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MANAGEMENT PERCEPTIONS OF SHARE REPURCHASES IN EMERGING MARKETS: THE CASE FOR MALAYSIA

Lee Siew-Peng[1*] and Mansor Isa[2]

[1]*Faculty of Accountancy and Management, Universiti Tunku Abdul Rahman, Bandar Sungai Long 43000 Selangor, Malaysia*
[2]*Faculty of Business and Accountancy, Universiti Malaya, 50603 Kuala Lumpur, Malaysia*

[*]Corresponding author: leesp@utar.edu.my

ABSTRACT

The purpose of this paper is to study the perceptions of Malaysian chief finance officers (CFO) concerning their reasons for repurchasing shares. We sent a survey questionnaire to the chief finance officers of all the companies listed on the Malaysian Stock Exchange that made repurchase announcements over the period 1 September 1997 until 31 December 2011. The results indicate that the main reason for Malaysian companies to engage in share repurchases is to protect their share prices from market undervaluation. This reason supports the signalling hypothesis, which is found in most of the empirical studies on market reaction to share repurchase announcements. Other repurchase motives, such as to increase EPS, to adjust capital structure, and to use as a substitute for cash dividend received less support from our respondents. These findings are useful, especially to investors for understanding the intention of companies to repurchase shares.

Keywords: share repurchase, undervaluation, hypothesis, management perception

INTRODUCTION

Share repurchase is a rather recent phenomenon in the Malaysian corporate scene, which came into effect in the aftermath of the 1997–1998 financial crisis. The timing of the regulations was most likely motivated by the expectation that companies would quickly take the opportunity to repurchase their undervalued shares. In this context, repurchase is perceived by the regulators as an instrument to support declining share prices. In theory, there are several possible motives for repurchase: to signal underpricing of shares, to signal future performance of companies, to substitute cash dividends for capital gains, to increase leverage in

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the capital structure, to help protect a company from potential takeovers, and to accumulate treasury shares. Although empirical studies generally find a positive market reaction to repurchase announcements, the true reason is relatively unknown as positive market reactions may be consistent with several motives. It is also possible for companies to have multiple objectives for engaging in share repurchases.

Several researchers have conducted management surveys to determine firms' reasons for making repurchases. However, the findings of these surveys indicate significant inconsistencies in the managers' responses. For example, surveys in the US tend to find responses related to under-pricing of shares as the main motivation for share repurchases (Wansley, Lane, & Sarkar, 1989; Tsetsekos, Kaufman, & Gitman, 1991; Baker, Powell, & Veit, 2003; Brav, Graham, Harvey, & Michaely, 2005). In Australia, the main reason for repurchases seems to be to increase earnings per share (EPS) (Mitchell, Dharmawan, & Clarke, 2001), while, in the UK, managers cited the need for an optimal capital structure as their main reason for repurchases (Dixon, Palmer, Stradling, & Woodhead, 2008). Although there may be common motives in the list of motivations resulting from these surveys, the fact remains that the leading reason is the divergence across markets. More surveys are needed to discover whether management repurchase decisions are based on common grounds across markets, or whether there are unique reasons for each market.

The objectives of the present study are to obtain direct information from the companies concerning their actual reasons for making repurchases and to understand various aspects of repurchasing practices. A two-page survey instrument that contains questions concerning the motives and practices for repurchases is used in the survey. The study contributes to the literature in several ways. Previous studies on managers' views concerning repurchases have been performed in developed markets, such as the US, UK and Australia; the present study is the first such study in Malaysia, hence providing evidence from a developing market. In addition, Malaysia's repurchase regulations are rather strict with respect to announcement requirements, timing, price, and amount restrictions compared to other countries. Therefore, this study could be compared with others in terms of differences in regulations, market size, and market maturity.

REPURCHASE REGULATIONS

Share repurchase has been permitted in the Malaysian market since 1 September 1997.[1] Companies are only allowed to make repurchases in the open market, and shareholders' approval is required before repurchases can occur. The regulations require the shareholders' approval and for companies to make an immediate announcement to the stock exchange upon the board's decision to engage in share repurchases. Shareholder approval may be obtained in an annual general meeting or in an extraordinary general meeting. The approval is valid for a year or until the next shareholders' annual general meeting. The actual purchase of shares may be spread over a period of time and may even continue for over a year. If the repurchase is not completed in the approval year, a new approval must be obtained. Companies are allowed to repurchase a maximum of 10% of the number of outstanding shares.

The regulations further stipulate that repurchases can only be funded by retained earnings and/or the share premium account; they may also be funded from other sources, but they must be sufficiently backed by retained earnings and the share premium account. The firms making repurchases are also required to disclose details of the exchange transaction, such as the repurchase price and volume at no later than 6.30 p.m. on the day the repurchase was made. Regarding the repurchase price, the rules require that it must not be greater than 15% above the 5-day average price for that security calculated over the last five market days immediately prior to the repurchase date. Local regulations allow repurchased shares to be cancelled or retained as treasury shares or to be partly cancelled and partly retained. The treasury shares may be used for stock dividend distribution, employee share option schemes, or re-sold to the market. In any case, once shares are repurchased, the number of outstanding shares and the equity component in the capital structure will be reduced. Repurchased shares are not entitled to voting rights or dividend payouts.

The local regulations differ significantly from those in the US, but are more similar to the UK, Hong Kong, and European markets. A detailed discussion on repurchase regulations across ten of the world's largest markets is provided by Kim, Schremper and Varaiya (2005). In the US, Canada, and Japan, share repurchases do not require shareholder approval as is required in Malaysia and many other markets. Furthermore, there are no restrictions with regards to the timing, volume, or repurchase price levels in the US, and companies are not required to report their repurchase activities to the market. In Malaysia, as discussed above, there are various restrictions concerning a repurchase transaction, the most important of which includes price and volume restrictions as well as reporting requirements.

