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Business Model Optimisation

Reviewing the business model. Why do it? What does it involve?

Tax
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Introduction

Well-managed companies review their “business model” on an ongoing basis, critically assessing how the model is operating, and making necessary adjustments and enhancements. Such companies also regularly consider the viability and sustainability of alternative operating models. Optimising the business model can be a mere revision to, or enhancement of, a small facet of the business (e.g. adding a step in the supply chain), but it can also involve a paradigm shift in the way in which the business is conducted. Failure to engage in regular assessments can expose a company to unnecessary risks or result in missed opportunities.

Fundamental changes to the way a company does business generally result from external factors, such as changes to regulations, advances in technology and communications, and changes in the market (e.g. the location and composition of customers, sources of raw materials, labour and financing). Two examples of this type of transformation, made possible largely because of advances over the last 15 years in technology and communications, transportation and logistics, are:

- **The “offshoring” and “outsourcing” of significant parts of business processes:** For example, the processing of claims in India for insurance providers; the manufacturing of products in Asia for original equipment manufacturers; the undertaking of tax return preparation in India or Central Europe; and setting up procurement centres in the same country as low cost manufacturers.
- **The creation of central entrepreneur business models (a principal, contract/toll manufacturers and commissionaires/limited risk distributors):** These integrated operating business models can increase productivity, economic scale, and efficiency, while reducing operating costs, and working capital. These models often feature an offshore principal selling goods made by low cost contract/toll manufacturers to customers in local markets through commissionaires or limited risk distributors in the countries in which the customers are located.

Many factors need to be evaluated when business transformation is being considered. Stakeholders throughout an organisation must consider and evaluate the impact of changes on their parts of the business. Throughout this process it is important that the impact on all areas of the business is examined and that nothing significant is overlooked. Tax, of course, is a key consideration.

Reviewing the “business model”. Why does tax matter?

Tax is a factor even if a company is only making a small enhancement to its business model: the company should at least confirm that the tax implications of the change, if any, have been appropriately considered to prevent any unpleasant surprises down the road, and ensure that advantage is taken of available opportunities.

Tax issues certainly must be taken into account if a fundamental change to the business model is contemplated. Paradigm shifts or business transformations generally entail the following broad work streams:

- Realigning for business transformation, such as the design of a new supply chain.
- Reconfiguring IT systems to ensure the infrastructure supports the new processes.
- Readying Human Resources by managing the movement of people and facilities.
- Reorganising legal, finance and tax structures to preserve the transformation value with efficient strategies.

Based on our experience with business model optimisation projects, it is best practice for tax to be a consideration from the outset, and for the tax function of the company to be represented on the steering or other committee responsible for directing and managing the business transformation. Any unforeseen tax costs, such as an unexpected exit charge, may upset the “cost-benefit” calculations, whereas tax savings achieved through an enhancement can offset many of the up-front costs of the transformation itself.

It is important to have a path to follow when embarking on business transformation. Different steps need to be taken depending on whether the changes are mere enhancements or paradigm shifts.

Case study 1: enhancement to an existing business model

There will always be opportunities to increase profitability by making incremental changes to the supply chain - some of these may be common to a particular industry, while others will be specific to the unique circumstances of the company. This case study looks at how adding a step to the supply chain of a low cost manufacturer exporting goods to certain countries can yield substantial savings in customs duties.

Many companies use the business model illustrated in Diagram 1 on page 3: a manufacturer sells to a related company (Intermediary) which then sells to the distributor, even though the goods are shipped directly to the distributor. One major reason for adopting this business model may be to centralise invoicing and cash flow: all manufacturing entities invoice the Intermediary and are paid by that company, and the Intermediary invoices all distributors and receives payments from them. Transfer pricing considerations generally require the Intermediary to mark up the price of the goods it on-sells in

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