

**A STUDY ON ECONOMIC VALUE ADDED WITH SPECIAL REFERENCE TO  
THE INDIA CEMENTS LIMITED TIRUNELVELI**

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**ABSTRACT**

Advancement in the nature of business and management performance has pushed the need of people to build a more effective and structural financial measurement. Today it is well established that the aim of every business entity should be to maximize shareholders' wealth. Value based measures like EVA & CFROI which measures performance in terms of change in value have received a lot of attention. Economic Value Added (EVA) is a relatively new concept in the area of financial management. EVA is the performance measure most directly linked to the creation of shareholder wealth over time. The concept of the Cash flow return on investment also suggests that prices of stocks in the stock markets are set on the basis of cash flow rather than the earning or the performance of a business. This empirical study has been taken up with the objective of measuring the financial performance of India Cements Limited using EVA. The secondary data for the study were taken from the records of the company for the period of five years. Ratios, CFROI are the tools used in this study to suggest and recommend, if any.

**Keywords:** Financial measurement, shareholder's wealth, Economic Value Added, Ratios.

**INTRODUCTION**

For an existing and investor, performance and profitability measurement is one of the significant yardsticks to evaluate / check their rationality behind the investment or potential investment. There are different ways to measure the profitability of a concern but no perfect method or technique is available so far. Financial analysis is the process of understanding the financial strength and weakness of a firm by establishing the relationship between the term of the balance sheet and the profit and loss account. Financial analysis is therefore the starting point of making plans, before using any sophisticated forecasting and planning procedures. This study makes a humble attempt to evaluate the company on financial performance criteria.

## **STATEMENT OF PROBLEM**

EVA measures corporation's true economic profit and help to understand which business units best utilized their assets to generate returns and maximize shareholders value. The following aspects of Economic Value have inspired me to take this project:

- ❖ EVA is better technique of measure of performance.
- ❖ EVA is better discloser of genuine addition or draining the net worth of shareholders.
- ❖ Unlike other taking techniques it can be used in decision- making process.

## **OBJECTIVES OF THE STUDY**

This empirical study has been taken up with the following objectives.

- ❖ To compare and contrast EVA with other measures of performance like (ratios, ROI).
- ❖ To measure the financial performance of India cements limited using EVA.
- ❖ To suggest and recommend, if any, ways of improving EVA.

## **LIMITATIONS OF THE STUDY:**

The study is based on accounting information. So all the limitations of accounting apply to this study.

- ❖ The study has only made a humble attempt at evaluating financial performance and does not and cannot claim as the perfect study.
- ❖ The data used for calculation is historical data and may have some adjustments made.
- ❖ Time constraint

## **Research Methodology:**

Research is a structured enquiry that utilizes acceptable scientific methodology to solve problems and create new knowledge that is generally applicable. Research methodology is a way to solve the research problem in a systematic manner. The sequence or steps, which will be followed, are explained under in detail. The study on EVA of India Cements is based on the secondary data collected from the annual reports of the company. Last five years Balance sheet, Profit & loss A/c, cash flow statement and stock price of the company were taken for analysis.

## **Review of literature**

**Andrew C. Worthington and Tracey West (2001)** With increasing pressure on firms to deliver shareholders value, there has been a renewed emphasis on devising measures of corporate financial performance and incentive compensation plans that encourage managers to increase shareholder wealth.

**Madan Lal Bhasin. (2013)** It is universally accepted that the goal of financial management is to maximize the shareholder's value. In recent years, Economic Value Added (EVA) framework is gradually replacing the traditional measures of financial performance on account of its robustness and its immunity from creative accounting.

**Bolek, Monika Kacprzyk, Marta Wolski, Rafał (2012)** Economic Value Added (EVA) a profitability measure and a Cash Conversion Cycle a liquidity and profitability measure are presented in this article.

