

## Role of Economic Value Addition (EVA) in Financing Pattern of Tata Consultancy Services Limited

**Mukesh Kumar Jain\***

Department of Commerce, M.M.H.College, Ghaziabad 201001 (U.P.) India  
Email: mkj.1962@gmail.com

### Abstract

The present study surveys TCS Ltd. to find out about its corporate finance practices vis-a-vis capital budgeting decisions, cost of capital, capital structure, and dividend policy decisions. It analyses the responses by the firm characteristics like profitability, leverage, and P/E ratio. The analysis reveals that practitioners do use the basic corporate finance tools that the professional institutes and business schools have taught for years to a great extent. The present study reveals that various financial tools used for Management Decision Making are playing important role and are very much upto mark. The results seem to suggest that if the firm does not have specific capital structure in mind when deciding as to how best to finance its projects where in case of the company it has always been kept in mind.

**Key Words:** EVA, Financing Pattern and TCS.

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## 1. INTRODUCTION

The word "corporation" derives from corpus, the Latin word for body, or a "body of people." Entities which carried on business and were the subjects of legal rights were found in ancient Rome, and the Maurya Empire in ancient India.

While corporate finance, on the other hand, is the field of finance dealing with financial decisions which the business enterprises make and is primarily concerned with the tools to make these decisions. The primary goal of corporate finance is to maximize corporate value while managing the firm's financial risks. Although it is in principle different from managerial finance which studies the financial decisions of all firms, rather than corporations alone, the main concepts in the study of corporate finance are applicable to the financial problems of all kinds of firms.

Financing pattern sets the trend and prospects for the joint development of any economy and companies working under it. Recently it has seen that there has been an unprecedented depression in the market prices of the securities and consequently prospective investors from within the country and outside have become panicky. This has brought in an atmosphere of uncertainty in the capital market. This tendency has also given rise to speculation in the share market. On account of globalization and liberalization, newer avenues of fund raising have emerged. The availability of funds has taken a quantum jump and the cost of funds has also substantially reduced. All these factors motivate us to study the present financial climate of the country and trends followed by the companies while accessing the finance from it for their different needs in different phase.

This Study primarily focuses on the importance of the capital structure financing decisions which may lay down the foundation of a good financial health. This can serve various purposes from saving the company against the financial threats from competitors to be able to remain profitable in long run.

**Company Profile:** Tata Consultancy Services is an IT services, consulting and business solutions organization that delivers real results to global business, ensuring a level of certainty no other firm can match. TCS offers a consulting-led, integrated portfolio of IT, BPS, infrastructure, engineering and assurance services. This is delivered through its unique Global Network Delivery Model™, recognised as the benchmark of excellence in software development. TCS' customer-centricity, deep domain expertise, agility in building new capabilities, and focus on constant innovation and IP development, and execution excellence has resulted in enduring customer relationships. A part of the Tata group, India's largest industrial conglomerate, with over 387,000 employees in 55 countries, and a global delivery footprint that covers over 141 solution centers across 19 countries, TCS is among the world's top 10 IT service providers. The Company's compounded annual growth rate (CAGR) since FY 05 is 21.6%, with industry-leading operating margins. Founded in 1968 as part of the Tata group, TCS is headquartered in Mumbai, India. The company generated consolidated PAT of INR 30065 cr. for year ended March 31, 2019 and is listed on the National Stock Exchange and Bombay Stock Exchange in India.

## 2. REVIEW OF LITERATURE

**Altaf (2016)** has tested empirically the claim made by Stern Stewart & Company that economic value added is a better metric than traditional earning based measures in explaining market value. For better exposition, a sample of 325 Indian firms has been divided into two parts - 170 firms

belonging to Indian manufacturing companies and 155 companies belonging to the Indian service sector. After performing univariate and multivariate regression analyses, the results of the study reveal that the operating income has a strong linkage with market value added in both manufacturing and service sectors. For both the sectors, the economic value added shows weaker but positive relationship with the market value added.

**Barbullushi, E. (2015)** aimed to create a framework about the way how can be Economic Value Added estimated in Albanian Banking System context. In this paper author has analyzed the EVA philosophy with the restrictions met during its implementation. At the end of the evaluation process it was presented that to have a better understanding of the financial strength of the banks we cannot rely only on financial ratios. For most of the banks even when they reported profits, their economic value added was negative. This may lead to another point of view of bank financial performance evaluation in two directions from shareholders as it is usually used but also in bank supervision context. So the theories adopted in this paper and EVA calculations can serve in a future research in evaluating the efficiency of commercial banks.

