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Economic Value Added (EVA™): A Thematic-Bibliography

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Abstract

Purpose - This paper provides a thematic-bibliography of a selection of published journal articles that pertain to the EVA™ model.

Design/methodology/approach – Searches were conducted on the EBSCO Host, ProQuest, and Google Scholar databases to identify papers that had examined or otherwise incorporated the model in the research. This thematic-bibliography is divided into four categories regarding the literature on EVA™ - the first relates to the theory and development of the model the second where comparisons were made of the model against other models, and the next two relate to the use and application of the EVA™ model - as a tool for internal evaluation of projects and then as a tool for the measurement of wealth creation in terms of the share market value.

Implications – This analysis provides insights into the delineation between the uses and applications that have arisen in the literature and in that respect provides support for future research into the EVA™ model.

Keywords: Economic value added, EVA™, thematic-bibliography.

JEL Classifications: M41; G10
PsycINFO Classifications: 3600
FoR Code: 1501

Introduction

The Economic Value Added (EVA™) model can be traced back to the seminal work of Stewart (1991). Since its inception it has become an alternative approach for companies as a measure of financial performance both at corporate level and at a sub level when evaluating project or divisional performance (Uyemura, Kantor & Pettit (1996). The EVA model has been held to provide a information that can be considered as incremental to the traditional Earnings Per Share (EPS) ratio and can arguably provide greater assistance in forecasting future earnings (Movassagh, Seyyedi & Tahmasebi (2011). The EVA model has been subjected to empirical testing since its inception with some papers attempting to clarify variables inherent in the formula. A simple and somewhat easy to follow approach is presented in Figure 1 below.

Figure 1.

Economic Value Added Formula

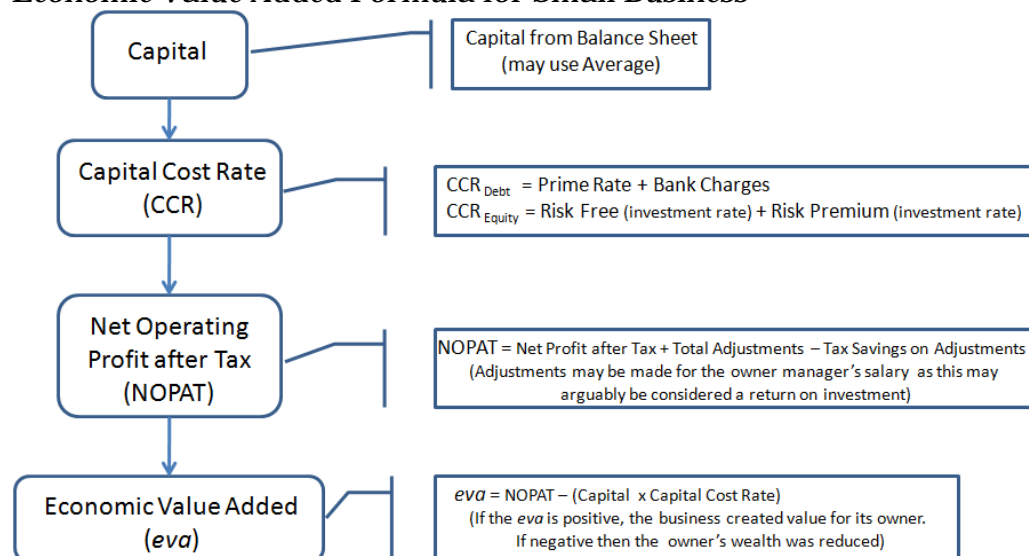
$$\begin{aligned} \text{EVA} &= (\text{Return on Capital} - \text{Cost of Capital}) * \text{Capital} \\ &= (\text{Capital} * \text{Return on Capital} - \text{Capital} * \text{Cost of Capital}) \\ &= (\text{NOPAT} - (\text{Capital} * \text{Cost of Capital})) \\ &= \text{NOPAT} - \text{Capital Charge} \end{aligned}$$

Source: adapted from Uyemura, Kantor & Pettit (1996).

