
Understanding the Health Care Business Model: The Financial Analysts' Point of View

Per Nikolaj Bukh and Christian Nielsen

This study focuses on how financial analysts understand the strategy of a health care company and which elements, from such a strategy perspective, they perceive as constituting the cornerstone of a health care company's business model. The empirical part of this study is based on semi-structured interviews with analysts following a large health care company listed on the Copenhagen Stock Exchange. The authors analyse how the financial analysts view strategy and value creation within the framework of a business model. Further, the authors analyze whether the characteristics emerging from a comprehensive literature review are reflected in the financial analysts' perceptions of which information is decision-relevant and important to communicate to the financial markets. Among the conclusions of the study is the importance of distinguishing between the health care companies' business model and the model by which the payment of revenues are allocated between end users and reimbursing organizations. *Key Words: strategy, business models, disclosure, financial analysts, revenue streams.*

For the health care sector in general, the customer base is growing steadily. In developed countries the demographic changes will in the coming decades increase the percentage of elderly considerably, because of the post-World War II baby boom as well as the fact that our lifespan also is increasing. In the developing countries, *e.g.*, the so-called BRIC countries (Brazil, Russia, India, and China), higher living standards will give rise to the creation of large health care sectors. However, this does not imply that health care companies will be greeting times of unwarranted prosperity.

As globalization creates greater demands for health care services, globalization too will create greater competition for health care companies. Therefore, explaining and communicating uniqueness, profitability, and strategy, *i.e.*, the business model, will play a vital role in attracting capital. This article thus studies the constituents of a health care company's business model through the eyes of the analysts following it.

The capital market plays an important role in our present day society as it facilitates

the distribution of capital between investors and companies. Within the realm of the capital market, information plays a central role because of, for example, agency costs¹ and the fact that there is information asymmetry² between company management and

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investors. Recent research in relation to IPOs in the health care industry³ suggests that new companies entering the market represent great peril to the investment community because a mere financial analysis of the company is insufficient to understand future profitability in this sector.

By means of the annual report, Web pages, investor meetings, conference calls, as well as private meetings, publicly listed health care companies provide information to the capital market, *i.e.*, investors and financial analysts, in order to minimize such information asymmetry. In principle, the disclosure of additional relevant non-financial information, for example, relating to the pipeline and relevant partnerships across the pharmaceutical industry, is expected to lower the cost of equity capital⁴ because increased disclosure reduces information asymmetry and lowers investor uncertainty about the future prospects of the company, thus facilitating a more precise valuation of the company, as discussed by Botosan.⁵ It is, however, not sufficient that credible, reliable, and neutral information is conveyed to the capital market. The information should also be relevant in relation to assessing aspects of the company's current and future performance, and, more importantly, the investors and analysts should be able to comprehend this information.

Most literature concerning supplementary reporting models⁶ and voluntary disclosure in general⁷ suggests that information on the strategy of the company, in the form of key value drivers, should form the basis for disclosure of information and therefore also for the dialogue with financial analysts. From a strategy perspective, such a reporting model or framework for disclosure is offered by the concept of a *business model* and Lev⁸ has

previously argued that the existing problem of lacking transparency in corporate reporting can be overcome by basing disclosure on the company's business model. Business models have earlier been intimately connected with e-business;⁹ however, the concept as such has a much broader meaning in recent management literature.

The aim of this study is to identify which elements a health care business model could consist of in order to form the basis for the communication between management and financial analysts. Previous literature on business models has mostly been based on theoretically anchored models of, for example, value creation—relationships between resources or growth drivers where one or sometimes a few companies have been used as cases or illustrations of the models. This article, however, does not attempt to verify the usefulness of a specific perspective on business models. Rather, we take financial analysts' understandings of strategy and strategy related elements as a starting point, and then analyse the business model of a health care company, in turn identifying the elements that financial analysts mobilise when they understand, analyse, describe, and rationalise strategy.

Thus, the main contribution of this study is the identification of the elements that constitute financial analysts' concrete understanding of the health care business model since a more general formulation of a business model should comprehend building blocks that can facilitate the communication of these elements.

The empirical part of this article is based on interviews with 12 financial analysts from European investment banks about the business model of a large health care company listed on the Copenhagen Stock Exchange.

Our focus when conducting the interviews was on identifying the general elements that constitute a business model from the analysts' point of view. In this article the interviews are analyzed using a coding approach where codes determined from a comprehensive survey of the literature on business models are taken as a starting point.

