ABSTRACT OF THE PH.D THESIS

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STUDY OF MEASUREMENT OF WEALTH CREATION BY
CAR MANUFACTURERS THROUGH ECONOMIC VALUE
ADDED CONCEPT BETWEEN 2001 TO 2005

Subject: Accountancy
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1. INTRODUCTION:

Today maximizing shareholders’ wealth has become the new corporate paradigm. Shareholders’ wealth is measured by the returns they receive on their investments. Returns are in two parts, from dividends and capital appreciation reflected in the market value of shares, of which market value is the dominant part.

Wealth maximization means creation of maximum value for company’s shareholders which mean maximizing the market price of the shares. Shareholders’ wealth is result of companies’ performance management. In order to measure the performance companies’ management, several tools have been used. Some tools are traditional profit based measures and some of them are new trendier value based performance measures. Among new performance measures, Economic Value Added (EVA) has received attention and recognition in accounting and financial literature as a vital tool to measure corporate performance.

EVA is a measure of corporate performance that differs from others by including charged profits against cost of all the capital employed. EVA against other measure tools emphasis that if a firm wants to create wealth for its owners, it must earn more on its total invested capital than the cost of the capital. Operationally defined, EVA is the difference between Net Operation Profits after Taxes (NOPAT) and capital charge.

2. PURPOSE OF THE STUDY:

The basic theme of the study is woven around the relationship between Shareholders’ Wealth and Economic Value added (EVA) in Indian Car Manufacturers Companies, listed in Bombay Stock Exchange (BSE).

The first reason for undertaking this study is assessment of Indian Car Manufacturer Companies ability to create shareholders’ wealth.

The researcher is of the opinion that positive or negative EVA affects earning per share, the market share price, the market value of company and thereby the shareholders’ wealth. Therefore EVA is a measurement tool for
measuring the shareholders’ wealth. Finding out the relationship between created shareholders’ value and EVA is the second main reason for selection of this study.

Considering the relationship between Shareholders’ Wealth and other operation company's measures tools, in order to find out the best tool to measure the performance management is the third reason for undertaking this study.

3. OBJECTIVES OF THE STUDY:

The main objectives of the study are as follows:

1. To identify that Indian car manufacturer companies have created wealth for their shareholders during 2001 to 2005,
2. To identify that created wealth for shareholders in the study period is more than other benchmarks,
3. To introduce the Economic Value Added as a new report for measuring the management performance, and review the particulars, capabilities, that are drawn from EVA report,
4. To study the relationship between Economic Value Added with two parts of shareholders' wealth viz: earning per share and share price in stock exchange market,
5. To measure Shareholders’ Wealth through Economic Value Added,
6. Comparison different operation measurement tools, to identify which has more relationship with Shareholders' Wealth,
7. To identify the incorrect financial information which leads to wrong decision making,
8. To offer suggestions that can improve quality of financial information.

4. HYPOTHESIS OF THE STUDY:

1. Indian car manufacturer companies have created wealth for their shareholders during the period of 2001 to 2005,
2. The created shareholders’ wealth in the period of the study is more than the rate of required return, sensex and risk free rate of return,

3. There is a meaningful relationship between shareholder’s return, with sensex, rate of required returns and risk free rate in car manufacturer companies,

4. Measurement the Shareholders’ Wealth through EVA is a meaningful concept.

5. Market Value Added that reflects the Created Shareholders’ wealth of a company has a significant relationship with EVA,

6. There is a significant relationship between EVA and market share price,

7. There is meaningful relationship between EVA and Earning per Share,

8. EVA as a measurement tool can be used to measure the shareholder wealth,

9. EVA is the best measurement tool to measure the performance management.

5. PROCEDURE AND METHODOLOGY:

5.1. SCOPE OF THE STUDY:

As the Indian market has adjusted itself to the new environment, thus relevant performance metrics are required to be employed, in order for investments as well as for information. In this study the Economic Value Added as a useful measure in this regard has been measured.

The study covered a period of five years starting 2000-2001 and ending 2004-2005. The study has been restricted to 10 Car Manufacturers Companies listed in Bombay Stock Exchange.

5.2. SELECTION OF THE COMPANIES:

There are 48 companies that are engaged in manufacturing of Automobile in India. Twenty six of these companies have been listed in Bombay Stock Exchange. Out of which only twenty three of them are active in BSE.

As the study is related to shareholders’ wealth, ten companies which had maximum number of deals and trades have been selected for in depth analysis.
5.3. COLLECTION OF DATA:

Some data of this study is based on secondary data in the form of published Annual Reports of Indian Car Manufacturers Companies. Besides, large quantity of data has been collected from the “Research, Statistics and Publication Department” and from the “Library” of Bombay Stock Exchange. Journal of Capital Market is one of the rich sources in these types of researches. Capital Market Journals and a large number of Annual Reports have been referred to the Library of NIBM. Various web sites in internet have been used for compiling of the data.

