Summary of proposal submitted to KPMG and the University of Illinois Business Measurement Research Program

Reporting on the business model:
Understandings from the management and analyst point of view

Research team:
BDO-Professor Per Nikolaj Bukh  
(Principal Investigator)

Christian Nielsen,  
Mette Rosenkrands Johansen  
Karina Skovvang Christensen  
Lene Thorsgaard Jensen

Aarhus School of Business  
Fuglesangs Allé 4  
DK-8210 Aarhus V, Denmark  
Ph. +45 89 48 66 88  
E-mail: pnb@pnbukh.com
Introduction

As a preliminary activity of the Business Measurement Research Program, KMPG and the University of Illinois at Urbana-Champaign (UIUC) held its first Business Measurement Research Workshop in Copenhagen on the 28th of April 2002. One of the key issues identified at the Copenhagen workshop was that a major challenge in relation to improving information for decision-making to outside stakeholders is external reporting on firms’ business models. More specifically, reporting to their stakeholders how the firms create value.

Based on experiences from the so-called Danish Intellectual Capital Project (DMSTI 2003) where researchers from Aarhus School of Business, Copenhagen Business School and about 100 Danish firms participated, a major difficulty appeared to be the understanding of firms’ value creation. This problem applied both to management and stakeholders. A main hypothesis arising from the Danish Intellectual Capital Project was that an improved and shared understanding of a firm’s business model is a prerequisite for determining which information to disclose in relation to value creation.

If managements’ understanding of value creation is disclosed to the stakeholders in a form that corresponds to the stakeholders understanding, then disclosure and interpretation of key performance indicators would also be facilitated. Another source of background knowledge for this project is a study on disclosure of intellectual capital in Danish IPO prospectuses from 1990 to 2001 that was conducted by the research team (Bukh et al. 2003).

The need for disclosure is changing

Disclosure of information on intangibles, knowledge resources and other value drivers, has in recent years gained importance. Intangibles are increasingly seen as an integral part of firms’ value creating processes and several recent reports (Blair & Wallman 2001, Upton 2001, Eustace 2001) and researchers (Lev 2000; Lev 2001; Eccles, Herz, Keegan & Phillips 2001; Beattie & Pratt 2002a, 2002b) argue that the demand for external communication of this kind of value drivers is increasing, as companies increasingly base their competitive strengths and thus the value of the company on know-how, patents, skilled employees and other intangibles.

Actually, the supply of information is also increasing in various reporting media. Firms are disclosing an increasing amount of information, but most often leave it up to the reader to extract whatever messages are needed. However, some firms, especially in the Nordic countries, have started developing Intellectual Capital (IC) reports supplementing the traditional annual report. These reports accentuate the role of IC in relation to value creation and communicate how
knowledge resources are managed in the firms within a strategic framework (Mouritsen et al. 2001, Bukh 2003).

In Denmark a number of firms have since 1998 co-operated with researchers and government agencies in order to develop a guideline for intellectual capital reporting (DMSTI 2003). One of the firms that participated in the Danish Intellectual Capital Project was Coloplast (www.coloplast.com). Coloplast was also represented at the Copenhagen workshop previously referred to and the problems of communicating with external stakeholders and creating a mutual understanding of strategy and value drivers was also experienced by Coloplast. Hence, the firm agreed to cooperate in this research project.

Due to the cooperation of Coloplast in the contact to financial analysts, this project offers a unique opportunity to gain an in-depth understanding of the needs for disclosure – both private as well as public disclosure – from an analyst’s perspective, when the point of reference is a specific company.

External Reporting of Intellectual Capital at Coloplast

With respect to communicating externally about performance drivers, strategy and knowledge resources Coloplast is a rather unique case, since the company for the last five years has published an intellectual capital statement as an integral part of the annual report. This intellectual capital section of the annual report uses text, figures and illustrations to show the value generated by Coloplast.

The indicators disclosed in the report are chosen in such a way that they relate to the company mission, vision and business objectives. One of the purposes of publishing an intellectual capital statement at Coloplast is to enter into a dialogue with the stakeholders in order to share expectations and attitudes in a mutual process and generate value. From this process, Coloplast expects to get valuable feedback about how the company is meeting the expectations of their stakeholders.

It is the stated policy of Coloplast to enter into open dialogue with market players to ensure that they receive the best possible information about the company - with due respect to the Stock Exchange Codes of Ethics. Meetings and conference calls with shareholders, investors, financial analysts and other interested parties are held regularly both in Denmark and abroad, whenever possible with Group Management presence.
It is planned to engage most major analysts in this project. Due to the close cooperation with Coloplast and the fact that the research questions and outcomes of the research project is of vital importance also to the analysts, analysts are expected to be willing to participate.

**Research objectives and research questions**

Departing in the notion of an intellectual capital statements’ idea of viewing value creation from a user perspective and the issue concerning improving information for decision-making to outside stakeholders via external reporting on firms’ business models, the objective of this project is to study the possibilities of creating a mutual understanding of the firm through the business model. The user perspective is also evident in the management literature touching upon business models. Joan Magretta, for instance, sees business models as “stories that explain how enterprises work” (Magretta 2002, 4) showing not only how the firm makes money, but also answering the fundamental questions: “Who is the customer? And what does the customer value” (Magretta 2002, 4). One possible way of describing a business model is KPMG’s SSA-framework, which provides a somewhat more robust definition, a business model can be conceptualized as, “a simplified representation of the network of causes and effects that determine the extent to which the entity creates value and earns profits” (Bell & Solomon 2002, xi).

