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A STUDY ON SHAREHOLDERS' VALUE OF SELECTED INDIAN COMPANIES

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Abstract

One of the most important purposes of every business is to maximize their profit and wealth of their shareholders. Now day's companies are focusing their efforts on creating shareholder value to survive in strong competition**.** In this study shareholder's value creationin selected Indian companies as measured by EVA. In this study researcher has taken dividend andcapital structure as independent variable and EVA as dependent variable. Regressiontechnique has been used in order to examine the impact of Dividend and Capital structureon Shareholder Value Creation. It is also found that majority of the companies are having positive EVA which indicates that these companies are notonly thinking about profit maximization but also focusing on the objective of wealthmaximization.

Keywords : Economic Value Added, Shareholders' value creation, Capital structure, Dividend

INTRODUCTION

One of the most important purposes of every business is to maximize their profit and wealth of their shareholders. Now day's companies are focusing their efforts on creating shareholder value to survive in strong competition. It is becoming essential for companies to measure the value they create for their shareholders. No companies can exist and develop, if it fails to create value to its shareholders. Hence, value creation is a basic measure which is used for measuring the financial Sustainability of an enterprise. Sustainable oriented actions have become progressively more important for firms. The correlation between sustainability-oriented activities and financial performance carries significant possible importance for managers and investors. Corporate sustainability implies the creation of long-term shareholder wealth by adopting sustainable development into business strategy and operations.

In ethics, "Values" denote orientations standards and objectives which direct and steer people's action. They are constitutive for every cultural, social and economic system and thus also for economic action.

Examples of this include economic value, protected value, existence or preservation value, moral values or self – oriented values, social values, capitalist value, liberal value, socialist values, green values and democratic values".

The concept of equitable value creation for all stakeholders including debt holders, employees, customers, suppliers and society is now gaining momentum. Strong and equitable value creation for each of the stakeholders has undoubtedly been a contributing factor in company's continued success.

Thus, unless companies create value for stakeholders, shareholder wealth creation will not be sustained in the long run. Value creation is a never ending cycle. It begins with modeling business operations, prioritizing areas for more detailed investigation, identifying opportunities for improvement, implementing the changes required to maximize success and the measurement and revision that starts the process over again and allows management to stay abreast of company and market changes. Value creation analysis is a critical but often overlooked component for the financial sustainability of every company. Without this type of inspection, value will not be created at the maximum pace.

DEFINITION OF VALUE CREATION:

- Value creation is the Primary financial performance indicator for measuring and evaluating financial performance within the group".
- The essence of investing is putting funds at risk with the hopes of receiving a greater amount in return. If this is accomplished, it can be said that one has created value.

There are different stakeholders who are directly interested in financial matters of a company. These stakeholders include promoters, money lenders, government, creditors, shareholders etc. in the era of corporate governance and globalization, the efficient management of a company is pre-condition for survival of any company. The value

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creation for shareholders is one of the parameter of efficient management of the company. It is continuous endeavor of companies to increase shareholder wealth. Shareholders wealth is directly connected with financial sustainability of the company and shareholder both.

1) According to Beatric Nyiramahoro and Natalia Shooshia have defined shareholder value as the "Total economic value of an entity such as a company or a business unit is the sum of the value of its debt and its equity. This value of the business is named corporate value while the value of the equity portion is named shareholder value in the form of equation".
2) 'Every for – profit organization's goal is to create consistent, profitable growth for the company and a return to the investors that is consistently above what they could earn somewhere else at a similar amount of risk. When company improves the return on investment, company is creating shareholder value'.

-By Nanda Ramanujan

'Shareholder value creation is real key to creating wealth'.

