CHAPTER I
INTRODUCTION

1.1 REVOLUTION OF STOCK MARKET
The evidence of debt was dated back to the ancient world in the metropolitan clay tablets that rewarded the interest bearing loans. The key event as the Dutch East India Company founded in 1602, which built up the spice trade. The shareholders were rewarded well for their investment which they were paid an average dividend of over 16 per cent per year from 1602 to 1650.

Stock market had begun in the 16th century when countries in the world started trading with each other. However, many initiatives merchants wanted to start huge businesses, but due to insufficient amount of capital, business could not be stated that no single merchant could raise alone. A group of individual investors pooled their money and therefore emerged themselves as business partners and co-owners of the companies. This spin-off the idea of investment.

In 17th century trading were initially done in a coffeehouse which was later renamed as ‘The Stock Exchange’. This was when the first stock exchange came into existence as London Stock Exchange. There are several stock exchanges in worldwide today, all of them supplying necessary capital to ensure the growth of industry. Stock market provided individuals the scope of saving and to enhance their personal wealth, plan for financial stability to support their retirement. However, major indexes were used to gauge the performance of various industries which allow or make decision on whether to buy or sell securities. (Wyss, 2001)

In United State of America, New York Stock Exchange had the most number of companies enlisted. While in London, stock exchange emerged as the major exchange for Europe. Likewise, various developed countries including Germany, France, the Netherlands, Switzerland, South Africa, Hong Kong, Japan, Australia and Canada developed their own stock exchanges; however majority of companies were serving the domestic companies.

In India, Bombay Stock Exchange is BSE which was established in 18th century as Asia’s first and fastest stock exchange. BSE had facilitated the Indian corporate sector’s growth by providing an effective capital raising place. The most fundamental necessity to set up a business is capital. For several decades many companies have availed the capital through
The leading companies that availed the benefits of buy back of shares in India are Bajaj Holding, DLF, Sasken Communication, SMS Pharmaceuticals Limited etc.

Stock or share used to indicate the shareholder’s ownership of a company. Those who purchased stock or share in a particular company generally called as shareholders and stockholders. A shareholder owns a part of everything the company owned. The idea was very successful that the trading of shares slowly spread to other countries like Spain, France and England. Industries were also initiated to raise the capital through stock marketing activities.

1.2 IMPORTANCE OF FINANCE FOR STOCK MARKET

Finance has been the life blood and important centre of a business, just as circulation of blood is essential in the human body for maintaining life; finance has been very essential for smooth running of the business. No business, whether big, medium or small, can be started without an adequate amount of finance.

In this competitive business world, finance has become the key store of each and every operational activities of the business. None of the business can be started without sufficient financial resources nor can it be succeed. In this respect, all the business concerns need money to make more money. All the business activities directly or indirectly involves the acquisition and use of funds.

When a company has been formed to issue the equity shares to the promoters, they have to raise loan from banks, financial institutions and other sources. As the need for financing increases, the company may issue shares and debenture privately to promoters.

Generally financing of sole trader and partnership is simple however the financed requirements are limited. But in case of company type of organization financial requirements are huge volume of finance which cannot be contributed by a few investors. Hence, it can mobilize their financial resources through issue of shares. This method allows the company to sustain in the business without comprising their objectives.

There are two important links between economics and finance. Firstly, macro-economic environment which defines the setting within which a firm operates and the micro economic theory provides the conceptual underpinning for the tools of financial decision making.
Secondly, finance and accounting functions are closely related and almost invariably fall within the domain of the chief financial officer.

As an Individual, stock marketing assists them in generating money which could be a saving or investment. There is no limit for any individual to buy number of shares.

As an organization or company, the buyback of shares assists them to invest the money in a new business, an equipment, an infrastructure, an operation etc.

1.3 FINANCIAL MANAGEMENT AND STOCK MARKET

Financial Management and Stock market works in hand in hand; they compromise each other by supporting in term of finance. In order to sustain the stock market operations, the finance has to the meticulously managed.

Financial Management is referred as the management of flow of funds in the firm. Financial Management deals with the financial decision making of the firm. It is mainly concerned with the timely procurement of adequate finance from various sources and its utmost effective utilization for the attainment of organizational objectives. Raising of funds and their utilization has been the best key for the success of the organization.

Bradley stated that Financial Management is the area of business management devoted to a judicious use of capital and a careful selection of sources of capital in order to enable a business firm to move in the direction of reaching its goals. (Cited, Murthy 2015, pp.1.2)

Pandey (2013), mentioned that Financial Management is a managerial activity which is concerned with the planning and controlling of the firm’s financial resources. Company managers are much interested and crucial decision of the firm based on the finance. Companies were raising their finance through Shares.

