

VALUE CREATION INSIGHTS

**A Foundational Understanding of How Firms Build
Knowledge and Create Value**

Bartley J. Madden

OVERVIEW

**Madden Center for Valuation Creation
Florida Atlantic University**

DEVELOPMENT OF THE PRAGMATIC THEORY OF THE FIRM

- **Callard Madden & Associates 1970**
 - ✓ Life-cycle Framework, CFROI
 - ✓ Holt Global Database
- **Independent Research**
 - ✓ Knowledge Building, Systems Thinking
- **Key Publications**
 - ✓ Value Creation Principles 2020
 - ✓ Journal of Applied Corporate Finance Summer 2025
(compilation of my JACF articles on the Pragmatic Theory of the Firm)
 - ✓ Value Creation Insights 2025



VALUE CREATION INSIGHTS

A FOUNDATIONAL
UNDERSTANDING
OF HOW FIRMS
BUILD KNOWLEDGE
AND **CREATE VALUE**

BARTLEY J. MADDEN

BACK COVER ENDORSEMENTS

Bart Madden's book provides a compelling and powerful account of a systems approach to business. It deserves to be widely read and highly influential on business thinking and practice.
Professor Colin Mayer, CBE, University of Oxford.

Madden's systems perspective provides a great framework for corporations to leverage their Balanced Scorecard for rapid strategy adaptation in a fast-changing world.

Robert S. Kaplan, Emeritus Professor, Harvard Business School, co-author, *The Balanced Scorecard: Translating Strategy Into Action*.

***I have been waiting for a book that successfully translates the insights of systems thinking into a theory of the firm. Bart Madden's book setting out his 'pragmatic theory of the firm' successfully achieves this.**

Dr Michael C. Jackson OBE, Professor Emeritus, University of Hull

***Value Creation Insights* is a series of insights by a shrewd analyst gained over a half a century of examining what works, what doesn't and why. Madden's system-based analysis makes you wish you had read this book earlier in your career.**

Jon Lukomnik, Managing Partner, Sinclair Capital, co-author, *Adapt or Fail: A 5x5 Governance Framework for Boards of Directors*

***Systems Thinking is the thread that connects all of the chapters.**

WE LIVE IN A FAST-CHANGING COMPLEX WORLD

- **Environmental, political, social and economic challenges are complex**
- **Systems thinking is needed**
 - **Appreciate that interrelationships of the parts determines the whole**
 - **Understand the purpose of a system**
 - **Avoid local optimizations that degrade system performance**

NEED A VIABLE THEORY OF THE FIRM

—— AGENCY THEORY ——

- **Dominant theory of the firm taught in business schools**
- **Rooted in adversarial principal-agent relationships**
- **Provides few value creation insights for users**
- **Does not facilitate systems thinking**

What constitutes a viable theory of the firm?

VIABLE THEORY OF THE FIRM SATISFIES FOUR PRACTICAL NEEDS

#1 Facilitate systems thinking

#2 Clarify the purpose of the firm

#3 Identify the critical determinant of the firm's long-term performance

#4 Connect the firm's long-term financial performance to market valuation and shareholder returns

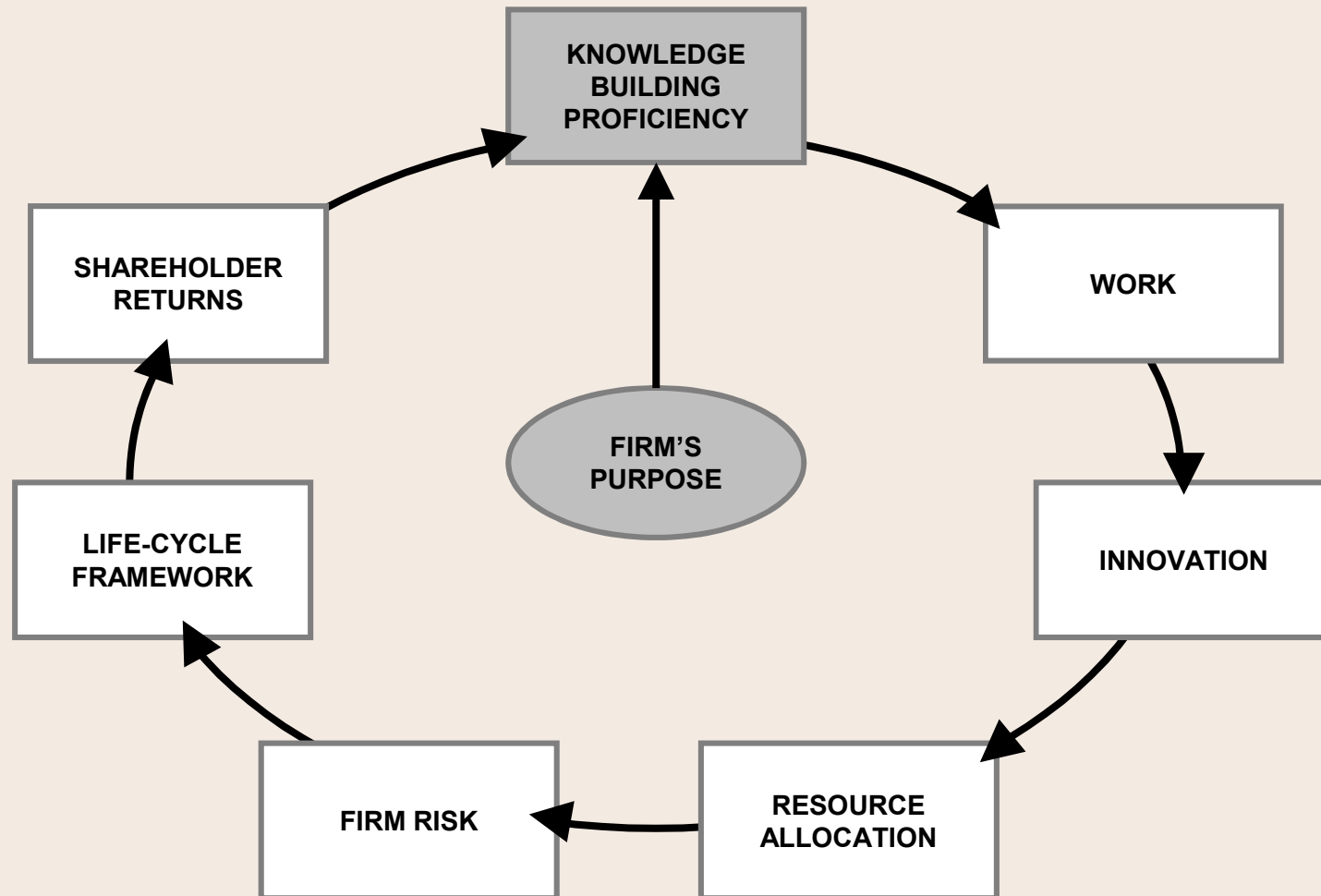
Pragmatic Theory of the Firm satisfies these needs

THE PURPOSE OF THE FIRM

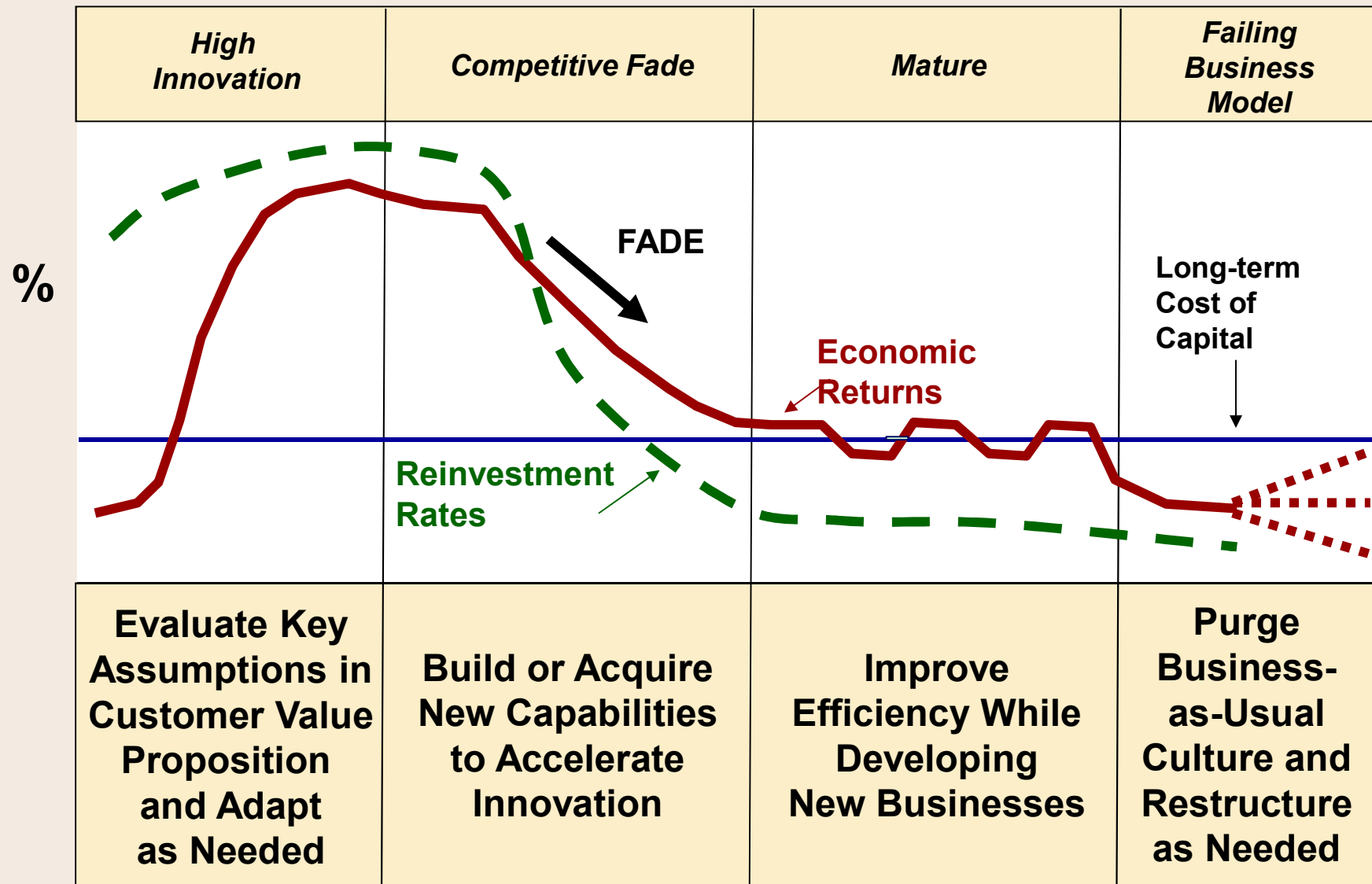
- Communicate a *vision* that can inspire and motivate employees to work for a firm committed to behaving ethically and making the world a better place.
- *Survive and prosper* through continual gains in efficiency and sustained innovation, which depend upon a firm's knowledge-building proficiency. Nothing works long term if a firm consistently fails to earn its cost of capital.
- Work continuously to *sustain win-win relationships* with all of the firm's stakeholders.
- Take care of *future generations* with a commitment to ensure the sustainability of the environment. The early design stage of products and processes needs to focus on minimizing waste and pollution.

Maximizing shareholder value is positioned not as the firm's purpose, but as the result of a firm successfully achieving its purpose.

