

Buyback of shares

Buyback means buying back off a company's own securities from the open market. It is also known as stock buyback. company limited by shares for a company limited by guarantee and having and capital can buy or purchase from its shareholders share Issued by company.

Effects of buyback: Following are the effects of buyback.

1. There is a reduction in capital of the company the extent of face value the shares bought back.
2. There is an outflow of cash from the company.
3. The shareholders whose Shares are bought back ceased to be owner of the company.

Objectives and importance of buyback.

1. Buyback leads to increase in E PS.
2. It increase Intrinsic value of shares.
3. Buyback reduces Excess share capital of the company.
4. It reduces the chances of hostile takeover.
5. Company can utilise surplus cash or idle cash balance for buyback.
6. It Increase the share holding of promoters of the company.
7. share capital structure can be organised.

Sources of buyback. Sec. 68(i)

Company can buy back from

1. Fresh issue of shares.- shares should not be of same class of shares to be buyback.
2. Free Reserves - General reserve, P/L A/c, Security premium.
3. From sale of asset.

Conditions or Restrictions on buyback

1. Buyback must be authorised by Article of Association of company.
2. Shares must be FULLY PAID UP. Which means Company cannot buy back partly paid shares.
3. Company can buyback maximum 25% of its issued share capital.
4. After buyback Debt-Equity ratio should not exceed 2:1.
5. Company cannot take bank loan or borrowings for buyback.
6. Buyback must be completed within the period of 1 year from its declaration.

Conditions for Number of shares to be buyback and its Offer price.

There are **5 steps** to be remember for checking conditions or find out number of shares to be buyback.

I. OWN FUNDS

Share capital (Equity + Preference)

Reserves and surplus (Free Reserves)

Less: Miscellaneous Expenditures

II. BORROWED FUNDS

Debenture

Bank loan / Term loan

III. MAXIMUM AMOUNT OF BUYBACK ₹

- i. 25% of Own fund ₹
- ii. Own fund – $\frac{1}{2}$ of Borrowed funds ₹
- iii. Free reserves (General reserve + p/L A/c + Security premium) ₹

Whichever is LESS

IV. MAXIMUM NUMBERS OF SHARES TO BE BUYBACK

25% of its issued shares

$$\text{V. OFFER PRICE} = \frac{\text{Maximum Amount of BB}}{\text{Maximum No. of shares}}$$

Accounting Entries for Buyback of Shares

In the books of _____ Co.

1. Entry for making partly paid shares as fully paid up.

i) **Final call due**

Final call money a/c **Dr.**

To Equity share capital a/c
(Being Final call money due)

ii) **Final call money received.**

Bank a/c **Dr.**

To Final call money a/c
(Being Final call money received)

2. Entry for fresh issue of shares.

Bank a/c **Dr.**

To Equity share capital a/c
To Security premium a/c
(Being Shares issued at premium)

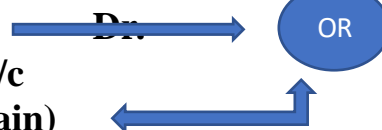
3. Entry for sale of Assets or investments

Bank a/c **Dr.**

Profit and loss a/c (loss) **Dr.**

To Assets/investments a/c

To Profit and loss a/c (gain)



4. Entry for Amount due on Buyback

Equity share capital a/c (FV) **Dr.** **10**

Premium on buyback a/c (Premium) **Dr.** **05**

To Equity shareholders a/c (offer price) **15**

(Being amount due for buyback)

5. Entry for creating/transferring divisible profit used to CRR

General reserve/profit and loss a/c/sec. prem. a/c **Dr.**

To Capital Redemption Reserve(CRR)

(Being divisible profit used transfer to CRR)

6. Entry for writing off Premium on buyback a/c
Security premium/ Profit and loss/general reserve a/c Dr.
To Premium on buyback a/c
(Being premium on buyback written off)

7. Entry for payment of buyback amount
Equity shareholders a/c Dr.
To bank a/c
(Being amount due for buyback paid)

Items of Balance sheet affected due to Buyback

- 1. Share capital**
(Especially Equity share capital will reduce)
- 2. Reserves and Surplus**

General Reserve	(Reduce)
Profit and loss a/c	(Reduce)
Security premium a/c	(Reduce)
CRR	(Created or increase)
- 3. Bank Balance** (Add/Less)
- 4. Assets/Investments** (Reduce)
(If sold)