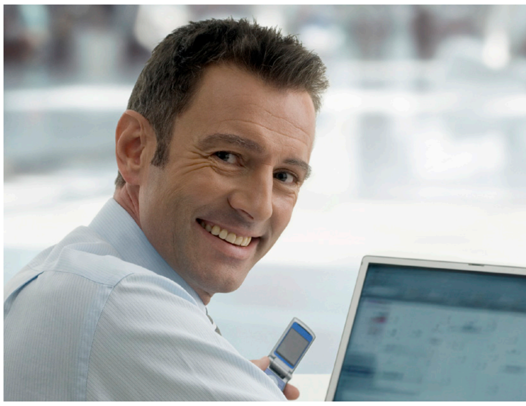
Business model redundancy
and the ***'Boiling Frog Syndrome'***

Remodel your business to stay ahead of the competition



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> “Current volatile cyclical forces are masking deep structural shifts in many industries.”

> “The wrong way forward in a structural shift is more of the same.”

Executive summary

The contraction of the economy during the Global Financial Crisis (GFC) has disguised the structural issues facing many businesses, introducing them to the ‘boiling frog syndrome’.

This metaphor is used to describe a business’ inability to react to significant changes that occur over time. If a frog is placed in boiling water it will react by jumping out; but when placed in cold water that is heated gradually, it doesn’t perceive the danger and will boil to death.

When businesses fail to react to structural forces, their business models are weakened and can become redundant. Such businesses will fall behind their competitors, both in the development of their business model and in securing market share.

Structural changes arise from: technological developments, regulatory shifts, changing customer preferences, product substitution, new market entrants and the introduction of enhanced business models by competitors.

As economic uncertainty continues, assessing the sustainability of your business model is essential.

Will you be the one of the successful companies that addresses structural change or will you fall behind your competitors as you succumb to the boiling frog syndrome?

Why do some businesses prosper during volatile conditions while others suffer?...

Structural change

Changes in an industry's structural components can significantly impact the future viability of your business. Structural forces include:

- Technological changes
- Changing customer preferences
- New market entrants
- Substitution of products and services
- Regulatory shifts
- Shifts in buying and supplier power
- Number and rivalry of industry competitors
- The introduction of new business models by your competitors

Cyclical volatility

The rate of contraction or growth, influenced by:

- Inflation, employment and gross domestic product (GDP) numbers
- Equity market movements
- Credit spreads and bond prices
- Interest rate movements
- Foreign exchange movements
- Sovereign credit ratings

