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IMPACT OF BUY BACK OF SHARE ON EARNING PER SHARE OF INVESTOR

P. Satish Kumar
E-Mail Id: satishkumar.jkc1@gmail.com
Department of Management, CMR College of Engineering and Technology, Hyderabad, Telangana, India

Abstract- Buyback of shares has been used widely as a means of financial restructuring to maximize shareholder's wealth. It reduces the number of outstanding shares and thus enhances Earnings per Share. As a result, price earnings ratio is also affected. The main objective of the study is to know the reason for Buy Back of Share, to analyze the Performance of Selected Ratios and to study the impact of Buy back of Share on Wealth of Share Holder. The present study examines a sample of buyback announcement made by 5 companies listed on BSE during 2011-2017. Earnings per Share have been used to analyze the impact of buyback of shares on the financial performance of the companies. Paired t-test has been used to examine these ratios before and after the buyback. The Study found that there is improvement in EPS ratio. However, the pre-buyback ratios are not statistically significantly different from the post buyback ratios at 5 % level of significance. Hence there is a significant impact on buy back on Shareholders Wealth. Thus it can be concluded that the shareholders value is not largely influenced by the buyback of shares.

Key Words: Buy Back Of Shares, Bombay, BSE, EPS

1. INTRODUCTION

Competitive forces with the unleashing of the liberalization policies have made corporate restructuring as a necessity for survival and growth. Operational, financial and managerial strategies are employed to maintain competitive edge and turnaround a sickened performance. Financial restructuring involves either internal or external restructuring (i.e. Mergers and Acquisitions). In the internal restructuring an existing firm undergoes through a series of changes in terms of composition of assets and liabilities. Section 77A, 77B and 77AA now allow companies to buy back their shares following the recommendations of committee on corporate restructuring, which was set up by the government to propose various strategies to strengthen the competitiveness of the banking and finance sector, companies are now allowed to repurchase their own shares. This will enable the companies to catch up with other developed markets as part of the government's moves to liberalize the local market and hence emerged the concept of SHARE BUY BACK in the Indian corporate scenario. Share Buyback is a financial tool for financial re-engineering. It is described as a procedure that enables a company to purchase shares from the shareholders. The rationale behind buyback of shares is to boost demand by reducing the supply, which in theory should push the price up. The repurchase of shares reduces the number of shareholders, which in turn enhances the earnings per share (EPS), and thus improves investor's sentiments. Share purchase or Stock buyback is the re-acquisition by a company of its own stock .It represents a more flexible way of returning money to shareholders. The main purpose of buyback of shares is Companies has typically had two uses for profit. Firstly, some part of profits can be distributed to shareholders in the form of dividends or stock repurchases. The remainder, termed retained earnings, are kept inside the company and used for investing in the future of the company, if profitable ventures for reinvestment of retained earnings can be identified. However, sometimes companies may find that some or all of their retained earnings cannot be reinvested to produce acceptable returns. Share repurchases are an alternative to dividends. When a company repurchases its own shares, it reduces the number of shares held by the public. The reduction of the float, or publicly traded shares, means that even if profits remain the same, the earnings per share increase. Repurchasing shares when a company's share price is undervalued benefits non-selling shareholders (frequently insiders) and extracts value from shareholders who sell.

2. SHARE BUY-BACK (POSITIVE ASPECTS)

- The market generally interprets share buy-backs as positive signal.
- Shareholders have a choice of deciding whether or not to receive the payout by selling or holding their shares, unlike a dividend payout.
- Returning excess cash by way of a share buy-back gives a company greater flexibility with regard to its dividend policy
- Share buy-backs could enable a company to achieve its desired capital structure more quickly or facilitate a major restructuring
- A share buy-back could avert a hostile takeover bid by reducing the number of shares in circulation.

3. SHARE BUY-BACK (NEGATIVE ASPECTS)

- The repurchase of its own shares may conversely have a negative signaling effect as the market place may think that the company has fewer growth opportunities after a share buy-back, due to erosion of cash resources.

