

ECONOMIC VALUE ADDED ANALYSIS OF YES BANK

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ABSTRACT

The primary goal of financial management is to maximize the shareholder's wealth. The shareholder's/ Investors wealth is measured by returns they receive on their investment. The banks that are able to increase their shareholder's/ Investors wealth are witnessing consistent improvements in their return from stocks. EVA is a tool that focuses on maximizing shareholder wealth. Different studies reveal that banks in India are not earning positive EVA & investors /shareholder's wealth is being destroyed. This means that the banks return on equity is less the cost of equity. As over the years the capital adequacy norms become more stringent, the banks are increasingly relying on the capital markets to meet their capital adequacy requirements, it is important that they pay adequate attention to earning a positive EVA. Inadequate return on the capital employed by the banks would make it difficult for them to access the capital markets to expand their capital base, which could lead to lower growth in loans and advances, causing a slowdown in the general economic activity.

In this paper the author measures the financial performance of Yes bank using EVA benchmark. Yes bank is one of the established mid-sized bank in India & has grown to a great extent over the years. To attain this objective ,in the study EVA is calculated for the bank from April 2009 to March 2014(5 years) .The results of the study reveals that Yes bank has been creating positive EVA values & value addition for its shareholders for all the years except 2009-10 & 2013-14.

Keywords: Economic value Added, Yes bank, Shareholder's wealth, financial performance, Value addition.

Introduction

Shareholders are the residual owners of banks & expect the bank's management to return value in excess of the cost of capital & risk undertaken by them. Economic Value Addition (EVA) is a term developed and used by a US based consulting firm named Stern Stewart & Co.

EVA is a tool to measure the extent to which banks are Successful in achieving the objective of enhancing shareholders' wealth at the end of a particular year .A bank creates shareholders value only if returns generated are more than cost of capital leading to positive Economic Value Addition (EVA) for bank. In case of negative EVA, the bank destroys the shareholders value, then shareholders are going to withdraw their funds leading to decline in the value of bank's share prices. EVA is a useful tool to analyze the financial performance of banks.

Objective of the study

The specific objective of this study is:

- 1) To analyze the performance of YES bank on Economic value addition parameter for a period of Five years 2009-10, 2010- 11,2011-12, 2012-13 & 2013-14.
- 2) To analyze the results.

Literature Review

The concept of Economic Value Addition has received considerable attention in the recent literature. **R.Satish & Dr.S.S.Rao** in their paper highlighted the awareness and applicability of Economic Value Addition in Indian Banks on the basis of survey report & concluded that Economic Value Addition is slowly gaining an increased attention as a financial measure of business performance of banks. **Jagdish R.Raiyani & Nilesh K.Joshi** studied the bank's profile to demonstrate direct correlation between the investment in stakeholders relationships & corporate performance. The study evaluated the SBI bank & HDFC bank financial performance using Economic value addition for a time period 2005-06 to 2007-08. **Gabriela Popa, Laurentiu Mihailescu & Codin Caragea** in their study introduced the concept of EVA and its advantages compared to other performance indicators. The study concluded the EVA is a superior measure of bank performance than other performance indicators, as they do not consider

the cost of equity capital employed & do not suggest whether the bank is diminishing or creating value to its shareholders. **Mohammad Saleh Jahur & Al Nahian Riyadh** aimed at analyzing banks' performance through EVA. For calculation of EVA assumptions to the cost of equity and operational profit adjustments were undertaken. The study concluded that rank correlation coefficient between EVA and different criteria like Return on Asset, Net Profit, Profit per Employee and Deposit per Employee have close resemblances to the ranking under EVA & ranking for Interest Income and Spread does not match with the ranking under EVA.

About Yes Bank

Since its inception in 2004, Yes bank has fructified into a full service commercial bank that has steadily built Corporate and Institutional banking, Financial Markets, Investment Banking, Corporate Finance, Branch Banking, Business and Transaction banking and Wealth Management business lines across the country. Yes bank has a widespread branch network of over 500 branches across 350 cities, with more than 1050 ATMs and 2 National Operating Centres in Mumbai and Gurgaon. Yes bank, India's fourth largest private sector bank is an outcome of the professional entrepreneurship of its founder, Rana Kapoor. Yes bank is the only bank awarded by the RBI with Greenfield license in the last 17 years, associated with the finest pedigree investors.

Methodology

Economic Value Addition of Yes bank is calculated for a period of Five years (2009-10,2010-11, 2011-12,2012-13 & 2013-14).

The methodology used for calculation of EVA is:

Economic Value Addition (EVA) = (Return on equity –Cost of equity) * economic capital of bank

Return on equity (ROE) measured in percentage

Cost of equity measured in percentage

Economic capital of bank = Shareholders capital + Reserves & Surpluses

The formula used for cost of equity is:

Cost of equity/ Expected Rate of Return of stock(r) = Risk free rate (rf) + Beta(β) (Market risk premium (rm - rf)

β = Covariance (range of % change of equity, range of % change of BSE index)/Variance(range of % change of BSE index)

Risk free rate (rf) – Interest rates of fixed deposits of SBI bank of 1 year has been undertaken

Market risk premium is calculated as difference between expected markets return & risk free rate

Expected market return = geometric mean of percentage return of BSE index.

Table 1 : Calculation of cost of equity

Year	Beta	Expected market	Risk free rate	Expected market risk	Cost of Equity
Apr09-mar10	1.42	53.71%	7.00%	46.71%	73.33
Apr10-mar11	1.23	10.74%	7.25%	3.49%	11.54
Apr11-mar12	1.06	-9.05%	8.00%	-17.05%	-25.59
Apr12-mar13	1.07	8.76%	8.25%	0.51%	8.81
Apr13-mar14	3.95	14.78%	9.00%	5.78%	31.38

The table 1 shows the values of beta, expected market return, risk free rate, expected market risk premium & cost of equity of the bank from the year April 09 to March 2014.

