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SHARE REPURCHASE AS A TOOL OF FINANCIAL RESTRUCTURING: A CASE STUDY

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ABSTRACT

In the present competitive business environment, financial restructuring plays a pivotal role to strengthen the firm's financial position and also generate value for the shareholders in order to ensure efficient use of finance. Among various methods of financial restructuring available to a company, Buyback of Shares is a very significant one. The present paper investigates whether the financial restructuring undertaken by the company through share repurchase helps in the improvement of the financial performance by means of some traditional tools like Earning per Share(EPS), Dividend per Share (DPS), Return on Investment (ROI) and Market value to Book value ratio(M/B) and modern tools like Economic Value Added (EVA), Market Value Added(MVA) and Shareholders Value Added(SVA). For analyzing the impact of share buyback on share price, the concept of sub-periodic growth rate has been applied by using the "Kinked Exponential Models". In this paper "Control Sample Methodology" has been applied to facilitate the analysis of all the financial parameters and share prices' growth rate. The data has been collected from "Capitaline 2000" database package. The findings indicate that share buyback is a significant tool of financial restructuring which leads to greater financial flexibility to the corporate firms. However, this finding of the study based on one company cannot be generalized for the industry as well as the economy as a whole in the long run, which demands a broad based research study.

Keywords: *Share repurchase, EVA, MVA, SVA ,share price movement, Kinked Exponential Model.*

INTRODUCTION

With the advent of Liberalization, Privatization and Globalization (LPG) in the present era, there has been a significant dynamic change in the restructuring of the Indian Corporate Sector which has become indispensable for its growth and survival in this competitive environment. The term "Financial Restructuring" is an important component of Corporate Restructuring. Restructuring of a firm is a necessity when the company has reached a level where the original structure can no more properly manage the various common interests of its stakeholders..Financial Restructuring includes either internal or external restructuring (joint ventures, merger & acquisition etc.). It refers to remodeling of the financial structure of the firm for the purpose of accomplishment of its long term as well as short term objectives. It helps to build a strong financial base of the firm thereby generating value for the shareholders. One of the important methods of financial restructuring is Share Buyback. Buyback of Shares basically refer to the reversal of equity offerings. This topic is a part of many theoretical as well as practical research which is considered as a significant method of increasing the company's share price. By making a reduction in the number of outstanding shares, the interaction of demand and supply would lead the share price to float upward. Moreover, a rapid increase in the number of share price announcements over the last few decades pose an important question that whether share repurchase really offers the firm certain advantages in the long run.

There are various methods of share buyback through which the firms may repurchase the shares in a proportionate basis from the existing shareholders. Share repurchase may be made through tender offer or from the open market either by inviting tenders or by the book-building process; or odd-lot shares or the shares issued to employees pursuant to a scheme of stock option or sweat equity. USA has the longest history when the genesis of buyback of shares is talked about. It started in the US in late 1960s and became very popular during mid 1980s. In India, it was introduced in 1998 and it drew attention of all the major firms. Share buyback in India as well as in other countries of the world is regulated by corporate laws. Companies interested in buyback has to comply with the provisions of Section 77A, 77AA and 77B of the Companies Act, 1956. But recently after the amendment of the Companies Act in 2013, Section 68 consists of the provisions of Buyback of Shares. It has become a very common phenomenon in the different financial markets of the world. There are various reasons which initiate the companies to go for share buyback. Firstly, when the companies perceive that their shares are undervalued and they want to support the share price. Secondly, when the companies want to distribute cash to its shareholders. Thirdly, with the intention enjoying the tax advantage in markets where capital gain taxes are lower than taxes on cash dividends. Fourthly, it helps in raising the earning per share, promoter's voting power as well as the debt-equity ratio of the company and there are several other motives.

According to the Securities and Exchange Board of India, the total buyback offer size was Rs 13057.92crore in 2011-12 as compared to Rs 5315.80crore in 2010-11. This large volume of increase has led to a significant amount of academic research in the aforesaid area.

