

INVESTOR SENTIMENT AROUND BUYBACK IN INDIAN STOCK MARKET

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ABSTRACT

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While Buyback helps companies to invest in themselves by reducing the number of outstanding shares in the market, it increases the investor sentiment with respect to the company as the investors expect an increased Earnings Per Share, When the Earnings Per Share increases, the market react positively and shares prices will increase. This study attempts to examine the significance of stock price behavior around the public announcement of buyback. The effect of public announcement is studied by analyzing the behavior of abnormal returns of ten companies, which made buyback announcement during the financial year 2018–19. The companies were selected from securities exchange board of India (SEBI) and National Securities Exchange (NSE) website that portrays the public announcement of all such companies. This is an event study which attempts to measure the valuation effect of a corporate event, namely public announcement of buyback by examining the response of the stock price around the announcement of the event. To test the impact of public announcement Abnormal Returns (AR) and Cumulative Abnormal Returns (CAR) are computed. The study concludes that the buyback announcement does not have any significant impact on the share price.

KEYWORDS: Buyback, CAR, Abnormal Returns, Investor sentiment

1.INTRODUCTION

Buyback is a part of corporate restructuring which means buying back the company's shares which has issued earlier from the market. This will lead to distribution of excess cash flow among the shareholders by way of repurchasing its own shares at a premium. In India buyback of shares were introduced in 1999. Share buyback decreases the total number of shares. It is an option available to the shareholders to exit from the company.

Before the amendment of the companies act 1999 there was no way for a company to buy back its own shares from the shareholders without a prior sanction of the court (except for the preferential shares). The laws regarding buyback were very stringent. These are some of the ways by which a company could buy back its shares: -

- Reduction of share capital as per sections 100 to 104.
- Redemption of redeemable preferential shares according to section 80.
- Purchase of shares on an order of the court for scheme of arrangement under section 391 in compliance with provision of sections 100 to 104.

d. Purchase of minority shareholders shares under the order of the company law board under section 402(b).

Section 77A, 77AA and 77B were inserted in the companies act through the amendment in 1999. The companies (Amendment) Act, 1999 (Act 21 of 1999), permits a company to buy-back its own securities whether it is public or private, after following the prescribed procedure specified in Sections 77-A, 77-AA and 77-B.

Investor sentiment is the general attitude of investors with regards to the price developments in the market. It may be bullish sentiment or bearish sentiment. In case of bullish sentiment the stock market prices rises over a sustained period and vice versa. Usually the investor sentiment is measured with the help of economic stories in the media, professional market forecast, etc.

In buyback of shares, the company reduces the number of outstanding shares in the market, which increases the ownership stake of the shareholders. As a result of buyback the Earnings Per Share on the remaining shares will increase.

In this case the investor sentiment is bullish in nature. The investors expect a price rise in the shares in the near future because they know that a buyback will immediately increase the Earnings Per Share. The investors prefer buyback over dividend because of the tax benefit associated with it. Investors perceive buyback as a positive signal as the shares to be undervalued and therefore new investors will be attracted to the company. The existing investors expect a higher amount of dividend as there are fewer shares remaining after buyback. Overall there is a positive psychology of investors is present. But over a long term period, buyback may or may not be beneficial to the shareholders.

2. REVIEW OF LITERATURE

Companies can use their profits in two ways: they can distribute a portion of profit in the form of Dividends to shareholders or buyback of shares and the remaining portion of profit can be utilized for investing in the further growth of the company. Buyback was restricted in India till 1998. After amendment of company act in 1999 buyback gain its popularity. Companies announced buyback as a substitute of dividends. Repurchases of shares by the company decreases the shares held by the public.

Rajlaxmi (2013) in her research work titled “share buyback: an empirical study of announcement effect on stock prices in India” the effect of announcement was tested for which 5 day pre CAR and 5 day post CAR was calculated. The sample for this study comprises of 6 buyback announcements and the result indicates that the gain from buyback announcement is short term.

Mishra(2005) conducted a study in the period 1999 till 2001 entitled, “an empirical analysis of share buybacks in India”. The buyback announcement from the management resulted in an increase in the stock price. It is a short-term phenomenon. Therefore, after the buyback the price of a share decreases below the price before the announcement of the buyback. The various researches shown that the buybacks were not successful in India and that a buyback could not ensure a sustained increase in the share prices.

Thirumalvalavan and Sunitha (2006) carried out first event study in India in order to measure the buyback announcement effect when compared to dividend announcements. With a sample size of 22 firms, the average return on repurchases over an event window of 10 days, 5 days prior and 5 days post announcements has been found to be 1.95% , while this return is maximum for first 2 days, i.e. 3.2%. Besides, this study found out a declining trend in abnormal returns with passage of time beyond 3 days.

