

## Economic Value Added Break Even Point of Commercial Banks

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### ABSTRACT

Economic value added (EVA) is an estimate of a firm's economic profit, or the value created in excess of the required return of the company's shareholders. Economic Value Added is the net profit, less the equity cost of the firm capital. The idea is that value is created when the return of the firm's economic capital employed exceeds the cost of the capital. The amount can be determined by making adjustments to Generally Accepted Accounting Principle accounting. This article aims to measure the Economic Value Added breakeven point of commercial banks in India.

**Keywords:** Economic Value Added, Operating Expenditure, Net operating profit after tax, breakeven point.

### INTRODUCTION

Economic value added is a recent phenomenon in the corporate world. It is used as an internal as well as external performance measure, because it is consistent with the organizational objective of shareholder's value creation. It is an accounting-based measure used to evaluate the operating performance. It is a strong tool for business planning and it is a better approach than the traditional performance measure based on profit after-tax. It explains clear surplus of the bank and effectively helps to explain the ability of a bank to generate clear surplus and it is the spread of the bank. EVA is a systematic measure of a bank's financial functioning and operations. It is based on the residual wealth calculated by deducting its cost of capital from its operating profit, adjusted for taxes on a cash basis. EVA can also be referred to as economic profit, as it intended to capture the real economic profit of a firm. As the banks increasingly rely on the capital markets to meet their capital adequacy requirements, it is important that they should pay adequate attention to earn a positive EVA.

### Objectives of the study

1. To calculate the EVA and to compute the EVA breakeven point of Indian Commercial Banks.
2. To offer suggestions to improve the EVA of commercial banks in India.

### RESEARCH METHODOLOGY

The studies dealt with calculate the EVA and to compute the EVA breakeven point of the Indian Commercial banks listed in the Bombay Stock Exchange. This study is completely based on the secondary data and the financial data of the banks under study were collected from the Report on Trend and Progress of Banking in India, in particular "Statistical Tables Relating to Banks in India".

### REVIEW OF LITERATURE

**Shand** says economic value added measures a corporation's true economic profit. The objective of EVA is to understand which business unit has best leverage to generate returns and maximize shareholder value. According to economic theory, capital eventually moves to the investment opportunities with the best returns because investors want to maximize their profits. Getting decision-makers to think about economic profits as they evaluate new business opportunities is the purpose of using EVA.

**Bardia** in his article "Economic value added vs. Traditional corporate performance parameters" concluded that EVA has superiority over the traditional financial performance parameters. He conducted his study on Infosys and Satyam. To prove his study he used various statistical tests. Finally he concluded that the performance of Infosys was better than Satyam.

Lehnthat EVA and MVA are increasingly being eyed as alternative measures of business performance and strategies development. To provide clarification on the subject, a study which examines the effectiveness of EVA and MVA as measures of performance, as signals of strategic change in these metrics of strategic development was conducted. The study used the data from 241 firms for the time slab 1987-96, which showed that EVA and MVA effectively measured the quality of strategic decisions and served as signals of strategic change and they were found to be significantly correlated with stock price performance and inversely related to turnover. It was concluded that firms having greater focus in their business activities had higher MVA than less focused counterparts.

**Shyam Lal R.Sharma** carried out his research article on the topic “Economic Value Added” and concluded that EVA is a single value based measure which was used to assess business strategies, capital projects and to maximize the shareholder’s wealth. With the help of EVA it can be decided that whether the firm has created or destroyed the value by comparing the returns with the cost of capital used to produce them. On the basis of this the management of the firm can decide to withdraw value destructive activities and invest in projects that are helpful increasing value for the maximization of the wealth of shareholders.

## ANALYSIS AND INTERPRETATION

### Economic Value Added Breakeven Point

To check economic value addition or destruction in banks the following hypothesis has been framed.

