

Economic performance evaluation of furniture company through indicator EVA

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Abstract: *Economic performance evaluation of furniture company through indicator EVA.* Many Slovak managers have recognized that to evaluate the performance of the company only on the basis of profit or revenues is not enough. Financial results provide more or less view into the past and say a little about the perspectives of the company. Therefore, many companies stopped taking accounting as the sole basis for measuring of performance. Modern approaches consider finance as only one of many indicators. So the management of the company to be able to work effectively, it must set aims that it wants to achieve, must have the exact numbers, which reflect the state of the reporting period and also to have some philosophy of management. All these conditions fulfill the concept of economic value added (EVA) belonging to the modern approach of business performance measurement. EVA sets a target to achieve the greatest added value for business owners, allows the measurement of corporate performance and presents an integrated financial management system. The aim of the present paper is to evaluate the performance of the selected furniture company through the indicator of economic value added – EVA.

Keywords: economic profit, performance measurement, EVA, value management

INTRODUCTION

The most common methods for the evaluation of business performance include the standard indicators of profitability (ROE, ROA,). Their significant deficiency lies in the possibility to influence the profit of the company (*Biernacka, 2004*). It may further discuss the value of the assets, which does not reflect the amount of property, which is not owned by the business but serves to business, i.e. leasing, and the last but not least the fact that the following methods do not take into account the time value of money and business risk. The consulting company Stern Stewart & Co came with an indicator in 1991, which eliminates the failures mentioned above. Method of economic value added (EVA) was elaborated as a tool for management and business valuation. The work with economic profit is the basic principle of the method EVA, thus the profit, which is reached not only after payment of current costs but also the cost of capital. ***The aim of the present paper is to evaluate the performance of the selected furniture company through the indicator of economic value added – EVA.***

MATERIALS A METHODS

The aim of the so-called ***business value management*** is to achieve *economic profit*. Value management is trying to create enough value for the business that exceeds the cost of capital. The most famous way of value management is just the ***method of economic value added - EVA***. The company contributes through its activities to increasing the value of the owners, if it achieved a positive EVA values. We used the following formula to calculate EVA in the selected furniture company (*Mařík, Maříková, 2005*):

$$EVA = NOPAT - WACC \times C \quad [1]$$

where:

NOPAT - operating profit after tax

WACC - average cost of capital

C - invested capital

NOPAT - Net Operating Profit After Taxes presents the profit from core business, modified for some costs to reflect the real economic benefit of the company to its owners (Wagner, 2009).

$$\text{NOPAT} = \text{EBIT} \times (1 - t) \quad [2]$$

where:

EBIT - operating profit

t - income tax rate

C - Invested Capital - this item includes all of the funds necessary to achieve the profit. This value is also known as Net Operating Assets – NOA (Pavelková, Knapková, 2005).

WACC - Weighted Average Cost of Capital reflects the average cost of capital and are the hardest detectable item from the view of identification (Brealey, Myers, 1991):

$$\text{WACC} = R_d(1 - t) \times \frac{D}{C} + R_e \times \frac{E}{C} \quad [3]$$

where:

R_d - cost of foreign capital

t - income tax rate

D - foreign capital

C – invested capital

R_e - the cost of own capital

E – own capital

To get the values of the parameters required for the calculation of EVA, it was necessary to perform a transformation of the accounting data. *Basic source of data for calculation of EVA create balance sheet and profit and loss account. The accounting values of accounting data is necessary to modify. The basic steps of conversion are* (Kislingerová, 2002):

- *conversion of operating assets,*
- *conversion of funding*
- *tax conversion,*
- *shareholder conversion.*

The conversions of the basic components of EVA are presented in Tables 1 – 3.

Tab. 1 Determination of Net Operating Profit After Taxes (NOA) - impact on the asset side

IMPACT ON THE ASSET SITE
- non-operating fixed assets
+ goodwill
+ intangible assets related to capitalized costs
+ increase in the value of fixed assets from revaluation (hidden reserves)
+ value of the leased property (leasing)
+ cumulative unexpected losses
- cumulative unexpected profits
- non-operating current assets
+ hidden reserves from revaluation of current assets
- non-interest short term liabilities

Tab. 2 Determination of Net Operating Profit After Taxes (NOA) - impact on the liabilities site