In an effort to address the need to calculate the EVA for small business Rotocki and Needy (2005) formulated an approach that was more applicable to the circumstances of a small business. The approach is presented in Figure 2 below. To distinguish between the traditional EVA model and this new variation to the model they used lower case italicised letters which in their own words were to emphasise "... objective of this system ...". Unfortunately, there is little evidence in the literature of this model being used to empirically test its application or robustness.

Figure 2.

Economic Value Added Formula for Small Business



Source: adapted from Roztocki & Needy (1999).

Since the EVA model has two possible uses, one at the corporate level and the other at the level of individual projects, the published research is rather diverse in nature and esoteric in addressing the use of the model. This paper is aimed at providing a review of those areas of the research that highlight the diverse nature of the industries and uses for which the model has been applied and accordingly this is intended to underpin future research.

Method

In keeping with the method as espoused by Perrin and Laing (2012) the thematic - bibliography involved a literature search of the databases ProQuest, EBSCOHost, and Google Scholar. The analysis is restricted to published journal articles because they have been subjected to a review process. This thematic -bibliography follows the approach established by Perrin and Laing (2012) and exemplified by Volkov (2012) –the literature is classified according to the characteristics identified in each of the journal. For the purpose of this paper, the literature was divided into four categories the first relates to the theory and development of the model the second where comparisons were made of the model against other models, and the next two relate to the use and application of the EVA™ model - as a tool for internal evaluation of projects and then as a tool for the measurement of wealth creation in terms of the share market value of organisations. Within each category the papers are presented in date order. A summary of these categories is provided in Table 1.

Table 1

Categories of research articles

Topic	Number of journal articles	Total number of citations
<i>EVA Theory and Model Development</i>	21	478
<i>EVA Comparisons with other Models</i>	3	40
<i>EVA as a tool for measuring Internal Investment Projects</i>	6	40
<i>EVA as a tool for measuring Organisational Wealth</i>	19	360

This paper in keeping with the thematic-bibliography method does not provide annotated abstracts instead it provides details of the contribution of the papers, the number of citations, and any changes emanating from the papers in terms of the formula or variables in the model. The citations were current as at the 15th May 2013.

EVA Theory and Model Development:

Sharma, A. & Kumar, S. (2010). Economic Value Added (EVA) - Literature Review and Relevant Issues, *International Journal of Economics and Finance*, 2(2), 200-220.

Contribution - provides an overview of the literature up to 2008 addressing aspects of the EVA model and application to research.

Citations – 36.

Holler, A. (2008). Have Earnings Lost Value-Relevance? Revisiting Latest Evidence on EVA, *The Business Review*, 10(2), 245-254.

Contribution – reviews the issues relating to value relevance of EVA, residual income (RI), earnings and operating cash flows.

Citations – 8.

- Erasmus, P. (2008). Evaluating the information content of nominal and inflation-adjusted versions of the measure Economic Value Added (EVA), *Meditari Accountancy Research*, 16(2), 69-87.
Contribution – introduces new variations to the model – the version are nominal EVAnom and inflation adjusted EVAreal.
Citations – .
- Magni, C. (2005). On Decomposing Net Final Values: Eva, Sva and Shadow Project, *Theory and Decision*, 59(1), 51.
Contribution – presents a new model Systemic Value Added (SVA) derived from net final values (NFV) and EVA.
Citations – 16.
- de Wet, J.H.. (2005). EVA versus traditional accounting measures of performance as drivers of shareholder value - A comparative analysis, *Meditari Accountancy Research*, 13(2), 1-16.
Contribution – contrasted EVA against MAV and earnings per share (EPS, dividends per share (DPS) return on assets (ROA and return on equity (ROE) .
Citations – 47.
- Griffith, J. (2004). The True Value of EVA®, *Journal of Applied Finance*, 14(2), 25-29.
Contribution – examined the performance of companies that had employed EVA.
Citations – 49.
- Cuganesan, S., Free, C. & Briers, M. (2004). Controversies in EVA Implementation: A Case Study of an Australian Financial Services Organisation, *Accounting, Accountability & Performance* , 10(2), 1-34.
Contribution – examines the implementation issues of EVA for a company and how it has been developed to measure customer value and profitability.
Citations – 2.
- Pagano, M. & Stout, D. (2004). Calculating a Firm's Cost of Capital, *Management Accounting Quarterly*, 5.(3), 13+.
Contribution – addresses the theoretical and empirical issues of estimating a compny's weighted average cost of capital (WACC).
Citations – .
- de Wet, J.H. & Hall, J. (2004). The relationship between EVA, MVA and leverage, *Meditari Accountancy Research*, 12(1), 39-59.
Contribution – examined the leverage effect of fixed costs to determine impact on EVA and MVA .
Citations – 9.
- Keef, S. & Roush, M. (2003). The Relationship Between Economic Value Added and Stock Market Performance: A Theoretical Analysis, *Agribusiness*, 19(2), 245-253.
Contribution – examined the theoretical aspect of EVA in semistrong form efficient market senario.
Citations – 10.
- Weaver, S. (2003). Consistency of the economic value added financial performance metric, *Corporate Finance Review*, 7(5), 13.
Contribution - provides an investigation of the financial performance outcomes of EVA.
Citations – 7.

