

AN ANALYSIS OF EVA OF SELECTED PHARMA COMPANIES IN INDIA

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Abstract

Shareholder wealth maximization is now widely considered to be the main objective of the management of firms. Countless firms have affirmed their commitment to shareholder wealth and several managers have fallen for not giving adequate importance to it. Of the companies that have been most successful at increasing shareholder wealth as measured by consistent improvements in the return from the stocks, an increasingly common factor is their use of the concept of economic profit as a measure of performance. Economic profit or economic value added (EVA) has become a popular tool for managers to measure performance and for guiding investment decisions. But in the recent years, value based measures like EVA which measures performance in terms of change in value have received a lot of attention. This research paper which will throw light on this concept of value added. This consist the meaning, calculation and analysis of EVA with in selected pharma companies in India. The design of the study is analytical in nature. This is a secondary database research. The relevant information is collected from various sources like internet, books, magazine etc.

Key words: EVA, pharma.

Introduction

External financial disclosure is defined as any financial information, quantitative or qualitative, that is, deliberately released by the company through formal or informal channels. It is also reasonable to expect some conflict of interest to exist between managers and other outside parties since each party attempts to maximise their own interest. Managers may therefore not fully report all Economic Value Added (EVA) information they possess. Even in the response of regulation, full disclosure EVA is not guaranteed. This is because company reporting EVA regulation is intended to provide outside investors with maximum quantity of information needed to decide on their performance and their investment. Essentially EVA has the difficult task of deciding as to how much information EVA should be disclosed.

EVA is nothing but a new version of the age-old residual income concept recognized by economists since the 1770's. Both EVA and 'residual income' concepts are based on the principle that a firm creates wealth for its owners only if it generates surplus over the cost of the total invested capital. Perhaps EVA could bring back the lost focus on 'economic surplus' from the current emphasis on accounting profit. In a lighter vein it can be said that in an era where commercial sponsorship is the ticket to the popularity of even the concept of god, the concept of residual income has not found a good sponsor until Stern Stewart and

Company has adopted it and relaunched it with a brand new name of EVA. Technically speaking EVA is nothing but the residual income after factoring the cost of capital into net operating profit after tax.

Mathematically

$$EVA = (\text{Rate of return} - \text{cost of capital}) \times \text{capital}$$

Where;

Rate of Return = NOPAT/Capital

Capital = total assets minus noninterest bearing debt, at the beginning of the year

Cost of capital = cost of equity x proportion of equity + cost of debt (1-tax rate) x proportion of debt in the capital.

Indian Context

India has found supporters for EVA. It has already earned favor with journalists and leaders in corporate reporting. However most of them do not calculate EVA rigorously, rather they take casual approach in calculating and reporting EVA. It is imperative to examine a study by Economic Times, the most popular business daily in India and the annual report of Infosys Technologies limited that has won prestigious 'best presented annual report' being awarded by the Institute of Chartered Accountants of India (ICAI) for five years in this context. Indian companies have started using EVA for improving internal governance. The Tata Iron and Steel Company (TISCO) are using EVA to measure performance of its mines and other business segments. Managers of the company find the measure quite useful and are highly enthused by the use of this measure. It is expected that EVA will gain popularity more as a management planning and control tool. The concept of EVA is based on the sound economic principle that firm value increases only if it is able to generate surplus over its cost of capital and therefore it is based on strong theoretical foundation. However its calculation involves significant subjectivity and this reduces its informative value. Moreover it fails to provide better signals to the capital market as compared to conventional accounting measures like ROI, however hard selling of EVA has contributed positively in highlighting the fundamental economic principle, long forgotten by managers. In India companies are using EVA internally as a performance measure for improving productivity that would lead to enhancement of shareholder value.

Review of Literature

Bluszcz Anna and Kijewska Anna (2016) made an attempt to study the Factors Creating Economic Value Added of Mining Company. The company's strategy that focuses on the growth of the company represented by the economic value added (EVA) requires the identification of factors affecting the size of the EVA. For this purpose, in the paper the

formula for EVA was transformed in such a way as to reveal the determinants affecting its value.

Naghshbandi Nader, Chouhan Vineet and Jain Priya (2016) did a study on Value based measurement of financial performance. Every company has to be very cautious in selecting their measurement tools, as it will affect substantially the management resources and every department of the company. The concept of economic framework is an innovative way to measure the value of a company.

Rogerson P. William (2015) analysed the effect of managerial investment incentives and alternative investment with reference to income. The result showed that there exists a effectiveness and induces the manager to choose the efficient investment level. The income measure created by this allocation rule is usually referred to as residual income or economic value added.

Scope of the Study

This study explores the suitability of using EVA as a measure of performance of selected pharma companies in India for providing additional empirical evidence on EVA. The present study is set to make prudential decisions, volume of turnover, and soundness of business and creditability of the companies through the comparison of NOPAT value. The preferential value of the shareholders shall be guided appropriately with use of inferences and empirical value of the study.

Methodology

The researcher has selected three pharma companies for analysis which are sensitive to changes in economic, political and other factors, the selected companies such as sun pharma, Dr.Reddys and Cipla. The sample of three companies was taken in to account on the basis of their efficient performance, high turnover and peak share market value during study time. The sample period is from 2009-10 to 2015-16.

Limitations of Study

- One of the major limitations of the paper is that the study will be based on ten years' data of selected companies from the Indian pharma sector. So, findings will not be applicable to whole industry for a long period. Because sample may not be represent all the common characteristics of universe.
- The paper is based on secondary data. So the limitations of secondary data may be revealing with this paper.
- Statistical tools have their own limitation which will be affected to the result of paper.

EVA (in Rs. Crore)

Company	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Sun Pharma	-59335	-13498	-32039	-47064	-11095	-41901	-41603
Dr.Reddys'	-99915	-10219	-20571	-31702	-38381	-49752	-55690
Cipla	-71777	-68013	-11033	-20541	-25764	-42008	-93778

Hypothesis Testing

H_0 : There is no significant different among EVA of selected pharma companies.

ANOVA: Single Factor

Summary Groups	Count	Sum	Average	Variance
Sun Pharma	7	6148.5	1053.90	414520
Dr.Reddys'	7	5918.6	998.89	403200
Cipla	7	5881.3	981.01	399834

ANOVA

Source	SS	DF	MS	F	P value	F Crit
Between	3716002	2	3891603	15.358	15.9375	4.6325
Within	3015432	18	252412			
Total	6731434	20				

Here, the calculated Value of F is greater than the table value. So, H_0 will be rejected at 0.05 significance level. There is significant difference among EVA of selected pharma companies.

Conclusion

The study concluded that the EVA of pharma companies and their relationship in the sample of three companies of Indian pharma sector from the year 2009 -10 to 2015-16. In general all the companies have created wealth or added value for its Shareholders. According to the study, all the times there is negative EVA in the entire sample companies. There for in General, company is not generating positive EVA from its Operations.

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