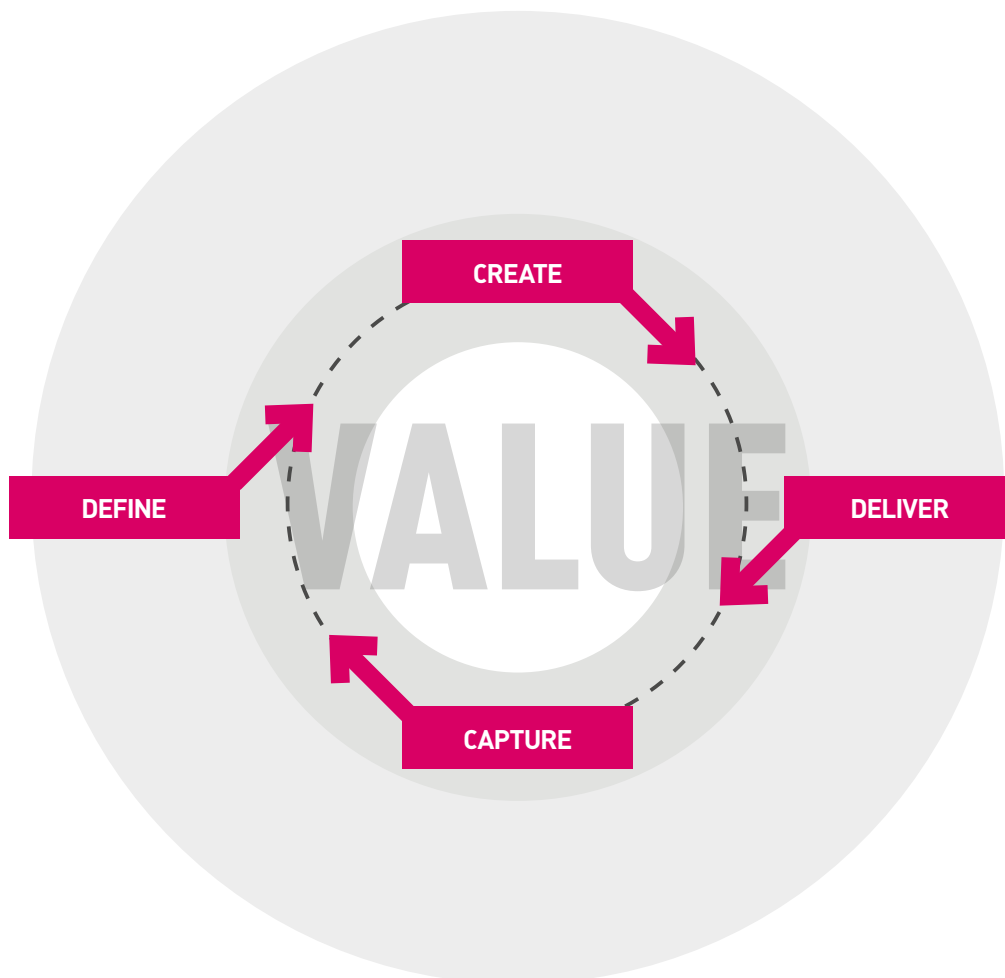


An *FM* Report

# RETHINKING THE BUSINESS MODEL



# CIMA FM REPORT 2016

By Dr Noel Tagoe FCMA, CGMA

## ABOUT THE AUTHOR

As executive director of CIMA Education, Dr Noel Tagoe oversees the formulation and implementation of CIMA's research strategy, the development of CIMA's qualifications and related assessment. He was previously head of research and development at CIMA.

Prior to joining CIMA, Noel taught at University College Dublin in Ireland and the universities of Manchester, Reading and Oxford in England. Between academic appointments he held senior accounting and strategy positions with BP and Elf Aquitaine (now part of Total Oil) in Africa. In addition, Noel established and led KPMG's financial advisory consulting practice in West Africa for three years.

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I am delighted to be sharing CIMA's thinking on the business model. As the value engine of the organisation, it is critical that the business model can be flexed in line with changing external and internal forces, while enabling a shared vision of how the organisation defines, creates, delivers and captures value.

Simply put, the focus for all organisations should be achieving success over time. To achieve this they need to meet the needs of their customers and other stakeholders, including society as a whole. A critical stakeholder is the long-term investor but their return is dependent upon meeting customer needs in return for a fair consideration.

Our thinking provides a unique framework, within which all of these aspects can be considered by both the board and management. It takes the following points into account:

- The objectives of the organisation, in particular the products or services to meet customer needs.
- How these objectives will be met.
- Through which channels.
- How the surplus arising will be shared.

Our reset of the business model will define how the objectives are met and how value is created today. But to address the sustainability of the organisation over time the board needs to consider:

- Its objectives and for which stakeholders.
- The values to be adopted, particularly in meeting the needs of customers, suppliers, partners and staff.
- How the value derived from customers will be shared between investors, employees, investment in the business, and society, mainly through taxation and regulation.

The board must also focus on the forecast changes in the external environment driven by technology, and it must also focus on the implications for the delivery of products and services, and for the expectations of society. It must flex its approach using a series of lenses, such as values and behaviours, risk and risk appetite, and of course value creation for the investor and other stakeholders.

Our research follows in-depth and rigorous data collection and analysis. Four in-depth interviews with CEOs and CFOs from both the public and private sector were conducted. Twenty randomly selected FTSE 100-annual reports were also tested to uncover how they defined the concept of the business model, how it shaped their strategy and operations and how it was used to report on performance.

This is just the start of our journey. By sharing our thinking with you, as well as other business leaders and academics, we aim to generate further discussion, and in doing so refine our thinking on the business model. In a world where pre-financial value by far outstrips financial value, the business model must conceptually keep pace and be able to represent and enable an integrated vision with a focus on the whole business as opposed to just the balance sheet.

Please do share feedback on our research to *business.model@cimaglobal.com*.

**Charles Tilley OBE, FCMA, CGMA**  
**Chief Executive CIMA**

# EXECUTIVE SUMMARY

It may be one of the most common terms used in the corporate dictionary, but the frequency and vagueness with which “business model” is used suggests that a rethink is needed.

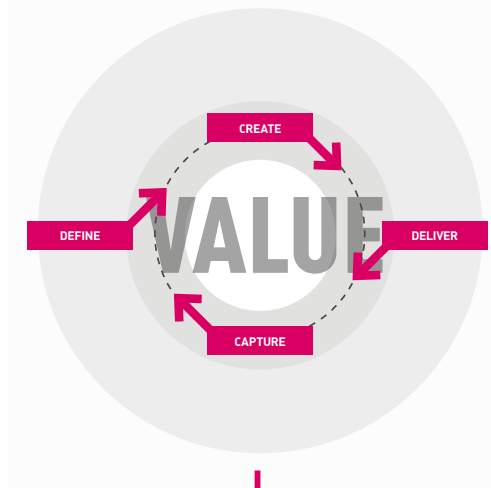
With this in mind, an influential panel of experts has worked with CIMA to produce a business model that brings strategy and operations together in a framework that places value at its heart.

CIMA’s business model considers the whole areas of co-determination and co-creation, where value sits and what value is to anyone at any moment.

For the first time, an uncluttered approach ensures that the difference between strategy and operations is clearly defined.

CIMA’s reframing of the business model is set out below in a three-step build to the final concept.

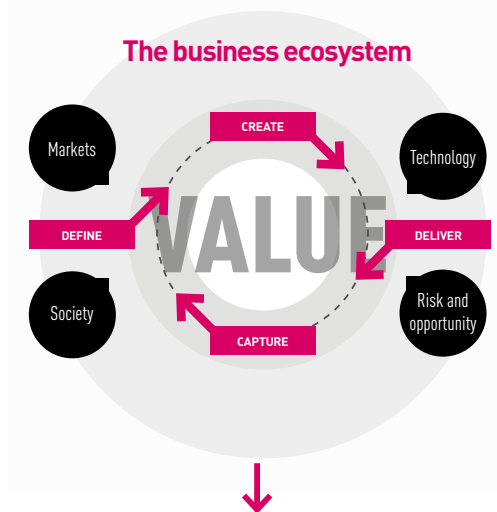
Figure 1:



We focus on how value is:

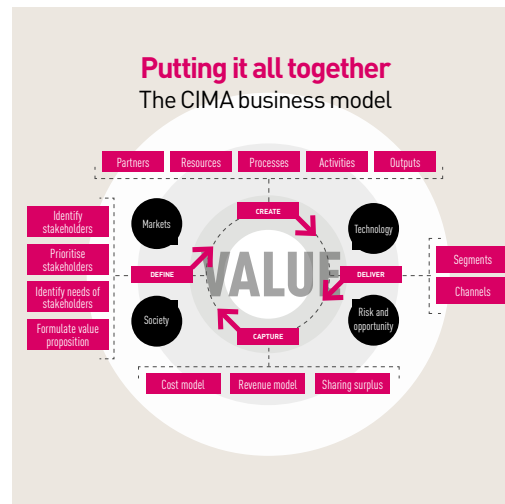
- **Defined** by customers, investors and other stakeholders.
- **Created** through the harnessing of key resources and relationships.
- **Delivered** to ever-more demanding and sophisticated customers.
- **Captured** for reinvestment and distribution to shareholders and wider society.

Figure 5:



We also recognise the ecosystem within which this all operates. Businesses are dynamically linked to markets and society, for example, while technology drives innovation, opening up risk and opportunity.

Figure 12:



# INTRODUCTION

## Why business models?

The concept of the “business model” is widely used in business and academia for three main reasons. First, some regulators require some firms to describe their business models when reporting to shareholders. The requirement by the UK Companies Act for firms to include a strategic report as part of their annual report, and the Financial Reporting Council’s (FRC) “Guidance on the Strategic Report” that places the business model at the heart of the strategic report, is an example of such regulation. This is reinforced in Section C1.1 of the UK Corporate Governance Code, which requires directors to “state that the annual report and accounts ... provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy”.

Second, there is a presumed link between business models and the long-term performance of companies. Business models are the means by which the firms create long-term value and sustained success. According to the International Integrated Reporting Council (IIRC) a well-designed, aligned business model promotes integrated thinking which is the basis for organisational success. From this perspective a major role of senior managers is to design and deploy appropriate business models, which enable firms to exploit business opportunities around them. Regulators base their requirement for firms to disclose their business models in reports to shareholders on this thinking.

Lastly, to some firms the use of business models represents best practice in managing fast-changing operating environments and even firms that are not required to use or disclose their business models are doing so. They are often responding to disruptions in their operating environments, particularly from firms who have new or better business models.

This report seeks to clarify and develop the concept of business models. It is primarily intended for board members, senior executives and finance people who help them to understand, develop, deploy and report their business models.

It aims to use the business model to explain how value is created, delivered and shared between stakeholders. Although it stresses both customer and investor value, it argues for a wider concept of shared value. A central plank of this work is its emphasis on the need for connectivity and alignment between the firm and its operating environment (both internal and external) and thus promotes integrated thinking. The business model shapes and is shaped by the firm’s culture. An understanding of the business model can enable leaders to examine the firm’s cultures and sub-cultures, and to align it with the firm’s purpose and vision.