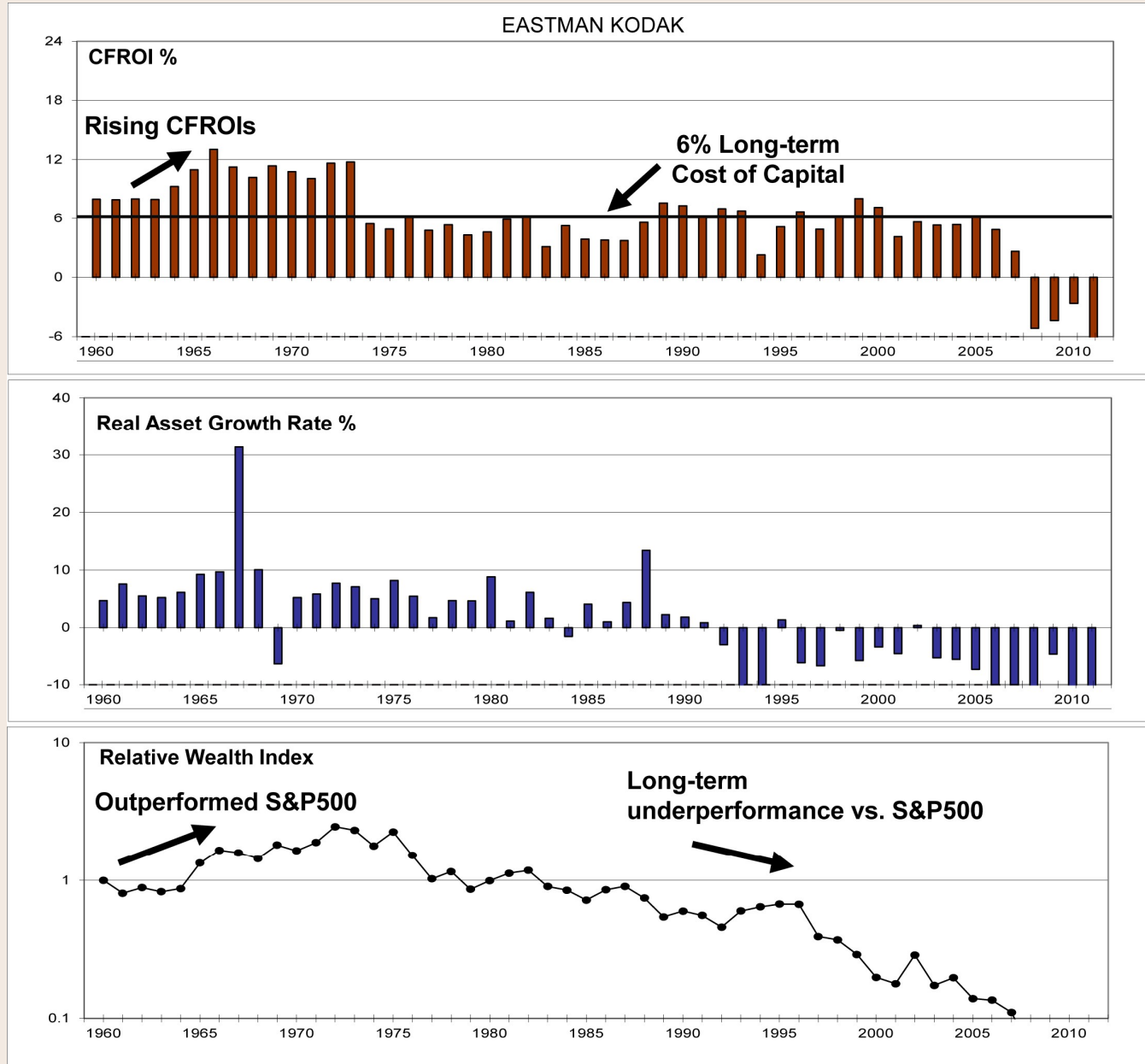
COMPONENTS OF THE PRAGMATIC THEORY OF THE FIRM



THE LIFE-CYCLE FRAMEWORK



EASTMAN KODAK 1960 TO 2011



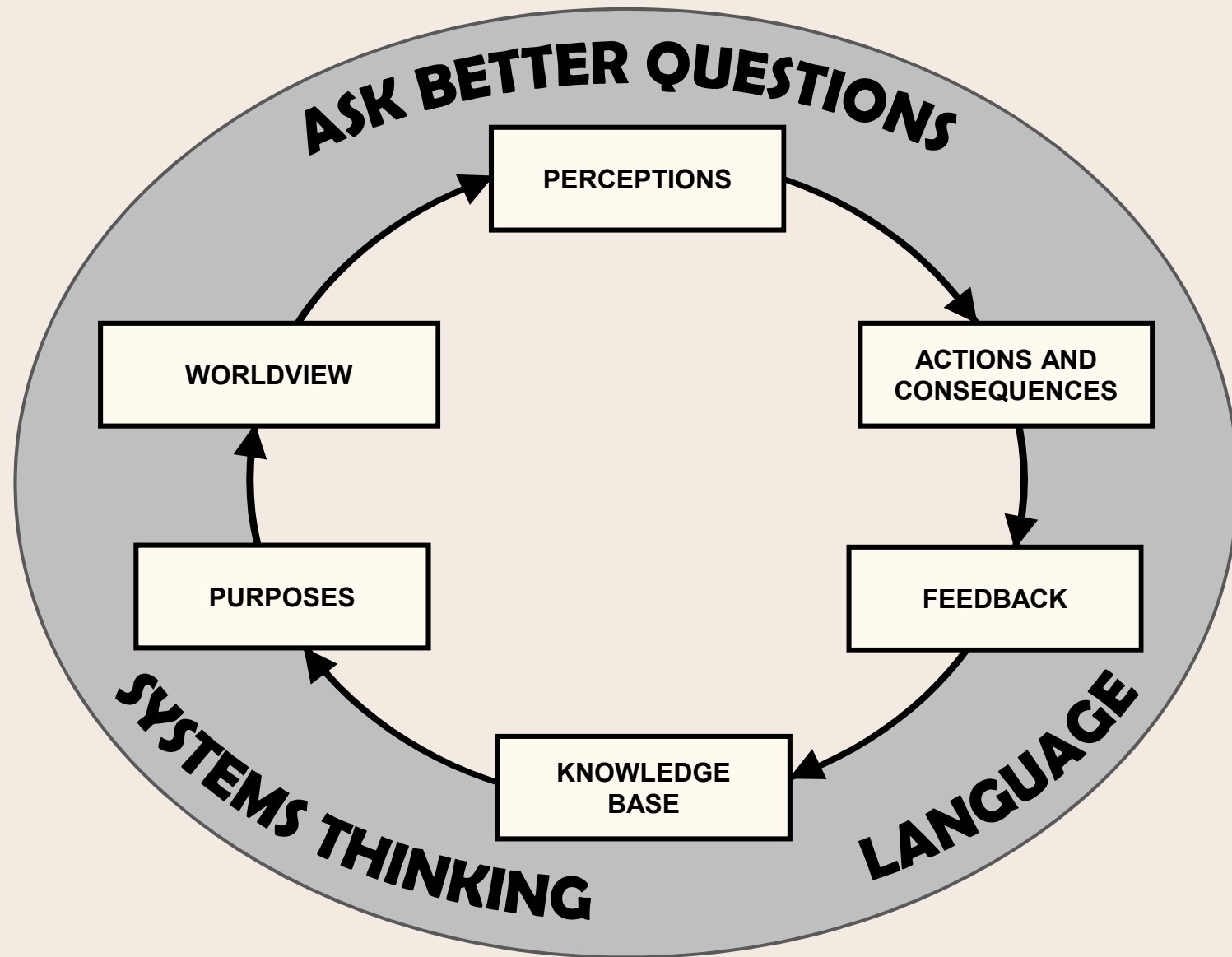
FIRM'S KNOWLEDGE-BUILDING CULTURE DRIVES LONG-TERM PERFORMANCE

Brad Smith, CEO Intuit 2008 to 2018:

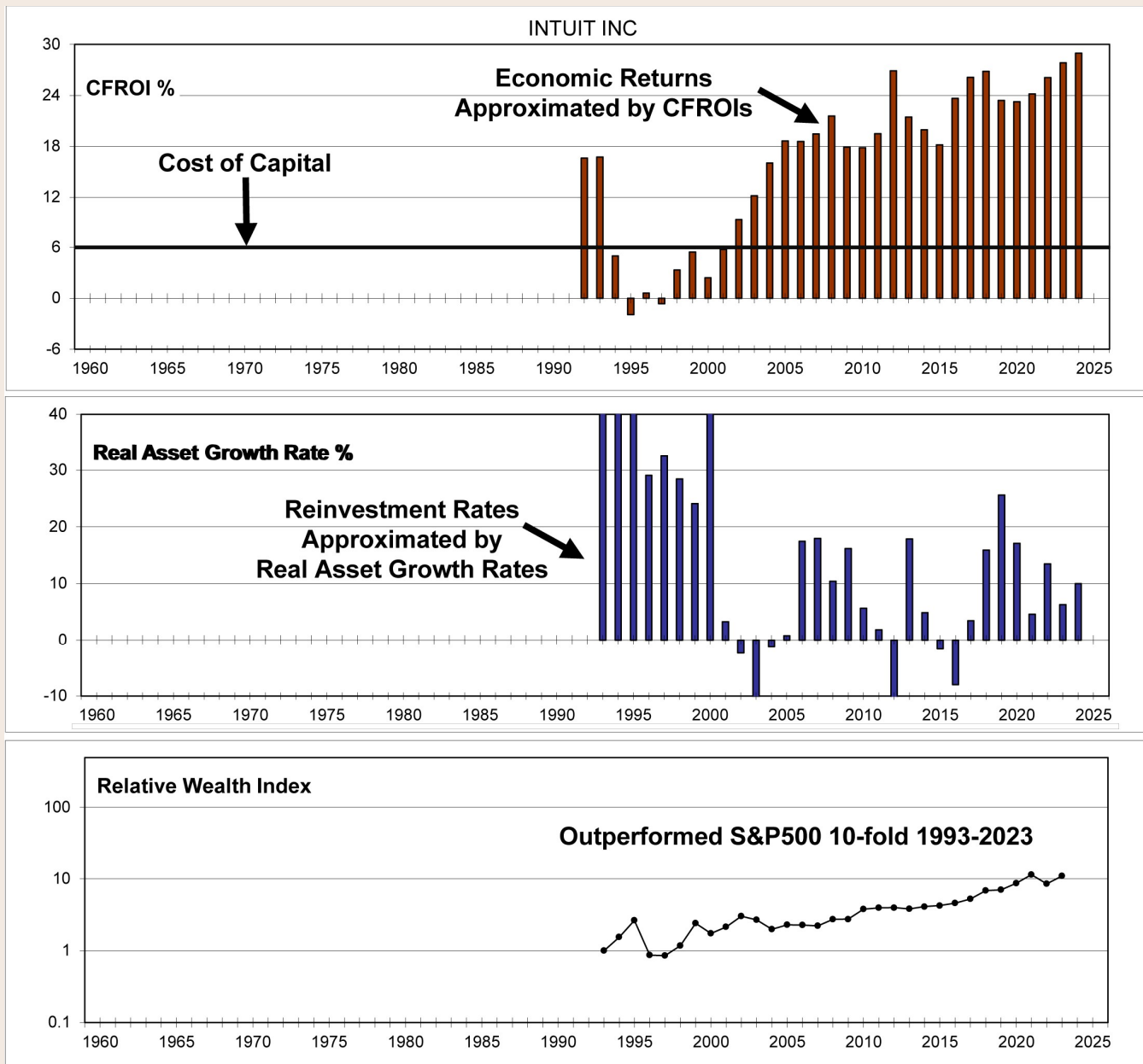
“Job one in creating a culture is building a purpose-driven culture ... At Intuit, our mission is to improve our customers’ financial lives so profoundly they can’t imagine going back to the old way ... one way that leaders can create an action-oriented environment is to match inspiration with rigor, adopting a rapid-experimentation culture. Great ideas are simply hypotheses unless matched with tangible proof they deliver meaningful impact. A rapid experimentation culture cuts through hierarchy (especially if leaders hold their own ideas to the same scrutiny of testing), creating an environment where everyone can innovate, and “debate” turns into “doing.””

Brad Smith. 2016. “The Most Important Job of a CEO.” [Investors.intuit.com](https://investors.intuit.com). accessed March 13, 2016.

