ABSTRACT

Historically, Economic Value Added (EVA) was a financial tool reserved for large corporations and mature businesses. However, EVA can be particularly useful for small businesses and entrepreneurial endeavors. The value, computed from uncomplicated and available financial data, can direct the tactical and strategic activities of the firm toward value producing projects, help regulate spending, and serve as an exit indicator for firms that may never become successful.

INTRODUCTION

Launching a business or new venture is often a risky undertaking, requiring both foresight and steadfastness. Those who are drawn to start-up phases of business often understand what minimal requirements must be met for basic survival. But do most entrepreneurs and small business owners push themselves to find tools that will lead them past survival toward legitimate, profitable success? By taking advantage of revealing financial measures, the entrepreneur can raise expectations in pursuit of profitable and challenging financial goals, rather than settling for the minimal necessity of positive cash flow.

While most entrepreneurs possess intuitive traits that contribute to general entrepreneurial activity, it is the incorporation of legitimate financial assessments like Economic Value Added (EVA) that distinguish long-term success from short-term survival. The purpose of this article is to discuss the means by which EVA can contribute to the long-term success of a new business venture through its use in evaluating proposed uses of resources, evaluating managers of resources, and evaluating the continuing economic viability of existing committed resources. EVA is the term coined by the Stern Stewart and Company, a New York City-based consulting firm, for a financial indicator that evaluates a company's efficient use of resources, taking into account the cost of capital. EVA is generally derived by deducting a capital charge (owners' equity plus interest-bearing debt times the weighted average cost of capital) from the after-tax operating income.
Though EVA has been heralded for the past several years as a key financial measure for large corporations and mature businesses, we discuss its importance in assessing small businesses and entrepreneurial new ventures. For the following several reasons, EVA is a particularly relevant measure for these types of business entities.

To most entrepreneurs and small business owners, cash is the most precious resource. EVA helps better manage this critical business resource by including the cost of capital in tactical and strategic financial planning. Furthermore, the use of an EVA evaluation helps create a framework for future goals and measurements. Developing initial organizational and assessment systems is an activity that often gets overlooked by extremely busy entrepreneurs.

By acknowledging the cost of capital and establishing EVA as an initial and valued financial measure, a new venture can create a system of measurement that is scalable and relevant, one that is useful as the business grows. EVA is a tool that remains consistent throughout the tenure of a venture’s life by focusing on the cost of capital even though the cost of capital is likely to change as the new venture’s capital structure changes over time. Furthermore, this use of EVA provides an objective measure for sole proprietorships and partnerships, firms that are absent the scrutiny of shareholders. A final benefit of EVA is its effectiveness as an exit indicator for firms whose future may not be promising.

**LITERATURE REVIEW**

Although Stewart (1990) are credited with the introduction of EVA, there have been a number of contributors to the topic. In writing this piece, we reviewed articles discussing EVA, entrepreneurship, and the characteristics of each that made the marriage of the two a reasonable expectation. The first challenge in assessing the topics involved establishing the most appropriate definitions of our critical terms. Though a number of academics and professionals have developed definitions of EVA (Pressley, 1999; Dodd & Johns, 1999), we used the equation used by Brewer, Chandra, and Hock. (1999). EVA, for our purposes, is calculated by deducting a capital charge (the owners’ equity plus interest-bearing debt times the weighted average cost of capital) from the after-tax operating profit.

Complicating this definition were opinions that suggest accurate EVA evaluations depend on a clear understanding of over 160 GAAP definitions (Keyes, Azamhuzaev, & Mackey, 1999). Some suggest that the numbers used to calculate EVA are intrinsically ambiguous, this referring particularly to the use of after-tax operating income. Stern and Stewart themselves, however, dispute the necessity to consider all 160 GAAP adjustments and offer a test to companies to guarantee that their EVA calculations are not skewed because of faulty input variables (Keyes et al, 1999.). With this support, a simple calculation suffices for our purposes.

