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VALUE-BASED MANAGEMENT: A CASE STUDY OF VISEGRAD FOUR COUNTRIES

Andreea Mitan[1,a] , Anna Siekelova[2,b,*], Mihaela Rusu[3,c] and Martin Rovnak[4,d]

[1]National University of Political Studies and Public Administration, Faculty of Management, Expoziției Blvd. 30A, 012104 Bucharest, Romania
[2]University of Zilina, Faculty of Operation and Economics of Transport and Communications, Univerzitna 1, 010 26 Zilina, Slovakia
[3]National University of Political Studies and Public Administration, Doctoral School in Communication Sciences, Expoziției Blvd. 30A, 012104 Bucharest, Romania
[4]Faculty of Management and Business, University of Presov, Konstantinova 16, 080 01 Presov, Slovakia
[a]andreea.mitan@facultateademanagement.ro, [b]anna.siekelova@fpedas.uniza.sk, [c]michaelarusu@yahoo.com, [d]martin.rovnak@unipo.sk
[*]Corresponding author

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Abstract:
Research background: As companies evolve over time, so do their goals. In the past, the main goals of companies were profit and goals (as market share), are no longer relevant or effective. These goals are outdated, and companies have replaced them with goals that are consistent with the current changing times of competition. Worldwide, most large companies are using, or planning to use, a new approach called value-based management that focuses on value creation. Therefore, the main goal of companies using a value-based management approach is value creation.
Purpose: This study aims to validate the existence of a statistically significant relationship between the economic value added (EVA) indicator, which represents the successful implementation of the value creation process in companies, and selected value generators.
Method: For this study, information about 14,313 companies operating in the Visegrad Four countries were collected from their respective financial statements. The research period was 2019–2020. Twenty value generators were selected for this study. The hypotheses were tested using the correlation coefficient. The strength of the relationship between the observed variables is described by using the Pearson correlation coefficient.
Findings and value added: A trivial or small dependence was observed between the EVA indicator and non-current assets, current financial assets, and income tax. A moderate dependence was observed between the EVA indicator and stocks, receivables, interest expenses, and other liabilities. A large dependence was observed between the EVA indicator and bank loans, profit and loss (P/L) statement, and the cost of capital. The survey results can be a useful tool for businesses in their efforts to focus on a suitable value generator in the process of value-based management implementation, focusing on the process of value creation.

Keywords: value, value-based management, economic value added, V4

JEL Classification: D01, D22, G32

1. Introduction

Many new management approaches have been described in recent years. Some of them have been successfully established in business practices, while some of them have failed. In many cases, the biggest problem is that these new management approaches are not clearly defined, and they do not consider the ultimate target of creating value. Value-based management can be perceived as a solution to this problem (Papatya, 2020; Watts and Zimmerman, 1978), as it provides a precise and unambiguous metric upon which an entire company can be built. This value is derived from the achieved discounted cash flow (Ausloos, 2020). Value-based management is based on a company's overall aspirations, analytical techniques, and management processes, focusing on the management decision-making process for key value drivers. (Ugrin et al., 2017; Valaskova et al., 2020; Eckert, 2020; Wilms et al., 2020; Firk et al., 2016)

Value-based management is a relatively modern subject, although it is not considered a 'new' management technique. Value-based management differs from the 1960s-style planning systems. Initial studies dealing with the issue of value-based management have been conducted since 1990. Large companies have mainly turned to managerial techniques through which shareholder value is created. Danaiata et al. (2021) defined value-based management as a set of known management methods that are directed at maximising shareholder value. In the decision-making process, managers focus on shareholders' value creation. Hou and Zhang (2007) stated that value creation should be considered a central strategic task from management.