The remainder of this article is structured as follows: After an introduction to the information needs of analysts, we introduce the concept of a business model. Then we review the literature on business models focusing on the identification of specific characteristics, followed by an introduction of the research methodology and the interview data, and the empirical analysis of the health care case-company structured around the business model characteristics, respectively. Finally, we offer conclusions on the study and further avenues of research.

Analysts' Information Needs

Both from the perspective of the financial markets and accounting organizations, a growing frustration with traditional financial reporting has been evident in the last two decades. Such frustrations have been expressed in the 'Jenkins Report,'¹⁰ the work of the former commissioner of the Securities and Exchange Commission (SEC), Steven Wallman¹¹ and, more recently by the Accounting Standard Board¹² and The Canadian Institute of Chartered Accountants.¹³

Various studies of investors' and analysts' information demands¹⁴ indicate a substantial difference between the types of information found in companies' annual reports and the types of information demanded by the capital market.¹⁵ This information gap is partly due to an increased demand for

non-financial information, *i.e.*, concerning the company's strategy and competencies, and its ability to motivate the staff, increase customer satisfaction, etc. However, this information gap may also be due to a lack of understanding of business models and of proper communication between company management and the capital market.¹⁶ In this respect, Nilsson *et al.*¹⁷ suggest that the main objective of applying a business model approach is to bridge the communication gap between management and external stakeholders, as shared models become a platform for creating common understanding.

From the financial analysts' point of view, information disclosed in the annual report or in a supplementary report only constitutes one part, maybe even an inferior part, of the information set needed to make recommendations to clients. This is because financial analysts are in a privileged position to "get more information—and sooner—than all [other information users] except the very largest investors."¹⁸ Thus it might be the case that information provided in the annual report has value relevance, but the analysts have already a much more detailed understanding about, for example, the research and development activities than what could be gained from reading about the aggregated research and development expenses.

The Business Model as Basis for Corporate Communication

Changes in the nature of value creation have inevitably called for new reporting metrics and frameworks. Blair and Wallman¹⁹ argue for instance that a model for business reporting reflects the dynamics of wealth creation. Business reporting should

essentially constitute a representation of the company's business model

by describing the relationships among the various input measures and outcome measures, and to link the primary inputs to intermediate inputs and, ultimately, to financial performance and other measures of total value creation.²⁰

Competition now increasingly stands between competing business concepts as Hamel²¹ argues and not only between constellations of companies linked together in linear value chains, as was the underlying notion in the original strategy framework by Porter.²² If companies within the same industry operate on the basis of different business models, different competencies and knowledge resources are utilized in the value creation processes, and the mere benchmarking of financial or non-financial indicators will not provide insight in the profit or growth potential of the company. Comparisons of the specific company with its peer group require interpretation within an understanding of differences in business models.

The business model concept has intimate connections to corporate disclosure and the ongoing debate about transparency. Since forward-looking information can be difficult to comprehend if it is not mobilized within the relevant context, supplementary disclosures must be linked to value creation.²³

There exists a substantial amount of literature on business models. However, there is no generally accepted definition of what a business model is and the theoretical grounding of most business model definitions is rather fragile. Nielsen²⁴ offers a definition along the lines of:

A company's business model describes its collaborative portfolio of strategy choices put in place for the handling of the processes and relationships that drive value creation on operational, tactical and executive levels.

Furthermore, business model definitions vary significantly as they are derived from a number of different perspectives. In this study we are interested in how business models can form the basis for communication between management and financial analysts.

Thus, we perceive the business model as a management technology that helps management communicate and share its understanding of the business logic to external stakeholders,²⁵ in our case primarily analysts and investors. The notion here is that management must explain the company's unique value proposition to external parties, as Sandberg²⁶ states: "Spell out how your business is different from all the others." Finally, the mere process of modelling the business helps management in identifying and understanding the relevant elements of its business,²⁷ such as, for example, value drivers and other causal relationships.

Characteristics of the Business Model

It is not possible to cover all literature on business models within the scope of this article, but in this section we review those parts of the literature that we have found representative or most relevant in developing a business model framework useful in corporate communication.

We have as shown in Figure 1 chosen to structure our review around nine topics that are typically discussed in the literature on

Figure 1. Overview of Business Model Characteristics

1. Criteria for Long-Term Performance	<ul style="list-style-type: none"> • Sustainable development • Strategy • Improving the business and innovation
2. Points of Departure for Creating Products and Services	<ul style="list-style-type: none"> • Resource base • Value chain • Value proposition
3. Interconnections That Drive Value	<ul style="list-style-type: none"> • Value drivers • Value creation • Causal relationships

business models. These areas, which are termed ‘characteristics of business models’ are in this article grouped in three overall categories covering the areas that are most often included as part of a business model:

- The overall criteria that determine long-term performance;
- The point(s) of departure for creating products and services; and
- The key interconnections that drive the value generation of the company.

