CREATING AND MEASURING SHAREHOLDERS' VALUE IN INDIAN COMPANIES

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Abstract: *The present study endeavors to explore and study the shareholder's value creation in Indian companies as measured by EVA and to determine the key factors that have an impact on shareholders' value creation. In the present study we have taken dividend and capital structure as independent variable and EVA as dependent variable. Regression technique has been used in order to examine the impact of Dividend and Capital structure on Shareholder Value Creation (SVC). The study reveals that both Dividend and Capital structure have influence on the Shareholder Value Creation. It is also found that mostly all companies are having positive EVA which indicates that these companies are not only thinking about profit maximization but also focusing on the objective of wealth maximization.*

Key Words: *EVA, Shareholders' value creation, Dividend and Capital structure*

1. INTRODUCTION

Shareholder Value Creation is the returns generated by the company over and above the cost of capital. Some companies can create the value (return higher than the cost capital) and some can destroy the value (return lower than the cost of capital). Shareholder value started to take on a life of its own as a result of the Capital Asset Pricing Model (CAPM), which argues that the returns both received and expected by investors are related to the risk incurred by owning particular financial assets. As it is commonly understood, the higher the risk the greater the return should be. The main insight of the CAPM model which is central to the shareholder view of the world is that there is a risk-weighted discount factor which allows one to assess the value today and tomorrow's developments, profits and cash flows. Most of the studies dealing with shareholder value creation have investigated the information content of innovative performance measures over the traditional measures.

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1.1. Economic Value Added

Economic Value Added (EVA) a registered trademark of Stern, Stewart and Co. EVA is a modified concept of *"Residual Income".* It measures excess of return over the cost of capital.

$$EVA= NOPAT-(WACC*C.E)$$

EVA stands well out from the crowd as the single best measure of wealth creation on a contemporaneous basis and is almost 50 percent better than its closest accounting-based competitor [including EPS, ROE and ROI] in explaining changes in shareholder wealth *(Stern et al. 1996).*

2. REVIEW OF LITERATURE

Jalaja (2010) compared value creation of old generation companies with new generation companies by adopting Pablo Fernandez model. The study considered the sample of 50 companies representing ten industrial sectors for a period of five years, from 2002 to 2006. The result showed that the old generation companies (companies representing the industry sectors- Steel, Sugar, Oil & Gas, Textiles and Cement) created more shareholder value than new generation companies (companies representing the industry sectors- Pharmaceuticals, Automobiles, IT, FMCG and Capital Goods). There was found to be a positive correlation between shareholder value creation and market capitalisation in 44 companies out of a sample of 50 companies, but the degree of correlation varies. There is strong correlation in 23 companies, moderate level of correlation in four companies and weak correlation in 17 companies and the correlation is negative in six companies. According to empirical evidence it was so proved that shareholder value creation does not depend on the size of the company (measured in terms of market capitalization).

Abdoli *et al.* (2012) studied the relationship between every independent variable, including Economic Value Added (EVA) and residual income as the representatives of economic models with shareholders value creation. The sample size of the statistics is 85 companies. The study used simple and multi-variable regression methods to analyze the data. The results showed that both residual income and the economic value added (EVA) have a significant relationship with the shareholders' created wealth. However, in relation to created shareholder value, the residual income criterion seems to be more significant. The difference between the impacts of the two variables raised due to accounting adjustments through which the effect of accrual accounting is being eliminated, therefore, it is considered as a considerably better criterion for the evaluation of performance and increase in shareholder's value.

Chauhan (2012) analyzed the shareholder's value creation in the Indian petroleum industry. The Indian petroleum industry is mostly dominated by private sector firm and public sector firm. The study had analyzed the performance of the

company. Petroleum industry was divided into private sector firms and public sector firms. The study had used MVA, PAT, NOPAT, EVA, EPS and market capitalization data which was provided by CMIE Prowess database, for the period of 10 years, from 2001-02 to 2010-11. For all seven companies, the 10-year correlation between EVA of each year and every year's NOPAT, MVA, PAT, EPS and market capitalization was calculated. T-test was applied to test the hypothesis in the present research. EVA was found to have significant correlation with NOPAT, EPS, OP, Market capitalization and MVA figures of the firm of both sectors. Both sectors have created a positive EVA and MVA in the study.