Based on several definitions of value-based management, it can be described as a comprehensive approach to management that focuses on value creation by achieving goals. It should focus not only on the short-term impact but also on the long-term effect of achieving a higher level of value compared to the previous period. Value-based management focuses on a better decision-making process at all levels of an organization. Focusing on the long-term effects, Blume (2016) describes the role of value-based management in companies. Wang (2006) defined value-based management as the essence of culture management in companies. Value-based management can be considered an adequate management technique in contemporary postmodern societies. Mavropulo et al. (2021) defined value-based management as a philosophy that requires managers to include the interests of shareholders in their strategic and operational business decisions. The most important factor is the difference between value-based management and profit-focused management, that is, decisions made today should not be driven only by short-term profits. Managers must focus on the long-term effects of future sustainability and profitability of the company.

Before the industrial revolution, firms were small, with a low degree of internal complexity, the business environment was stable, and the process of value creation was straightforward. In fact, it can be stated that the need for value-based management techniques did not exist during that period. More recently competition between firms became fierce and their international performance became linked to innovation (Vătămănescu et al., 2020, Vătămănescu et al., 2021). Value-based management approach can be seen as a way of navigating the more complex business environment extant nowadays. Several explanations of value-based management can be found in research studies (Buhl et al., 2011; Davydov, 2019; Firk et al., 2016; Sosnowski, 2018; Svabova et al., 2018). The evolution of the basis of value-based management concepts is described in research by Ievdkymov et al. (2018) and Faupel (2012).

Definitions show that the three basic principles of value-based management are value creation, value management, and value measurement.

This study focuses on the process of value measurement and its techniques. Two indicators used in value measurement can be distinguished: traditional and modern. Tradition indicators

are based on the organisation's accounting data, and are not suitable for value measurement because they do not consider the risk and cash flow that will occur in the future. These indicators include earnings after taxes, earnings before taxes, earnings before interest and taxes, earnings before interest, taxes and amortisation, return on sales, return on assets, return on equity, and return on investment. Value-based management recommends the use of modern indicators to measure value. Modern indicators for evaluating the financial performance of a company are based on economic profit, which is the main criterion of performance or cash flow. Financial statements are modified to reflect economic reality, and data are not distorted by the accounting policies adopted by the company. These indicators, in contrast to conventional indicators, are used to measure financial performance. They consider risk, cost of capital, and some companies also take into account the impact of inflation, which largely addresses most of the constraints associated with the use of conventional indicators (Jankalova and Kurotova, 2020).

Table 1 shows a comparison of selected modern indicators that are used to measure value.

Table 1: Comparison of selected modern indicator for value management

	EVA	**MVA**	**RONA**	**CVA**	**TSR**	**ER**	**SVA**
Measurement unit	€	€	%	€	%	€	€
The assessment of the cost of capital	✓	*	x	✓	*	✓	✓
Degree of consideration of borrowed capital costs	✓	*	x	✓	*	✓	✓
Measurability at lower levels of management	✓	x	✓	✓	x	x	✓
Applicability for business valuation	++	+++	+	++	+++	+++	+++
Applicability for the development of a remuneration system	+++	+	+	++	+	+	+
Simplicity of application in management	+++	0	+++	+++	0	0	++
Simplicity of calculation	4	1	2	3	4	4	4

Source: Processed by authors

Note:
+ small possibility of use, ++ possibility of use, +++ high usability, 0 no usability
1 - simple; 2 - needs simple adjustments; 3 - moderately demanding; 4 - high degree of difficulty
** The cost of capital is considered in the discount rate when converting future values and is therefore not explicitly stated.*

This study aims to verify the existence of a statistically significant relationship between the EVA indicator, which represents the successful implementation of the value creation process in companies, and selected value generators.

It is not clear which indicator is best for a company. When market changes are rapid, it becomes difficult to choose a performance indicator to measure value creation. According to several studies, the EVA indicator is best suited for value-based management. It does not require the company to be publicly traded, it is easily applicable across all management levels, including lower levels of management, and it is the most appropriate indicator for a company's

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valuation system (which is an integral part of value-based management). Thus, the EVA indicator is used in the value-measuring process in V4 countries. The calculation of the indicator is described in the methodology section.

2. Methodology

This section presents a description of the database and the EVA calculation method.

