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ARAŞTIRMA MAKALESİ
RESEARCH ARTICLE

# Stock Buybacks in Public Companies: A Necessity or a Trap?

## Halka Açık Şirketlerin Kendi Paylarını Edinimi: Bir Gereklilik Mi Yoksa Tuzak Mı?

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**ABSTRACT**

Stock buyback programmes have been at least as important as dividend payments for almost a quarter of a century given their positive effect on financial metrics such as the price-to-earnings and return on equity ratios. Stock buyback is considered one of the most effective remedies against hostile takeovers and manipulations. Although there are several pre-bid corporate defense mechanisms – the paper only covers the option of poison pills – acquisition by a company of its own shares is increasingly seen as an efficient alternative to those. An Anglo-Saxon-centric concept of stock buybacks is commonly used to address concerns regarding shareholder short-termism and analyst forecasts. This stream of thought predominantly deems the buyback of undervaluaed stocks significant for capital maintenance as opposed to the dominant European view that repurchasing shares for commercial reasons may run counter to capital maintenance. This study, accordingly, conceptualises whether a stock buyback is indispensable in protecting a company's assets or used for mitigating agency problems through signalling managerial optimism.

**Keywords:** Stock buybacks, Hostile takeovers, Poison pills, Capital maintenance, Managerial optimism

**ÖZ**

Ekseriyetle son çeyrek yüzyılda en az temettü dağıtımı kadar önem kazanan ve uygulaması yaygınlaşan pay geri alım programları fiyat kazanç, mali rantabilite ve benzeri finansal faydalarından ötürü oldukça ön plana çıkmıştır. Pay geri alımları aynı zamanda düşmanca devralma ve manipülasyonlar yoluyla şirketlerin kendi iradeleri haricinde dışarıdan yönetilmesine karşı en etkili çözümlerden biri olarak da anılmaktadır. Şirketlerin bu tehlikeler henüz gerçekleşmeden uygulamaya koyabilecekleri çeşitli kurumsal savunma mekanizmaları vardır fakat bu çalışma bu yollardan yalnızca en etkili alternatiflerden birisi olarak görülen zehir hapı seçeneğini irdelemektedir. Anglo-Sakson temelli bir müessese olan pay geri alımları genellikle pay sahiplerinin kısa vadeciliğine ve analistlerin tahminlerine ilişkin endişelerin bastırılması için öngörülen bir yoldur. Bu anlayış, sermayenin korunması gayesiyle pay geri alımlarının eksik değerlenmiş hisselerin şirketçe iktisap edilmesi olarak ifade edilebilir. Ancak Avrupa'daki hakim görüş, şirketlerin kendi paylarını münhasıran ticari kaygılarla ediniminin sermayenin korunması ilkesine aykırılık teşkil ettiğidir. Bu çalışma bahsi geçen hususlar ışığında, pay geri alımlarının şirket malvarlığının korunması için mi yoksa yönetimsel iyimserlik kisvesi altında temsile ilişkin aksaklıkların üzerinin örtülmesi için mi daha çok zaruret arz ettiği hususunu kavramsallaştırmaktadır.

**Anahtar Kelimeler:** Payların geri edinimi, Düşmanca devralma, Zehir hapı, Sermayenin korunması, Yönetimsel iyimserlik

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## I. INTRODUCTION

The shareholding structure in joint stock (public) companies is financed by large shareholder groups through public offerings. Many companies whose financial structure deteriorated due to the shrinking economy during the Covid-19 pandemic preferred the public offering to meet their liquidity needs as well as increasing their prestige and credibility. This situation intensified the interest of individual investors in addition to the existing institutional investors in terms of financing companies (the convenience provided by technological developments in share purchase and sale transactions also plays a major role in this participation of individual investors) and further encouraged companies to offer their shares to the public.[1] However, companies deciding to list their shares on the stock exchange may face various risks such as hostile takeovers and manipulations on share prices. For this reason, public companies must produce preventive measures to eliminate these risks to ensure the continuation of controlling stockholders' dominance. In view of this situation, the stock buyback option is seen as a frequently used preventive method for public companies.

Stock buyback, among the prominent dividend policies seen especially in the US, in which it is recently on the march, is the process of using idle balance for the financing of the company. As of 1997, buybacks have taken precedence over dividend payments in the distribution of net income.[2] The UK also joined this trend and increased its buyback amounts gradually, and as of 2019, record levels of purchases were made.[3]

Stock buybacks, alias share repurchases, represent at acquisition by a company of its own shares. They generally denote a way of transferring profit to shareholders other than paying dividends. It is expected that existing shares would become more valuable as the number of shares in circulation decreases. In other words, stock buybacks provide an opportunity to shareholders for having more valuable shares in exchange for not getting dividends, due to the reduction in the number of stocks outstanding. However, it should be noted that no clear inference can be made on the financial effectiveness of share repurchase decisions, since a counterfactual analysis cannot be made. The stock buyback occurs at the saturation point, where executives have the confidence to refinance the business based on their own foresight and belief in the company's strong resources and future earnings, meaning that it no longer needs external equity funding. For this reason, investors pay close attention to stock buybacks. From at company's standpoint, stocks buyback is a profitable

