

Accounting Through the Business Model

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Abstract

While the business model has become a popular concept in many academic disciplines, it has not been invited into the accounting sphere. A new development, Integrated Reporting, promises to challenge this, but unfortunately its conceptualisation of the concept is flawed. Can the accountancy profession grasp value propositions to customers?

Introduction

The business model concept has entered a growing number of academic disciplines during the past decade. Its impact has been impressive, as might be expected of such a fundamental and far-reaching concept. There are exceptions to this general trend, however. The present paper focuses on the comparatively modest reception the business model concept has received in the accounting discipline and argues there is reason to believe this could change given the pivotal role the business model concept is recognised to play within

Integrated Reporting (IR) development. Unfortunately, this does not promise to be a mere formality as current thinking on the business model in relation to IR is partial (Tweedie *et al.*, 2018), and perhaps intentionally so (Roslender and Nielsen, 2018). In our view, this is well understood by those who commend a particular interpretation of IR, one that threatens to emasculate the concept's capacity to radically reconfigure financial reporting in ways that might worry many of those who see themselves as the guardians of this project.

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Approach

This paper discusses the two fields of Integrated Reporting and a new visibility for customers in accounting and reporting.

Integrated Reporting

For some years IR has been touted as the new generic model for financial reporting. It is envisaged as replacing the now ageing corporate reporting model that emerged in the mid-1970s. Concerns have been expressed about the latter model since the early 1990s but for several reasons these concerns have not prompted significant change. This is not least due to the inherently conservative nature of the global accountancy profession, and particularly its financial reporting constituency. Twenty years ago, corporate reporting seemed likely to be replaced by some form of business reporting model (ICAS, 1999) but the resilience of corporate accounting practices, and its guardians, effected its survival to the present day. IR advocates must recognise the strength and influence of these guardians.

IR originally emerged in South Africa approaching fifteen years ago. At its simplest IR recognises the necessity to account for a wider range of capitals than does corporate reporting and to a similarly wider range of stakeholders. Arguments for a stakeholder emphasis rather than the traditional shareholder emphasis have proliferated in recent years. IR originally emphasised the necessity to account to the environmental lobby (now the sustainability lobby). Consequently, in its early years IR attracted enthusiastic support from these stakeholders, including the environmental accounting community. The admission that it was crucial to take the environment into account was portrayed as a much merited and potentially valuable advance.

The environment was not to be the only additional capital to account for. Both intellectual capital and human capital, together with social and relational capital, are identified as additional capitals to the more traditional emphasis on physical and financial capital. The identification of six capitals was crucial in the framework the International Integrated Reporting Council (IIRC) identified in its 2013 conceptual framework for IR. The IIRC had emerged in 2010 to promote the IR concept, largely as envisaged by its South African creators, as a potentially feasible basis for a new financial reporting

approach. The subsequent commercialisation of the IR concept was not to everyone's liking, however, at the extreme being portrayed as a betrayal of the originally highly desirable admission of the need for a much more integrated approach to financial accounting and reporting. Flower (2015) provides one of the most excoriating critiques of the IIRC's reconfiguration of the initial concept. Such was the opprobrium conveyed in its pages, two stalwarts for a sustainability emphasis, Adams and Thompson, penned a pair of 'let's take a moment to think about this' responses published alongside it.

Leaving aside the debate about the compromised purity of the IR concept in the hands of the IIRC, which debate promises to run for some time yet, of more interest here is the way in which the IIRC has enrolled the business model concept in its IR framework. The business model sits at its very core, something clearly evident in figure 2 (IIRC, 2013:13). The six capitals are identified as inputs to the business model which sees them transformed into (six) outcome capitals. It is this transformation process that IR seeks to account for. This departs significantly from what corporate reporting presently seeks to account for, which might be conceptualised as the growth of the financial value of a business entity during an accounting period, as represented in the balance sheet. This financial value, and any increases (or indeed decreases) in it, is understood to be the rightful reward for those prepared to risk their capital in the venture itself.

