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Share Repurchase in Malaysia: Does Ownership Matter?

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ABSTRACT

This study presents the impact of type of ownership structure on share repurchase for Malaysian listed companies by using the pooled panel data analysis for a period of six years (2005 to 2010). Findings from this study indicate that companies with government, foreign and managerial ownership have significant influence on share repurchase. It is concluded that the higher the government ownership, the higher the value of share repurchases transaction and vice versa. Meanwhile, there is an inverse relationship between foreign and managerial ownership; and share repurchase in Malaysia.

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Introduction

The trend of companies making share repurchase or stock buyback has been increasing every year. It has been clearly significant after the economic turmoil in 1997. This program then was introduced to gain back confidence in the Malaysian stock market. Initially, the buyback scheme provides an avenue for companies to distribute cash to all their shareholders, either in the form of dividend or share repurchases. Behaviour and tax preferences play an important role in choosing between dividend and share repurchase (De Jong et al., (2003). In comparison with the Western countries, there is generally no tax imposed on capital gain in Malaysia; thus, allowing strong shareholders to force the managers to use cash repurchase as a way to reduce a conflict of interest.

From the perspective of an investor, this program is able to give short-term bonus to them in which the the company's share price will be boosted with the declining number of shares outstanding,. Those investors who are now holding more expensive shares can immediately sell out and receive higher capital gain. Interestingly, compared to the American market or European market, Malaysian capital gain is generally not subjected to personal tax while dividend is still subjected to double taxation. Therefore, foreign owners prefer share repurchase instead of dividend payout since they do not need to face additional tax on dividends (Liljebloom and Pasternack, 2006).

Government owned companies or Government Linked Companies (GLC) are the second largest equity holders in Malaysian companies in a concentrated ownership setting. Companies with government ownership prioritize in social and political goals instead of profit maximization (Boycko et al.,1996; Megginson et al., 1994). They engaged in dividend smoothing with the highest target payout, and they are the most reluctant to cut dividend (Gugler, 2003). In Malaysia, there are also multinational companies that are listed through their subsidiaries on the Bursa Malaysia. Foreign companies are allowed to hold more than 30% of shares (as stated under New Economic Policy). This was after the requirement was revised by the Malaysian Government in June 2003. Managerial ownership also exists in Malaysia whereby the managers are not

family members. Since ownership in Malaysia varies with managerial, government, and foreign ownership, result is expected to show different influence on share repurchase. Most of the studies are more focused on studying the relationship between ownership structure and dividend payout (Ameer, 2007; Sulong & Mat Nor, 2008; Ramli, 2010; Sulong & Ahmed, 2011). Therefore, it is interesting to investigate the role of ownership in influencing share repurchase in Malaysia.

Empirical Reviews and Hypothesis

Skinner (2008) examines the relationship between earnings and dividend payout for the last three decades and discovers that firms that pay only dividends have largely extinct. This contributes to the increasing use of repurchased shares in place of dividend, even for firms that continue paying dividends. The author finds that firms' dividend history plays an important role in why firms continuously pay dividend for the period 1980 until 2005. Firms with the shortest dividend history tend to have the lowest dividend payout ratio. However, dividend payout ratio is higher for firms with 10 to 29 years of dividend history. The highest dividend payout is recorded in firms with 30 years of past dividends payment. Using regression model, Skinner (2008) finds that most firms substituted dividend with share repurchase because repurchase adjusts quickly to earnings change. Meanwhile, there is a weak relationship between earnings and dividends. Repurchase provides greater flexibility than dividends. In distributing cash to shareholders, Grullon and Michaely (2002) surmise that dividend and share repurchase are substitute for each other. However, Dittmar (2000) sees it differently where substitutability is not found between dividend and share repurchase. According to De Jong et al. (2003), behavioral and tax preferences play important roles in deciding between dividend and share repurchase.

Typically, ownership structure in Malaysia is concentrated (Ramli, 2010). Based on non-financial public listed companies' data from 2002 to 2006, the author signifies that companies make higher dividend payouts as the shareholding of the largest shareholder increases. In addition, the author also reports that dividend payout also increases when there is a presence of a second largest shareholder in the company.

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Government Ownership

Gugler (2003) determines that government-controlled firms as institutional investors will influence payout policy. As an institutional investor, government acts on behalf of the citizens. Huang et al. (2010) showed that the interactions between corporate governance mechanism and institutional ownership would negatively influence share repurchase decision. Since they have more information and professional knowledge, institutional investors played an important role in supervision. It is also noted that firms with government ownership are less likely to face difficulty in raising capital to finance new projects. Furthermore, most of them are more focused on social needs instead of being concern only on maximizing profit (Gul, 1999). Therefore, they are reluctant to substitute dividends with share repurchase. In this setting, the hypothesis is constructed as follow:

H₁: There is a negative relationship between government ownership and share repurchase.

