Buybacks, Capital Flows, and Investment

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

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Lazonick (HBR, 2014)

"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. <u>That left very little for investments in productive capabilities or higher incomes for employees</u>.**"

Harvard Business Review

2014 HBR McKinsey Awards

FIRST PLACE

"Profits Without Prosperity"

SEPTEMBER 2014

A meticulously researched study by **William Lazonick,** a professor at the University of Massachusetts Lowell, suggests that executives are using massive stock buybacks to manipulate share prices and boost their own pay—at great cost to innovation and employment.

Excessive-Shareholder Payout Meme Goes Viral

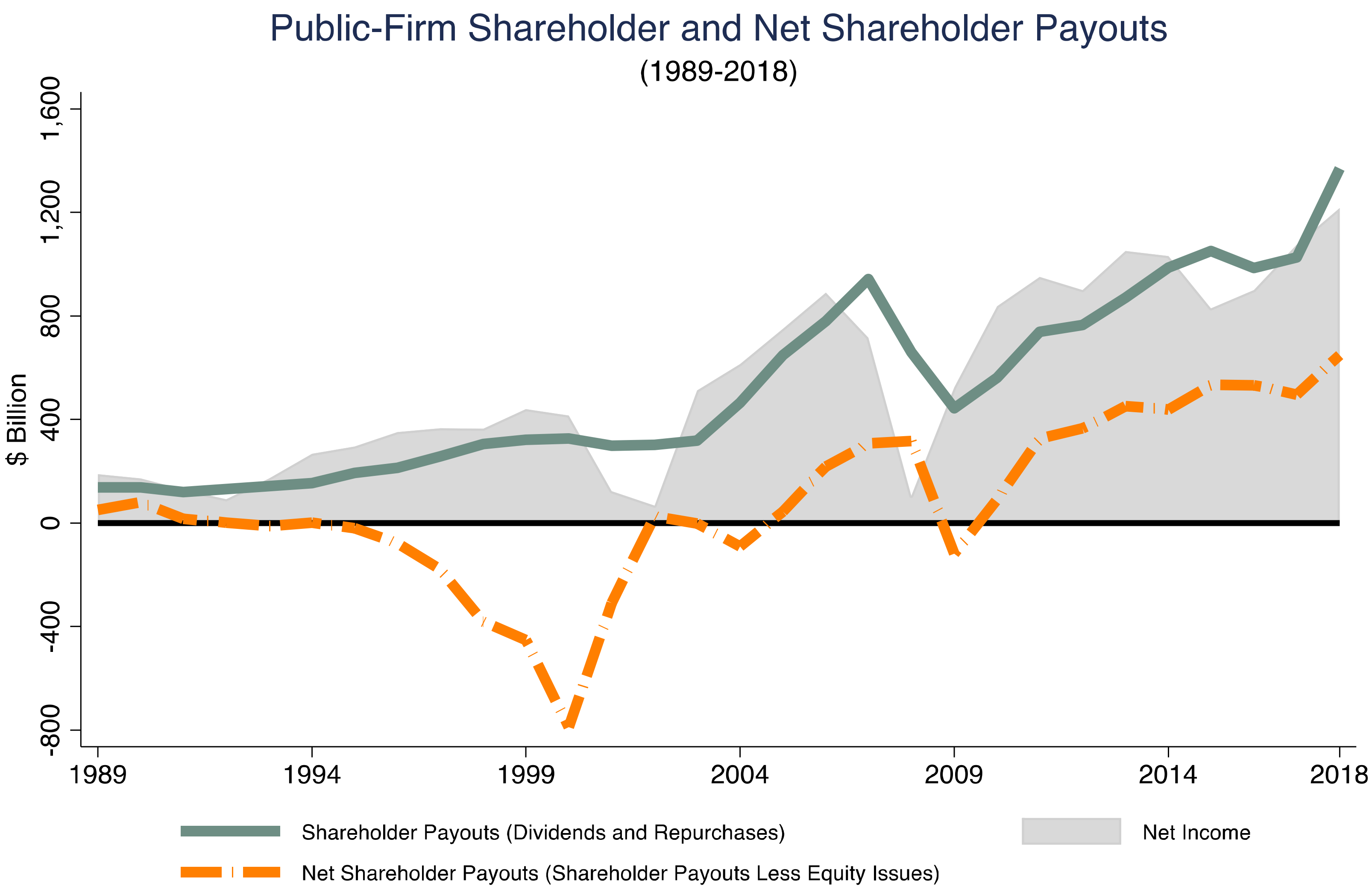
- think tanks (Brookings Institution, 2015; Roosevelt Institute, 2018, 2019)
- asset managers (Fink, 2015; 2016; 2017)
- corporate lawyers (Lipton, 2015)
- politicians (Biden, 2016; Clinton, 2016; Baldwin, 2016; Schumer, 2018; Warren, 2018; Sanders, 2019)
    - At least 10 bills in Congress/Senate introduced to heavily regulate or ban open-market repurchases