REPURCHASE HYPOTHESES

Several hypotheses are discussed in the finance literature on the possible reasons for companies wanting to repurchase their shares. Grullon and Ikenberry (2000) and Dixon et al. (2008) present an excellent discussion on various repurchase hypotheses. In this section, we evaluate the merits of these hypotheses when applied to the local market.

Presumably, the most prevalent hypothesis is the signalling of the underpricing of shares. This phenomenon occurs when a repurchase decision is made because the firm's management believes that its shares are undervalued by the market. Being an insider, the management is assumed to possess superior knowledge about the firm compared to the general public. When a company announces a repurchase decision, this announcement is taken by the market as signalling an underpricing of shares, and a positive market reaction is expected. The market reaction, therefore, prevents further share undervaluation. In addition, buying shares at an undervalued price may also be considered a good investment for the firm. However, a more traditional application is the signalling of a better financial future for the firm. Due to information asymmetry, the good prospect of the firm may not have been completely incorporated in the current market price. In other words, the management expects share prices to adjust upwards once the market becomes aware of the hidden information. Whatever the signalling case may be, the repurchase decision is driven by the discrepancy between management valuation and market valuation. Together with the signalling reason, there are other closely related motives for repurchases, such as "to stabilise or to support share prices". The management feels that the share prices have dropped too low in relation to the fair value, which prompted them to take action in an effort to prevent prices from further declining.

Another often discussed motive for share repurchase is to cause a change in the capital structure, which comes in the form of reducing outstanding shares and the equity component, thereby increasing leverage. If the repurchase is financed by debt, gearing ratios will adjust more rapidly as the level of debt is increased, while at the same time, the level of equity decreases. Increasing leverage in general may reduce the cost of capital. Capital structure studies in the US have documented that the market reacts positively to changes in capital structure, which leads to an increase in leverage. However, in Malaysia, Isa (2008) finds that most companies are averse to debt and have rather low debt ratios. This phenomenon may imply that companies are not keen to increase their respective leverage. Furthermore, a study by Kester and Isa (1994) finds that managers prefer new equity to debt when external financing is needed—a finding that is contradictory to the pecking order hypothesis found in most developed markets. Hence, the local market may not attach a valuation effect to a leverage increase decision of a firm similar to that found in developed markets.

Grullon and Ikenberry (2000) mention that in press statements announcing a repurchase, managers often state that the reason for repurchases is to increase EPS. It is indeed true that repurchases would reduce the market capitalisation of a company, and in turn, increase a company's EPS as earnings, which are distributed across a smaller volume of shares. As long as analysts and investors are placing importance on the role of EPS in share valuation companies, they may continue to use share repurchases to enhance their respective EPS. However, it should be noted that the increase in EPS is due to the accounting treatment of repurchases and should not be regarded as a source of value. The source of value necessarily comes from a more fundamental reason that takes place in a repurchase activity, such as a better allocation of assets where low-yielding excess cash is used to invest in the companies' respective undervalued shares.

Share repurchases may act as a substitute to cash dividends, thereby enabling companies to distribute cash to shareholders in the form of capital gains as opposed to cash dividends (Grullon & Ikenberry, 2000; Grullon & Michaely, 2002; Skinner, 2008). In markets where capital gains taxes are lower than dividend taxes, share repurchases may become a better alternative for cash distribution among shareholders. Although the dividend substitution hypothesis suggests a positive impact of share repurchases on market prices, this effect may not be that obvious when applied to the Malaysian setting. In Malaysia, capital gains are non-taxable. Before 2008, Malaysia practiced a full imputation tax system on cash dividends, but since 2008, a single tier tax system has been implemented. Briefly, in a single tier tax system, dividends are non-taxable. Hence, cash dividends and capital gains would similarly affect shareholder's wealth.

Other hypotheses, such as the anti-takeover strategy and the accumulation of treasury shares, may not be important motives in the local context. This conjecture stems from the fact that restrictions on the amount of shares and repurchase prices may not be significant enough to deter takeover threats. Regarding treasury shares, their accumulation is not a necessary condition for the purpose of stock dividends and ESOS, as new shares may be created from the capital accounts.

Given the discussion above, it seems logical to expect that the main reason for local firms to repurchase shares is related to their undervaluation of shares. Other hypotheses, such as dividend substitution and altering capital structure, may not be supported based on economic arguments and firms' practices. Increasing EPS may seem to be a popular motive among market participants, but this phenomenon is just an accounting outcome of the repurchase activities.

LITERATURE REVIEW

Market-based Research

Most previous studies on share repurchases find a positive market reaction to repurchase announcements. This positive reaction is observed in different markets across the globe after the announcement of a repurchase programme, as well as after the announcement of an actual market repurchase. Studies on the announcement effect of a repurchase programme in the US market include Dann (1981), Ikenberry, Lakonishok and Vermaelen (1995), and Chan, Ikenberry and Lee (2004). These studies find the announcement of abnormal returns to range between 3.0 and 4.0%. Abnormal returns of various magnitudes are also found in other markets, such as the following: in Australia by Otchere and Ross (2002); in Japan by Zhang (2002), and Hatakeda and Isagawa (2004); in Korea by Lee, Jung and Thornton (2005); in Malaysia by Lim and Bacha (2002), and Isa and Lee (2014); in China by Huang and Zhou (2007); and in New Zealand by Koerniadi, Liu and Tourani-Rad (2007).