Criteria for Long-Term Performance

While the ultimate goal from an extreme shareholder perspective could be said to increase the stock price by creating profit, business models sometimes address broader criteria such as *sustainable development*, which implies that focus is shifted from mere profit orientation towards sustainable enterprises and an economic reality that connects industry, society, and the environment.²⁸ This need for linking sustainable development to business strategy is for instance acknowledged by Funk,²⁹ who characterizes the sustainable organization as “one whose characteristics and

actions are designed to lead to a ‘desirable future state’ for *all* stakeholders,” and by Afuah and Tucci³⁰ who argue that the business model concerns sustainable development through the company’s unique value configuration.

In using the notion of a business model as our key concept in this study we have implicitly assumed that it comprehends something more than *strategy* or at least is a concept different from strategy. In this sense Magretta³¹ is clear when she states that “business models describe, as a system, how the pieces of a business fit together. But they don’t factor in one critical dimension: competition,” which implies that she finds companies’ competitive basis to be completely outside the business model.

Another perspective is offered by Czuchry and Yasin³² who argue that a business model is not necessarily successful by itself because companies must integrate and align strategic and operational efforts, activities, resources, and decisions into a systematic organizational strategy, thus indicating that strategy is an integrated component of a business model. Departing from this discussion, Chesbrough and Rosenbloom³³ argue that

while business models are more oriented towards value creation and sustainable development from a bounded rationality perspective, strategy theory is more apt to consider value creation from a shareholder perspective, and suppose full analytical rationality of decision-makers.

Finally, business models have also been associated with company's efforts to *improve the business and innovate*. Much early literature³⁴ departed in how new technology, most notably the Internet, revolutionized certain industries and changed the feasibility of existing business models. This was for instance illustrated by Gallaugh³⁵ who showed how e-commerce enabled the emergence of new business models.

Also from an innovation perspective Kartseva *et al.*³⁶ suggest the business model as a basis for strategic analysis since it offers the possibility for mapping new business ideas graphically in a clear and communicable fashion. In this way business models facilitate change because of their building-block-like approach to formulating the business logic of a company.

Points of Departure for Creating Products and Services

In this section we take a closer look at how business models describe elements of the organization that are a part of the company's performance. Performance-related elements are elements that relate to the actual structure of the company. We distinguish among three characteristics:

1. Resource base;
2. Value chain; and
3. Value proposition.

The company's resource base is important, as there has been a lot of focus on which

resources actually drive company value creation. For example, in the knowledge society it is stated that primarily knowledge drives value creation. Along these lines, Miller *et al.*³⁷ argue that capabilities are the backbone of a company's competitive advantage because resources are a more stable element on which to base sustainable development than competitive strategy in a highly volatile business environment. Klaila³⁸ explains how the business model helps to identify the critical behaviours, competencies, and market conditions and account for the company's resources of intellectual capital. From the resource-based perspective we must perceive resources in the sense of being assets³⁹ and inputs to the value creation process of the company. As it is difficult for organizations to understand the role of knowledge resources in their value creation,⁴⁰ the business model approach becomes advantageous by visualizing the company's capability configurations, which are the cohesive combination of resources and capabilities embedded within its infrastructure, and which generate value.⁴¹

Porter defines the value chain as a basic tool for analyzing the sources of competitive advantage of the company, by enabling systematic examination of all the activities a company performs and how these activities interact.⁴² Every company is essentially a collection of interdependent activities that are performed to create value. The value chain can also be perceived as, according to Shank and Govindarajan,⁴³ a generic concept for organizing our thinking about strategic positioning. They define the value chain as "the linked set of value-creating activities all the way from basic raw materials to the ultimate end-use product delivered into the final consumers' hands."⁴⁴ Within the notions of

business models, the value chain comprises the company's activities and organization⁴⁵ and the structure of the company.⁴⁶ In Bell *et al.*'s⁴⁷ framework, core business processes and activities, and the analysis hereof, are viewed in the light of a value chain perspective. Likewise, Chesbrough and Rosenbloom⁴⁸ imply that the value chain perspective leads to identification of the activities and assets (inputs) that are necessary to deliver the company's value proposition (outputs).

