Financial Performance Analysis Using Economic Value Added (EVA)

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Abstract. Financial performance is an indicator of the company's success in managing the finance functions. EVA method is very good to measure financial performance because it can describe the actual of company value. The object of this research is PT Kalbe Farma Tbk with financial data from the year 2012 up to 2014. This research uses the descriptive quantitative method. Based on computations, the EVA value of the company has fluctuated and positive. The positive value of EVA indicates that the company has the ability to create economic value added and rate of returns (operating profit exceeds the cost of capital). In other words, the company has created wealth for the shareholders. In this research, some recommendations are given to increase the EVA value.

1. The first section in your paper
Facing the current global competition, make a company faced with a very tight business competition. Free trade making business competition is very wide open and business competition in various sectors will make the management of the company should set up new strategies so that the company can survive running its business. One strategy that can be applied is to increase the company value.

Obtain the maximum profit is one of the purposes of the company. Besides that, the purpose of the company is to increase the company value with the goal of prosperity for owners. The company value is a measure of the success of the implementation of the financial functions. To increase the value, companies must be able to improve its performance. The performance of a company depends on financial management activities. In order to get raising company value, the company must be able to analyze financial management. The financial performance measurements needed to know the effectiveness of business strategies.

One way to assess the financial performance is by way of analyzing the financial statements. Analysis of financial statements is used to predict the future and to help anticipate future conditions. Information from the financial statements analysis indicates whether the company is going forward or getting financial difficulties.

PT Kalbe Farma Tbk, is a leading pharmaceutical industry company has four business areas, namely Pharmaceutical, Commerce, Trading, and Pharmaceuticals Representative and Agency. Kalbe has four divisions, prescription drugs division, health products division, nutrition division, and distribution division. PT Kalbe Farma Tbk is one of many companies that conduct performance measurement financial conventionally by using financial ratio analysis such as, current ratio, debt to
total asset ratio, ROI (return on investment) and ROE (return on equity). The table below is a report on the financial performance of PT Kalbe Farma Tbk in the years 2012-2014.

| Financial Ratio       | Year | 2012 | 2013 | 2014 |
|-----------------------|------|------|------|------|
| Current Ratio (%)     |      | 340.5| 283.9| 340.3|
| Debt to Total Asset Ratio (%) |      | 2.17 | 5.21 | 2.38 |
| ROA (%)               |      | 18.41| 16.96| 16.62|
| ROE (%)               |      | 23.52| 22.58| 21.03|

Based on the table above, it can be seen that the current ratio fluctuated from 2012 to 2014, but debt to total asset ratio, return on assets (ROA) and return on equity (ROE) has decreased. Despite the decline occurred wasn’t significant, the company needs to find out the causes.

Traditionally, financial assessment uses ratio analysis. Financial assessment by using ratio analysis has many weaknesses. Ratio analysis does not indicate the actual successful of the company. Financial performance assessment based on financial statements is unreliable, financial performance looks good but actually is decline. Based on the ratio analysis weaknesses new approach called EVA (economic value added) was found by Stern Stewart & Co. of New York in 1993. EVA index has more superior ability to explain stock price changes than the traditional index (O’Hanlon & Peasnell, 1998).

EVA defined as net income after tax minus cost of capital. EVA is a financial management method used to measure economic profit. The company welfare only created when a company able to pay all operating costs and capital costs (Tunggal, 2001). EVA index was rapidly promoted when it was put forward in USA, and was introduced for performance evaluation in many enterprises such as Coca-Cola, Siemens and so on. The introduction of EVA has further promoted with the development of the financial engineering management concept, and has been gradually and widely recognized as the core of the financial engineering management strategy (Xin’e, Ting, & Yuan, 2012). EVA can be useful as a performance guidance tool, rather than simply as a measurement tool, provided it is associated with the indicators of activities that create or destroy value in the firm (Bahri, St-Pierre, & Sakka, 2011).

2. Literature review

2.1. Financial performance
Performance can be interpreted as an accomplishment of an effort to achieve the goal. Financial performance is an analysis aimed to look whether the company has managed its financial based on rules or not (Fahmi, 2014). The benefit of financial performance analysis is to give the information about company prospect in a financial perspective.

2.2. Financial statement
A financial statement is a tool used by management to obtain financial information of the company. The financial statement consists of financial data in a certain period. Financial statement provides the progress of financial performance that used by stakeholders (investors, managers, shareholders, employees) to make decision making. Munawir (2010) stated that financial statement is a result of accounting process to communicate financial data or the activities to its stakeholders.