Studies on market reaction to actual repurchases include Vermaelen (1981), Comment and Jarrell (1991), Grullon and Michaely (2002) for the US market; Zhang (2005), and Firth and Yeung (2005) for the Hong Kong market; McNally, Smith and Barnes (2006) for the Canadian market; Huang and Zhou (2007) for the Chinese market; and Ginglinger and Hamon (2007) for the French market. Generally, these studies find the abnormal returns around the repurchase days to be between 2.5% and 3.5%, except for the Hong Kong market where the abnormal return is much lower – at less than 1.0%. In Malaysia, Isa, Ghani and Lee (2011) find an abnormal return of 1.28%.

Although empirical results indicate an increase in share prices on a repurchase announcement, it is not immediately clear which factors drive the market reaction. A positive market reaction may be consistent with several hypotheses, such as the signalling of undervaluation, substitution of a cash dividend for capital gains, increasing leverage, distribution of excess cash or lack of profitable investments. The majority of the studies seem to support the signalling hypothesis; these studies include Vermaelen (1981), Ikenberry et al. (1995), Stephens and Weisbach (1998), Kahle (2002), Grullon and Michaely (2004), Chan et al. (2004), and Firth, Leung and Rui (2010).

Studies focusing on other hypotheses are lacking. Skinner (2008), Von Eije and Megginson (2008), Andriosopoulos and Hoque (2013), and Jiang, Kim, Lie and Yang (2013) study the US and European markets, respectively, and conclude that there is an observable trend among firms utilising share repurchase for replacing dividends as a form of cash distribution to shareholders. Grullon and Ikenberry (2000) note that, in 1998, for the first time, the amount of cash spent on repurchases in the US surpassed the amount of cash dividends. Their study also finds that the average dividend payout ratio fell from 22.3% in 1974 to 13.8% in 1998, while the average repurchase payout ratio during the same period increased from 3.7% to 13.6%.

Other studies, such as Guffey and Schneider (2004), Grullon and Michaely (2004), Espenlaub, Lin, Strong and Wang (2006), and Oswald and Young (2008), present evidence that is consistent with the distribution of excess cash hypothesis. Specifically, Stephens and Weisbach (1998), and Lee and Suh (2011) observe that firms with more excess cash, *ceteris paribus*, tend to buy back larger volumes of shares. Evidence of repurchasing shares to influence firms' gearing is presented by Chan et al. (2004), and Guffey and Schneider (2004), while Bens, Nagar, Skinner and Wong (2003), and Hribar, Jenkins and Johnson (2006) show evidence in support of firms' efforts to increase EPS or to prevent the dilution of EPS. Regarding takeover deterrence, Dittmar (2000) fails to find any evidence that takeover deterrence is a motive for open stock repurchases.

Overall, the results of previous studies support the role of share repurchases in enhancing firm market value, as reflected by the positive market reactions. However, the source of the value increase is relatively uncertain. The majority of the previous studies seem to indicate consistency with the undervaluation signalling theory.

Survey Research

In the quest to determine the real reasons for companies making repurchases, several researchers resort to asking the managers directly about their reasons for making such repurchases. In this section, we discuss survey evidence from the US, Australia, and the UK pertaining to repurchases. The US surveys are provided by Wansley et al. (1989), Tsetsekos et al. (1991), Baker et al. (2003) and Brav et al. (2005); the Australian evidence is provided by Mitchell et al. (2001); and the UK evidence is provided by Dixon et al. (2008).

Wansley et al. (1989) examine the view of US corporate management on the use of open market repurchases and tender offer repurchases. Based on 98 repurchase respondents, the most important reason for repurchases was management's perception that shares were undervalued, followed by "to signal management's confidence in the future of the firm". Respondents also agreed to a lesser extent with the motives "to increase leverage", "to distribute cash" and "the lack of good investments". Managers generally disagree with the motives "share prices were low", "as a takeover defence strategy", and "as a dividend substitution strategy".

Tsetsekos et al. (1991) survey major US corporations concerning their repurchase motives. Based on 183 respondents, the authors find that the most important repurchase reasons are "to change firm's capital structure", "to raise share prices" and "to signal information to the market". In a separate question, the respondents agreed that the main circumstances that lead to share repurchases are "low stock price", followed at a great distance by "the need for treasury shares" and "lack of profitable investments".

Baker et al. (2003) survey top financial executives to understand their perspective regarding firms’ share repurchases in US companies in the late 1990s. Based on 194 responses, their results indicate that important reasons for repurchases include "to add value to shareholders", "low share prices", hence making it a good investment, "to increase EPS", to "support share prices", and "to distribute excess cash". Less important motives include "to convey positive information", "tax-efficient way to distribute cash" and "to accumulate treasury shares". Respondents show less agreement for other motives, such as "to change capital structure", "as a substitute for cash dividend" and "as a takeover defence strategy".

In a more recent study, Brav et al. (2005) find that the method and purpose of dividend and repurchase payments were basically different. Specifically, repurchases were believed to be a more flexible form of payment that was paid out of temporary income rises or when good investments were hard to come by, while dividend payments were considered to be less flexible, and, therefore, paid out of permanent income rises. The survey finds that both dividends and repurchases are generally used to convey information to investors, thereby providing strong support to the signalling hypothesis. Moreover, while dividend payments also support free cash flow and clientele hypotheses, repurchase programmes were used to invest in their own shares due to very low prices as well as to signal undervaluation and allow managers to recognize repurchases as a takeover defence strategy.