Tian *et al.* (2013) made an attempt to measure the value-creation ability of the enterprises. EVA was applied to analyze the value-creating ability of the whole blue economic zone based upon the accounting report data from 2009-2011, by taking the listed companies in the Shandong Island blue economic zone. Thereafter, a comparison regarding the value-creating ability of these listed companies was proposed in the view of the industry. As a result, the ability to create value of the listed companies in the Shandong island blue economic zone had shown an increasing tendency during the last three years. The EVA rate, which is an index which can reflect capital efficiency, increased at first and started decreasing afterwards. However, there showed a huge gap between the different industries.

Vijayalakshmi and Manoharan (2013) carried out an empirical study which examined the impact of the leverage on shareholder value creation of the Indian miscellaneous manufacturing sector. For corporate growth, shareholder value creation has become a focusable area. Because the shareholders are the ultimate owners of the enterprises, every firm has to construct a capital structure keeping in mind the objective of shareholder's wealth maximization. Miscellaneous manufacturing sector is said to be a capital intensive sector, where a greater emphasis is laid upon designing the capital structure. The period for which the study was conducted was 1995-96 to 2009-10. To analyze the data a panel approach has been applied. According to the results of the study, the leverage has a significant influence on the shareholders value creation.

Bhasin (2013) explored that the main goal of financial management is to maximize the shareholder's value. The main objective of the study is to examine whether or not the sample companies have been able to generate value for its shareholders and also to analyze the effectiveness of EVA over the conventional and traditional measures of corporate performance. Various statistical tools like ANOVA, regression analysis and trend analysis were used for analyzing the data. The study indicated that EVA is superior to the traditional performance measures in its association with MVA.

Mistry *et al.* (2013) measured the relationship between Shareholder's value, that is, residual income measures and financial variables, that is, residual income components; traditional value measures and cash flow measures. According to

the results of the company, the majority of the selected variables of the study differ significantly among selected pharmaceutical players, except traditional value measures, that is, P/E ratio. The study found that shareholders' value can be predicted by the selected financial variables.

Murthy (2013) analyzed the performance of TCS and INFOSYS with regard to its shareholder wealth maximization. To study the performance of ROE, Du Pont Analysis has been applied. The basic objective to select the two companies is to understand and apply the concept of value creation in the two companies with different factsheet. According to the study, TCS has provided consistent return to their equity shareholders on their investment, even more than Infosys.

Haque *et al.* (2013) made an attempt to study the relationship between dividend payouts and Economic Value Added (EVA), an indicator to shareholders wealth creation, introduced by United States based consultants Stern Stewart and Company, New York, in 1990_s, using data of Square Pharmaceutical Limited (SPL), one of the largest pharmaceutical companies in Bangladesh, for the periods 2004-05 to 2010-11. The study concluded that there is an inverse relationship between dividend payouts and EVA, using the simple regression equation method, and also recommended that SPL should continue the existing dividend policy of retaining a bulky portion of earning rather than a high payout ratio.

3. RESEARCH METHODOLOGY

3.1. Research Objectives

1) To determine Shareholder Value Creation as measured by EVA.
2) To analyze the impact of dividend and capital structure on Shareholder Value Creation.
3) To compare the industry wise and company wise Shareholder Value Creation.

3.2. Hypothesis

The financing decision is one of the key financial decisions of the company, which ultimately affects its performance. The optimal capital structure can minimize the cost of the capital and, consequently can maximize the shareholder value creation. Similarly the dividend decision is also a crucial decision to make. It ultimately affects the value of the firm and cost of capital. As per literature review, there are number of determinants of Shareholder Value Creation but the present study only analyzed the impact of major determinants (Dividend and Capital structure) on Shareholder Value Creation because ultimately the shareholders are always interested in dividend and company is always interested in its optimum capital structure. Therefore, the major objective of this paper is to study the impact of capital structure and dividend on shareholder value creation.

H_0: There is no significant impact of dividend and capital structure on Shareholder Value Creation.

