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# Share buybacks as an avenue for managerial opportunism – a Malaysian experience

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**ABSTRACT**

Using share buybacks to signal undervaluation of share prices and to improve earnings per share (EPS) have been prevalent in Malaysia since amendments to Companies' Act in 1997. Interestingly, the number of companies participating in share buybacks has been consistently at around 15% of the total number of companies in Bursa Malaysia. The behavior and amount of buybacks by Malaysian companies, is peculiar and low. This study aims to analyze the motives of improving earnings per share (EPS) by Malaysian companies using the segmentation of EPS model by Margaret (Peg) Horan (2012). Using the sample size of 127 companies in year 2017, the findings concluded that only 7% of compnaies qualified in the increase of EPS due to buyback exercises. The balance of 93% of companies shows no evidence of increases in EPS despite being active in share buybacks activities. The paper concluded that the purported motive of boosting EPS by companies using share buybacks in Malaysia is more fallacy than a novelty of change and allows perpetuation of managerial opportunism to a large extent

**Keywords:**
*share buybacks, mispricng, segmentation, signalling effects, Eanings Per Share (EPS).*

## 1. Introduction

Pundits in the industry will generally agree that share buybacks are used to correct mispricing in share prices and to meet corporate earnings forecasts. However, the use of signalling theory to correct mispricing in share prices has not been readily supported. Rohaida et. al.,(2015) in their study of Malaysian listed companies' share prices performance from 2001 to 2012, found that the Malaysian market was semi strongly efficient, that prices fully reflect all publicly available information, and there appeared to have no abnormal return due to announcement effects.

The 'buyback waves' in America in the last few years have been widely criticised by scholars and politicians alike that the buyback programmes are undermining long term growth of the companies. (Lazonick, 2014).The large scale open market buybacks are manipulatively boosting the share prices of the companies. The ultimate benefits of these price increases are benefitting principally the managers who decide on the timing and amount of buybacks, and who are also the major shareholders of the companies. Other implicit assumption is that these companies are in fact in thirst of profitable investments, and may resort to buybacks to prop up their share prices for short run phenomenon at the expense of long-term shareholder wealth. (Alberto Manconi et al, 2018).

There seems hardly any official explanation on what is exactly the correct share price of any company (Mansor Isa 2011). Opinions varied on the determination of its value amongst bigger and smaller firms. This view is supported by the study by Dimitris Andriosopoulosa, (2010), on 970 companies from 1997 to 2006, in UK, France and Germany that smaller firms are more likely to have higher information asymmetries and more likely to be undervalued than bigger firms. In a more recent study by Dimitris Andriosopoulosa, Ahmed Etbadry and Frank Skinner (2015) on the best practice of corporate governance of 376 UK large firms on London Stock Exchange between 2004 and 2010, they found that large firms with more independent board effectiveness and using debts to monitor management have inverse relations to the degree of information asymmetry of those firms. The findings contended that although the best practice of corporate governance is meant to mitigate the agency problems of companies it has also contributed to a great extent in alleviating shareholders concern of the agency problems and hence increases share prices and reduces volatility in trading activities.

According to the Efficient Market Hypothesis, share prices will reflect the true value of companies, supporting the underpinning theory of a semi strongly efficient market (Fama 1970). However studies by Kim and Shamsuddin (2008) found to the contrary that Malaysian market may not be as strongly efficient as generally perceived while Zaluki, et al (2012) also found that Malaysian market is affected by the behavioural finance theory on market anomalies that when announcements are released on Friday, the market will react differently.

The managers of the company, being insiders, are believed to have better grasp of the correct intrinsic value of the share price than the public at large (Lee & Mansor, 2015). 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). With information asymmetry, the information on prospects of the company may not be readily incorporated in the share price of the company. Together with the buyback decision, investors may expect to gain from the upswing in share price as buying orders increase. Alberto et.al.(2013) in a study of 31 non US companies from 1998 to 2010 using 9034 announcements found that there was significant positive abnormal returns in short term stock performance, subject to undervaluation of stock prices trading below their intrinsic values.

## 2. Share buybacks in Malaysia

In Malaysia, listed companies were allowed to buy back their own shares after the Asian Financial Crisis 1997 (Mohd 2013). The buyback offer is an alternative means of returning cash to investors besides dividend payments. Malaysian companies intending to carry out share buyback programs must make a general offer to all existing shareholders specifying their purpose and the intended repurchase prices, in accordance with the rules in Chapter 12 of Bursa Malaysia Listing Requirements on share buybacks.

In 1998, Section 67 of the Malaysian Companies Act 1965 was amended to include Section 67A to allow listed companies of Malaysia to buy back their own shares or to give financial assistance to any person for the sole purpose of purchasing their shares. In April 2016, the Companies Act 1965 was further amended to allow private limited companies to buy back their own shares (Isa 2015).

