

# ECONOMIC VALUE ADDED AS A MEASUREMENT TOOL OF FINANCIAL PERFORMANCE

\*Omkar Gopale \*\* Vaibhavi Lambore

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## Abstract

*The valuation of a company depends upon various factors and is calculated differently depending upon the requirement of the investors. EVA is one of the methods used by the individuals in order to determine whether the company has created any additional value for the shareholders'. This study attempts to show the significance of EVA model and how it efficiently calculates the increase or decrease in the wealth of the shareholders' for a period of three years from 2020-22.*

**Key words:** *EVA, shareholders', wealth and value.*

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## INTRODUCTION

Increase in shareholders' value is created when a company earns a return on invested capital (ROIC) that is greater than its weighted average cost of capital (WACC). In order to maximise shareholder value, there are three main strategies for driving profitability in a company: 1) revenue growth 2) increasing operating margin 3) increasing capital efficiency. Valuation of a company can be done in various ways such as asset valuation, historical valuation, relative valuation, etc. Economic Value Added (EVA) is one of the methods which calculates whether the firm or the company is generating or adding value to the shareholders investment. EVA is one of the methods which assesses the performance of a company and its management through the idea that a business is only profitable when it creates wealth and returns for the shareholders.

## PROBLEM STATEMENT

- In traditional method of evaluating the value of shareholders will never have economic benefits. By applying the EVA model it is assumed that there might be value creation for shareholders.

## OBJECTIVE

- To study the concept of EVA
- To analyse the value of equity shareholders by applying EVA model

## METHODOLOGY

- A random sample of a company having both equity and debt has been considered for the study.
- The data for the study is purely a secondary data collected from the annual reports of the selected company named "TATA Steel" for a time period of 3 years starting from the financial year 2019-20 to 2021-22.
- The EVA method is taken into consideration for analysing whether the company is creating value for the shareholders or not

## ECONOMIC VALUE ADDED (EVA)

EVA is a measure of a company’s financial performance based on the residual wealth calculated by deducting its cost of capital from its operating profits adjusted for taxes on a cash basis. EVA can also be referred to as economic profit, as it attempts to capture the true economic profit of a company. The entity prefers cash operating profit to evaluate the true value for its shareholders’. The NOPAT entitles the true profit which is considered. The amount of interest is considered as post tax benefit and it will not be taken as a benefit for paying the tax. It is used to measure the value a company generates from the funds invested in it. If a company’s EVA is negative, it means that the company is not generating value from the funds invested into the business. Conversely, a positive EVA shows that a company is producing value from the funds invested in it. EVA of a company can be calculated by using the following formula

$$EVA = NOPAT - \text{Capital Charge}$$

Where, Capital charge = invested capital x WACC

NOPAT = Net Operating Profit after Tax

## ANALYSIS

(Amount in crores)

Particulars	2021-22	2020-21	2019-20
<b>NOPAT (A)</b>	<b>50360.93</b>	<b>14886.85</b>	<b>8314.56</b>
Gross Equity Capital	32491.44	47372.78	73416.99
Gross Debt Capital	9747.431	15159.29	34248.18
Total Capital	42238.87	62532.07	107665.2
Debt-Equity Ratio	0.3	0.32	0.49
Weightage of Equity	0.769231	0.757576	0.681901
Weightage of Debt	0.230769	0.242424	0.318099
Cost of Equity (Ke)	9.254992	2.418963	2.029053
Cost of Debt (Kd)	29.42488	19.67625	9.004946
WACC	13.90958	6.602548	4.248078
<b>Capital Charge (B)</b>	<b>5875.25</b>	<b>4128.71</b>	<b>4573.7</b>
<b>EVA (A-B)</b>	<b>37435.8</b>	<b>6469.87</b>	<b>1952.91</b>

## INTERPRETATION

Economic value added signifies that the firm has created a value on profit after retiring their obligations on interest and dividend.

It further clarifies that the shareholders' investment with firm has not only created wealth for its investors and also had economic benefit on its residual value

In the concluding year 2021-22, the total value addition to the wealth of shareholders after deducting the costs recorded at 37435.8 crores which was higher and more significant as compared to the year 2019-20 in which it stood 1952.91 crores.

## CONCLUSION

Though there are various techniques in valuing a business, EVA is the most effective method to measure the value that is created and generated for the shareholders. It also shows whether the invested funds are producing effective returns through the operating activities of the business or not. This allows the investors to make their investing decisions in the shares of the company. In the above case of TATA Steel the EVA for the 3 financial years starting from 2019-20 to 2021-22 is positive. This positive EVA shows that the company is creating wealth for its investors which in return is creating a positive and significant goodwill for the company.

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