Issue of shares has been main source of long term finance shares which are issued by firms to the public. A firm divide it shares capital into units of a definite face value. Each unit is called a share. A person holding shares is known as a shareholder.
Share signified ownership rights of their holders, that buyer of shares are called shareholders or stockholders who are the legal owners of the firm. Shareholders invested their money in the share of the company in the expectation of a return on their invested capital. The return consists of dividend and capital gain. Shareholders make capital gains (or losses) by selling their shares.

1.4 STOCK EXCHANGE

The Stock Exchange has provided a market place for purchase and sale of securities. Stock Exchange ensures the free transferability of securities, which has been the essential basis of corporate system. The private corporate system cannot function efficiently without the existence of stock.

Securities Contract Regulation Act 1956 has stated that the Stock Exchange means anybody of individuals, whether incorporated or not, constituted for the purpose of regulating or controlling the business for buying, selling or dealing in securities.

The securities were:

- Shares, scrips, stocks, bonds, debentures stock or other marketable securities
- Government Securities and
- Rights or interest in securities

As economic development proceeds, the scope for acquisition and ownership of capital by private individuals also grows. Along with it, the opportunity for stock exchange to render the service of stimulating private savings and channeling such saving into productive investment exists on a vastly great scale. These were services, along the stock exchange which render efficiently.

1.5 DEFINITIONS OF STOCK EXCHANGE

According to Derek Honeygold, Stock Exchange can be described as the place where a marriage of convenience is enacted between those who wish to raise capital, such as companies, governments and local authorities, and those who wish to invest- largely households through the medium of institutions acting upon their behalf. (Cited, Guruswamy (2011) pp.167)
1.6 STOCK EXCHANGE IN INDIA

In India, stock exchanges played an important role in the building of a shareholder’s democracy. The growth in the number and size of companies has increased the significance and the role of stock exchanges. Capital Market through which the bulk of investment activities are conducted by individual persons and institutional operators, stock exchanges facilitate the transfer of existing flow of savings into the profitable channels. (Rik and Scott, 2007)

Stock Exchange has played a vital role in the capital formation of economy created the way for the industrial and economic development of country. Stock exchanges encourage the people to save and invest in the company that can be profitable to them.

Stock Exchange has contributed in enormous measure to the growth and expansion of national business and to the ultimate benefit and well-being of the national economy and its people. Stock Exchange has provided an ideal channel which huge amount of capital flow takes place through the interconnected network of financial organizations to all corporate enterprises in the country. Stock Exchanges ensure liquidity and transferability of financial assets that were dealt with.

Stock exchange has provided an organized marketplace for the investors to buy and sell securities freely. The market offered perfect competitive conditions where a large number of sellers and buyers participate. Additional, stock exchanges provided an auction market in which members of the exchange participate to ensure continuity of price and liquidity to investors.

The efficient functioning of the stock exchange was to create a encouraging climate for an active and growing primary market for new issues. However, an active and a healthy secondary market in existing securities led to a better psychology of expectations, thus considerable broadening the investment enquiries and thereby, earning the task of raising resources by entrepreneur easier. In fact, good performance and outlook for equities in the stock exchanges imparted flexibility to the new issue market. (Cited Guruswamy (2011) pp.168)

The stock market has been assuring the owners of corporate securities to sell their holdings at any time and thereby provides liquidity. At the same time those who invest their surplus funds for long term capital raises or for speculative gain can also buy securities in the market.
## Table 1

### Trading Statistics of Stock Exchanges

<table>
<thead>
<tr>
<th>Stock Exchanges</th>
<th>Quantity of Shares Traded (Lakh)</th>
<th>Quantity of Shares Delivered (Lakh)</th>
<th>Value of Shares Delivered (in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2010-11</td>
<td>2011-12</td>
<td>2012-13</td>
</tr>
<tr>
<td>Ahmedabad</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>BSE</td>
<td>9,90,776</td>
<td>6,54,137</td>
<td>5,63,883</td>
</tr>
<tr>
<td>Bhubaneswar</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Calcutta</td>
<td>778</td>
<td>1,681</td>
<td>1,776</td>
</tr>
<tr>
<td>Delhi</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Jaipur</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Madras</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>MPSE</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>MCX-SX</td>
<td>0</td>
<td>0</td>
<td>17</td>
</tr>
<tr>
<td>NSE</td>
<td>18,10,910</td>
<td>16,05,285</td>
<td>16,44,259</td>
</tr>
<tr>
<td>OTC EI</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Pune</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>UPSE</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Vadodara</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>28,02,464</td>
<td>22,61,023</td>
<td>22,89,935</td>
</tr>
</tbody>
</table>
In the Table 1-1 shows the Trading statistics of stock exchange with quantity of shares traded. The data is taken from the period of 2010-2011 to 2013-2014. The statistics shows that Bombay Stock Exchange and National Stock Exchange have been trading comparatively high, than other stock exchanges in India. The Calcutta and MCX-SX are performing fairly low. As such, the data from analysis was taken from BSE as it is one of the top performances.

