

# **Customer Equity: To Capitalize or Not to Capitalize – That is the Question**

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A Study on Customer Equity in Subscription-based Enterprises  
from Stakeholders' Perspectives

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## **Customer Equity: To Capitalize or Not to Capitalize – That is the Question**

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### **Abstract:**

Customer equity is a concept that stems from the marketing field of research, however, its usefulness extends beyond the valuation of marketing activities. Within the accounting field of research, customer equity has been examined by a limited number of researchers who have identified it as the main, value-driving, intangible asset in subscription-based enterprises, currently missing from the financial reports. With the rapidly growing popularity of subscription-based enterprises, customer equity and its appropriateness of being recognized as an intangible asset on-balance is worth looking into. In this study, stakeholders to subscription-based enterprises have been interviewed and their sentiments towards capitalizing customer equity and, alternatively, towards a uniform way of disclosing customer equity off-balance, have been examined. We demonstrate the challenges, brought forward by the stakeholders, relating to an accounting change regarding customer equity. Capitalizing customer equity was, in spite of potential benefits, dismissed due to the uncertainty in the item and a standardization in off-balance disclosures was deemed to be difficult to implement.

### **Keywords:**

Customer equity, Subscription-based enterprises, Customer lifetime value, Capitalization, Intangible assets

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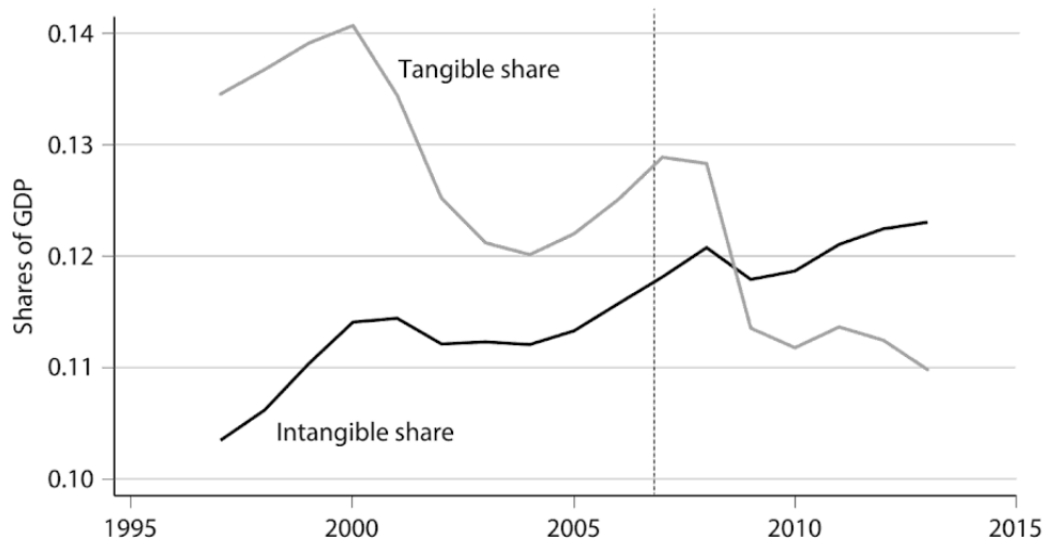
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# 1. Introduction

## 1.1 The Rise of Subscription-based Enterprises

Netflix revolutionized the television industry. Spotify revolutionized the music industry. Blue Apron Meal Kits revolutionized the food industry. The common factor in these companies is that they are all subscription-based enterprises (SBEs), which is defined as an enterprise where a customer pays a fee to have access to the firm’s products or services for a certain period of time (Bonacchi and Perego, 2012). According to the Harvard Business Review, “business-to-consumer subscription businesses have attracted more than 11 million U.S. subscribers in 2017, and the industry as a whole has been growing at 200% annually since 2011” (Fader and McCarthy, 2017). Previously dominated by newspapers, magazines, and telecommunications companies, the subscription-based business model has advanced into industries of, for instance, consumer software, food preparation, health and beauty products (McCarthy et al. 2017). The main assets in these emerging subscription-based enterprises are intangibles; instead of robust machines, revenues are driven by the customer base, brands, and trademarks.



**Figure 1.** Intangible and tangible investments in Europe and the United States (Haskel and Westlake, 2018)

Investments in intangible assets are increasing and surpassed tangibles sometime during the years of 2008/2009, as the graph above illustrates. Intangible assets have, as such, become more significant and are viewed upon as the major value creators of modern businesses (Lev, 2018). Nonetheless, most measurement conventions ignore intangible assets and as intangibles have

become more important, we seem to be entering an era of capitalism without capital (Haskel and Westlake, 2018).

Berjemo and Monroy (2010) state that: “Intangible assets are difficult to measure, but nowadays the value of the shares of firms in the stock exchange market contains a high percentage of intangible capital and customers are one of the main intangible assets that should be evaluated” (p.142). Furthermore, Blattberg et al. (2001) explain that: “The customer is a financial asset that companies and organizations should measure, manage, and maximize just like any other asset” (p.3). As such, the value of the customer base, namely customer equity, is a crucial, intangible asset in subscription-based enterprises, which currently is being neglected in the financial reports (Bonacchi et al., 2015). Customer equity can be defined as the discounted value of future cash flow/profit attributed to existing and future customers within the customer base (Bonacchi and Perego, 2012). Although customer equity is considered to be the most important, value-driving asset of subscription-based enterprises, as of this writing, accounting standards prohibit these companies from reporting customer equity as an intangible asset on the balance sheet, i.e. capitalizing customer equity (Bonacchi et al., 2015).

## **1.2 The Research Gap**

Marketing researchers have extensively examined customer equity based on, so called, bottom-up customer lifetime valuation models, with the primary purpose to evaluate marketing activities (Persson and Ryals, 2010; Skiera and Schulze, 2014). The bottom-up method aggregates the discounted value of each customer, taking acquisition cost, retention rate, and lifetime into account (Bonacchi and Perego, 2012). Marketing researchers address the need for them to transfer the knowledge of the valuation methodology of customer equity to other areas, such as accounting and finance, as its usefulness extends beyond the valuation of marketing activities (Wiesel et al. 2008). Further, the method is claimed to be specifically suited for subscription-based enterprises, as revenues are driven by the number of subscribers and the expected lifetime of each subscriber (Fader and McCarthy, 2017). As such, the valuation methods originating from the marketing field of research can be used to value the “missing” intangible asset of customer equity within subscription-based enterprises (Bonacchi et al., 2015).

While there is extensive research on intangible assets within the accounting field, there is, to our best knowledge, only a few accounting researchers who have examined customer equity

and suggested customer equity being an intangible asset to be recognized on the balance sheet. For instance, the importance of intangible, value-driving assets, that currently are neglected in the financial reports, has been emphasized by Lev (2018), and customer equity has been identified as such an intangible asset by Bonacchi et al. (2015). Apart from this narrow area of research within the field of accounting, there has been a lack of interest in customer metrics such as customer equity (Gleaves et al., 2008). Between the marketing researchers' valuation methods of customer equity and the accounting researchers' focus on intangible assets in general, but not customer equity in particular, a research gap has been identified regarding recognizing customer equity as an intangible asset on-balance.

### **1.3 Purpose and Research Question**

In our thesis, we aim to contribute to the aforementioned research gap by examining the feasibility of recognizing customer equity as an intangible asset from the perspectives of different stakeholders in subscription-based enterprises. The purpose is to explore the sentiments of the stakeholders in subscription-based enterprises that might be impacted in a potential accounting change regarding customer equity and to evaluate the plausibility of implementing such a change. The stakeholders participating in the study constitute of equity research analysts, managers, investors, and an accounting expert. The starting point is to examine the stakeholders' sentiments towards customer equity being accounted for as an intangible asset on the balance sheet. An alternative method, that also will be examined, is customer equity-related metrics being disclosed off-balance in a uniform way and stakeholders' sentiments towards such a method. In conclusion, the research question is: What are the sentiments of stakeholders of subscription-based enterprises towards capitalizing customer equity and, alternatively, towards a uniform way of disclosing customer equity-related metrics off-balance?

### **1.4 Delimitations**

The main delimitation of the study concerns the valuation methods of customer equity. The study does not aim to test any of the proposed valuation methods within the research field, neither to calculate nor present a new method. Furthermore, another delimitation concerns the regulation of intangible assets, as the study does not aim to focus purely on accounting regulation changes, nor to outline different accounting standards.

