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Buyback of shares in India: A conceptual framework

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Abstract
This research work focuses on the concept of share buybacks in India. It discusses the purposes and advantages of share buybacks, as well as the legal provisions and regulations governing the buyback of shares in India. The research compares the provisions of the Companies (Amendment) Act 1999 and the New Companies Act 2013 regarding share buybacks. Overall, this research provides a comprehensive understanding of share buybacks in the Indian context.

Keywords: Share buybacks, India, purposes, advantages

Introduction
In India, the stock market is the primary source of funding for businesses, and corporations' ability to obtain money depends on positive fluctuations in stock values. Share prices are crucial indicators for assessing a company's true worth, including its historical performance, financial structure, asset valuation, earning capabilities, and future possibilities. Share repurchase is a technique to improve stock price performance. It involves the acquisition of a certain proportion of a company's own shares from its current owners, generating value for existing owners while decreasing the current inventory. This is an essential mechanism for financial restructuring, particularly in situations of excessive capitalization.

Share buyback has been widespread in the financial markets of wealthy Western nations since the 1960s, first emerging in the United States around the late 1960s and gaining significant popularity in the mid-1980s. The rate at which share repurchases increase is nearly four times higher than the rate at which dividend payments increase. In 1999, there were 1252 buyback announcements made by corporations listed on the New York Stock Exchange, totaling around US$216 billion.

The Securities Exchange Board of India (SEBI) allowed the implementation of the share repurchase mechanism in India in 1998, following the modified provisions of the Indian Companies Act, 1956. Since then, the popularity of buybacks of shares has steadily grown and garnered the attention of prominent corporations.

The New Companies Act 2013 has replaced the Companies Act 1956, allowing Indian corporations to repurchase shares under sections 68-70. The Act introduces flexibility in management and administration by allowing electronic means for notifications and voting, aligning with the MCA's efforts to enhance electronic media. It also prohibits certain companies from using their securities premium account for share buybacks unless their financial statements comply with Accounting Standards set for that class of companies.

The Act includes dividends as a prerequisite for announcing the repurchase of shares, imposes limitations on repeated buybacks within a single year, allows for the establishment of a CRR in equity share repurchases, eliminates the practice of repurchasing shares in small quantities, and modifies the meaning of free reserves.

Both unlisted and private firms must also adhere to Rule 17 of the Companies (Share Capital and Debentures) Rules of 2014 and the Securities and Exchange Board of India (Buyback of Securities) (Amendments) Regulations. Share buybacks are often used to enhance ownership stakes, limit a company's equity, and cultivate confidence in shareholders.

Researchers in wealthy nations have extensively explored the ideas of undervaluation, signalling, free cash flow, and liquidity in share repurchase announcements.

Purposes of share buybacks
The primary purpose of share buybacks is to prevent hostile takeover attempts and stimulate the capital markets. However, there are other reasons for repurchasing shares, which are listed below.

To distribute the surplus funds to the owners
If the firm has excess cash and few lucrative investment and development prospects to sustain the rate of return, it may choose to engage in share repurchases as a means of using this capital instead of distributing greater dividends.

To improve the capital structure's efficiency
Companies may seek to enhance the debt-to-equity ratio to attain or sustain a desired capital structure. Initially, the firm may have used stock funding, but subsequently, it has achieved success in sustaining its revenue. In such a scenario, the corporation may choose a more leveraged capital structure in order to provide improved returns to the shareholders. The repurchase of shares may facilitate a decrease in share capital without necessitating the protracted procedure of capital reduction.

To boost earnings per share (EPS)
Corporations may use the repurchase programme as a means to enhance their earnings per share (EPS). After the repurchase of shares, the quantity of outstanding shares drops, resulting in a rise in EPS, assuming profits stay unchanged.

To provide a favourable indication in the market
The repurchase of shares may lead to an increase in the net asset value of the shares, which could signal to the market that the stock of the business is now undervalued.

Advantages of Taxation
Companies may choose share buybacks instead of dividend payments as a means of rewarding shareholders, mostly due to the tax implications involved. Dividends are subject to taxation at a higher rate compared to capital gains. According to the Income Tax Act, short-term capital gains are taxed at a rate of 10%, whereas long-term capital gains are exempt from taxation.