Ikenberry, Lakonishok and Vermaelen (2000) in their study titled “Stock Repurchases in Canada: Performance and Strategic Trading” shows an abnormal returns of 0.93% in the month of the announcement for Canadian firms undertaking buybacks. They divided Canadian repurchase firms mainly into three categories: firms purchasing no shares, firms that purchased less than 30% of the announced volume, and firms that repurchased more than 30% of their announced magnitude. The first group experienced significant abnormal return in the announcement year but not in the subsequent two years of the announcement, and that the firms in the second and third groups did not have significant abnormal return in the announcement year but did so in the subsequent two years to the buyback announcement.

Amitabh Gupta (2006) found in his study that announcement of share buy backs result in increase of the

shares price around the time of announcement and large companies generate lower abnormal returns than small companies. It happens because of low information asymmetry between the management and investors of these large companies. Equity buybacks are important tool for convey the investors that the shares are undervalued and its future profitability.

Kaur (2012) studied the impact of public announcement of share buyback of BSE listed companies. On the announcement day, about 55% of open market share buyback events experience positive returns. From day -3 to -1 (before the announcement), returns are positive. This is because of much of the information about share buy-backs is announced in board meetings, and shareholders meetings. This will results in hike in prices in pre-announcement period. Further, it is seen that post-announcement returns are very low and mostly negative and insignificant. This depicts that market is so quickly absorbs the information and the market is an efficient one.

Grullon and Michaely (2002) from their study found that buying back its own shares have much tax benefits when compared with the dividend distribution. Therefore usually companies prefer buyback over dividend. They found out that young firms preferred buyback of shares over dividend, as they consider it is the best way to distribute cash to its equity shareholders. A Large-established firm also interested in payout of cash through repurchases. Dividends and share repurchases are considered as substitute payment methods by the investors.

Guthart (1967) conducted a study entitled “Why Companies Are Buying Back Their Own Stock” shows the importance of repurchase in between 1964-1966. This study also focuses on the motivations underlying the stock repurchases and found that many companies believed that company’s equity capital was too high in relation to volume of business so for reducing the equity base was the most important reason of buyback. Share repurchases leads to increase in Earnings Per Share and minimize the risk also. Other major motivations of share repurchase are it is a good investment, it support the market, it eliminate small stockholders, and to gain or improve control in business.

Vernmaelen (1984) made an impactful study on share buybacks by the US companies. He examined a total of 131 buyback tender offers. From the study it is revealed that 13 percent of the positive returns received by shareholders of the company were permanent. In this study he actually relates the positive reaction of the stock market to an information signaling effect. Here the management provides the information to investors that the shares of the company have been undervalued through the announcement of buyback at a premium. 23 % is the average premium offered to shareholders as part of the buyback.

Wiyada and Aekkachai (2013) from their study of buyback in Thailand found out that eighty-six repurchase announcements from 69 companies listed on Stock Exchange of Thailand (SET) have been made during December 14, 2001 to May 22, 2012. The study focused on whether the repurchase announcement has any effect on the abnormal return of the listed firms or not. Event study methodology is used in this case. The result shows a positive abnormal return of 2.23 percent, at 1 percentage level of significance. Before 2 days of announcement, cumulative abnormal returns were significant. This show a clear picture that repurchases was done when stock was underpriced and management knows about this information.

3. RESEARCH PROBLEM

After amendment of company Act 1999, buy back in India gained popularity. Many companies use this route to achieve various corporate goals after the amendment. But the success rate of buyback is comparatively low; impact of buyback decision on investor's sentiment is also not uniform. There is no much more studies are addressed on this issue. In this regard, this study was undertaken to analyze the investor sentiment around buyback of shares with regards to ten companies which done the buyback at the end of the financial year 2018- 2019. This study will helps to understand the impact of buyback on the security returns.

4. OBJECTIVES

- To examine the impact of share buyback announcements on stock price behavior in India.
- To study the performance of selected companies, post and pre announcement of Buy Back of shares.

5. RESEARCH HYPOTHESIS

H0: There is no significant difference between the share prices before and after the buyback announcement.

H1: There is significant difference between the share prices before and after the buyback announcement.

6. RESEARCH METHODOLOGY

a) SOURCE OF DATA

The study is completely based on secondary data. The data required for the study is mainly secondary in nature.

SECONDARY DATA: Secondary data has been collected from different sources such as NSE database, various journals and internet.

b) SAMPLE DESIGN

The companies under the study were selected from securities exchange board of India (SEBI) and National Securities Exchange (NSE) website that depicts the public announcement of all such companies as and when announced. The sample of ten companies were selected that made public announcement for buyback in the end of the financial year 2018 – 2019.

c) RESEARCH TOOLS

ABNORMAL RETURNS (AR)

It is the difference between the actual returns of a security and expected return. It is also known as excess returns. Abnormal returns are generally activated with the buyback announcements. It can be both positive as well as negative. Under market model the abnormal returns can be calculated using cumulative abnormal returns method.

$$AR_t = R_t - E(R)_t$$

AR_t = Abnormal Return

R_t = actual return on stock

ER = expected returns

CUMULATIVE ABNORMAL RETURNS (CAR)

A cumulative abnormal return (CAR) is the sum of the abnormal returns. The CAR is used to determine the effects of events such as buybacks have on stock prices. Cumulative Abnormal Returns are usually calculated over small windows, often only days. It is so because the compounding of daily returns may create bias in the results.

