

ANALYSIS OF FRAMEWORK

CHAPTER 2: FUNDAMENTAL CONCEPTS – BUSINESS MODEL (Section 2C)

DEFINITION

Question 7: A business model is defined as an organization’s chosen system of inputs, business activities, outputs and outcomes that aims to create value over the short, medium and long term (paragraph 2.26).

7. Do you agree with this definition? Why / why not?

NOTE: This objective analysis includes only the most prevalent, significant or controversial issues as far as they relate directly to the content of the Consultation Draft of the International <IR> Framework¹, for the attention of the Working Group and therefore not all matters raised in submissions are referenced in it.

Drafting this analysis involved considerable judgment in deciding how to categories comments into issues/themes and how to summaries the underlying positions. Statistics have been included to provide a snapshot and starting point for analysis. Although the statistics indicate the prevalence of different views, due consideration will be given to the substance of all positions expressed.

In total the IIRC received 359 submissions to the Consultation Draft. 352 are included in this analysis. The remaining 7 submissions (of which 6 were late and one was in too complex for collation) are being reviewed separately.

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A – OVERVIEW

A1 Of the 352 total comment letters received by the IIRC, 267 (75.6%) of the respondents provided a response to Question 7 regarding the definition of ‘business model’ in the Consultation Draft. The responses received can generally be categorized into the following categories: (A) Agree, (B) Agree with Minor Modification/Comment, (C) Disagree, or (D) Other. The following table provides a summarized breakdown of the responses received:

Question	Agree	Agree with qualification	Disagree	Other*
Q7. Do you agree with the definition of ‘business model’? Why/why not?	48% (129)	21% (55)	17% (45)	14% (38)
	69% (162)			

* These respondents did not directly answer the questions, were undecided, or answered in a manner that was unclear whether they agreed or not.

¹ <http://www.theiirc.org/consultationdraft2013/>.

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- A2 As noted in the table, nearly 70% of the respondents either fully agreed with the proposed definition of 'business model' or agreed with a minor modification or comment, further highlighted by strong support from the following groups:
- 63% of report preparers
 - 79% of providers of financial capital
 - 71% of assurance providers
 - 74% of professional bodies
- A3 Those in agreement with the proposed definition generally cited the following reasons for their support:
- *[The proposed definition] provides a holistic view of the business and its sustainability over the long term.*
 - *"The definition is concise, but also exhaustive."*
 - *"The [proposed] definition is logical, a business is in place for the primary objective of creating value - however that is defined by the organisation."*
 - *"It is sufficiently broad and high-level to allow organizations the flexibility to report their business model in the way that makes sense to them, and that reflects how they talk about it and communicate it internally."*
 - *"Companies would like flexibility to describe their business model in their own way so we would caution against an overly prescriptive approach to the business model in the Framework."*
 - *"The [proposed definition] reflects the realities of business and the individual characteristics of each organization."*
 - *"[The proposed definition] adequately captures the supply and value chains of the organization."*
 - *"We agree with the suggested definition of business model, as it allows companies to provide a unified picture of value creation and of company's impact on external environment."*
 - *"... pleased that it encourages organisations to account for all the non-financial value creation."*
 - *"The definition above shows the flow of the organizations operating in an objective way, describing the logical sequence of activities applied to organizations seeking to create value over time."*
- A4 Despite an overwhelming majority of responses in support of the proposed definition of 'business model', 45 respondents voiced their opposition to the current definition. Eleven report preparers disagreed with the definition, which is roughly 25% of the total dissention.
- A5 The following issues were commonly raised by those dissenting responders, and are summarized more fully in Section B – Key/major issues of this memo:
- Other commonly accepted definition(s) of 'business model' already exist
 - The proposed definition does not acknowledge that an organization may have multiple business models
 - The proposed definition may not apply well to all types of organizations (i.e. for-profit vs. not-for-profit entities)
 - The inclusion of the term 'outcomes' is inappropriate and only causes further confusion
 - The use of the term 'value creation' is confusing and could result in misleading disclosures