- Adsera, X. & Vinolas, P. (2003). FEVA: A financial and economic approach to valuation, *Financial Analysts Journal*, 59(2), 80-87.
Contribution – integrated EVA, DCF and MM to derive a new model referred to as financial and economic value added (FEVA).
Citations – 28.
- Paulo, S. (2002). Operating income, residual income and EVA: Which metric is more value relevant--a comment, *Journal of Managerial Issues*, 14(4), 500-506.
Contribution – raises concerns over theoretical basis of the EVA model – citing the reduced relevance of accounting information..
Citations – 7.
- Chen, S. & Dodd, J. (2002). Market efficiency, CAPM, and value-relevance of earnings and EVA: A reply to the comment by professor Paulo, *Journal of Managerial Issues*, 14(4), 507-512.
Contribution – provides a response to Paula on the relevance of accounting information.
Citations – 17.
- Morris, V. (2001). The EVA Challenge: Implementing Value-Added Change in an Organization / EVA and Value-Based Management: A Practical Guide to Implementation, *Financial Analysts Journal*, 57(6), 106-108.
Contribution - provides a review of the books on EVA and the implementation process espoused by the authors.
Citations – 3.
- Ray, R. (2001). Economic value added: Theory, evidence, a missing link, *Review of Business* 22(1/2), 66-70.
Contribution – in traduces a new variable into the EVA model – the concept of productivity.
Citations – 54.
- Shrieves, R. & Wachowicz, J. (2001). Free cash flow (FCF), economic value added (EVA), and net present value (NPV): A reconciliation of variations of discounted-cash-flow (CDF) valuation, *The Engineering Economist*, 46(1), 33-52.
Contribution – identifies the relationship of free cash flow to EVA concepts as well as DCF.
Citations – 79.
- Pierce-Brown, R. (2000). EVA® and other Arthurian myths: A comment on Zafiris & Bayldon (2000), *Journal of Applied Accounting Research*, 6(1), 2-22.
Contribution - provides an overview of the literature and comments on changes suggested by Zafiris and Bayldon (1999).
Citations – 2.
- Zafiris, N. & Bayldon, R. (1999). Economic value added and market value added: A simple version and application, *Journal of Applied Accounting Research*, 5(2), 84-105.
Contribution – presents insights into the use of EVA for strategic decisions with some suggested modifications to the model formulation.
Citations – 1.

Ferguson, R. & Leistikow, D. (1998). Search for the best financial performance measure: Basics are better, *Financial Analysts Journal*, 54(1), 81-85.
Contribution - provides an overview of the literature up to 2008 addressing aspects of the EVA model and application to research.
Citations – 57.

Biddle, G., Bowen, R. & Wallace, J. (1998). Economic value added: Some empirical EVAdence, *Managerial Finance*, 24(11), 60-72.
Contribution - provides an overview of the literature up to 2008 addressing aspects of the EVA model and application to research.
Citations – 53.

EVA comparisons with other Models:

Oberholzer, M. & van der Westhuizen, G. (2010). The relationship between economic value added and data envelopment analysis based on financial statements: Empirical evidence of South African listed banks, *Management Dynamics*, 19(3), 29-41.
Contribution – uses EVA combined with data envelopment analysis (DEA) to evaluate bank efficiency .
Citations – 0.

