A Study on Impact of Buy Back of Shares on Company EPS P/E Ratio and Market Price of the Shares

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Abstract

Share repurchase was evolved as an alternative method of payout and a corporate finance tool in 1950 in the USA. Then, gradually it spread to other countries like UK, Canada, etc. It has achieved a significant growth in the last two decades when compared to dividend payment by companies. Buyback of shares is just the opposite of raising capital through issue of shares. It is a process of capital restructuring which allows a company to buy back its own shares, which were issued by it earlier. Companies go for buy back shares either to increase the value of shares still available, or to eliminate any threats by shareholders who may be looking for a controlling stake. However, in India, a continuous demand has been rising from the corporate sector to buy-back shares in order to increase the rate of earning and also the market price per share for the remaining shares after cancelling a part of the shares.

Keywords: Share buyback, Determinants, Liquidity, Earnings management, SEBI Buyback Regulations (1998), Companies Act 2013.

Introduction:

A buyback offer is when a company buys some of its shares from its shareholders and extinguishes them. When a Company utilizes its accumulated profit which is supported by sufficient liquid funds in order to cancel a portion of its shares by purchasing either from the open market or by direct purchase from the shareholders. This happens particularly when the market value of such shares fall below the face value/book value.

The primary object of the cancellation of shares is to distribute the surplus cash among the shareholders, i.e., the shareholder will get liquid cash for the shares that he purchased. The logic behind this principle is that so long as the earning remains constants, the cancellation or repurchase of share will, no doubt, reduce the total number of shares which, in other words, will increase the earning per share as also the market price. In short, the EPS and MPS of each share will be increased.

Buy-back of shares is a method of financial engineering. It can be described as a procedure which enables a company to go back to the holders of its shares and offer to purchase the shares held by them. Buy-back helps a company by giving a better use for its funds than reinvesting these funds in the same business at below average rates or going in for unnecessary diversification or buying growth through costly acquisitions.

Review of literature:

Buy back of shares is just the opposite of raising capital through issue of shares. It is a process of capital restructuring which allows a company to buy back its own shares, which were issued by it earlier. Companies buy back shares either to increase the value of shares still available (reducing supply), or to eliminate any threats by shareholders who may be looking for a controlling stake. A buyback allows companies to invest in them. By reducing the number of shares outstanding on the market, buybacks increase the proportion of shares a company own share. Buybacks 3
Shareholders may be presented with a tender offer whereby they have the option to submit (or tender) a portion or all of their shares within a certain time frame and at a premium to the current market price. This premium compensates investors for tendering their shares rather than holding on to them. 

Shachi Bhargava and Puja Agrawal (2015), Gruillon and Michaely (2002) the firms have gradually substituted repurchases for dividends. Majority of firms that initiate cash payments do so through share repurchases and many firms that have been paying dividends have also started to repurchase shares as well. It has also been suggested that differential taxes between dividends and capital gains matters a lot. The market’s reaction to repurchases is more positive when the tax gains from repurchases are higher than dividends.

Ikenberry et al (1995) took a long term perspective and have analysed the effect of share repurchases over a period of 10 years. The findings indicated that the average market response to the news of open market share repurchase was only 3.5%, despite the public endorsement made by the company that the shares were undervalued and it was a ‘good investment’. This showed that managers are overly optimistic about the firm’s value. For value stocks, undervaluation can be a reason for repurchasing wherein the AAR is 45.3% (four year buy and hold return) but for glamour stocks this was not the case. Share repurchase or buyback of shares means companies purchase their shares from the shareholders. It is an investment technique used by the companies to invest in their shares. Repurchased shares may be either cancelled or kept in treasury for further issue depending on the country’s rules and regulation. Firms have to extinguish the repurchased shares in countries like India, Australia, Sweden, France, Canada and UK. In countries like the US and Spain, the companies keep the repurchased shares in treasury for reissue. In Italy, companies can either extinguish the shares or held as treasury stock for reselling. Share repurchases are similar to a dividend on the distribution of cash to the shareholders. However, the dividend is pervasive in the sense; companies have been paying regular cash dividend since the inception of joint stock companies around three hundred years ago. Initially, it is the only method of payment of surplus to the shareholders.

Dr. L. C. Gupta, March (2005), When the Indian corporate lobbied with the Government for allowing share buybacks and the Government accepted the idea, the uppermost question in our mind was about motives behind such a move. The motives of the various parties involved and the objectives to be achieved through share buyback are of direct interest to shareholders. Really speaking, the share buyback system should be judged both from the angle of shareholders and that of the national economy.