OBJECTIVES OF THE STUDY

The primary objective of the present research paper is to make an in-depth and detailed analysis of the financial restructuring through share buyback in India. The objectives of the study are as follows:

- Comparison of pre-buyback and post-buyback financial performance of the sample company and its control firm using Traditional and Modern tools.
- Study of pre-buyback and post-buyback analysis of share price movement of the sample company and its corresponding control firm.

REVIEW OF LITERATURE

Jensen (1986) reveals that the firms intend to repurchase shares in order to distribute excess cash flow. Stephens and Weisbach (1998); Vermaelen (1981) finds that there lies a positive relationship between share repurchase and levels of cash flow. Harris and Ramsay (1995) claims that buyback of shares generates value for the company and its remaining shareholders. Vermaelen (1981) and Ikenberry, Lakonishok and Vermaelen (1995) reveal abnormal returns of approximately 3% over a two-day announcement period. They formulated a hypothesis claiming that share repurchase act as a signaling mechanism and thus helps in providing new information . Using a sample of 1239 open market repurchases announced between 1980 and 1990, they demonstrate that making an investment in the companies that announce share repurchase result in 12.4% abnormal returns over 4 years. Porter, Roenfeldt and Sicherman (1999) examined that undervalued closed end funds gains value after repurchase of shares.

Balachandran and Troiano (2000) are also of the thought that undervalued share prices are the primary reason for the adoption of share repurchase by the concerned firms.

There are several research work which focus on the change in the earning of the firm with respect to share repurchase. Nohel and Tarhan (1998) investigated share purchase through tender offer method to distinguish between the signaling of information and free cash flow hypothesis and conclude that the investors' positive response to share repurchase is best explained by the free cash flow hypothesis. Dr. L.C.Gupta , Navin Jain and Anil Kumar (2006) undertook a research study where they examined the effect of share buyback on share prices. They attempted to make a clear distinction between announcement effect and actual post buyback effect. They also made a comparison of the share prices between the pre buyback and the post buyback period and found that share buyback has a positive impact on the share price and the buyback company's share depict an upward rising trend whereas the market movement is just the reverse.

Liang and Sharpe (1999) undertook a study which aimed to depict the impact of buyback of shares and employee stock option exercise on net share retirement for S & P 500 companies. They revealed that in the last five years, gross purchase has led to reduction in outstanding shares 2% annually but due to the exercise of the employees stock options, only half of those shares had actually retired.

Masulis (1980) examined that in and around the event day , there would be no announcement effect on price. Thus they found out some other alternative approaches for the purpose of testing the value effect of share repurchase.

Dann (1981) revealed that the shareholders enjoyed a positive return of approximately 15% due to share repurchase and these positive returns were mostly permanent.

Comment and Jarrell (1991) examined the signaling hypothesis in relation to buyback announcements. This study considers three main methods of buyback – open market, tender offer and Dutch auction and conclude that fixed price tender offer signal maximum amount of information to the investors and open market repurchase provide least information.

Dr. A.K.Mishra (2004) examined and analyzed the trend of returns from the viewpoint of tendering (participating) and non-tendering (non-participating) shareholders. He further found that share repurchase is beneficial to mainly two groups of people, namely, the promoters and the existing shareholders.

Saha (1999) claimed that share repurchase is a good financial strategy having several advantages and a few disadvantages as well. He proposed that first the firm's financial position is to be analyzed and then this particular strategy is to be adopted.

DATA BASE AND METHODOLOGY

The database for this study is taken from a secondary database package. In order to measure the financial performance of the company and its control company both traditional and modern tools has been used. The traditional tools include Return on Investment, Earning per Share, Dividend Per Share, Return on Investment, Market value to Book value and modern tools include Economic Value Added, Market Value Added and Shareholder's Value Added.