**Li, Pingli, Tang, Guliang and Dai, Narisa, (2012)** Key Conclusions the evolutionary change is achieved in Chinese state-owned enterprises by staged performance measurement system development in which Economic Value Added is introduced gradually.

**Othman, I.W.; Pok Wee Ching ; Ghazali, A.W. (2012)** This study examines the relationship between Economic Value Added (EVA), being the measurement for value creation of companies and the Malaysian stock market performance.

**Ashok Banerjee (2000)** Maximizing shareholder value has become the new corporate paradigm. Corporations in the US have started disclosing EVA information from the beginning of 90s as a measure of corporate performance.

**Bahri, Moujib, (2008).** Nowadays, companies are facing complex challenges. They have to deal with a business environment characterized by rapid and significant changes.

**William g. Sullivan<sup>a</sup> & Kim lascola needy (2007)** This paper discusses a measure for estimating the wealth creation potential of capital investments in manufacturing.

**David sparling, calum G Turvey, (2003)** Sparling and Turvey (2003) revisit the relationship between EVA and shareholder return and re-examine the evidence and issues surrounding the

use of EVA as a tool for valuing investments.

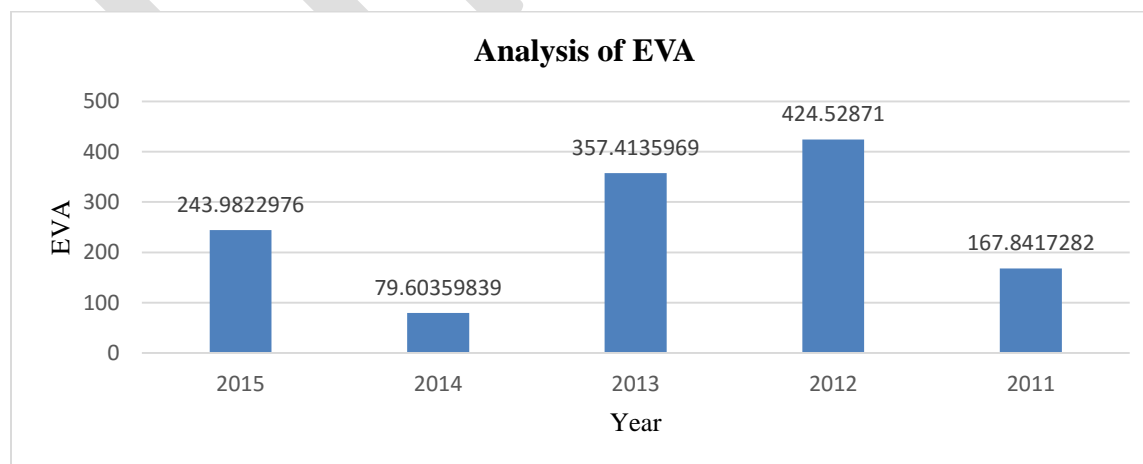
**RussRay, (2001)** Ray (2001) analyzes the efficiency of Economic Value added, financial-management tool. This analysis offers a new definition of value, and suggests that the missing link in the EVA process is productivity, generally found to be the engine of all economic growth.

**EVA IN THE INDIA CEMENTS LIMITED**

**Table: 5.1**

Net Operating Profit After Tax	672.83	505.24	734.49	815.35	411.92
Cash Tax	0	0	88.82	88.02	21.77
Invested Capital	4293.64	5113.07	5115.5	4851.85	4927.62
Return on Invested Capital	17.33	8.41	15.08	17.45	10.06
Cost Equity (Ke)	0.00	0.00	0.03	0.02	0.02
Cost of Debt (Kd)	0.11	0.09	0.08	0.09	0.05
E (market value of the firm's equity)	307.18	307.18	307.18	307.18	307.18
D (market value of the firm's debt)	2678.34	2666.64	2754.00	2268.59	1836.67
V= E+D	2985.52	2973.82	3061.18	2575.77	2143.85
Weighted cost of equity (E/V)*Ke	0.000	0.000	0.003	0.002	0.003
Weighted cost of debt (D/V)*Kd	0.099	0.083	0.070	0.077	0.046
WACC (%) = Wke +Wkd	9.99	8.32	7.37	8.06	4.95
<b>EVA</b>	<b>243.98</b>	<b>79.60</b>	<b>357.41</b>	<b>424.52</b>	<b>167.84</b>