To stop hostile acquisitions
A takeover attempt by a hostile bid refers to the acquisition of a certain number of equity shares in a business, resulting in the acquirer obtaining a larger ownership position in the organisation than the promoter. This increased ownership allows the acquirer to exert influence over the company's operations. Therefore, a corporation may use share buybacks as a strategy to thwart such takeovers.

To enhance the level of control exerted by promoters
The corporation may choose share buybacks in order to preserve or enhance the promoters' ownership interest in the company.

To provide a way out
Shareholders may be given the opportunity to sell their shares via a repurchase by the firm, particularly if the ownership stakes are undervalued and not actively traded. Additionally, the firm may begin purchasing its own shares back from the market if it decides to shut down or leave the market.

Advantages of share buybacks
The financial ratios might be improved by decreasing the number of outstanding shares. For instance, the growth in earnings per share (EPS) and return on shareholder equity (ROE) leads to a corresponding increase in the price-to-earnings ratio (PE). Furthermore, the repurchase of shares leads to a decrease in cash on the balance sheet, thereby affecting the overall value of assets. This may result in an increase in the return on assets (ROA). As a result, repurchasing shares may be beneficial to a corporation for the following reasons.

1. The corporation may repurchase the shares in order to increase the share prices since it believes that the current market values are unjustly undervalued. The corporation capitalises on the opportunity presented by low share prices, with the expectation that the prices will see rapid growth.
2. The corporation chooses to repurchase its own shares instead of paying out dividends when it has excess cash. Once a corporation announces a dividend, investors may anticipate receiving more frequent and consistent dividends from the organisation in the future. If a corporation is unable to pay dividends in the future, it may anger shareholders.
3. The corporation may be capitalising on reduced pricing to initiate employee stock option programmes.
4. The business might protect itself against aggressive takeovers.
5. The repurchase of shares may also be beneficial for investors. Repurchasing shares leads to an increase in shareholders' value due to the rise in earnings per share. Furthermore, repurchasing shares provides additional alternatives for investors that are not available in the case of dividends. A shareholder has the option to offer their shares for repurchase and receive cash in return. Under these circumstances, he is obligated to remit the capital gain tax. However, when it comes to receiving a cash dividend, he is obligated to accept it and fulfil his tax obligations.

Disadvantages of repurchase of shares
The repurchase of shares has numerous points of concern and drawbacks.

1. The repurchase of stocks may not yield its intended advantages if it has been carried out just to boost the ownership of the company's promoters rather than with the aim of enhancing the financial well-being of the shareholders.
2. The New Companies Act 2013 mandates a minimum interval of one year between two buybacks, but it does not impose any limitations on conducting numerous buybacks in consecutive years. This might potentially lead to an eventual increase in the stock holdings of promoters.
3. Share repurchases are disclosed at the board meeting. However, the real repurchase occurs at a later time. This might increase the likelihood of insider trading.
4. According to the Companies Act, dividend payments are not obligatory. Furthermore, a dividend tax of 10% must be paid on any sum that is declared, distributed, or paid as a dividend by a domestic firm. Additional

repurchases of shares conducted under Section 68 of the Companies Act 2013 are not considered a dividend. Therefore, corporations have the option to refrain from distributing dividends and instead allocate a significant portion of their profits to reserves. Then, the company has the option to repurchase its own shares and then, after a period of six months, issue more shares up to the amount repurchased. Subsidiaries of overseas corporations may use this approach to return earnings to their home country without paying dividend taxes.

5. From the investors' perspective, the reliability of share buybacks may be questionable, but cash dividends are considered more predictable. This might be attributed to the fact that investors tend to allocate more capital into shares that provide a more reliable and consistent dividend payout.