Mitchell et al. (2001) survey managements' motivations for repurchases in Australia. Based on the mean score of 112 respondents, their results reveal that the most relevant motivations are to "improve EPS", followed by "the undervaluation reason" and "to achieve optimal capital structure". Respondents show a lack of support for the motives "to signal management's confidence in the future of the firm", "to support share prices" and "to increase leverage". Australian managers do not seem to support the "takeover defence strategy" and "substitution for cash dividends" as acceptable repurchase motives. Furthermore, Australian managers believe that they are familiar with the potential benefits of repurchases, but are uncertain of the shareholders' understanding of repurchase implications.

A recent study by Dixon et al. (2008) focuses on repurchase practices in the UK. The authors survey the motives for repurchases among finance directors of the top 200 UK companies. The results indicate that the primary motive for share repurchases in the UK is "to achieve an optimal capital structure". The authors regard this result as demonstrating that lowering the cost of capital is a major function of UK directors. The next important motive is "to return excess cash to shareholders", followed by "to improve EPS", and "to increase gearing". Less important reasons include "lack of good investments" and "undervaluation of shares" and "to signal management's confidence in the future of the firm". UK managers do not seem to support "substitution for cash dividends", "low share prices" and as a "takeover defence strategy" as important motives for repurchases.

In summary, prior theoretical research has developed an extensive list of motivations for share repurchases. However, studies of market behaviour are unable to produce a satisfactory single explanation for repurchases, despite the fact that the majority of the evidence seems to be consistent with the signalling hypothesis. Survey-based studies in the US, UK, and Australia tend to support the views that share repurchases are used when companies are undervalued and to signal the management’s outlook concerning the future of the company. Other important motives include "to increase EPS" and "to achieve an optimal capital structure". Secondary motives include "to distribute cash to shareholders", "lack of good investments" and "to support share prices". The use of repurchases as a "takeover defence strategy" and "as a substitute for cash dividends" does not gain support from the surveyed managers.

METHODOLOGY

Data were obtained from a mailed survey using a two-page questionnaire. The questionnaire is divided into three parts. The first part consists of several questions that are designed to obtain information regarding the objectives for repurchase and methods of implementation. The second part of the survey asks respondents to indicate their level of agreement or disagreement with several statements on corporate motivations for making share repurchases. The statements are related to possible motives for repurchases as found in finance texts, as well as from previous repurchase studies. The third part asks respondents to identify their position in the company, as well as their contact numbers if further clarification is needed. To facilitate comparison with previous surveys, most of the motivation statements are made consistent with those used by Wansley et al. (1989), Mitchell et al. (2001), Baker et al. (2003) and Dixon et al. (2008).

We searched the Malaysian Stock Exchange website for the names of all companies that made the announcement of their board's decision to repurchase shares, and we found a total of 509 companies that made the announcement between 1 September 1997 and 31 December 2011. However, four of these companies had been delisted. The questionnaires, together with a stamped return-addressed envelope, were mailed to the chief financial officers of all the 505 remaining companies in October 2012. A second mailing was made several months later to those who did not respond to the first mailing. By the end of May 2013, a total of 122 questionnaires were returned; however, only 118 could be used for analysis, giving a total response rate of 23.4%. This response rate is comparable to that of Wansley et al. (1989) in the US (22.6%) and Mitchell et al. (2001) in Australia (15.7%), but was somewhat lower than that of Dixon et al. (2008) in the UK (44.6%).

It should be noted that companies announcing their repurchase intention may or may not actually repurchase the shares. Because approval is good for a year, companies not making a repurchase in the year of approval, or making a partial repurchase of the approved amount, may ask for reauthorisation of the approval in the following year. There is no stated limit to the number of reauthorisations. Therefore, there is no way of knowing whether a company that was not making a repurchase in the first year of approval will ever make a repurchase in subsequent years. For our analysis, we divide our total sample into those making a repurchase in the first year, which were labelled the ‘purchase’ group, and those not making a repurchase in the first year, which were labelled the 'no purchase' group. The rationale for this approach is that if the firm is serious about wanting to repurchase shares, it does not have to wait for more than a year to execute a purchase. Our sub-groups separated the serious from the not-so-serious repurchase announcements. Of the 118 responses, 81 companies (68.6%) subsequently made an actual repurchase, while 37 companies (31.4%) did not.

RESULTS

Repurchase Practices and Managers' Perceptions

The first part of the questionnaire asks respondents for basic information concerning the company's repurchase practices as well as the respondents' perceptions concerning certain aspects of these practices. The questions begin by asking the respondents to disclose the main reason(s) for their respective company's decision to repurchase shares. This question was designed to allow them to think consciously of the actual reasons. The answers are summarised in Table 1. As shown in the table, the most commonly disclosed reason (36.44% of respondents) is "to prevent share price decline". This result is consistent with the undervaluation hypothesis mentioned in most studies. The second most important reason is very close to the first: 32.20% of the respondents stated that their share prices have fallen too low, which prompted the company to decide to repurchase in order "to support share prices". The third most common reason (30.51%) may be summarised as "to stabilise share prices". Included in this objective are other reasons such as "to reduce price volatility" and "to prevent excessive price movements". We rationalise this motive to mean that the company decides to obtain approval to repurchase in case there is a need to support the prices when it swings too low. Therefore, this objective is also related to the second motive. Another somewhat popular reason (22.88%) is "to improve EPS" of the company, i.e. to enhance share value. Less frequently mentioned reasons include "to distribute excess cash" (6.78%) and "to accumulate treasury stocks" (5.93%). There are hardly any surprises in the answers to this question. In fact, the answers confirm our expectation that the undervaluation of shares is the overriding reason for repurchase decision, which is consistent with the signalling hypothesis in market-based studies.