3.3. Sample Size

The sample size consists of 30 SENSEX companies. Listing on an exchange is a stipulation since stock price information is required for calculating the cost of equity. The study used the data for a period of five years from 2009-2013. This study examined the Shareholder Value Creation in Indian companies by adopting Economic Value Added model. As per the literature review, this model is believed to be the superior model than the traditional measures (ROE, ROI, EPS, EP etc.) to analyze Shareholder Value Creation. The sample companies list used for the research is given in Table below:

Table 1
List of 30 Companies of BSE-SENSEX as on 31st March 2014

Industry	Companies
Aluminium	Hindalco Industries Ltd.
Automobiles - 2 and 3 wheelers	Bajaj Auto
	Hero Honda Motors Ltd.
	Mahindra & Mahindra Ltd.
	Maruti Suzuki India Ltd.
	Tata Motors Ltd.
Banking	Axis Bank
	HDFC Bank Ltd.
	ICICI Bank Ltd.
	State Bank of India
Cigarettes	I T C Ltd.
Computers – software	Infosys Technologies Ltd.
	Tata Consultancy Services Ltd.
	Wipro Ltd.
Electrical equipment	Bharat Heavy Electricals Ltd.
Engineering	Larsen & Toubro Ltd.
Finance – housing	Housing Development Finance Corporation Ltd.
Gas	GAIL India
Mining	Coal India
	Sesa Goa
Oil exploration/production	Oil & Natural Gas Corporation Ltd.
Personal care	Hindustan Unilever Ltd.
Pharmaceuticals	Cipla Ltd.
	Dr. Reddy's Lab.
	Sun Pharma
Power	NTPC Ltd.
	Tata Power Co. Ltd.
Refineries	Reliance Industries Ltd.
Steel and steel products	Tata Steel Ltd.
Telecommunication – services	Bharti Airtel Ltd.

3.4. Data Analysis Technique

The study was based on secondary data. The data was collected from capitaline and money control website. The Risk Free interest rate was collected from Reserve Bank of India web site. Regression technique was used in order to examine the impact of Dividend and Capital structure on Shareholder Value Creation (SVC). The capital structure was determined with help of Debt-Equity Ratio (i.e. Debt/Equity). For the purpose of comparing Shareholder Value Creation of various companies as well as industry, mean scores of Shareholder Value Creation were considered and the companies as well as the industries were ranked on the basis of those mean scores. The comparison of calculated data of Shareholder Value Creation has been analyzed with the help of tables and graphs also. Indian companies considered for this study were listed on BSE (Bombay Stock Exchange) as on 31st March 2014.

3.5. Scope and Limitation of the Study

The scope of study is limited to Shareholder Value Creation as measured by EVA. This method was chosen after extensive literature review. As per literature review, there are number of determinants of Shareholder Value Creation but the present study only analyzed the impact of major determinants (Dividend and Capital structure) on Shareholder Value Creation because ultimately the shareholders are always interested in dividend and company is always interested in its optimum capital structure. The study is also restricted to some selected Indian companies from selected Industries like Aluminum, Automobiles, Banking, Cigarettes, Computers – Software, Electrical Equipment, Engineering, Finance – Housing, Gas, Mining, Oil Exploration/Production, Personal Care, Pharmaceuticals, Power, Refineries, Steel And Steel Products, Telecommunication.

4. DATA AND MEASURES

4.1. Determination of Economic Value Added (EVA) of Selected Companies (2009-2013)

Shareholder Value Creation means the residual income for shareholders. It is the excess of return over cost of capital. It can be measured by EVA method. EVA is a measure of the financial performance that differs from most other methods because it includes a charge against the profit for the total cost of capital that company employs. The following equation is used for determining EVA:

$$EVA = NOPAT - (WACC*C.E)$$

- EVA = Economic Value Added
- NOPAT = Net Operating Profit After Tax
- C.E = Capital Employed

- WACC = Weighted Average Cost of Capital

Calculation of NOPAT

NOPAT= Operating Profit- Tax

Calculation of Capital employed

Capital employed = Net worth + Total debt

Calculation of Weighted Average Cost of Capital (WACC)

WACC= (Equity Capital / Total Capital*Cost of Equity) + (Debt / Total Capital*Cost of Debt) + (Preference Capital / Total Capital*Cost of Preference shares)

- Calculation of Cost of Equity (Ke) by the CAPM (Capital Asset Pricing Model method)