5.4. PERIOD OF THE STUDY:

The period of the study is for five years, from 01-04-2000 to 31-03-2005. So Data obtained have been dealt with “collection of data” section, which has been restricted to the above mentioned five years.

5.5. ANALYSIS OF DATA:

In order to achieve the results of the study the researcher has used trend analysis in the three section of analysis. Calculation the rate of growth of variables was a good comparative manner. In order to neutralization the affect of unusual figures in the result, the average values of variables have been calculated.

In order to find out any relationship between different variables, Pearson correlation coefficient has been calculated. Scatter plots of Shareholder Wealth and other variables also have been drawn.

Microsoft Excel and SPSS Software package have been used for the purpose of analysis. The analysis has been done in to three Sections:

In the first section of analysis, In order to evaluate the position of creation wealth in listed companies, the shareholder’s returns has been compared with other benchmarks like: Zero, Return of Treasury Bonds (free risk Government bonds or Risk free Rate), Required Return to Equity, Shareholder’s returns of companies in the same industry and Return of the Stock Market Index (Sensex).
In section two, the study tried to find out whether any relationship existed between EVA and Shareholders’ Wealth. Shareholder wealth would be maximizing only if the company’s managers are able to add value to the total Equity Capital. This added value is Market Value Added (MVA) and MVA is equal with present value of future stream of EVA. In other words, MVA shows how much value the market adds over the book value of invested capital. This means consistent improvement in EVA drives market value of equity. Therefore relationship between MVA and CSV leads relationship between shareholders wealth and EVA. So in this section for analysis and measuring the created Shareholders’ Wealth through EVA, the Market Value Added has been used. At first an effort has been made to analyze the relationship between MVA and CSV in car manufacturer companies. In this section, in order to confirm that Shareholders’ wealth can be measured through Economic Value Added, the relationship between MVA as the criterion of Created Shareholders’ Wealth and EVA has been considered.

The third section analysis deals with whether shareholder wealth has more correlation with EVA than other performance measures like Earning per Share (EPS), Return on Capital Employed (ROCE), Return on Net Worth (RONW), and Net Operation Profit after Tax (NOPAT). The purpose was to find out whether any significant relationship exists between shareholder wealth and EVA.

6. CHAPTER SCHEME:

CHAPTER 1: FRAMEWORK OF THE STUDY:

In this chapter, the overall scheme of the study has been elaborated. The introduction of the topic, Significance of the study and Background of the study has been explained.

CHAPTER 2: STUDY OF PREVIOUS LITERATURE REGARDING EVA:

This chapter deals with the review of earlier literature regarding EVA. This chapter contains the following aspects of review of relevant literature studied from different angles:
1. Review of generalities about EVA
2. Review of particulars of EVA
3. Review of capabilities of EVA

CHAPTER 3: RESEARCH DESIGN:

This chapter discusses the Objectives, Problems, Purpose, Scope of the study, Period of the Study, Method of data collection, Hypotheses, Method of analysis of data relevance of the study and Limitations of the study.

CHAPTER 4: CALCULATIONS AND PREPARATIONS OF REPORTS:

In this chapter, because most of the selected companies have not prepared the EVA and other reports, the researcher has tried to prepare the EVA and other reports for these companies based upon their initial information by them. These data are classified in four sections:

1. Calculation of the Economic Value Added (EVA);
2. Calculation of the Market Value Added (MVA);
3. Calculation of the Created Shareholder Value (CSV);
4. Calculation of the Return on Capital Employed (ROCE) and Return on Net Worth (RONW).

CHAPTER 5: ANALYSIS OF DATA

Chapter five is the backbone of the study. It discloses the results of analyzed data. These results are supported by statistical techniques, such as Pearson Correlation Coefficient Analyses, Trend Analysis, and measurement of results on the basis of percentage, so on. After interpretations of the findings, major conclusions have been made in this chapter.

CHAPTER 6: SUMMARY, SUGGESTIONS AND RECOMMENDATIONS:

This chapter recapitulates the Observations and Conclusions of the study. Certain Suggestions and Recommendations are incorporated and the areas of further researches are also spelt out.

7. FINDING & CONCLUSION:
Acquired results in this study indicate that all the specific objectives mentioned in this study have been achieved.

In the overall analysis, the first part of study reveals that Car Manufacturers Companies have created value a return that is 46% more than Rate of Required Return, 40% more than the average of Sensex, 56% more than the average of Risk Free Rate of Return and 8 times more than the average of Risk Free Rate.