The data were obtained from the Amadeus database, which is a comprehensive financial database of firms across Europe. The Amadeus database is published by Bureau van Dijk, a Moody's Analytics company. For our research needs, information was collected from 14,313 companies operating in the Visegrad Four market (i.e. the Czech Republic, Slovakia, Poland, and Hungary). The sources of information are the financial statements of the respective companies, and the study period was from 2019 to 2020. Six search rules were applied, and the research was conducted only on active companies during the study period. The research is not sector specific. Only companies with total assets above 2,000,000 EUR and operating revenue higher than 100,000 EUR, were included. In the next step, companies with no recent financial data for variable calculations were excluded. Outlier detection and exclusion were the final steps, and outliers were detected using the interquartile range method. Outliers are described as values below $Q_1 - 1.5(IQR)$ or above $Q_3 + 1.5(IQR)$.

$$IQR = Q_3 - Q_1 \tag{1}$$

Where:
IQR represents the interquartile range,
Q_3 denotes the third quartile, and
Q_1 is the first (upper) quartile.

Table 2 shows thee detailed sample specification.

Within database EVA indicator was calculated according to the following formula.

$$EVA = NOPAT - NOA \times WACC \tag{2}$$

Where:
$NOPAT$ denotes the net operating profit after tax,
NOA is net operating assets, and
$WACC$ is the weighted average costs of capital.

These variables are not directly found in financial statements. The company's balance sheet, and profit and loss statements must be adjusted to reflect the economic reality. Stern, Stewart & Co. (a New-York based independent strategy consulting boutique) recommends 164 adjustments that are a company's secrets. It can be stated that only some of them are realised in practice.

Net operating profit after tax (NOPAT) is derived from the profit and loss statement as follows:

- to add paid interest;
- to exclude unusual items;
- to consider the effect of changes in equity;
- assess the operational nature of financial investments and current assets, if they are not related to the core business, they must be excluded; and
- convert modified taxes (taxes paid on net operating profit after tax) (Sok-Gee et al., 2018; Ball and Shivakumar, 2005).

Net operating assets (NOA) are derived from balance sheet as follow:

- to exclude the sum of assets not related to the company's operating assets;
- to exclude the sum of interest-bearing foreign capital;
- to exclude unusual items; and
- transform the accounting sum of assets into its real value. (El Diri, 2018; Gen et al., 2021).

Table 2: Data description

	Classification	Number of companies
Country	Slovakia	4,325
	Czech Republic	3,108
	Poland	3,882
	Hungary	2,998
Sector	Agriculture, forestry and fishing	1.85%
	Mining and quarrying	0.20%
	Manufacturing	10.55%
	Electricity, gas, steam and air conditioning supply	0.35%
	Water supply; sewerage, waste management and remediation activities	0.35%
	Construction	10.63%
	Wholesale and retail trade; repair of motor vehicles and motorcycles	21.21%
	Transportation and storage	4.25%
	Accommodation and Food service activities	1.73%
	Information and communication	6.85%
	Financial and insurance activities	1.10%
	Real estate activities	4.76%
	Professional, scientific and technical activities	17.59%
	Administrative and support service activities	3.86%
	Public administration and defence; compulsory social security	0.16%
	Education	1.22%
	Human health and social work activities	11.65%
	Arts, entertainment and recreation	1.06%
	Other service activities	0.63%
	Activities of households as employers; undifferentiated goods- and services producing activities of households for own use	0%
	Activities of extraterritorial organizations and bodies	0%
Firm Size	Very large	5,256
	Large	4,993
	Medium sized	4,064

Source: Processed by authors

The final part is calculating the weighted average cost of capital (WACC). The WACC consists of the sum of the cost of capital containing the cost of equity and debt, and it is calculated using the following formula:

$$WACC = \frac{D}{C} * r_d * (1 - t) + \frac{E}{C} * r_e \quad (3)$$

where:

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D denotes the sum of debt,
C is the sum of total capital,
r_d represents cost of debt,
t represents taxes,
E is the sum of equity, and
r_e denotes the cost of equity.

