CHAPTER II
THEORETICAL BACKGROUND, PROFILE OF BSE 100 AND REVIEW OF LITERATURE

In this chapter the researcher has traced the theoretical background of the study and the profile of BSE 100. The researcher has also pointed out the existing studies in this research area for finding out the Research Gap.

2.1 INTRODUCTION

In today's marketplace success largely depends on creating shareholder value. Now-a-days pressure on corporate executives to manage and report the creation of shareholder value on a regular basis has been increasing. In the emerging field of shareholder value analysis, various measures have been developed that claim to quantify the creation of shareholder value and wealth. More than ever, corporate executives are under increasing pressure to demonstrate on a regular basis that they are creating shareholder value, which has led to an emergence of a variety of measures that claim to quantify value-creating performance.

Economists say that, value is created when management generates revenues over and above the economic costs to generate these revenues. Various costs come from four sources: employee wages and benefits; material, supplies, and economic depreciation of physical assets; taxes; and the opportunity cost of using the capital. According to value-based view, value is only created when revenues exceed all costs including a capital charge. This value accrues mostly to shareholders because they are the residual owners of the firm. Generate value over and above the costs of resources consumed, including the cost of using capital are the Shareholders expectation from the management. Value will be lost, if suppliers of capital withdraw their capital in search of better returns, when they do not receive a fair return to compensate them for the risk they are taking. It will be hamstrung by a share price that stands at a discount to the underlying value of its assets and by higher interest rates on debt or bank loans demanded by creditors and a company that is destroying value will always struggle to attract further capital to finance expansion. Wealth creation is denoted by changes in the wealth of shareholders on a periodic (annual) basis. Changes in shareholder wealth are inferred
mostly from changes in stock prices, dividends paid, and equity raised during the period in case of listed firms. Since stock prices reflect investor expectations about future cash flows, creating wealth for shareholders requires the firm to undertake investment decisions that have a positive net present value (NPV).

2.2 Measuring Shareholder Value

A company can measure shareholder value in two approaches. If a company is listed in stock exchanges the value can be found out from the market value of shares. The value based measures help to measure the value created in the capital markets for the shareholders. If the company is not listed in any of the stock exchanges, the value could be calculated by the accounting information and the expected performance. It is also known as intrinsic value measures. Intrinsic value measures, measure the value created by the company through the utilization of management of resources. These measures can also be applied for the listed companies also.

2.3 Value Based Management Measures

In 1994, Taggart, Kontes and Mankins suggest a model that links the company's strategy to its value in capital markets. They figured out the chief drivers of organisation and they are Governance, Strategic Planning, Resource allocation, Performance management and top management compensation. Share prices in the market and competitor share price in the market with the intrinsic value of shares are the factors based on which the investors take investment decisions. Measuring and managing of shareholder value comprehensively involves metrics such as Economic Value Added (EVA), Cash Flow Return on Investment (CFROI), Shareholder Value Added (SVA), Market Value Added (MVA), Economic Profits and Economic Earnings and the like.

2.4 Approaches for measuring shareholder value

2.4.1. Share Holder Value Added

One way of measuring, what a company stock is generally worth to shareholders, or how it is likely to compensate those who invest money into it is Shareholder Value Added (SVA). In SVA, finance pros takes the net operating profit after tax (NOPAT), and subtracts the cost of equity. This helps to show a “value” for the company, albeit a subjective one. This is the basic idea behind SVA. For a company to truly provide for its
stockholders, equity returns (profits) have to exceed equity costs, the total value of outstanding shares. This is just a general value measurement that can help to show how equity is balanced against real profits from a company. Shareholder value added measurement is based on Weighted Average Cost of Capital (WACC). WACC is essentially the “balanced” valuation of different costs of capital. Common stock, preferred stock, bonds, and long term debt are all different kinds of cost of capital categories for a business. A weighted average cost of capital paradigm ensures that these are fairly valued.

2.4.2 Economic Value Added

Stern Steward has developed the concept of Economic Value Added. Companies across a broad spectrum of industries and a wide range of companies have joined the EVA bandwagon. EVA is a useful tool to measure the wealth generated by a company for its equity shareholders. It is also referred to as the measure of residual income after meeting the necessary requirements for funds.

Computation of EVA

EVA is essentially the surplus left after making an appropriate charge for capital employed in the business. It may be calculated by using the following equation.

\[ \text{EVA} = \text{Net operating profit after tax - Cost charges for capital employed} \]

EVA is the net earnings in excess of the cost of capital supplied by lenders and shareholders. It represents the excess return (over and above the minimum required return) to shareholders. It is the net value added to shareholders

Chief features of EVA Approach

EVA is a performance measure that ties directly, theoretically as well as empirically, to shareholder wealth creation. It converts accounting information into economic reality, that is readily grasped by non financial managers. It is a simple, yet effective way of teaching business literacy to everyone. It serves as a guide to various decisions such as strategic planning, capital budgeting acquisitions and operations. It is an effective tool for investor communication. The third method to determine the shareholder economic value is to calculate the value of equity by discounting cash flows available to shareholders by the cost of equity.
Nowadays, the company can place successful market only by creating value to their shareholders. The pressure of the company has been gradually increasing to create and to maintain the report of the creation of shareholder value and to adhere to the present trends in the market. More than ever, corporate executives are under increasing pressure to demonstrate on a regular basis that they are creating shareholder value, which has certainly led to a variety of measures that claim to quantify value-creating performance. The companies are now applying the various concepts like value innovation, value chain, value added, value analysis, value steam mapping and the like to create the value. Shareholder value creation refers to the value created when the management earns more revenue over and above the economic costs to generate the earnings, In an economist’s view. From the value based view, the value creation means when the revenues exceed all costs including the capital charge. This value accrues mostly to shareholders because they are the real owners of the firm.