When company generates returns over and above the cost of capital it is known as Shareholder Value Creation. For measuring the value of a firm and consequently the value of Equity, there are many methods. Appropriate corporate sustainable performance may be considered as a sign of superior management skills and more successful business and financial planning (Waddock, S.A.; Graves, S.B 1997) there are traditional measures like earnings per share (EPS), dividend per share (DPS), return on equity (ROE), return on assets (ROA), and the like have been used by the shareholders to measure performance appraisals. Such traditional measures have been criticized due to not inclusion of cost of capital resources of the firm (Hasani and Fathi, 2012). Thus in order to overcome such issues economic value based measures like economic value added (EVA), Market Value Added (MVA), Cash Value Added (CVA) and Shareholder Value Added (SVA) were proposed (Al Mamun, Entebang, & Mansor, 2012; Erasmus, 2008).

REVIEW OF LITERATURE:

Miller and Modigliani (1961) found that the value of the firm is unchanged by the dividend policy in a world without taxes and the business cost and where everyone was fully informed about the distribution of the firm's uncertain cash flows.

Gordon Donaldson (1985) concluded that the importance of managing for better shareholder value by classifying value drivers and using the same to reduce the value gap by focusing on Return on Net Assets , growth, retention rate and debt equity ratio.

Johnsen, B. (2003) observed that sustainability in corporate finance is firmly connected to socially responsible investing (SRI). It can be defined as a synthesis of conventional and sustainable investment optimization, intended at achievement of better social and environmental performance while maintaining the financial excess return.

Madhu Malik (2004) observed the relationship between shareholder wealth and different financial variables like Earning per share, Return on net worth , return on capital employed By using correlation analysis, it was found that there was positive and high correlation between economic value added and Return on net worth , return on capital employed.

Irala *et al*. (2006) stated that managers are encouraged to undergo projects that could increase shareholder's wealth using measurement tools like economic value added (EVA).

Cui, X.G.; Wang, L.Y.; Xu, H. (2007) studied the relationship between corporate growth and financial risk and found that the probability that a company will experience financial distress increases dramatically when its growth rate is excessive. The authors also report an insignificant relationship between the probability of financial distress and the real growth rate of non-excessively growing companies.

Artiach lee & Nelson Alker (2010) suggested that the relation between financial performance and social responsibility is also sensitive to the specification of substitute for profitability.

Soppe (2011) noted that Sustainability in finance certainly requires a multidimensional approach, which defines sustainable finance as a financial policy that makes every effort for triple bottom-line performance measurements with human actors that opt to maximize multidimensional preference functions.

Pratapsinh Chauhan (2012) observed the shareholders' value creation in the Indian petroleum industry. He analyzed the performance of the petroleum company divided into public sector firm and private sector firms. EVA has been found to have significant correlation with OP, NOPAT, EPS, Market Capitalization and MVA figures of firms of both the sectors.

RESEARCH METHODOLOGY:

- <u>**Research Objectives**</u>

  1) To measure Shareholder Value Creation as per Economic value Added (EVA).
  2) To study the impact of capital structure and dividend on Shareholder Value Creation.

3) To compare the company wise Shareholder Value Creation.

- **Formulating Hypothesis**
  H0: There is no significant impact of capital structure and dividend on Shareholder Value Creation.
  H_1: There is significant impact of capital structure and dividend on Shareholder Value Creation

- **SAMPLE SIZE AND TECHNIQUE**
  In this research, the researcher has selected ten companies from pharmaceutical industry as per randomly convenient sampling technique. The companies have been selected in the study by considering the following criteria.

✓ The companies which have been taken for the study are listed in Bombay Stock Exchange (BSE)
✓ The data for the study has been collected from 2009-10 to 2013-14.
✓ Ten companies from pharmaceutical industry have been selected for this research i.e. Cipla Ltd., Dr. Reddys Laboratories Ltd., Sun Pharmaceutical Industries Ltd., Lupin Ltd., Aurobindo Pharma Ltd., Cadila Healthcare Ltd., Divis Laboratories Ltd., Glenmark Pharmaceuticals Ltd., Biocon Ltd., Torrent Pharmaceuticals Ltd.

- **Sources of Data**:
  This study is purely based on secondary data. Data has been taken from AuditedPublished Annual reports, respective company web sites and ACE EQUITY database from IIM library.

