IJCMT

INTERNATIONAL JOURNAL OF CONTEMPORARY MANAGEMENT AND TECHNOLOGY

Vol 1, No. 1, January 2020, pp42-59 **|** e- ISSN:2682 9363 **|** http://www.ijcmt.my

An Empirical Study of Share Buyback Behaviour and Earnings Management of Companies in Malaysia

Pang Wee Pat
Sentral College, Penang / International University of Malaya-Wales
weepat.pang@sentral.edu.my (Corresponding Author)

ABSTRACT

This study seeks to analyse the behaviour and motives behind the decisions of share buybacks by Malaysian listed companies. More specifically, it focuses on the earnings management decisions in relation to price stabilization and earnings performance of the companies. The scope of the study covers companies that were involved in share buyback activities during the period from year 2010 to 2016. Interestingly, there is an increasing number of smaller firms participating in share buyback activities since the liberalisation of the Malaysian capital market. However, there is weak evidence to show that the smaller firms are more superior in long-term returns than those of the larger firms. Information asymmetry in smaller companies has contributed much of the ill intent buybacks by some Malaysian companies. Evidence has shown that the sum gains when disposing of those treasury shares are made at the expense of unsuspecting shareholders who participated in these share buybacks.

Keywords :
earnings management, signalling effects, corporate governance, undervaluation, buybacks.

Introduction

Share buyback is a process by which a company repurchase its own shares from the open market. This is one of the ways in which a company distributes cash to its shareholders. The only difference between dividend pay-outs and share buybacks is that in the case of dividend pay-out, shareholders still maintain ownership of their shares. However, in the case of share buyback, the recipients of the cash will need to dispose of their holdings of shares. It is the process of selling their shares in open market, while the purchaser in this case will be their own company. The result will be a dilution of share capital base in proportion to the amount of share buybacks and its frequency.

Research Background

Share repurchase has long been a common practice in developed markets and a favourite subject of financial studies. However, there is a noticeable scarcity of research on this topic in the Asia-Pacific markets, perhaps because it is only rather recently that share repurchases began to become important in these markets after the widespread financial liberalisation in the 1990s. For example, Australia allowed repurchases in 1989, Hong Kong in 1991, Korea and New Zealand in 1994, Japan in 1995, and Malaysia in 1997. (Isa & Lee, 2014).

In Malaysia, share buyback must be done using the distributable profits of companies or proceeds from recent share issues of companies. A company intending to carry out share buybacks must make a general offer to all existing shareholders specifying its intention at a predetermined price, which is usually at a slight premium to the current market trading prices.

In the process of share buybacks only those interested shareholders may dispose of their holding of shares to the company in exchange for cash payments, which is the repurchased price. In computation of the earnings per share (EPS) of companies, the profit after tax is divided by the outstanding share capital of the companies. Thus in share buybacks, the total number of shares in the company (the denominator) will be reduced proportionately to the quantum of shares repurchased. The repurchased shares may be cancelled or held as treasury stocks as part of the equity investments of the company for resale in future. The immediate effect of repurchase activities will result in the increase of the EPS of the company, hence showing an increase in earnings performance, which is frequently used as a yardstick for evaluation of companies. The other effect of the repurchase will immediately trigger an increase in share price due to signaling effects. This is due to the fact that investors often reckon managers know best about the future earnings and price performance of company’s share. Most investors will expect an increase in share price following an announcement in the company’s intention to buyback shares.

Share buybacks in Malaysia

In Malaysia, share buybacks were permitted soon after the 1997 Asian Financial Crisis. Unlike countries in the West, Malaysian authorities only allow listed firms to purchase from the open market and each repurchase should not be more than 10% of its prevailing total number of shares. Chapter 12 of the Bursa’s Listing requirements specify that the repurchase price should not be more than 15% of the 5-day weighted average market share price prior to the day of the announcement of repurchase. The buyback must be done using the distributable profit of companies or proceeds from recent share issues of companies.

The main aim of the Malaysian authorities in permitting share buyback was to restore confidence in the capital markets after the financial crisis. Market share price of most companies plummeted during post crisis period causing jitters among the investing public. The Kuala

Lumpur composite index plunged from 1012.84 points in July 1997 to 477.57 points in January 1998 due to depressed stock market conditions post financial crisis period. (Albaity & Diana, 2016). Since the ruling to allow share buybacks, 305 Malaysian firms (25% of all listed companies) participated in the buyback activities from 1997 to 2005 (Rohaida, 2010). From a recent sample study by Albaity el at (2016) between January 2000 and December 2010, 132 companies participated in buybacks with reported 221 daily events, which means on average half of the firms repurchase within 25 days intermittently. Table 1 shows the gradual increase in buybacks by Malaysian companies from 1999 to 2006. Share buyback activities hence became not only a new alternative for companies to improve share prices but also as a' sensible way' to dislodge cash when there are no apparent good investments for a company to consider, in the words of Warren Buffet.

Table 1. Summary of Share Buyback in Bursa Malaysia between 1999 and 2009

Year	Total number of companies
1999	12
2000	13
2001	26
2002	32
2003	62
2004	70
2005	127
2006	145
2007	154
2008	204
2009	196

[Adapted from Ramakrishnan, Ranindran, and Ganesan, 2007, *The Star*, January 30, 2010]

Ownership Structure in Malaysia

Ownership concentration in Malaysian listed companies is prevalent, Table 1 below shows that families hold around 44.7% of their shares while public holds 13.2% of shares as at 2008. With such a high level of ownership concentration, there would be a strong influencing power over the decisions of companies. Similar situations can also be found in Indonesia, Singapore and Philippines that hold 50%, 52% and 76% respectively of companies (Claessens et al., 2000). In these companies, family CEOs easily get entrenched, since ownersip control conveys additional voting power. They are less likely to be removed from the position, even though they perform poorly compared to non-family CEOs (Dahya, Lonie, & Power, 1998). The evidence of Korean firms suggests that the ownership concentration unveils the voting rights that positively affects share repurchases but negatively affects cash dividends (Hyo Jin Kim 2013). However, a study by (Zuriawati Zakaria 2013) pointed out the contrary in that ownership concentration has no influence in buyback decisions. Table 2 shows the control of public listed companies in East Asia compiled by R. W. Carney & T. B. Child (2013).

