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BUY-BACK OF SHARES AND SECURITIES

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Abstract

A buyback, also known as a share, repurchase or stock buyback, refers to the process through which a company repurchases its own shares or securities from the market, thereby reducing the number of outstanding shares. The concept of buy-backs of shares and securities holds significant importance, representing a strategic maneuver employed by companies to manage their capital structure, optimize shareholder value, and respond to changing market dynamics. The motivations behind share buy-backs are multifaceted and can vary depending on the company's strategic objectives and prevailing market conditions. One primary rationale is to return surplus cash to shareholders in a tax-efficient manner, providing them with an alternative form of capital distribution alongside dividends. Moreover, buy-backs can also serve as a defensive tactic against hostile takeovers or activist investors seeking to gain control of the company. while buy-backs offer various strategic benefits, they are not without controversy and regulatory scrutiny. Critics argue that buy-backs can be misused to artificially inflate stock prices, manipulate earnings per share metrics, and provide short-term boosts to executive compensation tied to share performance.

Key words: *shares, buy back, capital redemption reserve, tender offer*.

Introduction

A buyback, also known as a share repurchase or stock buyback, refers to the process through which a company repurchases its own shares or securities from the market, thereby reducing the number of outstanding shares. This can b[1]e achieved through various methods, including open market purchases, tender offers, or negotiated transactions with shareholders. This process involves a company using its own funds to buy back shares either on the share market or directly from its shareholders. (Roberts, J., Sanderson, P., Barker, R., & Hendry, J. 2006) The shares bought back are typically retired or held in the treasury, reducing the total number of outstanding shares. (Ikenberry, D., Lakonishok, J., &Vermaelen, T. 1995)

In the realm of corporate finance, the concept of buy-backs of shares and securities holds significant importance, representing a strategic maneuver employed by companies to manage their capital structure, optimize shareholder value, and respond to changing market dynamics. A buy-back, also known as a share repurchase or stock buyback, refers to the process whereby a company purchases its own outstanding shares or securities from the open market or directly from shareholders. This practice has garnered attention due to its implications for corporate governance, financial markets, and shareholder wealth.(Okpara, J. O. 2011)

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The motivations behind share buy-backs are multifaceted and can vary depending on the company's strategic objectives and prevailing market conditions. One primary rationale is to return surplus cash to shareholders in a tax-efficient manner, providing them with an alternative form of capital distribution alongside dividends.(Dol, A. H., & Wahid, A. 2014) By repurchasing shares, a company can reduce its outstanding equity base, thereby increasing earnings per share (EPS) and potentially enhancing shareholder returns. This strategy is particularly appealing when management believes that the company's shares are undervalued in the market, presenting an opportunity to deploy excess funds towards a more lucrative investment – its own securities.(Koller, T., Goedhart, M., & Wessels, D. 2010)

Moreover, buy-backs can also serve as a defensive tactic against hostile takeovers or activist investors seeking to gain control of the company.(Taleska, A. 2020) By repurchasing shares, management can bolster shareholder confidence, increase ownership concentration, and deter external entities from acquiring a significant stake in the company.(Fried, J. M. 2014) Additionally, buy-backs may be utilized to offset dilution resulting from employee stock options, convertible securities, or other equity-based compensation schemes, thereby mitigating the impact on existing shareholders' ownership interests. (Bens, D. A., Nagar, V., Skinner, D. J., & Wong, M. F. 2003)

However, while buy-backs offer various strategic benefits, they are not without controversy and regulatory scrutiny.(Osterberg, W. P. 2011) Critics argue that buy-backs can be misused to artificially inflate stock prices, manipulate earnings per share metrics, and provide short-term boosts to executive compensation tied to share performance. Furthermore, concerns have been raised regarding the allocation of corporate resources towards buy-backs at the expense of long-term investments in research and development, capital expenditures, or employee wages, potentially hindering sustainable growth and innovation.(Lazonick, W. 2017)

From a regulatory standpoint, buy-backs are subject to stringent oversight and disclosure requirements imposed by securities regulators and stock exchanges to safeguard market integrity and protect shareholder interests.(MacNeil, I. G. 2012) These regulations often prescribe limits on the amount of shares that can be repurchased, the sources of funding for buy-back programs, and the disclosure of material information to shareholders and the public. Additionally, companies engaging in buy-backs must adhere to insider trading laws and refrain from trading on material non-public information that could affect the market price of their securities. (Brav, A., Graham, J. R., Harvey, C. R., & Michaely, R. 2005; Dhanda, N., & Kaur, K. 2014)

Reasons for sharing Buy-back.

