Research Paper

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Analysis of Indian Cement Industry through Selected Traditional And Modern Measures

Management

KEYWORDS : Market Value Added(MVA), Return on Net Worth (RONW),Capital Productivity (CP), Labour Productivity (LP)

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ABSTRACT

Economic value of the company can be determined as the amount of capital that share holders have committed to the firm throughout its existence, including earnings that have been retained in the business. In this direction, MVA is the best external performance indicator as it indicates the market assessment of the effectiveness with which companies' managers have used the scarce resources under their control. Hence, it turns out to be very significant and important to analyse and identify the internal indicators that relate well with Market Value Added (MVA). In the present study an analysis is made on the financial performance of cement Industry with the help of Market Value Added Approach and it is found that the performance of select cement units in terms of profitability cannot be increased unless the interlinked problems like modernisation, cost reduction, control, taxes etc. are solved.

INTRODUCTION

Companies and analysts traditionally, focus on the use of performance measures being aware of their critical role not only in evaluating the current performance of a firm but also in achieving high performance and growth in the future. Investors measure overall company performance in order to make right investment decisions. The financial performance measures are of primary interest of shareholders as they entrust for the application of capital in the business. To aid the shareholders, researchers have identified several new techniques and concepts. Activity Based Management, Balanced Scorecard, Benchmarking, Total Quality Management, Economic Value Added (EVA), and Market Value Added (MVA) are identified for measuring the company's health and performance (David Harper, 2010).

Measuring Company's health and company's performance are related to each other. Company's health will influence the decision making of the investors, stockholders, or internal staff of the company. The investors and stockholders reserve the right to have knowledge about the true condition of the company and the rate of return of the company. For the internal staff of the company, measuring the company's performance will influence the company's plan for the future and for the existence of the company (going concern concept).

Choosing right instrument and relevant information is needed to evaluate a company's performance. Financial performance metrics like Return on Capital Employed (ROCE), Return on Net worth (RONW), Return On Assets (ROA), Earnings Per Share (EPS), NOPAT and RI are basic instruments to measure a company's performance. The owners and the stockholders will use these tools to know the return and to compare it with other company's financial position to understand the company's health. But, the traditional measures such as ROA, ROCE, RONW and EPS are found with weaknesses. The afore-mentioned measures ignore cost of capital of the company, making it difficult to determine the company has value added or not. Besides, the evaluation using the traditional performance measures cannot stand alone. It needs to be compared with company's performance metrics to determine the company's performance.

In order to overcome the criticisms against traditional accounting measures, several researchers (Lehn and Makhija 1996, O'Byrne 1996, Worthington and West 2004, Dastgir and Izadinia 2004), suggested new performance measures, EVA, MVA and SVA. MVA is one of the external indicators which give the utmost satisfaction to the investors. From the investor's point of view, increase of the share prices is always desirable. The most reliable measure of management's long term success in adding value is known as "Market Value Added" (MVA). MVA is the difference between company's current market value as determined by its stock price and economic book value. If MVA is positive, it implies that the firm added value to the shareholders' wealth. If MVA is negative, it indicates that the firm is destroying the shareholders' wealth.MVA is equal to the present value of the firm's expected future EVA. Firms with positive EVA momentum are more likely to see their share price go up over time as the rising net profits of the overall capital costs increase in the firm's MVA (Milunovich&Tsuei1996).

Review of Literature

Studies related to EVA, MVA and Traditional Performance Measures

Fekrat (1994) done a study on Economic Value Added, Market Value Added and traditional performance measures of 420 U.S firms and found that performance measures based on Economic value-added had lower variability and higher persistency than many corresponding accounting-based numbers, including earnings and cash flows. Walbert(1994) examined the superiority of EVA and MVA over traditional performance measures and concluded that EVA has a stronger association with stock prices and firm values than traditional accounting measures. O'Byrne(1996) used nine years of data (for the period from 1985 to 1993) for companies in the year 1993 Stern Stewart Performance 1000 companies to test the explanatory power of capitalized EVA (which is EVA divided by the cost of capital), net operating profit after tax (NOPAT), and free cash flows (FCFs) relative to market value divided by IC. His initial findings showed that FCF explained 0% of the change in the market value divided by the capital ratio, while the r^2 was 33% for NOPAT and 31% for EVA. It looked as if NOPAT and EVA had almost the same explanatory power.