Mittal, R., Sinha, N. & Singh, A. (2008). An analysis of linkage between economic value added and corporate social responsibility, *Management Decision*, 46(9), 1437-1443.
Contribution – examines the correlation between corporate social responsibility (CSR) and EVA as well as market added value (MVA).
Citations – 37.

Erasmus, P. & Lambrechts, I. (2006). EVA and CFROI: A comparative analysis, *Management Dynamics*, 15(1), 14-26.
Contribution – presents a method for using EVA in terms of – EVA in monetary terms, EVA in real terms and cash flow return on investment as compared to traditional NPV evaluations.
Citations – 3.

EVA as a tool for measuring Internal Investment Projects:

Hahn, G. J. & Kuhn, H. (2011). Optimising a value-based performance indicator in mid-term sales and operations planning, *Journal of the Operational Research Society*, 62(3), 515-525.
Contribution - provides an overview of the literature up to 2008 addressing aspects of the EVA model and application to research.
Citations – 16.

Yao, L., Sutton, S. & Chan, S. (2009). Wealth Creation from Information Technology Investments using the EVA®, *Journal of Computer Information Systems*, 50(2), 42-48.
Contribution – uses EVA to evaluate maximization of incremental income above capital costs includes ROI and ROA comparisons.
Citations – 5.

- Rompho, N. (2009). Application of the Economic Value Added (EVA) Protocol in a University Setting as a Capital Budgeting Tool, *Journal of Financial Reporting and Accounting*, 7(2), 1-17.
Contribution – uses EVA to evaluate capital budgeting and develops a new variation Academic Value Added Ratio (AVAR).
Citations – 0.
- Fountaine, D., Jordan, D. & Phillips, G. (2008). Using Economic Value Added as a Portfolio Separation Criterion, *Quarterly Journal of Finance and Accounting*, 47(2), 69-81.
Contribution – uses EVA as a means to establish two portfolios with statistically different cumulative returns.
Citations – 19.
- Klumpes, P. (2005). Managerial Use of Discounted Cash-Flow or Accounting Performance Measures: Evidence from the U.K. Life Insurance Industry, *Geneva Papers on Risk & Insurance*, 30(1), 171-186.
Contribution - examined the use of EVA and embedded value (EV) for strategic management planning and control.
Citations – 17.
- Thibadoux, G., Scheidt, M. & Jeffords, R. (1999). Using economic value added (EVA) as a strategic management and evaluation tool, *Oil, Gas & Energy Quarterly*, 47(3), 627-636.
Contribution - provides an overview of the literature up to 2008 addressing aspects of the EVA model and application to research.
Citations – .

EVA as a tool for measuring Organisational Wealth:

- Singh, T. & Mehta, S. (2012). EVA VS Traditional Accounting Measures: A Pre Recession Case Study of Selected IT Companies, *International Journal of Marketing and Technology*, 2(6), 95-120.
Contribution - provides empirical evidence on the relative and incremental information content of EVA but with mixed results.
Citations – 1.
- Kumar, S. & Sharma, A. (2011). Association of EVA and accounting earnings with market value: evidence from India, *Asia - Pacific Journal of Business Administration*, 3(2), 83-96.
Contribution – content test reveal that NOAPT and OCF outperform EVA in explaining the market value of Indian companies. Incremental information test shows that EVA makes a marginal contribution. results do not support the hypothesis that EVA is superior to traditional accounting-based measures in association with market value of the firm
Citations – 5.

Tu, H. & Hou, J. (2011). The Effect of Internet Channels on the Market Value: AR and EVA Perspectives, *Contemporary Management Research*, 7(2), 89-103.

Contribution – the research examined firms' market values after adding Internet channels. The results showed that the magnitudes of the CAARs were uniformly positive and significant in [-10,+10] windows; the relationship between EVA before/after introducing Internet channels and abnormal returns were positive.

Citations – 1.

Paulo, S. (2010). The UK Companies Act of 2006 and the Sarbanes-Oxley Act of 2002, *International Journal of Law and Management*, 52(3), 173-181.

Contribution - A survey of the literature lead to the conclusion that the empirical evidence in support of the claims in favour of EVA® was not compelling, the epistemology and methodology of EVA® were examined, and were found to be deficient. There is insufficient supportive evidence to validate the claims of EVA®.