However, there exist other value configuration models than the value chain. Stabell and Fjeldstad⁴⁹ suggest that the value chain is but one of three generic value configuration models. Stabell and Fjeldstad⁵⁰ distinguish between three generic value configuration models:

1. The value chain;
2. The value shop; and
3. The value network.

They argue that such a distinction is required in order to create an understanding and ultimately facilitate the analysis of company-level value creation across a broad range of industries and companies. According to Giertz,⁵¹ each type of business is based on this kind of unique value creation logic. Understanding and managing companies, he argues, thus requires a simulation that will test the business model and its strategy. Sweet⁵² argues for the necessity of understanding how the business model and its value creating elements work, as a prerequisite for managing the company. Ramirez⁵³ too, offers an alternative view to that associated with value creation in industrial production, arguing that technical breakthroughs and social innovations in actual value crea-

tion render the alternative, a so-called value co-production framework.

The value proposition or offering of the company depicts which value it intends to deliver to its customers. "A 'business model' is ... a precise definition of who customers are, and how the company intends to satisfy their needs both today and tomorrow."⁵⁴ Morris's definition, departing in the value of the companies offering to the end users, is very close to the definition of the knowledge narrative from the Danish guideline for intellectual capital statements. The knowledge narrative "expresses the company's ambition to increase the value a user receives from a company's goods or services."⁵⁵ Chesbrough and Rosenbloom⁵⁶ similarly define the value proposition as the value created for the user of the company's offering. According to Webb and Gile,⁵⁷ departing from the notion of customer needs is the only true strategic approach to take, thereby arguing against the previous literature stating that the company's resources ought to be the starting point for strategy formulation. For Hedman and Kalling⁵⁸ the company's value proposition is equivalent to the generic strategy of the company. In a likewise manner, Alt and Zimmermann⁵⁹ define the value proposition as a part of the company's mission statement together with its vision and strategic goals.

Each type of business has its unique value proposition logic⁶⁰ as the value proposition is closely linked to the products and services delivered.

Interconnections That Drive Value

The final category of business model characteristics concerns descriptions of internal linkages in the company related to performance and creating value. By performance-related linkages we mean elements such as

value drivers, value creation processes, and causality between, for example, activities, resources, and processes.

These three categories regard the internal aspects of a company's business model because they all are concerned with *how* value is created. Bray⁶¹ perceives value drivers as the link between key performance indicators and business objectives, at the same time underlining that value drivers are not outcome-oriented key performance indicators; rather they are forward-oriented performance measures. As value drivers imply causal relationships, they are more clearly visualized in a business model.

As Bray depicted above, key performance indicators are linked to business objectives via identification of the key drivers of value, which in turn can be interpreted as key success factors.⁶² Value drivers are not static performance measures. Rather they will vary over time, both within a business cycle and from business cycle to business cycle.⁶³ Eventually the company's present value-drivers will be replaced. This may be a result of the company changing its strategy or business model, which must have an effect on the drivers involved in the value chain and value creation process, or it could be an effect of the changing external environment.

A business model is inevitably a representation of how the company creates value, and *value creation*, therefore, is a cornerstone of the business model concept. The external prerequisite, the value proposition, is a central notion when referring to the internal prerequisite value creation, as the company's offering affects which value it must create and deliver to its customers and the users of its products or services. According to Linder and Cantrell,⁶⁴ "a real business model is the organization's core logic for creating value." Alt and

Zimmermann⁶⁵ also link the business model to value creation, by stating that it describes the logic that lies behind the actual processes of a 'business system' for creating value.

The ability of establishing precise connections and causal links and relationships between knowledge resources, competences, intellectual capital, etc., and the value creation of an organization, has been in the interest of the business and academic communities for a long time. Via a business model approach it is possible to identify causal loops that depict linkages between key performance measures and financial results⁶⁶ and that link combinations of assets to value creation.⁶⁷

Data and Research Methodology

In the empirical part of this article, we examine the financial analyst's way of thinking about strategy and business models in terms of the techniques, methodologies, procedures, systems, presentations, frameworks, etc., that are used when they articulate their understandings of the strategy of a specific Danish case company, Coloplast.

In addressing this issue a qualitative research approach will be used. Financial analysts that regularly analyze the company, participate in corporate presentations, etc., and thus have a detailed knowledge about the company, its strategy and the industry, have been interviewed and the interviews are analyzed where the nine characteristics of the business model have been used as a starting point for the analysis of the data.

The Case Company, Coloplast

The case company, Coloplast (www.coloplast.com), founded in 1957, is a worldwide provider of high quality and innovative

health care products and services, and is represented in 30 countries. In the fiscal year 2006/07, its revenue amounted to approximately € 1.070 mill., and group profit before tax was approximately € 80 mill. Coloplast employs more than 7,000 people, 2,500 of them working in Denmark, and the firm has production facilities in six countries with approximately 75 percent of Coloplast's products being produced in Denmark.