Stringent requirements regulate strictly the treatment of treasury shares via Section 3 (C), 3(D) and 3 (E) of Section 67 of Companies' Act, particularly such as dealing with the rights attached to voting, dividends and specifically, treasury shares shall not be taken in calculating the number or percentage of shares in the company.

Singapore listed companies enjoy more flexibility when Section 76C of Singapore Companies' Act was amended in October, 2013 to raise share repurchase from 10% to 20% of total shares issued although they are also subjected to shareholders' approvals prior to any buybacks.

Countries in the West including USA are less restrictive as they only need to secure their respective board approvals before buybacks by disclosing the purpose and intent of share buybacks activities. Malaysian and Singapore firms together with most firms in Asia including UK are exempted from such disclosures but are subjected to prior shareholders' approvals of the buybacks. (Kim et al, 2005).

No doubt directors have an inherent fiduciary duty to their companies, that is, to improve shareholders' wealth and the profitability of the companies. Studies by (Mohd (2013); Tai et al, (2011); Yarram (2013) have shown that correction of mispricing of shares to gain abnormal return for companies is more of a fallacy than real. While share buybacks activities are purportedly being deluded to the correction of undervaluation of intrinsic value of shares, the timing of the buy backs has often been planned when the share prices are at the lowest. It is also when many shareholders are trapped and forced to sell their trapped shares during the share buybacks in order to raise the necessary liquidity needed.(Rohaida Abdul Latifa, 2015) This change of ownership facilitates the transfer of wealth from the trapped shareholders to those remaining owners, who will in turn benefit handsomely as they enhance their net worth when the share prices recover.

Table 1: Summary of share buybacks in Bursa Malaysia from years 2000-2017.

| | |
|---|---|
| 2000 | 13 |
| 2001 | 26 |
| 2002 | 32 |
| 2003 | 62 |
| 2004 | 70 |
| 2005 | 127 |
| 2006 | 145 |
| 2007 | 154 |
| 2008 | 204 |
| 2009 | 196 |
| 2010 | 126 |

| | |
|---|---|
| 2011 | 127 |
| 2012 | 124 |
| 2013 | 128 |
| 2014 | 126 |
| 2015 | 130 |
| 2016 | 137 |
| 2017 | 127 |

Source: Nadarajan et. al. (2009). Citation from Ramakrishnan et. al.(2007).
Information from 2010 to 2017 was compiled by researcher based on data available from Bursa Malaysia companies' announcements.

Table 1 above shows that Malaysian listed companies had been increasingly participating in share buyback activities since 2000. The total number of participant companies increased gradually from 13 companies in 2000 to a peak at 206 companies in 2008. However, soon after the global financial crisis of 2008, the total number of companies in share buybacks began to taper downwards to around 126 companies. The possible reasons for this phenomenon could be due to improvement in Malaysian economy when funds were diverted for more profitable investments and the lack of liquidity in capital market. The evidence of acute lack of liquidity in Malaysian market can be found in a study by (Ping-Xin Liew et.al, 2016) when tracking the level of market liquidity over 15 years from 2000 to 2014, with all indicators consistently showing clear evidence of liquidity dry-up soon after the bankruptcy of Lehman Brothers in 2008 that shattered the confidence in the Malaysian stock markets. The Malaysian stock market's behaviour strongly corresponded with the events and reactions in the international arena. The number of buyback companies in Malaysia stayed consistently at around 15% of the total listed companies in Bursa Malaysia form year 2010. This peculiar pattern of buybacks by Malaysian listed companies is in fact the key focus of this study.

## 3. New paradigm shift in US share buybacks

The Financial Times in its issue dated 27$^{th}$ April, 2015 carried a caption "US share buybacks loot the future'. The report highlighted the paradigm shift in the investment pattern of US corporate companies in this 21$^{st}$ century. The CEOs are enslaved to the share prices of companies. While lacking in investment opportunities, companies are rushing in to dislodge their excessive cash reserves into stock markets to buy back their own shares. It was reported in 2014, S&P 500 companies spent 95% of their operating margins in share buybacks and dividend payments.

This has come about due to the continued sluggishness in the 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). According to Goldman Sachs' estimates US corporates will return $1.2 trillion via share buybacks in 2018 due to massive tax cut by the Trump administration. (Financial Times 10$^{th}$ July, 2018). Already American corporate so far have authorised about US $ 750 billion as at August 2018. Warren Buffett told CNBC in February 2018, "The best chance to deploy capital is when things are going down." Berkshire in July 2018 had set total cash pile over $100 billion together with Apple's cash pile of $ 250 billion for share buybacks.

