Aalborg Universitet

The investor perspective on business models

Nielsen, Christian

Published in:
The Basics of Business Models

Publication date:
2014

Document Version
Early version, also known as pre-print

Link to publication from Aalborg University

Citation for published version (APA):
Nielsen, C. (2014). The investor perspective on business models. In The Basics of Business Models (pp. 85-104). Ventus.

General rights
Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.

? Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
? You may not further distribute the material or use it for any profit-making activity or commercial gain
? You may freely distribute the URL identifying the publication in the public portal ?

Take down policy
If you believe that this document breaches copyright please contact us at vbn@aub.aau.dk providing details, and we will remove access to the work immediately and investigate your claim.

Downloaded from vbn.aau.dk on: January 22, 2019

The investor perspective on business models

Author:
Christian Nielsen

Corresponding author:

Christian Nielsen, Professor
Business Model Design Center
Aalborg University
Fibigerstræde 11-58, 9220 Aalborg Ø, Denmark

E: chn@business.aau.dk

Web: www.bmdc.aau.dk

SSRN: http://ssrn.com/author=2361613

AAU: http://personprofil.aau.dk/profil/115869

@Linkedin: dk.linkedin.com/in/christianhnielsen/

#BMBUZZ: http://bit.ly/bmb2014v

Please quote this paper as: Nielsen, C. (2014), The investor perspective on business models, in Nielsen, C. & Lund, M. (Eds.) *The Basics of Business Models*, Vol. 1, No. 1. Copenhagen: BookBoon.com/Ventus Publishing Aps

SSRN abstract number:

Please retrieve the original publication here: http://bookboon.com/en/the-basics-of-business-models-ebook

1. INTRODUCTION

Disclosure of information concerning strategy, business models, critical success factors, risk factors and value drivers in general has gained importance in recent years. Both policy makers and academics have argued that the demand for external communication of new types of value drivers is rising as companies increasingly base their competitive strengths and thus the value of the company on know-how, patents, skilled employees and other intangibles.

In parallel with the focus on disclosure of value drivers, the concept of business models has gained popularity. However, business models in terms of "ways of doing business" have always existed. The business model reflects the way of competing of the specific company, whether it concerns being unique or being the most cost-efficient company in the industry. The supply of information on the value creating processes and value drivers of firms has actually been increasing in various reporting media such as annual reports, IPO prospectuses and the reports of financial analysts. Furthermore, some firms, especially in the Nordic countries, have started developing Intellectual Capital (IC) reports that communicate how knowledge resources are managed in the firms within a strategic framework, and new models for reporting on stakeholder value creation and CSR are gradually emerging. Despite this, an explicit recognition of value creation as a central part of a business model is generally lacking in this literature.

It is also noticeable that even though disclosure of information from companies has been increasing, there are no clear signs that the particular information demands of investors and analysts have been met. The paradox is therefore that while there are well-developed arguments for disclosure and evidence indicates that companies are disclosing more and more information, there are also indications that disclosure quality is insufficient at the present. This leads us to consider whether we are facing a reporting gap, or rather an understanding gap. This is where the business model can be applied.

There is a multitude of evidence that the nature of the business environment is changing. Among the factors that drive this development are the globalization of markets, greater mobility of the workforce as well as monetary and physical goods and the application of information technology and technology in general. As the above factors and greater integration of capital markets cause changes in the nature of value creation, and new competitive elements gain importance, new types of disclosure and reporting that are argued to be so vital for conveying transparent pictures of the corporate well-being are unfortunately not without problems, as these types of information are somewhat more complex than traditional financial information.

It could very well be a problem that the capital market agents simply do not understand non-accounting information. Perhaps business models enable the creation of a comprehensive and more correct set of non-financial value drivers of the company and are therefore a useful reference model for disclosure. In the near future, western-society citizens will be questioning not just the future of the financial sector of the western world, but also the sustainability of the industrialized western society as a whole.

On the one hand, pressure from under-burdened western society taxpayers (voters) who crave an average working week of 35-37 hours and retirement 40-50 years prior to their death will be on the rise. On the other hand, eager hardworking Asian and Indian consumers with surprisingly well-educated workforces will lead us to be questioning our chances of economic survival in a truly globalized world all throughout 2012.

One possible answer to this problem is that western societies to a greater extent need to rely on human capital in the quest for private sector value creation, innovation and competitiveness. However, human capital will not make the difference alone. Only when complemented by triple-helix based innovation structures, creativity and unique business models that commercialize innovation and human capital will this be an avenue to future sustainability.

It is in this connection that the financial sector needs to start understanding new types of business models and hence also new types of information. Environmental, Social and Governance (ESG) information is a

good example. It is today solely used by the buy- and sell-side in ex post audit society screening manner. We need to ambitiously pursue ex ante screening as a first step and then quickly move to actual active use of ESG information and information pertaining to sources of value creation in investment decisions. We should be hoping to see the first modules on analyzing business models and ESG information on post-graduate, MBA and CFA levels soon. At least for the sake of sustaining western society as we know it, we hope so!

2. INFORMATION NEEDS OF INVESTORS AND ANALYSTS

While disclosure of information has been increasing, there are no clear signs that investors and analysts' demand for information has been met. Eccles *et al.* (2001, 189) conclude that managers "genuinely believe they try hard to give the market the information it wants. But most analysts and investors believe managers could try harder". Literature is abundant with well-developed arguments for better disclosure, and empirical studies document that improved disclosure is related to e.g. increased analyst interest in the firm, lower cost-of-capital and decreased bid-ask spreads.

Back in the 1990's various studies of investors and analysts' request for information indicated a substantial difference between the type of information found in company annual reports and the type of information demanded by the market, and more recent studies show only limited improvements with respect to disclosure practises in the firms.