Coloplast's vision is to be the preferred source of medical devices and associated services, contributing to a better quality of life for the users of its products. Via close customer relationships, Coloplast aims at fulfilling the customer's needs with innovative, high-quality solutions. Further, Coloplast seeks to earn customer loyalty through responsiveness and dependability.

With respect to communicating externally about performance drivers, strategy, and knowledge resources, Coloplast is rather unique. Since 1998, Coloplast has published a supplementary section on intellectual capital, shareholders, and other external stakeholders as an integral part of its annual report. In Denmark, Coloplast's business reporting is generally regarded as a best-practise case. The company was for instance used as one of the main cases in the first Danish guideline for intellectual capital reporting,⁶⁸ and was suggested by DiPiazza and Eccles⁶⁹ as the main example of disclosing information on "how the company creates value." Furthermore, in October 2005, Coloplast won the Danish Financial Analyst Associations prize for best financial report for the second time in three years.

The Interview Data

The data collection was based on semi-structured interviews covering four themes,

each with a number of associated questions according to an interview guide. 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 according to that. The form of interviewing chosen was based on the principle of dialogue between the interviewer and the respondent⁷⁰ and has some similarities with the type of interview that Yin⁷¹ calls 'focused interviews.'

We interviewed all the sell-side analysts that followed Coloplast on a regular basis. The contact information of 12 analysts in total was attained from Coloplast and the analysts were contacted by the researchers after having received a letter of recommendation from Coloplast's Chief Financial Officer. All analysts confirmed that they performed regular analyses of Coloplast including the dissemination of these through analyst reports and all were willing to participate in the research project.

Of the 12 analysts actively following Coloplast eight were Scandinavian while four were large European investment banks located in Copenhagen, Stockholm, or London. The typical analyst specialized in four to six companies within the medico-technology sector and sporadically followed four to six major competing companies. However, there were also analysts with a broader focus, and some analysts were actively following up to 15 to 20 companies. All analysts were interviewed in December 2003, a few weeks after Coloplast's annual earnings announcement.

Our focus when conducting the interviews was on the general building blocks or elements that constitute a business model from the analysts' point of view. The interviews were structured around four themes. First,

we focused at the *analyst's* background, experience, and specialization. Next we shifted focus to the *company*, Coloplast, asking broadly about how the analyst perceives the company, its management, strategy, value creation, and what critical information they look for, etc. Thirdly, we asked about the analysis *process*, *i.e.*, what information is used, how the information is used, how the interaction with the company is, how the information is structured during the analysis, etc. As a continuation of the issues around the process we ended the interview by asking about the *annual report*, how it was used, how the different parts were perceived, etc.

The themes and questions were kept as close to the daily routines of the analysts as possible and we attempted to avoid referring to specific notions from the literature on business models. As a structuring device, we used an interview guide with a number of pre-determined questions or sub-themes for each interview theme. Not all questions were necessarily brought up in every interview, and as far as possible we let the analysts create their own structure during the interviews.

Analysis

Taking the nine business model characteristics identified earlier as a point of departure, *see* Figure 1, our analysis focuses on how and why these are mobilized by the respondents during the interviews.

The Overall Criteria for Performance

First of all, it is remarkable that the first characteristic, sustainable development, is not mentioned at all, while strategy was referred to rather constantly. This is rather interesting because the case company,

Coloplast, spends a lot of energy in its financial report, on the Internet and in presentations on communicating about how its products relate to creating quality of life for users and how the company works towards a healthy environment in the local community and for employees.

As previously described, strategy along with competitive advantage actually represented the analysts' overall approach to understanding the business model. Strategy concerned the mobilization of the core elements of the organization. Through the notions of strategy, the analysts described, often in great detail, how Coloplast's value creation was constituted, also depicting how these elements were adjusted to Coloplast's value proposition, company values, and vision. Strategy therefore relates to the different elements of the business (model) that are an integral part of the value creation process, *i.e.*, production, distribution, and logistics, along with marketing aspects.

Strategy also relates to strategic management processes, such as disclosure strategy and the management of the financial position, such as investment and disclosure strategy. In this sense, the business model to a great extent concerns core elements of the company's value creation process. It is also intimately connected with competitive strategy, as strategy becomes important in relation to the key business model characteristics of the company, *i.e.*, how the company mobilizes each core value creation (business model) element in order to create competitive advantage. If we differentiate between corporate strategy and strategy on an operative level, it would be compelling to suggest that the company's overall strategy is its business model and strategy on the more detailed levels concerns the ways of effectuating it.