T-test

It is the statistical tool used to observe the significance impact on stock returns. 5 % is the level of significance.

d) EVENT STUDY

An event study is a test used to measure the valuation effects of a corporate event, such as a merger or buyback announcement, by examining the response of the stock price around the announcement of the event. An efficient stock market is the most important requirement of the event studies, which means stock prices react quickly and accurately to new information. This study is also a part of event study and focus on impact of announcement of buyback on the stock prices. Event studies are highly useful for evaluating how a previous event affects the value of the firm or determining how a proposed policy will affect the value of the firm.

ESTIMATION WINDOW

The estimation window is used to determine the normal behavior of the stock market factors. Estimation window estimates the normal stock returns for the company for pre and post announcement of buyback and the event date also.

EVENT WINDOW

This is the time period which the impact of event is investigated. The length of the event window mainly depends upon the type of the event, and its significance. In order to get accurate results, generally longer event windows are used.

POST EVENT WINDOW

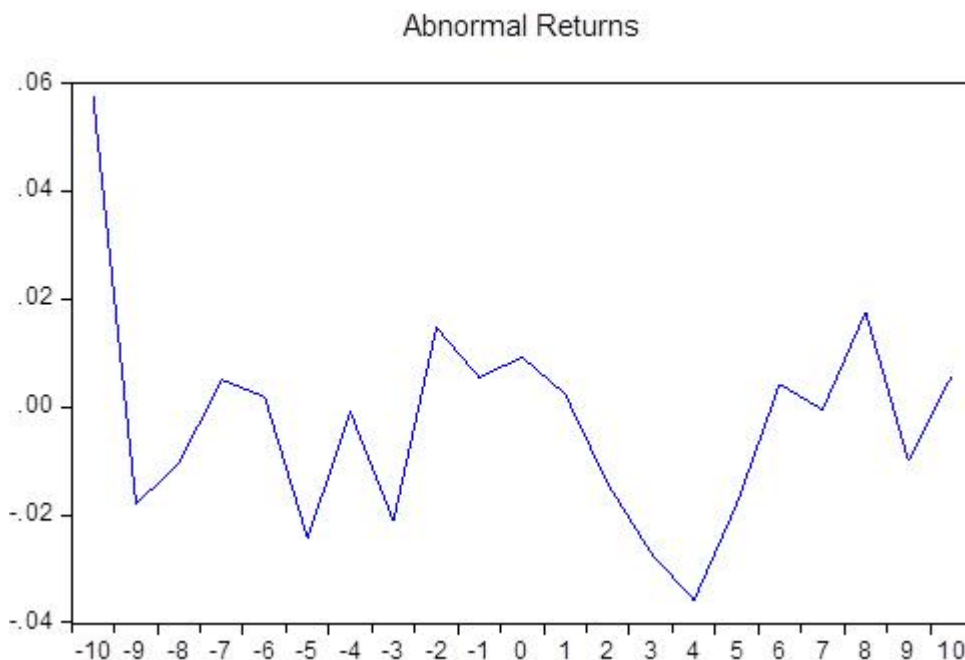
It is the period after the event occurred. Post event window investigate long term company performance following the event.

RESULTS OF THE STUDY

Name of the company	On the date of public announcement of buyback	
	Abnormal Returns	T - values
Aarti drugs limited	0.009258862	0.624221487
Baba arts limited	-0.004350338	-0.086438406
Coal India limited	-0.017461518	-1.218892907
NMDC limited	0.008314291	0.431164161
ONGC limited	0.019420279	0.748419336
PBM Polytex limited	0.026847404	1.076450698
Shanti gears limited	0.011455361	0.546834486
Shervani industrial syndicate limited	-0.011830628	-0.281555803
Tata investment corporation limited	0.004871094	0.22138047
Tech Mahindra limited	-0.004935248	-0.261494258

