

## Announcement effect of share buyback on share price: empirical evidence from Indian manufacturing companies

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### ABSTRACT:

*This study aimed to observe the announcement effect of share buyback on share price under tender offer and open market offer by Indian manufacturing companies for the period from 1.4.2016 to 31.3.2017. 23 samples are considered from both the methods of offers for the calculation. BSE Sensex is considered as benchmark index. Event study methodology is applied. 21-day event window observed. Market model is followed to arrive at the desired results. The announcement of buyback has led to positive abnormal returns for some of the sample companies under the both the methods of buyback offers. For the other companies, the negative AAR is observed. There is no noticeable trend related to the AAR in the event window as the sample companies have resulted in both positive and negative AAR for the 21day event window. The CAAR of 6.02% on the announcement day is being the highest among the 21event day under open market offer of the 7 sample companies and 2.31% of the highest CAAR in the tender offer buyback of the 16 sample companies. The sample companies AAR is found to be statistically insignificant at 5%. The findings reveal the information of buyback announcement is already reflected in the share price, leading to efficient and matured stock market for manufacturing companies in Indian stock market.*

### Key words:

*Buyback of shares, BSE Sensex, Event study, Market Model*

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### **INTRODUCTION**

It is the belief of the intellectuals and practitioners that share buy-back offers an alternate to dividend pay-outs as a means of returning funds to investors. It is one of the options for the companies to invest the cash earnings among the debt payments, expansions, acquisition of other companies, and dividends pay outs. Companies buying their own shares back in the market from shareholders through open market offer or free tender offer is a communal and widespread practice in most of the developed countries throughout the world. As far as India is concerned buyback has gained significance in the last decade due to the introduction of the companies amended Act of 1999, which gave a green signal to buyback of shares in our country. Capital restructuring, increasing earnings per share, stock undervaluation, anti-takeover mechanism, alternative to dividend and change in the management are some of the obvious motives behind the buyback offer by the companies. This phenomenon is practiced by all most all the companies, under different sectors as per the regulations stated by the companies Act. It reduces the public holdings thus the stock price is raised as it also boosts the earnings per share. Section 68 of companies Act of 2014 allows both the public and private company to go after buyback. The buyback should be 25% of the paid-up capital, it should be completed within a period of 12 months from the date of resolution passed by the offering company. The buyback of shares is also popularly called as share repurchase.

### **REVIEW OF LITERATURE**

(Kuntluru & Chacko, 2019) the study observed 47 samples of cash rich companies' buyback of India from 2016-17. The study found that short term market returns are higher than the long-term market performance and buyback has a positive a significant impact on the short term

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returns for the sample companies. (Rathore, 2018) the study witnessed the announcement of buyback not having a significant effect on the share price, resulting in market moving towards being informational efficient. The study considered 9 IT companies buyback announcement from August 2016 to March 2018. (Varma & Munjal, 2016) author studied 54 BSE listed samples from January 2004 to September 2013. The study observed a significant and positive AAR on the event day creating a positive return stating the tender offer buyback announcements carry a signal of undervaluation from management side to the shareholders of the company and acting as good tool for the company.

(Pradhan, 2017) the study revealed the positive impact of share buyback on share price but the same is not influencing trading volume if the price moves upwards after the announcement. The tax implications to the shareholders are suggested by the author to assist shareholders to get the tax benefit. 20 samples between 2017-18 were considered for the study. (Pritpal Singh Bhullar, Dyal Bhatnagar, 2018) author studied 180 BSE listed firms from 2006 to 2016, concluded that the firms value differs from pre and post buybacks of shares and buyback doesn't have any significant effect on firm value. (Shaw, 2017) the author learnt no significant positive impact of buyback on share price for the 2 sample companies. The traditional tools like EPS, DPS, ROI, EVA, MVA and SVA was adopted in the study.

