



# Getting the Business Future Fit

Communications companies are undertaking a variety of cost containment and cost reduction programs to address immediate business challenges. Our experience suggests that, while essential, such programs will at best enable them to keep pace with escalating competition and market erosion through the end of 2009. To ensure sustainable competitive advantage from now on, companies should also focus on getting fit for the future. For many, that effort means breathing new life into the organization by simplifying the operating model to strip out unnecessary complexity. The benefits should include enhanced flexibility, greater tax efficiency, and long-term cost control—essential qualities, all, for high performance in a fast-changing marketplace.

As communications companies have grown and evolved over time, so has the underlying complexity of their business models. A combination of factors has contributed to this trend, including:

- Organic growth, mergers, acquisitions, divestments, and joint ventures.
- The increasing burden of regulation and compliance.
- Multiple sales and distribution channels for various complex products (e.g., bundling) and offerings (e.g., limited period discounts).
- Complex management structures to provide governance and oversight.
- Measures designed to address evolving tax and other legal risks and opportunities.

During the last decade, the relatively benign business environment masked the negative impact of this underlying complexity. However, with the onset of the global recession, the operating models of all companies were put to the test and, in many cases, were found wanting. Instead of being equipped to cope with the profound challenges that arose, many communications companies found that their operating models (and underlying systems) were too complex to enable the flexibility and efficiency needed to deliver business strategy in an uncompromising market.

Now, as communications companies look to the future, the focus is shifting from short-term cost reduction programs to wider structural and transformational change initiatives, often accompanied by major systems investments. In other words, with immediate survival now assured, the priority is to ensure that the organization is agile and future-fit. As companies in all industries are already finding, corporate simplification has a vital role to play in this process.

## Evaluating the business

Moving toward future-fitness does not mean simply conducting a review of the company's business model and value proposition. Companies must be prepared to undertake a thorough evaluation of the whole business. Only then will they be equipped with the understanding they need to begin rationalizing their operating models.

Figure 1 presents the key elements of any business operating model, all of which companies must assess fully when they seek to identify opportunities for corporate simplification. For a communications company, moving beyond "what is our aim and go-to-market proposition?" requires effectively aligning the company structure and determining where the key decisions are made. Decisions must be made on such business interactions as global brand management and statutory reporting between local operating companies and the group. Effective resource management must support the decision-making process and ensure that the skills are appropriately deployed across the group structure.

The process of evaluation should take account of where the business is today (in terms of existing structure, costs, complexity, and opportunity) and where it needs to be tomorrow. Important questions to answer address customer/supplier trends, changes to business management structures, and tax optimization opportunities. Critically, companies must also consider just how big is the organization's appetite for change? Will radical change succeed, or does the prevailing culture favor incremental change programs?

The next stage is to identify, as precisely as possible, where value is being generated (and is likely to be generated) in the business. A whole range of areas must be considered, from managing and servicing customers to the process of developing profitable products

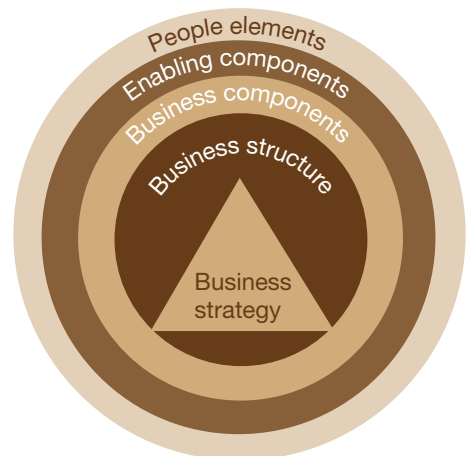
and services, ensuring billing accuracy and regulatory compliance, maximizing brand value, optimizing network asset management, and managing alliances and partnerships.

Having obtained insights into those areas of present and future value creation, management must ask what the insights mean for the business operating model. Key questions for consideration here include the appropriate level at which strategic and operational decisions should be made (i.e., what should be decided locally, regionally, or globally?); the nature and location of all tangible and intangible assets owned by the business; the extent of the operational activities that are being undertaken (are they being performed locally, and if so, are there any opportunities for simplification?); and the extent to which key support functions (e.g., information technology, finance, and procurement) can be shared across the organization.

## Making the case for change

Once this evaluation process has been completed, management should have the insights it needs to describe and make a compelling case for operating model rationalization. As well as providing a real impetus for action, this thorough evaluation ensures that when any change

Figure 1: Operating Model Framework



initiatives are introduced, the impacts and benefits can be clearly articulated to all stakeholders.

This article suggests three specific ways in which communications companies can set about rationalizing their business operating models.

Each is already being used to good effect by companies to secure significant ongoing financial and operational benefits. And each can be structured tax efficiently, which will help to limit the cost of direct and indirect taxation while providing protection against exposure to tax and regulatory risks.