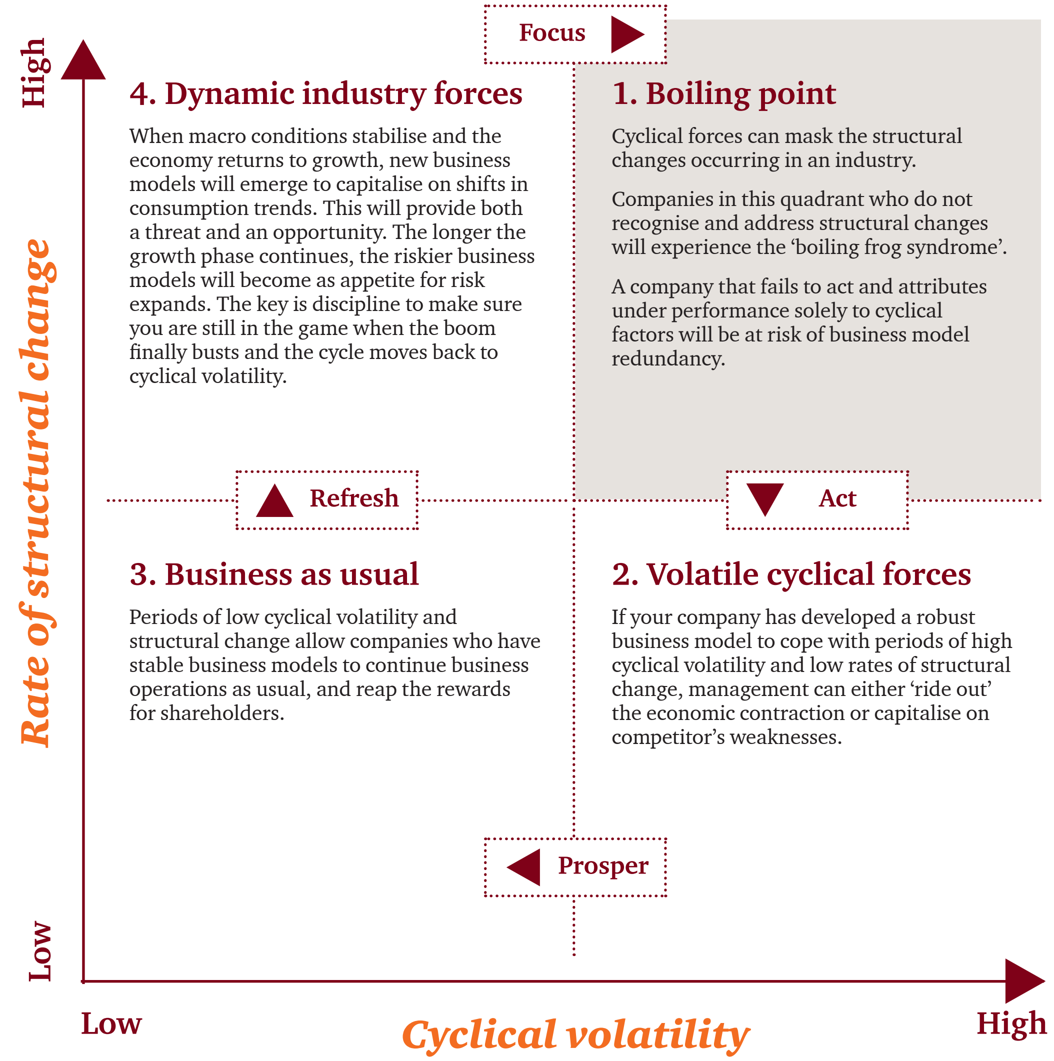
"There is a natural tendency to equate uncertainty with volatility and therefore cyclical forces."

...Successful businesses understand how to identify and exploit the emergence of new patterns