(Varma & Munjal, 2016) the study observed 26 announcements from 2004 to 13 and found increase in EPS is an important reason for the companies to proceed for tender offer buyback. Dividend payouts and buybacks are not substituting to each other in India. Capital correction is a significant driver for tender offer and companies with higher profitability, buyback through the tender offer. (Bhatia, 2013) the author conducted an event study by applying AAR and CAAR to check abnormal return, observed 21 days pre and post event window of 41 companies. Author observed a negative abnormal return prior to the announcement of buyback during 2011-12 indicating undervaluation of shares and positive abnormal return post announcement indicating signalling effect of share repurchases. Besides a small company tends to have higher price reaction than larger companies due to higher information asymmetry faced by small companies. The results are like the study of open market repurchases in advanced countries.

(Karamjeet Kaur, 2012) the study examined the stock market reaction to open market share buyback announcement in India for BSE listed companies. By considering 21 events from Jan

2011 to Dec 2011, by applying CPRA model and using statistical tools like t-test observed 10 days before the announcement and 9 days after the announcement date. Significant positive mean daily return is observed for two days observation period. Returns are positive even before the announcement, this shows that market quickly absorbs all the information on implying market being efficient in semi-strong form. (Rajlaxmi, 2013)the study selected 6 events during 2007-08 and 2010-11. Author has conducted event study by applying CAR model by observing 5 days pre and 5 days post CAR. The analysis revealed that the market has not absorbed the buyback announcement information around the information days. The returns generated post the announcement day are the proof of the fact that there is drift of returns from the event day. The short-term effect of these announcements is consistent with the earlier works with abnormal returns.

(Subhamathi & Buyback, 2014) the author articulated that share repurchase influence companies operating efficiency measurement by the solvency ratios EPS and book value of shares by considering 20 companies from January 2012 to October 2013 from BSE. The study also revealed that solvency ratios are decreased by the value after the buyback and EPS also declaim the value after the buyback. Most of the company's book value of share increased after buyback. The return on net worth ratio indicates that overall efficiency of existing shareholders of the company. Mostly companies return on net worth ratio falloffs after buyback and some companies increase the return on net worth after buyback. (B.Ramesh, 2013)With an objective of ascertaining the impact of buyback on shareholder value creation, Focused on 90 buybacks in the course of 2005-2010. On BSE by calculating EPS concludes that out of 32 buyback programs 78% of the program have registered an augmentation in the EPS while 22% have recorded a decrease therefore the study says that buyback of equity shares enhances the EPS and there by creates value for the shareholders.

(SARIN, 2013) the study aims at examining the impact of buyback activity on shareholders and the effect on the shareholders wealth by calculating EPS, author finds that the effect of share buyback on share price of the company practice has also been analysed from the shareholders angle. Which is shown using the effect of announcement of buyback and equating the share price at different point of time in the pre buyback period and changes in EPS has also been observed. (Chavali & Shemeem, 2011)author in their study "Impact of buyback on share price

performance of companies in Indian context". With a sample of 75 buyback announcement (NSE) from January 2000 to December 2010, observed 41 days event window. Event study is conducted to examine the market reaction. The findings indicate that market reacts positively with significant positive average abnormal returns on  $t_0$  and  $t+1$  day. The average abnormal return on the announcement day is 1.07% and CAAR is 1.59. The study concludes that there exists a positive market reaction with buyback announcement in case of Indian market and buyback have a favourable impact on the share price performance of the stocks as shown by the positive market reaction post announcement.

(Howe & Jain, 2006) the study observed 345 shares repurchase announcement by banks from 1994-1998 of securities data corporations, results suggest that increasing the capital ratio of bank beyond its optimal level is value reducing study adds to the diverse motivations for the use of share repurchases. (Grullon et al., 2000) observed in his study of Economic sources of gain in stock repurchase in US that the long horizon return evidence is most consistent with the mispricing hypothesis and to some degree, the free cash flow hypothesis. The study finds little support for the leverage hypothesis. (Miller & Shankar, 2005) the author noticed the effect of open market stock purchases by insurance companies in the Wall Street journal from 1980-2000 that the insurance firms experience a significant increase in the value at the time of repurchase announcement. They suggest that there is a perceived change in the competitive position of repurchasing firms occur at the expense of rival firms and dominate any signals of favourable industry conditions.