METHODOLOGY

✓ **FINANCIAL TOOLS**

1) ECONOMIC VALUE ADDED (EVA)

EVA as a residual income measure of financial performance is simply the operating profit after tax less a charge for the capital, equity as well as debt, used in the business.

Economic Value Added = NOPAT – [Invested Capital × WACC]

Step – 1 NOPAT = Net Profit + Interest on Borrowings – [1- Tax Rate]

Step – 2 Invested Capital = Paid – up Capital + Reserves + Total Borrowings

Step – 3WACC = Paid –up Capital × Ke + Borrowings × Kd

Where (1) Cost of Debt (Kd): = Interest on Borrowings (1- Tax Rate) * 100

(2) Cost of Equity (Ke): Ke = Rf + β (Rm - Rf)

Rf - The researcher has taken 365 T-Bills rate of particular year from Reserve Bank of India Websites as a risk free rate of return.

Rm - The market rate of return is calculated based on market Index.

β - Beta is the risk free coefficient which measures the sensitivity of the security returns of a particular security to change in the market returns. Beta has been calculated based on SENSEX for each year separately.

$$\textbf{Beta } (\beta) = \frac{N\Sigma XY - (\Sigma X)(\Sigma Y)}{N\Sigma X^2 - (\Sigma X)^2}$$

X = Monthly Closing Return on the Stock Market Indices (BSE)
Y = Monthly Closing Return on Share Prices of a particular company
N = No. of Months in a year

2) The capital structure was determined with help of Debt-Equity Ratio (i.e. Debt/Equity).
Debt-Equity Ratio = Total debt (Long-term debt + Short-term debt) /Shareholders' fund (Equity share capital + Preference share capital + Reservesand Surplus + P & L a/c – Miscellaneous expenditure)

✓ **STATSTICAL TOOLS**.

Regression technique is used in order to study theimpact of Capital structure and Dividend on Shareholder Value Creation.

For the purpose of comparing Shareholder Value Creation of variouscompanies mean scores of Shareholder Value Creation wereconsidered and the companies were ranked on the basisof those mean scores.

LIMITATION OF THE STUDY:

- This study is basedon secondary data.
- It is also restricted to some selected Indian companies from pharmaceuticals Industry.
- There are number of determinants of Shareholder Value Creation but the present study only examined the impact of major determinants (Dividend and Capital structure) on Shareholder Value Creation.
- There are number of techniques to measure Shareholder Value Creation but in this study only Economic Value Added (EVA) technique is used.

TABLE: 1 EVA CALCULATIONS

	EVA (RS. IN CR.)				
COMPANY	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**
Cadila Healthcare Ltd.	401.081	464.620	458.450	322.749	676.051
Cipla Ltd.	296.420	251.546	320.258	435.322	245.947
Dr. Reddys Laboratories Ltd.	255.647	256.703	194.882	651.627	912.129
Lupin Ltd.	411.575	396.659	466.402	881.612	1550.112
Sun Pharmaceutical Industries Ltd.	232.440	449.464	947.704	-469.688	-1010.098
Aurobindo Pharma Ltd	183.0147	89.34109	-597.939	-213.58	501.4351025
Divis Laboratories Ltd	96.86419	159.9984	240.9905	231.1248	381.7637064
Glenmark Pharmaceuticals Ltd.	-203.972	-106.875	-0.03623	139.1127	83.47483432
Biocon Ltd	-32.5734	101.8191	-115.355	-68.3616	5.221912953
Torrent Pharmaceuticals Ltd.	97.52149	159.2903	176.3961	389.3566	531.4866948

(Source: researcher's calculated data)

Interpretation

The above table shows the result of Economic Value Added of selected companies for selected period. The positive data of EVA presents that the companies aregenerating value and negative data shows that the companies are destroying valuefor shareholders.