Shareholder wealth creation means the changes in the wealth of shareholders on a periodic basis, which are inferred mostly from the changes in stock prices, dividends paid, and equity raised during the period. The value perspective is based on measuring value with the help of accounting based information with adjustments. The wealth creation relies mainly on stock market information. Creating value to its shareholders, customers and employees in sustainable manner is the prime duty of any business. Value creation is a concept that can be applied in a wide variety of contexts by the way of buying a product, obtaining service, working for a company as well as investing in a business.

The value creation is needed when investment is made in the form of money, effort or time. When the benefit is greater than the benefit that was demanded and vice versa, there will be value creation. Economic Value Added, popularly known as EVA, has become an increasingly popular mantra for a large number of businesses. Proponents of EVA, which include the bluest of the blue chip companies like Coca Cola, AT&T, Philip Morris, RJR Nabisco, Quaker Oats swear that EVA is the miracle that rejuvenates a company from top to bottom. EVA is said to be the panacea that improves corporate governance, makes managers think, act and get paid like owners and re-engineers the financial management system to measure and reward value-creating activities.
EVA Explained

Financial statements measure earnings as the residual after all factors of production other than shareholders, have been paid for their services. Similarly, administrative and marketing expenses are accounted for and so is the interest payments, which represents the "rental charge" on debt capital employed in the business. The residual is the net income that belongs to shareholders. Equity capital is a scarce economic resource with an opportunity cost, just as any other factor of production. Yet, financial statements do not explicitly account for the opportunity cost of equity capital. EVA is computed by subtracting from the net income the opportunity cost of equity capital as if it were leased from outside. If the business’ net income equals the opportunity cost of equity capital employed, then business has not added any value, even if it appears to have a sizable net income. Shareholders could have earned an equal amount by investing in capital market opportunities of similar risks. If a business earns less than the opportunity cost of equity capital employed, it has destroyed value because it has made shareholders poorer than they would be if they had realized expected returns on opportunities of similar risk in capital markets. The fair market value of equity for a growing concern equals the replacement cost of its assets added to the net present value of the expected investment opportunities. The net present value computation accounts for the opportunity cost of all capital. By subtracting from the fair market value of equity the replacement cost of capital employed, we get a measure related to EVA called the Market Value Added ("MVA"). Not surprisingly, MVA is much more highly correlated with EVA than earnings, earnings per share, return on assets or return on equity.

Why Is EVA Important

A modern corporation can be viewed as a nexus of a variety of explicit and implicit contracts involving several stakeholders, which includes employees, customers, suppliers, lenders, the community and shareholders. These stakeholders provide resources and services to the business enterprise and expect to get compensated. Shareholders provide the risk capital that guarantees the performance of the corporation’s explicit and enforceable contracts by subordinating their financial claim to that of other stakeholders. Shareholders willingly accept a residual claim and get paid only if there is anything left
over after employees, suppliers, taxes and other claims have been satisfied. In return, for providing the risk-bearing function, shareholders get unlimited upside potential by acquiring property rights to the residual income.

In order to efficiently perform their role as bearers of risk in a modern corporation, shareholders should diversify their investments across a large number of different enterprises. By diversifying their portfolios, they eliminate a large part of the risk they bear. In a competitive marketplace, the price of risk will be determined by those shareholders, who are able to bear the risk, namely, diversified investors. Therefore, market price of risk will only reflect risk which does not disappear in a diversified portfolio.

The fact that equity investors should, and routinely diversify to perform efficiently their risk-bearing roles which creates the dilemma that is the central concern of corporate finance. When shareholders are diversified and own small ownership stakes in several business entities, they are unable to monitor their investments. It is not in the interest of each shareholder to individually expend resources monitoring the operations of a company because doing so would cause each shareholder to incur full cost of such efforts while any benefit would be shared by all shareholders. The market will fail to provide for meaningful monitoring by shareholders even if it were in their collective best interest, which is rightly called by economists as market failure due to the free rider problem.

The separation of ownership of equity capital from the control of such capital by professional managers creates a potential conflict of interest. Managers of a business need not to necessarily be guided by incentives to enhance shareholders’ wealth and it is called by economists as agency problem. Management of corporations based on EVA will maximize shareholders’ wealth. In order to achieve this objective, shareholders should compensate management on the basis of incremental EVA they generate.

The marginal profitability of their product without regard to opportunity cost of equity capital is being estimated by most companies. Suppose a company finds that a certain operation is profitable by traditional measures and it decides to incur additional investment to increase production. The company may find that its profits have increased but its stock price has dropped because the shareholders could have earned higher marginal profits by investing elsewhere. EVA-based analysis will always provide the way
to motivate managers to act in shareholders’ interests. Their compensation should depend on increases in EVA they produce. Managerial objectives based on increasing income or market share, increasing return on assets or equity or other traditional measures can provide incentives inconsistent with maximizing the shareholders’ wealth. Maximizing EVA will always produce incentives to maximize shareholders’ wealth.

