VALUE ADDED REPORTING: A CASE STUDY OF ABANS LISTED MANUFACTURING COMPANY LIMITED IN SRI LANKA

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Abstract

A business enterprise specifically a company is a conscious, deliberate and purposeful creation for satisfying the domain of aspiration of the society at large. It is an independent and a separate legal entity. The survival stability and growth of such entity within society largely depend on the wealth created by it through the collective efforts of all the stakeholders-shareholders, providers of loan capital, employees and the government. All these stakeholders are the parties to whom the result of operations of business is communicated. Therefore, present study attempts to show how and to what extent the Value Added Statement (VAS) can supplement additional financial information to satisfy all the stakeholders of the enterprise. Further, in order to meet the objectives of the study, data were collected from secondary sources mainly from financial report of the selected company (i.e., ABANS Listed Manufacturing Company) which was published by Colombo Stock Exchange (CSE) in Sri Lanka. Hence, it is clear that ratios using Value Added (VA) indicate that the company little bit efficient in terms of utilization of materials.

Keywords: Value Added (VA); Financial Performance; and Value Added Ratios

JEL Classifications: M1; M4; M41

1. INTRODUCTION

A business enterprise specifically a company is a conscious, deliberate and purposeful creation for satisfying the domain of aspiration of the society at large. It is an independent and a separate legal entity. The survival stability and growth of such entity within society largely depend on the wealth created by it through the collective efforts of all the stakeholders-shareholders, providers of loan capital, employees and the government. All these stakeholders are the parties to whom the result of operations of business is communicated. To satisfy the information needs of these users, the conventional financial accounting system generates data relating to financial performance through Profit and Loss Account or Income Statement giving emphasis on the interest of shareholders (i.e., owners) only. The Profit and Loss Account does not provide any information showing the extent of the value or the wealth created by the company for a particular period. Contribution to the company by other stakeholders cannot be accessed through the Profit and Loss Account. Hence, there is a need to modify the existing accounting and financial reporting system so that a business unit is able to give importance to judge its performance by indicating the value or wealth created by it. To this direction inclusion of the VAS in financial reporting system is a newly developed technique, which is regarded as a part of social responsibility accounting and reporting.

2. OBJECTIVES

The following objectives are taken for the study;

1. To highlight the theoretical frame work of the concept of VA and VAS
2. To examine the VAS as a performance indicator for ABANS listed manufacturing company.

3. RESEARCH DESIGN AND METHODOLOGY

3.1 SCOPE

As the main objective of the study was to apply the model of VASs with regard to income statement to find out the result and there upon to evaluate performance through value added ratios;

a wider scope was considered not essential. Thus only one company was selected from listed manufacturing companies from Colombo Stock Exchange.

3.2 PERIOD OF THE STUDY

The study was taken to show the general trend of performance, therefore, 05 years (2003-2007) were taken the study period.

3.3 DATA SOURCES

In order to meet the objectives of the study, data were collected from secondary sources mainly from financial report of the selected company, which was published by Colombo Stock Exchange in Sri Lanka.

3.4 RELIABILITY AND VALIDITY OF THE DATA

Secondary data for the study were drawn from audit accounts (i.e., income statements and balance sheets) of the concerned company; therefore, these data may be considered reliable for the purpose of the study. Necessary checking and cross checking were done while scanning information and data from the secondary sources. All these efforts were made in order to generate validity data for the present study. Hence researcher satisfied content validity.

3.5 MODE OF ANALYSIS

The analysis has been made through value added ratio. For appraising the performance and judging the productivity of ABANS listed manufacturing company following ratios are considered for analysis.

Table 1. Calculations of Value added Ratios

Se. No	Value Added Ratios	Concept	Calculations
01	Value Added to Capital Employed Ratio	This ratio shows the value generation power of each unit of money representing capital employed. To arrive at capital employed figure, net worth and long-term borrowing are to be added together.	$\frac{\text{Net Value-Added}}{\text{Capital Employed}} \times 100$
02	Value Added to Sales Ratio	It shows the amount of value added by each unit of money of sales revenue. It measures the degree of vertical integration of a group of companies and also can be interpreted as an index of vulnerability to disruptive action affecting supplies of material and services.	$\frac{\text{Net Value-Added}}{\text{Sales}} \times 100$
03	Value Belongs to Employees to Vale Added Ratio	This ratio indicates the share of employees to value added of a concern. Value belongs to the employees includes wages and salaries and other benefits given to the employees.	$\frac{\text{Value belongs to Employees}}{\text{Net Value Added}} \times 100$

