

Governance *in focus*  
Describing your strategy  
and business model



# Contents

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Summary of the requirements	1
Making the most of the new requirements	2
Tips for preparers – key design principles	3
A framework for describing a business’ strategy and business model	4
Worked example	5
Pitfalls to watch out for	8
Questions for the board and/or audit committee to consider	9
Examples of strategy and business model disclosures that caught our eye	10
The Deloitte Academy	11

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**Governance in brief** provides a summary of the latest developments in governance issued shortly after announcement.

**Governance in focus** provides a deeper dive, guidance and views on key aspects of the latest developments in governance.

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# Summary of the requirements

In 2010 the UK Corporate Governance Code introduced a requirement for listed businesses to disclose in their annual report their business model and strategy for delivering corporate objectives. Only if investors have this information can they engage in real discussions on how value can be created and sustained in the long term.

Changes to the Code issued in September 2012 ask the board to state in the annual report that the information necessary for shareholders to assess the company's performance, business model and strategy has been provided.

The quality and relevance of the content of annual reports is currently a hot topic with regulators. Keeping "how we make money and add value" at the heart of the new requirement will ensure it stays focused.

This short document sets out Deloitte's recommended approach to provide guidance to listed companies to describe their strategy and business model, mindful of the need to meet regulatory requirements and support value creation through effective stakeholder engagement.

# Tips for preparers – key design principles

The approach to meeting the business model and strategy disclosure requirement illustrated in Figure 1 has been developed in line with four key design principles. These are:

- **Maintaining a simple and coherent narrative flow:** to support the clear communication of key messages to diverse stakeholders with a transparent flow between objectives and business outcomes. This flow should incorporate the themes behind the company's key performance indicators and principal risks and uncertainties.
- **Working within a standardised framework:** to provide consistency and clarity in how the business interprets and describes its strategy and business model, whilst giving sufficient scope and flexibility for the business to articulate what makes it distinctive.
- **Being able to describe both current and future states:** to allow the business to describe priorities for delivering and retaining value in the short term whilst also signposting the strategic direction of the business to meet longer term objectives.
- **Keep it high level:** the new requirements are designed to ensure strategy and business model are communicated in the Annual Report to enhance understanding of investors and other stakeholders – so keep it straightforward and easy to understand.



# A framework for describing a business's strategy and business model

Neither "business model" nor "strategy" have precise, commonly accepted definitions. We equate the business model with "how we make money and add value" and believe it is best described within the following framework:

Figure 1.