This research project will examine how analysts understand strategy, and which elements – from a strategy perspective – they perceive to constituting a business model. We expect to be able to reveal the relative importance of these elements and uncover the users’ perceptions of which decision-relevant information is important and interesting. By addressing the same questions with respect to management, we will be able to comprehend the underlying factors of the understanding gap and get closer to a definition of how to identify measures relevant to decision-making.

Identifying the key elements of a business model and the main discrepancies between management’s and analysts’ view of strategy also identifies the critical elements that should be communicated to analysts. Thus, the managerial implications of the research part of the project are that core value creation elements as well as ways of communicating these are identified.

Another feature of the way we see business models is related to our experiences from previous research regarding intellectual capital statements where value creation from a user perspective is the main issue. Thus, as a basic idea of the business model concept we are going to focus on how
it is spelt out, what the unique value proposition of the firm is and how it should be implemented.

If we change our focus from the specific firm, Coloplast, to a more general perspective, the value creation could e.g. be related to “solving a problem, improving performance, or reducing risk and cost” (Sandberg 2002, 4) which might require specific value configurations (cf. Sweet 2001) including relationships to suppliers, access to technologies, insight in the users needs etc. Following Stabell & Fjeldstad (1998) we will not restrict the value configuration to the classical value chain – although it is probably the proper way of modeling value creation in Coloplast.

The aim of this project is to develop an understanding of the following tentative research questions:

- How financial analysts view strategy within the framework of a business model
- How management views strategy within the framework of a business model
- How intellectual capital play a role in relation to value creation and to understanding the business model.
- Why the firm discloses reporting on value creation and intellectual capital as well as the specific strategic and financial information
- What kind of strategic and financial disclosure is needed from the analyst’s perspective
- Why differences in focus exist among analysts and management
- How information on value creation and the business model may be disclosed in an annual report
- How a common view on value creation may be facilitated by new forms of disclosure, e.g. within the framework of a business model.
- How the SSA-framework can support the analysts understanding of strategy according to the above mentioned dimensions.

Description of the proposed research activities and research methods

These research questions will be addressed based on a study of Coloplast, its existing external reporting and communication as well as the analysts and managements’ understanding of business models and the need for disclosure. Most research in the disclosure area has been based on questionnaires and has focused on the need for disclosure of specific indicators. This project, however, focuses on the understanding of strategy and business model and the need for disclosure that may be derived from this.

The main research activity is based on semi-structured interviews focusing on the above-mentioned issues with buy-side and sell-side analysts following the Coloplast share. The specific interview questions are to be developed in more detail based on a detailed literature review and
interviews with the management at Coloplast, and a pilot interview. Using a common interview guide, the same research questions will form the basis of interviews with Coloplast’s management team. Besides semi-structured interviews, the study also incorporates the application of a questionnaire and a workshop.

The project will be conducted in five phases:

- **Phase 1**
  This phase incorporates the completion of a preliminary literature review, the conduction of a pilot interview, which along with discussions with the PAB and Coloplast’s management team, will be a part of the preparation of the interview guide. With respect to this, the research team has contacted one of the analysts following Coloplast by phone and briefly discussed the research project with him. He has confirmed the research team of the relevance of the project and furthermore, agreed to participate in the pilot interview.

- **Phase 2**
  Phase 2 is the major research phase of the project. Interviews with analysts and management are conducted, transcribed and coded. The application of a rigorous approach to the coding will ensure complete utilization of the data collected.

- **Phase 3**
  This phase aims at surveying the information needs of other external users of Coloplast’s reporting. Based on the preliminary results from the interviews with management and analysts (phase 2) a questionnaire will be developed. The approach will be to identify possible implications with respect to reporting and in a structured Likert-style questionnaire, ask respondents whether they find this information relevant etc.

- **Phase 4**
  Phase 4 is a workshop for financial analysts, which will be held in close cooperation with Coloplast. The aim of the workshop is on the one hand validation of research results and managements suggestions for a modelling and/or reporting frameworks that can bridge the gap between mental models. On the other hand the workshop can also be seen as a further opportunity to study analysts understanding of strategy.

- **Phase 5**
  This final phase is formally outside the scope of this research project, but is regarded as a natural continuation of the activities. The results will be further disseminated and a teaching case, will be developed.
**Expected contribution of the project**

This project is unique as it offers an opportunity to gain an in-depth understanding of the need for disclosure – private as well as public disclosure – both from an analyst’s and management’s perspectives. Moreover, it also touches upon one of the most interesting current research topics, namely the disclosure of strategic information and information pertaining to the business model.

A key issue, distinguishing this project from previous research in the area, is the dual focus on understandings of strategy from both the management and capital market perspective and the ability to study the process of communication about strategy taking place between analysts and management. The project possesses several elements not seen in previous research. Hence, the results should be publishable internationally.

The results are expected to be reported on the one hand in a comprehensive research report and on the other hand as 1-2 articles in international journals as well as articles in Danish journals. Further, project results will contribute to the overall research agenda in the Business Measurement Research Program.

**References**


