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Business Model Reporting: Why the Perception of Preparers and Users Matters

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Abstract

The concept of business models has entered the realm of corporate reporting through recent regulations. This article aims to offer a conceptual discussion about the importance of investigating preparers' and users' perceptions of the business model and its constitutive elements in relation to such reporting and disclosure requirements. While prior studies on business model reporting have investigated the amount and quality of disclosures utilizing content analysis, we argue that it would be relevant to take a step back and understand how preparers and users of financial statements understand and consider this concept, as well as the respective alignment of their interpretation. Such an analysis is expected to provide insights on the underlying reasons for, and antecedents of, the current disclosure levels and about the capability of the business model concept to provide a framework for other types of information, as postulated by the literature.

Keywords: Business model concept, Definition, Non-financial reporting

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Introduction

The BM offers a simplified representation of how a company operates and creates value in the long term (Casadeus-Masanell and Ricart, 2010). The knowledge of the BM allows users to better understand the role of the different processes and resources in the value creation process (Bukh, 2003), exemplified by the case of financial analysts in Nielsen and Bukh's (2011) account of how they engage in BM discussions. Among such reasoning, the concept of BMs has been proposed by scholars as a framework for non-financial reporting (Nielsen and Roslender, 2015; Bini et al., 2016), with a focus on performance measures (Bini et al., 2018; Montemari et al., 2019). Accounting for BM from a stakeholder theory perspective has been conceptualised by Haslam et al. (2015) and Michalak et al., (2017) provide an overview of the state and the development of BM disclosures in corporate reports.

Recent regulations require certain large European companies to include a description of their BM in the annual report (Companies Act, Regulations 2013; EU Directive 95/2014). These initiatives confirm the importance of the concept of the BM in corporate reporting. However, they do not provide detailed guidelines or frameworks on how to report the given company's BM. The absence of a clear definition and of especially specific guidelines has led to the adoption of different approaches of BM disclosure by firms and to a misalignment between the BM information disclosed and investors' needs (FRC, 2016; Bini et al., 2016, 2019). Recently, the FRC (2018) has emphasized the need to improve BM disclosure practices to respond to investors' requests.

Current studies have documented varying levels of BM disclosures in the annual report and different market reactions to these disclosures (Bini et al., 2016; Mechelli et al., 2017; Bini et al., 2019; Malmrose and Lueg, 2019; Simoni et al., 2019) as well as to business model innovation (Abrahamsson et al., 2019). However, a lack of a widely shared definition of BM has also been addressed by academic scholars (e.g., Massa et al., 2017). In the academic literature, which is to a large part preceding or detached from BM reporting regulation, there is inconsistency about the

definition and constitutive elements of BM (Bagnoli et al., 2018). While most academics agree that the BM differentiates itself from similar "neighbour concepts" like strategy or value chain, different conceptualizations exist in the literature (e.g., Osterwalder and Pigneur, 2010; Wirtz et al., 2016).

It can be assumed that the low amounts and quality of information reported under the BM sections in companies' annual reports and their capability to influence user decisions depend on how preparers and users conceive the BM. Previous attempts at regulating non-financial information clearly indicate that the involvement of final recipients is necessary to guarantee the success of any regulatory process because they play a critical role in the implementation phase. A prominent example is provided by the initiatives related to the regulation of intellectual capital (IC) reporting. In the 1990s and early 2000s, companies started reporting their intellectual capital to satisfy investor demands. The growing importance of IC and intangibles created information asymmetries between the market actors, similarly to what the distinctive elements of a company's BM do. This communication took the shape of intellectual capital statements, which were prepared and presented either as part of, or separately from, the annual report. These statements' popularity grew to the point where regulation was issued at the national level in some countries (Mouritsen et al., 2003). However, even under the presence of a participatory and co-created guideline in Denmark, IC statements started a rapid decline, as many companies did not prepare them even when they were mandatory (Nielsen et al., 2017). The decline of IC statements can be attributed to several factors, including the loose regulatory requirements (Nielsen and Madsen, 2009; Nielsen et al., 2017), the lack of enforcement mechanisms, the perceived costs associated with intellectual capital disclosure, but also the lack of a clear and widespread definition of the intellectual capital concept, its boundaries, its main components.

Recent studies of BM disclosure of listed UK firms after the introduction of a mandatory requirement for corporate BM descriptions found that in the presence of low specified requirement, BM disclosure in annual reports is fragmented, mainly consisting of

generic descriptions and characterized by a high level of heterogeneity among companies (Bini et al., 2016), thus hampering any form of comparability.

Researchers that have examined BM reporting have not considered critical aspects such as how the concept of the BM is perceived by users and preparers, whether a definition is commonly shared and what the role attributed to the BM concept within non-financial information is. Different conceptualizations of the BM might lead preparers and users to consider different items as part of the BM or to assign different meanings to the concept. Thus, alternative conceptualizations of the BM could result in different perceptions in terms of relevance, compared to other similar concepts like strategy, value chain, or a company's purpose.

This discussion sheds light on the challenges that actors involved in the regulation process need to overcome to avoid future regulatory initiatives' failure. Furthermore, it can be of interest for both users and preparers to have a clear depiction of the main issues concerning BM reporting.

Approach

This conceptual paper discusses the importance of investigating market participants' views and conceptions of the BM concept. After having outlined relevant issues addressed in the management and accounting literature on BM and outlining the concept's relations with associated concepts that could limit BM reporting's efficacy, the article defines the "meaning gap" arising from possible misalignments around these concepts.

