

## Why analysts get it wrong so often

At the bottom of the dotcom decline, a wag was heard to ask how one could trust a person whose job title begins with "anal" ... that was a reflection of the market's general disillusionment with financial analysts and other market watchers.

By [Doug Leather](#) 23 Mar 2003

These analysts were responsible - to a great extent - for the over-inflated and illogical valuations of companies which ultimately led to the crash and burn that caused the economy worldwide to go into meltdown.

It seems like ancient history, but it was a mere two years ago that world markets went into free fall, causing the greatest loss of wealth of all time. We are still living with the consequences of that period, and will continue to do so for some time to come.

A key aspect of the problem was the extraordinary over-valuations - often ludicrous - assigned to companies which were clearly not worth a fraction of what the analysts said they were.

To put it bluntly, analysts generally got it hopelessly wrong when they went about the process of valuing companies between 1997 and 2001.

It's hardly amazing, but they're still getting it wrong. A brief run-through of the names that have become part of daily dialogue will show just how widespread the problem of company valuations is: Enron, WorldCom, Global Crossing, Equitable Life, Arthur Andersen, Adelphia Communications ... There are divergent reasons for the failure of these organisations and the accompanying valuations, but the outcome has been the same time and again: spectacular loss of value.

Part of the reason, it would seem, is that analysts are missing a key intangible of company performance: the competence with which a company manages its customers.

### *Tangible vs intangible*

The world has changed dramatically over the last three decades. In 1970, for instance, 50% of the average large company's value was reflected on the balance sheet (tangibles) and 50% in intangibles. By 1999, the ratio had changed to 80% intangibles and 20% tangibles (BusinessWeek, 1999). These intangibles include human and intellectual capital, processes and more ... Professor Claes Fornell of the University of Michigan Business School suggests that all of these constitute how well a company manages its customer relationships, along with the efficiency with which it deploys capital (taken together, these two points reflect revenue generation and cost containment, the two aspects of business that ultimately yield profit).

If the evidence suggests that analysts and other market watchers are getting it consistently wrong, and that they are asking the wrong questions, then it's time for customer-centric executives to start asking other questions, such as:

- \* Can you identify which customers you want to keep and develop (normally your most valuable customers)
- \* Can you align your organisation to deliver your propositions, develop the right customer competence in systems, people and inter-departmental cooperation to ensure consistent delivery?

- \* How satisfied are your best customers with you, versus the competition?
- \* Can you predict how much it will cost to do this, and what the benefits are likely to be?
- \* How satisfied are your key employees?
- \* Can you develop a set of customer measures, which will apply across functions (marketing, sales, service) and across the customer journey with you (not just one touch-point or transaction, but across the whole customer experience), which help you understand:
  - How well you are retaining the customers you have chosen to manage?
  - What they enjoy and don't enjoy about your actual service?
  - How well you are acquiring the right customers?
  - What share of their spend you have, for your category of products?
  - How much it costs you to manage them, during their interaction with your company?

It has become clear that executive management, by and large, cannot answer these and many other questions that relate to customers. They tend to have a sketchy knowledge of and superficial insights into issues such as churn rates, customer retention, staff turnover and replacement costs. Yet these all ultimately affect customer management and, along with it, business performance!

How well a business performs is a direct consequence of a highly skilled, motivated workforce delivering the correct and appropriate goods and services through the right processes at the right price to the right customers. Assessment of financial performance alone - which tends to occupy a large segment of executives' time - will skew the picture and leave management constantly grappling to find answers.

Financial success is a byproduct of other, correct activities. And, we are learning, customer management is a critical activity!

## ABOUT THE AUTHOR

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