**Gor (2010)** has examined 41 cases of domestic mergers in India during the period between 1999-2009 to ascertain whether post merger Economic Value Addition (EVA) improved or not when compared with pre merger EVA of both target and acquiring companies' EVA put together. In 27 cases out of 41 mergers examined, (forming 66 %) it was found that EVA improved whereas in 14 cases forming 34 %, post merger EVA did not improve. It was found that there was no statistically significant correlation between efficiency ratios and improvement of EVA. However, there was substantial evidence that growth in EVA was strongly associated with growth in net sales and growth in total assets.

**Khaddafi, M. & Heikal, M. (2014)** studied and analyzed financial performance using economic value added of industrial consumption enterprises in the Indonesia Stock Exchange. The samples used in this study was the financial statements of industrial consumption company in the Indonesia Stock Exchange. The results found that the company's financial performance as measured by using economic value added in manufacturing industries the average consumption is negative. Ades Waters Indonesia Tbk that have a value of positive EVA. Meaning thereby it indicates the cost of capital is greater than the operating profit after tax, so the company's financial performance is not good because they cannot maximize shareholder wealth.

**Paulina & Kenneth (2013)** have studied population consisted of both incubates and graduate incubates of Leather Development Centre at the Kenya Industrial Research and Development Institute. The findings show that the industry is characterised by low capacity building, and unskilled employees take long to upgrade their skills on the job. The industry uses old technology, does not practice expeditious machine upgrade; and repairs and maintenance are quite slow. Further, the industry is inadequately financed, and quality is compromised because of unavailability of affordable inputs. The study recommends that in order to increase value addition, manufacturers need to invest resources in upgrading their human capital and technology. The different players in the industry should also analyse weaknesses in the present national policy framework, and address the loopholes that exist.

**Salaga Jakub and et. el. (2015)** explained value-based concept of measuring business performance has its theoretical basis in economic profit. The idea of economic profit is based on

the existence of opportunity costs that are very well known in the economic theory. The article deals with measurement of the economic profit by the Economic Value Added indicator. It points out that while considering the economic profit and its measurement one must first distinguish the theoretical basis of the concept, forms of application and possibilities of application in practice. The gathered data and the transformation of this data from the form provided by the accounting into the desired patterns, respectively into the structures of Economic Value Added plays a key role in these processes. The aim of this paper is to present one of the possible methods of calculating the EVA indicator in conditions of Slovak companies and accounting legislation in Slovakia. Primary data as well as secondary data were used for the purpose of this paper, along with various methods such as analysis, synthesis, deduction, etc.

**Shivaraj & Kanahalli (2013)** have examined the global economic meltdown that affected the world economy in general and corporate world in particular. The corporate world had experienced the pressure of economic meltdown in the form of fall in business volume and profitability. There is lot of pressure on corporate world to create value for shareholders. This has forced them to relook into their corporate strategies especially in the area of cost management. Now, the corporate companies around the world and in India are developing cost management strategies to reduce cost, optimize cost and increase value for shareholders. Not much work has been done abroad focusing on value creation through cost optimization. No work had been in India on this area. This has encouraged the researcher to take up the present study. Consumer product sector was selected for the purpose of study. Five market leaders in the consumer product sector were selected for the study. Cost and financial data for the period of 2008 to 2012 was collected from annual reports and other records of the companies.

**Theuri & et. el, (2014)**, explained that the seafood sector contributes significantly to many coastal economies in generating income, employment, and foreign exchange earnings to the fishing communities, fish traders, fish processors and fish farmers. The sector supports about 80,000 Kenyans directly and about 800,000 indirectly. The sector is one of the key contributors to food security and poverty alleviation in many developing nations. Currently, most fish is handled, processed, transported and stored without proper equipment, which means low hygienic standards, unhealthy food products that cannot easily access the outside market. The study identified, strategic planning activities and processes, technological competitiveness, level of market competition and corporate policies as key determinants. Information gathered and the recommendations thereof will help to create a more complete and efficient chain.

### **3. THE OBJECTIVES OF THE STUDY**

The paper has been prepared with the following objectives :

1. To throw light on the importance of EVA used for Management Decision Making of TCS Ltd.
2. To examine the Relative Importance of EVA in the financing pattern followed for the Projects in TCS Ltd.