Crucially, because they also eliminate some of the deeper root causes of cost, these approaches all enable operators to focus on responding to changing market conditions and customer needs in a more agile way, while continuing to drive forward with their overall business strategy.

For some organizations, just one of the models may be relevant, while for others, a combination could be appropriate. The models, which are summarized below, are:

- **The centralized services company.** This model centralizes services (e.g., procurement activities) to enable savings from global and/or regional sourcing.
- **The limited-risk sales company.** This model provides a single point of contact for customers on a global or a regional basis.
- **The centralized content company.** This model centralizes content creation, acquisition, and distribution (e.g., premium TV channels or data content).

## Moving toward successful business simplification

Before explaining the benefits of these three models in greater depth, it is important to establish the ground rules for successful change initiatives.

Unless they are implemented within the context of a shared, holistic vision of a business strategy for the future, projects that seek to transform the operating model risk failing, and they may even harm the business. Examples include the following:

- In responding to the current economic environment, many organizations have adapted their operating models to include a range of cost-cutting and change projects, often without understanding the interrelated impact such projects will have on the way the business is managed.
- Information technology (IT) projects, while generally designed well and engineered from a technical perspective, often have disappointed because they have not been implemented to take account of what the overall business should look like (e.g., the degree of process standardization required or the extent of managerial decision making).

When making any fundamental change to the business operating model, being aware of the complex nature of such an undertaking is vital. There are multiple dimensions of the business to consider, such as legal, contracts, regulations, IT, and finance, each of which typically will be further encumbered by legacy practices, processes, and systems. Consequently, a systematic and holistic approach to implementation is essential.

Effective communication is key. The benefits of change need to be clearly articulated to all those likely to be affected, with an emphasis on transparent, unambiguous language to help bridge differing perspectives and allay uncertainties. Significant resources should be invested in education to make sure that all those affected fully understand how the business will work using the new model.

And, change must be coordinated and comprehensive. Business functions, such as finance and IT, will need to work toward clear objectives, with milestones in place to ensure that the overall business infrastructure is ready to support the new model.

### Model 1: The centralized services company

**Current position.** In most large operators, the traditional services model has procurement decisions being made at the local-operating-company level, with limited coordination by the group's central organization. While this model may offer greater local control over supplier relationships and contracting, clearly it leads to some significant disadvantages to the group overall. Because collaboration between procurement units is limited, enforcing global policies and standards can be difficult. Also, oversight of group-wide procurement activities may be limited.

There will be limited aggregation of spending, meaning that companies often fail to take full advantage of opportunities for bulk discounts. Disconnects between individual procurement functions often mean potentially unnecessary inventory holdings and inadequate management of demand. And the company may be prevented from capturing tax savings that would be available to a more centralized procurement function (because individual procurement functions are not measured on their tax efficiency, it is unlikely that they will be focused on tax optimization).

**Opportunity.** A trend that is emerging for centralizing procurement uses one of two models—centralized or center-led—both of which allow for savings and value from global or regional sourcing to be captured in a tax-efficient way. Centralized models consolidate all purchasing decisions with one team in one location,

potentially saving significantly on taxes, depending on the location of this central team. Center-led procurement models have a central team manage common supplier groups, with local teams executing framework agreements.

In the experience of PricewaterhouseCoopers, leaders in procurement across all industries tend to manage centrally and deliver locally, adopting a center-led rather than a fully centralized approach. The hybrid center-led model balances the advantages that centralized coordination offers with the need for local responsiveness. Furthermore, in complex, distributed enterprises, complete centralization is not always practical or even desirable.

As part of the process of evaluating opportunities for centralizing procurement, the following key points should be considered:

- Which aspects of procurement are best suited to a centralized and which to a center-led procurement approach—and should the model be structured to attract value to a low-tax location?
- Given the footprint of the countries involved, which countries offer the best opportunities for enhancing savings in a commercial environment (in the short, the medium, and the long terms)?
- What functions and which people should be included in any centralized or center-led function?
- What are the practical considerations involved (e.g., hiring people, language skills)?

**Benefits.** Both the centralized and the center-led models offer significant financial and nonfinancial benefits, provided that the operator is willing to commit the required organizational and system resources needed for successful delivery.

In our experience with communications companies, the financial benefits of successful centralization can include cost savings delivered through efficiently managing demand to reduce overall consumption and inventory holding as well as through economies of scale. Those economies are possible especially on large spending categories—networks, for example, and devices such as mobile handsets, routers, and set-top boxes.

Additional financial benefits flow from eliminating duplicate or conflicting procurement efforts. They result from optimizing the organizational structure from a tax perspective (taking account of tax planning, transfer pricing, and attribution of profit across the group). Revenue growth and differentiation, also, can be obtained through access to innovation from partnerships with strategic suppliers and from competitive advantage through speed to market.

