Research Paper   **Management**

Shareholders' Value Creation in Private Sector Indian Banks

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ABSTRACT

Economic Value Added (EVA) is a financial measurement tool that bankers can use to measure the financial performance of their bank. EVA determines if a business is earning more than its true cost of capital. For measuring the corporate financial performance, there are accounting profitability measures and shareholders' value based measures. Accounting profitability measures include ROI, ROE, EPS, ROCE and DPS etc. Shareholders valued based measures include EVA and MVA. This research is an attempt to analyze the relationship between the accounting profitability measures and shareholders' value based measures for measuring the financial performance of selected private sector banks of India. I have taken EPS as a measure of accounting profitability and EVA as a measure of shareholders value. This study is an attempt to analyze the trend and relationship of EVA and EPS in private sector banks during the period 2008-09 to 2010-11.

KEYWORDS

INTRODUCTION
EVA and Net Present Value arithmetically tie, so companies can be assured that increasing EVA is always a good thing for its investors—certainly not the case with EPS or Free Cash Flow. Many even argue that EVA is a better decision tool than NPV because it captures the period-by-period value creation or destruction of a given firm or investment, and makes it easy to audit performance against management projections.

Given the usefulness of the measure, many companies have adopted it as part of a comprehensive management and incentive system that drives their decision processes.

EARNINGS PER SHARE
This is the most important factor in fundamental analysis of a stock. This coupled with a few of the related ratios should give you a fair idea about the worth of a stock. Earnings per share as the name indicates is the 'per share earnings' of a company in a reported period.

EPS = Net Earnings / Outstanding Shares

PROBLEM OF THE STUDY
The problem of my study is to analyze the relationship between Economic Value Added and Earnings per Share in private sector banks. So my study is focusing on

"The Relationship between Economic Value Added and Earnings per Share in Private Sector Indian Banks"

OBJECTIVES OF THE STUDY
- To analyze the relationship between EVA and EPS.
- To judge the relation between EVA and change in per share earnings.
- To establish that EVA and EPS are better measures of performance.
- To give the framework to the investors to use EVA and EPS, considering both its favorable and unfavorable features in determination of the value created on their investments.

LITERATURE REVIEW
➢ Stern Stewart in 1990 has first studied this relationship with market data of 618 U.S. companies. Stewart presents the results in his book "The quest for value". Stewart has studied the relationship between EVA and market value of the company and he has produced a list of companies' EVA annually since 1982, its coverage is limited to the larg-

est 1,000 companies. Stern Stewart claims that:
- EVA is the only true indicator of business and management performance;
- EVA is "today's hottest financial idea and getting hotter";
- EVA "allows all financial decisions to be modeled, monitored, evaluated, communicated, and compensated in terms of a single measure";
- "EVA is the only reliable and unambiguous continuous-improvement metric"

➢ Banerjee in 1997 has conducted an empirical research to find the superiority of EVA over other traditional financial performance measures. Ten industries have been chosen and each industry is represented by four/five companies
➢ KPMG – BS Study in 1998 assessed top companies on EVA, Sales, PAT and MVA criteria. The survey has used the BS 1000 list of companies using a composite index comprising sales, profitability and compounded annual growth rate of those companies covering the period 1996-97.
➢ Pattanayak & Mukherjee in 1998 discussed that there are traditional methods to measure corporate income known as accounting concept and there is also a modern method to measure corporate income known as economic concept.
➢ Madhu Malik in 2004 examined the relationship between shareholder wealth and certain financial variables like EPS, RONW and ROCE. By using correlation analysis, it was found that there was positive and high correlation between EVA and RONW, ROCE. There was a positive but low correlation between EVA and EPS.

RATIONALE OF THE STUDY
One modern performance measurement tool i.e. Economic Value Added (EVA) and one traditional performance measurement tool i.e. Earnings Per Share (EPS) have been used to measure economic value and per share earnings of 6 Indian private sector banks i.e. ICICI Bank, HDFC Bank, Federal Bank, Kotak Mahindra Bank, Jammu & Kashmir Bank (J & K Bank) and IndusInd Bank.

SIGNIFICANCE OF THE STUDY
The research provides a fundamental platform to investors to analyze the companies in terms of its present positions, earning capabilities, and the growth potential unleashed which leads to value addition and subsequently affects the share prices.

DATA COLLECTION METHOD
This study is mainly based on secondary data. All the data of

6 private sector banks are collected from the annual reports of respective bank and various web sites.

HYPOTHESIS OF THE STUDY

H_0: There is no significant relationship between EVA & EPS.
H_1: There is significant relationship between EVA & EPS.

TOOLS & TECHNIQUES USED IN THE STUDY

I have used mainly two types of tools & techniques for the analysis purpose.

