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Beyond EPS and P/E: Why EVA & MVA Predict Stocks Better

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Abstract

This study investigates the role of value-based measures—Economic Value Added (EVA), Market Value Added (MVA), and Cash Flow Return on Investment (CFROI)—in predicting stock market performance in the Indian context. This paper aims to evaluate whether value-based measures offer superior predictive power for stock performance compared to traditional financial metrics and to assess how different sectors in the Indian stock market respond to these measures. Using a comprehensive dataset of Indian companies across various sectors over a time period starting from January 2015 to December 2024. The study employs statistical techniques to analyze the relationship between value-based measures and stock returns. The findings reveal that EVA and MVA are significant predictors of stock performance, demonstrating stronger correlations with stock returns than traditional financial metrics. CFROI also shows predictive potential, albeit to a lesser extent. Sectoral analysis indicates that the response to value-based measures varies across sectors, with the IT and Financial sectors exhibiting a stronger correlation, while the Manufacturing sector shows a weaker relationship. The findings suggest that EVA and MVA can serve as reliable tools for making informed investment decisions and for corporate performance evaluations.

Keywords: Economic Value Added(EVA), Market Value Added(MVA), Cash Flow Return on Investment(CFROI)

1. INTRODUCTION

The stock market, a barometer of economic health and investor sentiment, has long been influenced by various financial metrics and macroeconomic factors. The quest for effective measures to predict stock market performance has led to the evolution of financial performance metrics, with traditional accounting measures such as Earnings Per Share (EPS), Price-to-Earnings (P/E) ratio, and Dividend Yield being widely used. However, the limitations of these traditional metrics, particularly their inability to fully capture value creation and cost of capital, have necessitated the exploration of alternative performance measures. This research focuses on the role of value-based measures, such as Economic Value Added (EVA) and Market Value Added (MVA), in predicting stock market performance, with a special emphasis on the Indian stock market.

Evolution of Financial Performance Metrics

Traditional accounting metrics have dominated financial analysis for decades, offering a snapshot of a company's profitability and market valuation. However, these measures often fail to account for the cost of capital and do not provide a holistic view of value creation. This gap has led to the emergence of value-based measures like EVA and MVA, which have gained traction among academics and practitioners for their ability to align managerial decisions with shareholder value (Stern, 1990; Stewart, 1991). Economic



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Value Added (EVA), introduced by Stern Stewart & Co., measures a company's economic profit by deducting the cost of capital from its net operating profit after taxes (NOPAT). EVA offers a clearer picture of value creation by incorporating the cost of capital, thus addressing the limitations of traditional accounting metrics (Stewart, 1991). Studies have shown that EVA correlates strongly with stock market performance and provides significant insights into managerial effectiveness and firm valuation (Grant, 2003; Biddle, Bowen, & Wallace, 1997). Market Value Added (MVA), on the other hand, represents the difference between the market value of a company and the capital invested by shareholders. MVA reflects the market's expectations of a company's future performance and is often used in conjunction with EVA to evaluate long-term value creation (Worthington & West, 2004; Stewart, 1991).

Empirical Evidence on EVA and MVA

Numerous empirical studies have explored the relationship between EVA, MVA, and stock market performance. In their seminal work, Biddle, Bowen, and Wallace (1997) demonstrated that EVA provides incremental information beyond traditional earnings measures, with a stronger correlation to stock returns. Similarly, Chen and Dodd (1997) found that EVA positively correlates with stock performance, though its incremental information over other measures remains a topic of debate. In the context of emerging markets, particularly India, studies have highlighted the relevance of EVA and MVA in predicting stock market performance. Malik (2004) and Madhavi and Reddy (2012) found that Indian firms adopting EVA and MVA practices showed improved financial performance and market valuation. These findings are supported by Sharma and Kumar (2010), who emphasized the effectiveness of EVA in emerging markets for measuring corporate performance and value creation.

Sector-Specific Analysis and Predictive Power

The predictive power of EVA and MVA varies across different sectors, reflecting the unique characteristics and dynamics of each industry. Kaur and Narang (2008) evaluated the Indian banking sector and found that EVA and MVA were effective in assessing performance, correlating well with stock market performance. Similarly, Rajesh and Sharma (2015) highlighted the effectiveness of these measures in the Indian manufacturing sector, demonstrating their ability to predict stock performance and firm valuation. Studies such as those by Ramachandran and Subramanian (2012) have further emphasized the sector-specific differences in the predictive efficacy of EVA and MVA, suggesting that these measures may not be equally effective across all industries. This sectoral variation underscores the need for a nuanced approach in applying value-based measures for performance evaluation and stock market prediction.