Table 1-2

LIST OF STOCK EXCHANGES IN INDIA

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of the Exchange</th>
<th>Valid Upto</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Ahmedabad Stock Exchange Ltd.</td>
<td>PERMANENT</td>
</tr>
<tr>
<td></td>
<td>Address: Kamdhenu Complex Opp, Sahajanand College,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Panjarapole, Ambawadi, Ahmedabad - 380001</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>BSE Ltd.</td>
<td>PERMANENT</td>
</tr>
<tr>
<td></td>
<td>Address: P J Tower, Dalal Street, Mumbai 400023</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Calcutta Stock Exchange Ltd.</td>
<td>PERMANENT</td>
</tr>
<tr>
<td></td>
<td>Address: 7, Lyons Range, Kolkata - 700001</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Delhi Stock Exchange Ltd.,The</td>
<td>PERMANENT</td>
</tr>
<tr>
<td></td>
<td>Address: DSE House, 3/1, Asaf Ali Road, New Delhi - 110002</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Magadh Stock Exchange Ltd.</td>
<td>15-SEP-2016</td>
</tr>
<tr>
<td></td>
<td>&quot;SEBI vide order dated September 3, 2007 refused to renew</td>
<td></td>
</tr>
<tr>
<td></td>
<td>the recognition granted to Magadh Stock Exchange Ltd.&quot;</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Metropolitan Stock Exchange of India Ltd.</td>
<td>4th Floor, Vibgyor</td>
</tr>
<tr>
<td></td>
<td>Address: Bandra Kurla Complex, Bandra (East) Mumbai</td>
<td>400051</td>
</tr>
<tr>
<td>7</td>
<td>National Stock Exchange of India Ltd.</td>
<td>PERMANENT</td>
</tr>
<tr>
<td></td>
<td>Address: Bandra Kurla Complex, Bandra (East) Mumbai</td>
<td></td>
</tr>
<tr>
<td></td>
<td>400051</td>
<td></td>
</tr>
</tbody>
</table>


Source: [www.sebi.gov.in](http://www.sebi.gov.in) retrieved dated on 12/10/2015
The Table 1-2 shows the number of stock exchanges in India. Presently 23 Stock Exchanges are listed in India. Among 23 stock exchanges, 7 stock exchanges are permanent. BSE stock exchange was selected for this study. As it has been the also performer in stock exchange.

1.7 INTRODUCTION ABOUT SECURITIES EXCHANGE BOARD OF INDIA (SEBI)

Government of India sat up the Securities Exchange Board of India (SEBI) on April 12, 1988 on the basis of the recommendations of the high powered Committee on Stock Exchange Reforms headed by committee Member G.S.Patel. SEBI was given a legal status by the Securities and Exchange Board of India Ordinance, 1992. The members of the Board of Management of the SEBI comprised professional brokers, financial consultants, merchant bankers, investors, stock exchange authorities, finance ministry etc.

1.7.1 ROLE OF SEBI IN STOCK EXCHANGES

According to the SEBI Act, 1992 has empowered SEBI to have the statutory powers for

- protecting the interests of investors in securities,
- promoting the development of the securities market, and
- regulating the securities market

SEBI regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. SEBI can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act. It has powers to register and regulate all market intermediaries and to penalize them in case of violations of the provisions of the Act, Rules and Regulations made thereunder. SEBI has full autonomy and authority to regulate and develop an orderly securities market.

Table 1-3

Investigation by SEBI
In the above table 1-3, shows that SEBI main role is protect the interested investors. SEBI has helped the investors from dishonest persons in stock exchanges or some other complaints from investors. The table demonstrated period from 2010-2011 to 2013-2014 clearing all the investors problems in stock exchange nearly 120 cases were over till 2014.

1.8 STOCK EXCHANGE DEVELOPMENT IN INDIA

The role of stock market as a cause of economic growth has been extensively among the stockholders. Liquid financial market is an important enabling factor behind most of the early innovations that characterized the early phases of the Industrial Revolution. Recent advances in this area reveal that stock markets remain an important conduit for enhancing development.

Numerous investments needed a long term commitment of capital, but the investors hesitated to relinquish control of their savings for long periods. Companies were enjoying permanent access to capital raised through equity issues. Most profitable investments and liquid markets improved the allocation of capital and enhanced the prospects for long term economic growth for country.

Table 1-4

Industry wise Classification of Capital Raised
In the above table 1-4, shows the Industry wise that have growth of capital in stock exchange from the period of 2010-2011 to 2013-2014. An illustrated, the highest capital raised was the Banking and Financial sector and followed by Cement & Construction. However, sector like Food Processing Industry, Health care Industry, Paper and Pulp Industry had raised their capital fairly low. This shows that Banking sector has actively involved in stock market which has provided an avenue to raise the capital. The other sectors were Pharmaceutical, Bio Technology Service Sector, and Real Estate etc., indicated very high than other industries during the year 2010-11 and subsequently they perform low.