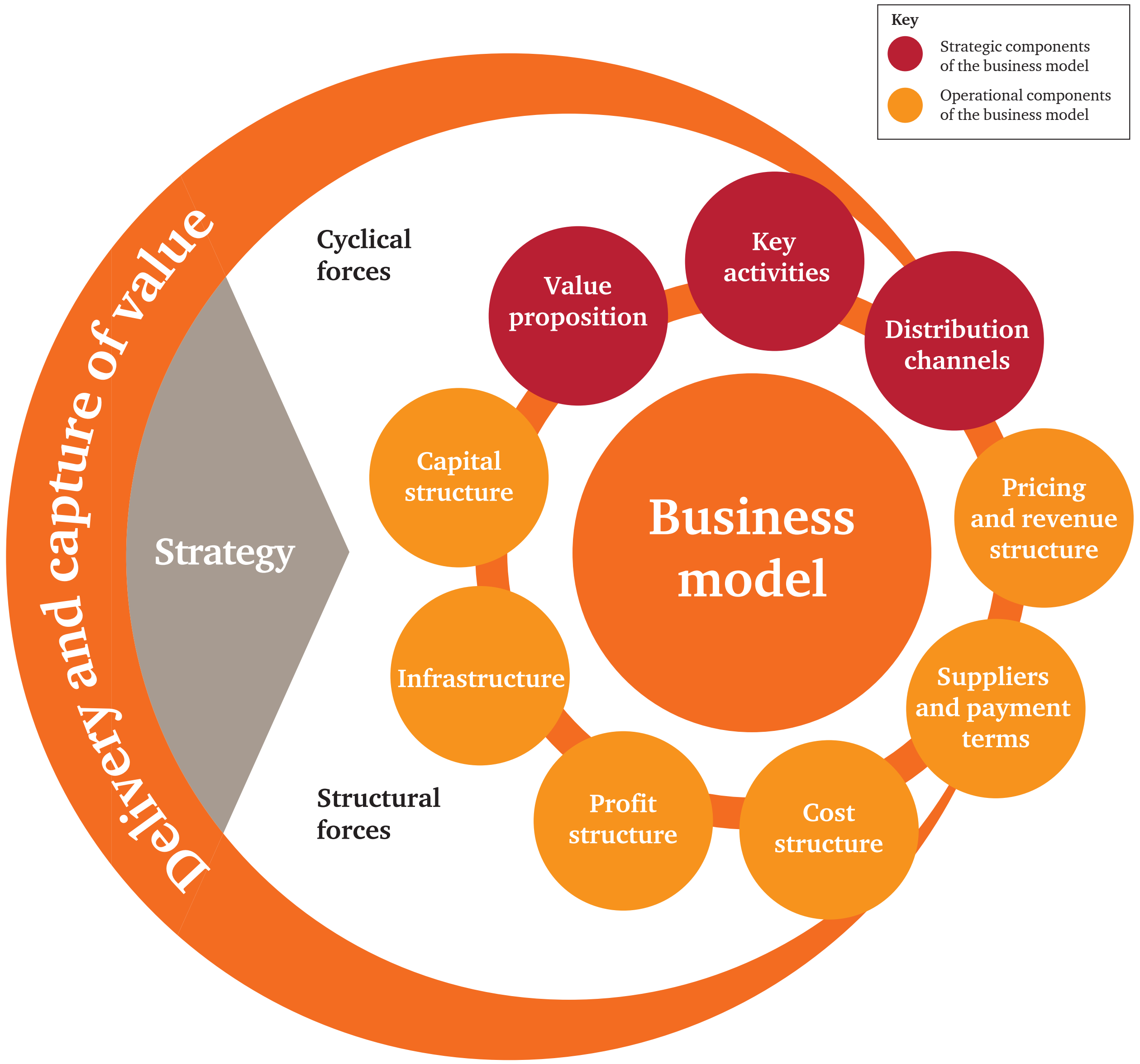
The diagram below illustrates that in times of uncertainty (quadrant 1) businesses can mistake long-term structural change for short-term cyclical volatility. This can cause a business to become oblivious to the emergence of new patterns in an industry, resulting in 'boiling frog syndrome'.

"Structural changes can lead to uncertainty and business model redundancy."

Causes of business model stress



What does a successful business model look like?



"In times of structural change old sources of competitive advantage weaken and new sources appear."

"A business model describes how a business delivers and captures value in order to make money."

What is a business model?

A business model describes how an organisation creates, delivers and captures value. The business model is a blueprint to deliver value to customers, implemented through an organisation's structure, processes and systems.

Strategic components of the business model

Value proposition

A concise value proposition should articulate the benefits that you can deliver to targeted customer segments. This should include the benefits and costs of your market offering, your impact on the customer, unique selling point relative to competitors and track record to support the proposition.

Key activities

Activities should be aligned to an organisations value proposition. Many successful business models include outsourcing of non core activities or removal of activities that do not add value to the end customer.

Distribution channels

Critical decisions for distribution channels include weighing up the opportunities and costs of different models, including direct vs. indirect, exclusive vs. non-exclusive outlets and e-commerce vs. bricks and mortar channels to market.

Operational components of the business model

Pricing and revenue structure

Traditional pricing structure options for businesses have included cost-plus, mark-up, target return and value driven models. However, in the last decade new pricing models have added complexity and therefore risk. New structures include freemium, bait and hook, subscriptions, bundling and open source to name a few.

Suppliers and payment terms

A business model that involves price competition should contain tight working capital policies. This means managing inventory and receivables days with discipline, including short credit terms and the willingness to accept stock-outs in order to avoid holding excess inventory. On the other hand a niche player is more inclined to extend favourable credit terms to reflect a business model that charges higher prices.

Cost structure

A business model with a low fixed cost base has lower levels of risk, but will not achieve the benefits of operating leverage during boom times. Alternatively a business with a high degree of operating leverage (relatively high fixed costs) will benefit from scale and volume.

