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## CONTENTS

Sr. No.	TITLE & NAME OF THE AUTHOR (S)	Page No.
1.	INTERNATIONAL STUDENT COLLABORATION AND EXPERIENTIAL EXERCISE PROJECTS AS A PROFESSIONAL, INTER-PERSONAL AND INTER-INSTITUTIONAL NETWORKING PLATFORM <i>JOSE G. VARGAS-HERNANDEZ, DR. ADRIAN DE LEON-ARIAS, DR. ANDRES VALDES-ZEPEDA &amp; DR. VICTOR MANUEL CASTILLO-GIRON</i>	1
2.	AN EMPIRICAL STUDY ON MARKETING OF GADWAL SARIS IN INDIA <i>DR. K.V. ACHALAPATHI, PREETI SHRIVASTAVA &amp; SHAILAJA BANGARI</i>	10
3.	IDENTIFYING THE FACTORS EFFECTIVE ON ORGANIZATIONAL INNOVATION IN SERVICES <i>MOSTAFA ALIMIRI, MOHAMMAD HASSAN MOBARAKI &amp; FATEMEH MOHEBBI FAR</i>	17
4.	THE EFFECT OF INDIVIDUALITY AND POWER DISTANCE ON INCOME SMOOTHING <i>SEYED HOSSEIN HOSSEINI &amp; MOHAMADREZA ABDOLI</i>	22
5.	MANAGEMENT OF ELECTRICITY POWER SUPPLY IN DELTA AND EDO STATES OF NIGERIA: PROBLEMS AND PROSPECTS <i>ANTHONY A. IJEWERE</i>	26
6.	EMOTIONAL INTELLIGENCE AND ITS IMPACT ON TASK PERFORMANCE AND CONTEXTUAL PERFORMANCE <i>U.W.M.R. SAMPATH KAPPAGODA</i>	32
7.	THE RELATIONS BETWEEN CASH MANAGEMENT POLICIES AND PROFITABILITY OF SMEs IN KANO <i>DR. MUHAMMAD AMINU ISA</i>	37
8.	ACCELERATED LEARNING SOLUTIONS (ALS) – A MODEL FOR LEARNING ON THE JOB & PRODUCTIVITY ENHANCEMENT OF FRESH ENGINEERING GRADUATES THROUGH TITP (TELECOM INDUSTRY TRAINING AND PLACEMENT) <i>SREENIVASAN RAM, SUDHIR WARIER &amp; LRK KRISHNAN</i>	40
9.	RURAL E-BANKING: A TECHNICAL FRAMEWORK USING MOBILE TERMINALS <i>DR. V. B. AGGARWAL, DEEPTI SHARMA &amp; ARCHANA B. SAXENA</i>	47
10.	BIOMETRIC SECURITY IN MOBILE BANKING <i>S. T. BHOSALE &amp; DR. B. S. SAWANT</i>	52
11.	SPIRITUAL INTELLIGENCE – A CHANGE MANAGEMENT STUDY <i>MADHUSUDAN.V &amp; DR. NAGALINGAPPA.G</i>	56
12.	INTEGRATED RELIABILITY MODEL AND FAILURE MODES EFFECTS & CRITICALITY ANALYSIS FOR OPTIMUM RELIABILITY <i>K. S. LAKSHMINARAYANA &amp; Y. VIJAYA KUMAR</i>	59
13.	FACTOR ANALYSIS OF DEFECTS IN SOFTWARE ENGINEERING <i>DR. SEETHARAM.K, LAXMI B RANANAVARE &amp; CHANDRAKANTH G PUJARI</i>	65
14.	CONCERNS FOR SECURITY IN MIGRATING TO CLOUD COMPUTING <i>NITASHA HASTEER, DR. ABHAY BANSAL &amp; TANYA SHARMA</i>	67
15.	PREDOMINANCE OF TRADITIONAL SECTOR IN UNORGANISED MANUFACTURING OF INDIA <i>DR. NEERU GARG</i>	70
16.	THE INSIGHT VIEW OF QUALITY OF WORK LIFE: A STUDY ON THE EMPLOYEES OF PUBLIC SECTOR AND PRIVATE SECTOR BANKS IN TIRUNELVELI DISTRICT <i>A. MADHU, T. RITA REBEKAH &amp; DR. R. MOHAN KUMAR</i>	73
17.	DATA MINING FOR MOVING OBJECT DATA <i>VOORE SUBBA RAO &amp; DR. VINAY CHAVAN</i>	78
18.	ECONOMIC TOURISM MANAGEMENT: AN APPLIED S.H.G. MODELING THROUGH CASE ANALYSIS OF ELLORA CAVES & DAULATABAD FORT – AN INDIAN APPROACH <i>DR. S. P. RATH, DR. BISWAJIT DAS, SATISH JAYARAM &amp; MEENA SINHA</i>	81
19.	IMAGE RETRIEVAL USING CONTENT OF IMAGE <i>PREETI MISHRA &amp; AVINASH DHOLE</i>	87
20.	FACTORS INFLUENCING COMPANY VALUATION: AN EMPIRICAL ASSESSMENT OF THE INDIAN CORPORATE SECTOR <i>DR. KAUSHIK CHAKRABORTY &amp; NILANJAN RAY</i>	90
21.	CHRONOLOGICAL STUDY ON POSITIONING WITH EMPHASIS ON MALLS <i>SURESH SANNAPU &amp; NRIPENDRA SINGH</i>	94
22.	CYBER ATTACK MODELING AND REPLICATION FOR NETWORK SECURITY <i>B.VENKATACHALAM &amp; S. CHRISTY</i>	98
23.	WORKING CAPITAL MANAGEMENT OF HUL – A CASE STUDY <i>SOMNATH DAS</i>	102
24.	A STRATEGIC FRAMEWORK TOWARDS INDIAN RURAL RETAIL INDUSTRY IN THIS COMPETITIVE ERA <i>URVASHI GUPTA</i>	107
25.	EVALUATION OF THE PERFORMANCE OF TRAINING PROGRAM AT CARBORUNDUM UNIVESAL LIMITED, RANIPET <i>R. GEETHA &amp; DR. A. DUNSTAN RAJKUMAR</i>	112
26.	QUALITY DATA REPRESENTATION IN WEB PORTAL – A CASE STUDY <i>S. CHRISTY, S. BRINTHA RAJAKUMARI &amp; DR. M. SURYAKALA</i>	117
27.	PERFORMANCE ANALYSIS OF FIRE ALARM SYSTEM BASED ON WIRELESS SENSOR NETWORKS USING NS-2 <i>B. RAJESH, D. UPENDER &amp; K. SRINIVAS</i>	120
28.	COMPARISON AND ANALYSIS OF WIRELESS NETWORKS FOR HEALTH CARE TELEMONITORING SYSTEM <i>KANTA JANGRA &amp; KAVITA DUA</i>	125
29.	ECO-FRIENDLY MARKETING AND CONSUMER BUYING BEHAVIOR: AN EMPIRICAL STUDY <i>ADIL ZIA</i>	131
30.	A PROPOSED FRAMEWORK FOR AUTO REGULATED MIGRATING PARALLEL CRAWLER <i>VISHAL, SUBHASH CHANDER &amp; NEELAM</i>	136
	REQUEST FOR FEEDBACK	140

