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Apple's financial success: The precariousness of power exercised in global value chains

Colin Haslam[a,*], Nick Tsitsianis[a], Tord Andersson[b], Ya Ping Yin[b]

[a] School of Business and Management, Queen Mary University of London, United Kingdom
[b] Business School, University of Hertfordshire, United Kingdom

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ABSTRACT

The topic of this paper is the Apple Inc business model and how, in a financialized world, the success of this business model is represented by what we term financial 'point values'. Our argument is that there is a tendency to promote specific point valuation multiples as measures of success, but these values, by their nature, do not reveal the contingent and variable nature of the power relations exercised in and along global supply chains. Firms such as Apple exploit their resources and capabilities to 'create value' but also exercise power to recalibrate relationships with suppliers in the value chain to secure 'value capture' for financial transformation. Value capture is an active ingredient that can help inform our understanding of the fragility of the Apple business model value proposition and frame a critical argument regarding the precarious nature and sustainability of Apple's substantial profit margins.

1. Introduction: the conditions of success in present day financialized capitalism

The literature on financialization is concerned with how the world has changed, and this is represented at a number of levels of analysis. This literature emphasizes the structural adjustment of national balance sheets from tangible to financial assets (Krippner, 2005) and how global financial and physical value chains are being elongated and recalibrated to extract additional cash that is then increasingly distributed to shareholders (Millberg, 2008). The object is to increase earnings capacity and modify cash and profit distribution towards investors (Andersson, Haslam, Lee, & Tsitsianis, 2007; Lazonick, 2008). Often, corporate narratives exaggerate the extent of financial transformation (Froud, Johal, Leaver, & Williams, 2006), promising more than the numbers deliver. Our specific use of the term 'financialization' in this article draws upon this literature but also significantly reframes the analysis to focus on the focal firm as a financial reporting entity and how power is deployed to recalibrate activities to capture value and modify relative financial ratios and trajectories.

In the world of the stock market analyst, financial performance matters in terms of the influence this information has on the valuation of a reporting entity's stock and on buy and sell side recommendations. There are no fixed standard measures of financial performance but rather a range of financial metrics that include, for example, cash flow return on investment (CFROI), Economic Value Added (EVA^{TM}), cash return on capital employed (Cash ROCE), earnings per share (EPS) and the price to earnings ratio (PE). The key metrics used by analysts often combine market value with a relevant reporting entity financial metric that is assumed to have a material correlation with market value (MV). Thus financial variables such as Cash ROCE are correlated with higher or lower market valuations when, for example, the ratio increases or falls. In a UBS Warburg (2011) 'Valuation Primer', we are informed that:

* Corresponding author. Tel.: +44 2078828984.
E-mail address: c.j.haslam@qmul.ac.uk (C. Haslam).

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> A valuation multiple is simply an expression of market value relative to a key statistic that is assumed to relate to that value. To be useful, that statistic – whether earnings, cash flow or some other measure – must bear a logical relationship to the market value observed; to be seen, in fact, as the driver of that market value.
> http://pages.stern.nyu.edu/~ekerschn/pdfs/readingsemk/EMK NYU S07 Global Tech Strategy Valuation Multiples Primer.pdf

The literature on stock valuations that often refers to such multiples is often termed 'point analysis', but the numbers/ratios employed in the analysis combine the product of complex interactions and on-going adjustments to the productive, financial and regulatory boundaries of a reporting entity. These ongoing adjustments and recalibrations constitute and modify a reporting entity's financial numbers (Haslam, Andersson, Tsitsianis, & Ping, 2012). A significant criticism often made by valuation practitioners and analysts is that the focus on 'point values' conceals much of what is 'driving' value. According to UBS Warburg (2001):

> A multiple is a distillation of a great deal of information into a single number or series of numbers. By combining many value drivers into a point estimate, multiples may make it difficult to disaggregate the effect of different drivers, such as growth, on value. The danger is that this encourages simplistic – and possibly erroneous – interpretation.
> http://pages.stern.nyu.edu/~ekerschn/pdfs/readingsemk/EMK NYU S07 Global Tech Strategy Valuation Multiples Primer.pdf

Bowman et al. (2012) are also critical of point value analysis because it frames our understanding in a way that denies 'anomalies and adverse consequences' because they are not observable. The authors illustrate how power along supply chains can lead to substantial inefficiencies and financial costs that burden up or down-steam entities within the (global) supply chain. The significance of this argument is that the use of power within supply chains needs to be deconstructed, accounted for and made visible. Moreover, as we argue in this paper, these power relations (once revealed) are also not uniform but are rather contingent and variable and this, in itself, provides the foundation for precarious financial transformation. Thus the turnaround in Apple Inc's financial fortunes after the mid 2000s was the direct result of combining blockbuster products with a series of moves that changed the mix of activities that Apple conducted within its financial boundaries. Apple exercised power to externalize expenses such as product development and component manufacture while capturing the value extracted from product sales within the boundaries of its financial accounts in the form of inflated cash margins and return on capital. Apple's US manufacturing facilities have long since closed, and Apple is currently internally focused on design, the provision of technical services and managing retail stores. Assembly is off-shored, substituting relatively high internal for lower external employment costs now congealed in Apple's external purchases. Moreover, R&D and apps development are also outsourced and currently account for just 2 percent of sales, well below the 10–15 percent reported by Apple's peers. This recalibration of what is captured within and outside Apple's financial boundaries depends upon how power is deployed to place pressure on suppliers to drive down costs and how this has helped transform cash margins. In point value terms, this was 'a brilliant corporate success'.

Our concern in this paper is not in identifying point values and how these inform and influence correlation coefficients and valuation estimates. Rather, our proposition is that reporting entity point values should be supplemented with a process of deconstruction that reframes the social analysis and generates critical narratives regarding whether outcomes are precarious or sustainable. In terms of supplementing point values, we argue that it is important to add context concerning how power is variably deployed to modify a reporting entity's key financial operating ratios. Thus a reporting entity's financial data provides information about changing cost structures, adjustments to financial boundaries and activity displacement. Furthermore, it is necessary to compare a focal firm with other firms within its business model to construct alternative critical narratives concerning relative performance on individual firm point values. Our analytical framework is thus deliberately grounded in

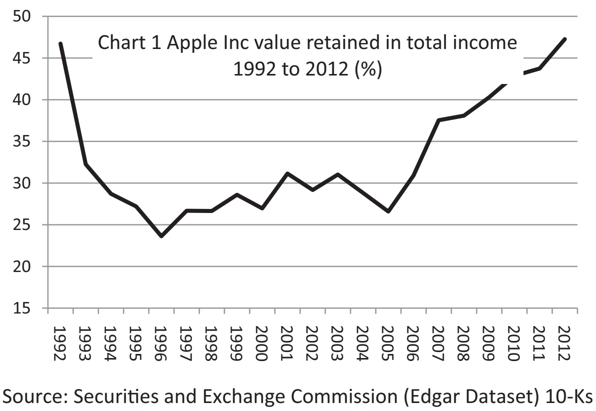

Chart 1.

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