How can economic value added (eva) statements be used to improve financial statem...

Finance

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Economic Value Added (EVA How can Economic Value Added (EVA) ments be used to improve financial ment reporting, results, and success? To determine how Economic Value Added (EVA) statements can be used to improve financial statement reporting, results, and success it would be necessary to determine what Economic Value Added is, its purpose and why companies are using it. The use of Economic Value Added (EVA) statements enable companies to determine if the company is earning or not. This is determined in the Economic Value Added (EVA) statements by deducting the cost of financing the company's capital or cost of money from the profit or revenue made by the company. By deducting the cost of capital and capital itself from the profit made by a business enterprise, the shareholders are able to know the value created by the capital (and includes debts) they put in the company. It is a given that all business operates under the principle of profit motive, which intends to generate revenue. The practice of Economic Value Added (EVA) however helps the financial reporting of a company's performance to its investors and shareholders by reporting the rate of return of the investor's risk taking in the company which enables the investors and shareholders to compare the performance of their investment in the firm vis-a-vis putting it in other investment instruments. Through Economic Value Added (EVA) statements, they are able to determine that their money is creating more value in the company than other mode of investments. On the end of the firm, Economic Value Added (EVA) statements as a financial management system enable its managers to determine how much the company's capital is used and how much value it creates using the current strategy of the company. This allows the firm's management to determine how effective and efficient they are in utilzing their available resources to create value for the firm because Economic Value Added (EVA) statements includes all the cost and expenditures of the company's operation whether they are reflected in the income statement, balance sheet or footnotes of financial statements putting managers in better position to determine their effective use of resources. In effect, the use of Economic Value Added (EVA) statements in reporting contribute to the company's success because it allows management to keep its focus on the company's key function, that is to create value, increase investor and shareholder's rate of return for their investments (and debts in case the capital was loaned) and compels them to be efficient in the process to optimize returns. This results in more wealth and value to its investors and shareholders (including the employees and managers) and ensures the profitability of the firm. 2. What are some problems found with EVA? Economic Value Added (EVA) is limited by its very nature of merely reflecting the economic return of investments as it cannot reflect growth opportunities in its statements. Opportunities or getting into emerging market does not have a quantifiable value yet and thus cannot be factored in the Economic Value Added (EVA) statements. For example, pioneering in a certain market or industry presents a huge opportunity for growth and profit but this will not be recognized in Economic Value Added (EVA) financial reporting because it does not have a concrete economic value yet. To cite an example, the creation of a new product, say for example, computer tablet by another company (aside from Apple), is huge opportunity for profit knowing that the computer tablet business succeeded. But in Economic Value Added (EVA) reporting, this does not have any value at all and will only recognize such once actual sales are made. In effect, the exclusive use of Economic Value Added (EVA) makes a company reactionary and conservative and therefore less willing to take risks that could make the company grow. Economic Value Added (EVA) is also more favorable for big business with huge asset base because its managers have more resources to generate value with Economic Value Added (EVA) statements whereas small firms with very limited resources may not perform well in terms of Economic Value Added (EVA). Integrating Economic Value Added (EVA) in a company's financial management is also time consuming and costly which could be a set-back for small companies that do not have the time and resources to spare to integrate in their systems. The integration of Economic Value Added (EVA) in a company requires a reorientation of its financial management system and this would entail training and adjustments among its key personnel to be able to adapt to the new financial management system. This transition requires time and resources which could be a burden to small companies and quite slow to integrate in large companies.