THE EFFECT OF SHARE REPURCHASE ON THE PERFORMANCE OF COMPANIES LISTED ON BURSA MALAYSIA

Nurul Izza Abd Malek *, Mohamad bin Jais , Kho Lian Hoe.
Faculty of Economics and Business,
Universiti Malaysia Sarawak, 94300 Kota Samarahan, Sarawak, Malaysia
Corresponding e-mail: amnizza@unimas.my*

ABSTRACT

The aim of this research is to examine the impact of share repurchase towards the performance of listed companies in Bursa Malaysia. Share repurchase has become significantly popular in recent years. It has been recognized as one of the effective tools to enhance communication between companies and their shareholders. This research consists of two specific objectives; to examine the relationship between repurchases of shares and the performance of listed companies on Bursa Malaysia and to examine the relationship between Share repurchase and return on asset (ROA). This research comprises several theories such as signaling theory, efficient market hypothesis, free cash flow hypothesis as well as substitution hypothesis. In this research, company performance is the dependent variable while the independent variables are known as share repurchase. The impact of independent variable towards dependent variable has been examined in this research. Furthermore, asset turnover, cash flow margin, leverage, and market-to-book ratio of company was the control variable. This research has employed secondary data to examine the effect of share repurchase towards listed company's performance in Bursa Malaysia. The data was derived from several sources such as Bursa Malaysia official website, annual report of the company as well as DataStream database. Several statistic tests have been carried out to test the objective of research.

INTRODUCTION

Share repurchase was initially not allowed in Malaysia. However, starting from the date of 1 September 1997, share repurchase has been approved and was made permissible in Malaysian market. The market then realized there is an increase in number of companies repurchasing their shares from investors and shareholders in the open market. This is due to the drop of share prices in 1997. During the early stage of the Asian financial crisis from 1997 to 1998, a decision of the authorities on policy change has been made to allow companies to repurchase their shares, which are currently undervalued from their investors or shareholders. This is expected to help in stabilizing the weakening market (Isa, Ghani, & Lee, 2011).

Malaysia, companies can buyback their own shares from their shareholders or investors through the open market only. There is a maximum of 10% of the number of outstanding shares is allowed for the company when buying back their shares from shareholders or investors. The company plans to buy back their shares has to get the approval of their shareholders or investors hen buying back their company's shares. This approval can be obtained during AGM, also known as the annual general meeting of the company or during an extraordinary general meeting. The validation period of the approval from shareholders or investors to the company for share repurchase is within one year or some is until the next annual general meeting of the company's shareholders. The approvals of the shareholders or investors need renewing if the progress of share repurchase is not completed within the approval year (one year).

According to Ikenberry, Lakonishok, and Vermaelen (1995), there are several motivations for companies to buy back their shares from their investors, which include preventing takeover risk, company's capital structure adjustment, distribution of excess cash, signaling, wealth expropriation from bondholders and substitution for cash dividends. A study by Miller and Rock (1985) mention that share repurchases were used by the manager of a company to give signals about better prospects. When the market is incomplete, the repurchase of shares can be used to signal the future cash flows of a company. In other words, the decision of share repurchase can reflect certain information such as the profitability of the company to the investors. This concept can be explained by using signaling theory. The purpose of a company to buy back its shares is to signal the public that the company is currently performing well and will become better in the future. Thus, the purpose of this research is to examine the effect of share repurchase on the performance of company listed on Bursa Malaysia.

LITERATURE REVIEW

This section will review related theories, previous literature and hypothesis development, which can be used to explain the relationship between share repurchase and the company performance.

Signaling Theory

According to Connelly, Certo, Ireland, and Reutzel (2010), signaling theory is described the behavior of two parties when there is asymmetric information accessed by them. Spence (2002) supported that signaling theory can be used to reduce asymmetry information between different parties. A study of corporate governance by Zhang and Wiersema (2009) shows the way which company's CEOs give signal to the potential investors regarding the non-observable quality of their company through the observable quality of company's financial statements. Several researchers applied signaling theory when they are explaining about the way companies communicate adherence to social values to the stakeholders of an organization by using heterogeneous boards (Miller & Triana, 2009).

The decision-making processes of individuals or groups can be influenced by information. Public information is the information which is freely available and can be easily access by individuals. On the other hand, private information is only available or accessible to certain group of individuals from the public (Connelly et al., 2010). Stiglitz (2002) claims that when there is situation such as "different people know different things", then there is information asymmetries. This is due to some information is private and only accessible to certain group of people.

However, based on Johnstone and Grafen (1993), the signalers were suspected to have an incentive to "cheat" or provide information which is not true. This is due to the partial competing interests between the signalers and receivers. By providing the false information, the company misleads the decision of public to select them as their choice. Westphal and Zajac (2001) stated that some companies initially signal their investors or stockholders regarding future stock repurchase but do not exercise it at last. This situation shows the discrepancy between formal plans and subsequent actions by the company. It is called as decoupling. A reputation for dishonesty might be developed due to companies and their executive have decoupled their formal plans and subsequent actions from time to time. Due to this reason, Signal honesty has been referred by the management scholars, which means there is quality-signaler associated with the signal.

There are several reasons found in different literature which are, to distribute excess cash to investors of the company when there is lack of investment opportunity in the current market, to avoid any takeover by potential parties, to signal the market regarding the undervaluation of shares, to make adjustment on the financial leverage of company and others (Lee, Ejara, & Gleason, 2010). According to Punwasi and Brijlal (2016), the signaling theory explains about the 'signal' provided by the management of a company to the market, enable the current market to realize the undervaluation of market price of the shares. Initially, information asymmetry between management and investors is expected to be occurred. There is a higher tendency for a company's value to be obscured due to information asymmetry when there is higher degree to assess the value of a company. Therefore, the issue of undervaluation is unlikely to occur on the company.

Punwasi and Brijlal (2016) also claimed that the ability of company to acquire back the shares