Revisiting the EPS : A Path-Breaking Approach Toward Performance Measurement in the Capital Markets : A Case Study of Reliance Industries Ltd.

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Abstract

The most widely recognized and quoted measure of company success in the capital market is earnings per share (EPS). It does, however, have a major flaw. Due to the fact that it was only calculated using the equity component of the entire equity, the results conflicted with return on equity (ROE), which is calculated with reference to total equity. Consequently, even while the numerator, or profit after tax (PAT), remained the same, the denominator of the two ratios varied. As a result, EPS indicated a larger return than ROE. This made it difficult for analysts and investors to decide which metric to employ when making investments or disinvestments. Making a choice based only on EPS could have disastrous effects on the money invested. Thus, there is a requirement for an extensive EPS measurement so that it produces precise and comprehensive findings. Can we then go back and modify the EPS measurement to make it more reasonable and in accordance with ROE? We really can, in fact. We might do this by classifying all equity as equity capital since ownership by shareholders is derived from both equity capital and other equity, which is represented by reserves and surplus. Stated differently, the whole of the preceding equity capital and other equity would represent the resulting equity capital if accumulated reserves and surplus were allocated as bonus shares. Earnings per share of total equity (EPS-TE), often known as the path-breaking ratio, can now be calculated. Once this revolutionary concept was applied to the EPS of Reliance Industries Ltd., EPS-TE was computed, and the outcomes demonstrated that EPS and ROE were now precisely in sync.

Keywords : earnings per share, basic earnings per share of total equity (EPS-TE), diluted EPS-TE, PE, return on equity

JEL Classification Code : M21, M160, M410

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Corporate management's ultimate goal is to maximize return on investment (ROI). The anticipation of a large return drives both new and existing investors to participate in the company's common stock (also known as equity or equity capital in India) and common shareholders to stay with the business. It serves as the last gauge of the management's effectiveness and success. Thus, the primary factor influencing a company's destiny is whether or not the ROI is adequate. The ROI group computes and analyzes two key financial ratios: Earnings per Share (EPS) and return on equity (ROE).

Return on Equity – ROE

This ratio calculates the net profit on equity shareholders' funds or total equity. Two resources belong to equity shareholders in a corporation.

- One is in the form of equity capital, or "Equity," which is their contribution and is given to them once the surplus and reserves have been capitalized.

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- Second, "Other Equity" refers to unallocated accumulated reserves and surplus.

Thus, "Total Equity" represents the entire ownership of the equity stockholders. The ROE of a business is calculated by deducting the cost of borrowed funds, government income taxes, and dividend payments to preferred (or preferred stock in the USA) shareholders. This is the ratio that matters most to all stakeholders, not just equity holders.

Earnings Per Share – EPS

In the capital markets, this ratio is the most frequently discussed and utilized. This ratio assesses the overall profitability in terms of per equity share of capital belonging to the owners. For instance, Walmart Inc. reported an EPS of $4.90 for the fiscal year that concluded on January 31, 2022, a higher result than the $4.77 level recorded the year before. Redefining ROE is the aim of EPS. As per paragraph 8 of FASB's FAS-128 "EPS," the calculation involves dividing the "Weighted average number of common shares outstanding during the reporting period" by "Earnings, that is, income available to common stockholders." The weight of shares that were issued and acquired throughout the period is determined by the percentage of time that they were outstanding. When assessing a company's performance, this ratio is the first and most important one that potential and current shareholders and financial analysts consider.

FAS-128 summary further states that the provisions in this statement were substantially the same as those in IAS 33: EPS, issued by the IFRS Foundation (IFRS-IAS 33) for a global community. Next, let's move on to India, where the Ind-AS 33: EPS fully converges with IFRS in all relevant areas. As a result, there is a significant similarity between the three standards, indicating global homogeneity in EPS computation. On EPS, there is an additional narrative.

(1) Basic EPS : The definition of EPS according to FAS 128 is shown above. Basic EPS is indicated when the EPS prefix is omitted. Consequently, the words EPS and Basic EPS are typically used synonymously.

(2) Diluted EPS : According to paragraph 11 of "FAS 128," the process of calculating diluted EPS is the same as that of calculating basic EPS, with the exception that the denominator is now greater to account for the number of additional common shares that would have been in circulation had the outstanding dilutive prospective common shares been issued. As diluted EPS suggests that EPS will be sustainable in the future, it is, therefore, the true EPS.