IMPACT ON THE CAPITAL SITE	
OWN CAPITAL	
- non-operating assets	
+ goodwill	
+ capitalized costs	
+ hidden reserves	
± edition of the profit on costs related to lesing	
+ cumulative unexpected losses	
- cumulative unexpected profits	
+ costs reserves, which have not the character of real liabilities	
FOREIGN CAPITAL	
- non-interest short term liabilities	
+ liabilities from leasing	
- costs reserves, which have not the character of real liabilities	

Tab. 2 Determination of NOPAT – impact on the accounting values

1. Results from ordinary activities
+ costs interests
- revenues non-operating assets (mainly financial revenues)
+ costs on non-operating assets
+ deprecisions of goodwillu
+ cost with investment character
- deprecations of intangible assets created to activate these costs
+ lease payments
- depreciation of leased assets
+ unexpected losses
- unexpected profits
2. Elimination of costs reserves creation
3. Modification of taxes on the level of NOPAT

RESULTS AND DISCUSSION

For performance evaluation of the analyzed furniture company the method of economic value added EVA was selected, because this method is the most appropriate modern method which can evaluate a company limited, that is not traded on the stock exchange and thus is not possible to obtain a market expression of its value. When we calculate the indicator EVA, we used gradual modifications that were presented in the methodology paper. Tables 4 - 7 present the modified values of necessary parameters to determine the indicator EVA of furniture company.

Tab. 3 Modification of accounting values – unfinished investment

	2010	2011	2012
Unfinished intangible assets	0	0	0
Unfinished tangible fixed assets	12525	10 532	11 328
Unfinished investment	12525	10532	11328

Tab. 4 Modification of accounting values of no-interest capital

	2010	2011	2012
Reserves	24 084	26 322	22 365
Long term liabilities	1 833	1673	1513
Short term liabilities	79 830	62 451	69 874
Accruals of liabilities	0	0	0
Sum	105 747	90 446	93 752

Tab. 5 Determination of NOA

	2010	2011	2012
Intangible assets	0	0	0
Tangible fixed assets (after modification)	589 587	609 768	610 794
financial fixed assets	0	0	0
Total asset	598 587	609 768	610 794
Resources	124 889	100 632	89 751
Claims	425 629	389 752	321 023
Current financial assets	95	1250	986
Accruals	3 805	0	0
No-interest liabilities	(-)105 747	(-)90 446	(-)93 752
NOA	1 038 258	1 010 956	928 802

Tab. 7 Determination of NOPAT

	2010	2011	2012
Economic result from the ordinary activity before tax	- 48 810	-32 542	-40 262
Modified economic result	- 46 157	-29 589	-38 789
Difference	2 653	2 953	1 473
Original tax	-14 289	-6 183	7 650
Additional tax	716	768	354
NOPAT	-32 584	-24 174	-38 966

Table 8 presents values of modified indicators and calculated values of EVA during the monitored period of years 2010-2012.

Tab. 8 Determination of EVA

	2010	2011	2012
NOPAT	-32 584	-24 174	-38 966
NOA	1 038 258	1 010 956	928 802
WACC	10,14 %	15,20 %	12,10 %
EVA	-117 721	-177 839	-151 351

Based on the calculated values of EVA, we can conclude that during the monitored period the analyzed furniture company reached negative value of EVA, from which implies that the company did not create any value for its owners.

CONCLUSION

To determine the value of EVA, we used a procedure which has been established by company Stern & Stewart. Calculated negative EVA values during the monitored period mean that the company does not produce any value for the business owners have (i.e. negative phenomenon).

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Streszczenie: *Ocena produktywności firmy meblowej przy użyciu wskaźnika EVA.* Wielu słowackich managerów uznało że ocena produktywności firmy tylko na podstawie zysków czy dochodów nie jest wystarczająca. Financial results provide more or less view into the past and say a little about the perspectives of the company. Therefore, many companies stopped taking accounting as the sole basis for measuring of performance. Modern approaches consider finance as only one of many indicators. So the management of the company to be able to work effectively, it must set aims that it wants to achieve, must have the exact numbers, which reflect the state of the reporting period and also to have some philosophy of management. All these conditions fulfills the concept of economic value added (EVA) belonging to the modern approach of business performance measurement. EVA sets a target to achieve the greatest added value for business owners, allows the measurement of corporate performance and presents an integrated financial management system. The aim of the present paper is to evaluate the performance of the selected furniture company through the indicator of economic value added – EVA.

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