CHAPTER-3 LITERATURE REVIEW

3.1 Introduction

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3.3 Requisite of Literature Review

3.4 Study Reviewed
3.1 Introduction:

At the commencement of any research, it is necessary to have the idea about the research which was done previously. Generally literature survey is to be considered as the collection of the information from other sources. It is to be considered as the collection of information from other sources.

A literature review is a critical and in depth evaluation of previous research. It is a summary and synopsis of a particular area of research. A good literature review expands upon the reason behind selecting a particular research question.

The literature review is not a chronological catalogue of all other sources but an evaluation, integrating the previous research and also explaining how it integrates into the proposed research program. It is not a collection of quotes and paraphrasing from other sources. A good literature review should also have some evaluation of the quality and findings of the research.

3.2 Definition:

According to Cooper (1988), “a literature review uses as its database reports of primary or original scholarship and does not report new primary scholarship itself. The primary reports used in the literature may be verbal but in the vast majority of the cases reports are written documents. The types of scholarship may be empirical, theoretical, critical or methodological in nature. Second a literature review seeks to describe summaries, evaluate and clarify the content of primary reports”.

3.3 Requisite of Literature Review:

A literature review has a great importance because it is done by scholars and researchers. It is to be considered as on introductory part of the research. The purpose of writing literature review is to convey the reader, what knowledge and ideas have been established for the research topic and what are strength and limitations. The other importance of the literature review is given below.
1. The literature review provides the limitations of previous research.
2. It provides rational guidelines to the researcher.
3. It is easy to detect conflicting points of view expressed by different authors.
4. To know about the different methods and methodology used by the other researchers.
5. The utility of the past research can be measured and it can be improved,
6. It is easy to avoid the repetition of research work.

3.4 Study Reviewed:

3.4.1

There are different objectives of investors to invest their funds in corporate world. For example, to take the benefit of the capital appreciation, regular return on their investment in the form of interest and dividend, sometimes capital appreciation and regular income etc. The measurement of capital appreciation can be done on the basis of the securities. When market value is greater than face and paid up value, the difference between two is treated as shareholder value creation, shareholder value creation is a result of composite effect of different factors. One of them is EVA. Mandeep & Sweety (2009), had undertaken study on “Shareholder value creation in India’s most valuable companies”[1], found that EVA generated by a company is an important determinant influencing the market value of its shares.

3.4.2

The concept of shareholder value creation is based on several factors like capital appreciation, market value, regular income, return on investment, leverage, dividend payout ratio, profit consistency etc. out of them one factor is leverage, which can be use for expansion of business, if the leverage is used properly than it creates value for the shareholders but if not then it becomes the liability for the company. By the means of dividend policy, it can be said that by giving dividend, the company is able to satisfy the shareholders as because it is the return on their invested money. The other is that to keep the profit as reserve in the
company instead of distributing dividend. The profitability is having direct relation with the shareholder value creation. Saurabh Ghosh (2008) had undertaken the study on “leverage, Dividend policy and profitability influence on value of the firm”[2]. He found that there is non-linear relationship between leverage, profitability and probability of increase in future value of the firm.

3.4.3

Every organization has a main goal to earn the maximum amount of profit. Profit maximization and wealth maximization were the main goals of the organization. From the limitation of these two, the concept shareholder value creation was emerged. Return on equity, return on investment and return on net assets are conventional methods for performance measures. These methods are based on accounting figures so it can not reflect true and fair picture of shareholder value. EVA is the factor based concept for performance measurement so it is necessary for measurement of shareholder value creation. EVA is also useful for the managerial decision making process. Dr. N.C. Tripathi & Dr. G.P. Chousaria had undertaken the study on “EVA : Performance Measurement of Shareholder Value”[3] found that EVA is the only financial system that provides a common language for all operating and staff functions and allow the management decision to be modelled, monitored, communicated and compensated in a single and consistent way, always in terms of value added to the shareholders.

