

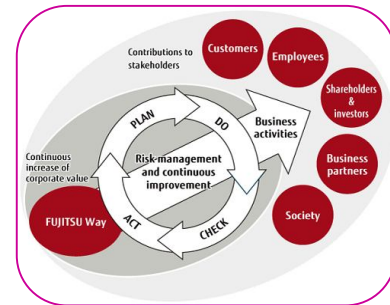


BUSINESS RISK AND VALUE ADDED: AN IMPACT ASSESSMENT AND ANALYSIS

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ABSTRACT

Risk nourishes business but it could also kill it. There can be no business without risk. It is the wealth that comes from taking risk that keep the spirit of entrepreneurship alive and business going while it encourages and tempts business to take risk. It is the not managed properly it could just wipe out the company. Therefore, it would be very pertinent to understand what is the amount of operating risk, financial risk and also the total business risk of cement companies, keeping the importance and the nature of business risk in view, this paper is organised to bring an analysis of risk categorizing into its varieties and their respective impact and relationship with Economic Value Added(EVA) which is the modern and improved metric of business performance of the cement companies in India. Therefore, this paper is organised to show in the first analysis relating to risk and in later its impact on Economic Value Added through the new concept called Economic Value Added Per Unit of Risk(EVAPUR) and relationship with EVA.



In order to carry out the work, the major objectives set is to appraise the an impact Assessment and analysis of Indian Cement Industry through EVA and EVAPUR by pursuing the following sub-objectives;

- 1) To calculate the Business Risk in Indian Cement Industry.
- 2) To calculate the EVA and EVAPUR of Indian Cement Industry.
- 3) To offers suggestions in the light of findings.

KEY WORD: Operating Risk, Financial Risk, Business Risk, Economic Value Added.

Section I

INTRODUCTION -

Risk nourishes business but it could also kill it. There can be no business without risk. It is the wealth that come from taking risk that keep the spirit of entrepreneurship alive and business going while it encourages and tempts business to take risk. It is not managed properly it could just wipe out the company.

Business and risk are inseparable. The nature and the magnitude of risks that companies have to cope with increased at a mind-boggling rate in the recent times. Each of these, though emanating from unexpected corners has a definite impact on the bottom lines of the companies.

- a) Loss of the business assets.
- b) Loss of the income due to death, illness, accident of the owner of the Business firms.
- c) Liability towards third parties, producers, wholesalers, retailers all of them store a possible quantity of stock and they are bound to suffer the loss till the stock tasts. Therefore, a business should determine and evaluate the risk in the business. Before determining and evaluating the business risk and its variety in select

cement companies in India, it would be very much required to understand in brief, the nature of business risk. Hence, nature of business risk is understood by pursuing certain points:-

- 1) Risk is unavoidable or essential part of the business. Nobody can escape from the risks in business According to Peter F Drucker “Bearing of risk, is the essential element of the business risk.”
- 2) Fundamental causes of risks are uncertainties: All the business risks arise due to human uncertainties, natural uncertainties and professional uncertainties.
- 3) Profit is the reward for bearing risks. It is often said that where there is risk, there is profit.
- 4) Degree and depth of risks varies with the size of the firm. The size of the business regulates the degree of risks, while the bigger transactions may have higher degree of risks.
- 5) Degree of risks varies with time: The degree of risks affected by equilibrium is demand and supply. If there are more disturbances in the country, the risks will be more, but during peaceful days the risks may be minimum.

Here our focus is on business risk and its impact on Economic Value Added. Therefore this paper is organised in five sections. The first section provides introduction, second section brings Hypothesis, Objectives, Methodology, sample design and data collection is explained in the third section Results and Analysis is the subject matter of fourth section and limitations of the fifth and final section.

SECTION II

HYPOTHESIS:

The following hypothesis have been formulated.

Hypothesis 1

Ho=All profit making companies are uniformly creating value.

Ha= All profit making companies are not uniformly creating value.

HYPOTHESIS 2

Ho= There is no difference in the performance of select cement companies in the industry as the nature of business is same.

Ha= There is significant difference in the performance of select cement companies in the industry.

HYPOTHESIS 3

Ho= There is no significant relation between Business Risk and Economic Value Added.

Ha= There is significant relation between Business Risk and Economic Value Added.

OBJECTIVES OF THE STUDY:-

The first and foremost objective of the present study is to impact of Business Risk in Indian cement Industry through Economic Value Added. In this context it attempts to peruse the following objectives;

- i) To calculate the Business risk to Indian select cement companies.
- ii) To calculate Economic Value Added and Economic Value Added Per Unit Of Risk (EVAPUR).
- iii) To calculate impact of Business risk on economic Value Added.
- iv) To offer suggestions in the light of findings.

