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**ANNOUNCED REASONS AND ANTICIPATED RESULTS
OF SHARE REPURCHASE PROGRAMS
– CASE OF WARSAW STOCK EXCHANGE COMPANIES**

1. INTRODUCTION

The article aims to present the meaning of the share repurchase (also referred as buy back or buy-back) programmes and to identify the reasons announced and potential results of share repurchase made by firms listed on the Warsaw Stock Exchange (WSE) in Poland.

The main hypothesis to be verified states that there are more reasons to repurchase shares than just a cash transfer to shareholders and there are different results than just diminish cash holding.

The problem is significant enough for since share repurchase in the literature is deemed as a substitute for dividends and as another way for cash transfer to shareholders [Horbaczewska 2012; Pieloch 2012; Duraj 2008]. But the author strongly believes that share repurchase might be used, for example, as one of the tools conveying information about the company to the financial market. It means that share repurchasing possesses information content which stems from the reasons for shares repurchase and might be used to convey specific information to their shareholders. Another aspect of share repurchase is that companies buy back their shares to mitigate the conflicts of interest between the management and the shareholders.

2. SHARE REPURCHASE PROGRAMS POPULARITY

In recent years share repurchase programs have become an important financial management tool. E. F. Fama and K. R. French found that in the years 1978–1999 the proportion of dividend payers fell from 66,5% to 20,8% [Fama

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and French 2001: 3–43]. G. Grullon and R. Michaely found that expenditures on share repurchase programs (related to total earnings) increased from 4,8% in 1980 to 41,8% in 2000. Consequently, share repurchases as a percentage of total dividends increased from 13,1% in 1980 to 113,1% in 2000 with the amount of 200 billion dollars. Grullon and Michealey also found that the amount of share repurchase as a percentage of net profit increased from 4% to 31% and the number of companies repurchasing their shares increased from 31% in 1972 to 80% in 2000 [Grullon and Michaely 2002: 1649–1684]. In 1999 and 2000 industrial firms spent more money on share repurchases than on dividend payments. It means that for the first time in history, share repurchase programs have become more popular than dividends. The number of US companies and the amount of money spent on dividend payment were reduced, while the number of companies and money spent on share repurchase increased [Fama and French 2001; DeAngelo et al. 2004: 425; Hrdlicka 2006].

Due to the financial crisis, American companies diminished the amount of money spent on dividend and share repurchase. Yet, they did not stop paying. In 2007 money spent on share repurchases reached the amount of \$170 bn, in 2008 reduced to \$80 bn, and in 2009 to \$30 bn, but in 2010 they soared to 78 bn dollars [Demos 2011]. In 2012 American companies' expenditures on share repurchase program reached the level of 274 billion dol. This amount is higher than the amount of money raised in IPO in 2012 [Linebaugh 2012].

Even in Poland, the popularity of share repurchases has been growing for a couple of years. It is important to mention that in 2004 in Poland there were amendments to Commercial Code and then share repurchase procedure was eased. The years 2008 and 2012 are crucial as the number of companies repurchasing their shares increased to more than 40. It is about 12.5% of companies listed on the Warsaw Stock Exchange (WSE). There were also two other years when the number of companies repurchasing their shares was significant – these were 2009 and 2011 when the number of these companies increased to about 30. It is also about 10,0% of all the companies listed on WSE.

3. THEORIES OF SHARE REPURCHASE

There are various theories in the literature that try to give rationale behind stock repurchase. The similarities between dividends and stock repurchases allow perceiving them as the two ways of payout policy (cash distribution to stockholders) and make it easier to apply the dividend theories to stock repurchases.

At the most fundamental level, the dividend irrelevancy theory of Miller and Modigliani states that share repurchases and dividends are perfect substitutes (substitution hypothesis) for each other, provided that capital market is perfect

and complete and provided that the investment policy is determined [Miller and Modigliani 1961: 411–433]. By this assumption, firms pay residual cash to investors either through dividends or share repurchases without affecting the value of the firm. Miller and Modigliani [1961] prove the irrelevance of cash payout to firm value under perfect market assumptions. Relaxing the perfect market assumptions to let managers be better informed, they suggest that payout policy can reveal unrecognized firm value.

Another theory is clientele hypothesis; the authors were Litzenberger and Ramaswamy [1980: 469–4825]. The theory was developed by Allen, Bernardo and Welch [2000: 2499–2536]. This hypothesis states that investors enjoy specific preferences and they buy shares of the company whose policy and the course of action they accept, and they sell shares when they feel dissatisfied with the company's policy and performance. The clientele hypothesis is also explained by the differences in tax rates or heterogeneous tax status of shareholders. Marginal tax rates faced by investors might be dominant while deciding on share repurchase.