### **4. RESEARCH HYPOTHESES**

As the study is entirely based on the secondary sources of information. The following hypotheses may be formulated:

1. There is no significant role of EVA in the Management Decision Making; and

2. EVA has insignificant importance in the financing pattern followed for the Projects in TCS Ltd.

**5. RESEARCH METHODOLOGY**

**Research Design:** The proposed study in descriptive – cum exploratory in nature.

**Sources of data:** Both primary and secondary data has been used in the present study for the purpose of analysis. Primary data has been collected with the help of questionnaire among the employees of TCS. Secondary data has been collected from the annual Reports of TCS Ltd. As well as publication of various associations connected with business and industry, banks, stock exchanges etc. Sample size is 40 executives of TCS Ltd. Gurgram (Haryana)

**Analysis of Data:** MS Excel 2010

**Interpretation of Data:** Response on Relative Importance of Various Financial Tools used for Management Decision Making

**Table 1(a)**

Management Objectives	Rating in %	Mean Scoring	ROCE		EVA		WACC	
			Low	High	Low	High	Low	High
To maximize EBIT/EPS	85.10%	4.48	4.5	4.45	4.43	4.53	4.49	4.46
To maximize the spread between ROI and WACC (EVA)	75.90%	3.99	3.87	4.1	4.11	3.88	3.87	4.1
To maximize the spread between CFROI and WACC (CVA)	54.40%	3.32	3.28	3.36	3.44	3.2	3.26	3.37
To maximize Market Value Added (MVA) of the firm	53.80%	3.33	3.43	3.23	3.63	3.03	3.23	3.41
To reduce the side costs in form of conflicts amongst various shareholders	33.00%	2.39	2.23	2.55	2.38	2.4	2.33	2.45

Source: Compiled from Primary Data

**Table 1(b)**

Management Objectives	Rating in %	Mean Scoring	P/E Max.		P/E Min.		CA	
			Low	High	Low	High	No	Yes
To maximize EBIT/EPS	85.10%	4.48	4.47	4.46	4.53	4.41	4.25	4.55
To maximize the spread between ROI and WACC (EVA)	75.90%	3.99	3.57	4.35	3.71	4.22	3.71	4.09
To maximize the spread between CFROI and WACC (CVA)	54.40%	3.32	3.11	3.49	3.06	3.54	3.15	3.37
To maximize Market Value Added (MVA) of the firm	53.80%	3.33	3.14	3.41	3.08	3.46	3.5	3.27
To reduce the side costs in form of conflicts amongst various shareholders	33.00%	2.39	2.19	2.78	2.26	2.7	2.1	2.49

Source: Compiled from Primary Data



The respondents were asked to indicate the relative importance of different objectives of management decision-making in corporate finance in their organization. While 85.10% weightage was given to the objective to maximize earnings before interest and tax (EBIT) and earnings per share (EPS) as very important/important, 75.90% weightage was given to the objective to maximize the spread between return on assets (ROA) and WACC, i.e., EVA objective as very important / important, 54.40% weightage was given to the objective of maximizing the spread between CFROI (Cash Flow Return on Investment) and WACC (CVA), 53.80% weightage was given to the objective of maximizing Market Value Added (MVA) of the firm and surprisingly only 33.00% weightage was given to the objective of reducing the side costs in form of conflicts amongst various shareholders.

**Response on Relative Importance of the following Project Choice Criteria of TCS Ltd.**

**Table 2(a)**

Management Objectives	Rating in %	Mean Score	ROCE		EVA		WACC	
			Low	High	Low	High	Low	High
Payback Period	67.50%	3.79	3.83	3.75	3.73	3.85	3.90	3.68
Accounting Rate of Return	34.60%	2.62	3.05	2.20	2.92	2.33	2.66	2.58
Net Present Value Method (NPV)	66.30%	3.73	3.51	3.93	3.85	3.61	3.85	3.61
Internal Rate of Return (IRR)	85.00%	4.36	4.43	4.30	4.60	4.51	4.18	4.54
Profitability Index (PI)	35.10%	2.51	2.83	2.23	2.74	2.31	2.49	2.54
Break-even Analysis	58.20%	3.58	3.72	3.45	3.77	3.40	3.51	3.65

Source: Compiled from Primary Data

**Table 2(b)**

Management Objectives	Rating in %	Mean Score	P/E Max.		P/E Min		CA	
			Low	High	Low	High	No	Yes
Payback Period	67.50%	3.79	3.75	3.81	3.78	3.78	3.45	3.90
Accounting Rate of Return	34.60%	2.62	2.80	2.35	2.77	2.38	2.55	2.64
Net Present Value Method (NPV)	66.30%	3.73	3.59	3.70	3.65	3.65	4.14	3.58
Internal Rate of Return (IRR)	85.00%	4.36	4.08	4.57	4.19	4.46	4.20	4.42
Profitability Index (PI)	35.10%	2.51	2.45	2.34	2.39	2.40	2.20	2.63
Break-even Analysis	58.20%	3.58	3.69	3.43	3.89	3.24	3.55	3.59

