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Information disclosure, CEO overconfidence, and share buyback completion rates

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ABSTRACT

An open market share buyback is not a firm commitment, and there is limited evidence on whether firms repurchase the intended shares. Unlike US studies, we use data from unique UK regulatory and disclosure environment that allows to accurately measure the share buyback completion rates. We show that information disclosure and CEO overconfidence are significant determinants of the share buyback completion rate. In addition, we find that large and widely held firms that conduct subsequent buyback programs and have a past buyback completion reputation exhibit higher completion rates. Finally, we assess whether other CEO characteristics affect buyback completion rates and find that firms with senior CEOs who hold external directorships and have a longer tenure as CEO are more likely to complete the buyback programs. In sum, our results suggest there is a clear relationship between information disclosure, CEO overconfidence, and buyback completion rates.

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1. Introduction

When firms announce they intend to repurchase shares, the market reacts positively (Vermaelen, 1981; Ikenberry et al., 1995; Chan et al., 2004), even though such announcements are not firm commitments and, therefore, costless. Moreover, firms can consciously use share repurchase announcements to boost their share price while misleading shareholders, since there is no long-term economic benefit (Chan et al., 2010). However, share buyback announcements attract the market's scrutiny, preventing bad firms from mimicking good firms. Thus, buyback announcements can be credible, which justifies the positive market reaction (Bhattacharya and Dittmar, 2003).

Typically, firms are not required to disclose their intention to conduct an open market share buyback, though many firms do. Interestingly, when firms announce they intend to repurchase shares, some choose to disclose explicit information on the intended buyback while others do not. When firms make no share buyback announcements, managers reserve the flexibility to repurchase shares before any mispricing discovery by the market. When firms announce only their intention to repurchase shares without explicit details, managers send a mispricing signal to the market that reduces the managers' flexibility in taking advantage of any early mispricing. When firms disclose the full details of their intended buyback program, the firms signal to the market that they have a clear strategy and intention to repurchase shares (Ikenberry and Vermaelen, 1996). Therefore, understanding why firms announce explicit information and whether information disclosure is related to buyback completion rates is important. We contribute to the literature by testing whether disclosing explicit information (or not) about the intended buyback program can serve as a strong indicator of firms' real intentions to deliver on the promise to repurchase shares. We find strong evidence supporting our expectations that announcing explicit information about the shares intended to be repurchased can serve as a strong signal of firms' "commitment" to follow through with their announced buyback programs.

When firms intend to repurchase shares, managers, and effectively chief executive officers (CEOs), reserve flexibility on the timing of and method for implementing the buyback program (Guay and Harford, 2000; Jagannathan et al., 2000). Malmendier and Tate (2005) find that managerial overconfidence influences corporate investment decisions. In addition, Malmendier and Tate (2008) show that overconfident CEOs make more acquisitions and the market reacts negatively to such acquisitions. Malmendier et al. (2011) show that overconfident managers view their firms as undervalued and external financing as expensive, and thus issue less equity compared to their peers. In addition, they show that

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overconfidence and early life experience explain firms' capital structure variations. Hirshleifer et al. (2012) find that firms with overconfident CEOs have higher return volatility, invest more in innovations, obtain more patents and patent citations, and achieve greater success in innovative research and developments. In this paper, we examine whether overconfident CEOs perceive their equities as undervalued and complete the announced buyback programs. To our knowledge, this is the first study to investigate the impact of CEO overconfidence and other CEO traits on share buyback programs and their implementation. We find that overconfident CEOs perceive their shares as undervalued and have a higher buyback completion rate.

Another stream in the literature shows that CEO traits can have a significant impact on corporate decisions, such as the decisions affecting capital structure (Cronqvist et al., 2012), financing choices (Malmendier et al., 2011), and risk-taking attitude (Masulis and Mobbs, 2011). Frank and Goyal (2007) find that CEO characteristics can have a significant impact on the variation in leverage across firms. Yim (2013) shows that CEO age is positively related to mergers and acquisitions. Song and Thakor (2006) deal with the incentives for a CEO to provide less precise signals about projects proposed to the board, and Hermalin and Katz (2000) develop a model in which CEOs have an incentive to choose a less informative regime that would be desired by the owners.

CEOs with a long tenure in a firm are more likely to be entrenched, thus exerting more influence with low levels of ownership simply by virtue of tenure (Morck et al., 1988) and avoiding any agency monitoring (Hill and Phan, 1991). Moreover, powerful and entrenched CEOs can influence the board composition toward their preference, leading to a weakening of board monitoring (Hermalin and Weisbach, 1998). Consequently, tenured CEOs are less likely to succumb to shareholders' pressure to make a payout in the form of share buybacks to reduce potential agency costs. Overall, we have limited knowledge on the potential impact that varying CEO characteristics have on corporate financing decisions and in effect on payout policies. We relate CEO traits and disclosure policies with share buyback completion rates and find that firms with more senior CEOs who have more corporate connections and longer tenure as a CEO are significantly more likely to complete the firms' share buyback programs.