## What is a business model?

There are many definitions of business models. They depict “the content, structure and governance of transactions designed so as to create value through the exploitation of business opportunities” (Amit and Zott, 2010) or represent “the logic of the firm, the way it operates and how it creates and captures value for its stakeholders” (Baden-Fuller, et al, 2008). Business models are also stories that explain how firms work, including how they make money and how they deliver value to customers at an appropriate cost (Magretta, 2002). They are “a set of key decisions that collectively determine how a business earns its revenue, incurs its costs and manages its risks” (Girotra and Netessine, 2015) and embody “nothing less than the organisational and financial ‘architecture’ of a business” (Tece, 2010).

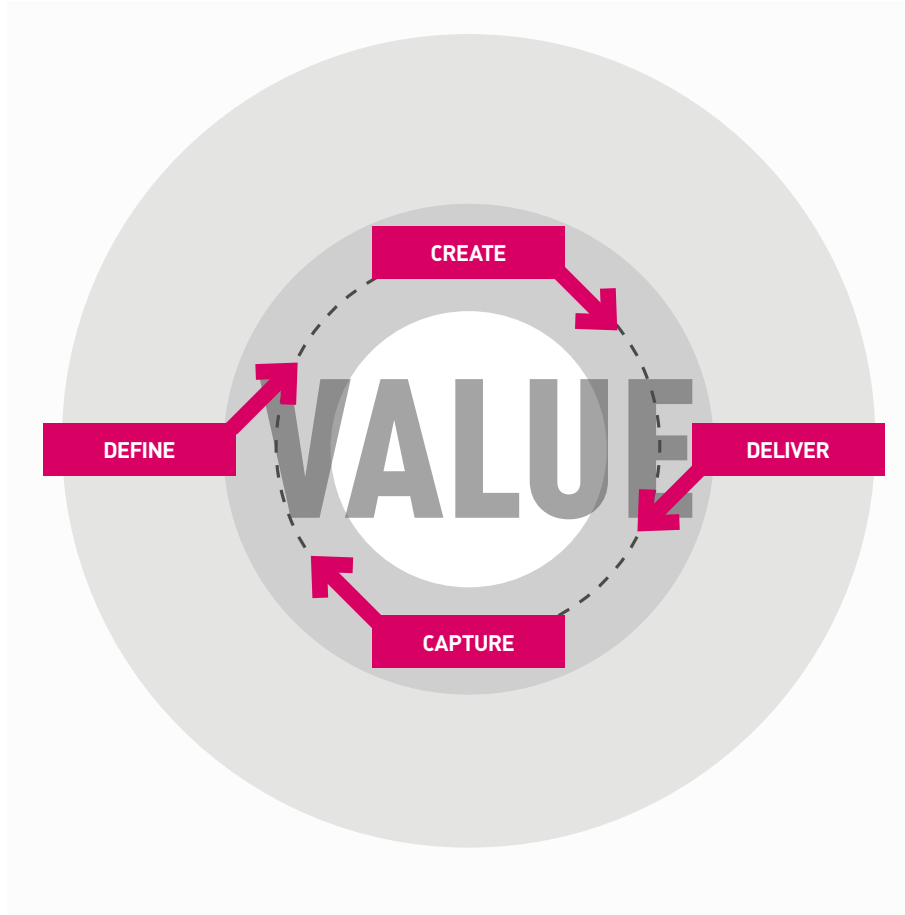
Value creation is a common theme in the definitions of business models. The FRC encapsulated this by defining business models as “how the entity generates or preserves value over the longer term”. This is not surprising because every firm exists to meet the needs of an identifiable group. Value is experienced by that group when its needs are met. In that sense the main purpose or intended outcome of the activities of firms is to provide value to their key stakeholders. That is why “value is at the heart of business models”.

According to KPMG any description of the business model must include how the firm is structured, the markets in which it operates, how it engages with those markets, its main products and services, its main categories of customers, and its main distribution methods. Thus the business model not only looks at how firms create value but also includes how they deliver value (Magretta, 2002), capture value (Baden-Fuller et al, 2008) and make decisions that underpin value creation (Girotra and Netessine, 2015).

This gives us four parts of the business model: firms define value (ie make decisions about value), create it, deliver it and capture residual value for themselves and others (*Fig 1*). To define value, firms look at who they create value for and what counts as value for them. To create value the focus is on how resources are sourced and turned into outputs that customers and others desire. Delivering value means finding ways to get value to those it was created for. To capture value is to ensure that there is adequate residual value to share between the firms, their shareholders and others.

Each part of the business model is aimed at a range of stakeholders. All stakeholders are in view when firms define value, although the customer is often prioritised. Those who provide resources and help turn them into outputs (eg suppliers and employees) are key when creating value. They also receive value from the firm at the same time. Customers are the ones to whom value is delivered. The firm captures residual value to share among the providers of financial capital, government, senior executives and for reinvestment. The parts of the business model are linked and aligned to each other.

Figure 1: High-level depiction of the business model



In view of the foregoing we conclude that a business model shows how a firm defines, creates, delivers and captures value for, with and to its key stakeholders in a consistent and coherent manner.

This definition can be illustrated with the business models of some FTSE-100 firms published in their most recent strategic reports. For example, Tesco's business model has four parts that correspond to the four parts of the business model above:

**1. Customers:** "Tesco exists to serve customers and our business model has customers as our number one priority. Our scale and reach mean we have the expertise to really understand our customers; allowing us to focus on the delivery of an offer with real value in all areas of price, quality, range and service. This focus means that we will champion our customers at every level and earn their loyalty." (Define value)

**2. Product:** "The product we create for customers is developed by our product team. They work with our suppliers to source the best possible range of quality products that meet and anticipate our customers' needs. Our relationships with suppliers are crucial to meeting our customer offer." (Create value).

**3. Channels:** "To bring the best products to customers easily, we work through a range of channels ... As part of improving our offer we will invest in making our channels even more efficient and convenient for our customers." (Deliver value).

**4. Reinvest:** "Our clear priority is to improve Tesco for customers. As we do this, we have committed to reinvest any savings or outperformance into further improvements in our shopping trip." (Capture value).

Similarly, Unilever’s business model “begins with consumer insight that informs brand innovation, often with partners in our supply chain, to create products we take to market

supported by marketing and advertising across a range of distribution channels”. The objective is to achieve profitable and responsible growth (Fig 2).

Figure 2: Unilever business model



## The concept of value

Value is at the heart of business models so it is apposite to say a few brief words about our approach to it. We adopt a wider view of value than is often used in accounting.

Value is about people. It is about how their needs are met. It is created by people, with people and for people. So it is contingent on context and experience. Economists and philosophers explain this with the concept of utility.

Value goes beyond shareholder value to creating shared value. Firms such as Nestlé now produce shared value reports annually. This acknowledges that it is co-created by different stakeholders. Therefore, there needs to be symmetry in the value exchange between participating stakeholders. Put another way, shareholder value can be optimised in the long run if other stakeholders are given appropriate incentives to co-create value with shareholders.

Value can be financial or non-financial and must be differentiated from price, cost, profit or cash flow. These are related concepts but they are not the same as value. For example, we value air but we do not pay for it. Nevertheless they are important because they act as measures or stores of value.

Value and its drivers can be both tangible and intangible. The move from an industrial economy to a knowledge- and information-based economy increased the importance of intangible value to firms. This is shown in changes to the

relative proportion of book value to market value over the years. The IIRC’s six capitals acknowledge this trend.

Value is not limited to the past, it also extends to the present and the future. Past value is often used in reporting, present value in operational management and future value in investment appraisal.

Value covers both the short term and the long term. The short term is important because firms must survive for them to have any long-term prospects. However, short-term value must not undermine long-term value.

## The link to management accounting

The CGMA Global Management Accounting Principles (the Principles) define management accounting as “the sourcing, analysis, communication and use of decision-relevant financial and non-financial information to generate and preserve value for organisations”. Given that value is at the heart of business models, management accounting can help to design, implement and report on the business model.

Firms do not engage in the value activities in isolation but as part of their environments. They shape and are shaped by the environment. In other words, they adapt and evolve with their environment. The nature of a firm’s environment is examined next.



# THE FIRM IN ITS OPERATING ENVIRONMENT

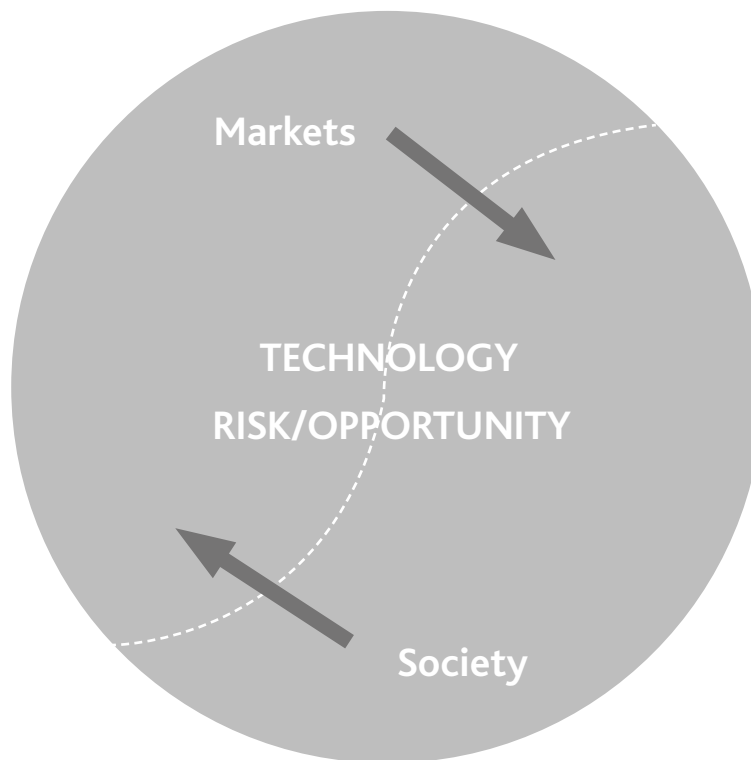
## Interdependent networks and relationships

Firms inhabit and operate in environments that comprise interdependent networks in relationships which connect to (and interact with) each other to produce outcomes.

Two connected networks and two enablers in the networks shape and are shaped by the firm's business models. The networks are markets and society. The enablers are technology

and risks/opportunities. The interactions within each network – and between the networks themselves – are facilitated and enabled by technology. Society, market and technology, and their interactions with each other, provide the risk and opportunity space for the firm.

Figure 3: The networks, relationships and risks in a firm's environment



## Markets

The market is the space in which firms interact with their customers, suppliers, partners and competitors. Its defining characteristics are exchange, competition and profit. There are different types of markets in which firms operate. This includes the product market, financial markets and the labour markets.

