CHAPTER-II
EVA: AN APPROPRIATE PERFORMANCE MEASURE

2-1) Introduction:

Maximizing shareholders value is becoming the new corporate standard in the world. Shareholder’s wealth is measured in term of the returns they receive on their investment. The returns can either be in the form of dividends or in the form of capital appreciation or both. Capital appreciation depends on the subsequent changes in the market value of the shares. This market value of shares is influenced by a number of factors, which can be company specific, industry specific and macro-economic in nature.

To help corporate to generate value for shareholders, value-based management systems have been developed. Indeed, value-based management, which seeks to integrate finance hypothesis with strategic economic philosophy, is considered as one of the most significant contributions to corporate financial planning in the last two decade or so.

Many of the traditional corporate performance measures have been found to poorly correlate, or even conflict, with management's primary objective which is maximizing the market value of a firm's stock. Now, there are several new measures in the financial world that attempt to align the behaviors of an organization with its stockholders’ interests. One measure that has received a great deal of notice and acceptance is Economic Value Added (EVA) which developed by Joel M. Stern and G. Bennett Stewart & Co.

Implementation of one of these measures, such as EVA, can fundamentally change the behavior of an entire organization. The
new measure focuses the behavior of individuals throughout all parts of the organization in a way that is better aligned with creating stockholder wealth. Because performance compensation incentives are based upon the new measure, employees and stockholders mutually benefit.

The EVA framework, which is becoming more and more desirable tool for measuring the financial performance of corporates, offers a consistent approach to set goals and measure performance, communicate with investors, evaluate strategies, allocate capital valuing acquisitions and determine incentive bonuses. However, the EVA implementing and improvement process is one of the several ongoing initiatives for a new corporate.

2-2) EVA: Evolution and Growth

Stern Stewart defines EVA as the difference between a company's net operating income after taxes and its cost of capital (Stern Stewart, 1993). The idea is that the value (positive or negative) a company creates over a period of time is determined by its actual financial performance minus the cost of capital required to fund the performance. In essence, Stern Stewart took an accounting-based metric, residual income (RI) that has existed for several decades and breathed new life into it by manufacturing a very attractive acronym, EVA.

At first glance this appears almost identical to the definition of EVA and raises the question as to whether EVA is simply another name for RI. There are, however, some important differences. In general, RI does not adjust accounting earnings or accounting assets in calculating the level of RI generated by an organization during a given time span. In essence, RI is a simplified form of EVA. It means EVA is not a newer innovation.
Residual income is defined as operating profit subtracted with capital charges. EVA is thus, one variation of residual income with adjustments to how one works out income and capital. According to Wallace, one of the earliest to point out the residual income concept was Alfred Marshall in 1890. Marshall described economic profit as total net gains less the interest on invested capital at the current rate.\(^1\) However residual income has been used by companies for years. For example, General Electric (GE) used residual income in the 1950s and 1960s to measure performance.

During 1970s, the residual income concept did not get enough publicity and it did not finish up to be the prime performance measure of companies. However EVA, practically, the same concept with a different name, has come to fore in to fore in the recent years. Moreover, the propagation of EVA and residual income measure does not seem to be on an abating trend. On the contrary, the number of companies adopting EVA is increasing rapidly. One can only guess why residual income did never gain recognition of this level. One of the possible reasons is that Economic Value Added was marketed with a concept of Market Value Added (MVA) and it did offer a hypothetically significant connection to market valuations.\(^2\) This relation can be observed clearly in the definition of EVA by Stern and Stewart (1990)\(^3\). They expressed it appropriately:


"EVA reflects a reality of the stock market and a reality of the capitalist society we live in. The reality is that all companies are in the same business which is to make efficient use of scarce capital resources. To be successful, companies must essentially "beat" their respective capital associates. They must earn returns on scarce capital that exceed the returns offered by its capital competitors who are also competing for scarce capital. Companies that succeed will add value to invested capital. The stock will then trade at premium to reflect this. Companies that don't succeed will essentially misallocate or misuse capital. The market will discount the stock accordingly..."