1.9 BOMBAY STOCK EXCHANGE (BSE)

BSE also known as Bombay Stock Exchange Ltd, established in the year 1875, is the Asia’s first and fastest Stock Exchange and one of the India’s leading exchange groups. BSE crossed past 140 year and has facilitated the growth of the Indian corporate sector by providing an efficient capital raising place. BSE as “The Native Share and Stock Brokers’ Association".

<table>
<thead>
<tr>
<th>Industry</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
<th>2013-14</th>
<th>Apr 13-Dec 13</th>
<th>Apr 14-Dec 14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
<td>No.</td>
<td>Amt</td>
<td>No.</td>
<td>Amt</td>
<td>No.</td>
<td>Amt</td>
</tr>
<tr>
<td>Banking/FIs</td>
<td>18</td>
<td>17,248</td>
<td>20</td>
<td>35,611</td>
<td>7</td>
<td>9,735</td>
</tr>
<tr>
<td>Cement &amp; Construction</td>
<td>3</td>
<td>2,641</td>
<td>2</td>
<td>187</td>
<td>1</td>
<td>9</td>
</tr>
<tr>
<td>Chemical</td>
<td>5</td>
<td>247</td>
<td>0</td>
<td>1</td>
<td>9</td>
<td>0</td>
</tr>
<tr>
<td>Electronics</td>
<td>0</td>
<td>1</td>
<td>121</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Engineering</td>
<td>5</td>
<td>1,394</td>
<td>1</td>
<td>217</td>
<td>74</td>
<td>5</td>
</tr>
<tr>
<td>Finance</td>
<td>4</td>
<td>715</td>
<td>1</td>
<td>89</td>
<td>12</td>
<td>2</td>
</tr>
<tr>
<td>Food Processing</td>
<td>1</td>
<td>1,145</td>
<td>0</td>
<td>2</td>
<td>19</td>
<td>0</td>
</tr>
<tr>
<td>Healthcare</td>
<td>3</td>
<td>292</td>
<td>1</td>
<td>65</td>
<td>2</td>
<td>120</td>
</tr>
<tr>
<td>Information Technology</td>
<td>1</td>
<td>170</td>
<td>2</td>
<td>138</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Paper &amp; Pulp</td>
<td>0</td>
<td>2</td>
<td>306</td>
<td>0</td>
<td>1</td>
<td>28</td>
</tr>
<tr>
<td>Plastic</td>
<td>0</td>
<td>1</td>
<td>11</td>
<td>0</td>
<td>3</td>
<td>18</td>
</tr>
<tr>
<td>Power</td>
<td>4</td>
<td>9,469</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>411</td>
</tr>
<tr>
<td>Printing</td>
<td>1</td>
<td>52</td>
<td>2</td>
<td>71</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Telecommunication</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>4,173</td>
<td>1</td>
</tr>
<tr>
<td>Textile</td>
<td>3</td>
<td>207</td>
<td>0</td>
<td>0</td>
<td>4</td>
<td>582</td>
</tr>
<tr>
<td>Others</td>
<td>40</td>
<td>31,519</td>
<td>28</td>
<td>3,943</td>
<td>31</td>
<td>8,352</td>
</tr>
<tr>
<td>Total</td>
<td>91</td>
<td>67,609</td>
<td>71</td>
<td>48,468</td>
<td>69</td>
<td>32,455</td>
</tr>
</tbody>
</table>
More than 5500 companies were listed on BSE making it world's No. 1 exchange in terms of listed members. The companies listed on BSE command a total market capitalization of USD 1.68 Trillion as of March 2015. It has been the one of the world's leading exchanges (5th largest in March 2015) for Index options trading.

BSE also provided a host of other services to capital market participants including risk management, clearing, settlement, market data services and education. It has a global reach with customers around the world and a nation-wide presence. BSE systems and processes are designed to safeguard market integrity, drive the growth of the Indian capital market and stimulate innovation and competition across all market segments. It has been the first Exchange in the country and second in the world to receive Information Security Management System Standard BS 7799-2-2002 certification for its On-Line trading System (BOLT). It operates one of the most respected capital market educational institutes in the country (the BSE Institute Ltd.). BSE also provides depository services through its Central Depository Services Ltd. (CDSL) arm.

BSE's popular equity index - the S&P BSE SENSEX – has been India's most widely tracked stock market benchmark index. It has been trading internationally on the EUREX as well as leading exchanges of the BRCS nations (Brazil, Russia, China and South Africa). Source: www.bseindia.com retrieved dated on 12/10/2015 http://www.bseindia.com/static/about/introduction.aspx?expandable=0

Table 1-6

Cash Segment of Bombay Stock Exchange
In the above table 1 – 6, showed the Cash Segment in Bombay Stock Exchange from the period of 2010-2011 to 2013-2014. The table demonstrated how many companies were increased in Bombay Stock Exchange up to December 2015 and listed companies, permitted companies traded companies in BSE. 5541 companies were listed in Bombay Stock Exchange and 2977 companies were traded their shares in Bombay Stock Exchange.