Firms provide goods, services and experiences that meet the needs of their customers. This involves combining attributes such as price, quality, convenience and experience in ways that appeal to different segments of customers better than their competitors. To achieve this, firms collaborate with their customers and partners to understand customer needs

and to plan for their fulfilment. They also coordinate with their suppliers to enable them to use the right resources, processes and technologies to produce the goods, services and/or experiences that their customers require at the right time. Lastly, they compete with their rivals by positioning themselves in a more favourable way with their customers.

Thus, within markets there are interlinked interactions among different players around collaborations, coordination and competition. These markets evolve continuously as different players and interactions enter or exit the space. Porter's five forces model provides an example of a dimension of market interaction.

## Society

Society regulates the conduct, activities and operations of firms through laws, customs, moral norms and social action. It comprises governments (at all levels), regulators, local communities and civil society organisations. It transcends national boundaries and in a digital global world it has both local and global dimensions. Society provides the social, economic and legal infrastructure that enable business activities to take place. It can give or withhold the permission to operate in its jurisdiction. It can also prescribe and proscribe various activities of firms.

In the past, firms operating in the West prioritised markets

over society. More recently, the rise of ESG (environmental, social and governance) issues on the agenda of firms shows the increasing importance of society. It is redressing the balance of influence between society and markets in the business model of firms in the West. Society influences all four value activities. The extent of influence differs from one society to another.

PESTLE (Political, Economic, Social, Technology, Legal and Environment) analysis is one of the tools used to understand the impact of society on firms. *Fig 4* (below) shows an example of how PESTLE analysis is used for Coca-Cola.

Figure 4: Example of how a PESTLE analysis is used for Coca-Cola based on information taken from [www.coca-colacompany.com](http://www.coca-colacompany.com)



## Technology

Technology is the application of scientific knowledge to solve problems and tackle issues that people and society face. It is the means by which firms and their partners make things happen and is embodied in tools, techniques, methods and processes.

The impact of technology on society and markets is immense. No wonder the history of mankind is divided into periods delineated by shifts in technology. Its impact on society is shown in demographic shifts (eg an increasingly ageing population), new forms of interaction and organising (using social media), new expectations and experiences.

Technology impacts markets through its effect on productivity, efficiency and the production and delivery of new types of goods and services. As a result it has been the source of competitive advantage for firms. In recent times technology (especially digitisation) has been the single most important source of disruptions in the firms' environment. Technology strongly influences how value is created and delivered.

## Risk and opportunity

The networks interact within themselves, with each other and with the firm to produce the risk and opportunity space for firms. Risk and opportunity are two sides of the same coin. It depends on how firms see themselves and their positioning within the networks.

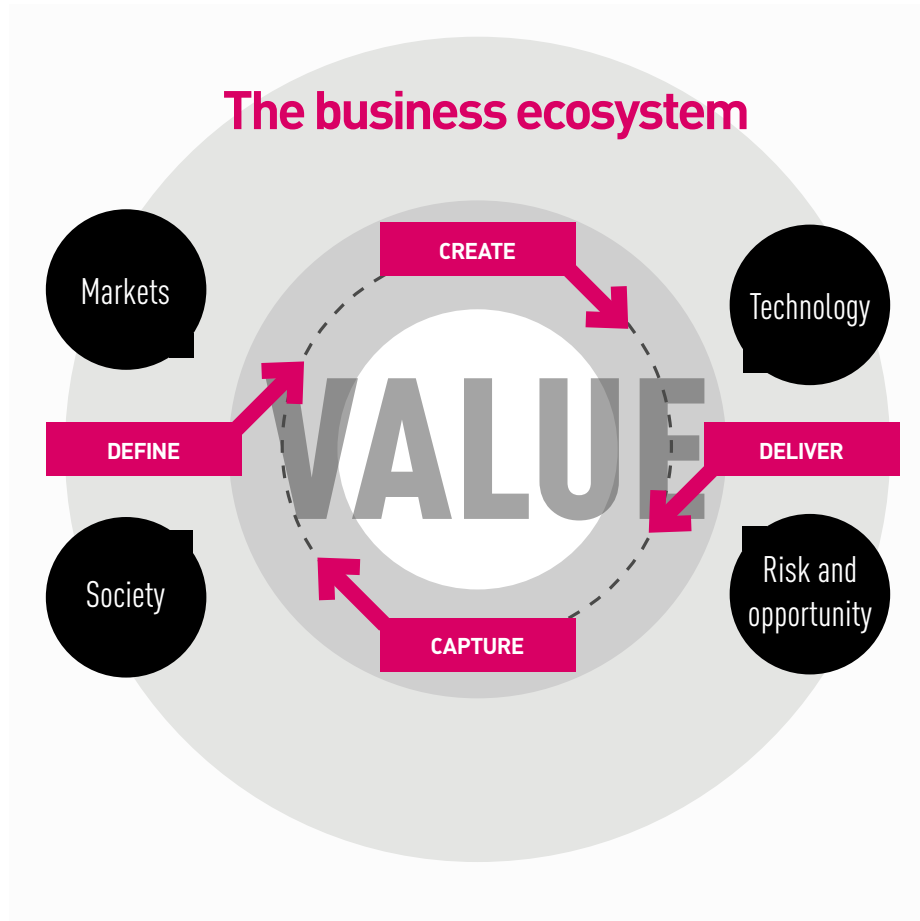
The opportunity space provides new possibilities for firms to collaborate, coordinate and compete with others enabled by law, demographic shifts, market arrangements and technological innovation. Firms that identify and exploit these opportunities are able to generate and deliver value to their stakeholders. SWOT and scenario analyses are some of the ways in which such possibilities are identified and exploited.

Risks refer to the chance that events will occur that will prevent the firm from achieving its value objectives. Risks arise from the decisions, activities, events and interactions in and around the firm. They do not operate in isolation and are often linked to each other. This link accentuates their effects. Risks are managed according to the risk appetite, capacity and tolerance of the firms.

## The business model and its ecosystem

The impact of the firm's operating environment on its business model is shown below.

Figure 5: The business model and its ecosystem



## Managing in VUCA environments

The rate and type of change, as well as the level of disruption in this environment, has been described as volatile, uncertain, complex and ambiguous (VUCA).

Firms adapt to (and evolve with) VUCA environments using one or more of three postures. None of them are enough in themselves and firms might use a combination of them at any particular point in time. First, they use innovation to proactively shape the events and interactions in the environment to suit their purposes. In such cases the firms create the disruptions themselves and move the industry in their preferred direction. Apple is the archetypal example of such firms. Second, firms use agility to create spaces for themselves to avoid undesirable interactions and outcomes in their environments. This is a reactive posture with a

simple logic: I cannot alter what will happen but I can alter how it will affect me. Lastly, firms build resilience to enable them to withstand undesirable interactions and outcomes in their operating environment. This is essentially a defensive mechanism that ensures the survival of firms in adverse times.

Using a boxing analogy, the three postures can be explained as follows. Innovation is similar to taking the fight to one's opponent – the boxer dictates the pace and outcome of the fight. With agility the opponent dictates the pace and direction of the fight but the boxer learns to move and position himself in such a way that his opponent does not land any blows. Resilience involves taking the blows but staying on one's feet without being knocked out.

## Analytical tools and techniques to understand the firms' environments

Below is a list of tools that are often used to analyse and understand the operating environments of firms.

### Elements of Environment

- Markets
- Society
- Technology
- Risk and Opportunity

### Tools and Techniques

- Porter's Five Force Model
- PESTLE
- PESTLE
- Enterprise risk management
- Risk heat maps
- SWOT analysis
- Scenario analysis
- Environmental and horizon scanning
- CIMA strategic scorecard

# DEFINING VALUE

## Value, values, purpose and vision

Before creating value firms have to decide who they are creating value for, with and why. Many firms create value with providers of resources and services for the benefit of their customers in order to earn returns for their investors

while acting within the law. To do this firms identify their stakeholders, specify their roles and place them in a pecking order. The Balanced Scorecard (BSC) exemplifies this approach. It asks the following questions:

### FINANCIAL PERSPECTIVE

How will we look to our shareholders if we succeed?

### CUSTOMER PERSPECTIVE

To achieve our vision how must we look to our customers?

### PROCESS PERSPECTIVE

To satisfy our customers and our shareholders at which processes must we excel?

### LEARNING AND GROWTH PERSPECTIVE

How do we align our intangible assets to improve critical processes?

The answers that firms give about what counts as value, who they create it for, with and to what end, are defined by their DNA. It reflects the firms' identities and is about their values,

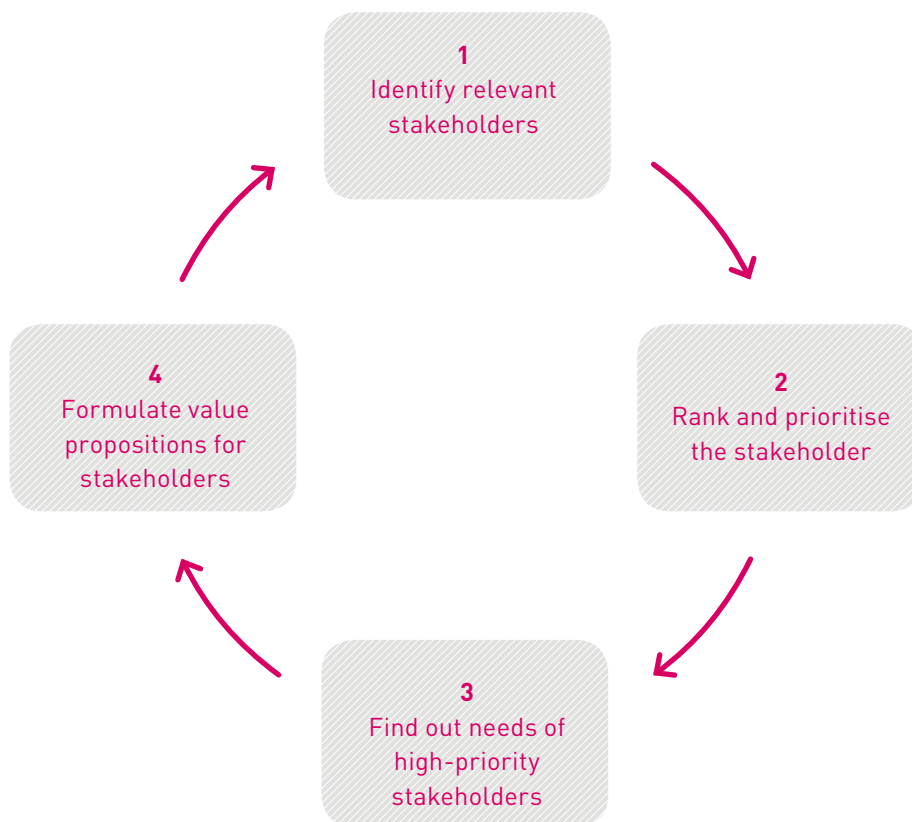
purpose and vision. These issues are at the heart of strategic decision-making. Boards and senior executives will be expected to lead and set examples in this area.

