Part One

Foundations of Value

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Why Value Value?

The guiding principle of business value creation is a refreshingly simple construct: companies that grow and earn a return on capital that exceeds their cost of capital create value. Articulated as early as 1890 by Alfred Marshall,[1] the concept has stood the test of time. Indeed, when managers, boards of directors, and investors have forgotten it, the consequences have been disastrous. The financial crisis of 2007–2008 and the Great Recession that followed provide the most recent evidence of the point. But a host of other calamities, from the rise and fall of business conglomerates in the 1970s to the collapse of Japan's economy in the 1990s to the Internet bubble, can all to some extent be traced to a misunderstanding or misapplication of this guiding principle.

Today these accumulated crises have led many to call into question the foundations of shareholder-oriented capitalism. Confidence in business has tumbled.[2] Politicians and commentators push for more regulation and fundamental changes in corporate governance. Academics and even some business leaders have called for companies to change their focus from increasing shareholder value to a broader focus on all stakeholders, including customers, employees, suppliers, and local communities. At the extremes, some have gone so far as to argue that companies should bear the responsibility of promoting healthier eating and other social issues.

Many of these impulses are naive. There is no question that the complexity of managing the coalescing and colliding interests of myriad owners and stakeholders in a modern corporation demands that any reform discussion begin with a large dose of humility and tolerance for ambiguity in defining the purpose of business. But we believe the current debate has muddied a fundamental truth: creating shareholder value is not the same as maximizing short-term

[1] Alfred Marshall, *Principles of Economics* (New York: Macmillan, 1890), 1:142.
[2] An annual Gallup poll in the United States showed that the percentage of respondents with little or no confidence in big business increased from 27 percent in the 1983–1986 period to 38 percent in the 2011–2014 period. For more, see Gallup, "Confidence in Institutions," www.gallup.com.

profits. Companies that confuse the two often put both shareholder value and stakeholder interests at risk. Indeed, a system focused on creating shareholder value isn't the problem; short-termism is. Banks that confused the two at the end of the last decade precipitated a financial crisis that ultimately destroyed billions of dollars of shareholder value, as did Enron and WorldCom at the turn of this century. Companies whose short-term focus leads to environmental disasters also destroy shareholder value, not just directly through cleanup costs and fines, but via lingering reputational damage. The best managers don't skimp on safety, don't make value-destroying decisions just because their peers are doing so, and don't use accounting or financial gimmicks to boost short-term profits, because ultimately such moves undermine intrinsic value that is important to shareholders and stakeholders alike.

WHAT DOES IT MEAN TO CREATE SHAREHOLDER VALUE?

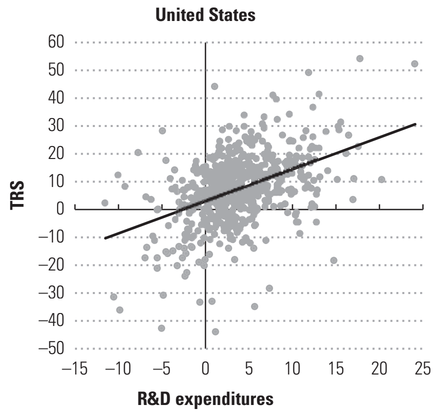
At this time of reflection on the virtues and vices of capitalism, we believe that it's critical that managers and boards of directors have a new, precise definition of shareholder value creation to guide them, rather than having their focus blurred by a vague stakeholder agenda. For today's value-minded executives, creating shareholder value cannot be limited to simply maximizing today's share price for today's shareholders. Rather, the evidence points to a better objective: maximizing a company's collective value to *current and future* shareholders, not just today's.

If investors knew as much about a company as its managers do, maximizing its current share price might be equivalent to maximizing value over time. But in the real world, investors have only a company's published financial results and their own assessment of the quality and integrity of its management team. For large companies, it's difficult even for insiders to know how financial results are generated. Investors in most companies don't know what's really going on inside a company or what decisions managers are making. They can't know, for example, whether the company is improving its margins by finding more efficient ways to work or by simply skimping on product development, maintenance, or marketing.