**H<sub>0</sub>**: There is economic value addition in commercial Banks

**H<sub>1</sub>**: There is no economic value addition in commercial Banks

**Table-1Economic value added Breakeven Point of the Public Sector  
Banks from 2008-09 to 2020-21**

(Rs. in Crore)

Banks	NOPAT	Capital Charge	% of NOPAT Covered capital charge	Required NOPAT in %	Hypothesis Accepted/ Rejected
Bank of Baroda	7857	10624	-2767 (74%)	26	Rejected
Bank of India	6751	7989	-1231 (85%)	15	Rejected
Bank of Maharashtra	1567	1587	-20(99%)	1	Rejected
Canara Bank	5878	8368	-2490 (70%)	30	Rejected
Central bank of India	2543	3257	-714 (78%)	22	Rejected
Indian Bank	2788	3435	-647(81%)	19	Rejected
Indian Overseas Bank	3111	3299	-188(94%)	6	Rejected
Punjab National Bank	8445	9530	-1085(89%)	11	Rejected
Punjab & Sind Bank	839	935	-96.2(90%)	10	Rejected
Union Bank of India	4845	5303	-459(91%)	9	Rejected
UCO Bank	2568	2683	-115(96%)	4	Rejected
State Bank of India	31783	42823	-11040(74%)	16	Rejected

**Source:** Computed from published annual reports of the respective Banks

### Interpretation

It is observed from that table 1 that no public sector bank has achieved EVA breakeven point. The NOPAT of five public sector banks (Bank of Maharashtra, Indian Overseas Bank, Punjab & Sind Bank, UCO Bank and Union Bank of India) covered finance charge of more than 90 per cent, and three banks (Bank of India, Indian Bank and Punjab National Bank) covered finance charge of 80 to 90 per cent, and remaining four banks (Bank of Baroda, Canara Bank, Central Bank of India and State Bank of India) covered finance charge of 70 to 80 percent.

**Table- 2Economic value added Breakeven Point of the Private Sector Banks from 2008-09 to 2020-21****(Rs. in Crore)**

Banks	NOPAT	Capital Charge	% of NOPAT Covered Capital charge	Required NOPAT in %	Hypothesis Accepted/ Rejected
Axis Bank Ltd	10997	16333	-5336(67%)	33	Rejected
City union Bank Ltd	502	530	-28(95%)	5	Rejected
Federal Bank Ltd	1414.4	2515.1	-1100(56%)	44	Rejected
HDFC Bank Ltd	15724	18256	-2532(86%)	14	Rejected
ICICI Bank Ltd	17911	30604	-12693(59%)	41	Rejected
Indusind Bank Ltd	3353	5717	-2364(59%)	41	Rejected
Jammu & Kashmir Bank	1063	1071	-8.4(99%)	1	Rejected
Karur vysya Bank Ltd	818.85	989.77	-171(83%)	17	Rejected
Kotak Mahindra Bank	3377	5806	-2425(58%)	42	Rejected
Karnataka Bank Ltd	642.3	772	-129(83%)	17	Rejected
South Indian Bank Ltd	716	791	-75(91%)	9	Rejected
Yes bank Ltd	<b>4201</b>	<b>4103.2</b>	<b>97.8 (100%)</b>	-	<b>Accepted</b>

**Source:** Computed from published annual reports of the respective Banks

### Interpretation

It is observed from the table - 2 that the only one private sector bank has earned positive EVA. The NOPAT of three private sector banks (City union Bank Ltd, Jammu and Kashmir Bank Ltd and South Indian Bank Ltd) covered finance charge of more than 90 per cent, and three banks (HDFC Bank Ltd, Karur Vysya Bank Ltd and Karnataka Bank Ltd) covered finance charge of 80 to 90 per cent, and remaining four banks (Axis Bank Ltd, Federal Bank Ltd, ICICI Bank Ltd, IndusInd Bank Ltd and Kotak Mahindra Bank Ltd) covered finance charge of below 70 per cent.