2.4.3 Market Value Added

Another kind of measure of corporate returns to shareholders is a market value added assessment. Not all traders and investors use SVA, but it can be helpful just to see that a company can make its own money and stand on its own legs. In market value added (MVA), the calculator takes all “capital claims” against the market value of a company’s debt and equity. The MVA is an often-used tool for looking at how a company might return profit to shareholders. Investors use these kinds of tools to look realistically at projected returns before buying a company. In modern times, the application of higher math to financial markets has led to a much greater variety of items like SVA and MVA that help those with money to look clearly at options for allocating that money towards investments that will pay off.

MVA and its Characteristics

Value based management and shareholder value analysis are well known concepts in the 1980’s, but there is now a renewed interest in them and also newer related concepts such as MVA. Market value added is the difference between the Company’s market and book value of shares. According to Stern Stewart, if the total market value of a company is more than the amount of capital invested in it, the company has managed to create shareholder value. If the market value is less than the capital invested, the company has destroyed shareholder value.

Book value of equity refers to all equity equivalent items like reserves, retained earnings and provisions. In other words, in this context, all the items that are not debt (interest bearing or noninterest bearing) are classified as equity. Market value added (MVA) is identical in meaning with the market–to–book ratio. The difference is only that MVA is an absolute measure and market–to–book ratio is a relative measure. If MVA is positive, it means that the market–to–book ratio is less than one. According to
Stewart, Market value added tells us how much value the company has added to, or subtracted from, its shareholders investment. Successful companies add their MVA and thus increase the value of capital invested in the company. Unsuccessful companies decrease the value of the capital originally invested in the company. Whether a company succeeds in creating MVA or not, depends on its rate of return. If a company’s rate of return exceeds its cost of capital, the company will sell on the stock market with premium compared to the original capital. On the other hand, companies that have rate of return smaller than their cost of capital sell with discount when compared to the original capital when invested in the company. Whether a company has positive or negative MVA depends on the rate of return compared to the cost of capital. Market value added can also be defined in relation to Economic Value Added (EVATM). By increasing EVA, a company increases its market value added or in other words increases the difference between Company’s value and the amount of capital invested in it. The relationship of MVA with EVA has its implication on valuation. By rearranging the formula, market value of equity can be defined as:

$$\text{Market value of equity} = \text{Book value of equity} + \text{Present value of all future EVA}.$$ 

MVA is essentially the difference between the company’s current market value, as determined by its stock price, and its economic book value. The shareholder value creation approach helps to strengthen the competitive position of the firm by focusing on wealth creation. It provides an objective and consistent framework of evaluation and decision-making across all functions, departments and units of the firm. It can be easily implemented, where the only additional input needed is the cost of capital. The adoption of the shareholder value creation, approach requires a change of the mind-set, and educating managers about the shareholders value approach and its implementation.

2.5 PROFILE OF BSE 100

2.5.1. History

The Bombay Stock Exchange which had its inception in 1850, is the oldest exchange in Asia. has its history inception in 1850s, when four Gujarati and one Parsi stockbroker gathered under the banyan trees in front of Mumbai’s Town Hall. Constant increase in the number of brokers changed the location of these meetings many times.
The group eventually moved to Dalal Street in 1874 and in 1875, it became an official organization known as 'The Native Share & Stock Brokers Association'. Official recognition by the Indian Government under the Securities Contracts Regulation Act to BSE was given in 1956. BSE SENSEX came into force in 1986, by Bombay Stock Exchange, giving the BSE a means to measure overall performance of the exchange. Derivative trade became common at BSE from the year 2000. In the year 2000 the BSE used this index to open its derivatives market, trading SENSEX future contracts. The development of SENSEX options along with equity derivatives followed in 2001 and 2002, expanding the BSE's trading platform. Historically, an open outcry floor trading exchange, the Bombay Stock Exchange, switched on to an electronic trading system in 1995 by taking only fifty days for transition. This automated, screen-based trading platform called BSE On-line trading (BOLT), currently has a capacity of 8 million orders per day. The BSE has also introduced the world's first centralized exchange-based internet trading system, Bseweb.co.in to enable investors anywhere in the world to trade on the BSE platform. The BSE is currently housed in Phiroze Jeejeebhoy Towers at Dalal Street, Fort area.

2.5.1 Base Year: The base year will be the financial year 1983-84 considering the price stability during that year and proximity to the index series. S&P BSE-100 index is re-based to 58 from 100 with effect from June 4, 2012.

2.5.2 S&P BSE Dollex-100: BSE also calculates a dollar-linked version of S&P BSE-100 and historical values of this index are available since its inception.

2.6 S&P BSE-100 index - Scrip Selection Criteria

1. Eligibility is based on the Equities of companies listed on BSE Ltd. (excluding companies classified in Z group, listed mutual funds, scrips suspended on the last day of the month prior to review date, stocks objected by the Surveillance department of the Exchange and those that are traded under permitted category and SME category).

2. Listing History: Minimum of 3 months of the stock’s listing history at BSE is required. If the average free-float market capitalization of a newly listed company ranks in the top 10 of all the companies listed at BSE, an exception may be granted for one month. A minimum listing history is not required, in the event that a company is listed on account of a merger / demerger / amalgamation or otherwise.
3. The shares of the company should have been traded at 95% of the trading days in the last three months. Exceptions can be made for extreme reasons like scrip suspension etc.

4. The list of constituents selected through Steps 1-3 are ranked on Average Free-Float Market Capitalisation, Average Turnover and Average Impact Cost.