Since investors don't have complete information, it's easy for companies to pump up their share price in the short term. For example, from 1997 to 2003, a global consumer products company consistently generated annual growth in earnings per share (EPS) between 11 percent and 16 percent. Managers attributed the company's success to improved efficiency. Impressed, investors pushed the company's share price above those of its peers—unaware that the company was shortchanging its investment in product development and brand building to inflate short-term profits, even as revenue growth declined. In 2003, managers had to admit what they'd done. Not surprisingly, the company went through a painful period of rebuilding. Its stock price took years to recover.

EXHIBIT 1.1 **Correlation between TRS and R&D Expenditures**

Compound annual growth rate,[1] 2003–2013, %



[1] Sample includes companies with real revenues greater than $200 million.

This does not mean that the stock market is not "efficient" in the academic sense that it incorporates all public information. Markets do a great job with public information, but markets are not omniscient. Markets cannot price information they don't have. Think about the analogy of selling a house. The seller may know that the boiler makes a weird sound every once in a while or that some of the windows are a bit drafty. Unless the seller discloses those facts, it may be very difficult for a potential buyer to detect them, even with the help of a professional house inspector.

Despite such challenges, the evidence makes it clear that companies with a long strategic horizon create more value. The banks that had the insight and courage to forgo short-term profits during the last decade's real-estate bubble earned much better returns for shareholders over the longer term. Over the long term, oil and gas companies known for investing in safety outperform those that skimp on such investment. We've found, empirically, that long-term revenue growth—particularly organic revenue growth—is the most important driver of shareholder returns for companies with high returns on capital.[3] We've also found that investments in research and development (R&D) correlate powerfully with positive long-term total returns to shareholders (TRS), as graphed in Exhibit 1.1.[4]

[3] B. Jiang and T. Koller, "How to Choose between Growth and ROIC," *McKinsey on Finance*, no. 25 (Autumn 2007), 19–22, www.mckinsey.com. However, we didn't find the same relationship for companies with low returns on capital.

[4] We've performed the same analyses for 15 and 20 years and with different start and end dates and always found similar results.

Creating value for both current and future shareholders means managers should not take actions to increase today's share price if those actions will damage it down the road. Some obvious examples include shortchanging product development, reducing product quality, or skimping on safety. Less obvious examples are making investments that don't take into account likely future changes in regulation or consumer behavior (especially with regard to environmental and health issues). Faced with volatile markets, rapid executive turnover, and intense performance pressures, making long-term value-creating decisions can take courage. But it's management's and the board's task to demonstrate that courage, despite the short-term consequences, in the name of value creation for the collective benefit of all present and future shareholders.

CAN STAKEHOLDER INTERESTS BE RECONCILED?

Much recent criticism of shareholder-oriented capitalism has called on companies to focus on a broader set of stakeholders beyond just its shareholders. It's a view that has long been influential in continental Europe, where it is frequently embedded in corporate governance structures. And we agree that for most companies anywhere in the world, pursuing the creation of long-term shareholder value requires satisfying other stakeholders as well. You can't create long-term value without happy customers, suppliers, and employees.

We would go even further. We believe that companies dedicated to value creation are healthier and more robust—and that investing for sustainable growth also builds stronger economies, higher living standards, and more opportunities for individuals. Our research shows, for example, that many corporate social-responsibility initiatives also create shareholder value, and that managers should seek out such opportunities.[5] For example, IBM's free Web-based resources on business management not only help to build small and mid-size enterprises; they also improve IBM's reputation and relationships in new markets and develop relationships with potential customers.

Similarly, Novo Nordisk's "triple bottom line" philosophy of social responsibility, environmental soundness, and economic viability has led to programs to improve diabetes care in China. Novo Nordisk says such programs have burnished its brand, added to its market share, and increased sales while improving physician education and patient outcomes. Or take Best Buy's efforts to reduce attrition among female employees. Best Buy says the program has not only lowered turnover among women by more than 5 percent, but has also helped female employees create their own support networks and build leadership skills.

