Chapter 2 Review of Literature

2.1 Introduction

2.2 Review of different Articles on Economic Value Added
2.1 Introduction:

This chapter contains review of literature in the area of EVA techniques used in financial reports.

This chapter compiles the following different resources.

1. From Stern Stewart and Co. opinions about EVA;
2. From EVA reports that has been published by different companies in different countries;
3. From articles published in journals;
4. From specific books on the subject, and;
5. From websites related to EVA in internet.

This chapter contains the following aspects of review of relevant literature studied from different angles.

1. Review of generalities about EVA containing:
   - Introduction, Meaning and Definition of EVA, EVA and Residual Income, Economic Profit versus Accounting Profit, Computation of EVA, Elements of EVA’s formula, Measurement of EVA, Adjustments for making EVA and Strategies for increasing EVA,

2. Review of particulars of EVA:
   - EVA and traditional performance measures, Implementing of EVA, Advantages of EVA, Limitations of EVA, and Application of EVA,

3. Review of capabilities of EVA:
   - EVA as performance measurement and reward system, EVA and management system, EVA and Net Present Value (NPV), Relationship between EVA and Market Value Added (MVA), EVA and shareholder value, Wealth creation, and finally EVA and market value of firms.

Historically, Performance Measurement (PM) systems was developed as a means of monitoring and maintaining organizational control, which is the process of ensuring that an organization pursues strategies that lead to the achievement of overall goals.
and objectives. PM plays a vital role in every organization as it is often viewed as a forward-looking system of measurements that assist managers to predict the company’s economic performance and spot the need for changes in operations. In addition, PM can provide managers, supervisors and operators with information required for making daily judgments and decisions. PM is increasingly used by organizations, as it enables them to ensure that they are achieving continuous improvements in their operations in order to sustain a competitive edge, increase market share price and increase profit in order to increase the shareholders wealth. There are many kinds of performance measurement systems and tools. But which kind of these systems or tools would be useful is related to the organizational goals.

Indeed maximization shareholder value has become the new corporate paradigm. Although managers and researchers have traditionally recognized shareholder wealth maximization as the ultimate corporate goal, the maxim has gained new dimension in recent years. The concept of Economic Value Added (EVA) as a performance measurement tool coined and registered by Stern, Stewart & Co, New York. EVA is a residual income that subtracts the cost of capital from the operating profits generated by a business.

2.2 Review of different Articles on Economic Value Added:

Economic Value Added (EVA) is a value based performance measure that gives importance on value creation by the management for the owners.

Stern, (1990) observed that EVA as a performance measure captures the true economic profit of an organisation. EVA-based financial management and incentive compensation scheme gives managers better-quality information and superior motivation to make decisions that will create the maximum shareholder wealth in an organisation.

Easton, P. Harris, T. and Ohlson, J (1992) observed that Economic Value Added (EVA) is an increasingly popular corporate performance measure one that is often used by companies not only for evaluating performance, but also as a basis for determining incentive pay. Like other performance measures, EVA attempts to cope with the basic tension that exists between the need to come up with a performance
measure that is highly co-related with shareholders wealth, but at the same time somewhat less subject to the random fluctuations in stock prices. This is a difficult tension to resolve and it explains the relatively low correlation of all accounting based performance measures with stock returns at least on a year to year basis.

Stewart, (1994) has expanded that adoption of the EVA system by more and more companies throughout the world clearly depicts that it provides an integrated decision-making framework, can reform energies and redirect resources to create sustainable value for companies, customers, employees, shareholders and for management.

Stewart (III), and Bennett, G. (1994) observed that “EVA is a powerful new management tool that has gained growing international acceptance as the standard of corporate governance. It serves as the centerpiece of a completely integrated framework of financial management and incentive compensation.” In essence, EVA is a way both to legitimize and to institutionalize the running of a business in accordance with basic microeconomics and corporate finance principles. The experience of a long list of adopting companies throughout the world strongly supports the notion that an EVA system, by providing such an integrated decision making framework, can refocus energies and redirect resources to create sustainable value for companies, customers, employees, shareholders and for management.

You Lee (1995), in his article he stated that the use of EVA as a corporate performance measurement tool. His main research finding was that, within the context of the JSE (Johannesburg Stock Exchange), EVA is at best marginally better than measures such as ROA and ROE.