## 2. Theoretical Development

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*In the following section, the literature that will constitute the foundation of the study is presented. Section 2.1 is divided into two sub-sections; a review of the relevant literature within the field of marketing and of the relevant literature within the field of accounting. Section 2.2 presents the theoretical framework that will guide the study.*

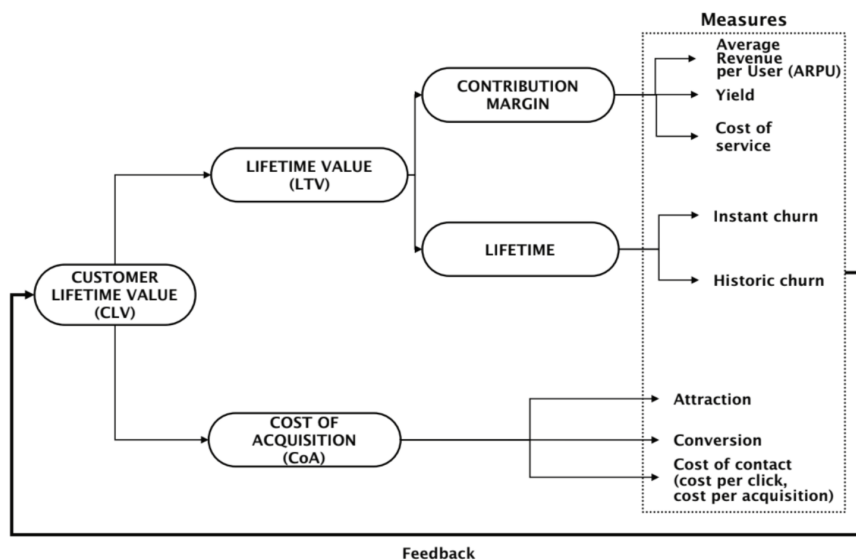
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### 2.1 A Review of the Literature

#### 2.1.1 Marketing Literature

Customer equity was first mentioned in 1996, when Blattberg and Deighton (1996) developed a customer equity model that aimed to determine the optimal balance of customer acquisition and retention spending (Persson and Ryals, 2010). As stated by Persson and Ryals (2010), since the original customer equity model was presented (Blattberg and Deighton, 1996), marketing researches have evolved the concept from different perspectives, taking into account, for instance, brand switching (Rust et al., 2004), the customer acquisition process (Villanueva et al., 2008), and using only publicly available data (Gupta et al., 2004). Furthermore, focusing on subscription-based enterprises, Bonacchi and Perego (2012) developed a step-by-step valuation model of customer equity, which will be used to define customer equity in this study. The definition is presented later in this sub-section.

Customer equity has primarily been important within the marketing field of research, as it helps marketers to determine how to optimally target customers with marketing campaigns and to measure the effectiveness of marketing actions after implementation. An integral part within the customer equity model is customer lifetime value (CLV), which has become increasingly important in the past decade (Gupta et al., 2006). There are several reasons for its growing popularity, such as traditional marketing metrics not being able to sufficiently show returns on marketing investments, CLV being a relatively good proxy for the overall value of companies (Gupta et al., 2004), as well as technology being more advanced and therefore enabling larger collection of customer data (Gupta et al., 2006). Customer lifetime value is defined as the value of future cash flow/profit attributed to a single customer or a group of customers, discounted using the company's average cost of capital (Bonacchi and Perego, 2012). See Figure 2 for an illustrative overview of the components of the CLV-model.



**Figure 2.** The Customer Lifetime Value Model (Bonacchi and Perego, 2012)

Customer equity, on the other hand, is the sum of the customer lifetime values of both existing and future customers of a company and it has been identified as the most important asset for subscription-based enterprises (Bonacchi and Perego, 2012). For these enterprises, the primary source of future cash flow is customers and hence customer data is important to investors and equity research analysts (McCarthy et al., 2017). Furthermore, Wiesel et al. (2008) state that investors would be affected by firms’ reporting of customer equity since it enables them to monitor firms’ performance with respect to their customer assets. Similar to customer lifetime value (Gupta et al., 2004), customer equity can also be used as a proxy for the market value of firms (Silveira et al., 2012; Zhang, 2016).

### 2.1.2 Accounting Literature

The concepts of, and fundamentals for valuing, customer equity and customer lifetime have been extended to the accounting field of research by only a few researchers, such as Bonacchi et al. (2015). As illustrated above, the customer-based valuation approach has become popular among researchers in marketing, however, within the fields of accounting and finance the popularity is significantly lower (Skiera and Schulze, 2014; Bonacchi and Perego, 2019). Gleaves et al. (2008) state that the management accounting literature largely ignores customer lifetime and customer equity, perhaps due to “the accountant’s inbuilt conservatism and reluctance to wrestle with these more creative and judgement based measures” (p.825). Within the accounting field of research, there has as such been a lack of interest in examining the potential of recognizing customer equity as an intangible asset, however, research on intangible assets in general has been popular for long.

The rise of intangible assets has been a subject of discussion within the accounting field of research since the 1980s (Lev, 2018). Research has shown that financial statements provide insufficient information about intangible assets – assets that are growing both in terms of size and importance – and such lack of information leads to significant costs to companies, investors and society as a whole (Lev, 2003; Amir et al., 2003). Furthermore, Amir et al. (2003) conclude that although there is substantial information available beyond financial reports, this information does not compensate for all the intangible-related deficiencies in the financial statements. According to Lev (2003), the potential solutions to the current problems with intangible-related deficiencies are on-balance-sheet accounting and/or additional disclosures.

An argument for the prudent accounting of intangibles has been its uncertainty, which has led to the “conservative” immediate expensing of such assets (Lev, 2003). However, in 2018, Lev stated: “Consider the accounting absurdity: the major value creators of modern businesses, like R&D, brands, or IT, are treated as salaries or interest expenses having no future benefits, whereas the ‘commoditized’ tangible (fixed) assets — marginal value creators because they are available to all competitors — are capitalized” (p.2). Lev (2018) further claims that: “It’s hard to find more outdated and harming accounting and reporting rules than those pertaining to intangible investments” (p.22). Unlike tangible assets, intangible assets are ignored by most measurement conventions and although there are arguments for being prudent about intangible assets, the fact that intangibles have become all the more significant and widespread means that capitalism is now measured without counting all the capital (Haskel and Westlake, 2018).

Lev (2018) identifies two main factors for the lack of change-incentives and the related absence of a change in the accounting of intangible assets. Firstly, policy makers and regulators generally react to crises, whereas the rise of intangible assets has been a gradual transformation since the 1980s and is still in progress. Secondly, it is a concern to managers being required to stand accountable for the value changes of capitalized intangibles if recognized on the balance sheet. According to Lev (2018), investors will benefit from an intangibles rule change, but they are too fragmented to exert pressure on standard-setters. Damodaran (2018) identifies a difference between investors in publicly traded companies and venture capitalists in terms of power to extract information from managers, meaning that the smaller investors should benefit from customer-related disclosures.

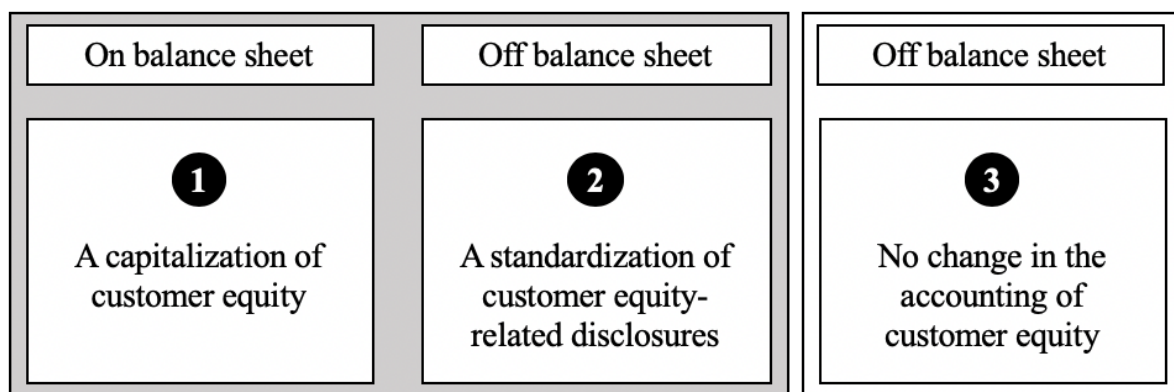
As aforementioned, customer equity as an intangible asset has, to our best knowledge, only attracted the attention of a limited number of accounting researchers such as Bonacchi et al. (2015). According to Bonacchi et al. (2015), customer equity is a major intangible asset missing from the balance sheet, since it has become a significant element of the subscription-based business model; an indicator of future profitability and containing essential information relevant to the valuation of SBEs. Bonacchi et al. (2015) continue: “As SBEs are quickly expanding their role in the economy, they are likely to attract attention from both investors and regulators” (p.1024). In their study, Bonacchi et al. (2015) introduce a model that translates the main drivers of SBEs, namely average revenue per customer, cost per customer acquisition, cost of service, and churn, into a measure of customer equity (stated as customer franchise value). Applying the model to companies that voluntarily disclose customer metrics, the authors show that the value of the customer equity measure is positively and significantly associated with the market value of the company and future earnings. Furthermore, the authors state that standard setters should find the analysis helpful in identifying and recommending new disclosure items, which is considered salient as companies voluntarily are disclosing certain customer-related data with a lack of uniformity and consistency. Bonacchi et al. (2015) continue and state that the inconsistency makes “an efficient analysis and valuation of SBEs challenging and, in the case of nondisclosures, nearly impossible” (p.1025). The problems with the current situation of non-standardized customer-related disclosures are discussed by Schilit et al. (2018). For instance, there are several ways to define a “user” in the Average Revenue Per User (ARPU) metric, enabling companies to manipulate their calculations to generate exaggerated figures, in turn deteriorating the comparability of the metric (Schilit et al., 2018). As such, Bonacchi et al. (2015) and Schilit et al. (2018) shed light on issues with the current way in which companies handle customer metrics, which makes it an area of interest for accounting research.