[5] S. Bonini, T. Koller, and P. H. Mirvis, "Valuing Social Responsibility Programs," *McKinsey Quarterly* (July 2009), www.mckinsey.com.

But what should be done when a company's interests and those of its stakeholders aren't complementary—for example, in areas such as employee compensation and benefits, supplier management, and local community relationships? Most advocates of a stakeholder-centric approach seem to argue that companies can maximize value for all stakeholders and shareholders simultaneously, without making trade-offs among them. For example, Cornell Law School professor Lynn Stout's book *The Shareholder Value Myth* argues persuasively that nothing in U.S. corporate law requires companies to focus on shareholder value creation.[6] But her argument that putting shareholders first harms nearly everyone is really an argument against short-termism, not a prescription for how to make trade-offs. Similarly, R. Edward Freeman, a professor at the University of Virginia's Darden School of Business, has written at length proposing a stakeholder value orientation. In the recent book *Managing for Stakeholders*, he and his coauthors assert that "there really is no inherent conflict between the interests of financiers and other stakeholders."[7] John Mackey, founder and co-CEO of Whole Foods Market, recently co-wrote *Conscious Capitalism*,[8] in which he too asserts there are no trade-offs to be made.

Such criticism is naive. Strategic decisions often require myriad trade-offs among the interests of different groups that are often at odds with each other. And in the absence of other principled guidelines for such decisions, when there are trade-offs to be made, prioritizing long-term value creation is best for the allocation of resources and the health of the economy.

Consider employee stakeholders. A company that tries to boost profits by providing a shabby work environment, underpaying employees, or skimping on benefits will have trouble attracting and retaining high-quality employees. Lower-quality employees can mean lower-quality products, reduced demand, and damage to the brand reputation. More injury and illness can invite regulatory scrutiny and more union pressure. More turnover will inevitably increase training costs. With today's more mobile and more educated workforce, such a company would struggle in the long term against competitors offering more attractive environments. If the company earns more than its cost of capital, it might afford to pay above-market wages and still prosper, and treating employees well can be good business. But how well is well enough? The stakeholder approach, defined as running the company in a way that treats all stakeholder interests equally, doesn't provide an answer. A shareholder focus does: pay wages that are just enough to attract quality employees and keep them

[6] L. Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Oakland, CA: Berrett-Koehler, 2012).

[7] R. E. Freeman, J. S. Harrison, and A. C. Wicks, *Managing for Stakeholders: Survival, Reputation, and Success* (New Haven, CT: Yale University Press, 2007), 5.

[8] J. Mackey and R. Sisodia, *Conscious Capitalism: Liberating the Heroic Spirit of Business* (Boston: Harvard Business School Publishing, 2013).

happy and productive, pairing those wages with a range of nonmonetary benefits and rewards. Even companies that have shifted production of products like clothing and textiles to low-cost countries with weak labor protection have found that they need to monitor the working conditions of their suppliers or face a consumer backlash.

Or consider how high a price a company should charge for its products. A shareholder focus would weigh price, volume, and customer satisfaction to determine a price that creates the most shareholder value. However, that price would also have to entice consumers to buy the products—not just once, but multiple times, for different generations of products. A company might still thrive if it charged lower prices, but there's no way to determine whether the value of a lower price is greater for consumers than the value of a higher price to its shareholders.

Consider whether companies in mature, competitive industries should keep open high-cost plants that lose money, just to keep employees working and prevent suppliers from going bankrupt. To do so in a globalizing industry would distort the allocation of resources in the economy, notwithstanding the significant short-term local costs associated with plant closures.[9]

Energy companies have particularly difficult decisions to make. Government energy policy typically toggles between the goals of cost, energy security, and environmental impact. These do not easily line up in a way that makes for smooth integration into energy companies' investment decisions. In practice, the companies need to make careful, balanced judgments around the trade-offs embedded in government policy actions in order to factor them into long-term value-creation strategies. And the greater the policy uncertainty, the harder it is for companies to create long-term value in a way that is good for efficient resource allocation and the health of the economy.