The cost of debt can be defined as the average interest rate paid by the company to its creditors. It can be calculated by the Damodaran recommendation as follows:

$$r_d = r_f + r_p \tag{4}$$

where:
r_d represents the cost of debt,
r_f is risk-free rate (usually derived from the yield of government bonds), and
r_p denotes the risk premium.

The capital asset pricing model (CAPM) model was used to estimate the cost of equity.

$$r_e = r_f + \beta(r_m - r_f) \tag{5}$$

where:
r_f denotes risk-free rate,
β represents beta of asset; and
r_m is the expected market return.

3. Results and Discussion

As mentioned above, information about 14,313 companies operating in the Visegrad Four market were collected. The variables for the EVA estimation were calculated according to the methodology of the contribution. Table 3 presents an example of the variable values of the five selected companies in 2020.

Table 3: Example of calculated variables (2020)

Company	NOPAT (EUR)	NOA (EUR)	WACC (%)	EVA (EUR)	EBIT DA (EUR)
Company 1	225,386	201,598	14	197,162.28	280,693
Company 2	40,589	259,074	28	-31,951.72	-5,968
Company 3	88,962	239,578	8	69,795.76	89,236
Company 4	128,954	369,598	32	10,682.64	15,669
Company 5	20,025	189,569	17	-12,201.73	-10,963
…	…	…	…	…	…

Source: Processed by authors

Table 4 shows the descriptive statistics of the EVA indicator within the dataset.

Table 4: Descriptive statistic of EVA indicator in 2019 – 2020

	Mean	Median	Standard Deviation	Kurtosis	Skewness
2019	114,7086.16	89,1173.38	11,2169.87	-1,65	0,54
2020	89,258.12	21,098.65	12,369.25	-1,06	0,48

Source: Processed by authors

Based on the results shown in Table 3, there are significant differences between the value of the EVA indicator, representing the ability to create value, and the sum of EBIT DA. It can be seen that the median value of the EVA indicator in 2020 decreased significantly compared to the 2019 value.

The company should be focused on 'generators' that have a significant impact on value creation. There are three types of known value generators:

- operational generators,
- financial generators, and
- generators of sustainability. (Ball, 1972; Dechow and Skinner, 2000; Bertella et al., 2020; Roxas et al., 2020; Lahouel et al., 2020; Ronen and Yaari, 2008)

Operational generators of value creation affect a company's ability to generate money, which can be enhanced by increasing or improving overall efficiency. Business management can easily influence most generators in this category, so this group of value generators is key in the process of value-based management implementation. Factors that help a company minimise the costs of capital are considered financial generators of value creation. Sustainability generators help the company maintain operations without fluctuations in the long run.

Due to the nature of the research sample, the contribution is further focused on the identification and influence of operational and financial generators on the value of the EVA indicator. These indicators were estimated by the decomposition of the EVA indicator. The selected generators include the following:

- non-current assets – divided into intangible, tangible and financial assets;
- current assets – divided into stocks, receivables, financial assets;
- equity – divided into shared capital, other capital funds, statutory reserve funds, other funds from profit, profit or loss, as well as profit or loss from previous years;
- debt is divided into long-term and current bank loans and other long-term and short-term liabilities;
- interest expense;
- income tax;
- cost of debt; and
- cost of equity.

Based on the previous, the following hypotheses are verified.

H_0 There is no statistically significant relationship between the EVA indicator, representing successful implementation of the value creation process within companies, and the selected value generator.

H_A There is a statistically significant relationship between the EVA indicator, representing successful implementation of the value creation process within companies, and the selected value generator.

A correlation coefficient was used in the hypotheses verification process. The test statistic has a Student's t-distribution with $(n-2)$ degrees of freedom. The strength of the relationship

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between the observed variables can be estimated using the Pearson correlation coefficient. The results are defined as follows:

- $0 <$ | Pearson correlation coefficient | ≤ 0.1 trivial dependence;
- $0.1 \leq$ | Pearson correlation coefficient | ≤ 0.3 small dependence;
- $0.3 <$ | Pearson correlation coefficient | ≤ 0.5 moderate dependence;
- $0.5 <$ | Pearson correlation coefficient | ≤ 0.7 large dependence;
- $0.7 <$ | Pearson correlation coefficient | ≤ 0.9 very large dependence;
- $0.9 <$ | Pearson correlation coefficient | ≤ 1 nearly perfect correlation.