- Management may not seek to utilize any existing excess cash effectively by acquiring new investments or developing profitable markets.
- Possible mismanagement may arise if too high a price is paid for the re-purchased shares, to the detriment of remaining shareholders, or if cash resources are eroded to the level that could give rise to a risk of insolvency at the expense of its creditors.
- If buy-back is undertaken by replacing shares with debt in cases where companies do not have adequate funds for buy-back of shares, the proposal may misfire on the company.
- A return of funds by way of a share buy-back is less certain than an annual dividend stream.

4. CONDITIONS TO BE FOLLOWED IN CASE OF BUY BACK OF SHARES

4.1 Companies Act 1956 Provides in Section 77A, 77AA, and 77B the Conditions to be Followed in Case of Buyback of Shares by the Company

- The buyback should be authorized by the Articles of Association of the company.
- It is to be made from the existing security holders on a proportionate basis, through open market, holding odd lots or purchasing securities issued to the employees pursuant to a scheme of stock option.
- The sources of funds for such a buyback are free reserves, premium account, or the proceeds of any shares or specified securities.
- A special resolution has to be passed; 5) The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating a full and complete disclosure of all material facts, the necessity for the buy-back, the class of securities intended to be purchased under the buyback, the amount to be invested under the buy back and the time limit for completion of buy-back.
- The buy-back should not exceed 25% of the total paid-up share capital and free reserves of the company and buy-back of equity shares in any financial year should not exceed 25% of the total paid-up equity share in that financial year.
- The debt-equity ratio should not exceed 2:1 after such buyback.
- All shares or specified securities for buyback should be fully paid up.
- The buyback has to be completed within12 months from the date of passing of the special resolution;
- A Declaration of Solvency has to be made by the Board of directors, before the buyback, to the effect that they have made full inquiry into the affairs of the company and have formed an opinion that the company is capable of meeting its liabilities and will be rendered within a period of one year from the date of the Declaration. Such declaration has to be signed by at least two directors, one of whom shall be managing directors, if any. It has the to be filed with the concerned Registrar of Companies and SEBI.
- Where shares have been bought back from free reserves, a capital redemption reserve account has to be created which would be equal to nominal value of the shares bought back. This Reserve can be used, among others, for issue of bonus shares.
- The shares have to be extinguished and physical destroyed within 7 days after buy back.
- No further issue of same kind of securities is permitted within 24 months of completion of buy-back except by way of bonus issue or discharge of existing obligations such as conversion of warrants, preference shares, debentures, etc.
- The company has to maintain a register of securities bought back and file a return with the concerned ROC and SEBI within 30 days of completion of buy back.
- If a company makes a default in complying with the provisions of this section, the company or any officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to fifty thousand rupees, or with both.
- The company is not directly or indirectly allowed to purchase its own securities through subsidiaries or investment companies.
- A buyback cannot be affected where there is default by the company in repayment of deposit or interest, redemption of debentures or preference shares, payment of dividend, or repayment of loan or interest to financial institution or bank.
- All the buyback of the shares or other specified securities should be in accordance with the regulations made by the SEBI.

4.2 Reason for Buy Back

Following are possible reason for which companies go for buy back of their own shares.

- To return surplus cash to shareholders: When a film doesn't have any profitable opportunity then, many companies try to reward their share price by returning them cash for share. It’s one form of distributing the profit similar to dividend.
- To increase the underlying shares value: Some time companies undertake buy back decision to uplift the moral of the share holders. Company displays their confidence and long term vision by paying high premium for their own share. It attracts new investor and helps the desperate shareholders to exit at a

premium. The buyback of share by company signal undervaluation of the share, which attracts new investor. This helps in controlling the falling share prices.

- To achieve or maintain a target capital structure: Companies often undertake buy back decision to change its capital structure. Company buy back its share to reduce weighted average cost by replacing costly equity capital with cheaper and tax deductible debt. This strategy allows the company to actively manage its capital and to improve performance measures. Reduced share capital results into increased earnings per share and price earnings ratio.
- To replenish the pool of shares available for employee: Company often undertake buyback to reduce the dilution caused by company share option plans. Such plans have become an increasingly large part of company's compensation plans worldwide. From time to time companies buyback share avoid excessive dilution that may occur as more and more options are granted and later exercised
- To prevent or inhibit unwelcome take -over bids: The buyback regulation provides a fair chance to the incumbent management to protect their turf in case of a hostile takeover. The takeover code allows the company to offer a buyback even after a hostile bid has been made. A buyback at higher price raises the market prices and make the takeover expensive for the raider.