Warren Buffet had in fact moved down his buyback policy from 1.1 times to 1.2 times to book value as criteria of the group's buyback. This sentiment of buy backs was also manifested by some other well-known US companies such as CISCO, the American technology giant which announced their intentions to invest more than $25 billion in share buybacks. Other giants like Wells Fargo and Pepsi had both authorised buybacks of $ 22 Billion and $15 Billion respectively since January 2018.

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 paradigm of a "buyback economy" in US (Damodaran 2015). The role of efficient allocation of resources in an economy to increase productivity and full employment has since diminished (Gustavo Grullon and David L. Ikenberry 2000). The view has been supported by William Lazonick (2015) that it helps in creation of "downsize-and-distribute" of US enterprises and leads to their ultimate value destruction.

## 4. Peculiar share buyback behavior in Malaysia

Majority of the previous studies on share repurchases focused mainly on the determinants and price effects of announcements and actual repurchases of shares. In Malaysia however, 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 their share price. It is often argued that the main reason for companies to repurchase own shares is signaling of undervaluation.(Mansor Isa 2011; Mohd 2013). Companies believe that their shares are undervalued and that share repurchases may correct the mispricing of share prices.

Studies concluded by Rohaida et al (2015) also found that companies do not gain abnormal returns during post resale of treasury shares. Their studies based on 95 Malaysian listed firms' 626 resale events of treasury shares between 2001 and 2012 showed that these companies experience significant positive 4% abnormal gains prior to the actual resale of treasury shares. Using market model (MM) and market adjusted return Model (MAR), their studies concluded that abnormal gain diminished soon after resale. This phenomenon supports the Efficient Semi Strong hypothesis in Malaysian market that share prices fully reflect all published information.

Table 2: Share buyback percentage of sample firms by sectors from 2010 to 2017

| Sector | No. of firms (less than 1%) | No of firms (1% to 5 %) | No of firms (5% to 10%) | Total | Total buyback events | Average buyback per firm per year |
|---|---|---|---|---|---|---|
| **Trading & Services** | 9 | 15 | 7 | 31 | 1,696 | 7 |
| **Industrial Products** | 11 | 21 | 3 | 35 | 2,510 | 10 |
| **Consumer Products** | 7 | 7 | 2 | 16 | 1,233 | 10 |
| **Construction** | 7 | 3 | 0 | 10 | 449 | 6 |
| **Plantation** | 5 | 3 | 1 | 9 | 370 | 5 |
| **Technology** | 5 | 3 | 1 | 9 | 405 | 6 |
| **Property** | 11 | 5 | 1 | 17 | 932 | 7 |
| **Total** | **55 (43%)** | **57 (45%)** | **15 (12%)** | **127** | **7,595** | **51** |

Source: Data compiled by researcher based on Bursa announcements by companies.

Table 2 above shows in a study by Pang (2019), on 853 Malaysian companies from 2010 to 2017, only 14.5% or 127 companies from the total of 853 companies in Bursa Malaysia, carried out their actual buybacks during the period. Of which, 43% or 55 companies completed buyback of less than one per cent of their market capitalization. The table also shows that 32% of the companies went back to the open market every month to carry out buybacks. The balance of 68% of the companies carried out their buyback activities every two months. The study finds that the total buyback value of 127 companies as at year 2017 was RM 1.76 billion or 0.1% of market capital of RM 1486.3 billion for the year.

This is slightly higher than a previous study by Rohaida et al (2013) on 77 companies between the period 1999 to 2006, where the buyback values were RM 558.5 million or 0.06% of market capital of companies at RM 975.4 billion. The results coincide with a study by Abdul Latiff, (2010) that the buyback behaviour of Malaysian companies are having two common characteristics, that they are frequent buyers and often buyback a small portion of the company's shares of about 1% of market capitalization.

Compared with the rest of the world, on average companies buy back 7.7% of their outstanding shares, while U.S. firms seek 9.2%. While in Taiwan and India, buybacks vary between 4.9% and 13.1% respectively. Except for Brazil, Hong Kong, and Japan, the percentage of share buybacks is 3.1% or smaller. (Alberto Manconi et al, 2018)

Table 2 also shows that total share buybacks event over the eight year period from 1$^{st}$ January, 2010 to 31$^{st}$ December, 2017, that there were 7595 buybacks events. The analysis further shows that for Industrial and Consumer Products sectors were most active in their share buybacks every month, while the rest of the sectors like Trading, Construction, Technology and Property sectors were moderately active by buying back in alternate months. This heavy multiple buybacks of shares seems rare and peculiar in occurrence by Malaysian listed companies.

