



ECONOMIC VALUE ADDED: AN ANALYSIS ON HUL

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Abstract

Maximization of shareholders wealth is the major objective of every company. In modern times, Economic Value Added (EVA) is considered to be the most important criterion for evaluation of internal performance. On the other hand, stock return is another key factor in decisions of the stock. It provides some information which have been used by many potential and actual investors for financial analysis and prediction. Economic Value Added is a measure of true economic performance of a company and a strategy for creating shareholder wealth. EVA is the difference between Net Operating Profit After Tax and Capital Employed. The present study aims at evaluating the relationship between EVA, PAT, NOPAT & EPS to Capital Employed as well as the variance analysis between EPS, ROCE, ROE and EVA, of Hindustan Unilever Ltd.

Keywords: *Economic Value Added (EVA), Shareholders Wealth, Cost of Capital, NOPAT, ROCE, ROE, EPS.*

Preface

The important goal of financial management is to create highest capital employees (owners & lenders) wealth and consequently enhancing the value of the firm. The question arises about the method to evaluate a firms value. In answer to this question, it can be said, various accounting based measures like Earning Per Share (EPS), Return on Equity (ROI); Return on Capital Employed (ROCE) and growth in sales have been used to evaluated the performance of the business. But the problem with these performance measures is that they lack a proper benchmark for comparison. The shareholders require at least a minimum rate of return that the above mentioned performance measures ignore. EVA is an estimation of firm's economic profit or value generated over the generated over the required rate of return.

Economic Value Added (EVA)

Economic Value Added (EVA) concept, developed by Stern Stewart in 1990's has been considered as a financial measure and referred as economic profit or residual income by economists. EVA focuses the economic profit as against accounting profit. Cost of equity share capital is the return expected by the Equity Share holders for their investments and the risks undertaken by them. Cost of debt is the cost involved in procuring fund from any fixed income bearing securities. These costs were not considered by the financial managers while computing the profit of the company earlier, hence a proper justification could not be found between Accounting and Economic Profit. Economists do take all such costs including opportunity costs in order to compute a firm's earnings. Thus profits of a business differ in financial manager's view point and that of an economist's view point.

EVA, in general does not take into account if a company is making profit or loss. It considers the earnings that remain after all costs from all resources are taken into account including opportunity cost of capital. Opportunity cost for equity capital means the cost that is incurred to compensate the equity shareholders at a market determined rate of return.

After meeting these obligations if the company is still left with earnings then it means that it created a Positive EVA else it created a Negative EVA. This finally concludes the fact that business earnings are inadequate to compensate the equity capital at its required rate of return as determined by the market. From EVA stand point, if a company is making profits it does not necessarily mean that it is creating positive EVA likewise if a company is making losses it neither means, creation of negative EVA.

EVA is an attempt to not just figure out the accounting profit of an organization, but to put an amount on the actual economic value created by the company. This takes into account how well management is doing at obtaining capital investments as cheaply as possible, and then how well they are doing at selecting the right uses of that capital.

Objectives of the Study

The financial statement is a mirror, which reflects the financial position and operational strength and weakness of concern. But a mere look at the financial statement will not reveal some crucial information. To bring out the hidden information, financial statements over a period are to be studied.

Hence the study is conducted to evaluate the relationship between component parts of the financial statements of the HUL and to obtain better understanding of the company position and performance.



Scope of the Study

Scope of the study covers the area of study. The study is concerned with the analysis of Cost of Capital Employed and the Net Operating Profit After Tax (NOPAT) of HUL.

Objectives of the Study

- To know the overall efficiency and performance of the firm through financial analysis.
- To measure the growth of company.
- To offer suitable suggestions based on findings.

Sources of Data

The study is based on secondary data. It was a case study, studying particular unit, i.e. HUL. For the purpose of analysis, the researcher has collected final accounts of HUL. The researcher has gone through various journals, magazines, newspapers, publications and websites for obtaining information.

Period of Study

The study concerned with financial aspects of HUL. The Study period is from 2008 to 2016.

Tools for Analysis

The researcher has analysed the financial statements of HUL with the help of ratio analysis such as Leverage Analysis. To analyse the impact of leverage on profitability of HUL, the important statistical techniques such as arithmetic mean, standard deviation, correlation have been used for the study.

Key Variables

The variables that have been adopted for the present study are NOPAT Net Worth, Capital Employed, Interest, Loans, Cost of Equity, Cost of Debt and Weighted Average Cost of Capital

Limitation of the Study

- This study is concentration on one particular company, not inter firm comparison.
- The study is based on secondary data to that extend it has limitations.
- Lack of availability to certain data due to confidentiality of information.
- Due to constraints of time cost and non-availability of data, the study was restricted to a period of 9 years.

