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Comparative Study of Economic Value Added Of Selected Oil and Gas Companies in India

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ABSTRACT: The performance measure, Economic Value Added (EVA) is being increasingly adopted by more and more firms and is beginning to appear in the mainstream finance textbooks. Despite such acceptance, not much empirical work has been done on the relationship between EVA and Market Value Added (MVA). This study empirically tests the strength of the relationship between EVA and MVA in Indian Automobile Companies for the period between 2001 and 2005. The results indicate that there is strong evidence to support Stern-Stewart's claim that EVA is superior to the traditional performance measures, and it is the best internal measure of corporate success in adding value to shareholders' investments.

The prime concern of any business study is to evaluate the corporate performance, which can be expressed in different terms like efficiency, profitability, productivity, growth, competition, market share, long-run survival etc. It is needless to mention that corporate success plays a major role in the economic development of any country. Since the early period, though corporate performances were used to be counted in different dimensions, in the present day world, however, such dimensions of performances have got more prominence. Apart from the financial performance, now-a-days, corporate give equal emphasis on measuring their environmental performance, social performance, sustainable performance etc. The interesting point is to note here that in the domain of social science the performance, like the other phenomenon such as satisfaction, value, perception etc., is difficult to define as well as to measure. Performance measurement is actually a diverse subject by its nature. Researchers with different functional backgrounds such as accounting, marketing, finance, economics, psychology and sociology are all actively working in the field and trying to explore the subject. They are developing new performance parameters on a continuous basis with the help of which performances of an organization can better be estimated.

I. INTRODUCTION

The measurement of corporate financial performance in terms of traditional accounting based metrics, have been often viewed as inadequate, especially when firms begin to focus on shareholder value as the primary long-term objective of the organization. The traditional metrics actually fail to take into account the factors that drive shareholder value. Value based measures have, therefore, been created which explicitly acknowledge that both equity and debt have costs, suggesting the incorporation of the financing risk-return into performance calculations. Value based management system thus requires the value based performance metrics as traditional accounting measures are unsuitable for capturing shareholder value creation. More specifically, net earnings, earning per share (EPS), return on investment (ROI) can be manipulated and cannot reconcile to the market value of the firm. But the value based measures such as, economic value added (EVA), shareholder value added (SVA), market value added (MVA), economic profit (EP) etc. follow the valuation theory and can also capture shareholders value more accurately.[1]

"The Real key to Creating Wealth" has pointed out that EVA outperforms the accounting-based traditional measures as well as the other value-based measures on the following grounds:

- a) EVA is the corporate performance measure that is tied most directly, both theoretically and empirically, to the creation of shareholder wealth.
- b) EVA is the only performance measure that always gives the right answer on creation of shareholder wealth.
- c) EVA is a framework to the corporate financial managers that guides every decision, from operating budgeting to capital budgeting, strategic planning, mergers and acquisitions, and divestitures.
- d) EVA is a framework that a company can use to communicate their goals and achievements to investors.
- e) EVA is a key variable which is unique in incentive compensation system that truly aligns the interests of managers with those of shareholders and causes managers to think like and act like owners.
- f) EVA fosters an internal system of corporate governance that motivates all managers and employees to work co-operatively and enthusiastically to achieve the very best performance possible.
- g) EVA is the superior in the framework of comprehensive financial management system because the EVA measure itself contains enormous analytical power, and explains more about the dynamics of business than any other performance measures.[2,3]



III. DISCUSSION

Comparison of Oil Marketing Companies Shares

Bharat Petroleum Corporation Limited (BPCL)

- It has headquarters in Mumbai, Maharashtra and incorporated in 1952.
- The corporation operates two large refineries of the country located in Mumbai and Kochi.
- It is second largest oil marketing company in India with a market share of 22% in domestic sales volume.
- Also , it is the third largest in terms of refining capacity in India (15.33% of India’s refining capacity).[4]

Hindustan Petroleum Corporation Limited (HPCL)