Legal provisions regarding the buyback of shares in India

The primary law regulating the repurchase of stocks in India was established in 1999 via essential modifications to the Corporate Law Act of 1956. Sections 77A, 77AA, and 77B were added to accommodate the implementation of share buybacks. SEBI has implemented new criteria for the repurchase of securities. Nevertheless, with the implementation of the conceptual and legal framework, certain required modifications have been made to the repurchase of shares requirements as stipulated in the New Companies Act of 2013. SEBI periodically announces modifications to the regulations governing the repurchase of securities. Currently, there are two distinct rules, namely the Companies Act and SEBI Regulations, that outline the requirements for an Indian business to buy its own shares. Furthermore, the New Companies Act 2013 includes a provision known as Rule 17 of Corporations (Share Capital and Debentures) 2014, which regulates the repurchase of securities by private firms and unlisted public corporations. This section aims to provide a comprehensive explanation of these provisions. A comparative analysis of the provisions regarding the repurchase of shares in the Companies (Amendment) Act 1999 and the New Companies Act 2013 has also been provided to enhance comprehension of the laws.

The New Corporations Act of 2013 includes sections 68-70, which govern the process of repurchasing shares.

Sources of Buyback

Free reserves, securities premium accounts, and securities issuance proceeds may be used to buy own shares or designated securities under Section 68 (1). However, the proceeds from prior securities cannot be used for buybacks. Rule 17 mandates a separate bank account, cash payments, no borrowing for repurchase, and no revenues from prior securities.

Preliminary restrictions for Buyback

Section 68 (2) specifies the requirements that a corporation must meet in order to repurchase its own stocks. These requirements consist of obtaining authorization from the company's articles, adopting a special resolution at the general meeting if the repurchase exceeds 10% of the company's paid-up equity capital and free reserves, and ensuring that the buyback does not exceed 25% of the company's paid-up capital and free reserves within the same financial year. The proportion of debts that are secured and unsecured after the repurchase should be equal to two times the company's paid-up capital and free reserves. For a listed firm, the repurchase must adhere to SEBI laws. Furthermore, it is recommended to refrain from making any buyback offers within a year after the conclusion of the prior offer.

Explanatory Statement

The notice for a special resolution must include a comprehensive disclosure of all relevant information, including the need for the repurchase, the specific class of shares or securities to be acquired, the amount of investment, and the deadline for completing the buyback. The Share Capital and Debentures Rules, 2014 contain supplementary details including the board meeting date, the quantity of securities to be repurchased, the approach to be utilised, the price at which the repurchase will occur, the criteria for determining the repurchase price, the maximum payment amount, and the funding sources. In order to participate in the buyback process, individuals must submit the number of shares they wish to tender, along with comprehensive information on their transactions and holdings over the past year. Additionally, they must provide confirmation that they have not defaulted on any repayments for deposits, interest payments, debentures, preference shares, dividend payments, or term loans. The directors must also take into account the firm's obligations as if the organisation were being liquidated under the Companies Act, 2013.

Time Limit of completion of buyback

According to Section 68 (4), it is required that any repurchase be completed within one year of the approval of the special resolution or board resolution.

Modes of Buyback

Section 68 (5) permits the repurchase of shares from current stockholders, the open market, or employees of corporations via stock option or sweat equity programmes.

Declaration of Solvency

Prior to initiating a share repurchase, a company's board is required to submit a statement of solvency to the Registrar and Securities and Exchange Board. This declaration must be signed by a minimum of two directors, one of whom must be the managing director. The statement must adhere to a certain format and be confirmed by an affidavit, affirming the company's capacity to fulfil financial obligations and prevent bankruptcy within a one-year timeframe.

Extinguishment of Certificates

According to Section 68(7), the corporation is required to physically dispose of the shares or securities that were repurchased within seven days after the final date of the buyback.

No further issue [Section 68(8)]

A corporation is prohibited from issuing additional shares or securities for a period of six months after completing a buyback, unless it is for bonus issues or to complete certain requirements such as warrant conversions, stock option plans, or preference share conversions.

Register to be maintained

According to Section 68(9), a firm that repurchases its shares is required to keep a record in Form No. SH.10. This register must include information such as the purchase price, consideration, cancellation date, and physical destruction date. The record is securely held by the company's secretary or an authorised board member, and all entries must be officially verified.

Return of Buyback and Declaration

According to Section 68(10), a corporation is required to provide a report within thirty days that provides information about the repurchase of shares or securities, save for those that are not listed on a recognised stock exchange. Furthermore, the return must include a certificate, signed by two directors, that certifies adherence to the Act's terms.