Determining the distinguishing characteristics of entrepreneurs and small business owners was an equally daunting endeavor. Based on the research of Chrisman, Bauerschmidt, and Hofer (1998), we settled on our terminology of ventures, small businesses, and entrepreneurial endeavors. This was important in that the terminology helped distinguish traits that put the businesses entities we are focusing on in like groups.

We also benefited from these authors regarding research in determining the appropriate definitions for survival and success. Again, the article by Chrisman et al. (1998) that detailed the determinants of new venture performance provided sound definitions of necessary terms. Additionally, Karen Bishop’s work on the characteristics of entrepreneurs (2000) also proved particularly useful.
Our article presents the attributes of EVA that can take small businesses and entrepreneurial endeavors from survival to success. However, a number of objections exist regarding the general use of EVA and the benefit of the measure for young firms.

The primary objection comes from opponents of the Stern Stewart measure who feel the measure is complex, the calculation is ambiguous, and the results are easily manipulated by shrewd managers seeking financials that are more impressive than true. Many in the field feel this potential manipulation of the EVA measure is highly detrimental because firms will capitalize expenditures that have little to no future value, de-emphasize long-term planning, and decrease customer satisfaction and continuous improvement processes because they do not directly improve the EVA figure (Keyes et al. 1999; Brewer et al. 1999; Dodd & Johns, 1999).

Others object to the measure because it is short-term oriented, stating that EVA is ineffective for firms that generate huge economic losses but still create value (Delves, 1999). These would be firms in high-tech or bio-tech fields, for example. Critics argue that EVA does not account for the intangibles that certainly contribute to the long-term value of a firm. Using the same line of reasoning, many argue that EVA is only relevant for firms that have capital primarily stored in hard assets such as buildings and equipment. Under this thinking, EVA would not be beneficial for service industries. Furthermore, many object to the benefit of EVA because the calculation does not measure future cash flow, rather it is based on past accounting accrual net income.

**DEFINITION OF TERMS**

Established corporations regularly take advantage of popular financial tools like EVA to assess growth and performance. A Fortune article (Anonymous, 1993: 38) touted the successful use of EVA by major United States companies such as Coca-Cola, AT&T, Quaker Oats, Briggs & Stratton, and CSX. The article provided evidence that the use of EVA in decision-making and performance evaluation had been a major contributor to the success of those companies. Our focus, however, is to identify the impact this measure can have on small businesses, new ventures, and entrepreneurial endeavors.

Venture performance is based in two primary dimensions, survival and success. For the purposes of this article we define survival as the continued existence of a firm as an economic entity. Success, on the other hand, is the relative measure of venture performance that occurs when the venture creates value for its stakeholders in a sustainable and economically efficient manner (Chrisman et al. 1998). We will discuss how the use of EVA by entrepreneurs and small business owners bridges the gap between mere survival and flourishing success.

**DEFINITION OF EVA**

Traditional income statements include only the revenue and the cost associated with transactions that are reflected in the accounting records. The cost of financing the business enterprise is not fully reflected in the accounting records to the extent that the business is financed with equity capital. EVA attempts to remedy that situation.

Accountants and economists have never used the same metric for measuring the performance of the firm. The accountants and the economists agree on the measurement of revenues, but they differ on the measurement of costs. In calculating a firm's profit, the accountant considers only costs that are evidenced by objectively verifiable transactions such as the cost associated with the purchase of raw materials or the cost associated with the paid salary of a supervisor. Economists consider those same objectively verifiable costs, but they go further...
to include "economic costs" that are not objectively verifiable based on documentation. Among these "economic costs" is the cost of equity capital. Accountants recognize that equity capital has a cost, but that cost is not objectively verifiable and thus it is not recorded in the accounting records and is not considered in determining the firm's profit. The power of EVA is that it is based on the economist's view of profits and thus, it is more inclusive in consideration of costs when measuring the firm's profit. This contrast between the accountant's view of profits and the economist's view of profits is explored more fully after our discussion of the calculation of EVA which follows.