5. REVIEW OF LITERATURE

Vermaelen (1995) in his study examined 131 buy-back tender offers and 243 open market repurchase. He found the average abnormal return of 3.67% and13.9% for an open market repurchase and tender offer announcements respectively. He found that the earnings per share were found to be abnormally high for the years following a tender offer and used as a proxy for cash flow per share. Heex aimed a period from 1962-1977 when most of the firms repurchasing shares were small firms, normally not followed by many researchers. These firms were mostly considered to be undervalued and thus required a greater need to follow tender offer. He endorsed that the management undertakes buy-back to satisfy the investors that the shares of the company are undervalued.

Nohel and Tarhan (1998) examined 242 tender offers during the period 1978-1991and argued that the effects of buyback announcement are not adequate to conclude that the signalling or the free cash flow hypothesis holds true. They observed some improvement in the performance of the companies buying back but there were sheer differences between high- growth and low growth firms.

Weisbenner (1999) found that if the firms grant stock options, it will reduce earnings per share because the number of shares over which earnings are divided would be increased. EPS is an important determinant of the performance of a company. Once the share is bought back, the number of outstanding shares is reduced. However, the cash utilised repurchase the shares is not taken out of earnings. Weisbenner concluded that the companies carry out gradual share repurchase in order to offset the adverse earnings per share resulting out of stock option programmes. The study of Ben, Nagar, Skinner and Wong (2003) also examined that corporate executives' stock repurchase decisions are affected by their incentives to manage diluted Earnings Per share. They found that dilutive effects of employee stock option plans on diluted EPS help explain executives' stock repurchase decisions.

Bravetal. (2005) findings further supported this argument and found that to counteract the adverse effect of employee share option is the third most significant cause of share buyback decision. In order to examine the price reaction of the share buyback announcement Mishra (2005) studied 25 buybacks in India during the period between 1999 and 2001. He mentioned that the company's intention to reveal its high confidence in itself is the major reason behind the buyback of shares. He tried to find out whether the management took best care of the interest of the non tendering shareholders when it decided to go for buyback of shares. In order to describe the trends of various performance measures like share prices, a trend analysis was carried out for pre and post buyback period. The study established that the repurchase returns were generally momentary and the markets came back to the previous level after only three months. Thus share buyback was used to increase promoter's shareholdings.

Bravetal(2005) found after interviewing 384 CFO's that increase in earnings per share is the second main important factor which affects a company's decision of share buyback. The reason supporting this argument is that if share is repurchased, the number of shares outstanding is reduced and as a result EPS will grow assuming net income remains unchanged. However, there are various reasons which that may contradict the apparent association between EPS and share buyback. First, a share buyback will not necessarily boost earnings if positive NPV investments opportunities exist that is the funds used for the buyback would not succeed to earn the desired cost of capital. In this case it is better to invest in the company's own stock than other available investments otherwise executing a share buyback may actually bring down the shareholder value.

Li and McNally (2007) in their paper found that the average number of shares outstanding actually grows by 4.7 percent for the companies buying back shares, in comparison with a sample of non-repurchasing where number of share outstanding increased firms by 10.0 percent for the same time period. This further means that all share buyback programs do not reduce the number of shares outstanding. In their conceptual study Nadarajan, Ahmad and Chandren (2009) attempted to examine the share buyback announcement effects on earnings within the jurisdiction of Malaysian Stock Market. The study concluded with a conceptual model, which provides with an insight of valuable connection between share buyback targets and earnings per share, Dividend Payout ratio and cash flows of firms making share repurchase announcements in Malaysian markets. Secondly, it may be quite possible that repurchase of shares does not always result into a decrease number of shares outstanding at the end of the buyback program as on one hand a firm is repurchasing its shares, and on the other it may also be issuing shares to execute employee stock options. There are studies which proved that the number of shares outstanding actually increases as a result of share buyback.