Ke = Rf +Beta (Rm - Rf)

The calculated data of Economic Value Added of 30 listed companies for the last five years has been shown in the following table:

Table 2
EVA of BSE SENSEX Companies from 2009-2013 (In Million)

Companies	2013	2012	2011	2010	2009
ITC	561664.75	47477.57	36349.55	29701.97	25003.75
Hindalco	-83084.00	12970.00	6964.700	-2617.20	9245.90
Tata Motors	3994.62	41919.87	24544.73	-20328.27	28540.75
M&M	24630.41	22972.18	17480.98	10068.55	9102.61
Bajaj Auto	-29632.16	-22228.96	-27380.35	-38662.71	-1481.70
Hero Honda	25104.92	28181.75	18938.44	206173.99	9708.77
Maruti Suzuki	185216.83	156218.04	128729.37	105382.15	97909.55
HDFC Bank	-88262.64	-67003.95	-55166.31	-56692.17	-44035.55
ICICI Bank	195543.85	180543.14	114167.25	15621.46	173697.39
SBI	625115.38	628625.28	425557.36	150396.81	442924.85
Axis Bank	140599.90	111199.20	73468.91	18726.54	46612.98
Infosys tech.	50961.04	76047.73	38503.07	12110.73	61477.23
Tata consultants	89353.32	83711.11	59989.13	39500.52	50892.52
Wipro	34839.41	27795.90	31626.92	28529.05	33662.73
BHEL	41671.70	47333.18	39624.85	16624.49	20354.86
L&T	23396.84	33174.22	18323.05	-17090.33	36769.13
HDFC	166707.95	140296.90	95873.65	75205.69	94102.23

contd. table 2

Companies	2013	2012	2011	2010	2009
GAIL India	25338.24	26490.242	22925.46	13588.40	19337.16
Coal India	-23931.91	1178.94	-18597.28	-95144.94	33465.67
Sesa Goa	-6214.11	9703.01	21434.67	15337.39	22478.51
ONGC	224592.33	332508.98	303861.84	282189.06	232349.90
Hindustan Unilever	26331.66	22376.70	18354.23	19496.87	22623.16
Sun Pharma	-2560.47	10166.10	7211.83	-5025.23	-972.31
Dr. Reddy's Lab.	9171.87	9357.21	5437.98	62.12	1394.52
Cipla	8953.65	7218.14	5988.16	6352.24	8555.65
NTPC	66017.58	44824.47	46087.74	36112.87	48674.44
Tata Power	3730.04	3392.03	4307.41	5282.84	4305.53
Reliance Ind.	254019.61	280213.17	327873.55	255794.45	209675.42
Tata Steel	40213.33	39686.35	46763.39	-2744.53	49354.93
Bharti Airtel	77704.72	72160.13	88927.47	85943.13	133205.21

Source: Computed

Interpretation

The above table shows the result of Economic Value Added of SENSEX companies in India from 2009-2013. The positive data of EVA presents that the companies are generating value and negative data shows that the companies are destroying value for investors. Mostly all companies are having positive EVA from 2009 to 2013 which indicates that these companies are not only thinking about profit maximization but also focusing on the objective of wealth maximization. If the company is creating Shareholder value it implied that the company is efficient in managing its resources as its profits are more than its WACC. The companies which give stress on the Wealth Maximization principle for the real owners, those companies will be able to attract the investors in future. It is also implied that the companies which creates Shareholder value will be financially sound. The above table shows that there are two companies (HDFC Bank and Bajaj Autos) which gave negative EVA from 2009 to 2013. It indicates that these companies are not generating wealth for shareholders. They are treated as value destroyer. The result implied that these companies are not able to control its cost of capital because of which their earnings are less than WACC. The management of the company has done a poor job in creating shareholders' value.

