Buybacks, Capital Flows, and Investment

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[based on work w/ Charlie Wang (HBS)]

November 2019
“Corporate profitability is not translating into widespread economic prosperity. The allocation of corporate profits to stock buy-backs deserves much of the blame. Consider the 449 companies in the S&P 500 index that were publicly listed from 2003 through 2012. During that period those companies used 54% of their net income—a total of $2.4 trillion—to buy back their own stock, almost all through purchases on the open market. Dividends absorbed an additional 37% of their net income. That left very little for investments in productive capabilities or higher incomes for employees.”
Excessive-Shareholder Payout Meme Goes Viral

- think tanks (Brookings Institution, 2015; Roosevelt Institute, 2018, 2019)
- asset managers (Fink, 2015; 2016; 2017)
- corporate lawyers (Lipton, 2015)
- politicians (Biden, 2016; Clinton, 2016; Baldwin, 2016; Schumer, 2018; Warren, 2018; Sanders, 2019)

- At least 10 bills in Congress/Senate introduced to heavily regulate or ban open-market repurchases
Lipton (2015)

• “In response to short-termist pressures brought by hedge funds and activist share-holders, companies have been fundamentally altering their business strategies to forego long-term investments in favor of stock buybacks, dividends and other near-term capital returns. At this point, theoretical debates about [short-termism and corporate governance] ... have been superseded by observable, quantifiable trends and behaviors. For example, according to Standard & Poor’s, dividends and stock buybacks [in S&P 500 firms] ... totaled more than $900 billion in 2014—the highest level on record... ”
Against Buyback Alarmism

- Market-wide, about 80% of buybacks and 50% of shareholder payouts (dividends + buybacks) are offset by equity issuances
  - So net shareholder payouts much smaller than shareholder payouts
- Investment by pub cos at record highs
- Cash balances in pub cos at record highs
- And
  - Pub cos can always issue more equity if needed
  - Capital flowing out of pub cos available for investment in non-pub cos, which are just as important to economy
Public-Firm Shareholder and Net Shareholder Payouts
(1989-2018)

$ Billion

From Jesse M. Fried and Charles C.Y. Wang (October 2019)
Public-Firm Investments
(1989-2018)

CAPEX + R&D ($Billions)

R&D Expense ($Billions)

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Public-Firm Investment Intensity
(1989-2018)

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Public-Firm Cash Holdings
(1989-2018)

Cash+ST Investment ($ Trillion)

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Yes, There’s More

1. Pub cos can always issue more equity if profitable opportunities
   - Non-S&P500 firms are net absorbers of equity capital every year
     - *Historical* payouts should not constrain *future* activities

2. Capital leaving public market not “wasted” – can go to private market
   - E.g., venture, PE (where much innovation happens)
     - Private firms account for 50% of nonresidential fixed investment, employ 70% of non-gov workers, and account for nearly 50% of business profits
Thank you!