
SHAREHOLDER VALUE CREATION THROUGH BUYBACK OF EQUITY -AN EARNINGS PER SHARE MEASUREMENT ANALYSIS*

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ABSTRACT

"Stock buybacks reduce by nature the number of outstanding shares. The decrease in the number of the outstanding shares increases the earnings per share. Thus, each remaining outstanding share represents a slightly higher percentage of the company to the shareholder. The sample of the paper consists of 32 buyback programs announced by 27 Indian companies and 5 multinational companies belonging to 21 industries during the period 2005-2010. The paper finds that 78% of the buyback programs have registered an enhancement in the earnings per share while the earnings per share of the remaining 22% decreased. The outcome of the paper agrees with the findings of the research work done in the past. Therefore, the study concludes that the stock buybacks enhance the earnings per share and thereby create value for the shareholders."

INTRODUCTION

Shareholder value creation in the borderless world has become a major concern of the companies. The companies may enhance the wealth of their shareholders by employing the financial strategies like merger and acquisition, buyback of equity or stock split depending upon financial condition, cash position and stability of the stock price. However, there are a very few studies conducted on shareholder value creation by employing these strategies. Moreover, there is not much work done on for creating value for shareholders by enhancing the earnings per share through buyback of equity. Therefore, the present paper entitled

* The paper presented in the 35th All India Accounting Conference and International Seminar on Accounting Education and Research on January 5-6, 2013 at Rajkot.

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'Shareholder Value Creation through Buyback of Equity—An Earnings per Share Measurement Analysis' makes an attempt to explore the evidences on whether buyback of equity improves the earnings per share to enhance the value of the shareholders.

BUYBACK AND SHAREHOLDER VALUE

Buyback of shares may create the value for the shareholders by the following four means,

Abnormal Returns : Stock buybacks generally signal undervaluation of stock. As a result, the market reacts positively to the buyback announcements. This results in the abnormal returns for the shareholders.

Earnings per Share : Buyback by their very nature reduce the number of outstanding shares. With fewer outstanding shares after a buyback, the earnings per share of the remaining shares increases. Thus, each remaining outstanding share represents a slightly higher percentage of the company to the shareholders.

Fair Price : Very often, shares are traded below the intrinsic value. But the company knows better about its stock than the market. Therefore, in the short run, the buyback price is considered as the fair market price at which unhappy shareholders can quit the company with a handsome profit i.e., wealth to the tendering shareholders.

Stable Market Price : The buyback of share ensures sustained stability in the stock price as it creates demand for stock through reduced supply to the extent of the shares bought back i.e., wealth to the existing shareholders.

REVIEW OF LITERATURE

The literature on shareholder value creation through buyback of shares is very limited. Some of the known are cited below,

- ❖ Vermaelen (1981) and Dann, Masulis and Mayers (1991) show that initial market reaction is positively related to subsequent increases in earnings per share following the share buyback.
- ❖ Solomon (1989) opined that the companies acquire their own shares to improve earnings per share by reducing the number of shares outstanding..
- ❖ Pinches (1990), Dyckman, Dukes and Davis (1995), Skousen, Stice and Stice (1995), Willson and Rohel and Bragg (1995) and Keeso and Weygandt (1998) said that share buybacks by their very nature decrease the total number of outstanding shares and as a result the earning per share of the remaining shares increases after the buyback.
- ❖ A.K.Mishra (2005) analyzed 25 buyback programs i.e., 18 tender offers and 7 open market operations from 20 listed companies during the period 1999 to 2001. He found

that 44% of the buyback programs have registered enhancement in the earnings per share.

OBJECTIVES AND METHODOLOGY

The main objective of the paper is to ascertain the impact of buybacks on shareholder value creation. An Earnings per Share measurement analysis has been carried out to achieve the objective of the paper. The data on the buyback programs announced by listed companies from 2005 to 2010 have been collected from SEBI website, Buyback archives of BSE and other publications. The sources listed 90 buyback programs during the aforesaid period. Of these, the paper consists of 32 sample buyback programs announced by 27 Indian companies and 5 MNC's belonging 21 industries. The sample buyback programs have been selected on the basis of the ranking of the company based on the market capitalization by Compendium of Top 500 Companies in India published by Capital Market in 2009. In the case of multiple buybacks, only initial buyback has been considered and subsequent buybacks have been ignored. The earnings per share of the sample companies (before and after buyback of shares) have been collected from the financial reports of the companies.

