Chapter 6

"Findings, Suggestions and Conclusion"

The primary principle of every organization is to take capital from the investors and make it worthwhile. But in reality, this principle doesn’t hold good. Often the companies talk about “Maximizing Shareholders Value”, but only a few go about realizing this fundamental principle. To achieve this, a company must not be only the biggest player but, also efficient in its operations. Most of the companies shift their focus on metrics like share prices, earnings, earning per share, etc. but, these metrics do not take in to account the amount of additional capital contributed for generating additional income. For this purpose, the companies need to focus on the value added to shareholder’s wealth.

Hypotheses Testing:

H0: There is no significant difference in the shareholder value creation by the companies in the automobile industry in India.

H1: There is a significant difference in the shareholder value creation by the companies in the automobile industries in India.

Analysis of the study: t-test (EVA)

(in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>EVA of Tata motors ltd.</th>
<th>EVA of Mahindra &amp; Mahindra ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>-24,737.075</td>
<td>-14,391.89</td>
</tr>
<tr>
<td>2004-05</td>
<td>-27,819.918</td>
<td>-16,503.21</td>
</tr>
<tr>
<td>2005-06</td>
<td>-28,510.425</td>
<td>-19,511.31</td>
</tr>
<tr>
<td>2006-07</td>
<td>-36,495.465</td>
<td>-32,226.28</td>
</tr>
<tr>
<td>2007-08</td>
<td>-47,813.635</td>
<td>-37,436.36</td>
</tr>
</tbody>
</table>
### Analysis of the study:t-test (MVA)

*(In crores)*

<table>
<thead>
<tr>
<th>Year</th>
<th>MVA of Tata Motors ltd.</th>
<th>MVA of Mahindra &amp; Mahindra ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>1,76,659.07</td>
<td>61,392.42</td>
</tr>
<tr>
<td>2004-05</td>
<td>2,32,137.48</td>
<td>57,390.66</td>
</tr>
<tr>
<td>2005-06</td>
<td>3,39,141.04</td>
<td>2,08,455.17</td>
</tr>
<tr>
<td>2006-07</td>
<td>2,79,143.01</td>
<td>2,01,343.31</td>
</tr>
<tr>
<td>2007-08</td>
<td>53,480.63</td>
<td>61,358.32</td>
</tr>
</tbody>
</table>
Findings, Suggestions and Conclusion:

Findings:

**Economic Value Added:**

According to the study, Tata Motors Ltd. and Mahindra & Mahindra Ltd. have negative EVA during the study period. It means that both companies would not be able to create any wealth for their shareholders. There would be several reasons for that:

- In both companies, main cause of negative EVA would be higher cost of capital. There would be high maintaining cost of equity in both companies.

- Here, betas of both companies are sometimes higher than one, so market prices of both companies are volatile to some extent. That’s why cost of equity is high in both the companies.

- Sometimes historical values distort EVA. Distortions of EVA are more pronounced in cyclic business where peaks and valleys feature in EVA figures. Industries with lots of fixed assets and with short investments period get affected by this pitfall since current assets do not represent the majority of total amount of assets; so value of assets not would be close to current value of capital tied the business. Thus it gives wrong signals about the aggregate company performance.
• In both the companies, they most probably use the owner’s capital, so there would be less use of borrowed fund. That’s why they would not get benefit of leverages.

• There would be increase in operating profit with the additional capital in the business, but the proportion of increase in profit is lower than the proportion of increase in the capital.

• The companies in the growth phase or business units with heavy new investments are likely to have current negative EVA although their true rate of return may be good and so long term shareholder wealth added (true long term EVA) would be positive. This is main criticism of EVA being a short term performance measure.

**Market value added:**

• From the calculation of MVA we can see that in Mahindra & Mahindra Ltd. and in Tata Motors Ltd. trend of MVA is fluctuating.