The only significant difference between RI and EVA is the financial statements used in the calculations. Stern Stewart believes that traditional financial statements do not adequately reflect the underlying economic events associated with the enterprise. It argues that GAAP-based performance measures are distorted and must be adjusted to obtain meaningful metrics. For example, GAAP requires expensing Research & Development (R&D) in the period incurred.

It can be argued that R&D benefits future periods and should be capitalized. Hence, in a year of relatively high R&D, GAAP statements will understate income statement earnings and balance sheet accounts. To correct for such distortions, Stern Stewart suggests a list of specific adjustments that add equity equivalent reserves to capital and periodic changes in the reserves to after-tax operating profits (Stewart, 1991; Stern Stewart, 1993). Examples of the equivalent reserves include items such as: deferred Income tax reserves, LIFO reserves, cumulative goodwill amortization, unrecorded goodwill, intangibles not capitalized, allowance for doubtful accounts, and other reserves.
EVA is a powerful tool for several reasons: It aligns employee behavior with stockholder value generation, separates employee incentive compensation from the traditional performance measurement that compares actual to budgeted results, and it is relatively easy to communicate and understand.

EVA can bring great value to a company by focusing the entire organization on activities that produce results valued by shareholders. With a well-grounded understanding of EVA, the financial organization is uniquely capable of providing counsel that will ensure successful implementation of this new measure.

2-3) EVA as a tool of financial management measurement

The important goal of financial management is to create highest capital employees (owners & lenders) wealth and consequently enhancing the value of the firm.

Shareholder wealth is traditionally reflected by either standard accounting magnitudes (such as profits, earnings and cash flow from operations) or financial statement ratios (including earnings per share and the returns on assets, investment and equity). This financial statement information is then used by managers, shareholders and other interested parties to assess current firm performance, and is also used by these same stakeholders to predict future performance. The question then arises is whether these measures of corporate performance are linked to the expectation of the shareholders.

The problem with these performance measures is that they lack a proper benchmark for comparison. The shareholders require at least a minimum rate of return that the above mentioned performance measures ignore. Most of the time the benchmark used is the industry average or the nearest competitor performance. But the fact the industry average or competitors
performance may be below what is required by the investors is ignored. So a company may be earning returns better than others in the industry but it might not meet the capital employee’s minimum expectations.

An appropriate performance measure should assess how managerial actions affect the firm value. For this to be happen, the performance measure must incorporate at least three things.

a. the amount of capital invested
b. the return earned on the capital and
c. the cost of capital (WACC)

Table (2-1) presents a comparison of profit, EPS, ROCE, ROE across the above three parameters. It shows that those criteria have failed to capture the capital employees’ value creation/destruction as a result of management actions. There was a question which indicators can measure reliably the change in the value of the firm?

Table 2-1: A Comparison of different traditional performance measures

<table>
<thead>
<tr>
<th>Performance measure</th>
<th>Computation includes</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Return</td>
<td>Capital Employed</td>
<td>Cost of Capital Employed</td>
</tr>
<tr>
<td>Profit</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>EPS</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>ROCE</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>ROE</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
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</table>

Over the past several years, an alternative performance measure called Economic Value Added (EVA) has been gaining acceptance in United States. It is acknowledged by institutional firms as a credible performance measure. In order to overcome the
limitations of accounting based measures of financial performance, Joel Stern postulated a modified concept of economic profit in 1990 in the name of Economic Value Added (EVA) as a measure of business performance.

Stern has claimed that EVA as a tool of financial management was neither just a phenomenon nor it is limited to ‘for profit’ organizations. Economic Value Added has been put to use for management performance evaluation and much more than just a measure of performance, it is the framework for a complete financial management (for improving scarce capital allocation; and for valuation of a target company at the time of acquisition).

Economic Value Added, through the implementation of a complete EVA-based financial management and incentive compensation system, gives managers superior information and superior motivation to make decisions that will create the greatest shareholder wealth in any publicly owned or private enterprise. It can improve the working lives of every one in an organization by making them more successful and can help them produce greater wealth for shareholders, customers, creditors and themselves.

