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Why Companies Use the Policy of Buyback of Shares in India

Authors

Dr. Neelam Dhanda[1], Karamjit Kaur[2]

[1]Professor, Department of Commerce

Kurukshetra University, Kurukshetra

[2]Research Scholar, Kurukshetra Universty

Kurukshetra

Email: *drneelamdhanda@gmail.com*, *karamjeet17@gmail.com*

Abstract

Buy Back of shares in India is permitted in 1999.This is the new Concept in India. Because few companies are used the buyback of shares in India .Because there are the perception only rich companies are using the buyback of shares in India .But there are many benefit of the buyback of shares in India .This research paper discuss about all the aspect of buyback of shares which are benefit able for the companies as well as shareholders. The main objective this research paper to check the effect of buy back of shares post and pre performance.

Key Words: *Buy Back of Shares, Companies, Ratio*

Introduction

Shares buy back have become a company event in the financial market worldwide. Buyback program the company distributes the excess cash flow among the shareholder by way of repurchasing its own shares, generally at premium .India shares buy back were introduced in 1999 has receive and attention of all major companies .Since then there has been a spate of announcement of share buy backs. Small investors in India also need to know whether they will benefit by will participating in the buy -back offer or they will be better off in the post buy back phase companies acquire their own shares to improve earnings per share by reducing the number of shares .Share buy backs by their very nature decrease the total number of shares .Outstanding with fewer shares outstanding after a buy back and assuming that buy back does not adversely affect the company earning ,the per share effect of the remaining shares will increase.

History of Buy back of shares

The buyback ordinance was introduced by the government of India (GOI) on October 31; 1998.There was insertion of new section of new sections 77A, 77AA, and 77B in the company's law which allowed buy back. The major objective of the buyback ordinance was to revive the capital markets and protect companies from hostile takeover bids. The ordinance was issued along with a set of conditions intended to prevent its misuses by companies and protect the interest of investors .The buyback of shares was allowed only if the articles of association of the company permitted it to do so and after passing a special resolution at a general meeting .It also allowed the promoters of a company to make an open offer to purchase the shares of its subsidiary .This allowed foreign promoters to utilize their surplus funds and make an open offer to acquire a 100% stake in their Indian subsidiaries .Now that the norms have been altered and MNC's were permitted to carry on their business without any such compulsion ,they would rather operate as wholly subsidiaries without being listed on the bourses Several MNC's like Philips India Philips, Cadbury India Otis Elevators Carries Zircon Reckitt benkisers etc announced offers to buy back the shares of its Indian subsidiary under Security exchange board of India .