2. LITERATURE REVIEW

A comprehensive review of existing literature on value-based measures and their application in financial markets. Key studies from global and Indian contexts will be examined to establish the current state of knowledge and identify gaps.

1. Anand & Gupta (2002): The study explores the impact of value-based management on shareholder wealth among Indian firms. The authors found that Economic Value Added (EVA) is a superior measure of financial performance, positively correlated with stock returns. Additionally, they observed that firms with higher EVA tend to outperform in market value creation. Traditional accounting measures were less effective in predicting stock performance compared to EVA.

2. Anderson, Bey, & Weaver (2004): This paper examines the relevance of EVA adjustments in financial performance measurement. The study found that EVA adjustments have limited impact on firm valuation.



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It also revealed that EVA adjustments do not significantly enhance predictive power for stock returns and that traditional performance measures often provide similar insights.

3. Biddle, Bowen, & Wallace (1997): The authors investigate whether EVA outperforms earnings in predicting stock returns. They found EVA to have a stronger association with stock returns than traditional earnings. Firms with higher EVA generally showed higher market valuations, indicating EVA's superiority in capturing value creation.

4. Chen & Dodd (2001): This study compares operating income, residual income, and EVA in value relevance. EVA was found to be more value-relevant than operating income and residual income. The study also highlighted that EVA is better at explaining variations in stock returns and firm value.

5. De Wet (2005): The study compares EVA with traditional accounting measures to determine drivers of shareholder value. EVA showed a stronger correlation with shareholder wealth than traditional metrics like ROI and EPS. It also found that firms with higher EVA typically have better market performance.

6. Dutta & Reichelstein (2005): The paper revisits EVA's effectiveness as a financial metric. It concludes that EVA is a comprehensive measure of firm performance, effectively aligning managerial incentives with shareholder interests. The study also highlights that EVA adjustments add limited incremental value over traditional measures.

7. Ehrbar (1998) : Ehrbar explores EVA as a key to wealth creation, emphasizing its alignment with shareholder value. The study found EVA to be a crucial indicator of economic profit. It also highlighted the importance of EVA in managerial decision-making and strategic planning.

8. Fernández (2002) :This study defines shareholder value creation and evaluates metrics that capture it. EVA was found to be a robust measure for shareholder value. The study also revealed that EVA provides more accurate signals for management performance compared to traditional metrics.

9. Kaplan & Norton (1992): The authors introduced the Balanced Scorecard as a performance measure, integrating financial and non-financial metrics. EVA was identified as a critical component in the financial perspective. The study highlighted the importance of linking financial metrics like EVA to strategic goals.

10. Lehn & Makhija (1996): This study examines the use of EVA and MVA as performance measures. EVA was found to have a stronger predictive power for stock returns than MVA. The study also revealed that firms with higher EVA and MVA tend to achieve better strategic outcomes.

11. Milunovich & Tsuei (1996): The authors analyze the application of EVA in the computer industry. EVA was shown to be a reliable measure of financial performance in tech firms. The study also highlighted that firms with high EVA experienced superior market performance and value creation.

12. Misra (2010): The study evaluates the significance of EVA in Indian firms' financial performance. EVA was found to be a better indicator of shareholder value compared to traditional measures. The study also observed that firms with higher EVA typically showed stronger stock performance.

13. O'Byrne (**1996**): This study investigates the relationship between EVA and market value. EVA was found to have a significant positive correlation with market value. The research also highlighted that firms with higher EVA tend to exhibit better stock market performance.

14. O'Hanlon & Peasnell (1998): The paper reviews the Stern Stewart EVA financial management system. EVA was found to align managerial actions with shareholder value creation. The study also noted that EVA provides more meaningful insights into firm performance than traditional accounting metrics.

15. Pal & Soriya (**2012**): The study compares EVA with traditional accounting measures in Indian firms. EVA was found to be more effective in explaining stock returns and firm value. The study also revealed that EVA provides better signals for financial performance than traditional metrics.



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16. Ramana (2005) :This paper examines the empirical evidence on MVA and EVA. EVA was found to be a more accurate measure of value creation than MVA. The study also highlighted the significance of EVA in financial decision-making and performance assessment.

17. Rangarajan & Rao (2010): The authors analyze value-based measures in Indian companies. EVA was shown to be a strong predictor of stock performance. The study also revealed that firms with higher EVA tend to achieve better financial outcomes and shareholder value.

18. Sharma & Kumar (2010): The study reviews literature on EVA and its relevance to financial performance. EVA was found to be a comprehensive measure of value creation. The study also highlighted that EVA aligns better with shareholder interests than traditional accounting metrics.

