

Earnings guidance: The real issue

The current debate focuses on the wrong question.

BY SAM SILVERS AND WENDY HUANG

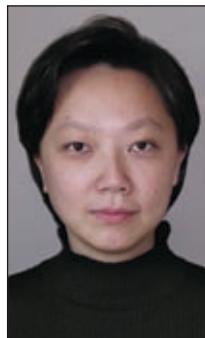
THERE IS A long-running argument about whether or not companies should provide earnings guidance. The media has produced an endless string of articles and opinion columns. Academics have churned out study after study. And corporate executives have debated the issue until they were blue in the face. But in our view, all of these arguments focus on the wrong question.

The real issue is how to get analysts and investors to see your future prospects the same way you do — to believe in your company's "story." In this broader context, quarterly earnings projec-



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tions are little more than a footnote.

Yet companies around the world continue to waste countless man-hours agonizing over their earnings numbers as if they are all that matters. Sure, earnings are important. But they are only part of the story (and not necessarily the most compelling part). In many cases, companies might be better off with a more balanced approach that doesn't revolve entirely around earnings per share.

In recent years, there has been a slow but steady trend away from giving earnings guidance. Deloitte recently conducted research to see how some of the world's most profitable companies provide market guidance without relying solely on projecting earnings per share. The study revealed three additional angles a company might choose to highlight when telling its story:

- *Strategic Initiatives.* A number of these companies tell their story by focus-

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Earnings guidance

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ing on their overall strategy and the key initiatives that support it, which helps them gain the market's confidence. If investors and analysts find the story and strategy compelling, management can provide guidance simply by showing that the strategic initiatives are on track. A number of leading financial institutions use this as their primary approach to guidance. One insurer even goes so far as to produce a separate supplemental disclosure that describes the progress the company is making against its strategic initiatives.

- *"Big Picture" Trends.* Other companies tell their story by linking the company's prospects to larger trends such as macro-economic factors and demographic shifts. If analysts and investors buy into the company's overall strategy — and how it relates to the larger trends — they are likely to remain on

board as long as the trends continue to unfold as expected. A leading Internet company relies on this technique as its primary approach to providing guidance. As long as Internet usage continues to expand in size and scope, investors and analysts are likely to maintain their rosy view of the company's market value and future prospects. Other companies use a similar approach, but hitch their fortunes to trends such as interest rates, energy prices, and immigration patterns.

- *Management Confidence and Trust.* Some companies have such a strong track record of meeting or exceeding investor expectations that the market is willing to accept their story more or less on faith. Many of the world's most respected companies fall into this category. For example, one highly profitable investment banking firm provides investors and analysts with very little guidance or insight into its business, preferring to let the firm's performance speak for itself.

Establishing this level of confidence and trust isn't easy; however, companies that have achieved it should definitely use it to their advantage. A similar technique is to showcase a team of senior executives responsible for a region or market segment that is particularly critical to the company's profitability.

Boards should be taking a critical look at how the company is telling its overall story. Is management using all of the techniques at its disposal? Or is it fixating on quarterly earnings? Choosing the right approach — or mix of approaches — can have a significant impact on market value. It can also allow company executives and staff to focus more attention on managing the business, instead of wasting their time fussing with the numbers. ■

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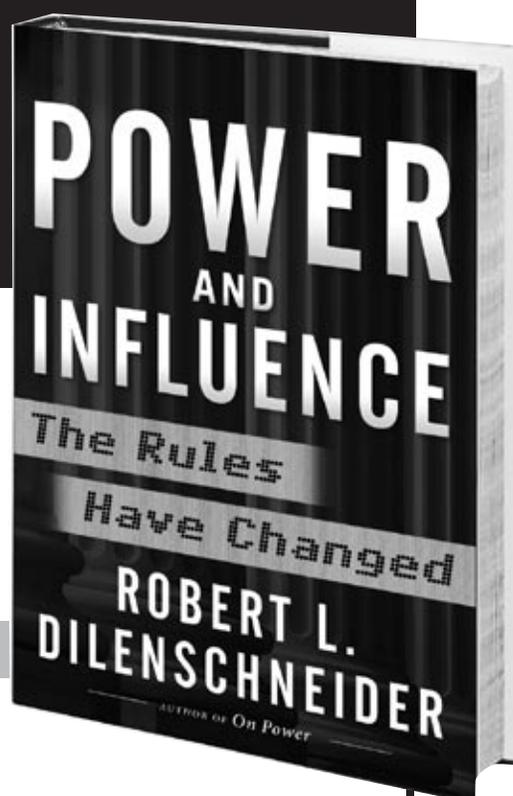
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