Source: Computations of the Researchers

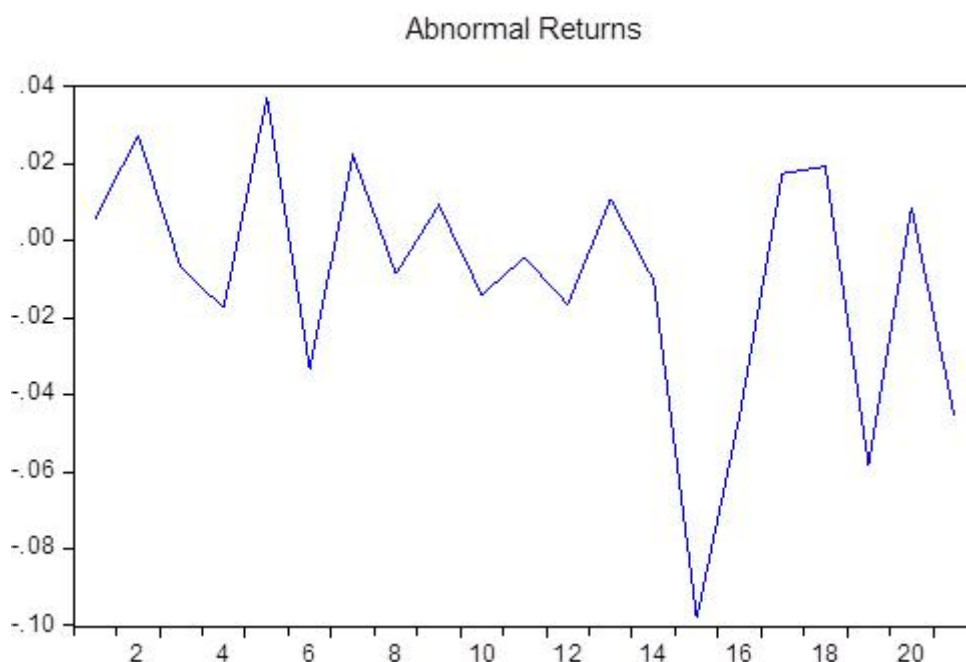
Figure 4.1: ABNORMAL RETURNS OF AARTI DRUGS LIMITED



The above data presents the daily abnormal returns for all 10 days prior and post announcement day. It is observed that AR is positive for -10th, -7th, -6th, -2nd, -1st days and negative for -9th, -8th, -5th, -4th, -3rd, days during the prior announcement period. In case of post announcement period AR is positive for 1st, 6th, 8th, 10th days and negative for 2nd, 3rd, 4th, 5th, 7th, 9th days. A common trend shown in both pre

announcement and post announcement period of buyback was the abnormal returns are insignificant in most of the cases. The abnormal returns were negatively significant in 4th day which is -2.4155 and positively significant in -10th day which is 3.9. On the date of public announcement of buyback or the event day the abnormal return is positive but insignificant. The significance was tested using t – test at 5 % level of significance which is 1.96.

Figure 4.2: ABNORMAL RETURNS OF BABA ARTS LIMITED

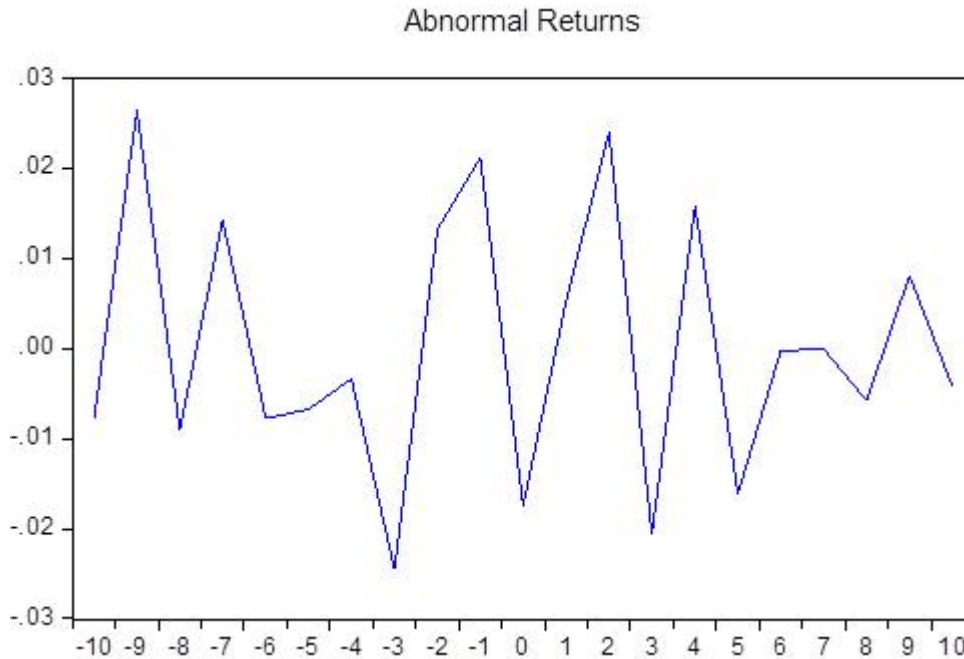


According to the above information the Abnormal Returns were positive for -10th, -9th, -6th, -4th, -2nd days during the pre announcement period and negative for -8th, -7th, -5th, -3rd, -1st days. In post announcement period of buyback the Abnormal returns were positive for 2nd, 6th, 7th, and 9th days and negative for 1st, 3rd, 4th, 5th, 8th, and 10th days. On the date

of public announcement of buyback the abnormal returns were negative but insignificant. In all these event days the abnormal returns were insignificant and during the 21 days event window the abnormal returns were positive for only 9 days and negative and 12 days. So we can understand that the buyback announcement does not increase the value of shares

and therefore there is no positive impact on share price. From the above chart it is clear that after the public announcement of buyback the abnormal returns show a decreasing trend.

