How does your business model add value? And will it in 2020?

Clear information and reporting on your business model is the first step to making it fit for the future, argue Mark O'Sullivan and Carlo Gagliardi. It's a matter of survival

Are traditional business models dead?

Only six of the Fortune 100 companies active in 1940 are active today. But now it's not about surviving the next 70 years – it's really, urgently, about the next ten. Massive changes to technology and particularly digital's unrelenting grip on most aspects of business is accelerating the success of those that get it right – and the decline of those that don't.

Very few of the business models thriving in 2005 will be around in 2020 in the same form. We can already see a variety of new business models bubbling up in industries from banking to media. But we've also seen many companies collapse in the last few years and, more often than not, failure to adapt the business model is a key factor.

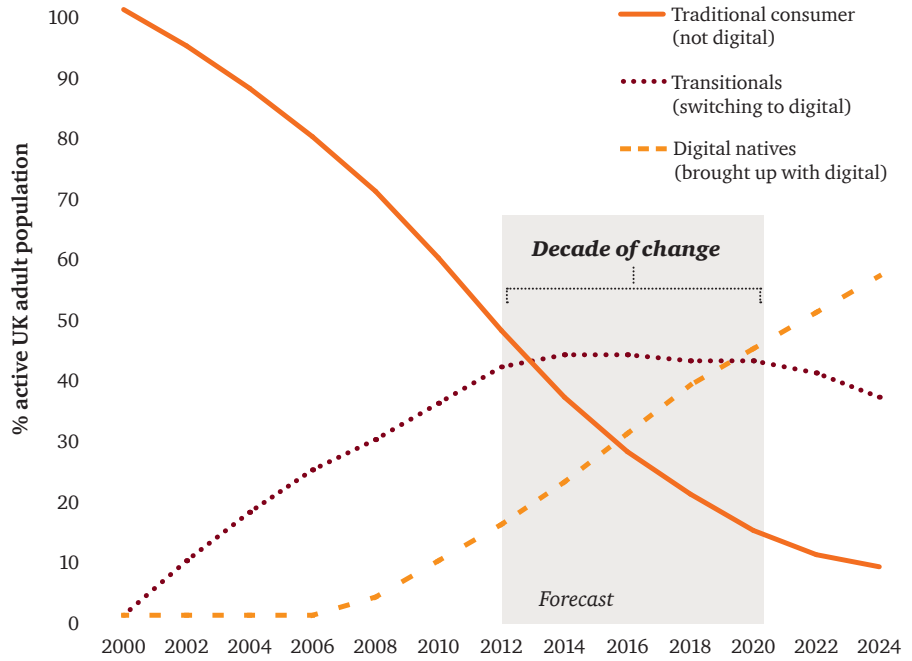
There are two trends that will require completely new business models within the current decade:

- People brought up with computers in the home – 'digital natives' – will become the dominant type of customer, and
- After years of digital technology changing the way products and services are transacted, we will see it increasingly change the way value is created

We were all 'traditional consumers' in 2000, but this year the 'transitionals' who have learned to use digital technology will overtake. And by 2020, digital natives will become the main consumers, which will have a dramatic impact on business models.

Business models – the decade of change

The changing consumer mix and the rising influence of the digital natives will force further change



Source: Total Retail

"The dynamics and alchemy of value creation are changing fundamentally, and this creates both threats and opportunities for growth.

But there's a big cultural challenge: for the last 20 years most companies have improved performance by focusing on their operating models; now they need to change their business models."

Digital changes the way value is created

The next decade will demand a much more sophisticated understanding of how value is created in our business ecosystems and the key to making the most of these opportunities is relevant data. Successful companies are studying interactions, spheres of influence and roles, and collecting data that provides the knowledge to evolve their business models. They understand:

- How customers – by consuming products and services – create and consume value for themselves
- How providers capture a portion of that value by enabling customers to create and consume value for themselves

Leading companies will be those who equip themselves with business models that:

- Articulate how 'value-adding activities' transform inputs into outputs, and
- Articulate how orchestrating and understanding the interactions between all stakeholders (ie, your suppliers, suppliers' suppliers, distributors, customers, customers' customers, etc) can create value

Take a long, hard look at your business model

These emerging trends create a host of opportunities – and threats. And to navigate these, companies will need to take a long, hard look at their business model.

But has your organisation explicitly defined and documented its business model? Start-up businesses are usually adept at explaining their business model succinctly – but many larger organisations are out of the habit. It's almost as if a new language is needed to help us all answer the tough questions about our business models and take action to evolve or transform them.

So if you do find yourself looking down the barrel of your business model, what kind of questions should you be asking?

- What business are you actually in? Are you selling computers, or an experience?
- Can the current model survive the mega trends in technology, digital trading, demographics, climate change, etc? Where will value come from in future?
- Go beyond products and services – what customer outcomes are you trying to enable?
- Are you driven by your customer? Are you allowing them to create part of the value?
- Where will your critical insights come from? How will you get hold of them and use them effectively?
- Does your customer trust you enough to use information about them for their benefit? If not, why not?

Are you building trust?

Sustaining and building trust in the business model will depend on communicating effectively with investors and others about how value is created now and going forward.

> *"Only 40% of companies report insightful detail about their business models."*
> **PwC reporting survey,** *Trust through transparency*

If you ask any investor about their assessment of a company, they're likely to tell you that one of the first things they try to do is form a view on a company's business model – they just haven't used a single point of reference before, because the information hasn't been there.

Articulating your strategy and business model is going to be more important than ever in the next 10 years. But how do you take all the elements into account and communicate them clearly? And can you show that the model is sustainable? How will investors react?

The problem is, no-one is very clear about how to define 'business model', or what you should say to your stake-holders about it. As one finance director commented when grappling with business model reporting: "we know what we do…it's just very hard to articulate it on paper".

Current reporting is not meeting investors' or other stakeholders' need to understand the business model and its current and future viability. They'd like to understand your value proposition, profit formula and the key resources required to deliver the proposition. They would then like to know how this business model interacts with your risk profile, strategic priorities and KPIs.

Where to start with explaining your business model

Integrated reporting could really help (see page 31) – the business model is at the centre of their draft framework.

To identify the right external disclosures, there needs to be real clarity internally about what your business model is and how it links to both operational and financial drivers of the business.

It can help to start with some simple questions that stakeholders might ask:

- What do you do and where?
- What resources and relationships do you rely on?
- Who do you interact with and how does that create value?
- How do you make money from that value?
- What differentiates your business from others?
- How will you sustain that value creation and ensure that your business model is versatile?
- How can you share the relevant information about your business model in the context of a changing environment?
- What do your providers of capital perceive your investment case to be? Is this consistent with your view?

However you approach working out what your business model is, and how it works, it's clear that reporting effectively on it today is the first step towards making it fit for the future.

www.pwc.co.uk/reporting-assurance/publications/business-models-back-to-basics.jhtml

Mark O'Sullivan
Corporate reporting director at PwC

Carlo Gagliardi
Strategy partner at PwC

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