B – KEY/MAJOR ISSUES

OTHER COMMONLY ACCEPTED DEFINITION(S) OF 'BUSINESS MODEL' ALREADY EXIST

- B1 A number of respondents from various geographies and stakeholder perspectives noted that businesses are largely familiar with the term 'business model' from other existing reporting requirements or standards. Their shared view is that introducing a new, slightly different definition would only create additional confusion for reporting entities and result in unnecessary work for these entities to re-package information in a different way to satisfy the requirements of the <IR> Framework. To this point, one respondent (Provider of financial capital from Europe) noted that *"this is an example of the opportunity for the IIRC to build on existing foundations, making acceptance of its work by more organisations more straightforward."*
- B2 Respondents noted examples of existing reporting standards or procedures that already define 'business model' in a different way. These examples included IFRS and U.S. GAAP, Future Value, and the Financial Stability Board's Enhanced Disclosure Task Force, among others.

THE PROPOSED DEFINITION DOES NOT ACKNOWLEDGE THAT AN ORGANIZATION MAY HAVE MULTIPLE BUSINESS MODELS

- B3 A number of respondents from various stakeholder perspectives criticized the proposed definition because it does not acknowledge the possibility for an organization to have multiple business models. Some respondents emphasized that large, multinational companies or conglomerates who have multiple business models will find this definition to be "highly conceptual" and "problematic for companies that are trying to decide at what level to position their description of the business model." A respondent representing report preparers in Asia noted that *"many Japanese businesses have diverse business models reflecting the diversified nature of the business."* This respondent requested guidance to be added to the Framework that discusses how to concisely communicate multiple business models in an integrated report.
- B4 One respondent suggested cross-referencing the discussion of 'business model' in Section 2C with the additional discussion in Section 4E. Others who made this comment about multiple business models prefer that the definition in paragraph 2.26 contain explicit guidance indicating that an entity may have multiple business models. Their suggestion is to make 'business model' and 'system' plural (i.e. business model(s) are defined as an organization's chose system(s) of inputs...).

THE PROPOSED DEFINITION MAY NOT APPLY WELL TO ALL TYPES OF ORGANIZATIONS (I.E. FOR-PROFIT VS. NOT-FOR-PROFIT ENTITIES)

- B5 Some respondents noted that the proposed definition appears to have been crafted with a private, for-profit entity in mind. The notion of "value creation" will likely convey different meanings depending on the type of organization that is preparing the report. One respondent noted that *"charities (NFPs) are established to fulfill their charitable purposes, not to create value for shareholders."* An assurance provider added that the definition will likely need to be modified from a public sector perspective as the *"inclusion of terms such as 'business' and 'value' may act as a barrier"* to understanding and implementation.
- B6 One respondent went so far as to say, *"Rather than seeking to be everything to everybody, should the IIRC not be explicit that this "organization" is a profit-driven entity...?"*

THE INCLUSION OF THE TERM 'OUTCOMES' IS INAPPROPRIATE AND ONLY CAUSES FURTHER CONFUSION

- B7 A handful of respondents disagreed with the inclusion of "outcomes" as a part of the definition of 'business model'. These respondents believe that the business model should focus on the activities a company undertakes to create value for shareholders, noting that outcomes are the result (or consequence) of an organization's business model

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– its inputs, activities and outputs. As such, some respondents (including report preparers, professional bodies and policy makers) recommend removing ‘outcomes’ from the definition.