Though the information disclosure precedes buyback announcements, its relation with buyback completion rates may be affected by the omitted factors driving disclosures and buyback completion rates. It is important that we separate out the real effects of information disclosures from the effects of company characteristics and CEO characteristics that provide disclosure. Thus, we consider information disclosure as endogenous with the buyback completion rate. We conduct a Hausman (1978) test of endogeneity and model information disclosure and buyback completion rate in a two-stage regression framework as in Brockman et al. (2008). Although we find that information disclosure is endogenous, a positive relationship between information disclosure and the buyback completion rate survives after controlling for endogeneity.

Until the mid-2000s, the only disclosure requirement regarding open market buyback programs in the United States (US) was the quarterly reporting of the number of shares outstanding. Therefore, tracing stock repurchases connected to a specific buyback announcement was challenging and became questionable whether firms are committed to completing the intended buyback programs. Stephens and Weisbach (1998) find that the buyback completion rates can significantly deviate from the intended target initially set by the firms.[1] Bonaimé (2012) uses several buyback proxies and finds that the average completion rate in a sample of US listed firms is approximately 73%. According to Kim et al. (2004), US disclosure requirements "are among the least stringent" of all the major stock exchanges the researchers examined. Following a change in US regulations in 2004, firms are held to a higher degree of disclosure regarding share buyback program, but even so, these requirements do not allow for accurate and timely measurement of buyback completion rates.[2] Banyi et al. (2008) assess the accuracy of the share buyback proxies commonly used in the US literature and find strong evidence suggesting these proxies suffer from inaccuracies, potentially leading to a significant distortion of the evidence and interpretations reported in the existing literature. This has been only partially addressed following the change in US regulations in 2004; firms are now required to disclose buyback trades but on quarterly statements.

We overcome the unavoidable measurement and reporting timing inaccuracies of the US studies by using accurate daily share buyback data from the more rigorous disclosure environment of the UK.[3] UK regulations mandate that firms disclose the repurchased shares and the price paid on the day when the actual repurchase trades occur, until the start of the following trading day. Since the UK has similar institutional and regulatory frameworks to the US but a more stringent disclosure regime, even compared to other European countries where share repurchase trades are reported monthly, it constitutes a unique setting for analyzing the drivers of share buyback completion rates.

In sum, we find that greater information disclosure and CEO overconfidence have a significant influence on firms completing their intended buyback programs. We also find that CEO age, connectedness, and tenure affect share buyback completion, while controlling for firm-specific characteristics. Moreover, we find that firms that initiate their buyback program shortly after the announcement and conduct repeat buyback programs are more likely to have higher buyback completion rates.

The rest of the paper is organized as follows. In Section 2, the literature is reviewed and the hypotheses set. In Section 3, the data, variable definitions, estimation methods, and descriptive statistics are discussed. In Section 4, the results for the factors that influence share buyback completion rates are discussed. The robustness tests are presented in Section 5. The conclusions are in Section 6.

2. Review of literature and hypotheses

2.1. Disclosing details on buybacks and buyback completion rate

Corporate disclosures could alleviate the adverse selection problems (Verrecchia, 2001) and increase the liquidity of shares or reduce the agency cost (Hermalin and Weisbach, 2012) by mitigating the information asymmetries. Previous studies show that an increase in voluntary disclosure reduces firms' cost of capital. Several papers study the relationship between disclosure ratings from the Association for Investment Research (AIMR) and the cost of capital measures such as bid-ask spread and trading volume (e.g., Healey et al., 1999). Some studies use self-constructed measures of disclosures and link these measures with measures of the cost

[1] Fama and French (2001) adjust the changes in Treasury stock used by Stephens and Weisbach (1998) to account for the cancellation of Treasury shares; however, the researchers' focus is not measuring the buyback programs' completion rates.

[2] In particular, according to the change in Rule 10b-18 of the SEC Act of 1934 in the US, concerning the disclosure requirements of open market buybacks, listed firms are required to report on a monthly basis the exact volume and price data of their repurchasing activity in their prerequisite quarterly filings. This change in Rule 10b-18 was introduced on December 17, 2003; however, it became effective for all quarterly and annual filings for periods ending on or after March 15, 2004.

[3] Oswald and Young (2004) in the UK, Ginglinger and Hamon (2007) in France, and Zhang (2005) in Hong Kong use daily data on share repurchases and the respective actual repurchase trades; however, the researchers do not focus on the completion rates of the announced share repurchase programs or on identifying the factors that affect the programs' completion.

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