Table 2. The Control of Publicly Traded Companies in East Asia, 2008

	Widely held (%)	Family (%)	State (%)	Widely held Financial (%)	Widely held Corporation (%)
Malaysia	13.2	44.7	33.5	0.6	4.3
Indonesia	13.1	50	13.5	2.2	13.3
Thailand	38.6	33.3	12.1	2.3	7.8
Philippines	7.6	76.	5 3.	4 1.	9 5.9
Singapore	18.5	51.9	19.6	1.7	3.9

Note. Adapted from "Changes to the Ownership and Control of East Asian Corporations between 1996 and 2008: The primacy of Politics," by R. W. Carney & T. B. Child, 2013, Journal of Financial Economics, 107, pp. 494–513.

Government-controlled institutions also hold significant shares in Malaysian listed companies. Government ownership is established when company shares are held by federal/state institutions, agencies, and government-linked companies (GLCs). However, instead of placing more emphasis on their social objective, government-controlled companies in Malaysia appear to be more closely politically connected (Mohd Ghazali & Weetman, 2006). Nevertheless, agency costs still arise in government-controlled companies (Eng & Mark, 2003). Thus, shareholder wealth maximization might not be the priority for GLCs. Managers of these types of companies are less likely to be indifferent. to the market on corporate control. This is because the Government, a long-term investor of the GLCs is unlikely to support unsolicited takeover offers. Hence, with less governance, there is a greater potential for misuse of company funds by managers to the detriment of minority shareholders. In terms of dividend payment, foreign companies recorded the highest pay-outs in Malaysia. British American Tobacco (Malaysia) Berthed was the highest dividend payer for the year 2008, at RM2.63 per share, followed by Nestle (Malaysia) Berthed (MSWG, 2009). Foreign controlled companies are more closely akin to the market reaction in share price performance and put more pressure for profit performance on these companies (Megginson & Netter, 2001).

Development of Share Repurchase in Malaysia

Prior to 1997, Malaysian companies were not allowed to deal and trade in their own shares. After the financial crisis, Section 67 of the Malaysians Companies Act 165 was amended to include Section 67A, wherein listed companies of Malaysia are allowed to buy back their own shares or to give financial assistance to any person for the sole purpose of purchasing their own shares.

The Malaysian Accounting Standard Board (MASB)'s Technical release in April 1999 stated that Section 67A (as amended) of the Companies Act 1965 allows a public company with a share capital, if so authorised by its articles, to purchase its own shares. The Act further specifies that the company is solvent at the date of the purchase and will not become insolvent by incurring the debts involved in the obligation to pay for the shares so purchased.

Malaysian Companies Act subsection (3A) of section 67A allows a public listed company which has repurchased its own shares either: to cancel the shares so purchased, to retain the shares so purchased in treasury (referred to as "treasury shares" in the Act), or to retain part of the shares so purchased as treasury shares and cancel the remainder.

Subsection (3B) of section 67A provides that the directors of the company may distribute the treasury shares as dividends to shareholders in the form of share dividends (commonly known as bonus shares); or resell the treasury shares on the market in accordance with the relevant rules of the stock exchange.

However, the same provision states that while the shares are held as treasury shares, the rights attached to them as to voting, dividends and participation in other distribution and otherwise are suspended and the treasury shares shall not be taken into account in calculating the number or percentage of shares or of a class of shares in the company for any purpose.

The Bursa Malaysia's revised Guidelines Governing Purchase of Own Shares by Listed Companies in Chapter 12 requires that a listed company's purchase of its own shares must be made wholly out of retained profits and/or the share premium account. However, the listed company is not permitted to use the amount of retained profits and share premium available on a group basis as a basis of computing the total amount of retained profits and/or share premium available for effecting a buyback.

Previous findings noted that Malaysian investors are mainly individuals and thus prefer short term capital gains in their investment approaches (Isa & Lim 1995). Therefore, policy makers should be vigilant to guard against company management abusing the buybacks as a tool in their price fixing activities to the detriment of those unsuspecting investors. While more studies are encouraged to evaluate the cause of mispricing of shares, authorities should adopt a more liberal policy to nurture the rapid growth of the Malaysian capital market to meet the challenges and vagaries of the global environment.

It is also hoped that companies should measure up to the challenges by improving corporate governance disclosures so as to instill better confidence in the investors.

Buyback Economy in US

Contrary to its traditional role of channelling the surplus savings to fund deficit corporations for their investments, the capital market has transformed into a new "buyback economy." The role of efficient allocation of resources in an economy to increase production and full employment has since diminished (Gustavo Grullon and David L. Ikenberry 2000).

This has come about due to the continued sluggishness in the 21st century global business outlook. Many giant American corporations see an urgent need to seek an alternative source of investments for their mountains of retained earnings. The rise of buybacks activities will chart the new 'investment' strategies of giant US corporations in the coming decades.

According to statistics released by the Federal Reserve in March 2015 between 2004 and 2013, 25 of the top US companies that accounted for 42 per cent of S&P 500 repurchased $1.460 trillion, or 60 per cent of their net income, along with dividend distributions of $869 billion. These giant corporations have a combined revenue of $12.1 trillion and $804 billion in profits, and with 26.4 million employees worldwide in 2012 (Damodaran 2015).

In 2014, the same S&P 500 companies spent $565 billion on buybacks, up 18 per cent from the previous 12-month period. (Lazonick 2015). In 2017, these companies bought $508 billion, down from $589 billion in 2016. However, due to corporate tax cuts, Goldman Sachs estimated that in 2018, S&P firms will repurchase $ 1.2 trillion almost a total of 2016 and 2017 purchases.

Professor William Lazonick (2015) highlighted that these capital abundant American corporations would dominate the new 'Buyback economy', which will eventually help in the creation of the new "downsize-and-distribute" enterprises instead of the traditional "retain-and-reinvest" enterprises in US.