Review of Literature

Das & Pattanayak (2007) examined the effect of the of quarterly earnings announcements on firms constituting the Bombay Stock Exchange .The study showed that the quanta of the effect of the announcements in temporarily up of prices in response to positive news and vice versa. The study analyzed the stock returns of thirty companies constituting Bombay Stock Exchange Sensex for the quarter ended September 2006. The effects of quarterly earnings announcement on equity share prices have been examined by taking daily adjusted market price data. The study observed that the thirty days of earning (t=-10 to t= +9) is assigned the event period. The results indicated that on the day of announcement the Average Abnormal Return had been maximum negative which implied that the actual returns on this stock had been much less than the expected returns. **Kaur & Singh (2010)** the study tested abnormal returns for information Signaling free cash flow and leverage Hypothesis. The study analyzed that the buyback are emerging as a tool of capital restructuring. It made an empirical analysis by taking the data for the year 1999-2004.It found that the data 100 events of shares buyback are available on Bombay Stock Exchange listed companies. The results indicated that the market reaction to buyback announcement is positive. It observed that the positive price reaction start even before the public announcement. It was reported that the mean abnormal returns of the 2.22 percentage for share buybacks on the day of announcement. The study analyzed the different variables as proxy measures to test the Signaling and Undervaluation Hypothesis. **Kaur (2012)** investigated that the impact of open market share buyback announcements on share price s of Bombay Stock Exchange listed companies. The study observed that the significance positive mean daily returns are analyzed for two days observation period .The study examined the a sample of 172 events of shares buyback through open market repurchase announced between March 2001 to March 2012 .The study found that the shares buyback announcement was created positive market reaction on stock market .The study also suggested that the stock market was welcomed share buyback. **Latif & Mohd (2013)** the study focused on two major issues .Firstly firms with prior price performance are more likely to repurchase shares and secondly firms with better operating performance are more likely to repurchases shares .The study examined the managerial motives for repurchase in Malaysia using signaling and substitutes hypothesis. It showed that the west and developed market have established that firms repurchase share to substitute for dividends payment. cash. **Rajlaxmi (2013)** the study measured expected returns of the stock by taking analytical period 2007 to 2010.It also indicated the six repurchase announcements with the help of single index model. The study found that beta is obtained by regressing the daily return with index return .It based on "efficient market hypothesis" which theory provided the information that is past ,public or insider information . The results indicated that the investors therefore view repurchase announcement as a means for short term gains and not a visible strategy for significant long term abnormal gain or loss. **Agarwall et al. (2013)** examined the market timing ability of Indain firms engaged in open market repurchases. The study focused on three motivating factors through open market repurchases in India .First factor repurchase environment which was disclosed of the open market repurchases are more frequent in India than in most other markets .Second factors in India maximum period allowed for open market repurchases .Finally factor was Indian financial market which provided the greater degree of information asymmetry between insiders and the outsiders .**Bhatia (2013)**examined the short term effect of shares repurchases on stock price in India .The study focused on two major hypothesis .Firstly ,Undervaluation Hypothesis which indicated the negative abnormal return before share repurchase announcement. Secondly, Signaling Hypothesis which indicated that the positive abnormal return after share repurchases announcement. The study also analyzed the Undervaluation and Signaling Hypothesis by taking the data for the period 2011 to 2012.The results indicated that the negative abnormal returns by testing the Signaling Hypothesis .It found that the size affected by the shares repurchases reaction. It showed that the cumulative abnormal return 4.5 percentages which were showed positive impact of share repurchase. **B & Rane (2013)** assessed the performance of share buyback by taking the study period 2005 to 2010 from the listed companies on Bombay Stock Exchange .The study examined the impact of buybacks on shareholder value creation .The study showed that when buyback was announced decreased in the number of shares and increased the earning per share .The study examined the sample of 27 Indian companies and 5 Multinational companies .The study found that the all buyback announcement related to belong 21 Industries .The results indicated that the 78 percentage of the buyback programs have registered on enhancement in the earning per share while 22 percentage have recorded.

Research Methodology

Research methodology can be defined as a way to systematically solve the research problem by logically adopting various steps. The process used to collect information and data for the purpose of making business decisions. The methodology may include research, interviews, surveys and other research techniques, and could include both present and historical information

Objective of Study

1. To study the effect of buy back of shares on Liquidity Ratios
2. To study the effect of buy back of shares on Post and Pre performance of the Companies.

Study Period

The period of the study had been taken from 2009 to 2011 the companies have been listed on Bombay Stock Exchange.

Data Collection

The study will be based on secondary data. The data will be collected from official website of SEBI (Security Exchange Board of India), NSE (National Stock Exchange), BSE (Bombay Stock Exchange) CMIE data, CAPLINE, PROWESS data base and other sources.

Tools of Analysis

Mean

Mean is the mathematical average of a set of numbers. Average is calculated by adding up two or more scores and dividing the total by the number of scores. Mean facilitates quick understanding of general and complex mass of data into single typical feature. The task of comparison becomes easy and conclusions can be drawn. Mean is valuable in setting standards, estimation and other managerial decisions. An average becomes essential when it is desired to trace the mathematical relationships between different groups.

Ratio Analysis

A ratio is a statistical yardstick that provides a measure of relationship between two accounting figures. A ratio may be expressed as a quotient, proportion and percentage. Ratio analysis of financial statements stands for the process of determining and presenting the relationship of items and group of items in the statements. There are several ratios which an analyst can employ, but the type of ratios he would precisely use depends on the purpose for which the analysis

Is made. For example, a creditor would like to know the ability of the corporation to meet its current obligations and therefore would think of current and liquid ratios. Ratios facilitate the comprehension of financial statements and evaluation of several aspects such as financial health, profitability and operational efficiency of the undertaking. Ratios such as earnings per share book value and dividend per share also help in investment decisions in the case of shareholders, bankers and financial institutions...