Finally, given the phenomena studied in this thesis being an accounting issue, it was deemed important to consider the Conceptual Framework for Financial Reporting by the International Accounting Standards Board (IASB, 2018) and to bear this framework in mind when assessing the need for, and usefulness of, a new way of accounting for customer equity. Based on the Conceptual Framework for Financial Reporting (IASB, 2018), the fundamental qualitative characteristics of financial information are relevance and faithful representation. Relevance is fulfilled when the financial information is capable of making a difference in the decisions made by users, while faithful representation is fulfilled when the financial information faithfully represents the substance of the phenomena that it purports to represent. As such, if financial

information is to be useful, it must both be relevant and faithfully represent what it is supposed to represent. In addition, comparability, verifiability, timeliness, and understandability enhance the usefulness of financial information. Furthermore, IASB (2018) states that reporting financial information imposes costs on users of financial reports and it is crucial that the benefits of reporting information justify these costs.

## 2.2 Theoretical Framework

In this section, the framework that is to constitute the foundation of the study is presented. The literature overview implies that necessary action towards the accounting of intangible assets is required (Lev, 2003). Customer equity can be viewed upon as such an intangible asset that should be included on the balance sheet (Bonacchi et al., 2015) and in terms of a change in the current accounting of customer equity, two main alternatives have been identified: (1) a capitalization of customer equity on-balance, and (2) a standardization of customer-equity related disclosures off-balance. A third alternative serves the purpose of making the framework as collectively exhaustive as possible, and hence is (3) no change in the accounting of customer equity. The study will examine the feasibility of the first (1) and second (2) alternative, according to the different stakeholders affected by a change in the current accounting, to conclude if any of the alternatives would be more beneficial for any of the stakeholders, compared to alternative three (3), which is to remain in status quo. Therefore, the study will also examine if any explanations for alternative (3) can be identified, to explain the lack of action (Lev, 2018) regarding the accounting of intangible assets, such as customer equity.



**Figure 3.** Theoretical Framework

When weighing the benefits against the costs in developing a new standard, the International Accounting Standards Board seeks information from providers of financial information, users,

auditors, academics, and others regarding the expected nature and quantity of the benefits and costs (IASB, 2018). As such, in this study, the aforementioned alternative ways of accounting for customer equity will be examined from the perspectives of different stakeholders to subscription-based enterprises. The relevant stakeholder groups have been determined to be: 1) Equity Research Analysts, 2) Managers in Subscription-based Enterprises, 3) Investors, and 4) an Accounting Expert. Equity research analysts and investors are the users of financial reports and as such, accounting for customer equity is assumed to bring usefulness to them in terms of providing equity research analysts with more relevant information and enhancing investors' decision-making. Accounting for customer equity could be useful for managers, as it would enable them to disclose on-balance items or off-balance disclosures that are in line with the value-creation of the firms. In contrast to the previous stakeholders, accounting for customer equity would not directly bring usefulness to the accounting expert, instead, (s)he serves the purpose of providing a broader perspective on the subject in terms of representing an accounting standard-setting body.

### **3. Method**

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*In the following section, the applied research method is presented. Section 3.1 presents the chosen research methodology, section 3.2 presents the data collection, and section 3.3 presents a discussion of the quality of research.*

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#### **3.1 Research Methodology**

Customer equity is, as aforementioned, a relatively unexplored subject within the accounting field of research (Gleaves et al., 2008). Due to the early stage of the subject and the lack of data, a quantitative method was considered to be inappropriate and instead, a qualitative method was chosen, in line with Flick (2009). Furthermore, the qualitative research method is used in an inductive way to gain an understanding of a phenomenon of interest (i.e. customer equity), from the perspective of those who are affected by it (i.e. the stakeholders) (Mills and Birks, 2014). The findings from this qualitative research relate to a certain context which allows a specific expressiveness, however, the findings cannot be generalized outside of this context (Flick, 2009).

According to Lewis and McNaughton Nicholls (2014), interviewing is “a core, and effective, method of qualitative data collection” (Ritchie et al., 2014, p.55). In this study, semi-structured interviews (Alvesson and Deetz, 2000) were used as the method to collect the qualitative data, because of the method’s flexibility combined with its structure and the possibility to ask supplementary questions (Gillham, 2005). Furthermore, the conducted interviews can be defined as expert interviews, which is a form of semi-structured interviews, where the interviewees represent a group of experts and their expertise within a specific field are of greater importance than the interviewees themselves (Flick, 2009). The interviews loosely followed an interview guide with predetermined, open questions that enabled deviations and improvised follow up questions depending on the interviewees’ responses. The questions in the interview guide were formulated in accordance with the recommendations by Yeo et al. (2014); to utilize open, clear and non-leading questions (Ritchie et al., 2014).

## 3.2 Data Collection

### 3.2.1 Primary Data

The study is based on eight interviews conducted during the period February to April 2019. The duration of the interviews ranged from 30 minutes to 62 minutes, with an average of 44 minutes and a median of 43 minutes. The interviews were held with nine professionals from four different stakeholder groups: 1) Equity Research Analysts, 2) Managers in Subscription-based Enterprises, 3) Investors, and 4) an Accounting Expert. The purpose of selecting interviewees with different roles and experiences, i.e. different stakeholders, was to cover as many perspectives as possible to incorporate different views and opinions.

<b>Equity Research Analysts</b>	<i>Interviewee</i>	<i>Bank</i>	<i>Covering</i>	<i>Date</i>
	Analyst #1	Nordic Bank A	SBE-1	20/02/2019
	Analyst #2	Nordic Bank B	SBE-1	06/03/2019
	Analyst #3	Nordic Bank C	SBE-2	29/03/2019
<b>Managers in SBEs</b>	<i>Interviewee</i>	<i>Company</i>	<i>Role</i>	<i>Date</i>
	Manager #1	SBE-2	Head of Group Controlling	14/03/2019
	Manager #2	SBE-3	CEO	05/03/2019
<b>Investors</b>	<i>Interviewee</i>	<i>Investment Firm</i>	<i>Role</i>	<i>Date</i>
	Investor #1	Investment Firm-1	Investment Manager	05/04/2019
	Investor #2	Investment Firm-2	Executive Vice President, Business Development	08/04/2019
	Investor #3	Investment Firm-2	Corporate Finance Director	08/04/2019
<b>Accounting Expert</b>	<i>Interviewee</i>	<i>Role</i>		<i>Date</i>
	Expert #1	Member of the Swedish Accounting Standards Board		05/03/2019

**Table 1.** Overview of Interviewees

The equity research analysts and managers have connections to specific SBEs (SBE-1 to SBE-3), however, the aim is not to examine these specific subscription-based enterprises themselves, instead, the companies are representing SBEs in general. Nonetheless, these companies have a subscription-based business model, are stationed in Sweden, and are operating in one of two high-growth industries; the music streaming industry and the digital publishing industry.

Within the stakeholder group ‘Equity Research Analysts’, three interviews were held with analysts stationed in Stockholm, Sweden. All three analysts work full time with analyzing and valuing companies. Each of them works at different Nordic banks, which eliminates the risk that two analysts are working as close colleagues and as such would give answers that are too interrelated. One analyst is covering SBE-1, the second analyst has covered SBE-1 and the third analyst is covering SBE-2. As such, the equity research analysts were chosen on the basis of their experiences of valuing subscription-based enterprises. The presumption when contacting equity research analysts was twofold: 1) customer data should be important to equity research analysts, as it is one of the inputs in their company valuations and, as such, 2) since they are valuing subscription-based enterprises, they should be affected by a change in the accounting of customer equity (McCarthy et al., 2017; Bonacchi et al. 2015).

Within the stakeholder group ‘Managers’, interviews were conducted with representatives from two subscription-based enterprises stationed in Stockholm, Sweden; the Head of Group Controlling at SBE-2 and the CEO at SBE-3. The interviewees were chosen on the basis of their experience of, and internal perspective from, subscription-based enterprises; the Head of Group Controlling at SBE-2 is analyzing and forecasting the economic performance of the company and the CEO at SBE-3 possesses operational expertise and overall knowledge of all parts of the company. In addition to their valuable insights, managers, as a stakeholder group, were chosen based on the presumption that they would be highly affected by a capitalization of customer equity and hence have strong opinions regarding the subject. For example, Lev (2018) states that: “Reporting the capitalized intangibles on the balance sheet and being exposed to questions about changes in their value is obviously of concern to managers” (p.19). Hence, the literature implies that managers are reluctant towards presenting uncertain items on the balance sheet, as they do not want to be subjects of impairments.

Within the stakeholder group ‘Investors’, two interviews were held with Stockholm-based investors with experience of subscription-based enterprises. At one of the interviews, two

investors from the same investment-firm (Investment Firm-2) were present, and as such, in total three investors were interviewed. The investors were chosen on the basis of them working at investment firms currently investing, or contemplating on investing, in SBEs. The main focus of Investment Firm-1 is growth investments and therefore, many of their portfolio companies are newly founded and have subscription-based business models. The main focus of Investment Firm-2 is long-term ownership and hence, the portfolio mainly consists of mature companies. Nonetheless, Investment Firm-2 is currently in the process of transforming the revenue models of several companies within their initial portfolio to subscription-based models, in addition to investing in new SBEs. As such, the interviewed investors all possess an overall understanding of SBEs and the subscription-based business model. Furthermore, according to the literature, investors as a stakeholder group play a crucial part; Bonacchi et al. (2015) state that: “As SBEs are quickly expanding their role in the economy, they are likely to attract attention from both investors and regulators” (p.1024). Furthermore, Wiesel et al. (2008) state that investors will be affected by firms’ reporting of customer equity since it enables them to monitor firms’ performance with respect to their customer assets.

