

Market Value Added (MVA)

- Running score of how well managers perform their primary task – creating wealth.
- How good (or bad) Economic Value Add (EVA - period to period) performance investors expect of company in future?

MVA= Total Market Value of Company

- All the money (capital) that has ever been invested in it
- = Cash investors could get out of company today
- Cash that has been put in to company
- = Current Market Value of Company's Securities (stocks and bonds)
- Invested Capital (debt and equity and debt offerings, bank loans, retained earnings, Capitalized R&D spending)

If positive – the company has made its shareholders richer.

If negative – shows how much shareholder wealth has been obliterated.

MVA tends to move in tandem with the market.

Economic Value Added (EVA)

- How efficient is management at turning investor money – capital – into profits?
- EVA measures the amount by which profits exceed or fall short of the cost of capital in any one period.
- EVA correlates better than any other measure with changes in MVA. Continuous increases typically mean increases in MVA while declining EVA typically means decreases in MVA.

EVA = After-tax Operating Profit – Cost of capital to Make that Profit

Note, Stern Stewart doesn't amortize goodwill and capitalizes R&D

Economic Value Add (EVA) Market Value Add (MVA)

EVA and MVA are Value-Based Metrics seen as good measures of a company's performance, as telling as EPS (earnings per share) and ROE (Return on Equity)

Stern Stewart – the consulting firm that trademarked the term

Challenges

- How to use EVA/MVA to affect results and dictate actionable performance down to the front line.
- How to find and measure drivers of economic profit at a level employees can control
- How to explain/understand these more abstract, complex metrics to everyone in the company
- How to integrate into existing MIS systems (ERP) and other managerial initiatives like JIT
- How to meld with decision-making systems such as strategy and budgeting
- How to implement with staff and support groups
- How to link incentive pay to these economic drivers

ERP packages now incorporating EVA/MVA (Strategic Enterprise Management (SEM) systems)

- Must allow company-specific definitions/calculations
- Must massage data to calculate Net operating profit after tax (NOPAT)
- Must make at least half a dozen adjustments to NOPAT that include capitalization of R&D. – Manipulate the general ledger, draw from Activity-Based costing (ABC) calculations, Convert to cash-basis accounting, create separate “shadow” ledger of economic-profit data. It is difficult to translate operating numbers into the company-specific definitions of NOPAT
- Must figure out amount of capital employed and apply appropriate capital charge

Sources: “America's Greatest Wealth Creators”, Fortune Magazine – 11/10/97
“Who are the Real Wealth Creators?” Fortune Magazine – 12/09/96
“Metrics for the Masses” CFO Magazine, May 1999