EVA as a tool of financial measurement enlightens us whether the operating profit is enough to cover the cost of capital. Shareholders must earn sufficient return for the risk they have taken in investing their funds in company’s capital. The return generated by the company for shareholders has to be more than the overall cost of capital to justify risk taken by shareholders. If a company’s EVA is negative, the firm is destroying shareholders wealth even though it may be reporting a positive and growing earning per share and return on capital employed.4

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Economic Value Added simply balances a company's profitability against the capital it employs to generate this profitability. If a company’s earnings, after tax, exceed the cost of the capital employed in the business, EVA is positive. Market studies have indicated that a company that continually generates an increasingly positive EVA will be rewarded by a higher stock price. Of course, if a company’s long-term prospects are impaired, due to market conditions, litigation, management change or some other reason, then its stock price will not necessarily increase.

Several evidences exist to support the relationship between EVA and firm performance. Specifically, the advantage of EVA is that it tends to identify specific idle assets or, from a portfolio of assets, identify those that provide the lowest economic return.

Consequently, EVA can be raised and by:

1. earning more profit without using more capital,
2. Using less capital, and/or
3. Investing capital in high return projects.

Figure (2-1) shows the relation among Cash from operations, accounting earnings, Residual Income and Economic Value Added. It summarized the steps that transform underlying cash flow from operation (CFO) into economic value added (EVA).
2-4) EVA defined and EVA calculation

What is the Definition of EVA?

EVA is defined as the excess of a company’s after tax net operating profit over the required minimum rate of return that investors and lenders could get by investing in other securities of comparable risk. EVA is the financial performance measure that captures the true economic profit of a company.

A company that wishes to fill a demand for a good or service obtains capital (debt, equity), which is used to build products and services. In order to build these products, the company must buy
materials, equipment, and labour which results in the company incurring operating expenses and affects on operating profit. In addition, the company must also pay the costs of obtaining the capital. If capital is in debt form, then the cost is simply interest. Equity is trickier. The cost of equity is simply a level of return that would be acceptable to its shareholders. This is essentially called the opportunity cost which is basically a return that a shareholder could have been obtained if the shareholder invested their capital somewhere else. These costs are defined as cost of capital.

Then Net operating profit after taxes (NOPAT) subtracted with capital costs (cost of capital x capital employed), whatever remains is economic value added (EVA), which can be distributed or reinvested accordingly. If you have Positive EVA, congratulations, you have created wealth. If you have negative EVA, be worried, you've destroyed wealth in your company.

Stewart defined EVA (1991) as Net operating profit after taxes (NOPAT) subtracted with a capital charges.

\[
EVA = NOPAT - CAPITAL COST \leftrightarrow EVA = NOPAT - (COST \times CAPITAL\,\,EMPLOYED)
\]

Cost of capital or weighted average cost of capital (WACC) is the average cost of both equity capital and interest bearing debt. Cost of equity capital is the opportunity return from an investment with same risk as the company has.

❖ What is EVA calculation?

The calculation of EVA can be performed at corporate level or for any profit centre within an organization. Consequently, the EVA of an individual division, product line or even an individual customer

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can be calculated to determine where shareholder value is being created or destroyed within the organization. EVA can be enhanced if earnings can be increased more rapidly than invested capital (i.e. by making profitable investments) or if activities generating negative EVA (i.e. destroying value) can be discontinued.

It is important to note that the figures for earnings and invested capital used to calculate EVA will generally not be those appearing in financial statements as EVA focuses on economic earnings and economic capital rather than accounting earnings and capital.

- **Cost of capital calculation:**

Calculating the cost of capital is one of the more technical aspects of EVA, but understanding this dimension of EVA is one of the key areas where the financial organization can significantly improve the results from using EVA. Cost of capital, also known as the weighted average cost of capital (WACC), represents the expected returns of debt and equity holders of the firm, weighted for the proportionate share each holds in the business.