Banerjee (1997) has conducted an empirical research to find the superiority of EVA and MVA over other traditional financial performance measures. Ten industries have been chosen and each industry is represented by four/five companies. ROI and EVA have been calculated for sample companies and a comparison of both has been undertaken, showing the superiority of EVA over ROI. Indian companies are gradually recognizing the importance of EVA. Some of such companies are Ranbaxy Laboratories, Samtel India Ltd and Infosys Technologies Ltd. Leistikow(1998) examined the Performance of EVA,MVA and Traditional Accounting Measures and concluded that growth in earnings is not enough to create value, unless returns are above the cost of capital. They are of the opinion that EVA works best as a supplement to other measures when one is evaluating shares and that EVA sometimes works when other measures fail. McClenahen(1998) in his case study observed that traditional corporate performance measures are being relegated to second class status as metric such as EVA become management primary tool. Pattanayak and Mukherjee (1998) discussed that there are traditional methods to measure corporate income or known as accounting concept and there is also a modern method

to measure corporate income or known as economic concept. EVA, which is based on economic concept, is professed to be a superior technique to identify whether the organization's NOPAT (Net Operating Profit after Tax) during a period is covering its WACC (Weighted Average Cost of Capital), thus generating value for its owners. But it is very tricky to calculate EVA. Companies trying to implement EVA are asked to incorporate 164 amendments to their financial accounts.

Selection of Sample Companies

The following are the selected sample companies for the present study.

1. ACC Ltd.
2. Ambuja Cements Ltd.
3. Anjani Cements Ltd.
4. Grasim Cements Ltd.
5. India Cements Ltd.
6. Madras Cements Ltd.
7. Panyam Cements Ltd.
8. Sagar Cements Ltd.
9. Shree Cements Ltd.
0. UltraTech Cements Ltd.

Period of Study

The period of the study is 10 years beginning from the financial year 2001-02 and ending with financial year 2010-11. The rationale behind the selection of a 10-year period for the study is to cover a complete business cycle.

Analysis

The Market Value Added (MVA) is positive in the case of Ambuja Cements Ltd, Grasim Cements Ltd , India Cements Ltd, Madras Cements Ltd, Sagar Cements Ltd., and UltraTech Cements Ltd therefore, the performance of these companies in terms of MVA is good. It implies that these companies added value to the shareholders' wealth. In the case of Anjani Cements Ltd, Panyam Cements Ltd and Shree Cements Ltd, the MVA is negative. It means that the financial performance of these two units is not satisfactory. In other words, these three Cement units are destroying the wealth of shareholders'. Regressions are run of MVA on eight variables mentioned above individually to examine the effect of each variable on MVA. The results are shown in Table 1.

Table 1: Regression co-efficients of select Independent Variables with MVA

Variable	R	R-Square	Significant value
RONW	0.412	0.085	0.768
CP	0.316	0.096	0.877
LP	0.213	.0426	1.054
EPS	0.912	0.976	0.026 *
EVA	0.615	0.036	0.233
ROS	0.431	0.861	3.011*
ROA	0.532	0.087	0.765
CP	0.785	0.895	4.897*

* : Significant at 5% level

It can be inferred from the above analysis that three variables out of eight viz., EPS, ROS and CP are found to have significant impact on MVA. This implies that the MVA of Cement Industry is not only affected by select independent variables but also influenced by other factors.

Conclusion

From the analysis it is found that the Indian Cement Industry is not only affected by select independent variables but also influenced by other factors To increase the profitability of the industry, it has to reduce the interlinked problems like modernisation, cost reduction, control, taxes etc. are solved. Since Cement Industry is playing an important role in building the industrial base of the nation and providing infrastructure for the development for the economy, the government of India should play a pivotal role in extending financial support to the Industry at concessional rates and should take suitable policy measures for its development.

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