Problem Statement

Majority of the previous studies on share repurchases have focused on the determinants and price effects of announcement and actual repurchase of shares. For many countries, data on resale of treasury is difficult to obtain and companies always shy away from it because of its stringent rules (Abdurrahman 2015), (Amedeo De Cesari 2011) and (Dimitris Andriosopoulosa 2010). This study is made possible as Malaysia has the advantage of providing complete and timely information on resale of treasury shares on Bursa Malaysia's website.

Table 3. Studies on share repurchases in Malaysia

Year-Data	Measurement used for sample selection	No. of companies	Focus
Mohd Jais 2009	2000-2005	All events 227 events	Substitution Determinants
Abdul Latif (2010)	1999-2006	All SR# of > 1% 82	Price effects
Edward Wong et al. (2011)	2006-2009	Top 100 35	Price effects
Mansor et al. (2011)	2001-2005	All 149	Price effects
Abdul Latif et. al (2013)	1999-2006	All SR# of > 1% 82	Signalling & Substitution

[Adapted from Rohaida Abdul Latif, K. N. T. M. a. H. K. (2015). "Market Performance on Resale of Treasury Shares." International Journal of Business and Social Science **Vol. 6**(No. 12;): 148-155.]

In Malaysia, previous evidence examined various reasons on why companies repurchase their own shares. Nasruddin and Angappan (2004) find that the main reason for repurchasing in Malaysia is to stabilize the company's share price. Table 3 shows the reasons and focus of previous studies in Malaysia on share buybacks. It is often argued that the main reason for companies to repurchase own shares is signalling of undervaluation (Mansor Isa 2011; Mohd 2013). Companies believe that their shares are undervalued thus share repurchases may correct the mispricing.

Price stabilization effects

A frequent but peculiar feature of repurchase activities by Malaysian companies is that companies buy back only a small portion of their shares (Abdul Latif, 2010). On average, Malaysian companies bought back only 1 percent of their own shares (Abdul Latif, 2013).
In US, companies bought back an average 6% of their shares. (Ikenberry et al, 2000).

Abdul Latif (2010) reports that Malaysian companies are frequent buyers of their own shares. About 90 per cent of these companies will repeatedly buy back their shares every year. Previous studies also confirmed that companies gain significant and positive abnormal returns during the repurchasing period.

Lim and Baca (2002) in their joint study of 131 Malaysian companies highlighted that only 43 companies carried out actual buyback of shares, while the remaining 88 companies announced buyback plans but never proceeded to actual buyback of shares. Their analysis seems to suggest that in share buybacks, announcements of buyback plans are more important than actual process of buyback of shares.

Chong et al (2015), using t statics to analyse the changes in cumulative average abnormal returns (CAAR) on share prices of 100 Malaysian companies from 2007 to 2011in share buybacks, confirms a positive effect of buyback announcements on the share price stabilisation of companies, amplifying the signalling effects of share buybacks on companies.

Earnings Management effects

Finance literature has defined earnings per share (EPS) of companies as profit after tax divided by the total number of shares outstanding. Hence, share buybacks have been quoted to counter the dilution effects of denominator during share option exercises of companies.(Weisbenner, 2001).

Chang, Ikenberry, Lee and Wange (2010) demonstrate however that buyback programs are used to conceal the dwindling effects of financial performance during financial crisis which confirms the findings of Li & Mc Nally (2003). It is also pertinent to note the use of EPS multiples in the evaluation of a company's performance and share price evaluation is a common practice in Malaysia (Mansor Isa 2011).

It should be noted that an improvement in EPS does not increase the company's value, as it is only an accounting treatment on reported earnings. Lee & Esa (2014) term the increase in EPS as cosmetic effects and mainly used for window dressings to show improvement of performance in companies with no real increase in net value of companies.

In summary, this research intends to investigate the motives of buyback in relation to the earnings management of the individual company. The study will also cover the long term price impact and the effects on EPS due to managerial opportunism (Arturo Redriguez, 2008).

Table 4: Relationship of Hypotheses with Share Buyback Decision

Hypothesis	**Sign**
Excess capital	+
Leverage	+
Stock option	+
Signalling	+
Excess capital	+
Leverage	+
Stock option	+
Takeover Deterrence	+
Substitution	-
Liquidity	+
Earnings Per share	+

[Adapted from Sarthak Kumar Jena, C. S. M. a. P. R. (2016).
"Share Repurchases: A Literature Review" Asian Journal of Finance & Accounting **Vol. 8**(No. 2).]

Table 4 shows study by Sarthak et al (2016) on buyback decisions of Indian companies that most hypothesis show positive while only substitution results in negative.

Research Objectives

Current studies show that buyback motives by Malaysian companies are to correct share price and institute positive effects of signalling on undervaluation of intrinsic values (Nasruddin and Angappan 2004, Mansor Isa ,2011 and Mohd ,2013) . This study intends to expand the scope by examining the motives of earnings management to improve EPS and enhance price performance. Evidence by Zunaidah et al (2014) following a study on 724 Malaysian companies from 2010 to 2012 confirms positive managers' behaviour in earnings management of their companies. By managing share price down temporarily, a company will stand to gain by buying the deflated share price and reap exceptional profit when the share price recovers. This practice certainly does not augur well for the interest of those shareholders who sold off their shares during the buyback excises; although in such situations, it does improve performance of the company without any genuine improvement in its operational results.

The specific objectives of this study are as follows:

(1) To study the market reaction to the repurchase announcements;
This will indicate extent of information asymmetry on undervaluation for Main board and ACE companies. The investigation hopes to analyse the rationality of Malaysian investment public in response to share buyback announcement by companies.
(2) The study hopes to analyse the real motives of buyback by companies. As undervaluation and the dislodging of excess cash flow appear to be the main priorities for buybacks, companies should record a negative abnormal return before buyback and a positive return after the buybacks.
(3) The amount and frequency of the buyback in relation to the profitability of companies and the investment opportunities available to the companies. The analysis on the repeated buybacks of less than 1 % of shares would establish the real motives of these companies and their peculiar characteristics.
(4) To provide an assessment of Earnings per Share (EPS) on the companies as a result of share buybacks.
It is also noted that market share prices are theoretically determined by using EPS multiples thus supporting the evaluation claim that a company's performance and share price evaluation is commonly based on reported EPS of a company.(Mansor Isa 2011).