Finally, within the stakeholder group ‘Accounting Expert’, one interview was conducted with a member of the Swedish Accounting Standards Board, specialized within financial reporting. The interviewee was chosen on the basis of his/her expertise from working with accounting issues and his/her overall knowledge about accounting regulation. Furthermore, it was deemed necessary to incorporate the perspectives from an accounting standard-setting body that has the power to implement new accounting standards and therefore possesses knowledge and experience useful for this study.

### *3.2.2 Secondary Data*

Complementary to the conducted interviews, secondary data used in this study constituted of equity research documents (e.g. initiating coverage of SBEs), accounting standards reports and company information (e.g. annual reports). The documents served a purpose of enhancing the understanding of the stakeholders’ different perspectives. Additionally, the secondary data was a way to scan the landscape, to explore which kind of customer data was public, and to what extent, at the time of the study and how such data was regulated.

### **3.3 Quality of Research**

In terms of quality of research, validity and reliability are central concepts (Ritchie et al., 2014). Validity is defined as to which extent the findings accurately reflect the phenomenon observed, whereas reliability is defined as the replicability of the findings (Ritchie et al., 2014). In terms of validity, the sample included in the study is limited to nine interviewees and hence, their individual perspectives and experiences might not be representative for the whole population. As such, if the study was replicated using other stakeholder representatives, i.e. other interviewees, the findings might not be identical to the research findings in this study. However, qualitative research methods are often associated with complex subjects being studied with the inevitable impact of context and thereby, the discussion of replication of qualitative research is problematic and, according to some researchers (Lincoln and Guba, 1985), even considered to be naive (Ritchie et al., 2014). However, Ritchie et al. (2014) state that unless there is some chance of a successful replication of a study, the wider relevance of the subject studied might be doubtful. In terms of reliability and valid interpretations, the quality of recording and documenting data is essential (Flick, 2009). Therefore, all interviews were recorded and during the interviews, detailed notes were taken. All interviews were later transcribed to ensure that the data could be reviewed (Gillham, 2005). Furthermore, both authors of this study were present during all interviews, in order to eliminate as much subjectivity as possible.

As previously mentioned, the findings from this qualitative research relate to a certain context which allows a specific expressiveness, however, the findings cannot be generalized outside of this context (Flick, 2009). According to Lewis et al. (2014) qualitative research cannot be generalized on a statistical basis and nor is that the objective of such research. The objective is, on the contrary, to reveal the breadth and nature of the phenomena under study (Ritchie et al., 2014).

## 4. Empirical Findings

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*In the following section, the empirical findings are presented. The section is divided into subsections based on different themes that were brought up during the interviews. The empirical findings will later constitute the basis of the analysis.*

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### 4.1 The Subscription-based Business Model

#### 4.1.1 The Expansion of SBEs

The empirical findings suggest that the number of subscription-based enterprises is growing rapidly and is expected to continue to do so.

*“Many newly founded firms try to implement such a [subscription-based] business model and traditional firms with a different revenue model are trying to readjust [towards a subscription-based model].” – Investor #1*

*“If we [the investment firm] are interested in a company we always evaluate if it would be possible to shift the business model towards recurring revenues. [...] We seek after such [recurring revenue-based] firms or firms where we can implement such a [recurring] revenue model.” – Investor #2*

Furthermore, the subscription-based business model is not only growing in popularity among firms but also among customers.

*“[Customers] want products and services on demand. [Customers] want to subscribe and have access to products and services whenever they need it, to the latest version. It really coincides; what customers demand and what suppliers offer.” – Investor #1*

#### 4.1.2 Characteristics of SBEs

The interviewed stakeholders mentioned several characteristics of SBEs, of which the recurring revenue model was the most significant. The interviewees emphasized that the recurring

revenue feature leads to less risk when assessing the future revenues compared to a traditional revenue model.

*“The risk is lower [in subscription-based enterprises]. That is the reason for the high market prices; you have to pay for the lower risk. For example, if I have a business where I hope a customer will make a purchase tomorrow as well, versus if I have a business where the customer has signed up for a subscription, there is a large difference in risk. In the first case, you do not know if you will get any future revenues and you have to invest in the customer each day, versus in the second case, where you have a customer base that has signed up and that you know will generate revenues in future periods.”* – Investor #1

*“It is easier to estimate next year’s profit [in subscription-based enterprises]. Deviations from [estimations] are often low for subscription-based enterprises.”*  
– Analyst #1

Nonetheless, a common characteristic for many SBEs is that they also are in a phase of high growth, which on the other hand involves uncertainty.

*“[Being growth companies], there is remarkably more uncertainty in these subscription-based companies, compared to [large, old and mature industrial companies], of which we have a relatively good picture. At [SBEs] we do not even know which countries they will operate in within two years.”* – Analyst #3

Being in a high growth phase further results in SBEs often making losses, as the firms are investing in customer acquisitions today, which will yield revenues and profits in the future. Hence, the SBEs in growth phases are planning on harvesting the benefits in the future; benefits that are generated by large investments and losses made today.

*“[The SBE] might not be profitable today but one must take the [growth] model into consideration; the firm will be profitable over time once a certain volume is reached. [...] It is according to plan that [the SBE] will not make money today but instead invest in the product and the customer base, pursuing a strategy where [the SBE] will show negative results during [a couple of] years and once a [certain*

*amount of] subscribers are reached, the [results] will start to rocket. Within the next [number of] years, the accumulated net profit will be much higher compared to a traditional model where [the SBE] would have aimed at being profitable from day one. The [growth] model requires persistence during the first phase until [the SBE] reaches breakeven.” – Investor #1*

## **4.2 The Use of Customer Data in Practice**

### *4.2.1 Customer Metrics*

The interviewed managers, equity research analysts and investors all use some kind of customer lifetime valuation method, primarily as a key metric to measure the performance of the SBEs.

*“One of our key metrics is CLV/CAC [customer lifetime value divided by the customer acquisition cost]. That quotient discloses whether we are creating value or not.” – Manager #1*

One manager expressed that the customer lifetime value is used to attract investors.

*“For us to get financing from investors, we have to show a lifetime value that is a few times multiple of the customer acquisition cost: Are we able to obtain a customer to the right customer economics?” – Manager #2*

Furthermore, the same manager explained that (s)he only uses the CLV/CAC metric and does not discount CLV to receive customer equity. Nonetheless, the manager believed that customer equity was something investors considered.

*“[The CLV/CAC key metric] is easier to communicate. We sell the dream of an investment and too complicated valuation models do not add any value. The investment banks make all the necessary calculations. I am sure they have already discounted the [customer lifetime] values and made other assumptions. The type of investors engaging in these kinds of companies [SBEs] definitely look at [customer equity]. – Manager #2*

One of the equity research analysts stated that (s)he uses customer lifetime value as a key metric, in line with the managers.

*“Customer lifetime and CAC [customer acquisition cost] are used to see if the company is moving in the right direction, meaning whether they are doing the right things.” – Analyst #1*

The empirical findings suggest that investors take the customer base into account at the time of the initial investment, after which the customer lifetime value and similar metrics are used as key metrics to monitor the SBE’s operational performance. Furthermore, there was a consensus among the interviewed investors regarding the importance of the customer base when valuing a firm.

*“I believe there is a large value in the customer base. [...] In different firms with the same level of sales and similar balance sheets but completely different type of customer bases, one must take the customer base into account when valuing the different companies. Different customer bases yield completely different values of the companies.” – Investor #1*

#### 4.2.2 Customer Data in Company Valuation

One equity research analyst stated that a bottom-up valuation of the customer base is a core component of the valuation of a subscription-based enterprise. The equity research analyst in question explained that (s)he did a number of bottom-up valuations based on different scenarios. Then, if one of the core assumptions in the model turned out different than expected, the equity research analyst could act on that, e.g. give buy or sell recommendations.

*“Of course you have to do a bottom-up valuation. [...] You need to create a reasonable range of scenarios used as a starting point. Then you need to think about your assumptions: Which scenario would increase the valuation? What factor am I worried about that would yield a lower value? I give buy and sell recommendations based on the assumptions that are crucial to me.” – Analyst #2*

The other interviewed equity research analysts suggested alternative methods, emphasizing the usefulness of multiples. Furthermore, the empirical findings suggest that the valuation

techniques used on SBEs differ from the methods equity research analysts use on non-subscription-based companies. Since many SBEs are making negative profits, due to the large customer acquisition costs, profitability metrics are problematic to use. Instead, one equity research analyst suggested that one can look at, for example, sales multiples such as EV/Sales [enterprise value divided by sales].

