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DISSECTING THE NEXUS OF ECONOMIC VALUE ADDED (EVA) AND PROFITABILITY: A SCHOLARLY EXPLORATION OF THEIR INTERDEPENDENT DYNAMICS

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Abstract

This study is conducted with a view to find out if there is any interdependency or correlation exist between Economic Value Added (EVA) and Profitability. To find out that a sample of one company – HUL ltd taken from Indian Fast Moving Consumer Goods (FMCG) industry with the help of Non Probability method (Judgmental sampling technique). The period of study is 6 years from 2014-15 to 2019-20. First of all, calculation of Economic Value Added (EVA) was done on the basis of financial data provided in the annual reports of the company. Then correlational test was done and it was found out that there is a significant correlation exist between EVA and Profit. Then regression test was done to find out that if profitability has any significant impact on EVA and result also supported the argument that profitability has a significant impact on EVA.

Keywords*: Economic Value Added (EVA), Net Profit, HUL ltd*

INTRODUCTION

In the recent times many new dynamics are added to the accounting and relating concept. Many new concepts emerged and used in place of some old/traditional measures. One of them is Economic Value Added (EVA). Economic Value Added (EVA) gained so much of popularity that it becomes one of the tools to analyse the performance of the company. Some experts do think that it is even better than measurement tool than profit. [2],[5],[9] With that it cannot be denied that in one way or another Economic Value Added (EVA) somewhat related to Profitability. So, to ensure this concept this study is conducted.

ECONOMIC VALUE ADDED (EVA)

Economic Value Added (EVA) is a new measurement tool for analysis of financial performance. It is technique in which cost of capital is reduced from the net operating profit of the company. Experts do believe that it gives much more accurate results about the financial performance of the company than profit. It can be rewrite in equation as follows :[1],[6],[7]

- **EVA = Net Operating Profit After Tax – Weighted Average Cost of Capital**
- **EVA = NOPAT – WACC**

REVIEW OF LITERATURE

Nicos Zafiris, R Bayldon, (1999) This paper is based on a modified version as well its application of Economic Value Added (EVA). As it is a well known fact that the performance of the company can be easily and precisely can be measured by EVA. So researchers tried an experiment and they just modified the equation. They took cost of capital based on market not on book value. So essentially they are doing some different activities to calculate the EVA. They took sample form UK stock market and successfully experimented this equation onto them.[10]

David E Keys, Mumin Azamhuzjaev, James Mackey,(2001) This is an analytical article about Economic Value Added (EVA). Article discuss about the claim of the founder company of EVA that it is the best measure to analyze the performance of the company. According to them this method is much better than older techniques like residual income which is already out dated for many multinational companies. As EVA's popularity increases ,

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many authors and managers recommend this technique to be used in corporate. This article also explores Pros and Cons of using EVA.[4]

Bartolomé Deyá Tortella, Sandro Brusco, (2003) This research paper throws light on the fact that Economic Value Added (EVA) is widely adopted and useful technique to know the amount of value generation. This method is much better than any other traditional indicators or techniques to measure the value or wealth. In this paper researchers tried to study the impact of introduction of Economic Value Added (EVA) on market. For this they tested the behavior of market before and after the introduction of EVA. They had also found out the good and bad points about this.[8]

A. P. Chirodiya, (2022), This research paper is a comparative study on the Ultratech Cement ltd and Ambuja Cement Ltd with the help of the Value Added Ratios. The main aim of this paper is to analyze the financial performance with the help of Value Added Ratios. This research paper shared information that Ultratech Cement Ltd is doing than Ambuja cement Ltd (Chirodiya, 2022). [3]

RESEARCH GAP

After going through the review of literature, it was found out that there are very few studies took place in existing stock of knowledge which analyse a particular company (case study) and find out that if there is any existing relationship between Economic Value Added and Net Profit. Hence, this study has the primary objectives to find out if there is any correlation between the Economic Value Added and Net Profit along with the case study.