Research Questions

The following are the research questions to be explored in this study. The real effects on long term price sustainability and the net effects of improvement in EPS in the form of earnings management of companies.

Q1 : Do Malaysian companies use share buybacks as a means to manage their earnings?

Q2 : Are Malaysian companies with low market to book values more likely to buy back their shares?

Q3 : Do non buyback Malaysian companies perform better than those buyback companies?

Q4 : Are there significant abnormal returns gained on announcement of buybacks?

Research Underpinning Theory

Academic literatures have documented that the major underpinning theories of share buybacks are signalling effects, disgorgement of excess cash flow, substitution of cash dividends for repurchase, satisfying management interests, reducing tax, and maintaining optimal leverage level (Mohd 2013).

Signalling Theory

One of the often-quoted motives of buyback of company shares is to correct the undervaluation of share price by sending signals to potential investors about the company's future earnings prospect. This signaling effect is often used when the share price of a company falls below its book value. The buyback activity is meant to inform investors that the future earnings of the company will be higher than its present market price. Malaysian firms repurchase shares partly to signal undervaluation and better operating performance. They also buy back shares whenever there is an increase in cash flows (Mohd 2013).

The main reason for undervaluation of shares is due to information asymmetry and that potential investors do not possess any insider information on the prospects of the company (Wahid 2013). The study showed that as managers are having more insider information than those outsiders, the share buyback by company will send a direct signal to the potential investors on what should be the real value of its share price. The buyback thus sends a clear indication that the company's share should be worth more than its current trading price. Potential investors often perceive that managers know better than others and follow suit in buying up the shares creating a demand-pull effect on the share price.

Undervaluation of share appears to support the signaling hypothesis in correcting mispricing in shares (L. Y. Chong 2015). But the conditions necessary must be that share prices were on the decline prior to the buyback and the share prices did increase on the announcement of share buyback by companies.

Chong et al (2015) believes that in times of depressed market conditions, share buybacks provide a suitable avenue for companies to buy back their own shares at low prices. The share buyback announcement serves as a means to signal to the outside investors the company's belief that the real value of share price should be higher.

Efficient Market Theory

Advocates of efficient market theory would stand by the belief that the share price of a company is always a reflection of the expectation of the investors. It means that the share price of a company is fairly priced in the market. However, in actual practice, the share price of companies is often influenced by information asymmetry. Smaller firms are affected more by information asymmetry syndrome as smaller firms, unlike larger firms, see less investments by big institutional investors, hence generally lacking in media coverage and analysis (Mansor Isa 2011). The study concurs with a similar study by (Dimitris Andriosopoulosa 2010), on 970 companies in UK, France and Germany. Their studies found that small firms are more likely to have higher information asymmetries and more likely to be undervalued. Their results show that, consistently in all three countries, large firms that are widely held and pay cash dividends are more likely to announce their intentions to repurchase their shares in the open market. However, unlike cash dividends or tender offer buybacks, open market repurchases are costless and non-committal; they should therefore not be treated as credible signals. More so in the case of ownership concentrated companies where management holds the majority of a firm's shares and when the firm conducts a share repurchase, in effect the management pays with its own wealth. (Damodaran 2007) suggests that one way to assess whether ownership concentration can influence share buybacks is by using the percentage of closely held shares divided by the number of total common shares outstanding in a company. The highly concentrated companies would be less committal in buybacks.

Agency Problem Theory

A study by Wahid (2013) argued that companies with low investment opportunities would buy back shares to reduce agency problems. The study quoted Jenen's Theory of Overinvestment by managers in cash surplus companies.(Keasler 2015) In their quest for expansion, managers often fall into the traps of taking higher risks or to invest in low net present value (NPV) projects. In this way, the high cash surplus in a company does not bring benefits to the shareholders but instead increases higher agency costs in monitoring managers' performance. Therefore, share buybacks are used as a form to dislodge excessive cash and to reduce agency problems.

In Malaysia, companies are using share buybacks to reduce the equity ratio by dislodging excessive cash from their reserves (L. Y. Chong 2015). The action hence reduces the company's cash flow, and simultaneously increases its debt ratio when its need to borrow. The net effect of tax shield will reduce costs of capital of the company. But the study highlighted that if the company's existing debt ratio is already high, further increase in debt ratio will increase costs of capital of the company.

By comparison, one of the main reasons for the explosion of share buybacks in the US is attributable to companies being flushed with mountains of cash following the monumental growth of profit cycle in the 2000s. From 2004 to 2008 companies spent about $1.8 trillion in stock buybacks (RamMohan R. Yallapragada 2014). Amongst the corporate giants that participated in share buybacks were Exxon Mobil, IBM, Microsoft, Cisco and Porter & Gamble which jointly spent about $660 billion in repurchase in 2013. In addition, a new participant had joined the troupe of cash distribution. Berkshire Hathaway bought back 15% of the company's market capitalisation of $150 billion according to Fortune Finance (March 2016).

Dividend pay-out theory

In countries in the West, where capital gain taxes are lower than dividend taxes, share buybacks would naturally become more popular than dividend payments to shareholders. Since Malaysia has a single tier tax system, both capital gains and dividend payments would affect shareholders' wealth. (Isa & lee 2015). Of course this is not the only reason for dislodging the cash. (Damodaran 2007) listed 4 reasons for companies to return cash to their shareholders. These are;

(1) dividends by tradition need to maintain an increasing rate while buybacks do not.
(2) Buybacks affect share counts hence increase in EPS of companies, while dividends do not,
(3) Dividends return cash to all shareholders while share repurchase only to those self-selected and,
(4) Dividends and buybacks create different tax consequences.

This is because dividends are treated as incomes while repurchases' tax effects are more subtle because if the investors sell their shares in depressed market conditions where market prices are below purchase price, there would be no capital gains tax.