### 1.10 HISTORY OF BUYBACK OF SHARES ACROSS THE GLOBE

As mentioned in Para 1.1 Revolution of Stock Market buying of shares can trade back to 16th Century. Likewise, Buyback of shares have been popular in many countries like United States of America, Canada, Germany, Japan and United Kingdom in the year 1980-1990 started the Buyback of shares program in their countries. Under the Securities and Exchange Commission (SEC) procedures, buyback of shares by US corporations can be done in four different methods, namely,

- Open market repurchases,
- Fixed price tender offer,
- Dutch auction tender offers and
- Privately negotiated repurchase

Out of the four methods as mentioned above, fixed price tender offer and Dutch auction tender offer were most flexible due to prorate allocation clause in case of higher number of offers and flexibility to extend its duration beyond the specified date in case of under subscription. Manconi, Peyer and Vermaelen (2014), mentioned that Buyback of shares around the world were positively announcement returns but long term excess returns were abnormality in an efficient market.

Rajagopalan and Shankar (2013) have explained about the buyback of equity shares by companies allowed in the early 1990s in the US and the UK, and various countries in the European Union started following the UK by incorporating changes in their respective laws. This was considered as a good beginning for introducing flexibility in the capital structure. As regards to the rest of the world, abolition of restrictions on buyback of equity shares was introduced in Australia in 1989, Hong Kong in 1991, Korea in 1994 and Japan in 1995.

Subsequently US, Canada and many other countries around the world have made amendments as to allow buyback under the corporate legal framework. In most of the European countries, the changes have occurred before the conceptualisation of European Union and after the passing of European Union directive in 2004 under which the regulations in respective countries have started to converge towards a common framework (Ginglinger et al., 2008).

On the other hand, there were large number of markets across the world which were not allowed for buyback of shares. As per Rashid Sabri (2003) explained that, countries like China, Jordan, Morocco, Poland, Saudi Arabia, Oman, Egypt and Lebanon still have regulations which disallow buyback in their respective markets.

Grullon and Ikenberry (2000) said that companies have long been permitted to buy back their stock, it was not until the early 1980s that U.S. corporations began adopting share repurchase programs in large numbers. This surge in activity was fueled by an explosion in the use of open market repurchase programs. In the 1990s, this movement went world as countries like Canada and the U.K., with repurchase laws already in place, also saw an increase in repurchase activity. In addition, a host of countries that formerly prohibited stock
repurchases, such as Germany, Taiwan, Hong Kong, and Japan, adopted provisions allowing resident firms to repurchase equity in the open market for the first time.

### 1.11 HISTORY OF BUYBACK OF SHARES IN INDIA

The buyback of shares was referred as the repurchase of company own shares. Before 1998, the buyback of shares by a company was prohibited under section 77 of the Indian Companies Act. Now in India, companies can repurchase their own shares after the Companies Act (Amendment) 1999. A number of companies such as Reliance Industries and Ashok Leyland offered to buy back the equity shares immediately.

### 1.12 CONDITIONS OF BUYBACK OF SHARES:

- a) A company that buys back its shares will not be issued with fresh capital, except for bonus issue, for the next 12 months.
- b) The company has to state the amount to be used for the buyback of shares and seek prior approval of shareholders.
- c) The buyback of shares can be processed only by utilizing free reserves like reserves not specifically earmarked for some purpose.
- d) The company must not borrow funds to buyback shares.
- e) The shares bought under the buyback schemes will be extinguished and they cannot be reissued.

Source: [www.sebigov.in/cms/sebi_data/commondocs/bback_P.pdf](http://www.sebigov.in/cms/sebi_data/commondocs/bback_P.pdf)

### 1.13 METHODS OF BUYBACK OF SHARES

Buyback is done by the firm with the purpose of improving liquidity in its shares and enhance the shareholders’ wealth. Under the SEBI (Buyback of Securities) Regulations, 1998, a company has been permitted to buy back its shares or other specified securities by any of the following methods:

- From the existing security holders on a proportionate basis through the tender offer
- From the open market through i) book building process ii) stock exchange
- From odd-lot holders
The company has to disclose the pre and post buy back holding of the promoters. As to ensure completion of the buy back process speedily, the regulations have stipulated time limit for each step. (Cited Balla (2011) pp.203)

1.14 REASONS FOR BUYBACK OF SHARES IN INDIA

The reaction of stock markets to the new information release were quite large both at international and national levels. The buyback announcements and reaction of stock markets to the same have concentrated on various aspects, including undervaluation signaling, excess cash distribution, substitution for cash dividends, defense against takeover threat and the like. The foreign studies and the studies in the Indian context, by and large, documented undervaluation signaling Rajagopalan and Shankar (2013).

