IJETST- Volume||01||Issue||08||Pages 1327-1334||October||ISSN 2348-9480 2014

Open access Journal International Journal of Emerging Trends in Science and Technology

Market Reaction to "Share Buy-Back" of Reliance Industries Limited

Authors

M. Harikrishna, Prof. D.V.Ramana

Department Of Management Studies, Sri Venkateswara University, Tirupati

ABSTRACT

Indian corporations currently view share buy-backs as an effective capital management tool that has the potential to increase shareholder value. As a consequence, the level of buy-back activity has intensified in recent years with many corporations engaging in this practice. Share buy-backs were introduced in India in the year 1998. All major corporate have given attention to this concept and today India is a well known face in the financial market for this reason. Companies in India can buy-back their share either through open market route or through tender offer route. Majority of companies have been using the open market route through stock exchange. It was found out that RIL has underperformed the benchmark with poor returns prior to the announcement of buy-back, indicating undervaluation of shares and positive abnormal return in the post announcement indicating signaling effect of share buy-back during 2011-2013. This paper examines the reaction of market on the announcement of share buy-back of RIL.

Keywords: *Share Buy-back, Reliance Industries Limited (RIL), Market reaction*

INTRODUCTION

When companies are over capitalized there are two alternatives for allocation of their surplus fund. First alternative is to retain the fund with itself and invest it for further development of the organization. Second alternative is to return the fund to the shareholders of the company. It can be through dividend or in form of buy-back of shares. Buy-back can be considered as the reverse of issuing shares by a company as it offers to take back its shares owned by the investors at a specified price. Generally, companies go for a share buy-back either to increase the value of shares by reducing the number of shares in the open market or to eliminate any threats by predatory investors or companies who may be looking for a controlling stake. Some people consider buy-back as means other than dividend to return its wealth to shareholders. It can also be considered as a company investing in itself, or using its cash to buy its own shares. Since the company cannot be its own shareholder, the shares which are bought back are absorbed by the company and the number of outstanding shares in the market is reduced. As a result, the relative ownership stake of each investor increases because of fewer outstanding shares.

In India, the concept of share buy-back was introduced in 1998. Previous research has found that share buy-backs announcements create positive market reaction suggesting thereby that stock markets welcome share buy-backs. Most of research has been done in developed markets. The objective of this paper is to study the stock market reaction to share buy-back announcements by RIL.

Reliance Industries Limited:

The Board of Directors of RIL approved the buy-back of its fully paid up equity shares of Rs.10 each, at a price not exceeding Rs 570 per share, payable in cash, up to an aggregate amount not exceeding Rs 2,999 crore. This amount represents the limit of 10% of the total paid up equity share capital and free reserves of the Company as on March 31, 2004. In 2004, RIL announced a buy-back of shares worth Rs 3,000 crore but had actually acquired shares worth only Rs 150 crore.

RIL shares, which fell by 35% in 2011. On February 7, 2012, RIL had launched the largest buy-back programme. The maximum price of the buy-back offer is Rs 870. This is within the market expectation band of Rs 850-900. The upper limit of the buy-back price is also 10% more than Rs 793, the closing price on the final announcement date. However, the maximum size of the buy-back, Rs 10,440 crore, is at the lower end of the market expectations. RIL's net worth was Rs 151,540 crore as on 31 March 2011 and the market expected an allocation of about Rs 15,000 crore. As per SEBI rules, a company can spend only up to 10% of its net worth (capital plus reserves and surplus) for buy-back offers. The Rs 10,440 crore cap announced by RIL works out to 7% of its net worth. According to its annual report, RIL had bought back 46.24 million shares worth just over Rs. 3,900 crore till January 16, 2013 from public shareholders through an about year-long share repurchase programme, achieving just about 38 per cent of the target.

RIL by launching the largest buy-back programme by any Indian company had joined the league of global energy firms like Exxon Mobil, ConocoPhillips and Chevron Corp to reward its shareholders by announcing a mega buy-back of shares. Last year, the three US energy majors rewarded their shareholders by announcing buy-back of shares worth $31.5 billion, when the US economy was reeling under a recession. Exxon had announced a buy-back of $16.7 billion, while ConocoPhillips and Chevron announced a buy-back of $11.8 billion and $3 billion respectively.

During 2007-10, global energy majors have done large share buy-backs. Some of the major share purchases include buy-back of Exxon Mobil at $100 billion, Conoco-Phillips ($19 billion), Chevron ($13.5billion), BP ($9.6 billion), Shell ($7.9 billion), BASF ($3.5 billion) and Dow Chemicals $2.4 billion.