Since companies regulations allow companies to buy back their shares over the 12-month period it is not surprising to note that only few companies in Malaysia would carry out their buybacks in one single buyback. In fact, most companies will carry out their buybacks with multiple buybacks. (Albaity el at, 2016)

Table 5 shows that although there were 212 companies or 24.8% of the total companies which signified their intentions to buybacks, only about half of the companies did carry out actual buybacks. This peculiar pattern of buybacks by Malaysian companies reaffirms Latif and Taufil (2013)'s study that the substitution hypothesis argument does not stand as Malaysian companies do not substitute share buyback for dividend payments.

Table 3: Frequency of buyback events by Malaysian listed companies from 2010 to 2017

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total | % |
|---|---|---|---|---|---|---|---|---|---|---|
| Total buyback events | 1200 | 1180 | 1121 | 868 | 769 | 892 | 1006 | 559 | 7,595 | 100 |

Source: Data compiled by researcher based on Bursa Malaysia website.

Table 3 shows that the share buyback events in Malaysia fluctuate from 2010 with highest buybacks of 1200 events to its lowest of 769 events in 2014 to bounce back to top 1006 in 2016 before scaling downwards to 2017. Table 4 shows that KLCI Index was at 1300 in 2010 and at its height of 1950 in 2014. The KLCI chart moved gradually downwards from 2015 from 1750 down to 1600 in 2016. The buyback events from 2010 to 2017 thus moved inversely to the trend of KLCI Index chart flows. It also denotes that buyback events will increase if the KLCI index declines, signifying bearish stock market conditions when stock prices decline. The reverse is thus that when KLCI index is high, and volatility in share prices amid bullish market conditions with most of the shares overvalued, the buyback events will decrease.

Table 4: Bursa Malaysia KLCI Index Chart from 2010 to 2017


Source: Bursa Malaysia KLCI Index Chart

## 5. Signalling effects as motives of managerial opportunism

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 prospects. 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 use share buybacks to signal undervaluation and to better operating performance. They dual processes have been motive of managerial opportunism whenever there is an increase in cash flows in the companies (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 a 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. This is consistent with the study by Peyer and

Vermaelen (2009), that "market timing" of managers are pertinent to actual announcement when their stock is undervalued.

Advocates of efficient market hypothesis 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.

Since small firms are more likely to have higher information asymmetries and more likely to be undervalued, (Yarram 2013) and (Damodaran 2015) find that in Australia smaller firms experience a higher signalling impact due to the information asymmetries. Consistent with Bargeron et al. (2017), abnormal returns will be higher in market that is likely to be less efficient, where frequent buybacks will thrive in illiquid markets.

Tai et al, (2011), in examining the long-term wealth effects of 948 share repurchase announcements in the Taiwan market, found evidence that share repurchases induce positive buy-and-hold abnormal returns during the 12-month post-announcement period. Their findings support the undervaluation and the signalling hypotheses repurchase and that the increase in firms' value is only short term, but not long term.

## 6. Earnings Per Share (EPS) as motives of managerial opportunism

Study by Jesse M Fried (2001) illustrated the motive of managerial opportunism where managers using the design of share buybacks to boost their own wealth rather than that of the minority shareholder. And it is not mandatory that managers, after announcing share buybacks, actually carry out that obligation. This being the case, Jesse M fried (2001) argued that managers are exploiting that loophole of non-mandatory requirements, and would announce without having intentions to carry out share buybacks but instead would off load their holdings of shares onto the market. However, if the managers were intending to take the advantage of under-pricing of share prices, they would carry out actual buybacks of the under-priced shares. Hence, the net effect would result in transferring of wealth from the minority shareholders to the managers. Jesse (2001) showed that the findings were more plausible as motives of managerial opportunism than the signalling hypothesis.

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. This form of EPS management is not necessarily in the long-term interest of shareholders (Lin et al. 2009).

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. Her 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 Exxon Mobil 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 tool by management, (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.

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.

## 7. Segmenting EPS in Malaysian listed companies

Table 2 shows that from the sample size of 127 companies in Malaysia, 55 companies carried out their buybacks with less than 1% of their total share capital, while the balance of 72 companies bought back more than 1% and above but less than 10% of their total share capital. To adopt Margaret (Peg) Horan (2012)'s method of segmenting EPS of companies, this paper shall focus on segmentation of EPS of the 72 companies in order to determine the real contribution of buybacks in increasing EPS of their respective companies.

There is common belief by practitioners and academics that increased EPS is often associated with share buybacks. Study by Jacob Oded & Allen Michel (2008) touts that share buybacks earnings are flawed. It contended that the buyback of shares did not increase shareholders' holdings and or the economic value of the investors. The same study characterised share buybacks as mere risk – return trade off in assets of companies. The notion of using share buybacks to reverse the effects of dilution of EPS due to issuance of employees' shares has been unfounded as the issuance of additional option shares did not prevent dilution of shareholders' values.

