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# *Financial Strategy of an Organisation in Periods of Change and Transformation*



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## *Financial strategy*



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***The nature of strategy...***

**Why do organisations  
need strategy?**

**How does strategy  
come about?**

**Why do companies  
fail?**

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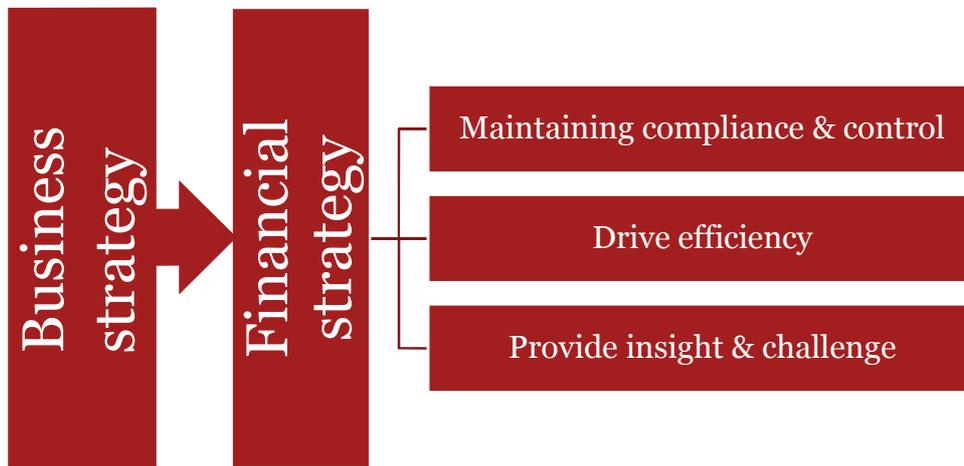
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***Why is business strategy necessary?***

- To set direction
- To focus the organisation
- To provide consistency
- To define the organisation
- To satisfy a need for order
- To exploit resources/opportunities efficiently
- To provide stability

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## ***What is financial strategy?***



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## ***The 'regular' approach***

The financial strategy of an organisation should always be aligned with the business strategy



When out of alignment – the business can suffer



Modern businesses adopt a cascade mechanism from business strategy to financial strategy

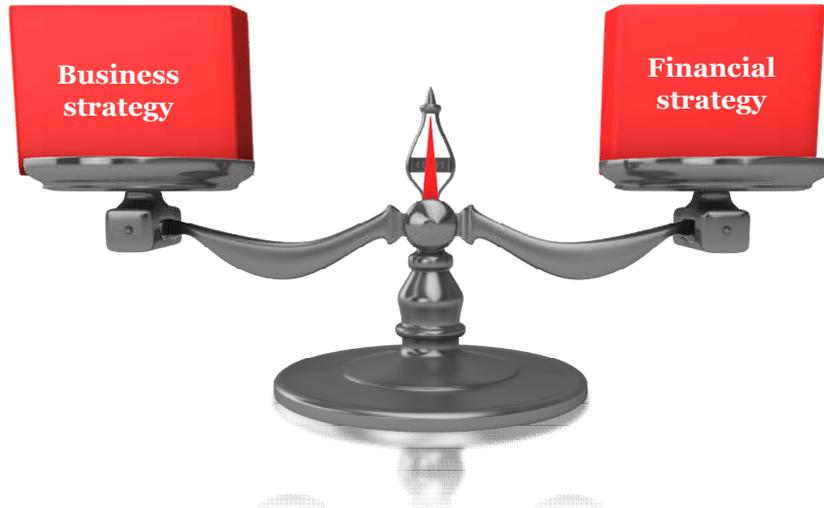


Financial strategy is simply how resources are allocated to support the business strategy

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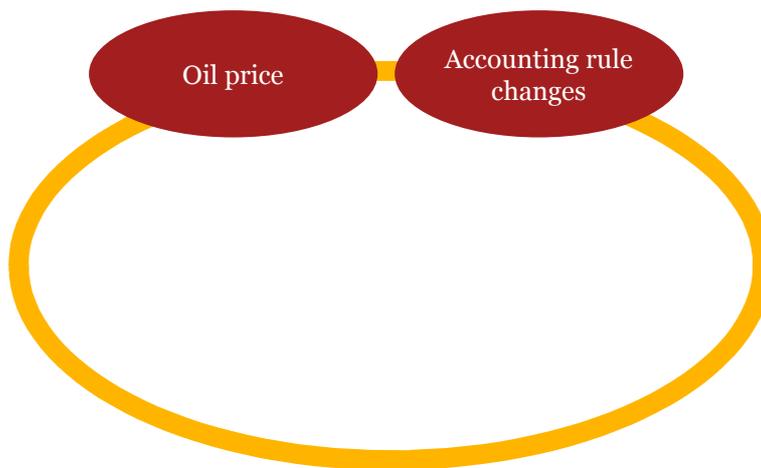
***Where does success come from?***