Citations – 9.

Stahle, P. & Stahle, S. (2011). Value added intellectual co-efficient (VAIC): A Critical Analysis, *Journal of Intellectual Capital*, 12(4), 531-551.

Contribution - studies conducted in the developed countries have largely been found to be supporting EVA though there are certain studies in these countries too that consider conventional measures as better tools of corporate performance reporting. However, in developing economies less numbers of studies are available supporting the empirical validity of the concept.

Citations – 3.

Silverman, H. (2010), Valuing Technology Stocks With EVA(TM): A Bridge Too Far?, *Journal of Business Case Studies*, 6(2), 9-20.

Contribution - found a marked disparity between EVA(TM) estimates of Present Value and actual market value for the US technology sector.

Citations – 5.

Yao, L, Sutton, S. & Chan, S. (2009). Wealth Creation from Information Technology Investments using the EVA®, *Journal of Computer Information Systems*, 50(2), 42-48.

Contribution – results from the sample firms were inconsistent when applying traditional accounting measures (i.e. IT investment was not correlated with increases in ROI and ROA but was correlated with ROE and ROS). However, a significant relationship exists between IT investment and EVA®, indicating increased IT investment was associated with increased wealth creation.

Citations – 9.

Maditinos, D., Sevic, Z. & Theriou, N. (2009). Modelling traditional accounting and modern value-based performance measures to explain stock market returns in the Athens Stock Exchange (ASE), *Journal of Modelling in Management*, 4(3), 182-201.

Contribution – Examined stock market returns with EPS and EVA® found combination of EVA® with EPS increases significantly the explanatory power in explaining stock market returns.

Citations – 4.

- Leong, K., Pagani, M. & Zaima, J. (2009). Portfolio strategies using EVA, earnings ratio or book-to-market, *Review of Accounting & Finance*, 8(1), 76-86.
Contribution - results of the thirty portfolios created following the Fama and French portfolio formation methodology show that the highest EVAM ratio (EVAM10) performed the best.
Citations – 22.
- Huang, C. & Wang, M. (2008), The Effects of Economic Value Added and Intellectual Capital on the Market Value of Firms: An Empirical Study, *International Journal of Management*, 25(4), 722-731,779.
Contribution - results showed that residual income based on EVA® was no better than that based on current GAAP in its capacity to explain variations in a firm's market value and that intellectual capital did provide incremental information for the evaluation of stocks.
Citations – 16.
- Ismail, A. (2006). Is economic value added more associated with stock return than accounting earnings? The UK evidence, *International Journal of Managerial Finance*, 2(4), 343-353.
Contribution – applies panel data regression to examine EVA as a measure of variation in stock returns.
Citations – 35.
- Palliam, R. (2006). Further evidence on the information content of economic value added, *Review of Accounting & Finance*, 5(3), 204-215.
Contribution – raised issues with the variables used in the EVA model – specifically with the calculation of the cost of capital.
Citations – 27.
- Ferguson, R., Rentzler, J. & Yu, S. (2005). Does Economic Value Added (EVA) Improve Stock Performance Profitability?, *Journal of Applied Finance*, 15(2), 101-113.
Contribution – used event study method to investigate the performance of firms that had adopted EVA – found a higher average profitability.
Citations – 38.
- Austin, L. (2005). Benchmarking to economic value added: The case of Airways Corporation of New Zealand Limited, *Benchmarking*, 12(2), 138-150.
Contribution – examined the use of EVA as a benchmarking tool for the performance of state owned enterprises .
Citations – 16.
- Worthington, A. & West, T. (2004). Australian Evidence Concerning the Information Content of Economic Value-Added, *Australian Journal of Management*, 29(2), 201-223.
Contribution – used pooled time series, cross sectional data top evaluate EVA against traditional accounting based measures.
Citations – 52.

Madanoglu, M., Chang, D. & Yung-Hui, C. (2004). Creating economic value in the US airline industry: are we missing the flight?, *International Journal of Contemporary Hospitality Management*, 16(4/5), 294-298.

Contribution – used EVA to examine performance of the US economy.

Citations – 2.

Sparling, D. & Turvey, C. (2003). Further Thoughts on the Relationship Between Economic Value Added and Stock Market Performance, *Agribusiness*, 19(2), 255-267.

