Economic Value Added (EVA) and its Impact – A study with special reference to IT Companies and Pharma Companies

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Abstract- In today’s business world, shareholders’ wealth maximization is very important. The survival of any company is not possible without wealth generation for its shareholders. Many companies consider equity capital as free cost of capital but this approach is not relevant in the modern business world because equity is a costlier source than other sources of finance. Indian corporate have started accepting the global challenges and increased the interactions between the investors and company. The investors expect higher value for their investment. Hence, there are some existing models accepted and employed all over the world. One of such model is EVA. It is the popular idea for measuring shareholder’s value. Now a day the demand for shareholders value is rising more strongly than ever. However, the measuring parameters like Return on Investment (ROI) and Earnings per Share (EPS) have failed to consider the most important aspect (i.e.) called shareholders wealth creation (value creation). Hence, the century old concept “EVA” is popularly used for this purpose. In this paper, an attempt is made to empirically analyse how the EVA helps to measure the shareholders wealth (value) creation with special reference to Information Technology companies and Pharma companies.

Keywords: Economic Value added, Shareholders’ wealth creation, Return on Investment,Earning per share, value creation

I. INTRODUCTION
The equity shareholders are real owners of company. They all invest their money in equity shares of a company with the primary motive of achieving good capital appreciation and regular & stable return (i.e., dividends). Maximizing the shareholder value is considered as one of the fundamental goals of all businesses. The excess returns generated by a company are higher than the cost of capital is called as value. Creating value for shareholders is the widely accepted concept. For measuring the corporate financial performance, there are accounting profitability measures and shareholders’ value based measures. Accounting profitability measures include ROI, ROE, EPS, ROCE and DPS etc., Shareholders valued based measures include EVA and MVA. There are various models used to measure the shareholders value creation both in India and in other countries. These include Cash Flow Returns on Investment (CFROI) by the Boston consultancy group, Cash Value Added (CVA) and Shareholders Value Added (SVA). Besides all these, there is the concept of Economic Value Added (EVA), which is most popular.

Measurement of Shareholder’s Wealth
The following are the important measures used to measure the shareholders wealth creation
1. ROCE: Return on Capital Employed is the post tax version of earning power. It is a ratio that indicates the efficiency and profitability of a company's capital investments.
2. Market Capitalisation: Market Capitalisation is a measure of a company's total value. It is estimated by determining the cost of buying an entire business in its current state and often referred to as "market cap".
3. MVA: Market Value added shows the difference between the market value of a company and the capital contributed by investors (both bondholders and shareholders). In other words, it is the sum of all capital claims held against the company plus the market value of debt and equity.
4. EVA: EVA means excess of profit, which remains after deducting the company’s cost of capital (viz debt and equity). It is nothing
but a measure of the values a commercial enterprise has created for its shareholders.

b. Review of Literature:

To study shareholders wealth creation using Economic value added, Market value added, Return on capital employed and Market capitalization the following relevant studies from India and abroad are reviewed.

Dr. N.Sakthivel (2011) studied the shareholders’ value in Indian Pharmaceutical Industry: An empirical analysis. The researcher concluded that the companies under pharmaceutical industry has succeeded to meet public expectations in terms of shareholders’ value creation through EVA either by increasing operating income from assets in place through reducing cost of production or increasing sales, or reducing the cost of capital by changing the financing mix in capital structure.

Economic Value Added (EVA) and Shareholders Wealth Creation: A Factor Analytic Approach BY A.Vijayakumar (2011) examines whether EVA has got a better predictive power of selected automobile companies in India or not. Finally the author found that out of the eight variables, three factors have been extracted and these three factors put together explain 69.902 per cent of the total variance. Further, sales and profit after tax are found to have a stronger relationship with EVA.

Perways Alam and shaik Mohammed Nixzamuddin (2012) in their study entitled “Performance Measures of Shareholders Wealth: An Application of Economic Value Added (EVA)” emphasized that Economic Value Added (EVA) is a value based performance measure that gives importance on value creation by the management for the owners. Stern Stewart’s EVA raises storm in corporate world and gives a new way to think about rewarding management.

Shipra pruthy (2013) studied the EVA and MVA of power sector companies in India. In this study it has been found that Indian Oil Corporation Ltd. is the most wealth creating company and Reliance Power is the most wealth destroying company for the year 2009-2011. The reason for negative economic value added is high cost of equity.

