To forecast or not to forecast?

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Beware firms that refuse to issue annual financial targets

Illustration by Claudio Munoz

DIVINING what the future holds is tricky at the best of times; at the worst, it is devilishly difficult. So why bother? Citing the chaos of the global downturn, a growing number of companies, including Unilever, an Anglo-Dutch consumer-goods firm, Costco, a big American retailer, and Union Pacific, one of America's big railroads, have decided not to give annual earnings estimates for 2009.

If ever there was a moment for firms to keep their crystal balls under wraps, this may appear to be it. But many companies are still issuing annual forecasts in spite of the uncertainty roiling their markets. On February 24th, for instance, Home Depot, another American retailer, estimated that its revenues and earnings per share from continuing operations would decline by about 9% and 7% respectively in its 2009 financial year. Earlier this month, Reckitt Benckiser, another European consumer-goods group that competes with Unilever, said it was confident it could increase its revenues by 4% this year.

Issuing such targets is pointless and dangerous, critics claim. They argue that, with the banking industry catatonic and consumers pulling their purse strings ever tighter, the world is so topsy-turvy that any financial goal will be out of date as soon as the ink dries on the press release. Moreover, when companies then issue a *mea culpa* and lower their forecasts, disappointed investors will hammer the price of their shares. To avoid this punishment, managers will be tempted into short-termism, slashing investment in research and development or new machinery, for instance, even if that damages their firms' longer-term prospects. Better, then, to stay mum rather than risk a mauling.

But such arguments do not mean that companies should ditch forecasts altogether. Precisely because peering into the future is harder today than it was a year ago, managers should be using every available means to gauge what the world could look like in the coming months and to establish targets using this analysis. And they should draw up contingency plans for cutting costs without damaging vital investments if revenues fall short. Indeed, firms that shy away from forecasting should attract extra scrutiny from shareholders. It may indicate that managers are underprepared, or that they are trying to use the turmoil as an excuse to avoid setting goals for which they could be held accountable.

Target practice

What about the charge that firms issuing annual forecasts could be punished if they miss them through no fault of their own? This has a lot to do with the sort of numbers firms give. Managers ought to think twice before issuing a single, headline number for most financial targets. Even when things were rosy, such spuriously accurate figures were of less use than a description of how the main factors affecting a business could change. Given the dire state of the global economy, such information should now often be accompanied by a range of potential outcomes for the most important financial indicators.

Some firms could be tempted to issue ranges that are so wide you could drive a double-decker bus through them. But if they do, then investors will rightly conclude their chief executives do not have a tight grip on the business. It will take some effort to convince everyone that a range of outcomes makes more sense—analysts love to punch headline numbers into their spreadsheets. So here is one forecast for 2009 that is certain to come true: investor-relations departments will be busier than ever.