Risk and Return Analysis of ITC Limited - An Empirical Study

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Abstract *Investment is an employment of cash on assets with an aim of getting return in the form income or capital appreciation. The expectation of return varies from investors to investors based on their level of risk tolerance. The variability in actual return from expected return is termed as risk. Fast Moving Consumer Goods (FMCG) industry is a defensive industry as the consumption of daily use products continues even during the adverse economic situation. ITC Limited is a well-known brand for its cigarette business, but it also has a spread in various other businesses like FMCG, Hotels, Packaging, and Agri-business. Since the cigarette business being the core revenue generating business for ITC, the increase in tax rate imposed by the government created the image among the public that cigarette business is an anti-society business which may harm the well-being of the people. This could be the reason for the volatility in the price of ITC's stock. This research paper aims to discuss the risk & return of ITC's stock with respect to the Market Index-NIFTY and to explore the reasons why ITC Limited is underperforming in the long run.*

Keywords *Return, Risk, and Volatility*

INTRODUCTION

Investment is the process of employing money on assets to earn return. The 2 attributes risk and return are highly associated with each other. The return would be in the form of income or capital appreciation. Higher the expectation of return higher will be the risk. The risk is the deviation of actual return from the expected return. Risk could be of 2 types Systematic Risk and Unsystematic Risk. The former means the risk which is associated with the market and the latter means that the risk associated with a particular industry or with the company. Therefore, it is essential for the investors to assess the risk, both systematic and unsystematic and return associated with securities.

Indian Fast-moving consumer goods market is the most attractive sector in the world. It is the 4th-largest sector in India. The key drivers of this sector are rising income, increasing awareness, expanding urbanization, easy accessibility, shift in the lifestyles of people and healthy flow of Foreign Direct Investment. Companies in the FMCG Sector are intensifying their capacity in the domestic and global market as well.

ITC Limited is an Indian Conglomerate which has a wide wings with a diversified range of businesses. Being a producer of tobacco in the initial years, it has started spreading its wings into various other businesses like Packaging, Printing and Hospitality businesses. The ITC Limited has also dipped into FMCG business in early 2000s and also into few other industries.

The coronavirus outbreak made all the firms experience the heightened uncertainty and posed a lot of challenges to the businesses. The FMCG sector has also experienced an adverse impact in India like other sectors. Irrespective of the impact of COVID-19, ITC yields a negative return to its investors who have bought the stocks 5 years or 7 years back. This research article aims to aid investors in understanding the performance of ITC stock with respect to the benchmark index and reasons why the ITC stock is underperforming in the long run.

REVIEW OF LITERATURE

Krishnapranha and Vijayakumar (2015) have chosen 25 companies listed in BSE to analyse the risk and return associated with each stock. They have chosen these stocks based on the market capitalization and analysed the performance of those stocks for the period from January 2010 to December 2014. The study adopted various statistical measures such as average returns, standard deviation, beta and covariance. The researchers revealed in their study that the IT, FMCG and Pharmaceutical sectors yield high returns with low risk.

Sathish and Nagarathinam attempted to study the risk and return of a few selected FMCG stocks from NSE FMCG Index. They found that all the selected FMCG stocks had shown positive returns during September 2019 and gave negative returns during March 2020, the COVID-19 phase.

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HUL stock reported a positive return during March 2020 and Nestle India Ltd shown a relatively positive return over other companies. They have also reported that ITC yielded the lowest return over the other stocks.

Giri Kumari and Narayanappa intended to study the risk and return associated with 5 FMCG stocks of BSE. They analysed the performance of those stocks for a period of 5 years from April 2014 to March 2019. The researchers had adopted the measures like average return, standard deviation, beta and alpha and compared all the 5 stocks with respect to the benchmark index BSE Sensex. Among the 5 companies' stocks, Britannia, HUL and Dabur reported a good average return compared to ITC and Wipro. The study also revealed that the volatility of the ITC stock is high, and the stock was doing worse in generating required return compared to the market return Sensex.

OBJECTIVES OF THE STUDY

The researchers have framed the following objectives for this study:

- To understand the risk and return associated with ITC Limited's stock.
- To analyze the performance of ITC Limited's stock return with respect to the market return in the long run.

RESEARCH METHODOLOGY

The current research is empirical in nature. The data collected were from the secondary sources. The Risk and return of ITC Limited stock and the benchmark index NIFTY were evaluated using the weekly closing prices taken from the NSE website and from yahoo finance website. The data were taken for the period of 5 years from July 2016 to July 2021. Several statistical measures were adopted to assess the stock's return, variation in return and volatility and also to test the study assumption:

- Standard Deviation
- Beta
- Average Rate of Return
- Correlation
- Simple Regression

Research Hypothesis

The following assumption has been formulated for this research study.

H_1: There is an influence of NIFTY's Return on ITC Stock's Return.

FINDINGS

This section discusses the results of various statistical measures used in the study. The following table depicts the Average Return, Standard Deviation, Beta and Alpha of ITC Limited's Stock for the last 5 years from July 2016 to July 2021.

Table 1: Shows the Measurements of Return and Risk of ITC Limited Stock

Measures of Return and Risk	ITC (Y)
Average Return	-0.12%
Standard Deviation	6.59%
Beta	0.72
Alpha	-0.00845

The table explains that the average return of ITC stock is negative (-0.12%) in the long term. The investors and the society view the cigarette as a demerit good. This may be the major reason why the stock of ITC Limited is less attractive to the young socially responsible investors and is underperforming in the long run.