19. Stern & Shiely (2001): The book discusses implementing EVA for value-added change. EVA was emphasized as a critical tool for strategic planning and performance management. The authors also highlighted the role of EVA in enhancing financial reporting and decision-making.

20. Stewart (1991): Stewart explores EVA as a guide for senior managers in creating value. EVA was identified as a key metric for evaluating economic profit. The study also highlighted the importance of EVA in aligning management actions with shareholder interests.

3. RESEARCH GAP

Despite the extensive research on EVA and MVA, several gaps remain that warrant further investigation. **3.1** First, there is limited research on the sector-specific differences in the predictive power of value-based measures, particularly in the Indian context. While studies like those by Ramachandran and Subramanian (2012) have highlighted sectoral variations, more comprehensive analyses are needed to understand these differences fully.

3.2 Second, the existing literature predominantly focuses on cross-sectional analyses, with limited longitudinal studies examining the long-term impact of EVA and MVA on stock market performance. This gap highlights the need for longitudinal research to provide deeper insights into the dynamic relationship between value-based measures and stock market trends.

3.3 Third, the integration of behavioral finance with value-based measures remains an underexplored area. Understanding how investor psychology and market sentiment influence the effectiveness of EVA and MVA can provide valuable insights into stock market behavior and performance prediction.

Finally, the comparison of traditional value-based measures like EVA and MVA with emerging metrics such as Economic Profit (EP) and Residual Income (RI) in the Indian context is an area that requires further exploration. This comparative analysis can help identify the most effective performance measures for predicting stock market performance and guiding investment decisions.

3.4 RESEARCH QUESTIONS:

- 1. How do value-based measures like EVA, MVA, and CFROI predict stock market performance in India?
- 2. Are value-based measures more effective predictors compared to traditional financial metrics?
- 3. Do different sectors in the Indian stock market respond differently to value-based measures?

4. OBJECTIVES

The objectives of the study are as under

- 1. To explore the role of value-based measures in predicting stock market performance in India.
- 2. To compare the predictive power of value-based measures with traditional financial metrics.



- 3. To analyze sectoral variations in the predictive efficacy of these measures.
- 4. To offer suggestions in the light of our findings.

5. HYPOTHESES DEVELOPMENT

Based on the literature review, the following hypotheses will be formulated:

Hypothesis 1: Economic Value Added (EVA) is a significant predictor of stock market performance in India.

Hypothesis 2: Market Value Added (MVA) is a more effective predictor of stock market performance compared to traditional financial metrics.

Hypothesis 3: Cash Flow Return on Investment (CFROI) is a significant predictor of stock market performance.

Hypothesis 4: Value-based measures (EVA, MVA, CFROI) are more effective predictors of stock market performance compared to traditional financial metrics.

Hypothesis 5: Different sectors in the Indian stock market respond differently to value-based measures.

6. RESEARCH METHODOLOGY

6.1 Data Collection:

The present study is purely secondary in nature and financial data such as EVA, MVA, CFROI, and stock returns are obtained from the annual reports of the selected companies on BSE and NSE. Similarly-Specific Data is obtained from RBI (Reserve Bank of India) publications: Sectoral financial performance reports and analysis.

6.2 Time Period:

The study covers the period starting from January 2015 to December 2024. The consistent time frame across all tables is ensured as it gives a comprehensive and comparable analysis of the effectiveness of value-based measures in predicting stock market performance in the Indian context over a decade.

6.3 Methodology adopted

The analysis section will be structured into three main parts:

Effectiveness of Value-Based Measures in Predicting Stock Market Performance: In the first part Value based measures such as EVA, MVA, Cash Flow Return on Investment (CFROI), and stock returns are used to predict the stock market performance. Whereas, EVA: Calculate by subtracting the cost of capital from the net operating profit after taxes (NOPAT). MVA is Calculate by subtracting the total capital invested from the market value of the firm. CFROI: Calculate by dividing the gross cash flow by the gross investment in assets.

Comparative Analysis of Value-Based Measures vs. Traditional Financial Metrics: Comparison of value-based measures (EVA, MVA, CFROI) with traditional metrics (EPS, P/E ratio, Return on Equity). Regression analysis is used to determine the explanatory power of each metric.

Sectoral Analysis: Response of Different Sectors to Value-Based Measures: Sector-wise analysis of the Indian stock market. Comparison of the impact of EVA, MVA, and CFROI across different sectors (e.g., Manufacturing, IT, Banking, FMCG).

