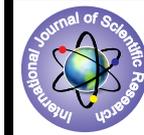


A Comparative Study on Wealth Maximization in Selected Automobile Industries



Finance

KEYWORDS : Wealth Maximization, Market price, Automobile Industry, Profit maximization

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ABSTRACT

The Wealth Maximisation objective is considered superior than the profit maximisation objective. Many of the organization have entered into the concept of Wealth based management. It is concentrating on what a firm should do to maximize its contribution to the society such as employees, creditors and customers. The researcher has chosen Tata Motors and Ashok Leyland for measuring the wealth of the companies for nine financial year from 2004-2005 to 2011-2012 based on the top companies in selling the heavy vehicles in automobile industry. The Problem taken for this research is that due to the fluctuations in the market price of the shares, it is essential to measure the wealth created by the organization. The researcher has compared the firm Tata Motors and Ashok Leyland for the better understanding of wealth creation of two organisations. The objectives of the research are to measure and compare the Wealth of the selected automobile industries and to provide the suitable suggestion for the selected industries and for the investors for their Wealth Maximization. In this research there are six financial tools has been used to analyse the dada. And based on the analysis the researcher has compared wealth creations of selected organisations and suitable suggestions have been given to the selected organisations and also for the investors.

1. Introduction

A firm's main objective should be maximizing the wealth of the company, and the owners of a company are its shareholders, the main financial objective should be the maximization of shareholder wealth. Since shareholders receive their wealth through dividends and capital gains, shareholder wealth will be maximized by maximizing the amount of dividends and capital gains that shareholders receive over time.

The Wealth maximisation objective is considered superior than the profit maximisation objective. Wealth maximization is based on the assumption that management should strive to maximize the value of the firm. Many of the organization have entered into the concept of value based management. It is concentrating on what a firm should do to maximize the wealth of its shareholders and contribution to the society such as employees, creditors and customers. The researcher has chosen Tata motors and Ashok Leyland for measuring the wealth of the two different companies for nine financial years from 2004-2005 to 2011-2012. Because they are the top two companies in selling heavy vehicles in automobile industry.

2. Statement of the Problem:

The firm's primary objective is maximizing the wealth of the shareholder. Due to the fluctuations in the market price of the shares, it is essential to know what are all the factors influencing the wealth and it is required to measure the wealth of the organization.

The researcher has compared the firm Tata Motors and Ashok Leyland for the better understanding of wealth maximization of two organisations.

3. Objectives of the Study:

- To measure and compare the Wealth of the selected automobile industries.
- To provide the suitable suggestion for the selected industries and for the investors for their Wealth Maximization.

4. Literature Review:

Hayek (1960) and Friedman (1970)¹ "Says that a firm should be operated in a manner that maximizes its economic profits. In the financial scenario, although the investors always wanted their share value to appreciate but their primary focus was on profits distributed by way of dividends".

Rappaport (1986)² "The business strategies should be judged

by economic returns they generate for their shareholders which are measured as dividend and increase in the share price".

Kirloy (1999)³ "Shareholder wealth can only be created if the performance of the management is more than the expectations".

Aswath (2001)⁴ "Discussed the reasons why the shareholder wealth maximization objective should be the main objective of a firm".

Chartered Institute of Management Accountants⁵ (2004) "Value based management thus places the interests of owners of companies back in the centre of decision making. This is turn means those investors can rely on more than just instruments of corporate governance to protect them from the possible conflicts of interest arising from the split between ownership and management".

A.Lakshminarasimha⁶ (2006) "While the merit of value based metrics as such is not in doubt, the choice of metric should very well be decided based on one convenience and objectives. Ultimately, it is not the metric that one uses that determines the final result, but how one actually performs".

R.Azhagaiah and Sabari.⁷ (2008) "The study proves that the wealth of the shareholders is greatly influenced mainly by five variables viz., Growth in sales, improvement of profit margin, Capital investment decision, Capital structure decision and Cost of capital".

K.Sunitha⁸ (2011) "Banks which eroded shareholders value should invest in growth, keep the cost of capital down, and squeeze optimal returns from its investments to add shareholder value".

Debdas Rakshit⁹ (2011) "From the segment wise Profit and loss A/C and Balance sheet it is found that all segments earned profit but from EVA based Segmental reporting it becomes clear that all segments are not value generating segments even though under traditional methods all segments earned profit".