Companies have clearly become aware of the importance of managing their external communication systematically, and the importance of investor relations is increasing. Also, investors and analysts are becoming more aware of the importance of factors not included in the financial statement, although traditional financial information is still considered to be of greatest importance. The general tendency emerging both from surveys of information needs and normative reports is that the capital market actors request more reliable information on e.g. managerial qualities, expertise, experience and integrity, customer relations and personnel competencies since these factors are considered important for the ability of the company to generate value.

Much of this information is, however, too complicated to summarise e.g. in annual reports. Furthermore, experiences from the management literature with respect to new strategic reporting models as for instance the balanced scorecard approach or intellectual capital reports show that it is just as complicated for management to define what factors are actually the few most important drivers of future performance, as it is for external stakeholders to understand such information when it is disclosed.

Related to this a recent report (KPMG 2003) based on answers from a sample of non-executive directors in the U.K indicated that while 94% of the respondents considered themselves to have considerable knowledge of financial performance measures, only 60% considered themselves sufficiently knowledgeable with regard to non-financial measures such as critical success factors, strategy etc.

Major questions regarding how this information should be defined, how it should be structured, and how it should be communicated to the market still remain. Furthermore, from the perspective of the capital market, similar questions arise:

- How should the information be used?
- How can it be trusted?
- How should it supplement traditional financial information?
- What overall framework can support the evaluation of the firm's strategy?

3. BACKGROUND ON THE MARKET FOR INFORMATION

According to Ball (1996, 11), the theory of efficient markets is an imperfect and limited way of viewing capital markets as the prescriptive theories of finance

on which the Efficient Markets Hypothesis is based, widely ignores the human nature of the participants that constitute the capital market and especially the three groups of opinion-formers:

- Company management
- Sell-side analysts
- The fund management function

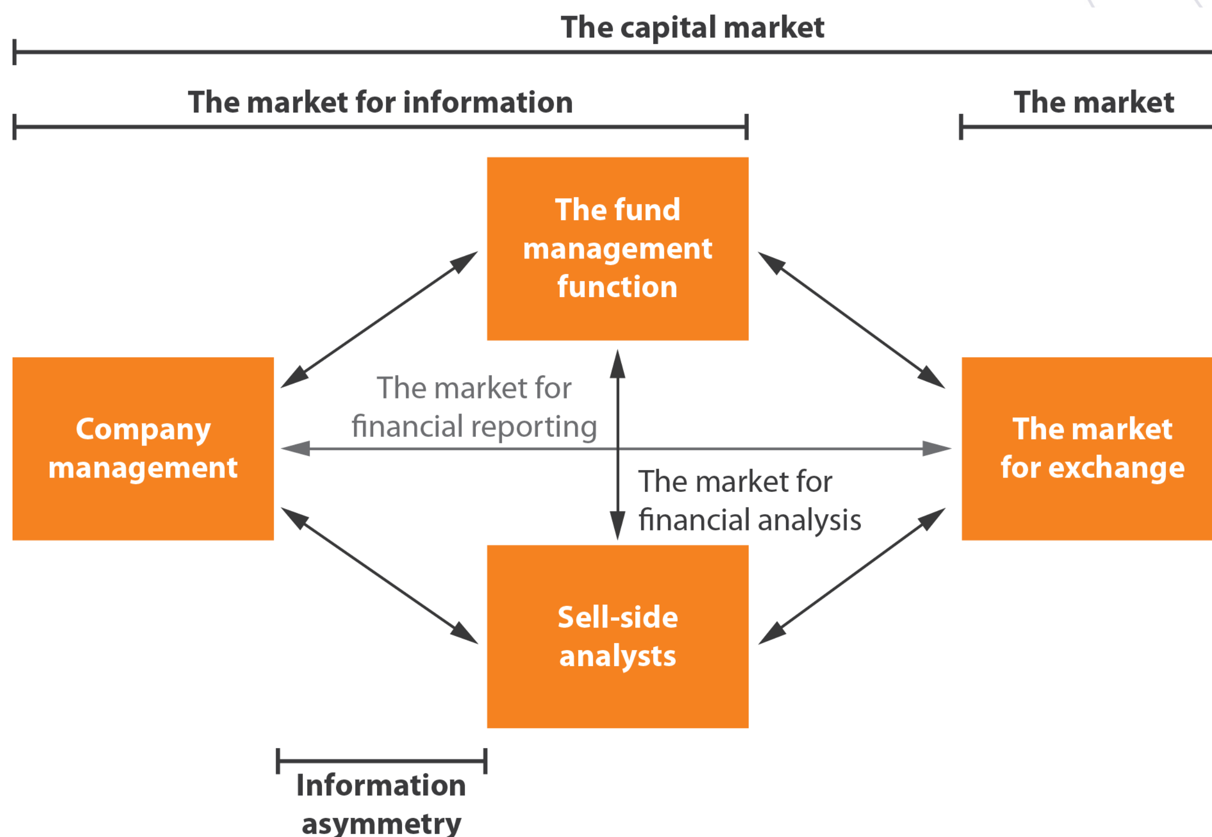

Figure 1: The market for information

In order to understand the functioning of the capital market correctly, we must make a distinction between the market for exchange and the market for information (see figure 1). This distinction was first introduced by Gonedes (1976), who argued that many of the assertions of traditional finance theory were misleading, because they did not deal with the relevant part of the capital market, i.e. the market for information. By relevant, Gonedes (1976) meant those groups of actors that were the major opinion-makers with respect to valuation, and he, furthermore, argued that "failure to explicitly consider the market for information may induce unwarranted inferences about the capital market" (1976, 628).