2.3. Economic Value Added (EVA)
Economic value added (EVA) is one of financial performance assessment method. EVA defined as the difference between NOPAT and cost of capital (Young & O’Byrne, 2001). The cost of capital is equal
to the invested cost of capital (capital use) multiplied by the weighted average cost of capital (WACC). EVA is the residual income a company earns after capital costs are deducted. More specifically, it is operating profits minus the required dollar-amount return for the capital employed (Horne, 2002). Under the pressure of the EVA performance evaluation, management seeks to decrease the cost of capital and maintain normal business operations. Therefore, its ultimate goal is to control cash within a reasonable scope to improve the value of the enterprise and its personal interests (Shen, Zou, & Chen, 2015).

EVA can be used as financial performance assessment and focus on value creation; 2) EVA make the company more concern to capital structure policy; 3) EVA make the management focus on maximizing the investment return and minimize the cost of capital; 4) EVA can be applied to select profitable projects/investments. EVA value can be grouped into three categories:

2.3.1. \( EVA > 0 \) or \( EVA \) is positive In this position means the management of the company has succeeded in creating economic value added for the company.

2.3.2. \( EVA = 0 \) In this position means the management of the company is in break even. The company suffered a setback but at the same time does not progress economically.

2.3.3. \( EVA < 0 \) or \( EVA \) is negative In this position means there no additional economic value added or the company can’t meet shareholders and creditors (investors) expectation.

The step of EVA computations as follows:

- Calculate cost of debt or \( K_d \).

\[
K_d = K_b \times (1-T)
\]

Where:
- \( K_d \) = cost of debt after tax
- \( K_b \) = interest rate
- \( T \) = tax

- Calculate cost of equity or \( K_e \).

\[
K_e = R_f + (R_m - R_f) \beta
\]

Where:
- \( K_e \) = cost of equity
- \( R_f \) = risk free rate
- \( \beta \) = covariant of company return
- \( R_m \) = market return rate

- Calculate capital structure; determine weight of cost of debt (\( W_d \)) and weight of cost of equity (\( W_e \)).

\[
W_d = \frac{\text{Long term debt}}{\text{Long term debt} + \text{Equity}} \times 100\%
\]

\[
W_e = \frac{\text{Equity}}{\text{Long term debt} + \text{Equity}} \times 100\% \quad \text{atau} \quad W_e = 1 - W_d
\]

- Calculate Weighted Average Cost of Capital (WACC)

\[
\text{WACC} = (W_d \times K_d) + (W_e \times K_e)
\]

- Calculate Economic Value Added (EVA)

\[
EVA = \text{NOPAT} - (\text{WACC} \times \text{Capital Structure})
\]

3. Methodology
This research is qualitative research by collecting financial data of PT Kalbe Farma Tbk from the year 2012 up to 2014. The purpose of this research is to assess financial performance by using EVA.
approach. The secondary data from Indonesia Stock Exchange website. The secondary data such as financial statement year 2012-2014, annual report year 2012-2014, interest rate year 2012-2014, share price year 2012-2014 was collected and calculated by using EVA calculation procedures. While computing EVA, capital employed represents capital invested at the beginning of the year. The logic behind taking beginning capital for computing EVA is that a company would take at least one year time to earn a return on investment. It may be mentioned here that calculation of EVA involves some tricky issues. Each element of EVA, therefore, has been discussed individually. EVA requires three different inputs for its computation, NOPAT (Net Operating Profit after Tax), Invested Capital (C), Weighted Average Cost of Capital (WACC) (Patel & Patel, 2012).

| Table 2. The Financial Data |
|-----------------------------|
| Year | Interest | Debt | Interest rate (Kb) | Tax (T) | Debt | Equity |
| 2012 | 4,708,613,838 | 204,252,407,762 | 2.31% | 23.09% | 204,252,407,762 | 7,371,643,614,897 |
| 2013 | 14,390,983,649 | 583,823,955,413 | 2.46% | 23.4% | 583,823,955,413 | 8,499,957,965,575 |
| 2014 | 38,382,364,823 | 296,128,806,117 | 12.96% | 23.25% | 296,128,806,117 | 9,817,475,678,446 |

4. Data analysis and results

4.1. The financial performance of PT Kalbe Farma Tbk

4.1.1. Net Sales Kalbe recorded positive sales during the year 2012 up to 2014. In 2012 Kalbe net sales IDR13,636 billion, IDR16,002 billion in 2013, and IDR17,368 billion 2014.

4.1.2. Net income Kalbe net income in 2012 is IDR1,775 billion and then increased to IDR1,970 billion in 2013. In 2014, the net income increases up to IDR2,121 billion.