Review of Literature

- In order to overcome the limitations of accounting based measures of financial performance, Joel Stern, managing partner of M/s Stern Stewart & Co. introduced a modified concept of economic profit in 1990 in the name of Economic Value Added (EVA) as measure of business performance. Stern (1990) observed that EVA as a performance measure captures the true economic profit of an organization. EVA-based financial management and incentive compensation scheme gives manager better quality information and superior motivation to make decisions that will create the maximum shareholders' wealth in an organization. EVA is a performance measure which is most closely linked to the creation of shareholders' wealth over a period of time. The financial management and the incentive compensation system based on EVA give the manager superior information and higher motivation. Accordingly EVA should be made the focal point for financial reporting, planning, and decision-making. The executives of an organization should look out for appropriate techniques that will guard them against any future attacks by corporate marauders. The best way of maximizing shareholder return is to offer incentives to managers for making decisions that boost long-term value. A major step is to provide cash bonus or stock option arrangements with incentives to that create built-in share value. The objective is to motivate the managers to look beyond short-term measures of economic performance by essentially turning managers into owners. The managers may be guided by EVA and pursue such objectives that improve operating profits investing more capital. Managers can be remunerated a proportion of both the total EVA and the positive change in EVA.
- Stewart (1994) has expended that EVA is a powerful new management tool that has gained worldwide recognition as the standard tool of corporate performance. EVA presents an integrated framework of financial management and incentive compensation. The adoption of EVA system by more and more companies throughout the world clearly depicts that it provides an integrated decision-making framework, can reforms energies and redirect resources to create sustainable value for companies, customers, employees, shareholders and for managements.
- Ochsner (1995) says companies that use shareholder value growth alone as a measurement for executive performance pay leave less-skilled management dependent on luck. Economic value added measures, with some modification and in varying forms, can serve as leading indicators of company performance. Thus, investors will use

them to give managements a compass to steer by. A company that adopts economic value added (EVA) is likely to need a substantial education program for managers. It also may elect to state EVA in terms of operating profits and use of capital. This puts EVA in the role of a target-setting mechanism, which assures that EVA figures will be available to the board of directors and, if necessary, major shareholders for tracking and comparison purposes.

- Rice (1996) believes that there is a direct relationship between EVA improvement and a higher share price. EVA has been made a part of Varsity's mantra company for building corporate culture and creating wealth for shareholders.

Specific ways that EVA has been applied at Varsity Company include:

1. EVA caused the company to take a closer look at its capital structure.
 2. EVA identifies operations and projects that return more than the cost of capital.
 3. EVA is used to evaluate potential joint ventures and
 4. EVA provides a means of determining whether the sale of businesses or assets is in the best interest of shareholders
- Rajeshwar (1997) offered in his study that EVA can also be used as a device for shareholders' communication and manager incentive system, apart from measuring the financial performance of organization. Demand for EVA among the corporate world has spurred competition among financial consultants, who help in computing EVA of business organizations.

Company History

Incorporated in 1933, Hindustan Unilever Limited has a diversified presence in the FMCG sector with more than 35 brands spanning 20 distinct categories including soaps and detergents, shampoos, skin care, toothpastes, and packaged foods.

Over the years, HUL has grown substantially by acquiring landmark brands and has managed to maintain its dominant market position in various categories. HUL's portfolio includes leading household brands including Lux, Lifebuoy, Surf Excel, Rin, Wheel, Fair & Lovely, Pond's, Vaseline, and Lakme. By the end of 2015-16 HUL reported a Net Worth of Rs 4,603 Crores, with Earnings per Share of Rs 15.65 and Price to Earnings ratio of Rs 46.10.

Economic Value Added

HUL is mainly an Equity financed company which can easily be seen from the Proportion of Debt and Equity in its Capital Structure. Due to the increase in Debt Proportion, the interest amount has fallen. Moreover the Weighted Average Cost of Capital (WACC) of HUL has fallen from 16.03% in 2008 to 11.99% in 2016.