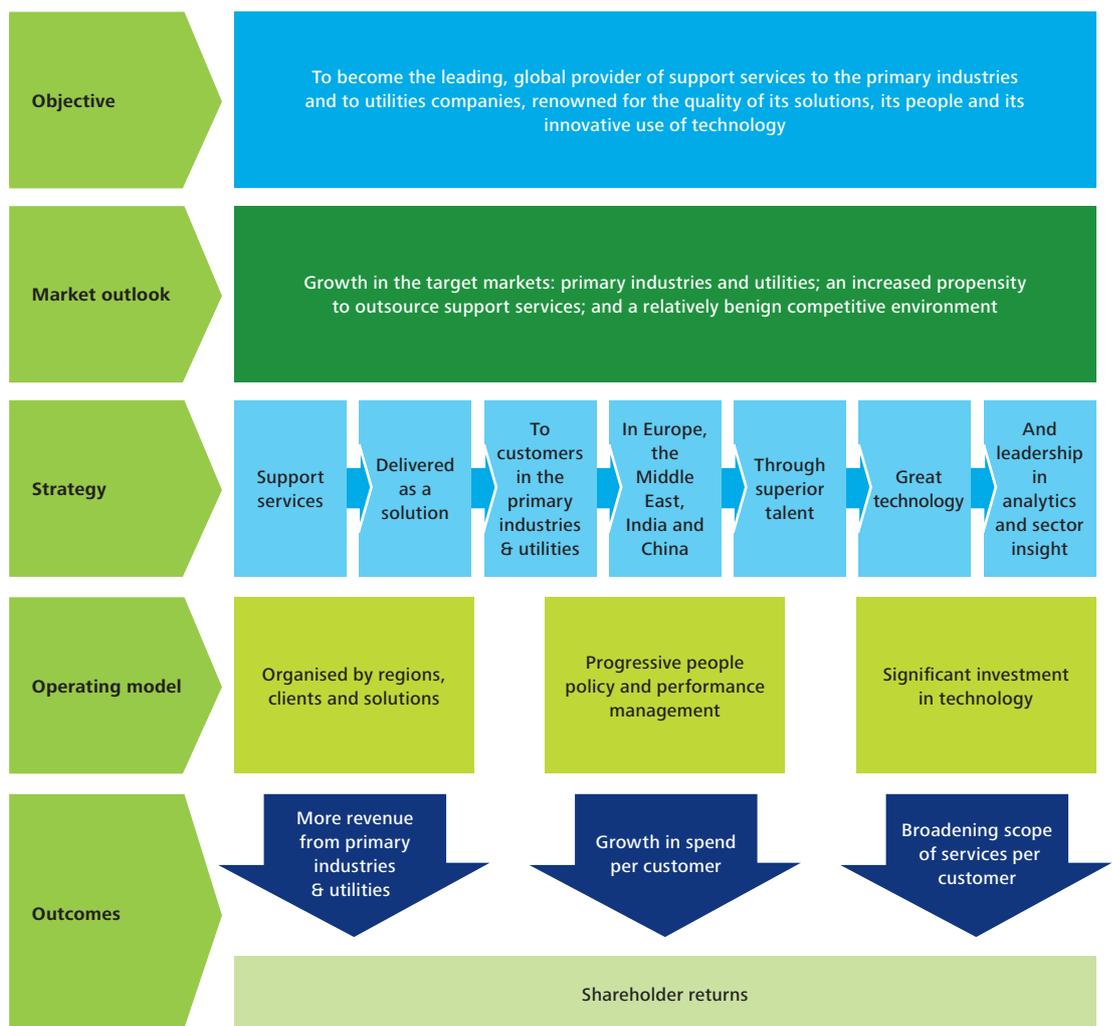


# Worked example

## Context

The London Growth Organisation PLC (LOGO) has historically provided services and some products into a wide range of industries, typically supporting back office services. The company has grown both organically and inorganically across Europe and is following its clients further afield. Scale is bringing benefits, and greater cohesion will drive greater effectiveness and efficiency. The company's clients are demanding a more solution orientated proposition and more flexibility as they grapple with regulatory change, and changes in the shape of demand for their products and services. LOGO competes on the quality of its services, but faces disruption in some quarters from competitors who provide a lower cost, lower quality proposition.

LOGO believes that the future lies in focussing on the primary industries and on utilities, and providing a broader scope of support services, offered as managed or outsourced contracts. These services will be underpinned by a carefully configured delivery platform that combines scale and efficiency where possible, and customer intimacy where necessary. Continuous improvement, fed by a powerful data analytics capability, needs to pervade the organisation and will result in bottom line impact for clients.



## A. Objectives

LOGO will become the leading, global provider of support services to the primary industries and to utilities companies, renowned for the quality of its solutions, its people and its innovative use of technology.

## B. Market Outlook

The demand for LOGO's services depends primarily upon:

- the health and wealth of the industries LOGO serves;
- the propensity to outsource support services in these industries; and
- the ability of LOGO to gain market share.

The primary industries, whilst impacted by the global economic slowdown, are expected to grow at c. 7% per annum globally over the next 5 years driven by emerging market demand, and developed economy recovery. Supply side constraints and regulation are expected to support pricing and maintain or improve profitability. Utilities are also expected to grow, following a similar profile but with lower growth of 4-6% per annum.

Outsourcing of support services provides access to economies of scale, but also best practice. As delivery of support services increasingly involves an array of digital device driven interaction, access to technology platforms is increasingly a driver of outsourcing. The propensity to outsource is expected to grow, with LOGO's end market likely to grow at c. 10%.

LOGO is currently one of 3 organisations of significant scale to address this market, also competing with a long tail of smaller, more local, organisations. The typical size of clients in the primary industries and in utilities make it more difficult for the local organisations to compete. LOGO has been growing market share by emphasising its ability to provide cross functional support services, an increasing emphasis on technology, and investment in customer relationships through a structured customer account programme.