4.2. Impact of Dividend and Capital Structure on Shareholder Value Creation

As per literature review, there are number of determinants of Shareholder Value Creation but due to lack of time only the impact of major determinants such as Dividend and Capital structure is studied. The capital structure is determined with the help of Debt-Equity Ratio. It is calculated by applying the following formula:

Debt-Equity Ratio = Total debt (Long-term debt + Short-term debt) / Shareholders' fund (Equity share capital + Preference share capital + Reserves and Surplus + P & L a/c – Miscellaneous expenditure)

The Impact of key factors on Shareholder Value Creation is analyzed with the help of Regression Analysis. We took Shareholder Value Creation as dependent variable and Dividend and Capital structure as independent variable. As there is variation in the calculated data, we applied LOG to remove such variation and then we applied regression techniques with the help of SPSS. Therefore the regression equation is formed as:

$$Y = a + b_1 X_1 + b_2 X_2 + E$$

Where, Y = Shareholder Value Creation;

X_1 = Dividend;

X_2 = Capital structure

E = Error,

a = Intercept

b_1, b_2 = Regression Co-efficient

Table 3
Regression Analysis

Model	R	R Square	Adjusted R^2	Std. Error	F- Test	p-value
Regression	.636	.404	.360	.48372	9.152	.001*

*Significant at p<0.05
a. Predictors: (Constant), Equity, Dividend, Debt
b. Dependent Variable: SVC

Table 4
Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.(p- value)
	B	Std. Error	Beta		
(Constant)	2.633	.498		5.291	.000*
Dividend	.377	.180	.315	2.091	.046*
Capital structure (D/E ratio)	.325	.081	.607	4.027	.000*

*Significant at p<0.05
a. Dependent Variable: SVC

The above analysis shows that both Dividend and Capital structure have influence on the Shareholder Value Creation. As the significant value is less than

0.05, therefore our null hypothesis is rejected that there is no significant effect of Dividend and Capital structure on the Shareholder Value Creation. The overall model is significant as the p- value is 0.001. The value of R is 0.636 which shows high positive relationship between Independent variables and dependent variables. The value of R Square is 0.404 indicates that the 40.4 percent of variance is explained by dividend and Capital structure. It implied that approximately 60 percent variance will be explained by the rest of the factors which we have not considered in the present study due to the major limitation of less time. The above table shows the result that these factors have great impact on SVC, as the p- value of Dividend (0.04) and p- value of Capital structure (0.00) significant at 5 percent level of significance. Therefore, there is significant effect of Dividend and Capital structure (p-value<0.005) on Shareholder Value Creation.

4.3. Company Wise Comparison of Shareholder Value Creation

To compare the Shareholder Value Creation of various companies, mean scores of EVA are considered and the companies as well as the industries are ranked on the basis of these mean scores.

Interpretation

The table 5 shows the ranking given to different companies on the basis of average Economic Value Added. Some companies showed high wealth of shareholders like SBI, ONGC, ICICI Bank, Reliance Ind. and Maruti Suzuki etc. It indicates that these companies are creating shareholder value at higher level. Some companies shows low wealth of shareholders like Tata Power, Dr. Reddy's Lab, Hindalco and Sun Pharma etc. The results also shows that these companies are creating shareholder value at moderate level which is somehow satisfactory as these are not at least destroying the value of shareholders. Mostly all companies are having positive EVA from 2009 to 2013 which indicates that these companies are not only thinking about profit maximization but also focusing on the objective of wealth maximization. If the company is creating Shareholder value it implied that the company is efficient in managing its resources as its profits are more than its WACC. The companies which give stress on the Wealth Maximization principle for the real owners, those companies will be able to attract the investors in future. Some companies like HDFC Bank, Bajaj Auto and Coal India have negative value of EVA which clearly shows that these companies are completely destroying the value of shareholders.

The above table also shows the ranking of the companies on the basis of EVA. It can help the investors in taking investment decision in future. The top ranked companies are creating shareholders value and generate wealth for shareholders. It implied that the major objective of these companies is to create wealth for its shareholders. The companies are giving utmost importance to shareholders. Therefore the investors can invest into these companies to get the highest return.