5. 75% weightage to Average Turnover Rank and 25% weightage to the Average Impact Cost Rank will be given for calculating liquidity rank.

6. 75% weightage to Average Free-Float Market Capitalisation Rank and 25% weightage to Liquidity Rank will be given for final rank.

7. The filtered list of constituents selected through step 6 is sorted out on Final Rank.

8. Exclusion is based on constituents ranking beyond 200 on Final Rank.

9. The remaining companies are then sorted based on whether they are an existing member of the BSE-100 constituents or on the Final Rank.

**REVIEW OF LITERATURE**

In any study, the review of previous studies are considered important for getting a better understanding of the problems, the methodology followed and to identify the unexplored part of the field of study under consideration. In this regard, a review of some of the studies in the field of present study has been undertaken and presented in the following section.

Erik Stern (2013)\(^1\) has examined the question why EVA is the best measurement tool for creating shareholder value. The author concludes that the EVA correlates better with stock price than with any other measure by 50 percent, compared with up to 30 percent for other metrics and he also stated that EVA charges for all the factors of production, continuous improvement in EVA always furnishes investors with an increase in value.

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\(^1\) Erik Stern, *"Why EVA is the best measurement tool for creating shareholder value"*, May 2013 at http://www.qfinance.com.
Arabsalehi and Mahmoodi (2012)² have investigated the explanatory power of four value based measures including EVA, Refined EVA, MVA and SVA and compared it with five accounting based measures including EPS, ROE, ROA, Cash flow from operations and Return on sales in explaining stock returns. The study conclude that the value based measures add only marginal information content beyond accounting measures. However, the results indicate that the accounting measures generally dominate value based measures.

Daiva Burksaitiene (2012)³ made an analytical study on Measurement of value creation namely Economic Value Added and Net present value. This paper analyses EVA and Discounted Cash Flow techniques that are used to measure value creation of companies. He commended a positive EVA signals value creation. He concludes that both NPV and EVA are related to shareholder value and the use of both these approaches may be effective tools in fact, to create value for investors. Both approaches show that value is created only if the company can earn in excess of investor required returns when measured by the cost of capital.

Pratapsinh Chauhan (2012)⁴ has examined the shareholder's value creation in the Indian petroleum industry. He has analysed the performance of the company with the help of EVA, MVA, NOPAT, PAT, Market capitalization and EPS. The study revealed that the EVA has significant correlation with OP, NOPAT, EPS, Market Capitalization and MVA figures of firms both Private and Public sectors. The correlations between EVA and OP for public and private sector petroleum firms have been high and positive correlation. The study also revealed that the private sector petroleum firm's trend of EVA and MVA was higher than the public sector petroleum firm. EVA and MVA which are considered to be an effective indicator of shareholder value creation, is also highly sensitive and is associated with the market capitalization of firm and market value added in both sectors.

³ Daiva Burksaitiene, Measurement of value creation: Economic value added and Net present value”, 2012 at www.ktu.edu
Ritesh Jayantibhai Patel, Mitesh Patel (2012)\textsuperscript{5} tried to analyze the Impact of Economic Value Added (EVA) on Share Price: A Study of Indian Private Sector Banks. The study concludes that in the year 2010, ICICI bank has maximum NOPAT. The value of EVA was ranging from 14.18% to 91.14% during 2010. Only Kotak Mahindra bank has positive correlation between Kotak Mahindra Bank EVA and Kotak Mahindra Bank share prices. Rest of the banks, have negative relation between their respective EVA and the share price and the study also concludes that the hypotheses were developed to test significant impact of EVA on stock price of bank and that hypothesis was tested by using ANOVAs.

Maja Ilic (2010)\textsuperscript{6} has made an attempt to show the practical examples of the extent to which traditional assessment of a company's success may differ from the business overviewed from the perspective of Economic Value Added. The study was concluded that the application of the concept of Economic Value Added could lead to significant improvements and developments in companies. Through additional reports, shareholder would be better informed, which would contribute to attracting new investors and subsequently the reduction of additional debt.

Ashok Kumar and Karambal (2008)\textsuperscript{7} clearly stated that "Shareholder value creation is based on the principle of "The survival of the fittest" of Economics. As our economy, approaching towards complete liberalization and government control, is gradually going away, and hence companies are bound to take decisions purely on commercial basis to safeguard the interest of their shareholders. The concept of Shareholders' value and economic value added are well-known to Indian corporate. But its applicability in our country is of recent origin. Hence the practitioners differ in the methodology of calculation of adjustment required for accounting profit to net operating profit after tax, beta and risk free rate of return"


Dr. B.K. Mohanty (2008)\(^8\) clearly recommends that "the shareholders investment in equities should first focus on the value of the company rather than the price of the share. Profitability and sustainability are the key drivers to the valuation of growth. What makes growth valuable is its power to compound returns over a period of time. And mid-cap stocks have the propensity to create wealth faster than the heavy weight blue clips but the surety of wealth creation is greater for large cap stocks, in his study of market capitalization, a suitable growth approach for shareholders value creation".

Dimitris Kyriazis and Christos Anastassis (2007)\(^9\) has studied the relative explanatory power of the Economic Value Added (EVA) model with respect to stock returns and firms' market values and compared them to established accounting variables, in the context of a small European developing market, namely the Athens Stock Exchange, in its first market-wide application of the EVA measure. Relative information content tests reveal that net and operating income appear to have more value than EVA. Additionally, incremental information tests suggest that EVA unique components add only marginally to the information content of accounting profit. Moreover, EVA does not appear to have a stronger correlation with firms' Market Value Added than the other variables, suggesting that – for our Greek dataset – EVA, even though useful as a performance evaluation tool, need not necessarily be more correlated with shareholder's value than established accounting variables.