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***Financial strategy shocks***



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## ***An example – Accounting rule changes***

From 2018 the way companies account for their revenue may change  
From 2018 the accounting for financial instruments will change resulting  
in good news for corporates but bad news for banks...  
...which could be bad news for corporates!

However, the most significant change is likely to come from changes to  
the leasing standard in 2019...

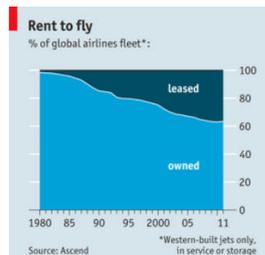
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## ***The new leases standard – all started with a plane!***

“... approximately \$1.25 trillion in non-cancellable  
future cash obligations committed under operating  
leases .... are not recognised on issuer balance sheets...”

*SEC 2005*



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January 13, 2016

Reporting rule adds \$3tn of leases to balance sheets globally

January 20, 2016

Accounting's big shake-up to bring more transparency

FINANCIAL TIMES

## Overview

Lessee recognises *right-of-use asset* and *lease liability* for almost all lease contracts

Lessor accounting stays substantially the same as under current guidance

Comprehensive guidance on the definition of a lease

Exemptions for short-term leases and leases of low-value assets

Effective date  
1 January 2019

Huge impact on KPI (debt/equity ratio; EBIT/EBITDA/operating cash flow)

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## Overview

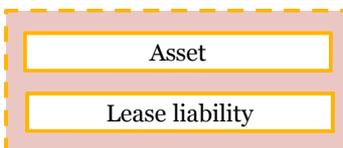
Recap of current IAS 17 rules

### IAS 17: Classification based on risk and rewards

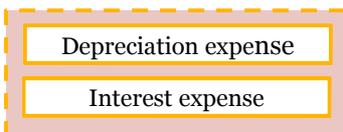
**Finance lease**  
(Substantially all the risks & rewards of ownership are transferred to the lessee)



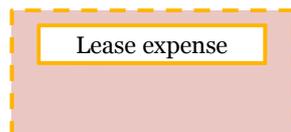
**Operating lease**  
(Lessor retains substantially all the risks & rewards of ownership)



**Balance sheet**



**Income statement**



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## Under IFRS 16 all leases come onto the balance sheet of lessees

### IFRS 16: All leases on the balance sheet

#### All leases

#### Balance sheet

Right-of-use asset

Lease liability

#### Income statement

Depreciation expense

Interest expense

Higher income statement charge in early years of lease, lower in later years

Can impact net assets, will impact key statement of financial position ratios

Cash cost remains the same but impacts on how they are shown in statement of cash flows

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## Impact of lease capitalisation in different industries

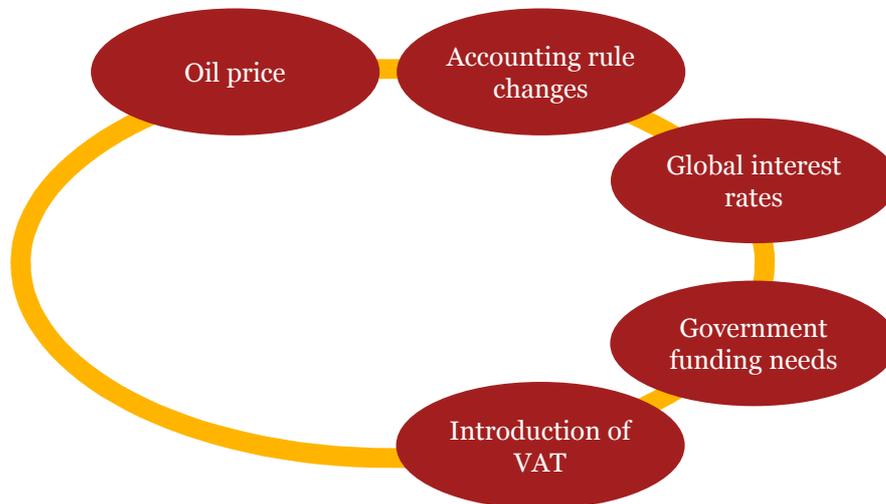
Industry	Median increase debt (*)	Median increase EBITDA	Median change leverage (**)		Median decrease in solvency (***)	
			Before standard	After standard	Before standard	After standard
<b>All companies</b>	<b>22%</b>	<b>13%</b>	<b>2,03</b>	<b>2,14</b>	<b>35%</b>	<b>32%</b>
Retailers	98%	41%	1,17	2,47	41%	28%
Airlines	47%	33%	3,26	3,63	25%	19%
Professional services	42%	15%	0,53	0,96	40%	37%
Health care	36%	24%	2,11	2,92	22%	19%
Wholesale	28%	17%	2,04	2,31	31%	29%
Transport & Infrastructure	24%	20%	2,21	2,52	36%	30%
Entertainment	23%	15%	1,78	1,30	30%	25%
Telecommunications	21%	8%	1,65	2,00	23%	21%