4.1.3. Assets On 31 December 2012, the total assets of the company reached IDR9,418 billion, then reached IDR11,315 billion per 31 December 2013 or increase of 20.1%. Meanwhile, on 31 December 2014, the company's total assets grew up to 9.8% or reached IDR12,425 billion.

4.1.4. Equity In 2012 the equity reached IDR7,372 billion. In 2013, the equity reached IDR8,500 billion (increased 15.3%). In 2014, the equity reached IDR9,818 billion (increased 15.5%).

4.1.5. Earnings Per share In the year 2012, after implementing stock split with a ratio 1:5, earnings per share reached IDR37. In 2013, the company has recorded a growth of earnings per share reached IDR40.9. In 2014 the company recorded growth of earnings per share reached IDR44.

5. The financial performance by using Economic Valued Added (EVA) parameter

5.1. Cost of debt
The cost of capital is the cost because the company borrows the money. Total debt (consists of long term debt and short term debt) make the company should pay the interest.
Table 3. Cost of debt of PT Kalbe Farma Tbk

| Year | 2012 | 2013 | 2014 |
|------|------|------|------|
| Interest | 4,708,613,838 | 14,390,983,649 | 38,382,364,823 |
| Debt | 204,252,407,762 | 583,823,955,413 | 296,128,806,117 |
| Interest rate (Kb) | 2.31% | 2.46% | 12.96% |
| Tax (T) | 23.09% | 23.4% | 23.25% |
| Correction factor (1-T) | 76.91% | 76.6% | 76.75% |
| Kd | 1.78% | 1.88% | 9.95% |

The table above shows that the cost of debt (Kd) of PT Kalbe Farma Tbk increase every year. In 2012 the value cost of debt of 1.78%, in 2013 and increase of 0.1% to 1.88%. Then, in 2014 cost of debt reached 9.95%. The higher of the cost of debt affected higher interest expenses paid by the company.

5.2. Cost of equity (Ke)
The cost of equity is expected the rate of return of shareholders. The table below shows the cost of equity from the year 2012 up to 2014.

Table 4. Cost of Equity

| Year | 2012 | 2013 | 2014 |
|------|------|------|------|
| Rf | 0.0577 | 0.0648 | 0.0754 |
| Rm | 0.0107 | 0.0003 | 0.0171 |
| (Rm-Rf) | -0.047 | -0.0645 | -0.0583 |
| β | 0.76678 | 0.99796 | 0.62516 |
| Ke | 0.0217 | 0.0004 | 0.0390 |

Based on the table above, the cost of capital that must be paid by the company in 2012 is 2.17%. Meanwhile, in 2013 cost of capital was decreased significantly. Decreasing cost of equity caused by decreasing Rm and Ri. In 2014, the cost of equity PT Kalbe Farma Tbk increase from the previous year to 3.90%.

5.3. Capital structure
Capital structure is the composition of the funds from the debt (long-term loans and short-term loans) and private equity (common shares and retained earnings) used by the company as a source of funding. Calculation of capital structure provides the information of capital proportion of own capital and debt used by companies as a source of funds in the company's operational activities.

Table 5. Capital Structure

| Year | 2012 | 2013 | 2014 |
|------|------|------|------|
| Debt | 204,252,407,762 | 583,823,955,413 | 296,128,806,117 |
| Equity | 7,371,643,614,897 | 8,499,957,965,575 | 9,817,475,678,446 |
| Total of debt and equity | 7,575,896,022,659 | 9,083,781,920,988 | 10,113,604,484,563 |
| Debt proportion (Wd) | 2.70% | 6.43% | 2.93% |
Based on the calculation of the capital structure of PT Kalbe Farma Tbk, it can be concluded that Kalbe tends to use internal funds (equity) higher than external fund (debt). In 2012, the proportion of debt is 2.70% and proportion of own capital is 97.30%. In 2013, the proportion of debt of PT Kalbe Farma Tbk increased to 6.43% and the proportion of own capital declined to 93.57%. In 2014, the proportion of debt of PT Kalbe Farma Tbk declined to 2.93% and the proportion of own capital increased to 97.07%.

5.4. Weight Average Cost of Capital (WACC)
WACC is the sum of the cost of debt and cost of equity after multiplying its proportion. WACC describe the value of the overall funds.

| Year | 2012 | 2013 | 2014 |
|------|------|------|------|
| Wd   | 0.0270 | 0.0643 | 0.0293 |
| Kd   | 0.0179 | 0.0189 | 0.0995 |
| We   | 0.9730 | 0.9357 | 0.9707 |
| Ke   | 0.0217 | 0.0004 | 0.0390 |
| WACC | 0.0216 | 0.0016 | 0.0408 |

The optimum capital structure is achieved when the WACC reach a minimum. In 2013 the company got optimum WACC. Meanwhile, in 2014 WACC is higher (4.08%). The Increasing of WACC caused by increasing interest debt.