Default and penalty

Section 68(11) specifies the consequences that firms will face if they do not adhere to the rules or conditions outlined in the section. Noncompliance may result in penalties of up to one lakh rupees, imprisonment for a maximum of three years, or both, as well as fines for those holding positions of authority.

Capital Redemption Reserves (Section 69)

Section 69(1) mandates a company to transfer the nominal value of bought-back shares to the capital redemption reserve account when purchasing shares from free reserves or securities premium accounts and disclose this in the balance sheet.

Restrictions on buyback of shares

Section 70 prohibits corporations from acquiring shares and stocks via subsidiaries, investment firms, or defaults. Nevertheless, if a default is resolved and a period of three years has passed, buy-back is no longer forbidden. If a firm fails to comply with requirements such as submitting an annual return, declaring and paying dividends, failing to pay dividends, and failing to provide accurate and honest financial accounts, it is prohibited from directly or indirectly buying its own shares or specified securities.

Other conditions under Rule 17

A firm that has been granted authorization via a special resolution is required to submit a letter of offer to the Registrar of Companies. This letter must be signed by a minimum of two directors and sent to stockholders or holders of securities within a period of twenty days. The repurchase offer must stay available for a period of 15-30 days. If the number of shares proposed is greater than the total number of shares available, each shareholder will get a proportional amount of shares. The corporation is required to authenticate bids within a period of 15 days. If no rejection is issued within 21 days, the offered shares will be considered accepted. The firm is obligated to deposit the full amount owed as payment for the shares upon the offer's closure. The corporation is obligated to guarantee that the letter of offer includes accurate, verifiable, and significant information. It is prohibited from issuing additional shares, save for any existing convertible instruments, and it cannot retract the offer once it has been communicated to shareholders.

Procedure of buyback of shares by unlisted and private limited companies

A board meeting is necessary to authorise a repurchase of more than 10% of the company's combined paid-up equity capital and free reserves. The explanatory statement should include a comprehensive account of the essential facts, the imperative need for the repurchase, the monetary value involved, the specific category of shares, and the designated timeframe. To comply with the requirements, a letter of offer in Form SH-8, signed by a minimum of two directors, one of whom must be the managing director, must be sent to the Registrar of Companies. Additionally, it is necessary to submit a solvency statement using Form SH-9. The letter must be sent to shareholders within a period of 21 days. The repurchase offer should have a duration of 15-30 days, and the corporation needs to finish verifications within 15 days. If the quantity of shares available for purchase is greater than the quantity to be repurchased, each shareholder will get a proportional amount of shares. Within 7 days, the corporation must transfer the entire purchase price into the designated bank account and make the full payment in cash. The corporation is required to physically obliterate or eliminate the repurchased shares within a period of 7 days.

Buyback Rules and Regulations under SEBI Act

The Securities and Exchange Board of India (SEBI) introduced regulations for the repurchase of shares by publicly traded businesses in 1998, which were subsequently revised till 2015.

1. A publicly traded business has the option to repurchase its own shares via several methods, such as tender offers, book-building procedures, stock exchanges, or from individual shareholders holding small amounts of shares. However, it is important to note that the firm cannot make an offer to buy back 15% or more of its total paid-up capital and free reserves from the open market.
2. According to Section 68(2) of the New Companies Act 2013, a special resolution must include an explanatory statement, including disclosures. Additionally, a copy of the resolution must be sent to SEBI and stock exchanges within seven days of its passage.
3. When a firm is authorised to repurchase its own shares or securities, it is required to issue a press release in English, Hindi, and regional languages within a two-day period of the Board of Directors approving the resolution. The notification must include explicit statements and be sent to the board and stock exchanges within a maximum of two days after the resolution has been approved.
4. Under the SEBI Act, corporations have the authority to repurchase their shares or securities from current owners in a proportional manner. Small shareholders are given a 15% reserve, as long as the company's intended buyback or distribution of securities is completed within a set timeframe.
5. The public notice's explanatory statement should include the following information: the maximum price at which shares or specified securities may be repurchased; whether the Board of Directors has the authority to ascertain the precise price; and comprehensive details regarding the promoters' holdings and transactions during the six months preceding the special resolution for buyback. This

should comprise the acquisition date, price, and quantity of shares.

