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## Additional evidence on the frequency of share repurchases and managerial timing<sup>☆</sup>



Adri De Ridder\*

Uppsala University, Campus Gotland, SE-621 67 Visby, Sweden

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### ABSTRACT

Are firms with multiple share repurchase programs associated with positive abnormal performance and is the performance related to cash flow levels in firms? Do managers repurchase the firm's shares at a lower price than a naïve investor? In this paper, I analyze these questions using a unique hand-collected data set with detailed information of repurchase transactions. The findings show that firms with multiple repurchase programs have returns that exceed the return on stocks in firms with fewer programs by 79 basis points per month and that firms with high cash flows have higher returns than firms with low cash flows. The results do not support the idea that managers can repurchase the firm's stocks at a lower price than an average investor can.

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### 1. Introduction

The past few decades have witnessed a substantial increase in share repurchases (primarily open market repurchase (OMR) programs) by firms as a method for distributing earnings to their stockholders, as documented by [Fama and French \(2001\)](#), [Grullon and Michaely \(2002\)](#), [Julio and Ikenberry \(2004\)](#) and [Peyer and Vermaelen \(2009\)](#) in the United States (US), and by [Oswald and Young \(2004\)](#) and [Ferris, Sen, and Yui \(2006\)](#) in the United Kingdom (UK). In addition, as new legislation within the European Union (EU) and in other parts of the world has been introduced, a number of countries removed restrictions on share repurchases in the 1990s.<sup>1</sup>

Several explanations for why firms use share repurchases have been addressed in the literature. For instance, [Dann \(1981\)](#),

[Vermaelen \(1981\)](#), [Ikenberry, Lakonishok, and Vermaelen \(1995, 2000\)](#), [Ikenberry, Lakonishok, and Vermaelen \(2000\)](#), [Chan, Ikenberry, and Lee \(2004\)](#) and [Peyer and Vermaelen \(2009\)](#) argue that firms use share repurchase programs to correct a perceived undervaluation. [Dittmar \(2000\)](#), [Jagannathan, Stephens, and Weisbach \(2000\)](#), [Grullon and Michaely \(2002\)](#) argue that share repurchases should be viewed as a substitute for cash dividends. [Bagwell and Showen \(1989\)](#) and [Oded \(2005\)](#) argue that a repurchase program is a shift towards the optimal capital structure in the firm, while [Kahle \(2002\)](#) reports that repurchase programs are used to offset dilution effects caused by share options to employees.

Most prior studies of the announcement of a share repurchase program document an increase in the stock price of the firm in the short-run and in the long-run. The most frequent explanation of the short-term abnormal return is that the announcement is a signal that the stock is undervalued (the signaling hypothesis). Evidence of long-run abnormal return following the announcement is consistent with the view that corporate managers are informed and re-acquire shares (the managerial timing hypothesis) and that the market reaction is incomplete.

However, because the findings and interpretations of share repurchases are primarily based on studies performed in the US, they may not be applicable to other countries. Therefore, more empirical studies from other markets with different regulations and disclosure rules seem appropriate. For instance, repurchase programs in the US can take several years to complete ([Cook, Krigman, & Leach, 2004](#)), whereas in Korea, the program must be

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\* Tel.: +46 0498 299900; fax: +46 0498 299963.

E-mail address: [adri.deridder@fek.uu.se](mailto:adri.deridder@fek.uu.se)

<sup>1</sup> Example of countries (year) that have removed restrictions on share repurchases are Australia (1989), Hong Kong (1991), Korea (1994), Denmark (1995), Japan (1995), Finland (1997), Poland (1997), France, Germany and India (1998), South Africa and Norway (1999) and Sweden (2000).

completed within three months (Lee, Jung, & Thornton, 2005). One extreme country is Japan, where regulators require firms to complete their program within 10 years (Ishikawa & Takahashi, 2011). Within the EU, and following several amendments to the directive 2006 (2006/68/EU and EUT L 264, p. 32), the former rule restricting share repurchases to a maximum of 10% of outstanding shares was removed. The maximum approved program length was also extended from 18 months to five years.<sup>2</sup> Note, however, that each member state of the EU can deviate from these directives within its own legislation. For a description of payout policies and repurchases in the EU, see von Eije and Megginson (2008) and Lee, Ejara, and Gleason (2010), respectively.

Although numerous studies have examined share repurchases with mixed results, more studies related to share repurchases deserve a thorough investigation. This article adds to the repurchase literature on the effect of the frequency of programs and the managerial timing issue by exploiting a superior dataset.

