



Podcast transcript

Changing business models and the evolving customer.

Erica Perry, Director, Transfer Pricing and Value Chain Management at KPMG in the UK and Sinead Murdock, Senior Manager, Transfer Pricing and Value Chain Management also at KPMG in the UK.

Musical intro

Announcer:

Hello and welcome to another episode of the KPMG podcast series for tax leaders. In today's episode, we explore how customers have changed, the drivers of change and the impact this is having on tax and operating models. To discuss these topics, I am joined by Erica Perry and Sinead Murdock. Erica is Director, Transfer Pricing and Value Chain Management at KPMG in the UK advising businesses on transfer pricing and the implementation of tax-effective business models. Sinead is Senior Manager, Transfer Pricing and Value Chain Management also at KPMG in the UK and brings a depth of experience from tax consulting and several years working in industry. Today, Sinead's primary focus is on integrating tax into business operations.

Erica and Sinead, thanks for joining me today over the phone. For these podcast we've been exploring the themes of geopolitics, digitization and changing business models. I think our topic today talking about evolving customers and how customers are changing fits within the changing business models theme.

So Erica, perhaps we could start by talking about how you've seen customers evolve in both the B2C and B2B sectors?

Erica:

So I think it's clear that today's customers are more empowered than ever before, they have new levels of choice, and access and service. So they really do call the shots. And as a result, they have the power to actually shape and define the business strategies of the companies that are serving and supplying them. You know, it's clear that good customer relationships and customer service have always been critical to the success of a business. But we hear more and more about customer centricity being really a prerequisite for survival. And it's no longer enough, certainly at least in a B2C context, to just provide that good customer service. So customers want a more connected, personalized, sometimes even emotional experience with the brands that they're consuming, where they feel like their needs are actually anticipated and they feel valued. Customers can also research and transact using different channels.

And they expect a very consistent level of service across all of these channels and touch points. And you know, they make it quite clear if they don't get that service. The customer's often more knowledgeable and so are businesses who are getting a wealth of data through social media, and also all of our online search history. So the online world is really changing as well, how efficient and how high performing we expect a business to be. And these characteristics are really not confined to just the B2C sector. Although, of course, they seem more obvious to us as consumers ourselves, but the changing demands and expectations of business customers are equally impacting the operating models of B2B businesses. So businesses expect suppliers to be ever more responsive and indeed predictive of their needs. B2B buyers don't necessarily want an off-the-shelf product, they want something that's more comprehensive and customized to what they need, and data and analytics are also enabling companies to make more informed decisions about their purchases, so they can achieve that at a much more reduced cost. And we see account-based selling also on the rise due to some of the deep relationships that are demanded more and more by B2B customers. So there's quite a lot of change in what it is that a customer expects from a company that is serving them.

Announcer:

Sinead, how is the evolution in technology and automation changed the customer journey and what impact do you see this having on operating models?

Sinead:

So the customer journey really starts when a customer becomes aware of your company or brands and continues through the full customer experience. And as Erica has mentioned, across B2B and B2C sectors, customer behaviours are changing and expectations are increasing right across that customer journey. Technology clearly has the road to enable business to respond to these demands, and has aligned business to disrupt their markets and operate in ways that really they never did before. Customer interactions are increasing the technology enabled in B2C businesses. And we're seeing data analytics driving greater personalization and areas also like digital marketing and demand planning. And this is similar in based in the B2B sector, customers are increasingly demanding greater involvement in the development roadmap and customizations of products and services to meet their needs and requirements.

Technology has also resulted in the emergence of new business models. And we have seen service and subscription models becoming increasingly widespread even in more traditional (sectors) such as automotive and industrial manufacturing. And that we wouldn't have seen in the past. And there is also a move towards more direct to customer models, effectively eliminating distributors and intermediaries. And then in part of based businesses, customers are demanding more agile and flexible supply chains. So supply chain decisions often now need to be made in real time and sometimes at a more operational level closer to the customer. And as a result of those changes, we're seeing that organizational structures are also adapting and pushing greater autonomy and responsibility down the organization hierarchy. So technology, also skills shortages, and the need for more cross functional and integrated decision making also means that there are more virtual organizations. And we're seeing an increased and move away from functional silos and organizations as well. So, some organizations are still playing catch up. And despite all of these changes, especially the established players in certain sectors, most of these have significant amounts of historical infrastructure and assets, including people. And those things not all need to be configured differently if they're going to become more customer centric in the future.

