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Economic Value Added vs Firm Performance

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ABSTRACT

This study is comparing the relative terms of information content, incremental information content of accounting models and discounting cash flow models. Where the model is represented by the accounting operating profit (OP) and net income (NI), while discounting cash flow models represented by one of the methods of assessment in value based management system that is market value added (MVA) and economic value added (EVA). The purpose of this study is to test empirically the relative information content of EVA variables, OP and NI of the MVA and the additional content of the information contained on EVA, OP, NI against MVA. Penelitian was conducted on 18 companies going public are included in the consumer goods industry. The analytical tool used in this research is the pool least square regression between the dependent variables and independent variable. The results based on the relative information content shows that EVA is able to explain MVA better in compared with NI and OP while based on incremental information content, NI can explain changes in EVA and MVA in comparision with OP. Finally, the results of this study proved that EVA is not the best measurmen of performance.

JEL Classification: D40; F16; G14.

Keywords: Information Ccontent; Incremental; Economic Value Added; Market Value Added.

1. INTRODUCTION

The performance assessment is vital performed by each company. The performance assessment is to determine the company's success in achieving the company's goal is to maximize shareholder value or to maximize the company's value. There are two kinds of models is the reference financial practitioners in measuring the creation of shared value horder by accounting models and discounting cash flow models. Accounting models are often used to make an assessment by focusing on the relationship of annual financial statements of the Market Valuation which can be seen from the price earnings ratio (PER) as EPS, net income, operating profit. While discounting free cash flow models incorporate investor expectations of future cash flow of the company into an unlimited time. Development discounted cash flow resulted in Economic Value Added (EVA) and Market Value Added (MVA). EVA is an indicator of the additional value of an investment that takes into account the cost of capital. EVA is calculated by using traditional accounting that adapts and takes into account the cost of capital (cost of capital), so it can be known whether the company create value or not.

Positive EVA indicates that the management of the company managed to increase the value of the company in accordance with the company's goal is to maximize the value of the company. While the MVA is the excess of the market value of a company (as indicated by the share price) with the book value of that capital invested. So MVA also called the value of the premium / discount a company formed by the market, whose value is above or below the amounts invested investor in the company, based on market expectations on the overall value of EVA in the days to come. MVA is also a cumulative sum of the present value of EVA in the future so that they are positively related anatra EVA and MVA. Several studies have been done on the relationship that the EVA, MVA with a share price of which Stewart (1991) result is no strong relationship between EVA and MVA. Lern Makhija (1996) connects the accounting return (ROE, ROI and ROS), EVA and MVA with stock returns. The result EVA has a high correlation to stock returns than the other.

In contrast, Biddle et al (1977) examined the correlation of various performance measurement. EBEI results show a higher correlation than EVA, residual income and CFO. Research conducted by Garvey and Milbourn (2000) on EVA versus Earnings. The result showed that the EVA is more correlated than earnings. In addition, research conducted by Peixoto (2001) which compared the relationship between MVA and EVA, and the relationship between MVA, net income and operating profit. The results of this study indicate that net income is the only significant variable.