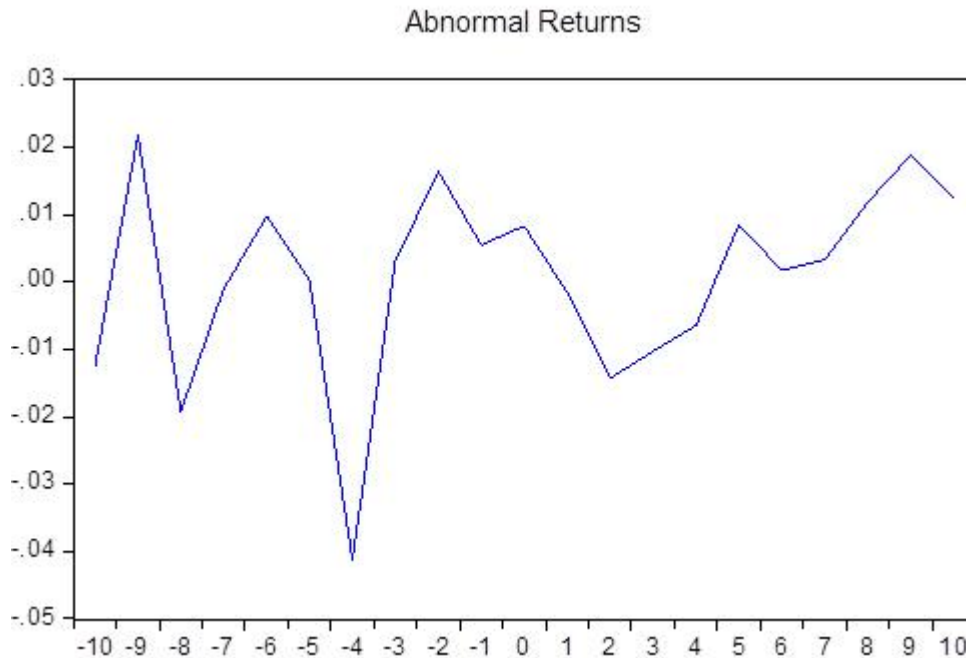
Figure 4.3: ABNORMAL RETURNS OF COAL INDIA LIMITED



As per the above information of Coal India limited it is clear that the company had positive abnormal returns for only 9 days and negative abnormal return for 12 days including date of public announcement of buyback. In pre announcement period abnormal returns was positive for -9th, -7th, -2th and -1st day and negative for -10th, -8th, -6th, -5th, -4th, and -3rd day. During the post announcement period of buyback the abnormal

returns were positive for 1st, 2nd, 4th, 7th, and 9th day and negative for 3rd, 5th, 6th, 8th, and 10th day. The abnormal returns were not significant in any of the event days and moves in a zigzag manner. Here we cannot find out a particular trend of abnormal returns. So we can interpret it as the public announcement of buyback has no impact on the share value of Coal India limited.

Figure 4.4: ABNORMAL RETURNS OF NMDC LIMITED



According to the above information the abnormal returns were positive for 13 days and negative for 8 days during the event window of 21 days. In the pre announcement period the abnormal returns were positive for -9th, -6th, -5th, -3rd, -2nd

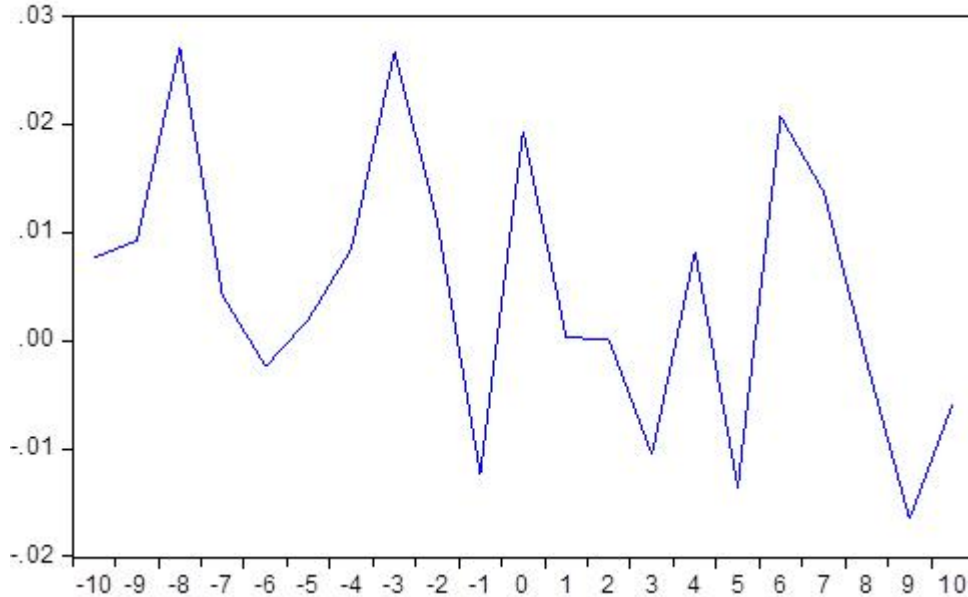
and -1st days and negative for -10th, -8th, -7th, and -4th days. In case of post announcement period the abnormal returns were positive for the event day, 5th, 6th, 7th, 8th, 9th, and 10th days and negative for 1st, 2nd, 3rd, and 4th days. From this we can

identify that the abnormal returns were negative for first 4 days after the announcement of buyback. But after these 4 days there were changes happens and continuously shows

positive abnormal returns for the next 6 days. In most of the cases the abnormal returns were insignificant. Only on -4th day the abnormal returns were negatively significant.

