CHAPTER 2 : LEGAL FRAMEWORK

2.1 USA

In the USA, share repurchases are divided into two major categories, that is tender-offers (fixed-price or dutch-auction) and open market share repurchases. In a fixed-price tender-offer, the repurchasing company specifies the number of shares ought to be purchased at a pre-determined offer price. Shareholders may tender their shares until the expiration date of the offer. In a dutch-auction tender-offer, the repurchasing company also specifies a number of shares sought, but instead of fixing a single price, it determines a range of prices within where each tendering shareholders can choose his or her minimum acceptable price (Vermaelen 1981).

In open market share repurchases programmes, companies announce their intention to buyback a specific percentage of their outstanding equity in the open market. Open market share repurchases involve a gradual process of buying back quantities of shares in the open market (Vermaelen 1981). The focus of this study is on the open market share repurchases due to the fact that the share repurchases in Malaysia fall into this category.

2.2 Malaysia

2.2.1 Companies Act

In Malaysia, prior to 1 September 1997, the only mode of cash distributions to shareholders was by way of dividends. The provision of share repurchases was first introduced in the Companies (Amendment) Act 1997 and enforced in 1 September 1997. With the provisions of section 67A of the Companies (Amendment) Act 1997, a public listed company can purchase its own shares if authorised by its Articles of Association (Companies (Amendment) Act 1997). At that point in time, section 67A (3) of the Companies (Amendment) Act 1997 read as "*where the company purchases its own shares the company's issued capital shall be diminished by the cancellation of the shares* *so purchased and the amount by which the company's issued capital is diminished shall be transferred to the capital redemption reserve*". This section allowed public companies to purchase their own shares or gave financial assistance to any person for the purpose of purchasing its shares. However, the repurchased shares are cancelled and automatically delisted under Section 67A. Issued capital is correspondingly diminished and transferred to the capital redemption reserve, but cancellation is not, for the purpose of the Act, deemed to be a reduction of share capital.

The Companies (Amendment) (No.2) Act 1998, which was approved by the Dewan Negara in 1 October 1998, introduced amendments and new provisions with regards to share repurchases. Firstly, "financial assistance to any person for the purposes of purchasing its shares" is deleted from section 67A(1) and inserting in section 67A(2) the words "and will not become insolvent by incurring the debts involved in the obligation to pay for the shares so purchased."

Secondly, the following alternatives or options have also been provided for the directors to decide:

- Retaining all the shares bought back as treasury shares; or
- Cancelling all the shares bought back; or
- Cancelling part of the shares bought back and retaining the remainder as treasury shares.

Finally, the directors may distribute the treasury shares as dividends to shareholders as "share dividends", or resell the treasury shares on the market of the stock exchange on which the shares are quoted.

Treasury shares are provided with the following features in the new provision 67A (3A)(b) of the Companies Act 1965 :

- The voting rights, dividends and participation in other distribution are suspended;

- They shall not be used for calculating the number or percentage of shares or of a class of shares in the company on substantial shareholding, takeovers, notices, the requisition of meetings, quorum for a meeting and the result of a vote on a resolution;

- As regards to distribution as share dividends, the costs of the shares on the original purchase shall be applied in the reduction of either the share premium account or the funds otherwise available for distributions as dividends or both;

- As for cancellation of shares bought back or treasury shares, the issued share capital shall be diminished by the shares so cancelled and the amount by which the company's issued capital is diminished shall be transferred to the capital redemption reserve account.

2.2.2 Kuala Lumpur Stock Exchange

"Members' Circular dated 10 September 1997 - Guidelines governing purchase of own shares by listed companies" was the first of the nature introduced by KLSE in relation to the amendments made with the Companies Act. Among others, Section 2 of the circulation states that immediate announcement must be made to the Exchange of any decision by the board to submit to shareholders a proposal for the purchasing of its own shares or to give any financial assistance to any person for the purpose of purchasing its own shares.

This circular was superseded by "Members' Circular dated 15 September 1997 - Guidelines governing purchase of own shares by listed companies". According to the circular dated 15 September 1997, Section 2 – Announcement to the Exchange of proposed purchased was waived for a period of three (3) months from the date of this circular unless otherwise notified by the Exchange.

"Members' Circular dated 6 January 1998 - Guidelines governing purchase of own shares by listed companies" was subsequently introduced to extend the waiver in section 2 until further notice by the Exchange instead of the proposed three months time period.

In line with the more comprehensive framework for economic recovery mechanisms by the National Economic Recovery Plan, the "Members' Circular dated 1 November 1998 - Guidelines governing purchase of own shares by listed companies" was finally implemented. According to Section 1.4 (b) (i) of this circular, a listed company shall ensure that any decision by the board to submit to shareholders a proposal for the company to be authorised to purchase its own shares must be announced to the Exchange immediately.

2.2.3 How do companies initiate share repurchases

A listed company must not purchase its own shares unless the shareholders of the listed company have given an authorisation to the directors of the listed company to make such repurchases. Thus, at the start, share repurchases required a special resolution, which can only be passed with at least 75% shareholders' approval at Extraordinary General Meeting. Companies will have to issue a circular detailing the potential impact of share repurchases to seek shareholders' approval. Approval will cover the period up to the next Annual General Meeting, and new approvals will have to be sought for subsequent yearly extension, for which 51% shareholders' approvals are required. Management is normally given the authority to repurchase up to a maximum of 10% of their outstanding paid-up capital. Any purchase by a listed company of its own shares and / or resale of its treasury shares may be only be effected on the market of the Kuala Lumpur Stock Exchange. Finally, In Malaysia, the Board of Directors authorises a maximum repurchase amount but leave the final repurchase decision to the discretion of manager. They can carry out the share repurchases programme over several months or even years, and are under no legal obligation to repurchase any shares at all.

2.3 Financial impact of share repurchases

Theoretically, earnings per share (EPS) would be enhanced because share repurchases would reduce the effective paid-up capital used to calculate EPS. At the same time, share repurchases will deplete cash, so the implicit assumption is that management has no immediate or more productive use of funds.