Dr.A.Vijayakumar¹⁰ (2012) "Testing with t-statistics, the table transports that PAT is found significant if tested at 11.8 percent level where as EPS and sales are observed quite significant even at 1 percent level of significance. The result of multiple regression analysis showed that Sales, EPS and PAT are the best explanation of MVA of Indian automobile industry during the study period".

5. Research Methodology

5.1 Research Design:

Analytical research design is used for this study and researcher used the facts or information already available, and analyzed these to make a critical evaluation of the Wealth of the firms.

5.2 Source of Data:

Secondary data has been used for the analysis, and for the analysis the financial statements are collected through company annual reports, websites, journals, and books.

5.3 Period of the Study:

Nine years of data from 2003-2004 to 2011-2012 are being used by the researcher for the analysis.

5.4 Tools Used for the Study:

The following financial tool are being used by the researcher

1. Economic Value Addition.
2. Market Value Addition
3. Cash flow Return on Investment
4. Total Shareholders Return
5. Total Business Return.
6. Marakon Approach.(Market value to book value ratio)

6.0 Analysis and Interpretation

6.1 Economic Value Added (EVA):

EVA is an estimate of a company's Economic profit or Residual income, which is the amount by which the earnings exceed or fall short of the return that could get by investing in other business of comparable risk. EVA is defined in monetary terms and is a period – based measure.

Table No.1

TEVA of Ashok Leyland (Rs in crores)

Year	NOPAT	WACC (%)	Capital	WACC* C	EVA
2003-2004	252.99	0.0629	1550.48	97.53	155.46
2004-2005	301.81	0.0317	1550.48	49.20	236.87
2005-2006	365.69	0.0736	1994.39	146.78	218.90
2006-2007	473.11	0.0721	2534.98	182.77	290.33
2007-2008	552.94	0.0903	3036.48	274.19	278.74
2008-2009	347.30	0.1409	5435.87	765.91	-418.61
2009-2010	525.52	0.0905	5936.75	537.27	-11.75
2010-2011	820.22	0.1159	6621.15	767.39	52.82
2011-2012	821.23	0.0880	6607.30	581.44	239.78

Source: Annual reports

From the above table it is inferred that the Economic Value of Ashok Leyland is fluctuating from 290.33 crores to 155.46 crores from the year 2003-2004 to 2007-2008. After that it shows the negative EVA of -418.61 crores and -11.75 crores for the next two years from 2008-2009 to 2010-2011. Again it increased from 52.82 crores to 239.78 crores in the financial year 2010-2012.

Table No.2

EVA of Tata Motors (Rs in crores)

YEAR	NOPAT	WACC (%)	CAPITAL	WACC * C	EVA
2003-2004	1036.30	0.0494	4849.54	239.56	796.73
2004-2005	1471.25	0.0734	6606.81	484.93	986.31
2005-2006	1876.12	0.0747	8477.91	633.29	1242.31
2006-2007	2368.21	0.0808	10938.89	883.86	1484.34
2007-2008	2500.48	0.0894	14119.72	1262.30	1238.17
2008-2009	1706.18	0.1499	25560.43	3831.50	-2125.33
2009-2010	3486.33	0.1453	31429.69	4566.73	-1080.40
2010-2011	3195.61	0.1249	35908.99	4485.03	-1289.42
2011-2012	2460.85	0.1058	30379.29	3214.12	-753.27

Source: Annual reports

From the above table it is inferred that Economic value of Tata motors are increasing from 796.73 crores to 1484.34 crores from the financial year 2003-2007. After that It show the negative EVA from the financial year 2008-2009 to 2011-2012.

6.2 Market Value Added:

The Market Value Added approach measures the change in the market value of the firm's equity and equity investment. Though the concept of market value added is normally used in the concept of equity investment and, hence, is of greater relevance of equity shareholders. It can also be adapted to measure value from the perspective of all invested funds including preference share capital and dept. The market value added approach cannot be used for all type of firms whose market prices are available.