### **4.3 Comparability**

#### *4.3.1 Uncertain Estimates*

An issue raised by all interviewees regards the uncertainty of customer equity. The accounting expert pointed out that although customers of SBEs have signed up for subscriptions, they are not necessarily bound by contract. For instance, not all subscriptions have a period of notice and in such a case, a customer can terminate the subscription at any time, deteriorating the reliability in the calculated value of customer equity if recognized on-balance. The accounting expert stated that customer equity does not necessarily meet the requirements of an intangible asset and stressed that including uncertain items on the balance sheet must be done with great caution, referring to the financial crisis and scandals relating to intangible assets. The accounting expert further proposed that disclosing key metrics regarding the customer base off-balance instead might be sufficient enough in terms of bringing value to the users of financial reports.

*“Those [e.g. investors] who use this [customer-related] information, do they really need [customer equity] to be on the balance sheet to get an idea [of the performance and outlook] of the company?” – Expert #1*

However, regarding the current way in which companies disclose customer metrics, equity research analysts, managers, and investors expressed their concern about the arbitrariness in the underlying assumptions of customer equity calculations, e.g. how many months a customer will pay for the service. Furthermore, the concern of arbitrariness was justified by the opaqueness in SBEs’ reporting of such customer metrics, as none of the firms are transparent with their calculations.

*“None of the firms explain how they do the underlying calculations of the customer lifetime valuation. Sometimes I get surprised: How can they report such a high*

*figure? [...] Given the fact that they are not transparent with their calculations, I assume the estimates are very uncertain.” – Analyst #3*

Nonetheless, the same equity research analyst expressed that, regardless if the firms are transparent with their estimates or not, it is extremely difficult to forecast the behavior of the customers within industries of high growth, i.e. the kind of industries that many SBEs are active in.

*“If the company has not been around for long and most of the subscribers have been customers for only two or three years, how long will they stay loyal? How will the price develop in the future? Customer lifetime valuation is associated with uncertain estimates. [...] In general, these kind of firms [SBEs in growth phases] are associated with a lot more risk than industrial companies.” – Analyst #3*

Another equity research analyst commented that, as long as it is not clear how firms calculate customer metrics, such financial reporting information is useless from a firm valuation perspective, due to the lack of comparability.

*“If firms calculate customer metrics differently, such precalculated figures will be impossible to consider when valuing a company. I must understand how the metric is calculated. [...] I have to do a bottom-up calculation of the customer base myself.” – Analyst #2*

One manager confirmed that no industry practice exists regarding the calculation and reporting of customer metrics. Furthermore, when producing internal forecasts, the manager commented that (s)he tries to back-track peers’ estimates when possible and uses this information combined with internal historical data to decide upon which estimates to use.

*“There is no industry practice regarding how many months to use when calculating the customer lifetime value. It is discretionary. [...] We usually use [x] months. [A peer company] had a presentation showing some graphs of customer lifetime and customer acquisition cost. We back-tracked their calculations and they also use [x] months.” – Manager #1*

Further, all interviewed investors stated that they do the calculations of customer metrics themselves, regardless whether the SBEs present customer metrics or not, since even if SBEs disclose them, there are remarkable differences in how firms calculate these numbers.

*“The comparability [issue] is difficult to solve, I believe. [...] What type of subscription have the customers signed up for? Is it paid on a monthly basis or is it a three-year deal with automatic prolongation? These yield completely different values [and have] different certainty.”* – Investor #1

The investor also explained that when newly founded SBEs pitch their companies to the investment firm, the SBEs’ own calculated numbers often deviate from the calculated numbers the investor later produces, but not necessarily because the SBEs want their firms to look more favorable, but perhaps because the companies in such an early phase might have done incorrect calculations.

*“[For example, these] companies might not have handled the data in the right way, [or might have] used the right methods but on the wrong data.”* – Investor #1

#### *4.3.2 Unwillingness to Disclose Data*

Demanding companies to disclose data about customer equity in a specific way would make these figures comparable across companies. Nevertheless, one of the managers expressed an unwillingness to disclose such data, due to an unwillingness to make some information available to competitors.

*“It might be good to be transparent with the fact that we are creating value [despite reported losses]. However, we would not be keeping our business secrets, as competitors would get very much insight. We do not want to disclose how long our customers stay nor differences in our gross margins on different contracts since we are not allowed to discuss our deals with our competitors.”* – Manager #1

#### *4.3.3 Prerequisite for Change*

The accounting expert stated that a lack of comparability is a common reason for a new accounting standard, or a change in the current regulation.

*“A key driver [for a change in accounting regulation] is divergence in practice; when rules are applied differently in different companies. It is not a problem if something is unregulated, as long as companies apply the same methodology. It is of utmost importance that the accounting is comparable.” – Expert #1*

However, the empirical findings suggest that a change towards a uniform way of calculating and disclosing customer equity, either on-balance or off-balance, would be difficult to implement, due to the uncertainty in the underlying estimates.

*“[Customer equity] involves estimates, it is not an exact science such as the balance sheet and income statement, where one establishes facts from the present time. I believe it will be difficult to find a way to standardize [customer equity] and even more difficult to regulate it. It would be desirable but not doable, due to the estimates. A company would probably not dare to present anything [regarding customer equity] if they legally would be held against their word on what figure they stated, since the figure would only be a best guess.” – Investor #1*

Furthermore, the same investor stated that the value of a new customer differs depending on the outlook and the opportunities for the subscription-based enterprise to cross-sell, which in turn depends on the type of industry the SBE is active within. Therefore, the empirical findings suggest that it will be difficult to standardize the valuation method of the customer base since one cannot generalize across different industries.

*“If I have a customer base buying socks, I might be able to cross-sell t-shirts, but the potential future value of such a customer base is limited. On the other hand, if I have subscribers buying a financial service, they might start with a car loan, then mortgage, savings, fund savings, and insurance. Such a customer is more worth from day one. [...] [Therefore I believe] that [investors] should continue to do individual assessments of SBEs and customer bases, and that one should not generalize metrics across different firms that probably should not be generalized.”*  
– Investor #1

Another investor expressed a concern about implementing a new accounting standard regarding capitalization of customer equity. For instance, (s)he emphasized that such a change would require extensive efforts and might cause inconveniences for the stakeholders involved.

*“I have a hard time picturing how one could implement [such an accounting change as capitalizing customer equity] without having to include a giant note underneath [the recognized item] showing the calculations, which you would have to dig into. The small investor and savor might not cope with that. [...] [Capitalizing customer equity] will lead to even more items that will just be impaired and show up in D&A [depreciation and amortization]. It would be tough, it would not be possible to compare current and historical figures. It would increase the workload for the companies who would have to report two metrics; one before [an accounting standard change] and one after.”* – Investor #3

#### **4.4 Potential Change in Regulation**

##### *4.4.1 Driving Change in Regulation*

A question discussed during all interviews was whether a change in regulation regarding customer equity as an intangible asset is necessary, as well as who, in that case, should be the one taking initiative to change the regulation. The accounting expert suggested that the ideal would be that users of financial reports would be the ones taking initiative. Nonetheless, stakeholders must consider whether driving the change in regulation is worth the efforts. In the empirical findings there is no evidence of managers, investors nor equity research analysts having incentives to drive such a change.

*“[A change in regulation] is not something I would put time nor energy on. [...] I will not be the one asking for more regulation.”* – Manager #2

*“I think [such a regulation] would make things more difficult, [for example] historical data would no longer be comparable.”* – Investor #3

*“[A change in regulation] is not something I have thought about. Accounting rules exist and we just simply follow them.”* – Analyst #3

Furthermore, the interviewed accounting expert explained that a crisis often causes a rapid change in accounting regulation, as in the financial crisis. Changes in accounting regulation in other cases can be a much more protracted process. Since the issues with intangible assets have been discussed for decades, a rapid change in regulation regarding customer equity is not probable.

#### *4.4.2 Risk of Companies Misusing Change in Regulation*

A concern most stakeholders shared regarding customer equity being recognized on the balance sheet as an intangible asset was that such a permission could be severely misused. If the calculation of customer equity is not sufficiently regulated, the value of the asset – customer equity – would not be reliable.

*“If this is going to work [we] must have a mutual approach of how it should be done so that [companies] cannot play ugly and disclose inflated values.” – Manager #1*

In addition to the risk of other companies misusing customer equity if recognized on-balance, the manager also stated that (s)he would not want to include customer equity on the balance sheet, since (s)he would preferably avoid large revaluations.

*“I prefer an EBITDA close to cash, rather than having large revaluations [of customer equity].” – Manager #1*

Furthermore, one equity research analyst confirmed that a slim balance sheet was preferred, i.e. to not include uncertain items on the balance sheet.

*“[In my opinion] a slim balance sheet is better than blowing up a bunch of assets that might not last.” – Analyst #3*

#### **4.5 Facilitation of Financing**

Loan financing might be difficult for subscription-based companies since there is not much capital that can be used as collateral. The managers expressed that if customer equity was recognized on the balance sheet, it could enable easier loan financing.

*“A large asset [customer equity] on the balance sheet would make it easier to get financing.”* – Manager #1

Nonetheless, the accounting expert expressed his/her concern when it comes to using uncertain assets, such as customer equity, as collateral due to the uncertainty in the item.