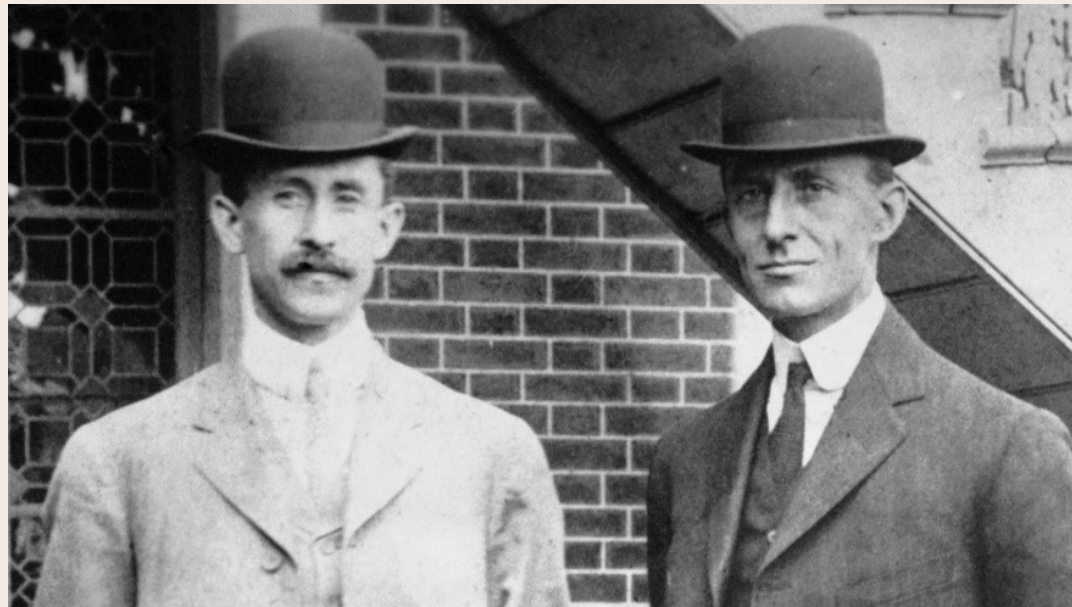
THE KNOWLEDGE BUILDING LOOP



INTUIT 1992 TO 2023

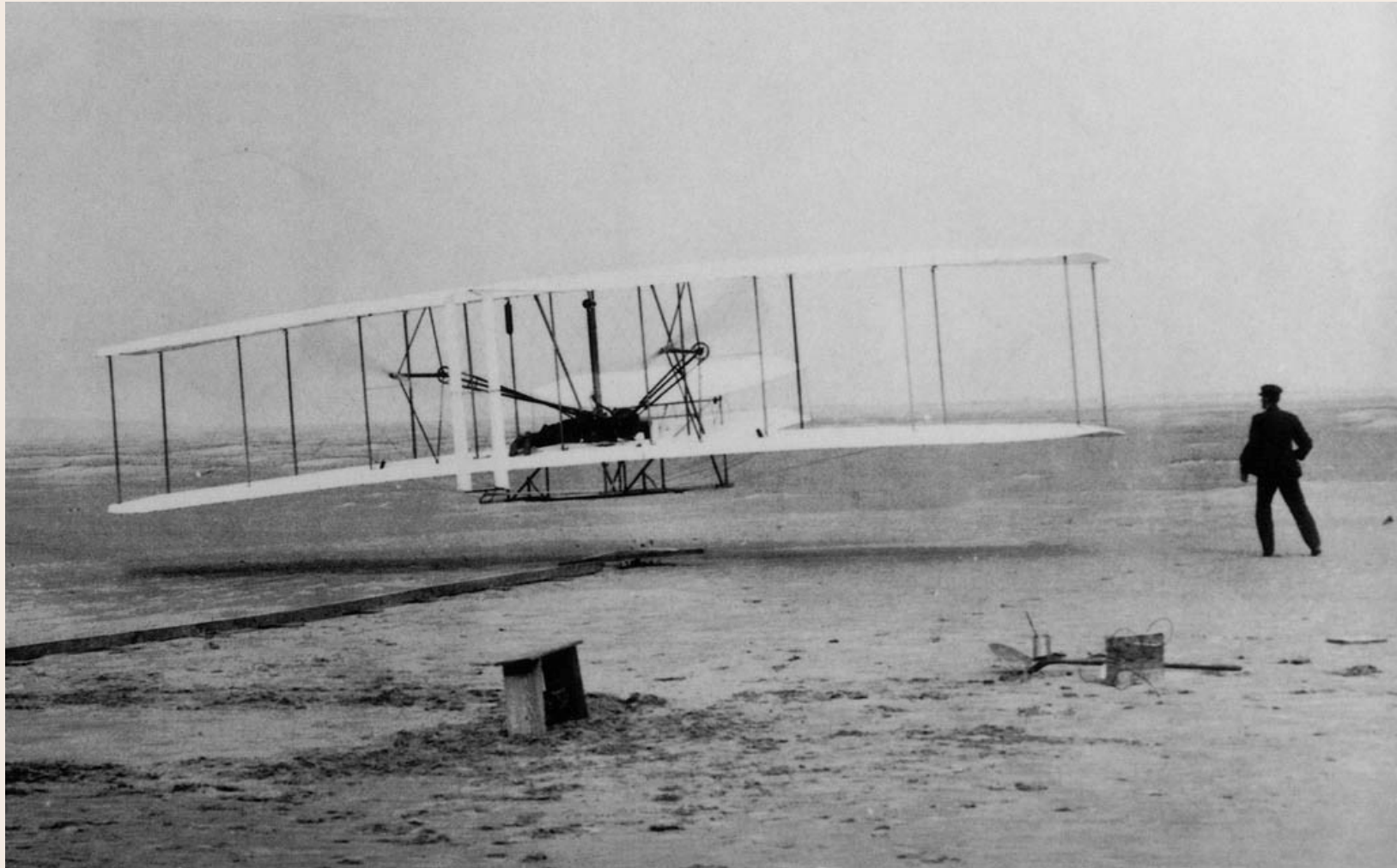


ORVILLE AND WILBUR WRIGHT



**UNIQUELY SKILLED AT FAST AND EFFECTIVE TRAVERSING
OF THE KNOWLEDGE BUILDING LOOP.**

WRIGHT BROTHERS SUCCEED, DECEMBER 17, 1903



TRAVERSING THE KNOWLEDGE BUILDING LOOP WITH THE WRIGHT BROTHERS

KNOWLEDGE
BASE

Maintain a **skepticism of conventional assumptions** and empirical findings.

PURPOSES

Achieve powered flight and **not die from a crash**

WORLDVIEW

Blend of linear cause-and-effect thinking and systems thinking with extreme focus on **maximizing control, not stability** as did their competitors

PERCEPTIONS

All perceived problems put in the context of **relationships within a holistic aircraft system**.

ACTIONS AND
CONSEQUENCES

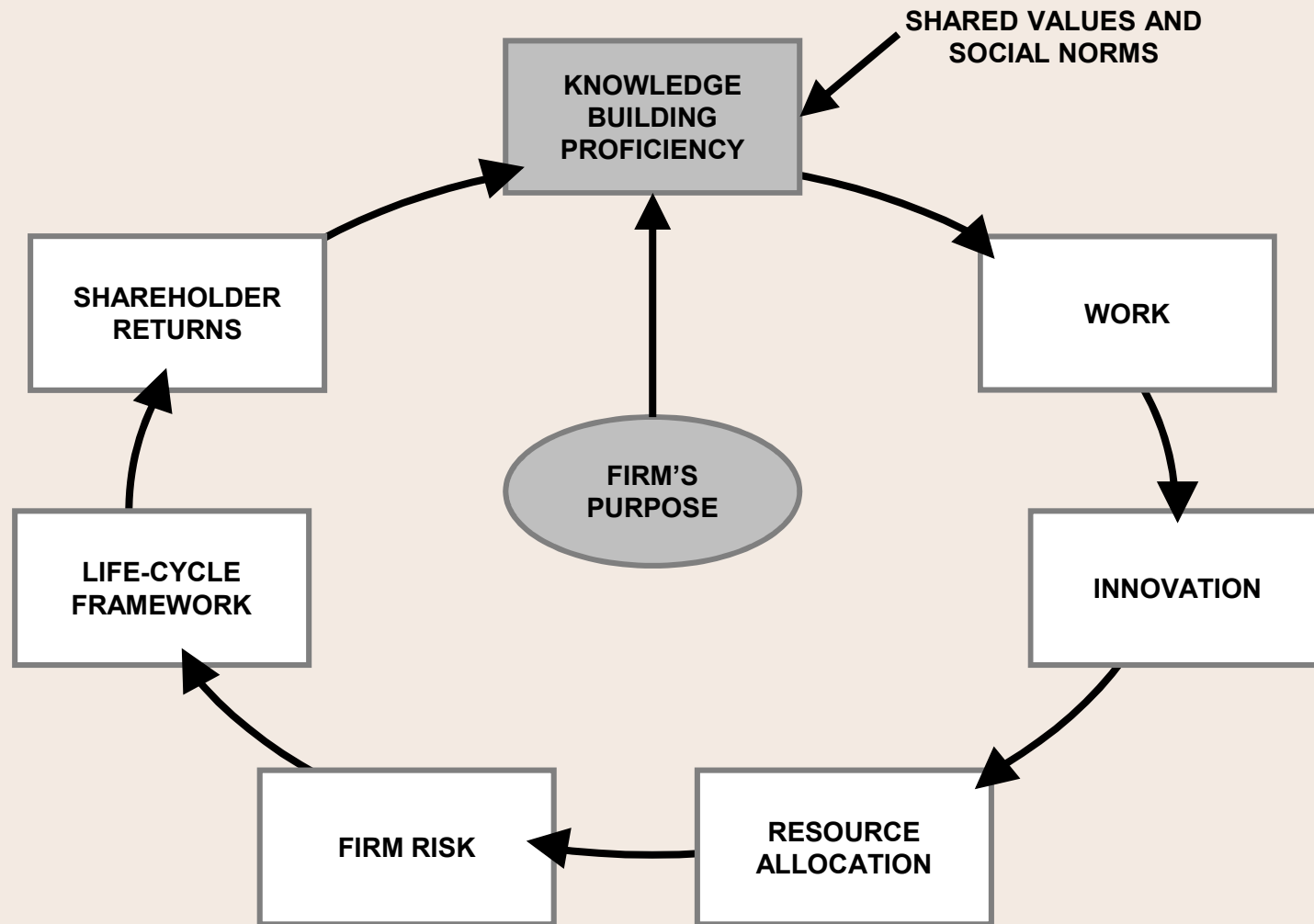
Ingenious wind tunnel experiments overturned **conventional assumptions**

FEEDBACK

In contrast to their competitors, they systematically experimented and learned how to change components of the aircraft in ways that **improved the performance of the overall system**

DEEPER UNDERSTANDING OF INNOVATION SUCCESSES AND FAILURES

COMPONENTS OF THE PRAGMATIC THEORY OF THE FIRM



SOCIAL NORMS

Social norms play a critical role in a firm's culture. Social norms are about doing what is right consistent with being a member in good standing in society, e.g., fairness, reciprocity, honesty, and trustworthiness. This is ignored in neoclassical economics and in the agency theory of the firm that stresses rational self-interest.

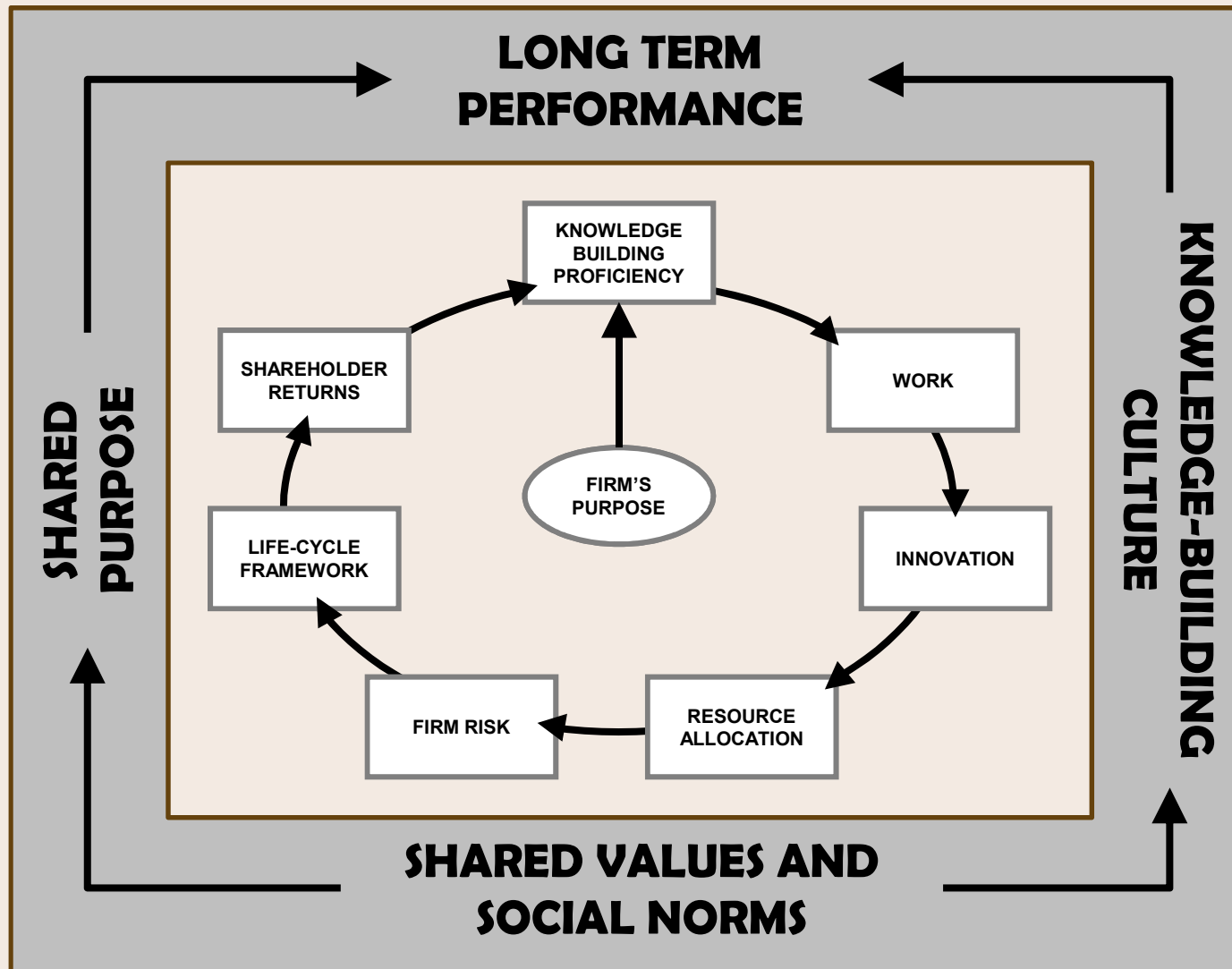
The Pragmatic Theory of the Firm with its four-part purpose that includes win-win relationships must (and does) embrace shared values and social norms. This also fits with firm risk that increases with the firm's unethical behavior, especially when widespread and condoned by management as a practical means to hit quarterly performance targets.

