



Accelerated share repurchases ☆

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Abstract

Accelerated share repurchases (ASRs) are credible commitments by firms to repurchase shares immediately. Including an ASR in a repurchase program reduces the flexibility that firms have to alter an announced program in response to subsequent changes in the price and liquidity of its shares, unexpected shocks to cash flow and/or investment, etc. Thus, we investigate whether firms' decisions to include ASRs in their repurchase programs are associated with factors expected to influence the costs of lost flexibility and the benefits of enhanced credibility and immediacy. We find robust evidence consistent with the costs of lost flexibility and the benefits of credibility and immediacy being important determinants of ASR adoption. Additionally, we find that ASR announcements are associated with positive average abnormal stock returns.

Introduction

A fundamental area of research in financial economics is the study of firms' payout policies. The level, frequency, and form of payouts have individually and collectively been the subject of considerable investigation.³ This paper examines a recent and important innovation in the share repurchase form of payouts, namely, accelerated share repurchases (ASRs). Specifically, we analyze the determinants of the choice to include an ASR as part of a repurchase program as well as the choice of the fraction of the shares in a program to be obtained via an ASR. We also document the stock price reactions to announcements of ASRs.

In an accelerated share repurchase, a firm enters into a contract with an intermediary, typically an investment bank, whereby the intermediary immediately delivers a specified number of the firm's shares in exchange for cash based on an agreed upon price per share (ordinarily the most recent closing price). The intermediary obtains the shares that it delivers to the repurchasing firm by borrowing them, typically from institutions. The intermediary then covers its short position by purchasing shares in the market over a specified time period, normally several months. The ASR contract also includes a provision whereby the

repurchasing firm is required to compensate or is entitled to receive compensation from the intermediary in shares or cash. The amount of compensation is based on the difference between the initial price per share paid to the intermediary and the estimated price per share the firm would have paid for the shares in an open market repurchase (OMR) conducted during the same period over which the intermediary buys the shares to cover its short position. The settlement terms are also structured to compensate the repurchasing firm for the opportunity cost of full prepayment for the initial shares when the intermediary actually acquires these shares (closes its short position) over a period of several months. Note that, absent any contractual caps or floors on the settlement amount, the repurchasing firm bears all of the risk of changes in its stock price between ASR initiation and settlement. Thus, the intermediary essentially acts as the firm's proxy in borrowing the firm's shares and the proceeds the intermediary receives at initiation are a source of financing for the intermediary. In sum, ASRs are repurchases with an associated forward contract that can be settled in cash or shares of the firm.⁴ Fig. 1 illustrates the structure and timeline of an ASR and Appendix A includes a description of the common provisions observed in ASR contracts.

For a sample of repurchase programs announced between 1996 and 2008, we collect data on whether or not the programs include an ASR as well as details of the ASR transactions. The frequency of ASRs has increased dramatically in recent years. Over the period 2004–2008, \$131 billion of stock was repurchased via ASRs, and, in 2007, ASR announcements (97) represented about 26% of the total number of program announcements (376) as illustrated in Fig. 2. Further, over the period 2004–2008, the frequency of ASRs has generally exceeded that of privately negotiated repurchases, fixed-price self-tender offers, Dutch-auction self-tender offers, and large special dividends as illustrated in Fig. 3. Lastly, we note that in recent years, the “boilerplate” language used by firms to announce repurchase program authorizations has evolved to generally include ASRs as potential mechanisms by which share repurchases will be implemented.⁵ In short, ASRs have become part of the repurchase vernacular and an important element of repurchase program activity.

We analyze the stage of payout policy formulation where a firm has concluded that a share repurchase is the optimal choice for distributing cash to shareholders and must now decide how best to execute the repurchase. Given the vast majority of repurchase programs in recent years have been executed via OMRs in which firms announce authorizations to repurchase shares periodically at market prices, we initially consider the decision to undertake ASRs relative to the alternative of repurchase programs comprised of OMRs. In a subsequent section of the paper, we consider the decision to undertake an ASR relative to executing repurchase programs, in part, via self-tender offers or privately negotiated transactions.

In contrast to conducting an OMR-only repurchase program, including an ASR in a program commits the firm to actually repurchase shares and the firm receives these shares immediately. Consequently, the larger the ASR portion of a repurchase program, the less flexibility the firm retains to significantly alter the program in response to subsequent changes in the price and liquidity of its stock, unexpected shocks to cash flow and/or investment, etc.⁶ In other words, the choice to undertake an ASR in a repurchase program represents a substantial partial exercise of the “flexibility option” inherent in a repurchase program that would otherwise be comprised entirely of OMRs, e.g., see Ikenberry and Vermaelen (1996) and Oded (2005). Therefore, factors affecting the costs of early exercise of the flexibility option inherent in an OMR should be important determinants of a firm's choice to include an ASR in a repurchase program, a possibility we refer to as the *flexibility hypothesis*.

