The Sky is not the Limit

Lund, Morten; Nielsen, Christian

Publication date: 2012

Document Version
Early version, also known as pre-print

Link to publication from Aalborg University

Citation for published version (APA):
The sky is not the limit

Table of context:
Abstract.................................................................................................................................................. 2
Keywords................................................................................................................................................. 2
Introduction............................................................................................................................................... 3
Business reporting to the users of corporate information................................................................. 5
The Business Model as a platform for structuring narratives ......................................................... 9
Description of the case company and methodology .................................................................... 11
    The case company ................................................................................................................................. 11
    Methodology ......................................................................................................................................... 11
Empirical discussion.............................................................................................................................. 12
Conclusions ........................................................................................................................................... 15
References .............................................................................................................................................. 16
Abstract

This paper is an account of a company that is in the process of writing its first prospectus and therefore has an aim of conveying a true and fair picture of its future prospects to existing partners and potential investors. Via a longitudinal case study over a period of 2½ years, we studied the development of a network-based company’s innovation process from a perspective of business model innovation rather than merely product innovation and throughout this process; story-telling was continuously emphasized in order to strengthen the value of the company and its partner network. In our theorization of the case company from a due diligence and business reporting perspective, the story-telling element is once again mobilized and is found efficacious in transferring the case company’s business model to a value-perspective that is also appreciated by investors. As such, this case study illustrates the merits of working systematically with business model analysis, both in relation to growing the company and promoting the investment case.

Keywords:
Business models, due diligence, investment case, business reporting, story-telling
Introduction

The traditional way for a successful startup is a lean startup focusing on creating the right product innovation, at the right price to a specific market. The small Danish engineering company Sky-Watch has succeeded in developing a small, rugged and extremely user-friendly Unmanned Arial Vehicle (UAV) at an affordable price, targeting the NGO’s and other industries that need reconnaissance in difficult accessible areas.

The success is based on the product innovation creating The Huginn X1, which is a small UAV that is easy to use and can be pre-programmed to perform a long range of operations automatically, thus letting the pilot focus on the task at hand.

It is the first micro-UAV from the small Danish innovative engineering company Sky-Watch. Originally, it was developed in collaboration with the University of Aalborg and civilian mine-clearing operators, and designed to be rugged enough for dusty, hot deserts in Africa, cold, wet and misty mountainsides in Eastern Europe as well as damp fields in Asia. It is lightweight, easily assembled, can be repaired with basic tools and – despite being extremely advanced – so easy to use that a mere couple of hours’ training is enough to make you a pilot. It was designed after the success-criteria that the UAV could be used by anyone anywhere at any time. In other words a success story based on a simple business model, providing value to a specific segment.

For the last 20 years standard-setting bodies and academics have been discussing how to improve the informativeness of narrative reporting, e.g. in the form of management commentary and br. During this period of time, there has been varying focus on which types of users management commentary is to be aimed at, and in turn perceptions of its possible content have been altered somewhat in composition. Since the turn of the millennium, it seems as if narrative reporting to a rising degree has been focused on meeting the needs of a much broader group of stakeholders than the perception of relevant users applied in earlier studies.

CSR seems to be the dominant discourse in the business reporting debate at the present. This is interesting as the discourse thereby is in conflict with the normative view of an organization’s purpose, namely to generate profits for shareholders. The CSR discourse, on the other hand, is much more in line with March & Olsen’s (1989) logic of appropriateness perspective, where corporate actions are much more concerned with communicating core values, mission statements, the business concept, political ideology, and social responsibility (see also Söderbaum 2002, 191). Thus, the dominant CSR-based discourse perceives disclosure decisions as being driven by appropriate patterns of behaviour, rather than e.g. the desire to maximize ‘transparency’ and the normatively argued causal effects of this.

For a number of years, this has had the consequence that the specific needs of professional users such as private and institutional investors and financial analysts have been downplayed somewhat in the business reporting debate. Some would go
so far as to say that the investment community is rarely heard in these respects (PWC 2007, 3). However, these professional stakeholders have, perhaps in the wake of the financial crisis, been given rising attention again in the last couple of years. Rather recently, the IASB has released its IFRS Practice Statement on Management Commentary (IASB 2009), which is a modified version of their discussion paper concerning management commentary that was open for comments during 2005 and 2009. Along with Bray (2010), the IASB release emphasizes existing and potential capital providers as the primary users of financial reporting and thereby also management commentary (IASB 2009, 8).

