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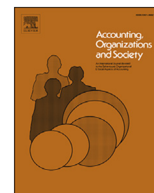

# Financialization as strategy: Accounting for inter-organizational value creation in the European real estate industry

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ABSTRACT

Financialization—the increasing relevance of financial markets, financial actors and financial logics—and the related rise of originate-to-distribute-cycles in the mortgage industry have been considered key explanations for the emergence of financial crises. Analyzing a case study in the European real estate industry, we show how actors strategically manage inter-organizational relations and take advantage of rising asset prices, through refinancing on the basis of loan-to-value even before the originate-to-distribute-cycle of the mortgage industry unfolds. Valuation and accounting are core practices of financialized business models that evolve around management fees, which serve as value carriers and bring potential future profits into the present. Auditing also plays a role as it legitimizes these business activities and facilitates jurisdictional arbitrage. We contribute to the accounting literature by explaining how the strategic configuration of a valuation-accounting nexus leads to organizational short-termism and rewards unsustainable business activities in the real estate industry.

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## 1. Introduction

One common narrative of the so-called sub-prime mortgage crisis in the USA interprets loan securitization and respective collateralized debt obligations as one of its main causes (see, for example, Carruthers, 2013; Fligstein & Goldstein, 2010; Ryan, 2008). While we do not refute the importance of these dynamics for destabilizing the economy, we argue that securitization is only one aspect of short-termism in real estate. Finance-driven business models in which valuation and accounting play a fundamental role are equally relevant for understanding the increasing dominance of finance in real estate (Engelen, Fernandez, & Hendrikse, 2014; Stockhammer, 2010), as they complement and precede banks' originate-to-distribute strategies.

Financialization is neither confined to the originate-to-distribute model of the mortgage industry (Purnanandam, 2011) nor to specific services, such as credit ratings, which assess (and co-create) structured financial instruments (Ashcraft & Schuermann, 2008). Instead, the establishment of value creation cycles through accounting and valuation is a deliberate and carefully managed activity that characterizes much of the real estate industry. More precisely, valuation and accounting are used in a strategic manner, taking advantage of jurisdictional differences and the leeway inherent to recognition and measurement of assets.

In this paper, we investigate inter-organizational relations, in particular, valuation and accounting practices, that bring about finance-led investment strategies in real estate. Our in-depth analysis of operational practices of valuation and accounting reveals the complexity of inter-organizational network relations in which profit generation unfolds. We show how up-front management fees are used to extract capital from envisioned future profits, as long as credit is in ample supply and asset prices are rising. Such finance-driven activities might last a considerable amount of time, but become vulnerable when growth slows, indicating the fragility of such business models.

We intend to demonstrate how "the world of accounting practice is implicated in the current financial crisis in a number of ways" (Arnold, 2009, p. 803). Analyzing organizational linkages between the real estate sector, the financial industry and their orbiting

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services firms, we focus on those accounting and valuation practices that precede the securitization dynamics commonly associated with real estate. In fact, we regard the 'generation' of assets just as important to understand the financialized nature of real estate investment cycles. Looking at what one might call the supply-side of financialization, we investigate how inter-organizational valuation and accounting practices advance the emergence of financialized business models in the real estate industry.

Empirically, we provide a critical case (Yin, 2014) of the rise and decline of a particular investment firm purchasing residential property in Germany. More specifically, we show how during the boom cycle of the mid-2000s valuation and accounting were fundamental to acquire more than 20,000 apartments with virtually no equity. While no single case can explain all aspects in financial globalization, our study of the German real estate market provides unique insights in order to unravel the strategic dimension of inter-organizational accounting and valuation practices and to analyze their distributive effects, thereby bringing the worlds of accounting research and 'accounting in action' somewhat closer together (Hopwood, 1978). Our findings address the social embeddedness and strategic application of accounting and valuation (Dent, 1990; Hopwood, 2000; Miller, 2008). In particular, we demonstrate how accounting relies upon and feeds back into the escalation of asset prices. Furthermore, we show how accounting practices contribute to short-termism of business models and how management fees, calculated transfer prices and the exploitation of a liberalized European corporate law help to bring potential future profits into the present.

## 2. Theory: financialized business models, accounting and strategic action

Economic liberalization and cross-national market integration, particularly in Europe, have brought a number of financial services firms to the fore that capitalize on jurisdictional arbitrage through actively exploiting the variety of legal, fiscal and professional rules of different jurisdictions (Semmler & Bernard, 2009; Vollmer, Mennicken, & Preda, 2009). The growth of financial markets provides new business opportunities for services firms that offer consultancy and accounting services, and thus, enable huge cross-border capital flows. An "increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions" (Epstein, 2005, p. 3) has inspired a research agenda under the label of 'financialization'. As research on financialization expands from accumulation regimes to shareholder value and the financialization of every-day life (van der Zwan, 2014), empirical findings increasingly discuss the relevance of organizational complexities (Froud, Sukhdev, Leaver, & Williams, 2006; Kädtler, 2009).

Financialized business activities drive socio-economic change and bring about instability as they lead to employment stagnation (Lin, 2016) and short-termism. Reaping financial benefits from jurisdictional arbitrage and 'boom and bust' dynamics (Minsky, 1986/2008) is a cornerstone of these activities. Short-term orientations become manifest in early investment payoff, often through management fees. Such payoffs are systematically privileged over long-run value creation (Erturk, Froud, Johal, Leaver, & Williams, 2010; Jackson & Petraki, 2011).

### 2.1. *Financialized business models as temporary inter-organizational configurations*

While the rise of finance has been observed by scholars of various disciplines (Dore, 2008; Epstein, 2005; Krippner, 2011; Nölke, Heires, & Bieling, 2013; Stockhammer, 2010; van der Zwan, 2014), inter-organizational analyses, so far, have been less prominent. Mostly, financialization studies concern themselves with general transformations of socio-economic logics (Krippner, 2005) or with the rise of equity ownership and the orientation towards shareholder value (Boyer, 2000; Froud, Haslam, Johal, & Williams, 2000; Jürgens, Naumann, & Rupp, 2000). Establishing the primacy of financial management within a firm (Boyer, 2007, p. 795), aligning the firm's operations with the demand of financiers through fair value accounting (Perry & Nölke, 2006) and changing CEO compensation (Jung & Dobbin, 2012) are relevant intra-organizational aspects of financialization. And yet, (re-)distribution of corporate surplus from stakeholders to shareholders through organizing, valuation and accounting is only slowly becoming part of the research agenda, which for a long time has predominantly been interested in the changing modes of investment and profit extraction. Therefore, in this paper, we go beyond these approaches by demonstrating the role of valuation and accounting practices in inter-organizational relations and by showing how they power financialized business models (cf. Zott & Amit, 2010).

Following Casadeus-Mansanell and Ricart (2010, p. 195) in that a business model "is a reflection of the firm's realized strategy", we understand it as a concept which defines an organization's value-generating logic. While a business model, thus, represents "the logic of the firm, the way it operates and how it creates value for its stakeholders", strategy, in turn, "refers to the choice of business model through which the firm will compete in the marketplace" (Casadeus-Mansanell and Ricart, 2010, p. 196). Business models therefore provide an analytical toolkit in order to understand how value creation is designed and organized (Teece, 2010).