Majority of the companies are having positive EVA which indicates that these companies are not only interested in profitmaximization but also giving importance of wealth maximization. If thecompany is creating Shareholder value it implied that the company is efficient inmanaging its resources as its profits are more than its WACC.When company generates returns over and above the cost of capital it is known as Shareholder Value Creation. The abovetable shows that there are four companies (Sun Pharmaceutical Industries Ltd.,Sun Pharmaceutical Industries Ltd., Glenmark Pharmaceuticals Ltd., Biocon Ltd) whichgave negative EVA. It shows that these companies are not creating wealth for shareholders. They are treated as value destroyer. The resultimplied that these companies are not capable to control its cost of capital because ofwhich their earnings are less than WACC.

TABLE: 2 Debt -Equity Ratio

COMPANY	2009-10	2010-11	2011-12	2012-13	2013-14
Cadila Healthcare Ltd.	**0.37**	**0.27**	**0.50**	**0.61**	**0.44**
Cipla Ltd.	**0.00**	**0.07**	**0.00**	**0.11**	**0.09**
Dr. Reddys Laboratories Ltd.	**0.10**	**0.24**	**0.23**	**0.27**	**0.29**
Lupin Ltd.	**0.36**	**0.31**	**0.29**	**0.14**	**0.02**
Sun Pharmaceutical Industries Ltd.	**0.01**	**0.01**	**0.01**	**0.01**	**0.33**
Aurobindo Pharma Ltd	**1.02**	**0.90**	**1.12**	**0.95**	**0.73**
Divis Laboratories Ltd	**0.02**	**0.01**	**0.03**	**0.01**	**0.01**
Glenmark Pharmaceuticals Ltd.	**0.43**	**0.58**	**0.22**	**0.23**	**0.12**
Biocon Ltd	**0.13**	**0.09**	**0.08**	**0.06**	**0.05**
Torrent Pharmaceuticals Ltd.	**0.59**	**0.52**	**0.44**	**0.42**	**0.49**

(Source: ACE EQUITY database)

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TABLE: 3 Dividends (DPS in Rs.)

COMPANY	2009-10	2010-11	2011-12	2012-13	2013-14
Cadila Healthcare Ltd.	5	6.25	7.50	7.50	9
Cipla Ltd.	2	2.80	2	2	2
Dr. Reddys Laboratories Ltd.	11.25	11.25	13.75	15	18
Lupin Ltd.	13.50	3	3.20	4	6
Sun Pharmaceutical Industries Ltd.	13.75	3.50	4.25	5	1.50
Aurobindo Pharma Ltd	5	2	1	1.50	3
Divis Laboratories Ltd	6	10	13	15	20
Glenmark Pharmaceuticals Ltd.	0.40	0.40	2	2	2
Biocon Ltd	3.50	4.50	5	7.50	5
Torrent Pharmaceuticals Ltd.	6	8	8.50	23	10

(Source: ACE EQUITY database)

Impact of Capital Structure and Dividend on Shareholder Value Creation:

Although there are number of determinants of Shareholder Value Creation but the impact of major determinants such as Dividend and Capital structure is calculated. The capital structure is determined with the help of Debt-Equity Ratio.

The Impact of Dividend and Capital structure on Shareholder Value Creation is analyzed with the help of Regression Analysis. Shareholder Value Creation as dependentvariable and Dividend and Capital structure as independent variable. There isvariation in the calculated data, we applied LOG to remove such variation andthen we applied regression techniques with the help of SPSS. Therefore theregression equation is formed as:

Y= a + b1X1 + b2 X2 + E

Where, Y = Shareholder Value Creation;

X1 = Capital structure X2 = Dividend;

E = Error, a = Intercept

b1, b2 = Regression Co-efficient

TABLE: 3 SUMMARY OUTPUT

Regression Statistics									
Multiple R	0.364549255								
R Square	0.132896159								
Adjusted R Square	0.095998123								
Standard Error	379.4225345								
Observations	50								
ANOVA									
	df	*SS*	*MS*	*F*	*Significance F*				
Regression	2	1037015.909	518507.9547	3.601713652	0.035048633				
Residual	47	6766188.604	143961.4597						
Total	49	7803204.514							
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*	
Intercept	171.7468265	109.4353232	1.569391139	0.123265527	-48.40864314	391.9023	-48.40864314	391.9022962	
DEBT - EQUITY RATIO	-246.6401458	190.3714067	-1.29557348	0.201449582	-629.6180108	136.3377	-629.6180108	136.3377193	
DIVIDEND (DPS)	21.27526224	10.2327122	2.079142052	0.04308647	0.689700883	41.86082	0.689700883	41.8608236	