Table 1
Reasons for share repurchase as provided by respondents in the open-ended question

	Repurchase motive	No. of respondents	Relative frequency (%)
1.	To prevent share price decline	43	36.44
2.	To support undervalued share prices (market prices fall below fundamental value; market prices too low; market price below net tangible asset)	38	32.20
3.	To stabilise share prices (to reduce price volatility; to prevent excessive price movements)	36	30.51
4.	To improve EPS (to enhance shareholders value; to reduce number of shares outstanding)	27	22.88
5.	To distribute excess cash (to optimize use of cash; to invest in own shares)	8	6.78
6.	To accumulate treasury stock	7	5.93

Table 2(a) summarises the responses for several questions regarding companies' repurchase practices. Question 2 of the questionnaire asks whether the companies use a timing strategy when making repurchase announcements. We find that the majority of the companies (79% of respondents) do not have a timing strategy for announcing their decision to engage in share repurchase. A few respondents (18%) disclose that they are not free to choose the timing of the announcements; instead, they must comply with the stated rules and regulations. The next question (Q3) asks about the approval process. We find that 110 companies (93%) of the respondents obtained shareholder approval in their normal Annual General Meeting (AGM), while only 8 companies (7%) called an Extraordinary General Meeting (EGM) for the specific purpose of approving a repurchase programme. It is not surprising to find that all those companies going for EGM made an actual repurchase in the first year of the approval. Among those who obtained approval in an AGM, approximately two thirds (81 companies) made an actual repurchase in the first year of approval, while one third (37 companies) did not.

We further asked the non-purchasers about the reasons for not making a repurchase, for which 30 (81.1%) of 37 respondents provided their motives. The reasons provided are summarised in Table 2(b). Half of the respondents (results not shown in the table) mentioned that they did not make the repurchase in the first year because the share price was not low enough. Other responses that carry the same meaning include share prices not falling below their benchmark, or share prices not being seriously undervalued. The next important reason (11 respondents, or 37.7%) was an increase in share prices or that their shares performed well after the announcement. These two reasons indicate that the primary reason for repurchase is undervaluation of the share prices; if prices are not undervalued enough, there is no reason to make a repurchase. Other less important reasons for not making a repurchase include insufficient public float in the market (2 respondents) and to preserve cash (1 respondent) and the company's response to market condition.

Question 5(a) enquires about the mode of financing the repurchase. Of the 81 companies that made a repurchase, 96% of them used internal funding, while only 4% used external funding (see Table 2(a)). In comparison, Baker et al. (2003) report that 71% of the companies financed their repurchase with available cash: 26% with short-term and long-term debt, and 3% via other means.

Question 5(b) asks whether the repurchase companies used some type of timing analysis to repurchase shares in the market. The majority of those making a repurchase (62 of the 81 companies or 77%) confirmed that some type of timing strategy was used, but only a few companies provided explanations regarding these strategies. Among the explanations given were: when share prices were too low and prices dropped below a target level, and when shares were least traded. The answers to Question 5(c) indicate that 75 companies (93%) kept most of the repurchased shares as treasury shares, and only 8 companies (10%) indicated that they cancelled the shares. In addition, 3 respondents (4%) mentioned that they resold some of the shares.

Table 2(a)
Background information repurchases practices

Questions	All response (N = 118) (%)	Purchase (N = 81) (%)	No purchase (N = 37) (%)
Do you choose a specific time to make repurchase announcement?			
• Yes, when share price is low	3.4	4.9	0.0
• No	78.8	71.6	94.6
• No, need to comply with regulations	17.8	23.5	5.4
How did your company obtained shareholders' approval?			
• AGM	93.2	90.1	100
• EGM	6.8	9.9	0.0
Did your company proceed to make the actual buyback (in the first year of approval)?			
• Yes	68.6	100	
• No	31.4		100
For those who made repurchase only (N = 81)			
How was the repurchased financed?			
• Internal funds (available cash)	66.1	96.3	0.0
• External funds (short-term loan)	2.5	3.7	0.0
• Other	0.0	0.0	0.0
In making repurchases, do you use a timing strategy?			
• Yes (only 30 respondent provide reasons, ie. Basically when management feels share price is too low)	52.5	76.5	0.0
• No timing strategy	16.1	23.5	0.0
What do you do to the repurchased shares?			
• Keep as treasury stock	63.6	92.6	0.0
• Cancelled	6.8	9.9	0.0
• Resold to the market	2.5	3.7	0.0

Table 2(b)
Reasons for not making repurchase after shareholders have given approval

Reason	N	%	Cumulative %
Share price not low enough	15	0.500	0.500
Share price increased during the year	11	0.377	0.867
Insufficient public share spread	2	0.067	0.933
To preserve cash for expansion and for working capital	1	0.033	0.967
Response to market condition and company strategy	1	0.033	1.000
Total	30	1.000	

Respondents were also asked about their opinion regarding whether investors understand the firm's objective for making share repurchases. The answer (not shown in the table) reveals that a large majority of the respondents (86.4%) feel that local investors do understand the objectives of the firm for making repurchases. In the next question, the answers show that approximately an equal percentage of the respondents (87.3%) feel that investors understand the impact of share repurchases on share prices. In this regard, Mitchell et al. (2001) find that only 54.5% of respondents consider the market as understanding share repurchases in Australia, and, furthermore, they are uncertain of whether the shareholders understand the implications of repurchases.

