

PERFORMANCE EVALUATION OF SELECTED BANKS USING ECONOMIC VALUE ADDED

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Abstract: All the business requires to win stakeholders confidence by presenting their reports in the most modern manner. The measurement tools like cash flow statements analysis, fund flow statements analysis, ratio analysis, common size statements Return on Investment (ROI), Return on Net worth (RONW), Return on Capital employed (ROCE), Earning per share (EPS) are the most popular traditional used techniques to measure the performance. In the recent years many modern techniques have also gained popularity like Balanced score card, value added statements, Economic value Added (EVA) Cash value Added, Shareholders Value Added etc. Though there are many modern techniques available Economic value added has gained popularity to measure performance from shareholders point of view. Through this paper an attempt is made to study how EVA helps the measurement the performance of banks.

KEYWORDS: ROI, ROE, RONW, ROCE, EPS, RONA, ROIC, LPG.

I. INTRODUCTION

Banking Sector in India has seen a tremendous growth since its inception, introduction of Liberalization, globalization and Privatization (LPG) in 1990s has dominantly changed the entire structure of banking sector. This sector plays a crucial role in the economic development of the country and is an important part of Indian Financial system. Economic value Added uses the residual income approach to measure performance. EVA is calculated by deducting total cost of capital (Debt + Equity) known as capital charge from the Net operating profit after tax (NOPAT). Traditional techniques dependent on the net profit which considers only cost of debt or borrowings. Economic value Added uses the residual income approach to measure performance. EVA is calculated by deducting total cost of capital (Debt + Equity) known as capital charge from the Net operating profit after tax. Traditional techniques dependent on the net profit which considers only cost of debt or borrowings.

OBJECTIVES OF THE STUDY

- As a Management tool how EVA helps for performance analysis does.
- To study the measurement tools and its application in selected banks.

SCOPE OF THE STUDY

EVA is a useful measure in this regard and number of banks that have given well returns to their shareholders. In this study, performance evaluation of selected banks using economic value added.

COLLECTION OF DATA

Secondary data is used for the study. The data is collected from the annual reports of the banks, Publications by RBI and stock prices of the banks are collected from stock market websites like yahoo finance, money control and BSE. For this study we have selected State Bank of India & UCO bank.

EVA AS A MANAGEMENT TOOL

EVA is superior to accounting profits as a measure of value creation because it recognizes the cost of capital and, hence, the riskiness of a firm's operations. Moreover the EVA is considered to be a value based tool. EVA is based on the common accounting based items like interest bearing debt, equity capital and net operating profit. It differs from the traditional measures mainly by including the cost of equity. Return on capital is very common and relatively good performance measure. Different companies calculate this return with different formulas and call it also with different names like return on investment (ROI), return on invested capital (ROIC), Return on Capital Employed (ROCE), Return on Net Assets (RONA), Return on Assets (ROA) etc. The main shortcoming with all these rates of return is in all cases that maximizing rate of return does not necessarily maximize the return for shareholders.

TOOLS FOR ANALYSING EVA

Various financial tools are used for different analysis like:

1. Net Operating Profit After Tax

$$\text{NOPAT} = \text{Operating Profit} - \text{Tax}$$

2. Return on Asset

It's one of the conventional ratios for measuring managerial efficiency of a bank. It indicates how capably the management of the bank has been converting the bank asset into net income and computed in the process.

$$\text{Formula: ROA} = \text{Net Income after Tax} / \text{Total Asset}$$

3. Capital Charge

The *capital charge* is the cost of *capital* times the amount of invested *capital*.

$$\text{Formula: Invested Capital} \times \text{WACC}$$

4. Economic value added

$$\text{EVA} = \text{Net profit before interest} / \text{Capital employed} \times 100$$

DURATION OF THE STUDY

The study is conducted for a period of two years i.e. 2015 – 16 and 2016 – 17.

