

# The Basic Business Model



*How any business works*

*and*

*how yours can too!*

by

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# The Basic Business Model

There's a simple model for understanding how any business works. It's a management tool. Anyone who wants to be in business for themselves needs to understand this basic model. Once you understand this model, you are well on your way to business success.

## First Things First

This model pre-supposes a few definitions.

First of all, what is a business? From the Middle English, the word is *businessse*, from *bisi*, meaning busy. Busy doing what?

According to The American Heritage Dictionary, "that which busies one, or that which engages the time, attention, or labor of any one, as his principal concern or interest, whether for a longer or shorter time; constant employment; regular occupation; as, the business of life; business before pleasure."

Not a very helpful definition, in my view, but it helps me see why so many people who go into business for themselves are thoroughly confused at the outset.

Now, before we get to business models, let's talk a moment about being in business for one's self. Many people who start a business thinking they are becoming an entrepreneur are really self-employed. Here is the distinction:

An entrepreneur is "one who organizes, operates and especially assumes the risk of a business venture." (The American Heritage Dictionary) The word "entrepreneur" comes originally from the Old French, from *entreprendre*, to undertake. Another definition, from Webster's Revised, "one who creates a product on his own account; whoever undertakes on his own account an industrial enterprise in which workmen are employed."

The key here is 'in which others are employed.' An entrepreneur, versus a person who is self-employed, has the ability to walk away from their business and the business will go on successfully without them.

## How It Works

Now, in order for any business to be successful, whether you are an entrepreneur or self-employed, is an understanding of the proper roles of the various parts of one's business. There are basically only three: Marketing, Operations, and Finance. Here's how they work:

Marketing's job is to bring in revenue. Operations' job is to make a profit (by minimizing expenses.) Finance's job is to manage the money (cash flow and long-term financing.) Anything else is superfluous.

Now, armed with this useful information, how does one make it work? Think of these 'jobs' as filters. If the marketing department has its attention on anything other than revenue, like winning awards, designing beautiful brochures, getting media attention, without being able to measure the contribution to revenue, then this part of the business is not working properly. Not only is it reasonable, it is imperative, to hold the marketing department, including advertising, sales, public relations, and sometimes customer service, responsible for bringing money into the business.

Similarly, it is imperative that Operations be focused on making a profit. There are many ways they can do this, including production efficiencies, quality control, effective communications, teams, training, discount buying, and other cost-saving measures. Their job must be not only to minimize costs, but to actually make a profit, which means that Operations must understand their position in the company relative to the revenue that is being brought in by marketing. Operations must not be caught up in the latest product innovations, the latest production methods, per se, but only in so far as they enhance the bottom-line profitability of the company.

Finally, there is Finance, whose job is to manage the money. This has both a short-term and a long-term objective. In the near term, cash flows must be balanced, income with receipts, expenditures with accounts payable. In the long term, in order to accommodate business growth, Finance must look toward borrowing or raising equity capital, and managing corporate valuation and shareholder dividends. Finance must also balance the tax and other financial considerations of decisions made by Marketing and Operations. These are essential to the financial well-being of the business.

Now, the difference between an entrepreneur and someone who is self-employed in managing these three functions is that the business owner, or entrepreneur, manages people, whereas the self-employed manage themselves. The functions remain the same.



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