Chong et al (2015) stated that in Malaysia dividend payments are always taken as a signal of the future performance of companies. Any decrease in dividend payments would be taken adversely by investors to indicate poor future earnings prospects. Therefore, companies would often prefer a constant dividend pay-out policy to shareholders. Any surplus of cash flow in the company would not be used to increase dividend payments but as supplemental cash pay outs to shareholders.

Mohd(2013) found that companies with low investment growth would prefer buybacks to distribute excess cash. Companies repurchased shares not to substitute or reduce dividend payments. Their research further indicated that there is no evidence to support that these firms bought back shares to substitute dividend payments. In fact, share repurchases are used to complement dividend payments. Further evidence shows that managerial ownership has significant influence on firms' repurchase decisions.

Isa (2008) detailed that in 2000s, only 60% of companies paid dividends and average dividend yield was between 2 per cent and 3 per cent in the same period. The findings concluded that dividend yields were not the main criteria for valuation of companies by investors. Malaysian investors are basically individuals who are more concerned with capital gains than dividend yields (Ramakrishnan 2007; Mansor Isa 2011).

Optimal Capital Structure Theory

Wahid (2013) observes that by increasing financial leverage of firms to alter the combinations of debts and equity ratios of companies, costs of capital of companies will reduce. As expected return on equity is always higher than debts, the move to reduce equity and increase debts will reduce cost of capital of companies. This is because the interest paid for debts is tax deductible and higher debts will provide tax shield effects. Based on Modigliani and Miller theory, the increase in the leverage tax deductible interest costs will increase companies' value. As share buybacks have the effect of increasing a company's gearing ratio, any shares repurchased will reduce the shareholders' equity and thus increase the debt-to-equity ratio. The effect of an increase in the debt-to-equity ratio holds true even if gearing is measured on the market value basis. In this case, the market value of the company's equity may decrease by the extent of the cash outflow after the repurchase.(Ramakrishnan 2007)

Mansor Isa (2011) however, has a differing opinion as Malaysian companies are generally risk-adverse and would prefer to issue new equity than debts when external borrowing is needed by the company. Their findings are in line with the research by Isa (2008) that the long-term debts ratios of Malaysian listed companies are generally below 20 per cent of the companies' capital. This finding thus contradicts the Peking Order hypothesis, where companies prefer to use internally generated funds, found to be applicable to most companies in the West.

L. Y. Chong et al (2015) explained that optimal capital structure theory is used to analyse abnormal returns in the share buyback activities. In a share buyback exercise, the repurchased shares will reduce the equity ratio of a company and simultaneously increase its debt ratios. The net effect of tax shield will reduce costs of capital of the company. But the study highlighted that if the company's existing debt ratio is already high, further increase in debt ratio will increase costs of capital of the company.

Yarram (2013)'s study of 255 Australian companies from 2004 to 2010 shows that total assets have significant positive influence on the decision to undertake buyback of shares. Based on his analyses, he concluded that large firms are more likely to buy back shares rather than small firms. Debt equity ratio, on the other hand, has a negative influence on the decision to buy back shares. The finding implies that firms are targeting optimal capital structure and buybacks to reduce the proportion of equity has not been statistically proven.

Hyo Jin Kim (2013) reveal that between 2004 and 2010 his study of 182 Korean companies found that controlling shareholders with excess voting rights tend to pursue private benefits by purchasing treasury shares as a way to secure control. Their analysis found that there is a positive relationship attributable to the discretionary power of the controlling shareholders in share repurchases. They use their controlling voting rights to purchase treasury shares in order to increase their control of shareholdings. As illustration, if a controlling shareholder owns 40% of the company, and the company voted to purchase 20% of treasury shares, the controlling shareholding will increase control to 50% = [40 %/(100 - 20 %)].(Hyo Jin Kim 2013)

Earnings Management Theory

The other commonly cited motive for share buybacks is to improve earnings per share (EPS) of companies (Wahid 2013). One of the ways to increase annual return on equity (ROE) and earnings per share (EPS) of companies is to participate in share buybacks. The repurchase move will reduce the total number of shares outstanding and results in increase in the reported EPS of company. Even if there is a fall in earnings but if the fall is lesser in proportion than the percentage of fall in total number of shares, the reported EPS would also increase. It is also noted that market share prices are theoretically determined by using EPS multiples thus supporting the evaluation claim that a company's performance and share price evaluation is commonly based on reported EPS of company.(Mansor Isa 2011)

As long as investors continue to use EPS as one of the basis of share evaluation of companies, companies will continue to use share buyback as one of the ways to improve their EPS(Isa 2015). It should be noted that an improvement in EPS does not increase the company's value, as it is only an accounting treatment on reported earnings. The increase in value of companies should come from fundamental improvements such as revenue enhancement, better product innovations, improvement in core competency of management expertise, skilled labor, increased market share and improvement in comparative advantages of the companies.

Chong et al (2015) stressed that share buybacks are used to counteract dilution of EPS of companies due to employees stock option schemes (ESOS). New shares are issued when implementing share option schemes for employees, hence increasing the total number of shares in a company. The EPS will be diluted as the denominator (total number of shares) increases as more option shares are exercised by employees. To prevent dilution of EPS, companies buy back shares to neutralize the net effects of the increase in total number of shares.

Treasury stock affects earnings per share (EPS) since the denominator of the EPS is outstanding stock, which excludes treasury shares. Thus when treasury shares are purchased the outstanding stock is reduced; and if it is of magnitude, it may result in increasing EPS even though net income has not increased.(Margaret (Peg) Horan 2012). Her research focuses on the surge of buyback activity for the period of Standard and Poor's 500 (S&P 500) figure of 2001 through 2010. The paper aimed to quantify the effect of buybacks by devising a new EPS model that communicates earnings from operations apart and separate from earnings due to buyback activity, along with a combined EPS.

In a study by (Oded 2008) on the performance and pay-out policies for ExxonMobil between the years 2002-2006, the EPS growth rose more than 16% in four years. This is an artificial result of its repurchases program and cannot be associated with improvement in operating performance.(Margaret (Peg) Horan 2012). (Cheng 2010) in his study of management motivation in share purchases, finds "that CEO stock options influence the choice, amount and timing of funds distributed as a buyback (p. 1).