Contribution – re-examined the use of EVA to select investments – in the food companies.

Citations – 29.

Cordeiro, J. & Kent, D. (2001). Do EVA(TM) adopters outperform their industry peers? Evidence from security analyst earnings forecasts, *American Business Review*, 19(2), 57-63.

Contribution – re-examined the link between EVA and firm performance compared to accounting measures.

Citations – 39.

Turvey, C., Lake, L., van Duren, E. & Sparling, D. (2000). The relationship between economic value added and the stock market performance of agribusiness firms, *Agribusiness*, 16(4), 399-416.

Contribution – examined performance of food companies stock market values compared EVA to ROA ROE and CAPM .

Citations – 47.

Summary

The Economic Value Added (EVA) model has been held as the new metric for executives to evaluate, remunerate and communicate corporate performance and for investment managers to supervise portfolio performance. Research of Stern Stewart & Co. initially claimed EVA's usefulness as being due to a superior association with stock prices. However, numerous studies have reported finding evidence that would seem to refute these claims. While few recent studies supported the notion that EVA ultimately provides superiority over earnings, changes in market recognition without analogous changes in financial reporting is a matter that requires further attention. In regards to the use of the model for internal evaluation of investment projects there is little research in the literature and the claim that it is superior to traditional methods such as NPV and IRR is an area that requires further examination. Future research may yield greater insights into this aspect of the model. Whilst there may be inconsistencies in the findings the work on developing and refining the model does show some promise with future research required to test these new variations to determine the robustness of the variables being used. The categories selected for use in this paper are designed for the purpose of a general overview of the literature and to that extent are consistent with the thematic-bibliography method.

This thematic-bibliography has highlighted the extent to which EVA has been subjected to scrutiny in regards to its application against corporate performance. The impact of EVA on the assessment of corporate performance is still not clear from the literature and the application to individual projects is something which because of its very nature is difficult to ascertain. Internal project evaluations are subject to greater secrecy due to their potential to undermine corporate privacy in the face of highly competitive business environment. This paper provides a general introduction to the literature on EVA and accordingly does not claim to be an absolute coverage of the literature.

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Economic Value Added (EVA) is important because it is used as an indicator of how profitable company projects are and it therefore serves as a reflection of management performance. The idea behind EVA is that businesses are only truly profitable when they create wealth for their shareholders, and the measure of this goes beyond calculating net income. Economic value added asserts that businesses should create returns at a rate above their cost of capital. The economic value calculation has many advantages. It succinctly summarizes how much and from where a company created wealth. EVA (Economic value added). 90 likes. EVA is an improved measure of checking the company performance so that the stakeholders can decide that the company... Although Economic Value Added (EVA) might improve the measurement of organisations' performance, The need to measure financial performance and the different metrics that can be used should be investigated to establish the best measure for each sector. EVA (Economic value added). 26 September 2012. The EVA (Economic Value Added) is an indicator of profitability and a measure of financial performance, based on residual wealth. It is the excess profit above the cost of capital, generated by the business, adjusted for taxes, and presented on a cash basis. The consulting firm Stern Value Management developed the method. It represents the difference between the Rate of Return and Cost of Capital and measures the value generated by invested capital. The Economic Value Added (EVA) attempts to capture the truest economic profitability of the company. Therefore, we also refer to it as Economic Profit. In corporate finance, as part of fundamental analysis, economic value added is an estimate of a firm's economic profit, or the value created in excess of the required return of the company's shareholders. EVA is the net profit less the capital charge (\$) for raising the firm's capital. The idea is that value is created when the return on the firm's economic capital employed exceeds the cost of that capital. This amount can be determined by making adjustments to GAAP accounting. There are potentially Economic value added (EVA) is a financial metric based on residual wealth, calculated by deducting a firm's cost of capital from operating profit. However, EVA relies heavily on invested capital and is best used for asset-rich companies, where companies with intangible assets, such as technology businesses, may not be good candidates. Understanding Economic Value Added (EVA). EVA is the incremental difference in the rate of return (RoR) over a company's cost of capital. Essentially, it is used to measure the value a company generates from funds invested in it. If a company's EVA is negative, it means the company is not generating value from the funds invested into the business.