## Iterative process of defining value

Defining value is an iterative process involving four steps. Firms identify the stakeholders for and with whom they seek to create value. They include customers, shareholders, employees and suppliers. Second, they prioritise and rank the stakeholders. In the majority of cases the customer is given the highest priority. Third they identify the needs of the high priority stakeholders. Lastly, they formulate value propositions that meet the needs of the high priority stakeholders. In practice, firms formulate value propositions

for their customers, identify those who can help fulfil the value proposition and find ways of attracting them to partner with to create and deliver value to the customer. A compelling value proposition is economically attractive for both seller and customers, creates one or more differentiating advantages for the seller, can be efficiently delivered to customers and positively positions the seller's brand image and relevance in the minds of customers, partners, investors and other stakeholders. This is part of the firms' strategies and sets the tone for all their activities and relationships.

Figure 6: Stakeholder analysis

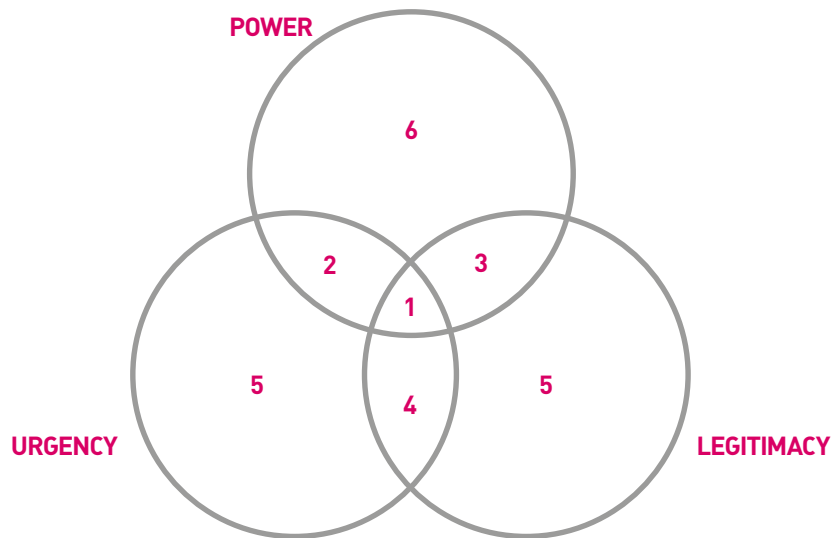


Stakeholder analysis is used to identify and prioritise stakeholders. Each stakeholder is ranked on the attributes of power, legitimacy and urgency. Stakeholders have power if they can impose their will on other parties in a relationship. They are legitimate if their actions or intentions are deemed appropriate according to the values or norms of the firm or

the society in which it operates. Urgency shows the degree to which a claim that is important to a stakeholder calls for immediate action.

In general firms prioritise the stakeholders who have all three attributes, then those that have a combination of two of the three attributes as shown in *Fig 7* (see overleaf).

Figure 7: Ranking stakeholders on power, legitimacy and urgency attributes



Once they have been identified and ranked, the needs of the stakeholders are stated next. *Table 1* shows us what the typical needs of each stakeholder group are.

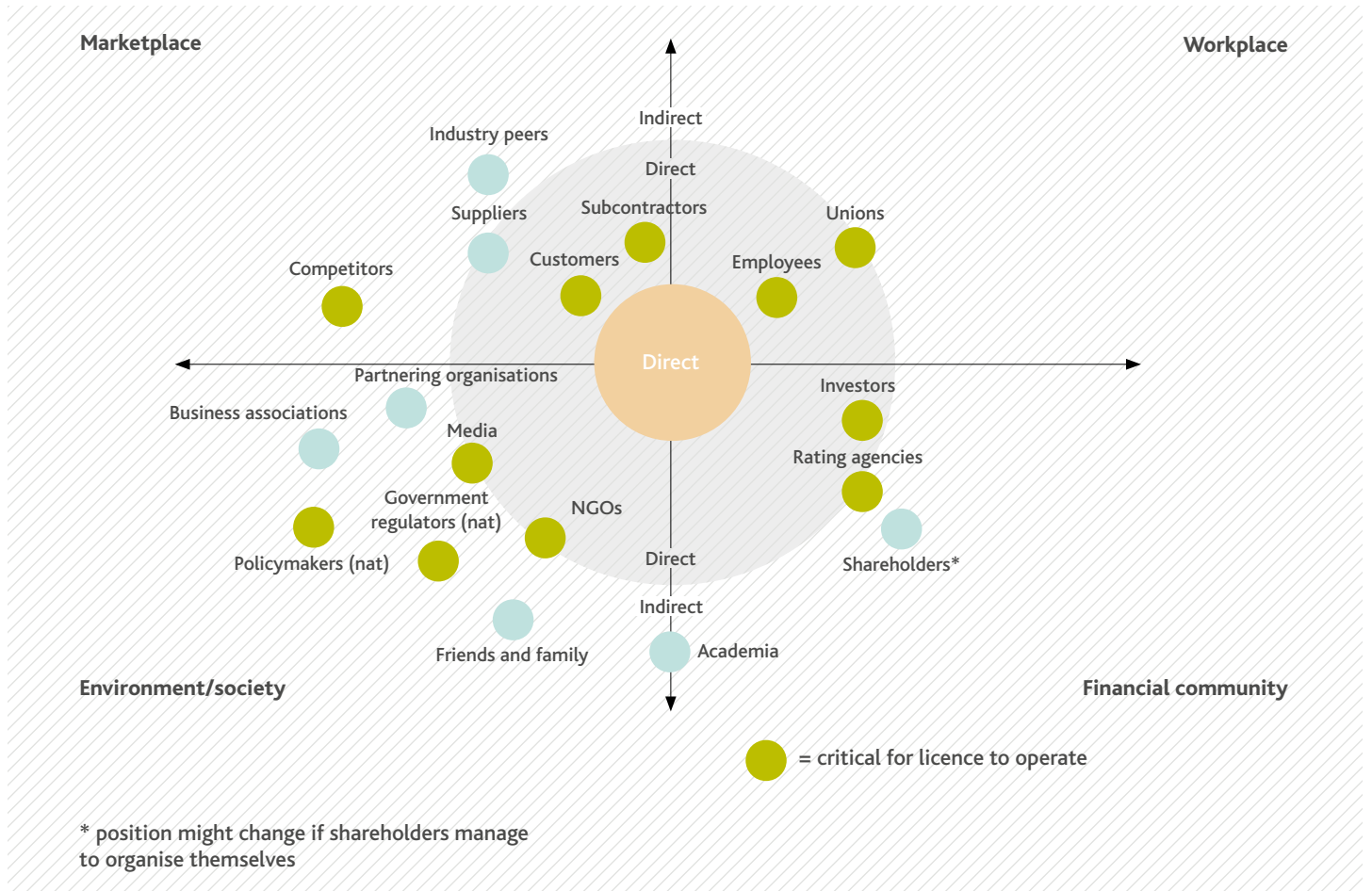
Table 1: Stakeholder needs and contribution to the firm

Stakeholder	What they want	Contribution	Benefits to the firm
Customers/consumers	Goods, services and experiences that meet their needs	Attraction Loyalty Advocacy	Higher sales revenue Higher brand value
Investors	Appropriate risk-adjusted return on investments	Capital	Adequate cash flow Lower cost of capital
Suppliers	Custom, loyalty and cash flow	Resources Technology Market intelligence	Lower cost of sales Resource availability
Employees	Employment Job satisfaction	Know-how Engagement Loyalty	High productivity Intellectual property High performance culture
Local communities	Employment Local development Care for environment	Infrastructure Support Permission to operate Reputation	Lower cost of operations Higher brand value
Regulators	Compliance to rules and norms	Support Permission to operate	Lower cost of operations

Deutsche Post DHL ranks and prioritises its stakeholders in a similar way to produce a stakeholder map which shows its relevant stakeholders who affect or can be affected by Deutsche Post DHL. The green dots are the critical stakeholders.



Figure 8: Deutsche Post DHL stakeholder map



### Tools and techniques used in defining value

Different types of stakeholder analysis tools, such as:

- Power-legitimacy-urgency tool.
- Power-interest matrix can be used.
- Balanced scorecard.
- Value exchange framework.

# CREATING VALUE

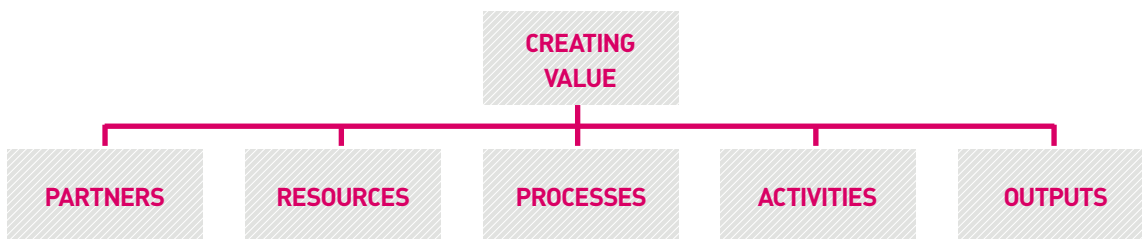
## Infrastructure, capability and relationships that create value

To create value, firms must put in place the infrastructure, capability and relationships that enable them to convert inputs to outputs that meet the needs of their customers. Many people equate the business model to this element. It is sometimes referred to as the operating model of the firm.

There are five main features that must connect and align with each other in order to create value at an appropriate

cost. They are: partners, resources, processes, activities and outputs. Each of these features can help firms to differentiate themselves from competitors, providing customers with the products, services and experiences they require.

Figure 9: Features of value creation



Costs are accumulated at this stage. To produce outputs firms need processes and activities. Processes and activities consume resources, while resources accrue costs.

### Partners

Firms have to motivate and mobilise partners (high priority stakeholders) they identified at an earlier stage to join them to create value. These include suppliers, employees, contractors and other partners who can give them access to resources, markets and technologies, and with whom they make things. To motivate these partners, firms must build relationships, earn their trust and reward them appropriately for their contribution to value creation. Value exchanges take place between firms and their partners all the time and firms have to ensure that they do not load the exchange symmetry too much in their favour otherwise the partnerships will deteriorate.

According to PwC, firms need to orchestrate the interactions of both the different players in their operating environment and the customers to maximise the value delivered, make money out of that for all players and give the firms a fair share of that value. The key performance drivers are relationship management and trust building.

Unilever uses its Partner to Win programme to enhance partner relationships. Its “2015 Strategic Report” stated the following: “We work with our partners in our supply chain, through our Partner to Win programme, to create innovations in products and packaging. 69 per cent of our innovations are associated with supplier-sourced technology ...”

### Resources

Firms use their relationships with their suppliers to source and secure the right resources to make products or services that satisfy their customers. These are both tangible and intangible inputs. The IIRC describes them as capitals and identify six classes: financial, manufactured, human, intellectual, social and relationship, and natural. The balanced scorecard uses similar but broader categories such as human capital, informational capital and organisational capital.

