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Accounting for the financialized UK and US national business model

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ABSTRACT

In this paper we adopt a 'business model' conceptual framework grounded in accounting to describe the processes and mechanisms of national economic development and transformation. We locate national business models within a broad econo-sphere where they evolve and adapt to information arising out of stakeholder/institutional interactions. These interactions congeal into reported financial numbers that are presented as current income flows (income, expenditure), balance sheet accumulations and changes in net worth (assets and liabilities outstanding). We employ financial data from national accounts to specifically describe how the US and UK national business models have become financialized as ongoing capitalizations run ahead of earnings capacity. This process of interminable re-capitalization is conditioned by variable institutional and sub-institutional sector characteristics. However, in financialized national business models the system of accounting takes on added analytical significance because it 'transmits rather than contains' and 'amplifies rather than dampens' adverse financial disturbance as capitalizations are recalibrated up or down in secondary markets.

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1. Introduction

In both the US and the UK the period after 2008 marked a significant economic break when capital markets became increasingly volatile, amplifying a process of corporate restructuring and forcing institutional interventions to maintain financial stability. The focus of policy in the US is now with macro-prudential management and in the UK with rebalancing the economy with a specific focus on stimulating manufacturing because this creates jobs and may close the underlying balance of trade constraint. Erturk et al. (2012) argue against mainstream attention focused on bottom line GDP outcomes and alternatively draw our attention to the constituent moving parts such as the different elements of final demand. Deconstructing the bottom line GDP figures reveals underlying mechanisms that are employed to critically evaluate the effectiveness of industrial policy centered on rebalancing the economy. In this article our objective is to likewise deconstruct the US and UK national accounts but to locate our analysis within a business models framework grounded in accounting.

The term 'business model' (BM) is generally used to describe the possibilities of transforming corporate activities and business functions (Osterwalder et al., 2005; Magretta, 2002). This concept can be adapted to describe the macro-economic processes and mechanisms driving national financial development and transformation. Thus, this paper argues for the

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examination of a national business model within an augmented accounting framework which captures and deconstructs both financial flows (income, expenditure, and flow of funds) and financial stock (balance sheet capitalization and net worth). We argue that such an accounting framework can be employed to describe the adaptation and evolution of national business models which are the product of stakeholder/institutional/regulatory interactions within the econo-sphere. Our objective is to locate national business models within accounting where financial flows and accumulated capitalization matter and to apply such a framework to construct a critical examination of the development of the US and UK national business model(s) over recent decades. Our general argument is that the US and UK national business model can be deconstructed into broad institutional elements: corporate (financial, non-financial), government and households. These institutional elements are constituted by the sum of their focal parts that is, focal firms and individual households operating with variable patterns of income, expenditure, cash surplus, allocation of funds and capitalization.

Our analysis of the UK and US national business model(s) reveals a general financial pattern namely: the accumulation of balance sheet capitalization (debt and equity) ahead of surplus generating capacity (Gross Operating Surplus). This financially leveraged outcome is explained by a range of factors that permit focal firms and households, within their respective national business models, to generate wealth recapitalizations ahead of surplus capacity. These factors include: low interest rates, financial product innovation (e.g. securitization, collateralized debt obligations and other derivatives), extension of financial intermediation, real estate and private equity firms, as well as accounting and regulatory adjustments that facilitate and extend the recognition of mark to market revaluations, goodwill, and holding gains in comprehensive income. This explanation contrasts with the notion that current capitalizations are the discounted present value of a stream of expected future cash surpluses extracted from productive corporate activities. In a financialized national business model, capitalizations are also the product of: financial innovation, brisk asset trading, the extraction of speculative holding gains and goodwill accumulations that, in turn, provide the collateral for further recapitalizations. Thus the augmentation of balance sheet capitalization, within national business models, is a function of both extracting cash from selling product and services for final consumption and an interminable process of financial manipulations to lever asset and liability values to generate holding gains and goodwill for wealth accumulation.

In this paper we argue that this process of financialization can best be understood within an augmented accounting framework that deconstructs national business models into their institutional and focal entity constituents. This paper is grounded in accounting and we employ financial numbers to make visible: cost structure, cash generative capacity, and balance sheet capitalization (asset and liabilities) upon which we construct critically engaged narratives about economic transformation (Froud et al., 2006; Haslam et al., 2012). There is a long-standing tradition within economics that is concerned with how national accounts can capture the relation between income, expenditure and capital accumulations in the balance sheet. Ruggles and Ruggles (1973) observed that the national accounts do not capture the financial relationship between capital gains and business/personal income even though this can be a major source of unearned income.

> Capital gains provide a substantial amount of unearned income, but this is not included in either business or personal income in the national accounts. Any understanding of the income distribution or measurement of income inequality should take into account this major source of unearned income (Ruggles and Ruggles, 1973: 113).

Eisner's (1980) paper 'Capital Gains and Income: *Real Changes in the Value of Capital in the United States, 1946-77*' is a comprehensive project concerned with how national accounts should account for capital gains. Eisner (1980) reveals the technical complexity associated with asset revaluations and estimating capital gains within the various institutional sectors. Eisner is convinced that capital gains should be accounted for because they inform us not only about the appropriate level of investment needed to maintain productive renewal but also about how capital gains can modify patterns of consumption and hence GDP.

> As individuals or as societies we may have wealth that is the present value of an expected future stream of income that does not correspond to our preferred and planned future consumption. A lowering in the rate of interest may increase the value of that wealth and enable us as a consequence to plan a path of consumption that dominates the previous path (Eisner, 1980: 178).

The relation between income flow and changes in balance sheet capitalizations (stock) are explained as changes in the pattern of financial transactions and adjustments in asset valuation. National income, flow of funds, and balance sheet statements are the product of double-entry book-keeping which ensures that differences between income and expenditure are represented by corresponding adjustments to the flow of funds and ultimately changes in assets and liabilities where a constant balance is maintained. Thus Godley and Lavoie in their text 'Monetary Economics' (2007) remind us of the importance of the concept of double entry book-keeping (the interlocking system of financial assets and liabilities) when constructing a 'transactions flow matrix' which captures movements in financial flows and changes in financial stocks within and across institutional sectors.

> The evolution of the entire system may be characterized (at the level of accounting) by saying that at the beginning of each period, the configuration of stock variables (i.e. all physical stocks together with the interlocking system of financial assets and liabilities) is a summary description of (relevant) past history. (Godley and Lavoie, 2007: 8)

Godley and Lavoie (2007) pay considerable attention to the construction of national economy financial accounts and argue that, for the purpose of constructing behavioral models, all transactions and price adjustments must be accounted for

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