CHAPTER 1

INTRODUCTION

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The real value of corporations is one of the most important things that shareholders and investors care about (Lin and Qiao, 2009). The primary goal of most firms is to maximize shareholder value (Brigham and Ehrhardt, 2005). Likewise, McTaggart et al. (1994) also believed that shareholder’s value maximization allows managers and board of directors to resolve any conflicts to all stakeholder’s long term benefits. Shareholder’s value creation has been an important issue for managers as it is the driving force behind strategic and operational decisions. Shareholder’s value means meeting the expectation of shareholders at the heart of the management decisions. Value based management is a management process that links strategy, measurement and operational processes towards creating shareholder’s value. In other words shareholder’s value is the sum of all strategic decisions that affect the firm’s ability to efficiently increase the amount of free cash flow over time (Bontis et al., 1999; Gamba and Triantis, 2008).

In a market driven economy many companies will create value and many other companies, however, will undoubtedly destroy it (Grant, 2003). For corporate managers, value creation is fundamental to the economic survival of the company. No company will be able to continue to exist if it fails to create sufficient value.
for their shareholders. In other words the company not generating value addition in their wealth will struggle to survive and over a period of time will be either a subject of takeover or liquidation. According to Worthington and West (2001): “Shareholder’s value is traditionally assessed by either standard accounting magnitudes such as profits, earnings and cash flows from operations or financial statements ratios such as earnings per share, return on assets or capital employed” (p.76).

The linkage between the value based performance measures and creation of shareholder’s value has been the debatable issues for academicians and practitioners in the last decade. Corporate managers and executives have engaged in the debate on whether the new value based economic measures are highly significant for shareholder’s value creation than the old traditional performance measures. The main goal of managers is to attempt to maximize the shareholder’s value. However, the manager’s decisions favor the interest of non-shareholders or stakeholders at the expense of shareholders (Brigham and Ehrhardt, 2013). Furthermore, Irala et al. (2006) mentioned that managers are encouraged to undergo projects that could increase shareholder’s value using measurement tools like economic value added (EVA).

According to Lee (1996), for years, investors and corporate managers have been seeking a timely and reliable measurement of shareholder’s value. With such a measure, investors could spot over-or under-priced stocks, lenders could gauge the security of their loans and managers could monitor the profitability of their factories, divisions and firms.

It has been a traditional goal for the managers of the corporate level to maximize shareholder’s value. In the economy that is market driven many firms create value for their shareholders whereas some of them certainly destroy it. The managers that fail to identify the importance of shareholders in an open economy,
do so for their own careers and the peril of the firms (Grant, 2003). According to Ster
cStewart Company, the following fundamental conditions are necessary for increasing
the shareholder’s value:

- A solid understanding of how the business is valued by the market
- A management system that drives market-based decisions about resource allo-
cation and management deep into the organization
- An incentive structure that makes managers think and act like owners
- A commitment to continuous improvement rather than short-term goals

In the past few years it has been an ultimate goal of an organization to make
a revolutionary change in the measurement of performance from the traditional
profit based measures like Earning per Share (EPS), Return on Capital Employed
(ROCE), Return on Equity (ROE), Net Profit Margin (NPM), Operating Profit
Margin (OPM) and Net Operating Profit After Tax (NOPAT) to the new modern
economic value based performance measures like Market value Added (MVA),
Shareholder’s Value Added (SVA), Cash Value Added (CVA), Equity Market Value
(EMV), Created Shareholder’s Value (CSV), Economic Value Added (EVA). Out
of the value based measures, EVA has received high attention as an important per-
formance measurement tool for the corporate performance and shareholder’s value
maximization. EVA helps the entity to focus on how to use capital and how to
generate cash from it. Managers are able to care about managing assets and income
and help in bringing up balance between them through EVA.

There are traditional measures like EPS, ROE, ROA and ROCE have been
used by the shareholders to measure performance appraisals. Such traditional mea-

ures have been criticized due to not inclusive of the cost of capital resources of the
firm (Hasani and Fathi, 2012). Nevertheless, the traditional profit measures of the
net income include depreciation costs (Historical fixed cost and long term assets)
and interest cost (Cost of Debt). However, the net income does not include the