EVA is net operating profit (on an after-tax basis) less a capital charge. The net operating profit is the profit before the deduction of any interest expenses. Effectively, it represents the profit from operations of the business without the deduction of any interest expenses associated with financing the business using debt financing. Many entrepreneurial business ventures have no debt financing. Thus, for a business without debt financing, net operating profit (on an after-tax basis) is the same as the business's after-tax income.

The capital charge, which is subtracted from the net operating profit, is an imputed cost (not recorded as an actual accounting transaction) associated with the capital that is employed in the business. This capital charge is determined by multiplying the estimated cost of capital times the capital employed in the business. The capital employed in the business is determined by reference to the balance sheet. It is the sum of interest-bearing debt and stockholders equity.

The cost of capital used in determining the capital charge is the after-tax weighted average cost of the capital employed. The calculation of the cost of capital recognizes that interest expense is tax deductible, whereas the cost of equity capital is not tax deductible. For example, if the entrepreneurial business enterprise has $100,000 of 12% debt and $900,000 of equity financing, the after-tax weighted average cost of capital would be calculated as follows assuming that the marginal tax rate is 36% and the cost of equity is 20%.

\[
\begin{align*}
\text{Debt} & \quad \text{Equity} \\
$100,000 \times 0.12 \times (1 - 0.36) & \quad $900,000 \times 0.20 \\
= & \quad = \\
$7,680 & \quad $180,000 \\
\text{Total} & \quad \text{Total} \\
$1,000,000 & \quad $1,000,000 \\
\end{align*}
\]

After-Tax Weighted Average Cost of Capital = $187,680 / $1,000,000 = 18.768%

In the above calculation, we used 20% as the cost of equity capital. The cost of equity capital is determined subjectively. It is essentially the return that the shareholders consider appropriate given the level of risk they are undertaking. It represents the shareholders opportunity cost – the rate at which the shareholder could earn in an investment of equal risk. The cost of equity capital will always be greater than the pre-tax cost of debt capital because the equity shareholder bears more risk than the lender.

If we assume that the net operating profit (on an after-tax basis) was $250,000, then the EVA calculation is as follows:

\[
\begin{align*}
\text{Net Operating Profit (After-tax)} & \quad $250,000 \\
\text{Less Capital Charge:} & \quad \text{Capital Employed} \quad \text{Weighted Average Costs} \\
& \quad $1,000,000 \quad \underline{18.768\%} \\
& \quad \text{Less Capital Charge} \quad -187,680 \\
& \quad \text{EVA} \quad \underline{62,320}
\end{align*}
\]
The EVA amount of $62,320 is significantly different from the after-tax profits of $242,320 that would have been reported on the income statement based on recorded transactions. The after-tax net income reported on the income statement is calculated as follows:

Net Operating Profit (after-taxes) $250,000
Less Interest Expense After-Taxes:
  Interest Expense $12,000
  Tax savings from interest $-4,320
  Interest Expense After-Taxes $-7,680
  After-Tax Net Income $242,320

In our opinion, it is the $62,320 EVA amount, rather than the $242,320 After-Tax Net Income amount that is relevant in assessing the performance of the new business venture during the year.

Some might argue that the EVA amount of $62,320 should be compared to the return on investment (ROI) associated with the $242,320 after-tax net income that was calculated for reporting in the accountant prepared financial statements. That ROI would be calculated as follows:

\[
ROI = \frac{\text{After-Tax Net Income}}{\text{Capital Employed}} = \frac{\$242,320}{\$1,000,000} = 24.232\%
\]

With the ROI measure, there is nothing explicit in the elements of the calculation that alert the entrepreneur as to the acceptability of the realized ROI percentage. Is 24.232% ROI and acceptable performance or is it not? EVA overcomes that disadvantage in that it includes cost of capital as an explicit element in its calculation. If the EVA measure is a positive amount (as it was in this case with a $62,320 EVA amount), then the entrepreneur knows that he or she is generating profit sufficient to cover all costs including the cost of capital employed. If the EVA measure is a negative amount, the entrepreneur knows that he or she is not generating profit sufficient to cover all costs including the cost of capital employed. ROI lacks that explicit consideration of the cost of capital and could result in an entrepreneur being deluded into thinking that the business venture has been a success when it has not been.