SECTION III

METHODOLOGY:-

The following methodology is employed to conduct the study:-In the first, operating risk is ascertained by using the following

$$OL = \frac{\text{percentage change in operating profit}}{\text{Percentage change in sales revenue}} > 1$$

OR

$$DOL = \frac{S - V}{EBIT}$$

Where,

DOL= Degree of operating leverage

S= Sales Revenue

V= Variable Cost

EBIT= Earnings Before Interest And Taxes

In the second Financial Risk is ascertained by using the following

$$FL = \frac{\text{percentage change in earnings per share}}{\text{Percentage change in operating earnings}} > 1$$

OR

$$DFL = \frac{EBIT}{EBT}$$

where,

DFL=Degree of financial leverage

EBIT=Earnings Before Interest And Taxes

EBT=Earning Before the Payment of Taxes

In third Business Risk ascertained by employment of degree of combined leverage. Degree of combined leveraged is nothing but it is a power of the respective company to use fixed cost consisting of fixed operating costs and fixed financial costs to magnify the effect of change in sales on earnings available to shareholders.

In fourth Economic value per unit of risk is in this study is done using the relationship between economic value added and the total business risk which is being measured by degree of combined leverage. The calculation of which is as follows:-

$$EVAPUR = \frac{EVA}{DOL}$$

Where,

EVAPUR=Economic Value Added Per Unit of Risk

EVA=Economic Value Added

DOL=Degree of operating leverage

SAMPLE DESIGN

The whole Indian cement industry serves the population for the study. For the present study only seven profit making stock market listed Indian companies were selected. They are as under,

- 1) ACC Ltd.
- 2) Ambuja Cement Ltd.
- 3) Birla Corporation Ltd.
- 4) J k Cement Ltd.
- 5) Madras/ Ramco Cement Ltd.
- 6) Shree Cements Ltd.
- 7) Ultratech Cement Ltd.

DATA COLLECTION

This study conceptually covers a period of only five years starting from 2009-10 to 2013-14. The data has been collected only through secondary sources. The secondary data has been collected from the book entitled “compendium of Top 500 companies in India”. The financial information of all select seven Indian cement companies have been picked-up from the above data base.

SECTION IV

RESULTS AND ANALYSIS

Table No.1.1 showing operating Risk of select cement companies in India for the study period 2009-10 to 2013-14

Year	ACC	Ambuja	Birla	J K	Madras/ Ramco	Shree	Ultratech
2009-10	1.19	1.08	1.07	1.10	2.10	2.13	1.15
2010-11	1.19	1.13	1.10	1.18	1.16	1.26	1.22
2011-12	1.18	1.16	1.07	1.22	1.21	1.57	1.23
2012-13	1.31	1.20	1.13	1.56	1.10	3.36	1.37
2013-14	1.37	1.25	1.20	1.29	1.15	1.94	1.25
AVERAGE	1.25	1.16	1.11	1.27	1.34	2.05	1.24

From the above table it is clear that all companies have exhibited on an average a range of 1.1 to 2.05 degree degree of operating leverage for the study period. Among all the companies Shree Cement Company is showing highest operating risk, whereas, Birla Company has got less amount of operating risk. This signifies small jump in sales will lead to big jump in operating profit for Shree Cement Company. On the otherhand, a small fall will lead to big fall in operating profit.

Therefore, Shree Cement is risky company operationally it is very contra to Birla Cement and other companies.

Table no.1.2 showing Degree of Financial leverage of select cement companies to indicate financial risk for the study period 2009-10 to 2013-14

Year	ACC	AMBUJA	BIRLA	J K	MADRAS/ RAMCO	SHREE	ULTRATECH
2009-10	1.04	1.02	1.03	1.14	1.25	1.15	1.05
2010-11	1.02	1.01	1.03	1.23	1.16	1.11	1.09
2011-12	1.03	1.01	1.05	1.22	1.1	1.15	1.07
2012-13	1.03	1.02	1.03	2.40	1.27	2.60	1.15
2013-14	1.06	1.03	1.12	1.50	1.34	1.34	1.06
AVERAGE	1.24	1.02	1.15	1.50	1.24	1.47	1.08

By the observation of the above table reveals that the average degree of financial leverage is ranging from 1.02 to 1.50 for select cement Companies for the study period. Out of these companies J K Cements, and Shree Cements are financially having higher risk compared to other firms in the industry. On the Otherhand, Ambuja Cements and Birla cements have got lower risk financially. Therefore, financially risky companies are advised to improve the sales and operating earnings so that they can bring more magnification on earnings per share.