We speak of *financialized* business models and focus on a particular subset of business models based upon and tailor-made to suit financial market logics. Financialized business models are designed to seek high returns quickly, thereby trumping other objectives such as long-term sustainability or customer satisfaction. In real estate, financialized business models are often associated with loan securitization ("originate-to-distribute"), which allows reducing debt on a lender's balance sheet through passing on credit to third parties via financial instruments (Ashcraft & Schuermann, 2008; Purnanandam, 2011). These activities not only rid lenders of most of their obligations, they also generate immediate returns by selling financial instruments (Goldstein & Fligstein, 2014). In this context, management fees are used within inter-organizational relations to allow the transfer of capital (Sikka & Willmott, 2010) and are often paid up-front to settle commissioned services (cf. Malkiel, 2013).

As we will show in this paper, fees are constitutive for inter-organizational management in the real estate sector and are instrumental to bringing forward unrealized gains, mainly through up-front management and structuring fees. Therefore, to understand financialized business models and analyze financialization at the inter-organizational level, it is paramount to consider these payments as value carriers which are rooted in valuation and accounting practices.

### 2.2. *Accounting as strategic inter-organizational practice*

In her review essay, Chua (2007, p. 487) emphasizes that "accounting research has not always focused on the doing of accounting work" and argues for looking more closely at "the diverse activities associated with the creation, circulation, transformation and destruction of accounts." More precisely, to understand the constitutive effects of varied forms of calculation, it is "important to pay attention to the diverse nature and constitutive effects of

accounting practices" (Miller, 2008, p. 53). Therefore, we explicitly focus on valuation and accounting as inter-organizational practices. We relate this perspective to the more recent practice turn in organization research (Whittington, 2011), which has led to renewed interest in the relation between the fields of accounting and strategy. This debate combines current work on accounting and strategy with discussions that originated in the early 1990s (see, most importantly, the respective special issue in Accounting, Organizations and Society from 1990). Skaerbaek and Tryggestad (2010, p. 108), for example, show how accounting "rejects, defends, and changes corporate strategy", thereby focusing on the role of accounting tools and devices. Jørgensen and Messner (2010), for instance, look at the role of accounting in the realm of new product development strategies and the limits of calculability.

A major achievement of practice-oriented work was to elucidate the micro-level interplay of both accounting and strategy-making practices. However, practice-based research is not necessarily restricted to the micro level. Jarzabkowski and Spee (2009, p. 71), for example, emphasize that "increasingly, the [strategy-as-practice] agenda attempts to make connections between the micro-phenomena studied in practice-based research and more macro-phenomena." Similarly, Whittington's (2006) distinction between practice, practitioner and praxis indicates the holistic approach when analyzing the interplay of strategy and accounting: While any practice is rooted in actual praxis and is re-produced by practitioners, it nevertheless constitutes a field-level phenomenon and has the potential to impact upon field-level outcomes. Here, we advocate a perspective that combines accounting and strategy-making practices to explain the emergence and change of financialized business models.

### 2.3. *Intentionality and the practitioners of financialization*

So far, different assessments about actors' intentionality in driving the proliferation of finance coexist. For the political sphere, Krippner asserts that "financialization was not a deliberate outcome sought by policymakers but rather an inadvertent result of the state's attempts to solve other problems" (Krippner, 2011, p. 2). Focusing on long-term socio-economic trajectories, discussions of finance-led growth regimes (Boyer, 2000) not only indicate a shift of influence between economic sectors more generally, but also enable the identification of winners and losers over time. Distributional aspects emerge as a core element of financialization (cf. Haslam, Gleadle, & Yin, 2012), such as the transformation of listed industrial firms into attractive objects for institutional investors as one expression of aligning industrial production with shareholders' interests (Froud et al., 2000).

Competition amongst large investors for profitable investment opportunities translates into increasing pressures for publicly listed firms to attract large investors as shareholders (Deeg, 2010; Windolf, 2005). These 'new owners' (Kädtler, 2009) impose a logic of short-termism onto management which can, in turn, use it to defend cost reduction and efficiency increase as "unavoidable and hence non-negotiable with the other players in the company, foremost among whom are its employees" (Kädtler, 2009, p. 231; cf.; Lin, 2016).

Financialization literature further highlights management's reliance on financial service providers and intermediaries, among them investment banks, consultancies and auditing firms. This is also the case for large public organizations, such as universities, that rely on financial service providers to align their operations with financial markets. Engelen et al. (2014) show how accounting for university's real estate management leads to a reconfiguration of the entire organization, mainly through consultants and professionals that come to dominate strategic decision-making and are remunerated through management fees. In these cases, management puts organizations at risk through increasing dependence on credit bringing about the "danger of strangulation by debt" (Engelen et al., 2014, pp. 1087f.).

Services firms are thus key agents in helping management to implement specific business models. Their support is crucial to enact financialized strategies and to legitimize decisions externally (Froud et al., 2006). Among these service providers are professional services firms, such as notaries, valuators and auditors, keen on expanding their services – often through legitimizing corporate accounting practices indirectly or directly through audits (cf. Cooper & Robson, 2006; Suddaby, Cooper, & Greenwood, 2007).

## 3. Methodology: research design and case characterization

Our study focuses on the organizational practices of a real estate investment firm active in the German market for multi-unit rental housing. The case study is situated in the highly dynamic and historically unprecedented market situation characterized above. We provide a critical case (Yin, 2014) by exhibiting how valuation and calculation are actively used to engage in commercial activities in a booming market.

Empirically, we investigate the growth of a real estate investment firm (labelled IMMOFIRM in the remainder of this paper) – a business entity comprised of a number of management and holding firms spread throughout Europe. Despite IMMOFIRM's organizational fragmentation at the formal level, our analysis focusses on the firm as a coherent unit, more precisely, a conglomerate of reciprocally dependent firms. While having accumulated multi-unit residential real-estate assets in Germany with a balance sheet value of over one billion euros, IMMOFIRM exited the market shortly after the financial crisis manifested in late 2008. It was exactly this market exit that enabled key informants to speak openly about the applied practices.

### 3.1. *Data collection and analysis*

Our data on the IMMOFIRM Group and its (management of) inter-organizational accounting and valuation practices is based on interviews and additional sources, such as press material, that concern both the developments at IMMOFIRM as well as industry practices more generally. First, we were able to conduct multiple interviews with two former leading executives of IMMOFIRM who presented detailed information about management goals and practices. Each of these interviews took several hours, was recorded and transcribed. In these open-ended, narrative interviews, we asked our interview partners to tell the story of the IMMOFIRM Group from the beginning as well as to give concrete examples of processes in real estate acquisition and management. We then cross-checked the information received from two key informants for plausibility and temporal accuracy by conducting shorter and more informal interviews with other people employed at IMMOFIRM between 2005 and 2007.

Much of the information shared with us by our interview partners concern highly sensitive economic data as well as delicate personal information. For ethical reasons and to avoid personal consequences for our interview partners, we have anonymized our data to ensure that neither the firm's nor its employees' identities can be reconstructed from the material presented here.[1] In

[1] We have communicated the company's name to the journal's editor to allow tracing our case while preserving the anonymity of our sources.

addition, we have also collected press coverage on both our focal case and field-level developments between 2005 and 2007.

Second, to understand the wider business context and to corroborate that inter-organizational practices around IMMOFIRM largely reflect industry standards at the time, we included four interviews with accounting professionals of one of the large ("Big Four") accounting firms specialized in the German real-estate market. These interviews were conducted by a research assistant and aimed at understanding the development and application of accounting and calculation practices more generally and to contextualize the developments of IMMOFIRM.

