

TACKLING THE ISSUES

Should Companies Drop Guidance in a Bad Economy?

This year, Starbucks, Macy's, CVS Caremark, and Jos. A. Bank are eliminating their customary financial disclosures because they claim the practice encourages short-term decisionmaking and confuses investors.

Analysts are saying, however, that some companies might be dropping guidance because they are embarrassed about their poor numbers.

Since the issue of whether to provide guidance continues to be topic of debate, *IRN* approached five investor relations experts to ask their opinion. Their answers appear below.

The question: Is dropping guidance the best approach in a bad economy when the company is struggling to meet numbers?

David C. Collins, Partner, Jaffoni & Collins



If you don't know where you are, you probably shouldn't be giving directions.

In other words, if economic circumstances are making it much more difficult to project the future performance of your public company with any level of accuracy, then dropping financial guidance makes

a lot of sense. Feigning visibility into your business trends to reassure investors is a short term "cure" with huge relationship and litigation perils.

Given that a fundamental objective of corporate financial guidance is to provide investors with a base-case scenario for future performance, it could very well be time to forgo specific guidance if you are having trouble gauging that base level. Helping investors understand the more general "drivers" is a better way to go.

It should be no mystery that retailers are dropping guidance during a challenged economy marked by job cuts, spiking energy and commodities prices, shrinking home values, and tightening credit standards. They are struggling to predict what this might cause in their business and providing guidance is fraught with peril.

What companies should do depends on the level of confidence management has in its internal projections. A strong economy can cover up a lot of forecasting sins; a weak economy raises the risk of predictions.

But helping Wall Street—as best you can—to gauge what is coming in the short

Editors

Elaine Stattler
estattler@ioma.com
Joyce Anne Grabel
jagrabel@ioma.com

Research Manager
Bikram Gautam

Contributing Editor
Henry L. (Hank) Boerner
Laura Naus Holland

President
Joe Bremner

V.P., Publisher
Randy Cochran

Sr. Marketing Manager
Laraine Kelly

Board of Advisors

Henry L. (Hank) Boerner – *Accountability Central*
David C. Collins – *Jaffoni & Collins Inc.*
Eileen O'Connor – *National Investor Relations Institute (NIRI)*
Robert D. Ferris – *RF Binder Partners Inc.*
Bruce Frumerman – *Frumerman & Nemeth*
Mary Beth Kissane – *Corporate Perception Research LLC*
Dean W. Krehmeyer – *Business Roundtable Institute for Corporate Ethics*
Paul Schulman – *The Altman Group*

Sr. Managing Editor
Janice Prescott

Managing Editor
Andrea Morell

Desktop Editor
Eleni Giakamozi

INVESTOR RELATIONS NEWSLETTER (ISSN 1535-5802) is published monthly for \$345 per year U.S. & Canada and \$395 International, by the Institute of Management and Administration, Inc., 1 Washington Park, Suite 1300, Newark, NJ 07102-3130. ©2008 Institute of Management and Administration, Inc. All rights reserved. A one-year subscription includes 12 monthly issues plus regular fax and e-mail transmissions of news and updates. Copyright and licensing information: It is a violation of federal copyright law to reproduce all or part of this publication or its contents by any means. The Copyright Act imposes liability of up to \$150,000 per issue for such infringement. Information concerning illicit duplication will be gratefully received. To ensure compliance with all copyright regulations or to acquire a license for multi-subscriber distribution within a company or for permission to republish, please contact IOMA's corporate licensing department at 973-718-4703, or e-mail jpjng@ioma.com. POSTMASTER: Send address changes to *IRN*, 1 Washington Park, Suite 1300, Newark, NJ 07102-3130; 973-718-4700; fax: 973-622-0595; e-mail: subserve@ioma.com.

term and long term, is the best advice. Investors' short-term decisionmaking will happen with or without you—don't blame guidance for that. So it's best to help investors understand what is happening with whatever metrics that make sense. That will help create trust and credibility—and it will forge enduring relationships for the long term.

Collins can be reached at 212/835-8500 or by e-mail at collins@jcir.com.