Dodd and Chen, (1996) in their study based on 566 US companies covering the period 1983-1992 analyse the correlation between stock returns and different profitability measures including EVA, non-adjusted residual income, ROA, EPS and ROE. In their study ROA explained stock returns best with R squared of 24.5%. The R squared for other metrics are: EVA 20.2%, residual income 19.4% and EPS, ROE approximately 5-7%. The study suggests that firms adopting EVA might as well adopt simple residual income concept, as the residual income correlates with share prices almost as well as its adjusted version called EVA.
Grant, (1996) found that EVA concept might have everlastingly changed the way real profitability is measured. EVA is a financial tool that focuses on the difference between company's after tax operating profit and its total cost of capital.

Lehn & Makhija, (1996) in their study based on the data of 241 US firms point towards the conceptual superiority of EVA over the traditional measures of financial performance. The study suggests that EVA is superior to accounting profits as a measure of value creation because it recognizes the cost of capital and, hence, the riskiness of a firm's operations. In terms of the impact that measures of financial performance have on the stock prices EVA has been found to be most significant.

Luber, (1996) confirmed that a positive EVA over a period of time will also have an increasing MVA while negative EVA will bring down MVA as the market loses confidence in the competence of a company to ensure a handsome return on the invested capital.

Rice, V.A. (1996) observed that “previously we used several measurements to gauge our financial outlook from earnings per share to discounted cash flow and return on average assets. With EVA, I saw a way to meet our business objectives and create a new corporate culture. It permeates every level from boardroom to the shop floor. Bonuses of all managers are determined solely by whether variety achieves its EVA targets. At our company every decision and every action result from analysis that uses EVA principles. We focus on ensuring that every investment produces return that exceeds our cost of capital. We believe this approach enables us to directly align management and shareholders interest”.

Uyemura, Kantor and Petit, (1996) based on their study on 100 Bank holding companies for a 10 year period find that the correlation of MVA with EVA is significantly higher than that with other measures like EPS, ROE, ROA, and Net Income. O'Byrne (1996) finds that the level of EVA explains 31% of the variance in the market value while the changes in EVA explain 55% of variations in changes in market value. This explanatory power of EVA has been found to be significantly higher than that of accounting profit (NOPAT).

Bacidore, J. M., J. A. Boquist, T. T. Milbourn and A. V. Thakor. (1997) has identified that performance measures to evaluate operating results are used for
allocating resources and determining compensation packages for managers. The most appropriate measure is the return shareholders earn through stock price appreciation and dividends in excess of an expected rate of return.

Banerjee, (1997) has conducted an empirical research to find the superiority of EVA over other traditional financial performance measures. ROI and EVA have been calculated for sample companies and a comparison of both showing the superiority of EVA over ROI.

Dierks, P. A. and A. Patel. (1997) suggested that implementing value-added measures into a company is a costly and timely process. Supporters justify the substantial costs and time by pointing out the benefit of optimizing the company’s strategy for value creation. A transition to value-added measurements requires serious commitment of the board of directors and senior management to use these measures to manage the business. Every individual in the company must buy into the plan to make it successful. It will also require extensive training and communication effort directed to everyone in the company. Everyone must be educated on the basic theory underlying the notion of creating economic value. Nonetheless, EVA "should not be viewed as the answer to all things". It doesn’t solve business problems, which is the manager’s responsibility.

Gary C. Biddle, Robert M. Bowen, James S. Wallace, (1998) in their paper "Economic value added: some empirical EVA dence" trace the growth in the use of economic value added (EVA, previously known as residual income) and uses two previous research studies to assess some claims for its merits. Compares EVA’s ability to explain stock returns with that of Earnings Before Extraordinary Items (EBEI) and cash flow using 1984-1993 US data; and finds EBEI is most closely related. Examines EVA’s incentive effects on management investing, financing and operating decisions and shows that, although EVA users decreased new investment, increased dispositions of assets, increased share repurchases, used assets more intensively and increased residual income, market reactions to this were weak. Suggests possible reasons for this and concludes that EVA may align management incentives with shareholders’ interests but this does not necessarily increase shareholder value.
Ethiraj (1998) derived those stock prices move up as a company adopts EVA as an internal performance criterion.

KPMG - BS study, (1998) assessed top 100 companies on EVA, Sales, PAT and MVA criteria. The Survey has used the BS - 1000 list of companies using a composite index comprising sales, profitability and compounded annual growth rate of those companies covering the period 1996-97. Sixty companies have been found able to create positive Shareholder Value whereas 38 companies have been found to destroy it.