Table No.3

Market Value Added For Ashok Leyland (Rs in crores)

Year	Market value	Book value	MVA
2003-2004	21854.61	11697.99	10156.62
2004-2005	13662.58	3072.46	10590.12
2005-2006	5466.80	3371.41	2095.39
2006-2007	8007.50	4274.86	3732.64
2007-2008	10245.37	5030.92	5214.45
2008-2009	11856.84	7411.68	4445.16
2009-2010	14839.23	8126.73	6712.50
2010-2011	15029.89	9145.08	5884.81
2011-2012	15830.00	9238.95	6591.05

Source: Annual reports

The Market Value is being added for Ashok Leyland from 10159.62 crores to 10590.12 crores from the financial year 2003-2004 to 2004-2005. After that it fluctuating from 2095.39 crores to 6712.50 crores for the financial year 2005-2006 to 2011-2012.

Table No.4

Market Value Added of Tata Motors (Rs in crores)

Year	Market value	Book value	MVA
2003-2004	104454.80	40396.10	64058.70
2004-2005	161233.20	47357.91	113875.30
2005-2006	221258.40	63195.59	158062.80
2006-2007	295920.30	78925.48	216994.80
2007-2008	291957.50	91875.33	200082.20
2008-2009	196905.00	148737.10	48167.90
2009-2010	321325.50	178651.20	142674.30
2010-2011	694558.00	235132.10	459425.90
2011-2012	381890.20	68482.42	313407.80

Source: Annual reports

The Market Value against the book value of Tata motors is being increased from 64058.7 crores to 216994.8 crores for the financial year 2003-2004 to 2006-2007. After that It is declining from 200082.2 crores to 48167.9 crores for the next two years. From the financial year 2009-2010 to 2011-2012 it shows the increasing trend.

6.3 Cash Flow Return on Investment of Ashok Leyland:

Cash Flow return on investment is the equivalent of ROI computed based on cash flows, instead of profits. CFROI compares the sustainable cash flow generated by a firm with the total cash invested (towards both fixed and working capital) to generate this flows. A valuation model that assumes the stock market sets prices based on the cash flow, not on the corporate performance and earnings.

Table No.5
Cash Flow Return of Ashok Leyland

Year	Cash flow Rs. In Cr	MVC Rs. In Cr	CFROI	CFROI (%)
2003-2004	349.44	21854.61	0.0159	1.59
2004-2005	301.81	13662.58	0.0309	3.09
2005-2006	365.69	5466.80	0.0898	8.98
2006-2007	473.11	8007.50	0.0778	7.78
2007-2008	552.94	10245.37	0.0721	7.21
2008-2009	347.30	11856.84	0.0443	4.43
2009-2010	525.52	14839.23	0.0491	4.91
2010-2011	820.22	15029.89	0.0723	7.23
2011-2012	821.23	15830.00	0.0964	9.64

Source: Annual reports

The Cash Flow Return on Investment of Ashok Leyland is increasing from 1.59% to 3.09% for the year 2003-2004 to 2005-2006. After that it decreases from the 7.78% to 4.43% for the year from 2006- 2007 to 2008-2009. Again it is increasing from 4.91% to 9.64% for the year from 2010-2011 to 2011-2012.

Table No.6 Cash Flow Return of Tata Motors

Year	Cash flow Rs. In Cr	MVC Rs. In Cr	CFROI	CFROI (%)
2003-2004	1418.90	104454.80	0.013	1.30
2004-2005	1921.41	161233.20	0.011	1.19
2005-2006	2400.06	221258.40	0.010	1.08
2006-2007	2955.50	295920.30	0.009	0.99
2007-2008	3152.81	291957.50	0.010	1.07
2008-2009	2580.72	196905.00	0.013	1.31
2009-2010	4520.20	321325.50	0.014	1.40
2010-2011	4556.38	694558.00	0.006	0.65
2011-2012	4067.59	381890.20	0.010	1.06

Source: Annual reports

From the above table it is inferred that the Cash Flow Return on Investment of Tata Motors is decreasing from 1.30% to 0.99% from the year 2003-2007. And it is increasing from 1.07% to 1.40% from the year 2008-2009 to 2009-2010. Again it is decreasing from 1.40% to 0.65% from the year 2010 to 2011. And it is increasing 0.65% to 1.06% from the year 2011-2012.

6.4 Total Shareholders Return:

Boston consulting group (BCG), an international consulting organisation, has developed an approach to shareholder value management namely TSR. Total shareholders return is the rate of return shareholders earn from owning a company's stock over a period of time.