Profit structure

A high volume business model is more likely to generate low margins, while a high margin business can be profitable with low volume. However, it is critical that management act if there is a deterioration in either volume or margin. The most successful business models can be characterised as having the attributes of both high margin and volume.

Infrastructure

The degree of capital intensity of business models can vary significantly. Generally speaking, the higher the capital intensity the less valuable the business model; the reason being, capital expenditure is a drag on free cash flow generation and the hurdle to generate returns on capital employed is higher. However, a high degree of capital intensity in some industries can act as a barrier to entry, providing a market structure where superior returns can be generated.

Capital structure

A business can finance its operations through debt or equity. The optimal capital structure should be targeted to maximise the value of the business. Debt is generally cheaper than equity and can magnify returns on equity. However, businesses with a high degree of operating leverage (fixed costs) should match the level of debt to the variability in cash flows, to manage financial risk.

Boiling Frog Syndrome: The warning signs

There are a number of indicators, which help to determine whether your business is under pressure and at risk of experiencing a distressed business model.

- Short to medium term forecasting is difficult.
- Your market share and profit margin of core product lines are declining.
- Your business competes heavily on price and you're continually required to respond to price competition by discounting.
- There is an overall feeling that the company needs to change its ways.
- There is no real sense of where your business will be in three to five years time.
- Economic cycles rather than business structure are blamed for loss of sales.
- Overheads are growing faster than sales.
- A defined target market is blurred as the business tries a scattergun approach to capture as many customers as possible.
- The strategy is not working or there is no strategy at all.
- High stock on hand coupled with low stock turnover.
- Customer preferences are changing but you have not revitalised your business model to adapt to these changes.

"PwC's Private Clients team have the experience and expertise to remodel your business"

Client case studies

Business model renewal for a publishing company

Like many of its competitors PublisherCo was being negatively impacted by a convergence of market pressures, including changing consumer preferences, rapid technological change and cyclical fluctuations in exchange rates. PublisherCo had reached a boiling point, finding themselves unable to adapt to the realities of the digital publishing era. This required a fresh approach to identify and deliver new sources of value to remain sustainable in the long-term.

PwC worked closely with the CEO and other key stakeholders, delivering a comprehensive plan that evaluated ways to improve cash flow, strategically reduce costs, refocus business strategy on core publications, and identify new opportunities for digital transformation. We presented a 3-stage roadmap to renew and reconfigure the organisation to capitalise on opportunities in the changing competitive landscape. PublisherCo has subsequently implemented a number of the initiatives put forward by PwC to help future proof their retail and publishing operations.

Business model transformation for a global logistic company

TransportCo is a Private Equity backed global logistics provider, with an international footprint covering 5 continents and 72 countries. The company was facing a number of structural changes in their industry, including industry consolidation, increasing use of technology, and the need for standardised global processes. TransportCo approached PwC for assistance in transforming their global service delivery model and cost structure to remain competitive.

In conjunction with the management team, PwC developed a six-point plan that set out a roadmap for global restructuring across key areas of the business model including, infrastructure, key activities, organisational structure, and cost base. This provided the CEO with a clear pathway to implement a leaner and more efficient business model to improve the company's competitiveness on a global scale.

Business model design for an innovative technology company

One such example of a company that has identified and exploited the emergence of structural patterns in its industry is virtual data room provider Ansarada. The company, which caters exclusively to those involved in mergers & acquisitions, has been able to grow sustainably and increase its market share against a backdrop of declining deal volumes. Rather than engaging in more of the same, Ansarada took advantage of technological change to enhance the value provided to customers and establish new sources of competitive advantage.

PwC recently worked with the management team of Ansarada to visually represent their business model in a simple and logical way. We developed a conceptual framework to uncover key inter-relationships and value creating interactions within the organisation. Following a workshop with the executive team at Ansarada, PwC developed a visual representation of the company's business model to communicate how the organisation is aligned to deliver and capture value.