Limitations of EPS

However, EPS has a significant drawback. It provides a result that is conflicting with ROE, which is computed with reference to total equity because it is only calculated with reference to the equity portion of total equity. Therefore, the denominator of the two ratios differs, but the numerator, or PAT, stays the same. Let us illustrate our thesis with a simple case. Table 1 presents the financial data and resulting ratios for a hypothetical corporation named Company A.

What Does This Case Reveal? It Reveals That:

- In spite of the fact that Company A was only earning 15% ROE on total equity, its EPS seemed to indicate that it would be making 20% of its equity capital, or $2, on a $10 equity capital.

- As a result, the perceived or suggested return gives the impression of being higher than the actual return. This makes it difficult for analysts and investors to decide which metric to employ when making investments or withdrawals. Making a choice based only on EPS could have disastrous effects on the money invested.

Table 1. ***Limitations of EPS : Hypothetical Case – Company A***

	Details	Company A	Working Notes
A	Equity capital	$30,000,000	
B	Other equity	$10,000,000	
C	Total equity (net worth)	$40,000,000	A+B
D	Weighted average number of shares O/S	3,000,000	
E	Face/Par value per share	$10	A/D
F	Net profit available to equity holders	$6,000,000	
G	Market price per share	$20	
	Results :		
H	EPS	$2	F/D
I	PE	10 Times	G/H
J	ROE	15%	F/C

➯ Therefore, a thorough measurement of EPS is required.

Extending the Case to Two Companies

To provide more comparative clarity, we can expand our case to include two companies. If the equity component differs between two companies with the same total equity and profit after tax (PAT), it will affect the EPS computation; that is, one company will have a higher EPS and the other a lower one. Because ROE yields consistent results, it gets over this restriction. Let us illustrate our idea with a simple scenario. Now let's discuss Company B and the previously described Company A. The data and resulting ratios are shown in Table 2.

What Does This Two Company Case Reveal? It Reveals That:

➯ Although the total equity of these two companies is the same, their equity capital is not. As a result, all equity investors have the same overall ownership.

Table 2. ***Limitations of EPS : Hypothetical Case – Companies A & B***

	Details	Company A	Company B	Working Notes
A	Equity capital	$30,000,000	$20,000,000	
B	Other equity	$10,000,000	$20,000,000	
C	Total equity (Net worth)	$40,000,000	$40,000,000	A+B
D	Weighted average number of shares O/S	3,000,000	2,000,000	
E	Face/Par value per share	$10	$10	A/D
F	Net profit available to equity holders	$6,000,000	$6,000,000	
G	Market price per share	$20	$30	
	Results			
H	EPS	$2	$3	F/D
I	PE	10 times	10 times	G/H
J	ROE	15%	15%	F/C

↳ On the total ownership, they are earning the same 15% ROE.

↳ Even so, because Company A's equity capital is greater than Company B's, despite the two companies earning the same net profit, Company A's EPS is less than $2 due to the disparity in the components of total equity. Conversely, Company B's lesser equity capital is resulting in a greater EPS of $3.

↳ According to their EPSs, Company A appears to be making $2 on equity capital of $10, or a 20% return on capital. Company B is making $3 on equity capital of $10, or a 30% return. However, it is still the case that they are making a consistent 15% on total equity.

Revisiting the EPS

The true situation is obviously not being shown by EPS. Despite the identical ROE, the results are different for the two companies. Because EPS is only based on equity capital, which is a small portion of total equity, the reason for this can be explained. The remaining portion of total equity consists of undistributed accumulated reserves and excess. Though the EPS calculation ignores this, shareholders still own the resources. This EPS shortfall is addressed via ROE measurement.

When the EPS measurement yields findings that are real and thorough, is it possible to go back and adjust it to better correlate with ROE? Sure, we are able to. As the ownership of the shareholders resides in both equity capital and other equity, as shown by the reserves and surplus, we can achieve this by treating total equity as equity capital. That is to say, the total of the previous equity capital and the additional equity would be the consequent equity capital if the accumulated reserves and surplus were shared as bonus shares.

Support for the Argument for Considering Total Equity as Equity Capital for EPS

The argument that undistributed other equity should be treated as a bonus when assessing total equity as equity in order to determine the outstanding number of shares is supported by internationally recognized financial accounting standards. In a capitalization or bonus issue, the number of equity/ordinary/common shares outstanding prior to the issue is adjusted for the proportionate change in the number of outstanding ordinary shares, according to paragraph 28 of both "IFRS-IAS 33: EPS" and "Ind AS 33: EPS." For instance, the number of ordinary shares outstanding before the issue is multiplied by three to determine the new total number of ordinary shares in a two-for-one bonus issue. Put differently, bonus shares will be included in the weighted average number of outstanding shares, and the EPS will be computed using the higher number of shares.

