Retrench or refresh?

Do existing business models still deliver the goods?

Economist Intelligence Unit | The Economist

Foreword

Do existing business models still deliver the goods?

Most companies need to review, and possibly renew, their business models. This report, written in cooperation with the Economist Intelligence Unit, reviews issues around the resilience and robustness of business models over the past 18 months and how they may fare in the future.

A key finding of the research indicates a lack of urgency, even complacency, among two-thirds of respondents, when faced with the need to change the ways they do business.

Most organisations surveyed turned to cost-cutting at the outset of the recession, and only a small percentage appear to have taken opportunities to better position themselves as the upturn comes.

We believe that this report will stimulate boardroom discussions about strategic options, and will trigger the move from retrenchment to fresh thinking to capture the fleeting opportunities available.

David Maxwell
Partner, National Leadership Board
Grant Thornton UK LLP

Contents

Foreword
Do existing business models still deliver the goods? 2

From the Economist Intelligence Unit:
Introduction
About the report 3

Executive summary
The case for business model change 5
Do existing business models still deliver the goods? 6

Findings
Few illusions about growth prospects 8
Unequal opportunity? 10
Playing defence when they need to score 12
Battling complacency 16
Converting risks into opportunities 22

Conclusion 25

From Grant Thornton:
Model behaviours 27
Heads in the sand 28
Ahead of the curve 30
Fighting the last war 32
Best before 34
Moving to the margins 36
Hitting the panic button 38

Business models – the challenges
Views from the experts 40
What changes in business models are needed if companies are to survive in today's uncertain economic climate? 41
What should business leaders focus on to survive? 45
What are the weaknesses in today's business models? 49

Seize the moment
Put business models on the board agenda 52

Contributors 54

Introduction

About the report

What is a business model?

The concept of the business model defies easy definition, there being no consensus in academic or corporate circles on its constituent components. Most would agree, however, with the notion that it represents the essence of the business, or the value an organisation strives to provide and the ways and means it uses to provide it. The business model is distinct from strategy, although changes to the former often reflect strategic choices.

For the purposes of this study, we identify five components of the business model:

The value proposition, or the benefits that a company's products or services provide to its customers.

Target markets: the customer segments and product and geographic markets a company aims to serve.

Revenue-generation mechanisms: an organisation's revenue and pricing models – for example, its decisions to earn revenue through direct sales, licensing, franchising, subscription or other mechanisms.

Cost structure, or the balance of fixed, variable and other costs within the organisation.

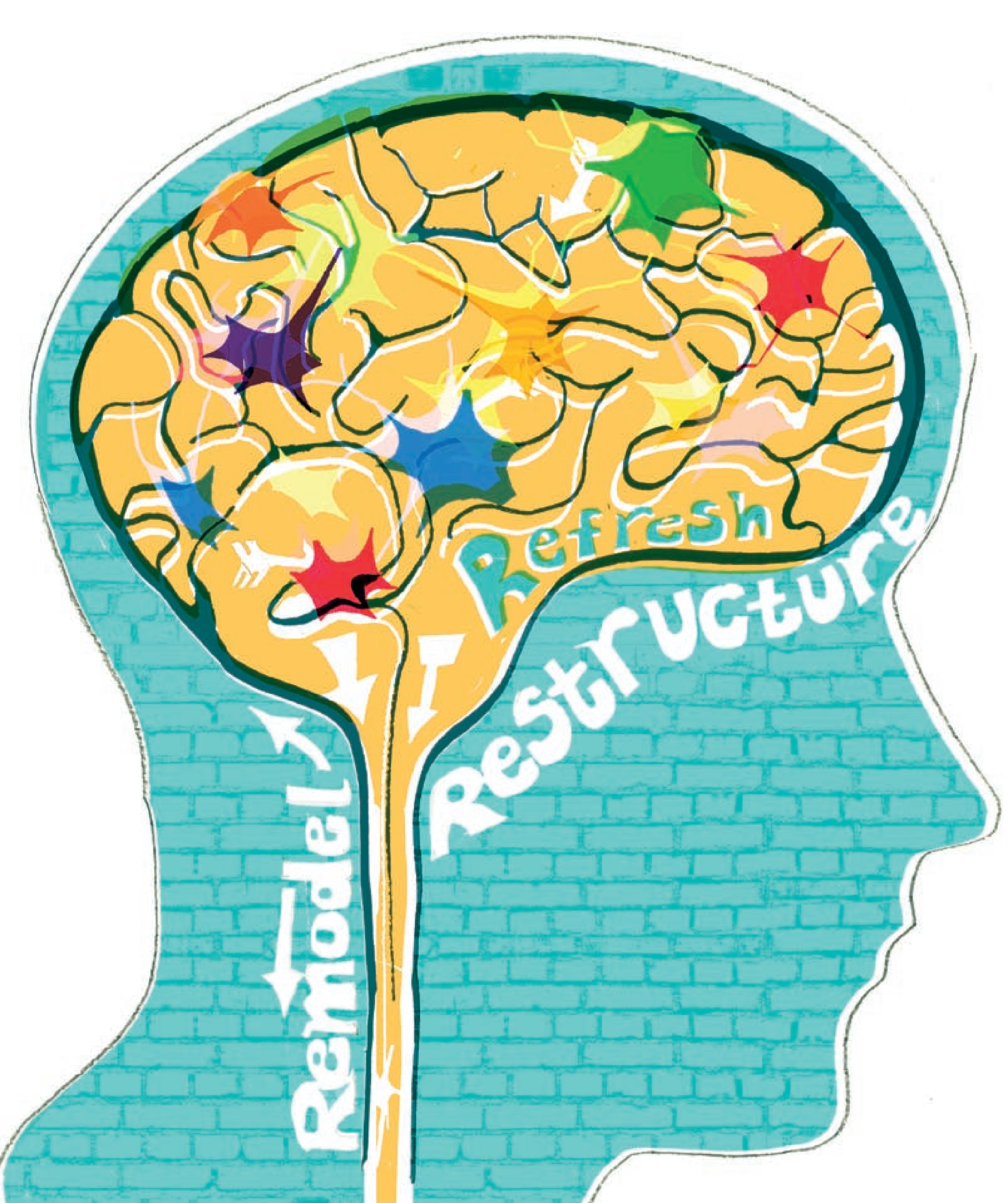
Value chain, combining a company's supply chain and the sales and distribution channels it uses to deliver its products and services to market.

About the research

The analysis in this study is based on a survey of 396 senior executives in the United Kingdom and 69 in the Republic of Ireland – 465 respondents in all – conducted by the Economist Intelligence Unit in October-November 2009. The survey sample was senior, with half of respondents being C-level executives, and hailed from a wide range of industries and company sizes. To complement the survey, the Economist Intelligence Unit also conducted a series of in-depth interviews with corporate leaders in the UK.

This paper is the first in a series of four reports on business model change in the UK and Ireland. Three subsequent briefing papers will focus on business models in the construction and property sector, the media sector, and the retail sector. All content was written by the Economist Intelligence Unit with the exception of the foreword, model behaviours and perspectives presented after page 26.

Please note that not all survey data shown in the charts add up to 100% because of rounding or because respondents were able to provide multiple answers to some questions.



The case for business model change

The UK and Irish economies are enduring their worst recessions since the Second World War. The Economist Intelligence Unit expects that GDP, after a significant decline in 2009, will edge only slowly back into the positive zone in the UK in 2010, and that Ireland will not emerge from recession until 2011.

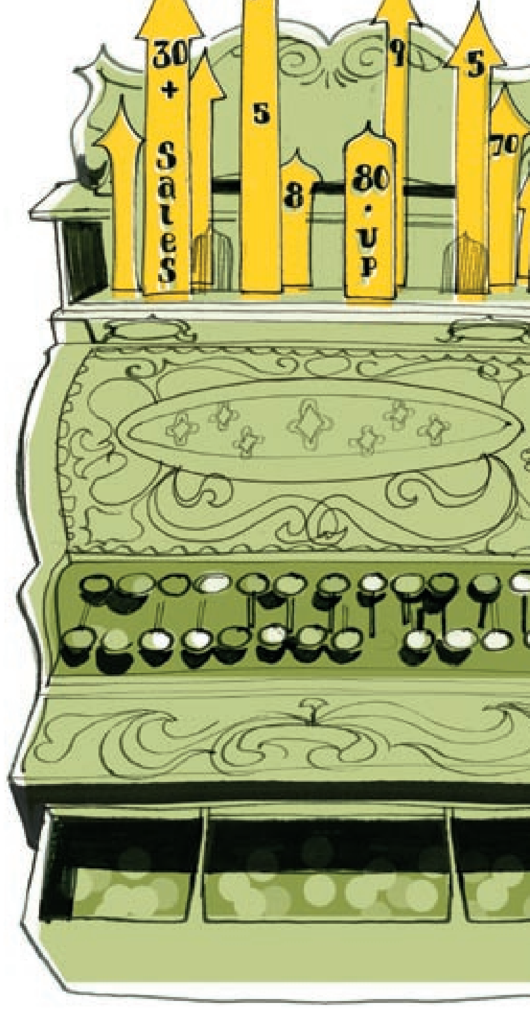
Although painful, the unique circumstances of a downturn can act as a 'burning platform' for companies: an opportunity, driven by urgency, to change their business models – the core objectives they pursue and the ways in which they operate. But are companies ahead of the curve, seizing opportunities, or do they have their heads stuck in the sand? A survey conducted by the Economist Intelligence Unit for this study finds that little more than one-third of companies in the UK and Ireland are pursuing, or plan to pursue in the near future, changes to their core products, target markets or revenue-generation mechanisms meant to position themselves for renewed market growth[1].

Most companies, however, exhibit complacency about the need to pursue innovation in their business models, believing that adjustments to cost structures are sufficient while market conditions remain tough.

[1]When asked in which areas their company plans to make significant changes to its business model in the next 18 months, 37% of survey respondents cited target markets, 35% the value proposition and 31% revenue-generation mechanisms, while 46% pointed to the cost structure as a focus of change.

Executive summary

Do existing business models still deliver the goods?



Over the next 18 months, the majority of UK and Irish companies surveyed for this study seem focused on survival rather than looking to business model changes that could position them to meet domestic and global competition when conditions improve.

Following are the key findings of the research:

Business model change has been overly cost-centred and left many companies unready for the future.
Eighty-six percent of executives claim their companies have adjusted their business models in some significant way as a result of the downturn. For the majority (63%) of companies, however, the cost structure has been the dominant focus of changes, although a minority have also pursued change in their value proposition (38%), revenue generating mechanisms (34%) or target markets (32%). Cost control is always important, but companies risk leaving themselves open to threats from rivals that are innovating more broadly. Fully one-third of companies admit that the assumptions in their business models will need an overhaul as a result of the recession.