Announcer:

Thanks Sinead. Erica, I wonder if I can now turn to you to talk us through how tax fit into this conversation around changing business models and the customer.

Erica:

Yes, of course, as much as this is a challenge around business models, it also presents some very important questions for tax and as customers are changing, it's clearly sharpening our focus on what is the correct mechanism for actually taxing value in an organization. And we see more and more debate amongst tax authorities, government authorities, and multinationals about how to tax the digital economy. The increased risk of challenge around permanent establishment, and also challenges in where taxable profits are then expected to accrue under transfer pricing rules. From a transfer pricing perspective, for example, there is a potential shift in the relative value contribution for certain business functions, such as R&D, supply chain and marketing, depending on how they're responding to this evolving customer. And we already see tax authorities beginning to ask more difficult and detailed questions about how and where value is created in a customer centric organization. So for example, you're arguing that there are local marketing intangibles, that the role of in market teams is not just in executing commercial strategy, but actually developing and fundamental to that core strategy or the IP in a business. And in some cases even arguments that position those customer relationships as much more valuable than some of the other more traditionally valuable intangible assets like technology or brand. And this really challenges the more traditional distribution models that a number of companies will have been adopting over the past few years where they characterize distributors as limited risk for transfer pricing purposes. As mentioned, we also see more PE challenges emerging. And that's because customers are buying in different ways and companies have to organize their sales strategies, and sales forces differently.

So for example, through e-commerce in stores, or even digital marketing in a B2B environment. And as mentioned, we have the various proposals both at a unilateral level with digital services taxes, for example, in the UK and France with the draft legislation, and then also at the OECD around the taxation of the digital economy. And concerns have clearly been raised around the OECD proposals about how far they go and how they would impact – likely impact all taxpayers, not least given how the customer and business models are evolving and traditional sector lines are being more and more blurred. And the current user participation proposal from the OECD consultation indicates that the existing tax framework ignores the value that certain business models derive from participation of users or customers. And the marketing intangibles proposal goes even further, and is even broader in scope and is potentially attributing value to marketing intangibles, regardless of legal ownership, or indeed what we would call the DEMPE analysis for transfer pricing purposes of assumptions relating to those intangibles. So it's a very evolving and fascinating debate to tax.

Announcer:

Thanks Erica. So Sinead, if I can come to you to wrap up for our listeners, what should taxpayers be doing in light of these changes?

Sinead: So as you've heard, we have a perfect storm of business change and international tax developments that are taking place and businesses under more scrutiny than ever from tax authority and the piece of international and domestic tax policy change continues. Even after BEPS. There are really two key areas that I would encourage tax teams to think about. And the first is that it is really vital attracting embed themselves in business conversations around how their operating models are changing in the short and in the longer term, so that they consider any immediate changes that are required to their tax model and also to plan upfront for the evolving business landscape, that will be happening in the longer term. And by being part of that conversation early. Not only are you better informed, but you can also then influence change where there are areas of tax risk, incremental tax cost or, in data opportunity. And part of this is really understanding how your business is changing or evolving. And whether customers are moving the dial in your business. You need to be able to identify whether value creation has shifted in your organization. And the best way to do this is through an in-depth value chain analysis. And after that value chain analysis will help you to identify the evolution of value drivers in the context of business change, identify the gaps that you have, and also the transformation. The second thing is that companies also need to actively engage in the international tax debate, particularly where there are consultations in their major markets, on areas such as the digital services taxes. And in particular, where these are being defined by the nature of your operating model, as is the case in the recent draft, the SEC legislation that we have here in the UK. And as you could find yourself being inadvertently caused by some of those measures. The other policy area taxing should be engaging voices around the OECD proposals for taxing the digital economy, particularly those two areas that Erica mentioned, marketing intangibles and user participation, and to really start to think about how this might impact and profit allocation in your groups. And once you're comfortable with your model and the tax issues around it, then it's important to monitor and maintain this steady state operating model with appropriate documentation to be able to explain the value chain and also the allocation of profits in your group.

Announcer:

Erica and Sinead thanks for joining us today.

Sinead:

Thank you. It's been great talking today

Erica:

Thanks very much for having us. It's been a pleasure.

Announcer:

Stay tuned for our next podcast in the Future of Tax program where we will explore another trending topic within geopolitics, digitization or changing business models and please email us with any suggestions you have for future topics at tax@kpmg.com. Thanks for listening!

Musical exit