B.Ramesh and P.Rane (2013) examined the sample of 27 Indian companies and 5 Multinational companies belonging to 21 different industries listed on BSE to measure the performance of share repurchase during the period 2005 to 2010. The study analysed the effect of share repurchase on the shareholder value creation. It was considered that the Earnings per share increased because the number of shares reduced after the buyback of shares. The study revealed that there was increase in EPS for 78% of the buyback programmes included in the sample. For the remaining a reduction in EPS was registered. Thus it was concluded that the buyback of shares created value to the shareholders through share buyback programmes.

Abdul Wahid (2014) discovered that the operating performance of the companies was improved just because of the reduction in the number of outstanding shares. It was also found that the important factors for improving the operating efficiency were earnings per share, return on assets, returns on equity and market to book value of equity. The sample included 101 companies listed on Main and Second Board of Malaysia and that had undergone through the share repurchase during 1999 to 2005. Share buyback was considered as a method of returning excess cash to its shareholders.

Dhanda and Kaur (2014) had published their research paper to discuss the benefits of share repurchase to the shareholders and the companies. The prime intention of the study was to test the impact of the share repurchase on the performance of the companies. They analysed the companies listed on the BSE and undergone the share buyback programme between 2009 to 2011. To measure the pre and post-performance of the companies' ratio analysis technique was used. Liquidity ratios are calculated to test the financial stability of the companies after the buyback of shares and to find the association between the liquidity ratio and the performance of the companies. They believed that if the firm is not able to provide the returns equivalent to what is required it should return funds to the investors so that they can invest such funds elsewhere to get their desired returns.

6. OBJECTIVES OF THE STUDY

The basic objectives of the study are as follows:

- To know the reason for Buy Back of share.
- To analyze the performance of selected Ratio
- To study the impact of Buy back of Share on wealth of Share holders

6.1 Need of the Study

This study is used to know the impact of buy back of wealth of shareholders and to know the reason for buyback of share and to analyze the Perform

6.2 Hypothesis

H0: There is no significant impact of buy back of share on Earning per Share.
H1: There is significant impact of buy back of share on Earning Per Share.

7. RESEARCH METHODOLOGY

To achieve foresaid objectives the following methodology has been adopted. The information for this report has been collected through the secondary source.

7.1 Secondary Source

Present study purely based on secondary data which is collected from from relevant web portals i.e.www.moneycontrol.com.

7.2 Sample Design

Companies i.e.Infosys, Tata Consultancy Services, HCL,Wipro, Tech Mahindra.

7.3 Statistical Tools for Data Analyse

The mean is the most commonly-used measure of central tendency. The mean is simply the sum of the values divided by the total number of items in the set and T-Test was used to test the hypothesis.

8. DATA INTERPRETATION

For each selected company Viz., Infosys, TCS, HCL, Wipro and Tech Mahindra four key ratio which is earnings Per Share, has been calculated for pre and post periods of Buy Back of Shares and mean has been calculated to apply T-test for both mean values to test hypothesis which is to know the significant impact of buy back of share on wealth of Shareholders. The overall compiled data is shown in table 8.1.

Table-8.1 Overall Result of T-Test

COMPANY	RATIO	PRE RETURN MEAN	POST RETURN MEAN	T-STAT	TABLE VALUE	HYPOTHESIS (H0)
INFOSYS	EPS	169.97	379.93	-4.12	4.3	Accepted
TCS	EPS	404.87	921.56	-6.21	4.3	Rejected
HCL	EPS	34.64	223.3	-10.90	4.3	Rejected
WIPRO	EPS	4.01	4.16	-0.11	4.3	Accepted
TECH MAHINDRA	EPS	5.03	6.59	-0.68	4.3	Accepted

Source: Compiled data

From the above analysis I found that Earnings per Share of Infosys, Wipro and Tech Mahindra are accepted. So, there is no impact for buyback of shares. And Earnings per share for TCS&HCL are rejected so there is impact for Buy back of shares.

CONCLUSION

Share buyback is considered as an effective mechanism of financial restructuring specially for creating value to the shareholders. The study observed that there is improvement in the financial performance of the companies after the buyback of shares. Earnings per share has been increased in the post buyback period. Thus it can be concluded that the buyback of shares enhances the value to the equity shareholders. However, such increase is found to be statistically insignificant which leads to the acceptance of both Null hypothesis and Alternative Hypothesis. Thus it can be concluded that there is slight change in the shareholder's value after the buyback of shares.

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