LITERATURE REVIEW

Empirical evidence from prior studies report negative long run abnormal returns following the buy-back announcement in U S, U K and Canada. Market reaction in the UK differs from that in the US for the short term market.

In Canada Ikenberry et.al (2000) found that the Canadian experience is similar to the earlier evidence obtained for US buy-back and the initial market reaction to repurchase programs is small; the abnormal return is less than 1 % in the announcement month. They also found that the market on average seems to under estimate the information contained in repurchase announcements. Further using a three- factor model, abnormal performance over a three year holding period is about seven percent per year. Their finding is consistent with well documented findings in the United States, that long run abnormal stock returns for these cases are negative.

Ikenberry and Vermaelen (1996) found that announcement returns are directly related to the volatility of the stock and the fraction of shares to be purchased. They also found that the market reaction is negatively related with the correlation co-efficient between stock returns and market returns.

McNally. W, (1998), suggests that the two types of offers generate roughly the same total returns (about 10–11%, on average, during the offering period) to shareholders who do not tender. Fixed-price offers involve considerably larger premiums (over the new, "full-information" price) and wealth transfers than Dutch auctions. Reflecting the higher premiums, shareholders tendering into fixed-price offers receive higher returns than those tendering into Dutch auctions (13.8% vs. 11.3% during the announcement period). He also finds some evidence that fixed-price offers involve a considerably larger wealth transfer from non-tendering to tendering shareholders, fixed-price repurchases compensate the non-tendering shareholders for the larger wealth transfer with larger increases in "intrinsic value," thus generating the same total return as Dutch auctions. Moreover, despite the large premiums offered in both types of offers, the wealth transfer implicit in the premium represents a small cost (less than 1% in fixed-price offers, and less than 0.1% in Dutch auctions) to non-tendering shareholders.

Isagawa (2002) examined corporate open market repurchase strategy and stock price behavior. He establishes a signaling equilibrium with the assumption that the firm is committed to an announcement of open-market repurchase intention. He also found that positive long run stock returns as well as positive announcement effects following open-market repurchase announcements.

Schaub, Mark (2008), provides some evidence that debt buy-backs may have beneficial impacts on stockholders' holding period returns and cash flows. His analysis is based on the 'all things constant' model popularized by Modigliani and Miller in the capital structure and dividend policy papers. He concludes, firms can obviously benefit by repurchasing their debt when market values have decreased. His study also suggests debt buy-backs may be valuable to stockholders in and of themselves, not just in times of rising interest rates and downgraded bond ratings.

Schaub, Mark (2009) finds some evidence of wealth effects associated with debt buy-back announcements. He observed significant positive average returns on the announcement date reflect investors' opinion that the event is considered 'good' news. He also suggested further research to find out whether there are long-term positive effects or even intra-industry information effects associated with such announcements.

In the Indian context, because of the restriction imposed by the law of the land up to
1999, empirical studies on buy-backs are a few.

Mohanty (2002) in the study of 12 buy-backs in India found a 3.86 percent return on the announcement day to document the first evidence of positive signalling in Indian context. In a study of 25 buy-backs between 1999 and 2001, Mishra (2005) found short term gain for the shareholders.

Sunitha (2005) investigated market reaction to announcements of stock repurchases and dividends of 22 firms in the BSE 500 index during 2002-2004, and choice between the two-payout methods (i.e stocks repurchases and dividends) and found that stock repurchase programs recorded a high cumulative abnormal return of 3.2 percent within two days of the event, whereas dividend announcement recorded a high cumulative abnormal return of 2.1 percent within one day of the event. There was no significant difference in abnormal returns as result of various repurchase levels.

Gupta (2006) studied 46 buy-backs between 1999 and 2005 and documented further evidence for the positive signalling by having observed a significant abnormal return of 1.66 percent.

Hyderabad (2009) found a statistically significant average abnormal return of 2.76 percent on the announcement day for the 70 corporate buy-back announcements made during the period 1999 to 2007 to support undervaluation hypothesis and documented non sustainability of abnormal returns in the post event period.

Ishwar (2010) studied 106 BSE listed companies, which announced buy-backs during the period from 1999 to 2006 and found an average abnormal return of 2.23 percent, but that was not statistically significant on the event day to signal the under-pricing of securities. The author opined that the market has not found any news in the announcement as revealed by the continuing trend that started before the announcement and the market anticipate the information and incorporated into prices before the announcements.