Although Bray (2010, 16) states that the CSR reporting movement is moving towards the capital markets and that early adopters potentially could build impetus for later regulation, such a movement will give rise to a major conflict of interest, and as such professional stakeholders will be more apt to pursue a normative perspective on disclosure streams. Information-flows from companies have been democratised dramatically in the last decade through the rise of the Internet and ubiquitous access to it through WLAN-connections and PDA-based mobile phones. At the same time, the complexity and amount of information have risen to unthought-of levels, making it more and more difficult for not only the ordinary investor to calculate the consequences of such information and thereby also the actions of the companies they wish to invest in.

Another potential area of inconsistency relates to approaches of communicating strategy and the business model (cf. Bray 2010). Today’s companies are competitive due to their extremely complex structures and their ingenuitive ways of retracting value from networks of resources. Seldom are state-of-the-art companies of today organised in the silos described in basic textbooks of organisation. However, when one reads the narrative sections of the same companies’ financial reports, this could very well be the impression that you get. The narrative sections of the financial report simply do not illustrate the actual value creation structures of the company. The argument is that the management commentary needs to imply an explicit interconnectedness between parts of the company. In other words, the narrative sections need to be aligned with the logic of the business model, thereby describing the specific structures and strategies of value creation.

The rest of the paper is structured as follows. Section 2 takes its point of departure in the many suggestions that business reporting must conform to users’ needs and asks the critical question who these users are. In the light of this we pursue the discussion of business reporting themes and which types of information the narrative sections of prospectuses, due diligence reports etc. ought to be focusing on, while section 3 discusses the application of a business model approach to solving the existing problems of lacking alignment between narrative communication and value creation. Section 4 describes the case company and the applied qualitative case study. In section 5 the empirical data is discussed and this is concluded upon in section 6.
Business reporting to the users of corporate information

In the past 20 years, a myriad of reports and guidelines have addressed the usefulness of business reporting and management commentary narratives. This section discusses the notions of these countless suggestions that business reporting must conform to users’ needs by asking the critical question: Who are the users of business reporting?

Having been a participant in this debate for a long time now, we are not certain that this question ever has, let alone will be, clarified. And it does not necessarily have to either. The most important issue is that it is made explicit who the target customer of a report is. For example, Bray (2010) states that the most important user of business reporting is the investor. Hence, it is of extreme importance to clarify whether there is a difference between the two segments, i.e. the users and the perceived target customers.

Beattie & Pratt (2002) argue that the type of disclosures contained in the narrative sections of the financial report are important to investors and analysts as these users base their earnings and cash flow expectations on both financial and non-financial information. Furthermore, as earnings and cash flow expectations are cornerstones in company valuation, non-financial information contributes to the accuracy of the valuation (Christensen & Demski 2003, Lang & Lundholm 1993). More informative disclosures and more explanation will thus reduce the information asymmetry between the company and the capital markets, thereby diminishing uncertainty regarding the company’s future prospects (Botosan 1997) and leading to more accurate forecasts on which investors can base their investment decisions (Lang & Lundholm 1996).

Furthermore, Vanstraelen et al. (2003) find that higher levels of forward-looking non-financial disclosures are associated with lower dispersion and high accuracy in financial analysts’ earnings forecasts. The sections above illustrate that providing voluntary information, e.g. through business reporting, is a way of satisfying users’ needs (cf. McEwen & Hunton 1999). The question then prevails whether the annual report as it is today can fulfill these needs? Holman (2002) states that comprehensive business reporting should convey a broader representation of the company and its value creation logic than that which is communicated through financial reporting as it is practiced today.

However, this notion of considering and researching the usefulness of annual reporting from a user perspective is not new. 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, and in subsequent studies by Arnold & Moizer (1984) and Pike et al. (1993) user requirements from the analyst’s perspective were examined. Bartlett & Chandler (1997) conducted a follow-up study on Lee & Tweedie’s 1977-study. They concluded that little had changed in the 20 years that had passed, despite the efforts of the accounting profession and the
business community to improve communication between management and shareholders.

