

Podcast transcript

Changing business models.

Podcast with Tim Sarson, Partner, KPMG in the UK

Musical intro

Announcer:

Hello! Welcome to our KPMG podcast series for tax leaders. For this episode I talk to Tim Sarson, Partner of KPMG in the UK who leads value-chain management for Global Tax. Tim has over seventeen years' experience as an international corporate tax specialist in Big 4 firms, as well as in industry where he was the group tax and treasury manager for an operational consulting practice.

In this episode, Tim and I discuss how business models are shifting as companies react to changes large and small, and re-position themselves to mitigate risk and seize opportunities. Hi Tim, and thanks for taking the time to speak to me today on the phone.

I know you've been working in this space for many years, so could you tell us about the most significant changes you've seen to business models and what you think are driving these changes?

Tim:

Well, they're always changing of course that goes without saying. I suppose the first thing that we need to do is define what we mean by a business model, because there's lots of terminology that's slightly similar, there's operating model, business model is used in different ways but what I mean by business model is essentially everything about how a business invests, makes its money, distributes its profits and deploys its capital, that's pretty broad. I've been thinking about this and I think there are a number of themes which all mean that the businesses we are working with now are very different from even the same businesses 10-15 years ago. First of all, there's the obvious stuff which everyone is reading and hearing about all the time, the way that businesses sell to their customers and the way the customers buy and that's B2B and B2B customers and that's changed significantly. Part of that is about digital, about the 'uberization' that you'll hear about in business models. In other words, we're moving from products to market places, traditional product companies are providing services and vice versa and there's a whole loads to talk about there. But there are also a lot of big changes happening behind the scenes which I think is

every bit as important. Supply-chains have been changing massively driven by some micro factors like the oil price, like micro-economics, geopolitics, but also driven by macro-factors like technology again.

Organizations have been changing as well, I want to talk a bit about that a little bit later on and that's partly, not all, but partly because family life and the way that individuals plan their careers is changing and that really affects the way that organizations are shaped. And finally, and I think this is not to be underestimated, is the way that capital around the world is applied and deployed by multi-nationals, and for multi-nationals, has changed beyond recognition. There used to be a time where the dominant source of capital was deployed by listed multi-nationals that were listed on stock exchanges, now with private equity, private capital being increasingly important, and the massive return of the state deployment of resources as well, outside of state owned entities, enterprises, or sovereign wealth funds, that the way that capital moves around the world is completely shifted.

Announcer:

So how do you see these business model changes develop further in the future?

Tim:

So these are always dangerous questions to answer, because predicting the future is a mugs game and the easy thing to do of course would be to say that we'll have more of the same. So the trends that we're seeing now, whether that's the acceleration of digital robotics taking over business models, or more and more platform models out there, more and more state owned enterprises, more and more geopolitics. That may happen, but I think what the last few years has certainly shown me is that there are always surprises and companies need to be prepared for surprises. They need to be prepared, for example, for technology to move in ways that they haven't expected. If I take cars, for example, autonomous vehicles, really no one was talking about that except in very esoteric circles, even 3-4 years ago, here in the UK certainly. Now, it seems like a very real possibility but who's to say that in two years' time everyone will have forgotten about that and will have moved on to the next thing.

Geopolitics is incredibly confusing. I advise a lot of clients at the moment on Brexit, it's hard even to say where Brexit's going let alone what's going to happen to the balance of power world-wide

and geopolitics really has been shaping the way that companies operate. And then finally, that there are things that we simply cannot predict, but which have massive impacts on business models. I'll give you one example of what happened a few years ago. I used to work quite a lot with Japanese headquarters groups, electronics groups, and in one year they faced both massive flooding in Thailand and the earthquake and tsunami that wiped out a lot of Japanese manufacturing capabilities because essentially there were shortages of electricity. Those twin problems for their supply-chains led to a major re-thinking of where they should, essentially, put all their eggs and there are always going to be things like that happening in the future that we can't predict. So for me the important thing when thinking about the future is making sure that organizations are ready to be taken by surprise and to adapt to it.

Announcer:

So when we're thinking about all of this, and on a pragmatic level, what approach should companies be taking about the effects changing business models is going to have?

Tim:

I think you can't do better, to be honest, for most companies than having a look at what's going on around them. Too many companies look inwards so they fixate on the problems that they see themselves having and what that leads to generally is that they use yesterday's solutions to address yesterday's problems. If you take for example how they deploy technology in an enterprise, generally speaking they will be sitting with a 'clunky' ERP system. The obvious fix to that, and to all of the issues that they're dealing with, is probably to roll-out a brand new ERP system. Sometimes they need to stop, lift their eyes above the horizon a little bit and think 'well if we started from here, would we be implementing the same technology that's been in our business for the last 20 years, or would we be thinking about skipping that and go in to something, for example, something cloud-based. It's the same with organizations.