**Chart 5.1**



- The India Cements Limited Economic Value Added was highly fluctuated from the year 2011 to 2015. Economic Value Added was at peak in the year 2012 and 2014 was the lowest.
- Increase in clinker production leads to high net operating profit in 2012. Obviously, the sale of cement was at 94.51 lakh tons as opposed to 99.32 lakh tons as compared to 0.32 lakh tons in the previous year. The cost of production was higher on account of the increase in the prices of materials, fuel, power, transport charges and consequently the Earnings before depreciation interest tax and amortization (EBDITA) was at Re. 922.64 Crores.
- In 2014, the total sales and other income for the year was at Rs.4529.84 crores as compared to Rs.4615.67 crores in the previous year. With huge supply overhang particularly in the South, the selling price of cement went down substantially from the second quarter resulting in a top line erosion which reflected on the bottom line. The cost of production was impacted with increase in the price of Gypsum, Fuel, depreciation of rupee, higher transport charges resulting in a lower earning before interest tax and amortization (EBIDTA) of Rs.594.20 crores as compared to Rs.841.95 crores in the previous year.
- With no major significant change in the market place, the weak demand for cement persisted during the first five months of year 2015 with a growth of 2% as per the information published in Department of Industrial Policy and Promotion (DIIP). The negative growth in the South continued depressing capacity utilization further.
- There is no tax in the year 2014. Therefore, the company generates operating profit is lower than 2013 were the tax is higher.
- The Net Operating Profit after Tax (NOPAT) was very less in 2011. Net Operating Profit after Tax is higher in the year of 2012 thus it increases the Economic Value of The India Cements Limited.
- Invested capital will be calculated by using net block plus net current assets. Invested capital is often determined by adding the total debt and lease obligations to the amount of equity in the firm and then subtracting the non-operating cash and investments.
- The Return on Invested Capital (ROIC) is higher in the year 2012 with increase in net operating profit subtracted by invested capital. Regarding 2015 it generates reasonable return on invested capital.

- From the calculation of debt and equity are compared to identify the value of the India Cements Limited (i.e  $V=E+D$ ). In the year 2013, the value is higher as compared to other years. In the year 2014 and 2015 it was gradually decreases. Thus it is recommended for the company to reduce its debts to raise its funds.
- Cash Flow Return on Investment (CFROI) provides a consistent measure, which can be used to compare performance across a portfolio, a market of companies. From the table, the cash flow was higher in the year 2011 as compared to other years.

## **CONCLUSION**

The research being reported on here focused on the extent to which EVA is used, the deviations from the Stern Stewart (EVA) Economic Value Added model and the reasons for these deviations. The company reduces its raw material cost, fuel cost etc, so it leads to higher net operating profit in the year 2012. Economic Value Added is fluctuated over the five years. In 2012 the Economic value figures cannot be relied on. The performance of the Company was in line with the market conditions and the cement production was at 41.53 lakh tons up to September 2015 (46.01 lakh tons) a drop of 9%. The cement prices however remained stable during the period under review.

Estimating future EVAs for the firm, would require some generalization of assumptions. Such an effort might have been counter-productive. Therefore, the above results could be considered keeping in mind these limitations. Economic value added as a measure of performance in contrast to return on investment showed that the performance of India Cements Limited financial area was favourable. EVA is Positive Shows the value added is happening year after year. The only place of concern is the debts and its assets. Thus it is recommended for the India Cements Limited to focus more attention to the criteria of Economic Value Added in evaluating shareholder's value.

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