1 Josue Cox, Daniel Greenwald and Sydney Ludvigson, 'What explains the Covid-19 stock market?' (National Bureau of Economic Research Working Paper 27784, 2020) <http://www.nber.org/papers/w27784> last accessed 9 August 2021; Meni Abudy, 'Retail Investors' Trading and Stock Market Liquidity', (2020) 54 The North American Journal of Economics and Finance 3; Deloitte, 'The rise of newly empowered retail investors: How they're changing customer expectations and investing dynamics' (2021) <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-the-rise-of-newly-empowered-retail-investors-2021.pdf> last accessed 9 August 2021.

2 Liyu Zeng and Priscilla Luk, 'Examining share repurchasing and the S&P buyback indices in the U.S. market' (S&P Dow Jones Indices, March 2020) <https://www.spglobal.com/spdji/en/documents/research/research-sp-examining-share-repurchases-and-the-sp-buyback-indices.pdf> last accessed 9 August 2021.

3 Sirio Aramonte, 'Mind the buybacks, beware of the leverage' (BIS Quarterly Review, September 2020) <https://www.bis.org/publ/qtrpdf/r_qt2009d.pdf> last accessed 9 August 2021.

yet low-risk deal (when compared with risky investments in research and development to build advantageous technologies), if and only if the corporate growth shows continuity.

Companies may choose the stock buyback route for various reasons, such as for a better consolidated company structure with an increased equity value and drawing advantage from the undervaluation of stocks. Long-term potential (sustainable) earnings of companies show their results in the short-term by reason of carrying out valuation in advance. However, despite this, the stock price might be undervalued. In this case, the company can purchase and hold its own shares until the price reaches a normal level. After the market is corrected itself, the company will reissue the stocks. This situation commonly emerges during periods when the economy gives negative signals. For example, it has been determined that stock buybacks made by companies registered in the S&P 500 have increased by 117% within one year due to the Great Recession in 2010.[4] In the recent period, stock buyback mechanism becomes intensified due to Covid-19 pandemic. Same situations can be observed in other big stock markets, namely London Stock Exchange (LSE), New York Stock Exchange (NYSE), Euronext N.V., Deutsche Börse, and Borsa Istanbul (BIST). This study, in this regard, provides a detailed comparative analysis by assessing legal systems executed in the US, the UK, Switzerland as well as Germany as an EU member state along with their pearls and pitfalls. This mixed picture is expected to contribute to guide lawmakers, company directors, and the academia in terms of developing policies, executing stock buyback programmes, and developing furher intensive discussions, respectively.

The main interest of this study is to analyse and elucidate the stock buyback theory as well as its practical implications in different jurisdictions. It aims to reveal whether and to what extent the practice bases upon that theory. In other word, this paper examines the consonance between the theory, practice, and case-law. Accordingly, at the outset, the functionality of stock buyback is questioned considering the global values of trade; further, this review is argued on the basis of selected countries' applications. Since multinational shareholder structure in companies has become more common with the globalisation of trade, a uniform and certain guarantee scheme should be provided to protect investors and encourage them to invest more. Different legal regulations in different regions discourage investors by pushing them to seek for more convenient legal systems. For example, in this regard, it is not a coincidence that the headquarters of the majority of large companies in the US is located in Delaware, where they have a *milder legal approach*. Considering all the facts mentioned hitherto, this article examines different legal cultures to propose a *lex ferenda*.

## II. THE CONCEPT OF STOCK BUYBACK

After every recession in the economy, stock buyback gains great importance, as it offers a way out for both shareholders and executives of public companies. According to the data provided by Goldman Sachs, the highest number of stock buyback events in the last 20 years occurred in the first 4 months

4 Standard and Poor's, 'S&P 500 Stock Buybacks Up 117% in 2010; Share Repurchases Increase fort he 6th Quarter in a Row' (Cision PR Newswire, 23 March 2011) <https://www.prnewswire.com/news-releases/sp-500-stock-buybacks-up-117-in-2010-share-repurchases-increase-for-the-6th-quarter-in-a-row-118496299.html> last accessed 9 August 2021.

of 2021.[5] This situation encourages investors to invest heavily in public companies offering stock buyback programmes, as they will be able to trade more comfortably under the guarantee that certain number of shares will be retaken by the company when the market value of shares falls below a set level.