- B8 Another respondent noted scepticism about what might happen if ‘outcomes’ remain a part of the reporting on an organization’s business model. In their estimation, *“Economic entities develop their business models focusing on the outputs that maximize shareholders’ value, rather than outcomes that maximize the value for all stakeholders. It could be idealistic to ignore this fundamental reality and inflate the definition of business model to include outcomes which cannot be objectively measured.”*

THE USE OF THE TERM ‘VALUE CREATION’ IS CONFUSING AND COULD RESULT IN MISLEADING DISCLOSURES

- B9 The topic of ‘value creation’ in the context of the ‘business model’ definition garnered significant feedback from respondents, particularly those who did not support the proposed definition. As noted by the comments below, there is a wide array of concerns with the concept of ‘value creation’.
- From a professional accounting body in Europe: *“We suggest to further clarify the concept of Value in the Framework document, as it seems to mean quite different things to different audiences and the additional interpretation document is not distinctive enough.”*
 - From a North American non-government organization: *“Within a closed-loop system, increases to one aspect of the system (for example: growing financial capital) typically result in decreases in another aspect of the system (for example: stripping out natural capital or social capital). The concept of “ability to create value over time” is mythology; you simply cannot increase everything at once. Like double-entry bookkeeping, it has to come from somewhere. Rather than “creating value,” what most organizations are doing at this point in economic history is instead converting value over time – in other words, converting public goods such as natural and social capital into private property such as financial, manufactured, and intellectual capitals.*
 - *The Framework needs reworking to eliminate the presumption of economic growth. Language which conveys unidirectional increase, such as “value creation,” must be replaced with language which both allows for and presumes that value will both increase and decrease.”*
 - From an analyst in Asia: *“As main report users are assumed to be investors –especially long-term investors as stated in section form 1.6 to 1.8–, the value created by business model must be financial or economic value. The main reason why long-term investors care for non-financial capitals such as intangibles or natural capitals is because those would strongly affect the company’s ability to create long-term financial/economic value, and therefore, long term risk–return profile. Accordingly, the business model should be an organization’s chosen system of inputs, business activities, outputs and outcomes that aims to create or achieve financial/economic value.”*
 - From a global analyst: *“This definition is appropriate but we believe it is important to define “value creation” and how to best measure it – whether it be total return over a given period or a more holistic economic value metric. This section should be more clearly linked to section 2D but that section needs to more clearly define the measurement and not just the definition and meaning.”*
 - From a non-government organization in Europe: *“We support the definition but would prefer to see “sustainable value” rather than just “value”.*

C – MINOR COMMENTS / SUGGESTIONS

- C1 In addition to the major issues noted above, there were also some more minor comments that were frequently repeated by multiple respondents. These additional points are summarized below:

THE DEFINITION NEEDS TO INCORPORATE THE REPORTING ENTITY'S VISION AND MISSION

- C2 A number of respondents (even some who generally agreed with the proposed definition) noted that an accurate definition of 'business model' should include a reference to the reporting entity's vision and mission. These respondents believe that the business model needs to encompass some clear, overarching purpose of the company that makes it unique. As one respondent noted, *"A statement of vision and value helps investors understand the rationale behind its subsequent choices, i.e. trade-offs, etc."*

THE DEFINITION SHOULD INCORPORATE THE ENVIRONMENT IN WHICH THE ORGANIZATION OPERATES

- C3 A few respondents commented that the proposed definition does not consider the environment in which the entity operates. They believe that an organization's interaction with its external environment should also be explained in the definition, consistent with its depiction in Figures 2 and 3.
- C4 Another respondent agreed, noting that *"a business is also strongly defined by the socio-political context in which it operates, and this aspect is not adequately brought out in the definition."*

THE DEFINITION OF TIME HORIZON (SHORT, MEDIUM, LONG) WILL DIFFER BETWEEN INDUSTRIES AND ORGANIZATIONS

- C5 Some respondents noted concern about what is meant by "short, medium and long term" in the proposed definition. One respondent commented that an organization's *"strategy can be measured in terms of short, medium and long term objectives. However, not all entities would have objectives and targets set for all three time horizons."* Their recommendation is to modify paragraph 4.19 (and cross-reference to paragraph 2.26) to reflect that *"an entity should only report on objectives and targets for those time horizons it uses for its management reporting."*
- C6 One respondent highlighted the fact that material matters in each timeframe (short, medium, long) may differ widely; for example, what is defined as a material risk in the short-term, may not be relevant or material in the long-term. Other respondents recommended removing references to "short, medium and long term" from the Framework, and instead just using the phrase "...create value over time." This modification will enable entities to determine the appropriate reporting horizons without feeling obligated to report on predetermined time tables.