Foreign Ownership

Foreign investors with substantial shares have the power on the management and are able to avoid agency problem. Thus, they have significant influence on dividend payout decisions (Wilkinson et al., 2001; Jeon et al., 2011). According to Baba (2009), foreign investors is said to significantly influence dividend payout decisions (whether to pay dividends or not to pay) though the impact is small in economic terms. However, it is evidenced that higher foreign ownership in Finland serves as a determinant of share repurchases (Liljebloom and Pasternack, 2006). It takes place due to different tax treatments between local and foreign investors. In Finland, local investors have a tax-induced preference for dividend in contrast to share repurchase while foreign investors are subject to withholdings tax. According to Ginglinger and L'her (2006), stock repurchase programs are good news when the firm is supported by foreign institutional investors, and in the case of controlled firms, when the firm has a second large shareholder, which guarantees an effective balance of power for the controlling shareholders. They also argued that the presence foreign institutional ownership is a form of moral guarantee of non-hostile financial decisions with regard to minority shareholders. It is also found that the presence of foreign institutional investors positively influences the price reaction to the announcement of repurchase program. Meanwhile, Dahlquist and Robertson (2001) conclude that foreign investors avoid firms with a dominant owner, and seem to attach considerable importance to such owners' influence in the firm. Based on that, the hypothesis is specified as follow:

H₂: There is a positive relationship between foreign ownership and share repurchase.

Insider Ownership

The greater the degree of insider ownership, the lower the payout will be (Holder et al., 1998). According to De Jong et al. (2003), if a company has executive stock option plans, it is less likely to pay out in the form of dividends. However, Fenn and Ling (2001) indicate that managerial stock ownership causes higher payouts in a company with high potential of agency problems. Executives may prefer shares repurchase or retained more earnings instead of increase in dividend in order to increase their own stock options (Weisbenner, 2000). According to Brav et al. (2005), managers now favor repurchases because they are viewed as being more flexible than dividends and can be used in an attempt to time the equity market or to increase earnings per share. Thus, the hypothesis is stated as follow:

H₃: There is a positive relationship between managerial ownership and share repurchase.

Methodology

This research will use the data from Datastream and the annual report of companies listed on the main board of Kuala Lumpur Stock Exchange (Bursa Malaysia) from 2005 to 2010. Information on ownership is extracted from the companies' annual reports and Bursa Malaysia. Datastream is used to collect information regarding Return on Equity (ROE), Market-to-Book Equity Ratio (MTBV), Firm Size (FZ) and Debt to Equity Ratio (LEV) which are treated as control variables in this study. On the other hand, from the original population, companies which do not have complete data, financial institutions, disposed off or taken over, and under PN4 and PN17 during the period of study will be excluded from the sample.

Table 1: Description of variables used in the study

Variables	
Share Repurchase (SR) = Log (Total amount paid to repurchase shares)	Oswald and Young (2004); Eije and Megginson (2008)
Foreign ownership (FO) Sum of all shares held by foreign shareholders.	Mohd Saleh (2009); Mohd Ghazali (2010); Sulong and Ahmed (2011)
Managerial Ownership (MO) % of shares held by executive directors to total number of shares issued.	Dutta (1999); Abdullah (2006); Haniffa and Hudaib (2006)
Market-to-book equity ratio (MTBV) = Market value of equity / Book value of equity	Skinner (2008); Linck (2008); Adjaoud and Ben-Amar (2010).
Risk (RK) Dummy 1 if BBB and above, 0 otherwise.	Guedes and Opler (1996); Opler et al. (1999).
Profitability Return on Equity (ROE) = Net Income / Shareholder Equity	Ling et al. (2008); Chay and Suh (2009)
Firm Size (FZ) The logarithm of total assets	Jiraporn (2006); Ahmed and Javid (2009);
Leverage (Lev) Debt to Equity Ratio	Sanders and Carpenter (2003).
Firm Age (Age) The logarithm of listing age	Linck et al. (2008); Sulong and Ahmed (2011)

During the period under study, out of 682 companies in the Main Board, there were 327 companies with complete data on total payout. In order to analyze the factors that influence share repurchase, we only take into account companies that have complete data on share repurchase during the period of the study. Thus, finally only 71 companies are examined. Pooled panel regression analysis is used to measure the relationship of all the variables with the share repurchase with 426 observations.

$$Y_{it} = \beta_0 + \beta_1 X_{it} + \beta_2 X_{it} + \dots + \beta_n X_{it} + \varepsilon_{it} \quad (1)$$

Where i denotes the firm (cross section dimension) and t denotes time (time series dimension). Therefore, Y_{it} is the dependent variable of pooling N cross sectional observations and T time series observations, and X_{it} s are the independent variables pooling N cross sectional observations and T time series observations. B_0 is the constant term or intercept across cross sectional observations, and ε_{it} is the error term.