Realising treasury shares can be used as a earnings management tool , (Margaret (Peg) Horan 2012) proposed a new model of calculating EPS in her study. The new EPS model is

proposed to report what portion of EPS is from operations and what portion is from the mechanical effect of the treasury shares when it is applicable.
This is presented and illustrated in the following formula:(Margaret (Peg) Horan 2012)

$Yt = Nt \,/\, It - ((Nt/\, It\,) - Nt\,/(\, It - Tt))$
Where
Yt = EPS reported for the current quarter
Nt= net income at present time
It= = issued shares in the present quarter
Tt= treasury shares in the present quarter

For illustration purposes the hypothetical company has the following data.

$Yt = EPS$ = \$5
$Nt = net\ income$ = \$100
$It = issued\ shares$ = 25
$Tt = treasury\ shares$ = 5

$Yt = Nt/\, It - ((Nt/\, It\,) - N\ t\,/(\, It - Tt))$
\$5 = \$100/25 ‐ ((\$100/25) − \$100/(25 − 5))
\$5 = \$4 ‐ (\$4 − \$ 5)
\$5 = \$ 4 + 1 (1)

The value added by segmenting the EPS is that it isolates the earnings from operations, which in this simple example is \$4, and to isolate the EPS from the equity component contributed from the treasury shares, which in this illustration is \$1. EPS is the total of \$5, which is the sum of the two.

Substituting Theory

One of the key drivers for share buybacks has been to distribute cash to shareholders. As good performance companies have been annually following a consistent pattern of dividend pay-out polies to shareholders, the distribution of cash by repurchasing shares serves as an effective means of reducing agency problems.(Dimitris Andriosopoulosa 2010).

In a study of three countries in Europe, namely France, Germany and UK, only France showed that repurchasing firms pay higher dividends. On comparison, repurchasing firms are larger in size in all three countries, and only in UK and Germany repurchasing firms have higher growth rates. In France, the repurchasing firms have significantly lower levels of ownership concentration but larger in size.(Dimitris Andriosopoulosa 2010) The analysis did not support the motive of companies using repurchase as a substitute for dividend payments. The study by (Mohd 2013) of 305 companies in Malaysia from 1997 to 2005 supported the findings that there is no substantive evidence to support that companies bought back shares to substitute dividend payments.

Theoretically, after a firm paid cash dividends, the price of its shares would come down proportionately with the amount of dividends paid. But in the case of announcement of share buybacks, the price will swing upward with an average return of 3 to 4 percent observed during the announcement period. Positive price reaction certainly gives rise to strong inclination in firms choosing to buyback rather than cash dividends.(Mohd 2013)

Corporate share buyback can be destructive in two ways.(Damodaran 2015) Firstly, if a firm is over geared and resort to buybacks by borrowing (not allowed in Malaysia), the cost of capital, although more advantageous to the company, but the higher leverage will eventually lead to bankruptcy of the company.(Mohd 2013). Secondly, share buybacks may drain the companies' available resources, neglecting the requirement of funds for future investment opportunities. The results will be capital constraints faced by companies.(Damodaran 2015)

A joint study by (Huei-Hwa Lai;Szu-Hsien Lin;Ai-Chi 2017) on 3802 Taiwanese companies from 2002-2011 found that the companies implemented share buybacks as well as cash dividend payments in order to attract investors. The same study concluded that low purchase companies have positive association with higher future earnings, while high purchase companies having lower future earnings. Even in poor operating conditions companies continue to pay dividends depicting the need to project an optimistic future earnings prospects of the management.

In a study of 509 Malaysian companies between 1997 and 2011, (Isa 2015) noted due to the current single tier tax system, there is no difference in terms of shareholder's wealth between cash dividends and repurchases. Therefore, there is no clear reason for companies to use repurchases as a substitute for cash dividend.

A similar study by (Yarram 2013) on Australian companies found that firms may at times buyback shares as a way to substitute dividend payments. Results show that pay-out has no significant influence on the buyback decisions of Australian firms.

Takeover Defense Theory

Companies faced with hostile takeovers may adopt share buyback as a strategy to push up share prices and to reduce total number of shares available in the market (Ramakrishnan 2007). By adopting share buyback strategy, the management hopes to increase the share price of a company to make it more expensive for the acquirer in mounting any possible take-over bids. The motive is used as a defense strategy to discourage any potential acquirer. By buying back its own shares the number of shares of the company will be reduced, rendering any possible takeover moves to become more expensive. At the same time by increasing the company's leverage, the management is exploiting share buyback as a defensive tactic to any offeror (L. Y. Chong 2015). Such a move to limit availability of shares and push up prices, however, may not be significant enough as an anti-takeover strategy (Isa 2015)

Such tactic used in defending a take-over, is, in fact a clear abuse of a management tool which should be aimed at improving shareholders' wealth and benefits. Further, when faced with the risk of a potential takeover, a company's management may forgo buyback of shares and instead opt to use up all surplus cash in high risk investments to the detriment of long term sustainability of the company (L. Y. Chong 2015)

It should be noted that if a company continues to report poor earnings and deterioration in share price, it is often due to the company's management inefficiency. Under such circumstances, a take-over of the company by a more efficient new management may actually bring better benefits to shareholders and enhance its long term profitability and share price level.

A study of 62 US companies which used buyback strategy as a defence move showed that investors in US reacted negatively to the announcement of share buybacks being used to defend possible take-over of the companies, according to (Ramakrishnan 2007).

OECD September 2015 Report documented that takeover activities around the world are more likely in open market share buybacks. Companies were using buybacks to deter takeover bids or even to get rid of shareholders not in support of management. Conventional studies often denote the prime objective of company is to maximise shareholders' wealth. But as share buybacks have been widely used as tactics to deter takeover bids, and to attain management's ulterior objectives, such buyback strategies are not in line with protecting shareholders' interest. Hence, firms that successfully use buybacks to deter a takeover bid will not experience long term positive excess returns. (Vermaelen 2015).