Shared values and social norms are required to build trust that enables a firm's knowledge-building culture to flourish.

Douglas E. Stevens. 2019. *Social Norms and the Theory of the Firm: A Foundational Approach*. Cambridge, UK: Cambridge University Press.

Bartley J. Madden and Douglas E. Stevens. "Extending the Pragmatic Theory of the Firm with Shared Values and Social Norms." Forthcoming 2025. *Journal of Applied Corporate Finance*.

THE IMPORTANT ROLE OF SHARED VALUES AND SOCIAL NORMS



COMMAND-AND-CONTROL VERSUS FLATTER ORGANIZATIONAL STRUCTURES

“In the permissionless corporation, fast, inexpensive experimentation takes over from slow, involved analysis, enabling organizations to pounce on opportunities as they arise. And at a time when speed and adaptability, rather than predictability and consistency, are the main sources of competitive advantage

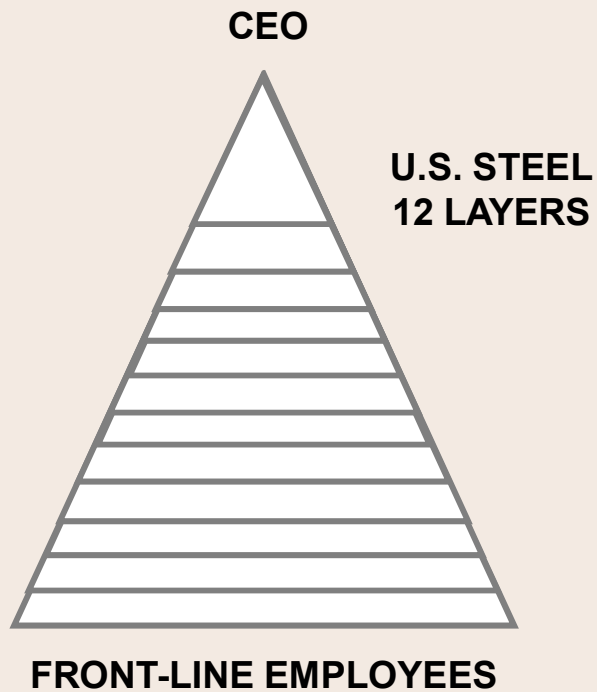
... a model [organizational structure] that allows people close to the customer to make as many decisions as possible is valuable. Companies with three or four layers, faster problem-solving, and a permissionless mindset will outcompete traditional players with 10 layers and slow decision-making processes. In fact, though it may take time, we anticipate that organizations that operate in the traditional [command and control] way will eventually cease to exist.”

—Rita McGrath and Ram Charan

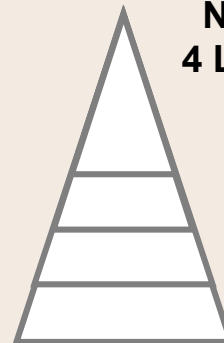
Rita McGrath and Ram Charan. 2023. “The Permissionless Corporation.” *Harvard Business Review*. January-February.

FLATTER ORGANIZATIONAL STRUCTURES FACILITATE KNOWLEDGE BUILDING

COMMAND-AND-CONTROL PYRAMID STRUCTURE



NUCOR
4 LAYERS



HAIER GROUP
FLAT



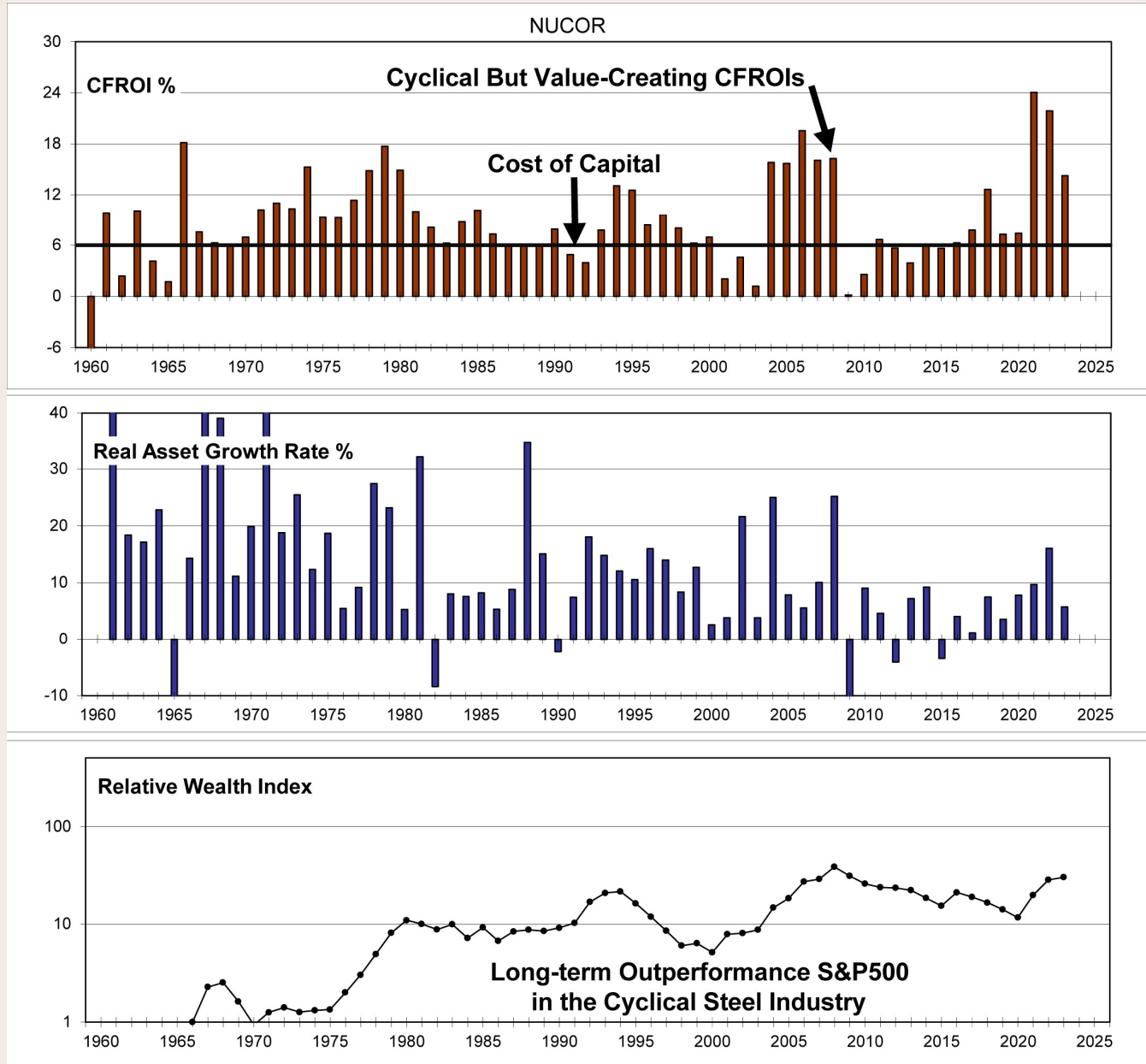
Budgets are the lifeblood of command-and-control.

KEN IVERSON ON NUCOR'S CULTURE

“Concede once and for all that employees, not managers, are the true engines of progress, and dedicate your management career to creating an environment in which employees can stretch for higher and higher levels of performance ... Instead of telling people what to do and then hounding them to do it, our managers focus on shaping an environment that frees employees to determine what they can do and should do, to the benefit of themselves and the business.”

Ken Iverson. 1998. *Plain Talk: Lessons from a Business Maverick*. Hoboken, NJ: John Wiley & Sons. p. 98.

NUCOR 1960 TO 2023



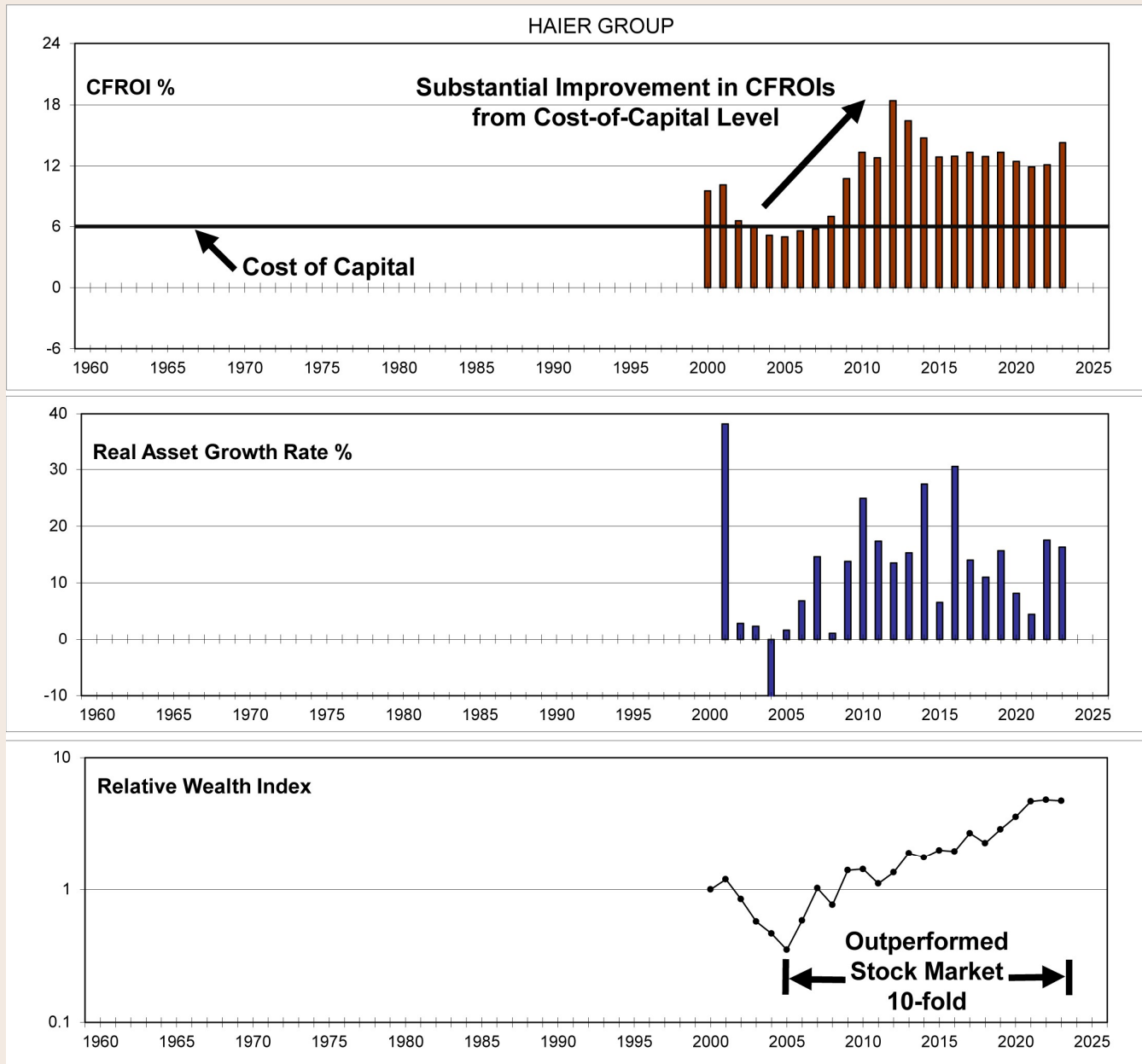
HAIER STANDS FOR ZERO DISTANCE

“Traditional organizations regard employees as tools, but Haier sees them as value creators. Traditional organizations have no users, only customers, and when a product is sold, the deal is done. Haier’s customers are users. The sale of a product is not the end, but a beginning. Haier continues to engage with users throughout product iterations.