Efforts with respect to improving the business are often mentioned as points within the realm of ‘changes in strategy.’ Moving production facilities overseas, increased focus on cost reduction and efficiency, and efforts with respect to maintaining quality in production, thereby ensuring excellence in products, are drawn forth meticulously by the respondents. Improving the business is also connected with innovation and product improvement. In Coloplast’s case, innovation is mentioned mainly in the sense of product development. One analyst commented that, “maintaining their high degree of product innovation is a key driver of growth [for Coloplast].” Thus, innovation is connected to future performance from an excellence perspective in the sense that market growth is achieved through better than average products.

Performance-Related Elements

The second category, performance-related elements, relates to overall modules that make up the company. For example, the value proposition or offering of the company relates to what the products or services do for users and customers. The resource base concerns the assets and inputs necessary for creating the offering, while the value chain regards the structure of the company and its value creation process. The resource base is related to the assets and inputs that are prerequisites for making the company’s products. Thus it is a prerequisite for value creation. In production companies inputs are normally raw materials or components. In Coloplast’s case, this would be plastic and other materials. But assets and inputs are more than merely materials. First of all, being a capital intensive production company, financial assets become of the utmost importance. For

example, capital is a necessity for increasing production capacity. An important resource base is also technology. In Coloplast’s case, it is the so-called adhesive-technology that is the central aspect. This technology was emphasized as the main synergy connecting Coloplast’s various business areas, although some analysts declared it too low-technological to be a distinct competitive advantage for the company.

Also among the core resources in Coloplast are the employees. Respondents argued for the importance in not only having the right employees, but moreover having satisfied employees. Finally, knowledge about the customer and the customer’s needs are a central resource for Coloplast’s value creation.

The value chain perspective was also partly illustrated above in the analysts’ understanding of strategy and the business model. When the analysts were asked about their views of Coloplast’s strategy, a major part of their reasoning was based on different elements of the business model, also elements pertaining to the value chain. This, of course, should be viewed in the light of the fact that Coloplast in essence is a traditional production company and thus is largely structured according to the value chain ideas. The value chain characteristic is mobilized in connection with production and distribution features. With respect to production characteristics regarding the value chain,

Coloplast has gone from having everything in-house to develop their production strategy by first outsourcing production to contractors, e.g. Mærsk Medical, and second step in this development story is to move own production from Denmark overseas.

Distribution features concern mainly their forward-integration strategy through, for example, their distribution affiliates HSC and Sterling, but also their progression into the home care segment is perceived as a successful operation by several of the respondents. The only worries aired in this connection have been that the operating margins in this section of the business are significantly lower than the other more lucrative areas. It seems that Coloplast must evaluate the costs and benefits of attaining a lower average return on invested capital against maintaining closer relationships with the markets and customers.

Finally, within this category, the business model is associated with the value proposition of the company, *i.e.*, the use value of the products or services delivered. In this sense the business model illustrates how the company goes about delivering its market offering, in other words, depicting the value creation process. Essentially, Coloplast is a production company, mass producing standard single use medical devices. But, Coloplast differentiates itself from being ‘merely’ a mass production company by basing its operations on an alternative set of values. One analyst summed up the link between Coloplast’s value proposition and business model in the following manner:

Coloplast puts the patient first, and does not consider bulk production. Coloplast asks themselves how they are able to improve the quality of life for patients and the users of our products and that is why they invest so much money in improving products, always being first to market with improved versions of products that are sellable at marginally higher prices, and all this has turned

out to be a rather lucrative strategy for Coloplast.

Thus, through the improving the quality of life proposition, Coloplast’s business model is product-innovation and customer-needs oriented rather than production focused.

Relationships Among Elements

As opposed to the previous category of characteristics, relationships among elements are more concerned with an action perspective of the business model, *i.e.*, what the processes are, what is done, etc. The three characteristics pertaining to this category are:

1. Value drivers;
2. Value creation processes; and
3. Causal links between different activities and elements of the business model.

Value drivers are in a sense key success factors with respect to the company’s future performance both competition-wise and financially. When asked to describe the value drivers of the company, most of the analysts apply the terminology “growth drivers.” This reveals the analysts’ focus on their valuation models, in which the growth rate of the company plays a central role. Although not mentioned explicitly, there seemed to be a consensus that a growth rate of 10 percent a year was vital in relation to the valuation of the company. The reason behind this very specific number may be because the Boston Consulting Group matrix, which is widely applied in most business schools worldwide, differentiates between high- and low-growth companies at precisely this level.