The four criteria are: (1) Companies with negative EPS will be excluded, (2) Companies with Price Earnings Ratio (PE) Ratio of more than 20 will be excluded (3) Companies delisted are excluded and last but not least (4) Companies with segmenting EPS of less than $0.01 will be excluded. (Refer Appendix A)

According to Hribar et al 2006 study and supported by Margaret (2012), an increase of $ 0.01 or more, indicated a net effect of increase in EPS due to share buyback activities. Further to determine the real effects of EPS segmentation, this paper has adopted four criteria in order to analyse the actual improvement of EPS due to share buybacks from increase in companies' operational EPS.

The decision to exclude shares with high PE ratio is because it is often viewed as signs of poor corporate performance by analysts. Mathematically low EPS which is the denominator in computation of PE ratio will result in higher than industry median PE of between 20 and 25. High volatility in share trading shows potential of higher price overvaluation. Furthermore, companies with negative EPS, resulting from poor corporate performance would negate all possible effects of any increase in EPS due to share buybacks.

## 8. Sample size

The sample size of this study is based on mean average of participating companies from 2010 to 2017. The mean percentage of buyback firms in Bursa Malaysia has been consistently at 15% to total listed firms in the exchange since 2005. Table 1 shows that the number of buyback firms rose up to 204 in 2008 and 194 in 2009, presumably due to the effects of global financial crisis in 2008. From 2010 to 2017, the mean average of buyback firms for 8 years is 128 companies. This consistent yearly trend of total number of companies participants in buybacks in post crisis period of 2008, denoted persistent growth in Malaysian economy with abundance of investing activities.

This study focuses only on the buyback behaviour of the main market companies as ACE market's participation in share buybacks is less than 10 companies and thus negligible for inclusion. This study has decided to adopt the actual number of buyback firms in 2017, which is 127 companies as the sample size firms for the study.

For the purposes of analysing buyback behaviour, the 127 companies are further classified into different sectors as in Bursa Malaysia. Table 7 shows that the 127 companies that participated in share buybacks are fairly distributed covering all sectors of companies under Bursa Malaysia. Thus based of the information obtained, the sample companies represent a fair representation of the buying behaviour of companies participating in share buybacks.

Table 5: Summary of actual buybacks of sample companies by sectors in 2017.

| Classification of firms | Total firms | Non buyback Firms | | Announced Firms | | Announced & actual buyback firms | | % of buyback firms to total |
|---|---|---|---|---|---|---|---|---|
| | | No. | % | No. | % | No. | % | |
| Trading & Services | 218 | 155 | 71 | 63 | 29 | 31 | 49 | 14 |
| Industrial Products | 225 | 164 | 72 | 61 | 28 | 35 | 57 | 16 |
| Consumer Products | 130 | 100 | 76 | 30 | 24 | 16 | 53 | 12 |
| Construction | 48 | 34 | 71 | 14 | 29 | 10 | 71 | 21 |
| Plantations | 43 | 31 | 72 | 12 | 28 | 9 | 75 | 21 |
| Technology | 88 | 78 | 88 | 10 | 22 | 9 | 90 | 10 |
| Properties | 96 | 74 | 77 | 22 | 26 | 17 | 77 | 18 |
| Finance # | (32) | NA | NA | NA | NA | NA | NA | NA |
| Hotels | 4 | 4 | 100 | 0 | 0 | 0 | 0 | 0 |
| Mining | 1 | 1 | 100 | 0 | 0 | 0 | 0 | 0 |
| Total | 853 | 641 | 75 | 212 | 25 | 127 | 60 | 15 |

Source: Bursa Malaysia. #Note: The financial sector is under separate legislation for supervision and therefore excluded from this research study. Actual buybacks companies based on Notice of share buyback by companies pursuant to Form 28A

## 9. Descriptive analysis

To determine the statistics on amount and total number of share buybacks, the net share capital of each company ending each year were obtained from individual annual reports of companies. Caution was exercised to use the year end share capital statistics to ensure that treasury shares were excluded from the total share capital as obtained from each annual report.

The percentage obtained for each sector and the number of companies were carefully categorised into 3 separate columns to provide a clearer presentation of actual share buybacks by percentage in each column as presented in Table 3.

Using the result of average buybacks per year, this paper was able to derive the frequency of buybacks for each sector. From the analysis we may conclude that Industrial products sector companies were carrying out their buyback activities on a daily basis during the last 8 years. A word of caution to note here is that the figures and statistics presented in Table 2 were computed using average and may have slight variations if compared to actual. Since the analysis is not for one single year but for the overall 8 years , the use of average will seem to present a near accurate representation of fact and hence safe to be used for frequency of buyback analysis. Table 2 however is the actual record of buybacks by companies based on their Bursa Malaysia announcements; the total buyback events are carefully handpicked from the total of all sectors to avoid any possible duplication of facts.