... Toyota stands for zero defect, while Haier stands for zero distance. Toyota’s zero defect works in the realm of products, but when a product becomes a networked appliance, it is merely a node in a network. The physical attributes of the product are no longer of greatest importance ... more importantly, the whole network behind it.”

Danah Zohar. 2022. Zero Distance: Management in the Quantum Age. NY: Palgrave Macmillian. p. xi.

HAIER GROUP 2000 TO 2023

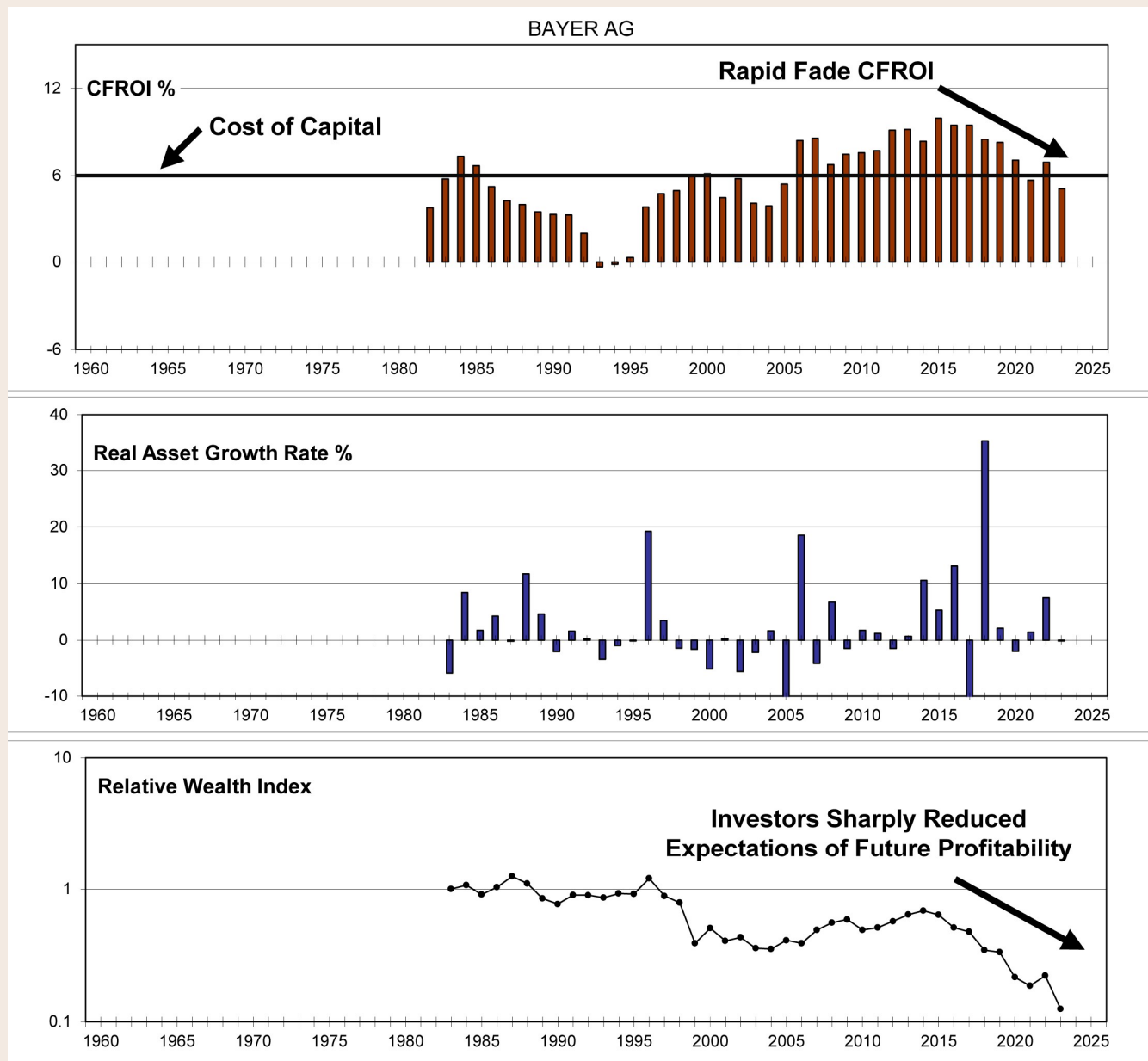


RADICAL RESTRUCTURING AT BAYER AG

“We want to turn our system on its head. In the future, 95 percent of the decision-making will shift to the people actually doing the work. We are introducing a new operating model, which we call Dynamic Shared Ownership. This new system will reduce hierarchy levels, eliminate bureaucracy and significantly accelerate decision-making. We will primarily work in small, self-managed teams, totally focused on improving our products and the lives of our customers. This shift will enable us to unleash the entrepreneurial power of each individual and ensure that all of our efforts are focused on the needs of consumers, patients, and farmers.”

Bill Anderson CEO, 2023 Shareholders Letter

BAYER AG 1982 TO 2023



INTANGIBLES AND THE NEW ECONOMY

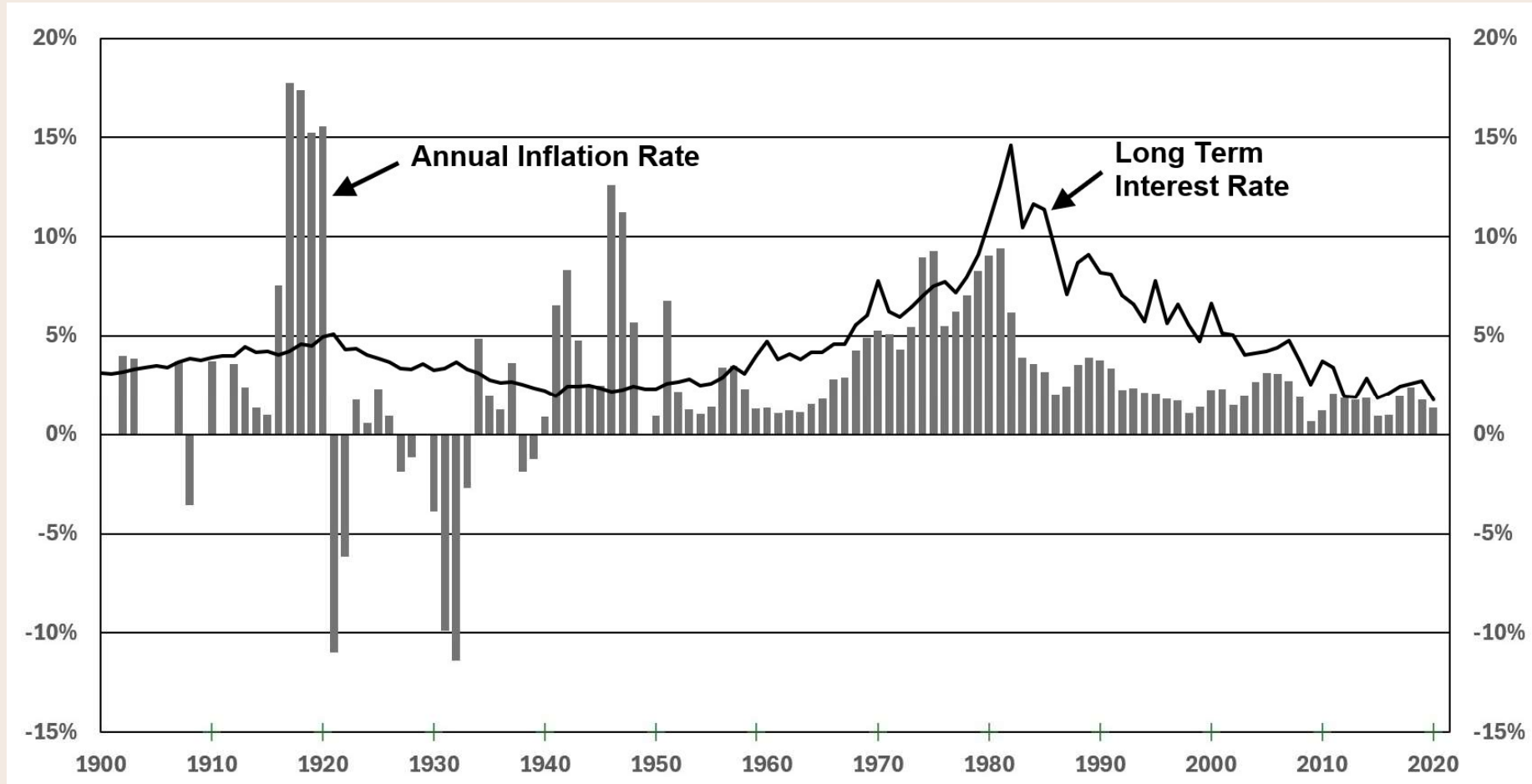
- Source of competitive advantage
- Ignored by U.S. GAAP accounting



Do Accounting Biases Matter?

- ROE – Return On Equity
- RONA – Return On Net Assets

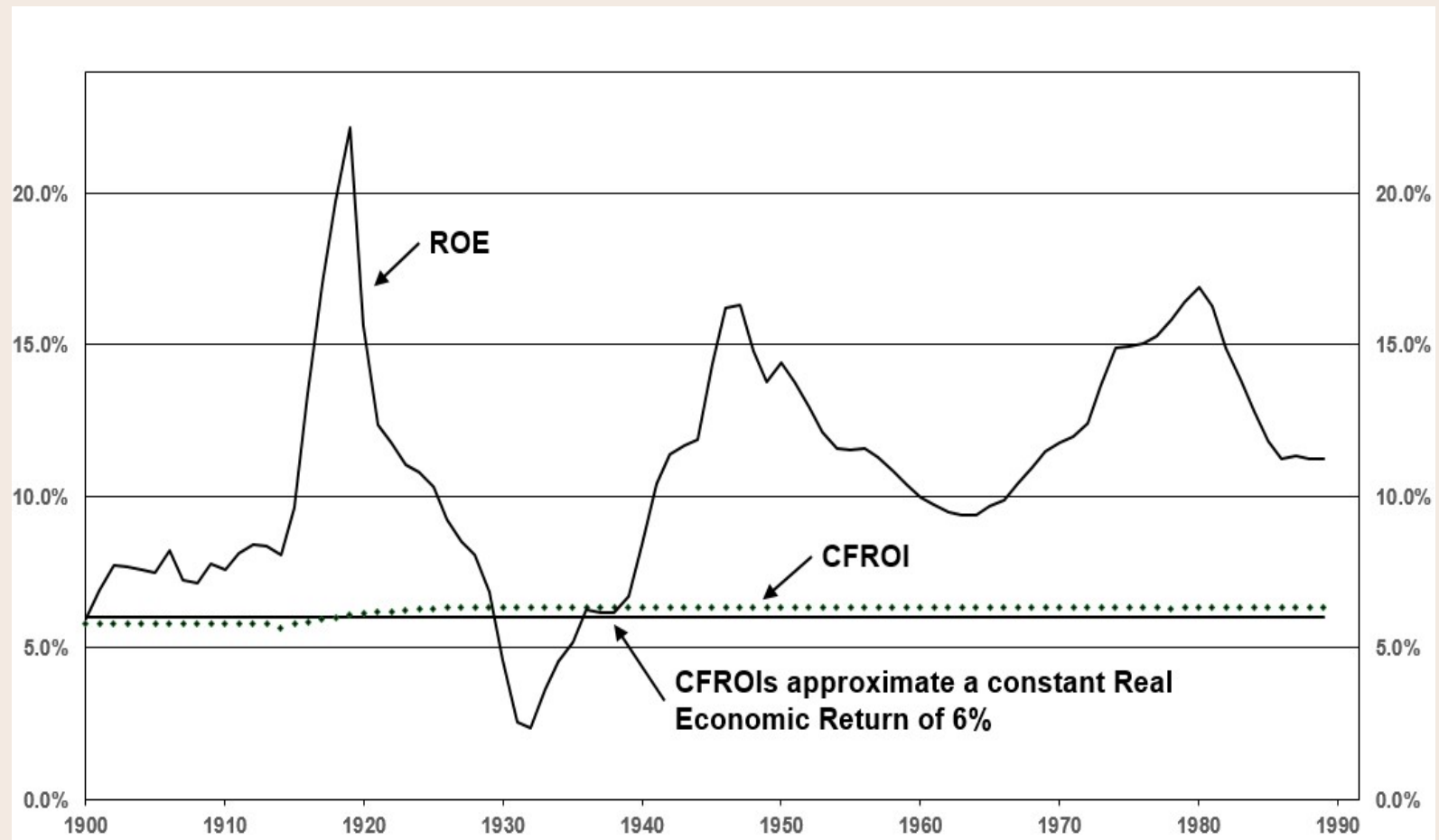
ANNUAL INFLATION RATES AND LONG-TERM INTEREST RATES, 1900 TO 2020



Source: Bartley J. Madden and Donn DeMuro. 2025. "Bridging the Gap Between Accounting Returns and Economic Returns: Translator Simulation Software." forthcoming. *Journal of Applied Corporate Finance*.