3.4.4

The shareholders are the real owners of the company. For that purpose, it becomes necessary to create the value of the shareholder. By creating the value of the shareholders, the company is able to sustain the interest of the shareholder. For creating value there are many aspects. These aspects are based on accounting terms. For the creation value of the shareholders the market factors are playing an important role. When the market value becomes greater than the paid up value of share, than the value is created. Dhananjay Sahu, Prashant Kumar & Brijesh Pratap Singh had undertaken the study on “SVA : The
Value Driver and its Traditional Counterparts\(^4\) had found that the shareholder value did not have the strongest correlation with the market price. The regression analysis was used for the study of variables.

### 3.4.5

For any profit making organization, the important goal is not to earn the profit but to earn the consistent profit. The growth of organization is depends upon the consistency maintained in profitability. When the company is able to return the amount above even if it is invested in similar type of organization with a similar amount of risk than the goal is satisfied. The value is created only when, the return on investment becomes consistent. Nanda Ramanujan (2009) had undertaken study on “Shareholder Value Analysis”\(^5\) found that best way of shareholder value creation is to break it down in to a series of small scale metrics. She also suggests that the shareholder value creation is not a short term notion but it’s a long term notion.

### 3.4.6

EVA is the measure of company’s true profitability and a strategy for creating corporate and shareholders wealth. It is a vital measure of total productivity, which reflects all dimensions by which the management can increase the value. EVA is the net operating profit minus the appropriate charges for the opportunity cost of capital invested in an organization. EVA is closely related to the net present value and the corporate finance theory. EVA is the technique which improves the working of every organization by making them active and that will helps to produce more wealth for the shareholders. Shurveer S. Bhanwat had undertaken study on “shareholder value creation in the Indian Banking Industry”\(^6\). He had taken public and private bank which is listed in BSE for the measurement of shareholder value creation by EVA. He used correlation and Karl pearson’s coefficient of correlation for the study. He found that Indian Banks do not create any value for the shareholder. He also found that the difference between the mean value of EVA for the public and the private sector banks was not found to be significant.
3.4.7

Creating shareholder value is the key to success in today’s market place. There is increasing pressure on corporate executive to measure, manage and report the creation of shareholder value on a regular basis. In the emerging field of shareholder value analysis is, various measures have been developed. Creating value for the shareholder is now a widely accepted corporate objective. Shareholder value creation becomes necessary because the capital market becomes increasingly global and investors can rapidly shift their investments in higher yielding opportunities. Bhargav Pandya had undertaken study on “shareholder value creation: an Overview”\[7\] found that the shareholder value creation approach helps to strengthen the competitive position of the firm by focusing wealth creation. It provides an objectives and the consistent framework of evaluation and decision making across all functions, department and units of the firm.

3.4.8

For the creation of shareholder value, there are several aspects like to increase in equity market, shareholder value added, shareholder return and the required return on equity etc. the equity market is increased when the market value in one year is the equity market value at the end of the year less the equity market value at the end of the previous year. Shareholder value added is the term used for the difference between the wealth held by the share holder at the end of the year and the wealth they held in the previous year. The shareholder return is the shareholder value added in one year and dividend by the equity market value at the beginning of the year. The required return to the equity is the return that the shareholder expect to obtain in order to feel sufficiently remunerated which is depends up on the interest rate of long term bond and the company’s risk. Pablo Fernandez (2001), had under taken the study on “shareholder value creation”\[8\] found that the company creates value for the shareholders only when the shareholder return exceeds the required return to the equity.
3.4.9

The shareholder value creation is having the composite effect of firm's liquidity, assets efficiency, expense control and the leverage. If the liquidity is maintained in the business entity can earn the good amount of the profit which is helpful to create the value of the firm as well as the shareholders'. The leverage is also an important factor for the value creation. Leverage is having both the positive and the negative impact on the liquidity and the profitability of the business entity. Tarek Ibrahim and Hany Kamel had undertaken the study on "shareholder value creation and the articulation of P/B and Stock Return in Egypt's CASE 50 index"[9], had found that regarding the classification of financial fundamentals, the shareholder value creation is significantly associated with firm's liquidity, assets efficiency, expense control and the leverage.

3.4.10

India's growth is now directly affected by the boom of share market. As the share market goes up our whole economy fly in the air but the day when the Sensex go down everybody worried about what happen to our economy. To stay in the competition, all companies have to perform at its best level. As compare to the public companies, the private companies have to pay more attention due to the high competition. Patrick T. Fingen had undertaken the study on "Maximizing shareholder value at the private company"[10] found that there are some issues which affect shareholder value creation. The issues are like Investors go far beyond earnings in evaluating performance.