• As MVA is based on market capitalization which is related to share prices. In Mahindra & Mahindra Ltd. market capitalization is also fluctuating. While in Tata Motors Ltd. market capitalization is not so much fluctuating.

• In both the companies market value added is not steady. These fluctuations are due to fluctuating share prices and somewhat level of performance standard.

• In both the companies MVA is positive, that means both the companies have added value.
SHAREHOLDER VALUE CREATION IN THE AUTOMOBILE INDUSTRY IN INDIA

Suggestions:

EVA is negative in both the companies. Following suggestions can be made to improve EVA.

- Increasing NOPAT with the same amount of capital.
- Reducing capital employed without affecting the earnings.
- Investing in those projects that can earn return greater than the cost of capital.
- By reducing the cost of capital.
- By applying above-mentioned suggestions, EVA of the firm can be increased or negative EVA can be converted into positive.

CONCLUSION:

Automobile industry is a key driver of any growing economy. It plays a pivotal role in country’s rapid industrial and economic development. It caters to the requirement of equipment for basic industries like steel, non-ferrous metals, fertilizers, refineries, petrochemicals, shipping, textiles, plastics, glass, rubber, capital equipments, logistics, paper, cement, sugar etc. it facilitates the improvement in various infrastructure facilities like power, rail and road transport.

Due to its deep forward and backward linkages with almost every segment of economy, the industry has a strong and positive multiplier effect and thus propels progress of a nation. The automotive industry comprises of the automobile and auto component sectors. It includes passenger cars; light, medium and heavy commercial vehicles; multi-utility vehicles such as jeeps, scooters, motor cycles, three wheelers, tractors, etc; and auto components like engine parts, drive transmission parts, suspension and breaking parts, electricals, body and chassis parts; etc.

In India, automotive is one of the largest industries showing impressive growth over the years and has been significantly making increasing contribution to overall industrial development in the country. Presently India is the world’s second largest manufacturer of two wheelers, fifth largest manufacturers of commercial vehicles as well as largest manufacturers of the tractors. It is the fourth largest passenger car market in Asia as well as a home to the largest motor cycle manufacturer. The installed capacity of the automobile sector has been 9,540,000 vehicles, comprising 1,590,000 four wheelers (including passenger cars) and 7,950,000 two and three wheelers. The sector has
shown great advances in terms of development, spread, absorption of newer technologies and flexibility in the wake of changing business scenario. It is also finding increasing recognition world wide and a beginning has been made in exports in vehicles as well as components. Here we have some fast facts about the automobile industry.

The economy has become more competitive and more dynamic in recent years and to succeed in it companies must juggle a host of conflicting demands. They must find ways of cutting costs and operating more efficiently. They must respond swiftly to changing customer demands and technological change. They must focus on nurturing the wellbeing of their employees who, in this new “knowledge” economy, are now recognized as core assets. They must constantly innovate if they want to keep up with and stay ahead of the competition. They must also carry out socially responsible actions, which help to reinforce their corporate reputation and brand image. As a consequence of companies trying to meet so many conflicting demands, however, traditional models and measures of company performance are being questioned, especially the shareholder value model. Is it valid in the current economic environment and will its use foster sustainable economic growth?

Creating shareholders value is the key to success in today’s marketplace. There is increasing pressure on corporate executives to measure, manage and report the creation of shareholder value on a regular basis. 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. This pressure has led to an emergence of a variety of measures that claim to quantify value-creating performance. Creating value for shareholders is now a widely accepted corporate objective. The interest in value creation has been stimulated by several developments.

In the modern economy, the stakeholders are looking for new ways to measure performance and profitability to gain competitive edge. As of now, what the companies are using as financial metrics is incompatible with the financial market mechanism. When it comes to metrics and performance, the companies must confirm the relevance of tools to all the concerned. So, the present day competitive environment demands value based management (VBM). This approach is to fulfill the expectations of shareholders. A large number of companies are adopting various value based tools, like Economic Value Added (EVA), Market Value Added (MVA), to measure profitability.