Resources become critical according to the industry and the life-cycle stage of firms. The scarcity of critical resources is of paramount interest to firms. Thus their objective is to ensure that resources are available in the right quantities, and at the right quality, time and price. When evaluating resources from a value-for-money perspective the key objective is economy. For critical resources long-term availability is also a primary objective.

Brewery giant SABMiller identified water as a critical resource. This is how they put it in their 2015 annual report: “Water is fundamental ... to SABMiller’s value chain ... The accessible supply of freshwater is finite and ... both water quantity and quality is in decline as populations surge and demand grows from agriculture, energy generation, industry and households ... Many of our breweries are in areas of water risk. To help us better understand the nature and extent of local risk ... we launched a bespoke water risk assessment

process which ... allows us to investigate risks more deeply, building detailed ... site-by-site picture of our water exposure ... The data enables our facilities to identify and prioritise risks and develop mitigation plans.”

### Processes

Firms need to design, develop and deploy processes that provide the infrastructure to convert resources (inputs) into goods and services (outputs). Processes comprise steps, sequences and dependencies to be followed to achieve desired objectives. They show how things are to be done and are embodied in fixed assets and reflect different types of technologies. The balanced scorecard identifies three types of processes that are relevant to this stage: operations management processes, innovation processes and regulatory and social processes.

High-quality processes can lead to improved cycle times, productivity, quality and costs. The relevant value-for-money metric is efficiency.

### Activities

Firms and their partners engage in activities that use the processes to convert resources into goods and services. It shows what is done and is where know-how, skills, learning and culture come together to make things happen. This captures another part of the people element in value creation. The key metrics are effectiveness and efficiency.

Activities bring processes to life. Processes are empty without activities. The flow of activities within a process is called the workflow. The design of effective workflows enables firms to streamline processes, drive efficiency and avoid gaps and duplication of efforts. The workflow can be used to allocate tasks and for operational reporting.

### Outputs

The resources are converted through activities and processing into outputs. The outputs are in the form of products, services and experience, which aim to meet the customer value proposition. This is done via the product attributes and pricing. The attributes include the product features, quality and style/design. Different combinations of these appeal to different types/segments of customers and the firm must be aware of this.

### Tools and techniques used for creating value

The following tools and techniques can be used for this part of the business model:

- Process mapping, management and re-engineering.
- Value chain analysis.
- Supply chain analysis.
- Value for money analysis/audit.
- Economy, efficiency and effectiveness.
- Various costing techniques, including ABC.
- Lean production.
- Quality management tools: six sigma, cost of quality.

# DELIVERING VALUE

Firms deliver value to customers by making available to them goods and services that meet their needs. Customers have become increasingly discerning and demanding. They expect to receive relevant messages and a good customer experience. To achieve this, firms need to understand their different customer segments and the channels by which to reach each segment. Firms earn revenue only when customers receive and/or use the goods and services.

## Customer segments

Customer segments can be based on geography (where they live); demography (gender, age, marital status, income), lifestyle (cultural practices, social values), behaviour (previous purchase history, product benefits sought, preferred means of interaction) and purchase journey (how they made purchase decisions, who was responsible for their spend, how they talked about the brand and purchase). Segments must be meaningful, mutually exclusive, measurable (with quantified market share), substantial, stable and easy to understand. Highly sought-after segments have customers who are frequent shoppers, have average order values, make few or no returns, regularly leave product reviews and use social media to tell friends about their purchases, and regularly respond to special offers and promotions.

To get the greatest benefit from segmentation Bain and Company suggest that firms must:

- Divide the market into meaningful and measurable segments according to customers' needs, their past behaviours or their demographic profiles.
- Determine the profit potential of each segment by analysing the revenue and cost impacts of serving each segment.
- Target segments according to their profit potential and the company's ability to serve them in a proprietary way.
- Invest resources to tailor product, service, marketing and

distribution programmes to match the need of each target segment.

- Measure performance of each segment and adjust the segmentation approach over time as market conditions change decision-making throughout the organisation.

## Channels

Firms deliver value to customers through communication, distribution and sales channels. Technology has opened up many channels for firms to connect with their customers, who in turn expect services that they can access from a range of touch points including, phones, tablets, retail outlets and social media. According to M&S "technology continues to shape how customers shop. The proliferation of different channels – stores, online, tablet, mobile – is turning shopping into a seamless experience. Mobile is increasingly the first port of call for consumers' research and the number of shoppers using smartphones to search for clothing has increased by more than half over the past year. Visits to M&S.com via mobile were also up 51 per cent" (M&S "2015 Strategic Report"). An Oracle report on cross-channel customer experience observed that customers "might start the buying process based on the recommendation of a friend, online product research, or an email or text message offer. They might then touch and feel the product in a retail store but ultimately buy it from the comfort of their home via a tablet or other device in the small hours of the night."

They expect the buying journey to be relevant and personalised, to reveal consistent features, offers and experiences based on where they've been, what they want and how they choose to get it. On average, Oracle's consumer research shows that more than three-quarters of consumers use two or more channels to browse for, research and purchase products. More importantly, 85 per cent of shoppers expect a consistent and personalised shopping experience ("4th Annual MyBuys/E-tailing Group Consumer Insights Survey").

Although the customer buying journey can be fluid, complex and involve multiple channels, those channels must be integrated. Firms need a multi-channel integrative customer model that delivers customer value and significant return on investment. According to Oracle firms must collect, clean, connect and transform customer data in order to drive personalisation seamlessly across the different channels. Failure to connect across all channels will eventually erode the firm's brand reputation and ability to completely satisfy its customers. Increases in engagement with the consumer and providing a unified consumer experience can increase advocacy and this leads to significant returns to the bottom line. A Deloitte (2010) study showed that engaged consumers delivered twice the spend value and three times subsequent sale through advocacy value. Firms earn their revenue when they deliver value to customers through their preferred channels. It is important that the revenue is turned to cash very quickly.

### **Tools and techniques**

The following techniques can be used:

- Segment analysis.
- Channel profitability.
- Matrix (channel x product offering).
- Customer relationship management.

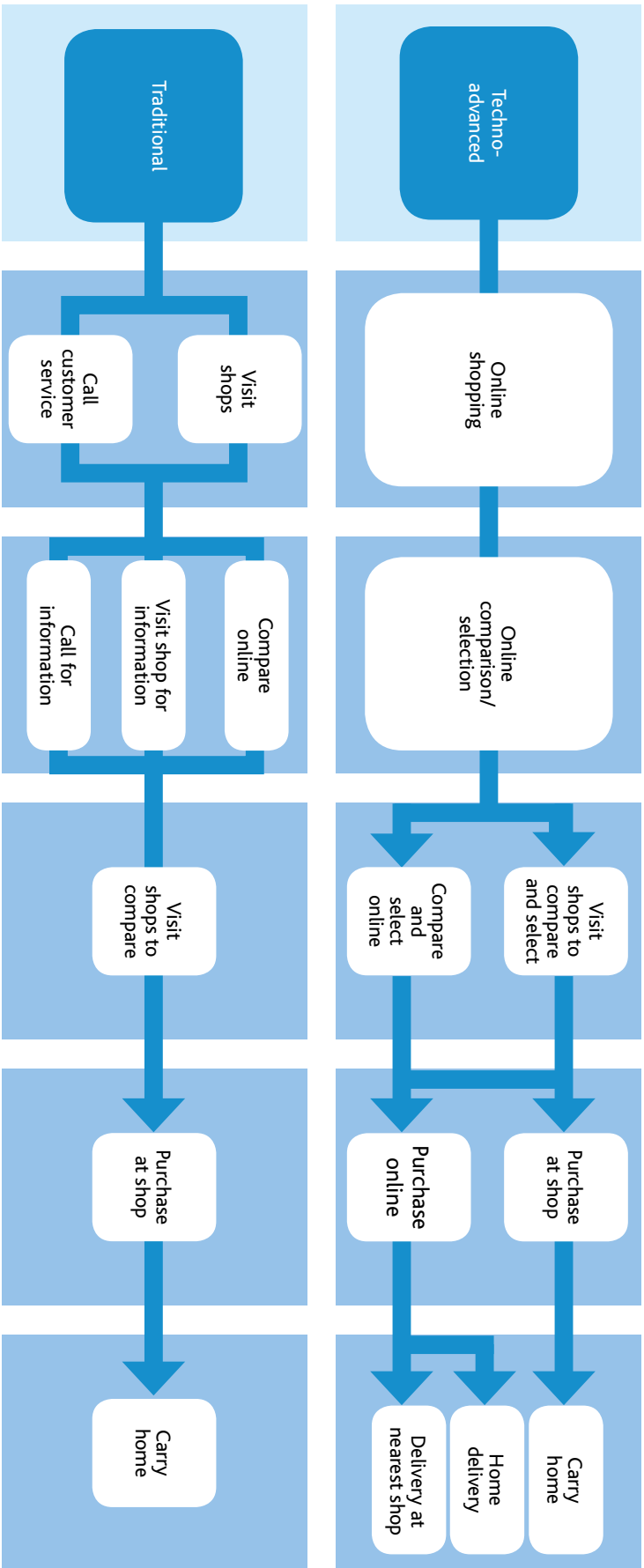


Figure 10: Technology-enabled customer purchasing journey

# CAPTURING AND SHARING RESIDUAL VALUE

## Capturing value

Value is captured when revenue earned from delivering value exceeds the costs of creating value. Firms incur costs when creating value and earn revenue when they deliver value to customers. The difference between the two creates some surplus, which firms have to share with stakeholders who have been part of the value creation and delivery journey but have not yet received any value themselves.

The size of the surplus depends on market conditions but also reflects the decisions made when defining value and the success with which firms execute those decisions. The three main issues to consider when capturing value are the cost model, revenue model and the distribution of surplus.

## Cost model

The cost architecture is established when defining value. It is influenced by the value proposition to customers and the partnerships that firms use to create and deliver value. The actual costs depend on how well the decisions are executed when creating value but also when delivering value as some costs are incurred when channels are created and used to communicate to, sell and deliver goods and services to consumers. The cost profile reflects the:

- Efficiency of the processes.
- Levels of activity.
- Resources consumed during activities.
- Price paid for resources.