For segmenting of EPS, the statistics on total share capital, market price, PE ratios, EPS, net profit figures, and year end treasury shares are obtained from companies' respective Bursa Malaysia announcements, annual reports and financial statements to provide an accurate data for computation purposes. Calculation on segmentation of EPS for each company was carried out individually adopting Margret's formula to identify any actual increase of EPS that is more than $0.01 to be considered significant (Hribar et al 2006).

## 10. Findings and Analysis

The findings of the analysis concluded as presented in Table 6 . From the total of 72 sample companies with more than 1% buyback of shares, 22 companies are having negative EPS and excluded, 4 companies with PE higher than 20 are excluded, and 2 companies been delisted are also excluded, leaving a balance of 44 companies for evaluation. Using Margaret's mode of computation, it is found that 39 companies or 54% did not record more than RM0.01 increase in EPS. Only 5 companies or 7 % recorded more than RM 0.01 increase in EPS. It seems as though only 54% of the sample companies did not record more than RM 0.01 increase in EPS. But, if all those 28 companies or 39 % of which were excluded are to be taken into consideration, the results of the findings will yield a total of 93% of companies non-qualified in this segmentation process.

Table 6: Segmenting of EPS for firms with more than 1% buyback of shares in 2017

| **Procedures** | **Number of companies** | **%** |
|---|---|---|
| Total number of companies with more than 1 % buybacks | 72 | 100 |
| Less :Number of companies with negative EPS | 22 | 30 |
| Less: Number of companies with PE higher than 20 | 4 | 6 |
| Less: Number of companies delisted | 2 | 3 |
| Balance of companies with increase EPS | 44 | 61 |
| Less: Number of companies with < RM 0.01 increase in EPS | 39 | 54 |
| Balance of number of companies with > RM 0.01 increase EPS | 5 | 7 |

Source: Data compiled by researcher based on Bursa announcements by companies.

The findings in Table 6 may be concluded that using share buyback exercise to enhance EPS is a fallacy than what is common belief by analysts, academics and investors alike. These findings of using Margaret's model may appear too simplistic to assume the net effects of share buybacks. But surprisingly, shareholders in general, not only in Malaysia but also the rest of the world, tend to agree that the motive of share buybacks is to increase EPS of companies. Perhaps more puzzling is the fact that academics, analysts and investors at large are willing to accept such rationale of increase in EPS and to support the proposed motive without casting any doubts at all.

## 11. Conclusion

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). The increase in holdings of treasury shares by share buybacks through reducing the total share capitals of companies causing an increase in EPS with no change in companies' earnings, would not enhance economic value to shareholders.

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. The question of whether share buybacks will increase actual values of shareholders, the increase holdings of riskier assets in treasury shares should be carefully appraised to dispel any fallacy, myth or delusion formed as the result of share buyback exercise.(Oded & Allen , 2008).

Using share buybacks to enhance earnings management as motives of managerial opportunism should no longer be a novelty of change and need to be carefully assessed for its real net effects. This paper hopes to provide an additional reference to investors and shareholders, to be more savvy in assessing the carefully crafted circular motives of increasing EPS in share buyback proposals. It is hoped that future studies may explore further the determinants used in computing EPS of companies with several alternatives of risk and return trade off and segmentation of its increases.

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## **APPENDIX A**: Segmenting of EPS for firms with more than 1% buyback in 2017