5.5. Net Operating Profit After Tax (NOPAT)
NOPAT is earnings from the operational activities after reduced taxes.

| Keterangan | 2012 | 2013 | 2014 |
|------------|------|------|------|
| Earnings before tax | 2,308,017,092,492 | 2,572,522,717,231 | 2,763,700,548,048 |
| Interest | 4,708,613,838 | 14,390,983,649 | 38,382,364,823 |
| EBIT | 2,312,725,706,330 | 2,586,913,700,880 | 2,802,082,912,871 |
| Tax | 532,918,244,560 | 602,070,267,545 | 642,609,966,418 |
| NOPAT | 1,779,807,461,770 | 1,984,843,433,335 | 2,159,472,946,453 |

Based on the table above, the NOPAT is IDR1,779,807,461,770 in the 2012. In 2013, NOPAT increased to IDR1,984,843,433,335. It is caused by increasing of EBIT from IDR2,312,725,706,330 to IDR2,586,913,700,88. The Increasing of EBIT caused by increasing of interest. Then, in 2014 NOPAT increase to 8.8% from IDR2,159,472,946,453 to IDR1,984,843,433,335. The increasing of NOPAT is caused by increasing of EBIT.

5.6. Economic Value Added (EVA)
After all components of EVA have calculated, then the EVA can be computed.
The value of EVA during 2012 to 2014 was positive and fluctuated. The positive of EVA (EVA>0) indicate that the company able to creates value added or in other words the company able to get return exceeded the cost of capital. In 2012, the value of EVA achieved about IDR1,616,168,107,681, and then in 2013 increased to be IDR1,970,309,382,262. Meanwhile in 2014 values of EVA decreased to IDR1,746,837,883,483. This is caused by the rising cost of capital due to the increased interest expenses.

6. Discussion and Implication
The positive of EVA for the year 2012 up to 2014 is a satisfactory accomplishment. It means the company has been able to give value add to investors and creditors. During the year 2012 to 2014, the EVA of Kalbe shows fluctuations in which EVA rise in 2013 but decreased in 2014. The declining of EVA in 2014 should make the company more concern to find out the causes. In 2014, EVA was decreased compared to two years before. It caused by increasing the cost of capital. The increasing cost of capital caused by increasing interest rate.

In 2014, Kalbe recorded good profit (IDR2.12 trillion), in addition, the company also strengthening its equity reach IDR9.81 trillion. The strong cash in 2014 is not enough to support the operational activities of the business, so companies still utilize alternative financing use debt. In this year, the macroeconomic were volatile due to decreasing rupiah exchange rate against the dollar. Financing by debt remains necessary in order to support raw material procurement.

In the uncertain macroeconomic situation, the company need implements an effective strategy. To maintain company performance, Kalbe need implements some strategies as follows:
- Strengthen internal financing to reduce financing from debt.
- Produce its products by using local raw material
- Strengthen profitable investment particularly in prescription drug division, nutrition division, and health products division.

7. Conclusion
Based on computation and analysis, there are some conclusions:
- The financial performance of PT Kalbe Tbk based on the financial statements from 2012 up to 2014 was satisfactory. During the years 2012 up to 2014 PT Kalbe Farma Tbk is able to create increasing financial indicators such as sales, net profits, assets, equity, and earning per share.
- Financial performance of PT Kalbe Farma Tbk using EVA (Economic Value Added) from the year 2012 up to 2014 generally was satisfied (EVA values were positive annually).
- The value of EVA in 2012 is IDR616,168,107,681, in 2013 is IDR1,970,309,382,262 (increase of 21.9%). But in 2014 EVA value has decreased, the value of the EVA in the reaches of PT Kalbe Farma Tbk 2014 is amounting to IDR1,746,837,883,483 (decrease of 11.3% from the previous year).

There are some actions to maintain the positive of EVA:
- Focus on maintaining increasing of profit to cover the cost of capital.
- Control debt composition

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Table 8. Economic Value Added (EVA)

| Year | NOPAT     | Cost of capital | EVA        |
|------|-----------|----------------|------------|
| 2012 | 1,779,807,461,770 | 163,639,354,089 | 1,616,168,107,681 |
| 2013 | 1,984,843,433,335 | 14,534,051,073  | 1,970,309,382,262 |
| 2014 | 259,472,946,453  | 412,635,062,970 | 1,746,837,883,483 |
• Reduce purchases imported raw materials
• Focus on profitable investment and unleash unprofitable investment.

However, to improve company performance just not uses EVA parameter. The company should use other parameters or methods.

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