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SHARE BUY-BACK

Introduction

The general rule is that a company may not return any assets to its shareholders or reduce its share capital while it is a going concern except in the form of dividends paid out of available profits. Section 76(1)(b) of the Companies Act prohibits a company from acquiring its own shares or units of shares in itself and from acquiring shares or units of shares in its holding company.

The general prohibition in section 76(1) is subject to other expressed provisions of the Companies Act. A company may by court order purchase its own shares under section 216(2)(d) or under section 76(13)(b); such an order is not caught by the prohibition.

Section 73(1) of the companies Act Provides that a company may reduce its share capital in any of the following:
(1) extinguish or reduce the liabilities of its unpaid share capital;
(2) cancel any paid up share capital which is lost or unpresented by available assets; or
(3) pay off any paid up share capital which is in excess of the needs of the company.

To effect a reduction of share capital three things are required in all cases:
(1) the reduction must be authorised by the company's articles;
(2) a special resolution must be passed; and
(3) the reduction must be approved by the High court.

The requirement of court approval is for the protection of creditors.

In addition, section 69(1) of the Companies Act provides that where a company issues shares for which premium is received, the value of the premiums received on those shares shall be transferred to an account called the "share premium account". Section 73(1) shall apply as if the share premium account were paid-up share capital of the company.

Under section 69(2) of the Companies Act, the share premium account may be used for:
(1) paying up unissued shares as fully paid bonus shares;
(2) paying up in whole or in part the balance unpaid on shares;
(3) payment of dividends;
(4) writing off the preliminary expenses or the expenses in connection with any issue of shares; and
(5) providing for the premium payable on redemption of redeemable preference shares.

In 1997, several blue chips companies in Singapore were pondering over the possibility of buying back their own shares from the market when it is permitted by laws.

In July 1997, Singapore Airlines Ltd ("SIA") chairman, Mr. S. Dhanabalan suggested at its annual general meeting that SIA would consider a share buy-back scheme.[(1)] This was in response to liberalising foreign ownership rules and the possibility of creating one class of shares only.

In September 1997, it was reported in the Straits Times that the Registry of Companies and Businesses ("RCB") was reviewing existing rules which prohibit share buy-back as part of their on-going review.[(2)]

In October 1997, Temasek Holdings Pte Ltd sought views from its eight major listed companies (i.e. Singapore Telecommunications Ltd, SIA, Singapore Power Ltd, Singapore Technologies Group, DBS Bank Ltd, Sembawang Corp Ltd, Neptune Orient Lines Ltd and the Keppel Group) for comments on share buy-back scheme.[(3)] About the same times, the Stock Exchange of Singapore ("SES") also wrote to the chief executive officers of all Singapore-listed companies seeking for their feedback on the proposal allowing share buy-back.[(4)]

In August 1998, the Monetary Authority of Singapore ("MAS") announced that share buy-back would be made legal by the fourth quarter of 1998 when laws and SES regulations are in place. This was in response to feedback from industry bodies and financial market participants and, a recommendation by the SES Review Committee to amend the Companies Act to allow share buy-back.[(5)]

In was reported in the Straits Times in October 1998 that the Parliament has given Singapore companies the power to buy back their own shares without having to apply to the High Court for approval.[(6)]

Concept of Share Buy-Backs

The concept of share buy-backs is not new to several countries. These countries which allow share buy-backs include Australia, Hong Kong, the United Kingdom, United States and Malaysia (recently approved in August 1997).

One form of share buy-back occurs when a company offers to buy back a stipulated number of shares from those shareholders who choose to tender their shares. Another form of share buy-back occurs when the holding companies acquire shares of their listed subsidiary companies.

There are three principal methods of share buy-backs:
(1) through open market buy-back ("OMB");
(2) through fixed-price tender offer ("FPT") ; and
(3) through Dutch auctions ("DA").[(7)]

Under the OMB method, the company buys back shares in the open market at prevailing market prices over a fairly extended period of time.

Under the FPT method, the company offers to buy back a fixed number of outstanding shares at a fixed price during a stipulated period of time. If the FPT is oversubscribed, the company may elect to purchase all or part of the excess. If the FPT is undersubscribed, the company may decide to cancel the offer or extend the expiration date.