To systematize and analyze our data, we first charted the organizational structure of the IMMOFIRM Group itself (see Fig. 2 below in section 3.3). In a second step, we reconstructed inter-organizational business practices around the IMMOFIRM Group by visually mapping (Langley, 1999) activities and interactions with business partners in valuation and accounting. Specifically, we identified inter-organizational practices in relation to IMMOFIRM Group's business process in our data and chronologically grouped both practices and actors involved. This allowed us to portray the overall business process in form of a cyclical flow chart as depicted in a simplified version in Fig. 3 below while preserving the longitudinal perspective required from analyzing process data.

In a third step, we identified and categorized those practices that explicitly dealt with re-valuing and value creation by first characterizing them individually and then by resolving any inconsistencies between categories. A final step consisted of presenting our abstractions of IMMOFIRM's activities to our interview partners to ensure that our interpretations reflect a correct assessment of the case, thereby verifying our interpretations of the developments.

### 3.2. Research context: the German real estate market

Since the early 2000s, the German real estate market has seen substantial price increases and has started to resemble features of the US housing market, namely securitization of large loans and the entry of institutional investors (cf. Aalbers, 2008; Ryan, 2008; Schwartz & Seabrooke, 2008). We focus on the market for rental units in Germany and analyze developments between 2005 and 2007, through the lens of one particular firm that was set up as a Europe-wide organizational conglomerate to acquire apartment buildings in East Germany. We analyze the inter-organizational business practices of a real-estate firm acquiring apartments for rent in pre-crisis Germany for both theoretical and empirical reasons. Similarly to the residential real-estate markets in the USA (Fligstein & Goldstein, 2010) or Australia (Keen, 2009), the German market experienced a notable increase in housing prices, however, without being considered overheated at the time. The market of multi-unit apartment buildings shows a considerable inflow of capital, in particular, foreign portfolio investment that coincided with large-scale privatizations in this market segment. The upward trend in both prices and turnover of multi-unit apartment buildings prior to the beginning of the US sub-prime crisis (Claβen & Zander, 2010) allows us to study financialization in the early phases of what might be considered 'boom and bust' dynamics (Minsky, 1986/2008).

Throughout the 20th century, Germany has been somewhat of an outlier when it comes to the housing market. Contrary to other countries, especially Anglo-America, ownership rates in residential property have been rather low.[2] In addition to supporting property ownership for the middle class, the provision of affordable rental apartments by public authorities has been a cornerstone of post-war social policy. In West Germany, family homes continue to be owned mostly by the people inhabiting them, especially in rural areas, where financing has traditionally been arranged regionally by building societies, cooperative banks or savings banks. In urban areas, in contrast, multi-unit housing was often provided by public entities, mainly municipal public housing establishments (Wohnungsbaugesellschaften) or by large industrial corporations providing housing to their employees. Publicly dominated corporations from the transport and energy sector (such as German Federal Railway, German Federal Post Office, VEBA, Viag) as well as industrial giants such as Hoechst, Preussag and Siemens used to own thousands of apartments, usually in close proximity to their production facilities.

In the East, where property ownership was attributed to the bourgeois past, private home ownership only continued where it had existed before the founding of the East German Democratic Republic. After the war, reconstruction of housing facilities and the development of new socialist housing – most famously its 'Plattenbauviertel', large residential property developments with prefabricated construction elements – were supervised and administered by the state. Following German unification, municipalities were put in charge of operating multi-unit residential properties and became owners of real estate.

The distinct historical trajectories in the East and the West contributed to some unique features of the German residential real estate market: an overall low quota of home ownership, relatively low rents, high involvement of public authorities, considerable real estate portfolios in the hands of municipalities, and large state-owned corporations as well as industrial firms as owners of substantial real estate assets.

At the turn of the century, the parameters of residential ownership changed profoundly. Local municipalities found themselves under pressure to privatize many of their holdings, due to EU deregulatory policies and a need for new sources of revenue.[3] Since the 1990s, municipal housing provision had no longer been considered a core element of social policy, thus, paving the way for a commercialization of urban housing. Simultaneously, during the privatization of large firms in the utilities, transport, logistic and energy sectors (Obinger, Schmitt, & Zohlnhöfer, 2014), the ownership of real estate was considered to be dispensable. The same was true for industrial giants seeking to address international investors who wanted to rid themselves of 'unproductive' assets such as company-owned apartments. This coincided with an increased interest of foreign investors –, initially from Anglo-America and later also from Continental Europe and Scandinavia – that interpreted German residential real estate as one of the few large but undervalued markets despite rather stringent tenancy law.[4]

[2] Less than 50% of all private homes and apartments are occupied by their owners. Historically, the larger portion of Germans pays rent, even though the ownership quota has seen an increase from about 40% in 1998 to roughly 46% in 2011 (Destatis, 2014).

[3] Between 1999 and 2011, 2 million apartments were sold; of those, 600,000 public housing units were privatized during that period. Most remarkably is the activity of Anglo-Saxon real estate investors that acquired a net total of 670,000 units from public and private owners in the 2000s (BMVBS, 2013: 38).

[4] Direct effects of large capital inflow into the German residential real estate sector are disputed. While tenancy laws still provide reasonable protection, gentrification is an increasingly relevant subject. Many investors engage in improving profits through property management, but in our case study this aspect only plays a marginal role which is why we do not focus in the effects of accounting practices on the living conditions of tenants.

Large commercial investors came to dominate the market for property transactions that included more than 800 apartment units. After 1999, sales picked up and developed very dynamically, most notably between 2004 and 2007 when more than 250,000 apartments changed hands each year – roughly five times more than in 1999. The growing sale of existing property is reflected by two indicators. First, German residential apartments were sold at a growing average purchase price per square meter (from €521 in the period from 1999-2003 to €830 in 2007 – an increase of 59%; BBR 2008, p. 7), indicating a rise in demand by investors. Second, at the same time, property portfolios were increasingly being resold from one investor to another. With privatization meeting its limits because the stock of available property rapidly decreased, the resale of apartments, and later the takeover of entire holding firms, became dominant. In 2006 and 2007, roughly half of all apartments were resales, changing hands form from one investor to the other in a relatively short period (see Fig. 1).

Most of the capital inflow into the German residential property market for multi-united housing came from large Anglo-American investors. Three new market entrants had acquired a substantial amount of property: as of 2007, UK based Terra Firma owned 190,000 apartments, Fortress had more than 150,000 units in its portfolio and Cerberus/Goldman Sachs owned roughly 90,000 apartments (BBR, 2008, p. 4). All three investors shared the same approach: seeking to buy cheap, building up a huge portfolio quickly with a high degree of borrowed capital and, in a relatively short period of a few years, organizing a sale or IPO of the entire firm. Such aggressive business activities, at least by German standards, became the blueprint for the business model of our case study. Other well-known foreign investors, such as Blackstone (US) or Babcock & Brown (Australia) used similar strategies.

### 3.3. *The IMMOFIRM case – riding the bull*

Legally, IMMOFIRM Group is a conglomerate of dozens of special purpose companies (property, holding and management companies) with a clearly hierarchical internal structure. The firm is pursuing a fairly simple investment approach: borrowing money, investing in large multi-unit residential properties in East Germany, arranging acquired assets into a diversified holding structure, reevaluating assets to obtain additional loans to be used in subsequent investments and, ultimately, aiming for an IPO at the London Stock Exchange.

The model gained acceptance with some well-established financial institutions, among them leading European investment banks, acting as senior lender. While the investment story appeared to be straight forward (and in line with what leading industry players such as Goldman or Fortress were doing), IMMOFIRM's operations were highly convoluted. It consisted of a multi-jurisdictional conglomerate of firms in which distinct management tasks were assigned to specific organizations spread throughout various jurisdictions depending on whether they were generating profit or costs – effectively, however, all under the roof of IMMOFIRM. Formally, IMMOFIRM Central Holding Ltd. is at the core of IMMOFIRM Group. Fig. 2 offers a simplified overview of the organizational structure of the IMMOFIRM Group and shows how property and operational activities were organizationally separated.