**EVA AND ECONOMIC PROFIT**

As mentioned earlier, accountants and economists view profits differently. The accountant determines profits by dealing with cost transactions that are recorded in the accounting records. Those cost transactions include purchases of raw materials, supplies, and assets, payment of wages, payment of interest, and other executed transactions.

On the other hand, the economist considers all of the executed cost transactions that are recorded in the accounting records but adds some economic costs that are not considered by the accountants. Normal profit is included among these economic costs. According to economists, who take a more theoretical perspective than accountants, normal profits represent the expected recompense to the owners for the factor of production called "entrepreneurship" and also any opportunity costs associated with equity capital. If the business enterprise is paying dividends to the owners, those dividends represent at least some portion of the recompense that the owner entrepreneurs expect in order to keep them involved and invested in the new venture and to reward them for committing equity capital to the venture. However, rarely does a new venture pay dividends in the early stages of development or during the growth phase of the business. Without dividends, there are no
transactions in the accounting system that represents the recompense to the owner who has invested capital in the new venture. Even when there have been dividends paid; those dividends are not regarded as costs that reduce profits. Instead, dividends are treated as reductions in retained earnings. The retained earnings account is a balance sheet account, not an element of the income statement.

The EVA approach to evaluating a new venture goes beyond the accounting profit. EVA attempts to make the cost of the capital provided by the owner entrepreneurs an explicit cost. The result is a cost amount that is closer to what the economist had in mind—a summation of the explicit accounting costs based on transactions and the imputed cost of the capital supplied to the new venture by the owner entrepreneur.

Evidence suggests that new ventures are often financed almost exclusively with equity capital rather than borrowed funds. In a recent year, the United State of America’s Federal Reserve System, under the leadership of Alan Greenspan, attempted to slow the overcharged economy by raising the federal discount rate, the interest rate at which member banks borrow from the Federal Reserve System. The result was that the common stock of established businesses, declined precipitously. However, the common stock of the newer business ventures continued to increase in value. Financial analysts, in an attempt to explain the divergent behavior of the common stock of the two business classifications, concluded that the market value of common stock of the new business ventures was not impacted by the increase in interest rates. The lack of impact was explained by the observation that new business ventures rarely have significant borrowed funds as a part of their capital structure. The financial analysts concluded that the capital structure of new business ventures was typically dominated by equity financing and therefore a change in interest rates had no impact on the reported profits of new business ventures.

This feature of the capital structure of new business ventures in which there is very little debt financing and significant equity financing results in very little of the cost of capital being regarded as an explicit accounting cost represented by the transaction of paying interest to a lender. Thus, if the cost of the capital is to be considered in determining the economic costs associated with the new business venture, that cost is going to have to be an imputed cost that is subtracted from the accounting profit amount to arrive at a better approximation of economic profit. EVA does just that.

**EVA BENEFITS**

Despite the tremendous regard in which cash is held, many small business owners and entrepreneurs unknowingly squander considerable amounts by not including the cost of capital in their evaluation of new projects. The reason is probably not lack of sophistication or financial savvy on behalf of the entrepreneur, but it is more likely a simple lack of exposure and/or instruction. Barron’s (Willoughby, 2000) recently discussed the change in attitude among venture capitalists as a result of the decline in the economic outlook for the companies traded on the technology-laden NASDAQ stock exchange. Whereas, new technology related ventures used to be evaluated based on their future prospects, the focus switched to the “burn rate” in early 2000 when the prospects for technology-related companies looked less promising. Willoughby (2000: 31) defined “burn rate” as “how fast they were depleting their cash reserves.” He went on to say that the NASDAQ-traded companies were critically dependent upon a continually receptive stock market to keep funding their furious spending. In our opinion, EVA is a tool to reinforce the discipline needed to avoid “furious spending.” Using EVA, spending cash is only justified when the spending is expected to enhance the EVA of the company.
As mentioned previously, EVA, for our purposes, is calculated by deducting the imputed capital charge from the after tax operating income. These are certainly obtainable values for the typical business owner.