A. Accounting Tools :   EVA & EPS
B. Statistical Tools :   Mean, Variance, Pearson's Correlation, t-test

FUTURE SCOPE FOR THE STUDY

This research has a limited scope, that is only three years and the data of only six banks is taken into consideration. These three years had showed a lot of variations with respect to beta, invested capital, weighted average cost of capital and share prices. To overcome this limitation of the study, the sample size and the years of consideration for the research has to be increased, so as to decrease the variations with respect to the above mentioned variables.

LIMITATIONS OF THE STUDY

This research work has following limitations.

- This study is purely based on the secondary data so any error in secondary data might affect the study.
- The research focuses only on 6 Indian private sector banks which are selected on the basis of the total income (that is sales) of the bank in the accounting year 2010-11 which may not applied to the whole industry.
- The study is focusing on data only for the last 3 years that is from 2008-09 to 2010-11.
- Limitations of EVA & EPS will be the limitations of this study also as this study is based of EVA & EPS.

ANALYSIS OF EVA

There are mainly 3 components of EVA. Namely,

1. Net Operating Profit After Tax (NOPAT)
2. Capital Employed (CE)
3. Weighted Average Cost of Capital (WACC)

Analysis of each component of EVA is as follows. After discussing each component, we will discuss the Economic Value Added.

Table: 1 Table showing analysis of Components of EVA

Parameters	ICICI BANK			HDFC BANK			FEDERAL BANK			KOTAK MAHINDRA BANK			J & K BANK			INDUSIND BANK		
	2010-11	2009-10	2008-09	2010-11	2009-10	2008-09	2010-11	2009-10	2008-09	2010-11	2009-10	2008-09	2010-11	2009-10	2008-09	2010-11	2009-10	2008-09
1 NOPAT	5888.74	9401.61	7139.92	2894.58	1943.48	1476.88	980.44	487.11	959.02	561.58	543.11	363.08	457.27	193.89	208.51	527.89	191.72	329.28
2 CE	70787.48	67111.11	52981.16	3111.32	4848.75	3077.51	4744.7	962.48	875.81	3248.71	7603.43	1845.13	580.38	608.05	3211.01	1415.41	812.71
3 WACC	7.67	7.06	7.64	111	7.55	6.62	10.08	10.42	1.38	9.46	9.15	1.7	5	4.51	4.02	10.31	9.90	9.9
4 EVA	5981.05	6727.63	10167	2140.58	1768.31	1456.97	874.01	787.14	987.01	320.96	368.83	118.33	484.97	757.73	271.03	1834	91.77	42.11
5 EPS	36.19	173.7	34.58	52.77	44.87	45.74	20.27	11.52	6.42	7.90	8.56	4.39	84.6	74.16	18.8	4.16	2.52	2.16

HYPOTHESIS TESTING

Table: 2 Table showing Hypothesis Test

Parameters	ICICI BANK		HDFC BANK		FEDERAL BANK		KOTAK MAHINDRA BANK		J & K BANK		INDUSIND BANK	
	EVA	EPS	EVA	EPS	EVA	EPS	EVA	EPS	EVA	EPS	EVA	EPS
1 Mean	3583.23	35.24	1740.36	44.46	874.52	28.33	204.81	6.95	344.57	75.78	65.76	2.88
2 Variance	221857	3.57	160211	73.67	9483.02	40.82	5084.51	5.2	4580.57	199.21	3111.89	1.36
3 Correlation	0.69		0.91		-0.24		0.99		1		1	
4 Table value at t	4.3		4.3		4.3		4.3		4.3		4.3	
5 Calculated Value at t	11.81		7.48		6.05		4.56		8.83		3.38	
6 Result	Accepted		Accepted		Accepted		Accepted		Accepted		Accepted	

CONCLUSION, FINDINGS & SUGGESTIONS

- Coefficient of correlation is showing positive correlation between EVA and EPS. Correlation coefficient is positive in all the selected banks except Federal Bank. Moreover in HDFC Bank, Kotak Mahindra Bank, J & K Bank and IndusInd Bank, it is between 0.90 and 1.00 it means there is a strong positive association between EVA and EPS. And in ICICI Bank it is 0.69 which is also showing positive association between EVA and EPS. And in Federal Bank only, correlation is negative that is -0.24.
- EVA is the performance measure that is tied most directly to the creation of share holder wealth or destroyed share holder wealth. In this study, all the banks all have created share holder's wealth as EVA is positive in all the banks in each year. EPS is a tool for measuring financial performance and per share earnings for the equity share holders.
- From this study, I can conclude that there is significant relationship between Economic Value Added and Earnings per Share. As Economic Value Added is based on Economic Profit and Capital Employed and Earnings per Share is also based on Net Profit and Number of Equity Shares, both are interrelated. And it is proved through t test. Null hypothesis is rejected in all the banks accept IndusInd Bank. It means all the banks accept Indus Ind Bank having significant relationship between Economic Value Added and Earnings per Share.

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