This **Quarter**

Managing value and performance

What should a company's objective be? Simply to maximize returns for shareholders by increasing the intrinsic value of a business, or should the company acknowledge the interests of other stakeholders—employees, customers, society—in its decision making? Over the past few years, the argument in favor of maximizing returns has taken more than a few blows because of the excesses of the dot-com boom, the stock market's obsession with short-term earnings, and the executive greed and scandals carried out in the name of maximizing shareholder value.

For McKinsey's corporate-finance practitioners, the tumultuous recent past has reinforced two fundamental beliefs. The first is that the business of business is precisely to maximize its shareholder value by increasing its intrinsic value. The second is that maximizing value involves managing both performance in the short term and the company's long-term health.

The fact is that the more shareholder value a company creates in an effectively regulated market, the better the company serves all its stakeholders. Research by McKinsey's corporate-performance center has demonstrated the wider stakeholder benefits of managing for long-term-value creation: the companies that created the most shareholder value over the past 15 years also created the most employment and invested the most in R&D. It's worth remembering, too, that many of a company's ultimate shareholders are ordinary people whose pensions depend on the value created by the businesses in which their retirement savings are invested.

Delivering shareholder value calls for managing not only the short-term performance of a company but also its long-term health—its ability to sustain performance over time. Corporate health involves many components: a robust strategy; well-maintained assets; innovative products and services; a good reputation with customers, regulators, governments, and other stakeholders; and the ability to attract, retain, and develop high-performing employees.

When most companies think about long-term performance, they think about growth, and as the world economy recovers, growth is top of mind for many CEOs. But a healthy company isn't necessarily one with high-growth plans. Indeed, many companies have destroyed value through their growth ambitions, particularly when they overpaid for acquisitions. Growth may well be part of sustaining performance, but the other key component is a decent return on capital invested. In industries facing low or declining growth, managing health may be more about sustaining returns.

This special edition of the *Quarterly* is devoted to a better understanding of maximizing shareholder value by managing performance and health. It draws on the soon-to-be-published fourth edition of *Valuation*, by Tim Koller, Marc Goedhart, and David Wessels—our textbook on measuring and managing for value. With more than 350,000 copies in circulation, *Valuation* is an essential tool to parse the intricacies of finance and value creation.

Articles adapted from the new edition explore issues crucial to understanding value. "Do fundamentals—or emotions—drive the stock market?" investigates the theories of behavioral finance, which holds that markets are irrational. The authors show that markets actually focus on intrinsic value.

"Don't expect too much of your share price" explores effective investor relations, which is not about maintaining the highest possible share price but rather about lining up share prices with a company's intrinsic value. "Measuring long-term performance" looks at ways for managers, investors, boards, and analysts to assess how well companies are doing.

Colleagues from around McKinsey have contributed insights on important issues related to creating value. "Mapping the global capital markets" presents research from the McKinsey Global Institute on the underlying macroeconomic trends that are driving and will drive markets. And "The view from the boardroom," with the findings of McKinsey's survey of more than 1,000 directors, shows that boards are ready to move beyond the compliance issues spurred by corporate scandals and to take a greater role in directing the strategy and value creation of the companies they govern. Those who understand the fundamentals will be in the best position to continue creating the value that keeps companies, and societies, healthy.

Richard Dobbs

Richard Dobbs
Partner, London office