SIMULATED ROE FOR AN INDUSTRIAL FIRM EARNING THE COST OF CAPITAL, 1900 TO 1990

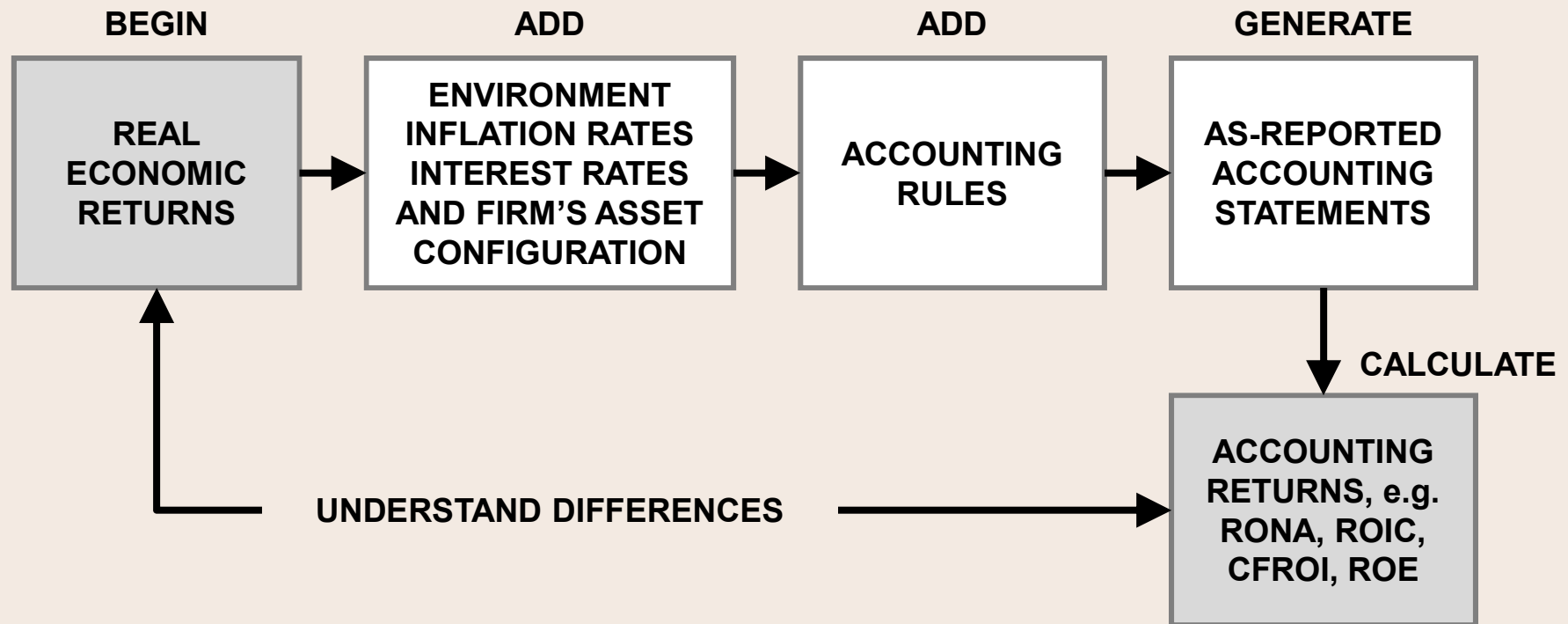
Accounting Biases Matter



CFROI is an inflation-adjusted accounting return

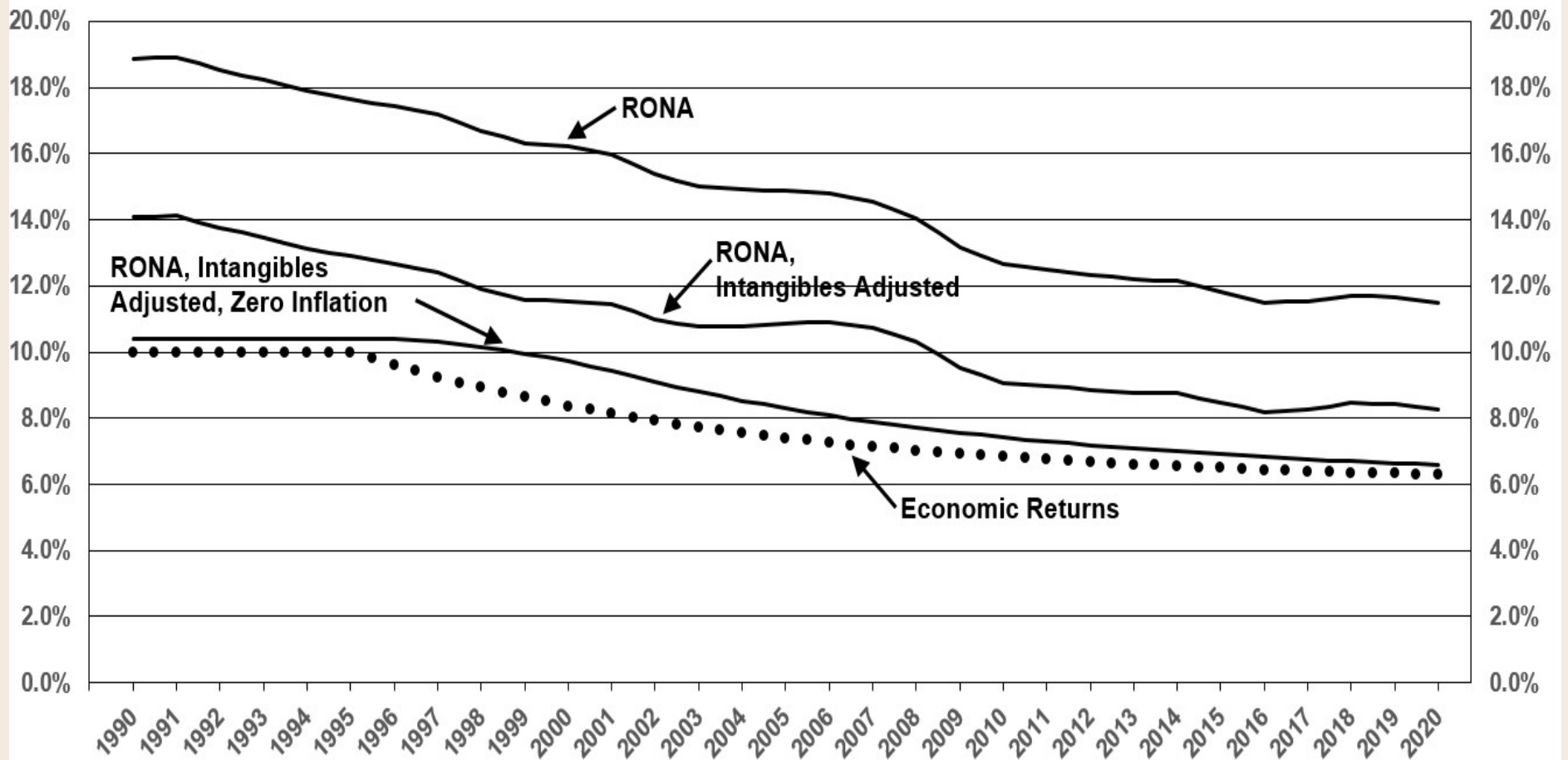
Source: Madden and DeMuro (2025)

THE TRANSLATOR SIMULATION SOFTWARE FACILITATES LEARNING



Bartley J. Madden and Donn DeMuro. 2025. "Bridging the Gap Between Accounting Returns and Economic Returns: Translator Simulation Software." forthcoming. *Journal of Applied Corporate Finance*.

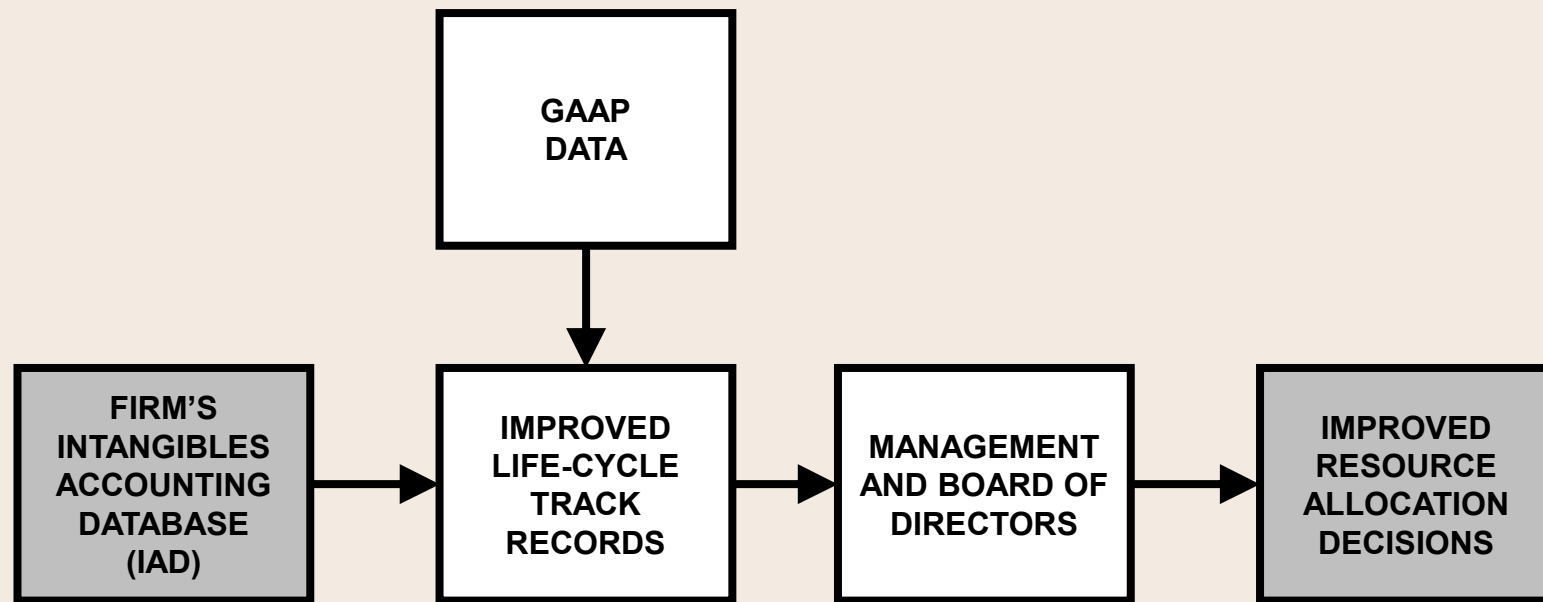
AS-REPORTED RONA VERSUS ECONOMIC TRUTH



Source: Madden and DeMuro (2025)