Avijit Sikdar (2013) in his research paper entitled “Value based performance indicators versus accounting earnings based performance indicators- A case study with reference to ONGC” attempted to examine the relationship between share price and market value added, economic value added and cash value added. Finally the author concluded that all the traditional earning based measure except EPS fails to capture the share price variation strongly and value-based measures like EVA, CVA and MVA have emerged as the effective performance measures.

Economic value added and shareholders’ wealth creation: the portrait of a developing Asian country by M. Shaikh (2013) examines the value-creation strategies of selected Indian companies by analysing whether EVA better represents the market-value of these companies in comparison to conventional performance measures. The study indicates that “there is no strong evidence to support Stern Stewart’s claim that EVA is superior to the traditional performance measures in its association with MVA”.

Shrikant Krupasindhu Panigrahi, Yuserrie Bin Zainuddin, and Noor Azlinna Azizan (2015) analyse the impact of economic value added on shareholder’s value: A perspective from Malaysian construction companies. The result found significant influence of EVA on shareholders’ value creation. It was also noticed from the trend analysis that from the 28 companies only 10 companies were having positive EVA whereas the remaining has destroying the shareholder value.

Ahmed Adeshina Babatund and Okene Christian Evuebie (2017) investigate the impact of economic value added (EVA) on stock returns in Nigeria. The results of the OLS regression analysis were statistically significant at 0.05 level. The F Statistics of 1.036 also shows that the result typically explained the model. The correlation coefficient also shows a significant positive relationship between EVA and stock returns in Nigeria. The findings of the study confirmed that EVA increases stock returns in Nigeria.

Sliman S. Alsoboa (2017), “The Influence of Economic Value Added and Return on Assets on Created Shareholders Value: A Comparative Study in Jordanian Public Industrial Firms” address the relationship between Economic Value Added (EVA) and Created Shareholders Value (CSV) in Jordanian public industrial firms (JPIF), the result shows that superiority of EVA in predicting and evaluating the CSV could be put into a conclusive and positive light compared to ROA. One financial measure cannot be enough to measure neither CSV nor firms performance.

c. Statement of the problem

Most of the foreign countries have succeeded in implementing EVA at top level management. It improves their capital efficiency and overall performance. But in India there are many problems faced by industries regarding the structural weakness
not only in the field of finance but also in other areas like, marketing, personnel, wealth of shareholders, employees and owners. In order to solve these problems many studies have undertaken with the help of various financial tools. But all these financial tools are not effectively evaluate the shareholders wealth using financial statement. EVA gives ways to overcome the structural weakness of the industry/company. Hence, an attempt is made in this study to measure the Economic Value Added (EVA) and its impact with special reference to IT companies and Pharma companies.

d. Objectives of the study
The following are the important objectives of the present study.
1. To identify the various methods used for measuring the shareholders wealth creation.
2. To compare Economic Value Added (EVA) with Market Value Added (MVA), Return on Capital Employed (ROCE) and Market capitalization of the sample companies.

II. METHODOLOGY OF THE STUDY
The present study examines the relationship between Economic Value Added (EVA) with Market Value Added (MVA), Return on Capital Employed (ROCE) and Market capitalization for the period of 2016-17. The samples for the present study include companies in three important industries like Information Technology Industries and Pharma Industries. The sample companies are selected from National Stock Exchange sectoral indices. In NSE IT index first five companies were selected they are Infosys Ltd, Tata Consultancy Services Ltd, HCL Technologies Ltd, Wipro Ltd and Tech Mahindra Ltd. NSE Pharma Index first five companies were selected they are Aurobindo Pharma Ltd, Biocon Ltd, Cadila Healthcare Ltd, Biocon Ltd and Divi’s Laboratories Ltd. The data used in the present study were collected from Prowess database, National Stock Exchange official website, concern Sample Company’s website, books and records of sample banks.

b. Tools for analysis:
1. Economic Value Added (EVA)
   Eva is the function of net operating profit after tax, cost of capital and capital employed in the business.
   \[ EVA = (NOPAT - (WACC \times Net\ Cap)) \]
   Where
   - NOPAT = Net Operating Profit after Tax
   - WACC = Weighted Average Cost of Capital
   - Net Cap = Net Economic Capital Employed

2. Market Value Added (MVA)
   MVA is essentially the difference between a company’s current market value as determined by its stock price and its economic book value.
   \[ MVA = No.\ of\ equity\ shares\ outstanding \times Market\ Price\ per\ Share. \]