The hypotheses were tested using the IBM SPSS software. $P - value$ was set as the criterion. This value was compared to the significance level α set at $\alpha = 0.05$. Table 5 shows the results of hypotheses verification.

Table 5: Results of hypothesis verifying

Value generator	$p - value$	α	Results - H_0	Results - described
Intangible asset	0,0234	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Tangible assets	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Long-term financial assets	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Stock	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Receivables	0,0021	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Short-term financial assets	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Shared capital	0,4917	0,05	H_0 accepted	There **is no** statistically significant relationship between EVA indicator representing the success of implementation

				of value creation process within companies and selected value generator.
Other capital funds	0,2769	0,05	H_0 accepted	There **is no** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.
Statutory reserved fund	0,3170	0,05	H_0 accepted	There **is no** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.
Other funds from profit	0,1315	0,05	H_0 accepted	There **is no** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.
P/L	0,0069	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
P/L from previous years	0,0565	0,05	H_0 accepted	There **is no** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.
Long-term bank loans	0,0259	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Current bank loans	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Other long-term liabilities	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Other short-term liabilities	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*

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Interest expense	0,0022	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Income tax	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Cost of debt	0,0237	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*
Cost of equity	< 0,0001	0,05	*H_0 rejected*	*There **is** statistically significant relationship between EVA indicator representing the success of implementation of value creation process within companies and selected value generator.*

Source: Processed by authors

3.1 Discussion

Based on the calculated results, there are significant differences between the value of the EVA indicator, representing the ability to create value, and the sum of EBIT DA. The median value of the EVA indicator in 2020 declined significantly compared to that in 2019. Perhaps, this is due to the impact of the COVID-19 pandemic on firms' ability to create value during this period.

Value creation is influenced by several factors, also called as value generators. The company should be able to correctly identify the generators of value creation. The study focused on the operational and financial generators of value. There are statistically significant relationships between the EVA indicator and the following value generators:

- non-current assets – divided into intangible, tangible and financial assets;
- current assets – divided into stocks, receivables, financial assets;
- achieved profit or loss;
- debt divided into long-term and current bank loans and other long-term and short-term liabilities;
- interest expenditure;
- income tax;
- cost of debt; and
- cost of equity.

The strength of the relationship between the observed variables is described by using the Pearson correlation coefficient. A trivial or small dependence was observed between the EVA indicator and non-current assets, current financial assets, and income tax. A moderate dependence was observed between the EVA indicator and stock, receivables, interest expenses, and other liabilities. A large dependence was observed between the EVA indicator and bank loans, P/L, and the cost of capital.

4. Conclusion

Value-based management is an important tool for improving a company's value creation. To achieve this, we must identify the value generators.

This study aims to verify the existence of a statistically significant relationship between the EVA indicator and selected value generators. As mentioned above, information about 14,313 companies operating in the Visegrad Four market were collected. Twenty indicators considered as value generators by the mentioned authors were tested. The hypothesis about the existence of a statistically significant relationship between EVA indicators and the selected value generators was tested using the correlation coefficient. The strength of the relationship between the observed variables is described using the Pearson correlation coefficient.

Based on the results, moderate dependence was observed between the EVA indicator and stocks, receivables, interest expenses, and other liabilities. A large dependence was observed between the EVA indicator and bank loans, P/L, and the cost of capital.

The survey results can be a useful tool for businesses in their efforts to focus on a suitable value generator.

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Data Availability Statement: The source of information are the financial statements of V4 companies. The researched period is 2019 – 2020. Data was obtained from the Amadeus database. Amadeus database can be defined as a wide-spread known database consists of financial data about firms across Europe. It is provided by Bureau van Dijk, a Moody's Analytics company. The data presented in this study are available on request.

Conflicts of Interest: The authors declare no conflict of interest.

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