The IIRC labels figure 2 the "value creation process", intimating that accounting for the business model is in fact accounting for value creation by the enterprise. This is because the business model is best understood to provide a visualisation of value creation, i.e., how value is created by the business enterprise. From a conventional financial reporting perspective, value is created for *shareholders*, who see an increase (or decrease) in the balance sheet and in turn the market value of their shares, be they individuals or institutional shareholders. Value creation *in relation to* a business model is not understood in this way, at least not in the first instance. Value is now to be understood to be created for, and delivered to, *customers* via appealing value propositions, a core concept in the business model literature and alongside it the strategic management literature. Since the 1980s the latter has reflected the

dominant role customers have in shaping sustained competitive advantage.

Customers: a new visibility in accounting and reporting
Traditionally financial reporting has been shaped by the need to report on the enterprise to its owners. In recent decades it has been recognised that additional stakeholders have a range of different, and sometimes competing, interests in such financial information, as a result of which financial reporting has evolved in this direction. IR marks a further stage in this evolution, in some part as an effort to take into account the concerns of the broader society in respect of sustainability issues. More significantly, however, despite the suggestion that IR is based in a more inclusive reporting paradigm, continued emphasis on *value capture*, as the principal objective of shareholders, constitutes a major denial of fundamental change. While a business model as the visualisation of value creation and delivery is positioned at the core of the new reporting model, securing and demonstrating continued value capture remains the prime motivation for those charged with reporting enterprise performance.

The intellectual capital literature identifies customers and customer relationships as major constituents of relational capital, together with brands and reputation. Long acknowledged as key assets of enterprises, their importance has escalated in recent decades. The generality of intellectual capital's constituents, and prior to this many aspects of goodwill, have not been incorporated within the balance sheet despite their importance, for reasons widely understood by the accountancy profession, managers and shareholders alike. These reasons make sense within prevailing regulatory framework guiding financial reporting. Although it is possible to identify examples of accounting for customers, these have been pursued within the managerial accounting literature. In some cases, such accounting has been indirect, such as in accounting for quality or target costing. Work at the interface between managerial accounting and marketing management has produced a literature that focuses on documenting (=counting) a variety of customer attributes such as customer retention, customer referral and customer engagement (with a parallel brand-oriented literature). Many accounting practitioners and academics would question whether such developments might

be considered as accounting despite their utility for enterprise managements.

Key Insights - Accounting Through the Business Model

Given the escalating importance of customers their relative invisibility within financial accounting and reporting is problematic. As long as the pursuit of robust balance sheet valuations prevails there seems little likelihood the impasse can be avoided. For this reason, the emergence of IR is to be welcomed. The reconceptualization of accounting and reporting its signposts is, however, potentially so fundamental it is likely to evince powerful resistance among the accountancy professionals.

Nielsen and Roslender (2015) offered the following characterisation of a business model:

[A] description of an organisation's concept for earning 'money' [which] identifies the platform that connects value creation and value delivery between the organisation, its stakeholders, and its customers in order to capture value. (p.265).

This characterisation consciously downplays the significance of accounting for value capture on the grounds that despite its various failings, the prevailing approach to financial reporting fulfils this role satisfactorily. The manner in which the guardians of financial reporting have sought to enrol the business model concept within IR marks a further attempt to refurbish a value capture emphasis, which is understandable and legitimate. In our view, however, this is not the most beneficial use of the business model concept within accounting.

The business model concept promises to facilitate accounting for value creation for and delivery to customers, which constitute generic activities that should now be recognised as posing the principal challenge to the accountancy profession, in tandem with the other management functions. A major dimension of this challenge is that financial values, which have for many generations provided the main preoccupation for those responsible for balance sheet preparation, will not be relevant to this exercise. Equally, the traditional

concern with costs that underpins a major part of income statement construction, and the greater part of cost and management accounting practice, is similarly of little relevance. In this context the 'value for money' aphorism that gained such currency a generation ago and continues to inform common-sense financial thinking, partially captures the transformation that is being signalled here. Its usual meaning is associated with an efficient use of financial resources, *inter alia* the limited spending power of individuals. However, on a daily basis many individuals engage in expenditures that contradict the pursuit of demonstrable financial value, preferring instead to secure a vast range of intangible or emotional value. Why else would so many people willingly exchange five euros for a cup of coffee?