Figure 4.5: ABNORMAL RETURNS OF ONGC LIMITED

Abnormal Returns

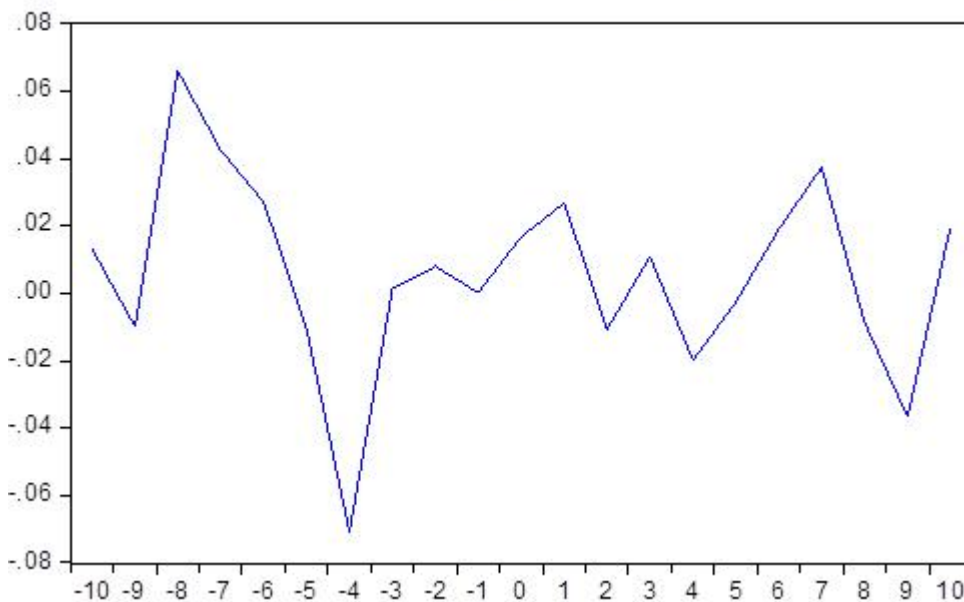


The above data of ONGC limited shows that the abnormal returns were positive for 14 days and negative for 7 days. In pre announcement period the abnormal returns were positive for -10th, -9th, -8th, -7th, -5th, -4th, -3rd and -2nd days and negative for -6th and -1st days where as in case of post announcement period the abnormal returns were positive for

1st, 2nd, 4th, 6th, 7th and includes the event day also and negative for 3rd, 5th, 8th, 9th and 10th days. The abnormal returns were insignificant in each day of event window including the event day also. Even though on the event date the abnormal returns was positive but it is insignificant. From the above chart we can understand that the abnormal returns of ONGC limited shows a decreasing trend during the event period.

Figure 4.6: ABNORMAL RETURNS OF PBM POLYTEX LIMITED

Abnormal Returns



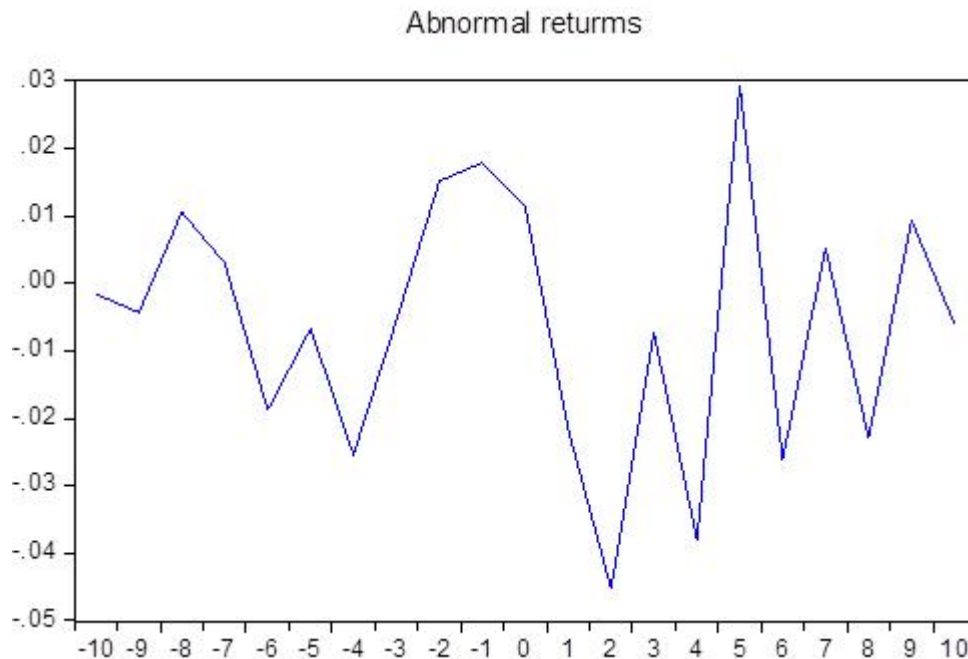
On the basis of the above plotted data it is clear that the abnormal returns were positive for 13 days including the event day and negative for 8 days. During the pre announcement period of buyback abnormal returns were positive for -10th, -