Significance of the Study

Previous studies on reasons of repurchases on signalling and undervaluation of shares (Ikenberry et al., 1995; Abdul Latif, 2010, Abdul Latif et al., 2013). Undervaluation of share appears to support the signaling hypothesis in correcting mispricing in shares (L. Y. Chong 2015). However, in actual practice, the share price of companies is often influenced by information asymmetry. Smaller firms are affected more by information asymmetry syndrome as smaller firms, unlike larger firms, are less invested in by big institutional investors, hence generally gross lacking in media coverage and analysts(Mansor Isa 2011).

On the reasons to disgorge excess cash flow, (L. Y. Chong 2015), (Oswald and Young, 2008), (Dittmar, 2000) and (Abdul Latif, 2010) have similar view on maintaining the capital structure. They will buy back shares whenever there is an increase in cash flows (Mohd 2013). From 2004 to 2008 companies spent about $1.8 trillion in stock buybacks (RamMohan R. Yallapragada 2014).

While Nasruddin and Angappan (2004) find that the main reason for repurchasing in Malaysia is to stabilize their share prices, uundervaluation of share appears to support the signaling hypothesis in correcting mispricing in shares (L. Y. Chong 2015)

Hence, this study will focus on earnings management of EPS and performance of companies to try to establish a managerial opportunism hypothesis in the motives of Malaysian companies. The study hopes to provide a strong evidence in downward management of price that affects the earnings of buyback companies.

The study also hopes to establish a strong correlation in the proportion of buyback of shares in relation to maintain a robust percentage of control of total outstanding shares of the companies. This means there will be a strong inverse relationship between the proportion of buybacks and the equity holdings of CEOs / Managers of buyback companies.

Limitations of the Study

This study has several limitations. First, this study is limited to the immediate announcement effect surrounding shares events. Future research may test on the persistence of the abnormal gains of shares price in the long-run. Besides signalling theory and information asymmetry, other underpinning theory of equity issuance can also be applied to share price: for example, mispricing theory, corporate life cycle theory. Corporate governance mechanisms have also been known to have important implications on the company's policy. This entails strenuous efforts and costs in monitoring the governing processes.

The second limitation is on the assessment of frequent and infrequent buybacks and to identify whether the frequency of repurchase has an effect on the long-term performance. This has been done in the U.S. market by Yook (2010) and Chan et al. (2007) as well as in the Korean market by Lee et al. (2005). They found that infrequent buybacks earned much better price performance than frequent buybacks. Abdul Latif (2010) reports that Malaysian companies are frequent buyers of their own shares. About 90 percent of these companies will repeatedly buy back their shares every year. This peculiar phenomenon as compared to western markets poses great challenge in the evaluation of benefits of buyback companies.

The third limitation of this study is the implication effects on the benefits of buyback to the interested parties, namely the companies. Even though Isa et al. (2011) stated that in the short-term share, repurchase can benefit firms and investors in Malaysia, with regard to longer horizon, this may not be the case. Lee et al.(2005), Yook (2010), and Rasbrant (2011) also proved that the total amount of share repurchased provides a significant result of long-term outperformance by the repurchasing firms. At this moment, in Malaysian market, Isa et al. (2011) and Wong et al. (2011) found no evidence of abnormal returns with respect to buyback volume. This implies that the restricted amount of shares that can be bought back does not provide strong price support to the stocks. Therefore, unless policymakers are willing to further liberalise Malaysian capital market by increasing the limits of buybacks from 10% to 20%, like in the case of Singapore, the impact of the study on the firms shall always be preceded by the limitation.

The fourth limitation of this study is on the effects of buyback to the smaller companies. Even though Ramakrishnan et al. (2007) found an increasing number of small firms participating in buyback activities, there is weak evidence discovered in their study that relates the small and value of firms to the superior long-term returns as compared with the larger firms. Thus, although the smaller firms are relatively undervalued, repurchasing shares may not benefit the long-term shareholders. Future studies may need to focus on the effects of smaller firms and the benefits they derive for their long term shareholders.

Conclusion

Share buy-backs are often referred to as share repurchase in Western countries. It involves the buyback of the existing shares by the companies in the open market. These open market share repurchase programmes are generally financed by internal cash balances for a specific time frame and pricing. The motives are generally to stabilise mispricing in share prices, to signal undervaluation of market value, to return excess cash, to increase EPS and to defend any possible hostile takeovers.

However, evidence has shown that instead of prioritising shareholders' wealth as the prime objective, the management or controlling shareholders have used them to strengthen their controls in the companies and using company funds to buy out shareholders who are not in support of the management. Whether share buyback forms a temporary mask of weaknesses in corporate performance entails further studies in future research. As the 'downsize and distribute' phenomena is becoming a prominent feature in the new 'buyback economy, 'academics should conduct more in-depth analysis of the factors that influence the buybacks. Future studies may need to focus on the ultimate signalling effects on stocks' liquidity, firms' profitability and book to market ratios of companies.

Policy makers may need to take careful note of the adverse effects of the current restriction of the 10 per cent annual limits of buybacks and the 15 per cent maximum limits on offer price on the buyback as countries in the West have no such restrictions.

Several studies done were not consistent on the decisions behind companies to repurchase their own shares. L. Y. Chong et al (2015) explained that optimal capital structure is used for share buyback decisions. (Yarram 2013) study of Australian companies show that total assets have significant positive influence on the decision to undertake buyback of shares. While (Hyo Jin Kim 2013) study of Korean companies found that controlling shareholders with excess voting rights tend to influence the decisions to buybacks.

Treasury stock increases EPS of a company by reducing its denominator although the earnings do not increase. As long as investors continue to use EPS as one of the basis of share evaluation of companies, companies will continue to use share buyback as one of the ways to improve their EPS (Isa 2015). Realising its cosmetic effects, (Margaret (Peg) Horan 2012) proposed a new model of calculating EPS to report what portion of EPS is from operations and what portion is from the mechanical effect of the treasury shares. Future studies should be done to segmentise future earnings of companies and the effects of buybacks.