Current Ratio

Current Ratio = Current Assets/ Current Liabilities

Current Ratio is measured as a ratio between current assets and current liabilities. It measures short-term solvency, - ability of the company to meet short-term obligations and is a margin of safety to the creditors. A current ratio of 1 would indicate that there are enough current assets to pay current liabilities. However, many companies maintain a current ratio of more than 1 so as to provide a cushion for timing difference between the payment of liabilities and conversion of current assets into cash and losses in the conversion. A ratio of 2 is considered as an ideal. However, a very high ratio does not indicate a satisfactory situation. Such ratio may be the result of accumulation of the accounts receivable due to slackness in collection and piled up inventories due to poor sales.

Table 1 Balance Sheet as on 31 March 2009, 2010, 2011 Current Ratio

Company	Current Ratio 2009	Current Ratio 2010	Post – Pre
Godrej Industries Ltd	0.67	0.69	0.02
Avantal Ltd	2.7	4.27	1.57
Valiant Ltd	10.02	9.06	-0.96
T.V today Ltd	4.06	3.67	-0.39
Fdc Ltd	2.97	3.22	0.25
Monnet Ispat Ltd	0.84	0.65	-0.19
Mangalam Cemant Ltd	1.05	1.18	0.13
LKP Ltd	1.25	2.92	1.67
Jindal Policy Films Ltd	2.13	1.69	-0.44
GSS American Infotech Ltd	13.7	23.67	9.97

Company	Current Ratio 2010	Current Ratio 2011	Effect Post-Pre
Godrej Industries Ltd	0.69	0.67	-0.02
Avantal Ltd	4.27	2.48	-1.79
Valiant Ltd	9.06	15.42	6.36
T.V today Ltd	3.67	1.88	-1.79
Fdc Ltd	3.22	3.69	0.47
Monnet Ispat Ltd	0.65	0.68	0.03
Mangalam Cemant Ltd	1.18	1.13	-0.05
LKP Ltd	2.92	1.22	-1.7
Jindal Policy Films Ltd	1.69	1.85	0.16
GSS American Infotech Ltd	23.67	19.87	-3.8

Table 3 t-Test

Year	Mean	N	Std. Deviation	Std. Error Mean
2009	3.9390	10	4.39550	1.38998
2010	5.1020	10	6.97449	2.20553
2011	4.8890	10	6.86351	2.17043

Paired Samples Correlations				
		N	Correlation	Sig.
	2009&2010 2011&2010	10 10	.941 .926	.000

	Paired Differences					t	df	Sig. (2-tailed)
				95% Confidence Interval of the Difference				
	Mean	Std. Deviation	Std. Error Mean	Lower	Upper			
Effect (2010-2009)	-1.16300	3.20611	1.01386	-3.45651	1.13051	-1.147	9	.281
Effect (2011-2010)	.21300	2.66634	84317	-1.69439	2.12039	.253		.806

Source Balance Sheet of Companies from moneycontrol.com, economicestimes.com, annual report of companies.

Table 2 Balance Sheet as on 31 March 2009, 2010

Company	Quick Ratio 2009	Quick Ratio 2010	Post-Pre
Godrej Industries Ltd	1.31	0.93	-0.38
Avantal Ltd	2.33	3.63	1.3
Valiant Ltd	6.06	6.05	-0.01
T.V today Ltd	4.02	4.23	0.21
Fdc Ltd	1.99	2.49	0.5
Monnet Ispat Ltd	3	2.38	-0.62
Mangalam Cemant Ltd	0.8	0.9	0.1
LKP Ltd	3.38	2.53	-0.85
Jindal Policy Films Ltd	1.69	1.18	-0.51
GSS American Infotech Ltd	13.7	23.67	9.97

Balance Sheet as on 31 March, 2010, 2011

Company	Quick Ratio 2010	Quick Ratio 2011	Effect Post-Pre
Godrej Industries Ltd	0.93	0.78	-0.15
Avantal Ltd	3.63	1.78	-1.85
Valiant Ltd	6.05	8.82	2.77
T.V today Ltd	4.23	2.65	-1.58
Fdc Ltd	2.49	2.89	0.4
Monnet Ispat Ltd	2.38	3.56	1.18
Mangalam Cemant Ltd	0.9	0.83	-0.07
LKP Ltd	2.53	5.57	3.04
Jindal Policy Films Ltd	1.18	1.31	0.13
GSS American Infotech Ltd	23.67	19.87	-3.8