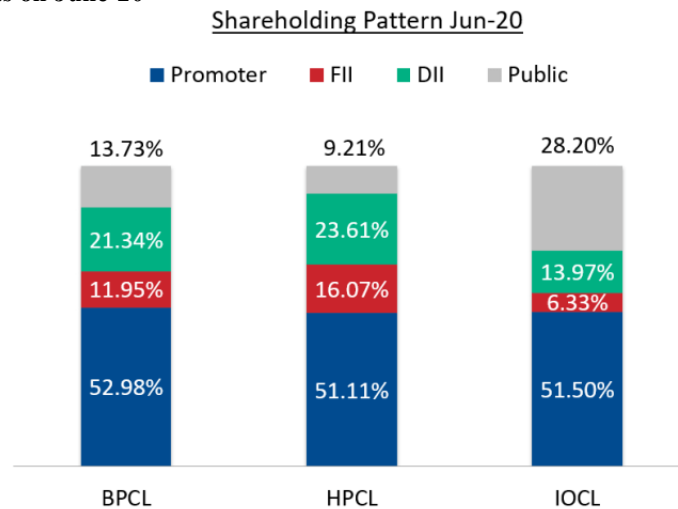
- HPCL is an Indian oil and natural gas company incorporated in 1952 as Standard Vacuum Refining Company.
- It has its headquarters in Mumbai and was renamed as ESSO India later. HPCL is basically merger of ESSO India and Lube India in 1974.
- It has about 25% market-share in India among public-sector companies and a strong marketing infrastructure. It has second largest market share in product pipelines in India.

Indian Oil Corporation Limited (IOCL)

- IOCL , incorporated in 1959 and it is an Indian state-owned oil and gas company .
 - It is the largest commercial oil company in the country with market share of 32% in domestic refining capacity.
 - IOCL Market shares – 51% in Crude & Product Pipeline , 42% in Petroleum and oil lubricants.
- All these companies are Government of India controlled “Maharatna Companies” and are engaged in refining of crude oil & marketing of petroleum products.

Let’s have a look at the comparative analysis of these companies on following parameters.[5,6]

1. Shareholding Pattern as on June’20



Shareholding Pattern of Oil Marketing companies as on June’20

- As it is evident from the share holding pattern, retailers favor Indian Oil Company Limited (IOCL).
- Currently, Government of India is interested in selling its entire stake in BPCL and it will trade on exchange as a private entity.



2. Market Valuation

Comparative Analysis			
Parameters	BPCL	HPCL	IOCL
1. Market Cap (Rs. Cr)	89,568	32,190	83,127
2. Current PE Ratio	18.75	6.42	9.34
3. Promoter Holding	52.98%	51.11%	51.5%
4. Promoter	Gov. of India	ONGC Ltd	Gov. of India
5. Historical Median PE	13.1	9.02	10.1

Oil Marketing companies Market Valuation

- As we can see, BPCL’s market cap and PE have increased mainly as Government of India is looking forward to divest its stake in BPCL.
- This is evident from the company’s historical median PE, as the current PE is ~40% higher than the historical median PE.

3. Ratio Analysis

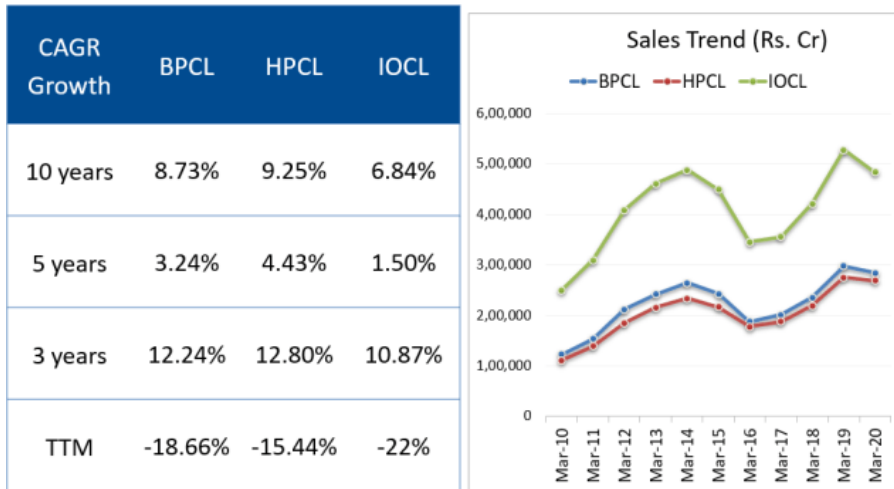
Ratio Analysis			
Parameters	BPCL	HPCL	IOCL
1. ROCE %	8.34%	5.45%	4.97%
2. ROE %	11.53%	11.59%	9.80%
3. Debt to Equity	1.69	1.27	1.32
4. Interest Coverage Ratio	3.05	4.35	1.30
5. Dividend Yield %	4.00%	4.62%	4.80%

Oil Marketing Companies Ratio Analysis

- Oil refining is a very capital intensive sector, hence it is important to look at return ratios like RoCE and RoE.
- As seen, BPCL has better return ratios (RoCE and RoE) as compared to its peers and hence justifies its premium valuation to certain extent.
- All the three companies have higher debt to equity ratios because of the capital intensive nature of the sector.
- However, BPCL and HPCL look good in terms of interest coverage ratio. Usually interest coverage ratio above 2.5 x is preferable.
- Being PSU companies, dividend yield is better as compared to private companies.[7]