Barker (1997), depicting the relationships between companies, analysts and fund managers, argues that there are two 'information markets' co-existing in the market for information, namely the market for financial reporting and the market for financial analysis. In his subsequent study, Barker (1998) concludes that the market for financial reporting is of considerably greater importance than the market for financial analysis. With respect to the market for financial reporting, other disclosures from the company than merely the annual report must also be considered, e.g. press releases, earnings announcements and conference calls. The market for corporate disclosure might therefore be a better description. The market for financial analysis can be perceived almost as an intermediary function, however not neglecting that investors too receive information directly from the company itself.

Barker (1998) analyzes the economic incentives with respect to information flows between these actors, arguing that these incentives must in some manner also reflect the tasks carried out. Barker (1998, 16) finds similar economic incentives between management and fund managers, "both having a similar time horizon on a benchmark of relative share price performance, and both take great care to avoid negative surprises". Barker also concludes that because of the economic incentives connected with the turnover-based commission income of the analysts, the analysts in contrast favour share price volatility rather than stability (Barker 1998, 16). Despite the fact that fund managers consider financial reporting and formal meetings with company management more important than the analysts, their role in the market for information is seen as a "news agency and a source of valuation benchmarks" (Barker 1998, 16).

Holland & Johanson (2003) problematize the abilities of the market for information participants to incorporate new types of information on e.g. intellectual capital and the value creation process of companies into valuations. They argue that because the fund management and analyst functions have difficulties understanding even their own value creation process and intellectual capital, then how can they be expected to understand those of the companies they are analyzing and investing in (Holland & Johanson 2003)? Furthermore, Holland & Johanson (2003) argue that ambivalence towards using new types of information is attributable to the institutionalized nature and culture of these actors. This is accentuated by Ikäheimo (1996, 30), who argues that "[t]he value of a share is derived from a consensus based on the institutionalized conception of how the value of the company should be perceived".

The statements above bring relish to a dilemma and unexplored avenue in relation to the decision-making of the market for information participants. To minimize uncertainty and risks in investments, market for information participants and other actors in the capital market wish to base their decisions on full information, i.e. from a rational, consequential set. However, as indicated above, they do not understand new types of information otherwise regarded as highly value relevant. Therefore, although they want their decisions to look consequential, they are in fact characterized by the logic of appropriateness. Furthermore, as practices and rules-of-thumb to incorporate and understand new types of information are not presently institutionalized, the market for information participants face grave difficulties when packing and unpacking such disclosures.

Holland has conducted a number of studies in relation to the market for information participants and the dissemination of voluntary information between them. Holland (1998) concludes that private information disclosed to institutional shareholders is a significant part of a larger corporate decision concerning public versus private voluntary disclosure. Furthermore, Holland & Doran (1998) have examined financial institutions' application of private information channels, finding that these invested much time and effort in cultivating relationships in order to gain an information edge over the market.

In a later study, Holland (2002a) has found that the limitations of finance theory and the limitations of corporate disclosures and other public domain information sources cause uncertainty in stock selection and in asset allocation decisions for fund managers. Finally, Holland (2004) argues that the fundamental mosaic is the cornerstone of communication between the 'market for information's' participants. According to Holland (2004, 67), the fundamental mosaic: "provides a coherent means to tie together this information in a broader picture and to assess the impact on corporate valuations and it provides a means to check corporate promises against reality".

In 2009 John Holland refines his thoughts on the mosaic of information even further in his paper "Looking behind the veil": invisible corporate intangibles, stories, structure and the contextual information content of disclosure. Here he depicts three archetypes of value creation processes used for telling the business model story, namely 1) hierarchical (from top management), 2) horizontal (operational value creation), and 3) network (or alliances and strategic partnerships).

Holland explains: "The hierarchical aspect of the corporate value creation story concerned common structures and categories of strategic drivers across companies. The hierarchical narrative concerned the story of the

board, its directors, and board committees as the primary internal corporate governance mechanisms. This narrative explained how the board chose top-management and incentives schemes, how top-management in turn developed and implemented a coherent strategy and how this was monitored by the board. ... The hierarchical narrative revealed top-down drivers of the value creation process. These primary drivers included top management qualities, coherence and credibility of strategy, management remuneration schemes, and corporate performance systems based on shareholder value."

Further, Holland writes that: "Each case company also articulated a concept or idea of its 'horizontal' or operational value creation process consisting of input sourcing decisions, transformation decisions and processes, and output decisions. This value creation process was normally conducted at middle management and employee operational levels. It was often the critical part of the corporate value creation story showing how a case company differentiated its economic transformation processes from those of its competitors in the same sector. ... The network value creation narrative sought to explain how the company sought to create many shared knowledge intensive competences at the boundary of the company. This normally involved the sharing both of tangible and intangible value drivers via supply, production and marketing alliances at various points in the corporate horizontal value creation process. It often involved sharing of unique or otherwise unobtainable intangibles."

Finally, Holland concludes that the business model narrative, or strategic story, normally connected many of the key elements in the value creation process. This was communicated externally to investors via a narrative connecting hierarchical, horizontal, and network value creation processes and the concept of an intangible, and its relative ranking, was given additional meaning by being placed and linked within the larger value creation story during the private question and answer sessions. This provided evidence and gave credibility to both the story and the relative ranking of the unobservable intangible factor. The combination of the narrative about the three value creation processes, the use of benchmark indicators or measures, their placing and linking within the story, all helped case companies provide the required 'full story' or 'big picture' to investors.

4. GAINING A COMPETITIVE EDGE IN THE MARKET FOR INFORMATION

There is an intricate and rather delicate relationship between analysts, investors and management, which at the same time is located in an extremely competitive context (Fogarty & Rogers 2005). It is an environment of secrecy amongst the competing analysts, who all seek to gain some sort of competitive advantage in relation to their peers. The notion of having been or being able to gain a competitive edge over the market can mean a variety of things. For the financial analyst, there are basically three ways to do this; it can e.g. pertain to having information that others do not have access to, having a unique perspective, or simply to having better analytical skills.

