

# Measuring non-measurables

By Kurt Lieberman, CEO of Magni Global Asset Management. He can be contacted at [kliberman@magniglobal.com](mailto:kliberman@magniglobal.com).

**Thank you for the positive feedback on the article titled 'Valuation of companies'. The topic deserves more than a single column, especially since I identified a problem and did not offer a solution. As per the last column, the valuation of companies is increasingly disconnected from the numbers on financial statements, though the algorithms used to convert forecasts of future profitability into valuations are as relevant today as ever.**

Improving the veracity of valuations requires additional information to better understand the prospects of a business. Disruption from technology is one such example, and a powerful one, though companies have demonstrated widely varying abilities to capture opportunities and mitigate threats from technology-driven disruptions. Information about disruptions is not enough.

**“ Governance is critical information for valuation ”**

The way a company perceives and responds to opportunities and threats provides insight into its prospects. Companies that routinely scan the 'horizon' tend to see opportunities and threats sooner. Quick identification may provide time to respond. Companies that are good at generating ideas are more likely to find a way to capture an opportunity or mitigate a threat.

Creative environments within companies produce more innovative ideas. Companies that are good at execution are more likely to convert ideas into action. Operational capabilities convert innovation into solutions with a greater likelihood of commercial success.

Companies that have strong relationships with stakeholders, such as customers and employees, are more likely to have

easier acceptance of change. Solutions are more likely to succeed when the people impacted by the change have more trust in the company.

Technology is a massive disruptor, but there are many other sources. Government intervention, geopolitical events and of course climate are all sources of disruption. Having worked in large companies, I can tell you that disruption provides a stream of opportunities and threats.

If a company's ability to handle disruption is important to its prospects, then valuation should include information about these abilities. Measuring abilities is not easy; it is largely qualitative.

Further, the financial services industry is very quantitative. Most of the analysts producing the spreadsheets for valuation purposes have training in finance and numbers. They may well take qualitative considerations for granted.

After all, they won't know where to put such information into a spreadsheet or how to turn a qualitative factor into a number.

These capabilities to handle disruptions relate to governance. A well-governed company likely will be adept at each capability, thus being better at capturing opportunities and mitigating threats.

Governance is critical information for valuation.

Measuring governance is also not easy. Data that historically has not been researched needs to be collected. Techniques for assessing the quality of the data are needed.

Algorithms and procedures for converting the qualitative to the quantitative need to be developed. Financial analysts need to understand how to take the resulting numbers and insert them into spreadsheets.

All of you can probably see where this discussion is headed. In prior columns I discussed

governance, the characteristics of good governance and the key requirements for effective measurement. I also discussed the need to get beyond the structural and demographic factors that are easy to measure yet provide little insight.

Governance is revealed by behavior, and measuring behavior is hard. The data that needs to be collected relates to the behaviors of everyone at a company, as well as the programs, leadership and controls used to assure the desired behavior.

Here is yet another reason why transparency is so important. Bad behavior tends to occur where it is unseen.

Valuation can be improved. Good governance and transparency are foundations of that improvement. ☺