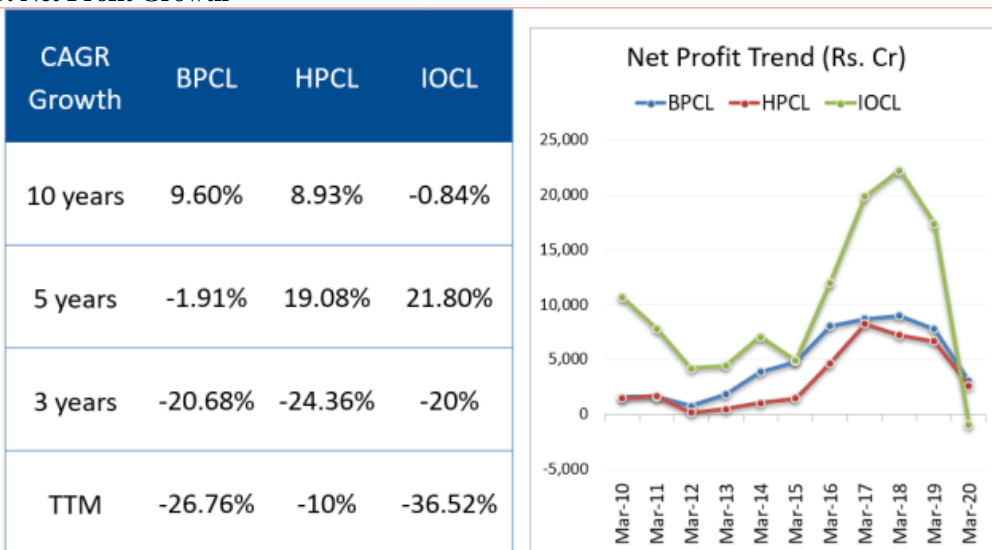
4. Sales Growth



Oil Marketing Companies Sales growth

- Overall the sales growth of companies is flat over the years (3,5 and 10). Also , the revenues were hit badly in this year due to COVID-19 pandemic.
- One of the reasons for muted growth can be changing consumer preferences for alternate energy resources as compared to conventional sources. Also the increasing traction of electronic vehicles will augur this shift in changing preferences.

5. Net Profit Growth

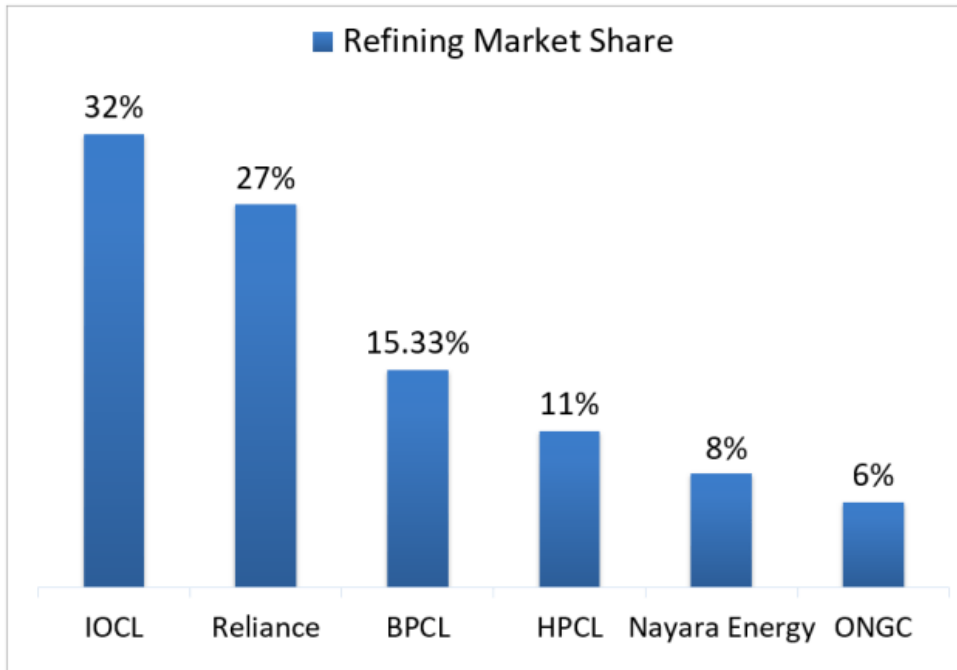


Oil Marketing Companies Net Profit growth

- On profitability front, all three companies have muted profit growth at least for 3 year period and on TTM basis.
- There are many profitability challenges mainly due to the government intervention in pricing and taxes charged.[8]