Firstly, possessing a piece of information about a firm that none of the competitors have, is an obvious competitive advantage. As there are strict rules and regulations with respect to having price sensitive insider information, this sort of competitive edge is typically mobilized through expert contacts, e.g. specialists in the specific field of a specific company or through collaboration across offices within the larger investment banks. In this manner, having an information edge is more likely to mean having a more detailed account of existing information, rather than new information that nobody else has.

In this respect, having a good relationship with company management teams and investor relations departments is a key to gaining a competitive edge, as more details on specific elements of the firm (Barker 1998, 16) or e.g. an alternative management perspective on a piece of information might be shared through private dialogue. According to Francis & Philbrick (1993), the analyst relies on his relationships with corporate executives for information and analysis that is not widely disseminated. Such relationships, which may be conducted through visits to corporate headquarters, telephone calls with senior executives, or in group settings, are crucial to the analyst in

establishing his claim to expertise (Philips & Zuckerman 2001, 393), i.e. competitive edge.

Also in relation to new information, the ability to be quicker to the market than competitors with newly disclosed information, e.g. in connection with earnings announcements, is another important competitive advantage. Typically, trading is stopped for 2 minutes around an earnings announcement. Within this interval the analyst must download and skim the report and be able to point out the direction in comparison to previous expectations to the sales-desk. For some analysts this is a crucial part of their job, while others do not see their value adding tasks in this situation. With respect to analyzing the company, having a competitive edge can either come through being the fastest, e.g. in connection with earnings announcements, or having the best analytical capabilities.

A key competitive edge, an analytical edge, is being the best at interpreting existing information. Frankel *et al.* (2002) find that analyst research helps prices reflect information about a security's fundamentals. This indicates that while the analysts' role may restrict itself to merely pre-announcing earnings numbers in connection with annual earnings announcements etc., their real value-adding activities relate to the more fundamental research and understanding of the company value creation logic, strategy etc.

Typically, the analysts create informativeness in comparison to the fund managers themselves and thus justify their existence by specializing by industry (Al-Debie & Walker 1999, 262) and by utilizing synergies between research functions within the investment bank. In relation to this, Desai, Liang & Singh (2000) find that stocks recommended by analysts following a single industry outperform those recommended by analysts following multiple industries. Hence, also the precision of their forecasts, which is a key point on which they are evaluated by investors, is a competitive edge.

Analysts seem to have their raison d´être where complexity is greatest. However, there is also evidence that even analysts have difficulties in making forecasts in certain situations, e.g. where knowledge-resources constitute a major part of the company value (Lee 2001), difficulties that could pertain to the inadequate applicability of conventional measurement and valuation approaches for such purposes (Lee 2001, Garcia-Ayuso 2003). Plumlee (2003) finds that information complexity imposes sufficient costs even on expert users and reduces their use hereof. Therefore, analysts' abilities to incorporate complex information in their analyses are a decreasing function of complexity and information processing costs. For instance, Bukh (2003, 53) argues that disclosing intellectual capital indicators without disclosing the business model that explains their interconnectedness leaves the analysts to do all the interpretation; something which they are not capable of. Garcia-Ayuso (2003, pp 60-61) questions the credibility of analyst recommendations in this light, vindicating for a bounded rationality perspective on analysts' cognitive abilities.

Investors and companies rank analysts differently, and even though some analysts are not the most accurate, they can still have the highest rating because their competitive edge comes from their ability to provide e.g. a new perspective on the firm (Beunza & Garud 2004, 14). Therefore, having a perspective edge, also termed 'a unique case', is a source of competitive edge. Beunza & Garud (2004) conceive analysts as makers of calculative frames. Analysts calculate, but they do so within a framework. According to Beunza & Garud (2004), analysts may appear to conform, but they also deviate from the pack to generate original perspectives on the value of a security, and, occasionally, displace prevailing frames.

The analysts rely on the factors mentioned above to gain an advantageous standing in the eyes of the investors, who then, in turn, trade through the analysts' investment banks and furthermore participate in rating the analysts among one another (Phillips & Zuckerman 2001). Typically, analyst ratings are a proxy for how much of their trading volume the investors will place at the respective investment banks, and as trading volume is what pays for the analyst services provided, the analysts live and die by their rating; hence the degree of competitiveness between analysts. Because analysts are dependent upon their customers, the investors, for their survival, it is appropriate to consider analyst reports as proxies for investors' information demands.

From the analyst point of view, indicators disclosed in the annual report or in a supplementary report only constitute one part, maybe even an inferior part, of the information needed to make recommendations to clients, because they are in a privileged position to "get more information – and sooner – than all except the very largest investors" (Eccles *et al.* 2001, 274). It might be that the information has value relevance, but the analysts have already a much more detailed understanding about e.g. the research and development activities, than that which can be gained from reading about the aggregated research and development expenses.

Taking the above description of the different angles towards gaining competitive advantage as the point of departure, let us briefly reflect upon how different 'types' of analysts position themselves accordingly within the market for financial analysis. Analysts are not a homogenous group of people (cf. Day 1986), although it has been suggested that their behaviour and understanding of social norms are indeed extremely similar (cf. Norberg 2001, Holland & Johanson 2003). In the following, let us distinguish between two types of analysts, namely the small cluster and the large cluster analysts, where cluster refers to the amount of companies they actively follow on a daily basis. The large cluster analysts typically focus on 10-20 different companies, whereas the small cluster analysts concentrate on 4-8 companies.

There are large discrepancies between their job descriptions, i.e. their client contact activities, and also with respect to the customer segments that they serve, i.e. private or institutional investors. Generally, the large cluster analysts have more and smaller clients, while the small cluster analysts generally serve fewer and larger institutional clients. Also, the large cluster analysts have a closer connection with the traders of their respective investment banks – some of them even taking orders from clients.