Pattanayak, J.K., Mukherjee, K. (1998), undertook a study on title “Adding Value to Money”. They have discussed that there are traditional methods to measure corporate income or known as accounting concept and there is also a modern method to measure corporate income or known as economic concept. EVA, which is based on economic concept, is professed to be a superior technique to identify whether the organization’s NOPAT (Net Operating Profit After Tax) during a period is covering its WACC (Weighted Average Cost of Capital) & generating value for its owners. But it is very tricky to calculate EVA.

Anand, et al, (1999) revealed that EVA and MVA are better measures of business performance that NOPAT and EPS in terms of shareholders’ value creation and competitive advantage of a firm.

Banerjee, (1999) based on his study on 9 selected industries in India for the period 1992-93 to 1997-98 finds that out of the five independent variables EVA is the better of the lot. Although EVA did not emerge as the best predictor of shareholders' wealth still EVA was the best explanatory variable in three out of nine selected industries (Automobile, Drugs and Pharmaceuticals and Finished Steel).

Banerjee, Ashok and Jain (1999), under gone through a study on title “Economic Value Added and Shareholder Wealth: An Empirical Study of Relationship”. They have carried out a research based on empirical data. Among the selected independent variables (EPS, EVA, Kp, Lp and ARONW), EVA has proved to be the most explanatory variable, when MVA was taken as the dependent variable and Backward Elimination method was applied to find the most explanatory independent...
variable. For this purpose, the time frame was of eight years and all the variables were calculated over this period for the sample companies.

Bao and Bao (1999) revealed that the EVA is positively and significantly correlated with the firm value.

Harihar, (1999) highlighted some myths regarding EVA. According to him, EVA calculations are not simple and need a lot of adjustments in the financial books. Further, EVA figures can be manipulated to suit the needs of management.

N Zafiris, R Bayldon, (1999) in their paper "Economic Value Added and Market Value Added: A simple version and application “seeks to improve Economic Value Added (EVA) framework’s application by proposing a version of EVA which anchors the opportunity cost of equity capital on market rather than book values. The case for this is argued on general grounds and the resulting model is convenient for examining the possible effects of the gearing factor. The practicability of the model is illustrated by applying the proposed ‘EVA’ formula to a mixed set of accounting and stock market data from a sample of UK companies.

Thenmozhi, (1999) compared EVA with some other traditional measure of corporate performance viz. ROI, EPS, RONW, ROE, ROCE etc. She has referred to some of the shortcomings of the concept of EVA but maintain that EVA is a better measure of corporate performance.

Banerjee, (2000) attempted to find out whether Market Value of Firm if the function of Current Operational Value (COV) and Future Growth Value (FGV). Based on the analysis of his data he comes to the conclusion that in many cases there was a considerable divergence between MVA and the sum total of COV and FGV.

Thenmozhi, M., (2000) In order to have an understanding of how the traditional performance measures are comparable to EVA, data of three financial years between 1996 and 1999 were chosen from 28 companies. Only 6 out of the 28 companies have positive EVA while the others have negative. The EVA as a percentage of Capital Employed (EVA/CE) has been found to indicate the true return on capital employed. Comparing EVA with other traditional performance measures the study indicates that all the companies depict a rosy picture in terms of EPS, RONA and
ROCE for all the three years. The study shows that the traditional measures do not reflect the real value of shareholders and EVA has to be measured to have an idea about the shareholders value.

Ray, Russ, (2001) observed that the missing link between EVA and improved financials is actually productivity. EVA can be a powerful tool. When properly applied, it allows a firm to ascertain where it’s creating value and where it’s not. More specifically it allows a firm to identify where the return on its capital is outstripping the cost of that capital. For those areas of the firm where the former is indeed greater than the latter EVA analysis then allows the firm to concentrate on the firm’s productivity in order to maximize the value created of the firm. Finally, as investors buy more shares in the firm in order to have more claims on its increased value, they automatically bid up and eventually maximize the firms share price. And as any good capitalist knows, maximizing share price is the name of the game in a free market economy. Thereafter marginal increases in value added can be attained by either decreasing the firms cost of capital or by increasing its productivity.

Riceman, et al, (2002) argued that EVA is a performance measure that is being used by an increasing number of companies, but academic research on EVA is limited.

Mangala and Simpy, (2002) discussed the relationship between EVA and Market Value among various companies in India. The results of the analysis confirm stern’s hypothesis and concluded that the company’s current operational value was more significant in contributing to change in market value of share in Indian context.

Bardia, (2002) revealed that in a dynamic environment, a common investor finds it increasingly difficult to monitor his investments. EVA guides investors in evaluating the performance of the company and monitoring their investments.

