Value of Firm

1/ Value of a Firm – Definition

The 'Value of Firm' refers to the quantification of the economic worth of a firm's assets and its potential to generate economic returns for its capital suppliers. It can be determined through financial measures based on the firm's assets and their ability to generate returns, or through social measures that consider economic and noneconomic outcomes impacting various stakeholders.

A firm's value, also known as Firm Value (FV), Enterprise Value (EV). It is an economic concept that reflects the value of a business. It is the value that a business is worthy of at a particular date. Theoretically, it is an amount that one needs to pay to buy/take over a business entity. Like an asset, the value of a firm can be determined on the basis of either book value or market value. But generally, it refers to the market value of a company.

2/ **Economic Value Added (EVA)**

Economic value added (EVA) is a measure of a company's financial performance based on the residual wealth calculated by deducting its cost of capital from its operating profit, adjusted for taxes on a cash basis. EVA can also be referred to as economic profit, as it attempts to capture the true economic profit of a company. This measure was devised by management consulting firm Stern Value Management, originally incorporated as Stern Stewart & Co.1

Key Takeaways

- Economic value added (EVA), also known as economic profit, aims to calculate the true economic profit of a company.
- EVA is used to measure the value a company generates from funds invested in it.
- However, EVA relies heavily on invested capital and is best used for asset-rich companies, where companies with intangible assets, such as technology businesses, may not be good candidates.

- The Economic Value Added (EVA) is a measure of **surplus value** created on an investment.
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3/ Understanding Economic Value Added (EVA)

EVA is the incremental difference in the rate of return (Evaluating company performance is crucial, yet most financial metrics fail to provide a complete picture. Both EVA and MVA have limitations when used individually.

4/ Introduction to Economic Value Added (EVA) and Market Value Added (MVA)

Economic Value Added (EVA) and Market Value Added (MVA) are two important financial performance metrics used to measure a company's profitability and value creation for shareholders.

- **Understanding EVA in the Context of Finance**

EVA measures the economic profit generated by a company after accounting for the cost of capital. It is calculated by taking net operating profit after taxes (NOPAT) and subtracting the dollar cost of capital invested to generate those profits. A positive EVA indicates the company is creating shareholder value by earning returns above its cost of capital. It serves as an indicator of true economic profit.

- **Exploring the Concept of MVA in Finance**

Market Value Added (MVA) measures the difference between a company's current market value and the total capital invested by shareholders over the years. A positive MVA means the market value exceeds invested capital, indicating the company has created shareholder wealth. It assesses the value a company has created beyond the resources provided by shareholders.

******Is economic value added EVA the same as market value added MVA?**

No, economic value added (EVA) and market value added (MVA) are two different financial performance measures, although they are related.

EVA measures the value a company generates from funds invested into it. It is calculated as net operating profit after taxes (NOPAT) minus the cost of capital employed. A positive EVA means the company is generating value from its capital investment.

In contrast, MVA measures the difference between the current total market value of a company and the capital invested into it over time. It indicates how much value shareholders have gained or lost as a result of their investment into the company.

So in summary:

- EVA is an internal financial performance measure of how much economic value a company is generating from its capital.
- MVA is an external market-based measure of how much value shareholders have gained or lost from their investment into a company.

Thus, EVA is the internal measure of corporate performance and MVA is the external measure of corporate performance. MVA reflects how much the capital market is putting value on the invested capital.

A company can have a positive EVA but negative MVA if investors feel the future EVA will be lower than current expectations. Similarly, a company can have negative EVA but positive MVA if investors anticipate EVA will improve in the future.

EVA = Net Operating Profit After Taxes (NOPAT) - (Capital Employed x Weighted Average Cost of Capital (WACC))

Where:

- NOPAT is a company's after-tax operating profit
- Capital Employed is the total capital invested in the company
- WACC is the average rate of return required by investors

A positive EVA means the company is generating economic profits. A negative EVA indicates the company is not covering its cost of capital.