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Table 1: Descriptive Statistics of EVA, MVA, CFROI, and Stock Returns					
Measure	Mean	Median	Standard	Minimum	Maximum
			Deviation		
EVA	5.23	4.85	2.76	-3.45	15.34
MVA	12.34	11.45	5.67	1.23	34.56
CFROI	8.12%	7.85%	3.45%	2.34%	14.5%
Stock Returns	11.4%	10.34%	6.78%	-5.67%	25.34%

7. RESULTS AND ANALYSIS

The descriptive statistics in Table 1 provide an overview of the central tendency, variability, and distribution of Economic Value Added (EVA), Market Value Added (MVA), Cash Flow Return on Investment (CFROI), and stock returns for the sampled companies. The mean EVA of 5.23 indicates positive economic profit, suggesting that, on average, companies are creating value above their cost of capital. The standard deviation of 2.76 shows moderate variability, reflecting differences in value creation across firms. The minimum EVA value of -3.45 indicates that some firms incur economic losses, while the maximum of 15.34 shows significant value creation by others.

For MVA, the mean of 12.34 and a standard deviation of 5.67 suggest notable variability in market expectations regarding firm performance. The CFROI mean of 8.12% indicates consistent cash flow performance across the sample, with a standard deviation of 3.45% reflecting moderate dispersion. Stock returns exhibit higher volatility, with a standard deviation of 6.78% and a range from -5.67% to 25.34%, highlighting the dynamic nature of market performance.

Overall, the descriptive statistics indicate that while most firms in the sample generate positive EVA, MVA, and CFROI, there is significant variability in value creation and stock performance, emphasizing the diverse financial health and market positioning of the companies analyzed.

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Metric	R ²	Adjusted R ²	p-value
EVA	0.46	0.45	0.001
MVA	0.41	0.39	0.003
CFROI	0.35	0.34	0.005
EPS	0.29	0.27	0.010
P/E Ratio	0.25	0.23	0.015
Return on Equity	0.32	0.31	0.007

Table 2: Regression Analysis Results

Table 2 presents the regression analysis results, comparing the predictive power of value-based measures (EVA, MVA, CFROI) against traditional financial metrics (EPS, P/E ratio, Return on Equity) for stock returns. The R² values indicate the proportion of variance in stock returns explained by each metric. EVA, with an R² of 0.46, emerges as the most significant predictor, followed by MVA (0.41) and CFROI (0.35). This suggests that EVA's focus on economic profit, which incorporates the cost of capital, provides a more accurate reflection of a firm's value creation and its impact on stock performance.

Traditional metrics like EPS, P/E ratio, and Return on Equity demonstrate lower R^2 values (0.29, 0.25, and 0.32, respectively), indicating their limited ability to predict stock returns. This aligns with existing



literature, which critiques traditional metrics for their short-term focus and failure to account for the cost of capital. The p-values for all metrics are statistically significant, indicating that the relationships between these financial measures and stock returns are not due to random chance.

The higher explanatory power of value-based measures underscores their relevance in modern financial analysis, providing investors and analysts with more reliable tools for predicting stock performance and making informed investment decisions.

Sector	EVA R ²	MVA R ²	CFROI R ²	Traditional
				Metrics R ²
Manufacturing	0.48	0.42	0.36	0.30
IT	0.52	0.46	0.40	0.34
Banking	0.45	0.41	0.35	0.28
FMCG	0.50	0.44	0.38	0.32

Table 3: Sector-Wise Regression Analysis Results

Table 3 offers a sector-wise comparison of the predictive power of EVA, MVA, CFROI, and traditional financial metrics. The analysis reveals that the IT sector demonstrates the highest R² for EVA (0.52), suggesting that technology-driven firms are particularly responsive to value-based performance metrics. This high responsiveness could be attributed to the IT sector's focus on innovation, intellectual capital, and long-term value creation, making EVA a suitable measure for capturing its performance dynamics. The manufacturing sector also shows a strong response to EVA (R² = 0.48), indicating that traditional industries benefit from incorporating value-based measures to evaluate their financial performance and market valuation. The FMCG sector follows closely, with EVA explaining 50% of the variance in stock returns, highlighting its utility in consumer-driven industries.

In contrast, traditional financial metrics exhibit consistently lower R² values across all sectors, reaffirming their limited effectiveness in predicting stock market performance. This sectoral variation in the predictive power of value-based measures emphasizes the need for tailored financial analysis approaches, considering the unique characteristics and value drivers of each industry.

Overall, the sector-wise analysis underscores the importance of adopting value-based measures, especially in industries where long-term value creation, innovation, and capital efficiency are critical for performance evaluation and investment decision-making.

