# Assessment of the Maintenance or Addition of the Value of State-owned Assets by Corporate Value Indicators

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## I. Indicators for the assessment of maintenance or addition of the value of state-owned assets (SOA) more capable of reflecting corporate value shall be established

It is written in the report from the Party's 16th National Conference that, "Effective systems and modes for SOA operation shall be continuously explored. Governments of various levels shall strictly implement laws and regulations relating to the management of SOA, separate governmental functions from enterprise management and separate ownership from management right to enable enterprises to manage their business on their own and assume sole responsibility for their own profits and losses and to realize the maintenance or addition of the value of SOA." So the objectives for management of SOA by continuous realization of the maintenance or addition of the value of SOA are stipulated strategically.

For the majority of state-owned enterprises (SOE), **the essence of the requirement for the maintenance or addition of the value of SOA is that, enterprises must take capital returns as the fundamental objective to realize the addition of the value of equity capital, namely the addition of the enterprise value.** Consequently, indicators which truly reflect the addition of enterprise value shall be selected for the assessment of the maintenance or addition of SOA value.

At present, as the assessment of the maintenance or addition of SOA value is concerned, the SOA administrative authority of local governments usually adopts indicators for the maintenance or addition of government capital, namely the appreciation rate of net assets in accounting statements. This indicator is simple and feasible and to some extent is able to reflect the appreciation of government capital in the enterprise. However, as the net cash flow for operation of the enterprise is not taken into account and the "opportunity cost" (the return rate for the owner of government capital from other investments of similar risk) of government capital is not deducted, so this indicator is not a true reflection of the addition of enterprise value.

In 1999 relevant authority also brought forward an indicator system for assessing the performance of government capital, covering 3 levels of basic indicators, corrective indicators and assessing indicators, totally 32 indicators. This indicator system is useful can is able to reflect an enterprise's general state of operation and financial performance. But it is excessively big, so it is difficult to focus on key points in actual assessment and at the same time indicators more capable of reflecting the addition of enterprise value is absent.

## II. Economic value added is a more suitable indicator for assessing the maintenance or addition of SOA

We think that an indicator system for assessing the maintenance or addition of SOA which is based on economic value added shall be established.

**Economic Value Added (EVA) refers to the net value after the cost of operational capital being deducted from a company's after-tax net operating profits and is an indicator to weigh the values generated by the company for its shareholders. EVA is computed as follows: EVA = after-tax net operating profits – cost of capital, where after-tax net operating profits refer to earnings before interest and taxes (EBIT) minus adjustment tax, which means income tax plus the tax adjustment to items such as financial expense, non-business earnings and subsidiaries etc.; cost of capital refers to equity capital and debt capital put in the operation (namely the equity capital and liabilities with interest after non-business investment being deducted).**

EVA reflects such a viewpoint: a company's equity capital and debt capital put in the operation is with "cost", "interest" in the liabilities with interest reflects the cost of debt capital, while the claim for obtaining compensation for the opportunity cost of capital input by equity capital owner reflects the cost of equity capital. If a company's EVA is positive value, that means there is a surplus left from the company's after-tax net operating profits after the cost of equity capital and debt capital put in the operation being deducted, a true value equaling to this surplus is generated by the company for its shareholders, and the company's value is added; on the contrary, if the company's EVA is negative value, that means the company's value is reduced.

EVA also reflects the concept of cash flow in company operation, namely: nothing else but net cash flow is a company's true "earnings" and the company's value can be reflected only after discounting of the net cash flow, which is closely related to the company's actual market value (the pricing of the company or its stock).

**Compared to some commonly used indicators, EVA can better reflect company value.**

The appreciation rate of net assets is an indicator for the appreciation of net assets, which equals to the percentage ratio between the addition of shareholder's equity and shareholder's equity at year beginning. This indicator can reflect the addition of shareholder's equity in terms of accounting, however, neither the cash flow in company operation is indicated nor is the cost of equity capital taken into account. So the company's value is not reflected comprehensively.

Earning rate of net assets, namely the percentage between net profits and shareholder's equity, reflects the earnings of shareholder's equity in terms of accounting, but the company's value is not truly reflected either. For instance, the operator can add accounting profits by increasing the incomes of those businesses whose net cash flow is negative value, or adopt falsely add accounting profits by account handling means of changing items such as inventory, discount and bad accounts etc., or adopt financial leverage means to increase financial risks so as to obtain higher earning rate of net assets, but, actually the company's value is decreased.