1.14.1 Free Cash flow

The most important reason for the buyback of shares is happens to be that a company may like to return surplus cash, which it cannot put to any profitable investment, to shareholder. Companies may also like to use surplus cash or free cash flow to buy back shares rather than pay large dividends which they cannot maintain in the future years. Companies having surplus cash may expand or diversity uneconomically. Instead of dividends payment to shareholders companies were buying back of share to discipline itself.

1.14.2 Tax Advantage

In some countries, where dividends are taxed at a higher rate than the capital gains, companies may like to alternative to shares buyback from time to time reduce shareholders tax burden. Share buyback which produced long-term capital gains was tax advantageous compared to a dividend payment.

1.14.3 Debt equity

A company which has very low debt equity ratio may like to reduce equity capital through the buyback mechanism to achieve a higher target debt-equity mix.

1.14.4 Retained Earnings
The portion of the profits which is not distributed among the shareholders but is retained and used in business is called retained earnings or ploughing back of profits. As per Indian companies Act, firms are required to transfer a part of their profits to reserves. The amount so kept in reserve may be used to meet long term financial requirements of the firm.

1.14.5 Price Constancy

Share prices fluctuate in response to changing market climate and periodic bull and bear raids. If a buyback its shares when the price looks depressed to the management, the repurchase action management tends to have sustaining effect in an otherwise bearish market. On the opposing, if the price appears inflated, management can issue additional shares. So that facility to buyback and reissue, on the whole, has a moderating effect on price fluctuations which can, at times, be excessive.

1.14.6 Control

Buyback of shares can be used as an instrument to increase the insider control in firms. Normally insider of company holder do not tender their shares when a firm alternatives to buyback of shares. Hereafter company end up holding a larger proportion of the reduced equity of the firm and thereby have greater control.

1.14.7 Positive Signal

A buyback of share decision is normally motivated by management’s belief that the shares of the firms are undervalued. So, the stock market greets corporate decisions to repurchase their stocks. Through buyback of shares managements demonstrate their commitment to enhance shareholder value rather than to expand their territories.

1.14.8 Direct Commitment

While regular dividends carry an indirect commitment to continue payment in future, buyback of shares are normally viewed as one time exercise. When a firm issue dividends to shareholders do not have any option. However, when a firm announces a share buyback programme, investors have the option to sell or not to sell. A buyback of shares programme has much more focused in paying cash only to those investors who want it. (Cited, Prasanna Chandra (2008) pp. 575)

1.15 ADVANTAGES OF BUYBACK OF SHARES:
1.15.1 *Return of surplus cash to shareholders*: The buying shareholders will benefit as the company generally offers a price higher than the current market price of the share. Liang et al (2012) examined the motives for share repurchases. Whereas most prior research points to either the signaling or free cash flow hypothesis, author found that the motives for repurchases differ depending on the firm’s life cycle stage. Particularly, author found out that a firm in the growth stage tends to announce a repurchase program to signal its undervalued stock where as a firm in the mature stage was prone to buy back shares to dispense excess free cash flow. The author revealed that the market reaction to repurchase announcements corroborates this life-cycle argument.

Chang (2014) mentioned that the free cash flow hypothesis, predicted a higher stock price reaction around repurchase announcements for companies with poor investment opportunities and high free cash flow. It was also predicted greater improvements in accounting profitability around repurchases for companies with poor investment opportunities.

Baker *et al* (1981) found that majority of companies use available cash balances to fund the buybacks; new short-term debts were the second alternative. Researcher explained that the free cash flow hypothesis argued that firms with excess cash and a poor portfolio of investment opportunities will face sizeable agency costs if the excess cash was not distributed to shareholders. Share buybacks reduced the amount of free cash flow, thereby mitigating the overinvestment problem. Fenn and Liang (2001) stated that companies distribute free cash through ordinary dividends and open market repurchases to control the agency costs of free cash flow.

1.15.2 *Increase in the share value*: When the company distributes the surplus cash, its operating efficiency and Price Earning ratio remains changed. With reduced number of shares, Earning per share (EPS) increases and share price also increases. Lee (2003) investigated whether or not the dilution error in EPS is positively related to corporate management’s likelihood to repurchase stocks and indicated a positive association between the likelihood of stock repurchases and the economic dilution in EPS. Brav *et al* (2005) has stated that share buybacks allow managers to alter the
payout in response to the availability of good investment opportunities, to accommodate time-varying attempts to affect the reported EPS or stock valuation or simply to return capital to investors at the appropriate time and when funds were available. Nohel and Tarhan (1998) has examined empirically the operating performance changes surrounding share buybacks. The authors found that prior to share buybacks, a company showed a limited growth in capital expenditure and sold its poorly performing assets to become more efficient and increase the asset utilization. The ROE (Return on Equity), EPS (Earning per share) and ROA (Return on Asset) were the possible and probable underlying constructs for improvement in operating performance of the buyback companies. Grullon and Ikenberry (2000) have mentioned about the EPS managers that they repurchase the stock in order to increase earnings per share. Investment bankers and stock analysts often cite that as “EPS bump” as a major, if not the primary, benefit of stock buybacks. The fact was, as long as earnings fall by less (in percentage terms) than the percentage of shares outstanding, then EPS will indeed go up. And, assumed that the market sat prices by mechanically capitalizing reported EPS at industry-wide multiples, and then stock prices will also go up. But there was a fundamental flaw or at least a hidden assumption in this logic. It was assumed that the firm has idle or unproductive assets; and that, by getting rid of such assets, as opposed to some magical EPS effect, the firm’s productivity (e.g., its EVA or return on capital) increases.