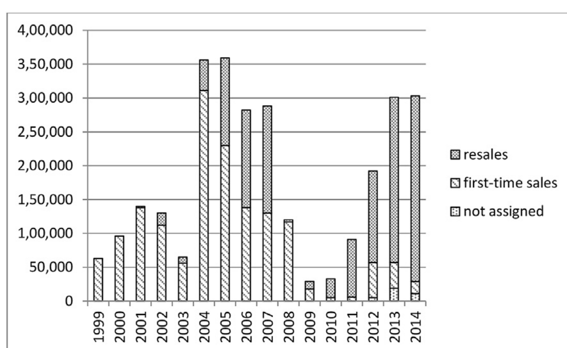


**Fig. 1.** Sales and resales of German apartments 1999–2012.
Source: BBSR (2012), p. 2 for the years 1999–2011and BBSR (2015), p. 4 for the years 2003–2014.

The property portfolio of the IMMOFIRM Group was comprised of over 100 residential properties, mainly in East Germany, organized in over 80 different property companies, which were then bundled in about a dozen holding corporations. Ownership of all these assets as well as profit distribution was assigned to the Investment Management Holding Ltd. registered in a European offshore tax haven (labelled Oasis). The key strategic decisions, however, were taken by Management Corporation A. The operational management of some special purpose companies was conducted by two other onshore management corporations in Continental Europe, owned directly by the CEO (Management Corporations B and C in Fig. 2). The continuous linkages in Fig. 2 indicate ownership relations, dotted lines illustrate the transfer of capital via management and structuring fees. The latter allowed transfer pricing to function as a core mechanism of wealth retentiveness, which enabled IMMOFIRM to avoid taxes and to facilitate the flight of capital (Spicer, 1988; Sikka & Wilmott, 2010).

The rationale for such a complex ownership structure was threefold: First, many smaller holding corporations allowed the owners circumventing the German limit on the tax deductibility of interest payments ('Zinsschranke'). Second, the multiplicity of organizational entities, which ran as formally separate enterprises, also helped to reduce the overall risk of liability. In case of economic or legal uncertainties, each entity could file for bankruptcy individually without endangering the entire group. Third, while management and structuring fees were paid for by entities onshore – in Germany and neighboring countries – earnings were exclusively accounted for offshore, and were designed to be levied at a minimum to effectively avoid corporate tax.

The purpose of such an organizational architecture was to minimize the tax base and maximize corporate profits in tax havens (cf. Milberg & Winkler, 2010). As a result, tax requirements guided the planning, evaluating and rewarding of organizational procedures and show how transfer pricing and related accounting practices are influenced by external factors (Cools, Emmanuel, & Jorissen, 2008).

As we learnt during data collection, such organizational constructs are not only wide-spread in real estate; they are actively suggested by both financing institutions, such as the bank acting as a senior lender, and by professional service firms that have developed advisory services specifically to enable forms of jurisdictional arbitrage. Therefore, professional service firms are intricately related to industry dynamics and sometimes even co-lead with regard to the business processes under study. The core interest of this paper, however, is to understand how accounting and valuation practices establish, fuel and exploit a financialized business model – not to analyze the inter-organizational setup itself.

## 4. Findings: accounting in action

In our case, the creative combination of valuation and

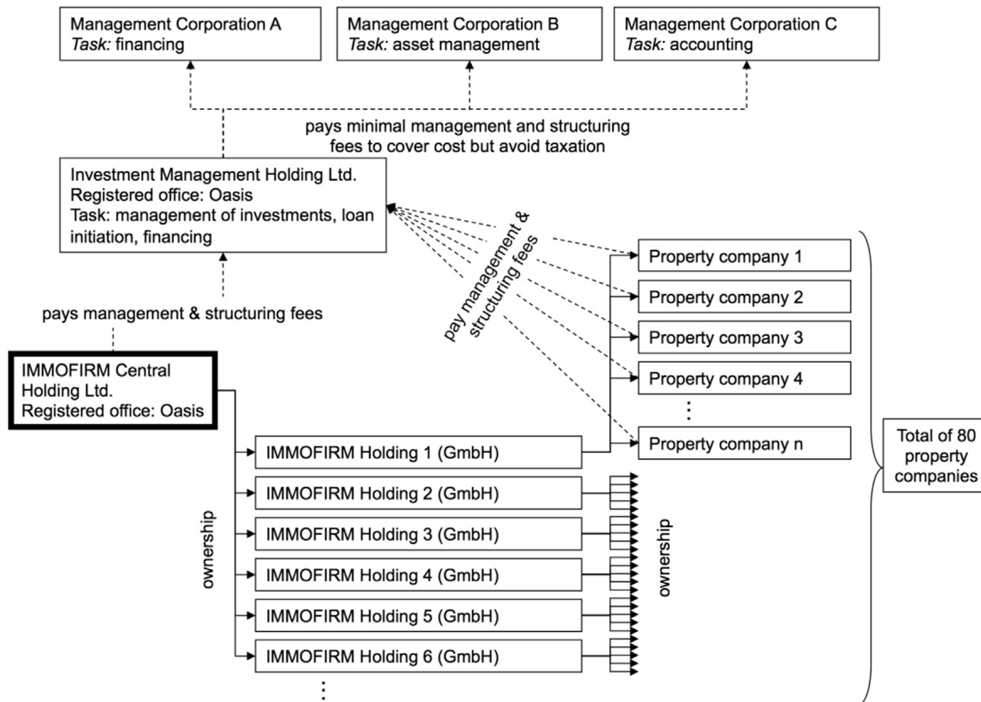


**Fig. 2.** Internal structure of the IMMOFIRM Group.
Source: Illustration based on authors' findings.

accounting practices constitutes the basis for profit generation. The business model presented here is sustained by a constant flow of capital, generated through revaluation that was used for the premature distribution of unrealized profits via fees, the majority of which were paid upfront. In this section, we show in detail how the business model revolves around taking advantage of the steep price increases of the real estate market and to secure easy credit. In fact, these practices constitute the core of the business model which was modified in an incremental fashion and adapted over time to address external challenges such as information requirements of creditors and future investors (cf. McGrath, 2010). Therefore, we speak of a financialized business model, in which both, valuation and accounting, depend on and further drive an economic logic of short-termism and unsustainable profit generation (Jackson & Petraki, 2011).

### *4.1. Business process and inter-organizational relations of the IMMOFIRM group*

While (re-)developing, letting and leasing of property are considered to be ordinary – if not core – business activities of real-estate firms, those tasks were not the focus at IMMOFIRM. Instead of managing its real estate property, the firm's primary goal was to assemble a sufficiently large stock of real estate assets that was to be taken public. Accordingly, renovation and modernization efforts of the property were kept to an absolute minimum, as one of the interviewees recalled: "We kept maintenance reserves so low, they would have never been sufficient to fund a full redevelopment of our properties. We only made some cosmetic fixes ('Pinselsanierung')" (interview with IMMOFIRM executive).

