

**A STRATEGIC APPROACH IN MANAGING
SHAREHOLDERS' WEALTH FOR COMPANIES
LISTED ON THE JSE SECURITIES EXCHANGE
SOUTH AFRICA**

by

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Summary

For a number of years there has been a growing awareness of the importance of shareholder value for financial strategy and management. At the same time, there has been growing concern that the traditional accounting measures of performance have serious inherent limitations that may lead to poor financial decision-making. This study starts off by providing an overview of the main accounting earnings-based measures, as well as the most important criticisms leveled against them.

The concepts of Economic Value Added (EVA) and Market Value Added (MVA), which are currently regarded as the most important indicators of shareholder value and financial performance, are examined, along with some research evidence supporting them (and other evidence opposing them). Various aspects of EVA and MVA are discussed, including different ways of calculating them, and their link to other financial concepts such as net present value (NPV) and operating and financial leverage.

After a discussion of the main drivers of EVA, namely the Return on Invested Capital (ROIC), the weighted average cost of capital (WACC), the performance spread and the invested capital (IC), the financial strategy matrix is introduced. The financial

strategy matrix has been used in this study to evaluate companies in terms of internal value creation (performance spreads) and cash flow management (sales growth compared to the sustainable growth rate). A selection of companies listed on the JSE was ranked according to their relative performance in terms of internal value creation (performance spreads) and the results of some individual companies and sectors were placed on the financial strategy matrix.

The statistical tests done on the data have indicated that the sales growth minus the sustainable growth rate does not contribute significantly to shareholder value and an alternative variable was recommended. Further tests have revealed that significant correlation between MVA and EVA could only be found if the median results over a ten-year period were used. The correlation between MVA and the main drivers of EVA was found to be weak on a year-on-year basis.

It is hoped that the results and perspectives gained from this study will be helpful to financial managers who aim to optimize their approach to shareholder value management.

LIST OF ABBREVIATIONS

AEVA	Adjusted EVA
APT	Arbitrage pricing theory
BFA	Bureau for financial analysis
CAOA	Cash flow from operating activities
CAPM	Capital asset pricing model
DFL	Degree of financial leverage
DOL	Degree of operating leverage
EAT	Earnings after tax
EBIAT	Earnings before interest after adjusted tax
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation
EBT	Earnings before tax
EMH	Efficient market hypothesis
EPS	Earnings per share
EVA	Economic value added
FAT	Fixed asset turnover
FCF	Free cash flow
FGV	Future growth value
FIFO	First-in-first-out
GAAP	Generally accepted accounting practice
IC	Invested capital
IC _{beg}	Invested capital beginning of year
IRR	Internal rate of return
IT	Information technology
JSE	Johannesburg Securities Exchange South Africa
LIFO	Last-in-first-out
MVA	Market value added
NI	Net income
NOPAT	Net operating profit after tax
NOPLAT	Net operating profit after adjusted tax

NPV	Net present value
PAT	Profit after tax
P/E ratio	Price earnings ratio
PV	Present value
R&D	Research and development
ROA	Return on assets
ROCE	Return on capital employed
ROE	Return on equity
ROIC	Return on invested capital
RRR	Real rate of return
SGR	Sustainable growth rate
SPM	Strategic performance measurement
SVA	Shareholder value analysis
TDL	Total degree of leverage
WACC	Weighted average cost of capital

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