1. The best determinant of value creation is the EVA.
2. Investors demand accountability by business unit in the form of the debt and equity decentralization.
3. Small and private companies operate more effectively when their managers have direct or indirect leveraged stakes in the units they manage.
3.4.11

The theory of shareholder value has traditionally suggested that every company's primary goal is to maximize the wealth of its shareholder. For the measurement of value creation some traditional methods like return on investment and earnings per share etc. were used. With the increasing globalization of markets, companies are focusing on some new aspects. From that one aspect is dividend policy. “Miller and Modigliani (1961)”[11] had written article and found that the value of the firm is unaffected by the dividend policy in a world without taxes and the transaction cost and where everyone was fully informed about the distribution of the firms uncertain cash flows.

3.4.12

It is known that the dividend policy is the important factor for the creation of value of the shareholder. Dividend policy is affected by the market value. According to “Gordon (1962)”, the market value changes with retention ratio or the payout ratio[12]. He presents a dividend capitalization model which explicitly shows the relationship of expected earnings, dividend policy and profitability in determination of the value of the share.

3.4.13

Economic value added is a registered trademark of US firm Stern & Co. EVA is the most successful performance metrics used by the companies. EVA is the measure of financial performance of a company which represents a powerful business tool if it is used correctly. The adoption of EVA should indirectly bring changes in management which ultimate create as the value of the firm because it is not only performance measure but also the main part of an integrated financial management system which leads to decentralization the decision making. Mohammad Fawazi Shubita (2010), had undertaken the study on “The relation between EVA and the stock return”[13] had found that EVA does not significantly outperform NI and NOPAT and sometimes it does not even
outperform RI. The findings do not lead any support to the claim Stern Sterwart and Co. that EVA is superior to the other measures in explaining stock return.

3.4.14

Maximize shareholder value has become the new corporate paradigm in the recent years. The corporate, which gave the lowest preference to the shareholders curiosity, have to face the lack of interest of the shareholders. Shareholder’s wealth is measured in the form of dividend or in the form of capital appreciation or both. Traditional performance measures such as NOPAT, EPS, ROI, ROE etc. have been criticized due to their inability to incorporate full cost of capital. To remove that limitation the concept of EVA was developed. Dr. Anil Sharma (2010), had undertaken the study on “Economic value added” \[14\] had found that Eva is now recognized as an important tool of performance measurement and management all over the world, particularly in advance economies by adopting it as corporate strategy. Still there are mixed evidences about the superiority of EVA over traditional performance measurement tools.

3.4.15

With the economic globalization, companies are growing by mergers and acquisitions to expand their operations and enhance their competitiveness and by that way it becomes possible to create the value of the shareholders. Consolidation of the business by large industrial houses and multinational companies operating in India, increasing competition amongst domestic companies and competition against imports have all combined to prompt mergers and acquisition activities in India. Bipinkumar Dixit had undertaken the study on “Do Indian acquires create shareholder value? The effect of affiliation to a family business group”\[15\] had found that the market reactions to acquires at the time of acquisition are positive and significant. He also found that the acquires are affiliated to a business group create less value for their shareholders as compared to the acquires which are not affiliated to the business group.
3.4.16

The theory of the shareholder value creation has traditionally suggested that every company’s primary goal is to maximize the wealth of its shareholder, which should be a given, since it is the shareholders that own the company and the rational investors expects a good return on their investments. In the past some traditional methods like return on investments and EPS were used for the performance measurement. With increasing globalization of market, companies are focusing on creating shareholder value in order to survive the competition. Robert Chikwendu Asogwa (2009) had undertaken the study on “Measuring the determination of value creation for public listed banks in Nigeria: A Random effect Probit Model Analysis”\(^\text{[16]}\) had found that the dividend that the dividend policy matter seriously affects shareholders value. Profitability and growth matter are not having the effects such like dividend.

