A measure of a company's wealth

Business, Company

Value added is important to a company as it is a measure of a company's wealth. The wealth created by a company will pay salaries, wages ; pensions to employees, dividends to shareholders, and interest to lenders of capital, taxes to governments and to fund investment to sustain, develop and grow the business. Bernard Cox defined value added as being " the wealth the reporting entity has been able to create by its own and its employee's efforts". (1) It is a particular concept of income measurement however it differs from sales revenue as it doesn't include the wealth that is created by the suppliers in the business.

Value added for a company is the difference between sales and the cost of bought-in materials, components and services and is the preferred measure of the value created by the company's activities. The fact that value added results in a calculation it is very much related to accounting. Unlike income calculation in accounting which is internationally defined as revenues minus expenses, value added can be calculated in two ways. Value added for companies can be calculated from audited company annual reports and accounts for European companies but not for U. S. and Japanese companies which do not publish sufficient information (employee costs are not quoted).

The total value added distributed in each of these four ways can be calculated for companies and countries, they can be split into a performance and social aspect. The performance aspect is given by the subtractive method and the social aspect by the additive. Value added information provides not only economic but social information by identifying the portion of output which goes to each participant of the process of a company.

Companies that are doing well will create sufficient value added to give themselves options and optimise the distribution to ensure a sustainable and growing business. To give an example, after interest has been paid on loans and taxes, a company may wish to keep a side funds to reward their employees in order to retain their skills. The company could well invest in the future by introducing new products and services; they will want to keep share holders happy by paying out dividends, in return the share holders may invest moremoneyto develop the business.

Value added is a much broader performance measure than net income, because it is not focused on and biased by the viewpoint of the equity-capital provider but it reveals the true income (wealth) of the organisation which belongs to, and has to be distributed to, all stakeholders. (2) If you take a look at a company there is aspects of profit, cash flow and value added that are all connected to the sales performance of the company. Value added may indeed be the true wealth of the company, however to monitor how successful a business is may depend on its profitability.

There is a strong connection between profit and a company's sales performance; it may be fair to say that if a company is not making a profit it can easily affect sales performance where it is not selling the volumes it intended to do so, which will in-fact result in the company making a loss. On the other hand, if the company is highly profitable then they may have a good sales performance, the company is selling volumes it intended to do or perhaps even above there own expectations. It is not always the case that increasing profit will lead to an increase in sales.

A company may buy goods from wholesalers at a very good price, they then charge the market value to their customers where they know that they will make a profit, how ever do not sell as well as they hoped to. Any organization whether big or small will need money to get started, to survive, to expand or invest in a new venture. Money is used to acquire resources, the resources are perhaps used to produce goods or services, the goods and services are exchanged for money, this cycle will continue and it's known as cash flow.

Cash flow is a record of an organisation's money income and money payments in a given period of time. (3) Cash flow is very much connected to sales performance, when a company sells its products, depending on the number of the product sold will determine how much a company will make. So if the company was doing well, the sales performance was good more money will be added to the cash flow cycle. If the sales performance of the company was not good they cannot put as much money as they hoped for in the cash flow cycle. Many businesses fail because of insufficient cash flow not lack of profitability.