Pablo Fernandez, (2003) concludes that it is impossible for accounting based measures, such as EVA, Economic Profit or Cash Value Added to measure value creation as these measures are based on accounting information, which is historic in nature. NOPAT has been found to be having the most significant relationship with the MVA. The study also concludes that the firm’s EVA, EP or CVA increase does not mean that the firm is making value, as the shareholders value creation has very little to do with EVA.
Stern, Joel, (2003) presented the results of Stem Stewart’s research on Indian companies, which shows considerable need to improve the wealth creation performance and allocation of capital in the Indian economy. They explained how the effective implementation of the EVA framework could be a solution to address this problem.

Terrance L. Pohlen, Thomas J. Goldsby, (2003) in their paper “VMI and SMI programs: How economic value added can help sell the change”, showed importance of EVA in Supply Chain. Supplier Managed Inventory (SMI) and Vendor Managed Inventory (VMI) have emerged as potential first steps towards successfully integrating activities and information across multiple firms. Despite the potential benefits, managers interested in these programs often cannot generate the “buy-in” among fellow management and executives or among those in the collaborative firm. The barriers stem from a misunderstanding of the concepts and an inability to demonstrate their potential effect on shareholder value across both firms. This paper draws a distinction between SMI and VMI and identifies where the approaches should be applied. A simultaneous Economic Value Added (EVA) analysis from the customer and supplier perspectives is proposed as a means to demonstrate the effect on shareholder value, measure performance, and overcome the obstacles confronting implementation.

Balachandran and Sriram, (2005) made an attempt to study the value created for the shareholders of the company. They used to determine the relationship between Economic Value Added and dividend paid to the shareholders. The study revealed that the company had utilized the dividend-paying fund ploughing back into the business. The company was very conservative in declaring dividend and always had long-term objective of creating wealth to the shareholders, which has been achieved.

Lloyd M. Austin, (2005) in his paper “Benchmarking to economic value added: The case of Airways Corporation of New Zealand Limited”, describes and analyses the adoption of Economic Value Added (EVA) income as a benchmark for setting pricing and other policies of a monopolistic state-owned enterprise in the absence of normal benchmarking mechanisms. By earning zero Economic Value Added profits the enterprise earns its cost of capital and escapes claims of monopolistic pricing and possible regulation. To test the success of this policy the financial series of the
enterprise are developed from the date of incorporation in 1989 along with the Economic Value Added series. The normal accounting profits are compared with the value added results. The value added results are used as a proxy for the pricing and other operational decisions of the firm that are not directly observable. The validity of the economic value added approach to provide a suitable benchmark is examined. Provides evidence that the enterprise was successful in avoiding charges of monopolistic pricing and subsequent regulation by linking pricing and other policies to its economic results. This was in a period when similar enterprises were regulate or threatened with regulation. The economic environments in the later years of the study have changed the goals of the enterprise.

Ahmad Ismail, (2006) in his paper “Is Economic Value Added more associated with stock return than accounting earnings?” The UK evidence, seeks to examine the claim of EVA advocates of its superiority as a financial metric compared with other measures. The paper uses a sample of 2,252 firm year observations from the UK market and applies panel data regressions to test the relative information content of EVA and other accounting measures and the incremental information content of EVA components in explaining stock return. It is found that net operating profit after tax and net income outperform EVA and residual income in explaining stock return; it was also found that accruals and operating cash flow have significant incremental information content, while the accounting adjustments of EVA proponents have significantly less contribution in explaining stock return. Yet the paper concludes that other variables must be considered in order to capture the unexplained variation in stock return models.

Ali M Ghanbari and Narges Sarlak, (2006) empirically reviewed the trend of EVA of Indian Automobile Companies. The results indicate that there was a significant increasing trend in EVA during the period of study and the firms in the automobile industry are moving towards the improvement of their firm's value.

Lokanandha Reddy Irala and Dr. Raghunatha Reddy, (2006) suggested that EVA should help reduce the difference in the interests of the managers and shareholders, if not perfectly align them. ‘Improving EVA performance is associated with a higher stock return. However the association of EVA with stock return is not as strong as suggested in anecdotal EVA stories’ (Chen and Dodd 1997). Managers
will act in shareholders’ interests only if they have right incentives. So it is very essential to align the interests of the managers and shareholders or at least reduce the difference between them.