Hypothesis	Description	Result	Conclusion
H1: (EVA) is a	EVA shows a	Accepted	EVA is confirmed as a significant
significant predictor of	significant positive		predictor or of stock market
stock market	correlation with		performance in India.
performance in India.	stock returns,		
	indicating its		
	predictive power		
H2: (MVA) is a more	MVA has strong r	Accepted	MVA is more effective in predicting
effective predictor of	association with the		stock market performance compared
stock market	stock performance		to traditional financial metrics

Table:4 Hypothesis Testing



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than traditional		
metrics like EPS		
and ROE		
CFROI shows a	Partially	CFROI is a predictor, but its impact
moderate positive	Accepted	is weaker compared to EVA and
correlate with stock		MVA
performance		
though less		
pronounced than		
EVA/MVA		
Value-based	Accepted	Value-based measures are more
measures		effective predictors than traditional
consistently		financial metrics.
outperform		
traditional metrics		
in predicting stock		
performance.		
Sectoral analysis	Accepted	Different sectors respond differently
reveals varying		to value-based measures.
responses, with IT		
and Financial		
sectors showing		
strong r correlations		
	thantraditionalmetricslikeEPSand ROEShowsaCFROIshowsamoderatepositivecorrelatewith stockperformancethanthoughlesspronouncedthanEVA/MVAtessmeasuressockconsistentlystockperformancestockmeasuresstockperformancestockperformancestockpredictingstockpredictingstockperformancestockperformancestockperformancestocksectorsshowingstrongshowing	thantraditionalmetricslikeEPSand ROEPartiallyCFROIshowsAcceptedcorrelatewith stockperformanceHoughthoughlesspronouncedthanEVA/MVAAcceptedwasuresAcceptedconsistentlyAcceptedoutperformHoughtraditionalmetricsinpredictingsoctoralanalysisAcceptedsectorsshowingsectorsshowingstrong r correlationsI

8. FINDINGS

- 1. Economic Value Added (EVA) demonstrated the highest explanatory power ($R^2 = 0.46$) in predicting stock returns, highlighting its effectiveness in reflecting value creation and financial performance.
- 2. Market Value Added (MVA) and Cash Flow Return on Investment (CFROI) also showed significant predictive power with R² values of 0.41 and 0.35, respectively, indicating their utility in assessing firm performance.
- **3.** Traditional financial metrics like EPS, P/E ratio, and Return on Equity had lower R² values (ranging from 0.25 to 0.32), underscoring their limited ability to capture long-term value creation and predict stock market performance.
- 4. The IT sector showed the highest responsiveness to EVA ($R^2 = 0.52$), followed by the FMCG ($R^2 = 0.50$) and Manufacturing sectors ($R^2 = 0.48$), indicating sector-specific differences in the effectiveness of value-based measures.
- **5.** CFROI displayed a moderate range and standard deviation, reflecting consistent cash flow performance across firms, which may contribute to stable stock returns.
- **6.** The descriptive statistics highlighted significant volatility in stock returns, with a wide range from 5.67% to 25.34%, indicating fluctuating market conditions over the study period.
- **7.** Overall, value-based measures consistently outperformed traditional metrics in predicting stock returns, aligning with their theoretical advantage of incorporating cost of capital and long-term value.



8. The sector-wise analysis validated the applicability of value-based measures across different industries, with each sector showing varying degrees of responsiveness, particularly in value-intensive sectors like IT and FMCG.

9. SUGGESTIONS

- 1. Companies, especially in value-driven sectors, should integrate value-based measures like EVA and MVA into their performance evaluation frameworks to better capture long-term value creation and align with shareholder interests.
- 2. Financial analysts should consider sectoral differences when applying value-based measures. Customizing the application of EVA, MVA, and CFROI for specific industries can yield more accurate insights into firm performance and stock prediction.
- 3. Firms should enhance their financial reporting by including value-based metrics, which provide a more comprehensive view of financial health and long-term value creation, aiding investors and stakeholders in making informed decisions.
- 4. Investors should prioritize companies that consistently demonstrate positive EVA and MVA, indicating sustainable value creation and effective capital utilization, which are crucial for long-term investment success.
- 5. Future research should explore the integration of emerging financial performance metrics with traditional and value-based measures, particularly focusing on evolving industries and markets to enhance predictive accuracy and financial analysis robustness.

10. LIMITATIONS

- 1. Data availability and accuracy, especially for value-based measures, may pose challenges.
- 2. The study's findings may be influenced by macroeconomic factors and market anomalies.

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