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*In Defense of Buybacks*

By Emily Chasan

When it comes to returning cash to shareholders, many investors and analysts look upon buybacks with a fair share of skepticism. The worry, of course, is that executives are artificially boosting earnings per share by decreasing the denominator in order to inflate their bonuses.

This concern is not entirely misplaced: A new study of U.K. companies between 1998 and 2006 found that companies with an explicit link between executive bonuses and earnings-per-share figures were twice as likely to buy back stock as other firms. But that same study concludes this isn't necessarily to the detriment of shareholders.

"It is a well-known anecdotal fact that one of the main factors that drive stock repurchases is executives' concern about their EPS figures," says Steve Young of Lancaster University and co-author of the study published in the **American Accounting Association's** journal. "I was really quite cynical that it was an earnings management device, but we started to realize that actually this outcome might not be as costly for shareholders as we might have first anticipated and there are actually very good outcomes for shareholders."

Among those positive outcomes is that companies doing buybacks were not substituting share repurchases for dividends. Rather, companies that bought back shares were actually paying higher dividends than other companies. They also found that the buybacks had no effect on long-term stock returns or return on asset figures for companies in the two years following the share buyback. The trend bears out for U.S. companies too. Last year, more than three quarters of the 342 S&P 500 companies that bought back shares also paid out cash dividends.

This is an important consideration for CFOs who are looking for the best way to return the massive amounts of cash accumulated during the recession.

Last year, S&P 500 companies spent some \$299 billion buying back their shares in 2010, up 117% from a year earlier, and the trend looks poised to continue. In the fourth quarter alone, share buybacks stood at \$86.4 billion, the highest since the third quarter of 2008.