**Ralph Palliam, (2006)** in his paper "Further evidence on the information content of Economic Value Added" tests assertions that Economic Value Added (EVA) is more highly associated with stock returns and firm values than accrual earnings, and evaluates which components of EVA, contribute to these associations. Thirty three non EVA users and 75 EVA users were selected at random. Variables used in this study were revenues, profits, assets, stockholders’ equity, market value, earnings per share, total return to investors, and percentage cost reduction over time. Data were collected on several metrics. The study suggests that the common and widely accepted metrics used by analysts and calculated for EVA users are not necessarily superior to that of non EVA users. The evidence support that EVA is somewhat invalid, unreliable, and questionable.

**Ralph Palliam, (2006)** in his study on information content of EVA suggests that the common and widely accepted metrics used by analysts and calculated for EVA users are not necessarily superior to that of non-EVA users. Based on the randomly selected 108 sample firms the study concludes that EVA is somewhat invalid, unreliable, and questionable and raises serious doubts about the capacity of EVA to deliver superior results.

**P.D. Erasmus, (2008)** in his study "Evaluating the information content of nominal and inflation-adjusted versions of the measure Economic Value Added (EVA)" implements inflation adjustments, as proposed by International Accounting Standard 15 (IAS15), to determine an inflation-adjusted version of Economic Value Added (EVA). The relationships between the nominal (EVA nom) and inflation-adjusted (EVA real) versions of EVA, and market-adjusted share returns are investigated, and compared with those of residual income, earnings and operating cash flow. Relative information content tests suggest that earnings have the strongest relationship with share returns, while the results of the incremental tests indicate that the EVA nom and EVA real components do not provide statistically significant information content beyond that provided by residual income.
R.K. Mittal, Neena Sinha, Archana Singh, (2008) in his paper "An analysis of linkage between economic value added and corporate social responsibility" indicates that there is positive relationship between Corporate Social Responsibility (CSR) and company's reputation but relationship between CSR and company's profitability has not been explored in the Indian context. CSR level of business firms in India is increasing in terms of both amount of the disclosure and the number of participating firms. Therefore the purpose of this paper is to explore the link between good financial performance measure and other indicators of corporate responsibility. This paper also aims at studying the trend of disclosure of CSR reporting by Indian companies. This study seeks to investigate the relationship between ethical commitment and financial performance over the four-year period, through statistical regression and correlation analysis. Studies of few Indian companies who have successfully implemented CSR initiatives have also been analyzed to investigate the level and nature of engagement of Indian companies in social responsibility initiatives. It has been reported that there is little evidence that companies with a code of ethics would generate significantly more Economic Value Added (EVA) and Market Value Added (MVA) than those without codes.

Nopadol Rompho, (2009) in his paper "Application of the Economic Value Added (EVA) Protocol in a University Setting as a Capital Budgeting Tool" attempts to propose the uses of a capital budgeting tool, the Economic Value Added (EVA) for a university. Although there are reports of widespread use of the EVA in many for-profit organisations, there is no evidence in literature that it has been adopted as a capital budgeting tool for a university. In this paper the application of the EVA for a university is proposed. It shows how the EVA can increase the awareness of the importance of asset utilisation in universities and guide universities to better resource management. EVA is proposed for use in a university setting in two different segments: for-profit and non-profit. The EVA has been adjusted with a new measure, Academic Value Added Ratio (AVAR) to reflect the university’s objective. The perception of academic staff in the case study university in Thailand with regards to the concept of applying the EVA to a university is further investigated. The results indicate that most members of management staff do not oppose this concept if it is implemented in a proper way.
Nikhil Chandra Shil, (2009) identified that EVA is required to be tailored in line with accounting system, management philosophy and the degree of demand of such a system. In this paper, an earnest effort has been made to explain theoretical foundation of EVA with its origination, definition, ways to make it tailored, adjustments required, scope and some other related issues. The methodology used is a type of theoretical mining of logics result in step-by-step process required for EVA implementation. As corporate house plans to move from traditional to value based performance measures, EVA would yield good result and the paper may become helpful to them to comprehend the methodology.

A. Al Mamun, S. Abu Mansor, (2011) has identified that EVA as an important financial performance measurement tool over the conventional tools around the world. Though, there are mixed evidences on the superiority of EVA (Sharma & Kumar, 2010), EVA has gained attention of corporate giants based on what EVA can be acclaimed to be the most recent and exciting innovation in company performance measures and it has been adopted by the advanced economies as financial performance measurement tool and corporate strategy.