The figure derived from this simple equation gives a considerably more accurate evaluation of the financial health of the venture than other more limited profit and earnings calculations. The use of EVA enlightens the entrepreneur by prompting him or her to be cognizant of the cost of capital from various sources. This is critically important as new ventures and small businesses grow because they are constantly deciding how to best use the treasured capital of the firm. In making these decisions, the entrepreneur must have reliable data on which he can base decisions. EVA is a reliable basis on which entrepreneurs and small business owners can gage progress toward true success.

**DISADVANTAGES OF EVA**

Now that we have extolled the advantages of EVA, it is appropriate to discuss the cited disadvantages associated with EVA. One of the primary disadvantages associated with using EVA as a measure of performance or economic viability is that it an absolute measure rather than a relative measure. When ROI is used to measure performance or assess economic viability, one can meaningfully compare the ROI of one business entity with the ROI of another business entity. In contrast, when EVA is used, it is meaningless to compare the EVA of one business entity with the EVA of another because, all else being equal, the larger business entity will have the larger EVA. Thus, EVA is an absolute measure, not a relative measure. However, in our opinion, the fact that EVA is not a relative measure is of no significance to an entrepreneur who is attempting to make economically viable decisions concerning how the resources of the new venture should be employed.

Another criticism of EVA is that it tends to place too much emphasis on the short-term and too little emphasis on the long-term. Brewer et al. (1999: 8), in discussing the disadvantages of EVA, mention that EVA overemphasizes the need for immediate results. We do not disagree. The same could be said of ROI, after-tax profits, or any other financial measure of performance. An entrepreneur must balance the short-term and the long-term perspective throughout the life of a new venture. The long-term perspective is best served by a portfolio of performance measures (financial and non-financial) as suggested by the literature on “Balanced Scorecard” (Kaplan & Norton, 1993, 1996). EVA is an appropriate financial measure for use in a balanced scorecard. When so used, its short-term focus is balanced with performance measures that focus on the long-term.

**EVA AS THE BRIDGE FROM SURVIVAL TO SUCCESS**

Survival, being the absolute measure of a business’ ability to continue to exist, requires the entrepreneur to meet basic financial obligations such as paying creditors, maintaining employees and equipment, and purchasing necessary supplies. Survival mandates that a business owner or entrepreneurs understand only the most fundamental financial aspects of business. Often, a business can maintain this level of existence without knowing or understanding critically important financial influences, such as cost of capital.

Though EVA has historically been preferred in established, mature businesses, the use of the financial measure for small businesses and entrepreneurial ventures makes sense for a number of reasons. First of all, there is not a lot that distinguishes a small business from a larger one in terms of desire for success and the ways success is achieved.
According to the Strategic Management Theory, a business unit's performance, or success, is both directly and indirectly related to the environment of the industry in which the business competes, the resources it controls, the strategy it uses to align available resources with opportunity, and the organizational structure, process, and systems, it employs (Hofer & Schendel, 1978). Research reveals that the determinants of performance in a new venture and an established venture are nearly identical (Chrisman et al. 1998).

By using EVA, the firm is better able to make the leap from survival to success by more carefully controlling the resources, identifying profitable opportunities through positive EVA values, establishing sound, systematic performance measures, and by directing decisions under a cohesive structure of financial goals.