- With the help of this buyback promoter increase their holding.
- It increases the EPS.
- It give the support when share price is less than the fair value.
- It is a use of surplus cash balance.
- Companies that provide stock options as part of their employee compensation packages frequently initiate stock buybacks. The practice is justified because when employees work out their stock options, the No of outstanding shares increases.
- As a means of preventing a hostile takeover by increasing promoters holding.

Limitation of Buy Back

- The companies may misuse the practice of buyback at the cost of innocent and scattered shareholders.
- Buyback may be misused by promoters to enhance and consolidate their holdings in the companies as a result of which the interest of minority shareholders may be effected badly.
- The practice of buyback of shares may prompt the promoters to adopt inside trading for their selfish motives. They may understate the profits of the company by manipulating company's accounting policies and by adopting other means, and then may resort to buy back company's shares at low rates. In this way, the insiders would make extra money when company purchases these shares at higher prices from the promoters. It provides an opportunity for the promoters to make hay out of buy back of shares.

Modes of share Buy-back

These are the methods of share buyback-

A. Share buyback through Tender offer
B. Share buyback through open-market purchase
- ➢ Through Book-Building process**,**
- ➢ through Stock Exchange

Sources of Buy-back

As per Section 68 of Company act allows a company to buy back its own shares out of its

I. free reserve or divisible profit
II. Or the securities premium reserve account, for this section free reserve also include security premium (Section 52).
III. Or company will issue new share up to face value of equity share to be buy backed as per SEBI guideline, same type of issue of share are not allowed, it means if company is purchasing its equity share through buyback then it cannot issue equity share.

Conditions of Buy-back

Condition of share buys back as per Section 68 are-

- The purchase should be authorized by AOA of the company.
- It should be passed by Special Resolution in General Meeting, but if the buy-back is up to 10% of the paid up capital and free reserve, then a company have to take Resolution it Board Meeting.
- Buy back is allowed equal to or less than 25% of number of share (share outstanding test).
- Buy back must be equal to less than 25% of paid up share capital and free reserves (Resource test).
- After buy-back debt-equity share holder fund ratio cannot exceed 2:1 or ≤ 2:1 (Debt-Equity test).
- Partial paid up shares cannot be brought back.
- Declaration of insolvency report in Form SH-9 to Register of Companies, signed by At least Two Directors, one must be a Managing Director, if any.
- Notice of meeting should be accompanied followings-
    - ➢ Disclose all the facts related to buyback;

- All the necessities for share buy back
- The sum invested under the buyback;
- Mention completion of buyback time limit;

- Register in prescribe Form SH-10 must maintain.
- Company have to destroy bought back share within seven days of completion of the share buy back
- No fresh issue is allowed for six month.
- Company can make buyback again after one year completion of preceding buyback.
- Complete the buyback within one year after passing the resolution.

Transfer of certain amount to the Capital Redemption Reserve Account (CRR)

- As per section 69, if bought back out of own resource, then company will transfer a sum equal to the face value of the shares to the CRR.
- The CRR account may be written off for making partial paid shares fully paid as bonus.

Restrictions on Buy-back of Securities in some cases

- Restriction of share buyback as per section 70 of company act 2013-
- On purchase through any subsidiary company;
- On purchase through any investment company;
- If company is not able to repayment of debenture and preference share.
- If a Company has failed to file the Annual Return, dividend declaration & final account.

Conclusion

It's important to note that while share buy backs can benefit shareholders, they also have critics, some argue that companies should be investing in growth, research and development, or other initiatives rather than repurchasing shares. Before engaging in share buyback, company typically need approval their board of directors and shareholders. Additionally, the company needs to comply with relevant regulations and ensure that the buyback is in the best interest of the company and its shareholders.

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