Throughout our interviews, it became clear that managing the internal relations within IMMOFIRM (as shown in Fig. 2 above) as well as outside relations with financial services firms, such as banks, notaries, valuators, auditors and consultancies were primary tasks, not managing the actual real estate assets. Valuation and accounting practices were vital to manage inter-organizational relations and IMMOFIRM commissioned services from reputable firms (including first tier Investment Banks and Big Four auditing firms). Consequently, when asked about the core business activities of the IMMOFIRM Group, our respondents solely talked about cycles of financing seeking to acquire assets in order to expand the stock of assets to become 'large enough' to go public. Within IMMOFIRM, when executives aimed at acquiring multi-unit housing facilities between 2005 and 2007 at an expanding rate, they named such financing rounds after characters of fairy tales (e.g. "Snow White") or holiday destinations (e.g. "Mallorca").

Fig. 3 depicts the different features of standard procedure of these financing cycles, which we have grouped into four stages, all of which are central to IMMOFIRM's business model (identifying assets, assessing the portfolio, securing finances and acquiring assets and reporting the deal). In practice, these stages do not merely follow upon each other; instead, filling the pipeline, evaluating portfolio and refinancing are interrelated activities that indicate the cyclicality of the business model. The reporting phase completes the initial round of acquisition as it brings together management accounting and financial reporting. It is also the stage in which value increases through reevaluation of assets are 'objectified' and become the foundation for subsequent real estate purchases.

For example, the portfolio revaluation is used to secure additional finances for future acquisitions (see also the calculation example presented in Table 1 further below). Resembling mortgages in the US, the bank acting as a senior lender would be willing to hand out additional loans when a rise in asset value for already acquired property could be demonstrated.

Fig. 3 shows the four main phases of the organization's business model: filling the pipeline, evaluating the portfolio, securing finances and reporting activities, all of which are described in further detail below.

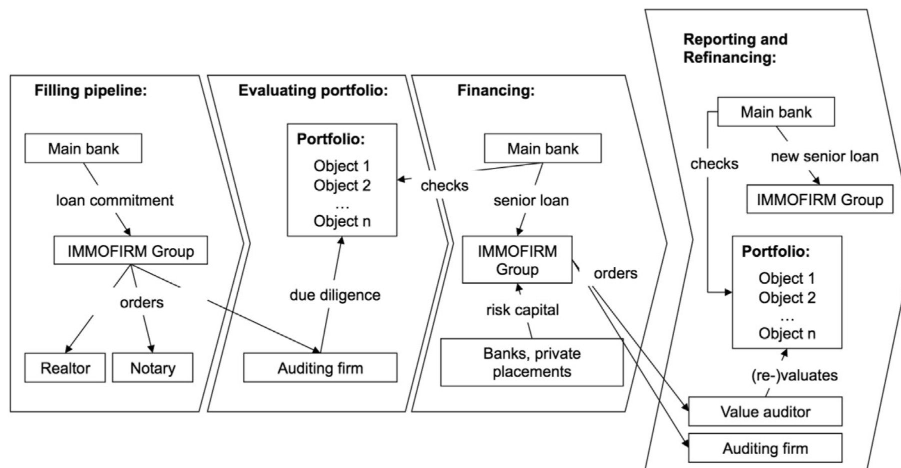


**Fig. 3.** Business process and inter-organizational relations of the IMMOFIRM Group.
Source: Illustration based on authors' findings.

***Filling the Pipeline***. The first step consists of preparing the acquisition of available real estate by property scouting and initiating future financing. Even before looking for potential assets, IMMOFIRM executives approached the main bank to get a non-binding loan commitment for a certain category of property (e.g., residential real estate in multi-unit housing facilities) up to a pre-defined amount (e.g., €150 million). Such a non-binding loan commitment then allowed IMMOFIRM to commission realtors to search for property under the resolutive condition of financing.

In 2006, as well as in 2007, immediately before the financial crisis, finding available property and closing a deal within very narrow time frames turned out to be a huge challenge for management: "Everything had to go really fast, there was a lot of time pressure. The faster you bought, financed and finalized that stuff, the better" (interview with IMMOFIRM executive). Time pressure originated from rising price levels in the German real estate market at the time. The IMMOFIRM interview partners remember the recurrent use of phrases such as "The market is bullish!" or "The window of opportunity is closing!" which led to the impression that closing a deal was more important than its price, as there was an overabundance of credit ("For some time, money was not really the problem").

***Evaluating the portfolio***. Once a sufficient number of residential properties had been identified (and the pipeline had been filled), at least two different auditing firms were hired to assess the portfolio, both financially and materially. For the successful settlement of the transaction, these evaluations were the most critical part. As one IMMOFIRM executive explained, the ex-post legitimation of an already negotiated purchase price was vital (emphasis added):

> We as the buyer wanted the property valuator to come up with a property valuation as high as possible; because we were going to receive *loan to value* from the bank and had already negotiated the prize [of the property]. So, either he'd justified the prize you had negotiated or you had to renegotiate or even drop the property, because the bank would say "you are paying too much" (interview with IMMOFIRM executive).

After the evaluation by the auditing firm, the main bank paid out a mortgage-backed loan (senior loan) covering between 80 and 85 percent of the acquisition (loan to value). The deal's total value also included transaction costs such as fees for notary, realtor and auditor services as well as lending fees, all of them paid up front, except for notary fees:

> Loan to value was calculated based upon purchase price plus fees related to the transaction. On average, fees add another 10% of the purchase price to value (interview with IMMOFIRM executive).

Lending fees were immediately deducted by the bank itself at the time the loan was awarded. The higher the property value, the higher the bank's fees. The term of such a loan is usually about five to ten years with full repayment of debt at the end of the term ("The fiction in the market is that you are going to refinance anyway", interview with IMMOFIRM executive). As a result, operating cash-flows from letting and leasing were almost exclusively used to repay interest; virtually no repayments of the loan during the credit period were made, as they were all held for maturity and usually refinanced before maturity was reached.

IMMOFIRM Group's main bank, a large full-service investment bank, in turn, re-packaged such a senior loan into chunks of asset-backed securities with different interest levels, which they offered on the respective securities markets ("The bank securitized the loan and passed it on", interview with IMMOFIRM executive). The bank's ability to securitize the contractual debt and sell it on is a core prerequisite for engaging in the market of residential real estate. Securitization became a profitable and apparently risk free activity as the senior loan was passed on to other actors on financial markets.

***Financing***. Receiving the senior loan meant that IMMOFIRM executives were only part way to finalizing the transaction. Equity had to be further reduced, most importantly because IMMOFIRM did not dispose over any substantial capital of its own to ensure growth. To increase leverage, the group's business model required finding investors for the remaining 15 to 20 percent of acquisition costs not covered by the senior loan from its main bank.

In addition to the senior loan, four different sources to raise capital were drawn on to reduce paid-in equity to practically negligible amounts: (1) mezzanine capital provided by the investment banking division of the same bank that provided the senior loan and required high interest payments and included special bonus clauses for the case of an IPO ("equity kicker"); (2) smaller investments by other banks; (3) private placements of individual investors via a rolling corporate bond; (4) refinancing as an

additional source of capital provision, relying on revaluating "older" senior loans from earlier acquisitions (loan to 'readjusted' value) and, thus, generating extra capital to be used in future investments. This indicates most clearly the cyclical nature of IMMOFIRM's business model. With regard to refinancing, one IMMOFIRM executive explained:

> The magic word was refinancing. The 80 percent that the bank was willing to finance, this 80 to 85 percent, were loan to value. This means, if I had bought property for 100 and a new property valuation says it's worth is now 150 and the bank accepts this, then [the bank] will increase your initial loan to 120 [instead of 80, paying out the additional 40].