The cost of debt varies by firm, depending upon the term and overall creditworthiness of the company. The cost of equity also varies by firm and reflects both the firm's investment opportunities and its degree of leverage. The balance of debt and equity represents the capital structure of a company, and it is frequently the role of the treasury function to establish a target capital structure. Cost of debt is computed as:

\[ K_d = \frac{\text{Total interest expenses} \times (1-\text{Effective tax rate})}{\text{Total borrowing}} \]

While calculating total borrowing, all short-term as well as long-term borrowing should be included as all debts which are interest bearing. Therefore, interest paid in the financial year has been considered as total interest expenses. Debt cost includes tax
shield (1-tax rate) since interest on debt can be deducted from the taxable revenues.

To find out cost of equity, Stern Stewart uses the Capital Asset Pricing Model (CAPM)\(^6\), a widely accepted methodology. Traditional accounting income captures the cost of debt as interest expense; however, it fails to include the opportunity costs associated with equity. According to this model, the shareholders’ expected rate of return is formulated as follows:

\[ r_e = r_f + \beta \left( r_m - r_f \right) \]

Where, \( r_e \) is the expected return on common stock, \( r_f \) is the risk-free rate of interest, \( r_m \) is the expected return on the stock market, beta is a measure of risk in market place and \( (r_m - r_f) \) is the expected market premium. The risk-free rate represents the most secure return that can be achieved. It can be considered the current rate of risk-free government bonds. The market rate of return has been calculated by using Index Number of Security Prices (Bombay Stock Exchange) from year to year basic. The sources of obtaining the index numbers are the Pune Stock Exchange database (Commercial 2000) and www.bseindia.com. The yearly return of the index numbers has been computed by using following formula:

\[ r_m = \frac{\text{Index Number of current year} - \text{Index number for previous year}}{\text{Index number for previous year}} \times 100 \]

The last component of cost of capital formula, Beta measures the volatility of a company’s stock price with respect to overall stock market. In simple terms, the greater volatility means the more risky share and the higher beta. A company having a beta of 1.2

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\(^6\) The CAPM was developed independently by Professors William Sharpe of Stanford University and John Lintner of Harvard University, drawing on previous contributions to finance theory by James Tobin and Harry Markowitz.
implies that if stock market increases by 10% the company’s share price will increase by 12% and if the stock market decreases by 10%, the share price will decrease by 12%.

The x-coefficient in a standard regression equation (referred to as Beta in this case) measures the sensitivity of dependent variable to unit change in the independent variable. For the purpose of ascertaining the cost of equity, the individual security prices have been taken as dependent variable and the return on the market (computed as yearly return of security market index) has been taken as the independent variable. To find out the receptiveness of individual security’s expected return (taken as proxy of the cost of equity) to the market rate of return; the beta coefficient has been calculated as follows:

\[ \beta_i = \frac{\text{cov}_{im}}{\sigma_m^2} \]

Where,

- \( \beta_i \) = the Beta of the security in the question,
- \( \text{cov}_{im} \) = stands for covariance between the return of security and return of market, and
- \( \sigma_m^2 \) = stand for the variance of market return.

So Beta is a statistical measure of volatility and is calculated as the covariance of return on stock market indices and the return on share prices of a particular company divided by the variance of the return on stock market indices. Here CMIE share price indices have been considered as market index.

- Adjustments in Financial reports:

When computing EVA, there are adjustments to both NOPAT and capital employed to reduce what could be considered non-economic accounting and financing conventions on the income statement and on the balance sheet. In computing NOPAT, certain expenses that do not affect cash are added back to the income
statement. These non-cash entries are not believed to affect value. Some of the adjustments required include those for last in, first out (LIFO), bad debts, deferred taxes, inventory obsolescence and warranty. Depreciation is not included among these adjustments because it is considered a proxy for a true economic cost in the EVA model. Interest expense after taxes, on the other hand, is added back to income to eliminate the effect of leverage on the income statement. The result of these adjustments is that NOPAT is unaffected by material, non-cash accounting adjustments or by the financial composition of capital.