The value of beta of the bank stock/security is more than 1, for all years which indicates that the YES bank security's price movements tends to be more volatile than the market (BSE index) movements & the investors expects more returns from bank's stock than that from the market i.e. BSE index.

The table also indicates that except for the year 2011 -12, the expected market return is positive, which is a good indication of market giving better returns than returns from risk free instruments

& it rewards investor to take risk & invest in market, since Expected market return risk premium is the excess of expected market returns over the risk free rate, that is expected by investor on his investment in market (BSE index) , so the value of Expected market return risk premium is also positive or higher than the return on risk free instruments for all years except for the year 2011 -12.

The expected market return being negative in 2011-12, indicates that the returns from market is low in comparison to return in risk free instruments, which is not a good sign for the economy & such situation may arise due to outbreak of financial crises. It simply implies that investors are withdrawing the money from market and investing in risk free instruments. The index improved after 2011-12, showed positive Expected market returns & market risk premium, leading to positive cost of equity.

Cost of equity is the required rate of return on equity which the investors expect to obtain as return on their equity investment in the bank. For the year 2011-12, the cost of equity is negative due to negative risk premium & implying that the investors do not expect return on their investment in Yes bank shares .The investors will withdraw the money from the shares of Yes bank & invest in those instruments where the returns are more.

The year 2011-12 was the time of global financial crisis, which adversely impacted the Indian market & investors expected negative returns from the market. Since the value of beta is more than 1 during this year for Yes bank, the decline in the bank returns will be more than market returns. So the investors will not prefer to invest in Yes bank shares.

Table 2 : Economic Value Addition (EVA) calculation

Years	Return on equity(a)	Cost of equity (b)	(a-b)spread	Economic capital(in Rs	EVA (in Rs cr)
Apr09-mar10	15.46%	73.33%	-57.87%	3089.55	-1787.92
Apr10-mar11	19.16%	11.54%	7.62%	3794.08	289.11
Apr11-mar12	20.89%	-25.59%	46.48%	4676.6	2173.68

Apr12-mar13	22.39%	8.81%	13.58%	5807.6	788.67
Apr13-mar14	22.60%	31.38%	-8.78%	7121.74	-625.29

The table 2 depicts the calculation of Economic value addition of the bank from the year 2009-2014. Return on equity (ROE) allows the investors to see how much return they can obtain from their equity investment in Yes bank. Cost of equity (COE) refers to the return that is required by investors/shareholders from bank.

Column 2 of the table depicts that return of equity of bank has increased from 15.46% in 2010 to 22.60 % in 2014 ,implying that banks management is able to give good returns to their investors on their invested amounts and able to satisfy their shareholders/ Investors .

Column 4 of the table shows the difference between ROE & COE. For the years 2009-10 & 2013-14 the return on equity is less than cost of equity, indicating that the bank is not able to give returns to their shareholders as per their expectations. The management is not efficient enough to use the shareholders funds & generate profits.

Column 5 of the table shows the calculated EVA using the formula A negative EVA value of the bank for the years 2009-10 & 2013-14, indicates that the bank is not earning sufficient return to reward investors for their risk undertaken. Since COE is more than ROE it leads to negative EVA of Yes Bank for these years. These negative EVA values when multiplied with their respective economic capital results in a large negative EVA values. These Negative values also indicate that for these years the bank is destroying value to the shareholder/investors investment. It also reflects that the bank has been less profitable during these years & the investors could have earned better returns by investing somewhere else.

For all the remaining years the spread between ROE & COE is positive indicating that bank is able to give to its shareholders more returns than their expectations also shows sound financial stability & good profits of the bank for these years . Positive EVA values of the bank indicates that it is earning sufficient returns to reward its investors/ shareholders for the risk they have taken. Positive EVA values indicates that for these years the bank is adding value to the

shareholder/investors investment. It also reflects the efficiency of banks management & the investors have made the right choice by investing in this bank.

Findings of the study

- 1) Yes bank has been creating positive EVA values & value addition for its shareholders for all the years except 2009-10 & 2013-14.
- 2) Banks management is able to give good returns to their investors on their invested amounts and able to satisfy their shareholders/ Investors .This is evident from increase in ROE from 15.46% in 2009-10 to 22.60 % in 2013-14.

Suggestions

The suggestions for improving EVA® of Yes bank are as under:-

- i) Banks should improve their profitability, for this the banks need to choose their products and services carefully and assess whether they are profitable or not.
- ii) To ensure better profitability, the banks need to price their products and services suitability without impacting their demand.
- iii) Banks have to consistently reduce their NPA's for better EVA, as it will ensure better returns from banking services .
- iv) The banks should also invest their capital appropriately to earn good returns.

Conclusion

EVA is an useful measure to judge a bank's performance in the view that whether the banks are adding value to its shareholders/ Investors or not. Factors that cause the negative EVAs in banks, are important to address , since unless banks earn positive EVAs investors would not be adequately rewarded and they will not invest in the banks, which in turn would make it difficult for banks to access new capital for expansion. This could pose a problem, not just for banks, but for the economy as a whole, because inadequate capital would reduce lending activities of banks

and it would in turn affect the economic growth of the country. Also as per the Basel III norms , the banks are required to maintain increased capital with them, which further adds burden on the banks.

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