By studying the literature on business reporting during the last 20 years as well as the general trends in business and management, it becomes clear that there for some time now has been a mismatch between the stakeholder perspectives being conveyed. Starting out at the time of the Jenkins report in 1994, it is clearly stated that the target users of business reporting are investors and financial analysts. Around the turn of the millennium, a much broader perspective is being communicated. Especially the Global Reporting Initiative (GRI 2002), but also the report from the World Business Council for Sustainable Development (WBCSD) Report (Heemskerk et al. 2003) is a central mark for this agenda. Towards the end of the period, we see the likes of IASB (2009), Bray (2010) and PWC (2007) again contend the sensibility of the broader stakeholder focus.

Although there is a great deal of agreement concerning the need for developments in corporate reporting practices, there is some ambivalence as to how this should be carried out. While some contributions argue that standard setters should be responsible for developing the comprehensive model for business reporting (cf. AICPA 1994), others reason that changes must come from the business community as market leaders and industries see first mover advantages of greater transparency (Bray 2002, 3). The problem is that e.g. non-financial information is inherently idiosyncratic to particular industries and perhaps even to individual enterprises (Upton 2001). Therefore it is not necessarily new accounting standards that are needed, rather standards for form, presentation, and disclosure of underlying assumptions as suggested by DiPiazza & Eccles (2002) in their three-tiered model of corporate reporting.

The reasons advocated for improving companies’ business reporting efforts relate to both external and internal objectives. Externally, relevance to the capital market is perceived as a main driver of business reporting, as the underlying premise that improving disclosure makes the capital allocation process more efficient and reduces the average cost of capital. Examples providing companies with helpful ideas of how to describe and explain their investment potential to investors e.g. is given in the FASB report (2001). Also, it is argued that a new generation of analytical tools is needed to enable company boards, shareholders and investors to judge management performance and differentiate good, bad and delinquent corporate stewardship (Eustace 2001, 7). Moreover, Blair & Wallman (2001, 45) accentuate that more reliable and useful information to financial markets must be obtained by improving internal measurement, which creates a better understanding of the company’s key value drivers.

In this manner internal and external objectives become closely interrelated. Blair & Wallman argue that “[t]he lack of good information about the most important value drivers in individual firms, and in the economy as a whole, makes it more difficult for managers within firms and individual investors in the capital markets to make sensible resource allocation decisions” (2001, 58). Also of internal relevance is the ability to communicate strategy, vision and corporate objectives to employees.
throughout the firm. According to Bray (2002), enabling management and employees to understand the reporting and communication strategy of the company can be achieved by synchronizing the company’s performance reporting with management’s decision making models.

Critics of management narratives, business reporting and voluntary disclosures as a whole, argue that the reliability of the information is questionable and that even if reliability was to be obtained through regulation or consistency of disclosures, there would still be problems of the subjectivity of management as well as problems of the shelf-life of the narratives.

Creating confidence in new types of information is a question of normalizing the individual company’s practices, being consistent and thereby generating user experience in understanding such performance measures. A recent survey of users needs made it clear that there is little investor demand for prescriptive standards on narrative reporting (PWC 2007). An underlying notion within the business-reporting debate is that mandatory requirements are not satisfactory in order to meet users’ needs, and that the future of corporate reporting includes aspects currently perceived as voluntary (DiPiazza & Eccles 2002). Eccles et al. (2001) argue that the implications of this will be moving companies’ practices from a performance measurement agenda to a performance reporting agenda.

The need for comparable non-financial measures is broadly accentuated, as a means of increasing the reliability of key performance indicators that are presented in management commentary sections (Blair & Wallman 2001). Comparability can be thought of along two tracks, namely either being related to the ability to track new metrics and non-financial value drivers from period to period (Upton 2001; FASB 2001), alternatively to the ability of benchmarking such measures across companies (Bray 2002). The industry-based KPI-taxonomies of WICI (2010) are an attempt at creating such benchmarking possibilities.

The argument made in the above literature is that if the information is important for the management of the company, then it is also relevant for external parties such as investment professionals seeking to piece together sufficient information to put the financial numbers in context. However, this too may be problematic as it will lead to an information overload. In a recent study of intellectual capital reporting practices, Nielsen & Madsen (2009) discuss how such business reporting practices have moved from generic reporting practices stressing the disclosure of as much information to stakeholders as possible, but seems to be in the process of being substituted by a new discourse, which emphasizes reporting what is seen from the perspective of management, namely the “right” information, and only that.