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## FACTORS INFLUENCING COMPANY VALUATION: AN EMPIRICAL ASSESSMENT OF THE INDIAN CORPORATE SECTOR

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### ABSTRACT

*Improvement of company value is one of the most challenging aspects of modern finance. In today's competitive world every company is trying hard to improve its value in order to accomplish its wealth maximization objective. In this backdrop, the present paper made a modest effort to assess the influence of three important variables, namely Total assets & total income, Profit after tax and Total reserves on company valuation. The sample size of the study consists of thirty four companies which have been selected by taking the top most companies on the basis of companies' total assets and total income. This selection has been made considering "The BW real 500, the definitive ranking of India's biggest companies" published by Business world, New Delhi, October, 2011. The issue analyzed in this study has been tackled using relevant statistical tools and techniques.*

### KEYWORDS

Market Capitalization, Company Valuation, Profit after tax.

### INTRODUCTION

 Globalization, privatization and liberalization of the Indian economy have introduced tremendous competition among companies throughout the globe. In this age of cut throat competition stakeholders are more active to know the real value of company. Value of the company can be measured in different ways. As a result, finance managers are now more serious to know the factors influencing company valuation as well as the nature of influence of these factors. More specifically they are trying to identify the parameters which have positive or negative impact on value of the company. In this backdrop, present study made a modest attempt to capture the impact of three important variables namely Total assets and total income (TATI), Profit after tax (PAT) and Total reserves (TR) on improving the value of company.