In an ASR, the repurchasing firm is credibly committed by contract to repurchase a significant number of shares immediately from the intermediary. In contrast, Stephens and Weisbach (1998) show that, 3 years after an OMR announcement, a substantial number of firms have repurchased no shares, about 10% of

firms repurchased less than 5% of the shares authorized, and just more than half of firms bought back the total number of shares authorized.⁷ Simkovic (2009) reports that OMR completion rates have increased recently perhaps in response to enhanced required disclosures regarding repurchase activity.⁸ However, given the need to access quarterly filings for this information, OMR repurchases can still only be verified with significant time lags. ASRs entail no such delay or required verification by investors. Thus, the ASR portion of a repurchase program permits the firm to more credibly and quickly accomplish certain goals, e.g., signaling information to shareholders, adjusting capital structure, defending against an unwanted takeover attempt, avoiding dilution from the exercise of employee stock options, or managing reported earnings per share through changes in shares outstanding. To the extent that certain objectives of a repurchase would be better met with enhanced credibility and rapid completion of the repurchase, the particular objectives for a program should also influence a firm's decision to include an ASR in the program, a possibility that we refer to as the *credibility and immediacy hypothesis*.

We find that the choice to undertake an ASR is significantly negatively (positively) associated with the variability of the firm's share price and the stock market *illiquidity* of the firm's shares (the size of the repurchase authorization). These findings are strongly consistent with the predictions of the flexibility hypothesis.

We find that the recent stock price performance of firms conducting ASRs is significantly better than firms not conducting ASRs, which is somewhat inconsistent with ASRs being used by firms facing greater undervaluation. However, further investigation of the undervaluation motive for ASRs using a variety of proxies for misvaluation generates some evidence suggesting that firms facing greater undervaluation are more likely to conduct ASRs. We find that firms tend to include ASRs when the firms have fewer growth opportunities or are further below their target leverage ratios. We also find that firms tend to include ASRs when the firms have recently completed asset sales or been the targets of unsolicited takeover attempts. Lastly, we find limited evidence that ASRs are undertaken to manage reported earnings per share (EPS). Taken together, these results are consistent with the predictions of the credibility and immediacy hypothesis.

The time series of ASR activity is also shown to vary with changes in the firm characteristics that our analysis indicates are important in firms' decisions to undertake ASRs. For instance, illiquidity and the standard deviation of returns increased during the recent upheaval in financial markets. Given these changes, our model predicts a sharp drop in the number of ASRs in 2008, an outcome which we observe in the data. We also find that relative to alternative repurchase methods and large special dividends, ASRs serve a unique role and represent an important innovation in payout methods.

We also examine abnormal stock returns around ASR announcements. We find that ASRs announced simultaneously with repurchase programs are associated with positive and significant abnormal returns. Further, we find that ASRs announced subsequent to repurchase programs are also associated with positive and significant abnormal returns consistent with shareholders viewing these transactions as incrementally wealth increasing relative to repurchase programs comprised entirely of OMRs. Cross-sectional determinants of ASR abnormal returns are also investigated. We find that ASR announcement returns are positively associated with the fraction of shares repurchased via ASR, negatively associated with recent prior stock performance, and, consistent with ASRs reducing the likelihood of a successful acquisition, negatively associated with the firm having been the recent target of a takeover attempt. We also find that the likelihood that a firm announces an ASR subsequent to announcing a repurchase program is decreasing in the program announcement abnormal return. This finding is consistent with firms choosing

to undertake an ASR to enhance the credibility of the signal inherent in the program announcement when that signal was weakly received by the market.

Our findings contribute generally to the literature on share repurchases and specifically to the nascent literature on accelerated share repurchases. The earliest paper to make note of ASRs was Cook and Kim (2006) which finds that firms engaging in repurchases using derivative contracts are generally larger than OMR firms. Marquardt, Tan, and Young (2009) show that firms more frequently conduct ASRs when managers' bonuses are tied to EPS, the repurchases are accretive to reported EPS for the period, and managers subsequently voluntarily leave the firm. Marquardt et al. do not investigate the relative importance of the flexibility inherent in OMRs or the immediacy of ASRs (outside of reported EPS) in determining firms' choices to undertake ASRs. The present paper finds limited evidence of earnings management motives for ASRs in the presence of proxies for the value of flexibility. Thus, while the present paper's analysis indicates that earnings management is not likely the primary determinant of ASR choice, Marquardt et al. examine this issue in greater depth.