There does not exist a final definition of what a value driver is and what a growth

driver is. The analysts used them interchangeably along with a third term, trigger points. A slight difference between the two terms could be that growth drivers often are connected to these share-triggers, while value drivers would be considered to be more long term.

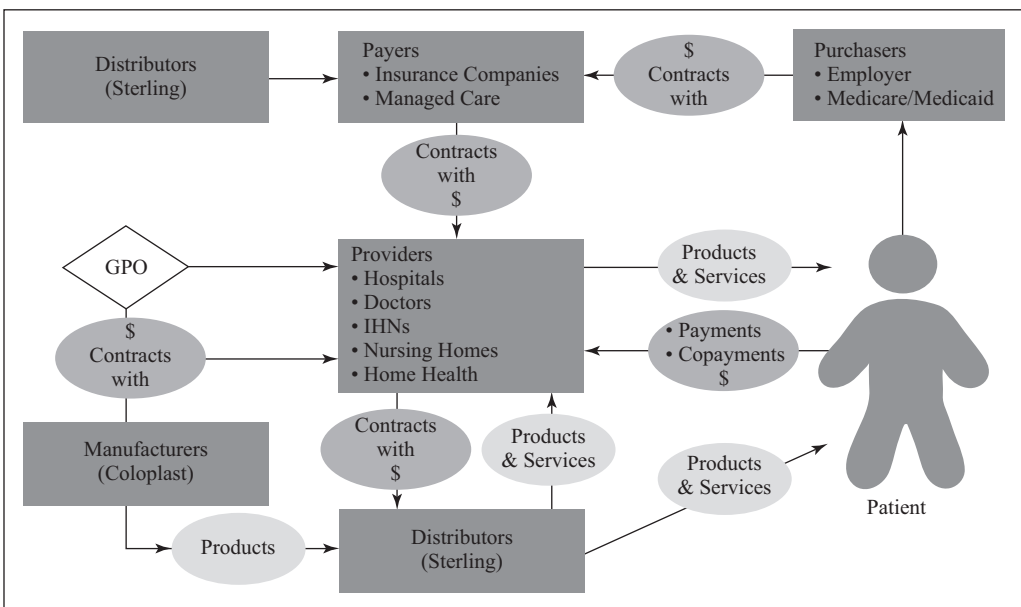
Along the line of argumentation that trigger points and value drivers are not the same, one analyst stated that “everything revolves around value drivers. What you could say is that some information differs from value drivers with respect to being what we call trigger points.” Furthermore the analyst elaborated that, “value drivers typically have duration of one to two years; whereas, when you talk of trigger points, then you are talking more about the kind of news flow that moves the share price.” Our empirical evidence also leads us to suggest

that a discontinuity in a value driver constitutes a trigger point.

The value drivers emphasized by the analysts included the already elaborated aspect of innovation, marketing and distribution, and a business model based on excellence. In addition, penetration of the US market was among the most debated themes in the interviews. In connection with Coloplast’s recently released objectives for the next five years, the issue of establishing itself on the US market was given a key role. Finally, and quite surprisingly, only two analysts mentioned demography as a value driver. The fact that the fraction of older people will increase significantly in the next 20 years is a considerable growth driver of the market in which Coloplast operates.

Surprisingly, value creation and value creation processes as such are not mentioned

Figure 2. The Health Care Revenue Model



in connection with the business model. From the analysts' perspectives, value creation is only thought of in terms of attaining revenues and thereby boosting profits and other shareholder value measures. An important insight from this study is, therefore, that the financial analysts have grave difficulties in distinguishing between the health care companies' business model and the model by which the payment of revenues are allocated between end users and reimbursing organizations. These revenue streams are illustrated in greater detail in Figure 2, where it is evident that the revenue streams indeed are complex.

The final characteristic in this category, causality, concerns the identification and significance of links between activities, resources, processes, and other value drivers. Although Coloplast, according to one analyst, operates in a sector that is not especially homogenous, causality between Coloplast's product segments is attained through its core adhesive technology: "Coloplast is a much diversified company seen from a product portfolio perspective. Despite this, there is a connection between the divisions. There are some technological connections, *i.e.*, the adhesive technology." However, other respondents disagree with this statement. One opponent comments that, "with regard to the general structure of the company, some of the divisions are total misfits. I cannot see any synergies in those divisions at all."