RESULTS AND DISCUSSIONS:

Net Operating Profit is considered instead of Net profit to find the Economic value added

$$\text{Net Operating Profit} = \text{Income} - \text{Operating Expenses}$$

Net Operating Profit after Tax is used instead of Net Profit to get a true Picture of the value

$$\text{NOPAT} = \text{Operating Profit} - \text{Tax}$$

CALCULATING THE NOPAT

BANKS	SBI		UCO	
	2015 – 16	2016 - 17	2015 - 16	2016 - 17
Total Income	1,91,843.66	2,10,979.16	20,157.28	18,440.29
Operating Exp	41,782.37	46,472.77	2,840.95	3,005.19

Operating Profit	17680.28	16799.75	22,956.54	20,290.96
Taxes	3823.40	4371.07	1,660.85	839.56
NOPAT	13856.88	12428.68	21295.69	19451.40

RETURN ON ASSET

BANKS	2015 - 16	2016 - 17	2015 - 16	2016 - 17
State Bank of India	9950.65	10,484.10	23,57,617.54	27,05,966.30
UCO Bank	1850.67	2799.26	2,44,882.53	2,31,339.71

ROA = NET INCOME AFTER TAX / TOTAL ASSET

					Return On Asset	
BANKS	2015 - 16	2016 - 17	2015 - 16	2016 - 17	2015 - 16	2016 - 17
State Bank of India	9950.65	10,484.10	23,57,617.54	27,05,966.30	0.0042	0.0038
UCO Bank	1850.67	2799.26	2,44,882.53	2,31,339.71	0.0075	0.0121

COST OF EQUITY (KE):

SBI	UCO BANK				
YEARS	2015 - 16 (%)	2016 - 17 (%)	YEARS	2015 - 16 (%)	2016 - 17 (%)
Risk free rate of return (Rf)	7.79	8.96	Risk free rate of return (Rf)	7.79	8.96
Market Return (Rm)	8.15	17.72	Market Return (Rm)	8.15%	17.72%
Beta	0.98	2.37	Beta	1.54	2.78
Ke	8.14	29.72	Ke	8.34	33.31

COST OF DEBT (Kd)

SBI			UCO BANK		
Years	2015 – 16 (in cr)	2016 – 17 (in cr)	Years	2015 - 16	2016 - 17
Interest Expenses	1,430,474	1,491,147	Interest Expenses	13713	12509
Borrowings	3,613,994	3,363,657	Borrowings	17240435	95349620
Cost of Debt (Kd)	39.58	44.33	Cost of Debt (Kd)	0.08	0.02

WEIGHTED AVERAGE COST OF CAPITAL (in%)

Bank / Year	2015 – 16 (%)	2016 – 17 (%)
SBI	7.59	6.14
UCO Bank	6.12	5.20

CAPITAL CHARGE

Name of the Bank	2015 – 16 (Rs in Crores)	2016 – 17 (Rs in Crores)
SBI	1441.44	1567.41
UCO Bank	1015.30	1028.30

EVA (ECONOMIC VALUE ADDED)

EVA = Net Operating Profit After Tax – Capital Charge

SBI			UCO BANK		
YEARS	2015 – 16 (in cr)	2016 – 17 (in cr)	Years	2015 – 16 (incr)	2016 -17 (incr)
NOPAT	13856.88	12428.68	NOPAT	21295.69	19451.40
CAPITAL CHARGE	1441.44	1567.41	CAPITAL CHARGE	1015.30	1028.30
EVA	12415.44	10861.27	EVA	20280.39	18423.10

ECONOMIC VALUE ADDED (%)

SBI			UCO BANK		
YEARS	2015-16	2016 -17	YEARS	2015-16	2016-17
Return on Invested Capital	11.40	10.25	Return on Invested Capital	-	-
WACC	7.59	6.14	WACC	6.12	5.20
EVA (%)	3.81	4.11	EVA (%)	- 6.12	- 5.20

FINDINGS

- From the above analysis we may understand that the State bank of India (SBI) added value to the shareholders wealth by generating a positive Economic Value Added and meeting its capital charge entirely. Whereas UCO bank could not add value to the shareholders wealth.
- Return on Capital Employed of SBI is greater than its cost whereas in case of UCO Bank Cost is higher than the Returns
- We may also see that the Borrowing of SBI has become lesser in the year 2016 – 17 than that of 2015 – 16.
- Hence this shows that the Banks stocks especially the SBI is performing much better than that of UCO bank and its volatile.

CONCLUSION

Banking sector in India is growing in steadily and in limit and is also approaching capital market for combination of funds to go up further growth in the banking sector. It is now significant for bankers to increase the shareholders wealth and persuade them for more investment in banks. To do this the banks have to measure their performance from shareholders perspective, bankers will have to follow wealth maximization as an objective to indicate that they are adding value to shareholders wealth and not deteriorating it. In order to determine this, bankers need to apply the Economic Value Added (EVA) as a Performance measurement technique, it is concluded that EVA can be used to value bank performance from shareholders point of view. Shareholders can use EVA values to decide on their investment decisions in different banks.

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