Lipton (2015)

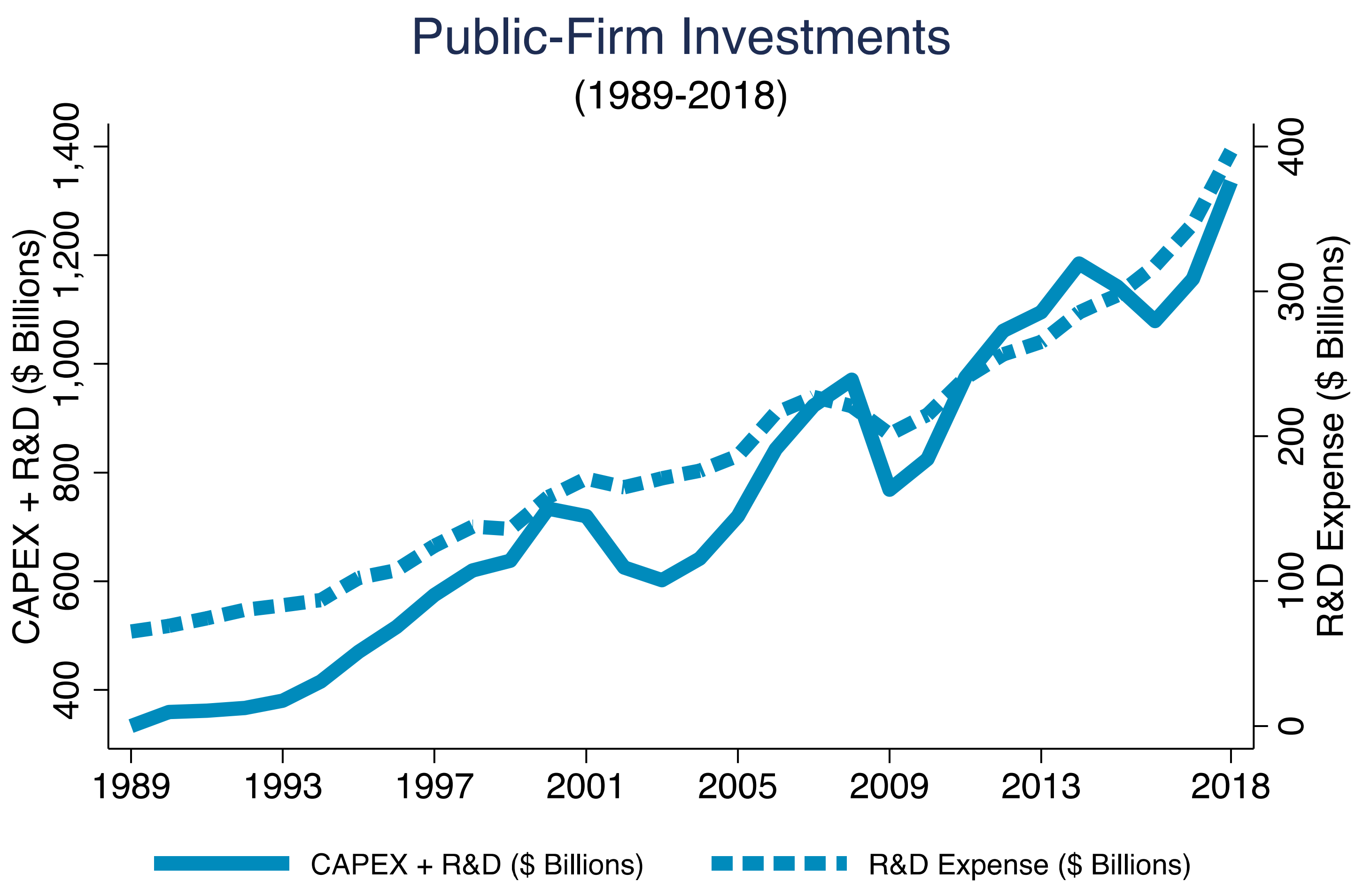
- “In response to short-termist pressures brought by hedge funds and activist share-holders, companies have been fundamentally altering their business strategies to forego long-term investments in favor of stock buybacks, dividends and other near-term capital returns. **<u>At this point, theoretical debates about [short-termism and corporate governance] ... have been superseded by observable, quantifiable trends and behaviors.</u> 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 <u>net</u> 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