Source: PwC Global Lease Capitalisation study of 3,199 listed IFRS reporters.

- (\*) Interest-bearing debt
- (\*\*) Net debt / EBITDA
- (\*\*\*) Equity less Intangibles / Total Assets

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## Financial strategy shocks



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## Another example - VAT in the GCC

### Latest developments

- GCC VAT common framework will form the legal basis for the introduction of a VAT system in each of the GCC States
- First implementation most likely by 1 January 2018
- Threshold likely to be revenue of \$1m
- Expected transition period between 12 to 18 months
- Envisaged system is a standard fully fledged VAT system applying on most supplies of goods and services with possible exemptions/exceptions

VAT on goods & services	VAT at Import
Standard rate 5%	Exports subject to 0%
Possible VAT exemptions	Minimum annual turnover
Deduction of input VAT	Periodical filing and reporting

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## **Challenges**



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### **VAT Implementation**

- Have you the appropriate resources to be compliant?
- Who will be responsible?
- Do you understand the new law/regulations?
- How do you keep up to date with changes?
- How do you price products in a VAT environment?
  - Do you pass it on to customers or absorb it?
  - Will your suppliers pass it on to you or absorb it?

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## **Challenges**



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### **Communication**

- Educate stakeholders- internal and external
  - 'Top down' approach
  - Contractual obligations – Marketing/supply chain
  - Financial/accounting prerequisites – Finance/tax
  - System/accounting requirements – IT
  - Training/workshops (immediate/ongoing)
- Interview sessions with all internal key stakeholders
- Compile information through standard VAT templates
  - Line by line characterisation and location analysis of revenues/expenses.

## Challenges

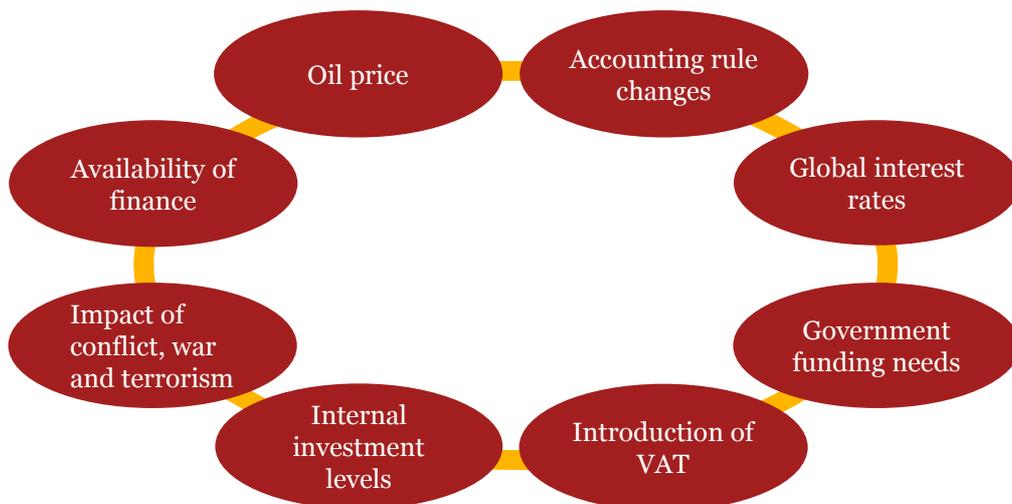
### Manage change



- Transitional VAT issues
  - Existing and future contracts
  - Pre VAT impact on major projects/asset purchases
- Understand tax planning and fraudulent VAT practices
- Test drive overall VAT commercial chain before going live
- Manage increased administrative costs
  - Understand and map resources – appoint VAT champion
  - Decide VAT management strategy-in house, outsource?
- Manage Cash flow, understand possible P&L impact

