

Business Model and Non-Financial Key Performance Indicator Disclosure

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Abstract

Business model disclosure is proposed as a communication tool for companies to increase the effectiveness of non-financial key performance indicator (NFKPI) disclosure. First, business model enables the identification of indicators that are aligned with strategic objectives. Moreover, it acts as an integrated framework, showing how different capitals are combined to create value.

Introduction

In the present economic context, companies base their competitive success on intangible factors (OECD, 1999; Teece, 2000; Bontis, 2001). Financial measures are not able to fully reflect the value of intangible assets because they are backward looking accounting-based metrics that reflect the use of physical capital (Smith and Van Der Heijden, 2017). For this reason, NFKPIs are necessary to assess a company's performance (Eccles, 1991; Ittner and Larcker, 2003; Montemari and Nielsen, 2013). The importance of NFKPIs has also been

recognized by standard setters and law-makers. Recent non-financial disclosure regulations, like the Companies Act Regulation 2013 in the UK and the European Directive 95/2014, have introduced the requirement for large companies to disclose relevant NFKPIs.

Despite the importance of NFKPIs, a big problem emerges in the identification of indicators that are relevant to the business (Badawy et al., 2016). This issue is especially critical for external users who may find it

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difficult to fully understand whether the NFKPIs communicated by a company are really “key” indicators (Holland, 2004). In keeping with previous BM literature and the most widespread regulating approach, this paper aims to propose the concept of business model (BM) as a valuable tool to assess a company’s NFKPI disclosure.

Approach

It is well established in accounting literature that, in order to be effective, indicators should be consistent with the way a company uses different tangible and intangible resources to generate value (Grasenick and Low, 2004; Montemari and Nieslen, 2013). This approach is shared by the majority of the regulatory frameworks, which recommend that NFKPI disclosure give market participants a view of a company “through the eyes of management” (SEC, 1989). In other words, external users should be able to see the company “in a manner which aligned with senior managers’ (presumably) holistic view of the business” (Beattie and Smith, 2013, p. 10).

The way a company combines its resources and knowledge to gain a competitive advantage defines its BM (Nielsen, 2010; Casadeus-Masanell and Ricart, 2010). As stated by Osterwalder et al. (2005), the BM offers “a conceptual model that explicitly states how the business functions” (p.3). Thus, it is a valuable tool to create a shared understanding of the business, both inside and outside the organization (Perckman and Spicer, 2010).

As a simplified, focused representation of the company, the BM represents a template that helps understand the configuration of various components within the organization (Winter and Szulanski, 2001). It can contribute to improve “tractability, understanding, as well as our ability to measure, predict and communicate” the main features of an organization (Massa et al, 2017, p. 84). Bukh (2003) maintains that examining a company’s BM is essential for investors to fully appreciate information about non-financial indicators. According to Mouritsen and Larsen (2005), the knowledge of a company’s BM allows users to appreciate individual pieces of information and measurements that, by themselves, do not link up directly to the value creation process. In light of this, the BM becomes particularly useful to frame NFKPI disclosure, offering insights into the logic that underlies the value creation process.

Key Insights

From the corporate communication perspective, the BM becomes a valuable communication device that can provide external users with “a convincing context to interpret the quantitative or relative indicators” (Holland, 2004, p. 97). This context-giving narrative allows external users to shape “a coherent picture”, where the interrelated factors that promote value creation are clearly identified (Nielsen and Bukh, 2013).

Linking NFKPIs and BM disclosure allows companies to offer investors a clearer picture of the value creation process (Bini et al., 2016). The BM serves two main purposes. First, it enables the identification of relevant NFKPIs – indicators that are aligned with strategic objectives. Moreover, it acts as a framework for disclosure, showing how different capitals are related and how they contribute to value generation. BM disclosure should highlight how the different resources are combined together to reach the results that are measured by appropriate NFKPIs.

This way, companies are able to offer an integrated communication: the strategy defines the objectives; the BM illustrates how different resources, both tangible and intangible, are used to reach those objectives; NFKPIs monitor progress against strategy (Bhimani and Langfield-Smith, 2007) and show how financial results are related to strategic objectives (Figure 1).

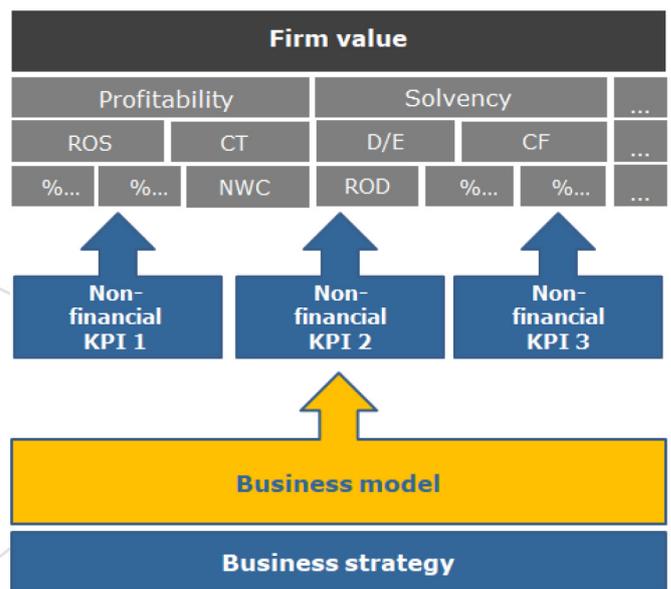


Figure 1: The link between strategy, BM and KPIs

Discussion and Conclusions

This paper proposes BM as a communication device to frame NFKPI disclosure. By linking BM and non-financial indicator disclosure, companies may offer an integrated communication that is capable of showing the connections between a company's strategy and the way resources are combined to generate value. According to Holland (2004), the disclosure of BM "would create a level playing field for disclosure for those investors not privy to direct one-to-one contact with companies", (p. 101) thereby reducing information asymmetries in the market.

Our proposal can be helpful for companies that face the need to communicate NFKPI and BM. This is especially the case of large companies that have to comply with the EU Directive 95/2014 and of those that voluntarily publish an Integrated Report (IIRC, 2013). In both cases, linking the description of a company's BM with NFKPI disclosure allows enhancing the reliability of disclosure. BM description, on the one hand, provides the "information context" –a story that illustrates the connections and relationships between various BM components. NFKPIs, on the other hand, provide evidence for the veracity –the credibility– of the company's story over time (Holland, 2006).

Our proposal provides insights also for many categories of subjects –standard setters, regulators, consultants, auditors– who are developing guidelines on non-financial disclosure. An integrated disclosure that emphasises the linkages between a company's BM and the related NFKPIs, in fact, raises the need to identify a specific meaning of *relevant* NFKPIs, as well as a detailed description of what a BM description should focus on.

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