(Samir & Abdurrahman, 2015) the study concluded in their research on "why do firms repurchase their own stocks? Theoretical framework and conceptual model" by observing the open market share repurchase announcement in Egyptian market that undervaluation and free cash flows are the reasons for repurchase of shares. (DR. Ishwar P, 2012) the author has examined the short-term market reaction to the buyback announcement on stock price in India and found negative and insignificant AR for majority of the days in the event period. Study observed 160 BSE listed company's buyback announcements between 1996-2006, to apply the market model from event study method.

(Hyderabad, 2013) the author has applied market model to estimate the correlation co-efficient of announcement return for 78 samples during 1998-2000 through SEBI. The evidence show

that low q firms with higher free cash flow ratio earn higher AR than other firms. Regression analysis noted positive co-efficient for low q firms with higher cash flow and promoters' control. (Hyderabad, 2000)the author concludes that rather than signalling hypothesis, market reaction to subsequent buybacks is better explained by cash flow hypothesis. Infrequent buybacks earn lower returns on the event day than frequent buybacks. The overall negative CAR in the post offer period indicates that all positive returns are realised in pre offer period only.

(Mishra, 2005)the study observed 25 announcements from 1999 to 2001, enunciates that for the Indian companies the long-term advantages of share buyback are not clear, generally buyback is used to improve the shareholdings of the promoters and to impart the benefits of the short-term gains to investors. (Ray, 2014) checked the buyback impact on financial performances of HUL from 2009-10 to 2013-14. Despite the Indian economy witness a slowdown, HUL derived healthy result. The PBIT and PAT of HUL grew up to 12% and 2% respectively. The buyback decision reflects undervaluation of company's share with its intrinsic value. It is also termed as best strategic option for the company.

## **STATEMENT OF PROBLEM**

The above literatures analysis clearly convey the various details on buyback of shares and its various impacts on the stock market, where in as a concern most importance is given to overall buybacks announcement effect, tax implications, shareholders value creation and so on. Out of these, announcement of share buyback is very significant and not a new area of research. Till now no sectoral wise studies are conducted on this topic in India. According to SEBI's annual report, in the year 2016-17, "51" buyback offers were announced out of which 10 were from open market and 41 from tender offer. 43 offers were closed during the year, with the offer size of Rs 37,460 crore. During the year 2016-17 out of 51 offers 26 were from the manufacturing companies, which is almost 51% of the overall sample, clearly indicates the essence of study in this perspective. In this connection this study is an effort to consider the buyback offers by companies from manufacturing sector during the year 2016-17 with the below mentioned objectives.

1. To evaluate the buyback announcement by Indian manufacturing companies
2. To summarize the outcomes and offer recommendations

## **HYPOTHESIS**

H<sub>0</sub>: The mean of Abnormal returns is not significantly different from 0.

H<sub>a</sub>: The mean of Abnormal returns is significantly different from 0.

## **SCOPE OF THE STUDY**

The study focused to find out the announcement effect of share buybacks, by the Indian manufacturing companies and significant difference between open market and free tender offer buyback announcement by the same. Any other financial aspects related to the sample companies are not taken into consideration.

## **METHODOLOGY**

The event study methodology is applied to study the market returns of the buyback announcement by sample company. Out of 51 effective overall announcements, 23 buyback announcements by the manufacturing firms from 1.4.2016 to 31.3.2017 under both tender offer and open market method are considered based on the availability of data related to announcement, event window period and price data in estimation etc. Other announcements are overlooked due to non-availability of valid facts relating to the announcement date, price data, and non-BSE listed stock exchanges, unlisted stock or lack of 252 days estimation period data. The present study is confined to 7 samples from open market buyback offer and from tender offer buyback 16 offers are considered. The sample companies are identified from the list of buyback companies by SEBI. The date of announcement is considered from the same website.