Bennett Stewart outlined the three general ways to increase the values, EVA, of a firm. These include:

1. Improving the rate of return on the existing capital base.
2. Investing in projects that return more than the cost of the capital.
3. Liquidating capital from projects where inadequate returns are earned.

By establishing these EVA principals as the guidelines by which day-to-day, tactical, and strategic goals are created, a new firm has a sound business policy intrinsic in its operation. The use of the financial tool directs the company to make efficient use of capital by investing in value-added projects and withdrawing from value-destructive projects (Dodd & Johns 1999).

These ideas are particularly beneficial for start-up firms because they are not completely intuitive. Research by Bishop (2000) suggests that entrepreneurs and small business owners depend heavily upon intuition in managing new business ventures and small businesses. Because of this self-reliance, owners may be less inclined to seek available tools, particularly those that are not completely intuitive, to validate their decisions. The use of EVA brings important issues into the analysis for entrepreneurs and small business owners and mandates, by virtue of the calculations, that capital is thoughtfully used.

This idea is supported by the tendency for entrepreneurs or business owners in start-up phase businesses to devote little attention to controls on spending. A term commonly referred to when talking about new ventures is "burn rate." The burn rate is the amount of cash a firm uses to sustain itself in infancy stages. Because so many significant costs are incurred at the start-up phase, the owner or entrepreneur can "burn" so much cash he or she becomes lax about completing a true cost-benefit analysis for significant expenditures. Spending becomes habitual and one becomes callused to the ultimate effects of the outgoing capital. EVA regulates spending and requires resource commitments to contribute value to the firm and be in line with the goals of the business.

The use of EVA by a start-up enterprise is especially important when one considers that during the start-up phase, entrepreneurs should be giving serious consideration to outsourcing. The use of EVA as a basis for evaluating the use of capital to acquire assets could be very persuasive. For example, assume the entrepreneur is considering the alternatives of acquiring a small fleet of delivery trucks or using contract delivery services. The savings associated with owning the fleet rather than contracting for delivery services should be sufficiently large enough to cover the cost of capital associated with owning the fleet. The use of EVA to evaluate the choice results in the cost of capital being explicitly considered. When comparing the two alternatives—owning the fleet or outsourcing the delivery—the savings could be calculated for the expected level of delivery activity. Assuming that the calculation revealed that owning the fleet would produce annual after-tax savings of $50,000 when compared with...
outsourcing, EVA would be calculated as follows assuming that the acquisition of the delivery fleet would require an investment of $400,000 and the after-tax cost of capital was 15%:

\[
\begin{align*}
\text{Increase in annual after-tax accounting profits} & \quad \$50,000 \\
\text{Less Capital Charge:} & \quad \\
\text{Required Investment} & \quad \$400,000 \\
\text{Cost of Capital} & \quad x \times 0.15 \\
\text{Less Capital Charge} & \quad -60,000 \\
\text{Economic Value Added} & \quad -10,000
\end{align*}
\]

The EVA of a negative $10,000 indicates that outsourcing would be a better choice when all of the relevant costs are considered. EVA enforces the consideration of all relevant costs.

Following the attainment of the young firm's desired success, EVA is a tool that does not go out of fashion. EVA is also the preferred financial tool because it maintains its usefulness once a firm has reached a comfortable level of business success. At this time, the capital structures of most company's will dramatically change, moving from equity financing to a blend of debt and equity financing. This shift reduces the cost of capital for the firm and can alter the perspective by which purchasing and investment decisions are made. EVA can transition with firms as they go through the various stages of development.

It is at this stage in the life of the business venture that the entrepreneur may hire a business manager to manage the business. At this stage, it will be necessary for the entrepreneur to establish financial objectives against which the business manager's performance will be measured. Those financial objectives, when expressed in terms of EVA, assure the entrepreneur that the successful accomplishment of those objectives will result in sufficient economic profit to sufficiently reward him or her for the entrepreneurial risk that the entrepreneur has undertaken.

