Does Share Repurchase Legalization Really Harm Corporate Investments?

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Key Question: Does allowing stock repurchases help capital markets & firm performance?

- Does it improve the performance of **firms repurchasing** their stock?
  - What happens to dividend payouts?
  - What happens to firm cash holdings & investment?
  - Does it improve the investment performance of these firms?
  - Are the changes concentrated in those firms that are not paying significant dividends?
- Does it improve the performance of **firms not repurchasing** their stock?
  - What happens to their dividend payouts?
  - What happens to their equity issuances? What happens to their debt issuances?
  - What happens to the firms' cash holdings & investment?

Main findings

- **Firms repurchasing shares exhibit**
  - Lower equity capitalization – not surprising
  - Reduced cash holdings – not surprising
  - Reduced investment – not surprising
- **Firms not repurchasing shares:**
  - **Invest more**, primarily in CAPEX & not much in terms of R&D – This is somewhat surprising – What is the explanation?
  - **Issue more equity, but do not issue much more debt** – This is also somewhat surprising. Is this because only the cost of equity is falling and not the cost of debt?
  - **Exhibit better stock performance** – But is this surprising if they have good investment opportunities?
- **Overall firm performance improves after a country legalizes stock repurchases – But is this a causal effect???**

Secondary findings

- Challenge the earlier work of Wang, Yin and Yu **WYY(2021)**
  - Justifiably criticize their approach to a class of quasi-natural experiments which employs a SDID experimental design
  - They note that WYY use a biased estimation method when dynamic and heterogeneous treatments occur
  - They are also critical of the WYY study for only studying firms that are repurchasing shares.
    - This can produce a serious selection bias – In fact, this study documents a number of significant biases relative to non-stock repurchasing firms
    - It clearly ignores potential **spillover effects** to non-stock repurchasing firms
    - A spillover effect could occur because investors receiving substantial cash payments from selling some of their shares may now be more likely to buy stocks of other firms.

Concerns & suggestions

- Is this a clean class of quasi-natural experiments? We need to know more!!
- When do countries decide to allow stock repurchases?
  - Is it **when the economy is doing well** on average? That needs to be checked!!
  - If it is, then there is another reason for change in firm investment & performance
- When countries decide to allow stock repurchases, **do they also make important changes to securities regulations or corporate law?**
  - Could these other changes explain some or all of the changes in firm investments or firm performance?
- Do firms that repurchase stock previously pay dividends? If so, what happens to its dividend payments?
- Are the results different for stock repurchasing firms that the previously paid dividends than for those repurchasing firms that did not previously pay dividends?
- Are the **cumulative average stock returns** adjusted for risk? Are they actually cumulative **abnormal** returns? If not, then this is also a concern.

Suggestions for further analysis

- Do non-stock repurchasing firms that issue new equity - exhibit stronger increases in investment?

- Do non-stock repurchasing firms that do not issue new equity exhibit weaker increases in investment?

- Do firms that repurchase stock behave differently if they have good corporate governance? Is this because of strong independent boards, large institutional shareholders or strong product market competition?
  - Is the performance of the good CG firms stronger?
  - Is the reduction in cash and investments larger at good CG firms?

Unanswered questions

- What are the incentives for CEOs to support stock buybacks?
- What are the incentives of boards to support stock buybacks?
- Are stock buybacks good for shareholders?
- Do capital markets benefit from legalizing stock repurchases?
  - Do these capital market become more efficient?
  - Do equity flotation costs fall in terms of the offering price discount need to sell the SEOs?
  - Is it now easier to sell larger equity offerings?
  - These are some of the metrics that need to be investigated

Other concerns

In the countries that legalized stock repurchases:

- Do some of these countries limit the size of the stock repurchases?
- Do they limit the size of dividend payments?
- Do they tax stock repurchases more heavily that dividend payment?
- Do these countries otherwise penalize stock repurchases in terms of heavier regulatory & disclosure burdens?
- Are the results weaker in countries with more corruption, weaker financial institutions, weaker disclosure regimes?
- **If some countries engage in some of these practices, then we would expect weaker results for those countries.**