Moujib Bahri, Josée StPierre, Ouafa Sakka, (2011) in their paper "Economic value added: a useful tool for SME performance management", propose a Performance Measurement and Management System (PMMS) for Small and Mediumsized Enterprises (SMEs), based on an analysis of the connections between these firms' business practices and performance measured by Economic Value Added (EVA). Secondary data from the PDG database was used on a sample of 108 Canadian manufacturing SMEs over two consecutive years. The primary statistical method used was regression analysis to investigate the influence of diverse business practices on EVA in these firms. This paper shows that EVA can be a useful tool for performance management in SMEs, when used in conjunction with a list of business practices that affect the firm's results. The findings indicate that some business practices have a direct impact on EVA within one year, while others have a deferred influence.

The impacts of other practices on EVA were found Alam, Perways and Nizamuddin, Shaikh Mohammed, (2012) suggested that corporate house plans to move from traditional to value based performance measures, EVA would yield good
result and the study may become helpful to them to comprehend the methodology. The study was more emphasize on to explain theoretical foundation of EVA with its origination, definition, ways to make it tailored, adjustments required, scope and some other related issues. It also identified that EVA largely depends on the quality of accounting information system, as traditional information system will not provide sufficient information to compute true EVA. Thus, EVA is required to be tailored in line with accounting system, management philosophy and the degree of demand of such a system.

Sirbu Alexei, (2012) identified that EVA is the methods of calculation, shaping their advantages and disadvantages and exemplifying comparing a series of measurements of the enterprise value created on the basis of financial data. Employees are required to meet or exceed shareholders' expectations by improving the company’s Economic Profit or Economic Value Added.

Axel Haller, Chris van Staden, (2014) in his paper "The value added statement – an appropriate instrument for Integrated Reporting", contributes to the discussions about the concept of Integrated Reporting (IR) and provides a practical and useful proposal of an instrument that could help to apply the IR concept in corporate practice. The study uses a deductive normative research approach. Based on a comprehensive review of international literature and research, the paper argues that a structured presentation of the traditional measure of “value added” in a so-called “Value Added Statement” (VAS) has the potential to serve as a practical and effective reporting instrument for IR. The proposed VAS not only meets the guiding principles of IR but also reports on the monetary effects of different types of capital included in IR and in this way complements and represents the concept of IR very well.

Gianpaolo et al, (2014) in their study ‘Measuring value creation: VAIC and EVA", Measuring Business Excellence’ proposes a comparison between Value Added Intellectual Coefficient (VAIC) and one of the most important performance evaluation methods, the Economic Value Added (EVA), starting from a re-interpretation of the VAIC. The empirical data were gathered from AMADEUS Bureau van Dijk and consist of 2,596 companies operating in Northern Italy, from six different economic sectors, observed for the year 2011. A correlation analysis
was carried out in order to highlight whether there is a relationship between the two concepts of VAIC and EVA. Results show that EVA and VAIC have no significant relationships; as a matter of fact, EVA is based on financial theory, whereas VAIC is focalized on the assessment of Intellectual Capital Efficiency (ICE).

**Anil Misra and Kanwal Anil**, EVA (%) is followed by ROTA, which is slightly less significant than EVA (%) in explaining the variations in the market value of firms' shares. EVA (in absolute terms) and ROCE have been found to be the third and the fourth most significant variables respectively in explaining the variation in the share prices. The results of the study have established the basic hypothesis. EVA (%) has emerged as the most significant variable, better than the traditional metrics of financial performance in determining the share prices. Companies that can improve their EVA by either increasing their NOPAT or by cutting down their cost of capital through certain proactive measures such as restructuring of their capital shall be able to give a boost to their share prices. In case of such companies that are unable to either push their NOPAT or cut down their cost of capital but are in a position to maintain the spread between the two, the share prices can be influenced positively by infusing more capital into the business provided there is a potential to increase the market share of such firms.

**Conclusions:**

EVA is useful in explaining the market value of a company, because it allows dissecting a company’s market value into known and unknown (expected) components. The present value of future stream of EVAs actually has two components, present value of current EVA (known component) and present value of expected EVA improvements over the current level (unknown component). The first component coupled with current book value of equity is called Current Operational Value (COV) and the second component is called Future Growth Value (FGV). As market value of a firm is essentially futuristic, it largely depends on FGV of a firm. FGV depends on EVA improvement. If a company maintains EVA (without any improvement), its NOPAT will provide a cost of capital return on current operational value and no return on FGV. Hence, EVA improvement is a precondition for growth in market value.