## Revenue model

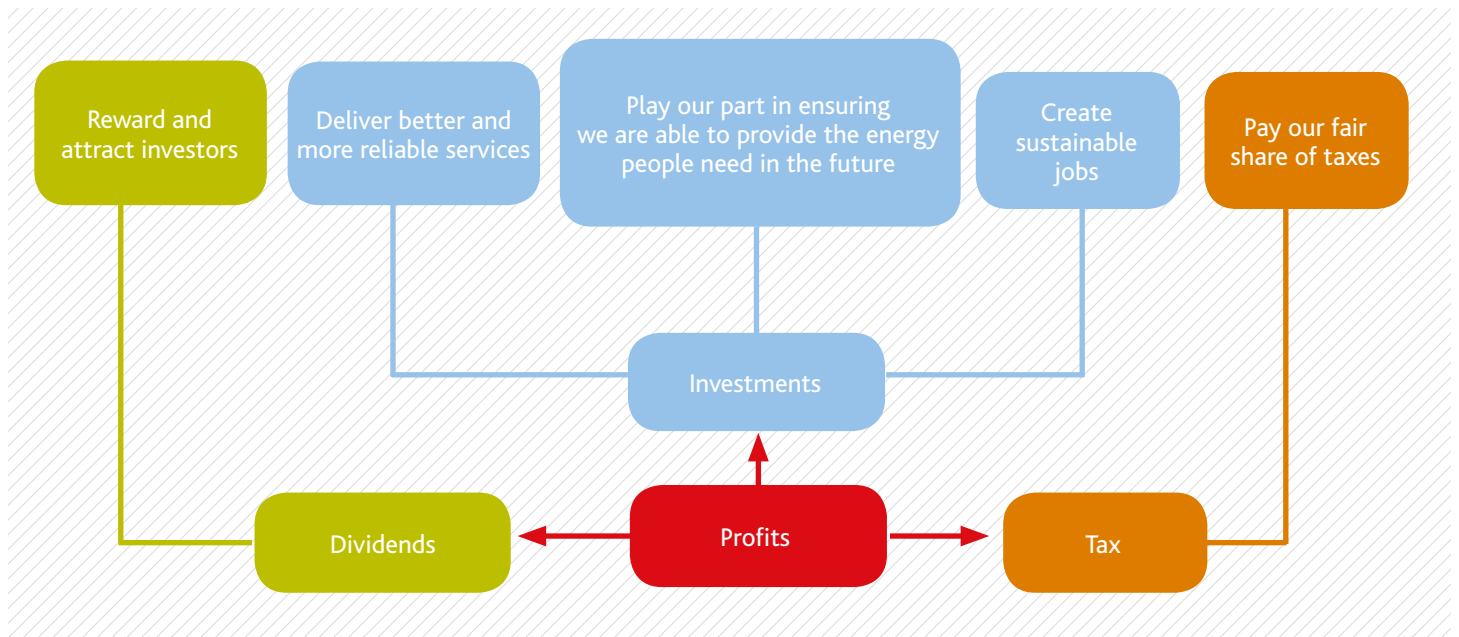
Revenue is earned when goods and services are delivered to customers. Pricing policy, carefully aligned to different segments of customers, can ensure healthy revenue. But this is not the same as cash. The collection policy will determine the pace at which revenue is turned into cash. Both pricing and collection policy (ie terms of trade) are affected by market conditions. Pricing is sometimes affected by regulation.

## Sharing residual value

Sharing value is based on the principle of creating shared value, which comprises shareholder value and the value delivered to other stakeholders. The pecking order depends on the seasons and cycles of firms and their operating environment. At least four stakeholder groups are in view: government (taxes); shareholders (dividends); incentives for executives (performance-related pay); and the firm (retained income for reinvestments).

The sharing has to be sensitive to the interactions in the operating environment so that it does not harm the firm's reputation, or the creation and delivery of further value. The key bases for decision-making here are: tax strategy, dividend policy, desired capital structure and investment opportunities.

Figure 11: Capturing and sharing residual value at SSE



### Tools and techniques

Some of the tools and techniques used for capturing and sharing value are:

- Cash flow and operating cycle modelling/analysis.
- Cost modelling.
- Revenue modelling.
- Incentive analysis.

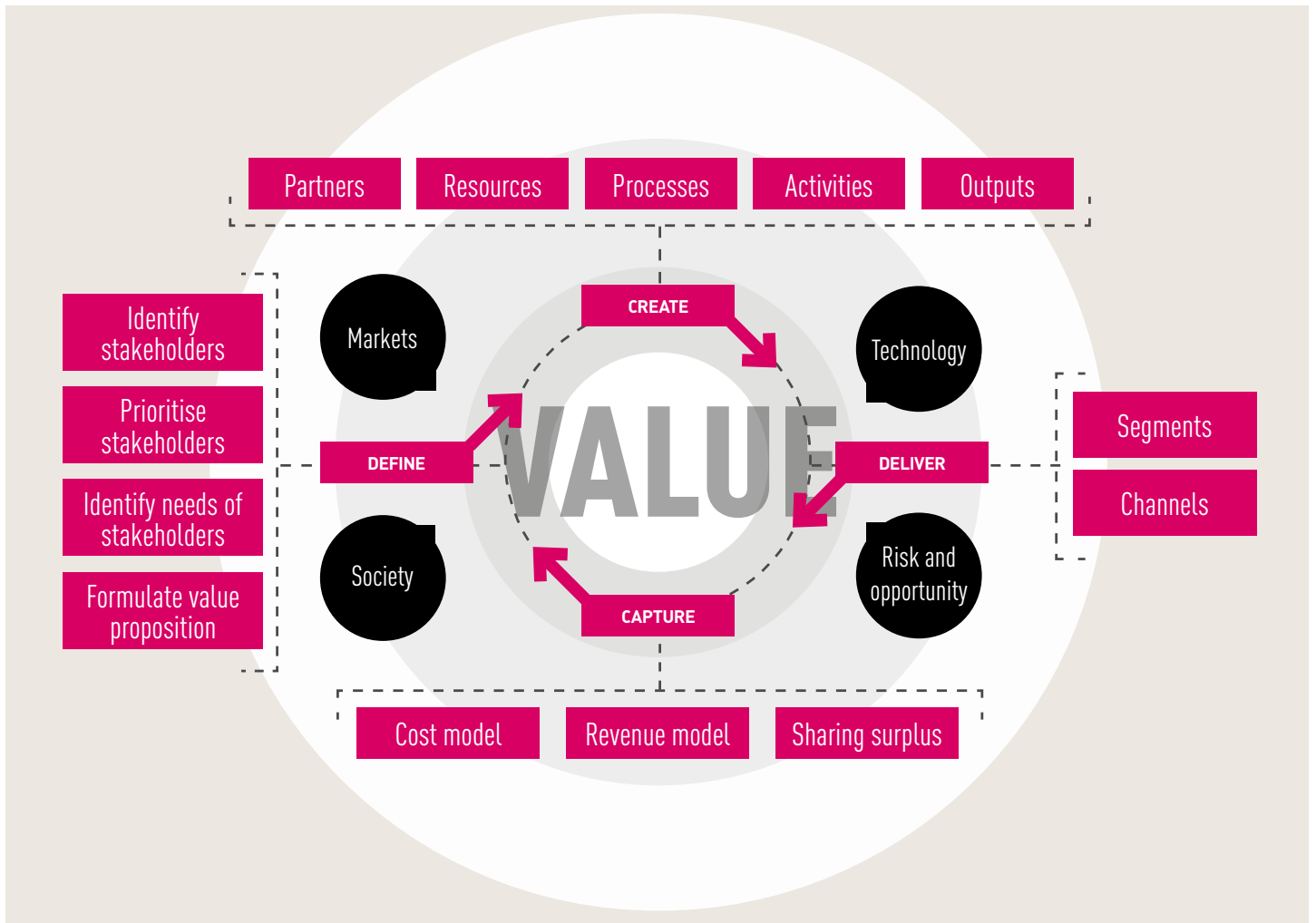


# BUSINESS MODELS, STRATEGY AND THE ROLE OF THE BOARD

## Business model

Put together, the business model and its different parts are shown in *Fig 12* (below). The important thing to stress here is that the different parts should connect to and align, both with each other and to the operating environment. Significant misalignment will affect the performance of the organisation.

Figure 12: The business model – putting it all together



## Strategic and operating models

There have been debates about the relationship between the business model and strategy. Some see strategy as the overarching frame of reference. The business model is the way in which strategy is implemented. To distinguish between strategy and the business model, Magretta goes back to first principles. She pointed out that a business model is a description of how your business runs, while a competitive strategy explains how you will do better than your rivals. That could be by offering a better business model – but it can also be by offering the same business model to a different market.

This paper makes no distinction between the business model and strategy. Rather, it argues that the business model comprises two interconnected models: the strategic model and the operating model. The decisions and actions involved in defining value, and capturing and sharing value, are essentially strategic in nature. They go to the very heart of the firm's identity and define its DNA. Those two parts of the business model then constitute the strategic model. This hardly changes. These decisions have to be executed to create value and deliver value. The operating model therefore comprises the value creation and value delivery part of the business model.

There are at least two important implications arising out of this conceptualisation of the business model. First, the parts of each model (ie strategic or operating) must both connect to and align with each other. At the same time the operating model should align with the strategic model. Then both of them (ie the business model) must align with the operating environment. Second, different levels of the firm will engage with different parts of the business model. For the different models to align with each other the different levels of the firm need to both relate to and communicate well with each other.

## Role of the board and senior executives

In some jurisdictions the board is required by regulation to report on the business model. This means that they have to have at least a high-level understanding of the essential parts of the business model, its internal consistency and its alignment with the operating environment. In addition, given the boards' responsibility for strategy and risk, boards should focus on the strategic model in the business model. Together with senior executives they must define value and plan for how it would be captured and shared. Lastly, given the impact of the operating environment on the business model, the board should also focus on the interactions, relationships and outcomes in the operating environment. This calls for an understanding of the markets in which firms operate, the society and regulatory regimes that define what they can do, and the technology and risks and opportunity profiles they face. Their time orientation is both the present and the future. The time horizon is the medium to long term.

Senior executives share responsibility with boards on charting, articulating and overseeing the execution of their firms' strategies. Therefore they should focus on the strategic model. In addition, they should have an even deeper knowledge of the operating environment and how their firms adapt in and evolve with the environment. To ensure that strategy is effectively executed they must monitor the cost and revenue models at a high level. The time orientation is the past, present and the future. The time horizon is the short to long term.

The rest of the firm focuses on the operating model that executes strategy. In activity terms they work within the operating model but in outcome terms they seek alignment with the strategic model. Their time orientation is the past and the present. The time horizon is mostly the short term and sometimes the medium term.

# CONCLUSION: ACCOUNTING FOR THE BUSINESS MODEL

There is widespread recognition that reporting practices based on traditional financial reporting standards – such as Financial Accounting Standards Board accounting standards and International Financial Reporting Standards – are inadequate to address the information needs of all the stakeholders with whom firms create value. Other frameworks have been added to the standards to provide a wider picture. This has led to a fragmented corporate reporting landscape. The Corporate Reporting Dialogue was established to respond to market calls for greater coherence, consistency and comparability between the different corporate reporting

frameworks, standards and related requirements. It identified eight reporting frameworks:

- Integrated reporting (IR).
- FASB accounting standards.
- IFRS.
- GRI.
- CDP.
- CDSB.
- SASB.
- ISO 26000 Social Responsibility.