Dhatt (2010) documented a statistically significant abnormal return of 2.55 percent on the event day for 40 cases listed in BSE for a period between 2004 and 2009, thereby signalling undervaluation. All the above studies were taken up in different time horizon and except one study all the other supported the undervaluation assumption or positive information signaling.

S.Narayan Rao (2010) examined the effects of announcement of offer of open market buy-back in India. The sample consists of 64 open market share buy- backs offer during 2003-June 2010. The evidence suggested that significant sustainable increases in firm values occur around the announcement of buy- back offer. The results support information signaling hypothesis of share buy-back.

Kaur Karamjeet and Singh Balwinder (2010) in their paper analyzed the market reaction to the share buy-back announcements of companies listed on BSE for the year 1999-2004 by employing event study methodology with Sensex as the market index and found that market reacts positively to the buy-backs. Further, abnormal returns are tested for information signaling, free cash flow and leverage hypotheses. Results reveal that only leverage and under-valuation hypotheses were found valid whereas signaling and free cash flow hypotheses were rejected.

Kaur Karamjeet (2012) found out that the impact of open market share buy-back announcements on share prices of BSE listed companies. A total of 172 events of share buy-backs through open market have been found during March 2001 to March 2012. About 55% of open market share buy-back events experience positive returns on the announcement day. Returns are positive even before the announcements Further, It is seen that post-announcement returns are very small, insignificant and mostly negative.

Bunny Singh Bhatia (2013) examined the effect of share repurchases on stock price. They found out negative abnormal returns prior to the announcement of buy-back during 2011-2012 indicating undervaluation of shares and positive abnormal return post announcement, indicating signaling effect of share repurchases. Besides, a small company tends to have higher price reaction than larger companies due to higher information asymmetry faced by small companies. The results are similar to the study of open market repurchases in Developed countries.

Most of these studies have found undervaluation of shares as the motive of announcing share buy-back programs, hence for positive stock market reaction. So far, no study on RIL buy-back has been conducted in Indian market. Hence, the need is felt to undertake this study.

DATABASE & METHODOLOGY

The sample in this section is RIL share buy-back announcements for the period from November 2011 to May 2013 in National Stock Exchange only. Everyday closing price of RIL shares are taken for this study. The public announcement dates of RIL share buy-backs are available on www.sebi.gov.in. The study is based on secondary data which is collected from published Annual Report; Journals; and Magazines and from various websites - ril.com, sebi.com, nse.com, etc. For the purpose of present study, MEAN has been used to examine the market reaction to share buy-back announcements. An attempt is made to investigate the difference in market reaction to share buy-back between pre buy-back, during buy-back and post buy-back phases.

SIGNIFICANCE OF THE STUDY

There has not been much research in India as compared to developed countries with respect to the stock repurchases and its impact, since companies in developed countries are commonly involved in buy back of shares. Whereas in India, stock repurchases have been allowed from 1998.

Till now, companies are not actively involved in the buy-back of shares in India. But recent changes introduced by SEBI, are expected to usher the growth of stock repurchases. This study intends to analyze the effect of share repurchases on price of shares with respect to RIL being biggest Indian corporate in buy-backs.

OBJECTIVE OF THE STUDY

In studying the market reaction to share buy-back of RIL only the price of the share was considered. Therefore the objective of the study is "To analyze the impact of share Buy-back of RIL on its share price movements".

Hypothesis

1. $H1_O$ µBBb = µABb

$H1_a$ µBBb < µABb or µBBb > µABb

µBBb = mean price before share buy-back

µABb = Mean price during share buy-back

The mean share price 'during' buy-back may be greater or lesser than mean share price 'before' buy-back. It shows whether share repurchases activities result in increase share price after opening of the offer which results in increasing shareholders' wealth or decrease in share prices leading to a decrease in shareholders' wealth.

2. $H2_O$ µABb = µAFBb

$H2_a$ µABb > µAFBb or µABb < µAFBb

µAFBb = mean price after share buy-back

The mean share price 'during' buy-back is greater or lesser than mean share price 'after' buy-back. It indicates whether share buy-back maximizes shareholders' wealth during buy-back or after buy-back.

3. $H3_O$ µAFBb = µBBb

$H3_a$ µAFBb > µBBb or µ AFBb < than µ BBb

The mean share price 'after' buy-back is greater or lesser than mean share price 'before' share buy-back. It shows whether share buy-back maximizes wealth after buy-back or before buy-back.

