



BUYBACK **OF SHARES.**

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MEANING OF BUYBACK **OF SHARES.**

Buyback of shares is the method of cancellation of share capital. It leads to a reduction in the share capital of a company as opposed to issue of shares which results in an increase in the share capital.

CRITERIA OF BUYBACK OF SHARES.

The company may undertake buyback after meeting the following criteria:-

- ◆ The company has exhausted all avenues of fresh investment in the near future.
- ◆ Buyback can be undertaken without jeopardising the lender's risk.
- ◆ The company enjoys return on capital employed which is significantly higher than the normal cost of borrowing.
- ◆ The market price of company's share is far lower than its intrinsic value.

REGULATION OF BUYBACK OF SHARES IN INDIAN SCENARIO.

According to **section 77A(1)** of the companies(Amendment) Act 1999,a company may purchase its own shares out of:-

1. It's free reserves;
2. The securities premium account;
- 3.The proceeds of any shares or other specified securities.

Section 77A(2) of this act specifies certain conditions for buyback:-

No company shall purchase its own shares or other specified securities unless:

1. The buyback is authorised by its articles.
2. Special resolution must be passed in general meeting of the company authorising the buyback.
3. The buyback is for **less than 25%** of the total paid up capital & free reserves of the company.
4. The ratio of the debt owed by the company is not more than twice the capital & its free reserves after such buyback.
5. All the shares or other specified securities for buyback are fully paid up.
6. The buyback securities must be listed with any stock exchange in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

According to the **section 77A(4)**, every buyback shall be completed within **12 months** from the date of passing the special resolution.

According to **section 77A(5)**, the buyback may be made :

1. From the existing security-holders on a proportionate basis ; or
2. From the open market;
3. From odd lots, the shares that are listed in stock exchange.
4. By purchasing the securities issued to employees of the company pursuant to a scheme of stock option.

According to **section 77A(6)**, where a company has passed a special resolution to buyback, it shall before making such buyback file with the registrar & the SEBI, a declaration of the solvency of the form as may be prescribed by the board.

According to **section 77A(7)**, where a company buys back its own share it has to extinguish & physically destroy the securities so bought back within **seven days** of last date of completion of buyback.

Section 77A(8) says that where a company complete buyback of its shares it cannot make further issue of same kind of shares within a period of **24 months**, except by way of bonus issue.

Section 77B states that no company shall purchase its shares:-

1. Through any subsidiary company including its own subsidiary companies;
2. Through any investment company's.

According to **section 77AA**, where a company purchase its own shares out of free reserves then company is required to transfer a sum equal to nominal value of shares so bought back to **Capital Redemption reserve account from free reserves**.

SEBI GUIDELINES.

In 1998,SEBI has made some regulations as follows:-

- 1.Buyback cannot be made from any person through negotiated deals whether on or after stock exchange or through spot transactions or through private management.
- 2.Public announcement among other things should specify the following:
 - a)Specified date i.e. the date of despatch of the offer letter shall not be less than 30 days but not later than 42 days.
 - b)SEBI shall be informed by the company within 7 working days from the date of public announcement.
 - c)The offer for buyback shall remain open to the members for a period of not less than 15 days but not exceeding 30 days.
 - d)The company shall complete the verification of offers within 15 days from the date of closure.
 - e)The companies are permitted to buyback the shares through six routes,namely,the tender route,open offer route,reverse book building,odd lot share purchase,reverse rights & purchase of employees stock options.

ADVANTAGES OF

BUYBACK.

- Buyback helps a company to reduce its excessive share capital that is not required for the time being.
- It helps the company to utilise its large sum of free reserves.
- It helps the company to improve its book value, earning per share, price earning ratio & return on equity.
- Companies may buyback its own shares as protection against unfriendly takeovers from others companies.
- Buyback is relatively a quick method for reduction of share capital. It involves lower cost transaction.
- If a company has a large sum of cash & decides how to invest it, one of the option is to distribute a part of it to the shareholders. Companies can do this either of two ways:
 - a) as dividends or
 - b) by buying up outstanding shares.

LIMITATIONS OF **BUYBACK.**

- ⊕ Rigid legal requirements.
- ⊕ Reduces cash surplus with the company.
- ⊕ Fear of share price manipulation.
- ⊕ It could divert away the company's funds from productive investments.
- ⊕ Post buyback debt equity ratio not to exceed 2:1.
- ⊕ Maximum number of equity shares to be brought back should not exceed 25% of the existing paid-up capital.

ACCOUNTING ENTRIES IN BUYBACK OF SHARES.