**Table 2: Comparison of eight reporting frameworks**

*Showing what each of the frameworks is trying to achieve.*

Initiative	Purpose
International IR framework	Help organisations explain to providers of financial capital how they create value over time.
CDP's information requests	Use the power of information disclosure to drive organisations to measure, manage and reduce their impact on the environment, and to build resilience while providing high-quality information to the market.
CDSB framework for reporting environment information and natural capital	Help organisations prepare and present environmental information in mainstream reports to provide consistent, comparable and clear decision-useful information for investors.
FASB accounting standards	Establish and improve standards of financial accounting and reporting by non-governmental entities to provide decision-useful information to investors and other users of financial reports.
GRI G4 sustainability reporting guidelines and G4 sector disclosures	Enabling organisations – regardless of size, sector or location – to report the sustainability information that matters.
IFRS	Provide high-quality, transparent and comparable information for investors, provide world capital markets with a common language for financial reporting; promote capital market stability through transparent financial reporting; and promote consistent application of standards.
ISO 26000 Social Responsibility	Provide guidance on how business and organisations can operate in a socially responsible way.
Sustainability accounting standards	Help public corporations disclose material sustainability information in mandatory SEC filings, such as the Form 10-K and 20-F.

In addition to the work of the Corporate Reporting Dialogue, other more integrative frameworks have been used to address the need to provide a broader range of information in corporate reporting. The following are germane to our discussion:

- Value-added statement.
- Balanced scorecard.
- Strategic report.
- Integrated reporting.

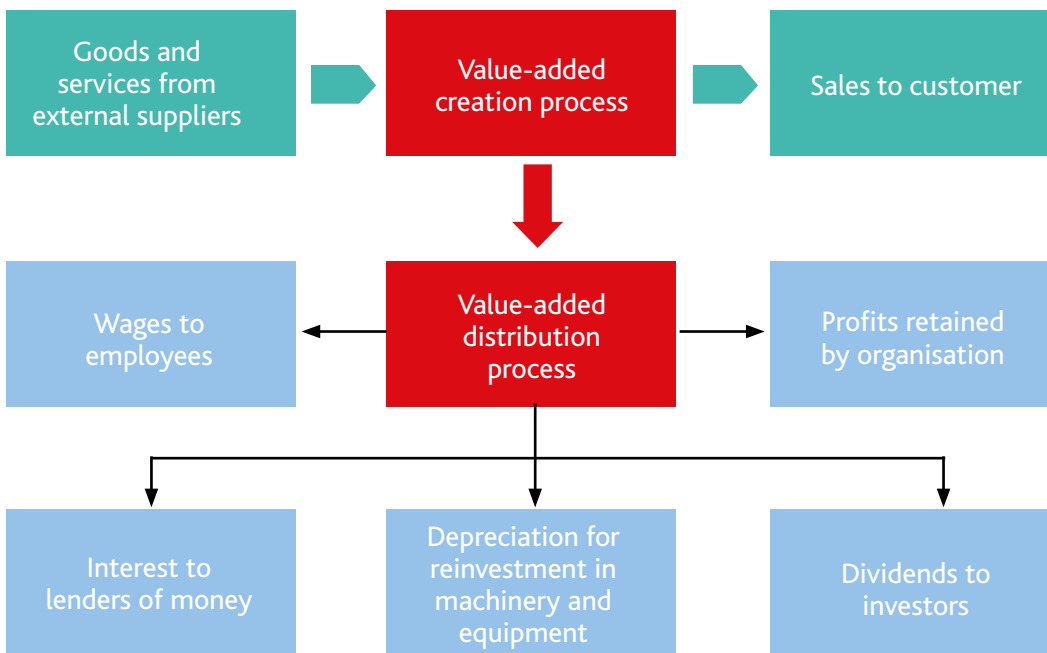
Each of these will be explored briefly.

**Value-added statement**

Value added measures the difference between sales and the costs of materials and services incurred to generate the sales. It is an output measure that shows the value created through

the firm’s production process. The value generated is the combined efforts of those who work in the firm (employees), and those who provide the capital (employers and investors)

**Figure 13: Value-added creation and distribution**



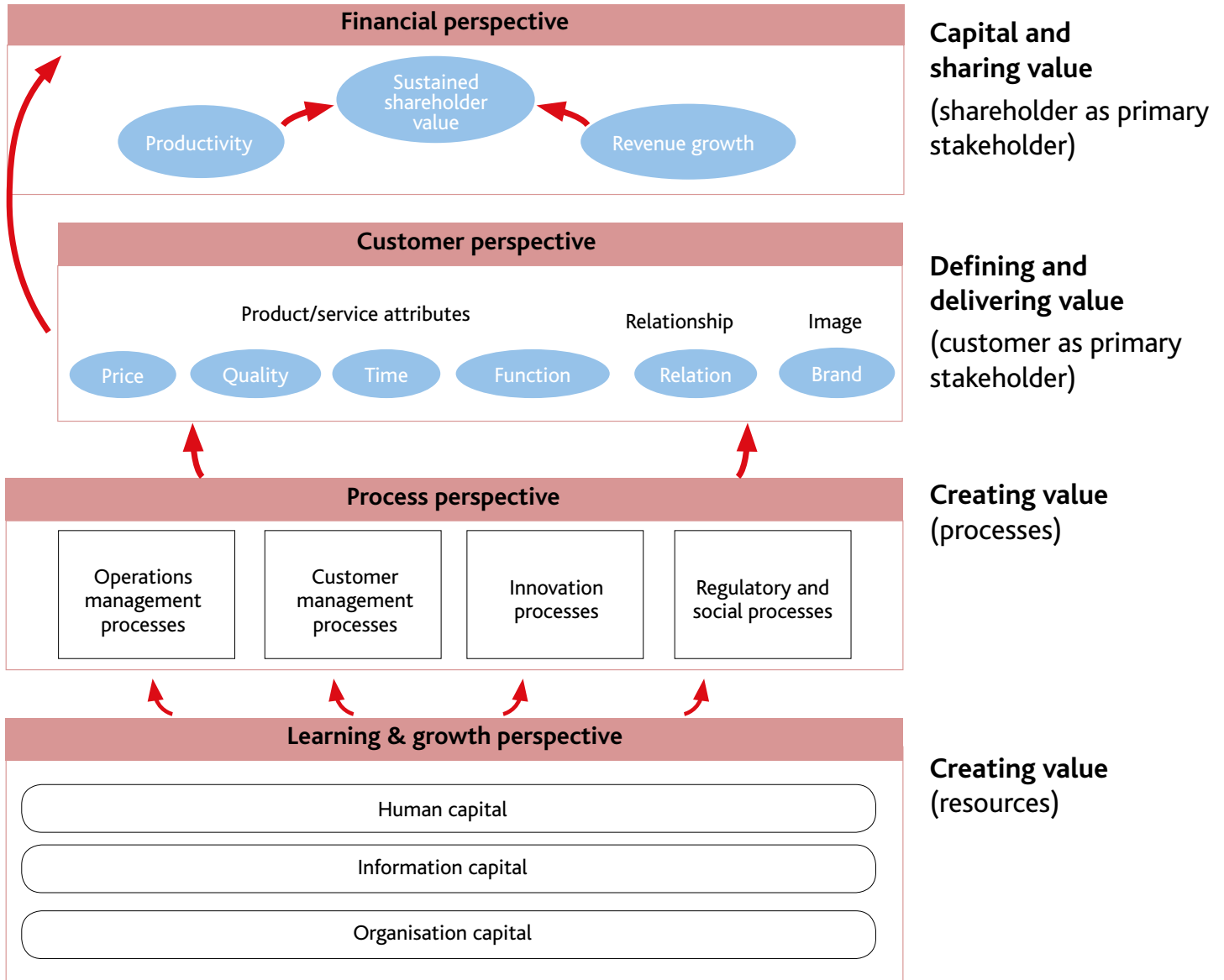
The value-added statement captures the value added and how it is distributed to those who contributed to creating value. It is constructed from the firm’s income statement.

Although this provides some insight into value creation it suffers from the same issues as the financial statements on which it is based.

### The balanced scorecard compared to the business model

The Balanced Scorecard (BSC) is reportedly the most popular management framework that firms use. As noted earlier, it seeks to link four different perspectives together in a causal chain. It starts with people who then use processes to provide value for customers, which in turn leads to financial outcomes for its investors. *Fig 14* (below) shows how the different perspectives of BSC maps to the business model

Figure 14: The balanced scorecard compared to the business model



## The strategic report

The strategic report was mandated by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 and clarified by the FRC "Guidance on the Strategic Report". Its purpose is to inform shareholders and help them assess how the directors have performed their duty to promote the success of the company.

It is expected to provide a fair view of a company's business and a description of the principal risks and uncertainties facing it. In particular, it should present a balanced and comprehensive analysis of:

- The development and performance of the company's business during the financial year.
- The position of the company's business at the end of the year.
- Analysis of key performance indicators (both financial and non-financial).
- Trends for the future.
- Information about:
  - Environmental matters.
  - Employees.
  - Social, community and human rights issues.
- A description of a company's strategy.
- A description of a company's business model.

This is a step in the right direction and enables a firm to explain its performance in relation to the business model. It is in its infancy at the moment and the quality of the various strategic reports produced so far is patchy.

## Integrated reporting

Integrating reporting <IR> is similar to the strategic report. Its purpose is to inform shareholders and help them assess how the directors have performed their duty to promote the success of the company. The aim is to:

- Improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.
- Promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organisation to create value over time.
- Enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social and relationship, and natural) and promote understanding of their interdependencies.
- Support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term.

The main contents are:

- Fair view of the company's business.
- Description of principal risks and uncertainties facing the company.
- Balanced and comprehensive analysis.
- The development and performance of the company's business during the financial year.
- The position of the company's business at the end of the year.
- Analysis of key performance indicators (both financial and non-financial).
- Trends for the future.
- Information about:
  - Environmental matters.
  - Employees.
  - Social, community and human rights issues.
- A description of a company's strategy.
- A description of a company's business model.

<IR> has introduced two major innovations in reporting. First, it stresses the need for integrated thinking as the basis for <IR>. Firms should seek to connect what they do internally between different parts of the firm and also between the firm and its environment in order to ensure that it is managed properly. <IR> then becomes the logical way to report on the activities and performance of the firm. In other words, <IR> is needed to tell how value is generated and preserved through integrated thinking. Second, <IR>, introduced the language of concept of the six capitals as both resource inputs to – and outcomes of – value creation. The six capitals are laid out in *Table 3 (overleaf)*.