By concentrating on cost, companies may be missing opportunities to use business model innovation to address future risks.
Cost structures will remain the central focus of business model change in the next 18 months, according to survey respondents, although to a lesser extent than in the recent past. Expectations of input prices rises and new climate change regulation, however, among other things, suggest both risks and opportunities for companies that more ambitious innovation in supply chains and new product and service development could help them address.

Executives are pessimistic about a rapid return to market growth.
Over half of those surveyed expect recovery in the main markets in which they operate to take 18 months or longer. Moreover, modest predictions about demand growth are, respondents say, the biggest uncertainties among their current business assumptions, with most emphasising downside risk. Such caution is in line with the Economist Intelligence Unit's own forecasts for the UK and Ireland, which see "little to suggest that a sustainable robust recovery is imminent".

Complacency is preventing more widespread business model innovation.
A worrying strain of complacency among British and Irish companies is revealed in the survey. Nine in ten (89%) executives believe that their company's business model is set up to let them succeed over the next year and a half. Most respondents also seem to believe they will be able to get funding from their preferred source, even given the dire state of the financial sector. And over one-third of companies believe that competition will stay the same, diminish or fragment as a result of the downturn, even though competitors from within the industry, as well as from adjacent sectors and other countries, will be driven to find new markets and products.

Perhaps more worrying than complacency towards the need for change is a perceived inability of management to engineer change. One of the top two barriers to business model change cited by survey participants is the capability of their management to lead it. As one interviewee puts it, "there is an element of head in the sand". But while British and Irish companies may have been able to prosper during the good times with a 'business as usual' approach, they will need more meaningful change if they are to fully prepare themselves for life after the recession.

Findings

Few illusions about growth prospects

Downturns are more than times of economic destruction; their very harshness can also induce rapid innovation across companies. This study – relying on a broad-based survey of over 450 senior executives and in-depth interviews with 11 corporate leaders – investigates how business models, and the assumptions which underpin them, are changing in light of current conditions.

The current economic malaise is hitting Britain and Ireland hard. UK GDP dropped by 4.7% in 2009 and Irish GDP by 7%. The UK's decline is tougher than most suffered by European Union (EU) countries, and about twice as severe as the downturn in the United States. Ireland's GDP contraction is the worst among the EU's pre-expansion members. (Meanwhile, emerging giants in Asia – in particular China and India – have merely experienced a growth slowdown rather than a decline.) These conditions are taking a toll – full corporate liquidations in England and Wales in the last half of 2008 and first half of 2009 were up 44% on the preceding 12 months; the number of companies entering administration or receivership shows a similar rise.

Looking ahead, executives are pessimistic. Fifty-one percent of UK respondents and 62% of Irish respondents expect a recovery to take at least 18 months in their main markets, in many cases longer. Although downbeat, these expectations are realistic. The Economist Intelligence Unit predicts anaemic GDP growth in the UK of 0.7% next year and an only slightly better increase of 0.8% in 2011. Worse still, its forecast sees many downside risks and "little to suggest that a sustainable robust recovery is imminent". The Irish picture is bleaker, with GDP expected to remain negative in 2010 and to turn positive only in 2011.

GDP growth at market exchange rates, 2008-2011 (% change).

*Forecast. Source: Economist Intelligence Unit

Moreover, respondents believe that demand is the biggest uncertainty in their current business assumptions (cited by 34% of respondents), and far more think it likely that in developed markets growth will be below expectations (25%) rather than above them (6%). John Frankiewicz, CEO of the construction company Willmott Dixon, sums up the prevailing view: "We have faced the worst recession since the war, and now we are going to face some difficult years ahead."

Findings

Unequal opportunity?

The conclusion seems obvious. In the words of Jayne-Anne Gadhia, Executive Chairman of Virgin Money: "Companies need to re-tool if they believe that their business models cannot cope with the ever-changing landscape." How this plays out in practice is less clear. Not all companies face the same, or even a hostile, market. Jason Kingsley, CEO of Rebellion Developments, a computer games developer, reports that of the roughly 100 such companies in Britain before the downturn, "more than a few dozen have gone bust in the last six months". In another part of the technology sector, on the other hand, Andrew Curran, COO of the fashion e-tailer My-wardrobe.com, reports that online trading is growing and fashion is the fastest growing segment within that. "We have found ourselves in a sweet spot," he says, with sales increasing by 168% over the previous year.

Nor does the recession hit everyone simultaneously. Natalie-Jane Macdonald, Managing Director of insurance provider Bupa UK, explains: "Healthcare-related businesses tend to be affected later than others. We see the recession being more visible in 2010 than 2009." Her peers agree: 59% of healthcare respondents see any recovery to be at least two years away.

This uneven economic terrain inevitably affects how business models evolve. Rebellion is experimenting with lower price-higher volume sales strategies with different distribution methods. Bupa is increasingly moving its product and service delivery online where possible to improve efficiency and customer service. Mr Curran explains, on the other hand, that fashion websites as a group are actually changing very little, continuing to invest heavily to establish market share, much as Amazon did in its early years.

Currently, though, most companies in a shrinking market face Mr Frankiewicz's challenge. He says "We can shrink with it or change the way we do business. We have done the latter."

Natalie-Jane Macdonald
Bupa UK

Andrew Curran
My-wardrobe.com

Vodafone targets the enterprise market

Business model innovation can go beyond serving the same customers; better to tap into entire new markets. Vodafone, according to Peter Kelly, Director of its Enterprise Division, explains that the mobile services provider – the world's second largest by number of subscribers – is now transforming itself into a provider of 'unified communications' (UC) to businesses. In the UK, its new Vodafone One offering aims to provide seamless contact for corporate employees across a wide range of communications technologies – including landline, mobile, PC, voicemail, messaging and email – all with a single phone number.

The shift involves a significant degree of risk. For one thing, the move has required substantial investment, including the purchase of UK fixed system integrator Central Telecom, and tens of millions of pounds spent integrating its own communication platforms. Few telecoms operators have mastered the range of business services that underpin the 'unified communications' concept, but Mr Kelly believes that his company's strong reputation and powerful brand as a mobile telephony provider will help it succeed in the corporate market.

Moreover, Mr Kelly sees clear strategic benefits that make the risks worth taking. Vodafone has found unmet demand that would help them establish a leading position in the growing market. "Customers are saying 'I have a lot of costs going out in fixed, mobile and IT services. Addressing real customer needs, and an adjacent market that is as big or bigger than our existing one, presents a big opportunity" says Mr Kelly.

The downturn may increase the new offering's attractions. Vodafone believes it can cut customer communications costs by 20%. "That is a good opening discussion to have with a CIO or CFO," says Mr Kelly. Thereafter, he adds, "the dialogue is not just about taking cost out, but about the customer's own business transformation," in that the new capabilities should enable the more efficient processes companies need in tough economic times.

'Unified communications' will likely become a crowded field; in September 2009, for example, rival mobile carrier O2 announced a fixed-line service for the business market, and traditional fixed-line operators are touting the same 'unified' capabilities. Vodafone's venture, however, promises to alter the competitive landscape in the lucrative business communications market.

Peter Kelly
Vodafone

Playing defence when they need to score

Amid the economic turmoil, companies are surprisingly calm: 85% of survey respondents believe that their business models have proven to be very (21%) or at least moderately (64%) resilient. A substantial number of companies, however, exhibit concerns. Eighty-six percent say their companies have adjusted their business models in some significant way as a result of the downturn. Even with such changes, one-third of respondents believe that their models will need an overhaul because of the recession. In some industries, this disconnect is particularly striking: 82% of financial industry executives think that their business models have been resilient, but nearly half also believe they require substantial modification.

The concerns may result from the fact that the business model changes have thus far focused largely on cost reduction rather than other areas. In the past 18 months, 63% of survey participants say their companies have made significant alterations to their cost structure, while smaller numbers (just over one-third) have made changes to their core products or services (the "value proposition"), to their revenue-generation mechanisms (pricing models, for example) or to their target markets. Looking ahead to the next 18 months, companies' focus on the cost structure looks to be less single-minded than it has been as the economy sputters to life, but it will remain uppermost in corporate thinking about business model change. Nigel Clibbens, CEO of Huddersfield Town Football Club, explains that "costs are more controllable than income and easier to deal with. They are usually the first port of call in a crisis" and can thus receive a disproportionate focus.

Taking cost out of the business is certainly not a bad strategy. When facing rapidly crashing demand, as did Mike Farley, Group CEO of construction company Persimmon, with unit sales dropping by 46% in two years and no letup in sight, sometimes severe cuts – including dropping headcount by over half – are the only option. Moreover, even for companies in better circumstances, as Bupa's Dr Macdonald points out, cost reduction should be about improving efficiency – never a bad thing. Indeed, as Mrs Gadhia of Virgin Money observes, companies should never take their eye off their costs: "Of course you have to pay attention to your cost base, but that is true in all business environments."

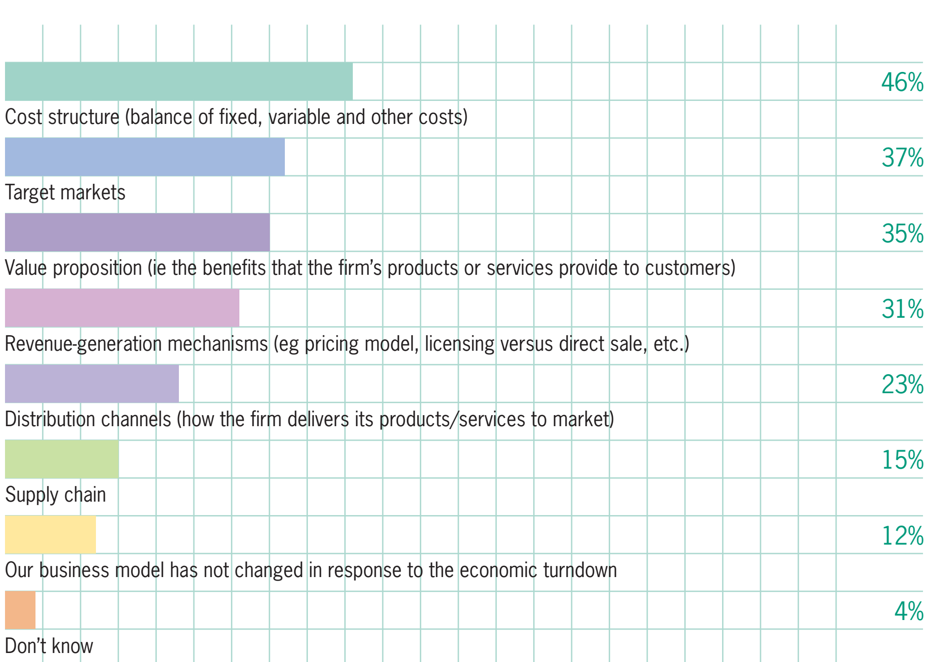
Mike Farley
Persimmon

In which of the following areas has your company already made significant changes to its business model in response to the economic downturn? Select all that apply.