Source: Compiled from Primary Data

Table 2 (a) and (b) investigates the tools used for capital budgeting decisions. The firm use DCF methodology for capital budgeting decisions today more than in the previous times. It uses multiple criteria in their project choice decisions. More weightage is given to IRR and NPV as its most frequently used capital budgeting techniques. 85% weight is given to IRR as a very important project choice criterion (mean score 4.36). About 65% weight to use NPV (mean score 3.73). The payback period method is also popular (67.5%) whereas, A.R.R., B.E.P. and P.I. are given less importance in comparison.

**Response on the Financing Pattern Followed for the Projects in the Company**

**Table 3 (a)**

Management Objectives	Rating in %	Mean Score	ROCE		EVA		WACC	
			Low	High	Low	High	Low	High
Loans from Financial Institutions	59.00%	3.31	3.61	3.03	3.73	2.93	3.10	3.51
Bonds Issue in the Primary Market	12.80%	1.49	1.74	1.25	2.03	0.97	1.34	1.63
Private Placement of Debt	32.90%	2.34	2.62	2.08	2.89	1.79	2.60	2.06
Hybrid Securities (FCDs/PCDs)	12.20%	1.28	1.43	1.14	1.51	1.06	1.24	1.32
Retained Earnings	89.90%	4.52	4.23	4.80	4.24	4.78	4.43	4.62
Issue of Preference Capital	15.00%	1.30	1.51	1.08	1.53	1.08	1.39	1.20
Issue of Equity Capital	16.90%	1.40	1.69	1.11	1.58	1.23	1.50	1.31

Source: Compiled from Primary Data

**Table 3 (b)**

Management Objectives	Rating in %	Mean Score	P/E Max.		P/E Min		CA	
			Low	High	Low	High	No	Yes
Loans from Financial Institutions	59.00%	3.31	3.60	3.11	3.74	2.97	2.80	3.48
Bonds Issue in the Primary Market	12.80%	1.49	1.94	1.00	2.16	0.82	1.22	1.58
Private Placement of Debt	32.90%	2.34	2.59	2.03	2.82	1.80	1.89	2.49
Hybrid Securities (FCDs/PCDs)	12.20%	1.28	1.55	1.55	1.64	1.14	1.35	1.26
Retained Earnings	89.90%	4.52	4.64	4.64	4.58	4.56	4.75	4.44
Issue of Preference Capital	15.00%	1.30	1.50	1.50	1.78	0.97	1.37	1.28
Issue of Equity Capital	16.90%	1.40	1.24	1.24	1.47	1.31	1.40	1.40

Source: Compiled from Primary Data

To find out whether managers in the company behave as predicted by the pecking-order theory of capital structure, the respondents were asked to indicate their sources of financing choices and rank them in order of their relative importance in terms of its use. The options given to them are retained earnings, debt, and equity funds. The results in Table 3 (a) and (b) indicate that retained earnings are the most favored source of finance. Nearly 89% weightage is given to retained earnings as very important source of finance. There is a significant difference in the use of internally generated funds by the firm (based on ROCE and EVA). Equity capital as a source of finance is not preferred by the company (mean score is 1.40). Only 16.9% weightage is given to it as most preferred source of finance. There is no significant difference in the use of equity capital in the company, classified on the basis of profitability, risk and growth.

**6. CONCLUSION**

The results of the present survey are consistent with the theory and simultaneously revealing too. The shareholder value maximization objective is widely used by corporate India now than before. The growth of the firm has substantial emphasis on the EVA maximization objective. On the other hand, the objective to reduce side costs in the form of conflicts amongst the various stakeholders of the firm is not very popular. It is reassuring that NPV is widely used now as a capital budgeting technique than it was ten or 20 years ago. The IRR method remains very popular despite its limitations. The firms use multiple criteria in their project choice decisions. The CAPM is also in use now to estimate the cost of equity capital. The present study's analysis of capital



structure finds that the retained earnings is the most preferred source of finance followed by debt and then equity. The results seem to suggest that firm do not have specific capital structure in mind when deciding as to how best to finance its projects.

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