These differences also have an effect on the type and detail of the research that they conduct and the thoroughness of the analyst reports in which they disseminate their results. Like with the analysts, there are also two types of analyst reports; the scheduled or earnings analyst report, and the fundamental analyst report, where fundamental analysis can be described as determining the value of corporate securities by a careful examination of key value drivers such as earnings, risk, growth and competitive position (Lev & Thiagarajan 1993, 190). Not all analysts conduct the so-called fundamental analyses, as it is not a part of their job descriptions. This typically relates to the type of analyst in question. This will be discussed further in connection with evidence provided in the empirical analysis below. As this paper focuses on gaining knowledge about how corporate reporting can be enhanced by investigating the types of information analysts consider important in their fundamental research, the point of departure for the empirical analysis will be fundamental analyst reports.

Studying financial data in relation to analysts' decision-making processes, Gniewosz (1990, 227) finds that the annual report is still considered the most important source of information (see also Brown 1997), although it is seen as having mainly a confirmatory function, rather than a primary information function, and a disciplinary effect on other corporate disclosure media (Christensen 2003). A number of studies have likewise examined the analysts' decision-making processes (cf. Schipper 1991) e.g. in connection with screening of prospective investments (Bouwman *et al.* 1987; Bouwman *et al.* 1995). A number of different foci have been uncovered, for example how analysts' decisions are products of group environments (Francis & Philbrick 1993), the identification of the most widely used valuation practices among analysts (Block 1999, 91; Plenborg 2002), and the uncovering of the various stages in the valuation process (Gniewosz 1990, Mouritsen *et al.* 2002a).

There seems to be some evidence pointing towards a context-specific use of valuation metrics. It has been indicated that fundamental strategic analysis is more appropriate for valuing younger firms but also more specifically new ventures, while the more capital-based valuation metrics, such as discounted cash-flow and Price/Earnings, are more aptly applied to mature firms.

Confirming the greater difficulties of valuating relatively new investment objects (the capital market's version of the company), be they companies, new ventures or spin-off projects, and also investment objects

characterized by consisting to a great extent of intangible assets, Mouritsen *et al.* (2002a) depict a seven-stage model whereby the valuation process of such "businesses" can take place. In relation to this challenge, Hägglund (2001) describes more closely how investors and analysts work together in this process. Hägglund's research, focusing on the conceptualization of the company rather than its value, illustrates the complexity of the flow of funds to companies through the capital market and that the process also encompasses social and behavioural aspects.

Luehrman (1997) states that traditional valuation approaches may have become obsolete in the light of the recent changes in the nature of value creation from tangible to being predominately intangible of nature. However, the market for information participants still need relevant information in order to enable correct and accurate valuations of the firms, i.e. to get as close to intrinsic value as possible. On the basis of these facts, Mouritsen *et al.* (2001) suggest that three different types of capital must be evaluated in order to get a correct picture of the value of the company. These are social capital, financial capital and "wise" capital, the latter including factors such as strategic knowledge and knowledge on organization and control.

5. INFORMATION TRIGGER-POINTS FOR INVESTORS

Events that cause significant movements in the stock price are called triggers. The term trigger is used in relation to initiating research and valuation of the company. Applying analyst terminology, trigger points are typically fundamental changes that alter the value of the company, e.g. changes to growth and value drivers or changes in the macroeconomic environment. In a sense, triggers represent possibilities for earnings surprises.
Possible triggers, points for stock price movement, and fundamental analysis could be (this is not necessarily an exhaustive list):

- The announcement of mergers & acquisitions
- Spin-off of existing operations into a new entity
- Entering into new geographical markets with existing product-base
- Introduction of new products to existing markets
- Significant cost-cutting initiations
- Change of strategic focus, e.g. from being low-cost producer to producing high quality products
- Changes in the top management team
- Announcement of passed stage gates in the R&D pipeline for future products
- Announcement of significant collaborative agreements in the value chain

Triggers such as those listed above do not represent information that can be put directly into an applied technical valuation model. Rather they represent key points in relation to the actors' fundamental mosaic. The perception of company value is determined by the realization of strategic options and future strategic choices made by company management. In this respect, e.g. quality of management, track record, strategic focus etc. become crucial for estimating the future performance of the company. The mosaic is a part of this understanding of how the fundamentals of the company will perform beyond the reach of certain cash flow estimates. Therefore, unpacking the black-box of the capital market actors' fundamental mosaic and its relationship to stock price is an important aspect to investigate.

The fundamental mosaic is the image of the company which each market for information participant has. Skubic & McGoun (2000, 17) suggest that communication of the corporate 'image', i.e. the fundamental mosaic, is necessary to attract attention to the company, i.e. increase analyst following (Wyatt & Wong 2002), enhance the credibility of disclosures, and facilitate the market for information participants' interpretation, because investment decisions are based on images rather than propositions. In essence, Skubic & McGoun (2000) here argue that a consequential understanding of the company is not what actually takes place. Rather, an appropriate representation of the company, like in the concept of business models is the basis for conceptualization and communication.

6. ANALYSTS AS INFOMEDIARIES

The analysts, serving as information intermediaries between companies and investors, take multiple sources of information into account in their recom-

mendations (Barron *et al.* 2002). This means that the analysts' reports, recommendations, and analyses are a separate 'secondary' source of information for the fund management function (Caramanolis-Cötelli *et al.* 1999; Holland & Johansen 2003, 467), and the analysts themselves act as sparring partners for the investors. Research confirms that investors react to e.g. financial analysts' research reports (Hirst, Koonce & Simko 1995), and also brokerage analysts' recommendations have investment value (Womack 1996), although Krishnan & Booker (2002) only find analyst recommendations to reduce investors' disposition errors in cases where they are supported by additional information in the form of a report.