This study intends to provide a strong evidence on the motives and behaviour of buybacks by Malaysian companies. Previous studies were focusing on cash flow and debt covenant effects on share buybacks. The researcher however, aims to focus the study on the frequency and motives given the negligible amount of buybacks each time a Malaysian company announces a buyback intention. Information asymmetry in smaller companies has contributed much of the ill intent buybacks by some Malaysian companies. Evidence has shown that these companies have to temporarily deflate their share prices so that they will be in a better advantage to purchase back these shares at below intrinsic share prices in order to reap handsome profit post share buybacks. The sum gains when disposing of those treasury shares are in fact at the expense of those unsuspecting shareholders, causing them to realise net loss while participating in share buybacks.

It is the intention of the researcher to highlight these cost benefit effects sustained by some genuine investors. It is also hoped that regulators and financial institutions while evaluating companies' performance to be wary of such managerial opportunism practices of some companies. Perhaps improvement in corporate governance and disclosure requirements should include reasons and rationale of each share buyback program so that investors in future will be able to make sound economic decisions.. Future studies should be carried out to investigate the real effects of opportunity costs and disinvestment effects of buyback companies in the long term.

It is also envisaged that approvals by shareholders on proposals of buyback schemes in future to include the amount and frequency of buybacks to prevent any ungenuine attempts by companies to mislead their own shareholders and investors at large. This prudent practice of corporate governance will certainly beneficial for the promotion of a healthier and cleaner investment climate in Malaysia's capital markets.

Reference List

Alzahrani, M., Lasfer, M. (2012). "Investor protection, taxes and dividends. Journal Of Corporate Finance **18** (745–762.).

Cheng, Y., Harford, J., & Zhang, T. (2010). "Bonus Driven Repurchases.".

Damodaran (2015). "Stock Buybacks: Misunderstood, Misanalyzed and Misdiagnosed." American Association of Individual Investors.

Damodaran, A. (2007). "Return on Capital (ROC), Return on Invested Capital (ROIC) and Return on Equity (ROE): Measurement and Implications." Stern School of Business.

Dimitris Andriosopoulosa, a. H. H. (2010). "The Determinants of Share Repurchases in Europe." The International Review of Financial Analysis.

Gustavo Grullon and David L. Ikenberry, R. U. h. m. (2000). "What Do We Know About Stock Repurchases?" Journal Of Applied Corporate Finance Volume 13 (Number 1): 31-51.

Huei-Hwa Lai;Szu-Hsien Lin;Ai-Chi, H. C.-J. C. (2017). "Share Repurchase, Cash Dividend And Future Profitability." The International Association of Organizational Innovation Vol 9 (Num 3): 101-111.

Hyo Jin Kim , H. J. S. S. Y. (2013). "Controlling shareholders' opportunistic use of share repurchases." Review Quantitative Financial Accounting **41**: 203-224.

Icahn, C. (2014). "Buying Outperformance: Do Share Repurchase Announcements Lead to Higher Returns?" Quantamental Research Jannuary 2014.

Isa, L. S.-P. M. (2015). "Management Perceptions Of Share Repurchases In Emerging Markets: The Case For Malaysia." Asian Academy Of Management Journal Of Accounting And Finance **Vol. 11**(No.1): 97-121.

Keasler, T., and Robin T. Byerly (2015). "An Examination of Corporate Stock Buybacks: Do They Really Create Value?" Economics, Management, and Financial Markets Volume 10(4),(2015): pp. 11–28,.

Kim, J., R. Schremper and N. Varaiya (2005). "Open Market Repurchase Regulations: Cross Country Examination." Corporate Finance Review Volume 9 29-38.

Kowerski, M. (2011). "Share Repurchases As A Form Of Payout For Shareholders." Financial Internet Quarterly ,e-Finanse **7**(4): 35- 54.

L. Y. Chong, M. N. A. M. A. Z. (2015). "The Wealth Effect of Share Buybacks: Evidence from Malaysia." Int. Journal of Economics and Management 312 9 (2): 312-340.

Lazonick, W. (2015). "Stock buybacks: From retain-andreinvest to downsize-and-distribute." Center for Effective Public Management at Brookings April 2015: 1-22.

Mansor Isa, Z. G. S. P. L. (2011). "Market Reaction to Actual Share Repurchase in Malaysia." Asian Journal of Business and Accounting, 4(2): 27-46.

Margaret (Peg) Horan (2012). "Are Buybacks Increasing Eps?" Accounting & Taxation Volume 4(Number 1): 11-24.

Mohd, R. A. L. K. N. T. (2013). "Signaling and Substitution Hypotheses in Malaysian Share Repurchases." Management 2013, 3(2): 99-104 **3**(2): 99-104.

Oded, J., & Michel, A. (2008). "Stock Repurchases and the EPS Enhancement Fallacy. ." Financial Analysts Journal 64(4)(24).

Ramakrishnan, S., Ravindran, R. and Ganesan (2007). "Share Buyback Signalling Tool: Malaysian Perspective."

RamMohan R. Yallapragada, F. (2014). "Stock Buybacks: Good Or Bad For Investors?" Journal of Business & Economics Research-Second Quarter 2014 Volume 12, (Number 2): 193-197.

Rohaida Abdul Latifa, K. N. T. M., Hasnah Kamardina (2015). "Ethnic Diversity and Share Repurchases Policy." International Soft Science Conference ISSC 2016 :: 113-118.

Tai-Yuan Chen, L.-J. K., Hsing-Yu Lin, (2011). "The Long-Term Wealth Effect Of Share Repurchases Evidence From Taiwan." The International Journal of Business and Finance Research Volume 5(Number 2): 21-33.

Wahid, A. H. D. A. (2013). "Measuring the Motivating Factors for Share Buyback: Evidence from Malaysian Companies." Online Journal of Social Sciences Research **2**(2): 35-50.

Yarram, S. R. (2013). "Corporate Governance and Share Buybacks in Australia." International Journal of Humanities and Management Sciences (IJHMS) Volume 1, Issue 1 (2013) ISSN 2320–4044 (Online) Volume 1(Issue 1 (2013)): 116-120.