The standard deviation value of 6.59% shows that the variability in stock's return is high. The major reason for this variability is due to the fact that the government has increased the tax rate on Cigarettes from 45% to 56%. This would have created among the investors the fear that they may be taxed much while consuming cigarettes.

The Beta value of .72 signifies that the stock return of ITC Limited is less volatile compared to the market return.

The Alpha measure indicates that the stock was not able to generate expected return in the last 5 years. The negative alpha value of -.00845 implies that the stock has underperformed in the last 5 years compared to the market average return. The excessive diversification of ITC's business could be the reason for this underperformance as a large range of industries are unrelated with one another.

Table 2: Shows the Regression Statistics

Regression Statistics	
Multiple R	0.601
R Square	0.362
Adjusted R Square	0.350
Standard Error	0.054
Observations	59

The multiple R is also a simple correlation value that shows the strength and direction of association between ITC Stock's

Return and Market Return. The value of 0.601 indicates that the ITC stock's return has moderate positive association with the return of the benchmark index.

The R Square value is used to predict the value of the dependent variable using the independent variable. The value of 0.362 means that NIFTY's return explains 36.2% of variations in ITC stock's average return. The remaining variations in return could be caused by any other company specific factors like the company's operations, financial performance and company leadership and also the industry specific factors.

Table 3: Shows ANOVA Statistics

	df	SS	MS	F	Significance F
Regression	1	0.093	0.093	32.281	0.00
Residual	57	0.164	0.003		
Total	58	0.257			

The statistically significant p value (0.00) shows that the regression model is fit to predict the dependent variable. The significance value is less than the level of significance at 5%. Therefore the null hypothesis is rejected and it is inferred that there is a significant influence of NIFTY's return on ITC Stock's return.

Table 4: Shows the Regression Coefficients

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%
Intercept	-0.0085	0.007	-1.192	0.238	-0.023	0.006
NIFTY	0.71996	0.127	5.682	0.000	0.466	0.974

The regression coefficient table helps to predict the value of dependent variable from independent variable. The p value of 0.000 shows that the NIFTY's return statistically significantly contributes to the model in predicting the return of ITC Stock.

The coefficient Beta value shows that one unit change in Nifty's return causes 0.72 unit change in ITC stock's return. Therefore, the regression equation for the model can be written from the table as:

ITC Stock's Return = - 0.0085 + 0.71996 * (NIFTY's Return)

DISCUSSIONS

The Indian population spends a significant part of their income on basic necessities like food and clothing. It could be a great opportunity for the companies in the FMCG sector like ITC to position them in the market. Though ITC Limited has kept diversifying its businesses and growing their subsidiaries, it earns 80% of its revenue from cigarette business and the net profit got affected due to the increase in tax rate on tobacco products. So ITC has started focusing on FMCG business to curb their business risk. FMCG business brings revenue for about 20% to ITC followed by Agri Business (19%) and packaging business (11.5%).

ITC has witnessed 24% drop in their market share whereas their close competitors such as HUL and Nestle had gained 24% and 52% respectively during December 2018. ITC has also faced a decrease in profit due to the heavy tax imposed by the government on Tobacco products. To make it further worse, the corona outbreak has affected countries all over the world. This forced ITC to lessen its reliance on its tobacco business and to focus on the FMCG business and hotel business. Even the pandemic caused a huge negative impact on its hospital business with a deep fall in tourism. Tax hikes and covid outbreak have only been recent contributors to ITC's underperformance. It had been underperforming even before these tax regulations were implemented. The company's leadership must also try to get investor's confidence by making strategic decisions required to be taken during adverse situations.

The young investors started looking for companies whose business practices have a positive effect on 3 parameters namely Environment, Social, Governance (ESG). ITC has an ESG rating of 27.4 out of 40 which is put under the medium risk category. ITC failed to attract the socially and environmentally conscious investors as there is a rise in sustainable investing practices among investors. This made ITC stock less attractive to FIIs resulting in decreasing investment on ITC by FIIs.

There is another important factor responsible for this underperformance is its excessive business diversification. ITC can start focusing on divesting the businesses which are not doing so good from its core businesses. This would help ITC generate revenue from its core business capabilities and to take back the investment from unwanted business ventures.

CONCLUSION

Investment in the stock market is subject to both systematic and unsystematic risk. The risk is the variation of actual return from expected return. The amount of return expected from a security varies based on the risk associated with it. Therefore it is significant for the investors to understand the risk and return associated with each securities before making investment decisions. The researchers have attempted to assess the risk and return of ITC stock and its association with the market return that is NIFTY. The average return of ITC stock is negative in the long term. The company's capital allocation policy and corporate governance have improved in recent years. Though ITC is into a range of diversified businesses, people see cigarette business as their major business and perceives that as a sin stock category. Therefore, the ITC stock is said to be an underperforming stock. There will be a situation where people will start accepting the fact that ITC is not alone with the cigarette business but it could also do better in the FMCG sector being the second largest FMCG player after HUL. If the investors are looking for a long term investment, this stock could be added in their portfolio as ITC has growth prospects in the long-run. This study concludes that there exists a moderate positive correlation between ITC stock return and the market return and also NIFTY has an influence of 36.2% on ITC stock's return. Therefore it is the discretion of the investors to choose ITC stock after assessing their individual investment objectives along with the level of their risk tolerance.

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