For IMMOFIRM's business model, two of the above-mentioned sources of financing stand out: First, the mezzanine capital allowed IMMOFIRM Group to substantially increase its stock of real estate assets. This credit line provided risk capital to close the 15-20 percent financing gap left open by the 80–85 percent major loan. Second, in later rounds, revaluating and refinancing earlier asset acquisitions allowed IMMOFIRM to expand without seeking any additional mezzanine or other risk capital; rather, refinancing senior loans on existing property enabled the purchase of more and more property in the course of increasingly self-fueling cycles – at least as long as residential real estate assets in Germany experienced an increase in market prices.

At the same time, service firms and, in particular, banks financing the transactions had vested interest in enabling new transactions fueled by refinancing practices because of the fees immediately paid out in the process. Table 1 presents an exemplary calculation of financing and refinancing in the case of IMMOFIRM with a focus on fees disbursed in the process. Our estimation indicates that roughly 9% of the asset purchase is immediately paid out in fees to the various stakeholders. In addition, at the later stage of refinancing an additional 3.5% (on a higher base value) is paid out when a new loan is taken out and the initial senior loan is repaid. It is particularly noteworthy that in both rounds IMMOFIRM charged management and structuring fees of 3% of the loan sum.

**Table 1**
Exemplary calculation of (re-)financing in the IMMOFIRM Case.

| | | *Amount (in million Euro)* |
|---|---|---|
| | **Purchase price at $t_1$** | **156.9** |
| *Initial financing at $t_1$* | Real-estate transfer tax (3.5%) | 5.5 |
| | Bank fees deducted directly from senior loan (3.5%) | 5.5 |
| | Court fees (0.5%) | 0.8 |
| | Notary (0.5%) | 0.8 |
| | Real-estate agent (1.5%) | 2.6 |
| | IMMOFIRM management and structuring fees (3%) | 4.7 |
| | **Transaction volume** | **176.5** |
| | Senior loan (85% of transaction volume) | 150,0 |
| | Mezzanine loan | 21.3 |
| | Other funding (private placements and delayed payment of some minor fees until the next deal is closed) | 5.2 |
| | **Fee totals** (incl. mezzanine loan fees of 0.6; ~9.4% of purchase price) | **14.7** |
| Refinancing at $t_2$ requires new valuation and its audit but neither RETT nor fees for court, notary or real-estate services. In addition to the internal fees, IMMOFIRM receives the spread between original and new senior loan. In return, annual costs for interest and (minimal) repayments rise and have to be covered by (higher) rent. | | |
| *Refinancing at $t_2$* | New valuation at $t_2$ (estimated price increase of 30%, 156.9 + 47.1) | 204.0 |
| | Senior loan (85% of newly estimated price) | 173.4 |
| | **Fees:** | 7.1 |
| | - Bank fees (3.5% of newly estimated value of 204.0; incl. fees for revaluation audits and deducted from senior loan) | |
| | - IMMOFIRM management and structuring fees (3%) | 6.1 |
| | **Additional capital for IMMOFIRM** based upon new valuation (after paying fees and repaying original senior loan of 150 million) | **10.1** |

Source: Table based on authors' analysis and confirmed by IMMOFIRM interview source, values rounded to one decimal place.

***Reporting***. Expansionary credit cycles and subsequent refinancing not only depended on increasing asset price levels, equally important was the 'incorporation' of rising values into IMMOFIRM's books, which laid the foundations for future refinancing. Increasing price levels of the German real estate markets were translated into considerable balance sheet profits, while the level of equity was kept to an absolute minimum ("There was not a cent more equity in the sense of paid-in capital than required by law. Never", interview with IMMOFIRM executive). The beneficial dynamics the firm was able to exploit in refinancing its loans 'to value' were reported on the basis of Fair Value Accounting (FVA) and exhibited pro-cyclical effects.

For 2006, the year's earnings of 300 million euros were in their entirety attributed to a revaluation of real estate property. ("Which is in conformity with IFRS, or rather, not only allowed but required", ibid.). Furthermore, the upward price movements of the German real estate market allowed for a continuous positive re-valuation of the property stock through the application of mark-to-market accounting. Under the conditions of notable price increases in the German real estate market in the early 2000s, a pro-cyclical dynamic unfolded between a raise in housing prices, increased balance sheet values, higher loans due to loan to value (re-)financing and renewed purchasing power to buy additional real estate.[5]

Surfing the German real estate bubble was as much IMMOFIRM's affair as it was a collective endeavor of the entire industry

[5] Irrespective of considerations whether the pro-cyclicality of the market at the time was natural or amplified (Barth & Landsman, 2010), the key issue is the bank's willingness to give an additional loan for an asset already purchased. Loan-to-value was a fundamental principle behind IMMOFIRM's activities and fair value accounting seamlessly made balance sheet profits visible to external actors.

in which every firm accounted for increasing market values mutually spurring the upward trend. Applying International Financial Reporting Standards (IFRS) was crucial for the envisioned IPO for which internationally accepted standards are required by European law ("We needed IFRS financial statements for bringing it to the stock market", interview with IMMOFIRM executive). While IFRS are cornerstones to woo potential investors and convince them of a firm's performance, international standards were not used to secure banks' support in refinancing activities ("Banks were not interested in our IFRS balance sheet but rather got their own picture of the situation," interview with IMMOFIRM executive). So, while fair value accounting was no prerequisite for loan-to-value refinancing practices, it was an important source of legitimacy for IMMOFIRM when engaging with outside investors.

Within the firm, management accounting and financial reporting had to be brought together despite fundamental reservations to account for real estate at market values. When putting the financial report together, IFRS stipulates that real estate is to be valued and marked to market:

> One has to say that it [mark to market] is obviously a stupid concept in some areas, in particular in real estate, where you recurrently have difficulties in that there is no market for a real estate asset, unless you sell. That is logical. There is only a benchmark. And then you can always dispute if the building two blocks up the street, that was sold last month, is nicer, bigger, rented more efficiently, in a different location or whatever. So, basically, you can claim anything, as long as a valuator signs it off (interview with IMMOFIRM executive).

Such ambiguities in reporting are dealt with by different professionals throughout the business cycle. External services firms contribute during the reporting phase by providing valuations (and revaluations) of real estate; in addition, they assess such valuations in subsequent periods, when auditors — in our case individuals working for one of the Big Four firms — certify the valuations provided by other professionals. Auditors were key players in approving IMMOFIRM Group's consolidated accounts that were a necessity for the planned IPO. Had it materialized, both the creditors as well as the owners of IMMOFIRM would have benefited one last time by cashing-in during the sale of shares of a company whose own equity was minimal and whose valued portfolio was much higher compared to purchase price levels.

Incorporating assets at market value into IMMOFIRM's books might have effectively limited transparency, because it conveyed a false sense of certainty. First, fair values are no substitute for information that allows judging an organization's risk exposure or the validity of reported fair values (Laux, 2012). Second, at the organizational level, fair values are deemed insufficient to help investors and creditors to evaluate stewardship (Abdel-Khalik, 2011). Our observations confirm Boyer (2007), who argues that fair value effectively obscures the value creation process because it mixes present profit with unrealized capital gains and losses, which was essentially at the heart of IMMOFIRM's business model.