We contend that additional equity is really an undistributed bonus. Consequently, we have to adhere to the accepted accounting guideline of "Substance over Form." The principle requires that EPS be calculated and presented in the manner that this study advocates. If so, the EPS figure during the current administration appears to be window-dressed.

Using the example mentioned above, let us review and see how this changes the outcomes. Be aware that for this purpose only:

↳ By restating the "reported numbers in the ratio of total equity to equity capital," the number of "outstanding shares in terms of total equity" has been calculated.

↳ The theoretical Ex-Bonus market price based on total equity has been computed by multiplying the market price per share as of March 31, 2022, by the reported weighted average number of shares outstanding for basic EPS and dividing the result by the weighted average number of shares outstanding based on total equity. This is necessary for comparison purposes as we have presumed that the entire other equity has been converted into bonus share capital.

Table 3. *Revisiting the EPS Hypothetical Case – Companies A & B*

	Details	Company A	Company B	Working Notes
A	Weighted average number of shares O/S	3,000,000	2,000,000	
B	Equity capital	$30,000,000	$20,000,000	
C	Other equity	$10,000,000	$20,000,000	
D	Total equity	$40,000,000	$40,000,000	B+C
E	Face/Par value per share	$10	$10	
F	Hence Weighted average number of shares O/S based on total equity	4,000,000	4,000,000	D/E
G	Net profit available to equity holders	$6,000,000	$6,000,000	
H	Market price per share	$20	$30	
I	Theoretical Ex-Bonus market price based on total equity	$15	$15	(H*A)/F
	Results			
J	Earnings per Share of total equity (EPS-TE)	$1.50	$1.50	G/F
K	PE Now	10 Times	10 Times	I/J
L	ROE Now	15%	15%	G/D

The Two Companies' Case Continued

Table 3 presents financial information and derived ratios derived from a review of the EPS.

What are the Results Now, and What Do They Reveal?

But first, allow us to clarify that EPS-TE is a recently developed phrase that indicates that EPS is now derived from the total equity held by shareholders. You could alternatively call it adjusted EPS, but that sounds more reasonable. It appears from this EPS-TE, whatever the term, that the owners of both companies have received a 15% return on their money. As a result, the EPS-TE is now perfectly synchronized with ROE. Compared to the 20% and 30% implied under the current regime, this is the actual return. Investors no longer need to confuse EPS and ROE when making decisions about investments or disinvestments because they have a single factor to consider.

- **PE Ratio :** It is also important for readers to notice that the two companies' PE ratios remain unchanged since the EPS-TE and PE ratios now have the same new denominator.

Literature Review

The following accounting standards govern the subject matter of EPS:

- Indian Accounting Standard 33 (Ind AS 33, 2015): "Earnings per Share."
- International Financial Reporting Standard 33 (IFRS 33, 2001): "Earnings per Share."
- Financial Accounting Standards Board (FASB, USA)'s FAS-128: "Earnings per Share."

Similar methods for measuring EPS are included in these standards, both nationally and internationally. The calculation of basic EPS and diluted EPS has been mandated. Within the basic EPS, two cases have been envisaged, and a measurement base has been prescribed for both :

- Changes in the number of equity shares without a corresponding change in resources and
- Rights issue.

The following scenarios have been considered within the diluted EPS, and the measurement base specified for each:

- Compulsorily convertible instruments.
- Share warrants or options.
- Anti-dilutive potential equity shares.

Nevertheless, none of them have addressed the revolutionary strategy put forth in this paper. Additionally, despite a thorough search, no research paper addressing the measurement strategy recommended in this study could be located.

Objective of the Case Study

After considering the previous discussion, the goal of this case study is to reexamine the EPS measurement in order to rationalize it and bring its results into line with ROE. This will allow investors to make decisions about their investments and disinvestments based on a single factor rather than EPS and ROE. We will try to accomplish this in the Reliance Industries Ltd scenario. To provide the study with an international perspective, references to the inclusion of global accounting standards, $ values, and amounts in millions have been included.

Data and Methodology

Information used in this case was obtained from:

- The consolidated financial results of Reliance Media for the year ending March 31, 2022, were released on May 6, 2022.
- Annual report of Reliance for the fiscal year that concluded on March 31, 2022.

The text that follows provides a detailed explanation of the methodology used to calculate Basic Earnings per Share of Total Equity (Basic EPS-TE), Diluted Earnings per Share of Total Equity (Diluted EPS-TE), and the resulting PE and ROE ratios.