We also ask respondents their opinion regarding the market reaction to each of the three mandatory repurchase announcements: board decision, shareholder approval, and actual repurchase. The respondents were also asked to indicate whether they feel that the market price would increase, decrease, or remain unchanged for each of the announcements. The results are shown in Table 3. As expected, most of the respondents feel that share prices should increase for the first announcement (board's decision) as this is new information to the market; the results indicate that 68.6% of the respondents feel that prices should increase, while the remaining 31.4% feel that prices should remain unchanged. For the announcement of shareholder’s approval, only 30.5% of the respondents think that share price should increase, while a large majority (69.5%) think that prices should remain unchanged. This result is not surprising given that shareholder approval is always granted. Regarding the third announcement (actual repurchase), 58.5% of the respondents expect share prices to increase, while 41.5% think that prices should remain unchanged. It should be noted that none of the respondents think that share prices should decline for any of the announcements. Generally, respondents feel that the first and third announcements are good news to the market. The opinion of the respondents regarding market reaction to repurchase announcements as presented here is consistent with the results of previous studies that reported significant excess returns accompanying stock repurchase announcements.

Table 3
Management's perception on market reaction to repurchase announcements

	All sample	Purchase	No purchase
In your opinion, what would be the market reaction to the following announcement?			
	Price increase	Price unchanged	Price decrease
All respondents (N = 118)			
Board's decision announcement	68.6%	31.4%	0%
AGM/EGM approval announcement	30.5%	69.5%	0%
Actual buy-back announcement	58.5%	41.5%	0%
Purchase group (N = 81)			
Board's decision announcement	76.5%	23.5%	0%
AGM/EGM approval announcement	24.7%	75.3%	0%
Actual buy-back announcement	53.1%	46.9%	0%
No purchase group (N = 37)			
Board's decision announcement	51.4%	48.6%	0%
AGM/EGM approval announcement	43.2%	56.8%	0%
Actual buy-back announcement	70.3%	29.7%	0%

Reasons for Share Repurchase

This section discusses the results of the main questionnaire that enquired about the respondents' views regarding the motivations underlying the use of share repurchase. A list of 16 statements that relate to various underlying reasons and motivations for share repurchases are listed. The respondents were required to indicate the extent of their agreement (or disagreement) to each of the statements on a 5-point Likert scale ranging from –2 to +2. The scale is interpreted as follows: –2 means strongly disagree, –1 agree, 0 no opinion, +1 agree and +2 strongly agree. We ran a reliability test on the statements and obtained a Cronbach's alpha coefficient of 0.832, which exceeded the usual critical value.

Table 4 presents the results of the survey. The first column shows the mean score for all respondents, the second column shows the mean score for the "purchase" subsample, and the third column presents the mean scores for the "no purchase" subsample. The statements are arranged based on the mean score of the total sample, from highest to lowest. Figures in parentheses are *t*-statistics for the mean being different from zero, while the last column shows *p*-values for the difference in the means of "purchase" versus "no purchase" groups.

Table 4
Mean score of the respondents for share repurchase motives

		All samples		Purchase		No purchase		
Q#	Repurchase motive	Mean (1)	Rank	Mean (2)	Rank	Mean (3)	Rank	*p*-value (4)
8	To stabilise share price	1.348 (0.000)	1	1.297 (0.000)	1	1.460 (0.000)	1	0.061*
15	Management believe shares are undervalued	1.239 (0.000)	2	1.260 (0.000)	2	1.190 (0.000)	3	0.616
1	To support share prices	1.196 (0.000)	3	1.186 (0.000)	4	1.216 (0.000)	2	0.381
11	To signal share undervaluation	1.179 (0.000)	4	1.237 (0.000)	3	1.054 (0.000)	4	0.191
10	To increase EPS	0.917 (0.000)	5	0.990 (0.000)	5	0.758 (0.001)	7	0.001***
3	As a strategy to increase share prices	0.789 (0.000)	6	0.781 (0.000)	6	0.812 (0.000)	6	0.051**
13	As a response to economic condition	0.536 (0.000)	7	0.395 (0.000)	8	0.838 (0.000)	5	0.186
5	To reduce equity amount in capital structure	0.416 (0.000)	8	0.419 (0.000)	7	0.406 (0.025)	9	0.478
9	To reduce no of shares outstanding	0.406 (0.000)	9	0.335 (0.003)	11	0.568 (0.001)	8	0.001***
4	To return excess cash to shareholders	0.365 (0.000)	10	0.381 (0.001)	9	0.326 (0.044)	11	0.732
2	As a substitute to cash dividend	0.355 (0.000)	11	0.359 (0.002)	10	0.350 (0.021)	10	0.872
16	To gain publicity for the company	0.068 (0.475)	12	0.136 (0.218)	12	–0.081 (0.661)	14	0.064*
14	Lack of investment	–0.110 (0.152)	13	–0.236 (0.030)	14	0.160 (0.360)	12	0.047**
7	As a defensive strategy to avoid take over	–0.118 (0.109)	14	–0.196 (0.017)	13	–0.053 (0.720)	13	0.365
6	To accumulate treasury shares	–0.288 (0.000)	15	–0.369 (0.000)	16	–0.106 (0.457)	15	0.736
12	To increase firm's gearing	–0.312 (0.004)	16	–0.344 (0.010)	15	–0.241 (0.203)	16	0.232

Note: Ratings are based on a scale of –2 (strongly disagree) to 2 (strongly agree). Column (4) provides *p*-values for statistical test in which the mean in purchase group and no purchase group is equal to zero. ***, ** and * denote a significant difference at the 1%, 5% and 10% level, respectively.