Table No.7
TSR of Ashok Leyland

Year	EMV Rs. In Cr	BMV Rs. In Cr	Dividend (Rs)	(EV-BV)/BV (Rs)	D/BV (Rs)	TSR(%)
2003-2004	3016.64	1116.67	12.21	1.586	0.0100	158.61
2004-2005	2497.95	3052.23	2.28	0.918	0.0070	-91.80
2005-2006	4917.74	2577.99	3.21	0.907	0.0010	90.88
2006-2007	5091.16	5389.08	4.99	0.055	0.0009	-5.43
2007-2008	4696.66	4862.97	5.29	0.034	0.0010	-3.31
2008-2009	2408.20	4763.19	1.43	0.494	0.0003	-49.41
2009-2010	7430.84	2448.12	4.77	2.035	0.0019	203.70
2010-2011	7570.54	7484.06	9.50	0.011	0.0012	1.28
2011-2012	8062.52	15393.30	2.13	0.476	0.0001	-47.60

Source: Annual reports.

From the above table it is inferred that the total shareholders return of Ashok Leyland is positive only for four years that 2003-2004, 2005-2006, 2009-2010 and 2010-2011 by 158.61%, 90.88%, 203.70% and 1.28% respectively. But for the remaining years it shows the negative TSR.

Table No.8 TSR of Tata Motors

Year	EMV Rs. In Cr	BMV Rs. In Cr	Dividend (Rs)	(EV-BV)/BV (Rs)	D/BV (Rs)	TSR(%)
2003-2004	171432.70	54849.98	18.36	2.125	0.0003	212.5%
2004-2005	149746.40	175448.80	42.73	-0.146	0.0002	-14.6%
2005-2006	357027.30	158529.00	51.92	1.252	0.0003	125.2%
2006-2007	280453.00	361091.70	74.47	-0.223	0.0002	22.3%
2007-2008	240340.00	269850.00	78.94	-0.109	0.0002	10.9%
2008-2009	92676.00	321770.30	11.68	-0.711	0.0003	71.9%
2009-2010	431172.20	104412.50	58.89	3.129	0.0005	313%
2010-2011	791676.00	479130.60	57.10	0.652	0.0001	65.2%
2011-2012	175000.60	789629.00	8.01	-0.778	0.0001	-77.8%

Source: Annual reports

From the above table it is inferred that the total shareholders return of TATA Motors is very higher in the years 2003-2004 and 2005-2006 by 212.5% and 125.2% respectively. But in the years 2004-2005 and 2011-2012 the TSR is negative. During the year 2005-2006 to 2009-2010 TSR shows the decreasing trend.

6.5 Total Business Return:

Definition of TBR is quite similar to the TSR, with the difference being that free cash flows from operation are considered in place of dividends. The beginning and end values are estimates of the business value of the firm at the beginning and end of the period. TBR considers that a company's return on investment and its growth rate would reduce over time towards a global average due to competitive pressure from new entrance.

Table No.9
TBR of Ashok Leyland

Year	EBV Rs. In Cr	BBV Rs. In Cr	FCF Rs. In Cr	(EBV-BBV)/BBV	FCF/BBV	TBR (%)
2003-2004	31592.50	13098.98	46.89	1.411	0.003	1.415
2004-2005	4424.30	32481.65	42.22	-0.863	0.001	-0.862
2005-2006	6899.90	4560.22	-40.86	0.513	-0.008	0.504
2006-2007	7493.70	7791.67	-220.20	-0.038	-0.028	-0.009
2007-2008	7600.10	7766.42	-140.59	-0.021	-0.018	-0.039
2008-2009	7711.11	10066.03	-73.56	-0.233	-0.007	-0.241
2009-2010	13234.50	8251.84	97.52	0.603	0.011	0.615
2010-2011	14058.60	13972.18	-598.70	0.006	-0.042	-0.036
2011-2012	14403.70	21734.53	-966.50	-0.337	-0.044	-0.381

Source: Annual reports

From the above table it is inferred that the total business return of Ashok Leyland is positive only in the years 2003-2004, 2005-2006 and 2009-2010 by 1.415, 0.504 and 0.615 respectively. Other than that the TBR is negative in all the years.

