



The real effects of share repurchases[☆]

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ARTICLE INFO

Article history:

Received 23 June 2014

Received in revised form

30 January 2015

Accepted 1 February 2015

Available online 29 August 2015

JEL classification:

G35

G32

Keywords:

Share repurchases

Employment

Investment

Regression discontinuity

ABSTRACT

We employ a regression discontinuity design to identify the real effects of share repurchases on other firm outcomes. The probability of share repurchases that increase earnings per share (EPS) is sharply higher for firms that would have just missed the EPS forecast in the absence of the repurchase, when compared with firms that “just beat” the EPS forecast. We use this discontinuity to show that EPS-motivated repurchases are associated with reductions in employment and investment, and a decrease in cash holdings. Our evidence suggests that managers are willing to trade off investments and employment for stock repurchases that allow them to meet analyst EPS forecasts.

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1. Introduction

This paper studies the consequences of share repurchases for firm investment and employment. Understanding the consequences of share repurchases is specially important, given the high levels of cash on US company balance sheets. Companies face intense pressure from activist shareholders, institutional investors, the government, and the media to put their cash to good use. Existing evidence appears to suggest

that a share repurchase is a good way for companies to return cash to investors, as cash-rich companies tend to generate greater abnormal announcement returns when starting new repurchase programs (Grullon and Michaely, 2004). However, some observers note that the cash that is spent in repurchase programs should instead be used to increase research and employment, and that the recent increase in share repurchases is undermining both the recovery from the recent recession and the economy's long-term prospects.¹ Repurchases have also been cited as a possible explanation for why the increase in corporate profitability following the recent financial crisis has not led to growth in employment, and overall economic prosperity (Lazonick, 2014).² Is there any ground for these claims? Do share repurchases have real effects on other corporate policies such as employment and research and development (R&D)?

[☆] We thank an anonymous referee, seminar participants at the University of Illinois at Urbana-Champaign, Georgia Tech, Pompeu Fabra, 2013 London Business School Summer Symposium, 2013 WFA, 2013 China International Conference in Finance, 2013 EFA, 2014 NFA, as well as Azizjon Alimov (discussant), Pablo Moran (discussant), Urs Peyer (discussant), Zach Sautner (discussant), Roni Michaely, Marina Niessner, Jacob Oded, and Kelly Shue for helpful comments. A significant part of this project was completed when Fos was with the University of Illinois at Urbana-Champaign.

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¹ See, for example, “As layoffs rise, stock buybacks consume cash,” *The New York Times*, November 21, 2011.

² See also “The repurchase revolution,” *The Economist*, September 13, 2014.