Area	%
Cost structure (balance of fixed, variable and other costs)	63%
Value proposition (ie the benefits that the firm's products or services provide to customers)	38%
Revenue-generation mechanisms (eg pricing model, licensing versus direct sale, etc.)	34%
Target markets	32%
Supply chain	22%
Distribution channels (how the firm delivers its products/services to market)	20%
Our business model has not changed in response to the economic turndown	12%
Don't know	2%

Source: Economist Intelligence Unit

In which of the following areas does your company plan to make significant changes to its business model in the next 18 months? Select all that apply.



Source: Economist Intelligence Unit

Rash, reactive cost-cutting, however, all too frequent in a recession, brings its own problems. Dr Macdonald believes that simply removing a predefined quota of spend is ultimately futile, as "the cost comes back". It can also damage staff morale. An even greater danger in a downturn is to use cuts as an excuse to do nothing else. In the coming 18 months, far more expect to address cost issues in their business models (46%) than those that will adjust their revenue-generation mechanisms (31%), even though equal numbers (24%) believe that each area faces the greatest degree of risk within the business model in that period.

As the London Evening Standard has demonstrated, however, revenue-generation changes can not only bring in money, they can help to see off new competitors (see box on page 15).

Giving it away to make a profit: London Evening Standard

After more than 180 years as a paid-for title, the London Evening Standard took the decision in October 2009 to go free – a move resulting from the convergence of several pressures on the daily newspaper.

Circulation had been in decline for a decade, as new media sources competed for commuters' attention. When the arrival of two free evening newspapers, London Lite and The London Paper, in 2006, added 900,000 copies to the mix, the Evening Standard suffered, its circulation declining by about 15%.

The economic crisis created further problems. Revenue from classified and display advertising dropped as budgets shrank and with them, the newspaper's ability to leverage the situation.

"In times of recession, the big players get stronger and exploit their power over little people," says Managing Director Andrew Mullins. "As we got smaller, our ability to be exploited grew and we had to fight harder only to secure more costly deals."

In February 2009 – shortly after the Russian oligarch Alexander Lebedev took control of 75% of the paper from Associated Newspapers – the Evening Standard launched a tiered pricing scheme, selling the newspaper at 20p and 10p after 8pm and 9pm respectively, and offering it free at key sporting events. However, this hybrid model meant that while circulation grew, the distribution and merchandising of the paper became more complex and expensive. "Also, it wasn't changing our leverage in negotiating advertising volume and rates with big media agencies – we were still vulnerable," says Mr Mullins. In May 2009, the newspaper re-launched and was offered free for one day. Some 850,000 copies were handed out – 250,000 more than planned. "We realised the demand," says Mr Mullins, and "we became interesting to advertisers again."

The move to go free permanently cost the Evening Standard an estimated £15m in annual revenue, according to Mr Mullins. At the same time, however, it saved £5m in annual marketing costs and slashed distribution costs from 30p a copy to just 4p. Furthermore, the move – coincidentally or not – saw off its free evening rivals. As a result, says Mr Mullins, the Standard's circulation has risen from about 250,000 to 600,000, and the move has delivered increases in advertising yield "by more than 50%".

Significantly, its free model means that unlike other newspapers, which increasingly see their future online, the Evening Standard cannot introduce a paywall to its website. "We have no significant ambitions for our online strategy," admits Mr Mullins. "The main thing is to concentrate on distribution efficiency and advertising revenues."

The consensus is that at a difficult time for the newspaper industry, the Evening Standard has succeeded in reversing its fortunes. "It used to be a case of spot the Evening Standard reader – now it's a case of spot the train carriage full of them," claims Mr Mullins. "Going free was a bold move, but it's clear we're back in the game again."

Andrew Mullins
London Evening Standard

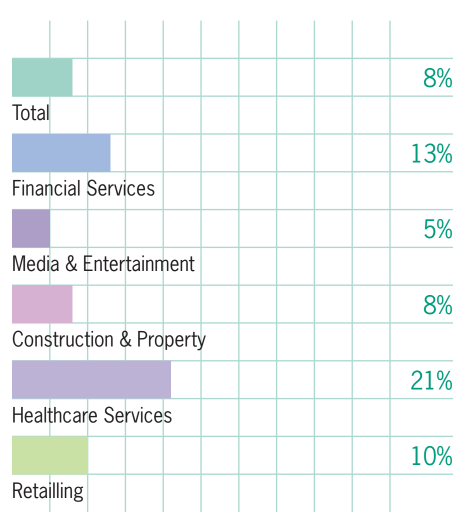
Findings

Battling complacency

Why do so many British and Irish companies exhibit an apparent lack of ambition when it comes to business model innovation? A lucky few, as noted above, may have reason to think there is no pressing need for change. Nobody, however, is completely safe in current conditions. David Bateman, Financial Director of the card and stationery company Paperchase, notes that, even though demand in his market typically remains relatively constant during downturns, the collapse of Woolworths and other retailers presented a challenge with large supplies of cards, stationery and wrapping paper coming onto the market at a deep discount.

Other companies will likely act more quickly only when forced. In the healthcare sector, for example, the delayed effects of the recession help explain why 21% of respondents say their business models are not geared for success in the next 18 months – well over twice the survey average.

Share of respondents who disagree with the following statement: "Our existing business model is set up to enable us to succeed over the next 18 months."



The problem goes deeper. Cost reduction gives the feeling of addressing the greatest immediate danger from a downturn – financial survival. Accordingly, a remarkably high 89% of respondents are convinced that their business models will let them succeed in the next 18 months, with only 8% showing concern for imminent problems. After years of relatively good economic times, in Dr Macdonald's words, "a lot of companies have become complacent". The research also reveals some concerns about the inability of the executive suite at many companies to bring about business model change. Mr Clibbens says of his sport, "Too many clubs don't know what to do to solve their problems and hope it will all come right in the end. They operate as hostages to events and let things happen to them."

Football, where teams rely more often on deep-pocketed owners than on paying customers, may be an extreme case, but the problem is worryingly widespread. When asked the main obstacle to business model change at their companies, tied with cost for the leading answer is the capability of management (23%).

Eighteen percent also cite the corporate culture, which management does so much to set. In certain cases, real change may even require a management shake-up. Mr Clibbens acknowledges that management change is "a good platform to discard some practices." Similarly, Dr Macdonald suggests that "the people who brought a company to where it is today may not be same people whom you need to unpick the business model."

Trying to read the cards correctly

The apparent complacency of companies in the UK and Ireland arises in part from a hopeful attitude about two key risks. Whatever the immediate benefit of belt tightening, cuts, especially if unaccompanied by efficiency gains, do little to address perhaps the greatest long-term danger of any recession – enhanced competition. While most survey respondents expect new competitive threats of some sort to emerge over the next 18 months, a surprisingly large number of executives in the media and entertainment (39%), retail (30%) and construction and property (27%) sectors think that competition will remain unchanged or even diminish. A significant number also believe it will fragment, which in some cases will result in less powerful rivals. Recessions, however, are rarely that kind to existing companies.

Opportunities and threats in the external environment

Those British companies looking for new geographic markets should benefit in the coming months from a continued weak pound: the Economist Intelligence Unit expects goods exports, for example, to expand by 11% in 2010 and 6% in 2011, after a steep decline in 2009; imports will also resume growth this year and next, although at slower rates. By the same token, the weak currency will make UK M&A targets more attractive for foreign suitors; inward foreign direct investment is expected to expand by one-third this year and by 50% in 2011.

Selected UK trade and investment indicators, 2008-2011 (US$bn)

	2008	2009	2010*	2011*
Goods exports fob	466.8	357.2	396.3	420.0
Goods imports fob	640.9	480.9	515.7	540.3
Inward direct investment	97.5	39.2	52.1	78.2
Outward direct investment	139.3	121.5	118.9	129.2

*Forecast

Source: Economist Intelligence Unit

More likely is the danger which most executives see from competitors consolidating into stronger companies, as well as new entrants from abroad or from adjacent industries. They are right to worry. As noted already, a minority of British and Irish companies, driven by recessionary pressures, have been seeking new markets, testing new value propositions and trialling new revenue-generation models. In other countries companies are doing the same, and those less affected by the recession have greater spending leeway to expand globally.

How do you anticipate your competitive environment changing over the next 18 months?

	Total	Financial services	Media & entertainment	Construction & property	Healthcare services	Retailing
The competition will consolidate	48%	64%	39%	40%	34%	34%
New rivals will emerge from related industries	32%	18%	27%	38%	43%	30%
New rivals will emerge from other geographic markets (eg emerging markets)	20%	26%	17%	8%	13%	13%
The competition will fragment	13%	13%	16%	20%	11%	11%
Competition is unlikely to change	12%	6%	25%	13%	15%	17%
Competition will diminish	10%	7%	14%	13%	4%	13%

Source: Economist Intelligence Unit

Competition from adjacent sectors in particular can yield nasty surprises. The iPod appeared amid a downturn nearly a decade ago from technology company Apple, and the music and radio industries are still adjusting. Today high street fashion stores, says Mr Curran, are consciously delaying investment in their websites to husband cash in the downturn, allowing My-wardrobe.com and its competitors to stake out much more of this lucrative growth market than they otherwise might. Virgin Money, meanwhile, has made no secret of wanting to enter high street banking. Says Mrs Gadhia: "The market is ready for a new and trusted bank and we're working hard to make that happen."

Attitudes towards financing reveal an even more widespread and surprising confidence – if not complacency – about the future. The vast majority of surveyed companies expect, over the next three years, to be able to access their preferred method of finance. More worrying is the fact that only 35% of respondents – and 44% of those from smaller businesses (those with annual revenue under £100m) – believe they will be able to access some form of bank financing, only slightly less (and more, in the case of smaller companies) than the number expecting to rely on internal sources. While the availability of bank financing is improving for larger companies, small companies are still having trouble obtaining bank loans today and are having to pay higher rates for the privilege. An economy recovering from the effects of a banking crisis is not one where financing will be easy.