One strand of prior studies relates OMR-programs to the frequency. The seminal study by Jagannathan and Stephens (2003) examines OMR-programs in the US after grouping firms based on the frequency of programs. Because the duration of a program in the US is not pre-determined, they classify programs based on the frequency over a five-year period: the first program is defined as infrequent, the second is defined as occasional and the third and subsequent programs are defined as frequent. Furthermore, it is also plausible to believe that a firm that announces repurchase programs more frequently has different motives compared to firms that announce only one program. They report that frequent repurchasers are larger, have less variation in income and have higher payout ratios. Similar findings for Australian firms are reported by Farrugia, Graham, and Yawson (2011). Prior studies regarding subsequent stock returns in OMR-programs, after controlling for frequency, have provided mixed results, as they use different definitions and methodologies. Jagannathan and Stephens (2003) found no difference in the return (size and industry matched) in the two-year period following the announcement between frequent and multiple programs. Lee et al. (2005) split their sample firms into two groups: firms with one and firms with two or more programs, and they report that only firms in the former group are associated with abnormal returns in the year following the announcement of a program. Yook (2010) use actual repurchase data and show that infrequent programs (firms with no additional announcement of a program during the three-year post-announcement period) have an average annual abnormal return of 4.8% over the first year for a sample of US firms. For frequent programs, the corresponding value was 2.4%, but it was statistically insignificant. The study by Farrugia et al. (2011) reports that firms with infrequent and occasional programs have higher raw returns compared to firms with frequent programs in the year following the announcement.

Another strand of prior studies examines whether firm managers possess managerial timing skills; specifically, the question is whether firm managers can repurchase shares at a low stock price. Two earlier studies, namely, Brockman and Chung (2001) and Cook et al. (2004), report that firms listed on the Hong Kong and New York stock exchanges, respectively, exhibit timing skills. Additional evidence of timing skills related to repurchases in Canada is

reported by McNally, Smith, and Barnes (2006) and McNally and Smith (2007), who contrast the findings by Ginglinger and Hamon (2007) and Bonaimé, Hankins, and Jordan (2012), which report no evidence of timing skills in France and in the US, respectively.

This study differs from existing literature as it analyzes OMR-programs using data that avoid problems related to the methodology used in prior studies. For instance, it is not plausible that firms can signal and correct a perceived undervaluation by announcing an additional program shortly after the first program. Thus, the frequency of programs should be considered. Additionally, the interpretation of the long-run abnormal return following the announcement of a program is unclear, as the firm usually releases several announcements (e.g., interim reports, new OMR-programs) after the first program has been announced. Moreover, in the analysis of whether firm managers possess timing abilities, periods when repurchases are not allowed due to regulations must be explicitly considered. Finally, and following a regulatory change in the US of the Securities Exchange Act of 1934 (effective December 2003), which requires that firms disclose their share repurchases each quarter and average prices paid, some authors state “the need to re-examine the results of earlier studies of share repurchases in light of the accurate repurchase data now available in SEC Forms 10-Q and 10-K” (Banyi, Dyl, & Kahle, 2008, p. 462).

Our insights into OMR-programs can be improved, as there appears to be no clear consensus in the literature of whether the frequency of programs influence stock returns and whether managers in repurchasing firms have timing ability. This study answers two primary questions related to OMR-programs. First, does the frequency of a program have any influence on subsequent stock returns? Second, do firm managers exhibit timing ability and is it related to the frequency? Using detailed data for OMR-programs in Sweden, where the duration of each program is pre-determined, I first analyze stock prices for firms using the calendar-time methodology. Next, I explore the issue of managerial timing by monitoring daily share repurchases and periods when repurchases are not allowed (“silent periods”).

In summary, prior empirical literature related to OMR-programs after controlling for frequency and whether managers possess timing ability are inconclusive, as prior studies have examined different markets, different methodologies and different sample sizes and periods. Recent US studies, using detailed data reported in filings to the Securities and Exchange Commission (SEC), provide no strong evidence for managerial timing skills. Ben-Rephael, Oded, and Wohl (2010) report that only small capitalization firms repurchase at a price lower than the market price. De Cesari, Espenlaub, Khurshed, and Simkovic (2011) report similar results, while Bonaimé et al. (2012) show that stock prices on average are higher in repurchasing quarters compared to non-repurchasing quarters.

A study with a focus on multiple programs must overcome four problems related to data and methodology. First, the issue of whether the firm has or has not activated its approved program must be determined. Second, to avoid overlapping programs, the exact duration and time horizon of each program must be identified. Third, if repurchase activities are regulated by silent periods, the analysis of managerial timing skills must explicitly consider these periods. Fourth, the look-ahead bias (the endogeneity problem) must be resolved; thus, if the firm after repurchase has corrected the perceived undervaluation and the firm refrains from additional programs, the analysis of subsequent stock returns must explicitly consider this.

I present three main results in the article. First, I find that firms with infrequent (frequent) programs on average have smaller (larger) programs. Second, after controlling for the frequency of programs, I document that firms with frequent programs

<sup>2</sup> In the Nordic countries, Norway has maximized the repurchase size to 10% of total outstanding shares and the length of the program to 18 months. Denmark does not have any restrictions on the repurchase size, but the maximum length of the program is five years. Finland has maximized the repurchase size to 10% of outstanding shares and the length of the program to 18 months. Currently, there is a proposal to remove the 10% level and keep the existing maximum program length of one year in Sweden (Fyra aktiebolagsrättsliga frågor, Ds 2010:8, Justitiedepartementet, Stockholm, 2010).

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