1.15.3 Undervalued share price: The share price of a number of companies may be undervalued. This may be particularly true for the developing capital markets. Companies may buyback shares at higher prices to move up the current share prices. Tirumalavanan (2005) has indicated that buyback of shares and dividends announcement mainly gives the signaling of management’s view that the company’s stock is undervalued. Buyback of shares and dividend announcements were immediately signaled about the share price movement. But the positive signaling existed only for a day after the announcements, after which the extent of positivity of shares started decreasing. Chang (2014) has explained about signaling theory thus predicted a positive stock price reaction to announcements of convertible preferred stock repurchases since companies eliminated the option to convert into common stock in the future. Managers with favorable private information were more likely to repurchase to prevent convertible preferred stockholders from sharing an increase in
stock value in the future. Overvalued firms, on the other hand, have no urgency to repurchase since no immediate good news is expected. Wahid (2013) has said that undervaluation of the companies’ share prices as a result of information asymmetry was often cited by previous studies as the motivation for share buybacks. Information asymmetry occurs when the managers and the investors do not have identical information about a particular company. In many cases, managers have better information regarding the future prospects and the true value of the company. The management understands the company and its prospects better that the outsiders, and thus, the manager knows when market prices do not reflect their true values.

Barth and Kasznik (1999) has stated that the higher the level of information asymmetry, the higher the likelihood that the company would buy back shares in an attempt of provide a signal to the existing as well as the potential shareholders regarding the true value or position of the companies. The undervaluation of the companies’ share prices due to the presence of information asymmetry serve as a factor that motivates companies to buy back their own shares as they believed these shares were undervalued.

1.15.4 Capital Structure: If a company has high proportion of equity in its capital structure, it can reduce equity capital by buying back its shares. Once a company has decided for investment project it wants to undertake capital structure. There were different view on how capital structure influences value. Some argued that there was no relationship whatsoever between capital structure and firm value; others believe that financial leverage has a positive effect on firm value up to a point and negative effect thereafter; still others contend that, other things being equal, greater the leverage, greater the value of the firm.

Capital structure depends on the tax advantage of debt, the financial distress costs and agency costs associated with debt, and the degree of informational asymmetry. Rajagopalan and Shankar (2013) mentioned in their study allowing buybacks, companies worldwide have started experiencing a new way of adjusting the capital structure by making downward adjustment in the paid-up capital. Buybacks can be regarded as the late 20th century adoptive strategy in the ever-changing, challenging and demanding scenario of modern corporate finance.
Wahid (2013) has slightly mentioned and clearly demonstrated how a share buyback was used for the restructuring process or capital structure adjustment is the leverage ratio. The debt to equity ratio (Debt - Equity) measures the leverage of the company. Brown and O’day (2006) used the leverage ratio to conduct capital restructuring assessments of a company. The debt to equity ratio represents the total liabilities to shareholders equity. Capital structure influence the earning per share secondly there is a impact on capital structure on return on equity. It was determined the level of debt that can be serviced by the expected cash flows of firm.

A Share buyback shrink the equity (net worth) of the company in relation to its debt, thereby increasing the debt-equity ratio. Hence it can be used to know effective changes in the capital structure.

1.15.5 Tax savings by companies: Dividend payments are taxable in the hands of companies at 15 per cent. Company will avoid paying dividends taxes if compensate shareholders through the share buyback. Maria has (2003) studied the tax hypothesis in Buyback of shares was one of the most popular motives for repurchases is their preferential tax treatment due to the personal tax rate advantage of capital gains. If a distribution is paid out as a dividend, it was fully taxable to the shareholder. But if it is paid out as a share repurchase, the payment results in a capital gain to the shareholders in the amount of the difference between the cost of the shares and the repurchase value of the shares tendered for repurchase. Pandey (2010) pp. 453-455.

In India, companies which were generally chosen to buyback of shares by the tender method or the open market purchase method. Under the tender method, a company offers to buy back shares at a specific price during a specified period which is usually one month.