For most firms, the pursuit of enterprise sustainability remains difficult to reconcile with the objective of increasing shareholder value. Indeed, some have even advocated that creating a more sustainable world will require firms
to sacrifice profits and shareholder value in favor of the public good. By starting with legal or moral arguments for firm actions, however, managers inevitably underestimate the strategic business opportunities associated with this important issue. To avoid this problem, managers need to directly link enterprise sustainability to the creation of shareholder value. The global challenges associated with sustainability, viewed through the appropriate set of business lenses, can help to identify strategies and practices that contribute to a more sustainable world and, simultaneously, drive shareholder value; this we define as the creation of sustainable value for the firm.

If anything has changed in the business world over the last couple of decades, it is the pace of business change. Yesterday's high performers are often today's laggards, if one can still find them listed at all. Many of yesterday's shining stars, whether in the realm of business thought or business action, mistook what was superficially new for what was really new, responding to the cacophony of boom and bust rather than to the steady creak of a tectonic shift. Companies that aspire to sustainable high performance must attend to sustained. Because of these fundamental sustained changes, the task of managing shareholder wealth also has altered, requiring innovative, more expansive ways of thinking about resources and how they can be used to create value for today and tomorrow.

Management that ignores the implications of these changes risks mismanaging both the most important component of their valuation as well as their most important value-creating resources.
Emergence of Value-based Management

Value based management ensures that companies are running constantly on value, usually, shareholders value. It is dependent upon corporate purpose as well as value. The value can be either of the economic value or other constituents. This includes components as given in below figure.
Value added:
A firm is said to have added value over a period of time when the profits generated by it are more than its cost of capital. This excess amount is referred to as economic profit. This concept of economic profit is the basis for various financial techniques. For this purpose tools like EVA and MVA has been used by companies to measure performance.

EVA is primarily used for evaluating the performance of management

Usage of MVA includes:

- Setting organizational goals;
- Measuring performance;
- Capital budgeting;
- Corporate valuation;
- Analyzing equities;
Motivation of managers;

Communication with shareholders and investors; and

Determining bonus.

Problems with EVA:

- EVA is considered as a good measure for analyzing short-term company’s value.

- Only one performance measure cannot be useful for measuring the performance of the company.

- It also suffers from wrong periodizing of returns and hence it may fail to depict the true result due to changes, like change in inflation rate.

- It represents the performance of current projects but not of future projects.

Such problems with EVA led to emergence of Market Value Added. MVA is considered as stock market’s assessment of EVA.

Implications of MVA:

MVA of a company is also an indicator of its performance. It is generally considered that higher MVA is favorable on part of the company’s performance. Higher the MVA, better is for the company. It can be depicted as below:
Implications of MVA

Positive or High MVA

Company has added value

Negative or low MVA

Company has lost value

Relation between EVA and MVA:

Expected EVA=MVA

Current EVA

Shweta gupta, lecturer in management, Apeejay institute of Management, Jalandhar, Punjab, India.
Problems with MVA:

- It does not consider opportunity cost of capital.
- It does not take into account cash returns to shareholders because it measures the difference between market value and the capital invested for a specified time period only.
- It cannot be calculated at strategic business unit level and in case of privately held companies.

An important goal of financial management is to maximize the wealth of the organization, highest capital employee’s wealth and consequently enhance the value of the firm. Shareholder wealth is traditionally reflected by either standard accounting parameters such as profits, earnings and cash flow from the operations or financial ratios like earning per share and the return on investment and equity. But, there was a question that, whether these measures of corporate performance are linked to the expectation of the shareholders or not. Value-based management is an important tool for improving the company’s performance. Because this approach moves about the notion of the value. At present, EVA and MVA are considered as the best economic metrics in order to measure the change in shareholder’s value. These concepts have their own limitations but at the same time if it can be avoided carefully, then definitely it has the intrinsic prospective to take the company to new mounting scale of success.