04	Net Profit to Value Added Ratio	This ratio shows the owner's share to the total pool; a high value shows that income is concentrated in few hands and vice-versa.	$\frac{\text{Netprofit}}{\text{Net Value Added}}$ X100
05	Wages to Value Added Ratio	This ratio shows the proportion of wages to value added output and is an ideal index of labour productivity as it is free from the influence of input and thus speaks clearly about the value added per unit of wages.	$\frac{\text{Wages}}{\text{Net Value Added}}$ X100
08	Value Added to Stock Ratio	This ratio is used in measuring the productivity of stock.	$\frac{\text{Net Value Added}}{\text{Stocks}}$ X100
09	Value Added to Fixed Assets	This ratio calculates the productivity of fixed assets.	$\frac{\text{Net Value Added}}{\text{Fixed Assets}}$ X100
10	Taxation to Value Added	This ratio computes the between of taxation as compared to value added. This ratio and trends therein are useful for inter industry and international comparison.	$\frac{\text{Taxation}}{\text{Net Value Added}}$ X100

4. THEORETICAL BACKGROUND

It explains value added; significance of value added; value added statement;

4.1 VALUE ADDED: CONCEPTUAL FRAMEWORK

The concept of value addition basically comes from the very manufacturing process where in the firm's raw materials are converted into finished goods. A manufacturing firm begins with a certain quantum of raw materials, and then engages itself in a conversion process to yield a product with new utility and market value which is different from the original cost of materials. The excess of such market value over the cost of materials is defined as VA. However in practice materials in VA calculations include all items purchased from outside and actually processed. This concept of value added has been defined differently by various experts, which are as follows.

The tem VA may be simply defined in economics as the difference between the value of output produced by affirm in a period, and the value of the inputs purchased from other firms in producing output. In equation form it can be stated as follows:

VA = Value of Output (VO) – Value of Inputs (VI)

According to Morely (1978) VA is the value, which the entity has added in a period that equals its sales less bought-in-goods and services. VA is the wealth the company has been able to create by its own and its employees' efforts during a period (John Sizer, 1994). In addition, VA is the increase in market value brought about by an alteration in the form, location or availability of a product or service excluding the cost of bought-in-materials and services (ICAI, 1985).

The term VA may be defined as the sale value less the cost of bought-in-goods and services used in producing those sales (Brown & Howard, 1992). The added value of a firm or for any other organization is the value added to materials by the process of production. It also includes the gross margin on nay mechanted or factored goods sold (Brech, 1994).

On the other hand VA is said to represent the total wealth of the firm that could be distributed to all capital providers, employees and the government (Evaret & Riahi Belkaoui, 1998). On the basis of above definitions we may conclude that value added is the wealth created by the business during a particular period of time and the wealth (or value) so created or added is distributed among the different stakeholders who created it. It is also observed that there are various techniques of measuring the value added and thus it is necessary o develop a standard practice for measuring value-added, so that the performance of different enterprises may be judged in a meaningful way and inter-firm as well as intra-firm comparison may be possible.

4.2 SIGNIFICANCE OF VALUE ADDED

The value added income concept is a significant tool for appraising the performance of enterprises whose operation affects the social and economic well-being of entire community. It recognizes other contributors and claimants who have contributed in the process of generating value such as employees, governments and providers of loan capital. Every one of them contributors to the value added and gets a proportionate share therein. An enterprise can survive without making profit, but not generating value is an evil to the society and may cause its death. The absence of profit does not mean that the enterprise is contributing nothing to the society because profit constitutes only a small fraction of the total value or wealth the organization generates in a particular period. A sick unit may be considered useful so long as it generates sufficient value to pay salaries and wages to its employees because its closures will create unemployment, which may result in a social crisis. At the time of preparing plans and targets of the company, financial managers usually set a profit target, but the value added could be a more appropriate criterion in this matter. Optimizing added value is more meaningful than optimizing profit, because 'added value' determines the reward for employees as well as for providers of capital. Therefore, incentive schemes can be designed in the light of VA. VA amount can also be used for profit planning of an enterprise. Productivity of different means of production can be measured in terms of VA. Moreover, it may be most appropriate criterion for resource allocation.

4.3 VALUE ADDED STATEMENT (VAS): A VOLUNTARY SUPPLEMENT

For the purpose of calculating the amount of value added and its distribution, the Value Added Statements (VAS) is prepared. The main concern of this statement lies in deriving a measure of wealth (i.e. value), the entity has contributed to the society through the collective efforts of the various stakeholders. This statement is prepared and published voluntarily with the annual financial reports.