The concept of the value proposition sits at the heart of business model thinking, something clearly evident in the case of Osterwalder and Pigneur's iconic Business Model Canvas (Osterwalder and Pigneur, 2010). Although it is easy to identify a variety of concrete business models explicitly intended to deliver financial as opposed to emotional value for money, Ryanair providing a powerful exemplar, the majority of contemporary business models are consciously (or sometimes not) informed by a recognition that the customer is normally seeking some level of emotional value from what is made available for them by the enterprise. Successful enterprises are those that fashion value propositions that satisfy the demands of their customers, albeit not at any cost. Excessive pricing will normally provide a degree of disincentive to purchase on the one hand and the motivation for competitors, new and old, to enter the market. This said, the margins that are at issue are not as sensitive as those asserted to characterise the competition existing between enterprises offering low cost value propositions, where cost leadership organises the marketplace. After Porter (1985), attractive product differentiation is likely to outweigh potential cost savings, viewed in absolute if not relative terms.

This set of business model related concepts is barely visible within the IR framework. Equally they are not part of the vocabulary of financial accounting and reporting, and as previously suggested are likely to engender discomfort among many within that particular community. From our perspective it is these ideas that should be recognised as constituting what should now be

accounted for in addition to what is presently the focus of financial accounting and reporting. This is quite distinct from what IR is represented as seeking to achieve. IR is touted as a possible successor to the prevailing mode of corporate reporting, a replacement that, as we have identified earlier, continues to privilege the value capture needs of shareholders, albeit not to the exclusion of some other stakeholders, some of whom are already being provided for to a degree. There is a strong argument that IR as presently envisaged by the IIRC and its supporters entails little beyond the provision of a marginally more inclusive balance sheet, based in the six generic capitals that are either enhanced, diminished or transformed in the course of the value creation process, as visualised in the enterprise's business model. There will need to be an increased level of narrative reporting of these latter processes since it seems unlikely that conventional hard numbers will be able to capture what has been accomplished, with significant emphasis on "what has been accomplished". Stripped right down, IR is principally focused on the production of historical information and is thus simply at odds with the future emphases of the business model concept as understood by most of those who commend it.

Discussion and Conclusions

The phrase *accounting through the business model* is used here to focus attention on the challenge of accounting for value creation for and delivery to customers rather than accounting for value capture for shareholders. In so doing, we are conscious of the objection that we are doing little more than exchanging one privileged stakeholder for another, albeit in the case of customers a very large stakeholder. It is important to affirm that what is envisaged entails something different to accounting for customers, which as was previously noted is already being pursued as a core component of strategic management accounting. What is now to be accounted for is the intangible or emotional value, the pleasure, the positive sensations that customers experience as they embrace and enjoy appealing value propositions, arguably the antithesis of what the accountancy profession has, for generations, based its jurisdiction on. This is not a task that the accountancy profession can accomplish on its own, in much the same way that target cost management was quickly recognised to require inputs from a range

of management functions, none of which was prime despite the importance that value engineering plays in all such exercises.

The objection that, in effect, accounting through the business model demands that accountants quantify the unquantifiable, is likely to spring to the minds of many. To some degree this objection has already been partly rejected by sections of the profession by virtue of their uptake of narrative approaches to reporting and disclosure, something likely to expand further in an era of IR. Accounting through the business model in this way provides an opportunity for further innovation, including the fabrication of customer self-narratives focused on the demand for and supply of appealing value propositions as an exercise in the co-creation of value as recently identified within the marketing management literature.

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