ANALYSIS & FINDINGS

Impact of share buy-backs on company's share price movements are a result of a bundle of factors such as company fundamentals, demand and supply of particular scrip and various corporate announcements and unpredictable global factors. The sensitive National Stock Exchange in India etc. reacts to these factors. Buy-back of shares an important event also affects the share price movements. The impact of share buy-back on company's share price movements is analyzed for three different stages i.e. pre buy-back phase, during buy-back and post buy- back phase.

Comparison of mean share prices before buy-back and mean share prices during buy-back:

The mean share price before buy-back is the mean of share prices 90 days before opening of the offer date of the company. The mean share price during buy-back is the mean of share prices from the opening of the offer date of buy-back to the closing of the offer. The period from offer date to closing date is one year.

A=Mean Share Price 90 days before opening of buy-back (From Nov 8th, 2011 to Feb 6th, 2012).

B=Mean Share Price during buy-back

(From Feb 7th, 2012 to Jan 18th, 2013).

% Difference between A and B = (B-A)/A×100

Mean share price of shares 90 days before opening of the offer date is Rs. 773.18 and Mean share prices of shares during buy-back is Rs. 778.01. It is evident from above that the Percentage Difference in mean share price before and during Buy-Back is 0.62%. Hence, the mean share prices increased after the announcement of buy-back.

Thus we can conclude that on an average mean share prices have increased during buy-back as compared to the mean share prices before buy-back as seen above. Therefore, the $H1_O$: The mean share price before buy-back = the mean share price during buy-back is rejected.

Mean share price of RIL

Before Buy-back	During Buy-back	% Difference
Rs. 773.18	Rs. 778.01	0.62

Comparison of mean share prices during buy-back and mean share prices after buy-back:
B=Mean Share Price during buy-back
(From Feb 7th, 2012 to Jan 18th, 2013).
C=Mean Share Price 90 days after closing of buy-back
(From Jan 21st, 2013 to Apr 18th, 2013).
% Difference between B and C = (C-B)/B×100

MEAN share prices of shares during buy-back is Rs. 778.01 and MEAN share price of shares 90 days after closing of buy-back is Rs. 838.58. It is evident from above that the Percentage Difference in mean share price during Buy-Back and mean share price 90 days after closing of buy-back is 7.79%. Hence, mean share prices after buy-back phase depicted positive sign. The mean share prices reacted positively after buy-back as compared to mean share prices during buy-back and increased up to 8%. Thus we can conclude that on an average mean share prices have increased after buy-back as compared to the mean share prices during buy-back. Therefore, the $H2_O$: The mean share price during buy-back = the mean share price after buy-back is rejected.

Mean share price of RIL

During Buy-back	After Buy-back	% Difference
Rs. 778.01	Rs. 838.58	7.79

Comparison of mean share prices before buy-back and mean share prices after buy-back:
A= Mean Share Price 90 days before opening of buy-back (From Nov 8th, 2011 to Feb 6th, 2012).
C=Mean Share Price 90 days after closing of buy-back (From Jan 21st, 2013 to Apr 18th, 2013).
% Difference between A and C = (C-A)/A×100
Mean share prices of shares during buy-back is Rs. 773.18 and Mean share price of shares 90 days after closing of buy-back is Rs. 838.58. It is evident that the mean share prices after 90 days of buy-back increased as compared to pre buy-back phase. Thus, the Percentage Difference in mean share price before and after Buy-Back is 8.46%. Hence, mean share prices of shares 90 days after buy-back depicted positive sign. The mean share prices reacted positively after buy-back as compared to mean share prices pre buy-back phase and increased up to 8.5%. Therefore, the $H3_O$: The mean share price after buy-back = the mean share price before buy-back is rejected.

Mean share price of RIL

Before Buy-back	After Buy-back	% Difference
Rs. 773.18	Rs. 838.58	8.46

The buy-back programme had begun on a slow pace, but gained some momentum in May 2012, when the stock price fell below Rs. 700. The programme was announced with an aim to shore up the value of RIL shares, which had underperformed the markets in 2011. However, The stock have gained nearly 15 per cent in the past one year, but it is still lower than the gains registered by the market benchmark index Sensex. On January 16, 2013, The stock was trading near Rs. 900 level, which is much higher than the maximum price of Rs. 870 per share fixed for the buy-back.