Miller and Modigliani also suggests that when markets are incomplete, firms can convey information about future cash flows through changes in payout policy. The idea of share repurchase information content draws on information asymmetry and signaling hypothesis. The separation ownership and management creates asymmetry in the information gained by owners and managers. The manager knows more and has better and thorough knowledge on the company operating activities. It means that the manager possesses private information about the firm, the one not shared with the market. And this asymmetric information has the impact on the investor decisions. Judging by decisions and actions taken by managers, investors can react properly. This situation leads to conclusion that managers' decisions and actions have information content and might convey information (signal) to the investors. The theory of information content and signaling hypothesis was developed by Ross [1977: 23–40] and Battacharya [1979: 259–270]. But the best known models are those of Bhattacharya, Miller and Rock [1985: 1031–1051], and John and Williams [1985: 1053–1070].

The signaling models suggest that firms adjust cash distribution level to signal their prospects. A rise in dividends or a declaration of a stock repurchase program typically signal that the firm will do better. If the company expects good future and expects to generate cash flow from future activities it is more prone to distribute cash. The signaling models suggest also that the managers might convey information on their own valuation of the firm [Ofer and Thakor 1987: 365–394]. If there is, in managers' opinion, disparity between firm's intrinsic value and market valuation, the companies are more willing to repurchase their shares. But share repurchase is very costly signal and as a signal of good

news it must be costly, so that other companies can not easily copy, otherwise the signal is void.

Another theory – agency theory was developed by M. C. Jensen and W. H. Meckling [1976: 305–360]. The main idea of this theory is that the agent (manager) and the principal (owner) have got different scope of duties and different interests. Agency theory suggests also that firms with free cash flows in excess of their investment opportunities are likely to spend them on value-destroying projects which reduce the firm's value. Grossman and Hart [1980: 42–64], Easterbrook [1984: 650–659], Jensen [1986: 323–329] argue that if shareholders can minimize the cash management controls, it will be much harder for management to engage in unmonitored spending. One way to take excess cash from the firm is to increase the level of payout (free cash flow hypothesis). In the presence of information asymmetry between investors and managers, Easterbrook and Jensen argue that managers are imperfect agents of investors and cash payout can mitigate agency conflicts [Easterbrook 1984; Jensen 1986].

4. REASONS FOR THE SHARE REPURCHASE AND THEIR EFFECTIVENESS

Share repurchases are deemed as a part of the excessive amount of money of payout policy and, thus, are treated as a substitute for dividends. But sharing with stockholders is not the only reason for share repurchase. It seems that there are also other reasons for share repurchase. The managers repurchase shares for the following reasons both internal and external [Horbaczewska 2012; Hsieh and Wang 2009]:

- 1) internal:
 - a) transferring cash to shareholders,
 - b) changing the capital structure,
 - c) changing the ownership structure,
- 2) external:
 - a) stabilizing share prices,
 - b) improving financial ratios.

Transferring cash to shareholders by share repurchase diminishes the amount of cash in the company. It is consistent with the free cash flow hypothesis and the agency theory. Diminishing the amount of cash mitigates potential over-investment. The lower level of cash encourages the management to make more effort while using money left in the company more effectively. The decision to repurchase shares in order to transfer free cash to shareholders is the subsequent decision. The main decision is to decide how much money the company is able to transfer to the shareholders (and how much to investment in the company itself). And then, once the company is aware the amount of cash available to the

shareholders, it has to decide on the way of transferring the money; whether by paying out dividend or by repurchasing shares. It is consistent with the substitution hypothesis. Share repurchase diminishes the amount of shares and the level of equity. It means that capital structure (equity – debt relation) is also changed. This relation should be changed only when the company is able to gain positive effects of leverage.

Share repurchase results also in changing ownership structure. When company announces share repurchase program, the dissatisfied investors might exercise their right to leave, while the voting power of the remaining investors (satisfied and loyal) gains in strength. Such an action is only support for the clientele hypothesis.

Repurchasing shares in order to change the ownership structure might be also used as a means of defense against hostile takeovers. But the price of share repurchased must be higher than offered by bidder. With large dispersion of shares and investors, after share repurchase, even investors holding small blocks of shares might have big impact on resolutions.

Share repurchase might be also used while creating employee ownership. Shares might be repurchased from the market and distributed to managers and employees as a kind of incentive. It also proves the agency theory because when managers and employees are owners they are more motivated and encouraged to make efforts more effective in order to meet the company's objects.

Stabilizing share prices affects the market share prices and is the most connected with information content and signaling hypothesis. The managers having a better knowledge on the company and taking decision on repurchasing shares send a specific signal. Repurchasing shares is a sign of managers being convinced that the shares are undervalued and the market share price should be higher. It means that managers believe that the actual situation and future prospects are good and satisfactory enough. The managers would not repurchase shares if they were not convinced of higher intrinsic value than the one of the market share prices. When getting a signal on shares undervaluation investors might become interested in buying these shares (because of their undervaluation and potential future higher profits per share).

