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False Signals from Stock Repurchase Announcements: Evidence from Earnings Management and Analysts' Forecast Revisions

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Abstract


This paper investigates the possibility of false signaling by firms announcing open-market stock repurchases. We examine a sample of 281 open-market share repurchases, with the self-styled reason of undervaluation, by firms between 1993 and 1998. Our results showed no evidence of an upward revision in the earnings forecasts of analysts following open-market share repurchase announcements, finding instead, small negative surprise revisions, which contradicts the prevailing empirical evidence. Moreover, we found that surrounding share repurchase announcements, managers manipulated discretionary accruals upward. We posit that this action, on the part of management, is to persuade market participants that the equity of their firm is undervalued. We also found no evidence of the market underreaction phenomenon but did observe negative abnormal returns in the 3- to 12-month period subsequent to the announcement. Overall, our results confirm that with a weaker signaling power, open-market share repurchase programs have been used to send a false signal to the marketplace, by emphasizing an undervalued equity.

Keywords: Signaling, Share Repurchase, Earnings Management, Analyst Forecast Revisions, Long-Run Performance

JEL Classification: G14, G29, M41, M43, G35, G34

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