## **DATA SOURCE**

To achieve the fore said objectives, the study has used the secondary source of data, the stock price and market returns are considered from BSE website. To collect the data like, date of event, date of opening and closing of buyback offers SEBI's official website is used. BSE S&P SENSEX index is used as benchmark index for calculation. For the study 252 days considered as estimation period.

## **TOOLS OF ANALYSIS**

The impact of buyback announcement on the manufacturing companies studied by using appropriate financial tools. In the event study the market model is applied for computing AR

(Abnormal returns) and CAAR (Cumulative average abnormal returns).

The study has considered the market reaction over 21 days event period in which the 21 days means 10 days before the announcement (-10) and 10 days after the announcement (+10). On the announcement day it is considered as 0. The announcement dates are taken from SEBI announcement notifications.

$$AR = R_t - E(R)_t \quad (1)$$

Where  $AR_t$  = denotes the Abnormal Return

$R_t$  = denotes the actual return on stock

$E(R)$  is for the expected returns

AAR: Average Abnormal Returns

AAR Formula: (2)

Where N denotes number of events

$$\frac{1}{N} \sum_{i=1}^N AR_{i,t}$$

AR is for abnormal returns

I for no of securities and

T denotes the days surrounding the event day.

CAAR: Cumulative Average Abnormal Returns

CAAR<sub>t</sub> Formula: (3)

$$\sum_{i=1}^N AR_{i,t}$$

Where N denotes number of events

AAR is for Average Abnormal Returns

I for no of securities and

T denotes the days surrounding the event day.

**T-test** - is conducted to observe the significance impact on stock returns. 1.975% is the level of significance considered to mark significance or insignificance.

Event study metrics, MS excel are used for the analysis. The charts are used for the graphical representation of the data for the analytical purpose.

Calculation of T statistic for ARs for each day during the event window by considering the



following formula:

$$t = \text{ARs} / \sigma (\text{ARs}) \quad (4)$$

Where, ARs= denotes Abnormal Returns and  $\sigma$  = denotes Standard error of Average.

To substantiate our findings the study has employed one sample t-test in 2 tables the first table t-table has been employed on individual company's event window in the second table t-test it is on AAR of all the sample companies. The significance level was taken at 5%

## EMPIRICAL FINDINGS

Buyback of shares are not new to Indian corporates, there is a positive trend in the growth rate of the same in our country. Year wise details of overall buybacks, size of the buyback offer from both the open market and tender offer and on buyback by manufacturing companies from 2013 to 2019 can be observed form the below table.

**Table 1. The recent trend in buyback of shares in India**

Year	No Of Buy Back Offers		Buy Back Offer Size * (In Crores)		No Of Offer From Manufacturing Compaies
	OMR	FPT	OMR	FPT	
2013-14	15	08	8,498.5	3,144.7	17
2014-15	25	08	225.6	147.5	02
2015-16	05	11	232.3	1601.5	10
2016-17	10	41	2,411	35,049	26
2017-18	05	65	348	59,447	31
2018-19	17	46	10,512	44,992	28

Source: SEBI Annual Report

Note: OMR-Open Market Buyback Offer and FPT: Free Price Tender Offer

\*Including the offer open and closed during the year

The above table speaks about the recent trend in the buyback of shares in our country. Recent years are the benchmark years with respect to the repurchases in our country as the maximum offers by the companies can be observed during the last three years compared to the previous years. During the year 2016-17 and 2017-18 it is noted that the number of buyback announcements are more in case of tender offer method than that of open market offer. The buyback offer size is generally decided by the announcing companies as per their motives and

requirements. From the year 2018-19 we can observe 17 offers from open market and 46 from tender offer with 10,512 crores being the buyback offer size. The year wise buyback by manufacturing company can also be seen in the above table which is also ascending in the recent years.