The comprehensive model for business reporting proposed by Jenkins (AICPA 1994, 44), initially identified ten components which should be included in a corporate report and thereby also constitute the backbone of management commentary. From figure 2, it becomes evident that there is a great deal of agreement among the reports reviewed that elements such as: management’s operating data, management’s analysis of financial and operating data, information on risks and opportunities,
critical success factors, value drivers, objectives, strategy, and vision should be a part of the management commentary in the corporate report.

Other areas emphasized include segment information such as the break-up of information by line of business and type of expenditure (FASB 2001), and generally the mobilization of key performance indicators in multiple dimensions (Bray 2002). Likewise, the significance of intangibles for value creation (Eustace 2001) invokes that additional data about intellectual capital, including human resources, customer relationships and innovation, would be beneficial as such information depicts the processes that people and the infrastructure put in place to achieve organizational objectives (Bray 2002, 13). Such information is regarded as important in minimizing investors’ perceived risk in connection with investing in the firm. Furthermore, the reporting of business risks, efforts with respect to business risk management, and corporate governance are aspects which are also emphasized within the realm of an enterprise wide perspective towards risk reporting. Three of the latest recommendation-type reports also argue for the mobilization of multiple stakeholder perspectives (Bray 2002, Heemskerk et al. 2003, Eccles et al. 2001) and linking social and environmental measures to business objectives.

Interestingly, considering the macro and regulatory environment as well as the general business landscape, is only mobilized in two of the reports, one being the latest report by the IASB. A much applied critique of the “usefulness” of narrative reporting has been the question of objectivity and timeliness, or the shelf-life, so to speak. This becomes especially problematic in relation to the macro environment and the competitive landscape, where the situation can change even between the writing and publishing of the narrative report. The investment community states in relation to this problem that the application of other information channels therefore is a necessity for them in their decision-making. Another problematic factor here is that often, institutional investors have their own macro economic perception from economists inside their organisation.

Hence, these professional users apply a wide array of information sources and channels in addition to the annual report in order to enhance their contextual understanding. Such types of information may include competitors’ data, market research reports, trade magazines and face-to-face management briefings. In the next section, we take a look at how companies can apply the ideas of the business model as a platform for strategy and thereby also as a platform for structuring the narrative sections of business reporting.
The Business Model as a platform for structuring narratives

Recent changes in the competitive landscape have given rise to a variety of new value creation models within industries where previously the “name of the industry served as shortcut for the prevailing business model’s approach to market structure” (Sandberg 2002, 3), competition now increasingly stands between competing business concepts (Hamel 2000). If firms within the same industry operate on the basis of different business models, then different sets of competencies and knowledge resources are key parts of the value creation, and mere benchmarking of financial and non-financial indicators does not provide insight in the profit or growth potential of the firm. A comparison of the specific firm with its peer group requires interpretation based on an understanding of differences in business models.

If firms only disclose key performance indicators without disclosing the business model that explains the interconnectedness of the indicators and why precisely this bundle of indicators is relevant for understanding the firms’ strategy for value creation, this interpretation must be done by the investors themselves. Currently, there exists no research based insight into how such an analysis and interpretation is conducted. From Nielsen (2005) the following definition of a business model is provided:

*A business model describes the coherence in the strategic choices which makes possible the handling of the processes and relations which create value on both the operational, tactical and strategic levels in the organization. The business model is therefore the platform which connects resources, processes and the supply of a service which results in the fact that the company is profitable in the long term.*

A business model is concerned with the value proposition of the company, but it is not the value proposition alone as it in itself is supported by a number of parameters and characteristics. The question is here: how is the strategy and value proposition of the company leveraged? Conceptualizing the business model is therefore concerned with identifying this platform, while analyzing it is concerned with gaining an understanding of precisely which levers of control are apt to deliver the value proposition of the company. Finally, communicating the business model is concerned with identifying the most important performance measures, both absolute and relative measures, and relating them to the overall value creation story.