There has been a lot of talk in recent years of the need to promote greater transparency in the communication from companies to the capital markets. Transparency is in the eyes of the beholder and is not equivalent to information availability or an objective condition to which organizations need to adapt. Therefore transparency is an outcome of internal and external stakeholders', i.e. company management and capital market agents, agreements on which information should be disclosed, i.e. a common conceptualization of the company business model.

Communication is often associated with information, the rationale being that a demand for more or better communication simply means more information. In the light of bounded rationality this becomes a problem, as external audiences have both limited access to information and limited information processing capacity. Equating communication to information is like presuming that messages are simply transferred from a sender to a receiver in accordance with the intentions of the former.

Communication between company management and analysts and investors can take place through a number of different information channels. Such disclosures can be conveyed through e.g. analyst meetings or open and closed conference calls. Private channels are found to be an important medium for disclosing supplementary information about the company. Research confirms that the financial report still is the most important information source to users of company reporting, regardless of their status as professional or private users.

Lee & Tweedie's twin studies (1977, 1981) examined first the private investors' and secondly the institutional investors' perceptions of the usefulness of the corporate report. They argue that even though there seems to be information symmetry between the investor groups, meaning that private investors get the same information as the large institutional investors, there is to a great extent an understanding asymmetry. They imply that financial statements are far too complex for ordinary investors to understand them (Lee & Tweedie 1977, 27).

7. TRANSLATED TO THE REAL WORLD CONTEXT THIS MEANS...

In the above sections we have reviewed a lot of literature on the roles of the actors in the market for information and the information needs of these people. Below we will translate this into some pragmatic advice for students, young entrepreneurs and small companies wishing to enhance their communication with the financial sector in general.

It may seem as if there is a world of difference between the needs and desires of well-paid financial analysts and institutional investors in well-established capital markets with billion-USD turnovers and the young entrepreneur starting his own company, and looking for a few lousy bucks to sustain his ideas for another 6-12 months. Yes there is in some sense a world of difference, but the decision-makers are much the same, and their line of thinking is exactly the same.

For small-company investors (SC investors), whether they are business angels, pre-seed funders, seed capital providers, venture capitalists, private equity funds or other, investing is about taking a risk and being rewarded for this. Here information plays a key role, as information minimizes the perceived risk of making an investment. Transparency reduces uncertainty in the sense of providing a foundation for predicting future profits. However, information can of course create uncertainty, even if it is "good" information. For example if the information gives rise to several possible scenarios for the company.

Generally speaking, the role of the business model is in discussing and visualizing the ambitions of the compa-

ny, e.g. is it a strong proposition, what are the scaling possibilities, can the company go global?

7.1 What does the small-company investor look for?

A SC-investor typically goes through an initial screening process of the companies that wish to engage in an investment partnership or sale. This initial screening process is sometimes quite rigorous, in other instances it is a question of assessing whether the SC-investor has knowledge of the proposed business area and competences to lift the business to another level, or whether they believe in the market the business is trying to address.

Surviving the initial screening typically means getting to present the company to the SC-investor board. Here one may typically expect a 30 minute session in front of the board where you should be talking for approximately 15-17 minutes and leave room for questions afterwards. In reality, the entrepreneur, or should we call him capital-seeker, needs to deliver his punch lines within the first 2 minutes. There exist numerous guides on which "business plan" information the entrepreneur should submit to SC-investors. The suggestion here is to construct 2 documents: 1) A report in a text format, and 2) A power-point presentation. Both could/should apply the following structure:

Table 1: SC-investor screening

FRONT PAGE	» INCLUDING COMPANY NAME AND CONTACT INFORMATION
Executive summary	» A teaser summing the key points of the presentation » Which market is being addressed and how? » Market growth scenarios, quantified » Which user needs are being addressed? » What is the value of meeting these needs seen from the user? » How does your product/service meet these needs? » How much capital is needed? » When will we see a ROI? » What is the exit-plan?
The management team	» Who is involved and what are their competences? » What are the teams management skills? » What is the track record of this management team?

The Business model	» Which value creation proposition are we trying to sell to our customers and the users of our products? » Which connections are we trying to optimize through the value creation of the company? » Are there any critical connections between the different phases of value creation undertaken? » Describe the activities set in motion in order to develop the company » Enlighten these activities through relevant performance measures » Which resources, systems and competences must be attained in order to be able to mobilize our strategy? » What do we do in relation to ensuring access to and developing the necessary competences? » Can we measure the effects of our striving to become better, more innovative or more efficient, other than the bottom line?
Market analysis	» A precise description of the market » What is the size of the market? » Market growth scenarios, quantified » What drives this market and what is the elasticity on it? » Which customer segments exist and how are they addressed (differently)? » Documentation!
Competitor analysis	» Who are the key competitors? » Describe the competitors you are going head to head with » Do a SWOT analysis on these » In which way is the product/service of the company unique in comparison to major competitors? » What are the key competitors' product/market strategies?
Product description	» Describe the product so that its properties are understandable to anyone
Patents	» Are there any patents, patents pending or patenting possibilities? » What is the patenting strategy?

Go-to-market strategy	» Describe how the product will be launched to the market? » Which distribution channels will be used? » Are there any bottlenecks or initial investments? » Who are the key decision makers to address?
Risks	» Which risks can undermine the success of the chosen business model? » What can we do to control and minimize these?
Key economic ratios	» Forecast expected revenues and costs » Be explicit about the prerequisites for these forecasts » Indicate the sensitivities of these prerequisites » Give a base case, best case and worst case scenario
The investor role and exit-plan	» Which role do you expect the SC-investor to play in your company? » Which competences and network do you wish to gain access to from your SC-investor? » How do you see the SC-investor filling out this role? » Which ownership balance do you see? » When do you expect an exit and to which kind of investor? » What is your expected exit-price at this point in time?
Milestones	» Describe milestones that the company has already reached, like e.g. proof of concept, previous investments » Describe future milestones for the company and which impact they will have
Company description	» Provide a brief description of the company, including history, vision, mission and strategy » Domicile » Communication and organization » Describe key IT systems in place » Describe the management control system

The structure outlined above follows most suggestions and guidelines in this field, but distinguishes itself by being more explicit about the business model. Ideally, the business model should play a larger and more central role in this process, but we do not feel that the SC-investor community is ready yet. They need time to understand the concept properly and therefore they still rely on a traditional business plan, sensitivity analysis and SWOT analysis structure.

