Part One

Questions

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Why Value Value?

The chief measures for judging a company are its ability to create value for its shareholders and the amount of total value it creates. Corporations that create value in the long term tend to increase the welfare of shareholders and employees as well as improve customer satisfaction; furthermore, they tend to behave more responsibly as corporate entities. Ignoring the importance of value creation not only hurts the company but leads to detrimental results such as market bubbles.

Value creation occurs when a company generates cash flows at rates of return that exceed the cost of capital. Accomplishing this goal usually requires that the company have a competitive advantage. Activities such as leverage and accounting changes do not create value. Frequently, managers shortsightedly emphasize earnings per share (EPS); in fact, a poll of managers found that most managers would reduce discretionary value-creating activities such as research and development (R&D) in order to meet short-term earnings targets. One method to meet earnings targets is to cut costs, which may have short-term benefits but can have long-run detrimental effects.

1. Data from both Europe and the United States found that companies that created the most shareholder value showed ______________ employment growth.
2. In the past 30 years there have been at least ______________ financial crises that arose largely because companies and banks were ______________.
3. Two activities that managers often use in an attempt to increase share price but that do not actually create value are changes in ______________ and changes in ____________________________.
4. Maximizing current share price is not equivalent to maximizing long-term value because ____________________________.

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5. During the Internet boom of the late 1990s, many firms lost sight of value creation principles by blindly pursuing ____________ without ____________.

6. The empirical evidence shows that the link between the value created by the acquisition of another company and earnings per share (EPS):
   A. Is strong and positive.
   B. Does not exist.
   C. Is weak and negative.
   D. Is strong and negative.

7. Paying attention to which of the following tends to lead to a company doing well in the stock market?
   I. Cash flow.
   II. Earnings per share.
   III. Growth.
   IV. Return on invested capital.
      A. I and II only.
      B. II and III only.
      C. II, III, and IV only.
      D. I, III, and IV only.

8. A firm that grows rapidly will:
   A. Always create value.
   B. Create value if the return on invested capital (ROIC) is greater than the cost of obtaining funds.
   C. Create value if the return on invested capital (ROIC) is less than the cost of obtaining funds.
   D. Create value if the firm increases market share.

9. In order to create long-term value, companies must:
   A. Focus on keeping costs at a minimum.
   B. Find the optimal debt-to-equity ratio.
   C. Seek and exploit new sources of competitive advantage.
   D. Monitor and follow macroeconomic trends.

10. The recent experience with the securitization of risky home loans illustrated how:
    A. Value could be created by the diversification of risk and increased number of investors.
    B. Value could be created by the diversification of risk only.
    C. Value could be created by the increased number of investors only.
    D. Value cannot be created by securitization.