What is more, while repurchasing shares, the company diminishes the amount of listed shares. These two aspects (the signal of undervaluation and the diminished number of listed shares), even under constant demand, lead to an increase in the market share price. Another aspect is that repurchasing shares, the company transfers cash to shareholders. This in turn is also a signal that company's financial prospect are not at risk. This is the way the managers want to show that company may expect good prospects and is able to gain necessary cash flow from future operations.

Share repurchase diminishes the amount of listed shares and equity. It changes and improves market ratios such as ROE or EPS. As these ratios are

important for investors, their improvement means that potential investors would be eager to buy the company's shares. These might lead to an increase in P/E ratio and, subsequently, to the rise in demand and share prices.

Clearly, there are many reasons for share repurchase. But it is worthwhile noting that repurchasing shares in order, for example to change capital structure, might result in share prices rise. Managers might achieve various results at the same time while repurchasing shares.

5. REPURCHASED SHARES ALLOCATION

While discussing the theories and reasons it is important to mention the way the shares are used after being repurchased from shareholders. According to Polish Commercial Code there are different procedures of using repurchased shares which are the following:

- 1) share repurchase resulting in redemption of repurchased shares or
- 2) share repurchase conducted in order to further resale repurchased shares.

Redemption of shares means that the number of shares issued and listed decreases. Redemption of shares brings to reduction of the owners' authorized capital and equity. It means that the level of equity is lowered permanently.

If the equity level is lowered, the equity – debt relation is also changed. Although the level of debt is not changed, the share of debt in capital increases as the level of equity diminishes. There is also change in total assets level and in their structure. Because companies buy their shares, they pay money, and the level and share of current assets is diminished. It leads to decrease in the level of liquidity.

Repurchasing shares with their redemption results in diminishing the number of shares. While the demand is constant, the supply falls, and it helps to maintain or increase the price of shares.

If the equity level and the number of shares is permanently lowered, the financial ratios such as EPS (earning per share), ROE (return on equity) increases. It does not mean that the earnings are higher but the denominator (the number of shares, the level of equity) diminishes. The rise in the level of financial ratios is done automatically with redemption of shares.

Repurchasing shares with their redemption allows to achieve all reasons mentioned above (transferring cash to shareholders, changing capital structure, changing ownership structure, stabilizing share prices and improving financial ratios).

Repurchasing shares for further resale means that the number of issued shares does not change. But the number of listed shares diminishes. The level of equity is temporarily lowered as long as the company holds its own shares (until their resale). Also the relation debt-equity and structure of total assets is changed

temporarily. After shares resale, the companies regain the level and structure of their balances (assets and liabilities).

Repurchasing shares for further resale allows reaching some (although not all) of the reasons mentioned above (transferring cash to shareholders, changing ownership structure, stabilizing share prices).

The usage of repurchased shares (shares redemptions or their further resale) affect the effectiveness of the share repurchase programs. It is also the important factor influencing the extent the aims of share repurchase program are met. The allocation of repurchased shares leads to achieving different results.

6. METHODOLOGY OF RESEARCH

The research is focused on the announced reasons and expected results of share repurchase started by listed companies. The article analyses selected statistical data of the listed companies that repurchased their shares from Polish stock exchange (Warsaw Stock Exchange). The table reports the number of companies that started share repurchase in subsequent years with the announced reason and allocation of share repurchase. The survey does not cover companies that only announced share repurchase not followed any action. Nor does it cover the companies that continued repurchasing their shares either (companies are included into research once only).

The survey covers the years 2005–2012. It is important to mention that in 2004 in Poland there were amendments to Commercial Code and then share repurchase procedure was eased. The analysed period covers the years of both prosperity and crisis.

The total number of companies that started repurchasing their shares exceeded 200. It is almost half of the companies listed on WSE. The table indicates that the number of companies repurchasing their shares is growing. The years 2008, 2009, 2011 and 2012 are crucial as the number of companies repurchasing their shares increased to more than 30. It is about 10–12% of companies listed on Warsaw Stock Exchange (WSE).

Under The Polish Commercial Code there is no requirement to indicate the reasons for repurchased share. It is more often than not that companies indicate no reason for share repurchase. About 70% of all companies that started share repurchase in the years 2005–2012 do not indicate any reason.

Common reason for repurchasing shares is incentive program for managers and employees. About 14% of all companies repurchasing their shares indicate this reason. It is especially true for 2007, 2008 and 2011 – the years of economic slowdown. And repurchasing shares in order to transfer them among employees and managers is consistent with agency theory.