Following the customer

Ultimately, the creation of new, more competitive business models is the natural result of companies doing what they should always do: following the customer as closely as possible. Says John Frankiewicz, CEO of Willmott Dixon: "If cost control is the necessary internal response to a recession, getting closer to understanding what clients need in the current climate, and how we can add value by knowing their challenges and helping to meet them is the external one." Indeed, a truly customer-focused organisation will almost inevitably adjust its business model in some way. Bupa's Managing Director Natalie-Jane Macdonald agrees: "Customers have been going through tough times. They are more demanding, have a higher expectation of value and are less tolerant. You have to adjust your business model, or face them leaving."

John Frankiewicz
Willmott Dixon

What will be your company's most likely sources of finance over the next three years?

	Total	Below £100m	£100–£250m	Above £250m
Capacity to finance from with the company	37%	38%	32%	40%
Bank loans	22%	22%	26%	17%
Private equity	17%	22%	21%	8%
Bank overdraft	13%	22%	10%	8%
Debt	12%	8%	10%	18%
Trade finance	8%	8%	6%	10%
Other equity	8%	9%	10%	5%
IPO	4%	3%	3%	7%

Source: Economist Intelligence Unit

Converting risks into opportunities

British and Irish companies seem relatively sanguine about their supply chains. No more than 30% of manufacturing executives, for example, and 25% of those from construction and property companies, expect to make major changes to their supply chains over the next 18 months. Among manufacturers, the reason may be that they have already implemented far-reaching changes – over half of manufacturing respondents say their companies have done so during the downturn. But when asked how supply-side conditions are most likely to change in the next year and a half, the most widespread belief (among 30% of overall respondents, 35% of construction and property executives, 43% of retailers and 54% of manufacturers) is that input prices will rise. This disconnect suggests that supply chain innovation among British and Irish companies has not gone far enough, and many may be in for a shock if their price fears come true.

It does not have to be this way. Small companies may lack direct leverage over suppliers, but creativity within the supply chain can accomplish much. Mr Frankiewicz of Willmott Dixon agrees that the construction industry will see "huge upward pressure" on inputs beyond the direct control of suppliers themselves. Companies therefore need to develop, he maintains, "an intellectual relationship with their supply chain," working with them on a range of areas such as local procurement and even redesign of products to reduce wastage. "There is a lot more we can all do in this area."

Larger companies have even more influence to initiate supply chain remodelling. Steve Churchhouse, Executive Vice President of Supply Chain Development at jet engine manufacturer Rolls-Royce, explains that Rolls-Royce is successfully arresting cost momentum on the input side. "Rolls-Royce has an intensive programme of cost down engagement with its suppliers to sustain a culture of continuous cost improvement within our supply chain and is putting out a big signal to suppliers that the end customers' business model has changed."

How are conditions most likely to change for your company over the next 18 months when it comes to the supply of key resources for your business? Select up to two.

	Total	Media & entertainment	Construction & property	Retailing	Manufacturing
Prices will rise significantly	30%	20%	30%	43%	54%
Larger and stronger suppliers will appear	20%	14%	17%	15%	19%
The geographic sources of supply will shift	20%	22%	10%	25%	22%
Traditional suppliers will disappear	16%	23%	20%	23%	13%
Prices will drop significantly	15%	11%	20%	8%	17%

Source: Economist Intelligence Unit

Old game, new strategies—with the help of technology

The last place one might expect IT to reshape the business model is a century-old sporting establishment playing a game with even older rules. Huddersfield Town Football Club, however, is using technology to offer new products and help transform its relationships with customers. In this the club reflects the consensus view of survey respondents that technology's heaviest impact on the business model over the next 18 months will fall in three areas: enabling the creation of entirely new products and services; the building of closer relationships with customers; and the creation of new marketing and product delivery channels.

Nigel Clibbens, the club's CEO, calls technology "an immense issue for us," starting with its core product – the footballers themselves. Huddersfield has invested £50,000 in what he terms as the most advanced player-performance-monitoring system available in the market. "It is standard in the Premiership [the UK's top football league], but nobody in our league has it, so it can give us the edge."

Meanwhile, to sell tickets, Mr Clibbens notes that "We have to be able to target our customers in a very sophisticated manner." This goes well beyond a web page to extend to mobile texting, email and pages on social networking sites such as Facebook. The team is even planning an online auction facility.

Finally, football, particularly in the north of England, is often a community activity – a tradition the club embraces – but Huddersfield is also looking to, in Mr Clibbens words, "give each person their own bespoke offering". He admits that "We are a long way from that, but that is where we need to go. We can, for instance, text a parent with a season ticket and say 'we know your daughter's birthday is on Saturday, why not bring her to the game?'"

The benefits of these technological investments are all the greater because, Mr Clibbens notes: "Most football teams won't embrace technology until it is forced on them. This way we can steal a march." British executives in ostensibly low-tech sectors should understand that their competitors may be seeking to establish such technology-driven advantages.

The spectre of climate-change regulation

Even in downturns, governments do not desist from new regulatory initiatives. Although many regulatory changes affect competition, most – happily – are not of the business-model-changing variety. Green regulation expected over the next two years, however, may prove to have just such an impact for many British and Irish companies.

Thirty-six percent of survey respondents believe that regulatory initiatives on carbon emissions or environmental protection are likely to lead them to modify their business plans, the area of regulation which they see as most likely to force change. As Mr Kelly notes, "carbon emissions regulation is very much on the agenda of business leaders at the moment". In certain industries, such as construction (65%) and manufacturing (63%), this expectation is, not surprisingly, much higher. That such regulation might affect business models indicates that carbon reduction now means more than just changing light bulbs: it will involve reorganising supply, production, delivery and even product elements of business models to – at the very least – make them more energy efficient.

Changes in which of the following areas of regulation are most likely to affect your business model over the next 18 months? Select up to two.

	Total	Construction & property	IT and technology	Manufacturing
Carbon reduction/environmental protection	36%	65%	41%	63%
Labour practices (eg hiring and firing)	30%	32%	28%	26%
Health and safety	24%	47%	19%	20%
Intellectual property	16%	2%	24%	9%
Tax legislation	16%	13%	15%	17%
Trade restrictions and tariff levels	2%	0%	13%	30%
Financial disclosure	9%	2%	6%	2%
Date privacy	9%	2%	13%	2%
Investment regulation	9%	5%	6%	4%

Source: Economist Intelligence Unit

Rather than sitting back and waiting to hear how new, more stringent carbon-emissions rules will affect them, some companies are moving ahead with green initiatives for good business reasons. For one thing, they promise to help the bottom line. Mr Churchhouse explains that through adjustments to its supply chain, Rolls-Royce has "had a lot of success in reducing our own carbon emissions. We have reduced energy consumption and saved cost."

More importantly, the interest of consumers and other companies in reducing their carbon footprint opens up whole new product opportunities. Rolls-Royce, for example, has created its own civil nuclear business unit in the expectation that governments will turn increasingly to nuclear power to reduce carbon. "Clearly companies should position themselves to provide technological solutions to the problem," says Mr Churchhouse.

The opportunities exist not only for manufacturers. Mrs Gadhia of Virgin Money believes consumers will "increasingly spend only with companies that are making the greatest strides in reducing their environmental impact, as well as offering products that address the issue". The company's Climate Change fund buys shares in businesses that have lighter carbon footprints.

According to Mr Frankiewicz, Willmott Dixon is sure that new environmental regulation will come, and believes it represents one of the company's biggest opportunities. The company launched an entirely new business in 2007 called Re-Thinking, a consultancy that helps clients incorporate sustainability into construction projects. It involves substantial R&D spending and the hiring of employees with different sets of skills—"more academic, theoretical people who can look at new technologies," says Mr Frankiewicz. He sees the fit with the group's construction companies as a natural one, though. "Once carbon is a currency, government and other players will have to reduce emissions. We have a huge part to play in that process. Also the cost of energy could rise substantially over the next few years, impacting the bottom line. That will also be a driver for change."

Conclusion

British and Irish companies are clear-eyed about the current economic malaise and the recession's likely after-effects. Most have, accordingly, sought to reduce costs, and the cost structure looks set to remain a central focus of change initiatives. The problem is that far fewer are looking at deeper business model innovation to address future pressures that they suspect are coming. For example, given ongoing change in customer preferences and behaviour – much of it driven by the emergence of new technologies – more firms would be wise to review their revenue, distribution and pricing models. With input prices expected to rise, thoroughgoing change to supply chains should also be considered beyond simply pressing suppliers for lower prices. Companies must plan for the impact that carbon-reduction regulation will have on their business, but should also seek the revenue-generation opportunities that may be opened as a result.

Too many companies in the UK and Ireland are suffering from a streak of complacency when it comes to the fundamental ways they do business, and perhaps from an inability of management to engineer change. Like every recession, this one will sort the losers from the winners. The latter will be those who seize the opportunities created by the upheaval, rather than simply survive the dangers.

Model behaviours

The analysis on the following pages is provided by Grant Thornton

In-depth cluster analysis of the research shows six different characteristic behaviours in relation to business models, in response to the recession. These are:

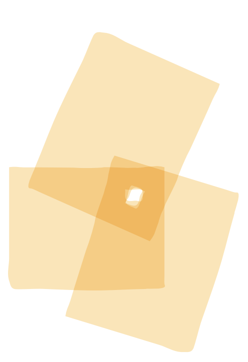
Heads in the sand
Ahead of the curve
Fighting the last war
Best before
Moving to the margins
Hitting the panic button

The analysis reveals a number of interesting factors:

Respondents' levels of confidence in business model resilience – to date and in the future. Levels and nature of change implemented and change planned to various elements of the business model. Changes to assumptions about the market environment – recent and in the future. Perceptions of risk to business models regarding strategic direction, clarity and focus.

Alysoun Stewart, Head of Entrepreneurial Advisory, Grant Thornton UK LLP, comments on each.

Alysoun Stewart,
Head of Entrepreneurial Advisory
Grant Thornton UK LLP



Heads in the sand

These companies consider their business models very resilient and have strong faith in their model's suitability over the next 18 months. Most state that their business model has not changed (90%) and will not change (62%) – compared to averages of just 12% across the whole sample.
They see little need to change or adapt their business models or the assumptions driving them in the future: 37% foresee no changes in business model assumptions during the next 18 months, against an average of just 7%.

Proportion of respondents: 10%
Model behaviour: Negative

They also identify few risks to their business models. Close to half (43%) believe that competition is unlikely to change over the next 18 months (average 12%). Almost as many (39%) are unlikely to change their demand assumptions over the next 18 months – compared to 11% across the sample. Yet more respondents than average (24% compared to 20%) predict changes in geographical sources of demand – a fundamental shift to which businesses surely need to adapt. It is difficult to square a 'no change' mentality with this trend, suggesting a worrying complacency which could cost these companies dear.

