International Journal of Engineering Technology and Management Sciences[IJETMS]

Website: ijetms.in Issue:1, Volume No.1, November-2017

An Empirical Study on Shareholder Wealth Creation Using Economic Value Added (EVA) in India

Dr. Ch. Shankar
Associate Professor Finance
Department of Business Management
Malla Reddy College of Engineering
Hyderabad.
Email: Shankar_123987@yahoo.co.in

Abstract: The modern financial management practices of business organizations are more concentrated on the value/wealth creation of shareholders/owners. The only way to achieve this goal for the business organizations is to reach the expectations of shareholders. The main problem here is how to measure the business organizations whether they are achieving their goals or not. To overcome these problems Joel Stern introduced a changed idea of economic benefits named "Economic Value Added (EVA)".By using this method this study focuses on knowing whether all Bombay Stock Exchange index (SENSEX) listed 30 companies are really providing wealth to the shareholder or not. To test this, following hypothesis has been framed - The entire Bombay Stock Exchange index listed companies are having positive EVA. The Grounded results, 56.67% of companies are getting a positive EVA since last five years, 13.33% companies have not achieved EVA benchmark in one year among last five years. 30% of companies have not achieved the EVA benchmark since last five years. The hypothesis of this study may not be accepted in this situation. Out of 30 companies, 9 companies are not reaching the EVA benchmark. In this study, the alternative hypothesis is accepted as in this case all BSE index companies are not having positive EVA.

Keywords: EVA, Wealth Creation, Value Added

I. Introduction

The major difference between traditional and modern financial management practices is, in the tradition financial management practice scope is limited to procurement of financial resources, where as in the modern financial management practice the business organizations concentrate more on the value/wealth creation of shareholders/owners. The only way to achieve this goal for the business organization is to reach the expectations of shareholders. The main problem here is how to measure the business organizations whether they are achieving their goals or not. Profits are the main indicators of organization performance but the problem here is the profits of an organization is not helping to understand the wealth of the shareholders. In the modern financial management especially in the 20th century many researchers concentrate and addressed this issue. The problem here is there is no such kind of benchmark

available to measure the business organization performance. There are many Accounting and Financial Management dealings like Earning per Share (EPS), Return on Capital Employed (ROCE), Return on Equity (ROI), and Ratio Analysis helps to quantify the execution of the business organizations. The problems of these measures are lack of comparison to benchmark. These measures ignore the shareholders required least minimum rate of return.

In order to overcome these problems, Joel Stern introduced an improved concept of financial profits named "Economic Value Added (EVA)" in the year 1990 as per a measure of business execution. Stern (1990) observed that Economic Value Added (EVA) helps to measure business performance, catches the genuine monetary benefit of an organization and motivates the manager's decisions to generate the extreme shareholders' wealth in an organization. Stewart (1994) expended that Economic Value Added is an innovative administration instrument that has increased worldwide recognition as the standard instrument for assessing the act of a business organization. By adoption of EVA tool business organizations all through the world plainly portrays that it gives an incorporated basic leadership structure, can change energies and divert assets to make practical incentive for organizations, clients, representatives, investors and for administration. Ochsner (1995) explains that EVA is a leading indicator of organization performance. It similarly may state that in terms of functional revenues and use of resources. It is a target-setting mechanism for business organizations; the EVA figures will help the real investors for following and examination of execution purposes. Rice (1996) explained that there is a straight association among Economic Value Added improvement and a greater share price. EVA helps companies to build corporate community beliefs and producing wealth for shareholders.

The main objective of this paper: To know whether all Bombay Stock Exchange index (SENSEX) listed companies are really providing wealth to the shareholder or not. To know this the EVA based benchmark is used for this study. If the company NOPAT is higher than the companies WACC value it means company reached the benchmark of the EVA and it is considered as companies have a positive EVA. If the company NOPAT less than the WACC value company is in a situation of negative EVA. The positive EVA companies are considered as wealth-creating companies to the shareholders.

II. Literature Review

Burkette and Hedley (1997) described that the Economic Value Added thought helps to measure economic profit of an organization. It can be applied for-profit and non-profit organizations. It can be used in different ways; management communication to tighten the management take the decisions which protect the shareholder's interests, encourage the management to increase the management research for long-term benefits and provide appropriate employee training purpose.