3.4.17

In the recent trends, the contribution of marketing functions has changed and interest now centers on its contribution to a firm’s financial performance. The marketing expert gives opinion that marketing metrics are related with the profits and profits are related with the shareholder value creation. For the generation of shareholder value it is not necessary to make the maximum customers but to manage the presently customers. Robert Errey and Peter Oppenheim had undertaken study on, “A strategic approach to target marketing – Choosing the preferred generic customer: A model of shareholder value performance”\(^\text{[17]}\) had found that marketing can strengthen its position by developing and successfully implementing strategies that focus on creation of shareholder value. For that purpose three important issues are to be taken in to consideration:

1. Knowledge to customer profitability.
3. Preparedness to shed unprofitable customers.
3.4.18

The equity share holders are the real owner of the company form of business organization. They all invest their money in equity shares of a company with the primary motive of achieving good capital appreciation and regular and stable return. The investors' objectives are purely based on the profitability and financial performance of the company. For measuring the corporate financial performance, there are accounting profitability measures and shareholders value based measures. Accounting profitability measures includes ROI, ROE, and EPS etc. While shareholder value based measures include EVA and MVA. Dr. N. Sakhtivel(2010) had under taken the study on “Shareholder value in pharmaceutical industry: An empirical study” [18] had found that the companies under this industry has succeed to meet public expectation in terms of shareholder value creation through EVA either by increasing operating income from assets in place through reducing cost of production or increasing sales or reducing the cost of capital by changing the financial mix in the capital structure.

3.4.19

For the expansion of the business entity the merger and acquisition issues are taken in to the consideration. There are taken many other issues which are related to the mergers and acquisition. Shareholder, stakeholders, creditors and many others are associated directly or indirectly with the firm. Anju Sheth (2009) had undertaken study on “Institutions, the theory of the firm and value creation: Evidence from the acquisition activity” [19] had found that, the merger and acquisition activities plays an important role to create the value of the firm as well as the value of the shareholders but further more research are required to get more beneficial results.

3.4.20

The aim of any company is to create the value of the shareholders. ‘Value’ for the shareholder reflects the required returns of the capital market. In order to create this value, the company has to create a competitive advantage to exploit
inconsistencies in the market which it operates both its trading environment and its financial environment. Shareholder value creation is the first challenge for the firm while measuring, enhancing and managing it are the challenges of the firm. Dr. V. Rajeshkumar (2007) had undertaken the study on “Creating, measuring, enhancing and managing Shareholder value – The Indian Experience”[20] had found that for an action to create value it has to do one or more of the following like increase the cash flows generated by existing investments, increase the expected growth rate in earnings and increase the length of the high growth period and reduce the cost of capital that is applied to discount the cash flows.

3.4.21

Shareholder value creation is the composite effect of marketing performance as well as financial performance. The issue of shareholder value creation of marketing is an important agenda for marketing executives, management and academics. Marketers have not been able to adequately, quantify and measure shareholder value creation through marketing expenditure. Victoria Louise Hodgson (2003) had undertaken study on “Linking marketing to shareholder value in listed and non-listed markets” [21] had found that stock effects represents the direct impact of marketing communication on financial performance measures and flow effects are the indirect flows from marketing communication through the performance measures to shareholder value.

3.4.22

In performance measurement theory, the dividend policy plays an important role. Dividend is commonly defined as the distribution of past or present earnings in the real assets amongst the shareholders of the firm in proportion to their ownership. Management’s primary goal is shareholder's wealth maximization. This goal can be achieved by giving the shareholders a fair payment on their investments. Sujata Kapoor(2009) had undertaken the study on, “Impact of dividend policy on shareholder value: A study of Indian firms”[22] had found that as the dividend decision is the important decision it can’t be
manage with higher share price. She also found that in India financial managers view dividend decision as an important part of their job.

3.4.23

According to the financial theory, corporate hedging can increase shareholder value in the presence of capital market appreciations such as direct and indirect cost of financial distress, costly external financing and the taxes. The shareholders wealth can be increased through corporate hedging by exploiting capital market imperfection that results in underinvestment and asset substitution problems. Arets, Kevin, Bartram and Sohnke M. (2009) had studied on “Corporate hedging and shareholder value” [23] had found that corporate risk management cannot increase shareholder value in the world hedging at the firm level can create value to the benefit of shareholders in the presence of real world capital market imperfections, such as direct and indirect cost of financial distress, costly external financing and taxes.