Companies that have traditionally grown up around the idea that there's a headquarters and then there are functions that sit in various countries depending on what is most suitable to do in that country, they will tend to do their planning based on an assumption that that's the right way forward. Again, sometimes they need to stop, look around and think 'well, what else is there out there and what might actually be a more efficient, cheaper and easier to implement way of organizing my people. So, do I need a headquarters in one place or can my headquarters be virtual? That's the way that employment is working anyway, does it still make sense to put my factories in country A and my distribution centers in country B just because they were there before? So I think practically speaking, it's just always worth companies stopping, thinking about would they be where they are now if they hadn't started here?

Announcer:

So Tim, do you think companies are becoming more innovative when it comes to their corporate structure? Do you have any examples you might be able to share with us?

Tim:

Ok, so let's take a couple of examples, one of them around M&A, and one of them around people and organization. So just building on this people and organization point, companies are being forced by the reality of finding it difficult to find talent and to find highly qualified staff, they're being forced by that. And this is a number of my, probably the majority, of my clients are starting to hire senior staff wherever they can get them. That means that some of the theories around for example virtual organizations operating through DC that were simply theories until a few years ago and now happening in practice. It means that there are challenges for those companies in getting people to talk to each other, massive challenges in terms of their transfer-pricing models, for example, particularly after the BEPS program. But they're having to adapt because that's just the way that the world is moving and we're having to adapt with them, particularly across Europe. This is a big and accelerating trend, the fact is that people simply don't 'up sticks', leave their family and move to other countries in the way that they used to so they're having to work with virtual organizations because that's just the way things are.

If we then say M&A, I think one of the big trends that I've seen over the last few years which starts to feature, starts to feature in to what we would have called 'business as usual' planning, is that M&A is no longer that one-off event that happens which is outside the ordinary. Again traditionally companies would grow organically, they would set-up an operating model that was driving profit in particular profitable markets that was investing in new markets, and everything would be geared-up for that 'business as usual' and then occasionally there would be a big M&A transaction where they felt that something was missing or where they felt that they needed market scale. Now particularly in, for example, R&D heavy industries M&A is just a fact of life, that's the way that they get growth. It's inorganic but it is kind of normalized. And you have to start building that in to the way that companies transfer-price their operating models for example, you need to build that thinking into the way that you describe the company to a tax authority. So things that used to be theoretical are really becoming normalized now.

Announcer:

So it's almost like the convergence that we're seeing in industry where it's becoming harder to categorize businesses?

Tim:

Yes, precisely and certainly in the context of M&A, it's a little bit of an artificial split now between your deals activity which was always seen as something out of the ordinary and then your day-to-day work and actually deals can sometimes be a big chunk of your day-to-day operations.

Announcer:

What do you think are the tax implications of all these changes to traditional business models?

Tim:

Well, tax drives business models sometimes, business models definitely drive tax. I think it's important to define again what we mean by tax. So tax is not just corporate income tax and it's not just tax that is paid by companies, it also includes personal taxes. Corporate income tax generally speaking is driven by where and how value is created by senior decision making. Indirect tax is incorporated into the supply-chain, it's a transactional tax and so it's really driven in terms of where it's collected by what the supply-chain looks like. And then person and payroll tax, well that's driven by where you have people, it's also driven by how those people move around. If you think about the topics that I have just been talking about, changing business models, changing parts to the customer they simply mean that value's going to be created in a different way in different places. So from a transfer-pricing and a corporate tax perspective, that means that we end up with tax in different places. It means that existing business models, or operating models for tax, may not be fit for purpose. Indirect taxes, both VAT and customs, has gone from something that we've done in the back-office to a really key driver of efficiency in operating models. And some of the geopolitical changes, some of the re-establishment of borders, you know Brexit, potential changes to NATFA being two examples, meaning that again customs duties, VAT are being collected in different places and creating different frictional costs in parts of the supply-chain that weren't there before and they really need to be both built into the supply-chain modelling and planning. And then finally, payroll taxes. When you have virtual organizations that are less centralized geographically, where you are hiring people wherever you want them, just the number of complex individual arrangements and question marks over people's personal and payroll taxes and also what that means for corporate tax permanent establishments for example, that's just burgeoning. So I'm getting at least weekly calls and conversations about new hires where someone might be based in Switzerland but wants to spend 2-3 days a week in country X, what could we do, how do we hire them, how do we pay them and where do we pay them? And that's only going to get bigger and bigger as organizations get more and more complex.

Announcer:

That's great Tim, thanks for taking the time to join us today. I think there's a lot there for our listeners to think about and to consider. We'll go on to explore changing business models in further episodes I'm sure.

In our next podcast we're going to turn our attention to geopolitics. How shifts in the geopolitical landscape effect businesses and what the implications are for tax departments. I'll be joined by Grant Wardell-Johnson, Lead Tax Partner, heading up KPMG's Economics & Tax Centre for KPMG in Australia. That's all we have time for today but please remember to keep emailing us any suggestions you have for future episodes at tax@kpmg.com. You can find out more about this topic, and other topics we've discussed in this podcast series by visiting kpmg.com/futureoftax Thanks for listening!

Musical exit