6. The corporation is required to issue a public statement in at least one widely circulated English National Daily, one widely circulated Hindi National Daily, and one widely circulated regional language daily within two business days after reaching a resolution. The board must receive a copy of the announcements and a draft letter of offer within five business days, together with the corresponding costs. The board has the ability to provide feedback on the draft letter of offer within a span of seven business days. In the event that more explanations or supplementary material are requested, the timeframe for issuing the letter might be extended up to the seventh business day. Additionally, it is necessary to provide a declaration of solvency in the specified format and method.
7. According to the Regulation 9 Buyback Offer procedure, a corporation is required to declare a record date for determining the names of security holders and entitlement holders. The tender form and letter of offer must be submitted within five business days of the board's receipt of comments. Ten business days must pass before the offer can be accepted based on entitlement. General shares are allocated to the remaining shareholders, while reserved shares are designated for minor shareholders. The aforementioned procedure was superseded by the SEBI (Buyback of Securities) (Amendments) Regulations 2012 and 2015, respectively. Acceptance of shares remaining for repurchase is proportional to the number of individuals who tendered in excess of their entitlement.
8. According to Regulation 10 of the Securities and Exchange Board of India (SEBI), corporations are required to deposit a certain amount of money in an escrow account as a guarantee for fulfilling their duties under the rules. The escrow account may include cash placed with a designated commercial bank, a bank guarantee in favour of the merchant banker, or a deposit of accepted securities with the required margin. The corporation should authorise the merchant banker to direct the bank to issue a banker's check or demand draft for the funds held in the escrow account. The merchant banker is prohibited from returning the bank guarantee or authorised securities held in the escrow account until all requirements specified in the rules have been met. Upon payment of consideration to security holders, the corporation is obligated to release the cash, guarantee, and securities held in escrow.
9. Regulation 11 requires the company to deposit a sum equal to 90% of the amount in the escrow account after the closure of an offer and to complete the verification of accepted offers or return the securities within seven working days of the offer's closure.
10. The corporation is required to physically obliterate security certificates that have been repurchased within 15 days after accepting the securities. It is crucial that all repurchased securities be completely eliminated within seven days from the last date of repurchase. If the securities have already been converted into electronic form, they must be terminated and eliminated in accordance with the rules set by the Securities and Exchange Board of India (SEBI). The firm is required to provide a certificate to SEBI attesting to its adherence to regulations, which must then be submitted to stock exchanges no later than the seventh day of the following month. The firm is required to retain a record of security certificates that have been cancelled or destroyed.
11. The term "odd-lot buyback" pertains to specified securities or shares of a publicly traded company that are not in the market lot as determined by the Stock Exchange. In this case, the provisions concerning tender offers remain in effect, albeit with a modification.
12. SEBI (Buyback of Securities) Regulations 14-18 allow a business to buy back equity shares or certain securities from the open market. The company must spend at least 50% of the repurchase funds for the transaction.
13. According to Regulation 15 of the Securities and Exchange Board of India (SEBI), a company is required to buy back its shares or specified securities through a stock exchange. The company must pass a special resolution specifying the maximum price for the buy-back, and it must not be made by promoters or those in control. The company must appoint a merchant banker and make a public announcement within seven working days, including disclosures about brokers and stock exchanges. The buy-back should only be made on stock exchanges with nationwide trading terminals. The company must send daily information about the bought-back shares to the stock exchange and upload it to its official website. The buy-back offer should open within seven working days and close within six months.
14. Regulation 15A delineates the procedural requirements for a corporation to repurchase physical shares or designated securities via the open market method. For this procedure, the organisation must establish an isolated window and repurchase shares exclusively from eligible holders subsequent to broker verification. The value of the buyback is calculated using the volume-weighted average price of the repurchased shares or securities for the week in which they were received. Consideration may be given to the previous week if no shares were repurchased on the regular market.
15. Companies must open an escrow account and deposit 25% of the buy-back amount under Regulation 15B of Regulation 14. Cash placed with a scheduled commercial bank or a merchant banker bank guarantee are examples. The company must authorise merchant bankers to order banks to pay escrow account balances to satisfy repurchase commitments. If part of the escrow account includes a bank guarantee, the corporation must deposit at least 2.5% of the total amount intended for repurchase, as mentioned in the resolutions, as security for fulfilling its commitments. Non-compliance may result in the merchant banker forfeiting the escrow account, up to 2.5% of the repurchase amount.
16. According to Regulation 16, the corporation is required to confirm acceptances within 15 days after payment and physically destroy certificates of security that have been repurchased within one month. This must be done under the watchful eye of a merchant banker and statutory auditor, as well as within one week of the final date of repurchase completion.
17. Regulation 17 permits a firm to repurchase its own shares or designated securities using the book-building