As the grand finale, causality is the key to the success of Coloplast's business model. First of all, there is an inevitable link between Coloplast's vision and values and the customer segment it serves. This is the link between improving quality of life and a business model based on excellence. Excellence

was also the key causal relationship identified among market relationships, product innovation, and production. This causal relationship among this tripartite is the key to understanding Coloplast's business model; whereas, the link between vision, values, industry segment, and the former tripartite functions as a test of the appropriateness of these causalities, precisely like the narrative test of the business model that Magretta suggests.⁷²

Conclusion

The initial literature review identified a series of focal-points concerning the content of a general definition of business models. Here, three overall *business model* themes, namely:

1. The overall criteria that determine long-term performance;
2. The point(s) of departure for value creation; and
3. The key interconnections that drive the value generation of the company, were identified.

Hence, in the following empirical sections, the financial analysts' perceptions of a health care company's business model was analyzed in accordance with these themes.

Having taken our point of departure in how analysts understand strategy and which elements they perceive as constituting the business model of the health care company, we were able to examine whether the characteristics suggested in the literature review were reflected empirically. By studying the financial analysts' perceptions of the health care company's business model, its structure, competitive strengths, and strategy,

we are able to point out a number of critical success factors for communicating business models and other forward-looking statements.

First, the analysis demonstrated that 'excellence' was the key notion of a number of the characteristics that were identified for the business model of Coloplast. The business model was seen to revolve around a link between improving quality of life and a competitive strategy based on excellence. Excellence was also the key causal relationship identified among market relationships, product innovation, and production. The causal relationships among this tripartite is identified as the key to understanding Coloplast's business model.

This study indicates that the financial analysts' understanding incorporated a wide array of elements of the business model. For example, the analysts described the method of doing business: focusing on the whole enterprise system and the company's architecture for generating value as well emphasizing roles and relationships, describing the uniqueness of the value generating infrastructure, links, processes, and causal relationships.

The analysts' understanding of Coloplast's business model was strongly related to the company's distribution strategy, where there were marked differences across product and market segments. This made it difficult to describe Coloplast's business model very precisely, at least on an aggregated level, suggesting that Coloplast operates with fragmented distribution (business) models on the geographical and segment levels. Also, it was by many respondents stated that Coloplast's competitive advantage lies in its adhesive technology. Rather than being product-development oriented,

Coloplast's business model was focused around a marketing relationship and excellence perspective.

If the business model should be useful in the communication of the company's strategy, it should be able to simultaneously express the uniqueness of the company's strategy and the market it operates in and at a general level facilitate a comparison between the company and its competitors. In the analysis it was indicated that the business model constitutes an explicit link to understanding the company's uniqueness, competitive advantage, and strategy—in a sense, being a link to understanding the key causal relationships that make up a business value creation process. Thus, if management is able to convey its understanding of the company's value creation logic in a way that corresponds to that of external stakeholders, communication would be eased significantly.

While the financial analysts studied in this article all had direct access to the company's management team, private investors do not have access to the same sources and amounts of information. Therefore, disclosing more information of the same type as used by the financial analysts via reporting media, *e.g.*, in relation to the business model, would be a significant improvement for the private investors, despite the fact that the analysts may not indicate that they in fact need such types of information.

The latter is due to the fact, as stated earlier in this article, that financial analysts primarily get the more complex types of information directly from the company and not through voluntary reporting. Eccles *et al.*⁷³ have argued for better disclosure from this point of view, but still the investors would be left with little clue about how indicators

on, for example, intellectual capital should be interpreted.

Sometimes companies report in their annual reports only key performance indicators or similar information without disclosing them within the context of the business model that explains their interconnectedness and why it is precisely this bundle of indicators that is relevant for understanding this particular companies' strategy and value creation. If this is the case, the interpretation must be done by the readers of the report. However, at the present there exists only limited research-based insight into how this reading and interpretation is conducted.

From an accounting point of view, improved disclosure is more or less about determining the types of information that most significantly explains market value, in order that these numbers can be disclosed and fed into the decision-making process, maybe even capitalized, but at least used for benchmarking purposes. It is, however, questionable whether the financial market, *i.e.*, investors and analysts, would regard capi-

talization or standardised non-accounting information as improved disclosure.

The analysts and professional investors already have deep insight into a lot of details on the company, and the most important information is likely to be related to the specific strategies of the companies and hence difficult to compare and interpret unless it is disclosed as an integral part of a framework that explains how value is created. Since understanding value configurations and customer value creation is more of interest from a strategy point of view, a possible reconciliation of the reporting-understanding gap could be for the company to disclose its business model, *i.e.*, the story that explains how the enterprise works, who the customer is, and what the customer values—and based on this—determine how the company is supposed to make money. As previously noted in this article, such a description should also help the financial community in understanding the differences between the—often complicated—*revenue model* of the health care company, and its *strategic business model*.

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