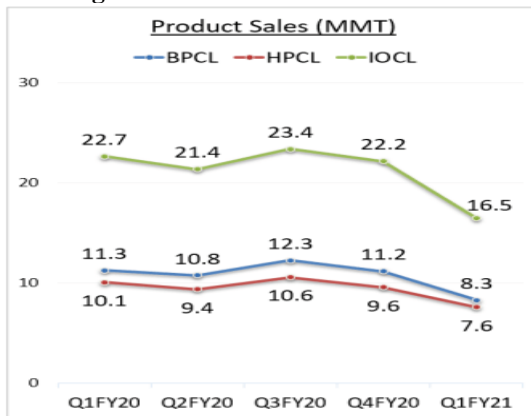


6. Refining Market Share (FY20)



Oil Marketing

Companies Refining Market Share



The decline in Product Sales in Q1FY21 from Q4FY20 is in line with the fall in the Refining Throughputs of the companies

Comparing QoQ Decline Q4FY20 to Q1FY21	Decline in Refining Throughput	Decline in Product Sales
BPCL	8.4 to 5.1	11.2 to 8.3
HPCL	4.5 to 4.0	9.6 to 7.6
IOCL	17.1 to 12.9	22.2 to 16.5

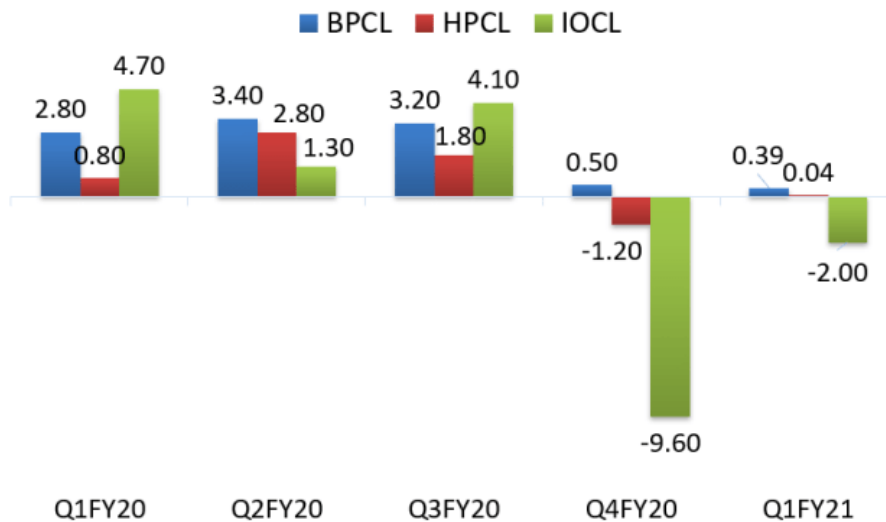
Here, IOCL is the leader in refining followed by Reliance Industries.

7. Product Sales (MMT)

Oil Marketing Companies Product Sales (MMT)

- There is a decline in product sales in this quarter, however before this quarter there was some growth in product sales.

8. Gross Refining Margins (GRM) (US\$/bbl)



Oil Marketing Companies Gross Refining Margins (US\$ / bbl)

- Gross Refining margin is (Value of Output Petroleum Products from oil refinery – Price of Raw Material i.e. Crude Oil). It is calculated on per barrel basis.
- As seen, for the last 2 quarters, the margins are very low mainly because of the pandemic.
- However ,till Q3FY20, all companies had stable margins in the range of 0.8% – 4.7%.
- Gross Refining Margins are dependent on two factors majorly – Value of final output products and value of losses of fuel.
- Thus, if the refinery produces high value products and has less spillage/ wastage, its GRM is higher.[9]

IV. CONCLUSION

Performance measurement is the current corporate standard in recent years used to measure shareholder’s wealth. Traditional financial performance measures are based upon the companies’ profitability and ratios only, but for driving shareholder value these methods were not found suitable while EVA has revealed its reign on these traditional measures. Some other researchers have disproved the claim of EVA by supplying data in support of company’s profitability and leverage based traditional accounting indicators such as NOPAT, Capital Employed and Weighted Average Cost of Capital.

EVA is now recognized as an important tool of performance measurement and management all over the world, particularly in advance economies by adopting it as corporate strategy. Still there are mixed evidences about the superiority of EVA over traditional performance measurement tools . India specific evidences are also not clear when EVA is compared with profit or leverage of companies’ metrics. With the above analysis Although the traditional financial performance measures have significant correlation with other variables of profit or leverage but the attributes configuring modern financial performance measures (EVA) have not influenced by dependent variables of profitability or leverage in selected companies.[10]

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