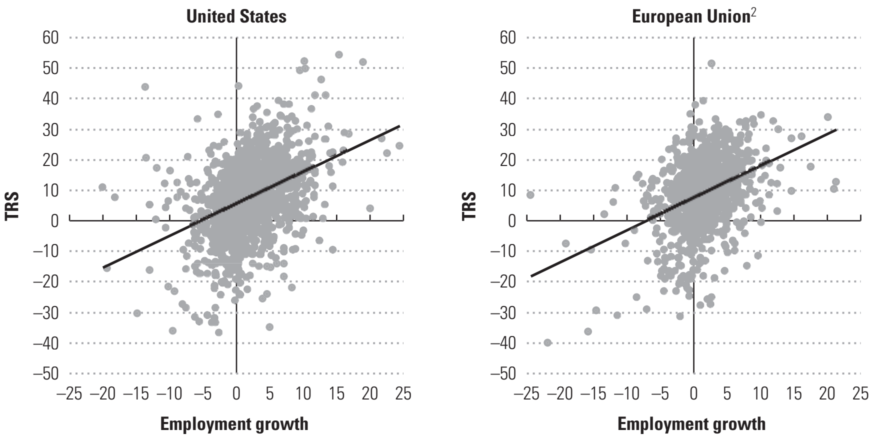
Managers may agonize over decisions that have such a pronounced impact on workers' lives. But consumers benefit when goods are produced at the lowest possible cost, and the economy benefits when unproductive plants are closed and employees move to new jobs with more competitive companies. And while it's true that employees often can't just pick up and relocate, it's also true that value-creating companies create more jobs. When examining employment, we found that the U.S. and European companies that created the most shareholder value in the past 10 years have shown stronger employment growth (see Exhibit 1.2).[10]

[9] Some argue that well-functioning markets also need well-functioning governments to provide the safety nets and retraining support to make essential restructuring processes more equitable.

[10] We've performed the same analyses for 15 and 20 years and with different start and end dates and always found similar results.

EXHIBIT 1.2 **Correlation between TRS and Employment Growth**

Compound annual growth rate,[1] 2003–2013, %



[1] Sample includes companies with real revenues greater than $200 million and excludes outliers with more than 20% employment growth.
[2] Sample includes companies in the core 15 EU member states.

SHAREHOLDER CAPITALISM CANNOT SOLVE ALL SOCIAL ISSUES

There are some trade-offs that company managers can't make and that neither a shareholder nor a stakeholder approach to governance can help. This is especially true when it comes to issues affecting people who aren't immediately involved with the company, as may be the case with investors, customers, and suppliers. These so-called externalities—for example, a company's carbon emissions affecting parties that have no direct contact with the company—are often beyond the ken of corporate decision making because there is no objective basis for making trade-offs among parties.

Consider how this applies to climate change, potentially one of the largest social issues facing the world. One natural place to look for a solution is to reduce coal production used to make electricity, among the largest human-made sources of carbon emissions.[11] But how are the managers of a coal-mining company to make all the trade-offs needed to begin solving our environmental problems? If a long-term shareholder focus led them to anticipate potential regulatory changes, they would modify their investment strategies accordingly—they might not want to open new mines, for example. But if the company abruptly stopped operating existing ones, not only would the company's shareholders lose their entire investment, but so would its bondholders, which are often pension funds. All of the company's employees would

[11] In 2011, coal accounted for 44 percent of the global CO_2 emissions from energy production. International Energy Agency, *CO_2 Emissions from Fuel Combustion*, 2013 ed., www.iea.org.

be out of work, with magnifying effects on the entire local community. Second-order effects would be unpredictable. Without concerted action among all coal producers, another supplier could step up to meet demand. Even with concerted action, power plants might be unable to produce electricity—idling their workers and causing electricity shortages that undermine the economy. What objective criteria would any individual company use to weigh the economic and environmental trade-offs of such decisions—whether they're privileging shareholders or stakeholders?