The point of departure for some suggestions in relation to voluntary reporting and management commentary is to illustrate the flows of value creation by linking indicators to strategy and supporting an understanding of them by providing a context giving narrative (Nielsen et al. 2009). Mouritsen & Larsen (2005) label this a process of “entangling” the indicators, arguing that individual pieces of information and measurements by themselves can be difficult to relate to any conception of value creation. As such, this “flow” approach is concerned with identifying which knowledge resources drive value creation instead of assigning a specific dollar value to those resources (Bukh 2002).
The problem with trying to visualize the company’s “business model” is that it very quickly becomes a generic organization diagram illustrating the process of transforming inputs to outputs in a chain-like fashion. The reader is thus more often than not left wondering where the focus is in the organization, and key differentiating aspects of the business model are drowned in attempts to illustrate the whole business. This is why the communicative aspects of focusing the information are so important (Nielsen & Madsen 2009).

At the very core of the business model description should be the connections between the different elements that we traditionally divide the management review into. Companies often report a lot of information about e.g. customer relations, employee competencies, knowledge sharing, innovation and risks, but this information may seem unimportant if the company fails to show how the various elements of the value creation interrelate and which changes we should keep an eye on.

It is crucial for the readers’ understanding of the business model that the company presents a coherent picture of the company’s value creation; e.g. by providing an insight into the interrelations that induce value creation in the company. Moreover, the non-financial reporting should follow up on the strategy plans and development in the business model in order to ensure consistency over time. As a business model should not necessarily be understood as a value chain, it should therefore not necessarily be reported as one.

A business model is also a forward-looking statement which goes beyond an identification of the company’s immediate cash flows. In capital market language, one would say: It is a statement on how the company will survive longer than till the end of the budget period. This means that when describing one’s business model, it is not enough to talk about the company’s historic development, not even if it includes an account of the company’s historic value creation, the company’s concept and how the company’s objectives and strategy have turned out.

Another central tool when describing a company’s history is to support facts by non-financial performance measures. One thing is to state that one’s business model is based on mobilizing customer feedback in the innovation process, another thing is to explain by what means this will be done, and even more demanding is proving the effort by indicating: 1) how many resources the company devotes to this effort; 2) how active the company is in this matter, and whether it stays as focussed on the matter as initially announced; and 3) whether the effort has had any effect, e.g. on customer satisfaction, innovation output etc. According to Bray (2010, 6), “relevant KPIs measure progress towards the desired strategic outcomes and the performance of the business model. They comprise a balance of financial and non-financial measures across the whole business model. Accordingly, business reporting integrates strategic, financial and non-financial information, is future-performance focused, delivered in real time, and is fit for purpose”.

One of the keys to making management commentary matter to the investment community is therefore to emphasize the interconnectedness between parts of the narrative sections according to the logic of the business model. The next section
looks at the differences in focus on the information types that relate to the business model between management commentary and fundamental analyst research.

### Description of the case company and methodology

#### The case company
The case firm, Sky-Watch A/S, was founded in 2009 as a result of a regional development project. The project were advocating network based business models, offering funding to support the innovation process. Four existing companies (Mekan, Danish Aerotech, Gomspace and Netimage) (called the “Eye in the sky network”) in the defense and aerospace sector developed a joint idea building a UAV inspired by a Danish NGO (Danish Church Aids) based on the competences in their existing businesses. The case firm Sky-Watch A/S sprouts up from this constellation on the initiative from an employee whom found two investors taking lead and ownership of the project. Today the Sky-Watch A/S increased its sphere of owners to raise the net capital, to increase investments. The company employees’ 12 people, all at their head office in Støvring, Denmark, and sales and service is done through a partner (DanOffice)

#### Methodology
This study is based on an in-depth qualitative case study of Sky-Watch A/S. The case study applied a series of data-gathering methods, varying from observations of board meetings, participative observations in the form of workshops, to semi-structured interviews and archival data were possible. The company was followed over a period of 2½ years by the research team and our data-gathering included talks with potential strategic partners, investors and venture capitalists.