Economic Value Added (EVA)

The term Economic Value Added (EVA) is a registered trademark of Stern Stewart & Co. of New York City (USA), Bennett Stewart in his book, *"The Quest for Value.* In simple words, any profit earned over and above the cost of capital is Economic Value Added.

$$EVA_t = NOPAT_t - WACC * \text{Capital Employed.}$$

Where,

$NOPAT_t$ = Net Operating Profit before interest and after tax during period t.

WACC = Weighted Average Cost of Capital.

Capital Employed = Net Block + Trading Investment + Net Current Assets at the end of period t.

Market Value Added (MVA)

Market value added (MVA) may be defined as the difference between company's market capitalization and book value of capital. If market value of capital is greater than its book value, then MVA provides positive results which signifies creation of wealth for the shareholders.

MVA = Market Capitalization – Equity

Where, Equity = Equity share capital + Reserve & Surplus – Miscellaneous expenses – P&L (dr.) balance.

SHAREHOLDERS' VALUE ADDED (SVA)

Likewise Shareholders' Value Added (SVA) is also a significant tool to measure value creation from shareholders' viewpoint. SVA actually represents the total value added to the shareholders, both realized as well as unrealized.

MAJOR FINDINGS

Earnings Per Share (EPS) (in rs)-

COMPANY NAME	IMMEDIATE IMPACT		SUSTAINABLE IMPACT	
	Before Buyback year	After Buyback year	Average three years Pre-buyback	Average three years Post-buyback
Sun Pharma	36.30	24.99	37.66	21.66
Aurobindo Pharma	33.14	24.73	46.58	14.79

The average values of EPS of Sun Pharmaceuticals Ltd in Period II (Rs 21.66) is less than that of Period I (Rs 37.66) and for its control company, Aurobindo Pharmaceuticals also EPS deposits a similar nature portraying a reduction in Period II (Rs 14.79) as compared to Period I (Rs 46.58). So, over the period of study, both the companies follow a downward trend in EPS.

Dividend Per Share (DPS) (in rs)-

COMPANY NAME	IMMEDIATE IMPACT		SUSTAINABLE IMPACT	
	Before Buyback year	After Buyback year	Average three years Pre-buyback	Average three years Post-buyback
Sun Pharma	2.50	4.87	1.72	4.66
Aurobindo Pharma	1.47	2.25	1.42	1.42

There is an increase average DPS of Sun Pharmaceuticals in Period II(Rs. 4.66) as compared to Period I (Rs.1.72) . In case of Aurobindo Pharma, for both the periods, the average DPS has not changed (Rs.1.42) displaying a mixed trend during the period.

Return on Investment (ROI)-

COMPANY NAME	IMMEDIATE IMPACT		SUSTAINABLE IMPACT	
	Before Buyback year	**After Buyback year**	**Average three years Pre-buyback**	**Average three years Post-buyback**
Sun Pharma	40.22	28.03	36.49	19.65
Aurobindo Pharma	31.60	21.20	40.49	16.09

The average ROI of Sun Pharma Ltd in Period II (19.65%) shows a remarkable reduction as compared to that of Period I (36.49%). Thus, it depicts a decreasing trend in ROI. For the control company also, similar trend is observed as the average ROI of the company in Period II (16.09%) as compared to 40.49% in Period I.

Market Value to Book Value (M/B ratio)-

COMPANY NAME	IMMEDIATE IMPACT		SUSTAINABLE IMPACT	
	Before Buyback year	**After Buyback year**	**Average three years Pre-buyback**	**Average three years Post-buyback**
Sun Pharma	1.55	3.72	1.31	7.49
Aurobindo Pharma	0.64	2.51	0.99	2.80

There is an increase in the average M/B ratio of Sun Pharma Ltd from 1.31 in period I to 7.49 in period II , thus showing an upward trend in the M/B ratio. Aurobindo Pharma follows a similar trend as its average M/B ratio has also improved from 0.99 in Period I to 2.80 in Period II.