Exhibit I

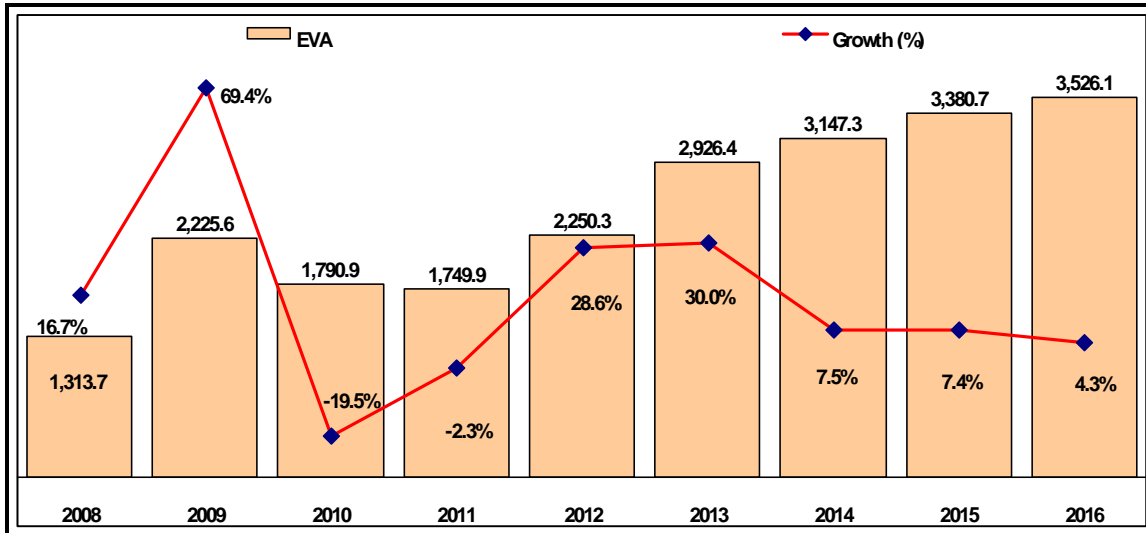
Economic Value Added Analysis

All in Crores	2008	2009	2010	2011	2012	2013	2014	2015	2016
1. Average Debt	382	342	119	2	0	0	0	0	0
2. Average Net Worth	2,402	1,928	2,497	3,118	3,462	4,018	3,715	4,338	4,603
3. Average Capital Employed : (1) + (2)	2,784	2,270	2,616	3,120	3,462	4,018	3,715	4,338	4,603
4. Cost of Debt, post-tax %	6.24%	3.91%	3.95%	5.36%	6.20%	6.02%	6.36%	5.56%	5.43%
5. Cost of Equity %	17.59%	14.47%	12.51%	12.93%	10.10%	10.07%	11.62%	10.91%	11.99%
6. WACC	16.03%	12.88%	12.12%	12.92%	10.10%	10.07%	11.62%	10.91%	11.99%
7. COCE* : (3) x (6)	446.275	292.376	317.059	403.104	349.662	404.612	431.683	473.275	551.899
8. Profit after tax	1,743	2,501	2,103	2,153	2,599	3,314	3,555	3,843	4,078
9. Add : Interest, after taxes	17	17	5	0	1	17	24	11	0
10. NOPAT	1,760	2,518	2,108	2,153	2,600	3,331	3,579	3,854	4,078
11. COCE, as per (7) above	446.275	292.376	317.059	403.104	349.662	404.612	431.683	473.275	551.899
12. EVA : (10) - (11)	1,314	2,226	1,791	1,750	2,250	2,926	3,147	3,381	3,526

*COCE: Cost of Capital Employed (Capital Employed x WACC)

The EVA of HUL has increased from Rs 1,313.7 Crores in 2008 to Rs 3,526.1 Crores in 2016. HUL is not a levered firm. It is running its business from its own money rather than Debt Capital. Since 2012 Debt has been nil. This is the main reason for high WACC.

Exhibit II
Eva Growth



Study of traditional profit tools i.e, PAT, NOPAT, EPS and EVA is taken to compare traditional and modern approach. Percentages of all the tools are calculated on Capital Employed.