For their part, longer-term investors, themselves concerned with environmental issues such as carbon emissions, water scarcity, and land degradation, are connecting value and long-term sustainability. In 2014, heirs to the Rockefeller Standard Oil fortune decided to join Stanford University's board of trustees in avoiding shares in coal companies. Long-term-oriented companies must be attuned to long-term changes that will be demanded by both investors and governments, so they can adjust their strategies over a 5-, 10-, or 20-year time horizon and reduce the risk of stranded assets, or those that are still productive but not in use because of environmental or other issues.

For any company, the complexity of addressing universal social issues like climate change poses an unresolved question: if the task does not fall to the individual company, then to whom does it fall? Some might argue that it would be better for the government to develop incentives, regulations, and taxes. In the example of climate change, this view might favor government action to encourage a migration away from polluting sources of energy. Others may espouse a free-market approach, allowing creative destruction to replace aging technologies and systems with cleaner and more efficient sources of power. This trading off of different economic interests and time horizons is precisely what governments are supposed to do, with institutional investors such as pension funds in a critical supporting role. At times, the failure of governments and long-term investors to step up and play their roles effectively can be what leads to the largest divergence between shareholder value creation and the impact of externalities. Failure to price or control for externalities will lead to a misallocation of resources.

Shareholder capitalism has taken its lumps in recent years, no question. Yet we see in our work that the shareholder model, thoughtfully embraced as a collective approach to present and future value creation, is the best one at bridging the broad and varied interests of shareholders and stakeholders alike.

CONSEQUENCES OF FORGETTING VALUE-CREATION PRINCIPLES

When companies forget the simple value-creation principles, the negative consequences to the economy can be huge. Two recent examples of many executives failing in their duty to focus on true value creation are the Internet bubble and the financial crisis of 2008.

During the Internet bubble, managers and investors lost sight of what drove return on invested capital (ROIC); indeed, many forgot the importance of this ratio entirely. Many executives and investors either forgot or threw out fundamental rules of economics in the rarefied air of the Internet revolution. The notion of "winner take all" led companies and investors to believe naively that all that mattered was getting big fast, and that they could worry about creating an effective business model later. Increasing-returns logic was also mistakenly applied to online pet supplies and grocery delivery services, even though these firms had to invest (unsustainably, eventually) in more drivers, trucks, warehouses, and inventory when their customer base grew. When the laws of economics prevailed, as they always do, it was clear that many Internet businesses did not have the unassailable competitive advantages required to earn even modest returns on invested capital. The Internet has revolutionized the economy, as have other innovations, but it did not and could not render obsolete the rules of economics, competition, and value creation.

Similarly, behind the more recent financial and economic crises beginning in 2008 lies the fact that banks and investors forgot the principles of value creation. Banks lent money to individuals and speculators at low teaser rates on the assumption that house prices would only increase. Banks packaged these high-risk debts into long-term securities and sold them to investors who used short-term debt to finance the purchase, thus creating a long-term risk for whoever lent them the money. When the home buyers could no longer afford the payments, the real estate market crashed, pushing the values of many homes below the values of loans taken out to buy them. At that point, homeowners could neither make the required payments nor sell their houses. Seeing this, the banks that had issued short-term loans to investors in securities backed by mortgages became unwilling to roll over those loans, prompting the investors to sell all such securities at once. The value of the securities plummeted. Finally, many of the large banks themselves owned these securities, which they, of course, had also financed with short-term debt they could no longer roll over.

In the past 30 years, the world has seen at least six financial crises that arose largely because companies and banks were financing illiquid assets with short-term debt: the U.S. savings and loan catastrophe in the 1980s, the East Asian debt crisis in the mid-1990s, the Russian government default in 1998, the collapse in that same year of the U.S. hedge fund Long-Term Capital Management, the U.S. commercial real estate crisis in the early 1990s, and the Japanese financial crisis that began in 1990 and, according to some, continues to this day.