Under the open market purchase method, a company buys shares from the secondary market over a period of one year subject to a maximum price fixed by the management. Companies like to now have a difference preference for the open market purchase method as it gave them greater flexibility with respect to time and price.
1.16 Objections of Buyback of Shares:

1.16.1 Biased Advantage:

A company buyback of shares it may make a bargain purchase that gave an imbalance advantage to the continuing, non-selling, shareholders.

1.16.2 Manipulation:

If companies were allowed to buyback of shares, managers may resort to manipulation. Through collusive trading, depress prices, create anxiety among investors, and tempt them to sell the shares to the company by making apparently attractive offers.

1.16.3 Excessive Payment:

A company may pay too much for the share buy back. Such things may be motivated by the desire of promoters to raise their stake in the company, even though it hurts the interest of remaining non-promoter shareholders.

1.17 Regulation of Buyback Shares

Regulation of Buyback of shares under company Act, 1956 were as follows

- A company can buy back 10 percent of its share annually with board resolution. For a buyback exceeding 10 percent in a year, a special resolution of shareholders is required.
- The post buy back debt-equity ratio of the company should not exceed 2:1
- The buyback should not exceed 25 percent of the total paid-up capital and free reserves of the company.
- After completing a buyback programme, a company should not make a further issue of equity securities within a period of 6 months except by way of a bonus issue or in discharge of a subsisting obligation (like conversion of warrants, debentures or preference shares into equity shares, stock option scheme, and sweat equity scheme).
- The buyback may be funded by the following
a) free reserves and share premium  
b) Cash generated from the disposal of capital assets  
c) a public equity issue made exclusively for the purpose of buyback and  
d) a debenture issue.

1.18 SEBI GUIDELINES FOR BUYBACK OF SHARES

- The buyback can be done through an open offer route, Dutch auction route, reverse book building, reverse rights, or through stock market purchases. Promoters, however, were barred from offering their shares if stock market purchases were made.
- The buyback cannot be done through negotiated deals (where a block of shares is picked up from a single/few investor, spot deals, and private placement).
- The buyback process has to be handled by a merchant banker(s) will be held responsible for due diligence, pro rata acceptance of shares and so on. Prasanna Chandra (2008) pp.575

1.19 IMPACT OF SHARE BUYBACK

Companies have believed that the buyback will be financially beneficial for the company, the buying shareholders and the remaining shareholders. If the company distributed surplus cash or free cash flow and it maintains its operating efficiency, EPS will improve. The share price will improved as Price Earnings ratio has expected to remain the same after the buyback. And debt equity ratio will improve because reduced the equity capital. Firms will low debt equity ratio will be able to move to their target capital structure.

1.20 NEED FOR THE STUDY

Buyback of shares introduced in the year 1998 in India but some of the Indian companies had announced the buyback of shares frequently. The companies are Reliance Industries, Britannia Industries, and Bosch India etc. very often they involved in the buyback of shares for re-engineering or restructure their company financials or expansion of infrastructure, starting of new business etc.
Numerous studies have been done related buyback of shares was outside of India but in India very few studies was undertaken to measure the share price effects on buyback announcement. Hence there was a need to study the buyback of shares in India.

Buyback of shares was a corporate tool or financial re-engineering in an organization. Buyback of shares has been very familiar in US but it was unfamiliar in India. There was hardly any Indian research related to Buyback of shares to help and guide the corporate managers, Investors, Market regulators, Policy makers, Teachers and students on this subject. Beside these, the research may throw some light on why the companies were going for buyback of shares and what were the factors influence them for participating in stock market.

1.22 LIMITATIONS OF THE STUDY

The research on the pre-determined path subject to certain limitations:

1. This research was restricted to BSE listed companies only

2. This study was limited for a period from 1998 to 2015.
1.22 Organization of Thesis

CHAPTER I INTRODUCTION

This chapter deals with a general introduction and background of the study about Buyback of shares in India. Besides the above, this chapter gives a brief account of the Need for the study, scope of the study, the methodology, limitations of the present study, and finally outlines of the structure of the study.

CHAPTER II REVIEW OF LITERATURE

This chapter focus on the literature review with respect to the Buyback of shares, present various important factors affecting the performance contained in works of several researchers, identifies the gap in past research, previous empirical findings, outlines the objectives of the study, the and models developed to analyze are thoroughly examined.

CHAPTER III RESEARCH METHODOLOGY

This chapter presents a detailed discussion of research design, the research hypotheses to be tested, and the methodology used to test the critical factors affecting performances and its hypotheses. Also it presents a simple conceptual model for testing the critical dimensions.

CHAPTER IV DATA ANALYSIS

This chapter summarizes the outcomes of the statistical and econometrical analysis that were used to test the hypotheses and related managerial implications are discussed.

CHAPTER V FINDINGS, CONCLUSIONS AND SUGGESTIONS FOR FURTHER WORK

This chapter presents the findings of the study pertaining to the hypotheses, the implications for the sector as a whole and individually, drawn from the research. This chapter discusses conclusion and suggestions for the future research.