How Much is Financial Information Worth?

If I could predict, with 100 percent certainty, the identity and price change of tomorrow's biggest gainer on the Nasdaq, would you pay me for that information? How much would it be worth to you?

You could calculate the actual value of that information -- the value to you specifically -- based on the amount of money you could afford to invest in the stock and the one-day rise in share price. Then you'd offer me somewhat less than you would earn, so that the transaction would be worth your while.

What if my information were only 96 percent certain? That would complicate the calculations, but you'd probably still want to purchase the information from me, albeit for a lower price, because chances are still great that you'd make a profit.

At what point would you no longer be willing to pay me for the information -- at what level of uncertainty would you start to feel uncomfortable: below 80 percent, 70 percent, 60 percent?

You could hire a statistician and/or an actuary to calculate probabilities and risks and values and returns. Even then, your comfort level with uncertain information would be different from another person's comfort level. In other words, emotional factors influence the value of information.

The fact is, there's no such thing as predicting, projecting, or forecasting with 100 percent certainty. Not only that, but in most cases you can't even estimate the degree of certainty. So the value of information -- any information that is used as a basis for decisions about the future -- can be highly subjective.

Anecdotes

That doesn't mean it's always difficult to decide whether to buy information. For example, I once had a client who was getting divorced. She knew that her husband had squandered a large sum of money, and she was desperate to find out what he spent it on. She was sure the money had been spent, not stashed away. So she asked me to track it down for her. I told her that I would charge her a significant fee for that information, when in fact it didn't matter where he spent the money -- if he drank it, snorted it, smoked it, wore it, etc. -- the money was gone, and the information wasn't going to affect the divorce settlement.

On the other hand, I know an entrepreneur who did not want to spend $200 on QuickBooks accounting software, even though the information that he'd derive from using the software was crucial to his success and worth many times the cost.

In the case of the divorcee, my client placed an inflated value on the information she wanted, and in the second case the entrepreneur badly underestimated its value. In my view, no calculations were necessary in either case -- the information's relative value was clear *prima facie*.

The point is, many people behave irrationally when valuating information. The recent accounting scandals have prompted a wave of investors demanding to know absolutely everything about everything, down to the amount that the company chairman spent having his dog walked. Defrauded parties pay for fraud investigations even when it appears almost certain that the money will never be recoverable.

In many cases -- often including bankruptcy, divorce, valuation and fraud investigations -- an expensive requisition and analysis of highly accurate information does little more than confirm your educated guess or "quick and dirty" analysis.

How to valuate information rationally

When the value of information is not so clear *prima facie* (at first glance), you should base your decision -- whether to go after it or not -- on the following criteria:

- What's in it for you? After you obtain the information, how will you use it? How will the information affect your decisions, and how will those decisions affect your bottom line? How *soon* will it affect your bottom line? If you can't answer these questions, the information probably isn't worth much.
- How reliable is the information? What is its source? Can it be verified or corroborated? Would you bet your mother's live savings on its veracity?
- How much information do you need to reduce the uncertainty about your decision? The proper use of financial information is to reduce the uncertainty level around decisions. When the cost of more information starts to increase relative to the further reduction in uncertainty, information gathering should stop.
- How timely is the information? Many companies would be satisfied with a monthly financial statements (issued 20 days after the end of the month) that include profit & loss, balance sheet, cash flow, budget, sales analysis, accounts receivable report, etc. Many retailers, however, would benefit from having sales figures daily and gross margins weekly. Professional practices might need receivables updated twice a month. Frequently updated information costs more, but it's worth much more in some cases.

sidebar:

Sometimes the Best Info Comes From Walking & Talking

Much of the information you need to manage or value a company, or assess the likelihood of a turnaround, is not available in the company's financial statements. Those statements would not tell you everything you need to know about the quality of the company's products or services; the efficiency of its systems; or the ability and cohesiveness of its management team.

To glean that kind of information, you might have to walk around the company's facilities, use its products, and talk to its employees and customers and vendors.

Here are some of the kinds of information -- indications that the company is flawed -- that you might gain by walking, using, and talking:

- Production and marketing managers disagree with the finance department on which products and services are profitable.
- The definition, calculation, or size of "profit margin" is hard to explain in plain English.
- There is not competition for what appears to be a profitable product.
- Competitors' prices seem unrealistically low.
- Customer don't mind price increases.

For example, one company that I worked with, a supplier of raw materials, was actually encouraged by its largest customer to raise its prices. The customer understood the true costs better than the company, and wanted to make sure that its supplier remained viable.