SHORT-TERMISM RUNS DEEP

One of the causes of these economic calamities is the short-termism of many companies. What is most relevant about Stout's argument and that of others is its implicit criticism of short-termism. It is a fair critique of today's capitalism. Despite overwhelming evidence linking intrinsic investor preferences to long-term value creation,[12] too many managers continue to plan and execute strategy—and then report their performance—against shorter-term measures, particularly earnings per share (EPS).

As a result of their focus on short-term EPS, major companies often pass up value-creating opportunities. In a survey of 400 chief financial officers, two Duke University professors found that fully 80 percent of the CFOs said they would reduce discretionary spending on potentially value-creating activities such as marketing and R&D in order to meet their short-term earnings targets.[13] In addition, 39 percent said they would give discounts to customers to make purchases this quarter rather than next, in order to hit quarterly EPS targets. Such biases shortchange all stakeholders.

As an illustration of how executives get caught up in a short-term EPS focus, consider our experience with companies analyzing a prospective acquisition. The most frequent question managers ask is whether the transaction will dilute EPS over the first year or two. Given the popularity of EPS as a yardstick for company decisions, you might think that a predicted improvement in EPS would be an important indication of an acquisition's potential to create value. However, there is no empirical evidence linking increased EPS with the value created by a transaction.[14] Deals that strengthen EPS and deals that dilute EPS are equally likely to create or destroy value.

If such fallacies have no impact on value, why do they prevail? The impetus for a short-termism varies. Some executives argue that investors won't let them focus on the long term; others fault the rise of shareholder activists in particular. Yet our research shows that even if short-term investors cause day-to-day fluctuations in a company's share price and dominate quarterly earnings calls, longer-term investors are the ones who align market prices with intrinsic value.[15] Moreover, the evidence shows that, on average, activist investors strengthen the long-term health of the companies they pursue—for example, often challenging existing compensation structures that encourage short-termism.[16] Instead, we often find that executives themselves or their boards are usually the source of short-termism. In a 2013 survey of more than 1,000 executives and board members, most cited their own executive teams and boards

[12] R. N. Palter, W. Rehm, and J. Shih, "Communicating with the Right Investors," *McKinsey Quarterly* (April 2008), www.mckinsey.com.

[13] J. R. Graham, C. R. Harvey, and S. Rajgopal, "Value Destruction and Financial Reporting Decisions," *Financial Analysts Journal* 62, no. 6 (2006): 27–39.

[14] R. Dobbs, B. Nand, and W. Rehm, "Merger Valuation: Time to Jettison EPS," *McKinsey Quarterly* (March 2005), www.mckinsey.com.

[15] Palter, Rehm, and Shih, "Communicating with the Right Investors."

[16] J. Cyriac, R. De Backer, and J. Sanders, "Preparing for Bigger, Bolder Shareholder Activists," *McKinsey on Finance* (March 2014), www.mckinsey.com.

(rather than investors, analysts, and others outside the company) as the greatest sources of pressure for short-term performance.[17]

The results can defy logic. At a company pursuing a major acquisition, we participated in a discussion about whether the deal's likely earnings dilution was important. One of the company's bankers opined that he knew any impact on EPS would be irrelevant to value, but he used it as a simple way to communicate with boards of directors. Elsewhere, we've heard company executives acknowledge that they, too, doubt that the impact on EPS is so important—but they also use it anyway, "for the benefit of Wall Street analysts." Investors also tell us that a deal's short-term impact on EPS is not that important. Apparently everyone knows that a transaction's short-term impact on EPS doesn't matter, yet they all pay attention to it.

The pressure to show strong short-term results often mounts when businesses start to mature and see their growth begin to moderate. Investors go on baying for high growth. Managers are tempted to find ways to keep profits rising in the short term while they try to stimulate longer-term growth. However, any short-term efforts to massage earnings that undercut productive investment make achieving long-term growth even more difficult, spawning a vicious circle.

