# WHAT IS SHARE BUYBACK?

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

*With prominent companies such as Infosys, TCS and L&T having gone for a share buyback, here is a low-down on the mechanism and the reasons for firms taking such a step.*

**What is a buyback?**

A buyback is a mechanism through which a listed company buys back shares from the market. A buyback can be done either through open market purchases or through the tender offer route. Under the open market mechanism, the company buys back the shares from the secondary market while under tender offer, shareholders can tender their shares during the buyback offer. Historically, most companies had preferred the open market route.

**Why does a firm go in for a buyback?**

Buybacks are typically done when a company has a significant cash reserve and feels that the shares are not fairly valued at the current market price. Since the shares that are bought back are extinguished, the stake of the remaining shareholders rise. Promoters also use this mechanism to tighten their grip on the firm.

**What are the benefits?**

Since the bought back shares are extinguished, the earnings per share (EPS) rise by default. Also, since a buyback is usually done at a price higher than the then prevailing market price, shareholders get an attractive exit option, especially when the shares are thinly traded. It is also more tax-efficient than dividends as a way to reward shareholders.

**How can a company execute a buyback?**

A company can use a maximum of 25% of the aggregate of its free reserves and paid-up capital for a buyback. A special resolution needs to be passed at a general meeting. However, if the company plans to use less than 10% of its reserves then only a board resolution is required.

**Can a firm opt for regular buybacks to boost EPS?**

A company cannot do a second buyback offer within one year from the date of the closure of the last buyback. Also, there are time-bound limitations on further share issuances like preferential allotment or bonus issue post a buyback. These checks have been put in place so that companies do not misuse the buyback mechanism.

***After share buyback, the stakes of existing shareholders rise***



**END**