ANALYSIS & INTERPRETATION OF DATA

The following table exhibits the earnings per share before and after stock buybacks from 2005 to 2010,

**Earnings per Share Before and After Buyback
2005-2010**

Buyback Companies	Type of Comp.	Industry	Date of BB	EPS before BB	EPS after BB	% change
Polaris Software Lab. Ltd	Indian	Software	03/05/05	5.20	1.18	-77.31
GlaxoSmithKline Pharma Ltd	MNC	Pharma	09/05/05	35.01	55.35	58.10
Berger Paints(India) Ltd	Indian	Paints	13/05/05	2.42	3.25	34.30
Indiabulls Financial Services Ltd	Indian	Finance	09/12/05	1.77	4.38	147.46
SRF Ltd	Indian	Textile	03/07/06	15.57	41.07	163.78
ICI (India) Ltd	MNC	Paints	18/07/06	11.43	105.13	819.78
Hindustan Unilever Ltd	MNC	Personal Care	03/10/07	7.57	7.21	-4.76
GTL Ltd	Indian	Telecom	25/10/07	4.88	12.32	152.46

Madras Cements Ltd	Indian	Cement	29/02/08	251.18	336.24	33.86
Great Offshore Ltd	Indian	Shipping	07/05/08	47.98	52.16	8.71
Patni Computer Systems Ltd	Indian	Software	10/07/08	27.28	29.87	9.49
Gateway Distriparks Ltd	Indian	Miscellaneous	11/08/08	5.91	8.10	37.06
Gujarat Flurochemicals Ltd	Indian	Chemical	21/08/08	27.08	30.35	12.08
Rain Commodities Ltd	Indian	Cement	25/09/08	9.12	11.37	24.67
DLF Ltd	Indian	Construction	17/10/08	14.42	8.95	-37.93
Monnet Espat & Energy Ltd.	Indian	Steel	21/11/08	33.76	44.19	30.89
Ipca Laboratories Ltd	Indian	Pharma	26/11/08	54.89	34.63	-36.91
Supreme Industries Ltd	Indian	Plastic	02/12/08	17.15	36.29	111.60
EID Parry(India) Ltd	Indian	Sugar	03/12/08	13.41	78.59	486.06
India Infoline Ltd	Indian	Finance	08/12/08	21.52	3.26	-84.85
Bosch Ltd	MNC	Auto Ancillary	10/12/08	185.83	193.71	4.24
Nava Bharat Ventures Ltd	Indian	Diversified	29/12/08	39.44	58.46	48.23
Jindal Polyfilms Ltd	Indian	Packaging	31/12/08	46.84	48.66	3.89
Icar Motors Ltd	Indian	Automobile	06/02/09	17.38	29.64	70.54
Reliance Infrastructure Ltd	Indian	Power	25/02/09	44.97	49.27	9.56
Godrej Industries Ltd	Indian	Chemical	25/05/09	0.58	2.55	339.66
Deccan Chronicles Holdings Ltd	Indian	Entertainment	03/08/09	5.72	10.77	88.29
Geodesic Ltd	Indian	Software	19/05/10	23.38	30.66	31.14
Binani Cement Ltd	Indian	Cement	21/06/10	14.40	0.91	-93.68
Parasara Biotech Ltd	Indian	Pharma	07/07/10	12.00	21.35	77.92
CRISIL Ltd	MNC	Miscellaneous	22/10/10	22.25	28.51	28.13
Finamal HealthCare Ltd	Indian	Pharma	10/12/10	21.46	6.60	-69.25

Source : Company websites, SEBI website and Compendium of Top 500 Companies in India

From the above table, it is clear that out of 32 buyback companies, 25 companies i.e., 78% have registered an enhancement in the earnings per share while the remaining 7 companies i.e., 22% have recorded a decrease in the earnings per share. However, on the basis of the type of companies, out of 5 MNC's and 27 Indian companies, only

one MNC and six Indian companies have reported a net decrease in their earnings per share.

The earnings per share of Indiabulls Financial Services Ltd. (147.46%), SRF Ltd. (163.78%), ICI (India) Ltd. (819.78%), GTL Ltd. (152.46%), Supreme Industries Ltd. (111.60%), EID Parry (India) Ltd. (486.06%) and Godrej Industries Ltd. (339.66%) increased by more than 100%. But the earnings per equity share of Polaris Software Lab Ltd. (77.31%), India Infoline Ltd. (84.85%), Binani Cement Ltd. (93.68%) and Piramal Healthcare Ltd. (69.25%) declined within a range of 50% to 100%.

The result of the study agrees with Solomon (1989), Pinches (1990) and others and A.K.Mishra (2005). However, the study records that 78% of the buyback programs have registered an enhancement in the earnings per share as against 44% reported by the study conducted by A.K.Mishra.

SUMMARY AND CONCLUSION

Stock buybacks reduce the number of outstanding shares. The decrease in the number of the outstanding shares increases the earnings per share. Thus, each remaining outstanding share represents a slightly higher percentage of the company to the shareholder. The study finds that out of 32 buyback programs, 78% of the programs have registered an enhancement in the earnings per share while 22% have recorded a decrease. Therefore, the study concludes that buyback of equity shares enhances the earnings per share and thereby creates value for the shareholders. However, further research can be carried out for a larger period with more number of companies and shareholder value creation by subsequent buybacks in the case of multiple stock buybacks.

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