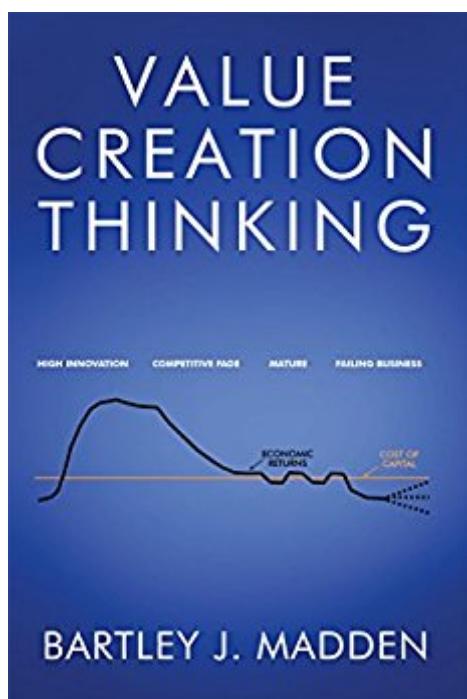


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# Value Creation Thinking



## Synopsis

"In a world where short-term thinking has taken hold for too many managers and investors, Value Creation Thinking provides a much needed perspective on the key drivers of long-term value. Madden unites the fundamentals of financial valuation with a unique emphasis on corporate purpose, culture, and knowledge. Based on decades of research and practice, Value Creation Thinking sheds light on enduring sources of competitive advantage and exposes how traditional business thinking and accounting practices often distract managers and investors from sustained performance. By speaking the language of both shareholders and stakeholders, Madden provides an important contribution to our understanding of capitalism at a critical moment, and an illuminating roadmap for the future of business."  • Dominic Barton, Global Managing Director, McKinsey & Co.

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## Customer Reviews

--Rawley Thomas 6-27-16   normally is so prompt in responding to reviews, I was concerned that this one below might have gotten lost in the flow over the weekend. Please let me

know. Thanks.--Uniquely Connects Powerful Dots in an Eloquent Way--Disclosure: I was a co-founder of the "T" in HOLT Planning in 1985." Bart cofounded Callard Madden & Associates in 1970 and the principals of HOLT at one time all worked at Callard Madden. Bart taught me most all I know about cash flow valuation during the decades from 1980 to today. In 1992 HOLT Planning split into two entities: HOLT Value Associates headed by Bob Hendricks and the corporate advisory part acquired by The Boston Consulting Group. Bart rejoined HOLT Value in 1993 to continue its research. Credit Suisse acquired HOLT Value in 2002. Credit Suisse HOLT supplied the company historical track records for Value Creation Thinking.--Value Creation Thinking represents a "Tour du Force" of Bart's evolution in deep thinking on his life's journey.--Purging obsolete assumptions represents the essence of value creation thinking. The purpose of the firm is not to maximize shareholder value; rather maximizing shareholder value is the result of achieving the firm's purpose. The firm's purpose becomes:1. A stated vision that inspires employees to commit to making the world a better place.2. Survive and prosper through continuous innovation and efficiency gains. Efficiency gains must produce operating returns that exceed the cost of capital.3. Develop win-win relationships to achieve the firm's vision.4. Take care of future generations.--Satisfying social responsibilities then becomes deeply embedded in the firm's operation and not an ethical add on. For free-market capitalism to survive, it is imperative for companies to avoid crony capitalism, where firms capture regulators. These crony firms seek to tilt the playing field in their favor, often over smaller competitors.--Important guidelines for management include:1. Eliminate constraints to the firm's entire system.2. Examine language for its effect on obsolete assumptions.3. Deeply understand the perceptions of employees "on the shop floor or store floor" to address human organizational constraints.4. Develop a knowledge building culture from continuous learning.5. This culture creates disruptive technology by questioning obsolete assumptions.6. This disruptive technology enables the firm to beat the normal competitive fade in operating returns and growth in investment. Normal fade in operating returns occurs toward the cost of capital.7. Beating the fade equips the firm to earn investment returns for their shareholders well in excess of benchmarks.8. Then, management communicates "Lifecycle Review Track Records" in graphical form with both shareholders and employees. In a most powerful way, these reviews display operating returns, asset growth, and their combined impact on the firm's relative shareholder performance. By Rawley Thomas, co-author of two books on valuation and one on solving the mortgage crisis.