Such robust confidence in the light of recent market conditions and continuing economic uncertainty may be questionable in most companies or sectors. Interestingly, however, almost half of these companies (47%) are from the media, construction and financial services sectors – industries that have suffered disproportionately in recent years for diverse reasons.

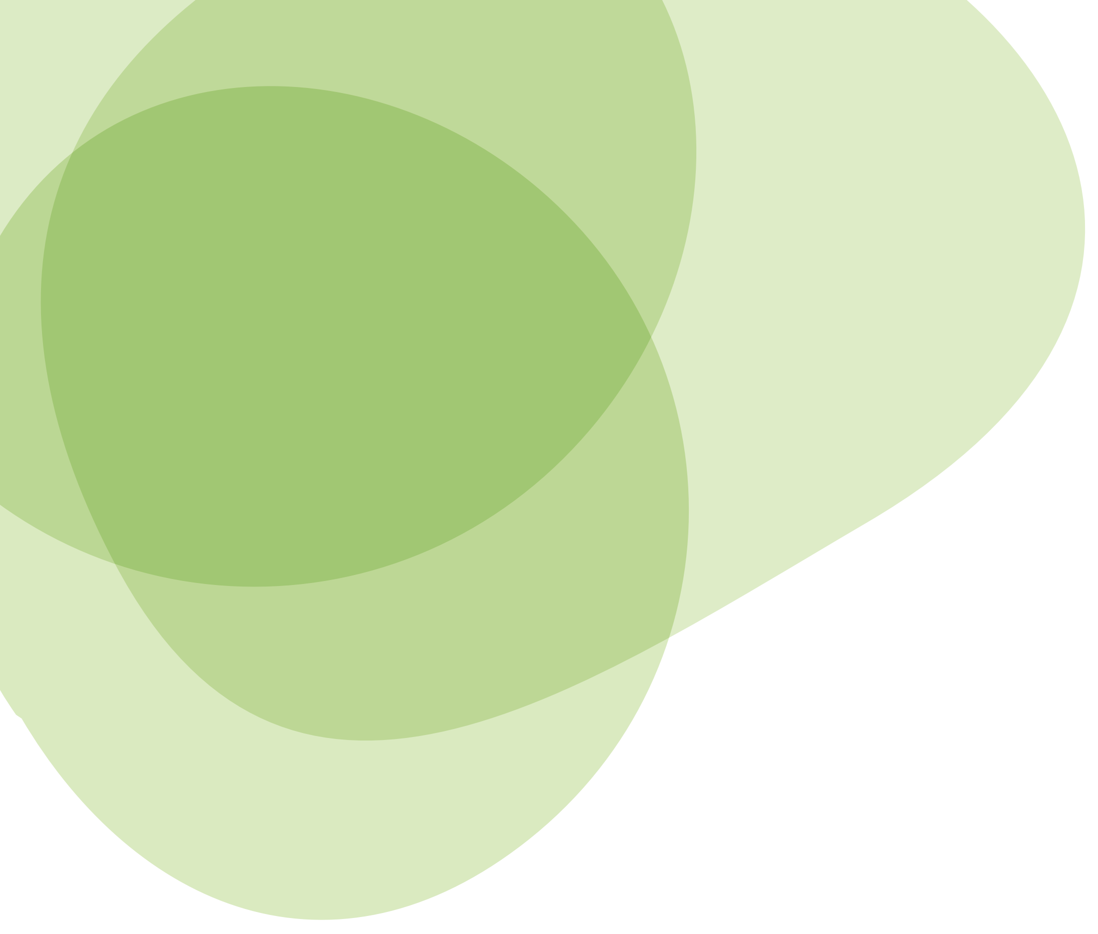
Companies in this group:
As a rule, these are smaller businesses – half have revenues under £50m.
The majority (50%) are privately owned, with a higher proportion than average of small cap companies.

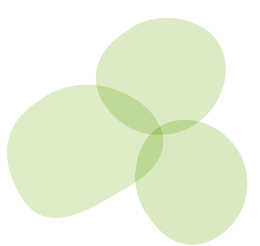
Focus required:
These companies need to heed, and adapt to, current market conditions and to mitigate critical risks over the long run – an omission which might call into question strategic capabilities at board level.

This could be seen as the classic "ostrich" syndrome. However, given that these are generally smaller businesses it is more likely that their seeming inability to react appropriately to the changes in trading conditions denotes a lack of management capability and experience rather than a refusal to face up to reality.

The only certain thing today is change and the watchword for every business needs to be flexibility – in business models, in the organisation structures through which they are delivered, in the cost base and infrastructure, and above all in management thinking. This is the time when openness to external support and challenge is likely to make the difference between survival and failure.

The outlook for the coming year is uncertain at best and if these businesses have not yet made fundamental changes to their approach and operating practices they are extremely vulnerable, particularly given the high percentage of these companies from high risk sectors.





Ahead of the curve

Despite expressing strong faith in their business models' resilience now and in the near future, and identifying little need for change, these companies are pressing on with adapting their business models to stay ahead of the curve. All have implemented some measure of change to their business model to date, and most (96%) anticipate doing more of the same in the near future.

Proportion of respondents: 19%
Model behaviour: Positive

They understand that change is the only constant, and are continually adapting their business models accordingly. For example, 40% are concerned that new rivals will emerge from related industries – compared to only 32% across the whole sample.

In doing so, these forward-thinking companies are focused on improving both the top and bottom line in order to enhance margins:

- 66% have changed their cost structure.
- 46% have worked on their value proposition
- 45% have altered their pricing model
- 45% have examined their target markets

And far from resting on their laurels, this group still plans significant changes to keep themselves ahead of the game:

- 46% cost structure
- 44% target markets
- 43% value proposition

When asked how the assumptions behind their business model will change in the future, the main responses were:

- Growth rates of demand (38%)
- The need to focus on margins (37%)

Companies in this group:
Often younger companies, with revenues under £250m in two-thirds of cases, change is in these companies' DNA. Nearly half (45%) are privately owned, while this cluster has a higher than average number of small cap companies and a slightly higher penetration of large public concerns. Interestingly, 15% are from the forward-looking IT and technology sector (compared to 12% of total respondents) – the largest industry group in this cluster.

Focus required:
Almost half (45%) of this group believe that technology will impact most heavily on their business model through the creation of new products and services – compared to a whole sample average of 30%. They may be looking for M&A opportunities – they are likely to be well placed to make bargain acquisitions – or are potentially grooming their business for sale. These companies have a strategic vision in place – their challenge is to implement it effectively.

The businesses that have fared best over the past couple of years are those that have been courageous enough to make change the cornerstone of their agenda, and who went into the crisis with a very clear understanding of their core business proposition, of their key markets and of how best to leverage their strengths. These businesses are characterised by the type of innovation that has enabled them to flex every area of their business and to make best use of the tools available to them, whether through new technologies or through new working models. They have the strength of both focus and purpose to be able to take advantage of the opportunities that both the recession and the eventual upturn will offer. They also recognise that competitive advantage now comes not from new products and services, but from new ways of doing things.

These companies believe that they have moderately resilient models and a reasonable degree of confidence looking ahead. As a result, they identify little need for change. However, their actions do not appear to match this stance – they have overwhelmingly focused on cost-cutting measures to date, and intend more of the same in the future:

- 75% have made changes to their cost structure – compared to 63% of all respondents
- Almost half (45%) intend to make more cost-driven changes

There is some focus on growth and margins moving forward, but this is low compared to the ruthless focus on cost-cutting.

- 38% see changes ahead in growth rates of demand
- Only around a third (37%) intend to focus on margins

Proportion of respondents: 25%
Model behaviour: Negative

These single-minded companies are only taking care of half of the equation. They appear to be stuck in a recession-based, cost-cutting mentality, still doing what's needed to get through the downturn. This 'salami-slicing' approach may risk cutting too deep, destroying value and damaging the ability to return to growth strategies, and missing the upturn when it comes.

Companies in this group:
Two-thirds have a turnover under £250m, but these companies are typically older than our 'ahead of the curve' group – a fifth are over 60 years old, suggesting they may be less agile and possibly more set in their ways. The greater proportion is privately owned. Some of these companies are in industries fighting terminal decline (14% in manufacturing) or suffering disproportionately from the downturn (17% in construction, 12% in retail).

Focus required:
There are two clear challenges for these companies. Firstly, they may need to take a smarter, more strategic approach to cost-cutting, to ensure that they preserve rather than destroy value. They also need to stop looking back and focus on revenue generation and growth opportunities. They will require a change in strategy if they are to capitalise on the upturn when it comes.

In some ways this is the most worrying group of all and it also represents the highest percentage of respondents. Axing the cost base is always the first and most obvious port of call for a management bereft of ideas and clear strategy. Experience of these circumstances suggests that as soon as the axe has been wielded once, and the immediate short-term benefit taken to the bottom line, the action can become habit forming with the result that the business ends up cut to a stump from which the green shoots will find it difficult to sprout and which will take a very long time to grow back into a healthy tree. Even if it eventually does so, it will be in a very different shape from the original and require a very different type of management. The companies in this group are typically longer-established and nearly half of them are in sectors where the need for innovation is critical and the only possible route to survival in the medium term. The denuded cost base is in danger of leaving them without the resources or talent to fight their way out of the current recession.

Best before

Confidence in this group's business model is contradictory: resilience is moderate, while there is a 50-50 split on whether an overhaul is needed. Yet they identify more than one key risk to their business model:

- Value proposition (32%)
- Revenue generation (27%)

Strangely, there is almost unanimous agreement that this group's business models are robustly adapted to the market for the next 18 months – yet their behaviour paints a different picture, having already made significant changes:

- 65% cost structure
- 46% value proposition

Proportion of respondents: 18%
Model behaviour: Negative

What these companies may be experiencing is business model expiry. These established players may have enjoyed success based on their current model for some years, but their actions betray insecurity about the future, which some respondents identify, but their actions more clearly portray.

Companies in this group:
They are typically larger, older companies: 87% are older than 10 years, and 40% have revenues of £100m-£250m. This cluster boasts the greatest proportion of large listed companies, with a healthy smattering of private equity-backed companies.

Focus required:
Companies facing genuine business model expiry will need to seek new revenue models. This may entail vertical integration/moving up or down their industry's value chain. Raising finance could prove a major issue in this situation. The strategic abilities of senior management are also likely to come under the spotlight.