*“The question is: Would one really want to lend money based on the customer base?”* – Expert #1

#### **4.6 Different Investor Groups**

According to the empirical findings, companies disclosing data in different ways is not a problem for professional investors, such as those interviewed. These investors have the capability and resources to evaluate the SBEs on their own, beyond the scope of what is disclosed by the companies.

*“For the type of investors that we are, [the fact that companies disclose data in different ways] is not really an issue since we look beyond that to see what is underneath.”* – Investor #1

Another investor expressed that regardless of which metrics the companies disclose, they do the calculations themselves. This is, according to the investor, also true if companies would report standardized customer metrics; the investor stated that (s)he would still do the calculations himself/herself, although it would be beneficial to receive some key ratios disclosed in a uniform way, such as recurring revenue per month.

*“We always do the calculations ourselves.”* – Investor #2

*“We trust the companies, but we need to have our own estimates.”* – Investor #3

Furthermore, one manager stated that professional investors are not concerned with the losses that many SBEs are making – losses that arise from having to expense customer acquisition costs. According to the manager, professional investors can determine whether a company is creating value or not, regardless if the company is reporting a loss. One of the interviewed investors explained that subscription-based enterprises making losses in the first year(s) is

natural since most of them are in a growth phase. These losses, that result from large costs of attracting customers, are simply large investments for the future, since the aim is that the acquired customers will stay and generate revenues for the SBE over a long period of time. Hence, as long as one understands the subscription-based business model, the losses the SBEs are making are insignificant when determining the outlook of the companies.

Nonetheless, one manager stated that it can be more difficult to explain such losses to small investors and savers who do not have the same insight to SBEs and the subscription-based business model. Furthermore, the manager stated that for companies that are mainly financed by small savers, it could be beneficial to recognize customer equity on the balance sheet to avoid expensing the customer acquisition cost immediately and, hence, increase the net income.

*“For a middle-sized player financed by small savers [it can be] tough to explain that [the company] is only making losses.” – Manager #2*

Furthermore, one of the interviewed investors suggested that such small investors and savers might be misled by the non-standardized way in which companies disclose data and information.

*“Some [SBEs] highlight their customer base, even if it is not presented on the balance sheet or in the income statement, but through pitches, on their websites, in investor memos etc. Then there is a risk that if you are a small saver and not as informed, you can get persuaded by how fantastic the customer base is, which could lead to overpricing.” – Investor #1*

## 5. Analysis

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*In the following section, the empirical findings are analyzed in relation to the literature. The empirical findings are discussed with regards to factors impacting the stakeholders' different views on accounting for customer equity on-balance and off-balance. Furthermore, the views of the different stakeholder groups are discussed and later summarized.*

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### 5.1 Divergence in Literature and Practice

The marketing literature emphasizes the importance and usefulness of customer metrics such as customer equity. As previously mentioned, Silveira et al. (2012) and Zhang (2016) describe customer equity as a good proxy for the market value of companies. Furthermore, Bonacchi and Perego (2012) identify customer equity as the most important asset for subscription-based enterprises. Although there is a limited amount of research on customer equity within the accounting field, and instead much on intangible assets in general, Bonacchi et al. (2015) state that customer equity is a major intangible asset missing from the balance sheet, since it has become a significant element of the subscription-based business model. As such, the literature suggests that customer equity should be an intangible asset on the balance sheet of subscription-based enterprises, or in other ways disclosed in the financial reports. Nonetheless, as of this writing, there is no common practice for how to calculate customer metrics, nor is customer equity regulated as an intangible asset. The sentiment for a capitalization of customer equity within different stakeholder groups can partly be explained by discussing the question of why there has been no change in the direction of what the literature suggests, shedding light on the fact that no stakeholder has undertaken any change initiative. After discussing the reasons for the lack of change in the past, the analysis will continue to discuss the implications and sentiments for capitalizing customer equity and, thereafter, for a uniform customer equity-related disclosure off-balance.

### 5.2 A Gradual Transformation, Confidentiality and Comparability

There is a consensus in the literature and the empirical findings that accounting regulation often follows as a response to a crisis. Lev (2018) states that policy makers and regulators generally react to crises, whereas the rise of intangible assets has been a gradual transformation, which is one of the main factors for the lack of change-incentives and the related absence of a change in the accounting of intangible assets. The accounting expert's statement agrees with the literature,

emphasizing that rapid changes in regulation are often caused by crises, whereas intangibles have been growing gradually. Hence, one explanation for the lack of regulation or common practice in the accounting of certain intangibles, such as customer equity, might be the successive emergence of the concept. Nonetheless, subscription-based businesses are growing at a rapid speed, at 200 percent annually since 2011 (Fader and McCarthy, 2017), which could indicate a growing demand for a change in the accounting of customer equity in the future.

Lev (2018) states that another factor for the lack of change-incentives, and the related absence of a change in the accounting of intangible assets, is that managers are reluctant towards capitalizing intangibles since they do not want to stand accountable for the associated value changes. This statement is supported by the empirical findings, where managers comment that although subscription-based enterprises might create value according to metrics such as the CLV/CAC [the customer lifetime value divided by the customer acquisition cost], the managers would rather expense customer acquisition costs directly and present negative results, than show positive results by capitalizing customer equity and consequently be subjects of impairments. One manager concluded that when weighting a positive result in the income statement against potential impairments, (s)he would rather avoid the latter than benefit from the first. Furthermore, the empirical findings suggest that managers are reluctant towards a change in accounting regulation of customer equity, since they preferably would not disclose the underlying assumptions and calculations of the customer equity value, as doing so is associated with disclosing business confidentialities to competitors.

Nevertheless, the reluctance towards disclosing required data leads to a lack of comparability across companies' disclosed customer metrics, as one cannot compare metrics that are calculated in different ways. This is in line with Bonacchi et al. (2015), who imply that customer equity-related metrics are not comparable across companies. Furthermore, one manager confirmed that there is no common practice for how firms calculate customer metrics and the empirical findings suggest that in the cases of companies disclosing such metrics, the majority of them do not disclose any further explanations to the figures. Nonetheless, comparability is one of the key drivers of changes in accounting regulation. The accounting expert points out that the purpose with accounting regulation is to regulate situations where there is a lack of comparability across companies' financial reporting. The lack of comparability and the opaqueness in disclosed customer metrics are problematic for users of financial reports, e.g. equity research analysts and investors, as they cannot back-track the companies' underlying

calculations nor compare different companies' reported figures. The empirical findings suggest that the only way in which customer-equity related reporting, on-balance or off-balance, would generate value to the users of financial reports, is if the figures are comparable and transparent across companies, as such being relevant and faithfully representative (IASB, 2018). For example, one equity research analyst expressed that when valuing a subscription-based enterprise, the company's own customer metrics are disregarded due to the opaqueness in the figures and instead, the analyst calculates the metrics from scratch to be able to modify the underlying assumptions. Investors expressed similar concerns regarding the comparability in the current way in which companies disclose customer metrics, and stated that they, as well, calculate the metrics themselves when contemplating on investing in a company. Despite the fact that managers might be at a disadvantage if reporting customer equity in a uniform way, this transparency in the figures, however, is required to make customer equity comparable across companies, and as aforementioned, users of financial reports would only benefit from customer equity in the financial reporting if such transparency would exist.

### **5.3 The View Upon Customer Equity as an Intangible Asset On-Balance**

Bonacchi et al. (2015) state that customer equity is a major intangible asset missing from the balance sheet. In contrast to this statement, the empirical findings suggest a reluctance – among all the stakeholders – towards defining customer equity as an intangible asset that should be reported on-balance, despite potential benefits such as facilitation of financing.

Regarding the characteristics of subscription-based enterprises, the empirical findings suggest that the recurring revenue model is associated with low risk, as it enables more precise forecasts of future revenues. However, the empirical findings simultaneously suggest that many SBEs are newly founded firms in phases of high growth, which makes long-term price development challenging to predict. Furthermore, one equity research analyst stated that newly founded firms have less historical data to use as basis for forecasts, making it difficult to analyze historical customer behavior. Mature, industrial companies were used as a contrasting example, where customer behavior is perceived as much more stable. With price development and customer behavior being two main factors to consider when calculating customer equity, the uncertainty in these factors ultimately leads to uncertainty in the customer equity value. As such, the empirical findings suggest that customer equity and customer-related metrics are useful when keeping track of company performance, however, customer equity is, according to all the interviewees, presumed to be too uncertain to qualify as an intangible asset to be recognized

on-balance. The accounting expert added that one must take into account that although customers have signed up for subscriptions, they can – depending on the notice period – terminate their subscription at any time and therefore, the estimate of customer lifetime is highly uncertain. Therefore, according to the accounting expert, customer equity does not necessarily meet the requirements of an intangible asset due to the concern regarding uncertainty. Such opinions from an accounting perspective have also been identified in the literature (Lev, 2003), where uncertainty is the main factor behind the conservative view on intangible assets.