From Jesse M. Fried and Charles C.Y. Wang (October 2019)



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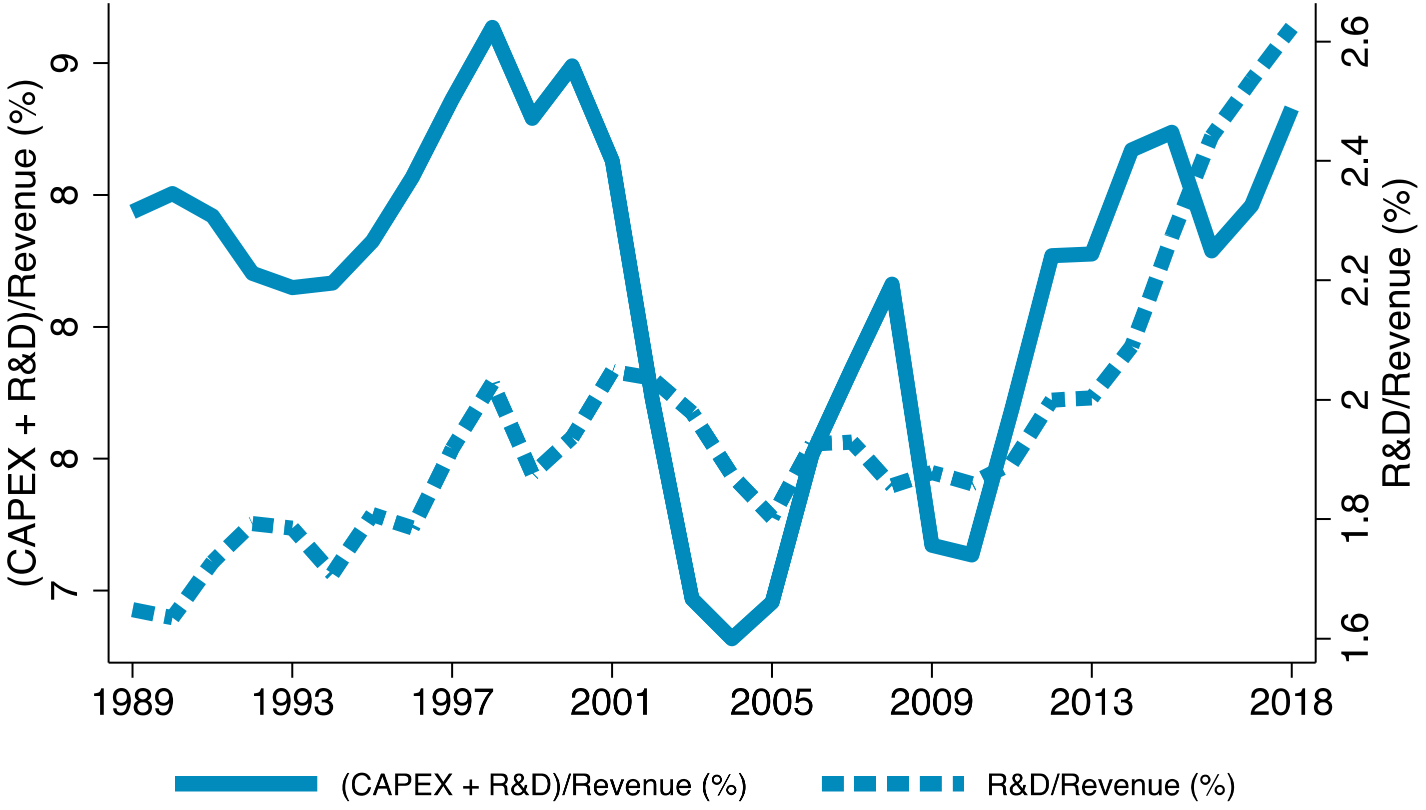
Public-Firm Investment Intensity