Economic Value Added (EVA)-

COMPANY NAME	IMMEDIATE IMPACT		SUSTAINABLE IMPACT	
	Before Buyback year	**After Buyback year**	**Average three years Pre-buyback**	**Average three years Post-buyback**
Sun Pharma	30.72	19.93	25.51	13.66
Aurobindo Pharma	17.92	11.32	24.66	6.42

The data reveals that there is a reduction in average EVACE of Sun Pharma Ltd from Period I (25.51%) to Period II (13.66%). It reveals a mixed trend but the overall inclination is towards a downward trend. In case of Aurobindo Pharma also there is a reduction in the EVACE of the company from 24.66% in Period I to 6.42% in Period II.

Market Value Added (MVA)-

COMPANY NAME	IMMEDIATE IMPACT		SUSTAINABLE IMPACT	
	Before Buyback year	**After Buyback year**	**Average three years Pre-buyback**	**Average three years Post-buyback**
Sun Pharma	308.40	2,444.54	106.19	4,086.86
Aurobindo Pharma	-174.04	1,342.93	(51.86)	1,002.65

On making a comparison between the data of the pre-buyback and the post-buyback period, it is evident that MVA of Sun Pharma is considerably high in the post-buyback period resulting in Rs. 4086.86 crores in Period II as compared to Rs. 106.19 crores in Period I. But the control company Aurobindo Pharma has revealed a negative MVA in most of the years.But its average MVA has increased from Rs. 51.86 crores in Period I to Rs.1002.65 crores in Period II.

Shareholder's Value Added (SVA)-

COMPANY NAME	IMMEDIATE IMPACT		SUSTAINABLE IMPACT	
	Before Buyback year	**After Buyback year**	**Average three years Pre-buyback**	**Average three years Post-buyback**
Sun Pharma	331.79	2,504.83	126.92	4,164.25
Aurobindo Pharma	-167.98	1,354.35	(46.19)	1,010.01

The table shows a significant increase in the average SVA of Sun Pharma from Rs. 126.92 crores in Period I to Rs. 4164.25 crores in Period II. The same trend is followed by Aurobindo Pharma as well. Its average SVA increases from Rs. -46.91 crores to Rs. 1010.01 crores in Period II.

Share Price Movement-

Sun Pharmaceuticals Industries Ltd.				Aurobindo Pharma Ltd.				Nifty			
VAR	**COEFF**	**t STAT**	**P-VALUE**	**VAR**	**COEFF**	**t STAT**	**P-VALUE**	**VAR**	**COEFF**	**t STAT**	**P-VALUE**
const	4.934	232.958	<0.00001 ***	const	4.741	91.626	<0.00001 ***	const	6.882	159.817	<0.00001 ***
t1d1	−0.22	−3.217	0.00179 ***	t1d1	−0.06	−0.468	0.64057	t1d1	−0.18	−2.062	0.04134 **
t1d2	0.37	5.944	<0.00001 ***	t1d2	0.75	5.729	<0.00001 ***	t1d2	0.20	2.188	0.03057 **

*** Significant at 1% level, ** Significant at 5% level, * Significant at 10% level.
Source: Author's calculation is based on gretl (Version 1.7.7)

From the table it is evident that compound exponential growth rates of Nifty and the share prices of both the companies has increased from negative growth rate in sub-period I(-0.18) to positive growth rate in sub-period II (0.20) at 5% significance level. In case of the control company, Aurobindo Pharma Ltd, the exponential growth rate has increased to 0.75 in sub-period II from the negative growth rate in the first sub-period of value -0.06. But only the second sub-period's growth is statistically significant at 1% level.

CONCLUSION

In this paper we try to test empirically that whether buyback of shares really generate value for the organization or not. The findings of the study reveal that there is no proper evidence to justify that Share Buyback acts as a tool for the purpose of company's value creation. The results does not show any positive impact of the financial tools taken for the purpose of measurement.

Additionally, the share price analysis of the buyback company as well as the control company also does not reveal a positive impact of buyback on the stock prices as said theoretically.

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