In this paper MC that is obtained by multiplying a company's shares outstanding by the current market price of the share has been considered as an indicator of the value of the company. Basically, there are three valuation approaches used to value business entities, viz., Income Approach, Cost Approach and Market Approach (Gautam & Banerjee, 2005). In the present study Market Approach of company valuation has been used by taking MC as an indicator of value of the company. MC shows the total value of the company or stated differently what it would cost to buy the whole company in the open market. In the present study MC has been considered as the indicator of the value of the company because MC is the consensus opinion of what the market thinks regarding the worth of the company (while book value is based on what accountants think the assets and liabilities of a company are worth). Besides this, MC is a short-cut that helps to determine how big or small a company is without doing all the calculations related to sales, revenues, liabilities, debt and all that (Chakraborty, 2011). The remainder of this paper is structured as follow. Section 2 deals with the review of the existing literature on the present topic that is impact of different variables on company valuation. Section 3 presents the objectives of the study. Section 4 deals with the methodology developed in this study. In Section 5 the findings of the study are discussed. Section 6 gives a brief conclusion about the study.

### REVIEW OF EXISTING LITERATURE

Before entering into the empirical study, a quick look through the existing literature on the analysis of the impact of different variables on company valuation seems desirable. The following paragraphs are devoted to a brief explanation of some significant studies on the issue so far carried out in India.

Ghosh and Ghosh (2008) in their paper studied how the probability of future value creation is affected by firm's profitability. They have considered firms listed in Indian stock exchange and used relevant statistical tools and techniques. One of the most important observations of the study was that the increase in profitability has a positive influence on the probability of creating future value and the relation is stronger for foreign standalone firms as compared to private Indian standalone or business group owned firms.

Chakraborty (2011) in his study measured influence of assets and profitability on the value of listed financial service companies in India. While doing so relevant statistical tools, techniques and tests such as simple correlation, multiple correlation and multiple regression, t-test, F-test have been applied. The study revealed that total assets had a positive correlation with the value of the company whereas influence of profitability on the value of the company was negative in case of Indian financial service companies.

Chakraborty (2011) conducted a study for examining the impact of assets and profitability on business valuation by considering thirty three listed non-financial companies. The study applied relevant statistical tools, techniques and tests such as simple correlation, multiple correlation and multiple regression, t-test, F-test to analyze the matter. The study disclosed that assets and profitability had a positive influence on the value of the company.

### OBJECTIVES OF THE STUDY

The study has the following objectives:

1. To assess the influence of TATI, PAT and TS on MC of the selected companies by computing Karl Pearson's simple correlation coefficient, Spearman's rank correlation coefficient and Kendall's correlation coefficient between MC and each of these selected important parameters that have influence on the MC of the company. The assessment has been done taking all the selected companies as a whole.
2. To evaluate the joint effect of the selected variables influencing value of the selected companies on their MC. The issue has been addressed by taking all the selected companies in a consolidated manner.

## METHODOLOGY OF THE STUDY

The study is based on thirty four companies which have been selected by taking the top most companies on the basis of companies' total assets and total income. This selection has been made considering "The BW real 500, The definitive ranking of India's biggest companies" published by Businessworld, New Delhi, October, 2011. Selected seven industries and thirty four companies have been displayed in Appendix. TATI, PAT and TR have been considered as the parameters which influence value of the company. MC has been considered as the indicator of the value of the company. The degree of the relationship between MC and each of the selected parameter that influence it (MC) has been assessed through correlation coefficients between MC and each of the selected parameter influencing MC taking into account their magnitudes (i.e., by Pearson's simple correlation coefficient), ranking of their magnitudes (i.e., by Spearman's rank correlation coefficient) and the nature of their associated changes (i.e., by Kendall's correlation coefficients). For studying the joint influence of the selected parameters influencing value of the company i.e., TATI, PAT and TR on MC, multiple correlation and multiple regression techniques have been applied. In order to examine whether the computed values of correlation coefficients and partial regression coefficients are statistically significant or not, t-test has been used. The multiple correlation coefficients have been tested by F-test.

