

Inviting Proposals of Candidates for Analysis of Stock Buyback Policies

Questions for corporate managers

Questions for investors

Responding to requests that the Forum resume attention to issues raised by corporate stock buybacks,¹ I will welcome suggestions for our selection of a company-specific case to present an example of both corporate and investor decisions about the use of capital to produce goods and services.²

Candidates will be considered based on the issues that are relevant, as well as on how effectively those issues can be addressed.³ Some of the issues that have been identified as important to Forum participants are summarized below, and I will of course appreciate your advice to refine our understanding of what may be relevant.

Questions for corporate managers

As a foundation for any review of proposed stock buybacks, it must be understood that for most U.S. companies the use of corporate capital for this or any other purpose is strictly a decision for the board of directors.

- ***Should capital be returned to investors as an alternative to improving management of the business?*** If the board has determined that the company's executive managers cannot be relied upon to use the capital for the competitive production of goods and services, the logical next step in most cases would be to replace those managers with new ones who can be relied upon to implement production efficiencies, improve product quality, expand markets, develop new products, or make some other use of capital to develop the business. Alternatively, if the board determines that replacing managers is not a practical strategy, directors would presumably want to sell the business – whether the whole corporation or its undermanaged unit – to someone who can pay a price based on the ability to improve management, and thus return all of the business unit's capital to investors rather than just some of it. There can of course be some kind of sound reason for returning some of a company's capital to investors, but whatever it is needs to be

¹ For reports of the Forum's suspension of its initial program upon a change in the subject company's management, see the [December 1, 2014 Forum Report: Walgreen Adoption of "Engagement" in Response to Information Requests](#) and [December 10, 2014 Fortune: "Walgreen CEO to leave after Alliance Boots deal in reversal of plan."](#)

² For previously referenced news reports and research of relevant issues, see the "[Stock Buyback Policy](#)" section of the 2014 program's website.

³ It should be noted that some preference will be given to candidates proposed by the subject company's managers, partly to demonstrate the Forum's commitment to supporting responsible corporate leadership, but also based on the assumption that both the definition of issues and the responses to investor interests may be more effective in a program initiated by the people who have access to all the information relevant to their company's capital allocation decisions. See the [August 11, 2014 Forum Report: Corporate Responsibilities for Issue Definition and Information Access](#).

considered by the board in this practical context of why the company is continuing to employ managers if they are unable to make use of the capital to develop a competitive business.

- ***Will the corporation benefit from requiring shareholder approval of a buyback plan?*** Noting that shareholder approval requirements are common in jurisdictions outside the U.S.,⁴ establishing a provision for shareholder voting approval of stock buybacks might be considered by a company's board as either a case-specific condition or as a permanent governance policy to insulate the company from pressures to accommodate investor constituencies interested in short term pricing of the company's shares.
- ***Should a company's officers be made responsible for trading in the company's stock?*** There has been a great deal of research, analysis and debate about whether a company's managers can be expected to conduct buybacks efficiently at prices below intrinsic value, and it should also be noted that "perfect market" theory suggests that efforts to buy the stock at bargain prices will always be futile. Concerns are also raised about whether a company's managers may be biased by subjective evaluations, compromised by insider information, or influenced by self-interest.
- ***Are stock buybacks a legitimate use of corporate capital?*** Both economic principles and legal theory⁵ view corporate capital as having been contributed for use in a business enterprise. Buybacks that are justified as investments in "undervalued" company stock, or as support for market pricing to benefit some of the current holders of previously issued stock, may not be consistent with those understandings of purpose.

Questions for investors

The issues for investors to consider are much simpler. Assuming a proposed buyback is rationally conceived, the analysis is essentially based on whether the shareholder is concerned with short term pricing – either for selling the stock or for determining the current NAV of a professionally managed fund – or with the long term realizable value of a continuing investment.

- ***Does an investor concerned with short term pricing need to consider the long term effects of a proposed buyback?*** Long term effects of a buyback on a company's access to capital can influence current valuations of a company, and in that context an investor interested in short term pricing must consider the relative influences on trading markets

⁴ For the example of UK practices, see [March 2016, Pensions and Investment Research Consultants Limited \(PIRC\): "PIRC 2016 Policy Position: Share Buybacks."](#)

⁵ See [March 20, 2015, Leo E. Strine Jr., of the Supreme Court of Delaware, published by the University of Pennsylvania Institute for Law and Economics: "The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law."](#)

of the apparent long term intrinsic value implications and immediate “financial engineering” benefits.

- ***How will a long term holder of the company’s stock benefit from a buyback?*** The continuing holder of stock does not receive any of the theoretical benefit of money being “returned” to investors, since that is given only to investors who sell into the buyback. The intrinsic value of the company is likely to be reduced by its diminished access to capital and resulting limited adaptability, but the buyback’s reduction in shares outstanding will increase the continuing holder’s proportional interest in that diminished intrinsic value. The long term investor therefore must analyze the relative effects of both the increased business risk and increased allocation of equity to determine the net benefit, or to determine whether to sell or continue holding.
- ***Can an indexed investor benefit from buybacks?*** Recent discussions of this question have not developed any theories of benefit. Since indexed investors cannot decide to sell any of their shares into a buyback, they will not be receiving any of the funds being “returned” to investors. It must also be assumed that substantially all of the “returned” money received by other investors will be committed to secondary market purchases of previously issued equity securities, rather than contributed to increased capital of the companies in the index to improve their production of goods and services. Finally, that use of “returned” investment to purchase previously issued equity securities will add to buy-side demand that increases the prices the indexed investor must pay for the equity it is currently buying for realization of long term values that will not be enhanced by the buybacks.
- ***Should a shareholder present or vote in support of a proxy proposal to require shareholder approval of corporate stock buybacks?*** As indicated in the section on corporate questions [above](#), the requirement of shareholder approval is common outside the U.S. and may support responsible management as well as the interests of long term investors.



It should be emphasized that this summary of preliminary questions is intended to stimulate broader thinking, and to encourage your participation in guiding our progress.

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