COLIN HASLAM, TORD ANDERSSON,
NICK TSITSIANIS AND YA PING YIN

REDEFINING BUSINESS MODELS

STRATEGIES FOR A FINANCIALIZED WORLD

ROUTLEDGE

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Strategies for a financialized world

Colin Haslam, Tord Andersson, Nick Tsitsianis and Ya Ping Yin

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Ya Ping Yin is a Senior Lecturer in Economics in the Business School of the University of Hertfordshire. He was educated as a national economic planner and specialist in national accounting systems in Beijing and was subsequently appointed as an economic systems modeller at Strathclyde University. Dr Yin's main research interests are focused on how we account for productivity and efficiency measurement; market conditions, firm conduct and performance; and multi-sectoral growth models. His recent research cautioned readers about the nature and risk of accumulating consumer debt and questioned the sustainability of a banking-led economic growth trajectory. His published research highlights the structural fragility and increased level of systemic risk generated within the UK national business model.

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ABBREVIATIONS

AIDS	acquired immunodeficiency syndrome
AIG	American International Group
AIM	Alternative Investment Market
ARM	adjustable rate mortgages
BEA	Bureau of Economic Analysis (USA)
BICRA	Banking Industry Country Risk Assessment
BM	business model
CAGR	compound annual growth rate
Cash ROCE	EBITDA as percentage of capital employed, where capital employed is the sum of equity and long-term debt
CDS	credit default swaps
CEO	chief executive officer
CFA	charted financial analysts
CFROI	cash flow return on investment
CIBER	Centre for International Business Education and Research
CII	capital intensity index
DLBM	digital lifestyle business model
EBIT	earnings before interest and tax
EBITDA	earnings before interest, tax, depreciation and amortization
EPS	earnings per share
EVA ™	Economic Value Added
FASB	Financial Accounting Standard Board
FDA	Food and Drugs Administration Agency
FDI	foreign direct investment
FDIC	Federal Deposit Insurance Corporation
FVA	fair value accounting
GAAP	Generally Accepted Accounting Practice

GDP	gross domestic product
GIIPS	Greece, Ireland, Italy, Portugal and Spain
GO	gross output
GOS	gross operating surplus
GSK	GlaxoSmithKline
GVA	gross value added
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IBM	International Business Machines
IC	intermediate consumption
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRR	internal rate of return
LBO	leveraged buy-out
LC	labour costs
MKTVAL	market value at year end
MVA	market value added
NCE	new chemical entities
NETINCPS	net income per share
NOPAT	net operating profit after tax
NPV	net present value
OPEB	other post-employment benefits
OTC	over the counter
PEBM	private equity business model
PEP	private equity partnership
R&D	research and development
RBS	Royal Bank of Scotland
RBT	resource-based theory
ROA	return on assets
ROCE	return on capital employed
ROE	return on equity
ROI	return on investment
S&P	Standard and Poor's
SBB	share buy-backs
SFAS	Statement of Financial Accounting Standards
SME	small and medium enterprise
SPV	special purpose vehicle
SORP	Statement of Recommended Practice
TIPS	Treasury Inflation-Protected Securities
VAR	value added retained
VC	venture capital
WACC	weighted average cost of capital

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INTRODUCTION

No quality newspaper has recently been complete without a story about the banking crisis and how sovereign governments are finding it increasingly difficult to fund their deficits and refinance their roll-over debt. The current financial crisis is global and interconnected because adjustments are transmitted and amplified by accounting systems that equalize the value of assets and liabilities either up or down. According to a recent Bank for International Settlements report *Rescue Packages and Bank Lending*, recent financial problems are related to the instability of the banking business model.

> The global financial crisis is widely regarded as the worst financial crisis since the Great Depression. While financial distress afflicted the entire financial system, many crisis-related problems crystallised in the banking system, starting with the interbank market freeze in August 2007. Between early 2007 and March 2009, the stock market valuation of the banking sector declined by 79% from peak to trough, losing over 20% relative to the broader equity index (comparing the MSCI World Index and Bank sub index). CDS[1] premia shot up across the board, indicating that the market was pricing in a greater likelihood of bank defaults.
>
> *(Bank for International Settlements, 2011b: 2)*

Liquidity in a credit-based system reconciles timing differences between long-lived assets (loans) and short-term liabilities (deposits). A distinction can be made between liquidity generated by central banks (official) and that which is generated by private corporate financial and non-financial sectors. Private liquidity now far exceeds 'official' liquidity and where asset values (capitalizations) inflate there is a possibility of a 'liquidity disconnect'. That is, capitalizations accelerate ahead of income and surplus driven by factors other than the trajectory of earnings/surplus.

However, when asset valuations reduce the serviceability of capital accumulated under threat, this can compromise the solvency of business models amplifying asset price adjustments, especially where a substantial proportion of 'realizable collateral' is imaginary and based upon intangible goodwill and optimistic assumptions about counterparty viability.

A Bank of England *Financial Stability Report* (December 2011) observes that 'A flight to safety could cause sharp asset price movements . . . Shifts in capital flows as investors seek "safe havens" could cause large and disruptive movements in many asset prices' (Bank of England, 2011: 18). The banking crisis of 2007–2009 reveals how credit losses (loan defaults) were quickly followed by goodwill write-downs that rapidly undermined banking sector capital adequacy, triggering the need for official interventions to sustain balance sheets, capital adequacy and solvency.

> As the crisis proceeded, total credit losses eventually outpaced recapitalizations. Combined credit losses of \$1,508 billion (\$801 billion in North America) exceeded total recapitalizations of \$1,318 billion (\$515 billion in North America).
>
> *(Bank for International Settlements, 2011b: 4)*

> Banks also increasingly came under capital pressure. The IMF estimates that banks' worldwide credit-related write-downs were around \$1.6 trillion between mid-2007 and end-2009.The national banking systems that have tended to cut back lending relatively sharply were the ones that have received the largest capital injections from their governments – a proxy for the pressure on their capital positions.
>
> *(Bank of England, 2010: 7)*

Thus in a credit-based system there is an ongoing tension between cash surplus capacity (liquidity) and ongoing capitalizations (as wealth accumulation for households) where complex global network relations, interconnectedness and financial imbalances have become the norm. When struggling banks were forced to write down goodwill assets in their balance sheets this also triggered a write-down in shareholder equity, threatening the capital adequacy capacity of banks to maintain lending and sustain GDP growth trajectories.[2] The reaction of regulatory authorities has been to try and strengthen global banking business balance sheets (with additional reserves and equity injections) to reduce 'official' exposure to the banking sector, but this may further curtail lending capacity.

> New Basle III capital adequacy will reduce lending capacity going forward by as much as 4–5 per cent.
>
> *(IMF, 2011: 3)*

> In normal times and particularly in boom periods, the supply of global liquidity will be largely determined by international banks (either directly or