(Source: researcher's calculated data)

The analysis shows that both Dividend and Capital structure have influence on the Shareholder Value Creation. As the significant value is less than 0.05, therefore our null hypothesis is rejected that there is no significant impact of capital structure and dividend on Shareholder Value Creation. The overallmodel is significant as the p- value is 0.03. The value of R is 0.36 which shows low positive relationship between Independent variables and dependent variables. The value of R Square is 0.132 indicates that the 13.20 percent of variance is explainedby dividend and Capital structure. It implied that approximately 87 percentvariance will be explained by the rest of the factors which need to be study for further research.as the p- value of Dividend(0.04)significant at 5 percent level of significance Therefore, there is significant effect of Divided (p-value<0.005) on Shareholder Value Creation but p- value of Capital structure (0.20) not significant at 5 percent level ofsignificance. Therefore, there is no significant effect of Capital structure(p-value>0.005) on Shareholder Value Creation.

Comparison of Shareholder Value Creation among selected companies:

To compare the Shareholder Value Creation of various companies, mean scores of EVA areconsidered and the companies are ranked on the basis of these mean scores.

TABLE: 5 ranking of selected companies on the basis of EVA

COMPANY	Average of EVA	rank
Lupin Ltd.	**741.272**	**1**
Cadila Healthcare Ltd.	**464.5902**	**2**
Dr. Reddys Laboratories Ltd.	**454.1976**	**3**
Cipla Ltd.	**309.8986**	**4**
Torrent Pharmaceuticals Ltd.	**270.8102**	**5**
Divis Laboratories Ltd	**222.1483**	**6**
Sun Pharmaceutical Industries Ltd.	**29.9644**	**7**
Aurobindo Pharma Ltd	**-7.54562**	**8**
Glenmark Pharmaceuticals Ltd.	**-17.6591**	**9**
Biocon Ltd	**-21.8498**	**10**

The above table 5 shows the ranking given to selected companies on the basis of average Economic Value Added. Some companies showed high wealth of shareholders like Lupin ltd., Cadila Health care ltd., Dr. Reddys laboratories ltd., Cipla ltd., Torrent pharmaceuticals ltd., Divis laboratories ltd, It indicates that thesecompanies are creating shareholder value at higher level. One company showslow wealth of shareholders like Sun Pharmaceutical Industries Ltd, which is somehow satisfactory as this is not at least destroying the value of shareholders. Some companies like Aurobindo Pharma ltd, Glenmark Pharmaceutical ltd., Biocon ltd having a negative EVA from 2010 to 2014 which indicates that these companies are completely destroying the value of shareholders.

The above table also gives an idea about the ranking of the companies on the basis of EVA. It can help the shareholders in taking investment decision in future. The top ranked companies are creating shareholders value and generate wealth for shareholders. It implied that the major objective of these companies is to create wealth for its shareholders. The companies are giving highest importance to shareholders. Therefore the investors can invest into these companies to get the highest return.

CONCLUSION:

Speculators are putting their well deserved cash in the organizations. It is the obligation of the organization the executives to build their riches. Stern Stewart recommended a real and true performance metric to find out the economic profit of the company. In India very a small number of organizations are unveiling its EVA in Annual reports. It should be compulsory for every company to disclose EVA, in its annual reports. So that Investor can check true financial capability of the company while investing. Getting financial sustainability is a long-term goal that requires the combined efforts of the entire organization. The companieswhich give importance on the Wealth Maximization principle for the shareholders, thosecompanies will be able to attract the investors in future.

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