# The Left Has Found a New Enemy: Share Buybacks

By Theo Vermaelen , INSEAD Professor of Finance

**Attacking share buybacks is misguided. When companies buy back shares it is not only a sensible use of excess cash, but good for shareholders and good for the economy.**

A number of leftwing American politicians, including Hilary Clinton, have found a new enemy: share buybacks.  The argument is that they are a short-term stock manipulation scheme and that firms should better use the money to invest and to increase salaries. In a speech in New York on July 24th, Ms. Clinton called for government and private companies "to join the fight against quarterly capitalism. It's bad for business; it's bad for our economy". She gets her buyback advice from Professor William Lazonick, notorious for his attacks on shareholder value and capitalism and author of an **anti-buyback article** in the Harvard Business Review.

As is often the case, politicians ignore inconvenient facts. If buybacks were a short term earnings-per-share manipulation scheme that hurts long term investments, stock prices would rise abnormally around the announcement and fall back later on. Evidence from numerous academic studies published during the last 35 years shows that the opposite is true.  Buybacks are good for shareholders, not only in the short run but also in the long run, and not only in the U.S. but also in the rest of the world. For some recent evidence on this see

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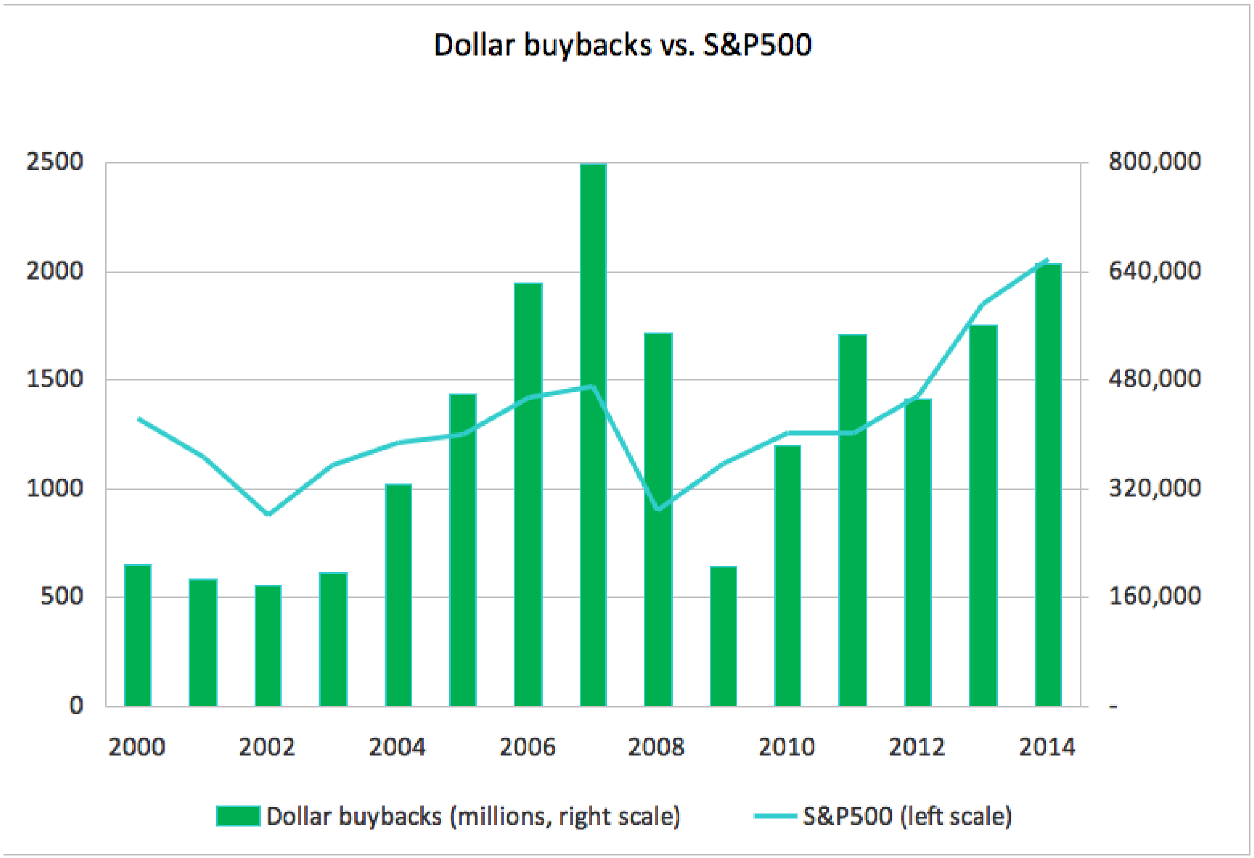
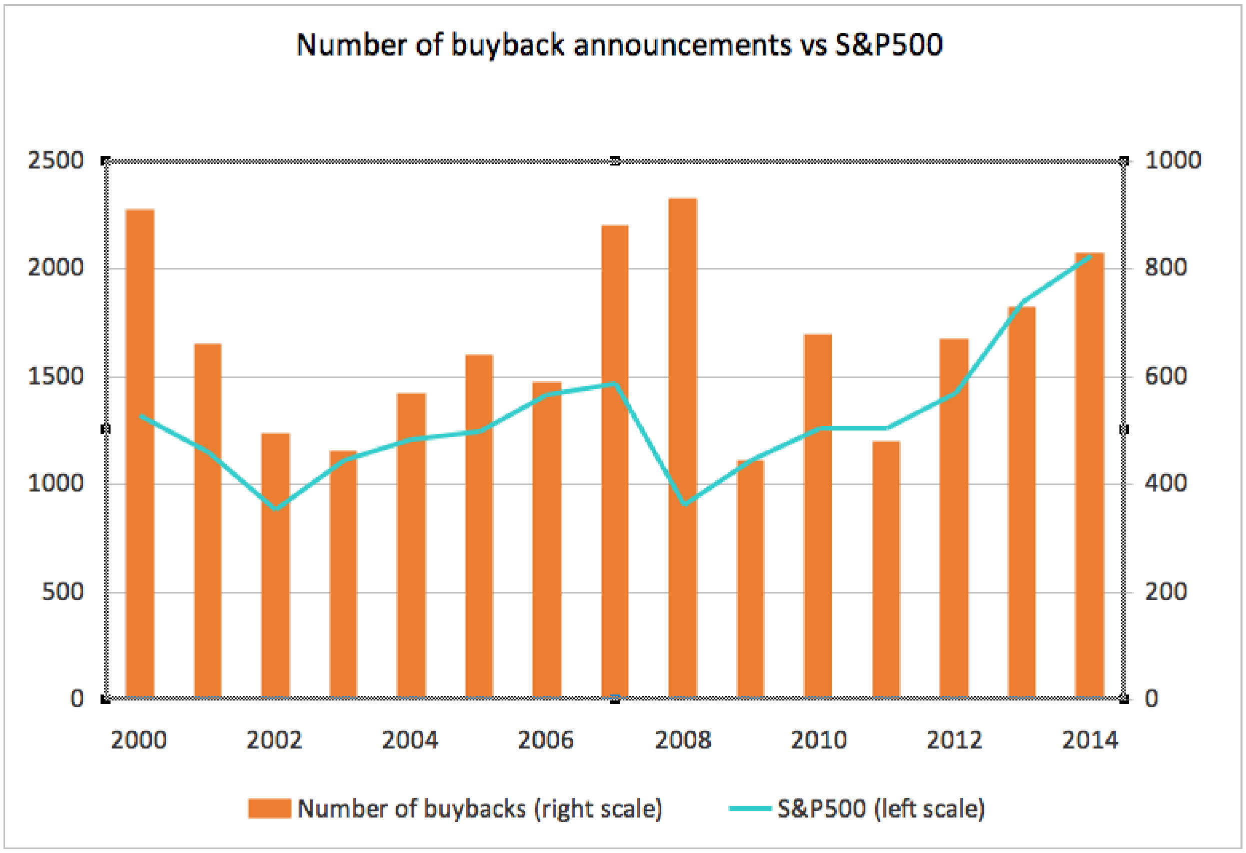
with Alberto Manconi and Urs Peyer.
The whole argument also wrongly assumes that firms can only invest retained earnings. Obviously a company can borrow money to invest and still payout cash. Borrowing is tax efficient as interest is tax deductible.  The argument also ignores the fact that when a company pays out cash, the cash does not disappear. The shareholders who sell their shares either spend the money or invest in stocks and bonds of firms that need to raise capital, stimulating economic growth. That’s how the economic cycle is supposed to work: cash is distributed to shareholders when a firm has excess cash or excess debt capacity. That cash is then partially reinvested in firms who need capital.