A Real-life Case : Reliance Industries Limited

We used a hypothetical situation to illustrate our point above. Let's now consider a real-world scenario. For that reason, there is no better party than Reliance Industries Ltd. (Reliance). The example will show both Diluted EPS and Basic EPS. As the biggest private sector company in India, Reliance is listed on the Fortune 500. Before we evaluate Reliance's reported EPS, let us first gain a grasp of its financial health. On May 6, 2022, Reliance issued a media release containing the consolidated financial results for the year that ended on March 31, 2022. A number of relevant excerpts from that place are shown in Table 4.

As required by IND AS 33, Reliance has disclosed the information in respect of EPS on the face of its consolidated statement of profit and loss for the year ended March 31, 2022. The data reveals that:

Table 4. ***Select Financial Information for the Year Ended as of March 31, 2022***

		₹ Millions	$ Millions	Working Notes
A	Equity share capital	67,650	891	
B	Other equity	7,727,200	101,767	
C	Total equity	7,794,850	102,658	A+B
D	Total income	7,365,810	97,008	
E	PAT attributable to owners of Reliance	607,050	7,995	
		₹	$	
F	Face/Par value per Share	10.00	0.13	
G	Market price per share on March 31, 2022 at Bombay Stock Exchange	2633.95	34.69	
H	Basic EPS	92.00	1.21	
I	Diluted EPS	90.85	1.20	
J	PE based on diluted EPS	29 times	29 times	G/I
K	ROE	7.79%	7.79%	E/C

Sources:

- "A to F" and "H and I": Financial performance for the year ended March 31, 2022. aspx (Reliance Industries Limited, 2010).
- G: Stock Prices (bseindia.com)
- Rest: Author's research.

Notes.

- Information "A to E" reported by Reliance in ₹ Crore and presented here by converting in ₹ Millions @ of 1 crore equal to 10 million.
- ₹ Figures converted into $ figures @ ₹ 75.93 to 1 $.

➭ **EPS** - Both basic and diluted- is more or less the same. Therefore, the dilutive impact on Reliance is insignificant.

➭ **Ideally Diluted EPS** of $ 1.20 should be used for necessary decision making. And consequently the PE ratio and ROE should be reported only on this basis, as done in Table 4 above.

➭ **Diluted EPS** of ₹90.85 (on a face/par value of ₹10.00) or corresponding $ 1.20 (on a per value of $ 0.13) suggests as if Reliance had earned ROE of 908.50% per share. But actually, the ROE earned is just 7.79%. The astute suggestion runs rather counter to the facts. Compared to the real, it is 117 times higher. We must thus correct it and review Reliance's reported EPS in order to do so. Prior to that, we must gain a comprehension of the intricate calculation of its EPS. The detailed computation of the reported EPS of Reliance is presented in Table 5. The computations are pretty clear. We are now ready to revisit the EPS of Reliance and come to our core issue.

Table 5. ***Detailed Computation of EPS for the Year Ended March 31, 2022***

		In Millions, Except per share		Working Notes
Face / Par Value per Equity Share		₹ 10	$0.13	
Number of equity shares outstanding, year-end		6,765	6,765	
A	**Basic EPS**			
A1	PAT attributable to Equity Shareholders of Reliance	₹ 607,050	$7,995	
A2	Weighted average number of equity shares	6,598	6,598	

	Basic EPS	**₹ 92.00**	**$ 1.21**	**A1/A2**
B	Diluted EPS			
B1	Weighted Average number of equity shares used for diluted EPS calculated as below:			
B2	Number of shares used for calculating basic EPS, as above	6,598	6,598	
B3	Add: Average number of potential shares	84	84	
B4	Total number of equity shares	6,682	6,682	
	Diluted EPS	**₹ 90.85**	**$ 1.20**	**A1/B4**

Source : Derived by the author from the financial statements of Reliance available at (Financial performance for the year ended 31 Mar 2022. aspx (Reliance Industries Limited, 2010).

Note. $ Figures not provided by the company. ₹ Figures converted into $ figures @ ₹ 75.93 per $.

Revisiting the EPS of Reliance

Table 6 displays the EPS-TE of Reliance and other ratios derived from it, supporting our position. Please take note of the following before examining this table:

↳ We also need to determine the "Weighted average number of shares outstanding based on Total Equity" because the reported weighted average number of shares (6,598 million) differs from the year-end number of shares (6,765 million) with respect to the year-end equity capital (₹67,650/$ 891 million). To achieve this, the weighted average figures have been restated according to the percentage that total equity bears in comparison to equity share capital. The weighted average number of shares has also been used to compute weighted total equity.