**Table 2. Results of Market Model-Open market offer**

Sl No	Company Name	Intercept	Slope	R -Square	Standard Error
1	Excel Industries Ltd	-0.000565837	1.529380283	0.21669856	0.031250334
2	Dr.Reddy's Labouratories Ltd	-0.000156603	0.775440238	0.166704955	0.018780294
3	ADF Foods Ltd	0.00234176	1.08951512	0.130023426	0.029482714
4	Transpek Industries Ltd	0.002385629	0.515993997	0.025885215	0.029214028
5	Ambika Cotton Mills Ltd	0.00088426	0.564372269	0.075472184	0.01853239
6	Fineotex Chemical Ltd	0.001685088	1.731863765	0.161609149	0.036513428
7	The Ramco Cement Ltd	0.002145607	0.922601913	0.164862036	0.018708825

**Table 3. Results of Market Model-Tender offer**

Sl No	Company Name	Intercept	Slope	R -Square	Standard Error
1	Sun pharmaceutical industries ltd	-0.00039085	0.848126196	0.100412029	0.026440602
2	Navartis India Ltd	0.000115338	0.544307752	0.122795715	0.015212095
3	Mayur Uniquoters Ltd	0.000343434	0.881700133	0.275097021	0.014938165
4	Bosch Ltd	-0.00268841	0.901296263	0.039962664	0.045877016
5	BEL Ltd	0.000579703	0.436080958	0.034602084	0.024245447
6	Disa India Ltd	0.001479973	0.650266261	0.096771735	0.018195319
7	Aarti Industries Ltd	0	0.689851819	0.096057833	0.019382228
8	Aarti Drugs Ltd	0.000800298	0.735176042	0.144916797	0.016288084
9	Lakshmi Machine	0.000104308	0.669428906	0.124026268	0.016135156

	Tools Ltd				
10	Navneet Education Ltd	0.001574746	0.746757073	0.12907816	0.017570379
11	Vardhaman Textiles Ltd	0.002339765	1.067831269	0.123380144	0.026555136
12	Balarampur Chini Mills Ltd	0.001615919	0.726629062	0.115420579	0.018916402
13	DhanukaAgritech Ltd	0.000593127	0.77132007	0.130398056	0.018657249
14	Apar Industries Ltd	0.002936123	1.516824482	0.215097799	0.026742307
15	GHCL Ltd	0.000803166	0.324008682	0.044459269	0.012455279
16	SKF India Ltd	-0.00039085	0.848126196	0.100412029	0.026440602

Volatility and ambiguity are a common characteristic of every market. Market risk involvement in buyback of shares are observed in the Table 2 and 3 reveals the results of the market model of the sample companies from both open market and tender offer buyback. The intercept and slope remain positive for most of the sample companies indicating less risk with regards to their expected returns. Few sample companies are having a negative intercept which depicts the riskiness to their expected returns. Where in slope speaks about the less volatility observed during the event period.

**Table 3. Summary of t-test for individual companies for the event window under Open market and Tender offer**

Event window	Open market offer		Tender offer	
Event window	Reject null Hypothesis	% rejected (7 samples)	Reject null Hypothesis	% rejected (16 samples)
-10	5	71.4	12	75
-9	1	14.3	6	37.5
-8	4	57.1	8	50
-7	4	57.1	7	43.8
-6	4	57.1	9	56.3
-5	4	57.1	6	37.5
-4	2	28.6	5	31.3
-3	3	42.9	8	50
-2	5	71.4	9	56.3

-1	1	14.3	7	43.8
0	4	57.1	5	31.3
1	6	85.7	10	62.5
2	5	71.4	10	62.5
3	3	42.9	7	43.8
4	5	71.4	10	62.5
5	6	85.7	11	68.8
6	3	42.9	10	62.5
7	4	57.1	12	75
8	4	57.1	11	68.8
9	7	100	6	37.5
10	4	57.1	10	62.5