On the balance sheet, the reserves associated with the aforementioned adjustments to NOPAT are considered to be "equity equivalents" in that they are included as part and parcel of capital employed. The argument is that if the reserves had not been recorded for accounting purposes, they would be included as part of the income included in equity. Another important adjustment to the balance sheet to arrive at capital employed is the capitalization of operating leases. The net present value of operating leases is considered an asset, and the future payments are considered a debt equivalent. These adjustments are intended to restate the balance sheet to its "economic" book value. Adjustments are designed to address the distortions suffered by traditional measures, such as return on equity, earnings per share and earnings growth, that change depending upon the generally accepted accounting principles (GAAP) adopted or the mix of financing employed.

To illustrate an adjustment to both balance sheet and income statement, a LIFO reserve is added back to inventory on the balance sheet to bring the valuation back to what would have been paid for the inventory if it had been bought today. The net increase to the LIFO reserve from one year to the next would be
added back to net income to arrive at NOPAT. A decrease in the LIFO reserve would be subtracted from net income. The tax effect of LIFO in NOPAT is not adjusted because the cash flow from the tax benefit or loss was, in fact, realized.\(^7\)

In order to compute Economic Value Added, Stern Stewart adjusts the NOPAT and Capital components of Residual income for what are termed “accounting anomalies”, or “distortions”.\(^8\) Some of their more common adjustments are shown in Table (2-2).

Table 2-2: Example of typical Stern Stewart adjustments for alleged accounting distortions

<table>
<thead>
<tr>
<th>Common Area where GAAP-based accounting is adjusted</th>
<th>GAAP Treatment</th>
<th>Nature of Adjustments</th>
</tr>
</thead>
<tbody>
<tr>
<td>R &amp; D costs</td>
<td>Expense</td>
<td>Record as asset and amortize</td>
</tr>
<tr>
<td>Deferred taxes</td>
<td>Record as asset and/or liability</td>
<td>Reserve recording of asset and/or liability to reflect cash basis reporting</td>
</tr>
<tr>
<td>Purchased goodwill</td>
<td>Record as asset; Amortize over particular years</td>
<td>Reserve amortization to reflect original asset amount</td>
</tr>
<tr>
<td>Operating leases</td>
<td>Expense</td>
<td>Record asset and amortize; record liability and related interest</td>
</tr>
<tr>
<td>LIFO inventory costing</td>
<td>LIFO permitted</td>
<td>Convert to FIFO</td>
</tr>
<tr>
<td>Bad debts and warrant costs</td>
<td>Estimate accrual</td>
<td>Reserve accrual to reflect cash basis reporting</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>Record as asset</td>
<td>Remove from assets</td>
</tr>
</tbody>
</table>


2-5) What are the Benefits and Limitations of EVA?

At the outset, it must be stated that much has been written over the past two decades concerning the dangers of relying on any single measure in assessing performance. Evaluating performance based on a single criterion will tend to encourage managers to behave dysfunctional so as to manipulate the performance measure. With this in mind, the benefits and limitations of using EVA as a performance measure will be assessed.

The ultimate aim of 'for-profit' organizations is to generate acceptable returns for their shareholders. A problem with many traditional measures of performance such as ROI is that they are not highly correlated with the share price of the organization. One of the major selling points of EVA is that its supporters suggest that a strong correlation exists.

Ultimately, to ensure that a performance measure is taken seriously by managers, it must be easy to understand and be linked to managerial compensation. Use of a performance measure which is highly correlated to share price makes it easier to ensure that managers act in the interests of shareholders because the pay of managers can be closely linked to the creation of shareholder wealth.

When EVA is used as a performance measurement tool, it can help in making strategic decisions about subcomponents of the business. Because it highlights where shareholder wealth is being generated or destroyed, it is useful in deciding which business segments to expand or contract.