In a DA, the company announces the number of shares to be buy-back and sends a bidding schedule to each shareholder. Each shareholder tenders for a certain number of shares at a certain price. Upon receiving all the tenders, the company arranged it in ascending order and the price at which the last successful share is tendered is the price to be paid to all shareholders who tendered shares at that price or below.

In Singapore, the provision passed for share buy-back was limited to ordinary shares and under the OMB method. Companies can buy back no more than 10 per cent of their issued ordinary share capital each time. To effect a share buy-back, companies must first obtain shareholder's approval at general meeting for such a move, and specify the maximum price to be paid for the shares. There is also a 5 per cent cap on the price movement, based on the average of the preceding five days' share prices.[(6)]

Rationale for Share Buy-Backs

In theory, a company would go for a share buy-back if it has cash in excess of their operating and investment requirement. Therefore, the best investment alternative is to buy back its shares and return cash to those shareholders who may wish to reinvest their money in other things. If earning remain constant, share buy-backs which reduce the number of shares in circulation will result in higher earning per share ("EPS") since profits are spread over fewer shares. This should result in a higher share price.

Share buy-back is a way that a company can convey signal to the market that the company's share is undervalued. It provides assurance to investors that management is confident about the company's future whilst returning excess cash to the shareholders.

Benefits of Share Buy-Back

Share buy-back represents significantly larger payouts than regular dividends payments. Shareholders have an option to sell or not to sell their shares. For those shareholders who choose to tender their shares would gain as they received a larger pay-out as a capital gain rather than as dividend income. Those shareholders who choose not to render their shares would gain as dividend income. Those shareholders who choose not to tender their shares would gain by owning their shares with a higher EPS caused by a reduction in the number of shares in circulation. In Singapore, there is a 26% tax on dividends but no tax on dividends but no tax on capital gains.

Share buy-back could provide management with the defence for hostile takeover. When a company becomes the object of a hostile takeover and they may want to take its shares out of circulation to maintain control.

Share buy-back is generally viewed positively by the public as it allows a company to return cash which is in excess and not required for operating and investment requirement to the shareholders. It was evident in the recent proposal by Singapore Press Holdings Ltd ("SPH") for capital reduction. SPH's shareholders voted overwhelmingly in favour of the capital restructuring exercise which involves returning half a billion dollars to its shareholders.(8)

Furthermore, share buy-back can have a positive impact on the share price. SPH's shares rose 10 cents after SPH's shareholders give the go-ahead for the capital reduction. It was also evident in the case of Creative Technology Ltd's proposed share buy-back plan. Creative Technology Ltd's shares surged as much as 16 per cent after it announced that it had won approval from the SES to buy back 9.3 million shares.(9)

Drawbacks of Share Buy-Backs

Share buy-back could provide a disincentive for management to utilize its excess cash for profitable investments or new markets. Thus cash could be poorly utilized and not at the advantage of the shareholders. There is a danger that companies could engage in buy-back so as to manipulate earnings benchmarks, to disguise an unsatisfactory business performance. Management may seek short-term results like using the cash in a share buy-back to induce a higher EPS instead of a viable business opportunity.

There is another danger that, depending on the scheme of buy-back, if the company acquires its own shares, a shareholder's equity interest in the company may increase making it a controlling shareholder unintentionally; and thus triggering-off mandatory takeover requirements.

There is also a real threat of insider trading if management does not make proper and timely disclosures. Companies would have an unfair advantage if they could buy back their shares ahead of a public announcement of positive corporate developments that would send the share price up.

In addition, the share buy-back announcement might signal to the market that the company has poor growth rates and fewer good investment opportunities. Then, there could be an adverse impact on its share price.

Misconceptions of Share Buy-Back

The misconception of share buy-back is that the market response to a buy-back is positive because return on equity ("ROE") is higher after the buy-back. The market reacts positively mainly because it gleans favourable information about the company's prospects. The fact that post-buyback ROE is greater is simply an arithmetic fact and should not affect shareholder's wealth.

Conclusion

The concept of share buy-back is very complex and new in Singapore. The rationale for share buy-back, along with its benefits, drawbacks and misconception need to be understood before a company would go-ahead for a share buy-back proposal. Quoting the Finance Minister Richard Hu: "Generally, the provisions are on the prudent side because we lack experience in administering such changes. We have probably over-provided for the protection of the small shareholders at the expense of more flexibility."(6)

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