## FINDINGS OF THE STUDY

In Table 1, the effects of TATI on MC, PAT on MC and TR on MC of the Indian corporate sector have been evaluated. These have been done by computing Pearson's simple correlation coefficient, Spearman's rank correlation coefficient and Kendall's correlation coefficient between TATI and MC, between PAT and MC as well as between TR and MC taking all 34 companies as a whole. In order to test whether the computed values of correlation coefficient are statistically significant or not t-test has been conducted. Considering that more TATI, PAT and TR increases the company's MC, we expect a positive relationship between TATI and MC, between PAT and MC as well as between TR and MC. Table 1 shows that there were positive association between TATI and MC, between PAT and MC as well as between TR and MC, which were statistically significant at 1 per cent level in 7 cases out of total 9 cases (only Kendall's correlation coefficient between TATI and MC was positively significant at 5 per cent level and Spearman's rank correlation coefficient between TATI and MC was positive but statistically insignificant).

In Table 2, multiple correlation analysis and multiple regression analysis have been conducted to investigate the joint influence of TATI, PAT and TR on MC, taking all the selected companies in a consolidated manner. The partial regression coefficients and the multiple correlation coefficients have been tested using the t-test and F-test respectively. The regression equation that has been fitted in this study is  $MC = B_0 + B_1.TATI + B_2.PAT + B_3.TR$ , where  $B_0$  is the intercept,  $B_1$ ,  $B_2$  and  $B_3$  are the partial regression coefficients. Table 2 exhibits that for one unit increase in TATI the MC decreased by 0.121 unit which was statistically insignificant. When PAT increased by one unit, the MC stepped up by 11.811 units which was statistically significant at 1 per cent level. Table 2 also depicts that for one unit increase in TR, the MC increased by 0.527 units which was statistically insignificant.

Table 2 also reveals that the multiple correlation coefficient of MC on TATI, PAT and TR was 0.853 which was found to be statistically significant at 1 per cent level. This Table also discloses that the selected influencing factors (TATI, PAT and TR) contributed 72.70 per cent of the variation in the MC.

## CONCLUDING REMARKS

1. In most of the cases computed values of Pearson's simple correlation coefficient, Spearman's rank correlation coefficient and Kendall's correlation coefficient taking all the selected companies as a whole, give proof of the significant positive relationship between TATI and MC (only Spearman's rank correlation coefficient between TATI and MC was positive but statistically insignificant), between PAT and MC as well as between TR and MC. Thus it conforms to that the larger the volume of TATI, PAT and TR, the higher the value of the company. In other words, TATI, PAT and TR have a positive correlation with the valuation of the company.
2. The partial regression coefficients shown in the multiple regression equation of MC on TATI, PAT and TR fitted in this study reveals that PAT made positive as well as very significant contribution towards improvement of the value of the company, while TATI made negative as well as insignificant contribution towards improvement of value of the company. The effect of TR on MC was positive but statistically insignificant.
3. Although the joint influence of TATI, PAT and TR on the valuation of the company was very significant, it was possible mainly due to very positive contribution of PAT towards improving value of the company as reflected in the multiple regression analysis made in this study.
4. It is clear from the outcome of the analysis of multiple determinations that 72.70 per cent of the total variation of valuation of the company was accounted by the joint variation in the volume of TATI, PAT and TR.

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## TABLES

**TABLE 1: ANALYSIS OF CORRELATION BETWEEN SELECTED FACTORS (TOTAL ASSET AND TOTAL INCOME, PROFIT AFTER TAX AND TOTAL RESERVES) INFLUENCING VALUE OF THE COMPANIES AND THE PARAMETER (MARKET CAPITALISATION) INDICATING VALUE OF THE SELECTED COMPANIES**  
(Taking all the companies in a consolidated manner)