## C. Strategy

LOGO's strategy is to provide a broad range of support services, typically delivered as a solution, to the primary industries and utility companies in Europe, the Middle East, India and China. The Americas constitute a large and attractive market and remain a significant opportunity for LOGO should the company choose to focus on this.

LOGO believes that growth and dynamism of their target customers requires flexible, scalable, best practice support services to maximise their market opportunities. LOGO, through significant investment in solution design, people and technology can offer a quality of support service beyond that of most, if not all, internal support services' departments. LOGO also believes that their customers gain considerable benefit from their focus on capturing data and insight across their portfolio of clients which provides the basis for continuous improvement.

### Objectives

What the business aims to achieve

### Market outlook

The environment the business operates in now and trends for the future

### Strategy

How the business intends to meet its objectives in the context of the market outlook

#### Operating model

How the business will deliver its strategy to effectively generate and preserve value

### D. Operating Model

LOGO's operating model is robust, and is centred upon:

- an organisation structure that is currently function based but is transitioning to being more client centric;
- progressive people policy and performance management; and
- technology.

The current organisational structure is typically arranged by type of service and has been significantly influenced by previous acquisitions. This is now being migrated into a structure that emphasises regions, clients and solutions, rather than service silos.

As the business becomes larger and more complex, and our clients place ever greater trust in us, the demands on our people increase. LOGO is moving to a global HR policy, and a principle of firm wide mobility and opportunities for our best people, underpinned by a rigorous approach to performance management that aligns employee efforts with client demands.

The strategy will require a rapid change to the new organisational structure, greater investment in the group's technology platform and in the key client account teams. The technology platform is critical both for delivery and also for the continuous learning that drives LOGO's differentiation.

#### Outcomes

Description of the outcomes delivered by the business, in terms of value generation and preservation, and how these relate to objectives

### E. Outcomes

LOGO is committed to significant growth in shareholder value that will be driven by:

- top line growth as the markets grow, as LOGO offers more to existing clients, and as LOGO expands geographically;
- profitability from economies of scale; and
- cash generation as margin growth outstrips the additional capital investment planned to support the development of the operating model and growth.

LOGO's success is predicated on its people, and LOGO is committed to being in the top 10 of the Economist's global employer survey.

LOGO also recognises its responsibility as a large, increasingly global organisation to the communities within which it operates. The company tracks the number of employee days spent contributing to the community and is committed to doubling this, and investing in coordination to increase impact, in the next three years.

LOGO will be focussing on three specific KPIs that help assess the implementation of the strategy:

- the proportion of revenues from primary industries and utilities;
- spend per customer; and
- scope of services per customer.

# Pitfalls to watch out for

In our opinion, there are a number of pitfalls for businesses to avoid:

**Lack of transparency** – it is important that there is a clear link between strategy, operating model and business outcomes to provide a coherent framework and discussion of how the business generates and preserves value in terms that are easily understood and that enhance transparency and management accountability.

**Lack of meaning** – there should be a clear and coherent description of how the business intends to generate and preserve value over the long term in terms that are meaningful and valuable to enable stakeholders to understand and challenge corporate decisions. The recent Kay review of UK equity markets recognised the negative impact of the provision of large quantities of reporting data that is of ‘little value to users’.

**No clear message** – there must be sufficient clarity of message of how the business is driving differentiation and long term value generation.

**Lack of linkage** – there should be clear linkage between the description in the business review, key performance indicators and key risks to the strategy and the business model. The strategy and business model is the context against which short performance described in the business review is set.

“Good quality narrative reporting can put the financial results in context, highlight important factors and communicate strategy and risks to investors in an understandable, engaging and concise format. Conversely, poor quality reporting can obscure key information in a morass of superfluous detail and marketing speak, lengthening reports and confusing investors.”

“High quality, succinct narrative reporting should be strongly encouraged.”