7.2 The 60 second elevator-pitch

When you have prepared your investor pitch according to the structure in the section above, you should also work on delivering your "Elevator Pitch". The "Elevator Pitch" must be landed in under 60 seconds and it must answer the following six questions:

1. What is your product or service? Briefly describe what you sell. Do not go into excruciating details.

2. Who is your market? Briefly discuss to whom you are selling the product or services. What industry is it? How large of a market do they represent?

3. What is your revenue model? More simply, how do you expect to make money?

4. Who is behind the company? "Bet on the jockey, not the horse" is a familiar saying among Investors. Tell them a little about you and your team's background and achievements. If you have a strong advisory board, tell them who they are and what they have accomplished.

5. Who are your competitors? Don't have any? Think again. Briefly discuss who they are and what they have accomplished. Successful competition is an advantage-they are proof your business model and/or concept work.

6. What is your competitive advantage? Simply being in an industry with successful competitors is not enough. You need to effectively communicate how your company is different and why you have an advantage over the competitors. A better distribution channel? Key partners? Proprietary technology?

7.3 Looking out for global scalability

In reality, SC-investors are looking for companies that can position themselves for growth, because growth sells further up the investor-value chain. A recent comparative study on the Polish and Danish SC-investor community conducted under the auspices of the Business Model Design Center, it is found that a further dimension to the framework in the SC-investor screening framework in table 1 should be added, namely that of assessing the "Born global ability" of the company. Fejfer (2012) finds six aspects that must be considered in assessing the born global ability of a new venture:

1. Level of global orientation

2. Existence of global competitive edge(s)

3. Level of business model scalability

4. Managerial competences

5. Strong networking competences

6. Strong learning capabilities

About the author

Christian Nielsen is Professor at Aalborg University, Denmark and Visiting Professor at Macquarie University, Australia. Christian heads the Business Model Design Centre (www.bmdc.aau.dk), one of the worlds leading interdisciplinary centres of excellence in business model research. Christian has worked with the field of analysing and valuing business models since 2001 both as a researcher and as a buy-side analyst, portfolio manager, consultant and board member and is also Joint-Editor of the Journal of Business Models.

REFERENCES

Al-Debie, M. & M. Walker. 1999. Fundamental Information Analysis: An extension and UK Evidence. *British Accounting Review*, Vol. 31, No. 3, pp. 261-280.

Ball, R. 1996. The Theory of Stock Market Efficiency: Accomplishments and Limitations. *Journal of Financial Education*, spring, pp. 1-13.

Barker, R. 1997. Information Flows between Finance Directors, Analysts and Fund Managers: A Study of Accounting Information, Corporate Governance and Stock Market Efficiency. Judge Institute of Management Studies, Cambridge University, Research Paper No.1997/16.

Barker, R. 1998. The Market for Information: Evidence from Finance Directors, Analysts and Fund Managers. *Accounting and Business Research*, Vol. 29, No. 1, pp. 3-20.

Barron, O.E., D. Byard, C. Kile & E.J. Riedl. 2002. High-Technology Intangibles and Analysts' Forecasts. *Journal of Accounting Research*, Vol. 40, No. 2, pp. 289-312.

Beunza, D. & R. Garud. 2004. Security Analysts as Frame-makers. Working paper, Department of Economics and Business, Universitat Pompeu Fabra, Barcelona.

Block, S.B. 1999. A Study of Financial Analysts: Practice and Theory. *Financial Analysts Journal*, Vol. 55, No. 4 July/August, pp. 86-95.

Bouwman, M.J., P. Frishkoff & P.A. Frishkoff. 1995. The Relevance of GAAP-Based Information: A Case Study Exploring Some Uses and Limitations. *Accounting Horizons*, Vol. 9, No. 4, pp. 22-47.

Bouwman, M.J., P.A. Frishkoff & P.Frishkoff. 1987. How do Financial Analysts Make Decisions? A Process Model of the Investment Screening Decision. *Accounting, Organizations and Society*, Vol. 12, No. 1, 1-29.

Brown, P.R. 1997. Financial Data and Decision-Making by Sell-Side Analysts. *The Journal of Financial Statement Analysis*, Spring, pp. 43-48.

Bukh, P.N. 2003. The Relevance of Intellectual Capital Disclosure: A Paradox? *Accounting, Auditing & Accountability Journal*, Vol. 16, No. 1, pp. 49-56.

Caramanolis-Çötelli, B., L. Gardiol, R. Gibson-Asner & N. S. Tuchschmid. 1999. Are Investors Sensitive to the Quality and the Disclosure of Financial Statements? *European Finance Review*, Vol. 3, No. 2, pp. 131-159.

Christensen, J.A. 2003. Why do Accounts Convey so Little Information? *Nyviden*, Special Issue, October (In Danish).

Day, J.F.S. 1986. The Use of Annual Reports by UK Investment Analysts. *Accounting and Business Research*, Vol. 16, No. 64, pp. 295-307.

Desai, H., B. Liang & A.K. Singh. 2000. Do All-Stars Shine? Evaluation of Analyst Recommendations. *Financial Analysts Journal*, Vol. 56, No. 3 May/June, pp. 20-29.

Eccles, R.G., R.H. Herz, E.M. Keegan & D.M. Phillips. 2001. *The ValueReporting Revolution: Moving Beyond the Earnings Game*. New York: John Wiley & Sons.