8th, -7th, -6th, -4rd, -2nd and -1st days and negative for -9th, -5th, and -4th days. In case of post announcement period the abnormal returns were positive for event day and 1st, 3rd, 6th, 7th and 10th days and negative for 2nd, 4th, 5th, 8th and 9th days.

On the event date the return was positive but it is insignificant. There are only 2 days on which abnormal returns are significant during the entire event window. On -7th day the abnormal returns was positively significant this was 2.6465 and on -4th

day the abnormal returns was negatively significant this was equal to -2.8397. Considering all these factors we can conclude that the buyback announcement had not much impact on the share price of PBM Polytex limited.

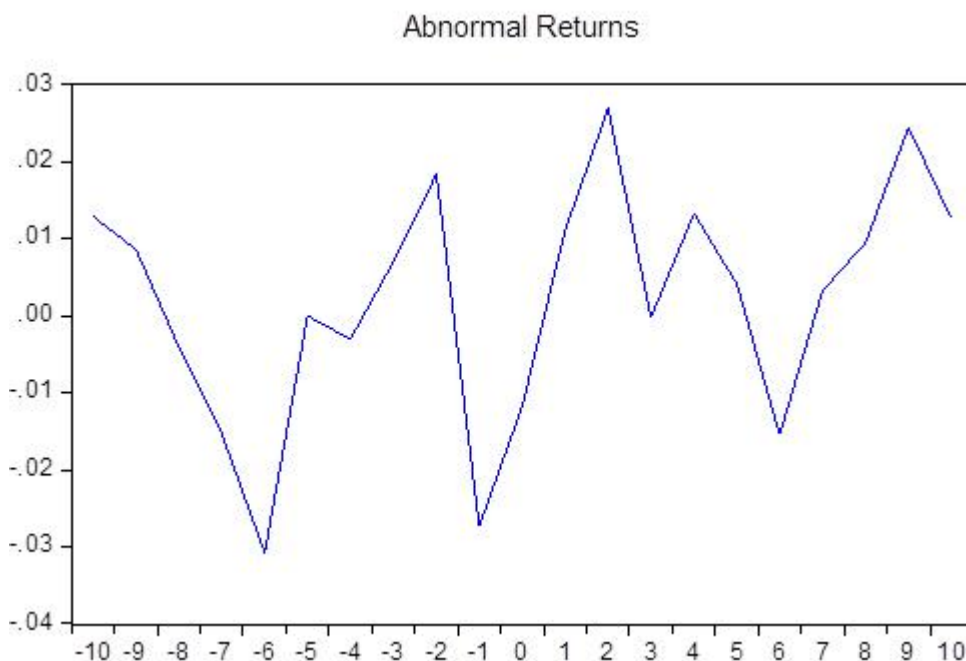
Figure 4.7: ABNORMAL RETURNS OF SHANTHI GEARS LIMITED



According to the above information the abnormal returns were positive for 8 days which includes the event day also and negative for 13 days. On pre announcement period the abnormal returns were positive for -8th, -7th, -2nd, and -1st day and negative for -10th, -9th, -6th, -5th, -4th, and -3rd days. In case of post announcement period the abnormal returns were positive for 5th, 7th, and 9th days and negative for 1st, 2nd, 3rd, 4th, 6th, 8th, and 10th days. On the event date the abnormal

returns were positive but insignificant. In case of Shanti gears limited only one day of event window shows significance in abnormal return. On the second day of post announcement the abnormal returns were negatively significant that was -2.1594. Here the chart moves in a zigzag manner so that we cannot find out a particular increasing or decreasing trend in the abnormal returns.

Figure 4.8: ABNORMAL RETURNS OF SHERVANI INDUSTRIAL SYNDICATE LIMITED



According to the data in the event window period it is clear that the abnormal returns were positive for 12 days and negative for 9 days which includes the event day also. In case of pre announcement period the abnormal returns were positive for -10th, -9th, -3rd, and -2nd days and negative for -8th, -7th, -6th, -5th, -4th and -1st days where as during the post announcement period the abnormal returns were positive for

1st, 2nd, 4th, 5th, 7th, 8th, 9th and 10th days and negative for 3rd and 6th days. On the date of buyback announcement the abnormal returns were negative and also insignificant. On every day of the event window the abnormal return remains insignificant whether it is positive or negative. Here also the chart moves in a zigzag manner and therefore we cannot find out a particular trend in movement of abnormal return.