EVA can be linked to customer profitability analysis as EVA can be used to assess the value generated by any component of the organization including individual customers.
A side benefit of EVA is that it highlights the cost of capital of the business. This may encourage senior management to more carefully examine the capital structure of the organization. In many small and medium sized business concerns, the capital structure can arise due to historical accident without having being subject to close scrutiny. Making the cost of capital (especially the cost of equity) explicit, may serve to concentrate managers' attention on financing the business in a cost effective manner.9

However, EVA does suffer from a number of limitations which have been mentioned as follows:

Like the majority of financial performance measures, EVA is inherently backward looking as it looks at the value added in a past accounting period and thus measures the success of past strategic decisions and investments. It fails to explicitly consider the current strategy being pursued by the organization and does not attempt to assess whether the organization is taking action to ensure it will develop and maintain a sustainable competitive advantage. One result of this is that EVA would appear to be of limited use for a young growing company.

Use of EVA may encourage short-term decisions amongst managers and may result in managers refusing to make investments which although having a large positive net present value (NPV), would depress EVA in the short term.

In common with other financial measures of performance, EVA does not explicitly attempt to place a value on the intellectual assets of an organization such as brands or goodwill. The result of this, is that EVA is not a complete measure of the manager's stewardship of the shareholders' investment (which is valued at

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market value and inherently contains a component of value for the future cash flow implications of the intellectual assets) and may therefore overstate the wealth generated during an individual accounting period.

In large multi-product organizations the difficulties in calculating EVA will multiply. Common assets and costs will need to be apportioned between divisions and/or products to enable calculation of divisional and/or product EVA. Of course, such problems do not solely arise in the calculation of EVA and already exist in the calculation of divisional/product ROIs. Use of activity based costing and activity based cost management techniques could assist in the apportionment of assets and joint costs between subcomponents of the organization.

A major practical issue that arises in the calculation of EVA is how earnings and capital should be defined. Stern Stewart has identified in excess of 164 alterations which might be required to adjust accounting earnings. It may be difficult for investors or analysts to make all the suggested adjustments because they will only have access to the information disclosed in the published accounts.  

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2-6) The common mistakes in implementing/using EVA

There are a few common mistakes that are often made in implementing or using EVA. Most of them are bound up with either misunderstanding and thus misusing the concept at upper levels (peculiar definition of EVA) or not training all the employees to use EVA and thus not using the full capacity of the concept. The common mistakes include:

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1. Defining capital costs intentionally wrong

With EVA approach capital costs are intended to be defined as correct as possible (as all the other costs). Capital costs are not supposed to set to some kind of target level:

Some companies have understood EVA controlling in the same way than ROI-controlling; if a unit produces a good return then also capital costs are set to a high level. This kind of procedure is against the whole EVA approach: the challenges are supposed to build in EVA-targets and not into capital costs because the whole idea is to enable and encourage to make all the investments that offer a return greater than the alternative investments.

In order to calculate EVA correctly all the capital must be allocated to units. Usually ROI is calculated so that only capital affectable to units is taken into account. With EVA the same procedure can not be used. If all the capital is not taken into account then the EVA-figures are upward biased (with ROI this has not caused any harm since the level of ROI has not been important)

2. Using EVA only in the upper management level

Investing too little in training of employees and EVA is not used at its full potential. Many companies use and train EVA only in the upper levels of organization. Thereby a lot of potential in lower levels is lost -especially at lower levels, in operating activities, the concept helps in finding the right actions Similar “under capacity-situation” is likely if EVA is not trained properly and thus employees do not know how to use the concept or are reluctant to use it
3. Practical definition of EVA in controlling

Usually companies do not really need all the complicated adjustments to EVA which originally belong to the concept, created by Stern Stewart & Co. EVA should be simplified to a degree where it is easily explained to employees and easily calculated in daily reporting as long as it does not cause any steering failures.

2-7) EVA in Indian Corporates

The corporate procedures have undergone through a deep-seated change in the modern time and the use of traditional financial variables to explain the behaviour of the present capital market is not an appropriate move toward. Further, in the changing corporate environment, the time has come to gaze at association between financial variables and stock prices or market risk in different way.

One outcome of the economic reforms implemented in 1990’s in most of the countries around the globe is that the whole world is becoming a universal economy and the size of business entities has been increasing. This has been happening because, in order to compete in the world market, an organization needs to have sizable resources and the capability to be the best performer of these resources.