The following entries may be required to record buyback of shares:-

a) **When investments are sold for buyback of own shares:-**

Bank a/c	Dr
Profit & loss a/c	Dr(for loss on sale of investment)
To Investment a/c	
To Capital Reserve a/c	(for the profit on sale of investments)

b) **For issue of debentures/other specified securities for buyback purpose:-**

Bank a/c	Dr
To Debentures/other Specified Security a/c	
To Securities Premium a/c	(if any)

c) **For cancellation of shares bought back:-**

Equity Share Capital a/c	Dr(with nominal value of shares buyback)
Free Reserves/Securities Premium a/c	Dr
To Shareholders a/c	(with actual cost of buyback shares)

(contd)

d)For making the payment of buyback shares:-

Shareholders a/c Dr
 To Bank a/c

e)For transfer of nominal value of shares bought back out of free reserves:-

Free reserves a/c Dr
 To Capital Redemption Reserve a/c

f)For expenses incurred in buyback of shares:-

Buyback expenses a/c Dr
 To Bank a/c

g)For transfer of buyback of expenses:-

Profit & Loss a/c Dr
 To Buyback expenses a/c

Ques -1) The balancesheet of premier ltd as at 31.3.2008 is given below:

<u>LIABILITIES</u>	<u>AMOUNT(RS)</u>	<u>ASSETS</u>	<u>AMOUNT(RS)</u>
Paid up capital 1,20,000equity shares of Rs.10 each	12,00,000	Fixed assets	36,00,000
Free reserves	18,00,000	Stock	10,00,000
Securities premium	6,00,000	Debtors	8,00,000
Debentures	25,00,000	Cash and bank balance	18,00,000
Creditors	<u>11,00,000</u> <u>72,00,000</u>		<u>72,00,000</u>

On the above date shares are brought back by the company to the extent possible, at a premium of Rs 40 per share. Journalise & give the balancesheet after buyback of shares.

WORKING NOTES:-

The amount of buyback of shares will be the least of the following two amounts:

Paid up capital before buyback 12,00,000

Free reserves 18,00,000

Total paid up capital & free reserves 30,00,000

(1) 25% of free reserves & paid up capital 7,50,000

(2) Amount of equity available after satisfying minimum post buyback debt/equity ratio (a) 18,00,000

(a) Post buyback debt/equity ratio is calculated as follows:

$$\text{Debt/equity ratio} = \frac{\text{debt (after buyback)}}{\text{equity (after buyback)}}$$
$$2 = \frac{25,00,000 + 11,00,000}{\text{equity}}$$

$$\text{Equity} = \frac{36,00,000}{2} = \text{Rs. } 18,00,000$$

Amount of equity available for buyback = equity before buyback - equity required after buyback.

$$= \text{Rs. } (36,00,000 - 18,00,000) = \text{Rs. } 18,00,000$$

Amount of buyback permissible is Rs. 7,50,000 (i.e. lower of the two amounts Rs. 7,50,000 & Rs. 18,00,000)

$$\text{Number of shares to be bought @ Rs. 50} = \frac{750,000}{50} = 15,000$$

JOURNAL ENTRIES

2008 march 31	Equity share capital a/c Dr Securities premium a/c Dr To Equity shareholders a/c (Being cancellation of 15,000 equity shares bought back & security premium utilised @ Rs 40 per share)		1,50,000 6,00,000	7,50,000
	Free Reserves a/c Dr To Capital redemption Reserve a/c (Being transfer of free reserves to Capital Redemption Reserve a/c)		1,50,000	1,50,000
	Equity shareholders a/c Dr To Bank a/c (Being payment made for 15,000 shares bought back)		7,50,000	7,50,000

BALANCE SHEET OF PREMIER LTD.
as at 31.3.2008

<u>LIABILITIES</u>	<u>RS.</u>	<u>ASSETS</u>	<u>RS.</u>
Paid up capital: 1,05,000 equity shares of Rs. 10 each, fully paid	10,50,000	Fixed Assets	36,00,000
Reserves & Surplus: Capital Redemption Reserve	1,50,000	Current Assets:	10,00,000
Free reserves	16,50,000	Stock	8,00,000
		Debtors	10,50,000
		Cash & Bank	
		Balance	
Secured Loans: Debentures	25,00,000		
Current Liabilities: Creditors	<u>11,00,000</u> <u>64,50,000</u>		<u>64,50,000</u>

Que-2) Bharat LTD. Decides to buyback 10% of Rs. 100 crores paid up equity capital. The face value per equity share is Rs,10 but the market price per share is Rs.15. Bharat Ltd. Takes the following steps for buyback of its shares:

1. To issue 14% debentures of Rs.100 each at par for face value of Rs. 10 crores.
2. To utilise general reserve.
3. To sell investments of Rs. 7 crores for Rs. 8 crores.
4. To buyback the shares at the market price.
5. To immediately cancel the shares bought back.

Journalise the above transactions.

JOURNAL ENTRIES

		Rs. (in crores)	
	Bank a/c Dr To 14% Debentures a/c (Being issue of 14% debentures at par)	10	10
	Bank a/c Dr To Investments a/c To Capital Reserve a/c (Being sale of investments & profit on sale transferred to capital reserve a/c)	8	7 1
	Equity share capital a/c Dr General Reserve a/c Dr To Shareholders a/c (Being cancellation of bought back shares of nominal value of Rs.10 crores & general reserve utilised for premium of Rs. 5 per share payable on 1 crore shares of Rs.10 each bought back @ Rs.15 per share)	10 5	15
	Shareholders a/c Dr To Bank a/c (Being amount payable on buyback of shares paid to shareholders)	15	15