NOT ALL ASPECTS OF AN ORGANIZATION'S BUSINESS MODEL ARE NECESSARILY "CHOSEN" BY THE ENTITY.

- C7 Another common response focused on the use of the word *"chosen"* in the definition, which seems to imply that the organization can freely choose or elect all aspects of its business model. Some respondents disagree with this notion, noting that *"the reality is that a significant part of an entity's business model is not chosen but forced on the organization in order to ensure continuity (survival)."* A European professional body noted *"the current use of the word 'chosen' implies the organization's responsibility and accountability for its business model and the resulting outcomes (both positive and negative) this choice entails. It would be helpful for this definition to reflect that organizations cannot fully choose the outcomes of their business model as these are also influenced by many external factors."*
- C8 Multiple respondents agreed and recommend eliminating or replacing the word *"chosen"* from the definition.

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AN ORGANIZATION'S CUSTOMERS SHOULD BE AT THE CORE OF ITS BUSINESS MODEL

- C9 A few respondents noted that reference to customers is a glaring omission from the proposed definition. In one respondent's view *"the customer should be at the core of an organization's business model."* Another respondent echoed that sentiment stating that *"while we agree with the general comprehensive definition of the business model, we would prefer a clearer emphasis on market needs and value creation for customers."*
- C10 Two other respondents noted their preference for the definition/description of 'business model' used by the Financial Stability Board's Enhanced Disclosure Task Force *"A business model describes how an organisation creates, delivers, and captures value (economic, social, or other forms of value). The essence of a business model is that it defines the manner by which the business enterprise delivers value to customers and converts that value into profit and how the enterprise is organized to best meet customer needs."*

D – OTHER ISSUES RAISED

- D1 Respondents to Question 7 also provided some feedback that, while not directly related to the definition of 'business model' in paragraph 2.26 of the Consultation Draft, does provide additional feedback about the general concepts, elements and principles of <IR> that are discussed in the Consultation Draft. These "Other" comments are listed below:

SHOULD THE <IR> FRAMEWORK BE PRINCIPLES-BASED OR RULES-BASED?

- D2 Respondents differed in their views as to whether they prefer more principles-based or prescriptive, rules-based guidance. Those who agreed with the proposed definition of 'business model' shared the belief that broad principles are necessary for the Framework to be applied by report preparers who have varied business models and strategies and represent a variety of industries and geographies. Those who share this view also commented that over-prescriptive guidance could lead to "boiler-plate language that is not useful."
- D3 On the other hand, some respondents noted that the definitions were too broad/general and requested "more concrete guidelines" and details in the Framework to make it practical to implement.

AUDIENCE OF THE INTEGRATED REPORT: PROVIDERS OF FINANCIAL CAPITAL VS. MULTIPLE STAKEHOLDERS

- D4 In addressing various points about "value creation" and "outcomes", some respondents indicated that a preference for broadening the intended audience or users of an integrated report from providers of financial capital to all stakeholders. One response typifies this sentiment by stating "If any business model does not consider interest of all the stake holders then that business model may not be considered as a sound business model."