The semi-structured interviews were conducted with respondents from the company and its network partners in the Eye in the Sky network. In order to structure the empirical enquiries, we applied the structure of Osterwalder et al.’s (2010) Business Model Canvas and therefore using nine interview themes listed in figure 1, each with a number of more specifically associated questions, to form the basis for the interviews.
If possible the wording and the order of the questions remained unchanged for all respondents, however the respondents were allowed to talk freely and the questions were adjusted accordingly and not all questions were necessarily brought up in every interview. The form of interviewing chosen was based on the principle of dialogue between the interviewer and the respondent (cf. Kvale, 1996) and has some similarities with the type of interview that Yin (1994, 84) calls ‘focused interviews’. The interviews lasted from 45 minutes to 2 hours with an average of 75 minutes and were conducted using the interview guideline described above. After the interviews, the tape recording was transcribed and analyzed according to the building blocks in Osterwalder et al.’s Business model canvas, wherein we were concerned with the discovery of data-induced hypotheses (Strauss & Corbin 1990).

Empirical discussion

From the perspective of the potential investor, the company’s work with illustrating the business model as a part of the due diligence process emphasizes issues of accountability and the outcome of a physical business report seems to address a disciplining effect in the market for venture capital. Hence, to some extent the disclosures provided through business reporting constituted an accountability solution to a normative problem, which theoretically may constitute an interesting paradox as these are often seen as representing two opposing paradigms in accounting research.

Initial we used the Osterwalder Business model canvas to analyze the existing business model of Sky-Watch A/S. This confirmed our opening hypothesis that the business model was a classic model based on a model generating a sustainable income model over time, as a result of the case company being in a classic supply chain with suppliers, partners and customers.
The analyses showed in headlines visualized through the Osterwalder business model canvas:

<table>
<thead>
<tr>
<th>Key Partners</th>
<th>Key Activities</th>
<th>Value proposition</th>
<th>Customer relations</th>
<th>Customers segments</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Suppliers (hardware)</td>
<td>- Product development</td>
<td>- Security</td>
<td>- One &quot;system&quot; → locking in the customer</td>
<td>- NGOs</td>
</tr>
<tr>
<td>- Suppliers (software)</td>
<td>- Test and quality control</td>
<td>- Quality</td>
<td>- Support</td>
<td>- Civil inspection</td>
</tr>
<tr>
<td>- Global service</td>
<td>- Software development</td>
<td>- Price / effect</td>
<td>- High initial investment; You don't just change the hardware</td>
<td>- Civil surveillance</td>
</tr>
<tr>
<td>- Industrial design</td>
<td>- Service to customers</td>
<td>- Cost reduction compared to existing solution</td>
<td></td>
<td>- Police</td>
</tr>
<tr>
<td>- Universities (Technology)</td>
<td>- Marketing / PR</td>
<td>- A solution to very specific assignments</td>
<td></td>
<td>- Coastguard</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Key Resources</th>
<th>Channels</th>
<th>Cost structure</th>
<th>Revenue stream</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Production facility</td>
<td>- Distributor</td>
<td>- Development</td>
<td>- Lifetime users, service and parts</td>
</tr>
<tr>
<td>- Technology and knowhow</td>
<td></td>
<td>- Pending patent</td>
<td></td>
</tr>
<tr>
<td>- Highly qualified personnel</td>
<td></td>
<td>- High qualified personnel</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Value proposition</th>
<th>Customer relations</th>
<th>Customers segments</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Security</td>
<td>- One &quot;system&quot; → locking in the customer</td>
<td>- NGOs</td>
</tr>
<tr>
<td>- Quality</td>
<td>- Support</td>
<td>- Civil inspection</td>
</tr>
<tr>
<td>- Price / effect</td>
<td>- High initial investment; You don't just change the hardware</td>
<td>- Civil surveillance</td>
</tr>
<tr>
<td>- Cost reduction compared to existing solution</td>
<td></td>
<td>- Police</td>
</tr>
<tr>
<td>- A solution to very specific assignments</td>
<td></td>
<td>- Coastguard</td>
</tr>
<tr>
<td>- Access to a digital platform</td>
<td></td>
<td>- Military</td>
</tr>
</tbody>
</table>

To innovate the business model, we used story telling to “manipulate” the process by inspiring the case company on how a successful business model is constructed. In this situation we used Apple’s IPhone/IPad as the case.