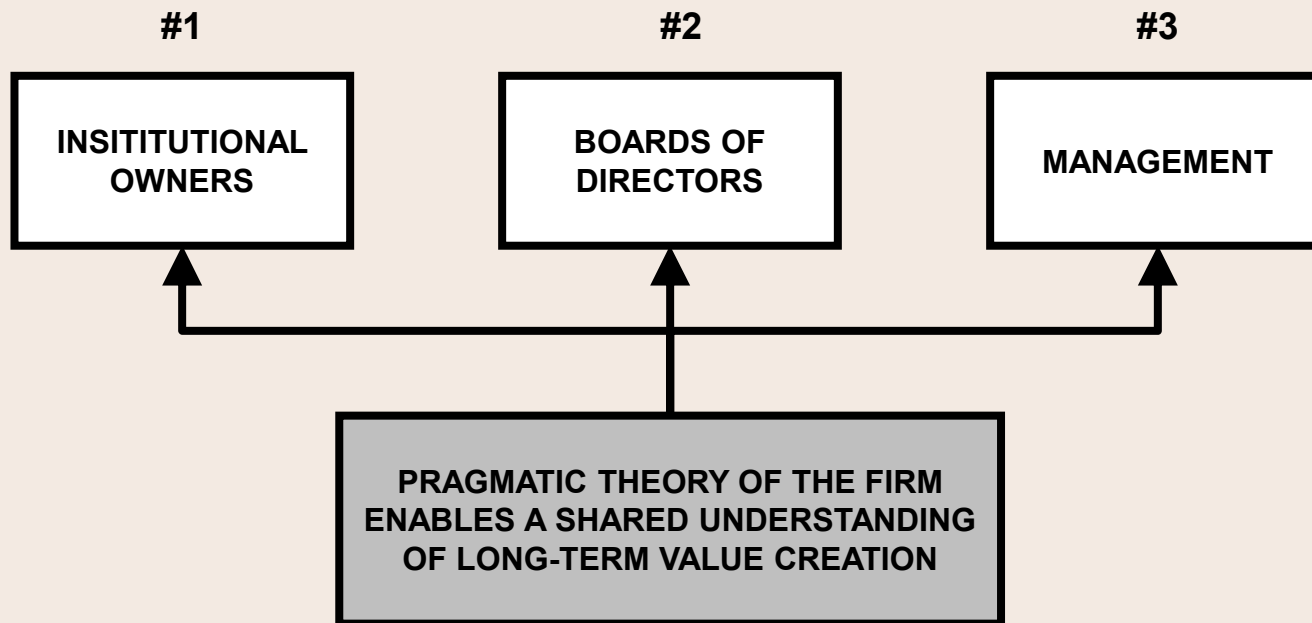
KEY RECOMMENDATION

Inside the firm management creates an Intangibles Accounting Database (IAD) and immediately improves accuracy of accounting returns, life-cycle track records for business units, and resource allocation decisions.



Bartley J. Madden and Douglas E. Stevens. 2025. "Increasing the Value of Accounting for Management, Boards, and Investors: A Path Forward for the New Economy." working paper.

THREE IMPLEMENTATION STEPS TO IMPROVED COMMUNICATION AND BETTER DECISION MAKING BY MANAGEMENT, BOARDS, AND INSITITUTIONAL OWNERS



Special issue 2025 *Journal of Portfolio Management*:

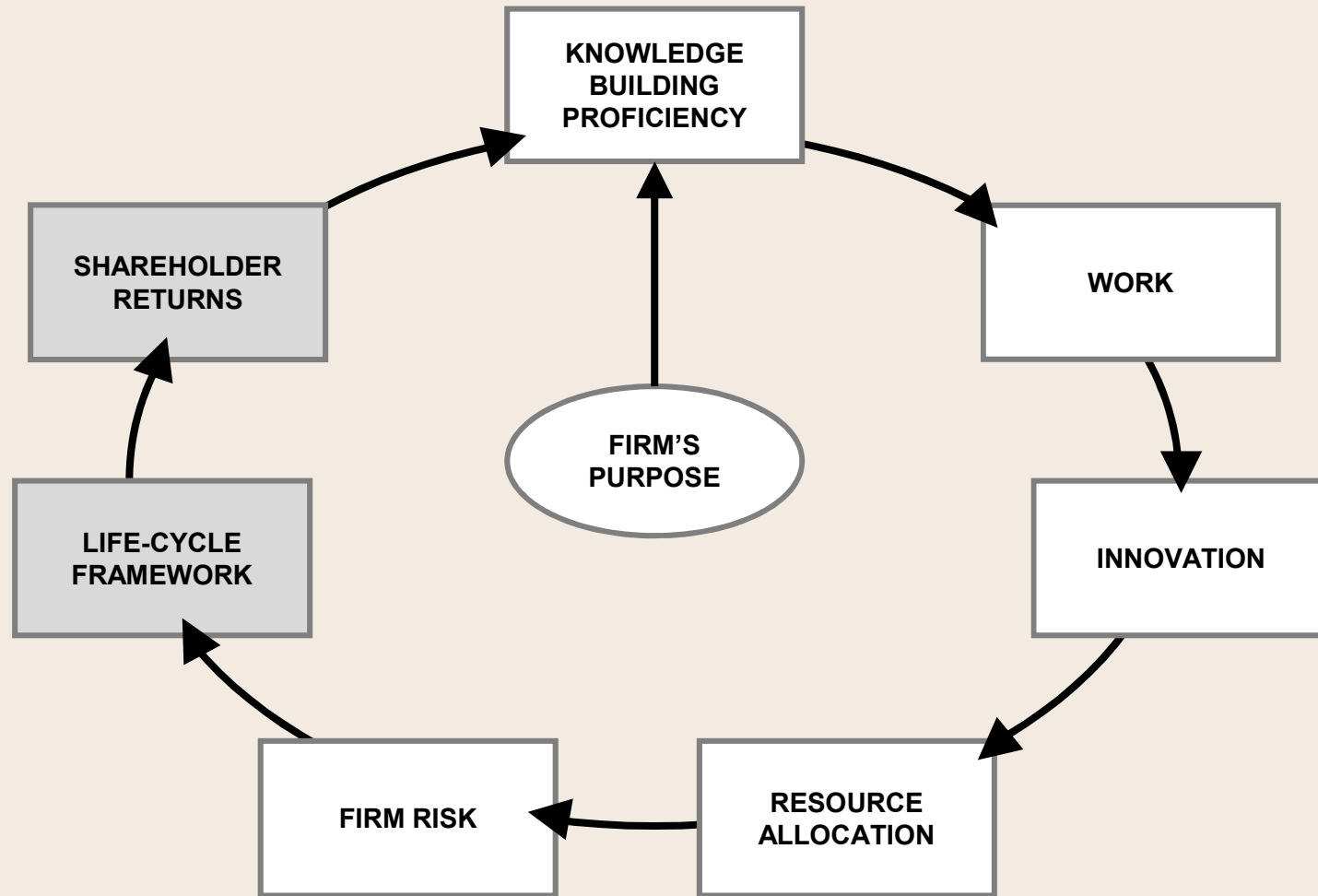
Keith Ambachtsheer. “Investing as Owners Rather Than Traders: How Pension Funds Can Transform Capitalism.”

Bartley J. Madden. “A Systemic Improvement in Corporate Governance Generates Higher Market Returns.”

