

Value Driven



BY GEOFFREY COLVIN

It's the Business Model, Stupid!

Sure, there are plenty of reasons your business is failing. Some of them sound sensible. But there's only one that really matters.

THE QUOTE OF THE YEAR FOR 2000 COMES FROM XEROX CEO Paul Allaire. Some investors blame him for the stock's near-total collapse, and you've at least got to fault him for bringing in Rick Thoman from IBM to be his successor in 1999—one of the many succession disasters we've seen lately, and the reason Allaire had to be put back into the CEO's chair seven months ago. But he gets the Distinguished Service Cross for extraordinary executive heroism because he told analysts in a conference call, "We have an unsustainable business model."

In the past CEOs of big, established companies didn't say things like that. They didn't tell the people who rate their stock that the way they make money doesn't work anymore. In truth, most CEOs still don't say it. But whether they say it or not, they have to face it. The largest fact of life in business today is that virtually every company, certainly every established company, has to change its business model to make it sustainable in the Interneted, infotech-based world.

Allaire isn't actually the only big-deal CEO to say it out loud. Mike Armstrong at AT&T is saying it. Here's a company that still gets more than half its business from long-distance calls. Yet Armstrong recently told FORTUNE that voice long distance "is not a business. It's neither durable nor sustainable." Translation: The way we make money doesn't work anymore.

For the many business people still in denial about that, it's tempting to think that business-model demolition is mainly a problem for tech-related companies. That clearly just isn't so. Are greeting cards a tech-related business? American Greetings lost 42% of its value in one day recently, after announcing earnings would be way below analysts' forecasts. An important factor is that ever more people are sending Internet-supplied e-mail cards, which are free. If it can happen to people who make birthday cards, it can happen to you or me or anybody.

The trouble with CEOs like Allaire and Armstrong, laudable as their now ice-clear view of reality may be, is that they didn't

have their epiphanies until the market hit them with a sledgehammer. Xerox's shareholders are \$38 billion poorer than they were 18 months ago. AT&T shareholders are \$150 billion poorer than they were nine months ago. It's a high price to pay to make the boss realize the world has changed.

Ideally we'd all spot these enormous transformative forces and respond to them quickly. But instead we find so many plausible, less alarming explanations for trouble. Earnings down? Well, the economy is slowing. Oil prices are volatile. The curo—what a pain. To look past these temporary problems and acknowledge a far larger, more frightening one—our business model is unsustainable—takes courage.

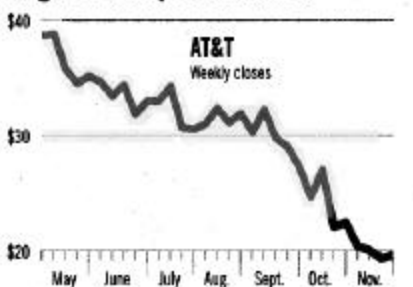
Still, we've seen it done. I'd argue that Bertelsmann did it when the company announced the innovative deal between its mammoth music operation and Napster. If ever an industry needed to face the hard reality that it has an unsustainable business model, it's the recording business; whether Napster lives or dies, file sharing has ended the era of selling music primarily on plastic disks. Yet most of the industry is still focused on trying to make the change go away by suing Napster. Bertelsmann instead figured out a new model in which it funds Napster, makes its catalog available to Napster, and gets an equity stake in return; Napster will charge users a flat monthly fee, some of which will go to Bertelsmann. Will it work? No one has any idea. But something will work eventually, and Bertelsmann has a strong chance of making it work better and sooner than its competitors.

Not just big, old companies face this reality. FORTUNE's Dot-Com Deathwatch is up to 135 failed companies in the past year—mostly startups with dumb business models no better suited to the new world than Xerox's. It's clear that in 2001 an effective way to separate winners from losers will be to ask the simple question: Did they or did they not acknowledge that their business model—the way they make money—is probably unsustainable?

Infotech slammed copiers ...



long-distance phone calls ...



and even greeting cards