Karam Pal and Ashok Kumar (2007)\(^10\) have used Granger causality test to answer the question which parameter like Return on Capital Employed, Net Operating profit after tax, Earning per share, Labour productivity, Capital productivity, Market Value Added, Economic Value Added is closely related with the market price of security. It is the matter of investigation.

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10 Karam Pal.k and Ashok kumar.,” Economic Value Added; An Indicator of Market Price”, SCMS Journal of Indian Management, Vol.4, April to June 2007, pp.87-104.
The study concluded that the Return on Capital Employed cause Market price in only five cases, Earning Per Share cause Market Price in Six cases, Net Operating Profit cause Market Price in five cases and further the study revealed that the Economic Value Added does not help to predict the Market Price of a security although there are many other factors which also influence the market price of a security.

**Ramachandra Reddy and Yuvaraja Reddy (2007)** in their article entitled “Financial Perspectives through Market Value Added approach”, made an attempt to calculate MVA for 10 cement companies in India to examine the effect of selected variables on MVA. The researcher has used Multiple Regression technique for fulfilling the objective. The study concluded that no factors influenced Market Value Added and Earning Per Share and the researcher concluded that the profitability of the selected companies cannot be increased unless the improved problems like modernization, cost reduction, control taxes and the like are solved.

**Dr. P.K. Chakraborty (2006)** has stated that the shareholders' value creation as a philosophy and as a goal is increasing in importance day by day. A company has to evolve as a value creating organization, a performance developer on which it can build shareholders value on a sustainable basis. It must meet the specific financial targets to meet the expectation of the shareholders. Shareholders' value creation is not only a necessity but also has become the ultimate identity of current scenario.

**Ghambari and Narges (2006)** carried out a study entitled EVA, an appropriate performance measure in Automobile Industry. In this study, they reviewed the trends of EVA of Indian automobile companies. The study concluded that the automobile industries have increasing trend in EVA during the study period.

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Ralph Palliam (2006)\textsuperscript{14} has made an attempt to test assertions that EVA is more highly associated with stock returns and firm values than accrual earnings to evaluate which component of EVA delivers superior results. The researcher has selected thirty nine non EVA users and seventy five EVA users at random. This study concludes that the common and widely accepted metrics used by analysts and calculated for EVA users are not necessarily superior to that of non EVA users. The evidence supports that EVA is somewhat invalid, unreliable and questionable and the researcher further stated that the EVA is not a satisfactory descriptor of the real world and therefore, it should be used with caution by management consultants, practitioners and investors.

Dennis Rajakumar (2005)\textsuperscript{15} has stated in his study that Infotech companies have definitely created wealth. This has increased both in terms of absolute amount and as a proportion of the national income. The info tech sector has on an average, created wealth for every additional unit of capital allotted to it. The study also revealed that there is a positive relationship between profit margin and wealth.

Panigraphi (2005)\textsuperscript{16} in his article entitled, “Supremacy of Economic Value Added over Market Value Added” made an attempt to know how the Economic Value Added is superior to Market Value Added. This has been done by financial performance of ITC Limited, which has adopted Economic Value Added as its performance measurement. This study has found out that by increasing Economic Value added, the shareholder wealth is created and established the fact that the Economic Value Added is superior to the Market Value Added.

Pandey (2005)\textsuperscript{17} in his article stated that the most common measure of the shareholder value creation is the comparison between the market value and the book value per share. When the market value exceeds the book value, the shareholder value is created and when the book value exceeds the market value, the shareholder value is destroyed.

\textsuperscript{15} Dennis Rajakumar, “Has New Economy created wealth? A study of InfoTech Companies”, Economy Work Regulation, 2005 P.P.175-198
\textsuperscript{17} Pandey, I M., “What drives the shareholder value?”, Asian academy of management journal of accounting and finance, vol, 1, 2005, pp 105 - 120.
Singh (2005) in his article entitled “EVA in Indian Banking: Better information content, More shareholder value” analysed an appropriate way to measure the performance of Indian banking industry and it has helped us to know which Indian banks have been able to create shareholder wealth since 1998-99 to 2002-03. This study is carried out with the help of selected 28 Indian private and public sectors that are listed in Bombay Stock Exchange. The researcher suggested that the relationship between Economic Value Added and Market Value Added is statistically significant. The study has helped in finding out the impressive performance in terms of Economic Value Added by State Bank of Bikaneer, State Bank of Jaipur, Global Trust Bank and Indusind Bank during the study period.

Viswanathan and Poornima Luthira (2005) in their article entitled the "Models for measuring and predicting shareholder value study of third party software service providers", have explained about the two models namely Strategic Profit Model and EVA Model. The article highlights the following points about the EVA Model. EVA highlights the areas of the company that created value. EVA based financial management gives managers superior information, motivation, empowerment and accountability to ensure that their decisions create the greatest amount of shareholder value. They also stated that the company increases EVA by increasing NOPAT and by reducing the capital charge by reducing the company's capital and the cost of capital.