Share price reaction of RIL to Buy-back

A. Before Buy-back	B. During Buy-back	C. After Buy-back	(B-A) x 100/A	(C-B) x 100/B	(C-A) x 100/A
Rs. 773.18	Rs. 778.01	Rs. 838.58	0.62	7.79	8.46

CONCLUSION

The present paper investigated the impact of open market share buy-back announcements on share prices of RIL. It is evident that shares are quite undervalued before the announcement of share repurchases programs. Further, Positive abnormal returns after the share repurchase announcement indicate that market reacts positively to the news of share repurchases announcement. The results of share price movements has shown that announcement effect resulted in a rise in price from announcement date to opening of the offer date thereby, supporting management's contention of undervaluation of shares. Besides, an analysis of the mean share prices shows that there was an increase in the mean share prices after buy-back as compared to the mean share prices for pre buy-back period. However, the overall effect of buy-back on the share prices is the algebraic sum of the announcement effect and the post buy-back effect and no assurance can be given regarding the price movements. These results lead to acceptance of both undervaluation and signaling hypothesis. Share repurchase becomes stronger signaling tool. It is necessary that market should have more reliability and confidence in the buy-back programs of corporate.

REFERENCES

1. A.K. Mishra (2005) "An Empirical Analysis of Share Buy-backs in India", The ICFAI Journal of Applied Finance, Vol.8, No.11, pp. 5-24.
2. Amitabh Gupta (2006) "Share Price Behaviour around Buy-backs in India", The ICFAI Journal of Applied Finance, Vol.12, No.12, pp. 26-40.
3. Brown J. S and Warner J. B., (1985), "Using daily stock returns the case of event studies", Journal of Financial Economics, Vol.14, pp. 3-31.
4. Bunny Singh Bhatia (2013) "Share Repurchases: Short Term Effect in India", International Journal of Applied Research and Studies (iJARS) ISSN: 2278-9480 Volume 2, Issue 12 (Dec - 2013)
5. Dhatt, G. K. (2010), "Impact of Buy-back announcements on Share Prices in India", The Indian Journal of Commerce, 63(3), 1-13.
6. Hyderabad, R L (2009), "Market Reaction to Buy-back Announcement in India", ICFAI Journal of Applied Finance, 15(12), 53-77.
7. Ikenberry, D.L., Vermaelen, T., 1996. The option to repurchase stock. Financial Man- agement 25, 9–24.
8. Ikenberry. D., Lakomishok. S and Vermaelen.T., (2000), "stock Repurchases in Canada: Performance and strategic Trading", The Journal of Finance, Vol, 55, No.5, pp. 2373-2397.
9. Isagawa. N., (2002), "open-market Repurchase Announcements and stock price Behavior in Inefficient Markets" Financial Management, Vol.31, No.3,pp. 5
10. Ishwar, P (2010), "Stock Price Responses to the Announcement of Buy-back of Shares in India", Indian Journal of Commerce and Management Studies, 1(1), 14-29.
11. Kaur, K. and Singh B. (2003), "Buy-Back Announcements and Stock Price Behavior: An Empirical Study", Journal of Applied Finance, 9(5), 23-30, (August).

12. Kaur, K (2012), "OPEN MARKET SHARE BUY-BACKS IN INDIA" A Journal of Radix International Educational and Research Consortium
13. Manconi, A., Peyer, U., Vermaelen, T., 2012. Buy-backs Around the World.
14. Raju L Hyderabad (2008), "Market Reaction to Buy-back Announcements in India", The IUP Journal of Applied Finance, Vol.15, No 12, 2009, pp. 54-78
15. Schaub, Mark (2008) 'A note on the effects of debt buybacks in the MM world', Applied Financial Economics Letters, 4: 2, pp77- 79
16. Schaub, Mark (2009) 'Short-term wealth effects from debt buyback announcements', Applied Economics Letters, pp1-
17. S.Narayan Rao (2010), "Announcement Effect of Open Market Share Buy-backs in India: Part-1", Research Seminar presented at T A Pai Institute of Manipal-2010.
18. S.Ramakrishnan (2007), "Share Buy-back Signaling Tool: Malaysian Perspective"
19. Skinner, D.J., 2008. The evolving relation between earnings, dividends, and stock repurchases. Journal of Financial Economics 87, 582–609.
20. Stephens, C.P., Weisbach, M.S., 1998. Actual share reacquisitions in open-market repurchase programs. The Journal of Finance 53, 313–333.
21. Thirumalvalavan, P and Sunitha, K. (2006). "Share Price Behaviour around Buy-back and Dividend Announcements in India," IICM 9th Capital Markets Conference Paper
22. Vermaelen, T., 1981. Common stock repurchases and market signalling: An empirical study. Journal of Financial Economics 9, 139 – 183.