Robert D. Ferris, Executive Managing Director, R.F. Binder Partners Inc.



Challenging economic times, whether macro or company-specific, call for conservatism, consistency, clarity, and transparency.

Public issuers would do well not to put their heads in the sand when things turn sour. To the contrary, they should be more attentive to clear messaging regarding the root of the problem(s) and present corrective measures that are under way or anticipated.

Of course, this attitude typically doesn't sit well with C-suite executives (not to mention counsel), but they nonetheless would do well to heed the advice.

I will always remember Warren Buffett's pronouncement on the cover of Berkshire Hathaway's annual report some years back. In a straightforward manner, he commented that the year "wasn't a good year." He then proceeded, in his letter to stakeholders, to delve into the year's challenges. Next, he articulated his business plan for a turnaround. This is a good model to follow. The man exudes credibility.

We all know that institutional investors disdain surprises regarding financial performance. Of course, they closely monitor bellwethers of the economy and take this

into consideration regarding investment strategy. But they can quickly turn fickle when management of their holdings doesn't "guide" appropriately regarding the subsequent impact of an expected economic downturn. It's even worse when the company does not temper its enthusiasm—or set the record straight with a pre-announcement—when the company becomes aware of an event that will materially alter previously expected numbers.

So I would counsel *not* to drop guidance entirely (alter the form, perhaps) in the face of a recessive economy or when a company is struggling to meet numbers. This is exactly the time when management should be most sensitive to consistent, transparent communications and the importance of its unique perspective about its business to the investment decision-making process.

Ferris can be reached at 212-994-7505 or by e-mail at robert.ferris@rfbinder.com.

Bruce Frumerman, President, Frumerman & Nemeth Inc.



Dropping guidance in a bad economy when a company is struggling to meet its numbers will not distract people from the fact that the company is going through tough times. In fact, it will make them imagine the worst about the company.

It is in a company's interest to avoid changing either the frequency of its communications or the types of information it releases in its investor relations efforts.

Any time a company makes such a change it should expect that one or more skeptics—be they analysts, the media,

Investors can turn fickle when management doesn't 'guide' appropriately during a downturn.

shareholders, or even short sellers—will speculate about the reasoning behind the action and repeat their thinking to others. Assume that critics will point this out as a sign that management is indicating continued bad times ahead and be willing to live with the potential negative publicity over the near- to mid-term.

Further, if your company has historically given monthly guidance and you're considering switching to quarterly or annual guidance, make sure management is fully committed to sticking to its new "rules of the game" once market conditions for the business improve.

Flip-flopping back to offering monthly guidance would bring out public complaints that management can't have it both ways.

Frumerman can be reached at 212-529-3373 or by e-mail at bruce@frumerman.com.



Dean Krehmeyer, Executive Director of the Business Roundtable Institute for Corporate Ethics

Discontinuing quarterly earnings guidance is a decision that can greatly increase corporate and investor focus on longer-term value creation.

However, leading companies that have made the decision recognize that dropping guidance is not the same thing as dropping communication with their investor and analyst communities—it is really about communicating more and communicating better.

Focused earnings guidance does a disservice to investors and analysts by implying a false simplicity to business strategy, operations, and execution. A better model—reflecting the complexity of business we all know exists—is for companies to provide information regularly on long-term strategy and goals.

The goals might include plans to increase market share, improve margins, or grow capacity.

Additionally, providing industry insights, nonfinancial metrics, and trend information offers greater clarity for analysts and investors and helps to focus attention on the strategic, value-creating purpose of the firm instead of on an arbitrary number.

Krehmeyer can be reached at KrehmeyerD@darden.virginia.edu.



John Palizza, Founder, Palizza Partners LLC

I actually think that most companies should not provide earnings and EPS guidance. I think that is the job of the analyst.

What the company *should* provide is a well thought out flow of information concerning the company that will allow investors to make informed decisions about the company's value. That information flow should be consistent and not vary with the economic times.

Our regulatory disclosure scheme allows, for the most part, companies to go into "Black Box" mode between reporting periods if they want to. What really helps analysts do their job correctly are the voluntary disclosures companies engage in, such as same store sales for retailers.