Table 6. *Revisiting the EPS of Reliance for the Year Ended March 31, 2022*

		In Millions, Except as otherwise specified		Working Notes
A	Equity share capital	₹ 67,650	$ 891	
B	Total Equity	₹ 7,794,850	$ 102,658	
C	Based on equity capital, the reported weighted average number of outstanding shares for basic EPS	6,598	6,598	
D	Number of outstanding potential shares, reported as a weighted average according to equity capital	84	84	
E	Based on total equity, the weighted average number of outstanding shares for Basic EPS	760,243	760,243	(C/A)*B
F	Add: Based on total equity, the weighted average number of potential shares	9,679	9,679	(D/A)*B
G	After the dilution effect, the total weighted average number of outstanding shares based on total equity	769,922	769,922	E+F
G1	The weighted average number of shares after dilution impact is used to	₹ 7,699,220	…..	G*10
	calculate the weighted total equity	…..	$ 101399	(G*10/75.93)
H	Net profit available to equity shareholders	₹ 607,050	$ 7,995	
I	Market price per share as of 31 March 2022	₹ 2633.95	$ 34.69	
J	Theoretical Ex-Bonus market price based on total equity as of 31 March 2022	₹ 22.86	$ 0.30	(C*I)/E

Results				
K	Basic Earnings per Share of Total Equity (Basic EPS-TE)	₹ 0.80	$0.0105	H/E
L	Diluted Earnings per Share of Total Equity (diluted EPS-TE)	₹ 0.79	$0.0103	H/G
M	PE based on (diluted EPS-TE)	29 Times	29 Times	J/L
N	ROE (Based on G1 above)	7.90%	7.90%	H/G1

Sources :

(1) "A to D" and H: Financial performance for the year ended 31 March 2022. aspx (Reliance Industries Limited, 2010).

(2) I: Market price per share as of 31 March 2022 [(Stock Prices (bseindia.com)].

(3) Rest : Author's research.

Note. $ Figures not provided by the company. ₹ Figures converted into $ figures @ ₹ 75.93 per $.

- Weighted total equity after the dilution effect and a number of reported potential shares (84 million) are treated similarly.
- After accounting for the dilution effect, the PE ratio and ROE were computed using weighted total equity and diluted EPS-TE.

Thus, the current findings indicate that:

(1) Diluted EPS-TE of ₹0.79 on a face value of ₹10 or $0.0103 on a par value $0.13 is suggestive of a return of 7.90% on shareholders' investment. The ROE of 7.79% calculated in Table 4 differs from this one since it was derived from year-end data.

(2) The return of 7.90% is also displayed via the ROE ratio. As a result, the outcomes of ROE and EPS-TE are now perfectly synchronized.

(3) Investors should be able to make better and quicker decisions about their investments now that they can use EPS and ROE interchangeably.

(4) The PE ratio remains unchanged as the new denominator in both the EPS-TE and PE ratios is the same.

Conclusion

It is evident that the measurement approach recommended in this article, "Revisiting the EPS: Case Study of Reliance Industries Limited," gently gets around the EPS's drawback, as was previously stated. This research is groundbreaking:

- It puts the result of EPS in complete sync with that of ROE.
- It now accurately gauges the success of the company and the return to shareholders.
- It deserves to be adopted by the accounting standards to prescribe this innovative performance measurement system.
- Hopefully, it should bring more clarity and precision in the investment decisions thus leading to a healthier growth of the capital markets.
- In order to further raise the standard of financial reporting, I hope it will start a fresh discussion on how EPS should be calculated and presented in scholarly and professional communities.

Scope for Further Research

This study can be expanded to include more companies in the same industry or different industries to compare the changes that occur when the recommended approach in the EPS-TE values is implemented versus the current technique.

Author's Contribution

The entire document was conceptualized, created, developed, prepared, and written by Dr. Ambrish Gupta, the only author of the work.

Conflict of Interest

The author certifies that he has no affiliations with or involvement in any organization or entity with any financial interest or non-financial interest in the subject matter or materials discussed in this manuscript.

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Similar Glossary

India	USA
Equity or ordinary shareholders	Common shareholders
Equity/Equity capital	Common stock
Face value of a share	Par value of a share
Preference capital	Preferred stock
Currency : ₹	$

Acronyms

Acronym	Full form
EPS	Earnings per share
EPS (TE) or Adjusted EPS	Earnings per share of total equity (owned by the shareholders)
FAS	Statement of Financial Accounting Standards Board
FASB	Financial Accounting Standards Board (USA)
IAS	International Accounting Standard
IFRS	International Financial Reporting Standard
Ind AS	Indian Accounting Standard
PE	Price Earnings Ratio
ROE	Return on Equity Ratio

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