In a contemporaneous working paper, Chemmanur, Cheng, and Zhang (2010) investigate many of the same potential explanations for ASRs as the present paper. However, despite the similarities in the papers' aims, the conclusions reached by the papers in terms of which factors are associated with the decision to include an ASR as part of a repurchase program are very different. While Chemmanur, Cheng, and Zhang note prominently in their hypothesis development that an ASR does not permit a repurchasing firm the flexibility to change or discontinue a share repurchase as in an OMR, they do not include in their analysis several variables that proxy for the relative value of this flexibility across firms. In contrast, the present paper finds these variables to be the most important determinants of the choice to include an ASR in a program. As described below, our treatment of ASRs as part of repurchase programs is also distinct from that of Chemmanur, Cheng, and Zhang who classify firms as strictly conducting OMRs versus ASRs which is not consistent with certain features of the data that reveal how ASRs are used by firms. Thus, the differences in results and conclusions across the two papers are largely attributable to several important variables omitted by Chemmanur, Cheng, and Zhang as well as fundamental differences in sample construction.

Michel, Oded, and Shaked (2010) report positive average announcement period abnormal returns and negative post-announcement drift for ASR firms. Michel et al. interpret this pattern of returns as indicating that the information content of ASRs is negative but the market does not recognize the full extent of the "negative news" at announcement. Also, Akyol, Kim, and Shekhar (2009) investigate the efficacy of ASRs as takeover defenses. They find that firms choosing to conduct ASRs are significantly more likely to have been the subject of takeover rumors prior to the ASRs; however, they also find that, after conducting ASRs, these firms are still more likely to receive bids perhaps indicating that ASRs are not effective takeover deterrents.

This paper proceeds as follows. In Section 2, we describe the predictions of the hypotheses to be tested. We describe our sample construction in Section 3. We report results in Section 4 and offer a concluding discussion in Section 5.

Section snippets

Predictions of the hypotheses

The cost of an ASR resulting from the early exercise of the flexibility option will clearly vary across firms. For instance, because the value of the flexibility option inherent in an OMR is increasing in the volatility of the firm's stock price, greater volatility increases the cost of exercising the option to adjust the repurchase amounts and timing. Thus, the flexibility hypothesis predicts that firms with greater stock market volatility will be less likely to elect to conduct an ASR.

Barclay ...

ASR sample

We search the U.S. Securities and Exchange Commission (SEC) Edgar database for any filing that mentions an accelerated share repurchase. The Edgar Full-Text searchable database includes a rolling window of the previous 4 years of SEC filings. Our initial search was conducted on October 2, 2007; hence, we obtained search results for all filings dated October 2, 2003 and later. We have continued to access the database quarterly to update the sample of ASRs. Given the rolling time window...

Univariate comparisons

As reported in Table 1, nearly 95% of the ASRs in our sample were undertaken after 2003. Thus, we limit our sample period to 2004 through 2008 when analyzing ASR election to ensure that we are comparing firm characteristics over a period when ASRs are not rare events. Table 2 reports characteristics of repurchasing firms based on whether or not they elect to include an ASR in a repurchase program. Details on data sources and variable construction are provided in Appendix B. Independent...

Conclusion

This paper investigates ASRs, a recent and important innovation in share repurchase transactions, relative to both open market repurchases and other alternative methods of distributing excess cash to shareholders. ASRs are credible commitments by firms to repurchase shares immediately. Including an ASR in a repurchase program reduces the flexibility that firms have to alter an announced program in response to subsequent changes in the liquidity and price of its stock, firm conditions, etc....

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...In line with the optimal capital structure hypothesis, we include Leverage to control for the motive of the firm to repurchase shares in order to inflate the firm's leverage until it reaches the level perceived by the firm to be suitable (Dittmar (2000); Bonaimé et al. (2014); Lei and Zhang (2016)). SDReturn and SDCF are included to be consistent with the flexibility hypothesis, where firms use their discretion over the number and timing of shares to buy back (Bargeron et al. (2011); Bonaimé et al. (2016)). Consistent with Bonaimé (2012), we include eight binary variables to capture firms' motives to repurchase shares....

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