Suruhanjaya Sekuriti
Securities Commission

S P E E C H E S

Welcome address by

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At the
Seminar on Economic Value Added (EVA):
As a Driver of Performance, Strategy and Incentives
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A very good morning to you and welcome to the seminar on Economic Value Added (EVA): As a Driver of Performance, Strategy and Incentives.

Ladies and Gentlemen,

We are undoubtedly living in times when business conditions and market sentiment are changing at a significant pace. The challenging circumstances currently prevailing in our economy puts even greater pressure on senior management and directors of public listed companies. Today's managers have to strive to maintain profitability, enhance company growth and successfully steer the company ahead amidst such vagaries of changing times, forthright setbacks and forthcoming challenges.

Managers have to find ways to measure and assess the business and its operations for feedback such that they indeed steer the company in a profitable direction. What top and senior management need are objective measures - clear and simple internal and external reporting and evaluation methods that point out the facts and figures about current status, problems or even potential problems. Traditional valuation measures of performance have served us well. The return on investment methods gauge earning power such as Return on Equity (ROE) and Return on Assets (ROA), which have their focus largely on the accounting profit. Cash flow return on assets is another measure and its use recognises cash flow as an important factor determining company performance.

Today, we will consider a new method of performance measurement, Economic Value Added or Stern Steward's proprietary method, trademarked as EVA. Basically, Economic Value Added is a value added performance measure. A Company adds value to its business over a period of time when it has generated a profit in excess of its cost of capital, that is, the cost of the sources of funds. The profit derived, after taking into consideration both the explicit and implicit costs of a business generating the profit, is called the "economic profit". By definition, economic profit is the amount of value added in a period and is referred to as the "economic value added".

A close concept related to economic value added is "Market Value Added (MVA)", which is a supplementary technique to evaluate a company's performance. Market Value Added is the present value of a company's future economic profit. In contrast to the economic profit, which is the value added over a given period, the market value added is a forward-looking measure and is the present value or discounted value of all the company's future periods' estimated economic profit. Both these value added measures focus on value. They are viewed as an improvement over the accounting-based income measures as these measures go further from cash flow to consider the cost of capital.

Value added measures are useful as they offer a clear and easily understood way to define targets and facilitate measurement and assessment of the company operations. In the area of capital budgeting, for example, Economic Value Added and Market Value Added measures are appealing as they are linked to the fundamental valuation techniques and are based on the same valuation principles as the net present value capital-budgeting technique, which managers are more familiar with. Yet, value added measures put in more flesh and blood, refining further its evaluation results.

The Economic Value Added approach has been lauded overseas as one of the successful methods to effectively solve some of the major issues in managing a company. It offers a management system that help define priorities and shape behaviour to focus on value. EVA instills capital discipline by forcing managers to consider the actual cost of capital they employ. It also boasts the merits of allowing pay schemes to be tied to performance and consequently, the change in mindset and motivation generated encourage managers to act as owners of the company, aligning shareholder and management interests alike.

Ladies and Gentlemen,

Let me also take this opportunity to talk about Corporate Governance. Managing public listed companies successfully require more than making the right investment decisions or employing the right performance measures and valuation techniques. It requires above all, the right mental attitude in applying ethical principles resulting in responsible and transparent corporate behaviour.

The launch of the high level Finance Committee Report on Corporate Governance last month, has officially spurred on the process of corporate governance reforms nationwide and it is hoped that this will continue at an accelerated rate. The Report summarises the main concerns that are:

- Strengthening laws governing shareholder rights, director's duties and duties of other corporate participants with particular emphasis on related party transactions;
- Enhancing disclosure and transparency;
- Promoting effective enforcement against infringing companies, directors, shareholders and other corporate participants;
- Developing a Malaysian Code of Best Practices on Corporate Governance, which seeks to restructure composition of the Board of Directors and thereby, create effective boards; and
- Training and education, which essentially falls under the purview of the Malaysian Institute of Corporate Governance or MICG.

In effect, regulators have set out to enforce the corporate governance mechanisms to raise the level of corporate governance in the country. It is envisaged that good governance will become one of the fundamental factors toward ensuring long-term and sustainable growth of the corporate sector and the economy.

Sound governance is a means to creating a growing and thriving business environment; it is clearly not an end in itself. The private sector stance, therefore, should not be one of box-ticking a burdensome mandatory process, but should see the issue of best practices as necessary self-regulation; ultimately benefiting the corporation and its shareholders. Good governance is not only about enhancing shareholder's value; it is also about accountability to shareholders; protecting minority shareholders and investors, thereby building investor confidence. Good governance is about enhancing the competitive edge not just of individual companies but also of the nation as a whole. Therefore, good governance is a responsibility shared by all.

Ladies and Gentlemen,

In closing, I would like to thank Mr. Joel Stern of Stern Steward and Company for being here to share with us in detail on this new methodology of EVA. I would also extend my appreciation to Morgan Stanley Asia for co-sponsoring today's seminar. To the participants, I would like to say that it is indeed encouraging to see so many of you here today and I look forward to your active participation in today's seminar.

Thank you.