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Is Price Support a Motive for Increasing Share Repurchases?

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Abstract: Prior research shows that companies repurchase stock during quarters with low returns, presumably because the stock is undervalued. We focus on repurchase increases and investigate another motive: Are repurchases increased to provide price support for a stock that, despite recent low returns, remains overvalued? Using an increase in short selling to indicate overvaluation, we regress quarterly changes in share repurchases on quarterly changes in short interest. Consistent with price support, the association is positive and statistically significant each year from 2003 to 2014. We find the price support quarter is followed by a sharp multi-quarter decline in ROA (return on assets), but the corresponding decline in EPS (earnings per share) is modest due to the reduction in outstanding shares. Abnormal returns after the price support quarter are positive, indicating that price support is effective. We also examine trading by insiders. While insiders generally sell when shorts sell, they hold onto shares during the price support quarter. This indicates insiders are confident they can maintain the current stock price.

Keywords: Short selling; Arbitrage; Share repurchase; Stock buyback; Overvalued equity.

Classification codes:

G 12

G 14

G 35

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