Successful centralization has delivered valuable nonfinancial benefits to our clients as well. Among those benefits are the opportunity centralization provides to create a center of excellence for procurement vision and policies, with streamlined supplier collaboration, along with mitigating risk through improved contract relationships and contingency planning. Companies benefit from utilizing assets and managing cash flow better through improved visibility and demand forecasting; from harmonizing standards and increasing levels of internal control; and from improving decision making across the organization through centralized management information.

### **Model 2: The limited-risk sales company**

**Current position.** A significant number of communications companies have businesses in multiple countries worldwide, and

most of them still undertake the majority of their sales on a local basis. This selling model was satisfactory when most customers were also decentralized or could be managed at a regional level. But to manage large global customers (an area in which most communications providers have experienced growth), operators must undertake a significant amount of administrative effort. They must make certain they not only maintain the agreed-upon levels of customer service and support, but also ensure that revenue and cost charges are allocated appropriately to each local operating company.

A localized sales model can increase the potential for sub-optimal commercial decisions, due to a lack of visibility over contract delivery costs and conflicting incentives. The multiple transactions that result are inefficient from both a cost and an indirect tax perspective.

**Opportunity.** Increasingly, customers are demanding a single point of contact from their global communications provider, along with standard products, services (e.g., billing), and terms and conditions. This demand—combined with intensive competition, downward pressure on margins, and high costs associated with the duplication of functions within local countries—has provided a catalyst for many multinational operators to evaluate their selling structure, again opting for a more centralized model.

We have helped a number of clients refocus local operations to concentrate on delivering services and maintaining local customer relationships, while the central group develops the overall sales strategy and product and service offerings. Centralizing the sales organization also enables companies to obtain superior insights into global customers' needs as well as the cost to serve them and into the impact this cost has on pricing strategies.

By selecting an appropriate location for the centralized sales organization, companies can achieve substantial tax savings.

**Benefits.** A centralized selling organization can generate significant benefits for communications providers that operate across multiple territories. These benefits include creating a simplified, flexible organization that can respond more rapidly to commercial and operational challenges; centralizing risk, core functions, P&L accounts, and key decision makers into a single entity, allowing local countries to focus on service delivery; and reducing the volatility of local operating company results by moving market risks to the center.

Additionally, because of significantly reducing inter-company transactions and cross-charges, there is a real opportunity to introduce both pricing consistency and a harmonized transfer pricing approach across countries, thereby simplifying

implementation and documentation requirements. As with Model 1, the limited-risk sales company model also creates opportunities for significant tax benefits by locating the central company, along with its key decision makers and the associated risk, in a tax-efficient jurisdiction.

**Model 3: The centralized content company**

**Current position.** Within many communications providers, the acquisition and delivery of content is left to local operating companies due to historical or legacy practices or the need for specific localized content. This approach means that, potentially, groups are missing opportunities to realize savings and efficiencies from a more coordinated, centralized approach.