Table 1

Reasons for share repurchase indicated by Polish companies listed on WSE

Year	Number of companies that started share repurchase	Share redemption			Further resale			None	Many
		Total	Cash distribution	Undervaluation	Total	Incentive system for employees	Capital group restructuring		
2005	22	19	3	4	3	2	1	0	0
2006	14	10	0	0	3	1	2	0	1
2007	11	9	0	0	2	2	0	0	0
2008	40	28	0	4	10	4	1	2	0
2009	30	13	0	3	9	6	1	4	4
2010	17	6	0	1	3	1	2	1	7
2011	33	8	0	1	10	7	2	3	12
2012	45	17	0	6	13	3	5	4	11

Source: first hand collected data from individual websites of listed companies.

Another reason indicated quite often by Polish companies is restructuring of their capital group (it refers to 8% companies repurchasing their shares). It is connected with mergers and acquisition. It mostly occurs when repurchased shares are used to pay for the acquired company. In some cases, it refers to the shares remained after the companies got merged.

Only 9% of all companies indicated undervaluation as the reasons for the share repurchase. These companies stated that „current situation on the financial markets does not reflect the actual value of the company”. All of these companies were willing to repurchase their share using procedure that results in share redemption. Share redemption leads to diminishing the amount of shares and the level of equity permanently. Share redemption reflects that the company is able to meet almost all the targets mentioned above. It especially holds true in respect of changing capital structure, changing ownership structure, and improving financial ratio (ROE, EPS). And what is more, with share redemption the supplies of shares decreases and the stable demand leads to the rise in the share price.

Only 3 companies (1,4% of all companies repurchasing their shares) admitted that they repurchase their share in order to transfer cash to their shareholders.

Under The Polish Commercial Code there is no requirement to indicate the allocation of repurchased share. Thus, it is only optional and good will when companies indicate the usage of share repurchase. But the majority of companies repurchasing their shares (more than half) indicate shares redemptions. About 26% of all companies repurchasing their shares indicate their further resale. In recent years, it has been more often than not (30% of all companies that started

to repurchase their shares in 2012) that companies indicate no usage or many usages of repurchased shares. It suggests that they do not want to reveal what they intend to do with repurchased shares. In this manner the managers are given a wide leeway to take decision on allocation and usage of repurchased shares at their convenience.

7. RESULTS

The aim of the article was to identify the announced reasons and potential results for share repurchases. The research was carried out by analysing the announcements of companies repurchasing their shares on the Warsaw Stock Exchange.

On carrying out the research for the listed companies, I found that shares might be repurchased for many different reasons and not only to signal the excessive amounts of cash held in the corporation. Viewing the numbers it is possible to state that transferring cash is the least important reason for repurchasing shares. It is likely that the research was done in the years of financial crisis and the companies did not want to dispose the cash holding it as a reserve for potential worse times.

It is also possible to conclude that managers are not willing to share with investors the reasons of share repurchase. It is possible to state that companies expect investors themselves assign reasons to share repurchase according to their knowledge. And usually share repurchase is deemed as action bringing good news.

It is also possible to notice that the true reasons are known to management, strategic investors, but not to minority shareholders. Thus, share repurchase programs allow minority owners to give up investing in the company and allow strategic investors to strengthen their voting power.

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On carrying out the research for the selected listed companies, I found that shares might be repurchased for many different reasons and not only to signal the excessive amounts of cash held in the corporation. Viewing by the numbers it is possible to state that transferring cash is the least important reason while repurchasing shares.

**DEKLAROWANE PRZYCZYNY I PRZEWIDYWANE SKUTKI
WYKUPÓW AKCJI WŁASNYCH SPÓŁEK NOTOWANYCH NA GPW**

Celem artykułu jest przedstawienie znaczenia wykupów akcji własnych, identyfikacji deklarowanych przez spółkę przyczyn wykupów akcji oraz potencjalnych skutków wykupów akcji (z uwzględnieniem umorzenia odkupionych akcji lub dalszej ich odsprzedaży). W literaturze dominuje przekonanie, że spółki dokonują wykupów akcji głównie w celu przeznaczenia nadwyżek gotówki na rzecz właścicieli. Główną hipotezą poddaną weryfikacji było stwierdzenie, że spółki wykupując akcje realizują większy zakres celów niż tylko dystrybucja gotówki. Przedmiotem badań były spółki notowane na Giełdzie Papierów Wartościowych w okresie 2005–2012.

Wyniki badań przeprowadzonych na potrzeby niniejszego opracowania wskazują, że akcje rzeczywiście są wykupowane nie tylko w celu dystrybucji gotówki. Właściwie, ta przesłanka stanowi najrzadziej deklarowaną przyczynę wykupów akcji.