Share Buyback in India: Issues and Evidence

Abstract

Share buyback is a corporate event when companies repurchase their own shares from the existing shareholders. Share buyback as a corporate engineering tool not only helps in distributing the excess reserve but alsoin restructuring the debt, ownership and financial position of the company. Because of these multi facet benefits, share buyback became very much popular among companies in developed countries. So, a major portion of the extant literature is based on developed markets. As such, share buyback as an area of research remain unexplored in emerging markets or developing economics. It is because, share buyback is introduced lately in many developing markets including India. This study examines the impact of share buyback on Indian companies in a differently regulated market.

Specifically, the study investigates the impact of buyback on Indian companies in four different aspects, *viz.*,1) Factors influencing share buyback decisions of companies by taking firm specific parameters representing the existing hypothesis (Signaling of undervaluation, Free cash flow, Substitution, Leverage, Stock option, Agency, Corporate governance and liquidity) by using logit regression, 2) Earnings management around share buyback by using four different models (Healy, DeAngelo, Modified Jones and performance matched) and its impact on long term and short term return, ownership and choosing of buyback methods, 3) Detection of insider trading before share buyback and its impact on share repurchase decisions, short term return and share buyback completion, 4) Factors influencing in choosing of buyback methods (Tender and open market method) for doing buyback by taking firm specific parameters.

This study finds that signaling of undervaluation, free cash flow, stock options, agency and liquidity hypothesis are influencing share buyback decisions in India.Substitution and Leverage hypothesis donot hold good in Indian context.The study also indicates that companies in India do earnings management before buyback and companies those indulge in doing more downward earnings management choose open market method than tender offer for doing share buyback. In addition the study observes higher insider trading before share buyback and insider buying is treated as an additional signaling tool for investors. Actual share buyback and program completion rate is higher in case of higher insider trading before buyback. Further, this study reveals that companies having higher cash reserve, higher promoter ownership, lower debt prefer tender method for doing buyback other than open market share repurchase. Companies whose shares are traded frequently in capital market prefer open market method than tender offer.

JEL classification: M40, M41, G19, G38

Keywords: *Share Buyback, Earnings Management, Insider Trading, Tender Offer, Open Market Method, Signaling, Promoter Ownership.*