**Facts about the buyback wave**

The concern about a recent job-destroying buyback “wave” is also misplaced. It is true that the dollar volume of buybacks has increased significantly since 2000 (see figure 1).




But the graph shows that the volume is highly correlated with the level of the S&P 500. This is not surprising as the typical repurchase announcement is for 7 percent of the value of the equity. When the value of equity rises, then 7 percent of the equity represents a larger dollar amount. On the other hand figure 2 shows that the number of buybacks since 2000 has remained relatively stable at around 700 per year, which represents 10 percent of all listed US firms.




So there is no buyback “wave” in the sense that more companies announce buyback programs. Because the dollar volume of buybacks mechanically rises when stock markets are high, one gets the wrong impression that companies are bad timers (they buy at the top of the market). In order to judge market timing ability one has to adjust for general market movements and calculate abnormal, risk adjusted returns. One cannot expect CFOs to predict major stock market crashes. So after adjusting for these market movements CFO’s seem to do a pretty good job, at least on average.

The hostility towards buybacks is surprising considering there is no equivalent hostility towards dividends. Companies are reluctant to cut dividends as, when they do, stock prices fall. So it is more likely that high dividend yield firms will cut investment to preserve the dividend. An open market buyback authorisation is not a firm commitment and firms mention this explicitly at the time of the buyback authorisation. This feature makes buybacks a more flexible payout mechanism. Such flexibility is important in a world with increasing competition and uncertainty.

**What’s the alternative?**

If politicians discourage buybacks, companies would simply pay more dividends, put the excess cash in marketable securities or make value destroying investments. One such investment is acquisitions. The record on acquisitions is not a pretty picture: on average bidders don't make money for their shareholders. Encouraging firms to make bad investments is not helping anyone in the long run, including workers. Interestingly, in the same speech Ms. Clinton attacked the oil and gas industry, the enemy of the climate change lobby. The fact is that today the most active repurchasers are oil and gas companies that, as a result of the collapse in oil prices, prefer to take advantage of depressed stock prices rather than investing in exploration and development.  How is forcing these companies to invest more going to save the planet? Isn't it better that they distribute excess cash that investors can use to participate in Tesla's recent $500 million equity offering?

In short, leftwing politicians should stop trying to justify restrictions on buybacks as "attempts to save the economy". Why not stick to the classical class warfare ideology: "We don't like capitalism and shareholders. We want shareholders to give their money to workers". This simple message is more honest and easier to understand.

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