The empirical model used in this study can be described as follows:

Model 1:

$$SR_i = \beta_0 + \beta_1 GO + \beta_2 FO + \beta_3 MO + \beta_4 MTBV + \beta_5 RK + \beta_6 ROE + \beta_7 FZ + \beta_8 LEV + \beta_9 AGE + \varepsilon_{it} \quad (2)$$

Where; β_0 = constant term; SR = Share Repurchase for firm i ; GO = Government Ownership; FO = Foreign Ownership and MO = Managerial Ownership. $MTBV$ = Market-to-Book Equity Ratio; ROE = Return on Equity; FZ = Firm Size; LEV = Leverage; AGE = Firm Age. The definition of variables are further in Table 1.

Findings

Descriptive statistic

Table 2 presents the descriptive statistics for variables used in the study for the period 2005 to 2010.

Table 2: Descriptive Statistics

Variables	Mean	Median	Maximum	Minimum	Standard Deviation
SR (RM)	16,192.7 23	1,345.5 24	108,000.0 00	81.00	85,329,362
GO (%)	3.37	0.63	30.38	0.00	4.86
FO (%)	16.10	10.41	73.01	0.00	17.32
MO (%)	8.30	1.66	57.48	0.00	13.98
RK	0.13	0.00	1.00	0.00	0.34
MTBV	1.22	0.86	25.72	(38.57)	2.79
ROE (%)	9.83	9.94	74.71	(52.66)	10.28
FZ	8.91	8.81	12.46	6.18	0.64
LEV (%)	55.91	34.44	376.46	0.00	65.34
AGE (Year)	16.10	12.93	47.34	0.41	10.24

On average, during this 6-year period, share repurchase records RM16,192,723 in total payout with maximum payout at RM108 million and minimum at RM81. The lowest share repurchase is recorded from YTL Land & Development Bhd, where in year 2006 the company buy back 100 shares at price RM0.8103. In Malaysia, on average (median), the percentage of government and managerial ownership, that is GO and FO, are at 3.37 (0.63) and 16.10 (10.41), respectively. The highest percentage holding by government and foreign shareholding is at 30.38 and 73.01 percent, respectively. These values are higher compared to the result reported by Sulong and Mat Nor (2010) at 6.1 percent (2.4 percent) and foreign ownership at 5.4 percent (1.7 percent). Sulong and Mat Nor's (2010) results are based on 403 companies (1612 observations) listed on Bursa Malaysia from 2002 until 2005. During the period of study they recorded maximum percentage holding by government and foreign at 79.2 and 76.8 percent, respectively. The average (median) percentage of managerial ownership, MO, is 8.30 percent (1.66 percent) with the highest at 57.48 percent.

As for Market-to-Book Equity value (MTBV), the average (median) is 1.22 percent (0.86 percent) with 25.72 percent being the highest. Looking at companies' profitability, it showed on average (median) percentage of return on equity (ROE) of 9.83 percent (9.94 percent), with as high as 74.71 percent profitability. However, during this time leverage is very high at 376.46 percent and the overall average is 55.91 percent. As for, the age of firm listed in Bursa Malaysia, the average age of the firms is approximately 16 years.

Regression Result

The result from Table 3 showed that four variables are significant at various levels. Share repurchases are positively influenced the company with government ownership. The coefficient of government ownership is 0.058 and that means a one standard deviation increase in government shareholding would lead to a 28 percent (0.058 x 4.86) increase in share

repurchase. This result leads to the rejection of H_1 where there is a negative relationship between government ownership and share repurchase.

Table 3: Panel Regression Result on Share Repurchase

Independent Variable	Coeff	S.E
CONSTANT	0.903	0.934
GO	0.058***	0.013
FO	-0.006*	0.004
MO	-0.009**	0.005
MTBV	-0.022	0.022
RK	-0.021	0.190
ROE	0.010	0.006
FZ	0.513***	0.110
LEV	0.000	0.001
AGE	0.0319	0.220
R^2	0.146	
Adjusted R^2	0.128	
F-Statistics	7.913***	
DW	1.054	

***, **, * indicate significance at 1%, 5% and 10% levels

In terms of foreign ownership, the result shows that the higher the foreign shareholding, the lower the share repurchases, though the result is only significant at 10%. Therefore, H_2 is rejected, where there is a positive relationship between share repurchase and foreign ownership. As for the coefficient of managerial ownership, MO , is -0.009 and is significant at 1 percent. It means a one standard deviation increase in managerial ownership causes a decrease in company share repurchase by 12.6 percent (0.009 x 13.98), hence H_3 is rejected.

Conclusion

The study highlights the importance of ownership in explaining share repurchase program in Malaysia. It is evidenced that government, foreign and managerial ownership are significantly affecting company payout decision. Contrary our hypothesis, we found positive association between government ownership and share repurchase. Meanwhile, Malaysian firms with high foreign ownership are less likely to choose share repurchase. The finding on companies with managerial ownership is also against our hypothesis which is consistent with Fenn and Ling (2001) who indicate that managerial ownership causes higher payouts.

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