Company	Total Assets & Total Income (Rs crore)			Profit after tax (Rs crore)			Total reserves (Rs crore)			Average market cap (Rs crore)
Reliance Industries	507774.33			19271.52			151111.73			319610.77
Indian Oil Corporation	431033.73			8085.62			55147.26			84272.53
Oil & Natural Gas Corporation	294039.31			22824.97			111049.49			253433.60
Tata Steel	219723.58			8856.05			34426.97			53343.58
Bharat Petroleum Corporation	197053.77			1742.06			15704.68			23198.10
Hindustan Petroleum Corporation	184645.83			1702.04			12941.43			13512.23
NTPC	180707.28			9348.23			60198.06			156310.40
Tata Motors	176075.22			9220.79			18533.76			53552.46
Bharti Airtel	168288.60			5899.20			46894.80			129653.14
Hindalco Industries	131625.79			2879.35			28824.29			35751.46
Larsen & Toubro	116729.93			4384.31			24514.93			106247.29
Reliance Communications	106077.06			1505.82			39467.17			27367.47
Steel Authority of India	103862.22			5017.29			33473.91			71640.98
Coal India	103364.55			10867.35			28622.21			222806.14
Sterlite Industries (India)	96387.43			7322.04			41099.36			56392.59
Adani Enterprises	81224.76			2825.90			17404.13			62039.99
MMTC	77915.21			112.26			1466.60			115307.68
Mahindra & Mahindra	74147.82			3197.79			13956.49			40702.87
Power Grid Corporation of India (s)	73860.22			2696.89			16737.27			45464.75
Jaiprakash Associates	70525.05			2059.03			10353.82			21970.46
Essar Oil (s)	69344.16			653.88			5155.63			16977.25
Bharat Heavy Electricals	64656.57			6053.36			19665.56			107731.62
GAIL (India)	64366.70			3980.85			19945.39			58186.83
Tata Consultancy Services	63106.64			9189.79			24209.09			196381.00
DLF	61126.46			1638.02			24031.77			46295.17
Tata Power Company	60655.07			2181.91			13790.55			30228.43
Wipro	59646.40			5265.30			21968.00			103124.74
JSW Steel	57535.32			1659.38			15429.36			21329.16
Infosys	54688.00			6835.00			25690.00			165052.21
Aditya Birla Nuvo	53587.74			907.97			25494.28			9016.79
Cairn India	53378.16			6334.40			38335.84			61001.20
NHPC	53336.23			2462.77			14229.52			33838.08
Maruti Suzuki India	52833.00			2307.10			14164.30			37185.99
Reliance Infrastructure	52191.79			1229.00			23340.14			20773.36
Correlation Coefficient	Pearson	Kendall	Spearman	Pearson	Kendall	Spearman	Pearson	Kendall	Spearman	
	0.519**	0.237*	0.320	0.846**	0.640**	0.777**	0.736**	0.419**	0.548**	
** Significant at 1 per cent level										

**TABLE 2: MULTIPLE CORRELATION ANALYSIS AND MULTIPLE REGRESSION ANALYSIS OF THE PARAMETER (MARKET CAPITALISATION) INDICATING BUSINESS VALUE ON SELECTED FACTORS (TOTAL ASSET, NET PROFIT AND SALES) INFLUENCING BUSINESS VALUATION**  
(Taking all the companies in a consolidated manner)

Multiple correlation of MC on TA, NP and S	Regression equation of MC on TA, NP and S. MC = B <sub>0</sub> + B <sub>1</sub> .TA + B <sub>2</sub> .NP + B <sub>3</sub> .S		
	Variable	Partial Regression Coefficients	t Value
R = 0.853 R <sup>2</sup> = 0.727 F = 26.686**	TATI	-0.121	-1.092
	PAT	11.811	4.374**
	TR	0.527	0.931
	Constant	18404.008	1.635
** Significant at 1% level Table value of F with (k, n-k-1), i.e. (3,30) degrees of freedom at 1% level is 4.51	** Significant at 1% level Table values of t with (n-k-1), i.e. 30 degrees of freedom at 1% level is 2.75		
Source: "The BW real 500. The definitive ranking of India's biggest companies" published by Businessworld, New Delhi, October, 2011 (Vol.31, Issue 23).			

## APPENDIX

## APPENDIX: 1

Name of the companies under study
Reliance Industries
Indian Oil Corporation
Oil & Natural Gas Corporation
Tata Steel
Bharat Petroleum Corporation
Hindustan Petroleum Corporation
NTPC
Tata Motors
Bharti Airtel
Hindalco Industries
Larsen & Toubro
Reliance Communications
Steel Authority of India
Coal India
Sterlite Industries (India)
Adani Enterprises
MMTC
Mahindra & Mahindra
Power Grid Corporation of India (s)
Jaiprakash Associates
Essar Oil (s)
Bharat Heavy Electricals
GAIL (India)
Tata Consultancy Services
DLF
Tata Power Company
Wipro
JSW Steel
Infosys
Aditya Birla Nuvo
Cairn India
NHPC
Maruti Suzuki India
Reliance Infrastructure

Source: 'The BW real 500, The definitive ranking of India's biggest companies', published by Businessworld, New Delhi, October, 2011 (Vol.31, Issue 23)

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