### 4.2. *Inter-organizational value creation and remuneration through fees*

The financialization of IMMOFIRM's business model materializes in two ways: First, as shown in the previous section, valuation and accounting practices provide the foundations of value creation by revaluating property and legitimizing the provision of additional credit. Second, payments of management and services fees represent materializations of calculated value increases. Fees provide pecuniary gains for all parties involved and allow them to benefit immediately from operations that are (supposed to be) generating profit in the future. Up-front management and services fees are the primary value carriers which allow the transfer of cash within IMMOFIRM Group and between IMMOFIRM and its services firms. It is noteworthy that the cash flow from traditional business activities in residential property management such as developing, letting and leasing of real estate plays only a marginal role for the business model as a whole. An indicator for the insignificance of traditional business practices is the outsourcing of these tasks. The IMMOFIRM Group had outsourced the facility management for nearly all its properties; and its main bank had also outsourced checking cash-flow reports to loan servicing firms.

Value increases are calculated on the basis of acquisition and revaluation of real estate property. Valuations, their assessment and certification need to be justified by outsiders that offer such services for fees. Their price is often attributed to the volume of the underlying deal or asset and is calculated as a percentage of the deal. Similarly to 'loan to value' credit practices, fees also increase in a bullish market environment and ensure that service providers benefit proportionally. Fees, therefore, play a key role in establishing and maintaining the valuation-accounting nexus at the heart of IMMOFIRM's business model. Lending fees, for instance, are calculated as a percentage of the overall amount of credit and are deducted by the bank when granting a loan. Following a similar logic, all other interaction partners involved in practices of property acquisition and revaluation around the IMMOFIRM Group had an interest in continuing the increasingly self-fueling cycles of property acquisition and property revaluation.

Table 2 gives an overview of the different elements of value creation throughout the business process. A more systematic characterization of practices, agents and value carriers underscores the importance of firms in supplying sophisticated finance-related services that provide outside legitimacy to IMMOFIRM's activities. Assembling and managing the organizational relations between the various entities of IMMOFIRM Group is therefore an ongoing activity. While value creation is a calculatory task, payments for acquired services are usually paid up-front, out of IMMOFIRM's cash flow, which in turn was generated at least partly through additional loans given out by creditors on the basis of revaluated property. Fees are therefore the material manifestation of calculatory value creation.

As Table 2 indicates, fees are instrumental in enabling and upholding the firm's business model in a number of ways. Loan commitment fees, transaction fees and valuation fees were paid to the financial services firms for the services they provide. Lending fees were part of the credit transactions with the bank and were paid for obtained senior loans as well as over one hundred million euros of mezzanine capital by the investment banking unit of its main bank. On top of all these inter-organizational fees, IMMOFIRM also paid out internal management and structuring fees to its offshore holding in the course of each financing and refinancing cycle (see Table 1 above).

From the bank's perspective, value generation takes place immediately as part of lending and structuration fees for the senior loan and, in case it was necessary, fees deducted from the mezzanine capital. The main difference between mezzanine credit and senior loans was the absence of auditing firms in the process when awarding the former, which is an indicator of its speculative nature; the mezzanine credit was given by the investment banking department of the main bank. Not just IMMOFIRM but also banks therefore had an interest in high property valuations, as their fees were a proportion of the size of the deal.

**Table 2**
Inter-organizational value creation process around IMMOFIRM.

| | *Value creation practice* | *Interaction partner(s)* | *Value carrier* |
|---|---|---|---|
| Filling Pipeline | Acquiring properties under the resolutive condition of financing | - Main bank, Realtor, Notary | Loan commitment fee<br>Transaction fee<br>Transaction fee |
| Evaluating Portfolio | Property valuations by auditing firms | - Auditing firms | Property valuation fee |
| Financing | Senior loan for acquiring property | - Main bank | Lending fees |
| | Risk capital (mezzanine, private placements) | - Investment banking unit, investors | Lending fees |
| | Securitization of senior loan | - Main bank | Transaction fee |
| Reporting | Property revaluations by auditing firms | - Auditing firms | Property valuation fee |
| | Reporting on assets | - Main bank | Lending fees in case of refinancing |
| | Refinancing existing assets | | |

Source: Table based on authors' analysis.

### 4.3. *The role of auditing in value creation*

With regard to the role of auditing firms, their critical contribution to the functioning of IMMOFIRM Group's business model was the certification of values of (previously acquired) residential property. These valuation processes relied mainly on the two criteria: operative cash flow and market value. However, each of these criteria depends heavily on assumptions (e.g. with regard to expected percentage of rental vacancies) and reference values (e.g. market prices paid for similar properties). In the case of the IMMOFIRM Group, the ‘accurate’ valuation was disputed even among different units of one Big Four auditing firm, as one IMMOFIRM executive described:

> One real estate valuer, a conservative German, expressed doubts with regard to the valuation of our assets that we had prepared for the IFRS report. He said that even though our calculation was correct, nobody was going to pay that much. We then pointed to a comparative case, which he turned down because it was property for owner-occupied apartments and not for rent. … In the end, the solution was that the office in Oasis [name of the tax haven] certified the valuation … these [auditors] are bullish to the breaking-point (interview with IMMOFIRM executive).

In order to avoid an open conflict between property valuators in Germany, which had certified a high purchase price in order to ensure loan to value, and the conservative German auditor from IMMOFIRM's Big Four auditing firm, another auditor from within the same Big Four firm was brought in. As the group's legal holding was formally (primarily for tax reasons) headquartered in an offshore tax haven, the solution was to leave the task of certifying the inflated property values to the auditing firm's unit in this jurisdiction.

Not only use Big Four auditors their capacities in tax havens to advice their clients with tax ‘management’, they are also able to provide ‘creative’ solutions from within the Big Four firm's global network in cases in which their more conservative auditors do not find themselves in a position to certify financial reports they deem overvalued. To cater to client's interests, the Big Four firm provided an audit from its unit based in an offshore tax haven. Shifting service provision within the auditing firm's network was resorted to in order to provide the needed audit to legitimize value creating.

Accounting professionals unrelated to the IMMOFIRM case pointed to the importance of standard procedures, while also emphasizing the substantial discretion of the individual auditor (“There is a lot of discretion. It is important that, in the end, the auditor can certify with a clear conscience,” interview with real estate auditor of a large auditing firm). In a nutshell, the circular logic inherent in valuation practices of large auditing firms contributed to the upward trend in market prices for residential real estate in Germany. Valuation and auditing practices both enabled and fueled the financialized business model.

## 5. Discussion

IMMOFIRM's impressive acquisition of assets (estimated to be roughly 1 billion euros over a three year period) was achieved with virtually no net equity. Subsequently, the financial crisis brought about the firm's collapse and bankruptcy: IMMOFIRM's managers were unable to continue the firm's financialized business model after the firm ran out of money when real estate markets contracted. However, the strategic – and skillful – usage and combination of valuation and accounting practices just about lead to the aspired goal of placing the firm on a large European stock exchange. Three core findings can be identified from the empirical analysis, which contribute conceptual insights to discussions on valuation and accounting practices:

First, *inter-organizational valuation and accounting practices*: The firm's business activities comprise both operational practices as well as strategic, long range planning to set up and run a complex organizational structure with a rather simple profit-making idea. To benefit from an increase in asset prices, the firm became engaged with a credit-based acquisition strategy which was favored by two dynamics: cheap refinancing conditions due to expansive monetary policy and low interest rates around the world on the one hand, and the spread of “esoteric” financial products (Goldstein & Fligstein, 2014, p. 10) facilitated by loan securitization on the other hand. However, the cornerstone of the model were inter-organizational valuation and accounting practices (Froud et al., 2006), exploiting the opportunities provided by markets and political conditions for the mutual advantage of all parties involved.