Tully (1997) mentioned EVA as a method for understanding monetary execution of an association and presents the strategy for figuring EVA and furthermore demonstrates some pictorial introductions of EVA's of a few organizations.

Dillon and Owers (1997) investigate the relationship between EVA and NPV. They suggest that EVA is a

context with other financial metrics. They concluded that there is the complex relation between Economic Value Added and Net Present Value than is sometimes assumed.

Chen and Dodd (1997) examine the association among Economic Value Added and stock return with a tester of 566 US companies. They inferred that enhancing EVA execution is related with a higher stock return, EVA is more effective than customary measures of bookkeeping benefit in clarifying stock return and EVA is like leftover salary in idea.

Villiers (1997) extended EVA tool for better decision making and estimate actual profitability. The EVA calculation procedure cannot give the accrual profitability in inflation time. His extended study Adjusted EVA can be used to better decision making and accrual estimation of profitability of the organization. He suggested than AEVA is an alternative tool for estimating the accrual profitability estimation.

Banerjee (1997) examined the performance on the base of Economic Value Added and other traditional economic performance dealings, with a sample size of Ten industries, every industry is spoken to by four/five organizations. return on initial capital investment and EVA have been figured for test organizations and an examination of the two has been attempted, the outcomes demonstrating that EVA is better finished ROI. He presumed that Indian organizations bit by bit perceive the significance of EVA.

Brabazon and Sweeney (1998) examined the correlation between the EVA and Share price of the organization with a sample size of 53 companies belong US and Canada. The thought one of the significant offering purposes of EVA is that a solid relationship exists amongst it and the offer cost of the association. He concluded that the economic concert measure and Economic Value Added help to measures the success of past strategic decisions.

Ethiraj (1998) measures the capital efficiency and economic value added of Indian companies. Based on his results of EVA, HLL life care and Indian Tobacco Company position at the topmost of the list. He concludes that stock price moves up as an organization embraces EVA as an inward execution rule.

Biddle, Bowen, and Wallace (1998) had shown observational proof that deals with the focuses. In this examination, he proposes that a portion of the cases with respect to EVA are exaggerated. While prove affirms that administrators react to EVA motivating forces, and there is no proof to help guarantees that EVA is all the more intently connected with value returns or firm esteems than net salary. They have talked about conceivable reasons in their article.

Roztocki and Needy (1999) analyzed Economic Value Added as an execution measure for little assembling organizations. They have explored favorable circumstances and impediments of utilizing Economic Value Added as an essential measure of execution when contrasted with deals, incomes, income, working benefit, benefit after duty, and net revenue are. The improved philosophy permits the real bits of Economic Value Added to be utilized by little assembling firms while dispensing with the greater part of the subtle elements that a little venture would discover unwieldy to execute.

Thenmozhie (1999) compared Economic Value Added with other customary economic performance methods like ROI, EPS, RONW, ROE, ROCE, etc.

The specific mentioned companies belong to India. He has used for analysis the companies like NIIT, HL, and ITC. He suggested that the customary economic performance methods do not replicate the actual cost of the shareholders whereas the Economic Value Added helps to measure the value of shareholders' wealth. He concluded that maintaining Economic Value Added is a superior method of company's financial performance equated to tradition financial performance methods.

Thibadoux, Scheidt, and Jeffords (1999) examined EVA over 300 major companies worldwide. They believe that EVA as an assessment instrument guarantees that when supervisors settle on key choices they will do as such in their own particular best advantages and in addition those of investors since positive changes in EVA will be seized in stock costs. They inferred that these strategies can be received by any oil and gas organization engaged with any period of industry movement.

Farsio, Degel, and Degner (2000) clarified how Economic Value Added advances investor premiums. To begin with, they plainly indicate to administration that the essential money related target of the organization is to make investor riches. Besides, their examination underscores constant change in the organization's EVA as the reason for expanded investor riches. Their system for concentrate the connection amongst EVA and stock return comprises of testing organizations that are found in surely understood stock files, for example, Standard and Poor's 500 and the Dow Jones Industrial Average.