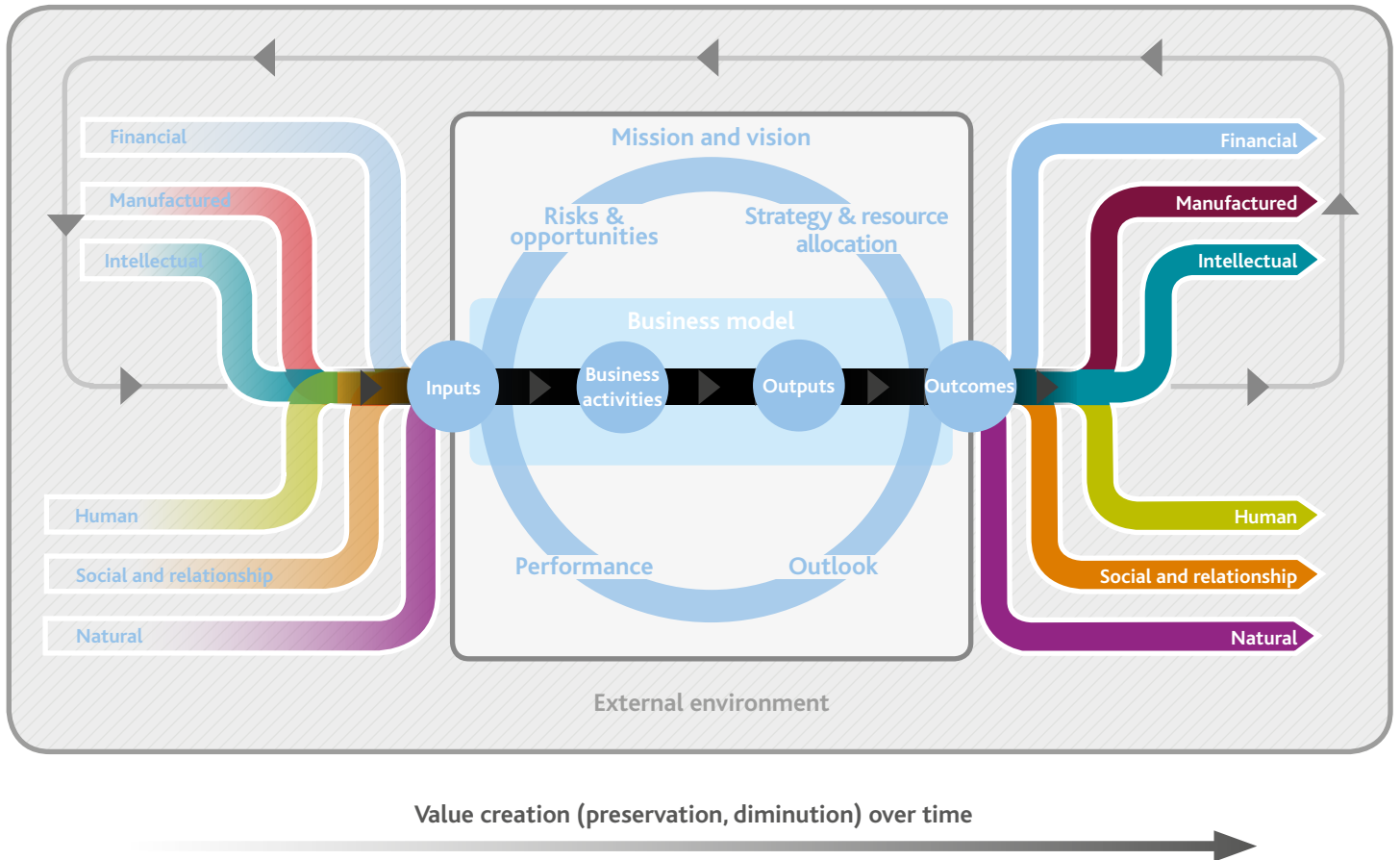
Table 3: Six capitals of &lt;IR&gt;

Capitals	Definition
Financial	The pool of funds that is available to an organisation for use in the production of goods or the provision of services obtained through financing or generated through operations and investments.
Manufactured	Manufactured physical objects that are available to an organisation for use in the production of goods or the provision of services. This includes buildings, equipment and infrastructure.
Intellectual	Organisational knowledge-based intangibles including intellectual property and "organisational capital" such as tacit knowledge, systems, procedures and protocols.
Human	People's competencies, capabilities and experience, and their motivations to innovate.
Social and relationship	The institutions and relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being.
Natural	All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current and future prosperity of an organisation.

The IIRC is careful to stress that not all capitals are equally relevant or applicable to all organisations.

The <IR> view of value creation is shown in *Fig 15* (below):

**Figure 15: The IIRC integrated reporting framework diagram**



**Role for accounting: Inform to transform**

Reporting frameworks that seek to report on the business model should aim to “inform to transform”. Accounting starts with the collection of information. Such information is cleaned and connected to other information to ensure its integrity and to help users make sense of it. In the digital age managers are faced with vast amounts of varied forms information at short notice that they cannot make sense of. This reduces the value of information to them. They need insight from the information to enable them to tackle

the issues at hand. Thus though collecting, cleaning and connecting information is necessary, it must be transformed and analysed to provide insight. Insight has been described as follows: “It is like a refrigerator. A light comes on when you open the door.” This insight is then communicated to those involved in generating and preserving value to influence their decisions, actions and behaviours. Subsequently, resources are provided so that people act in a manner that produces the right value impact. This is shown in *Fig 16* (below).

**Figure 16: Inform to transform**





This means that finance professionals should pay particular attention to the type and quality of metrics used and their connectivity with each other. Such metrics should enable oversight and highlight the impact of incentives behaviour.

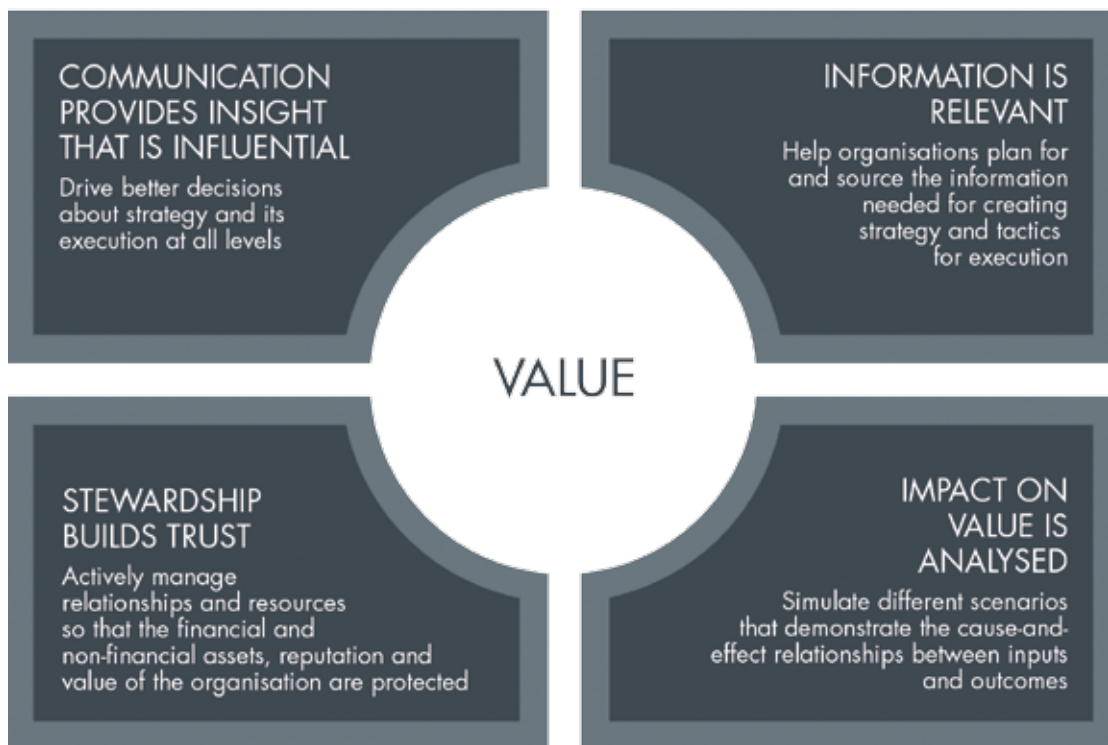
Given that the business model is all about generating and preserving value, valuation and an understanding of value drivers is key to the role of the accountant. The role of intangible value drivers and intangible value as an increasing part of the value of firms is crucial.

The CGMA Global Management Accounting Principles provide the underlying principles that allow finance

professionals to “inform to transform”. It is based on the view that effective finance functions comprise competent and confident professionals who can apply principles to the practice of finance to manage the performance of the firms successfully. The four principles (*see Fig 17*) are:

1. Communication provides insight that is influential.
2. Information is relevant.
3. Impact on value is analysed.
4. Stewardship builds trust.

Figure 17: Global Management Accounting Principles



## FEEDBACK

Please do feedback on our rethink of the business model – we look forward to hearing back from you on [business.model@cimaglobal.com](mailto:business.model@cimaglobal.com).

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Our members' expertise is rooted in the intensive and rigorous training and practical education provided by the CIMA syllabus which informs critical business decisions and judgements reached every day, drawing on the CGMA Global Management Accounting Principles© and CGMA Competency Framework.

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# FURTHER THINKING AND RESEARCH

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### Decision making for a new era

Senior business leaders are striving to position their organisations to thrive in the short, medium and long term, but they are having to do so in an environment that makes good decision-making incredibly difficult.

Our research has found a number of major flaws in companies' decision-making, which is costing them dearly. Based on a survey of 300 C-suite executives at major organisations around the world, it suggests that decision-making in many businesses could be fundamentally improved.

As our key findings demonstrate, many companies are struggling to:

- Overcome bureaucracy and achieve agile decision-making.
- Build greater levels of trust and improve collaboration.
- Take a long-term view and define the right metrics.
- Turn huge volumes of data into strategic insight.
- Build the decision-making skills of senior leaders.

Find the solutions to these decision-making challenges at [www.cgma.org/dots](http://www.cgma.org/dots).

## THE GLOBAL MANAGEMENT ACCOUNTING PRINCIPLES©

Quality decision-making has never been more important – or more difficult. Competition is relentless as new innovations daily disrupt the status quo. The volume and velocity of unstructured data is increasing complexity.

The Global Management Accounting Principles© (GMAPs) were created for this era of business. Management accounting is at the heart of quality decision-making because it brings to the fore the most relevant information and analysis to generate and preserve value. The GMAPs guide best practice in management accounting to ensure difficult decisions can be taken that will drive sustainable value.

The GMAPs were developed in conjunction with CEOs, CFOs, academics, regulators, government bodies and other professionals from 20 countries across five continents. They were prepared by the Chartered Institute of Management Accountants (CIMA) and the American Institute of CPAs (AICPA), which together represent more than 600,000 members and students in 177 countries.

The GMAPs support organisations in benchmarking and improving their management accounting systems. They help the public and private sectors to:

- Make better decisions.
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We have developed a self-assessment diagnostic tool that will help organisations evaluate and measure their finance team against both this decision-making framework and the standard to which CIMA (and our partners the AICPA) believe management accounting should be performed. It assesses 14 core areas of management accounting practice, from costing to financial strategy, and identifies areas for improvement. The assessment then produces narrative and infographic reports in the form of exportable heat maps and bar charts. It also allows you to identify gaps between how your finance team view themselves and how their internal and external customers perceive them.

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