

Share buy backs—who really is the winner?

A classic conflict of interest between shareholders and management arises if reward metrics distort the alignment of these two groups...

In 2015 US companies spent over \$700bn buying back their own shares. In Europe buybacks have been smaller but still significant.

So why are management so keen on share buy backs?

The majority of the FTSE reward schemes use earnings per share as the key metric. Reducing the number of shares increases the earnings per share figure. Improving this metric is reflected in improved bonuses.

How many management teams within businesses **truly assess the business value** prior to undertaking share buy back?

Share buy backs can be a useful and legitimate way of returning money to shareholders.

Management should use spare cash to undertake share buy backs or pay dividends **providing** no projects have been identified which generate higher returns for equivalent risk.

Share buy backs typically increase as overall the Share Markets rise—does this timing really make sense for the investor?

Creating or destroying value?

When you pay £100 for an asset worth £80, you are destroying value. In this example, the company is transferring £100 cash to shareholders selling shares worth £80.

Winner = The selling shareholder group benefit.

Loser = The remaining shareholders have overpaid for an asset and therefore lost value overall i.e. worse off.

This situation is clouded by the fact that the share price often rises after a buy back—the theory being the future profit streams are shared across fewer shares. But investors forget the extra cash has left the business and how lower project investment actually impacts future earnings potential.

There are of course times when the business can **buy undervalued shares**. In this case you are paying £80 for an asset intrinsically worth £100.

Winner = The remaining shareholders.