Banerjee (2000) studied EVA in the Indian environment with a sample of 200 companies done a historical of 5 years. He says Companies in the US have begun EVA data from the earliest starting point of the 90s as a measure of corporate monetary execution. It is trusted that market estimation of a firm would increment with the expansion in EVA. This investigation demonstrates that market estimation of a firm can be all around anticipated by assessed future EVA streams. His investigation has likewise discovered that market estimation of the vast majority of the organizations in the specimen is clarified more by current operational incentive than future development estimation of firms.

Turvey, Lake; Duren and Sparling (2000) overview the connection between Economic Value Added (EVA) and the share trading system execution of 17 traded on an open market organizations in the Canadian nourishment handling area. Utilizing 1996 yearly reports to process EVA, and day by day stock costs for 1994 through 1998, they endeavor to connect EVA with an assortment of measures including bookkeeping return on resources (ROA), return on value (ROE), share value, the Capital Asset Pricing Model (CAPM) returns and hazard, and others. Their outcomes discover little help for the guess that high-EVA firms prompt higher investor esteem.

JawaharLal& Malik (2001) studied a comprehensive case reading of Hindustan Lever Ltd. In their opinion, EVA is the revolution in corporate management and says that EVA is today's burning financial awareness. Economic Value Added is a method of business performance to increase the wealth of the shareholder's value. In this attempt, they show EVA's predominance over customary benefit based execution measure, calculation, usage, and application.

Eljelly and Alghurair (2001) studied the relation among stock returns and EVA and various traditional

measures like EPS, ROE, CF in diverse companies in Saudi Arabia. They concluded that there is a strong link between different customary bookkeeping measures and demonstrate that those measures give the comparable sign of an organization's general execution. The outcomes demonstrate that MVA and stock returns are related with customary bookkeeping measures, yet not with EVA. Notwithstanding, EPS is found to rule different measures of execution as for its relationship with stock returns and MVA.

Lovata (2001) studied 68 firms which are using EVA to evaluate management. He focused on whether MVA growths following to the adding of EVA into benefit agreements. MVA for these organizations is evaluated bringing about 317 firm-years tried utilizing calculated relapse. His outcomes give feeble confirmation that the utilization of EVA in execution assessment builds MVA.

Baek and Kim (2002) studied the connection between the official pay and execution measured by the financial esteem included (EVA) by utilizing 1996-1998 information on the S&P 1,500 firms. The ponder uncovers that EVA is adversely identified with pay level and decidedly identified with the impetus remunerations like the reward, confined stocks and to the estimation of investment opportunities and administration stock possession in a constrained sense. The discoveries propose that administration investment opportunities are either too much conceded or financially wasteful.

Bardia (2002) explained EVA concept is a better measure of business organization performance because EVA considered the general cost of capital. In this paper, an endeavor has been made to break down the money related execution of Infosys Technologies Ltd. On the premise of customary parameters like ROCE, ROE, EPS, and so on and the new execution measure EVA.

Roztocki (2003) inspects the impact of Integrated Activity-Based Costing and EVA on the facilities providing segment decision-making process, the study for those facilities providing segment businesses in which the tradition valuation scheme is not satisfactory. He argues using the integrated system organizations motive to trace overhead costs and capital costs. His examination bringing about upgrades in the dependability of item cost data are delineated through the case. which moved from natural cost estimation to dependable cost examination. At last, he talks about the effect of this incorporated framework on the administration area's basic leadership process and long haul business execution.

Sparling &Turvey (2003) examined the two potential relationships of shareholders return and Economic Value Added as a instrument for appreciating investments. They have taken 33 food companies to examine the relationship. The analysis results suggest that the associations found were very pathetic in all occurrences verified.

Ramana (2004) believes that the increased awareness of the shareholders pressurized the corporate companies to give the consistently better performance. This helps the development of Indian capital market. The indicators for increased awareness are mainly the performance methods like MVA & EVA. Quite a few studies studied the association among EVA and MVA and greatest of them found suggestion to support this association. Very few studies empirically test the association among EVA & MVA especially EVA impact on MVA. He studied Indian companies to measure the

relationship between EVA and MVA. The empirical study results suggest that there is no solid confirmation to help that EVA is better than the customary execution measures in its relationship with MVA.

