

EVA as Superior Performance Measurement Tool

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ABSTRACT

Prior to the East Asian financial crisis scholars found the necessity of a true financial performance measure in Malaysia. After more than one decade of the crisis Malaysian firms still stick with the conventional performance measures, which are criticised due to general accepted accounting principles. In this vein, this study aims to study a value based financial performance measure which can be adopted by the Malaysian firms over the conventional measures currently used. Economic Value Added (EVA) was introduced and advocated by Stern Stewart and Co. in 1982. This study intended to identify why EVA should be used as financial performance measure over the conventional measures and any added value or added advantage in EVA compare to conventional methods. EVA has been able to gain attention of the corporate giants like Coca-Cola, Sprint Corporation and Quaker Oats, as it is able to depict the true profitability of the company, however, there have been very little research conducted on EVA in Asian countries including Malaysia.

Keywords: Performance Measurement Tool; Economic Value Added (EVA); Value Based Measurement Tool; Malaysia; Conventional Measurement Tool

1. Introduction

Due to ample of evolution in last decade in the corporate world, managers and investors are seeking for an economic framework which better mirror the value and profitability of their company. Accounting tools which are being used till today are not sufficient and unlikely in facing the challenge arising from efficient capital markets and owners. Value based measurement framework, a new economic dimension is required, which could better reflect the opportunities and downsides. There are number of value based measurement in the economic framework, for example Economic Value Added (EVA), Cash Value Added (CVA), Cash Flow Return on Investments (CFROI), Shareholder Value Analysis (SVA) and Market Value Added (MVA) Erasmus, 2008 [1]; Maditinos, Sevic, & Theriou, 2006 [2]; Fredrik, 1997 [3]. Any of these can be chosen by a company as their economic framework.

Company have to be very cautious in selecting their measurement tools, as it will affect substantially the management resources and every department of the company. The concept of economic framework is an innovative way to measure the value of a company. This economic measurement system determines companies' worth and performance based on their economic situation not according to accounting numbers produced using traditional accounting rules. According to the past studies, economic frameworks set quality standard in measuring performance

and it is necessary for company to create value for shareholders.

2. What Is Value Based Measurement System?

Value based measurement has been argued as a major development tool comparing to the traditional financial performance measurement tools. According as, a company's cost of capital is taken into account in calculating whether there is value created of a firm (Erasmus, 2008). The inclusion of a firms' cost of capital in the calculation will determine whether or not value is created. An increase in shareholder's value is created if there is an excess of the returns results over the cost of capital in a firm Grant, 2003 [4]. These value based measurement tools are argued to be an attempt in overcoming the problems associated with the conventional measurement systems. From the available value based financial performance measurement tools EVA gains the most attention in the developed countries Worthington & West, 2004 [5] and Erasmus, 2008.

However, though value based measurement has gained attention in the developed economies, it is said that the developing economies are still behind in using value based performance measures as firm performance measurement tools. Abdullah argued that in Malaysia, ratios are widely used by the companies in order to measure the firm performance, may not be able to measure and capture