| Sector | Total share capital (M) | Price RM | PE | EPS Cts. | Treasury shares(M) | Net profit (M) | Incr. EPS(RM.) |
|---|---|---|---|---|---|---|---|
| **Properties** | | | | | | | |
| AMPROP (1007) | 591.86 | 0.70 | 12.41 | 23.2 | 18.3 | 137.4 | 0.6 |
| BCB (6602) | 408.2 | 0.58 | 6.75 | 8.2 | 12.2 | 45.42 | 0.034 |
| IGB ( 1597) | 689.5 | 2.97 | 13.6 | 35.0 | 9.3 | 234.6 | 0.31 |
| TROP(5401) | 1,470 | 0.89 | 8.67 | 11.65 | 20.0 | 170.0 | 0.16 |
| YTLLAND(2577) | 836.0 | 0.51 | 5.69 | (16.26) | 15.1 | (74.1) | NEPS |
| **Consumer product** | | | | | | | |
| CAMRES(7128) | 196.8 | 0.37 | 18.3 | 1.36 | 4.89 | 2.50 | 0.0324 |
| DEGEM(7119) | 133.3 | 0.98 | 10.7 | (0.01) | 3.15 | 0.108 | NEPS |
| PWF ( 7190) | 173.9 | 0.97 | 8,87 | 8.68 | 7.59 | 13.80 | 0.362 |
| PWROOT(7237) | 403.02 | 1.76 | 16.8 | 2.82 | 6.1 | 9.7 | 0.036 |
| SIGN(7246) | 394.9 | 0.60 | 7.74 | (0.38) | 5.7 | 6.6 | NEPS |
| TCHONG(4405) | 672.0 | 1.68 | 8.58 | 16.78 | 19.3 | 105.4 | 0.468 |
| UPA(7757) | 79.58 | 2.43 | 3.47 | 11.0 | 2.37 | 9.01 | 0.347 |
| **Construction** | | | | | | | |
| Benalec (5190) | 811.8 | 0.37 | 60.7 | (2.19) | 12.9 | (2.1) | PE>20 |
| Crest Builder (8591) | 178.0 | 0.95 | 7.6 | 41.13 | 6.23 | 72.2 | 1.47 |
| Brem Holding ( 8761) | 345.4 | 0.87 | 15.9 | 11.39 | 5.52 | 38.2 | 0.18 |
| **Technology** | | | | | | | |
| Grand Flo (0056) | 470.8 | 0.23 | 14.1 | 1.17 | 12.26 | 5.4 | 0.031 |
| Notion (0083) | 330.6 | 0.62 | 16.2 | 14.8 | 6.46 | 47.5 | 0.286 |
| Willowglen (008) | 496.0 | 1.09 | 13.0 | 2.28 | 9.40 | 11.08 | 0.043 |
| **Trading &Services** | | | | | | | |
| Sunway(5211) | 4924.4 | 4.44 | 14.8 | 13.66 | 72.2 | 658.9 | 0.20 |
| Berjaya food(5196) | 335.8 | 1.47 | 12.1 | 0.31 | 5.08 | 1.17 | 0.03 |
| Borneo Oil (7036) | 4318.5 | 0.10 | 50.0 | (0.08) | 171.0 | (5.8) | PE>20 |
| Unimech(7091) | 131.2 | 1.03 | 17.5 | (3.82) | 4.6 | (19.5) | NEPS |
| Fitters Divers. (9318) | 480.5 | 0.38 | 36.9 | 3.44 | 12.68 | 4.66 | PE>20 |
| Genting (4715) | 3851.8B | 5.69 | 12.25 | 35.58 | 26.32 | 1365.6 | 0.2 |
| Hai O (7253) | 298.7 | 4.70 | 23.6 | 15.79 | 9.2 | 13.6 | PE> 20 |
| Kumpulan Fima (6491) | 282.2 | 1.71 | 11.15 | 21.2 | 10.8 | 32.1 | 0.45 |
| Lion Forest (8486) | 231.5 | 0.64 | 9.97 | 8.4 | 3.74 | 19.22 | 0.13 |
| Mulpha Inter. (3905) | 319.6 | 2.41 | 5.64 | 73.78 | 1.5 | 235.67 | 0.34 |
| OldTown (5201) | 463.2 | 2.75 | 20.1 | Delisted | 11.7 | - | Delisted |
| Parkson Hold.(5657) | 1093.2 | 0.53 | 56.3 | (14.53) | 24.8 | 25.3 | PE>20 |
| Texchem (8702) | 124.1 | 1.06 | 10.7 | (5.60) | 2.39 | (6.8) | NEPS |
| Tiong Nam(8397) | 457.9 | 1.63 | 17.3 | (0.45) | 6.9 | 6.89 | NEPS |
| Warisan (5018) | 67.2 | 1.98 | 18.4 | 11.5 | 2.0 | 7.0 | 0.3 |
| **Plantation** | | | | | | | |
| Cepat Wawasan(8982) | 318.5 | 0.8 | 41.69 | 1.72 | 9.5 | 5.07 | PE>20 |
| Golden Land(7382) | 222.9 | 0.56 | - | (9.72) | 6.8 | (14.8) | NEPS |
| NPC Resource (5047) | 120.0 | 1.90 | - | (38.62) | 1.5 | (44.5) | NEPS |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Ind. Products** | | | | | | | |
| Ancom (4758) | 215.1 | 0.53 | 6.3 | 8.17 | 3.69 | 17.5 | 0.14 |
| Ann Joo (6556) | 538.3 | 3.41 | 9.4 | 28.13 | 68.3 | 149.5 | 4.3 |
| CB Ind. (7076) | 538.2 | 1.71 | 10.1 | 7.8 | 14.2 | 41,2 | 0.24 |
| CSC Steel (5094) | 380.0 | 1.28 | 13.8 | 5.93 | 11.3 | 21.8 | 0.17 |
| CYMAO (5085) | 73.7 | 0.32 | 11.4 | (7.21) | 1.46 | (4.28) | NEPS |
| DUFU (7233) | 175.5 | 1.14 | 5.75 | 22.50 | 7.9 | 36.8 | 0.98 |
| Eksons Corp (9016) | 164.2 | 0.82 | - | (7.31) | 3.3 | (20.18) | NEPS |
| Eonmetall (7217) | 188.4 | 0.72 | 8.09 | (3.22) | 2.5 | (5.98) | NEPS |
| EP Manuf.(7773) | 165.9 | 0.48 | - | (7.49) | 6.8 | (11.89) | NEPS |
| FIMA Corp (3107) | 282.2 | 2.03 | 10.3 | 11.36 | 4.17 | 32.06 | 0.16 |
| KOMARK Corp (7107) | 164.4 | 0.19 | - | (0.06) | 4.38 | (14.1) | NEPS |
| Lion Industries (4235) | 717.9 | 1.25 | 6.6 | (9.50) | 32.9 | (47.0) | NEPS |
| Leader Steel (9881) | 126.6 | 0.45 | 10.5 | 3.08 | 1.53 | 3.80 | 0.036 |
| NYLEX (4944) | 194.3 | 0.82 | 7.05 | 10.7 | 2.36 | 20.0 | 0.126 |
| Success Trans.(7207) | 247.6 | 1.05 | 6.35 | 3.04 | 5.8 | 7.0 | 0.71 |
| SUPERMAX (7106) | 680.0 | 2.16 | 18.7 | 16.18 | 11.8 | 110.1 | 0.285 |
| Tong Herr (5010) | 157.4 | 4.0 | 10.2 | 39.41 | 2.97 | 65.8 | 0.8 |
| UCHI Tech (7100) | 449.4 | 2.63 | 18.5 | 15.78 | 7.0 | 69.0 | 0.24 |
| WEIDA (7111) | 133.3 | 2.21 | 25.2 | Delisted | 6.4 | - | Delisted |
| White Horse (5009) | 240.0 | 1.98 | 19.0 | (15.4) | 4.5 | (27.2) | NEPS |
| YI LAI (5048) | 160.0 | 0.75 | - | (2.64) | 4.6 | (3.2) | NEPS |

