

# Obsolescence Risk and the Systematic Destruction of Wealth

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## **Abstract**

Obsolescence of physical assets and processes is a major component of operational risk for some companies. A simulation experiment shows that managers, who consider the retirement and replacement of individual assets in isolation, have rational incentives, due to risk aversion and uncertainty, to defer the replacement of assets past a time optimal from the perspective of the shareholder who owns the entire portfolio of such assets. This results in measurable wealth destruction—and a demonstrable opportunity to significantly enhance a company's value.