For more information on Ansarada, please visit: *www.ansarada.com*

" Working with PwC's Private Clients team was a great experience. They delivered on time, on budget, and most importantly they provided valuable commercial insight to our business. The business model design is now a focal point in our new offices "

Sam Riley
Ansarada CEO

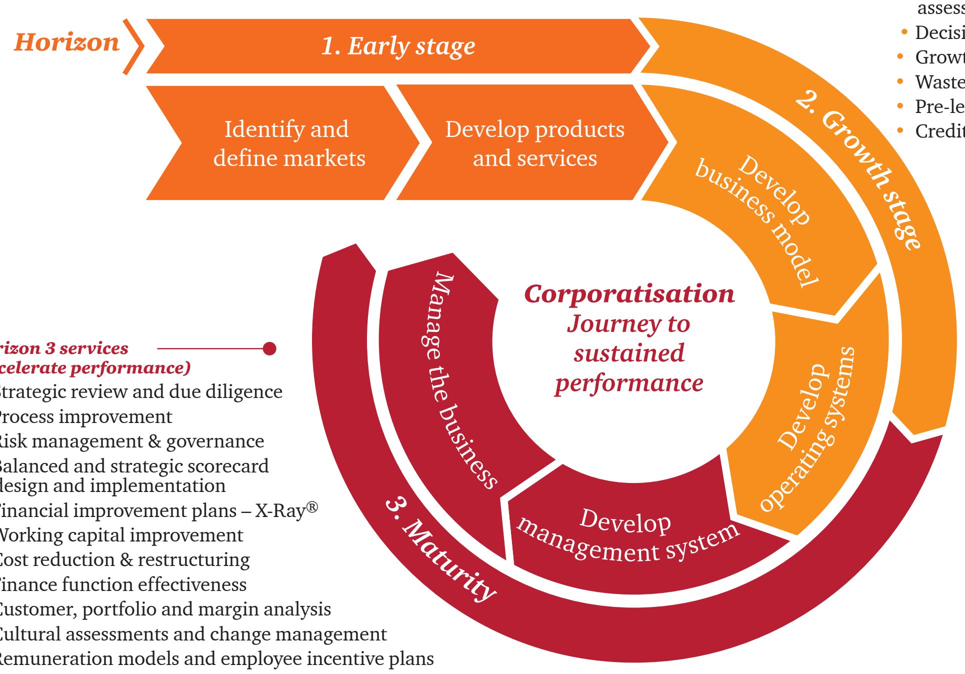
PwC have the experience and expertise to advise on how to re-model your business

PwC has worked with a large number of businesses to design and build more sustainable business models. From our experience we have built a knowledge bank of attributes that define the most successful business models that can be used to make your business stronger.

Private Clients Advisory – service offering

Horizon 1 services (Definition of business potential)
- Commercialisation plans, R&D and grant assistance
- Commercial due diligence
- Market research and industry analysis
- Competitor analysis
- Customer and product research
- Business plan design and review
- Business case development
- Financial modelling

Horizon 2 services (Roadmap)
- Financial Health Assessment – Financial X-Ray®
- Strategy design and strategic planning
- Business model design and review
- Activity based management and value driver analysis
- Value and wealth creation plans
- Organisational design and evaluation
- Capabilities and resource assessments
- Decision support analysis – what if Financial X-Ray®
- Growth 100 day action plans
- Waste audits
- Pre-lend reviews
- Credit risk assessments – Bankers X-Ray®



Horizon 3 services (Accelerate performance)
- Strategic review and due diligence
- Process improvement
- Risk management & governance
- Balanced and strategic scorecard design and implementation
- Financial improvement plans – X-Ray®
- Working capital improvement
- Cost reduction & restructuring
- Finance function effectiveness
- Customer, portfolio and margin analysis
- Cultural assessments and change management
- Remuneration models and employee incentive plans
- Succession planning

Contact us to discuss how you can maximise the potential of your business model

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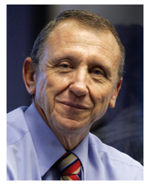

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"Businesses who sell undifferentiated products are increasingly competing on price. Unfortunately for many businesses, price competition is unsustainable."

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