When EVA is used to evaluate the performance of a manager, the focus is on the controllable investment. Assuming that the manager is given authority to manage a division of the company, the EVA calculation would focus only on the invested capital over which the manager has authority. If the capital employed by the division of the company was $2,000,000, then the annual financial objective expressed in terms of EVA should be calculated as follows:

\[
\begin{align*}
\text{Minimum financial objective for the year:} & \quad \\
\text{Cost of Capital Calculation:} & \quad \\
\text{Controllable Capital} & \quad \$2,000,000 \\
\text{Cost of Capital as %} & \quad 0.15 \\
\text{Cost of Capital} & \quad \$300,000
\end{align*}
\]

Thus, when establishing the annual financial objectives for the division manager, the entrepreneur should expect the division manager to commit to a goal of divisional after-tax profits in excess of $300,000. It is only when after-tax profits exceed $300,000 for the year that the entrepreneur is reaping any reward for the entrepreneurial effort.

Finally, EVA can serve as an exit indicator for start-up firms that may never become successful. Entrepreneurs have often developed an emotional relationship with their new venture and the emotional tie can be so strong that it clouds the judgment of the entrepreneur. When this happens, the entrepreneur may find it difficult to divest himself from the business
as long as it is at least surviving. EVA is the measure that can reveal that success is out of reach and substantiate the need to terminate the business.

Many entrepreneurs, by focusing on accounting profits, are lulled into a sense of success when the business is in trouble. Accounting profits do not include the cost of capital. When EVA is used as the basis for evaluating the performance of the business, the cost of capital is dealt with explicitly. An evaluation of the economic viability that considers the cost of capital is likely to be very different from an evaluation that focuses only on accounting profits in relation to invested capital (accounting return on investment). The use of EVA will provide a strong signal when it is appropriate for the entrepreneur to sell the business and pursue other interests.

If the entire business has a capital structure that includes stockholders equity and interest-bearing debt equal to $3,000,000, after-tax cost of capital is 15% per year, and after-tax operating income is $300,000, the EVA is calculated as follows:

<table>
<thead>
<tr>
<th>After-tax operating income</th>
<th>$300,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less Capital Charge:</td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>$3,000,000</td>
</tr>
<tr>
<td>Cost of Capital</td>
<td>.15</td>
</tr>
<tr>
<td>Less Capital Charge</td>
<td>-$450,000</td>
</tr>
<tr>
<td>Economic Value Added</td>
<td>-$150,000</td>
</tr>
</tbody>
</table>

The large negative EVA (-$150,000) is a strong signal that the business may not be economically viable. Divestiture of the business should not proceed based on only the EVA calculation. Future prospects for the business are of great importance; however, the EVA calculation provides a clear signal that the business is not currently covering all of its economic costs.

CONCLUSION

In this article we have presented a case for EVA as a tool that bridges the gap from mere survival to legitimate success for small businesses and entrepreneurial ventures. Though there are critics who believe EVA should be reserved for mature and established firms with significant assets and few intangibles, we think that the financial measure is also highly applicable to new businesses ventures.

First, EVA puts the focus on economic costs, not just accounting costs. EVA clearly identifies projects that actually add value to the business. Additionally, because the measure is short-term focused, it provides immediate results for a business and validates or refutes the financial decisions of the owners. This helps start-up firms grow quickly and develop tactical decision-making skills. As the business grows, the financial tool maintains its relevance throughout the various business life stages. Finally, EVA, while pointing out investments that contribute to growth and profitability, is also particularly useful as an exit indicator for situations in which it is better to terminate a business rather than devote capital to a lost cause.

Wise use of the firm's cash is one of the most important considerations that an entrepreneur will face during the early stages of the business. This means making wise investment decisions. In making investment decisions, covering the cost of capital is critical for the success of any business. Entrepreneurs and small business owners, who are less likely to recognize that necessity intuitively, can benefit greatly from EVA. EVA is the tool that bridges the gap between mere survival and legitimate success for small businesses and new ventures.
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