Business Models and Business Risk

by *Sundar Sankaran*[*] (Published January 7, 2002)

B**usiness risk** is the risk that an entrepreneur – whether individual or organizational - earns sub-optimal returns from the enterprise. Prudent entrepreneurs operate on **business models** that mitigate business risks.

Various **factors** contribute to business risk. Higher the *capital cost*, longer the *time to market*, greater the number of *agencies that can shake the foundations* of a business (for example through new technology) and more the *irrationalities in the market place* (for example the role of fashion) – more the business risk.

Chip manufacturing is an interesting industry. Capital cost is high at over $1bn for any plant; setting up a mass manufacturing facility takes 1 – 2 years; there is no dearth of technology initiatives that can shake the industry; and demand is derived from the needs of various sectors that are exposed to changing tastes.

How do chip manufacturers mitigate business risks? Japanese chip-makers are showing the way. Thirteen chip-makers including Hitachi, NEC, Mitsubishi, Toshiba, Fujitsu, Oki Electric and Matsushita have reportedly formed a manufacturing consortium for next generation chips.

Consortia in **electronics** are not new. But in the past, these have tended to stop with discovery of technology. Once the technology is in place, the organizations behind it seek to make it the industry standard through a process of licensing it out to others including competitors. The prevailing model in consumer electronics is to outsource manufacture to the globally least cost hub.

The proposed chip consortium implies that competitors are jointly promoting a manufacturing hub. Each manufacturer will sell the produce of the manufacturing facility under its own branding. *Ensuring differentiation in the eyes of the customer will be difficult, if the chips are otherwise standardized in features and performance.*

The **cellular services** industry abroad has re-sellers who buy air time in bulk from cellular service providers and retail it under the reseller's branding. The core offering is the same between the cellular service provider and the re-seller. But re-sellers attract their customers either through more intelligent and flexible tariff structures or through some element of service (say, billing) that the re-seller is able to provide better than the cellular service provider.

With chips, which would ultimately go into another end-product, ensuring such differentiation is tough, but not impossible. A smart manufacturer offering the same chip as a competitor may for instance offer a more favourable warrantee or better delivery terms and performance. In the **pharma industry**, multiple companies do sell the same formulation under different brand names.

Closer home, cellular operators, AirTel and Escotel have decided to share their cellular infrastructure in common circles. This strategic move ensures that incremental costs of technology and therefore consequences of failure are shared.

Japanese automobile companies were instrumental in refining a business model where they would concentrate only on core value added, while a significant portion of the cost of the automobile would be "bought out" from ancillaries. Such an approach ensured lower fixed costs and break even point – a significant strategic benefit in a market driven by "unpredictable irrationalities" and operating in a patriarchal country where employment for life is a rule rather than exception.

Business risks are a function of the unique characteristics of the sector as well as the realities of the market and country where the business operates. Entrepreneurs need to factor this while *choosing a business model that offers the best possible risk-reward equation from the preferred value proposition offered to the customer.*

---

[*] Sundar Sankaran is Director, Advantage-India Consulting Private Limited