Key Insights

The investigation of the degree of alignment between preparers and users can be accomplished by analysing the perceptions of respondents in these two categories. In the selection of subjects that can be identified as representing preparers and users, respondents working in organizations that have to prepare financial statements and financial analysts who follow those entities are good cases to examine. Since the preparation of corporate reporting gener-

ally involves many different functions within a company, preparers are usually represented by the entire organisation. On the other hand, users encompass all types of investors, including sophisticated users such as professional investors, and unsophisticated users, i.e., individual investors. Due to the heterogeneity that affects this category, researchers often prefer to focus on financial analysts. Being market intermediaries, financial analysts are considered an optimal proxy for investors. They are independent experts and regularly evaluate a set of listed companies. Thus, they represent an essential reference for investors, both sophisticated and unsophisticated.

According to agency theory, an information asymmetry exists between a company and its investors. This asymmetry results from unidirectional information flows that run from the "inside" of the company to the external users. That being the case, investors may suffer an information gap that prevents them from having sufficient and appropriate information for their decision processes. Concerning a company's BM, information asymmetries could be attributed to a second gap between companies and analysts, which is a "meaning gap". This gap derives from the misalignment of perceptions of the same BM element or BM as a whole by different subjects. Such a gap is able to undermine the effectiveness of the information flow, because the message sent by the issuer changes meaning when the recipient receives it. Research seems to confirm the existence of such a "meaning" gap related to the BM concept. Nielsen and Bukh (2011), in interviewing financial analysts about the role of BM information in company valuations, found that analysts tend to use information that can be seen as part of the BM, but they do not have a common understanding of what is meant by a BM and its potential role in depicting value creation. These results highlight the need for more research on this topic to verify whether, and to what extent, different perceptions of the BM concept exist between companies and analysts and to what extent they can influence the valuation process.

As stated above, there are at least two main issues that could be considered as potential sources of "meaning" gaps in relation to the BM concept: the lack of a unique and common definition of the BM

and its main components (Klang et al., 2014), and the relationships between the BM concept and related management concepts, like corporate strategy and value chains. Regarding the first aspect, Klang et al. (2014) complain that, despite the dramatic increase in the number of BM publications since the late 1990s and early 2000s (Ghaziani and Ventresca, 2005), primarily non-cumulative research exists with a weak conceptual base and idiosyncratic definitions (Zott et al., 2011). It is stated that BM studies mainly focus on clustering and the categorization instead of showing gaps and limitations of the current status quo of research that could be useful to increase the acceptance of the business model concept (Klang et al., 2014). In a similar vein, Morris et al. (2005) add that the lack of consensus leads to confusion in terminology “as business model, strategy, business concept, revenue model, and economic model are often used interchangeably” (p. 726). This has inevitably hampered the adoption of the BM concept in practice and has limited the convergence of disclosure practices among firms: “while it has become quite fashionable to discuss business models, many executives remain confused about how to use the concept” (Shafer et al., 2005, p. 199).

The overlaps between the BM and other related management concepts especially applies to corporate strategy. Both deal with the concepts of value and value creation. According to some scholars, the difference between the two interrelated concepts should be clear (Shafer et al., 2005; Zott et al., 2011), as the competitive strategy deals with how a company differentiates itself, while the BM defines on which basis this is to be achieved, i.e., how a company combines its know-how and resources to deliver the value proposition. Contrarily, other researchers do not even strictly differentiate between a firm’s strategy and its BM (Casadesus-Masanell and Ricart, 2010).

Similar considerations can be made about the relations between BM and the value chain. This aspect is less debated in the academic literature, but it appears to be of particular interest in the perspective of BM reporting, especially to avoid the duplication of information and to guarantee effective BM reporting. A value chain is commonly defined as a set of

serially performed activities for a firm in a specific industry. The BM is called to explain the different aspects of value creation across the value chain, showing how these aspects affect a company’s bottom line (Nielsen, 2010). The significant points of contact between the two concepts could give rise to concerns among managers and professionals who have to report about their companies’ BM. Therefore, it is important to make clear that the BM notion extends the value chain concept beyond the boundaries of a firm, and integrates external factors (like customers, competitors, suppliers, etc.) and processes (i.e., activities) that enable transactions and influence a firm’s performance (Zott et al., 2011). In fact, in current developed economies value is increasingly no longer created by firms that act autonomously, but by firms that operate in conjunction with other parties that are external to the legal entity. It implies that some BM components have their *locus* inside a firm, while others are related to a firm’s external stakeholders or to the environment it operates in.

These two issues are arguably very important in evaluating the BM concept’s potential in the domain of corporate reporting. Unambiguous identification of the constitutive pillars together with a clear distinction from other neighbouring contents is essential to identify the information to be disclosed and avoid possible misunderstanding. Previous evidence clearly shows the limitations of a generic BM regulation in enabling quality and reliable BM reporting.

Discussion and Conclusions

The considerations listed above call for investigating the understanding and perception of BMs’ meaning in reporting and the degree of alignment between preparers and users of this information. Such an investigation would have the potential to identify and specify the details of a possible “meaning gap” and justify the inclusion of these actors and their views into the regulatory process. The analysis of perceptions of preparers and users through survey research and interviews with the subject involved might also shed light on the incentives associated with the disclosure of the BM and its use in relation to corporate valuation. Interview research could also shed light on barriers, like proprietary costs of

disclosure for preparers and costs associated with information collection for users, which might cause further gaps among market participants. With its unique participatory setup directly involving company analysts, academics, and others, the Danish pro-

ject for IC reporting could serve here as a blueprint for inspiration. Similar to previous experiences in non-financial reporting, the creation of a commonly accepted framework is arguably also a necessary precondition for creating meaningful BM reporting.

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