To cut off voluntary disclosures when times get tough is short-term thinking on the part of company managements. It is basically telling Wall Street that the company will give you information only when it is good news, or it's so terrible that the regulations require that it be disclosed.

There is already research that says that investors automatically discount good news coming from the company, while giving more

credence to bad news announcements.

ages their credibility over the long term.

In my view, if companies shut down the information flow when times get rocky, it dam-

Palizza can be reached at 281-727-6775 or by e-mail at john@palizzapartners.com. □

NIRI-CFA Study on Guidance Practices and Preferences

In late May, the National Investor Relations Institute and CFA Institute released the results of member surveys conducted in March 2008 on financial and nonfinancial guidance practices and preferences.

The NIRI survey was sent to 3,119 NIRI corporate members, and the CFA Institute electronic survey was sent to 16,000 CFA Institute members. The response rates were 12 percent and 7 percent, respectively. The survey questioned members on earnings guidance, communication strategies, and incentives.

Findings on earnings guidance:

- Among NIRI members who do not provide quarterly earnings guidance, nearly three quarters (74 percent) refrain from doing so to focus on long-term company performance.

- Among CFA Institute members who think that providing earnings guidance is not a best practice, the main reason for their disagreement is the belief that companies should focus on their long-term performance (91 percent).

- Sixty-four percent of NIRI members report providing earnings guidance compared to 51 percent in 2007 survey results and 66 percent in 2006, representing the reversal of a trend toward fewer companies providing guidance.

- Seventy percent of NIRI members provide broader financial guidance (not including earnings guidance), consistent with 71 percent in 2007 survey results. Fifty-seven percent of NIRI members provide nonfinancial guidance.

- CFA Institute members surveyed approve of the use of yearly earnings guidance more than the use of quarterly earnings guidance.

- CFA Institute members who use financial guidance (excluding earnings guidance) preferred annual estimates of such guidance more than quarterly financial guidance or other options.

- CFA Institute members surveyed approved of the use of yearly nonfinancial guidance on a long-term basis (more than one year) or on an as-needed basis more than yearly or quarterly nonfinancial guidance.

Findings on communication:

- About 54 percent of investment professionals indicate that over half of the firms they follow adequately communicate their long-term strategic objectives. Conversely, approximately 47 percent state that less than half of the firms they cover adequately communicate their long-term objectives.

- CFA Institute members strongly prefer companies to simultaneously provide guidance on a broad number of

financial measurements, with revenue and capital expenditures as the top two (86 percent and 84 percent, respectively).

- Trend information that may impact a company's business and industry-specific information were the top two nonfinancial measurements preferred by investment professionals.

- The primary reason NIRI members indicated for providing all types of guidance is to ensure that sell-side consensus and market expectations are reasonable, which is consistent with prior survey results. In addition to earnings guidance, respondents provided financial guidance on revenue, capital expenditures, and tax rate guidance most frequently. Nonfinancial guidance is most commonly provided in the form of qualitative statements about market conditions, trend information, and industry-specific information.

Findings on incentives:

The CFA Institute survey reported that incentive structures of analysts and asset managers are currently geared to yearly performance, with incentives for periods of greater than one year more common than short-term incentives. Sell-side professionals, however, are more likely to have quarterly incentives in their pay packages than their buy-side counterparts.

The NIRI results reveal that there is a demand for various types of guidance, and that NIRI members are meeting that demand in the way best suited to their unique circumstances.

The NIRI survey results also support the concept that there is no one-size-fits-all form of disclosure, and that each company, when formulating an effective disclosure policy, needs to consider its internal forecasting abilities, the needs of the financial community, and other constituencies and industry practices—all in the context of stock exchange and federal and state disclosure rules and regulations.

For more information about the NIRI study, contact Matt Bruschi at National Investor Relations Institute at 703-506-3574 or e-mail mbrusch@niri.org.

To learn more about the CFA Institute Centre survey, contact Kathy Valentine at 434-227-2177 or e-mail kathy.valentine@cfainstitute.org.