<IR> FACES A NUMBER OF CHALLENGES THAT MIGHT LIMIT OR IMPAIR ITS BENEFITS AND USEFULNESS

- D5 While this is a broader issue that a number of respondents raised with regard to <IR>, it was often framed in the context of potential limitations on the effectiveness of business model reporting, as noted below:

- “We are left with the problem that many aspects of the business model as defined by IIRC and information proposed for inclusion in an integrated report can be accounted for solely in notional or qualitative terms.”
- “Some companies in a high competitive environment might choose not to disclose their business model due to the strategic level of the information.”
- “We expect that companies will be reluctant to disclose commercially sensitive aspects of their business models that result in perceived competitive advantage. This constraint on full disclosure could be acknowledged in the Framework and suitable guidance provided to mitigate by providing examples of what might constitute commercially sensitive information.”
- “The elements of the 'business model' definition will likely invite more narrative disclosure than reporting (data); therefore, the integrated report will likely be difficult to audit.”

APPENDIX – PROPOSED EDITS TO THE FRAMEWORK

- 1 As discussed above, respondents provided a variety of comments and insights about the proposed definition of 'business model' in the Consultation Draft. Some respondents took their feedback one step further and included proposed wording changes for the IIRC to consider incorporating in its final definition of 'business model'. Those proposed edits are highlighted below.
- 2 A non-government organization from Oceania made the following suggestions: (i) changing the focus by swapping the words the other way around, (ii) adding "create, capture and deliver" (iii) replacing business activities with processes, (iv) removing references to the short, medium and long term as no longer necessary, (v) also defining value, and (vi) also defining effects. (Note: A further suggestion was made to italicize words in the definition that are defined elsewhere in the document/glossary.)
 - *"A business model describes the rationale of how an entity plans to create, capture² and deliver value to stakeholders through changes in inputs, processes, outputs and outcomes over time."*
- 3 Multiple respondents noted that a business model may serve additional objectives besides just creating value. Each of the following suggestions provided by various respondents address this common issue:
 - *"... whose primary aim is to create value over the short, medium and long term."*
 - *"An organisation's business model is its chosen system of inputs, business activities, outputs and outcomes, that aims to fulfill the entity's strategic purposes³ and create value over the short, medium and long term'."*
 - *"...aims to deliver economic value to investors, while creating relative value for key stakeholders over the short, medium and long term. "*
- 4 A number of respondents took issue with the inclusion of the word "chosen" in the definition (as noted in the analysis above). Thus, the proposed edit from these respondents is simply to remove "chosen" from the definition in paragraph 2.26:
 - *"A business model is defined as an organization's ~~chosen~~ system of inputs, business activities, outputs and outcomes that aims to create value over the short, medium and long term."*
- 5 As noted above, a handful of respondents commented that an organization's vision and/or mission should be incorporated into the definition of 'business model' as well. One suggestion to reflect this concept is:
 - *"A business model is defined as an organization's chosen system of inputs, business activities, outputs and outcomes that aims to create value over the short, medium and long term, in line with its vision (purpose) and mission."*
- 6 One professional accounting body noted in their response that the wording in the definition could be strengthened by demonstrating connectivity between inputs, activities, outputs and outcomes that allows an organization to create value.
 - *"A business model is defined as an organization's chosen system of transforming inputs (or: input capitals), through business activities, into outputs (or output capitals) and outcomes that aims to create value over the short, medium, and long term."*

² Additional respondents echoed a similar modification to the definition that incorporates the aim of creating and capturing value over time.

³ One policy maker/standard setter from Europe noted that a charity is "established and exists primarily to fulfill its stated charitable purpose(s)."

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7 To add focus/recognition to triple bottom line:

- *"... over the short, medium and long term while considering its impact on its key stakeholders, society and the environment."*

8 One Asian report preparer noted that the term 'business activity' is too broad and proposed the follow change to the definition

- *"An organization's business model defines its activities at two levels – (1) At a physical level, the input, process and output, and (2) At a commercial level how it creates, delivers and captures value."*

9 One respondent suggested using the term "**planned work**" rather than "inputs and activities" and substituting "**intended results**" for "outputs and outcomes".

10 In addition to the proposed edits noted above, some respondents also encouraged the IIRC to include the follow terms in the definition of 'business model':

- "Relationships" or "Stakeholder relations"
- "Value allocation"
- "Sustainable business model"