BUY-BACK OF SHARES

Some years back buy back of shares and securities was not allowed in many developed countries (including India), Over the years, the situation has changed. Companies in India now can buy-back their own shares. Section 88, 69 and 70 of the Companies Act, 2013 deal with buy-back shares,

One of the first companies to offer the buyback of shares in India in. October 2000 was Philips India Pvt. Ltd, Later many MNCs, opted for this method to restructure capital, or avail other benefits.

Meaning and Definition of Buy-Back of Shares

Buy-back is the reverse of issue of shares, Buy-back simply means buying of own shares; It is a process of capital restructuring. It allows a company to buy-back its own shares, which were issued by it earlier. It is a method of cancellation of a company's share capital It leads to reduction in the share capital of a company.

Objectives of Buy-Back

1. To improve returns on capital

2. To return surplus cash to the investors.

3. To increase the market price of the share.

4. To change the capital structure (i.e., to restructure capital base).

5. To increase the EPS.

6. To prevent hostile takeover bids.

7. To improve the financial health after buy-back

8. To achieve optimum capital structure

9. To service the equity more efficiently

Reasons and Benefits of Buy-back

1. It helps to increase the EPS.

2. The market price of the share will go up.

3. It help to return surplus the cash to the investors

4. It increases promoters' holding in the company.

5. It helps to restructure the capital base of the company It helps to utilise the liquid assets to enhance the value of the company.

6. It is a reward for investors.

7. It will improve the company's image.

Damage of Buy-Back

1. It may be used as a tool of insider trading. This gives an opportunity to insiders to make extra money

2. It may be used for manipulating the prices of shares.

3. It weakens the position of minority shareholders

Sources of Buy-back

A company can purchase its own shares out of the following:

1. Free reserves (reserves that are free for distribution as dividend).

2. Security premium account

3. Proceeds of any shares or other securities. However, the proceeds of an earlier issue of same kind of shares / securities should not be used for buy-back. Thus, for example, if equity shares are to be bought back, preference shares or debentures may be issued for the purpose.

Methods (or Modes) of Buy-back

According to SEBI guidelines, there are three methods of buyback of shares. They are:

1. Through the tender offer.

2. From open market.

3. From odd lots

1. Buy-back through tender offer:

A company can buy back its shares from its existing equity shareholders on a proportionate basis. Under this method the company fixes a price at which it wishes to buy back a specified number of shares from its shareholders. If the number of shares offered for buy back at the stated price is more than the number of shares to be bought back, then the shares are bought back from each shareholder proportionately.

Escrow Account: A company has to open an Escrow Account if it wants to initiate the process of buy-back of shares. The word 'escrow7 literally means a contract or bond deposited with a third person (normally a bank) to perform its obligations under the scheme of buy-back. The company is required to deposit an amount equal to 25% of the consideration payable for shares to be bought up to Rs. 100 cores and 10% of the consideration in excess of Rs. 100 cores. After completion of all obligations this amount will be refunded to the company

2. Buy-back from the open market:

A company can buy back its shares from the open market also. This may be done in any one of the following methods: (a) through stock exchange, (b) book building process

(a) Through stock exchange: Under this method, a company can buy back its shares at the prevailing quoted price in a stock exchange. The buy-back is made only on stock exchange with electronic trading facility. This method does not require Escrow Account.

(b) Through book building process: Under book building process the shareholders offer their shares at a price at which they are willing to sell their shares within a price band (i.e., price range) specified by the company The Company will receive the offers from the shareholders. The merchant banker and the company shall determine the buyback price based on the acceptances received. The final price of buy-back shall be the highest price accepted and this price shall be /paid to all shareholders whose specified securities have been accepted for buy / back, litis method, requires the opening of Escrow Account.

3. Buy-back of shares from odd lots : The companies may locate the odd lots of shares (i.e., the block of shares that is not held in multiples of 100) and purchase them back from the odd lot holders

Accounting Treatment

Accounting treatment of buy-back of shares is more or less similar to redemption of preference shares. The following points may be noted:

1. Only fully paid up securities can be bought back, If the securities are partly paid, they must be made fully paid up by making final call

2. Sufficient balance must be standing to the credit of free reserves if buy back is to be made from free reserves.

3. If the shares are bought back out of free reserves or security premium, an amount equal to the face value of shares so bought back must be transferred from free reserves or security premium to Capital Redemption Reserve A/c (CRR).

4. The premium, if any paid on buy-back must be written off to security premium or free reserves.

5. Discount on payback, if any, must be transferred to Capital Reserve.

6. CRR can be utilized for the purpose of issuing fully paid bonus shares. It should be noted that for buy-back, security premium can be transferred to CRR.

Note: If the fresh issue of shares (for the purpose of buy back) is less than the amount of shades to be bought back, capital redemption reserve is to be created for the balance.

Journal Entries

1. If the company issues fresh securities for the purpose of buy back, appropriate entries are passed.

2. If the company buys back shares from free reserves or security premium, an amount equal to the nominal value of shares so bought should be transferred to Capital Redemption Reserve A/c. The entry is:

Profit and Loss or Other Reserves or Security Premium A/c Dr

To C.R.R. A/c

(a) *For buy back at par*
Share Capital A/c Dr. (with the face value of shares bought back)
To Bank A/c (with amount paid)

(b) For buy back at premium
Share Capital A/c Dr. (with the face value)
Security Premium/ Free Reserves Dr. (with the premium, i.e., excess of purchase price over face value)
To Bank A/c (with the amount paid)

(c) For buy back at discount
Share Capital A/c Dr. (with the face value of shares)
To Bank A/c (with the amount paid)
To Capital Reserve A/c (with the discount, i.e., the excess of face value over purchase price)

3. Write Journal entry for buyback expenses incurred in respect of buyback:

Buy-back Expense A/c Dr.

To Bank A/c

Buy back expenses account will be closed by transferring to Profit or Loss or other Reserves Accounts. The entry is

Profit or Loss (or Other Reserves) Dr.

To Buy-back Expense A/c

Note: Instead of one entry for buy-back, two entries can be written, i.e., for transferring the amount to shareholders account and the other for payment,