**Table no.1.3
Showing degree of combined leverage of select cement companies in India for the study period 2009-10 to 2013-14**

Year	ACC	AMBUJA	BIRLA	J K	MADRAS/ RAMCO	SHREE	ULTRATECH
2009-10	1.24	1.10	1.11	1.25	2.62	2.45	1.21
2010-11	1.21	1.14	1.15	1.45	1.34	1.39	1.33
2011-12	1.21	1.17	1.10	1.49	1.34	1.81	1.31
2012-13	1.34	1.22	1.27	3.78	1.39	7.59	1.58
2013-14	1.45	1.29	1.38	1.93	1.54	2.61	1.32
Average	1.29	1.18	1.20	1.98	1.64	3.17	1.35

In the above a quick examination of the computed value of business risk reveals that Shree Cement company and J K Cement company are more risky respectively compared to other firms in the list. Ambuja, ACC and Ultratech Companies are having less risk. Therefore, boom in economic conditions would lead to the more profit to Shree cements and J K Cements. on the other hand, recession in economic activities could contribute damage to the Shree cements and J K cements. Therefore, management of these two companies should be more careful in managing the risks. Proper understanding and management of business risk can go a long way in adding value to the shareholders.

Now it is the time to know the impact of business risk on Economic Value Added. In view of this economic Value added per unit of risk (EVAPUR) is calculated and analysed.

Table 1.4 showing Economic value Added per unit of risk of select cement companies for the study period 2009-10 to 2010-11.

ACC CEMENT

Year	EVA(IN CR)	BUSINESS RISK	EVAPUR(CR)
2009-10	Nil(-2.45)	1.24	Nil
2010-11	1180	1.21	975
2011-12	1677	1.21	1386
2012-13	1168	1.34	871
2013-14	8921	1.45	615

AMBUJA CEMENT

YEAR	EVA(IN CR)	BUSINESS RISK	EVAPUR(IN CR)
2009-10	Nil(-1.48)	1.10	Nil
2010-11	234	1.14	205
2011-12	1239	1.17	1059
2012-13	640	1.22	524
2013-14	216	1.29	167

BIRLA CEMENT

YEAR	EVA(IN CR)	BUSINESS RISK	EVAPUR(IN CR)
2009-10	238	1.11	214
2010-11	216	1.15	188
2011-12	205	1.10	186
2012-13	171	1.27	134
2013-14	44	1.38	32

JK CEMENT

YEAR	EVA(CR)	BUSINESS RISK	EVAPUR(CR)
2009-10	109	1.25	87
2010-11	630	1.45	434
2011-12	940	1.49	630
2012-13	781	3.78	206
2013-14	723	1.93	374

MADRAS/RAMCO CEMENT

YEAR	EVA(CR)	BUSINESS RISK	EVAPUR(CR)
2009-10	397	2.62	151
2010-11	437	1.34	326
2011-12	804	1.34	600
2012-13	697	1.39	501
2013-14	367	1.54	238

SHREE CEMENT

YEAR	EVA(CR)	BUSINESS RISK	EVAPUR(CR)
2009-10	859	2.45	350
2010-11	525	1.39	377
2011-12	1150	1.81	635
2012-13	1060	7.59	139
2013-14	788	2.61	302

ULTRATECH CEMENT

YEAR	EVA(CR)	BUSINESS RISK	EVAPUR(CR)
2009-10	386	1.21	319
2010-11	1548	1.33	1163
2011-12	533	1.31	406
2012-13	2638	1.58	1669
2013-14	1644	1.32	1245

By keenly observing the data present from the table 1.4 it was evident that decrease in risk in most of the cases has contributed an improvement in the EVA except Ultratech Cement. For instance, taking the case of Shree Cements when the degree of risk was 2.45 its EVA per unit of risk was 350 crore, when it has gone down to 1.39 and 1.81 respectively, economic value added per unit of risk went upto 377 and 635 crores from 350 crore on the other hand, for the same company risk increased to 7.59 and to 2.61, EVAPUR gone down to 139 crore and to 302 crore respectively from 635 crores.

SECTION IV**LIMITATIONS:-**

This study suffers from the following limitations-

- 1) The study is limited only to a limited period of five year which is not enough for constructing a final opinion about the problem.
- 2) Results calculated using the data is not validated personally.
- 3) Loss making and Non stock market listed cement companies have not been covered in this study.
- 4) Inflation impacts not ascertained separately.
- 5) Suggestions are advisory in character.

CONCLUSION:-

In absolute view, we can conclude the fact that, the degree of risk and economic value added has inverse relationship which we can mean higher the risk lower will be the wealth creation and vice-versa. Therefore from this we commend not only the concerned companies but also other companies to try their best to minimize risk of either operations or financial in improving the value creation. Hence, EVA is inversely driven by the quantum of risk that the company has.

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