Alpha @ 5%

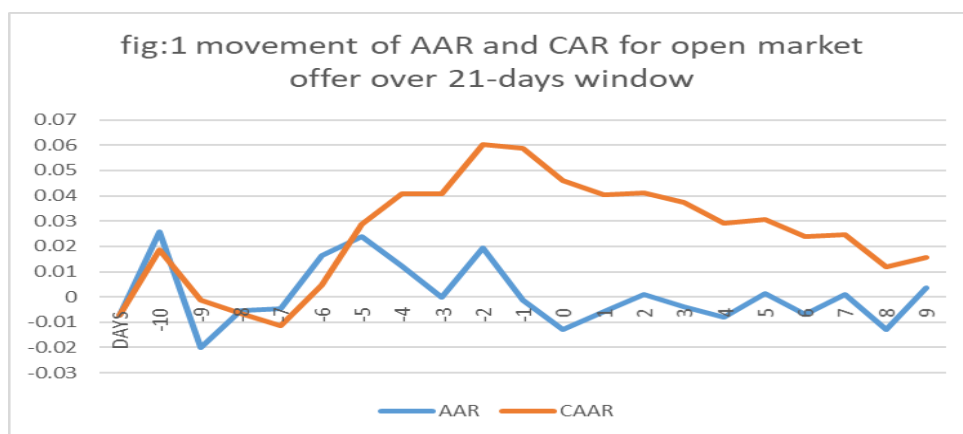
**Table 4. AAR and CAR for 7 buybacks in 21-day window period under open market offer**

Event Window	AAR %	Companies with positive AR	T-TEST	A/R Hypothesis	CAAR %
-10	-0.732	2	-1.58	Accept	-0.732
-9	2.58	6	5.551	Accept	1.848
-8	-1.99	3	-4.28	Accept	-0.142
-7	-0.523	3	-1.13	Accept	-0.665
-6	-0.479	3	-1.03	Accept	-1.144
-5	1.626	4	3.499	Accept	0.482
-4	2.382	5	5.126	Accept	2.864
-3	1.223	5	2.632	Accept	4.087
-2	-0.018	3	-0.04	Reject	4.068
-1	1.955	6	4.207	Accept	6.023
0	-0.13	3	-0.28	Accept	5.893
1	-1.28	1	-2.75	Accept	4.613
2	-0.573	2	-1.23	Accept	4.039
3	0.084	4	0.181	Accept	4.123
4	-0.391	2	-0.84	Accept	3.732
5	-0.817	2	-1.76	Accept	2.916

<b>6</b>	0.156	4	0.336	Accept	3.072
<b>7</b>	-0.68	3	-1.46	Accept	2.392
<b>8</b>	0.088	3	0.189	Accept	2.48
<b>9</b>	-1.276	0	-2.75	Accept	1.204
<b>10</b>	0.356	3	0.765	Accept	1.56

\*significant at 5%.

**Chart-1 movement of AAR and CAAR for open market offer**



(movement of AR and CAR of Tender offer over 21-day event window)

On the date of announcement, a negative AAR which is statistically insignificant, with a CAR Of 5.89% is observed. The highest percentage of 85.7 companies from sample had positive AR on the (-9) day and least of 0 on (+9) day window. Compared to post buyback period pre buyback days such as (-9), (-5), (-4), (-3) and (-1) positive AR which is statistically significant at 5% is noticed. On (-8), (+1) and (+9) days study witnesses with a negative AR which are negatively significant at 5 %. AAR results are in consistent for both pre and post tender offer period.

**Announcements return for sample from Tender offer**

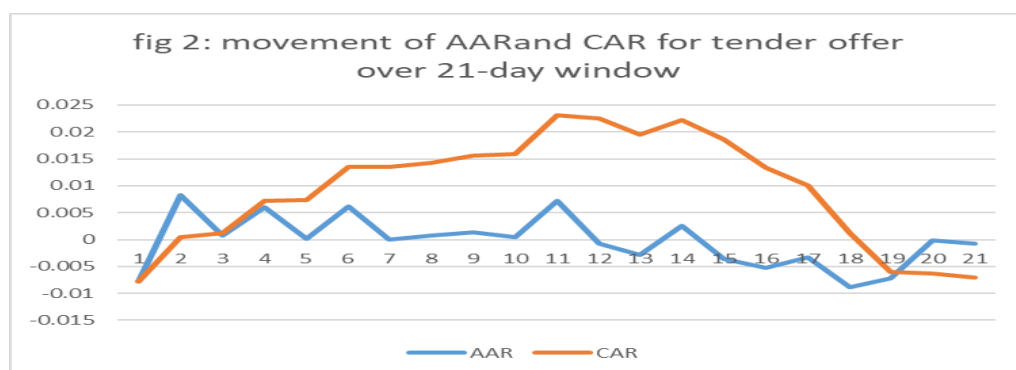
**Table:3. AAR and CAR for 16 buybacks in 21-day window period**