Exhibit III
Profitability & Capital Employed

All in Crores	2008	2009	2010	2011	2012	2013	2014	2015	2016
PBIT	2,496.7	3,254.8	2,993.4	3,187.2	3,856.9	5,343.1	5,551.4	6,659.6	6,308.4
PAT	1,918.9	2,509.9	2,164.6	2,306.6	2,800.1	3,839.4	3,955.7	4,375.5	4,094.1
NOPAT	1,760.0	2,518.0	2,108.0	2,153.0	2,600.0	3,331.0	3,579.0	3,854.0	4,078.0
EPS	7.16	8.17	8.79	9.56	11.69	14.63	16.07	17.18	15.65
Capital Employed(CE)	2,784	2,270	2,616	3,120	3,462	4,018	3,715	4,338	4,603
Net Worth	2,402	1,928	2,497	3,118	3,462	4,018	3,715	4,338	4,603
EVA	1,313.7	2,225.6	1,790.9	1,749.9	2,250.3	2,926.4	3,147.3	3,380.7	3,526.1
Total Assets	1,615.81	2,579.38	2,690.23	3,642.42	4,705.35	4,103.31	4,874.39	5,263.91	5,630.24
ROCE	89.7%	143.4%	114.4%	102.2%	111.4%	133.0%	149.4%	153.5%	137.0%
ROTA	119%	97%	80%	63%	60%	94%	81%	83%	73%
ROE	80%	130%	87%	74%	81%	96%	106%	101%	89%
EVA / CE	47.2%	98.0%	68.5%	56.1%	65.0%	72.8%	84.7%	77.9%	76.6%
PAT / CE	68.9%	110.6%	82.7%	73.9%	80.9%	95.6%	106.5%	100.9%	88.9%
NOPAT / CE	63.2%	110.9%	80.6%	69.0%	75.1%	82.9%	96.3%	88.8%	88.6%
PBIT / CE	89.7%	143.4%	114.4%	102.2%	111.4%	133.0%	149.4%	153.5%	137.0%
EPS / CE	0.26%	0.36%	0.34%	0.31%	0.34%	0.36%	0.43%	0.40%	0.34%

The statement shows the details value additions over past 9 years by HUL. Over the years the ratios like EVA, PAT, NOPAT, Operating Profit and EPS has increased as a percentage of Capital Employed. This increase is mainly due to the

increase in the profits of HUL. PBIT has increased from Rs 2,496.7 Crores in 2008 to Rs 6,308.4 Crores in 2016, Net Profit from Rs 1,918.9 Crores in 2008 to Rs 4,094.1 Crores in 2016, while EPS have doubled from 7.16 in 2008 to 15.65 in 2016 and Capital Employed from Rs 2.784 Crores in 2008 to Rs 4,603 Crores in 2016.

The second part of the Exhibit displays the relationship between several variables with Capital Employed.

EVA/ Capital Employed: This ratio indicates the value added by HUL and its Capital Employed. Moreover EVA is the difference between NOPAT and Cost of Capital Employed. Higher the ratios higher will the addition in the firm's value. EVA/ CE have increased from 47.2% in 2008 to 76.6% in 2016.

PAT / Capital Employed: This ratio indicates the relationship between Net Profit and Capital Employed. Over the years PAT have increased which in turn have created a positive impact in the form of return on investments.

NOPAT / Capital Employed: This ratio indicates the relationship between NOPAT and Capital Employed. NOPAT = PBIT x (1 – Tax). NOPAT to CE of HUL was 63.2% in 2008 which has increased to 88.6% in 2016

EPS / Capital Employed: This ratio indicates the relationship between Earnings per Share and Capital Employed which have increased from 0.26% in 2008 to 0.34% in 2016.

The Exhibit shows the application of statistical tools Mean, Median, Standard Deviation & Coefficient of Variance on traditional profit tools i.e, PAT, NOPAT, EPS and EVA.

Exhibit IV Statistical Measures

	Mean	Median	SD	COV
PBIT	4,405.72	3,856.87	1,566.88	0.36
PAT	3,107.21	2,800.14	950.73	0.31
NOPAT	2,886.78	2,600.00	841.41	0.29
EPS	12.10	11.69	3.84	0.32
CE	3,436.22	3,462.00	802.31	0.23
Net Worth	3,342.33	3,462.00	924.65	0.28
EVA	2,479.01	2,250.34	793.39	0.32
Total Assets	3,900.56	4,103.31	1,368.61	0.35
ROCE	126%	132.98%	22.40%	17.78%
ROTA	83.32%	81.15%	18.19%	21.84%
ROE	93.72%	88.94%	17.19%	18.35%
EVA / CE	71.87%	72.83%	15.11%	21.03%
PAT / CE	89.88%	88.94%	14.50%	16.14%
NOPAT / CE	83.95%	82.90%	14.45%	17.21%
EPS / CE	0.35%	0.34%	0.05%	14.43%

Standard deviation indicates that variability is highest in EVA which is 15.11%. PAT, NOPAT, EPS has less variability in comparison to EVA. There is lack of consistency in the growth of EVA which is mainly due to high WACC.