Comment

It is likely that companies in this group are more cash and resource rich than some others and while recognising the drivers, and necessity, for change they are not driven by the same absolute need to implement it. The theory of strategy as stretch – the suggestion that scarcity of resources is a driver for strategic change – is relevant here. These companies, which tend to be older, may also have management succession issues and with a lack of younger blood are less dynamic and responsive to the need to change established ways of thinking and doing.

Moving to the margins

Only moderately confident in their business models' resilience to date and ability to succeed in the future (only 5% strongly agree that their model will remain robust over the next 18 months), these companies have focused ruthlessly on cost-cutting during the recession:

- 71% have made changes to cost structure
- 58% are planning to do likewise

However, they are now training their sights on improving margins as market conditions evolve. In terms of the assumptions driving their business models:

- 46% have seen a need to focus on margins
- 43% expect this to become a focus

These responses compare to around a third focusing on margins across the whole sample.

Proportion of respondents: 18%
Model behaviour: Positive

This group predicts a changing competitive environment ahead and is adapting accordingly:

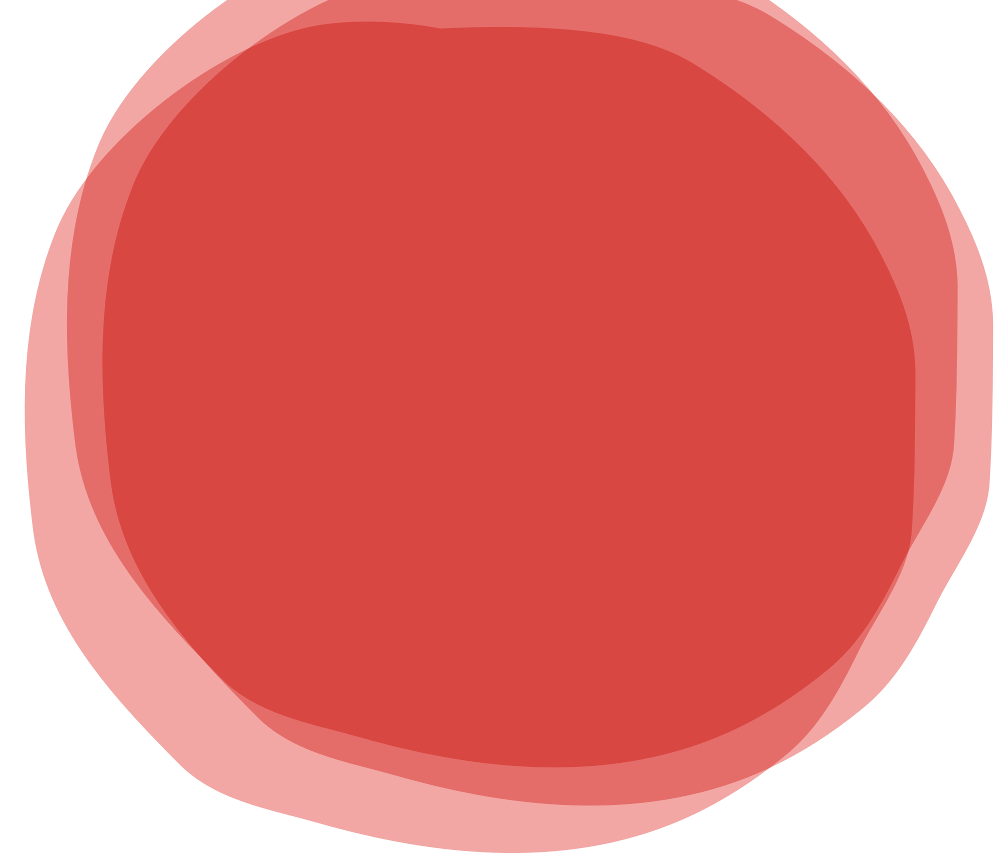
- 39% identify an increased personalisation of demand as a key change in their market environment – compared to 28% across the whole sample
- 58% identify consolidation – compared to 48%

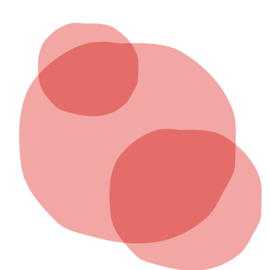
Companies in this group:
This cluster has a similar turnover profile to our previous group (the 'expirers'): two-fifths are in the £100m–£250m bracket. However, they are even more established, having the oldest age profile of our six typologies. The group features higher than average frequencies of large listed and private equity-backed companies.

It may be that these more experienced players, having seen the economic cycle come and go several times over, are quick to read the signs and position their business models for the upturn.

Focus required:
Like our 'ahead of the curve' group, these companies have their strategy in place – the focus needs to be on implementation: how to change gear from cost-cutting to margin building. Organisational change may be required.

One of the more interesting trends to emerge from the turmoil of the past couple of years has been the willingness of companies to both recognise and address perceived shortcomings in their organisation structures. Organisational effectiveness has been shown by many research projects to have a direct link to financial performance, but it is not necessarily easy to identify where across the three key dimensions of organisational health, management practices and functional contribution there may be issues that are impacting on overall performance. These companies clearly have experienced and capable management, but their effective response in the medium term will depend not just upon the way in which their business models and cost structures are flexed, but on the extent to which they can ensure that their organisational structures provide the most effective and efficient vehicle through which success can be achieved.





Hitting the panic button

These companies appear to be in a state of general panic over their business models, and are questioning just about everything, with little or no focus in their attempts to bolster their model.

Nearly three-quarters (72%) agree that their model has not proved resilient, while virtually none describe their business model as set to succeed over the next 18 months. An overwhelming majority (86%) identify the need for a business model overhaul – only 4% deny this.

Proportion of respondents: 10%
Model behaviour: Negative

These companies have already made significant changes to their business models:

- 71% – cost structure
- 42% – value proposition

…and are planning more changes to a range of elements:

- 56% – cost structure
- 48% – value proposition
- 40% – target markets

In terms of key changes in assumptions:

- 42% think new rivals will emerge from related industries, compared to an average of 31% of the whole sample
- 40% identify fluctuating growth rates in demand (average: 32%)
- 33% believe that demand-developed world markets will grow more slowly than anticipated (average: 25%)

Companies in this group:
These companies fall in the mid-range in terms of age – largely 11-40 years old. Nearly two-thirds have a turnover of up to £250m, the remaining third largely £250m–£5bn. They are predominantly privately owned.

Focus required:
There is an urgent need for strategic clarity to enable these companies to focus on profitable revenues, identify the most critical risks and formulate appropriate responses. Decision-making support may also be needed.
These companies may also be suffering the effects of poor post-merger integration of acquired companies.

Tom Peters said in the late 1980s that “there are only two types of business, the quick and the dead”. Unless these companies focus very quickly on the formulation of clear strategies and develop the necessary action plans and resource to deliver them, they will be dead. Indiscriminate cost-cutting and changes to the business model in the absence of a clear understanding of the demands of the operating environment are a recipe for disaster. Success in the current trading conditions can only come from a razor sharp clarity of purpose and focus.

Views from the experts

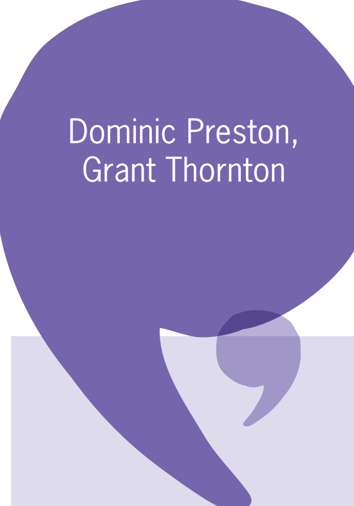
Experts explain how they feel business models need to change for survival, on what should leaders focus and what are the weaknesses in current models.

What changes in business models are needed if companies are to survive in today's uncertain economic climate?

The economic environment over the last couple of years has favoured those whose business models are the most flexible and whose offerings are best able to deliver short-term cost savings and or efficiency gains to customers. Businesses which have tended to suffer the most are those whose products require up front capital spend or large-scale commitments. The ability of businesses to evolve to business models where products and services are able to be paid for on an "as needed" basis are likely to flourish in the current economic climate. A clear example of this is the evolution within the IT world from the perpetual licence model for software sales to a Software As A Service, or SAAS, model. While the former offers the vendor a larger one-off sale, the latter offers the customer the ability to purchase the software they need as they need it – and spreads the financial commitment. Businesses which offer their customers a greater level of granularity in the way goods and services are purchased create the sense of choice and customer control – hence the appeal of the Ryanair "menu" of options compared to the BA "all-in single price" approach.

In uncertain times businesses need to remain flexible: to cope with contraction as well as growth. Recent experience has proven how a healthy collaboration with the workforce can deliver flexibility in the cost base, and it is likely this model will continue even post recession. But how to prepare and gear up for growth is also likely to change. For businesses in services or technology, partnering or venturing with others, who might be competitors, will be an attractive option. Manufacturers too can look at the outsource model, albeit maybe sharing risks and rewards to a greater degree than has been the norm. Focusing on a business' niche skills and unique offerings, investing in these to remain 'best of breed', and finding where these can be best deployed, is the real challenge.

What changes in business models are needed if companies are to survive in today's uncertain economic climate?



We have seen a number of businesses taking the opportunity to consolidate, enhance and broaden their market offering, through the acquisition of complementary assets, ranging from physical production lines, through adjacent real estate sites to top human capital talent from competitors.

Certain businesses with stable and sustainable cash balances are also taking the opportunity to make strategic minority equity investments in their own form of venture capital play. As opposed to a pure investment return contingent on a future liquidity/exit event, these strategic investments are providing instant value through technology and knowledge sharing, common back-office platforms and associated purchasing economies of scale, access to new customer bases, right through to good old-fashioned business mentoring. These really do look like win-win scenarios for both parties; with the fledgling business being able to leverage scale and experience whilst retaining control, and the established business benefiting from new technologies, processes and market-facing media.

Businesses continue to be confronted with challenging economic conditions, fragile confidence and a very uncertain outlook. There is no doubt the collective can have some influence over the general business landscape, but individual business' efforts should be very much focused on activities which can be actively and directly influenced and achieved by them. For example, this may include the approach to growth (strategic and organic), management of the cost base and retention of key people (customers and employees). Whilst important, the emphasis should not be solely on short-term profits and cash. There should undoubtedly be detailed consideration of building a flexible business model with a clear vision in respect of what the business needs to look like in the short, medium and long term in order to deliver sustainable profits and therefore growth in shareholder value.

Creating a flexible business model provides a range of opportunities to deal with "change and external challenges" such as the ability to scale up or down operations as required, varying approaches to maintaining and growing sales and profits, ie customer retention, cross-selling to existing customers, new customers, new markets and products as well as many more. This flexibility coupled with a longer-term vision provides for consistency and clarity which helps protect branding, confidence and market position.