Anderson et al. (2004) in their article entitled, “Customer Satisfaction and Shareholder Value” examined the relationship between customer satisfaction and Shareholder Value. The researchers have employed in American Customer Satisfaction Index database, nearly 200 publicly traded fortune 500 firms from the year 1994 – 97. The study concluded that there is a positive relationship between customer satisfaction and shareholder value and also indicated that the association between customer satisfaction and shareholder value varies significantly across industries and across firms.

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Feltham et al. (2004)\textsuperscript{21} has tried to find out how EVA beat reported earnings uses the updated EVA information of companies for employed by Wallace. He concluded that EVA has greater power than earnings in explaining market adjusted stock returns

Karam Pal Singh and Mahesh Garg (2004)\textsuperscript{22} examined the disclosure of EVA in Indian corporates. The study revealed that out of 50 companies, only 32 companies have generated positive EVA and 18 companies have destroyed their shareholders’ wealth in 1998. In the year 2000, only 29 companies have generated positive EVA. In 2001, only 34 companies have generated positive EVA. And the same trend continued in 2002. The study has also found out that one – third of total companies are reporting negative EVA throughout the period and another one – third companies are generating positive EVA. It also revealed that only two or three industries are reporting negative EVA and rest are generating positive EVA

Latha Chari and Mohanthy (2004)\textsuperscript{23} in their article explained the concepts of value from two perspectives namely stakeholders and shareholders. Under the stakeholder and to the government. Under the shareholder approach, they analysed the concept of value based measures like EVA, MVA, SVA and CFROI. They also stated that MVA is the best approach and they have explained about the value to the customers, suppliers, employees, investors measures to know the shareholder wealth. EVA is a tradmarked measure of shareholder value and SVA helps in understanding the drivers of the business that are most critical to value creation. It enables the management to focus its analysis more efficiently on key elements of a strategy.

Venkateshwarlu and Nitesh Kumar (2004)\textsuperscript{24} in their article entitled “Value Creation in Indian Enterprises – An Empirical Analysis” analysed the non market performance measures and true market value of FMCG, Healthcare, Information Technology and PSU in India. It was found that FMCG, Health Care and PSU sectors


have high correlation with the Market rate of return. Return on Equity, CFPS and CFROS also recorded high value creation in FMCG sector. In PSU sector, no significant relation was observed between market return and other than non market value per measures.

**Worthington and Tracey (2004)**\(^ {25} \) have made an attempt to analyse Australian evidence concerning the information content of EVA. He concluded that the stock returns were more closely associated with EVA than earnings and net cash flow.

**Fernandez (2003)**\(^ {26} \) analyzed 582 companies in respect of correlation between increase in MVA and EVA, NOPAT, WACC for successive ten years. The results revealed that the correlation coefficient between the increase in the MVA, EVA, NOPAT and WACC was 0.16, 0.21 and 0.21 respectively. He also analyzed the relationship between shareholders value creation and various other parameters, including economic profit and EVA, during the period 1991 to 1997. The increase in firms’ value was basically determined the changes in the firms’ cash flow, and by the changes in the firms’ risk which lead to changes in the discount rate.

**Peter Schuster and Mel Jamenson (2003)**\(^ {27} \) have analyzed the past performance and future value of companies. He commented that the EVA approach can be adapted for either forward or backward looking measures, while some of the other approaches focus on one or the other. The added value approach is suited only for performance measurement and also the study revealed that EVA requires the most intensive conversions, and so it is better tailored to company-specific situations, and it can be used for both backward-looking and forward-looking assessment. EVA estimates an appropriate cost of capital, which is advantageous.

**Spivey and Mc Millan (2003)**\(^ {28} \) in their article, “Value Creation and the Entrepreneurial Business” examined the association between the shareholder return and

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\(^ {27} \) Peter schuster and Mel Jameson. ”Past performance and future value of companies”, vol. 4, No. 4, 2003, pp. 41 - 52.

various non marketing, accounting and economic performance measures. The researchers have used Uni variate analysis and Multivariate analysis. The study has found that there was significant relationship between share holder return and the profitability measures and also found that there was positive association between the shareholder return and profitability measures.

Bardia (2002)\textsuperscript{29} in his article entitled “Economic Value Added as performance indicator – A case study of Infosys” argued that Economic Value Added is better than the concept of activity profit for finding out the value creation, because Economic Value Added is the only tool to consider overall cost of capital. The researcher analyzed the financial performance of the Infosys with the help of traditional financial measures and also with the help of a new performance measure Economic Value Added.

Costigan M.H and Lovata Linda (2002)\textsuperscript{30} stated that the EVA is a modern tool for analysing the performance. Moreover, the organizational strategy of the firm should influence the likelihood of employing EVA. The study concluded that the firms using EVA exhibit percentage of institutional ownerships and a lower percentage of insider ownership than non adopters. And the study also indicate the prospector firms as defined by a higher ratio of research and development to sales, tend to use EVA less than the defender firms. Accounting adjustments are a focal point of the EVA formulation and the results presented in this study suggest providing appropriate incentives.