Lloyd M. Austin (2005) compared the normal accounting profits and value-added results. He describes that EVA income is a benchmark for policies in state-owned owned-enterprises and the results of EVA helps for other operational decisions of the firm. He concluded that the fiscal situation in the upcoming years of the learning helps to change the aims of the innovativeness.

Ralph Palliam (2006) examined the association among the EVA with stock returns. The sample 33 non-EVA users and seventy five EVA operators were carefully selected at casual. The empirical study result support that EVA is slightly unacceptable, undependable, and doubtful.

George Athanassakos (2007) determined to the extent the Canadian companies Value Based Management methods. The examination finds that esteem based administration techniques are broadly utilized as a part of Canada, with the probability of utilization being higher for bigger organizations with more youthful and more taught officials with a bookkeeping/fund foundation.

R.K. Mittal et al (2008) explores the link among business societal responsibility and economic measures. Their finding suggests to facilitate present is an optimistic association among business communal responsibility and business organization status but in Indian context, the relationship is not explained in between the corporate social responsibility and company profitability. The study mainly focused on few Indian companies' who have successfully implemented company communal responsibility financial performance for a period of four years. They concluded that there is a little proof that the code of morals would produce essentially more Economic Value Added (EVA) and Market Value Added (MVA).

Ingrid Nappi-Choulet (2009) investigates the association among the EVA and MVA by using a sample of 250 French listed companies for a period of 1999 to 2004. The empirical results show that there is a negative relation in between increase in total assets and EVA. MVA also shows a negative relationship with increases in real assets. But the service industries show the low real estate intensity.

Franco Fiordelisi (2009) analyzed the shareholder's value creation by non depository economic institution, particularly by the Italian leasing and factoring organization. The economic value added calculated based on the COC of leasing and factoring companies. The COC is calculated using the accounting procedure. The results suggest that 50 percent of the organizations accomplished a positive EVA and the most reduced middle level of EVA made is right around 2 percent of capital put resources into the organization.

Daniel Ze´ghal and AnisMaaloul (2010) broke down the part of significant worth included as a marker of scholarly capital and its effect on the association's monetary, money related and securities exchange execution. 300 UK organizations partitioned into three gatherings of businesses: cutting edge, customary and administrations. The exact comes about demonstrate that organizations' scholarly capital positively affects monetary and money related execution. Be that as it may, the relationship between scholarly capital and securities

exchange execution is critical for cutting edge businesses. The outcomes likewise show that capital utilized remains a noteworthy determinant of budgetary and securities exchange execution despite the fact that it negatively affects financial execution.

MoujibBahri et al (2011) measure the financial performance of miniature and medium-sized enterprises base on economic value added (EVA). 108 Canadian assembling SMEs more than two back to back years utilized as an example for this examination. The discoveries show that some business hones directly affect EVA inside one year, while others have a conceded impact. The effects of different practices on EVA were observed to be powerless or irrelevant, a perspective that requires promote examination.

Satish Kumar and A.K. Sharma (2011) analyze the predominance of financial esteem included (EVA) on customary execution measures by utilizing a specimen of 873 firms year perceptions from the Indian market. The incremental data content test demonstrates that EVA influences a peripheral commitment to data to content past customary execution. The creators' outcomes don't bolster the theory that EVA is better than conventional bookkeeping based measures in relationship with the market estimation of the firm.

Objectives:

The main objective of this paper: To know whether all Bombay Stock Exchange index (SENSEX) listed companies are really providing wealth to the shareholder or not. To know this the EVA based benchmark is used for this study. If the company NOPAT is higher than the companies WACC value it means company reached the benchmark of the EVA and it is considered as company have a positive EVA. If the company NOPAT less than the WACC value company is in a situation of negative EVA. The positive EVA companies are considered as wealth creating companies to the shareholders.

Hypothesis:

H0: All Bombay Stock Exchange index (SENSEX) listed companies are having the positive Economic Value Added (EVA).