Our results indicate that the top four reasons are related to the undervaluation of shares. The reason with the highest mean score is "to stabilise share prices", followed by "management believes shares are undervalued", "to support share prices from further decline" and "to signal that shares are undervalued". However, these four reasons indicate both the circumstances and reasons that prompted the company to decide to repurchase shares. Management views that its shares are being incorrectly valued by the market and that prices have gone too low, which prompts the company to step in to support the shares from further decline. Our results are consistent with the undervaluation hypothesis discussed earlier. Furthermore, the top four reasons correspond exactly to the major reasons given by respondents in the open-ended question, as presented in Table 1. It should also be noted that the "purchase" and "no purchase" groups also agree with the first four reasons being the most important in their repurchase decisions. In addition, the mean score for the first reason is significantly different between the two sub-groups, with the "no purchase" group showing a higher mean score.

The next three reasons relate to the firm's effort in using repurchase as a strategy to increase share prices. The stated reason is "to increase EPS", "a strategy to increase share prices" and "as a response to economic conditions". These statements are in fact closely related to the first four statements discussed above. These statements indicate direct reasons for firms to repurchase shares as an effort to induce demand for the shares that would initiate a price increase. A related reason is that repurchase would necessarily increase EPS. It is often mentioned in press releases and in circulars to shareholders that the company is undertaking a repurchase in order to enhance the EPS, which in turn would precipitate an increase in share prices. As discussed earlier, an EPS increase is simply an automatic outcome of repurchase and should in no way be regarded as a reason for a price increase. However, as long as the local market continues to place (undue) importance on the role of EPS in market valuation, companies will continue to use EPS to rationalise their repurchase decisions. In fact, improving EPS is also one of the main reasons mentioned by respondents in the open-ended question (Table 1). The "purchase" and "no purchase" sub-groups also show a somewhat similar ranking for these three statements.

The next two statements refer to changes in the capital structure as a motive for repurchases. The statements are "to reduce the equity amount in the capital structure", followed by "to reduce the number of shares outstanding". Both statements refer to capital structure changes that occur when shares are repurchased. Although it is obvious that the changes in capital structure veer towards an increase in leverage, in general, the respondents disagree with the statement "to increase firm gearing or debt ratio". As mentioned in an earlier section, local companies are relatively debt-averse; hence, increasing leverage may not correlate with managers’ intention to repurchase. In addition, there is disagreement between the "purchase" and "no purchase" groups on the statement "to reduce the number of shares outstanding".

The next two statements refer to the distribution of cash to the shareholders. The statements are "to return excess cash to shareholders" and "as a substitute for cash dividend". The statement "to return excess cash to shareholders" is meant to correlate with "lack of investment" or "investing in own shares", but the latter statement demonstrates a negative mean score and non-significance. Again, there is some element of inconsistency shown by the respondents. As for dividend substitution, given 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. This statement is expected to have a negative mean score, but our results indicate that a small number of respondents agreed with this reason. There is a clear agreement with the ranking of these two statements between the "purchase" and "no purchase" sub-groups.

The next three statements – "to gain publicity", "lack of investments" and "as a defence strategy against takeover"– are all non-significant. The last two statements — "to accumulate treasury shares" and "to increase firm's gearing ratio" — are not supported by the respondents. There is also a general agreement between the purchase and no purchase sub-groups on the ranking of the last five statements. Respondents do not support the repurchase motive "lack of investment". This result makes sense in the local market as companies can wait as long as they wish until a good investment emerges; there is no limit to the number of times companies can obtain reauthorisation for repurchase from shareholders. Respondents also disagreed with the view that repurchase is used to ward off potential takeovers. This result is not surprising in light of the Malaysian open-market share repurchases. According to Bagwell (1991), the tender offer of share repurchase is more appropriate for takeover defence.

In summary, we find that the main reasons for share repurchases in Malaysia are related to the undervaluation of shares and the need to support low share prices. Other motives, such as those related to changing capital structure and dividend substitution are found to be unimportant reasons for repurchase. Respondents also disagreed with the proposition that repurchases are used as a takeover defence strategy, as a means to accumulate treasury shares or increase the firm's gearing. We ran the Spearman rank correlation to analyse the consistency of responses between the purchase and no purchase sub-groups, and we find that they are highly correlated with a correlation coefficient of 0.932, significant at the 0.01 level. There appears to be no difference between the views of managers of the purchase and the no purchase companies regarding the underlying repurchase motivations.

Table 5 presents the results in the form of various repurchase hypotheses mentioned in the earlier part of the paper, together with the average of the mean scores. The average mean score is the simple average of the mean scores of the statements that are relevant to the hypothesis. As seen in the table, "the signalling of the undervaluation of share" hypothesis has the highest score, followed by "changing capital structure" and "dividend substitution" hypotheses. The last three hypotheses — the lack of investment, takeover defence, accumulation of treasury shares — are not supported. We also find that the sub-groups had similar rankings for the hypotheses.

Table 5
Average of the mean score for repurchase hypothesis

	All sample	Purchase sample	No purchase sample
Signalling undervaluation hypothesis	1.111	1.125	1.082
• To stabilise share price			
• Management believes shares were undervalued			
• To support share prices			
• To signal undervaluation of shares			
• To increase EPS			
• Strategy increase share prices			
Changing capital structure hypothesis	0.411	0.377	0.487
• To reduce equity amount in capital structure			
• To reduce number of shares outstanding			
Dividend substitution hypothesis	0.355	0.359	0.350
• To substitute cash dividend			
Lack of investment hypothesis	0.128	0.073	0.243
• To return excess cash to shareholders			
• Lack of investment			
Takeover defence strategy hypothesis	–0.118	–0.196	–0.053
• As a defensive strategy in take over			
Accumulation of treasury shares hypothesis	–0.288	–0.369	–0.106
• To accumulate treasury shares			

Comparison with Previous Surveys

In this section, we discuss our survey results compared to previous surveys. We choose three of the most recently available surveys in different markets: Mitchell et al. (2001) in Australia, Baker et al. (2003) in the US, and Dixon et al. (2008) in the UK. Table 6 presents the comparison of results by showing the rankings of our study vis-à-vis the ranking of other studies. The missing rank number means that the statement was not asked by the previous surveys. We do not report the mean scores due to the difference in scales used by the different studies.