3. Return on capital employed (ROCE):
   The return on capital employed means the rate of return produced by the firm against investment made by it.
   \[ ROCE = \frac{Profit\ before\ Interest\ and\ Tax \times (1-Taxrate)}{Average\ Total\ Asset} \]

4. Market Capitalisation
   Total market value of the company shares is called as market Capitalisation.
   \[ Market\ Capitalisation = No.\ Shares\ issued \times Market\ Price\ per\ Share \]

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c. Limitations of the study
The following are the limitations of the present study.
1. In the present study Economic Value Added (EVA) is calculated by using the secondary data.
2. In the present study only five companies from two sectoral indices were used as sample not all the companies in the sectoral indices.
3. The present study attempted to study shareholders wealth creation for the period of one year.

III. ANALYSIS AND DISCUSSION OF THE STUDY
The higher the Economic Value Added (EVA), the better. A high EVA indicates the company has created substantial wealth for the shareholders. MVA is equivalent to the present value of all future expected EVAs. Negative EVA means that the value of the actions and investments of management is less than the value of the capital contributed to the company by the capital markets. This means that wealth or value has been destroyed.
Table -1
VALUES OF EVA, MVA, ROCE AND MARKET CAPITALISATION
(In millions)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>EVA</th>
<th>MVA</th>
<th>ROCE</th>
<th>Market Capitalisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infosys Ltd.</td>
<td>3975.65</td>
<td>27867.49</td>
<td>23.19</td>
<td>28344.57</td>
</tr>
<tr>
<td>Tata Consultancy Services Ltd.</td>
<td>1166.223</td>
<td>62588.5</td>
<td>18.36</td>
<td>63835.0</td>
</tr>
<tr>
<td>HCL Technologies Ltd.</td>
<td>660.56</td>
<td>49632.15</td>
<td>40.96</td>
<td>55630.96</td>
</tr>
<tr>
<td>Wipro Ltd.</td>
<td>3174.537</td>
<td>24746.95</td>
<td>31.49</td>
<td>25930.62</td>
</tr>
<tr>
<td>Tech Mahindra Ltd.</td>
<td>2285.42</td>
<td>43769.3</td>
<td>31.46</td>
<td>54836.02</td>
</tr>
</tbody>
</table>

Table -1 Explains the Economic Value Added (EVA), Market Value Added (MVA), Return on Capital Employed (ROCE) and Market Capitalisation of five sample companies namely Infosys Ltd, Tata Consultancy Services Ltd, HCL Technologies Ltd, Wipro Ltd and Tech Mahindra Ltd. From this analysis it understands that the EVA, MVA, ROCE and Market capitalization of the Infosys Ltd were 3975.65 Million, 27867.49 Million, 23.19 Million and 28344.57 Million respectively. The position of EVA and MVA for Tata Consultancy Services Ltd is 1166.223 Million and 62588.5 Million, the value of ROCE is 18.36 Million and Market capitalization are 63835.0 Million respectively. The ROCE and Market capitalization for HCL Technologies Ltd is 40.96 Million and 55630.96 Million, the value of EVA and MVA is 660.56 Million and 49632.15 Million respectively. For the Wipro Ltd the EVA is 3174.537 Million, the MVA is 24746.95 Million, the ROCE is 31.46 Million and the market capitalization is 25930.62 Million respectively. EVA and MVA of Tech Mahindra Ltd are 2285.42 Million and 43769.3 Million where as ROCE and Market Capitalisation is 31.46 Million and 54836.02 Million respectively. From this analysis, it comes to know that all the sample IT companies obtained higher EVA, which indicates that all the sample IT companies, have created value for their shareholders.