We have culled out from buyback offer documents the reasons, Justifications, etc., as stated by company managements for proposing share buybacks. We have scanned the fairly extensive literature on share buyback practices and policies in various countries.

Research gap/ statement of problem:

Problem regarding towards this study is we don’t have complete information related to the buyback of shares of companies which affect the company’s market price and earnings per share.

Need of the study:

In the present corporate world, many companies are looking for Buy Back is one of the significant alternatives to adjust their surplus cash. Companies will go for buy back with an aim to increase its EPS and to utilize its surplus cash in a prudent way. But there are no studies on the real benefits to shareholders with buy back and its impact on EPS, P/E and Market price of the share. Hence there is a need to focus on a study.

Objectives of study:
1. To study the reasons for buyback in selected companies
2. To find out the change in EPS, Dividend and P/E ratio in selected companies due to buy back.
3. To assess the impact of buy back on Market price.
Hypotheses:

H1: There is significant relationship between market price and price earnings ratio on buyback.
H2: There is significant relationship between market price and earnings per share on buyback.
H3: There is significant relationship between market price and dividend per share on buyback.

Scope of the study:
The following are the 3 companies selected for analysis.

- Wipro
- Sun pharmaceutical Ltd
- Coal India Ltd
- The present study is useful to academicians, research scholars to have better insight over effect on buy back of shares.
- This kind of analysis is useful to know whether the companies are benefited with the buyback of the shares.
- This study also helps to known the performance of the company after buy back.

Research methodology:

- Data source
- Data collection method
- Sample size
- Sample unit

Secondary data:
If the time or hassle of collecting your own data is too much, or the data collection has already been done, secondary data may be more appropriate for your research. This type of data typically comes from other studies done by other institutions or organizations. There is no less validity with secondary data, but you should be well informed about how it was collected. There are a number of free services online. The source for the data collection for the present study is purely of secondary sources like books and web site.

Data collection method:
The source which is needed for the present study is secondary data.

Sample size:
The sample size taken for the study is 3 companies which went for buy back of their shares.

Sample unit:
Sample unit for this study is buy back companies

Data analysis:
The data has been analyzed using the following:

- Price earnings ratio
- Earnings per share
- Market value of companies
- Dividend per share
Table 1: COAL INDIA

There is significant relationship between market price and earnings per share during this period. So we accept null hypothesis because there is no sufficient evidence to prove the hypothesis.

The market value of company and earnings per share were correlated because the impact of buyback was there. The significant correlation between the earning per share and market value is 3% at 5% level of significance. This indicates a strong and positive association between these two variables.

**Relationship between P/E and EPS**
After testing the hypothesis indicates that the balance between market price and earning is favorable by the company and the decision taken by the company in these aspects is proper decision.

**Relationship between MPS and P/E ratio:**
After testing the hypothesis indicates that the balance between market price and price earning is not favorable by the company and the decision taken by the company in these aspects is not proper decision.

**Relationship between MPS and dividend:**
After testing the hypothesis indicates that the balance between market price and dividend is not favorable by the company and the decision taken by the company in these aspects is not proper decision.

Table 2: WIPRO

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
<th>Correlations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
<td>Zero-order</td>
</tr>
<tr>
<td>(Constant)</td>
<td>99.236</td>
<td>13.954</td>
<td>6.395</td>
<td>.024</td>
<td>.899</td>
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<tr>
<td>EPS</td>
<td>-3.209</td>
<td>.820</td>
<td>-3.322</td>
<td>-5.179</td>
<td>.035</td>
</tr>
<tr>
<td>PE</td>
<td>-3.308</td>
<td>1.101</td>
<td>-6.480</td>
<td>-3.004</td>
<td>.095</td>
</tr>
<tr>
<td>Dividend</td>
<td>63.793</td>
<td>31.068</td>
<td>3.523</td>
<td>2.053</td>
<td>.178</td>
</tr>
</tbody>
</table>

There is significant relationship between market price and earnings per share during this period. We reject null hypothesis because there is no sufficient evidence to prove the hypothesis.

The market value of company and earnings per share were not correlated because the impact of buyback was affected. The significant correlation between the earning per share and market value should and hold at 5% level of significance. But this indicate a and negative association between these two variables.
Relationship between market price and P/E ratio:
After testing the hypothesis indicates that the balance between market price and price earning is not favorable by the company and the decision taken by the company in these aspects is not proper decision. There is significant relationship between market price and dividend during this period. We reject null hypothesis because there is no sufficient evidence to prove the hypothesis.