Table 6 shows at a glance that there is a lack of consistency between our study and previous studies. Among our top four reasons, only one reason is in Australia's top four, two are in the US, and none are in the UK. The next four reasons in our ranking, rank 5 to 8, coincide with only one each for the US and UK studies, and none for the Australian study. The following four statements, rank 9 to 12, coincide with only one statement for the US study, and none for the UK or Australian studies. The final four reasons have negative mean scores in the local study; the ranking of these statements does not coincide with any of the previous studies under consideration. We ran a Spearman rank correlation between our study and the other three studies, as presented in Table 6. The results show that the ranks are not highly correlated. The correlation coefficients for the Malaysia-Australia, Malaysia-US and Malaysia-UK markets are 0.500 (not significant at 10% level), 0.632 (significant at 5% level) and 0.218 (not significant at 10% level), respectively. The correlation analysis therefore corroborates our observation on the comparisons between these respective markets.

The four studies representing the four different markets that are presented in the table indicate the uniqueness of each market with respect to their reasons for making share repurchases. In the local market, the main reasons for repurchases are the undervaluation of shares and the need to support share prices. In Australia, the reasons for repurchases are to increase the EPS and because the shares are undervalued. In the US, the reasons for repurchases are to add value to shareholders and to acquire stock at bargain prices (not shown in the table) (Baker et al., 2003). In the UK, the top reasons for repurchases are to realise optimal capital structure and to return excess cash to shareholders. It seems that Malaysian managers are very similar to Australian and US managers in that they have one common reason for repurchase, i.e., 'because shares are undervalued', while the UK managers cite entirely different reasons for their repurchase decisions.

Table 6
Comparative analysis of ranks with previous studies on repurchase motives

Repurchase motive	This research Malaysia	Dixon et al. (2008) UK	Baker et al. (2003) US	Mitchell et al. (2001) Australia
Stabilise share price	1		3	
Management believe share undervalued	2	6	2	
Support share price decline	3			5
Signal share undervalued	4		5	2
Increase EPS	5	3	3	1
Strategy increase share prices	6			
Response to economic condition	7	8		11
Reduce equity amount in capital structure	8		8	
Reduce number of shares outstanding	9		13	
Return excess cash to shareholders	10	2		7
Substitute cash dividend	11	8	10	13
To gain publicity	12	13	7	
Lack of investment	13	5	4	
Defensive strategy in take over	14	11	19	10
Accumulate treasury shares	15		7	
Increase firm gearing debt ratio	16	4		6

CONCLUSION

This study surveys Malaysian chief finance officers (CFO) concerning their reasons for repurchasing their shares as well as various aspects of repurchase practices. Our respondents represent 505 companies that announced their repurchase decisions over the period 1997–2011. A two-page questionnaire was mailed to the CFOs of these companies in October 2012. By mid-2013, we received a total of 118 questionnaires that were used for analysis. The Malaysian regulations require the approval of shareholders before a repurchase can be made. Companies are required to make an immediate announcement of the board's decision, of shareholder's approval, and of the actual repurchase if and when one is made. The regulations also impose an amount limit and a price limit for share repurchases.

Our results may be summarised as follows. The overriding reason for Malaysian companies to engage in share repurchases is to protect their share prices from market undervaluation. Some companies obtain shareholder approval for repurchases in order to have the right to exercise it when the need arises. However, it is found that companies are not in a hurry to buy back their shares after obtaining approval, as shown by approximately 30% of the companies in our sample not buying back in the first year of approval. Furthermore, it was clearly stated by those not making a repurchase in the first year that they had no reason to repurchase as either the share prices did not touch the undervaluation threshold, or instead, the prices might have increased. Other repurchase motives receive less support; these include "to increase EPS", "to adjust capital structure" or "as a substitute for cash dividend". Other respondents disagreed with the motives of using repurchases as a defence against takeover attempts, to accumulate treasury shares, or to increase the firm's gearing. Comparison with similar international studies indicates that local managers do understand the implications of repurchases and are clear in their reasons for engaging in repurchases. The main reason in the local market was centred on undervaluation of shares, to increase EPS in Australia, to achieve realise an optimal capital structure in the UK, and to add value to shareholders in the US.

The results of this study provide useful insights into the empirical findings concerning repurchases in the local markets by Lim and Bacha (2002), and Isa et al. (2011), who find positive market reaction to repurchase announcements. The current study also casts doubt on some commonly stated repurchase motives in the literature. These findings are useful, especially to investors for understanding the intention of companies to repurchase shares. Regardless of the official reasons stated in companies' circulars to shareholders, the underlying reason is always to support share prices, which is consistent with protecting shareholders' wealth. Therefore, it seems that the Malaysian government made the right decision to allow repurchases in the local market in response to the 1997 financial crisis.

NOTES

1. By virtue of the enactment of section 67A of the Malaysian Companies Act 1965, starting from 1 September 1997, a public listed company is allowed to repurchase its own shares using the distributable profit or free cash flow, given that prior approval from shareholders is obtained during the Annual General Meeting (AGM).

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