The result of analysis in the second part of this study indicates that 90% of companies under study had positive CSV and positive MVA. The P-value of Pearson Correlation Coefficient between EVA and MVA also is smaller than 0.01 and the amount of correlation is 49%. This has made certain the measuring of Shareholders’ Wealth through Economic Value Added Concept.

Third section of analysis has shows that, there was not any significant relationship between CSV with ROCE and RONW, but there were a significant relationship between CSV with EPS, NOPAT and EBDIT.

In short, the following findings have been achieved during the present study.

1. Economic Value Added and its generalities, particularities and capabilities have been introduced as a new financial report,
2. This study identified that in order to present the correct financial data to shareholders and other financial information users, the cost of equity capital has to be considered as a segment of cost of capital in financial information,
3. Capital asset pricing model, as an easy model to calculate the cost of equity capital that is based on beta has been introduced.
4. It is identified that Indian car manufacturer companies have created wealth for their shareholders in the period of 2001 to 2005”,
5. It is identified that created wealth for shareholders in car manufacturer companies in the period of study was more than other benchmarks,
6. Economic Value Added as a new report for measuring the management performance has been introduced,
7. It is confirmed, in car manufacturer companies MVA that is equal to CSV, had closest relationship with EVA,

8. It is identified that the measurement of shareholders wealth in Car Manufacturer Companies through Economic Value Added is meaningful, because there has been a meaningful relationship between CSV, MVA and EVA,

9. It is confirmed that in Car Manufacturer Companies, there was a significant relationship between Economic Value Added with Earning per Share,

10. It is confirmed that in car manufacturer companies there was no significant relationship between EVA and share price in stock exchange market as the elements of shareholders’ wealth. Because in these companies the share prices were influenced by the expectations of the shareholders and shareholders’ expectations were influenced by traditional measurement tools,

11. It is confirmed that in case of familiarity of car manufacturer companies shareholders with EVA, then their expectations of share price in capital market has been affected by EVA. Thus it is possible to achieve a higher relationship between EVA and Shareholders Wealth.

12. It is identified that in car manufacturer companies, financial users have used NOPAT, EBDIT and EPS, as reliable information when they wanted to make decisions.

13. It is identified that shareholders and other financial information users in car manufacturer companies, have used that kind of data which is easily available,

14. This study has introduced incorrect financial information which may leads to making wrong decision by investors.

15. The present study has offered some suggestions to improve the quality of company’s financial information,
8. RECOMMENDATIONS:

1. During the collection, preparation and analysis of data it has been observed that users of financial information, use that kind of data which is easily available and understandable. This study recommends the Indian car manufacturer companies to start preparing new performance measurement reports such as EVA, MVA, and CSV. so these data will be understandable for all of the financial information users;

2. Investors in Capital Market need that kind of financial data which would enable them to forecast their investments returns. This study suggests listed companies in BSE to disclose the created shareholders wealth per share every year;

3. Indian companies can play a vital role in the new Indian economic climate. As a first step they should adapt themselves with the new economic conditions in the world. One of these conditions is preparing and presentation of financial information to shareholders. Therefore this study suggests that Indian companies should compulsorily start to adapt themselves to these conditions;

4. In addition to initial financial information, financial decisions makers need some analysis on these data. The present study, in order to help the financial decisions makers, suggests companies to start preparing some analysis reports based on EVA and Shareholders’ Wealth;

5. Listed companies in BSE can estimate the market value of their stocks by using of Market value added. This can correct the shareholders expectations of share price. So it can be enable them to make the best decision about their investment;

6. In addition to preparing accounting profit, Indian companies can prepare economic profit as an extra financial information;

7. Indian companies can use EVA as a reward system in order to increase the management performance;

8. Having an active and updated Capital Market is one of the new economic conditions. It can help the listed companies to adapt themselves to new
conditions of world economy. BSE is the oldest capital market in Asia, but for now in order to adapt to the new economic conditions, it needs to revise its rules and provisions;

9. Mere preparation of new measuring reports, such as EVA, MVA and CSV is just not enough. Recognition and implementations of these reports is usually important. Institutes, Regulatory Authorities, Universities, Authors of Financial Journals and Newspapers can play a significant role to introduce these reports to financial users;

10. BSE as one of the reliable center for financial data should force the listed companies to present new measurements reports as an essential report to their shareholders;

11. In order to attract the foreign investors to invest in Indian car manufacturer companies, these companies should prepare EVA, CSV and MVA reports as the additional financial data;

12. The results and findings of this study are important for Companies, Institutions, Regulatory Authorities, and so on in their policy formulations;

13. This research was the first study about the relationship between EVA and shareholders’ value in Indian car manufacturer companies. Further researchers should study the other aspects of this study;

14. Finally this research engages in measuring created shareholders’ wealth through EVA in car manufacturer companies. There is need to study this subject in all other major Indian industries.