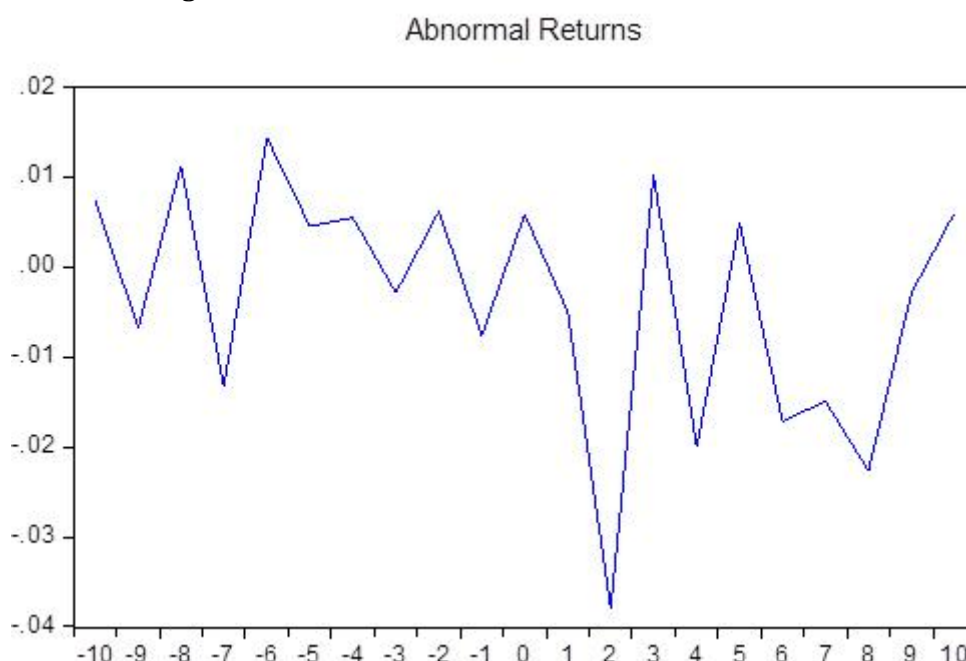
Figure 4.9: ABNORMAL RETURNS OF TATA INVESTMENT CORPORATION LIMITED



As per the above information of Tata Investment Corporation Limited it is clear that abnormal returns were positive for 7 days including the date of public announcement of buyback and negative for 14 days. In case of pre announcement period the abnormal returns were positive for -9th, -7th, -3rd, -2nd and -1st days and negative for -10th, -8th, -6th, -5th, and -4th days where as in case of post announcement

period the abnormal returns were positive for only 10th day. It is negative for 1st, 2nd, 3rd, 4th, 5th, 6th, 7th, 8th, and 9th days which means the abnormal returns were negative for all days in post announcement period except the 10th day. On the date of announcement the abnormal returns were positive that is 0.00487 but it is insignificant.

Figure 4.10: ABNORMAL RETURNS OF TECH MAHINDRA LIMITED



On the basis of above data it is clear that the Tech Mahindra limited has positive abnormal returns for 10 days including the announcement date and negative abnormal returns for 11 days. In case of pre announcement period the abnormal returns were positive for -10th, -8th, -6th, -5th, -4th and -2nd days and negative for -9th, -7th, -3rd, and -1st days where as in case of post announcement period the abnormal returns were positive for 3rd, 5th, and 10th day and negative for 1st, 2nd, 4th, 6th, 7th, 8th, and 9th days. On the date of public announcement the abnormal returns were positive but insignificant. Almost of all cases the abnormal returns proves to be insignificant. Only the 2nd day after the public announcement the abnormal returns were negatively significant that was -2.01042. The above chart moves in a zigzag manner so that we cannot find out a particular trend in movement of abnormal return.

SUGGESTIONS

1. A share should be repurchased at premium only when the market is more confident.
2. Instead of focusing on increasing the earnings per share, the motive of buyback is to create value to the shareholders by efficient management and improve the overall result of the company.
3. No fresh issue of shares should be allowed for at least one year after share buyback. This can prevent manipulation by the management and safeguard the interest of the shareholders.
4. Undertake a detailed and in-depth analysis of the buyback regulatory framework from legal point of view in contrast with different countries across the world.

CONCLUSION

From the analysis it is clear that the announcement of buyback does not have any significant impact on share value. This study reveals that during the event period of 21 days including the date of announcement any of companies does not have significant abnormal returns. The abnormal returns were negative for most of the event days for every company. In most cases, it is difficult to identify any particular trend in the movement of the abnormal returns. So it is clear that the announcement and returns have no connection. In certain cases the date of public announcement of buyback also shows negative abnormal returns. The share value is not affected from this announcement.

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