#### **5.4 A Uniform Way of Disclosing Customer Equity-related Metrics Off-Balance**

The previous section highlights challenges with recognizing customer equity as an intangible asset on the balance sheet, uncertainty being the main hindrance. This raises the question of whether it would be sufficient enough to disclose standardized customer equity-related data and the underlying calculations off-balance, in line with the accounting expert's reasoning. The latter way of accounting for customer equity would be more prudent than capitalization, while still facilitate equity research analysts' performance of company valuations and lead to better decision-making for investors, i.e. still be relevant (IASB, 2018). In line with Lev (2018), off-balance disclosures could be used as additional information to investors in the case of a SBE reporting negative results in the income statement while simultaneously creating value that is not captured by the financial reports. As such, disclosing customer metrics off-balance in a uniform way would not only contribute to comparability across companies, but also avoid reporting uncertain items on the balance sheet. However, the aforementioned benefit of a facilitation of financing would diminish if customer equity would be reported off-balance instead of on-balance.

Bonacchi et al. (2015) present a way of calculating customer equity and state that standard setters should find this helpful in identifying and recommending new disclosure items, since companies voluntarily disclose customer-related data with a lack of uniformity and consistency. However, the empirical findings bring forward several challenges with a standardization of customer equity calculations. First, to achieve comparability, companies would, as aforementioned, need to disclose data which they might view upon as confidential. Secondly, the empirical findings suggest that it will be difficult to implement a uniform way of reporting customer equity-related metrics off-balance, since the business models of different SBEs can differ remarkably and hence, one way of calculating customer equity might be unrepresentative for all SBEs. As such, the customer equity-related metric might not faithfully represent what it

is supposed to represent and instead turn out arbitrary (IASB, 2018). For example, one investor emphasized that different SBEs are associated with different opportunities to cross-sell, depending on the product or service, making the customer worth more or less at inception. Hence, the investor stated that one must take every individual SBEs' business model into account and as such, a standardization of customer equity and other customer related metrics, that would reflect each SBE in a fair way, would be challenging to implement. This is in line with Schilit et al. (2018) where problems with customer related metrics, such as the Average Revenue Per User (ARPU), are brought forward. In the ARPU metric, a "user" can be defined in countless different ways, which deteriorates the comparability of the metric. Furthermore, another issue with customer-related metrics is that they easily can be misused (Schilit et al., 2018). SBEs that are making losses during their growth phases could use such metrics to show value creation, however, if not successfully standardized, these metrics can on the other hand be exaggerated and used to portray an inaccurately favorable picture of the company's performance and, as such, mislead less informed investors.

These challenges associated with a uniform way of disclosing customer equity off-balance also apply to the first alternative; capitalizing customer equity on-balance. For instance, if customer equity was recognized on-balance, one would still have to determine a uniform way of calculating the value of the item. However, when capitalization was discussed during the interviews, it was evident that uncertainty was the dominating challenge that overshadowed other challenges.

### **5.5 Would the Pros Outweigh the Cons?**

As illustrated above, there are numerous challenges with both capitalizing customer equity on-balance and disclosing standardized customer equity-related metrics off-balance. The empirical findings imply a skepticism, among the interviewees, towards the feasibility of such regulation. Nonetheless, it is questionable whether successfully implementing such a regulation would in fact be impossible. Various accounting phenomenon that involve valuing intangible items have been standardized and a range of companies follow the same accounting standards, in spite of differing in size, business models, etc. Therefore, it seems improbable that standardizing the calculations of the customer equity value or other disclosures would be impossible. The more important question is perhaps whether the pros outweigh the cons. Accounting regulation changes require great amounts of time and effort and lead to high opportunity costs, and further, it is crucial that the benefits of reporting financial information justify the costs imposed by such

reporting (IASB, 2018). One investor brought forward examples of inconveniences that would result from a change in regulation regarding customer equity, for instance having to adjust the previous year's reports, making historical data incomparable, as well as having to deal with extensive notes related to customer equity if recognized as an intangible asset on-balance. It might be the case that the efforts required, should customer equity be regulated, would outweigh the potential benefits from the change, which would not be in line with IASB (2018). Furthermore, even if the value of customer equity would be calculated in a uniform way and reported either on-balance or off-balance, it is questionable whether the figure would bring enough value to the users of financial reports to outweigh the efforts, such as those aforementioned. The question is: Would it be worth it? If it is nearly impossible to fit every SBE into one framework of calculating customer equity and customer-related metrics, would such a standardized figure reflect the SBE and the customer base in a righteous way or would it only turn out arbitrary? Hence, a standardization of customer equity might be possible, however, the final figure might not bring enough value to the users of financial reports to make it worth the efforts and as such, would not be useful in accordance with the Conceptual Framework for Financial Reporting (IASB, 2018).

## **5.6 Stakeholders' Sentiments**

From the previous sections one can conclude that there are several factors implicating the feasibility of disclosing customer equity in a uniform way, on-balance or off-balance. The empirical findings suggest that different stakeholder groups have different perspectives on these factors. In this section, the sentiments towards a capitalization of customer equity and towards a uniform disclosure of customer metrics off-balance, with regards to the different stakeholder groups, will be summarized.

### *5.6.1 Equity Research Analysts*

Since the literature on customer equity within the marketing research field states that the value of the customer base can be used as a proxy for the overall value of the company (Gupta et al., 2004; Silveira et al., 2012; Zhang, 2016), the relevance of customer equity from an equity research analyst's perspective was considered interesting to examine. The empirical findings suggest that customer equity-related data is used as inputs in company valuations by some of the interviewed equity research analysts, however, none of the analysts perform a stand-alone valuation solely based on the customer base. The equity research analysts using customer-related figures explained that they calculate the value of the customer base themselves, since

they cannot back-track the calculations of the figures disclosed by the companies in question. The equity research analysts expressed that they would not be affected regardless of whether customer equity was reported on-balance or off-balance, however, they would benefit from transparent calculations of the figure, enabling them to analyze the underlying assumptions and use these when valuing companies. Nevertheless, their sentiment was skeptical towards the feasibility of implementing a uniform way of calculating customer equity as well as towards including such an uncertain item on the balance sheet.

### *5.6.2 Managers*

Since capitalizing customer equity would lead to results more in line with the true value creation within a company, it seems reasonable to assume that managers should be positive towards such accounting. The managers all expressed some positivity towards capitalization, considering benefits from a facilitation of financing or showing positive results to less informed investors. Nonetheless, in line with Lev (2018), the predominant sentiment among managers appears to be skepticism, both towards customer equity on-balance and towards a uniform way of disclosing customer equity off-balance. The empirical findings suggest three main reasons for this skeptical view: the reluctance towards showing non-cash items in the income statement (i.e. impairments), towards disclosing the assumptions behind customer metrics to competitors (i.e. information that is considered confidential), and finally, towards including intangible items on the balance sheet whose values are based on uncertain assumptions. Furthermore, the managers expressed that they do not want more regulation and are not likely to actively drive a change initiative. In conclusion, managers do not see themselves benefit enough from capitalizing customer equity nor from a uniform way of disclosing customer equity-related metrics off-balance, considering the efforts related to such accounting changes.

### *5.6.3 Investors*

According to the literature (Lev, 2018), investors would benefit from a capitalization of customer equity or an implementation of customer equity-related disclosures off-balance. However, the empirical findings suggest that this was not the case for the interviewed investors, as these, in line with equity research analysts, calculate customer metrics themselves and do not solely rely upon SBEs' own reported, non-standardized, customer metrics. The sentiment among the investors was, hence, in line with equity research analysts'; they would only benefit from the reported customer equity, on-balance or off-balance, if it would be comparable across companies as they would be able to analyze and use the underlying assumptions. However, they

were skeptical towards the feasibility of a standardization as they do not believe that it would be possible to implement a standardized customer metric that would be applicable to all SBEs. Contributing to Lev's (2018) findings, regarding investors being those who would benefit from a capitalization of customer equity, the empirical findings suggest that one must consider investors of different types and with different resources. In this study, interviews were held with professional investors who expressed no need for an accounting change regarding the intangible assets of SBEs, since they have the resources to calculate and evaluate customer equity themselves. However, the interviewed investors implied that small investors and savers potentially could benefit from a capitalization of customer equity, or a standardization of disclosed customer metrics off-balance, since they do not necessarily have the capacity, nor enough insight, to calculate the metrics themselves. This is in line with Damodaran (2018) who states that there are differences between investor groups, such as the difference between investors in publicly traded companies and venture capitalists in terms of power to extract information from managers.

#### *5.6.4 The Accounting Expert*

The accounting expert questioned the feasibility of capitalizing customer equity, due to the uncertainty in the elements of such an item, for instance, customer retention. The accounting expert expressed a concern regarding recognizing customer equity as an intangible asset by referring to previous accounting scandals where companies have included uncertain items on-balance. Hence, the empirical findings suggest that the accounting expert's sentiment was skeptical towards on-balance-sheet accounting. However, while the accounting expert problematized the usefulness of recognizing customer equity on-balance, (s)he expressed that customer equity-related metrics in the financial reports off-balance instead might fulfill the need of users of financial reports and therefore be a more appealing alternative.

#### *5.6.5 Summary of Common Stakeholder Sentiments*

To conclude, all stakeholder groups expressed skepticism towards a capitalization of customer equity due to the uncertainty in the item, while having different perspectives behind their opinions. None of the stakeholders seem to believe that implementing such an accounting method is feasible. A uniform way of disclosing customer equity-related metrics was viewed upon as a more appealing alternative, however, in line with capitalization, the empirical findings suggest that it would not be possible to implement without facing arduous challenges.