Descriptive Analysis

This research is based on Easton and Harris (1991) formal valuation model, which has been used by the majority of researchers who contacted similar studies (Biddle, Bowen and Wallace, 1997; Chen and Dodd, 1997 and 2001. The model links stock returns to earnings levels and earnings changes.

Relative information content is assessed by comparing R^2 from four separate regressions (1 to 4), one for each performance measure, EPS, ROCE, ROE and EVA.

Exhibit V
Correlation Coefficient (r)

Year	EVA	EPS	ROCE	ROE
2008	1,313.72	7.16	89.68	79.886345
2009	2,225.62	8.17	143.38	130.18361
2010	1,790.94	8.79	114.43	86.688426
2011	1,749.90	9.56	102.15	73.97787
2012	2,250.34	11.69	111.41	80.882149
2013	2,926.39	14.63	132.98	95.554256
2014	3,147.32	16.07	149.43	106.48022
2015	3,380.72	17.18	153.52	100.86468
2016	3,526.10	15.65	137.05	88.943732
RSQ = r²		0.8948226	0.7335808	0.133264

The Exhibit depicts a positive Co-relation between EVA & EPS, ROCE and ROE respectively. The correlation between EVA and EPS is 0.8948 while that of ROCE and ROE are 0.73358 and 0.1332 respectively.

Exhibit VI
t-Test: Two-Sample Assuming Unequal Variances

	EPS	ROCE	ROE	EVA
Mean	12.1	126.00315	93.717921	2479.0058
Variance	14.749375	501.73286	295.6271	629462.35
Observations	9	9	9	9
Hypothesized Mean Difference	0	0	0	
df	8	8	8	
t Stat	-9.3279	-8.89377	-9.01727	
P(T<=t) one-tail	7.117E-06	1.011E-05	9.136E-06	
t Critical one-tail	1.859548	1.859548	1.859548	
P(T<=t) two-tail	1.423E-05	2.022E-05	1.827E-05	
t Critical two-tail	2.306004	2.306004	2.306004	

T-Test is used to test the null hypothesis that the variances of two populations are not equal.

If t Stat value lies between - t Critical two tail and + t Critical two test we don't reject Null Hypothesis

EPS & EVA

$H_0: \mu_1^2 = \mu_2^2$ (There is significant relationship between EPS & EVA, Variance are not Equal)

$H_1: \mu_1^2 \neq \mu_2^2$ (There is significant no relationship between EPS & EVA, Variance is Equal)

Here the t Stat value don't lie between -2.306004 & +2.306004. Therefore, we accept the null hypothesis stating that the variances are unequal.

ROCE & EVA

$H_0: \mu_1^2 = \mu_2^2$ (There is significant relationship between ROCE & EVA, Variance are not Equal)

$H_1: \mu_1^2 \neq \mu_2^2$ (There is significant no relationship between ROCE & EVA, Variance is Equal)

Here the t Stat value don't lie between -2.306004 & +2.306004. Therefore, we accept the null hypothesis stating that the variances are unequal.

ROE & EVA

$H_0: \mu_1^2 = \mu_2^2$ (There is significant relationship between ROE & EVA, Variance are not Equal)

$H_1: \mu_1^2 \neq \mu_2^2$ (There is significant no relationship between ROE & EVA, Variance is Equal)

Here the t Stat value don't lie between -2.306004 & +2.306004. Therefore, we accept the null hypothesis stating that the variances are unequal.



Conclusion

- EVA has been adopted by the advanced economies as financial performance measurement tool and corporate strategy which helped EVA to be identified as an important financial performance measurement tool over the conventional tools around the world.
- EVA has been adopted as an important tool of performance measurement and management all over the world, particularly in advance economies by adopting it as corporate strategy.
- Still there are mixed evidences about the superiority of EVA over traditional performance measurement tools. Country specific evidences are also not clear when compared with other residual income metrics.
- We have calculated the relation between EVA, PAT and NOPAT & EPS to Capital Employed and found that the Variance mostly lies with EVA.
- The t test shows that the variances between EPS, ROCE, ROE and EVA are unequal.
- EVA is found more appropriate tool for measuring financial performance. EVA better represents the market value of company in comparison to conventional performance measures.
- Moreover, further researches are needed to implement EVA as a strategy, incorporating discounting techniques like NPV, IRR and managerial performance measurement aspects of EVA. Empirical studies conducted till date on EVA had used data for smaller period whereas there is scope for future research on the concept by considering the data.
- Therefore efforts should be made in this direction to further broaden the horizon of applicability of this useful concept.

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