Days	AAR %	Co's with positive AR	T-TEST	A/R Hypothesis	CAAR %
<b>-10</b>	-0.775	4	-6.52	Accept	-0.77
<b>-9</b>	0.82	10	6.902	Accept	0.045
<b>-8</b>	0.074	10	0.626	Accept	0.12

-7	0.597	9	5.024	Accept	0.717
-6	0.014	7	0.114	Accept	0.731
-5	0.62	10	5.219	Accept	1.351
-4	-0.005	11	-0.04	Reject	1.346
-3	0.078	9	0.657	Accept	1.424
-2	0.129	7	1.089	Accept	1.554
-1	0.043	10	0.358	Accept	1.596
0	0.72	11	6.061	Accept	2.317
1	-0.071	8	-0.6	Accept	2.245
2	-0.288	8	-2.42	Accept	1.957
3	0.262	10	2.202	Accept	2.219
4	-0.364	6	-3.07	Accept	1.854
5	-0.523	5	-4.4	Accept	1.331
6	-0.332	7	-2.79	Accept	0.999
7	-0.883	5	-7.43	Accept	0.117
8	-0.722	5	-6.07	Accept	-0.61
9	-0.022	10	-0.18	Accept	-0.63
10	-0.076	7	-0.64	Accept	-0.7

\*significant at 5%.

**Chart-2 movement of AAR and CAAR for tender offer**



(movement of AR and CAR of open market offer over 21day event window)

It can be observed from the above table that AAR is statistically significant at 5% level for the event window. The mixed results are noticed in abnormal returns as some companies are with positive ARs and some are with negative on the event days. The highest percentage 68.75 of companies with positive AR was observed on (-5) and (0) days and the least percentage 25 of

companies with positive AR was observed on (-10) day. On the date of announcement there was a positive AAR and CAR of 2.31 was observed, which is statistically significant at 5 %. In short term window of 21 days we observed positively significant AAR on (-9), (-7), (-5), (0), (+3). the negative AAR was observed mostly in post announcement days excepting (-10). In the post announcement (+2), (+4), (+5), (+6), (+7) and (+8). These findings are in inconsistent with the previous studies on the topic.

### **CONCLUSION:**

The present study is intended to observe the announcement effect of buyback of shares on share price under tender offer and open market offer by Indian manufacturing companies for the period from 1.4.2016 to 31.3.2017.23 samples are considered from both the methods of offers. The announcement of buyback has led to positive abnormal returns for some of the sample companies under the both the types of buyback offers. For the other companies, the negative AAR is observed. There is no noticeable trend related to the AAR in the event window as the sample companies have resulted in both positive and negative AAR for the 21day event window. The CAAR of 6.02% is being the highest among the 21event day under open market offer of the 7 sample companies. On the announcement day it was 5.89% and 2.31% of the highest CAAR in the tender offer buyback by the16 sample companies. On the announcement day it was 2.32%. The results of the study conveyed significant at individual company level on the event day indicating positive impact on share price. The sample companies AAR was found to be statistically insignificant at 5%. The findings reveal the information of buyback announcement is already reflected in the share price, leading to efficient and matured stock market for manufacturing companies in Indian stock market and buyback announcement does not have a significant impact during the post announcement period. It is evident from the findings that the share price during the event period are less volatile, and the companies can go for buyback confidently, on the other hand these announcements may not fetch much gains to the traders who expect good abnormal returns. Further studies on the same topic can be taken up by considering the other sector's companies as sample or other buyback announcement taking the latest data to validate with the findings of the study.

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