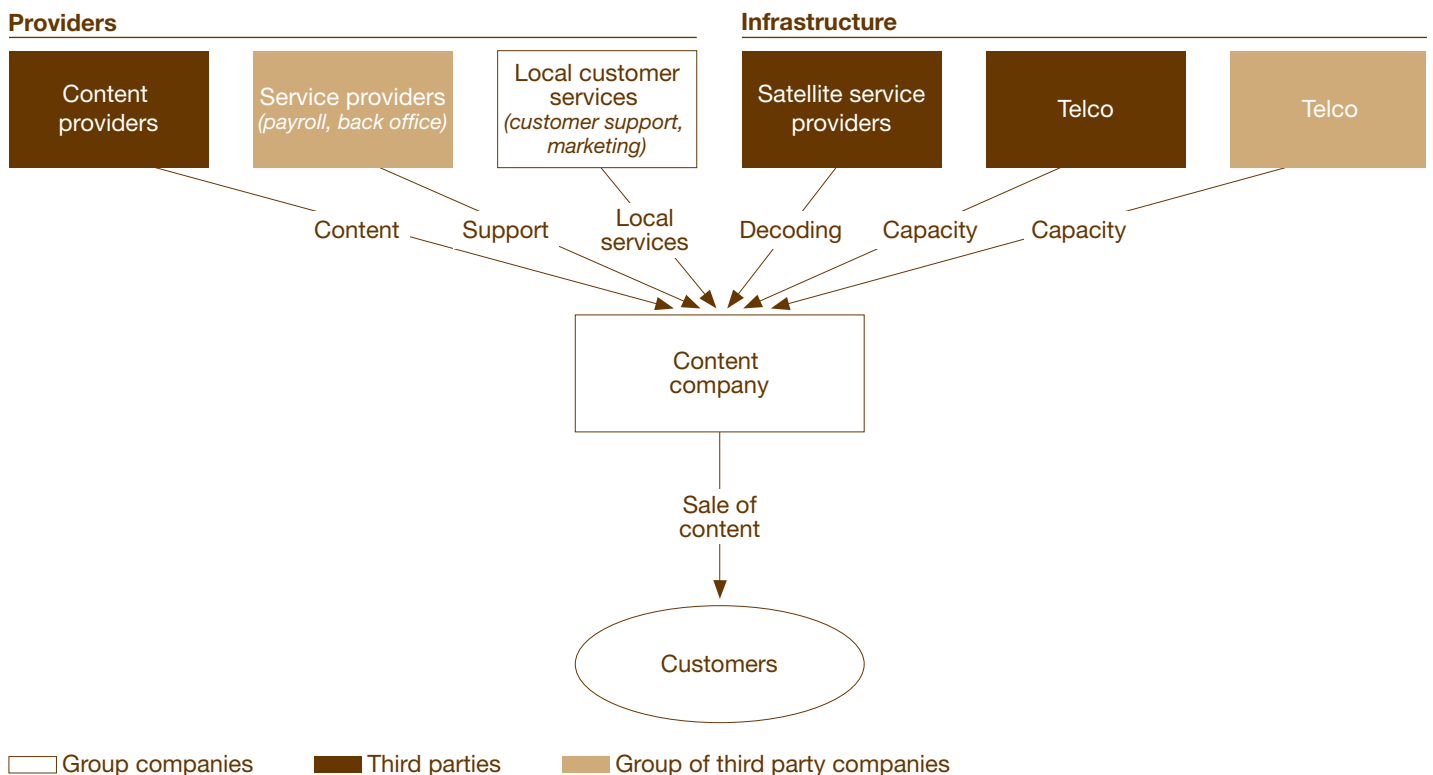
**Opportunity.** The centralized content company model creates an organization focused on acquiring and delivering content directly to customers. This company buys content from third-party providers

or commissions and funds in-house content development. The company packages and sells this content to customers, and it is responsible for buying or leasing the technical infrastructure required to deliver the content effectively.

This company can outsource support services, such as payroll services, back-office finance, and human resources, to third parties or to other parts of the organization. In-country operations can provide marketing and customer support. The content company of this business model (see Figure 2) is also able to take advantage of beneficial incentive programs that various countries offer for broadcasting and content-generation activities undertaken in their territories.

**Benefits.** As with the centralized services company model, the content company enables a range of financial and nonfinancial savings. In our experience, financial benefits have included volume savings achieved

Figure 2: Content Company



by consolidating content acquisition in one company; an improved negotiating position with content providers for promotional spending; and (by locating in a favorable jurisdiction) the realization of direct and indirect tax savings.

Nonfinancial benefits include streamlining and simplifying content acquisition processes and developing best practices. Because content can be acquired consistently, the business infrastructure is simplified and resource duplication can be avoided quickly. Technical benefits such as network capacity and quality can be obtained.

## Looking ahead

Communications providers have undertaken a variety of cost reduction programs to help them deal with the recent challenging trading environment. The current situation, however, provides an ideal opportunity for them to comprehensively review and transform their operating models.

A complex corporate operating model can be costly to manage and to maintain. It can create a number of specific challenges as well, not the least of them concerning impaired operational efficiency. Change is never easy, and successfully implementing any (or all) of the three models outlined in this article represents a significant challenge.

For that reason, and to ensure that the potential savings are real and sustainable, companies should be aware, from the outset, of the principal issues that need to be addressed. Very much in brief, and grounded in our experience, priority areas for attention should include:

- **Aligning the business, tax, and legal models into one integrated operating model.** The temporary disruption to the organization must be compared to the potential ongoing benefits of the new business model.

- **Choosing the jurisdiction for the central company.** The most suitable location will be based on a range of factors, such as the location of existing operations and infrastructure, the availability of attractive tax rates, efficient transport links, and access to talent.
- **Restructuring activities in order to implement the new business model.** Existing roles may need to be relocated or redefined (people issues often are the most difficult to resolve).
- **Changing relationships.** With suppliers, with customers, and within the wider organization, many relationships will need to be changed.
- **Restructuring data and systems needs.** The new organization must have access to appropriate management information, consistent with their decision-making responsibilities.
- **Complying with regulatory constraints.** Compliance must not be overlooked.

Provided that the points above remain front-of-mind throughout, the size of the prize at the end of a successful implementation can be significant—potentially enormous financial benefits, combined with a cost-effective, risk-compliant, tax-efficient, and flexible organization that is truly fit for the future, whatever it might hold. This is a reward that a growing number of communications companies around the globe have already judged to be well worth the effort.

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