VAS may be defined as the statement, which shows the income of the company as an entity and how that is divided between the people who have contributed to its creation. While income statement reports on the income of shareholders, the value added statement reports on the income earned by a large group of stakeholders-providers of capital plus employees and the government. VAS reveals the VA by an enterprise which it has been able to generate and its distribution among those contributing to its generation known as stakeholders (ICAI, 1985).

The VAS reports on the calculation of vale added and its application among the stakeholders in the company (Van Staden, 2000). It is actually aimed at supplementing a new dimension to the existing system of corporate financial accounting and reporting through the disclosure of additional information regarding the amount of wealth created by an organization in an accounting period and the way the wealth has been distributed by the enterprise amongst all the stakeholders (i.e. employees, providers of loan capital, government and owners) who have contributed to the 'wealth created'. Since VAS represents how the value or wealth created or generated by an entity is shared among different stakeholders, it is significant from the national point of view. Therefore, VAS represents a move in a new and different direction for financial reporting. Earlier, accountants have been giving much attention to answer the question- "How should we measure income?" But the VAS asks a different question- "Whose income should we measure?'' So this approach can raise question of distributive justice and is directly linked with the concept of social responsibility of an enterprise.

5. RESULTS AND DISCUSSIONS

All these ratios are computed on the basis of data compiled in Table-1 according to the purpose of our analysis.

Table 2. Value Added Ratios for Measuring Performance and Judging Productivity of ABANS Listed Manufacturing Company

Name of the Ratio (%)		1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Value added to Capital Employed	Ratio	55.22	52.03	54.04	62.79	59.39	67.07	77.01	74.73	91.93	127.64
	TV	42.60	49.17	55.75	62.32	68.90	75.47	82.05	88.62	95.20	107.77
Value added to Sales	Ratio	32.45	32.62	34.17	33.07	36.86	36.93	31.81	30.48	21.33	13.48
	TV	37.74	36.09	34.44	32.79	31.14	29.49	27.84	26.19	24.54	22.89
Net Profit to Value added	Ratio	15.85	10.92	20.41	14.75	15.83	15.96	13.64	8.82	20.94	10.25
	TV	15.87	15.62	15.36	15.11	14.86	14.61	14.36	14.11	13.86	13.61
Value added belongs to Employee	Ratio	36.04	32.99	59.83	6.2	65.92	70.15	78.32	64.80	66.94	65.53
	TV	34.26	38.79	43.33	38.79	34.26	29.72	25.19	20.65	16.11	11.58
Value added to Fixed	Ratio	1.85	1.55	1.84	2.07	0.98	0.68	0.81	0.84	0.84	1.29
	TV	1.80	1.68	1.56	1.45	1.33	1.22	1.10	0.98	0.87	0.75
Taxation to Value added	Ratio	15.06	10.80	12.64	13.50	5.56	10.25	4.92	2.17	4.93	1.11
	TV	14.64	13.19	11.73	10.28	8.82	7.37	5.91	4.46	3.00	1.55

***Note*: TV –** Trend Value
***Source*:** Calculated from the figures available in the income statements and balance sheets of the company concerned

Table - 1 depicts the information about the computed ratios of ABANS for the period under study (i.e., from 1998-2007). Value added to capital employed ratio of the company has an increasing trend over the periods of ten years. It indicates that the efficient utilization of capital for the generation of value added. Value added sale ratio also reveals a decreasing trend over the years, which reflects that the company has not an effective sales promotion policy to enhance the performance of the company. Again Net profit to value added ratio of the company also reflects the increasing trend, which indicates that the owner share in the pool has increased over time.

On the other hand, VA belongs to employee has almost decreasing trend (except in the years 1999; 2000) over the period under study. Again it is observed that the Value added to fixed asset ratio also decreasing trend over the period. These ratios of ABANS indicate that the efficiency of the company has to increase considerable over time in terms of both capital and labour productivity. It is observed that from table-1 that taxation to value added ratio shows decreasing trend over the period. All ratios indicate that the company little bit efficient in terms of utilization of materials.

6. CONCLUSIONS

Hence, it is clear that ratios using VA figure can be regarded as the index of managerial performance and they would be more sensitive to display the vivid picture about the efficiency of management of a firm in a highly complex and competitive business environment. It is observed that the ABANS company little bit efficient in terms of utilization of materials

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