**Table- 3 Ranking of Commercial banks based on the coverage of finance charge from 2008-09 to2020-21**

Name of the Bank	Category	Finance charge Coverage (%)	Rank	Positions
YES Bank Ltd	<b>Private Sector</b>	100	1	Outstanding
Bank of Maharashtra	Public Sector	99	2	Excellent
Jammu & Kashmir Bank Ltd	<b>Private Sector</b>	99		
UCO Bank	Public Sector	96		
City union Bank ltd	<b>Private Sector</b>	95		
Indian Overseas Bank	Public Sector	94		
Union Bank of India	Public Sector	91		
South Indian Bank Ltd	<b>Private Sector</b>	91		
Punjab & Sind Bank	Public Sector	90		
Punjab National Bank	Public Sector	89		

HDFC Bank Ltd	<b>Private Sector</b>	86	3	Very good
Bank of India	Public Sector	85		
Karur vysya Bank Ltd	<b>Private Sector</b>	83		
Karnataka Bank Ltd	<b>Private Sector</b>	83		
Indian Bank	Public Sector	81	4	Good
Central Bank of India	Public Sector	78		
State Bank of India	Public Sector	74		
Bank of Baroda	Public Sector	74		
Canara Bank	Public Sector	70	5	Fair
Axis Bank Ltd	<b>Private Sector</b>	67		
ICICI Bank Ltd	<b>Private Sector</b>	59		
IndusInd Bank Ltd	<b>Private Sector</b>	59		
Kotak Mahindra Bank Ltd	<b>Private Sector</b>	58		
Federal Bank Ltd	<b>Private Sector</b>	56		

**Source:** Computed from published annual reports of the respective Banks

### Interpretation

The ranking of public and private sector banks based on the coverage of finance charge is given in the Table 3. YES Bank ranked outstanding as it covered 100 per cent of finance charge. The banks (Bank of Maharashtra, Indian Overseas Bank, Punjab & Sind Bank, UCO Bank, Union Bank of India, City union Bank Ltd, Jammu and Kashmir Bank Ltd and South Indian Bank Ltd) which covered more than 90 per cent are ranked excellent. The 6 banks (Bank of India, Indian Bank, Punjab National Bank, HDFC Bank Ltd, Karur Vysya Bank Ltd and Karnataka Bank Ltd) which covered 80-90 per cent are ranked Very Good. The 4 banks (Bank of Baroda, Canara Bank, and Central Bank of India and State Bank of India) which covered 80-90 per cent are ranked Good. The 5 banks (Axis Bank Ltd, Federal Bank Ltd, ICICI Bank Ltd, IndusInd Bank Ltd and Kotak Mahindra Bank Ltd) which covered below 60 per cent are ranked Fair.

### Findings related to Economic value added Breakeven Point

- The study revealed that the YES Bank has earned positive EVA out of 12 public and 12 private sector banks during the period under review.
- The EVA breakeven point clearly showed that 5 public sector banks and 3 private sector banks have covered the finance charge more than 90 per cent, and 7 public sector bank and 8 private sector banks have covered the finance charge less than 90 per cent.

### Findings related to Ranking of Commercial Banks based on the Coverage of finance Charge

- The banks are ranked on the basis of finance charge coverage. The NOPAT of YES Bank covered 100 per cent of finance charge and ranked outstanding position.
- The study revealed that except YES Bank remaining banks have covered finance charge of less than 100 per cent, which represents the return provided by the banks are less than expected return.

### CONCLUSIONS

The EVA breakeven point clearly showed that four private sector banks have covered the finance charge less than 60 per cent. This showed the poor financial health and need to be addressed immediately. The regression results showed that the ROIC and Cost of equity (Ke) influence the EVA of both public and private sector Banks. In order to increase the EVA the

main focus should be given for increasing the ROIC and reducing the cost of equity. Thus, the economic value addition is possible only if there is an increase in the NOPAT and decrease in the capital charge.

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