Net profit reflects a company's net earning in terms of accounting, but similarly it does not reflect the cash flow in company operation and the cost of equity capital, consequently the company's value is not comprehensively reflected.

According to our empirical study of listed companies in 2000, different conclusions will be obtained when a company is assessed with different indicators. In most cases, companies with high EVA value also have high net profit. Taking a large PLC as an example, its net profit is as high as several billions of RMB and is ranked No. 1, however, as its depreciation and management expenses are too heavy, its EVA is negative value.

**As proven by foreign experiences, EVA is by far the best indicator for the assessment of a company's performance and helps implement the company's strategy of addition of value.** For the past 20 years, the concept of corporate value management has been under rapid development, and EVA is gradually becoming a prominent representative for the implementation of corporate value management and has been employed by many well-known multinationals such as Sony, Coca-Cola, Siemens and Danone etc. in performance assessment, salary-based encouragement and investment analysis. Sony only employs the 2 items of EVA and sales income to assess its subsidiaries, divisions and head office, the former can fully reflect the true value generated by business groups or units, while the latter reflects the company's market position. According to Roberto C. Goizueta, the former CEO of Coca-Cola, EVA provides a useful instrument to better manage the businesses of each operating unit. As one of the leaders in employing EVA to implement value management, Coca-Cola had an ordinary capacity in value addition in the 1980s when the EVA –based management mode was first introduced, but now it has developed into a leading company in the world in terms of value addition.

In countries like Sweden, New Zealand, Singapore and South Korea etc., EVA is also used to improve the efficiency of SOEs. Division for State Enterprises of Ministry of Industry, Employment and Communications of Sweden requires competitive enterprises under its administration to base their top priority on "creating value", introduces the indicator of EVA to assess state-owned enterprises and connects the rewards to employees and the management with EVA. SOEs of New Zealand are required to list their objectives of financial performance (including return rate of total assets, earning rate of net assets and EVA) and other objectives in Report of Enterprise's Objectives in each year. Singapore's Temasek Corporation requires those "government related companies" (GLCs) whose stock is held by it to maximize their financial performance in terms of EVA, return rate of total assets and earning rate of net assets. All of these practices have resulted in satisfactory effect. For instance, the value of Swedish SOEs was added by more than 12% during 1998~2001, while the market value of Stockholm Stock Exchange was merely increased by 6%. Another example: compared to companies of same kind in global private sector, Singapore's GLCs have much better performance in the aspect of earning rate of net assets.

## III. Some suggestions on EVA-based assessment

As the assessment of the maintenance or addition of SOA value by use of EVA is concerned, we provide some suggestions as follows:

**Design the assessment system for different category of SOEs according to their basic functions.** For the majority of SOEs falling in the category of ordinary competition, the assessment indicator of EVA may prevail; while for those minority SOEs with special objectives or obligations, the assessment can be based on other indicators.

**Combine the assessment of the company with the assessment of the operator.** Company assessment refers to the assessment of SOE by the implementing organ of the ownership of government capital, mainly assessing the value generated for government capital by the enterprise and the assuming of some special responsibilities, and the purpose is to provide decision-making basis for the implementing organ of the ownership of government capital to decide to input government capital or to quit and to exercise shareholder’s right. Operator assessment refers to the assessment of the general manager or CEO, mainly assessing the working performance of a SOE’s general manager (sometimes also including executive director and top management), and the purpose is to provide decision-making basis for the BOD to appoint or dismiss the general manager, decide the general manager’s term of office and endow the general manager with salary and rewards. Compared to company assessment, evaluation of the operator pays more attention to the monitoring of the enterprise’s actual operating, so the evaluation shall be performed with combined means of both EVA and the balanced score method.

**Gradually employ EVA in the strategic control and inner management of SOEs to combine the maintenance or addition of SOA value with the enterprise’s inner management.** Taking EVA as the key objective of enterprise operating, implementing this objective in various units of the enterprises and establishing a system of objectives, assessment and salary which is in accordance with the system of strategic decision-making, planning and monitoring, thus to form a mechanism in which the entire enterprise services the purpose of value addition.

**Create conditions to facilitate the EVA-based assessment.** Necessary preconditions include: improving the assessment system for enterprises and amending relevant managerial and accounting systems so that the implementing organ of the ownership of government capital is able to assess indicators such as EVA etc. of SOEs; enterprises shall not make “false accounts”, otherwise, the indicator will be of no use, no matter how prominent they may be.