3.4.24

For the creation of the shareholder value, the merger and acquisition becomes useful. Merger and acquisition create the value in the long run. With the economic globalization, companies are growing by mergers and acquisition in a bid to expand their operations and thus creating higher value for the shareholders. Narjess Boubakari, Georges Dionne and Thouraya Triki (2009) had undertaken the study on "consolidation and value creation in the insurance industry; The role of governance" [24] had found that mergers and acquisitions create value in the long run as buy and hold abnormal returns are positive and significant.

3.4.25

The main objective of investors is to maximize their expected return due to reducing its related risks. Therefore, financial researcher and analysts are seeking a performance measurement which can predict a company's stock return more proportionally. RizvanHejazi and Malektaj Maleki Usokuei(2007)
had undertaken study on “The information content of cash value added and P/E Ratio: Evidence on association with stock returns for industrial companies in Tehran Stock Exchange” [25] had found that there are variations in the results. The first set of analysis evaluate the correlation of CVA and P/E Ratio with stock return found that P/E ratio had not powerful correlation with stock returns.

3.4.26

Shareholder value creation is the worldwide approach. The company has to analyses the market forces for the expansion of the projects. If the company wants to create the strong position than it has to change the way it sets objectives and the measure of performance. Therefore, the key objective is to add the value of all the departments. Tom Brols(2010) had undertaken the study on, “The impacts of brands on shareholder value: within industry effect on stock market return and idiosyncratic risk” [26] had found that for the creation of shareholders value every departments in the company has to face the same direction of creating value. The concentration has been given to the activities like advertising, promotion, sales volume as well as financial performance.

3.4.27

With the globalization of competition and the capital market and a tidal wave of privatizations, shareholder value rapidly is capturing the attention of executives worldwide. If shareholders believe that the corporation is underperforming than they can try to replace the board in the next election. If they succeed the new board will appoint new management team. The objective function of the company is to maximize the shareholder value. Manager in most of the firms of the world focus on building shareholder value. Dr. K. R. Jadeja(2010) had undertaken the study on “shareholder value creation in India – A sectorial analysis”[27] had found that old generation companies of the industries like Oil & Gas, Steel, Textile, Sugar, Cement and Cement Products create more shareholder value than new generation companies of the industries like IT, Pharmaceutical, FMCG, Automobile and the Capital Goods etc. He also found that there is positive correlation between market capitalization and the shareholder value creation.
3.4.28

Every public listed affiliate of a business group publishes its own financial statements and is responsible to its own shareholders. Some of the business houses believe in empire building in terms of assets size rather than shareholder value as larger the asset size of the group, probably larger will be its economic power and its influence the society. Ram Kumar Kakani(2000) had undertaken the study on “Financial Performance and the Diversification Strategy of Indian Business Groups” [28] had found that, share holder value creation was negatively related to product diversification of business houses during all the period while international diversification was positively related to the business groups growth, profitability, profit margins and the share holders' value.

3.4.29

Merger and acquisition contributes a lot in the creating value of the firm as well as the shareholder. Cumulative abnormal shareholder returns due to the announcement of a merger reflects a revision of the expected value resulting from future strategies or wealth redistribution amongst the stakeholders. Jose Manuel Campa(2004) had undertaken the study on “shareholder value creation in European M&A” [29] had found that the target shareholders receive on average a positive and the significant cumulative abnormal return from the announcement of mergers.

3.4.30

It is now well settled that the aim of every business entity should be to maximize the shareholder wealth by enhancing the firm's value and all the activities of a firm should be directed to achieve this objective. Various theories of the firm conceptualize the firm in various ways and provide an understanding of the factors that contributes to the success of the firm. Ashish K. Bhattacharya & B.V. Phani had undertaken the study on, “EVA – A General Perspective”[30] had found that, the concept of EVA is based on the sound economic principle that firm value
increases only if it is able to generate the surplus over its cost of capital and therefore it is based on the strong theoretical foundation.

Since the core concept of this study is to measure shareholder value creation in selected Indian companies, thus historical background of Indian Corporate and history of selected company of the respective industry will not be irrelevant. So chapter number 4 deals with History of Indian Corporate, Selected industries and companies.
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