(1989-2018)



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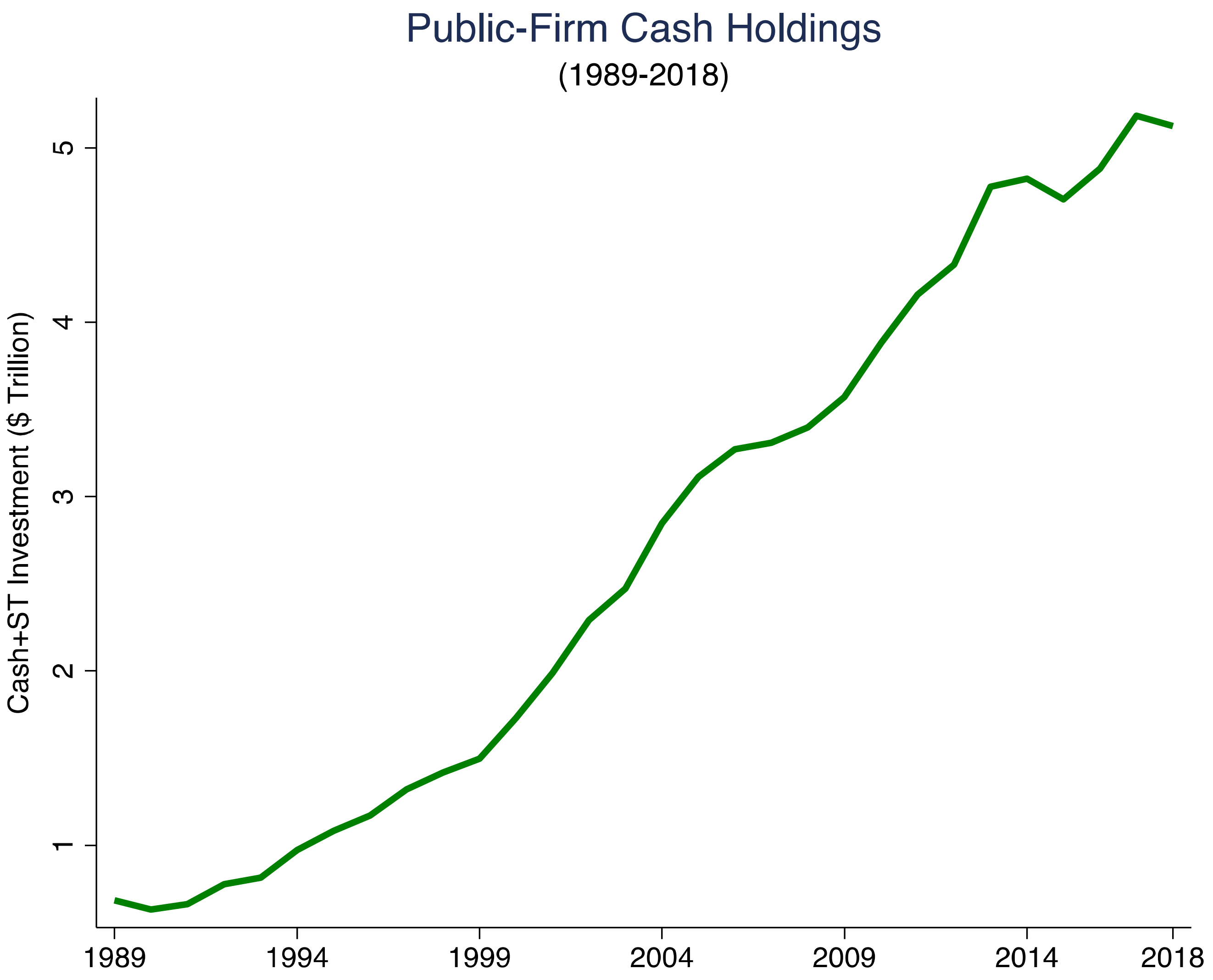

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Yes, There's More

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!