H1: All Bombay Stock Exchange index (SENSEX) listed companies are not having the positive Economic Value Added (EVA).

III. Methodology:

Data:

The data of30 index companies' balance sheet and Profit and Loss account statement are collected from internet sources for a period of 5 years from 2008 to 2013. The weekly closing prices of the companies are considered for calculating the EVA.

Sample:

Bombay stock exchange index (SENSEX) listed 30 companies are selected for the sample. Each company EVA is calculated for five years it means the total sample is 150.

Analysis:

$$\boldsymbol{EconomicValueAdded = NOPAT - CC}$$

Where

$$NOPAT = Adjusted\ Profit\ After\ Tax$$

$$CC = Capital\ Charge\ or\ Wacc * CapitalEmployed$$

$Wacc = WeightedAverageCostofCapital$

$(Cost\ of\ Equity\ +\ Cost\ of\ Debt + Cost\ of\ Preference\ Shares + Cost\ of\ Reserves)$

$CapitalEmployed = Equity + Debt + PreferanceShares + Reserves$

NOPAT:

The NOPAT is the thing that an organization gains in the event that it didn't have any obligation, equivalent to working salary (1- Tax rate). It is an option measure for measuring working effectiveness.

Weighted Average Cost of Capital:

Weighted Average Cost of Capital:

1. **Cost of Equity:** The cost of equity is figured by utilizing the Capital Asset Pricing Model (CAPM). The CAPM was presented by Jack Treynor in 1961, William Sharpe (1964), John Lintner (1965) and Jan Mossin (1966) autonomously, expanding on the prior work. This model decides the proper required rate of return of an advantage. The model considers the benefit's affectability to non-diversifiable hazard (otherwise called methodical hazard or market chance), frequently spoke to by the amount beta (β) in the money related industry, and additionally the normal return of the market and the normal return of a hypothetical hazard free resource.
2. $\boldsymbol{Cost\ of\ Equity\ (K_e) = R_f + \beta\ (R_m - R_f)}$

   Where

   $R_f = Riskfreerateofreturn$

   $\beta = Betavalue$

   (Beta is estimated yearly basis of the company performance. Beta is calculated each year individually)

   $R_m = Marketreturn$

   (Market return calculated on the basis of BSE SENSEX weekly returns. The Average of 16 years return was considered as the market return for this study.

3. **Cost of Debt**

   Organizations acquire reserves from outside from money related foundations or different assets the premium paid on that sum are called cost of obligation.

$$Cost\ of\ Debt = \frac{InterestExpended}{Total\ Debt}$$

4. **Cost of Preference Shares**

   Cost of inclination share capital sum which is payable to inclination investors as profit with settled rate.

$$Cost\ of\ Preference\ Share = \frac{Preference\ Dividend}{Preference\ Share\ Capital}$$

5. **Cost of Reserves & Surplus**

   Cost of reserves & Surplus amount which is charge on the company Reserves and Surplus value.

$$Cost\ of\ Reserves = Cost\ of\ Equity\ (1 - T)$$

IV. Results Discussion

Economic Value Added (EVA)

S.No	Company Name	Mar'2013	Mar'2012	Mar'2011	Mar'2010	Mar'2009
1	Housing Development Finance Corporation	-69%	-68%	-65%	-65%	-76%
2	Cipla	148%	139%	121%	478%	193%
3	Bharat Heavy Electricals	128%	436%	272%	244%	191%
4	State Bank Of India	-100%	-83.36%	-85%	-83%	-81%
5	HDFC Bank	-70%	-68%	-66%	-68%	-78%
6	Hero Motocorp	426%	571%	796%	1150%	365%
7	Infosys	223%	258%	260%	450%	435%
8	Oil and Natural Gas Corporation	94%	182%	380%	-16%	14%
9	Reliance Industries	16%	10%	63%	56%	28%
10	Tata Power	-38%	-30%	-33%	-31%	-53%
11	Hindalco Industries	-51%	-38%	-35%	-58%	-28%
12	Tata Steel	-18%	-10%	14%	-37%	23%
13	Larsen & Toubro	22%	61%	41%	5%	55%
14	Mahindra & Mahindra	158%	142%	164%	154%	54%
15	Tata Motors	-77%	-43%	-42%	-51%	-49%
16	Hindustan Unilever	1909%	1013%	1041%	2387%	1419%
17	ITC	372%	324%	229%	749%	254%
18	Sterlite Industries	-33%	-63%	-54%	-25%	-35%
19	Wipro	159%	94%	112%	338%	230%
20	Sun Pharmaceutical	8%	265%	-457%	387%	339%
21	GAIL	87%	130%	213%	264%	116%
22	ICICI Bank	-74%	-77%	-77%	-79%	-84%
23	Jindal Steel & Power	-18%	40%	103%	42%	111%
24	BhartiAirtel	-11%	16%	136%	122%	269%
25	Maruti Suzuki	40%	46%	108%	218%	70%
26	Tata Consultancy Services	498%	459%	425%	11268%	499%