Table 5
Ranking of 30 SENSEX Companies on the Basis of Economic Value Added (EVA)

Companies	Average (Mean scores) In million	Ranking
SBI	4545239.38	1
ONGC	275100.42	2
Reliance Ind.	265515.24	3
ICICI Bank	135914.62	4
Maruti Suzuki	134691.19	5
HDFC	114437.28	6
Bharti Airtel	91588.13	7
Axis Bank	7812.15	8
Tata consultants	64689.32	9
NTPC	48343.42	10
Infosys tech.	47819.96	11
ITC	38939.86	12
Tata Steel	34654.69	13
Bhel	33121.82	14
Wipro	31290.80	15
Hindustan Unilever	21836.52	16
GAIL India	21535.90	17
Hero Honda	20510.26	18
L&T	18914.58	19
M&M	16850.95	20
Tata Motors	15734.34	21
Sesa Goa	12547.89	22
Tata Power	4203.57	23
Dr. Reddy's Lab.	5084.74	24
Cipla	7413.57	25
Sun Pharma	1763.98	26
Hindalco	1316.40	27
Coal India	-20605.90	28
Bajaj Auto	-23877.18	29
HDFC Bank	-62232.12	30

Source: Computed

4.4. Industry Wise Comparison of Shareholder Value Creation

To compare the Shareholder Value Creation of various industries, mean scores of EVA are considered and the companies as well as the industries are ranked on the basis of these mean scores. The following tables showed the average of calculated EVA of selected industries:

Table 6
Mean Scores of Calculated EVA and Rankings of Selected Industries

INDUSTRIES	COMPANIES	Average EVA (In Million)	Industry wise average EVA (In Million)	Rankings
OIL EXPLORATION/ PRODUCTION	ONGC	275100.42	275100.42	1
REFINERIES	Reliance Ind.	265515.24	265515.24	2
BANKING	HDFC Bank	-62232.12	151581.98	3
	ICICI Bank	135914.62		
	SBI	454523.93		
	Axis Bank	78121.51		
FINANCE – HOUSING	HDFC	114437.28	114437.28	4
TELECOMMUNICATION– SERVICES	Bharti Airtel	91588.13	91588.13	5
COMPUTERS - SOFTWARE	Infosys tech.	47819.96	47933.36	6
	Tata consultants	64689.32		
	Wipro	31290.80		
CIGARETTES	ITC	38939.86	3893.98	7
STEEL AND STEEL PRODUCTS	Tata Steel	34654.69	34654.69	8
ELECTRICAL EQUIPMENT	BHEL	33121.82	33121.82	9
AUTOMOBILES	Tata Motors	15734.34	32781.91	10
	M&M	16850.95		
	Bajaj Auto	-23877.18		
	Hero Honda	20510.26		
	Maruti Suzuki	134691.19		
POWER	NTPC	48343.42	26273.49	11
	Tata Power	4203.57		
PERSONAL CARE	Hindustan Unilever	21836.52	21836.52	12
GAS	GAIL India	21535.90	21535.90	13
ENGINEERING	L&T	18914.58	18914.58	14
PHARMACEUTICALS	Sun Pharma	1763.98	4754.10	15
	Dr. Reddy's Lab.	5084.74		
	Cipla	7413.57		
ALUMINIUM	Hindalco	1316.40	1316.40	16
MINING	Coal India	-20605.90	-4029.00	17
	Sesa Goa	12547.89		

Interpretation

In table 6, various industries are ranked on the basis of average EVA and all the industries are having positive EVA except one i.e., mining industry. Analysis revealed that the first position is occupied by Oil Exploration/Production industry with 275100.42 million, second position is of refinery industry with 265515.24 million and third position is occupied by banking industry with 151581.98 million. It shows that the major objective of these industries is to generate wealth for its

shareholders.The industries are giving utmost importance to shareholders. Therefore the investors can invest into these industries to get the highest return. But mining industry is destroying the wealth of shareholders with -4029.00. Mining industry is not giving importance to the wealth creation of shareholders.

5. CONCLUSION

The study explored that most of the companies are having positive EVA from 2009 to 2013. These companies are not only thinking about profit maximization but also focusing on the objective of shareholders' wealth maximization. SBI, ONGC and Reliance Industries are the top most companies in creating value for shareholders; therefore companies will be able to attract the investors in the future. HDFC Bank, Bajaj Auto and Coal India are completely destroying the value of shareholders. It also indicates that these companies are not generating wealth for shareholders. They are treated as value destroyers. Also after doing a regression analysis we found out that dividend and capital structure have a 40 percent impact on shareholder value. Later on, in a sector wise analysis we found that the Oil exploration/production, Refinery and Banking sectors create the most shareholder value amongst others in the study.

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