method. A special resolution and board resolution are required to determine the upper limit for the repurchase price. Prior to initiating the repurchase, the corporation must select a merchant banker and issue a public statement no later than seven days in advance. Prior to the announcement date, it is necessary to deposit the escrow account and submit a copy to the board within a two-day timeframe. The book-building process must be carried out electronically, using a minimum of thirty bidding centres and ensuring the presence of at least one computer terminal at each centre. The repurchase price is set based on the approved acceptances.

18. The corporation must provide truthful, factual, and material facts in its offer letter, public announcement, and promotional material, and the directors must take responsibility. The corporation must conclude the offer before issuing shares or bonuses. After submitting the draft letter of offer or public notice, the corporation must pay cash and cannot withdraw the offer. The promoter cannot trade company shares or designated securities on the stock exchange or off-market. Following the buy-back offer, the corporation cannot obtain money unless it meets its commitments for one year. A buyback compliance officer and investor care centre must be appointed by the firm to resolve investor complaints. Until the lock-in period or securities become transferable, the corporation cannot purchase back locked-in or non-transferable shares. After the buy-back, the corporation must advertise in a national daily within two days.
19. The merchant banker must ensure the firm can execute the buy-back offer, has an escrow account, suitable payment arrangements, and makes a regulatory-compliant public notice. They must also issue a due diligence certificate and guarantee that the public notice and letter of offer are fair and factual. The escrow bank must release the money when all obligations are met.

Buyback provisions: A comparison of Companies (Amendment) Act 1999 and New Companies Act 2013

The Companies (Amendment) Act 1999 and the New Companies Act 2013 have provisions for share buyback that exhibit similarities, yet they also possess notable distinctions.

1. The New Companies Act 2013 introduced a new requirement for announcing share repurchase, which involves declaring a dividend. This change was not present in the Companies (Amendments) Act 1999.
2. The Companies (Amendments) Act 1999 imposes limitations on conducting numerous buybacks within a single year by increasing the minimum time interval required for buybacks from being authorised by the Board to being approved by the General Body.
3. The new legislation establishes a Capital Redemption Reserve (CRR) to redeem preference shares and repurchase equity shares. The CRR may also be used for issuing bonus shares, even in the absence of explicit restrictions.
4. The Companies (Amendments) Act 1999 imposed limitations on a company's capacity to repurchase shares after a failure to repay deposits, distribute dividends, or redeem debentures. Nevertheless, the new legislation prolongs this limitation for a duration of three years, prohibiting a corporation in default from declaring a repurchase even after the problem has been remedied.
5. The Companies (Amendments) Act 1999 allowed for the buyback of shares in odd lots, but this provision has been removed in the new Companies Act.
6. The Companies Act of 2013 added the securities premium account to the revised definition of free reserves.
7. Financial aid for the acquisition of shares for the workers' advantage is only permissible if the firm authorises the plan via a specific resolution.

Conclusion

Share buybacks are a common practice in India's stock market and have gained popularity among corporations. The primary purposes of share buybacks include distributing surplus funds to owners, improving the capital structure's efficiency, boosting earnings per share, providing a favourable indication in the market, taking advantage of tax benefits, preventing hostile takeovers, enhancing control for promoters, and providing an exit strategy for shareholders. Share buybacks have advantages such as improving financial ratios, capitalising on undervalued shares, and offering more flexibility for investors. However, there are also disadvantages, such as potential misuse by promoters and concerns about reliability compared to cash dividends. The buyback of shares is regulated by the Companies Act and SEBI regulations, which outline the procedures and requirements for Indian companies. The New Companies Act of 2013 introduced new provisions, including the requirement for a dividend declaration before announcing a buyback and the establishment of a capital redemption reserve. Overall, share buybacks play a significant role in India's stock market and corporate finance.

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