Table -2
VALUES OF EVA, MVA, ROCE AND MARKET CAPITALISATION
(In millions)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>EVA</th>
<th>MVA</th>
<th>ROCE</th>
<th>Market Capitalisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aurobindo Pharma Ltd.</td>
<td>4867.54</td>
<td>36458.57</td>
<td>13.28</td>
<td>27265.32</td>
</tr>
<tr>
<td>Biocon Ltd.</td>
<td>2154.130</td>
<td>53467.4</td>
<td>19.45</td>
<td>54625.0</td>
</tr>
<tr>
<td>Cadila Healthcare Ltd.</td>
<td>570.46</td>
<td>37452.25</td>
<td>30.75</td>
<td>43520.87</td>
</tr>
<tr>
<td>Cipla Ltd.</td>
<td>4256.453</td>
<td>34638.75</td>
<td>32.79</td>
<td>34850.54</td>
</tr>
<tr>
<td>Divi’s Laboratories Ltd.</td>
<td>3264.26</td>
<td>25641.36</td>
<td>15.38</td>
<td>25462.64</td>
</tr>
</tbody>
</table>
Table-2 explains the Economic Value Added (EVA), Market Value Added (MVA) Return on Capital Employed (ROCE) and Market Capitalisation of five sample companies namely Aurobindo Pharma Ltd, Biocon Ltd, Cadila Healthcare Ltd, Cipla Ltd and Divi's Laboratories Ltd. From this analysis it comes to know that the EVA, MVA, ROCE and Market capitalization of the Aurobindo Pharma Ltd were 4867.54Million, 36458.57Million, 13.28Million and 27265.32Million respectively. The position of EVA and MVA for Biocon Ltd is 2154.130Million and 53467.4Million, the value of ROCE and Market capitalization are 19.45Million and 54625.0Million respectively. The ROCE and Market capitalization for Cadila Healthcare Ltd is 30.75Million and 43520.87Million, the value of EVA and MVA is 570.46Million and 37452.25Million respectively. For the Cipla Ltd the EVA is 4256.453Million, the MVA is 34638.75Million, the ROCE is 32.79Million and the market capitalization is 34850.54Million respectively. EVA and MVA of Divi’s Laboratories Ltd are 3264.26Million and 25641.36Million where as ROCE and Market Capitalisation is 15.38Million and 25462.64Million respectively. From this analysis, it comes to know that all the sample Pharma companies obtained higher EVA, which indicates that all the sample Pharma companies have created value for their shareholders.

IV. FINDINGS, SUGGESTIONS AND CONCLUSIONS

a. Findings from the Study:

1. From the study it can be clearly understood that EVA gives the better share holder’s value rather than the ROCE and Market Capitalisation for all sample companies.

2. It found from the study that, when consider the Economic Value added (EVA) alone in IT companies Infosys Ltd has created more wealth to the shareholders and in Pharma companies Cipla Ltd has created more wealth to the shareholders.

3. From the above study it can be understand that, when consider the Market Value Added (MVA) alone, in IT companies Tata Consultancy Services Ltd shareholders enjoy the maximum wealth creation and in Pharma companies Biocon Ltd shareholders enjoy the maximum wealth creation.

4. It is understand from the study that, when consider the Return on Capital Employed (ROCE) alone, in IT companies the Wipro Ltd shareholders gained more wealth creation and in Pharma companies the Cipla Ltd shareholders gained more wealth creation.

5. It is clearly understand that, while considering the market Capitalisation alone, in IT companies Tata Consultancy Services Ltd performed well then the other sample companies and in Pharma companies Biocon Ltd performed well then the other sample companies.

6. Overall performance, in IT companies Wipro Ltd is considered as best company and in Pharma companies Cipla Ltd is considered as best company in creating the share holders wealth and capital contribution.

b. Suggestions from the Study:

In Indian, Economic Value Added (EVA) is not popularly accepted in measure for study the corporate performance because the corporate cannot believe that shareholder’s wealth can be through subtracting cost of capital from income. If Economic Value Added (EVA) is to be accepted as an effective metric for measure the corporate performance, there are more to be done and one such area is better disclosure norms for display the performance of Indian companies. At the time of making the investment in corporate securities the investor must studied Economic Value Added (EVA), Market Value Added (MVA) Return on Capital Employed (ROCE) and Market Capitalisation of the companies to get the appropriate returns because these factors are determining the return as well as growth for your investments.

V. CONCLUSION

In the present study Economic Value Added (EVA) gives the better share holder’s wealth creation rather than the Return on Capital Employed (ROCE) and Market Capitalisation. It is general argument that at the time of selling the shares, Market Capitalisation is considered as the realization value. But in reality market price involves high volatility with high risk. Hence there is no guarantee for shareholders to realize the value mentioned in the balance sheet. But at the time using EVA it gives considerable value as well as reduces the risk. EVA and MVA do not correlate perfectly because expected EVA measures the current performance of expected share prices reflection. Hence the companies which are adopting the EVA must keep the current share price without any down trend. Market Value Added (MVA) cannot be calculated for all companies especially closely held companies and non profit
organization because they are not holding the publicly traded shares. Creating the shareholders value is the fundamental goal of every company. EVA is a new metric of measuring economic value created by the corporate houses in another mile stone in the field of finance.

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