Table No.10
TBR of Tata Motors

Year	EBV Rs. In Cr	BBV Rs. In Cr	FCF Rs. In Cr	(EBV-BBV)/BBV	FCF/BBV	TBR (%)
2003-2004	175929.20	59346.50	-2246.4	1.964	-0.037	1.926
2004-2005	155991.40	181693.80	-1675.1	-0.141	-0.009	-0.150
2005-2006	365118.30	166620.00	-486.2	1.191	-0.002	1.188
2006-2007	290946.50	371585.20	-563.5	-0.217	-0.001	-0.218
2007-2008	254074.50	283584.30	-2881.3	-0.104	-0.010	-0.114

2008-2009	117721.80	346816.00	-11967	-0.660	-0.034	-0.695
2009-2010	739712.00	135271.60	-20097	-0.453	-0.148	-0.601
2010-2011	826950.30	514404.90	-20812	0.607	-0.040	0.567
2011-2012	204744.20	819373.60	-19251	-0.750	-0.023	-0.773

Source: Annual reports

The analysis says that the TBR of Tata Motors is Positive only in the years 2003-2004, 2005-2006, and 2010-2011 by 1.926% 1.188% and 0.567% respectively. But in the remaining years the TBR is negative and fluctuating every year.

6.6 Market Value to Book Value Ratio:

Shareholder value creation is measured as the ratio of Market value to Book value of firm's equity, where market value is the value in the stock market, while book value is the sum invested by shareholders.

Table No.11
Market Value to Book Value Ratio of Ashok Leyland (Rs in crores)

Year	MV	BV	M/B
2003-2004	171.72	86.32	1.98
2004-2005	78.64	9.61	8.18
2005-2006	28.53	11.37	2.50
2006-2007	42.33	14.14	2.99
2007-2008	39.03	15.99	2.44
2008-2009	23.15	15.85	1.46
2009-2010	40.43	17.46	2.31
2010-2011	64.21	19.97	3.21
2011-2012	35.67	10.89	3.27

Source: Annual reports

From the above table it is inferred that the market to book value ratio of the Ashok Leyland is increasing from 1.98 times to 8.18 times from the year 2003-2005. After that it fluctuating from 2.50 times to 3.27 times for all the years from 2005-2006 to 2011-2012. Marakon approach is greater than 1. Hence it infers that the Market value to book value ratio of Ashok Leyland is optimum in all over the study period.

Table No.12
Market Value to Book Value Ratio of Tata Motors (Rs in crores)

Year	MV	BV	M/B
2003-2004	283.20	81.22	3.48
2004-2005	428.44	101.71	4.21
2005-2006	556.82	113.65	4.89
2006-2007	740.72	143.94	5.14
2007-2008	721.72	177.59	4.06
2008-2009	334.35	202.70	1.64
2009-2010	509.09	240.64	2.11
2010-2011	1038.88	259.03	4.01
2011-2012	554.78	314.93	1.76

Source: Annual reports

The Market to book value ratio of the Tata Motors is fluctuating in all the study period. But in the year 2006-2007 it shows the higher ratio of 5.14 times due to the high market price against book value. Marakon approach is greater than 1. Hence it infers that the Market value to book value ratio of Tata motors is optimum in all over the study period.

7.0 Findings and Suggestions:

Ashok Leyland:

From the study it is found that the Economic Value of Ashok Leyland is fluctuating from 290.33 crores to 155.46 crores from the year 2003-2004 to 2007-2008. After that it shows the depressing EVA of -418.61 crores and -11.75 crores for

the next two years from 2008-2009 to 2010-2011. After that it increased from 52.82 crores to 239.78 crores in the financial year 2010-2012. It may be the reason that the net profit has been improved in the last two years.