Relationship between market price and dividend:
After testing the hypothesis indicates that the balance between market price and dividend is not favorable by the company and the decision taken by the company in these aspects is not proper decision.

Table 3: Sunpharmaceuticals:

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>Std. Error</td>
<td>Beta</td>
<td></td>
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<tr>
<td>(Constant)</td>
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<tr>
<td>1</td>
<td>PE</td>
<td>.142</td>
<td>.119</td>
<td>.460</td>
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<tr>
<td></td>
<td>Dividend</td>
<td>.705</td>
<td>4.321</td>
<td>.108</td>
</tr>
<tr>
<td></td>
<td>EPS</td>
<td>.086</td>
<td>.130</td>
<td>.438</td>
</tr>
</tbody>
</table>

a. Dependent Variable: MPs’
There is significant relationship between market price and earning per share during this period. We reject null hypothesis because there is no sufficient evidence to prove the hypothesis.

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The market value of company and earnings per share were not correlated because the impact of buy back was affected. The significant correlation between the earning per share and market value should and hold at 5% level of significance. But this indicate a and negative association between these two variables.

Relationship between market price and EPS:
After testing the hypothesis indicates that the balance between market price and earning is not favorable by the company and the decision taken by the company in these aspects is not proper decision.

There is significant relationship between market price and earnings per share during this period. We reject null hypothesis because there is no sufficient evidence to prove the hypothesis.

The market value of company and price earning were not correlated because the impact of buy back was not affected. The significant correlation between the earning per share and market value exist between these values more than that hold at 5% level of significance. This indicates and negative association between these two variables.

Relationship between market price and EPS:
After testing the hypothesis indicates that the relationship between market price and price earning is not favorable by the company and the decision taken by the company in these aspects is not proper decision.

There is significant relationship between market price and dividend during this period. We reject null hypothesis because there is no sufficient evidence to prove the hypothesis.

Findings:
1. After buy back analysis of the Wipro, Sun Pharmaceuticals, Coal India companies the following facts are identified.
2. It is evidence that all the selected companies having the high P/E ratio in the year 2016 after the buyback of the shares in the company.
3. It is also observed that the EPS of all the Wipro companies is started falling from 2011 to 2012 and it was started increasing trend after buy back
4. Price earnings ratio of Wipro company has decreased from 19.71 in 2015 to 17.51 in 2016 after buy back
5. And there was drastic improvement in MPS of Sun pharmaceutical’s after buy back and it was increased from 9.84 in 2015 to 16.07 in 2016.
6. And the EPS of the Sun pharmaceuticals was also goes on changing after buy back from 48.94 in 2015 to 56.34 in 2016.
7. From the above analysis, it is understood that sun pharmaceutical’s P/E ratio has significantly rose from 36.98 to 56.34 and dividend also rose from 4.66 to 4.84.
8. Coal India’s market value also increased from 26.49 to 30.29 i.e. from 2015 to 2016. It’s EPS and price earnings ratio also significantly increased from 11.33 in 2015 to 12.15 in 2016.

Suggestions:
1. companies must analyses thoroughly their ability to generate profits with their buy back in some rare cases, buy backs are announced to triggers certain favorable movements like anticipation of an upward movement in stock price
2. It is suggested to look at the size of the buyback offer, the buyback price and the duration of the offer. This is because if the buyback size is to small compared with the overall market capitalization of the company, the impact on the stock could be very small.
3. It is desirable that in the case of open market buy back offers,SEBI regulations should be amended to make the company mandatorily announce a minimum support price at which the company will accept the buyback offers made by the shareholders.
4. One of the motives of the buyback is to increase earnings per share. Companies should not resort to buy back only to fulfill this purpose. Corporate actions should always create value to shareholders by efficient management by improving the overall results of the company.
5. No fresh issue of shares should be allowed for at least one year after share buyback. This can prevent manipulations by the management and safeguard the interest of the shareholders.

Conclusion:
After analysis of buyback of Wipro Ltd, Coal India, Sun pharmaceuticals, the market value and earnings per share and price earnings ratio show the effect on the buyback of shares. After buy back of the company the market value of these companies was increased and for the coal India and sun pharmaceuticals’ buy back was positively toward the buy back. And many benefits also received by the shareholder after the buyback was taken place.

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