Crowther (2002)\textsuperscript{31} in their article examined several competing approaches to the management of a business and techniques for strategic decision making. He stated that the Value Based Management (VBM) is simple but the proponents of the technique would argue that its use would inevitably lead to better performance of the organization, both for shareholders and stake holders. Moreover, they would argue that the use of VBM technique would imply use different measures of performance management rather than traditional accounting measures


\textsuperscript{31} David Crowther,” Value Based Management; An Introduction to the concept of Shareholders Value”, the ICFAI Journal Vol.8, No.1. 2002
Cyrus A. Ramezani and et al. (2002)\textsuperscript{32} have made an attempt to analyze the growth, corporate profitability and value creation. They have pointed out that the investment industry demands the managers to maximize their sales and earnings growth overtime. This prescription is based on the presumption that growth is synonymous with shareholder value creation. The study indicates that the maximising growth does not maximize corporate profitability or shareholder value. On the contrary, companies with moderate growth in sales or earnings show the highest rates of return and value.

Mangala and Simpy (2002)\textsuperscript{33} in their article entitled, “Linkage between Economic Value Added and Market Value Added: An analysis in Indian context” examined that the shareholder’s wealth maximization became the new corporate paradigm. It was recognized by the managers and researchers for setting the corporate goal. It gained new dimension only in the recent years, due the concept of Economic Value Added. The researcher made an attempt to study the relationship between Economic Value Added and Market Value Added among the selected 15 companies from various industries like Fast Moving Consumer Goods, Information Technology, Pharmaceutical, Automobile and Textile and has been computed. The study concluded that the current operational value is more significant in contributing to a change in market value of share in Indian context.

Niranjan, et al. (2002)\textsuperscript{34} explained how well market value added was correlated with the firms' performance in terms of financial measures of the company such as economic value added, net operating profit after tax, return on capital employed, return on net worth and earnings per share on the one hand and purely economic factor of the company such as labour productivity, sales and R & D expenditure on the other. They selected a sample of 28 Indian Pharmaceutical Companies and economic measures in predict MVA in most of the Indian pharmaceutical companies.

Riceman, S.S and Cahan, S.F, (2002) observed that the EVA is a performance measure that is being used by an increasing number of companies, but academic research on EVA is limited. This study specifically observed that the managers on EVA based bonus plans outperform managers on traditional accounting based bonus plans. Researchers are able to test this because researchers have access to an EVA focused company that has managers on both EVA and traditional bonus plans. The results of this study suggested that the managers on EVA bonus plans who understand the EVA concept perform better than the managers on traditional bonus plans. Further, the study revealed that the effect of EVA bonuses and EVA understanding differs depending on the area of the firm in which the manager is employed.

Shrieves E. Ronald (2002) concluded that the researcher should help the user of Discounted Cash Flow methods by clearly locating the relationship of free cash flow and EVA concepts to each other and to the more traditional applications of DCF thinking. The research team follows others in agent, the equivalence between EVA and NPV, but their approach is more general in that it links the problems of security valuation, organization valuation, and investment project selection and additionally the approach relates more directly to the use of standard financial accounting information.

Garvey T. Herald (2001) revealed that the dissatisfaction with traditional accounting based performance measures has spawned a number of alternatives of which EVA is clearly the most prominent. The study found that the simple correlation between EVA or earnings and stock returns is a reasonable guide to their value as an incentive contracting tool. This is not because stock returns are themselves an ideal performance measure; rather it is because correlation places appropriate weights on both the signal and noise components of alternative measures.

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37 Garvey T. Herald, "EVA versus Earnings: Does it matter which is more highly correlated with stock returns", No. 52, 2001, at http://econ.claremontmckenna.edu/papers
Sahu (2001)\textsuperscript{38} in his article “Accounting Profitability versus Shareholder Value creation: an empirical study” made an attempt to find out the association between them and discount return on shareholder’s equity with the help of spearman’s correlation. Regression analysis is used to find out the effect of selected measures on the discount return on shareholder’s equity. The coefficient of determination has been used to find out the extent to which these measures explain the variation of discount return on shareholder’s equity. The study concluded that there was no positive relationship between discount return on shareholder’s equity and selected measures.

Thampy, A and Beheli. R (2001)\textsuperscript{39} have made an attempt to analyse the EVA in 12 commercial banks consisting of 4 public and 8 private sector banks. The period covered under the study is three years. In this study, the beta value has been calculated on the basis of daily stock price data with BSE 200 Index returns during the study period. The study showed that the performance of the Indian banks as measured by EVA is not very satisfactory. The results of the study reveal that the commercial banks under consideration have not created any positive EVA due to banks that are over capitalized and returns are very poor from banking business. It also suggests that the banks should improve their credit assessment technique and monitoring mechanism to bring down the non performing assets so as to improve the earning capacity.

Weaver Samul (2001)\textsuperscript{40} has observed that over the past decade, only very few companies have headed EVA. This survey bridges the gap between "theory" and "practice" by detailing how EVA proponents measure EVA. This survey is important because its fieldwork identifies significant inconsistencies in the measurement of EVA and its major components.


Banerjee and Ashok (2000)\textsuperscript{41} have selected 200 companies over a time span of four years from 1994-95 to 1995-98 for their study. The study revealed that the market value of a firm is the function of Current Operational Value and Future Growth Value. Current Operational Value is equal to the book value of initially invested capital plus the capitalized value of current year's EVA, whereas, Future Growth Value represents the present value of all future expected future improvements. The study found that there is a considerable divergence between MVA and the sum total of Current Operational Value and Future Growth Value. And the researcher also pointed out that this divergence maybe due to the short time span of the study, thus leading the inability of Future Growth Rate to capture the growth potential factored in the market value of the company's shares.