The Apple IPhone/IPad is an amazing product innovation, but the success is not only the product itself, it is the business model around it. The product is not only a product that you can use with the features build in by Apple, it is a platform where other suppliers develops software, hardware and contend to. Steve Jobs, the former CEO of Apple Inc. corroborated that this is an intentional part of their business model when he presented the IPad, not telling us (the customers) anything about the specifications of the product he was presenting, but instead saying “We have one hundred million credit cards registered to our iTunes store”, addressing the suppliers that should increase the value proposition to the costumers, to gain access to a new marked.

We used the story to visualize a new business model to Sky-Watch, changing the The Huginn X1 helicopter to become a platform like the IPhone and IPad. This will change the development from Sky-Watch being the product developer of applications to being the platform provider, opening up for partners developing software and hardware to the The Huginn X1 helicopter, broadening the use and specialization and thereby the value of the product. This is changing the simple business model into a new network based business model, elevating the potential of the product into a new dimension.
After this process we mapped their new business model using The Osterwalder Business model Canvas.

<table>
<thead>
<tr>
<th>Key Partners</th>
<th>Key Activities</th>
<th>Value proposition</th>
<th>Customer relations</th>
<th>Customers segments</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Partners (hardware)</td>
<td>- Product development focused on improving the platform</td>
<td>- Security</td>
<td>- One “system” → locking in the customer</td>
<td>- NGOs</td>
</tr>
<tr>
<td>- Partners (software)</td>
<td>- Test and quality control</td>
<td>- Quality</td>
<td>- Support</td>
<td>- Civil Inspection</td>
</tr>
<tr>
<td>- Global sales</td>
<td>- Software development</td>
<td>- Price / effect</td>
<td>- High initial investment; You don't just change the hardware</td>
<td>- Civil surveillance</td>
</tr>
<tr>
<td>- Global service</td>
<td>- Marketing / PR</td>
<td>- Cost reduction compared to existing solution</td>
<td></td>
<td>- Police</td>
</tr>
<tr>
<td>- Industrial design</td>
<td>- Support of the API</td>
<td>- The utility of the product increases</td>
<td></td>
<td>- Coastguard</td>
</tr>
<tr>
<td>- Developers and researchers (Technology)</td>
<td>- Testing, approval and integration of third party hardware and software</td>
<td>- A solution to very specific assignments</td>
<td></td>
<td>- Military</td>
</tr>
<tr>
<td>- End users (user applications and adaptation)</td>
<td>- Access to a digital platform</td>
<td>- Access to a digital platform</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Companies with potential synergies from integration of products</td>
<td>- Flexible technological platform for sensory technology</td>
<td>- Platform for sensory technology</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Highly qualified personnel</td>
<td>- The X1 Platform (the Helicopter)</td>
<td>- Product adaptation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Development</td>
<td>- Remote updates</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Software development</td>
<td>- Easy access to add-ons</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Service to customers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Technology and knowhow</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Pending patent</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Distributor</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Technology</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Software platform</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Developers</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Key Resources</th>
<th>Channels</th>
<th>Customer relations</th>
<th>Customers segments</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Production facility</td>
<td>- Distributor</td>
<td>- One “system” → locking in the customer</td>
<td>- NGOs</td>
</tr>
<tr>
<td>- Technology and knowhow</td>
<td>- Software platform</td>
<td>- Support</td>
<td>- Civil Inspection</td>
</tr>
<tr>
<td>- Pending patent</td>
<td>- Developers</td>
<td>- High initial investment; You don't just change the hardware</td>
<td>- Civil surveillance</td>
</tr>
<tr>
<td>- The X1 Platform (the Helicopter)</td>
<td>- Easy access to add-ons</td>
<td></td>
<td>- Police</td>
</tr>
<tr>
<td>- Highly qualified personnel</td>
<td>- Remote updates</td>
<td></td>
<td>- Coastguard</td>
</tr>
<tr>
<td></td>
<td>- Access to a digital platform</td>
<td></td>
<td>- Military</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost structure</th>
<th>Revenue stream</th>
<th></th>
<th>Customers segments</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Less development cost</td>
<td>- Lifetime users, service and parts</td>
<td>- One “system” → locking in the customer</td>
<td>- NGOs</td>
</tr>
<tr>
<td>- Maintenance of the platform</td>
<td>- Partner developed applications and hardware</td>
<td>- Support</td>
<td>- Civil Inspection</td>
</tr>
<tr>
<td></td>
<td>- License to developer tools</td>
<td>- High initial investment; You don't just change the hardware</td>
<td>- Civil surveillance</td>
</tr>
</tbody>
</table>

