

CHAPTER 1: INTRODUCTION

1.1 Background

In 1961, Prof. Franco Modigliani and Prof. Merton H. Miller (MM) said in their article Dividend Policy, Growth and The Evaluation of Shares: “To measure corporate performance for market capitalization, companies should consider earnings, cash flows, dividends and investment opportunities as alternatives”.

Stern Stewart, an advocate of Economic Value Added (EVA) approach to shareholder value understands the issues raised under the MM model which has led him to the view that “free cash flows is cash from operations that is available, attributable to both leaders and shareholders. In other words, it is the cash that is free for distribution to investors after all investments have been financed. Thus, when it is discounted to a present value at the company’s cost of capital, free cash flow is the foundation of any company’s market value”.

1.2 Justification

As corporate Malaysia re-engineers itself through industry consolidations and corporate restructuring, the application of EVA as a shareholder value measurement method will become a highly useful and dynamic tool to owners and managers of businesses.

1.3 Objective

The objective of this study is to discuss the effectiveness of the application of EVA as a superior measurement tool to enhance shareholder’s value.

1.4 The structure of the study

Chapter 2 explains in general the concept of shareholders' value.

Chapter 3 describes the weaknesses and limitations in accounting measurement namely earnings per share and cash flow.

Chapter 4 presents the theory of EVA as well as describing its true measure of corporate success.

Chapter 5 describes the basis of calculating EVA and provides an example of MVA and EVA calculations.

Chapter 6 discusses the relationship between EVA and divisional performance measurement.

Chapter 7 covers the implementation process and management involving EVA.

Chapter 8 covers the methodology of the study. It explains the sources of data and the method of analysis.

Chapter 9 presents the findings of the study.

Chapter 10 presents the critics of EVA.

Chapter 11 concludes the report with its summary and conclusions.