

The economic value added management concept: critical applying to ukrainian economics

Adam Gehr, professor DePaul university, Chicago, T. Gordienko, Kharkiv National Academy of Municipal Economy

On the current stage of the Ukrainian national economics development increase in the efficiency of production becomes the central issue of the progress of our country. Though, investment problem is one of the major obstacles for the Ukrainian economy maturity. Besides, the substantiation of the investment decisions occurs as a difficulty due to the fact that practiced economic efficiency evaluation techniques are incapable to reflect the exact state of company's business.

EVA is known as an effective perfection of the traditional financial measurements for the companies with the low debt loans and highly invested in real assets capital structure. Since the majority of Ukrainian companies longing for investments can be characterized as such companies, abovementioned concept can perform as the most appropriate measure.

Developed in 1982 by University of Chicago graduates, founders of Stern Stewart & Co , G. Bennett Stewart and Joel Stern as a "trade-market variant of residual income" EVA proves to be the most effective measure of operating performance which has been successfully adopted and practiced not only in USA but also in such countries as Australia, UK, Canada, Brazil, Germany, Turkey, Mexico, France, etc. Moreover, abovementioned methodic has gained its confession among international companies. This measure adoption has earned the "EVA converts" (Coca-Cola, Eli Lilly, Briggs and Stratton, SPX Corporation, etc.) strong market position, increased stock price and shareholder wealth.

Besides, such broad publicity of EVA can be explained by transparency and objectiveness of the investment projects' evaluation as it "shows the dollar amount of wealth a business has created or destroyed in each reporting period" (Stuart Stern). Consequently, this estimation parameter performs as the main criteria for investment attraction of a company. At a certain extent, such convenience of EVA concept usage for investment decision making is propelled by the fact that the capital charge is considered by abovementioned method as so called opportunity cost and performs as revenue which will be obtained if the bankroll was invested in other stock or bond of comparable risk.

Therefore, it is of great importance for Ukrainian companies to adopt such estimation concept as EVA which will be indicative of the sufficiency of the revenue to compensate invested equity capital, real profit.

The key obstacle to engraining this approach in Ukraine is the necessity of financial parameters transforming, making adjustments to the traditional book earnings in order to exclude accounting discrepancy affecting the economic results computation. Besides, even Stern and Stewart advises more than 160 adjustments in GAAP earnings and balance sheets in areas such as inventory costing, depreciation, bad debt reserves, restructuring charges, and amortization of goodwill for USA accounting.

The aim of the present research is to prove urgency and consequence of the particular tool for efficiency evaluation of the investment projects - EVA for Ukrainian economy, examine the strain adopting this concept to Ukrainian companies as well as to offer methodology of overcoming difficulties connected with transforming reporting data into those which could be used in EVA calculation adequately.

Case studies illustrating EVA adoption and computation for such companies as Toll Brothers Inc. and United States Postal office have been considered in terms of the present research. Besides, an attempt to appropiate the EVA methodology for the Ukrainian company and to compare the received EVA indicator with the indicators established by the traditional business estimation approaches has been made.

EVA is claimed to be a revolutionary methodic of computing worth of the company according to its economic reality, which observes wider range of significant estimation parameters than other contemporary techniques such as Earnings per share, Market value added, Cash flow return on investments, Return on equity, GAAP indicators, etc. The concept is based on the major marketing principle of maximizing shareholders wealth as the main goal of the business and economic profit approach, which effectively links investors' financial condition with company's earnings and assists in development of the policy of increase in the market value of the company.

The main parameters defining EVA are complex, affected by a big variety of aspects, which transforms abovementioned concept into a multifactorial economic model of valuation of the company's performance. Distortion between the financial results and present economic reality motivates to detail examining of each item of the financial statements, rather than accepting bottom line figures. Various discrepancies tend to occur due to the existence of the diverse questionable accounting practices as well.

As a result, two approaches of the Ukrainian financial statement data transformation can be suggested. The first considers alteration of the basis of the reporting methodology by espousing National Standards of accounting to GAAP and financial figures adjustment according to Stern & Stewart advises. The second and foremost approach is to transform the current financial figures into those which can be used in EVA factor modeling.

The first step of calculating EVA is to produce NOPAT component which reflects both revenue received by a company by using its assets and interest paid to creditors by adjusting company's net income.

Another parameter is Weighted Average Cost of Capital which performs as a discount rate transferring future values of EVA into the present value. The abovementioned parameter whose entries would be adjusted as well stands out with its complexity. Long term invested capital is not to be derived simply by balance sheet figures substitution into its formula due to the fact that reporting figures include items which can provoke misinterpreting real company's performance.

The principles of figures transformation for EVA concept implementation to Ukrainian companies should be of great importance providing that this methodology proved to be efficient worldwide.