OBJECTIVES OF THE STUDY

- To calculate and analyse the Economic Value Added (EVA) of HUL ltd
- To find out if there is any correlation exist between the Economic Value Added (EVA) and Net Profit and to which extent this correlation works

RESEARCH METHODOLOGY

6.1 Sample and Sample Selection

This is a case study of HUL Ltd. HUL ltd is a leading brand in Indian Fast Moving Consumer Goods (FMCG) Industry. It performed very well in the past financially and has a very bright future ahead. HUL ltd was chosen as sample to analyze the past, present and future situation and other emerging FMCG companies can learn from it.

Sample is selected with the help of Non-Probability method – Judgmental sampling technique.

6.2 Period of Study

Period of study is 6 years starting from 2014-15 to 2019-20.

6.3 Hypotheses of the Study

For Correlation Test

H_0 = There is not any kind of relationship exist between Profitability and Economic Value Added (EVA)

H_1 = There is a significant relationship exist between Profitability and Economic Value Added (EVA)

For Regression Test

H_0 = There is no significant impact of Profitability on Economic Value Added (EVA)

H_1 = There is a significant impact of Profitability on Economic Value Added (EVA)

6.4 Correlation Analysis

Correlation analysis is a statistical test to measure the that if two variable do have a correlation between them. Here, correlation means that one variable do affects the other one. Correlation analysis provide "r" as the correlation coefficient to measure the relationship between variables. The value of "r" can varies between (-1) to 1. It can be positive and negative also.

6.5 Regression Analysis

Regression analysis is a statistical tool to the extent to which one variable can affect the other variable able. This analysis also helps to measure the impact of one variable on other. Correlation analysis can only explain if the two variables are related or not but the level of correlation or effectiveness can be measured with Regression analysis.

DATA ANALYSIS AND INTERPRETATION

Table No. 1

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Calculation of EVA of HUL Ltd
(Source : Annual Reports of HUL ltd)

Analysis : It can be seen from the table no. 1 that Economic Value Added (EVA) is showing the incremental trend during the study period. to find out the Economic Value Added (EVA) first of all Interest paid during the period was added back to Profit After Tax, which results into Net Operating Profit After Tax (NOPAT). Then Weighted Average Cost of Capital (WACC) is reduced from NOPAT and remaining is known as Economic Value Added (EVA).

Years	Profit After Tax (PAT)	Add : Interest	Net Operating Profit After Tax (NOPAT)	Less : Weighted Average Cost of Capital (WACC)	Economic Value Added (EVA)
2014-15	3,843	11	3,854	474	**3,380**
2015-16	4,116	0	4,116	679	**3,437**
2016-17	4,247	0	4,247	749	**3,498**
2017-18	5,135	0	5,135	877	**4,258**
2018-19	6,080	0	6,080	789	**5,291**
2019-20	6,743	0	6,743	658	**6,085**

EVA was recorded at 3,380 Crores in 2014-15. Which was increased to 3,437 Crores in 2015-16. Then it was increased by a bit in 2016-17 and reached to 3,498 Crores. After which, it in creased by almost 260 Crores and recorded at 4,258 Crores in 2017-18. This incremental trend continued even in 2018-19, when it reached to 5,291 Crores. Then it increased by almost 700 Crores in 2019-20 and stood firmly at 6,085 Crores.

Table No. 2

Years	Share Holder's Value (Net Profit)	EVA
2014-15	**4315.26**	**3380**
2015-16	**4137**	**3437**
2016-17	**4490**	**3498**
2017-18	**5237**	**4258**
2018-19	**6036**	**5291**
2019-20	**6738**	**6085**