## **5.7 The Continuing Rise of Subscription-based Enterprises**

The rapid increase in intangible investments, together with the increasing number of subscription-based enterprises where intangibles are the main value drivers, implies that we are moving into an era of capitalism without capital (Haskel and Westlake, 2018). The empirical findings suggest that the rise of subscription-based enterprises will continue, since it is a business model that fulfills both businesses' and customers' needs, however, as of this writing, subscription-based enterprises can still be viewed upon as an exception to the rule. Nonetheless, it is questionable whether the issues with customer equity in these companies will be neglectable in the same way as of today, when the subscription-based business model becomes more and more widespread. Due to the current state of the world, where subscription-based enterprises are associated with high growth, new industries and, as such, extensive uncertainty, it is a subject of discussion whether the empirical findings are influenced by this view upon SBEs. During the interviews, it was evident that many of the interviewees were faced with the question regarding capitalization of customer equity for the first time and had not reflected upon it prior to the interview. This raises the questions: Would the empirical findings differ if SBEs would no longer be an exception to the rule, but more widespread already? What would the empirical findings be one decade into the future?

## 6. Conclusion

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*In the following section, the results from the analysis are presented. The conclusion intends to answer the research question: “What are the sentiments of stakeholders of subscription-based enterprises towards capitalizing customer equity and, alternatively, towards a uniform way of disclosing customer equity-related metrics off-balance?”*

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The sentiment among all stakeholders towards a capitalization of customer equity seems to be mainly skepticism. All stakeholders have brought up the uncertainty in the reported item as the primary reason, since customer equity is considered to be based on too uncertain assumptions (e.g. how many months a customer will remain a subscriber). Due to this uncertainty, none of the stakeholders consider customer equity to be an intangible asset in accounting terms, that should be recognized on the balance sheet, in contrast to Bonacchi et al. (2015), who state that customer equity is a major intangible asset missing from the balance sheet. The overall attitude was that a slim balance sheet is to be preferred; to only include items whose values can be determined with high certainty. In addition, the managers added another reason for the skepticism, namely a reluctance towards including items on-balance and standing accountable for the value changes, in accordance with Lev (2018).

The alternative approach is to establish a uniform way of disclosing customer equity-related metrics off-balance, since companies, according to Bonacchi et al. (2015), voluntarily disclose customer-related data with a lack of uniformity and consistency. Investors and equity research analysts were positive towards a standardization, although they believed it would be difficult, if not impossible, to implement in a righteous way. A standardization of the disclosures of customer equity-related data would make figures comparable across companies and would, in contrast to capitalizing customer equity, avoid including uncertain items on-balance. The comparable figures with transparency in the calculations would facilitate for equity research analysts and investors when they evaluate companies. However, the empirical findings suggest that it would be difficult to find a uniform way of calculating customer equity since SBEs have varying business models, products and services, which impact the value of the customer at inception. Furthermore, the managers expressed a reluctance towards disclosing comparable customer data or their underlying assumptions, as such data is considered to be confidential.

The aforementioned challenges associated with a uniform way of disclosing customer equity off-balance are also applicable to the case of a capitalization on-balance, as the recognized item would also have to be valued in a uniform, transparent way. However, in terms of capitalization, uncertainty was the predominant issue discussed during the interviews. Furthermore, in previous literature, investors are proposed as the stakeholder that would benefit the most from either alternative (Lev, 2018), however, this study has shed light on the fact that one cannot cluster together all investors but must take different investor groups into account. As such, the findings suggest that small investors and savers would be the largest benefiter, in contrast to professional investors who are more indifferent.

In conclusion, uncertainty in customer equity as an intangible asset on-balance was the main concern among all stakeholders regarding capitalizing customer equity. Regarding the alternative method of disclosing customer equity-related metrics off-balance in a uniform and transparent way, investors and equity research analysts would benefit, while managers potentially would be at a disadvantage. A common sentiment among the stakeholders was, however, that such a standardization would be difficult to implement, due to the challenge of finding one way of calculating customer equity that would be applicable to all SBEs.

It is, nonetheless, debatable whether a standardization of customer equity would in fact be impossible; instead, the question is perhaps whether the benefits from standardizing a customer equity metric would outweigh all efforts required in such a change. Furthermore, should such a metric be applied to all SBEs, it is also questionable whether the figure would be too arbitrary and therefore not bring enough value to stakeholders to make it worth the efforts and, as such, not be useful according to the Conceptual Framework for Financial Reporting (IASB, 2018).

Lastly, one explanation for the lack of change initiatives in the past, both in accordance with the literature and the empirical findings, is that the accounting of intangible assets has been a gradual transformation. Furthermore, as of this writing, SBEs can still be viewed upon as an exception to the rule, and are associated with high growth, new industries and extensive uncertainty, which should be beared in mind when considering the stakeholders' sentiments towards customer equity. Nonetheless, the rapid increase in intangibles and the increasing amount of subscription-based enterprises raises the question of whether issues with customer equity in SBEs will be neglectable in the same way when SBEs become more widespread and no longer are an exception to the rule. Although it does not appear in the financial reports,

customer equity is, after all, one of the most important, value-creating assets for subscription-based enterprises.

## **7. Contributions and Future Research**

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*In the following section, the main contributions to the accounting field of research are presented as well as recommendations for future research.*

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### **7.1 Contributions**

This study has contributed to the accounting field of research by shedding light on the sentiments of the stakeholders in subscription-based enterprises that might be impacted in a potential accounting change regarding customer equity. Furthermore, this study has highlighted the fact that despite the benefits of a uniform disclosure of customer equity off-balance – which seems to be the more feasible alternative since it is not associated with the uncertainty issue of capitalization – it might be difficult to implement in practice. Lastly, previous research states that investors would benefit from customer equity capitalization or disclosures (Lev, 2018), however, this study has contributed to the accounting literature by suggesting that one must take different investor groups into account as these are not impacted in the same way.

### **7.2 Future Research**

Several areas of interest for future research have been identified. Firstly, it would be interesting to further examine the actual feasibility in a uniform way of disclosing customer equity that goes beyond the scope of this study and as such, quantitative research of such an issue could provide additional explanatory value. Secondly, it would be interesting to examine the sentiment among small investors and savers and how they would be impacted by a change in the way customer equity is currently accounted for. Thirdly, in terms of assessing customer equity's potential of being recognized as an intangible asset, it would be interesting to compare customer equity with similar intangibles that have been recognized on-balance, e.g. research and development. Lastly, it would be interesting to conduct a similar study as to this one at a future point in time when the landscape of subscription-based enterprises has evolved.

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## 9. Appendix

### 9.1 Interview Guide

*The interview guide serves the purpose of providing a general idea of which questions were asked during the interviews and which topics were discussed.*

#### 9.1.1 General Questions to All Stakeholders

##### 1. Introduction

- Please briefly tell us about your background.
- Please briefly describe your relationship to subscription-based enterprises.

##### 2. Subscription-based Enterprises

- In your opinion, do subscription-based enterprises differ from non-subscription-based enterprises? In what ways?
- With the historical rise of subscription-based enterprises, have you noticed any change in your profession? In what ways?
- To what extent do you believe the subscription-based business model will be used in the future? Why?

##### 3. Customer Equity

- Would you classify customer equity as an intangible asset? Why/why not?
  - If yes, does customer equity, in your opinion, differ from other intangible assets? How?
- What could be the purpose of recognizing customer equity on-balance?
- Would you be affected if customer equity was recognized on-balance? How?
  - Do you think other stakeholders would be affected? How?
- Would you be affected if customer related data was disclosed in a uniform way off-balance? How?
  - Do you think other stakeholders would be affected? How?

##### 4. Accounting Regulation

- Do you find there to be a need for a change in accounting regulation regarding customer equity? Why/why not?

- If yes, in your opinion, what is the view upon the feasibility of an accounting change regarding customer equity?
- Would you be affected if there was a change in accounting regulation regarding customer equity? How?
- Do you think other stakeholders would be affected if there was a change in accounting regulation regarding customer equity? Why/why not?
- Do you believe any stakeholder is more likely [than the others] to drive such a change in accounting regulation, should there be a change?
  - If yes, which one and why?

### *9.1.2 Additional Stakeholder-specific Questions*

- Equity Research Analysts
  - Please briefly tell us about your experiences of valuing subscription-based enterprises.
  - When you perform a company valuation of a subscription-based enterprise, which factors do you take into account? Which are the building blocks of the valuation?
  - Does the valuation of subscription-based enterprises differ from non-subscription-based companies? How?
  - If customer equity [or related metric] is an input in the valuation, do you make your own calculations or rely on the figures disclosed by the companies?
- Managers
  - Do you report a value of customer equity? If yes, how do you calculate that value?
- Investors
  - Please briefly tell us about your experiences of investing in subscription-based enterprises.
  - When you invest in a subscription-based enterprise, which factors do you take into account?
  - If customer equity [or related metric] is considered when investing, do you make your own calculations or rely on the figures disclosed by the companies?

- Accounting Expert
  - Please briefly tell us about the current regulation of intangible assets.
  - What is the main purpose of accounting regulation?
  - Which factors generally drive regulation change?
  - What are the pros and cons of implementing a new accounting standard?