A question that arises, as organizations grow in size, get decentralized and are put into units, is that of financial performance evaluation. The financial performance evaluation measure used needs to be accurate, consistent, and globally analogous and should lead to goal similitude between the owners and managers. When all is said and is done, leading multinational companies, worldwide have already adopted EVA-based system financial management that out the system ahead of its competitors. In such circumstances, the Indian corporates simply
may not stay behind for understanding and implementing the concept. The corporates in India need to be fully equipped with ‘ifs’ along with ‘buts’ of EVA just not for the reason of global competition but for their long-standing persistent survival.

Outstanding and competent management or good corporate governance or a system for shareholders’ value conceptions, these are popular terms. Everybody speaks on the subject within and outside the corporate organization, but not many are aware of as what to do and what not to do with reference to this concept. On the other hand, the concept of good corporate governance is here to stay in this country and shareholders and financial institutions turn more down to business, feels Tejpavan Gandhok, country Manager, India for Stern Stewart & Company. According to him,” India companies on the whole have a poor average in wealth creation.” Over 400 companies’ worldwide implement the economic value added (EVA) program, but it is still relatively a new-metric and quite emerging technique for corporate performance measurement in India.\textsuperscript{11}

The EVA analysis, unquestionably, has attracted much attention in the Western countries both as a management innovation as well as stock market analysis. The recognition of such a technique in Indian context, nevertheless, shows to some extent diverse trends. Majority of companies are still not prepared to put in the EVA technique for evaluating their financial performance because of certain inherent difficulties associated with the computation. But in a country like India where capital is still costly, one would have thought, corporate managements would be trying to get a bigger return for every rupees invested in the business. This will be happened by utilizing the new performance measure, EVA.

It is emerging out from the discussion made above that the global market place is asking for some change in the role of policy-makers and managers in corporate sector. As information systems get more refined, managers will have the task of providing top management with information that is globally competitive for corporate decision-making. EVA is a measure that should be used by top management to evaluate investment centre managers because it considers goal picture between shareholders and corporate managers.

Recently a lot of emphasis is being positioned on EVA rather than ROI, as a measure of corporate performance in the Indian financial literature. However, using the concept may not be suitable since it is not without deficiencies and pitfalls. Certain disputes regarding EVA calculation and implementation have been highlighted by Sateesh Kumar (2000)\(^{12}\). Some of the important pitfalls in the use of EVA revealed by them are as follows:

- Most of Indian companies suffer from over-capacity situations, which distort the EVA results.
- EVA analysis does not give any idea about the financial performance of companies that are affected by business cycle variations.
- Possibility of error in calculating NOPAT and also estimating WACC is another gray area.
- When EVA is used as a measure to evaluate the performance of managers and their units, they feel reluctant to acquire new fixed assets even if the circumstances demand so.

\(^{12}\) Sateesh Kumar, “EVA is not an Unmix Blessing” Indian Management, June 2001, pp. 42-47.
Despite all these arguable issues, EVA has made a position for itself not only in the Western business community but also in the Indian corporate sector. However, the recognition of this concept in India is gradually picking up and it is expected that in the coming years, more and more Indian companies will start relying upon this new measure of financial performance. This would, possibly, catch the attention of policy-makers at Government level, corporate level, and NGO’s engaged in investors’ protection to press the corporate managers to come up to the expectation of shareholders in the country. With the appearance of EVA, the managers may be quite aware about the expected return by shareholders which is invariably higher than return expected by the debt holders. That is why, now a days, the corporate superiors are being required to work on the model of trading on equity that would design some surplus for equity shareholders. This surplus, if placed under technical terminology, may lead to positive EVA for the organization.

In view of the above fact, the competent authorities in India like ICAI, SEBI and Company Law Board should issue wide-ranging guiding principles for the computation of EVA and its practices in financial reporting and accounting disclosures by the corporate world. It further expected from ICAI to issue necessary guidelines to the appropriate bodies in the country so that it may become obligatory for Indian companies to disclose their EVA in the financial statements.