Calculatory practices were not only used to account for profits off-shore and for losses on-shore. Most importantly, valuation practices were used to drive up purchase prices in order to benefit from loan-to-value lending conditions common in the industry. In addition, IMMOFRIM retroactively calculated internal cash flow between the firm's different units, so that accounts would be in conformity with IFRS requirements for consolidated reports. Auditing also played its part when various audits from within one Big Four firm were sought until sufficient confirmation of a previous valuation from within the auditing firm's network was sought, until it was deemed appropriate by management. The combination of valuation, accounting and auditing practices made it possible to transform anticipated income into present profits (cf. Sikka & Willmott, 2010).

Second, *business model based on* fees: Bringing future potential profits into the present is a key feature of financialized business models (see also Erturk et al. (2010) for similar dynamics in private equity contexts). The early distribution of unrealized earnings via up-front fees enables to channel capital (including credit

retroactively provided for previous purchased assets) to the service industry which legitimizes the business model. One might say that fees represent the services firms' share of helping to establish and uphold financialized business models that have little prospect to outlive a boom phase. In addition, high fees compensate services firms for the absence of long-term commercial relations (cf. Goldstein & Fligstein, 2014, p. 17). Our analysis underlines the importance of fees as value carriers or transmission belts that benefit capital providers, services firms and the core unit itself. Refinancing, for instance, not only creates lending and structuring fees for the bank but also management and structuring fees within the core organization; in the latter case, structuring fees are calculated as (tax deductible) onshore expenses and distributed as (nearly tax-exempt) offshore profits. More broadly, prices of services increase as they are charged proportionally to market prices and therefore contribute to a rise in overall costs. Moreover, as shown by the internally collected management and structuring fees, financialized business models also explain why, over the last two decades, "fees have risen substantially as a percentage of assets managed" (Malkiel, 2013, p. 97).

Third, *temporal aspects of valuation and accounting practices*: Our case underlines the importance of sequence and timing as value creation unfolds cyclically. Business activities consist of numerous overlapping financing rounds in which earlier rounds feed later ones. Challenges arising from these complex dynamics play out in two ways: For one, firms need to be *reflexive,* so they are able to slightly alter their business model over time to incorporate earlier experiences and to maintain long-term relations, for example with the senior lender. For another, firms are required to respond in a *reactive* manner, addressing outside concerns, for instance, when preparing the accounts ex-post according to International Financial Reporting Standards (IFRS).

In general, reaping investment payoffs as early as possible, mainly through services, management and structuring fees, while piling up high loan commitments, is the main characteristic of financialized activities for which a temporal perspective is necessary: unrealized gains, which only constitute *potential* future profits, are deducted from calculated values and then paid out as fees. These prospective gains are linked to the growing value of an asset bundle that has effectively been established through calculatory measures, primarily valuation and accounting practices.

The temporal dimension of valuation and accounting is not only apparent in up-front fees where estimated profits are brought into the present. Conversely, with credit, the contrary dynamic is observable: repaying credit is postponed into the distant future. Periodic refinancing of loans turns (rising) credit obligations into a permanent characteristic of the firm. High up-front fees – bringing future profits into the present – and constant refinancing of credit obligations – postponing repayment of credit – are both expressions of a financialized business model.

To sum up, what makes financialized business models unstable (Minsky, 1986/2008) and unsustainable in the long run is that, until a public listing has taken place, gains are only calculatory – albeit manifest in terms of immediately profit-generating fees – and the inflow of new capital is used to acquire new assets and to restructure loans. To succeed, the individual firm (or the asset bundle it constitutes) needs steady growth in a thriving market – nearly impossible conditions in the medium and long term (cf. Boyer, 2007). Such a business model needs to be 'completed' before the wave breaks and an economic downturn sets in.

## 6. Conclusion

With this paper, we contribute to the literature concerned with the strategic aspects of financialization (Arnold, 2009; Froud et al., 2006, 2004; Kädtler, 2009). We presented a systematization of the strategic dimensions of financialization inherent in the establishment, management and exploitation of business models which rest on valuation and accounting practices. The insights drawn from the case study allow us to contribute some conceptual propositions to ongoing debates on accounting and financialization: Under the conditions of rising asset prices and cheap credit supply, financial logics can be used almost directly to design an organization with a corresponding short term business model – as long as reputable services firms provide external legitimacy.

Constructing overly complex organizational arrangements and paying substantial fees to services firms and credit providers are core characteristics of such a financialized business model. For such a model, external recognition is crucial. Property valuators are needed to legitimize the purchase of 'overvalued' assets and auditors, in turn, are indispensable in certifying valuation and accounting practices. Therefore, financial services firms actively contribute to excessive price developments privileging financial over productive activities.

Moreover, financialized business models not only mirror the dominance of financial markets in today's economy; rather, they embody a sophisticated gamble, essentially: a bet on rising asset markets, which is based on a valuation-accounting nexus spanning organizational boundaries. Highly leveraged business models incentivize the 'delivery' of valuation and auditing services that systematically foster expectations of above-average market returns.

We conclude that, at the industry level, financialization is not simply an unintended consequence of broader free-market dynamics. Instead, ample supply of credit and a dominant financial logic of short-termism are strategically drawn upon by acquiring, (re-)valuating and accounting for specific assets. In the real estate market, these dynamics extend beyond 'mere' speculation: In addition to acquiring objects with promising value increase, real estate firms such as the case provided here actively 'manufacture' higher values. They rely on external services which charge fees based on the value of the assets as they are calculated. We therefore find that fees are at the heart of driving this valuation-accounting-nexus and serve as value carriers transforming potential future income into current profits.

These findings extend the literature on financialization by going beyond the transformation of the productive sector (Boyer, 2007; Froud et al., 2006) and a proliferation of financialized logics more generally (Epstein, 2005). We show that, at the organizational level, financial logics become the guiding principle to set up financialized business models based on fees (see also Erturk et al., 2010). Externally, fees bring future profits into the present and settle obligations with services firms. Internally, transfer pricing arrangements are used in which fees serve to uphold business activities and enable tax evasion. Such financialized business models are based on strategic decision-making in which skillful actors transform and redistribute asset values. Fees are essential for the transformation of unrealized future gains as they 'liquefy' assets and allow the redistribution of their calculatory value from real estate firms to financial service providers.

Beyond the scope of this paper are potential macro-economic consequences concerned with the diffusion of business models, such as the one analyzed here. The recurrent referral to common industry practices and a shared understanding of specific interpretations of valuation and accounting practices on behalf of members of contracted services firms indicate that such business models are widely spread. In sectors such real estate markets, economic activities are to a large degree geared towards short-termism, often seeking to reap above average profits with little equity. A temporal perspective is essential to account for how organizational and industry dynamics relate to each other.

Finally, mark-to-market accounting needs careful reconsideration given its tendency to spur pro-cyclical dynamics. Accounting practices mirror these dynamics; at the same time – mediated through property valuators and auditors – accounting for steep price increases is also observed by other players in the industry. If regulatory activities were to aim at the reduction of systemic risk and macro-prudential security, accounting rules would have to be incentivized to not drive short-termism. This could lead to questioning the self-regulation in much of the professional services industry and to addressing the potential conflict of interest between commercial service providers being custodians for the public good.

The most effective action might be to target fees, the value carriers of financialized business models, by requiring transparency with respect to calculation and by more detailed publication requirements. Furthermore, a critical re-assessment of current corporate law along the lines suggested, for example, by Greenfield (2008) might lead to questioning the spread of organizations with no demonstrable economic purpose. Future research on the characteristics of fees, related accounting practices and potentially unintended consequences of liberalized corporate law, also in fields beyond real-estate, seems to be an endeavor worthwhile.

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