

The Hidden Benefits Of Regulation FD

by Philip B. Livingston

A year after the SEC's Regulation FD went into effect, the sky has not fallen as predicted. Though there remains some grumbling about constricted information flow from companies, both corporations and Wall Street seem to have adjusted. However, Philip Livingston suggests that corporations can do more than just adapt to Reg FD. Rather, they should use it to combat the whole culture of market obsession with short-term results.

Management's job is to increase shareholder value by delivering bottom-line results. Ideally, investors value companies on the basis of cash flow fundamentals and their prospects for earnings growth—a rising trend in long-term results should send stock prices up and vice versa.

In the past ten years, however, an escalating obsession with quarterly performance has threatened to eclipse the value of longer-term business building and value creation. Since the deluge of baby boomer capital increased general interest in the equities market and made media stars of industry analysts, stock prices have reacted dramatically to the difference between analysts' estimates of a company's quarterly earnings and the actual results. A penny shortfall can send a stock into a tailspin and the CEO or CFO or both into exile.

"Quarterly pressures shouldn't affect long-term performance," notes Tim Jerzyk, vice president of investor relations at Tricon Global Restaurants. "If they do, you have to question whether management really had a long-term strategy in the first place. But the pressure to meet the First Call estimate can divert management's attention near the end of a quarter, particularly when stocks are trading at lofty multiples."

John B. (Jay) Morse, chief financial officer of the Washington Post Company goes a bit further: "I do

believe long-term plans get sacrificed to short-term results in unstable markets. The expectation of precision in hitting these [consensus estimates] targets just isn't realistic. If you manage to a number for any other reason except to prove that you can do it, you're taking something away from the long term."

Regulation FD is encouraging true independent stock analysis by shifting analysts' focus from three-month EPS estimates to long-term company potential.

A mitigation of estimates' importance may come from an unlikely source: the SEC's Reg FD, which took effect almost a year ago on October 23, 2000. In promoting Fair (as opposed to selective) Disclosure to all investors on an equal basis, Reg FD is widening the range of analysts' estimates and forcing them to differentiate themselves by true independent analysis rather than by deeper access to corporate executives. Companies, meanwhile, must speak with one voice to the public at large. Some are even issuing their own earnings estimates on a 12-month basis.

Over time, these shifts may encourage analysts to devote more time and resources to evaluating a company's products, plans and market potential, with less focus on the three-month earnings per share (EPS) estimate. The dialogue between Main Street and Wall Street should be elevated, and the disparity between the way managers spend their time and the way they get measured by the market should be reduced.

The attention to quarterly results, estimates and actual, grew during the latest bull market for under-

Philip B. Livingston is president and CEO of *Financial Executives International*, Morristown, New Jersey.