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## Financial strategy shocks



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## ***Impact***

Many of these shocks have been foreseen and some have arisen as a direct result of other shocks e.g. the creation of the GCC VAT scheme in response to the increasing needs for new Government incomes as a result of oil prices

Some shocks will change the way that information is reported internally and externally which may create the impression that the business strategy is not working

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## ***Impact continued***

Earlier we identified the model of business strategy driving the need for an appropriate financial strategy

It can result in a reversal of the model...

**Shocks**



**Financial strategy**



**Business strategy**

The variety of impacts can result in the need for change or transformation

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## *Change and transformation*



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### *Strategic change*

One outcome as a result of the shocks is likely to be a review and subsequent change of the business strategy because of either:

- Changes required to the financial strategy result in a need to change the business strategy to ensure balance
- The business impact of the shocks result directly in a change in business strategy

The impact of the shocks in KSA have added to the need for transformation at a national level

Change and transformation can result in additional challenges for management

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## ***Change in business***

This is the process of moving from the current state to the “Vision” of the future. It involves a degree of transition which may also result in “pain” for some or, more commonly, all.



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## ***Psychology of change***

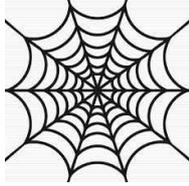
- The “If it is not broken, do not fix it mentality”
  - We have a tendency to live in our world and be comfortable. The most used word in the English language is “**OK**”. This is symptomatic of the problem, should the most used phrase be “**what if?**”
- Comfort zones
  - You must fight to bring a change, it will not be easy, our psychology itself will resist it
- Programmed behaviour
  - All through our lives we learn to dislike change

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## ***Power***



- Symbolised by a web
- Power is wielded by those at the centre
- Key levers
  - To change the organisation, you must get the support of the centre

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## ***Role***

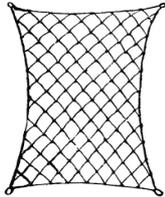


- Symbolised by a Greek temple
- Stability is the key, when it goes, it all falls down
- Key levers
  - Work up each pillar
  - Follow the structure and protocol

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## ***Task***



- Symbolised by a net
- Customer focused objectives
- Key levers
  - Take the key decision makers with you and gain buy-in from most members

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## ***Person***



- Symbolised by a constellation
- Key levers
  - You must effectively take everyone with you

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## **Barriers**

### **Culture**



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### **People**



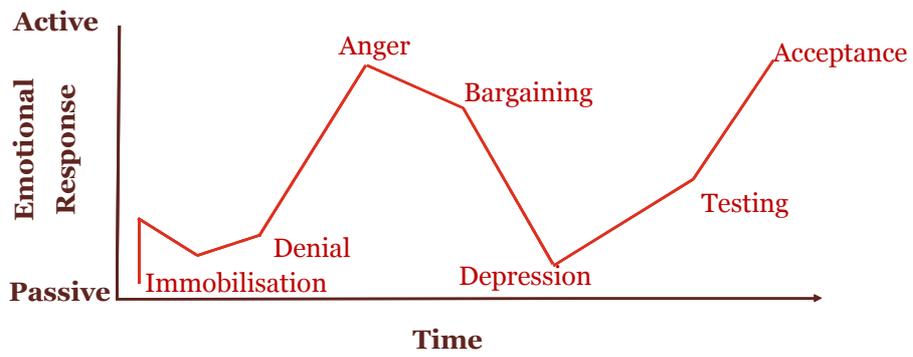
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## **People**

- People react differently to change
- Those opposed to change
- Those in favour of change