Kumar Satheesh (2000)\textsuperscript{42} has pointed out that the EVA is the best financial indicator. The study concluded that the EVA should be used for making comparisons between companies in the same industry group. He stated that the EVA should be expressed in terms of EVA in Rupees per unit of capital employed

Parasuram N.R (2000)\textsuperscript{43} has made an attempt to analyse the EVA position of 14 public sector banks, 7 new private sector banks, 5 old private sector banks and 2 foreign banks. The study concludes that the EVA was an important measure to judge a bank performance in view of the current scenario of banks. EVA has been found to have a high degree of correlation with ROA but not with any of the other measures. It signifies the fact that banks realize the importance of measuring EVA separately even if they do well on the other fields. Some of the banks which have higher net profit and ranked high have been found to have a negative EVA. The study expects that EVA will soon displace other measures of bank financial performance.

Anand, et al. (1999)\textsuperscript{44} revealed that EVA, REVA (Refined Economic Value Added) and MVA are better measures of business performance than NOPAT and EPS in

\begin{thebibliography}{99}

\bibitem{Kumar} Kumar, Satheesh, “\textit{Economic Value Added - A critique}, Indian Management, March 2000, pp. 57-62.
\end{thebibliography}
terms of shareholders’ value creation and it is a competitive advantage of a firm. Conventional management compensation systems emphasize sales / asset growth at the expense of profitability and shareholders’ value. Thus, EVA is a measure that shifts focus on an organizational culture of concern for value.

**Banerjee and Jain (1999)** carried out a research based on empirical data. Among the selected independent variables (EPS, EVA, Kp, Lp and ARONW), EVA has proved to be the most explanatory variable is taken as the dependent variable and Backward Elimination method was applied to find out the most explanatory independent variable. For this purpose, the time frame was of eight years and all the variables were calculated over this period for the sample companies.

**Kleiman (1999)** has made studied that the EVA is an appropriate performance measures in select seventy one companies of the study and the study conclude that the companies have increasing trend in debt ratio and sales of assets after introducing EVA.

**Bao and Bao (1998)** analyzed the usefulness of EVA and concluded that EVA is a significant factor in market returns and its explanatory power is higher than that of accounting earnings.

**Biddle, Bowen and Wallace (1999)** tried to find out the evidence on Economic Value Added and Market Value Added from the select companies using EVA and EP as parameters for their executives’ remuneration and the basis for calculating their variable compensation.

**Esa Makelainen (1998)** has made an attempt to clarify the concept of EVA especially from the viewpoint of business unit controlling. The study describes the theory and the characteristics of EVA. This gives the framework to discuss the main objective

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49 Esa Makelainen, ”Economic Value Added as a management tool”, 1998 at www.evanomics.com
on how companies should use EVA considering both its favourable and unfavourable features and further he stated that the Economic Value Added is a residual income variable. EVA’s equivalence with DCF and NPV holds in valuations although DCF and NPV are based only on cash flows and EVA is based also on historical accounting items. In order to be successful, EVA based bonus systems should be long-term and based mainly on changes of EVA and it should offer considerable bonuses for considerable shareholder value improvements. With implementation it is important to understand the EVA-concept thoroughly and tailor the concept to the unique situation of each company or business unit. EVA is at its best as an overall measure and organizational approach with strong link to payroll of managers and other employees. The study concluded that the substantial shareholder value increases and true success stories arise always from outstanding strategy, quick response, great ideas and good predicting of future. EVA helps in quantitative assessing of different strategies. Therefore EVA is an important also measure for those companies that use primarily other tools in assessing the achievement of their strategic goals.

Rogerson (1997)\textsuperscript{50} states that the traditional financial tools that is must have relationship with shareholders wealth. Traditional measures having incapability to incorporate full cost of capital. The accounting income is not a steady predictor of firm value and it cannot be used for measuring corporate performance.

Lehn and Makhija (1996)\textsuperscript{51} study EVA and MVA as performance measures and signals for strategic change. Their data consists of 241 U.S. companies and cover the years 1987, 1988, 1992 and 1933. The researchers first find out that both measures correlate positively with stock return and that the correlation is slightly better than with traditional performance measures like return on assets (ROA), return on equity (ROE) and return on sales (ROS). Additionally, they study how companies’ performance, as measured in terms of EVA and MVA, affect on the CEO firings. Finally, they examine the relationship between EVA/MVA and corporate focus. Lehn and Makhija found an inverse relation between EVA/MVA and abnormal CEO turnover. They also find that


firms with greater focus on their business activities have significantly higher MVA than their less focused counterparts. Lehn and makhija conclude that their results suggest EVA and MVA to be effective in performance measures that contain information about the quality of strategic decisions and serve as signals of strategic change.

Easton, P. Harris, T. and Ohlson, J (1992) have commended that the EVA has been used by the companies not only for evaluating performance, but also as a basis for determining incentive pay. EVA also attempts to manage with the basic tension that exists between the need to come up with a performance measure that is highly correlated with shareholders wealth, but at the same time somewhat less, subject to the random fluctuations in stock prices. This is difficult to solve and it explains the relatively low correlation of all accounting based performance measures with stock returns at least on a year to year basis.

Research Gap

Most of the existing research concentrates on Economic Value Added and Market Value Added only. In this study, the researcher has taken Shareholder Value Added also with Economic Value Added and Market Value Added for analysing the value creation of select manufacturing companies listed in BSE 100 Index. Moreover, the researcher has taken continuously listed companies without exclusion during the study period and company wise analysis has been made. These criteria have led to reach the most accurate results.

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