Table 4 t-Test

Years	Mean	N	Std. Deviation	Std. Error Mean
2009	3.8280	10	3.78687	1.19751
2010	4.7990	10	6.82292	2.15760
2011	4.8060	10	5.83940	1.84658

Paired Samples Correlations

		N	Correlation	Sig.
	2009&2010	10	.977	.000
	2010&2010	10	.958	.000

	Paired Differences					t	df	Sig. (2-tailed)
				95% Confidence Interval of the Difference				
	Mean	Std. Deviation	Std. Error Mean	Lower	Upper			
Effect (2010-2009)	-.97100	3.22280	1.01914	-3.27645	1.33445	-.953	9	.366
Effect (2011-2010)	-.00700	2.07818	.65718	-1.49364	1.47964	-.011	9	.992

Firstly we taken the ten companies which they had buyback their shares in year 2009 and .Then we calculated the liquidity ratio with help of the balance sheet for the year 2009, 2010 and 2011 years of the ten companies in India. Secondly we had taken the current ratio of the ten companies from the website moneycontrol.com. Further we compared the current ratio 2009 with 2010 and 2010 to 2011.Then we are calculated the post and pre performance of the companies. Further we had taken the quick ratio for the ten company's .the we followed the same process which have used in current ratio. Liquidity ratio measure the ability of a company to pay off its short-term liabilities when they fall due. The liquidity ratios are a result of dividing cash and other liquid assets by the short term borrowings and current liabilities. They show the number of times the short term debt obligations are covered by the cash and liquid assets. If the value is greater than 1, it means the short term obligations are fully covered. Generally, the higher the liquidity ratios are, the higher the margin of safety that the company posses to meet its current liabilities. Liquidity ratios greater than 1 indicate that the company is in good financial health and it is less likely fall into financial difficulties.

Results and Finding

The results indicate at the 95 % the t test value .281 0.827. Table 1 indicates that the liquidity ratio is increasing of Godrej industries ltd, Avantal ltd and Valiant Ltd Company. From the table 43comparisons between 2009, 2010 liquidity ratio and the 2011 are shown the significant. Godrej Industries Limited, Avantel Limited and T.V Today Network Limited sown the negative effect of the buyback of shares but the majority of the companies are shown the positive effect of buy back of shares on liquidity ratio. But the Valiant Communication Limited, FDC Limited, Monnet Ispat Limited, Monnet Ispat Limited, Mangalam Cement Limited, LKP Finance Limited, Jindal Policy Films Limited shown best effect of buy back of shares in India.

Why do Companies buy back their Shares?

Shareholders and management can have other reasons for wanting to buy back shares:

- A change in the relative weighting of shareholders between those who refuse to sell their shares to the company for reasons of control (i.e. in order to increase their percentage of ownership) and those who agree to sell some of their shares, hopefully at above their market value. This happened recently with Peugeot.
- Tax reasons, as it is often less costly for shareholders to get cash in the form of a share buyback than in the form of dividends;
- To send out a positive signal, i.e. that management considers the company to be undervalued. Buying back shares and cancelling them increases the value of the remaining shares. Given the recent movements in some stocks, this can be a very strong incentive.
- Leverage from debt, for the related tax benefits. This is not a very compelling motivation, as it overlooks the fact that debt and equity become riskier after a share buyback and thus more costly. The tax benefit is often illusory, especially as the company loses some financial flexibility. If share buybacks reduced

WACC, companies would always be `1 massively buying back their shares!

- Building up a reserve of shares to be used later for stock option awards or as a currency for an acquisition.
- Smoothing out share price fluctuations in the case of listed companies. But whatever is bought can be resold, and such buybacks, which are often in tiny doses, are tightly regulated by market authorities;
- Creditor considerations: share buybacks reduce a company's solvency and thus increases its risk and diminishes the value of its debt. But as creditors can oppose a c

Conclusion

The study discuses about the financial stability of the companies after the buyback of shares in India .The paper also analyzed the there are the significant relationship between the companies performance and liquidity ratio. The paper also analyzed the buyback of shares undervalued the price of securities. The main reason companies buy back their own shares is to switch cash from mature sectors and investments to new sectors or expanding companies. Share buybacks are an increasingly frequent and healthy phenomenon. When there are no investment opportunities offering a return commensurate with the required rate of return, management returns cash to shareholders, who, presumably, can find investments that meet their requirements.

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