A perspective from India

In the current economic climate, a number of businesses need to increasingly look at expanding into foreign markets, such as India, to escape the stagnant home markets. There are staggering opportunities in India as the country is still relatively under-developed, meaning there is room for growth. There are terrific market opportunities, just in terms of the sheer size of the young, upwardly mobile middle-class population. With a size of around 300 million this market is as big as all of Europe put together and growth rates being experienced are significant.

From provision of infrastructure services to the supply of fast moving consumer goods to education and health services – the opportunities for UK and Irish corporates are extensive.

However, whilst the market opportunities are enormous, companies need to tread very carefully when entering this attractive market and ensure any market entry is planned properly and executed with the right resources and structure.

Ireland must focus more stringently on an 'Export led economy' if it is to learn from the mistakes of the past. Never again, can a small open economy on the fringes of Europe generate so much of its perceived wealth internally. Businesses need to embrace innovation and product development, Government needs to support and encourage such initiatives and create social and commercial policy to conceive a smarter economy.

If we are to improve our outlook we need to compete with others not ourselves, develop new products, discover new markets beyond our borders and enhance the skills of our workforce. In order to achieve these objectives businesses need to re-engineer their present operations, which includes taking corrective action to make one's business commercially viable in today's market, tidy the balance sheet, re-capitalise where possible, create new strategic goals and implement new measurement tools. All of this is only possible following a complete root and branch review of existing corporate structures. All significant strengths and weaknesses should be identified and exploited or rectified, whichever is appropriate. Corporate Boards must be encouraged to question as well as being more experienced, pro-active and accountable for the decisions they take.

We have to believe that we can succeed, failure is not an option and therefore attitude must be paramount in any business model.

There has been a great focus on cost-cutting in the recession, which is a natural reaction to this situation. While 'trimming off the fat' can help a business to survive in the short-term, the way in which business leaders go about it needs to be carefully considered.

Cost-cutting across the board is not always beneficial – it can hamper a business's ability to survive, for example, by restricting cash to innovative projects that could deliver a new product or service or by cutting key drivers of the business.

The current economic environment could be the new 'normal' where the economy does not return to previous highs. Businesses need more than ever to focus on revenue growth and how they can adapt their business models to the challenges presented by this market (ie little credit available and a lack of bank finance). The thinking which was used to arrive at the current situation will not be successful in developing a plan to thrive in this environment.

This is when non-executive directors and other external influencers can play a key part in developing new thinking and new behaviours.

Businesses which find themselves in difficulty need to apply their business model in new ways, they need to identify strategic opportunities that will allow their businesses to grow, and then develop a clear implementation plan.

The small and mid-cap quoted sector, which the Quoted Companies Alliance represents, has been hit hard by the downturn. The QCA is working hard to ensure that companies continue to be able to access equity and debt capital to finance their business, while providing opportunities for quoted businesses to engage with their shareholders across a range of events.

What changes in business models are needed if companies are to survive in today's uncertain economic climate?

Business models – the challenges

What should business leaders focus on to survive?

In cash-strapped times businesses need to open up to new ideas – these can come from different and unusual sources and it doesn't have to cost a lot of money. Many large corporations are already switching to a relatively new approach to generating ideas, the 'open-innovation' model. This is epitomized by companies like Apple and Nokia that rely on people across the globe and outside of their organisation to help them come up with new and improved product ideas. Procter and Gamble produces 35 percent of its innovations and billions of dollars in revenue in this way.

NESTA has partnered with a number of businesses, from Virgin Atlantic, Oracle, Orange, McLaren, Tesco and Procter and Gamble to trial new 'open-innovation' business models. This involves engaging with consumers, employees, end users and entrepreneurs and has led to many practical outcomes. Our work with Procter and Gamble helped the company identify imaginative product ideas from entrepreneurs who would otherwise struggle to get their ideas to market.

Open innovation is fast becoming a critical component in any company's business strategy, particularly because of the recession. In a survey of over 150 FTSE 100-level companies carried out by NESTA, two-thirds of UK corporations said they are now doing more open innovation. In a world where customers are demanding more service and product innovations and where tough economic times mean resources are finite, this model is more relevant than ever.

The digital economy presents a huge opportunity for all businesses. We can't underestimate how much this has changed business models already. Some have adapted easily, some have been dragged kicking and screaming. The uncertain economic climate has been a catalyst for accelerating the migration to digital. From where I sit, I think the opportunities for innovative business models created by this digital global space are incredibly exciting, especially for TelecityGroup. People talk a lot about cloud computing. But a cloud is essentially the outsourcing and centralising of services and data. Our customers do this with us every day.

The prospect of low growth rates in the UK and the rest of Europe for the forthcoming years almost demands that businesses need to look outside of Europe for new markets. And these might well be export markets that require services or products that are different from those currently being sold into the domestic market. This presents another major challenge to management to reflect carefully on the customer needs and tailor the offering accordingly.

The danger of not applying rigorous analysis of overseas markets is that not only might a business be missing out on potential new sales opportunities, but they also need to be alert to the possible competitive, threat to the domestic market from new overseas entrants. And these new competitors are likely to be coming from non-traditional sources: the Middle East, the Far East, Eastern/Central Europe and South America. Underestimate them at your peril.

So it's a focus on new products and services, new markets and watching your back.

More than ever business leaders need to focus on the reasons why their customers choose them compared to their competitors, and to ensure that they maintain the differentiators that they have developed. At the same time they need to recognise the strategic direction of their competitors and to ensure that they retain a competitive edge if the market paradigm is changing. If, as may be the case, that requires an evolution of business model or a change in terms of trade in order to continue to be competitive, they should make sure that they have fully understood the financial implications of this. A move from a project-based business model to a managed service, for example, is likely to result in a significant shift in the cash flows of the business. Business leaders need to combine flexibility of strategic thinking with a pragmatic respect for the realities of trading cash flows in order to survive and thrive.

What should business leaders focus on to survive?

Ireland Inc. is suffering considerably from a significant lack of competitiveness on both the European and Global stage. During the years of the 'Celtic Tiger' Irish pay rates increased at a rate that was considerably faster than most of our competitors. It naturally follows that if we are to survive we need to increase competitiveness and reduce costs. This includes wages, rents, rates, levies and utility costs. The majority of employees in the private sector experienced wage cuts during 2009, a move that was followed by Government in 2010, when public sector pay rates were also cut.

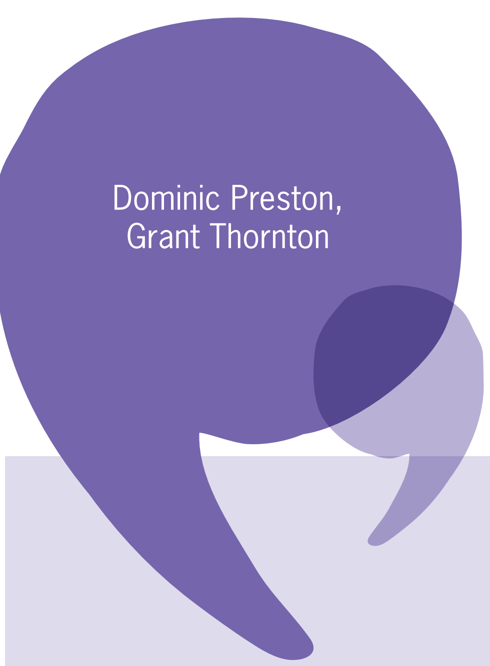
Improved competitiveness is also a consequence of increased efficiencies, utilising our resources better and changing our work practices. Management must be empowered to explore new ways and methods of achieving better results with equivalent or less resources. We need to get more for less!

The unprecedented level of business failures being experienced in the Republic of Ireland at present have a common theme, declining revenues and fixed costs. All too often the speed at which business leaders identify these factors is pedestrian and a consequence of this delayed identification and subsequent reaction is failure. Managers need to enhance their abilities to identify, calculate and analyse KPI's in order to increase their chances of business survival in this difficult trading environment.

The long-term focus should be on value creation; this could be delivered by operational, commercial or strategic thought, or indeed a combination of the three.

- Creating more collaborative ownership structures with joint ventures, mergers and strategic alliances such that economies of scale can be achieved and competitive pressures partially reduced
- Address capital structures and investment, by disposing of non-core assets, investing in high-return markets, re-equitising the balance sheets and shortening the working capital cycle
- Put the customer at the centre of everything, redefining business processes (efficiency and effectiveness), increase service and product quality and increase the size of key accounts

Hand in hand with the long-term vision goes the necessity to retain customers and people as well as collect cash; this will at least ensure the best chance of business survival in distressed markets, but the two must be implemented together in order to achieve sustainable profits and value creation.



Having addressed cost base and perhaps taken advantage of the opportunity to form strategic alliances, business leaders are focusing heavily on their talent pool and assessing how well-equipped the current complement of people are to trade out of recession. KPIs are being torn-up and completely re-written, even to the extent that certain businesses are demanding income generation capability from departments which were historically focused solely on cost control. Key people are being attracted, retained and motivated by a share in future enterprise value, with the smartest businesses using all-time low business valuations to bring in heavy hitters with the lure of some future equity value.

Even very traditional family-owned businesses are taking the opportunity to address generational succession and defuse any demographic time-bombs in their midst, with the outgoing generation using a combination of non-family professional management and their own KPIs based on knowledge transfer, hand-over of key customer and supplier relationships to next-generation family members. In some instances where an insurmountable generational skills vacuum has developed, this necessary introspection and evaluation has, after a heavy degree of soul-searching, forced some hard decisions whereby the family business looks set to be sold to either professional management or third parties, leaving the family to pass on wealth as opposed to the business.

The most innovative businesses are also finding strategic new ways to do business with counterparties in order to survive, whether that means aligning sales and purchasing terms and cycles between themselves so as not to leave one party or the other overly exposed, right through to joint venture arrangements where one party is providing a development site, and the other the labour and materials to complete it, with both parties taking their upside in the capital profits on exit.

Regardless of what sector you are in, survival means gaining an edge on your competitors. And the best way to do this is by investing in innovation – developing new products, services or business models which create value for your customers. NESTA's research shows that those companies which invested in innovation – measured by the percentage of sales from new products – grew twice as fast as non-innovative firms and they saw a 10% growth in turnover, in contrast to 5.8% for non-innovators.