27	NTPC	33%	20%	7%	29%	23%
28	DLF	-84%	-65%	-60%	-72%	-25%
29	Bajaj Auto	424%	505%	341%	753%	-
30	Coal India	7%	4%	-	-	-

The analysis results of EVA shows out of 146 samples 35% shown negative Eva value the remaining 65% samples had a positive EVA.

• 30% of the companies have not achieved the EVA benchmark since last five years.

• 56.67% companies performing well in the last five years and these companies have achieved the EVA benchmark since last five years.

• 13.33% company's performance is also good but these companies have not achieved EVA benchmark in one year since last five years.

• Among all banking sector companies SBI, HDFC and ICICI were not achieving the benchmark of the EVA. These companies had a negative EVA.

• In the Automotive industry except for Tata Motor Company all other companies Hero Moto Corp, Mahindra & Mahindra, Maruthi Suzuki and Bajaj Auto companies had positive EVA. Tata motor company not achieved EVA benchmark since last five years.

• The Conglomerate industry represented companies Larsen & Toubro and ITC had positive EVA.

• The Consumer finance Industry Company Housing Development Finance Corporation had negative EVA.

• The company related to Electrical equipment industry Bharat Heavy Electricals had positive EVA.

• Infosys, Wipro and Tata Consultancy Service companies which belong to Information technology had positive EVA.

• The Metal and Mining industry companies Hindalco Industries and Sterlite Industries had shown negative EVA whereas the Coal India Company had positive EVA.

• The Oil and Gas companies ONGC, Gail and Reliance industries had positive EVA. Except in one year where ONGC had shown negative EVA in the year 2009-10.

• The pharmaceutical companies Cipla had positive EVA; the sun pharma company also has positive EVA except one the year 2010-11.

• The Power industry companies Tata power and NTPC had a completely a different situation. The Tata power company had

negative EVA whereas NTPC had positive EVA for all five-years.

• The only one company which represent the Real estate industry that is DLF is showing a negative EVA.

• The Steel industry companies had mixed results, Tata steel company had a positive EVA in the year 2008-09 and 2010-11 remaining years 2009-10, 2011-12 and 2012-13 years and it had a negative EVA. The Jindal Steel and Power Company had a positive EVA except in the year 2012-13.

• The BharathiAirtel Company which represents the Telecommunication industry had a positive EVA except in the year 2012-13.

V. Conclusion

To overcome the problems of financial performance measure benchmark, Joel Stern introduced a modified concept of economic profit named "Economic Value Added (EVA)". By using this method this study focused on to know whether all Bombay Stock Exchange index (SENSEX) listed 30 companies are really providing wealth to the shareholder or not. To test this following hypothesis has been framed: The entire Bombay Stock Exchange index (SENSEX) listed companies are having the positive Economic Value Added (EVA). Based on the analysis results 56.67% of companies are getting a positive EVA since last five years, 13.33% companies have not achieved EVA benchmark in one year since last five years. 30% of companies have not achieved the EVA benchmark since last five years. The hypothesis of this study may not be accepted in this situation. Out of 30 companies, 9 companies have not reached the EVA benchmark. In this situation, the alternative hypothesis is accepted. All BSE index companies are not having positive EVA.

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