*‘Kay review of UK equity markets and long term decision making’, July 2012, 10.21 and recommendation 12, p.76*

# Questions for the board and/or audit committee to consider

Under the revised Code, issued in September 2012, in an expansion of the role of the Audit Committee, it was recognised that the board could ask the Audit Committee to advise on whether the business model disclosures provide sufficient information for shareholders to assess the company's performance, business model and strategy. Key questions the board and/or audit committee should consider include:

Question	Comment	Response
<b>Who should own the strategy and business model disclosures?</b>	<i>For companies with a Head of Strategy (or similar) the answer is relatively easy, but for others responsibility for these disclosures will largely rest with the CEO supported by his team, including significant input from the CFO.</i>	<i>It is vital that this section is not written in isolation – the messages need to be woven in with the business review in particular, but also reflected where necessary in the key judgements sections of the financial statements.</i>
<b>Do we need to reconsider our strategic planning process?</b>	<i>The issue here will be the frequency of the strategic planning process, since many companies adopt a “full strategic review” three or five year cycle – given the annual nature of this disclosure it is likely that strategic planning processes will need to be reviewed to accommodate, at least, an annual update.</i>	
<b>Have we considered our stakeholders and what they need to hear?</b>	<i>The stakeholder audience for these disclosures is diverse – and it is important to consider the wide range of potential interest groups – employees, investors, analysts, suppliers, regulators, NGOs.</i>	
<b>Are the disclosures consistent with our actual activities?</b>	<i>An obvious point but a crucial one – do the disclosures chime with the messages the company is currently regularly putting out into the market place?</i>	
<b>Does the description of our strategy and business model fit with our key performance indicators – i.e. with the way we run the business?</b>	<i>To be successful all layers of the operating model, the organisation design, the key performance indicators and remuneration must be aligned to the company's strategic objectives.</i>	
<b>Are expected changes to the business taken into account? e.g. if the business is undergoing a strategic review or facing considerable market or technology disruption?</b>	<i>There is an expectation that as far as possible the disclosure should encompass a description of future state, but the approach should also be capable of signposting where there are unknowns.</i>	
<b>How far have we gone with regard to outcome disclosures that may be commercially sensitive or proprietary?</b>	<i>It is not expected that any disclosure should be detrimental to the business' commercial position, but it should be a principle that the business will explain the fundamental drivers of value as clearly as possible, within the bounds of commercial sensitivities.</i>	<i>It should also be a principle that outcome metrics should be consistent year on year, unless the way the business generates and preserves value fundamentally changes. This will ensure that stakeholders can easily interpret year on year performance.</i>
<b>Has the disclosure balanced current and future activities effectively?</b>	<i>The relative emphasis between now and the future is likely to depend both on the point in the strategic journey and short term performance.</i>	
<b>Is the disclosure at a Group level or set out in business segments?</b>	<i>Whether business segments are described separately is likely to depend on the relative market capitalisation represented by each segment and the group's overall strategy.</i>	<i>Remember to make it clear how the segments fit together.</i>
<b>How does the disclosure fit with other parts of the annual report?</b>	<i>Linking all the parts of the Annual Report together is fundamental to telling a coherent story and setting short term performance in a strategic context. For example, the description of short term performance, remuneration and CSR disclosures will need to be set in the strategic context.</i>	
<b>Are there any implications for accounting decisions?</b>	<i>Areas to watch out for in the financial statements might include going concern and financing disclosures, impairment review assumptions, and the decision about whether a subsidiary is technically “held for sale” for example.</i>	

# Examples of strategy and business model disclosures that caught our eye

Coherent link between drivers, strategy, execution and KPIs

[http://investors.ttelectronics.com/pdf/Annual\\_Report2011.pdf](http://investors.ttelectronics.com/pdf/Annual_Report2011.pdf) pages 6 to 8

Clear meaning

[http://www.cobhaminvestors.com/pdf/Annual\\_Report\\_and\\_Accounts\\_2011.pdf](http://www.cobhaminvestors.com/pdf/Annual_Report_and_Accounts_2011.pdf) pages 4 and 5

Clarity of message

[http://corporate.sky.com/media/publications\\_and\\_reports/2012](http://corporate.sky.com/media/publications_and_reports/2012) page 9

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In addition to the wide-ranging programme of events and customised curriculum that we offer to members, the Deloitte Academy also provides complimentary use of the services at our purpose-built, state-of-the-art facility.

For further details about the Deloitte Academy including board training and membership enquiries, please contact Diane Slater on 020 7007 0768 or [dslater@deloitte.co.uk](mailto:dslater@deloitte.co.uk).

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