**APPENDIX B**

## Explanation of terms

| | |
|---|---|
| ACE companies | Formerly known as Second Board. Sponsor- drive companies with promising potential of future profit with minimum 200 public shareholders but no requirement of financial performance. |
| Bursa Malaysia | Malaysian Stock Exchange |
| Companies Act Malaysia | The Companies Act 2016 (CA 2016) repealed the Companies Act 1965 (CA 1965) and changed the landscape of company law in Malaysia. The CA 2016 reformed almost all aspects of company law in Malaysia. |
| EPS | **Formula**<br>EPS =( Net income-preferred dividend) / Total share issued – Treasury shares<br>When share buyback is exercised, the total share issued will be reduced (denominator) causing an increase in EPS. The buyback of shares must be of magnitude to cause an effect on EPS. |
| Main Market companies | The Main Market is under the Securities Market of Bursa Malaysia where it currently holds 906 companies. The company must have a market capitalization of more than RM500 million after listing. Besides that, there must be a one-full year of revenue generated. |
| Margaret (Peg) Horan's model of segmenting EPS formula (2012) | $\boldsymbol{Yt = Nt/ It - ((Nt/ It) - N\,t\,/( It - Tt))}$<br>Yt = EPS reported for the current quarter<br>Nt= net income at present time<br>It= = issued shares in the present quarter<br>Tt= treasury shares in the present quarter |
| PE Ratio | PE ratio = Market value price per share/ Earnings per share<br>The P/E ratio helps investors determine the market value of a stock as compared to the company's earnings. It also indicates whether a company's stock price is overvalued or undervalued.<br>P/E can be benchmarked with industry's median PE of between 20 and 25. |
| Section 67A. Company's Act of Malaysia | A Public company is allowed to buy back its own shares if authorized by shareholders in a general meeting. |
| Treasury shares<br>Subsection (3B) of section 67A | A company may retain the shares so purchased in treasury (referred to as "treasury shares"); or to cancel the shares so purchased. |
| Share dividends<br>Subsection (3B) of section 67A | The directors of the company may distribute the treasury shares as dividends to shareholders |
| Sale of treasury shares<br>Subsection (3A) of section 67A | The directors may decide to resell the treasury shares on the market of the Stock Exchange on which the shares are quoted |
| Voting rights & dividend | While the shares are held as treasury shares, the rights |

| | |
|---|---|
| Subsection (3A) of section 67A | 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. |
| Share buybacks in Malaysia | 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. |
| Risk-return trade off. | According to Oded et.al (2008) that in a buyback exercise, the firm retires safe cash and to acquire treasury shares whish is more risky. With the increased risk the expected return increases in the higher expected EPS. |