- The Market Value is being added for Ashok Leyland from 10159.62 crores to 10590.12 crores from the financial year 2003-2004 to 2004-2005. After that it fluctuates from 2095.39 crores to 6712.50 crores for the financial year 2005-2006 to 2011-2012.
- The Cash Flow Return on Investment of Ashok Leyland is increasing from 1.59% to 3.09% for the year 2003-2004 to 2005-2006. After that it decreases from the 7.78% to 4.43% for the year from 2006-2007 to 2008-2009. Again It is increasing from 4.91% to 9.64% for the year from 2010-2011 to 2011-2012. In general it shows that the cash flow has been increased in these years.
- From the study it is found that the total shareholders return of TATA Motors is very higher in the years 2003-2004 and 2005-2006 by 212.5% and 125.2% correspondingly. But in the years 2004-2005 and 2011-2012 the TSR is negative. During the year 2005-2006 to 2009-2010 TSR shows the decreasing trend. It shows that the end market value of shares is lesser than the beginning market value in the years where the TST is Negative.
- From the analysis it is found that the total business return of Ashok Leyland is positive only in the years 2003-2004, 2005-2006 and 2009-2010 by 1.415, 0.504, and 0.615 correspondingly. Other than that the TBR is negative in all the years.
- From the analysis it is found that the Market to Book value ratio of the Ashok Leyland is increasing from 1.98 times to 8.18 times from the year 2003-2004 to 2004-2005, it indicate that it is being over priced in the market. After that it fluctuating from 2.50 times to 3.27 times for all the years from 2005-2006 to 2011-2012. Marakon approach is greater than 1. Hence it infers that the Market value to book value ratio of Ashok Leyland is optimum in all over the study period.

Tata Motors:

- From the study it is found that Economic value of Tata motors are increasing from 796.73 crores to 1484.34 crores from the financial year 2003-2007. After that It show the negative EVA from the financial year 2008-2009 to 2011-2012. It indicates that the Net profit may be improved and cost of capital is to be reduced in the future years.
- The Market Value against the book value of Tata motors is being increased from 64058.7 crores to 216994.8 crores for the financial year 2003-2004 to 2006-2007. After that It is declining from 200082.2 crores to 48167.9 crores for the next two years. From the financial year 2009-2010 to 2011-2012 it shows the increasing trend.
- From the study it is found that the Cash Flow Return on Investment of Tata Motors is falling from 1.30% to 0.99% from the year 2003-2007. And it is increasing from 1.07% to 1.40% from the year 2008-2009 to 2009-2010. Again it is diminishing from 1.40% to 0.65% from the year 2010 to 2011. And it is growing from 0.65% to 1.06% from the year 2010-2011 to 2011-2012.
- The total shareholders return of Tata Motors is very higher in the years 2003-2004 and 2005-2006 by 212.5% and 125.2% correspondingly. But in the years 2004-2005 and 2011-2012 the TSR is negative. During the year 2005-2006 to 2009-2010 TSR shows the decreasing trend.
- The TBR of Tata Motors is Positive only in the years 2003-2004, 2005-2006, and 2010-2011 by 1.926% 1.188 and 0.567 respectively. But in the remaining years the TBR is depressing and variable every year.

- The Market to book value ratio of the Tata Motors is fluctuating in all the study period. But in the year 2006-2007 it shows the higher ratio of 5.14 times due to the high market price against book value. Market to book value ratio is greater than 1. Hence it infers that the Market value to book value ratio of Tata motors is optimum in all over the study period

8.0 Suggestions:

For Ashok Leyland:

- The company may maintain the stable dividend policy and other policies connected to improvement in the financial performance to maintain the good shareholder's return every year.
- The company may increase its free cash flows by improving its sales, so that the company can keep the stable and positive business return. So it may help to maximize the wealth of the shareholders.
- The company may reduce its cost of capital further by altering its capital structure to get better the economic value of the shareholders.
- The company may reduce the operating expenses for the higher improvement in operating income in the future years.

For Tata Motors:

- The company may maintain the stable dividend policy and bold decisions which affecting market price of the share to maintain the better shareholder's return in the future.
- The company may improve the cash flows by improving its sales performance, so that the company may obtain the constant and positive return in the future.

- The company may reduce its cost of capital further by altering its capital structure to improve the economic value of the shareholders.

For Investors:

Based on the analysis it is clear that the EVA, MVA, CFROI, and Market value to Book Value Ratio is healthier in Ashoke Leyland than the Tata Motors, so the investors may consider their investment in Ashoke Leyland for their Maximum Wealth in the future.

9.0 Conclusion:

As a whole the stock market is sometimes highly volatile. The share price of automobile sector is highly fluctuating; it depends upon the investors how they can make use of this in order to get money which he has invested in shares. Investors should be in a position to analyze the companies for investment in a particular sector to minimize the risk and maximize the return.

The investors should analyze the various aspects of a company such as economic value, market value, cash returns to get a good return for the investor's money. The study's interpretations will help the investors to take right investment decision in automobile industry.

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