Some analysts and some short-term-oriented investors will always clamor for short-term results. However, even though a company bent on growing long-term value will not be able to meet their demands all of the time, this continuous pressure has the virtue of keeping managers on their toes. Sorting out the trade-offs between short-term earnings and long-term value creation is part of a manager's job, just as having the courage to make the right call is a critical personal quality. Perhaps even more important, it is up to corporate boards to investigate and understand the economics of the businesses in their portfolio well enough to judge when managers are making the right trade-offs and, above all, to protect managers when they choose to build long-term value at the expense of short-term profits.

Changes in corporate governance might help. Board members might be required to spend more time on their board activities, so they have a better understanding of the economics of the companies they oversee and the strategic and short-term decisions managers are making. In a survey of 20 UK board members who had served on the boards of both exchange-listed companies and companies owned by private-equity firms, 15 of 20 respondents said that

[17]Commissioned by McKinsey & Company and by the Canada Pension Plan Investment Board, the online survey, "Looking toward the Long Term," was in the field from April 30 to May 10, 2013, and garnered responses from 1,038 executives representing the full range of industries and company sizes globally. Of these respondents, 722 identified themselves as C-level executives and answered questions in the context of that role, and 316 identified themselves as board directors and answered accordingly. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global gross domestic product (GDP). For more, see "Focusing Capital on the Long Term," www.fclt.org.

private-equity boards clearly added more value. Their answers suggested two key differences. First, listed-company directors are more focused on risk avoidance than value creation. Second, private-equity directors spend on average nearly three times as many days on their roles as do those at listed companies.[18] Changes in CEO evaluation and compensation might also help. The compensation of most CEOs and senior executives is still skewed to short-term accounting profits, often by formula. Given the complexity of managing a large multinational company, we find it odd that so much weight is given to a single number.

THIS BOOK

This book is a guide to how to measure and manage the value of a company. The faster companies can increase their revenues and deploy more capital at attractive rates of return, the more value they create. The combination of growth and return on invested capital (ROIC), relative to its cost, is what drives value. Anything that doesn't increase cash flows doesn't create value. This category can include steps that change the ownership of claims to cash flows, and accounting techniques that may change the timing of profits without actually changing cash flows.

This guiding principle of value creation links directly to competitive advantage, the core concept of business strategy. Only if companies have a well-defined competitive advantage can they sustain strong growth and high returns on invested capital. To the core principles, we add the empirical observation that creating sustainable value is a long-term endeavor, one that needs to take into account wider social, environmental, technological, and regulatory trends.

Competition tends to erode competitive advantages and, with them, returns on invested capital. Therefore, companies must continually seek and exploit new sources of competitive advantage if they are to create long-term value. To that end, managers must resist short-term pressure to take actions that create illusory value quickly at the expense of the real thing in the long term. Creating value for shareholders is not the same as, for example, meeting the analysts' consensus earnings forecast for the next quarter. Nor is it ignoring the effects of decisions made today that may create greater costs down the road, from environmental cleanup to retrofitting plants to meet future pollution regulations. It means balancing near-term financial performance against what it takes to develop a healthy company that can create value for decades ahead—a demanding challenge.

[18] V. Acharya, C. Kehoe, and M. Reyner, "The Voice of Experience: Public versus Private Equity," *McKinsey on Finance* (Spring 2009): 16–21.

This book explains both the economics of value creation (for instance, how competitive advantage enables some companies to earn higher returns on invested capital than others) and the process of measuring value (for example, how to calculate return on invested capital from a company's accounting statements). With this knowledge, companies can make wiser strategic and operating decisions, such as what businesses to own and how to make trade-offs between growth and return on invested capital. Equally, this knowledge will enable investors to calculate the risks and returns of their investments with greater confidence.

Applying the principles of value creation sometimes means going against the crowd. It means accepting that there are no free lunches. It means relying on data, thoughtful analysis, and a deep understanding of the competitive dynamics of your industry. We hope this book provides readers with the knowledge to help them make and defend decisions that will create value for investors and for society at large throughout their careers.