Companies are under enormous pressure to get products brought to market quickly, and this must be reflected in having a nimble approach to idea generation and product or service development. This means structuring your workforce and resources so that you can respond quickly to challenges, take on board new ideas, and then move to exploit opportunities. Look to take a bite out of markets that were previously not open – the downturn has meant a change for everyone. All companies are now considering new options to save money, provide a better service to customers and to break in to new markets. Where there is change there is opportunity for the business leader who is open to innovating. Successful innovation is often less about 'magic bullet' breakthroughs – and much more about core attributes such as adoption, flexibility and agility.

Leaders need to encourage collaboration. When people focus purely on keeping costs down they often forget to keep thinking in teams and developing ideas and networking outside of the business. This is essential to survive and innovate in the marketplace today. People need to work closely with staff, partners, customers, even competitors sometimes, to maintain an edge and to avoid getting left behind. Diplomacy is therefore an important characteristic in a leader!

Leaders should be listening to and learning from young people – their staff, friends, family and customers – to understand their needs from their perspective. Social norms have changed and that's a good thing. Leaders need to adapt to this.

What are the weaknesses in today's business models?

Many businesses operate on the basis of structures and working practices which have in essence been unchanged for years, if not decades. The UK has suffered declining productivity over many years and today's business models in many cases could be streamlined by the introduction of greater automation, more efficient management structures and greater flexibility of offering. In this environment the tendency can be for businesses to chase turnover in order to cover their overheads, and in many cases the business model being utilised would not be the starting point if the same offering was to be developed anew today. The challenge therefore is for management to take a step back from their businesses and to objectively review the way in which the business is structured/going to market at a time when most are focused on getting through the downturn. Great courage is required to take a fresh look at how a product or service is delivered to the market and to cut out practices which have taken years to evolve. Now is a good time for businesses to consider that old adage "turnover is vanity, profit is sanity and cash flow is reality" and consider ways in which they might evolve their business model to deliver more profit, even if that means sacrificing some turnover.

The weaknesses are generally a lack of ambition and vision. But who can blame the managers who are focused on survival, rather than building a long-term sustainable business? How can a long-term perspective be taken, with the short-term pressures to deliver results to the market and to keep the bank managers happy? Traditional, owner-managed businesses may not suffer so much from these pressures, but against a background of continuing change in technology and competition, the models need to be sketching out visions that will motivate and retain good staff, as well as delivering results that will support the financing required. And if the providers of finance are not willing to be risk takers themselves, this will impact the entrepreneurial spirit of the business owners and managers too. So where are the long-term providers of risk finance, especially for the smaller businesses?

The material weaknesses in many of today's business models are threefold and include in the following:

- Sins of the past!
- Weak management skills
- Absence of a strategic plan

All too often we are encountering businesses that are paying dearly for the sins of the past, poor investment decisions continue to haunt many businesses today and are often the primary reason why companies fail today. During the boom years many owner-managed companies supported corporate and personal financial investments taken in times of unprecedented wealth. Many of these investments were over valued and are creating a significant drain in the present day on many businesses that otherwise would be financially sound and have an ability to ride the storm.

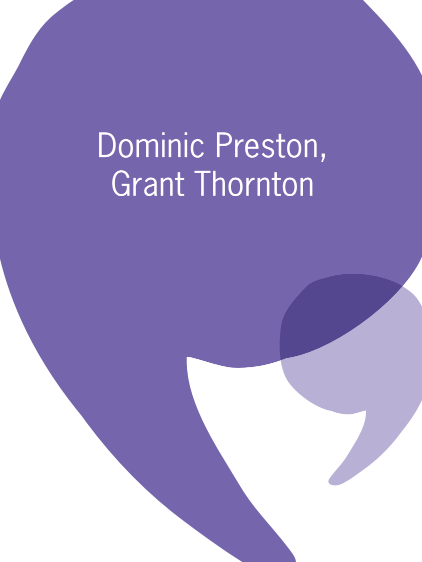
During the 'Celtic Tiger' era many people were over-promoted, particularly management. A consequence of these actions in the present day is that management do not have the necessary skill set to deal with the challenging times we are experiencing today. The tried and trusted apprenticeship route to management of the olden days no-longer appears to exist and business is suffering as a result. There is a lack of experience at the front line for identifying and dealing with many aspects of a business that is struggling.

Many businesses today do not have a clear and agreed strategic plan that has been developed and adopted at Board level. Very often business ebbs and flows like a 'cork in a flood' with no proper supervision or direction. We often say that 'fail to plan and you plan to fail' – sadly this is a reality!

A real challenge exists in striking the right balance between sufficient differentiation of product and/or services, without falling into the trap of finding oneself in too niche or narrow a market. Lack of differentiation is placing smaller players at the mercy of national and multinational competitors who will be leveraging their own balance sheets and reserves to 'buy in' work, sometimes at less than cost, in order to preserve turnover and avoid losing talent and manpower in anticipation of an upturn.

Conversely, larger businesses are finding their ability to refocus ailing service offerings hindered by a lack of speed and dynamism which their smaller competitors can deploy to more immediate effect.

Damned if you do and damned if you don't!



We live in a business world which is becoming smaller. This is largely due to the amount of readily available information on businesses and markets, the growing number of global superbrands such as Microsoft and Google, as well as the way in which customers wish to execute business, eg through global partnerships and electronic transactions. Many businesses are being forced down a route which requires them to have the right accreditations, size and global coverage before they can enter certain markets. Consequently, many businesses grow in an uncontrollable manner or oversize themselves when starting up, subsequently failing or struggling due to an over-invested fixed cost base.

Businesses need to recognise their own unique selling point, build a credible and sustainable base and then seek transformational growth opportunities.

We are living in a super-connected economy, competing against global markets. However, some businesses are still hesitant about embracing new platforms such as those offered by web or mobile technology which could allow them to exploit new markets. Retail chains selling books, films and music have been hit hard by the arrival of e-commerce and online distribution, and the downturn only increased their woes by making consumers eager to look for online bargains. Both Zavvi and Woolworths shut their doors in the early stages of the recession. But look across at businesses that have embraced new business models – and you see a very different story: HMV Group has reinvented itself, shifting its focus from dwindling markets such as music and DVDs into other rapidly growing areas such as live music and video games. Games and technology now represent 16% of the company's sales, and are helping it return to growth.

NESTA research shows that a relatively small number of high-growth companies can have a disproportionate effect on employment and the economy. Only 6% of high-growth businesses generated over half of all new jobs between 2002 and 2008. But, if we want to generate firms with the capacity for high growth, we have to embrace the opportunities that technological change can offer, not retreat from it.

Businesses need to start planning for problems they don't know they have yet. With the changeover to the digital economy lots of unexpected opportunities and glitches will emerge in business models. I think security of data is an issue that is going to get more and more complicated, especially as the more security we develop, the more cyber attackers are working to catch up. Companies need to be open to new ways of storing and managing data, whilst investing in robust systems to protect their customers.

Put business models on the board agenda

Our research shows that most companies need to review, and possibly renew, their business models.

Here are some suggestions from our own experts on the areas that you might wish to table:

Assumptions

Review those made when the model was last discussed – are they still valid or do you need to revise them?

Focus

Is it too internal or on the right customers?

Customers

Are you satisfying the needs of an ever more value conscious, more demanding market?

What changes do you need to make to ensure competitiveness of your product/service offering?

Markets

Are you in the right markets, product/service/geographic – are there new growth opportunities to be exploited?

What new technologies might you use to kick-start growth?

What M&A opportunities exist? eg from competitors in distress.

Competitors

How have your competitors responded to the downturn?

Have they focused more on innovation and growth than pure cost-cutting?

Funding structure

Is it still appropriate or are there alternatives available?

Resources

How flexible is your organisation in adapting to the changes brought about by the recession?

Could you source supplies from a lower cost country?

Are outsourcing options available?

Financial performance

How cash generative is your business?

Where could you improve margins?

Have you identified surplus costs?

What opportunities exist to improve your operational efficiency?

Talent

Are you acquiring, identifying and nurturing the best people?

Do you have the right leadership and people in place to take your strategy forward?

Relationships

How are you protecting relationships with customers, staff, suppliers, stakeholders?

Are you communicating transparently to them?

Contributors

Grant Thornton wishes to acknowledge the contributions made to the research by the 465 respondents and the following who commented on the findings:

David Bateman	FD, Paperchase
Steve Churchhouse	Executive VP, Supply Chain Development, Rolls-Royce
Nigel Clibbens	CEO, Huddersfield Town Football Club
Andrew Curran	COO, My-wardrobe.com
Mike Farley	Group CEO, Persimmon
John Frankiewicz	CEO, Willmott Dixon
Jayne-Anne Gadhia	Executive Chairman, Virgin Money
Peter Kelly	Director, Enterprise Division, Vodafone
Jonathan Kestenbaum	CEO, NESTA
Jason Kingsley	CEO, Rebellion Developments
Natalie-Jane Macdonald	MD, Bupa UK
Andrew Mullins	MD, London Evening Standard
Mike Tobin	CEO, TelecityGroup
Tim Ward	CEO, Quoted Companies Alliance

and from Grant Thornton

Terry Back
Partner
T 020 7728 2343
E terry.a.back@gtuk.com

David Brooks
Partner
T 020 7728 2936
E david.n.brooks@gtuk.com

Anuj Chande
Partner
Head of South Asia Group
T 020 7728 2133
E anuj.j.chande@gtuk.com

Colin Feely
Partner
T 353 (0) 1 6805 616
E colin.feely@grantthornton.ie

Wendy Hart
Partner
Corporate Finance Advisory
T 01865 799938
E wendy.e.hart@gtuk.com

David Maxwell
Partner
National Leadership Board
T 020 7865 2149
E david.maxwell@gtuk.com

Will Oxley
Partner
T 0113 200 1582
E will.m.oxley@gtuk.com

Dominic Preston
Partner
T 028 9031 6527
E dominic.a.preston@gtuk.com

Alysoun Stewart
Head of
Entrepreneurial Advisory
T 0118 983 9666
E alysoun.stewart@gtuk.com

Stephen Weatherseed
Partner, Head of China Group
T 020 7728 3001
E stephen.weatherseed
@gtuk.com

For more information please visit:

www.grant-thornton.co.uk/refresh

© 2010 Grant Thornton UK LLP. All rights reserved.

'Grant Thornton' means Grant Thornton UK LLP,
a limited liability partnership.

Grant Thornton UK LLP is a member firm within
Grant Thornton International Ltd ('Grant Thornton International').
Grant Thornton International and the member firms are not
a worldwide partnership. Services are delivered by the member
firms independently.

This publication has been prepared only as a guide.
No responsibility can be accepted by us for loss occasioned
to any person acting or refraining from acting as a result of
any material in this publication.

www.grant-thornton.co.uk

B1526101