Most finance and investing books are easy to review. This one was not. Most books keep within a sub-genre where they recycle and mix the usual concepts within the area. This book forced me to think about the philosophy of the firm in ways I hadn't before. The first sentence of the preface is "The ideas in this book reflect how my worldview evolved." This text is the intellectual biography of Bartley Madden. In 1969 he co-founded a firm that would eventually lead to the HOLT framework used by Credit Suisse today. Madden's research, thoughts and work effort is a huge part of the valuation framework and database that is today used by thousands of portfolio managers around the world. Value Creation Thinking has three parts where the first sets the philosophical stage and the following two fill in practical details. As such the first part is more interesting. Madden starts with a defense of capitalism worthy of Milton Friedman. Then he presents his competitive life cycle view of the firm. Successful innovation initially creates high returns on invested capital but this will over time be competed away as other companies enter the profitable area. Next the author discusses the purpose of the firm and the tasks that managers must perform to fulfill this purpose. In short managers must 1) understand how value is created, 2) use resources efficiently and 3) create a knowledge-building corporate culture. From this they can set goals and execute on strategies. The second part of the book covers the third task above and the third part the first task. I broadly agree with these parts and have little to add. I will instead come back to the purpose of the firm. At any point in time the society has a limited productive capacity. This capacity is in large part the sum of the tangible and intangible capital invested in corporations. These investments aim to, within the constraints of the available capital resources in the society, offer the most benefit to people in the form of products and services. The future stream of benefits net of the costs it takes to produce them equals the value of the firms producing them. This net benefit to society equals the net present value of all future free cash flows of the firms. If a firm maximizes shareholder value it also maximizes the benefit to society expressed in this way. On this we both agree. Madden doesn't think that maximizing shareholder value is the purpose of the firm since it would be a purpose that employees and stakeholders couldn't support. Hence, such a purpose would be self-contradictory, as the firm then couldn't create any shareholder value. Instead the author advocates a purpose package of a) having an inspiring vision and high ethical standards, b) survival through efficiency and innovation, c) creating win-win relationships with stakeholders and d) caring for future generations through environmental sustainability. These input variables will lead to the output e) maximizing the benefit to society (as defined above) that equals maximizing f) the shareholder value. Now, instead of as Madden calling

the input variables the purpose, I call the output the purpose. Is this just semantics? Defining the input variables as the purpose has a more positive tone to it while the opposite easily can be seen as cynical and hurt the image of a firm even though the practical actions might be the same. However, putting the input variables on top means that the ability to optimize on the target of creating maximum benefits to society becomes impossible. Therefore, if the democratic society can handle the task of setting rules of the game that truly internalize all costs of business processes, it is my view that defining the output variables as the purpose of the firm will make all of society more prosperous. The daunting task in this is to make people realize that maximizing shareholder value equals maximizing the benefit to society. Madden has written an intelligent and thoughtful book that many in the business community would benefit from reading. However, the abstraction level is high and the book doesn't fit nicely into a genre so I'm not sure they will. It's their loss. This is a review by [investingbythebooks.com](http://investingbythebooks.com)

This slim book packs a punch. From philosophical to practical, Madden ranges across important ideas in economics, business, and society. With a head nod to capitalism and its many benefits, he levels a sharp jab at its cheap substitute, cronyism, an incipient threat to our current free-market system. He links together the shared purposes of businesses with its executives and shareholders. Weaving through the various stages of the competitive life-cycle, the book offers real-world examples of business successes and failures tied to core principles. Value Creation Thinking draws from decades of research and observation and delivers a valuable framework for corporations that wish to attain and sustain their full potential.

Bryant Matthews, director of research at a global investment bank.

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