Fogarty, T.J. & R.K. Rogers. 2005. Financial Analysts' Reports: An Extended Institutional Theory Evaluation. *Accounting, Organizations and Society*, Forthcoming.

Francis, J. & D. Philbrick. 1993. Analysts' Decisions as Products of a Multi-Task Environment. *Journal of Accounting Research*, Vol. 31, No. 2, pp. 216-230.

Frankel, R., S.P. Kothari & J.P. Weber. 2002. Determinants of the Informativeness of Analyst Research, Working Paper 4243-02, MIT Sloan School of Management, Cambridge.

Garcia-Ayuso, M. 2003. Factors Explaining the Inefficient Valuation of Intangibles. *Accounting, Auditing & Accountability Journal*, Vol. 16, No. 1, pp. 57-69.

Gniewosz, G. 1990. The Share Investment Decision Process and Information Use: An Exploratory Case Study. *Accounting and Business Research*, Vol. 20, No. 79, pp. 223-230.

Gonedes, N.J. 1976. The Capital Market, the Market for Information, and External Accounting. *The Journal of Finance*, Vol. 31, No. 2, pp. 611-630.

Hägglund, P.B. 2001. Företaget som investeringsobjekt – Hur placerare och analytiker arbetar med att ta fram ett investeringsobjekt. Akademisk avhandling för avläggende av ekonomie doktorsexamen vid Handleshögskolen i Stockholm.

Hirst, D.E., L. Koonce & P.J. Simko. 1995. Investor Reactions to Financial Analysts' Research Reports. *Journal of Accounting Research*, Vol. 33, No. 2, pp. 335-351.

Holland, J. (2009) "Looking behind the veil": invisible corporate intangibles, stories, structure and the contextual information content of disclosure. *Qualitative Research in Financial Markets*, 1 (3). pp. 152-187.

Holland, J.B. & P. Doran. 1998. Financial Institutions, Private Acquisition of Corporate Information, and Fund Management. *European Journal of Finance*, Vol. 4 No. 2, pp. 129-55.

Holland, J.B. & U. Johanson. 2003. Value Relevant Information on Corporate Intangibles - Creation, Use, and Barriers in Capital Markets - Between a Rock and a Hard Place. *Journal of Intellectual Capital*, Vol. 4, No. 4, pp. 465-486.

Holland, J.B. 1998. Private Disclosure and Financial Reporting. Working paper, Department of Accounting and Finance, University of Glasgow.

Holland, J.B. 2002a. Fund Management, Intellectual Capital, Intangibles and Private Disclosure. Working paper, Department of Accounting and Finance, University of Glasgow.

Holland, J.B. 2004. *Corporate Intangibles, Value Relevance and Disclosure Content*. Edinburgh: The Institute of Chartered Accountants of Scotland.

Ikäheimo, S. 1996. Communication in the Share Markets. Ph.D Dissertation, The Turku School of Economics and Business Administration, Finland.

KPMG. 2003. Insights from KPMG's European Knowledge Management Survey 2002/2003. Amsterdam: KPMG Knowledge Advisory Services

Krishnan, R. & D.M. Booker. 2002. Investors' Use of Analysts' Recommendations. *Behavioral Research in Accounting*, Vol. 14, No. 1, pp. 129-156.

Lee, S. 2001. Financial Analysts' Perception on Intangibles: An Interview Survey in Finland. ETLA Discussion Paper No. 778. Helsinki: The Research Institute of the Finnish Economy

Lee, T.A. & D.P. Tweedie. 1977. *The Private Shareholder and the Corporate Report*. London: Institute of Chartered Accountants in England and Wales.

Lev, B. & S.R. Thiagarajan. 1993. Fundamental Information Analysis. *Journal of Accounting Research*, Vol. 31, No. 2, pp. 190-215.

Luehrman, T.A. 1997. What's it worth? A General Manager's Guide to Valuation, *Harvard Business Review*, Vol. 75, No. 3 May-June, pp. 132-142.

Mouritsen, J., H.T. Larsen & P.N. Bukh. 2001. Intellectual capital and the 'capable firm': narrating, visualising and numbering for managing knowledge. *Accounting, Organizations and Society*, Vol.26, No.7/8, pp. 735–762.

Mouritsen, J., P.N. Bukh & H.T. Larsen. 2002. Developing and managing knowledge through intellectual capital statements, *Journal of Intellectual Capital,* Vol.3, No.1, pp. 10-29.

Norberg, P. 2001. Finansmarknadens amoralitet och det kalvinska kyrkorummet – en studie i ekonomisk menatlitet och etik. The Economic Research Institute, Stockholm School of Economics, Stockholm. (In Swedish).

Philips, D.J. & E.W. Zuckerman. 2001. Middle-Status Conformity: Theoretical Restatement and Empirical Demonstration in Two Market. *American Journal of Sociology*, Vol. 107, No. 2, pp. 379–429.

Plenborg, T. 2002. Firm Valuation: Comparing the Residual Income and Discounted Cash Flow Approaches. *Scandinavian Journal of Management*, Vol. 18, No. 3, pp. 303-318.

Plumlee, M.A. 2003. The Effect of Information Complexity on Analysts' Use of that Information. *The Accounting Review*, Vol. 78, No. 1, pp. 275-296.

Schipper, K. 1991. Commentary on Analysts' Forecasts. *Accounting Horizons*, Vol. 5, pp. 105-121.

Skubic, T. & E.G. McGoun. 2000. Individuals, Images, and Investments. Working paper, Bucknell University, Pennsylvania.

Womack, K.L. 1996. Do Brokerage Analysts' recommendations Have Investment Value? *The Journal of Finance*, Vol. 51, No. 1, pp. 137-167.

Wyatt, A. & J. Wong. 2002. Financial Analysts and Intangible Assets. Working paper, The University of Melbourne.