EXCESS SHARE BUYBACKS

A PRESSING, OVERLOOKED ISSUE FOR IMPACT INVESTORS

Many asset owners globally are grappling with the challenge of how to use their investment portfolios to catalyze an economy that is more equitable, just, and sustainable. While much attention is paid to direct investments for impact, those same asset owners usually have substantial exposure to the public equity markets, where short-termism and value extraction are rampant.

As a glaring instance of that, publicly-traded corporations today are spending record amounts of cash repurchasing their own shares, boosting short-term share price returns at the expense of reinvesting in real future growth. Of $976 billion in net income generated by the S&P 500 in 2014, $571 billion – nearly 60% – was spent on share buybacks. Layer in dividends, and total payout ratios topped 93%, leaving just 7% for re-investment (whether in the current workforce or to fuel future growth).

Excess buybacks are driven by a combination of executive pay incentives (including bonuses tied to EPS), hedge fund pressure campaigns, and a uniquely permissive US regulatory regime. Given the cheap cost of debt, companies across industries are even levering up in order to free up cash for this purpose.

Buybacks can be detrimental for both long-term shareholders and broader stakeholders. For investors, these issues include:

- **Artificially inflated asset prices**, as EPS and stock price growth is driven by shrinking share counts rather than organic growth,
- **Misplaced priorities**, as the need to meet quarterly targets and pressure from short-term activist investors diverts cash away from human- and fixed-capital investment,
- **Execution Risk**, where buybacks can exhibit low (or even negative!) return on investment if share prices do not rise after repurchases and many buybacks mistime the market, and
- **Leverage Risk**, as company decisions to take on debt to fund buybacks can leave them vulnerable in a rising interest rate environment

Other stakeholders are negatively affected by excess share buybacks:

- **Workers** face layoffs and downward wage pressure as companies free up cash to fund repurchases
- **Consumers** experience service and product degradation or don’t share in the gains of industry consolidation, as has been the case in the airline industry, and
- **Taxpayers**, as share repurchases enjoy tax advantages over dividends and as companies demand public R&D and investment subsidies that could be funded by money going to buybacks

As buybacks are done in the name of boosting “shareholder value,” asset owners can bring unique value to the debate over the impact of corporate capital allocation decisions. Asset owners are uniquely positioned to catalyze change because of their ability to move significant capital and influence public policy. Opportunities to engage include:

- Communicating priorities with company executives, both overall and at key moments
- Shareholder resolutions that address disclosure, executive compensation, and policy
- Re-allocating portfolios away from hedge funds that pressure companies to disgorge cash through buybacks
- Engaging with elected officials, candidates, and regulators about these concerns

**Contact:** Andrea Armeni | Executive Director, Transform Finance | andrea@transformfinance.org

**Resources:** For background information on this issue, please see the recording of the Transform Finance Investor Network webinar [here](#).