

Information Content of Share Buybacks from an Earnings Perspective (Kandungan Maklumat Pembelian Semula Saham dari Perspektif Pendapatan)

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ABSTRACT

This study aims to examine the predictive ability of share buybacks from an earnings perspective. Panel data regression analysis is conducted to determine the impact of share repurchases on future firm performance using Malaysian publicly listed companies data over 2000-2020. This study is significant because of the importance of share buybacks to attract investors, especially during crisis periods. The results show that the share repurchase ratio is positively and significantly related to all the proxies for future firm performance, as represented by return on assets, return on equity, operating income, and funds from operations that are all measured in the following year of share buyback. The validity of the result is confirmed when tested with an alternative explanatory variable, while the sensitivity test shows that the signaling power of share repurchase is more apparent among share-repurchasing firms with small market capitalization. Overall, the findings support the information signaling hypothesis and suggest that share buybacks in Malaysia provide useful information about a company's earnings prospects.

Keywords: Signaling theory; information signaling hypothesis; payout policy; share repurchase; Malaysia

ABSTRAK

Tujuan kajian ini adalah untuk mengkaji keupayaan ramalan pembelian balik saham daripada perspektif pendapatan dalam kalangan syarikat senaraian awam di Malaysia. Analisis regresi data panel telah digunakan untuk menentukan kesan pembelian semula saham ke atas prestasi firma pada masa hadapan dalam tempoh sampel 2000 hingga 2020. Kajian ini sangat signifikan kerana kepentingan pembelian balik saham untuk menarik pelabur, terutamanya semasa tempoh krisis. Dapatan kajian menunjukkan bahawa nisbah belian balik saham adalah secara positif dan signifikan dipengaruhi oleh semua proksi untuk prestasi firma masa hadapan, seperti yang diwakili oleh pulangan ke atas aset, pulangan ke atas ekuiti, pendapatan operasi dan dana daripada operasi yang semuanya diukur pada tahun berikutnya pembelian balik saham. Kesahihan keputusan itu disahkan apabila diuji dengan pemboleh ubah penjelasan alternatif, manakala ujian kepekaan menunjukkan bahawa kuasa isyarat pembelian balik saham lebih jelas dalam kalangan firma pembelian semula saham dengan permodalan pasaran yang kecil. Secara keseluruhan, penemuan kajian menyokong hipotesis isyarat maklumat dan mencadangkan pembelian balik saham memberikan maklumat berguna tentang prospek pendapatan syarikat.

Kata kunci: Teori isyarat; hipotesis isyarat maklumat; dasar pembayaran; pembelian semula saham; Malaysia

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INTRODUCTION

The acquisition of a company's shares from the market is referred to as a share buyback or share repurchase. When repurchasing shares, Malaysians are subject to capital gains tax, but only when selling shares that have appreciated in value. As compared to dividends, share repurchases offer greater flexibility since companies are not obligated to buy back shares even after they announce a buyback program (Graham et al. 2021). Dividends, on the other hand, require a firm commitment over time and are more rigid because any change to the size of the dividend payment can easily cause the market to react negatively (Parrino et al. 2018).

Share repurchase was observed in the United States (U.S.) since the early 1980s and then quickly spread to the United Kingdom and Canada in the 1990s. Subsequently, other countries that had previously forbidden share repurchases began to permit such transactions. For instance, share repurchase was legalized in Hong Kong in 1991, Japan and Korea in 1994 and Finland in 1997. Meanwhile, France, Germany and Singapore authorized share repurchases in 1998. Following that, Norway, India and South Africa allowed share repurchases in 1999, while Taiwan, Denmark and Sweden permitted them in 2000. In Malaysia, it was not legal to buy back shares until September 1, 1997. The Asian Financial Crisis of 1997 impacted asset prices on the Kuala Lumpur Composite Index and caused the Malaysian ringgit to depreciate. In order to help the country recover from the aftermath of the crisis, share repurchases were permitted.

Despite the fact that there are several types of share repurchase, only open market repurchase is allowed in the context of the Malaysian market. Nevertheless, the single method of open market repurchase makes it easy to retrieve data for share repurchases, which encourages the study to focus on the Malaysian market. As compared to other countries, Malaysia's share repurchase regulations are rather stringent since various restrictions are in place, including controls on the timing, volume, price and reporting of transactions. Before initiating a share repurchase, approval from shareholders is required, which can be obtained at an annual general meeting or an extraordinary general meeting. The approval is valid for one year, and if the share repurchase is not completed within the stipulated period, a new approval must be obtained.

Building on the notion of asymmetric information, Bhattacharya (1979), Vermaelen (1981) and Miller and Rock (1985) theorized that managers purposefully deliver explicit signals about the future earnings of a firm through payout decisions at the cost of the management level, which led to the information signaling hypothesis (Miller & Modigliani 1961). Since then, numerous studies have investigated the association between share repurchases and future earnings (Evans & Evans 2001; Huang et

al. 2010; Jagannathan & Stephens 2003; Lie 2005), especially in the developed market, yet no consistent conclusion has been derived regarding this issue.

The 1997 Asian Financial Crisis caused the Kuala Lumpur Stock Exchange Composite Index to plunge 58% from its high that year. A volatile environment during the peak of the financial crisis called for share buybacks in Malaysia to stabilize the market. Moreover, the uncertainties brought about by a historic change in government as well as trade tensions between the U.S. and China had led to a sharp decline in the Malaysian stock market in 2018 (Toh 2019). Subsequently, RM1.56 billion was spent on share buybacks in 2018, which was nearly six times the amount spent in 2017 of RM264 million. However, it was claimed that companies tend to use share buybacks to manipulate stock prices, especially when managers are seemingly under heavy pressure to boost stock prices, they might have announced a repurchase only to convey a false signal. In the views of Malaysia's Minority Shareholders Watch Group (2020): If a company buys back its shares for the sole purpose of stabilizing its share price regardless of the intrinsic value, such action could be tantamount to creating a false market, an offence under the securities laws.

Based on the argument of false signals, we wish to evaluate whether share repurchases are potentially used by managers to mislead investors or to indicate real earnings growth in the future. As it is not specifically mentioned under the information signaling hypothesis which performance metric the managers wish to communicate to the investors, it is, therefore, significant to test the predictive ability of share repurchases towards firm prospects with different earnings indicators measured from multiple perspectives. Hence, the current study intends to fill the research gap by examining the impact of share repurchases on various proxies of future firm performance among Malaysian publicly listed companies.

From a theoretical perspective, findings from the current study could contribute to the literature by confirming the signaling theory and adding to the existing literature on the information signaling of share repurchases, especially in the developing market context of Malaysia. Besides, share buybacks are not only a regular source of income for investors but also an important input into the valuation of a firm. Hence, from a practitioner's viewpoint, the findings from the current study shall serve as a reference for investors in strategizing their investment plan through clarification between the probability of a false signal and real intrinsic value as conveyed by share buybacks.

The remaining sections of the article are structured as follows. Section 2 summarizes prior research. Section 3 describes the data, methodology and empirical model of the research. Section 4 discusses the empirical findings, while Section 5 wraps up the paper.