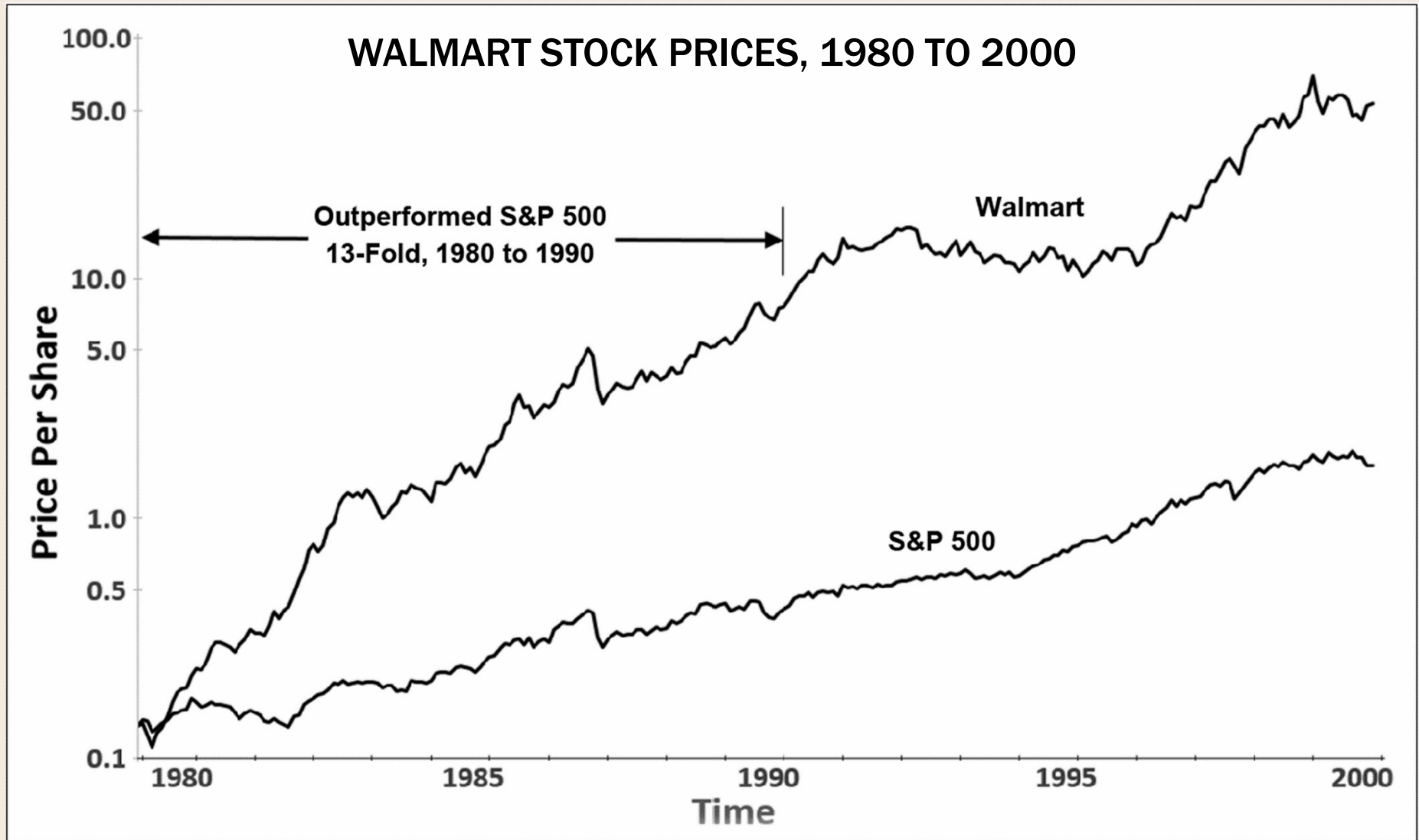
APPENDIX

**If time permits in the presentation of this PowerPoint,
topics in the appendix may be covered.**

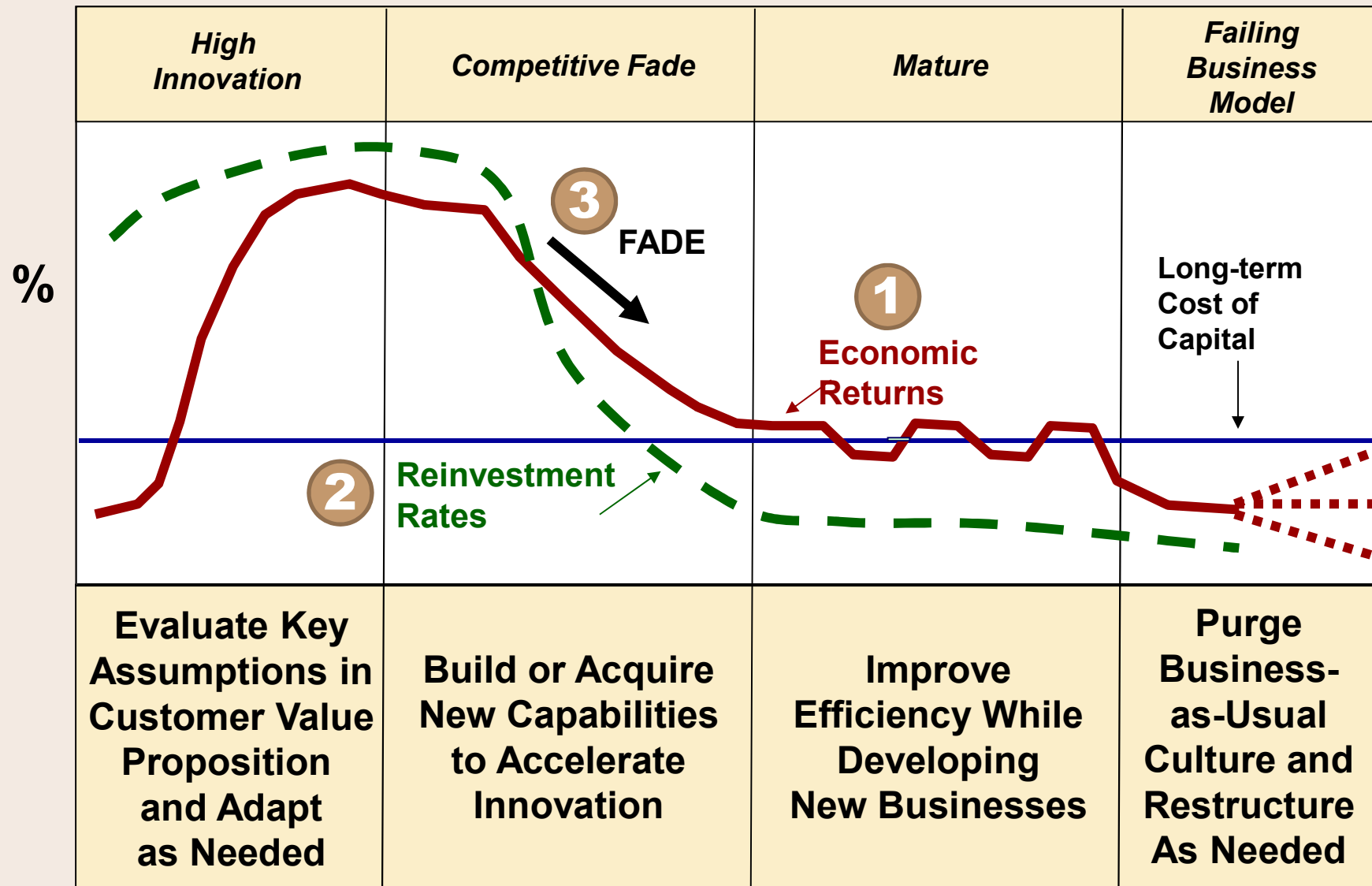
COMPONENTS OF THE PRAGMATIC THEORY OF THE FIRM



SHAREHOLDER RETURNS AND THE LIFE-CYCLE FRAMEWORK

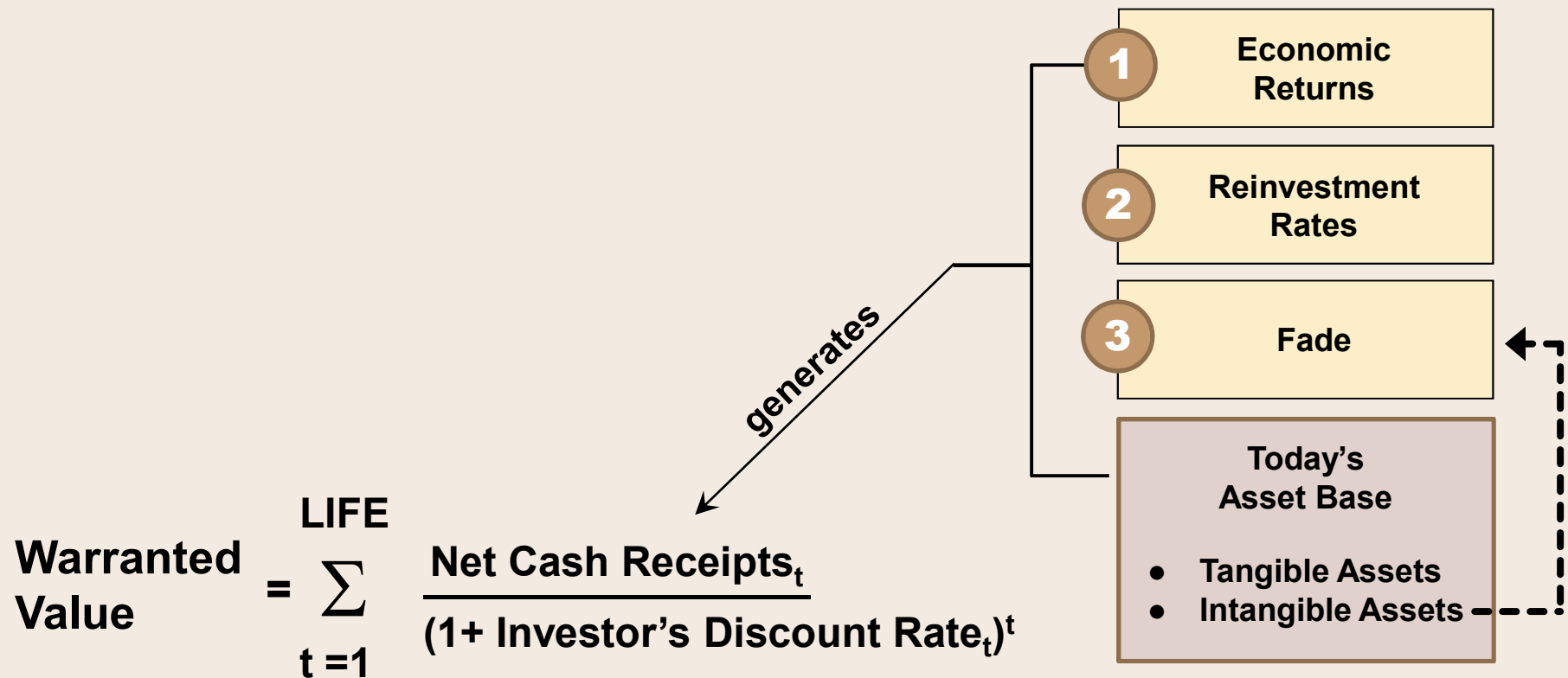


LIFE-CYCLE VARIABLES DRIVE NET CASH RECEIPTS



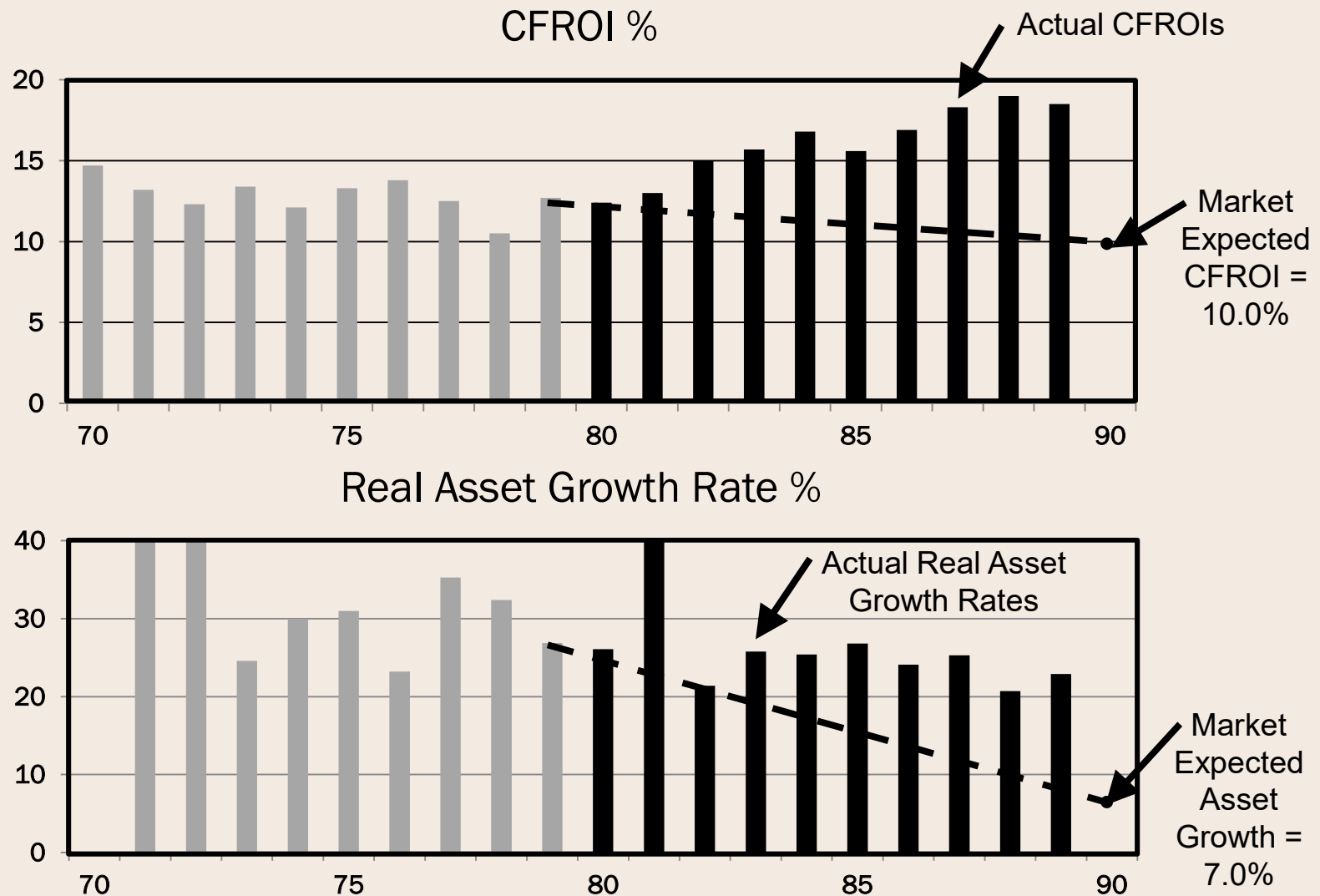
LIFE-CYCLE VALUATION MODEL

Forecast net cash receipts generated by future economic returns (CFROIs) and reinvestment rates that fade over time generate a net cash receipt stream



A firm's intangible assets are a critical determinant of the future fade rate

WALMART INVESTOR EXPECTATIONS CALCULATED AT YEAR-END 1979 (DASHED LINES)



With an estimated investor discount rate at year-end 1979 and a known market value for Walmart, life-cycle valuation model was used to derive implied fade of future CFROIs and reinvestment rates.

Source: HOLT Global Database

CLARITY ON SIX CONCEPTS ENHANCES IMPLEMENTATION THE PRAGMATIC THEORY OF THE FIRM

- #1 Knowledge building and value creation are opposite sides of the same coin.** Deeper understanding of a customer's pain point in accomplishing a needed task, solving a technical problem to more efficiently manufacture a product, and other knowledge improvements are prerequisites to creating value.
- #2 Systems thinking provides actionable insights by clarifying a system's goal, the interrelationships among the system's parts, and the critical constraints impeding the achievement of the system goal.** Systems thinking can counter-balance our inclination to constrict the scope of problems to make them more manageable. Systems thinking is also the key to discovering faulty policies and obsolete assumptions high in the organization that show up as lower-level problems that never are resolved. Systems thinking complements constructive skepticism about what we think we know.

SIX CONCEPTS

- #3 Language is perception's silent partner.** Attention to language offers an actionable pathway to disentangle the assumptions behind the words that may in turn reveal the root cause of a problem or expose a strongly-held but obsolete assumption.
- #4 An individual's worldview is the automatic pilot for perceiving problems, choosing data to analyze, and developing solutions.** Learning to experience alternative ways of seeing (a major benefit of systems thinking) can surmount this limitation and lead to a changed and improved worldview.

SIX CONCEPTS

#5 The Pragmatic Theory of the Firm views the firm as a holistic system for creating value thereby providing a more insightful understanding of a firm's history, its competitive advantage (if any), and its shareholder returns. Moreover, a deeper understanding of how a firm operates as a system sets the stage for exploring new value-creation possibilities. Systems thinking and the Pragmatic Theory of the Firm are a hand-in-glove fit.

#6 Insights about the knowing process via the Knowledge-Building Loop helps to better appreciate context, to see problems with alternative perspectives, and to ask better questions. This can lead to the big idea—discovering the critical obsolete assumption or customer understanding that once articulated becomes immediately useful because it explains so much.