The management team of Sky-Watch were throughout the due diligence process extremely focused on value drivers and value creation in the sense of the internal aspects of the company, its values and objectives; and also in a broader sense than profit-maximizing. Management was primarily concerned with branding the company as an ethical and socially responsible actor in the business environment, which was evident in their production of strategic information through the business report. This leads us to identify a number of substantial differences in the processes of utilizing information concerning the business model in relation to analyzing and valuing the company. We found that the potential investors own analysis processes were driven primarily by asset pricing discussions and in this sense the business model became a test-centre for validating real-options, so to speak. The investors’ needs for information on the business model solely took their point of departure in the estimated price of the company, and this could initially be translated as a reluctance to engage in discussions on the actual business model with company management. This would in some instances leave the management team with a feeling of meeting short-term spending budgets as the key value driver.
The business report was by potential investors mainly considered a work of reference, but also an important point of departure for extending the knowledge base on the company. In general, the business report was not necessarily read straight away; rather some time afterward its receipt and a good part into the analysis process. Understanding the business model and valuing the company was surprisingly seen as two completely different things to understand. Management were focused on value drivers and value creation in the sense of the company, its values and objectives in a broader sense than profit-maximizing, because the company operates in a rather sensitive field and management were not particularly concerned with value and fluctuations in value according to macro-environmental factors.

This study illustrates that the business report as a proposed accountability vehicle is not necessarily mobilized as a solution to the problem of disclosing information on the business model. That is not to say that accountability is not an issue for potential investors. However, the issue of accountability seems to be addressed in the disciplining effects of face-to-face meetings and visits to the company’s facilities and constant interaction between the actors although too close relationships could lead to subjectivity and blurred decision-making. The conclusion must therefore be that creating transparency of the business model and value creation does not necessarily revolve around the business report as a due diligence mechanism. This is a bold statement. Research addressing a wider array of stakeholders, indicates that the supplementary sections of the annual report are important in relation to employees, customers, private investors and the local community.

Conclusions

This paper is account of a company that is in the process of writing its first prospectus and therefore has an aim of conveying a true and fair picture of its future prospects to existing partners and potential investors. Via a longitudinal case study over a period of 2½ years, we studied the development of a network-based company’s innovation process from a perspective of business model innovation rather than merely product innovation and throughout this process; story-telling was continuously emphasized in order to strengthen the value of the company and its partner network.

Through the application of story-telling in order to manipulate the company to innovate on the business model rather than to endure in product innovation, this study illustrates how powerful the use of examples and narratives can be. Sky-Watch moved from product innovation to business model innovation; and in turn the existing product became a platform for creating synergies between the initial product and new hardware and software add-on solutions. This resulted in an increased value proposition to the existing customer base and it radically enlarged the market segments available to the company. The larger customer-base in return also acted as an energizer on attracting new customers in existing segments and also new partnership potential (and thereby new potential markets once more).
The revenue models also changed because Sky-Watch was forced to employ a varying set of distribution channels, e.g. acting as an OEM sub-supplier to larger industrial conglomerates. In this manner Sky-Watch was able to strengthen its partnerships with large industrial players and through such arrangements managed to lower costs on R&D, seeking out potential customers and managing the supply chain in general.

In our theorization of the case company from a due diligence and business reporting perspective, the story-telling element is once again mobilized and is found efficacious in transferring the case company’s business model to a value-perspective that is also appreciated by investors. As such, this case study illustrates the merits of working systematically with business model analysis, both in relation to innovating and growing the company, but equally as important in relation to promoting the investment case to the investment community.

References


Mouritsen, J. and Larsen, H.T. (2005), The 2nd wave of knowledge management: The management control of knowledge resources through intellectual capital information, Management Accounting Research, 16(4), 371-394.

Nielsen, C. and M.T. Madsen (2009), Discourses of transparency in the intellectual capital reporting debate: Moving from generic reporting models to management defined information, Critical Perspectives on Accounting, Vol. 20, No. 7, pp. 847-854.