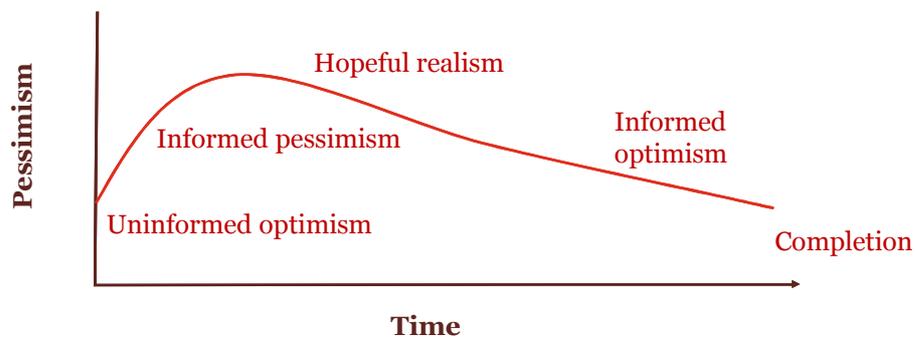
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## Negative response



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## Positive response



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## ***Organisational readiness to change***

		<b>Organisational change style</b>	
		<b>Proactive</b>	<b>Reactive</b>
Environmental stability	Low		
	High	<b>Average</b>	<b>Static</b>
		High	Low
		Management adaptability to change	

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## ***Resistance***

### **What are the reasons for resistance to change?**

- Loss of control
- Uncertainty
- Fear of the difference
- Loss of power
- Possible increased workloads
- Threat
- Misunderstandings

### **How do we deal with resistance?**

- Involve people in the process
- Provide training
- Develop a shared vision and buy-in
- Address the concerns of stakeholders
- **Above all, communicate**

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### ***How to succeed***

Success involves being **SMART**

- S** Strategy defined
- M** Management buy-in
- A** Assurance to staff
- R** Risk analysis
- T** Time critical implementation

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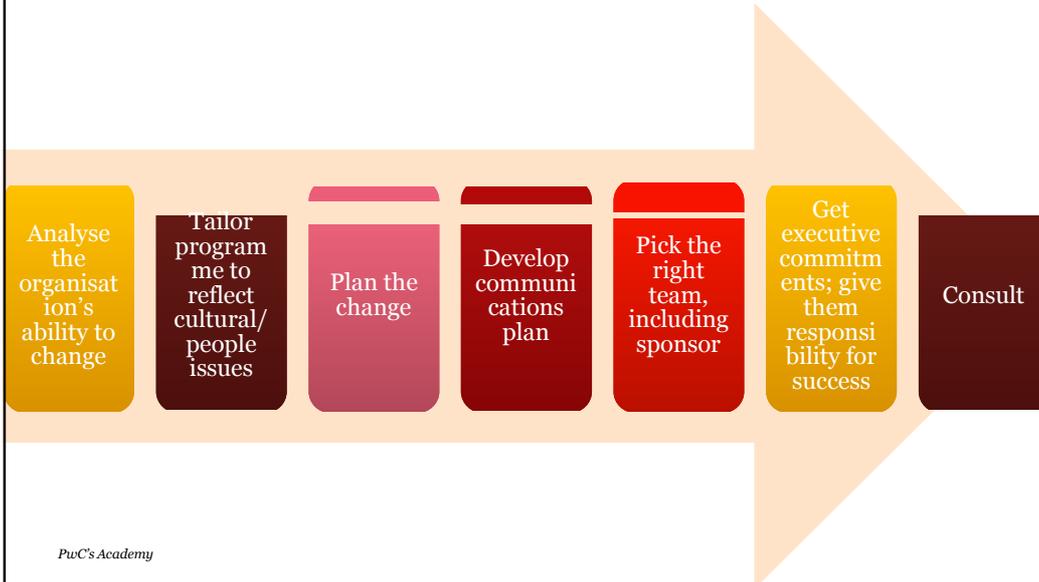
### ***How to fail***

Failure involves being **STUPID**

- S** Sponsorship not forthcoming
- T** Team members do not function as agents of change
- U** Unclear vision and commitment
- P** Poorly planned change programme
- I** Inappropriate / Insufficient communication
- D** Don't take account of culture

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## Key steps



## Conclusion and close



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## ***Conclusion***

Organisations are more successful when there is a clear business strategy

A clear business strategy needs to be supported by a sound financial strategy

Economic shocks can impact on the success of the financial strategy or have a direct need for a change in the business strategy

Changes in the financial strategy can result in the model being reversed and create a need to change the business strategy

Change and transformation can result in additional challenges for management

If the business strategy needs to change or transform due to shocks then it is critical that change management works

The culture and people within an organisation can be barriers to change

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