CHAPTER 1 : INTRODUCTION

Companies have two main cash disbursement methods for shareholders namely dividends and share repurchases. Dividends have been the primary vehicle for cash distributions to shareholders, but share repurchases have exhibited an increased popularity during recent years in the USA and also gaining popularity in the Asian countries. Why are share repurchases more attractive than dividends? What are the factors that contribute to its increasing popularity? In Asia, there have been plenty of investment opportunities for companies with lots of reserves. So why is it that out of the crisis, shareholders are getting their cash back?

Malaysia's decade-long growth record came to a halt with the depreciation of ringgit after the flotation of the bath on 2 July 1997. During this period of time, the net tangible assets per share of the companies were much higher than the share prices quoted on the Kuala Lumpur Stock Exchange. Malaysian government has installed various measures to help bring about economy recovery, among others, is the share repurchases. It was first implemented on September 1997 with the objective to help companies troubled by drastic drops in their share prices. According to Dr Mahathir, through share repurchases, the Government hopes to push up their prices and helps the companies to overcome problems arising from the bearish sentiments on the Kuala Lumpur Stock Exchange (Business Times 19 Aug 98). Reason being the depressed shares value have left Malaysian companies to become vulnerable to takeovers and acquisitions by foreigners whom will then strip the companies' assets. In other word, share repurchases programmes are being used as a vehicle to boost their shares. This is because they believe share repurchases programmes generally send out a positive signal to the general public from management with regards to the perceived value of a company and hence is a mechanism that should perhaps be encouraged during the market environment at that point of time.

But as more and more companies jump into the repurchase bandwagon, some investors are beginning to question if it is such a good idea for companies to repurchase their own shares at a time when their share prices are near pre-crisis high and the Asia region abounds with investment opportunities. In other word, what works best for the rest of the world does not necessary work well in the Asia region especially in Malaysia context. Can share repurchases actually increase share prices?

Various layman's reasons have been extended to explain why the shares of a company that has announced a share repurchase programme outperform the market. Appended below are some of the salient points:

- A share repurchase is a strong sign of corporate financial health. When companies repurchase significant number of their own shares, it demonstrates that a company has sufficient capital to cover both its expenses and make a major investment.

- Repurchases increase earnings and the value of shares. When a company repurchase shares, the total number of shares outstanding are reduced. That increases the price of every share you own as well as earnings.

- Share repurchases anticipate higher share prices. When companies repurchase their shares, it usually means corporate owners and managers – the ultimate insiders – perceive that the company's share is undervalued and expect share prices to go up.

- Share repurchases cut your taxes. If a company pays you a dividend, you have to report it and pay taxes on it right away. But when a company buyback their shares, your wealth increases along with share prices but you do not have any immediate tax obligation.

- Repurchased shares can act as a safety net. A company that holds a large number of its own shares has a strong incentive to step in and purchase more shares when price declines.

- Increase leverage. If a company wishes to increase debt in its capital structure, it could borrow funds and use the proceeds to repurchase shares or offer the shareholders the opportunity to exchange their shares for a new debt issue.

Generally, from the layman's point of view, share repurchases are welcomed by investors as they are seen as a good way to return capital to shareholders for companies with no immediate need for surplus cash. Furthermore, share repurchases help to recycle funds from companies that do not need them to those that do, and in this process it reinforces the shares market's role in allocating capital. In terms of economic value, if a company can find an investment opportunity and has the strength to undertake it, it should keep the capital and invest. But if a company prefers to focus on its core business and there are no investment opportunities available, then shareholders are better off if the surplus capital is returned to them.

On the other hand, there are some suggestions that share repurchases are becoming an easy way out for managers who are running low on investment ideas, lacking entrepreneurial instincts or simply too timid to venture abroad. The negative perception is that these companies do not have anything better to do with their money. Also, some concern is that some management may be advocating repurchases for their own rather than for the company's interest, and in cases of highly geared companies, share repurchases may aggravate the company's indebtedness as they substitute equity for more debt.

How true are the above layman's reasons with regards to market reaction to share repurchases programmes announcements? What the academics have to say? The answer to this question has been documented extensively.

Vermaelen (1981) finds abnormal price increase of 3.37% after the announcement of a share repurchase. Besides that, the academic finance literature has also produced various explanations for the increase in company value after share repurchases announcements. Among others, Vermaelan (1981), Dann (1981), and Comment and Jarrell (1991) suggest information signalling as a possible explanation initiating open-market share repurchases programmes, Jensen (1986) proposes the free-cash-flow hypothesis, and Ikenberry and Vermaelen (1996) suggest the insider-trading option model.

The remainder of the paper is organised as follows. Chapter two examines the legal framework of share repurchases in Malaysia context. Chapter three reviews the share repurchases literature review. Chapter four presents the methodology and analysis of the data. Chapter five provides the research results and discussion on results. Finally, Chapter six summarises and concludes the paper. It also provides limitations of this study and recommends suggestions for future research. The appendix features lists of companies that contain share repurchases programmes announcements and their statistical results before and after the share repurchases programmes announcements.