Graph No. 1
Net Profit and EVA

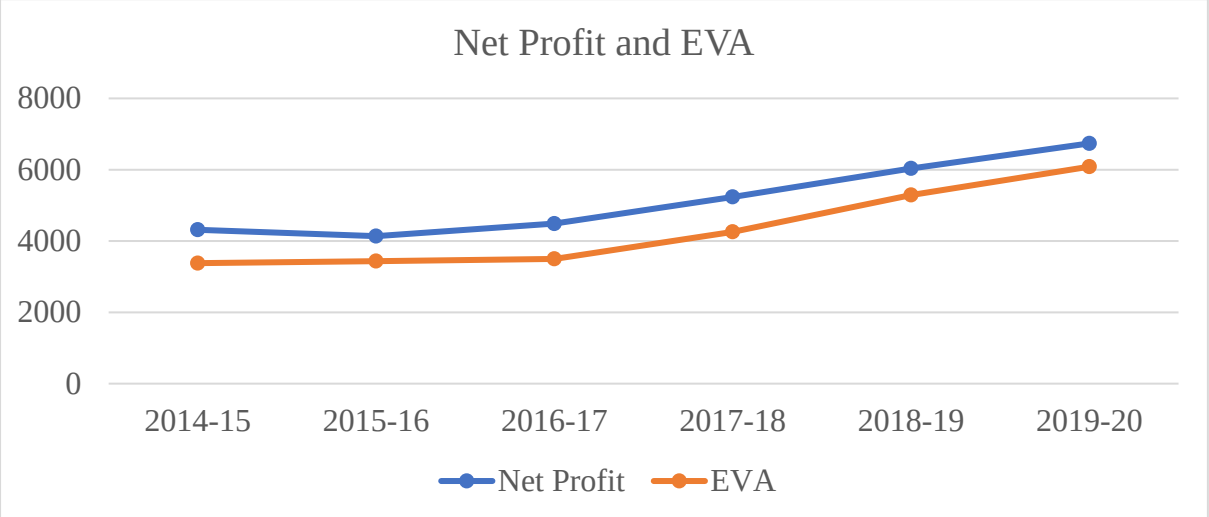

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Table No. 3
Correlation Test Statistics

Particulars	*Net Profit*	*EVA*
Net Profit	1	
EVA	**0.993365**	1

Analysis : Table no. 3 shows the data of Correlation test done on Net Profit and Economic Value Added (EVA). The main objective to run this test to know that if both variable (variable no. 1 is Net Profit and variable no. 2 was EVA) actually correlated to or independent from each other. To determine that 3 ground rules were followed.
Decision Rules:

- If Value of **"r" = 0 (ZERO)** then **NO Correlation** and Null hypothesis will be accepted.
- If Value of **"r" is between (-1) to 0** then **Negative Correlation** and Null hypothesis will be rejected.
- If Value of **"r" is between 0 to 1** then **Positive Correlation** and Null hypothesis will be rejected.

Table No. 4

Variable No.	Variable Name	Value of Correlation Coefficient "r"	Interpretation of "r" value
1	Net Profit	**0.993365**	**Strong Positive Correlation**
2	EVA		

- **Result**

As the correlation test gives the value of **"r" is 0.99 (Positive 0.99)** which suggested that Net Profit and EVA has a **Strong Positive Correlation** and hence, **Null hypothesis cannot be accepted** and it can be said that ***there is a significant relationship exist between Profitability and Economic Value Added (EVA)***

Table No. 5
Regression Test Statistics

Multiple R	0.993365
R Square	**0.986775**
Adjusted R Square	0.983469
Standard Error	134.511
Observations	6

Analysis : Table No. 5 is showing the regression statistics of the Net Profit and Economic Value Added (EVA). From the Table no. 3 and table no. 4, it is clear that both of these variables are "Strongly Correlated". Now, to find out to which extent these two variables can be interdependent regression test is done.
Regression test give answer in the form of **"R Square"**. Here, for this data **"R Square" is 0.986775**. which states that this model can explain the relationship of both variables **significantly effective**. Also, ***it can be said that this model can predict explained variable (dependent variable) 98 % of accurately.***

- **Result**

As the regression analysis done, the value of **"R Square" is 0.986**. which suggested that this regression model is significantly strong and hence, Profitability has a significant impact (almost of 98 %) on EVA. In other words, it can also be said that with this model, EVA (Explained/ Dependent variable) can be predicted with the help of Profitability with 98 % accuracy. Hence, **null hypothesis cannot be accepted** and it can be said that ***There is a significant impact of Profitability on Economic Value Added (EVA).***

FINDINGS

- Data of Net Profit and Economic Value Added (EVA) exhibits the fact that both have a correlated with one another.
- From the data it is also clear that Net Profit and Economic Value Added (EVA) is "Strongly Positive Correlated". Which means that if changes occurred in data they both move in same direction in graph.
- Regression analysis suggested that Net Profit can significantly impact Economic Value Added (EVA) as the model is 98 % accurate.

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