company events about Innovation Management and Talent Development.

Dr. Heuer has been quoted in several newspaper articles about product development and Innovation Management.

His career spans the creation of a German software development company and a successful, US-based decade in IT and Research & Development for one of the largest companies in the world.

He can be reached through the contact form at <http://www.sarjay.com>.