Share repurchase programs are the purchase of companies' own shares at the market value within the scope of the programs to be determined by companies. Since this action reduces the number of shares in circulation, it increases stakeholders' stock ratio (provided that they retain their shares) and that means an increase in the ratio of dividend per share. Analysts put a lot of pressure on companies with EPS forecasts along with the heavy use of new media in the field of finance. There are empirical studies showing that stock repurchase is also used in this manner to meet and beat analysts' forecasts.[6] It was showed that many companies would not have been able to reach expected EPS ratios consistent with predictions without making stock repurchase.[7] Therefore, although the archical reason for companies to resort to the stock repurchase mechanism is to improve EPS, it is not the only reason. Several shareholders having the view of short-termism act upon the attainment of the analysts' forecasts.[8] Therefore, making stock repurchase might signal managerial optimism[9] and mitigate agency problems.[10]

In terms of investors, financial returns from a stock stem from two factors, namely a change in stock price and dividends received. Even though the common practice concerning the profit distribution is to pay dividends, stock repurchases as an alternative and/or adjuvant for paying dividends become more widespread. However, it should be noted that investors could return their investments if and only if stock repurchases boost the share price by the positive atmosphere with the consideration that these repurchases are *per se* fructuous. This is because the EPS will increase, while the number of stocks decreases. This entices financiers to make further investments to mark up the stocks price. These financiers (shareholders) will also be pleased with the increase in stock prices, rather than having dividends because of its tax

5 Aziza Kasumov and Siddharth Venkataramakrishnan, 'US Companies prepare share buyback bonanza as Outlook clears' (Financial Times, 12 May 2021) <https://www.ft.com/content/d7adb226-e9a6-4cd8-9049-35d55c211ca4> last accessed 9 August 2021.

6 It is seen in British and American practices that the main purposes of stockbuybacks are to increase the rate of return per share, add liquidity to company and increase the value of underpriced shares. Paul Hribar, Nicole Jenkins and Bruce Johnson, 'Stock repurchases as an earnings management device' (2006) 41(1-2) Journal of Accounting and Economics 3-27; Steven Young and Jing Yang, 'Stock Repurchases and Executive Compensation Contract Desing: The role of earnings per share performace conditions' (2011) 86(2) The Accounting Review 703-33; Kent Baker, Gary Powell ve Theodore Veit, 'Why companies use open-market repurchases: A managerial perspective' (2003) 43(3) The Quarterly Review of Economics and Finance 483-504.

7 Hribar, Jenkins and Johnson (n 6) 3-27.

8 Fatih Erdem, 'Short-Termism in Publicly Listed Companies and Corporate Governance' (2021) 70 Annales de la Faculté de Droit d'Istanbul 1-18; Theo Vermaelen, 'Common Stock Repurchases and Market Signalling' (1981) 9 Journal of Financial Economics 139-83; Michael Jensen, 'Agency costs of free cash flow, corporate finance, and takeovers' (1986) 76 The American Economic Review 323-9; Gustavo Grullon and David Ikenberry, 'What do we know about stock repurchases?' (2000) 13 Journal of Applied Corporate Finance, 31-51.

9 Vermaelen (n 8) 139-83.

10 Jensen (n 8) 323-9; Grullon and Ikenberry (n 7) 31-51.

advantages. From this perspective, the stock repurchase seems a win-win situation.[11] Nevertheless, it must be known that repurchasing stocks may not be feasible when comparing to make an investment in R&D, since the competitive structure of the market would likely punish the company in the cause of being non-innovative.[12] Therefore, stock buybacks are beneficial to shareholders only if the stock price is less than the company's true value.[13] Therefore, the main purpose of stock repurchase for both the UK and the US is to increase EPS through taking advantage of the underpriced stock.[14]

When the EPS, which is one of the most used data by analysts, is below expectations, the company may attempt to misguide its actual and potential shareholders by manipulating them in regard to the company's profitabileness through taking a buyback decision. However, this decision without an increase in the company's earnings will cause a waste of company resources as well as preventing investors from making a conscious investment decision due to asymmetric information.[15] In companies that reward their managers with certain percentages of stocks in certain periods, the management may announce stock buyback programs in order to keep their EPS high, even if favorable conditions are not met. For this reason, while the stock repurchase program is an effective tool for values that do not reflect the company's performance, it may cause undesirable results when solely used for the benefit of the managers.[16]

There are multiple reasons why companies acquire their own shares. One of the most important reasons for the company aquiring its own shares is to protect its own resources. That is, companies can buy their own shares, whose value does not reflect the transaction price (when real price is less than the market price), instead of investing the excess liquidity in current or future projects. When the acquired shares reach their real values, the company can get a profit by reselling these shares. This should not be interpreted as a trade for setting benefits, rather it is about capital maintenance. During the share repurchase process, all other alternatives should be evaluated to find the most appropriate way for the company. In this context, there should not be a more efficient investment tool in which company managers can invest their surplus capital.

Apart from the investment purpose, the share repurchase is also adopted to eliminate the risk of hostile takeover. It is an important defense mechanism for the company to buyback its shares in order to intervene in manipulative actions that may artificially decrease or increase the share values (when company is in a conflict of interest with third parties) in a timely manner. The existence of such a mechanism becomes more important especially for family companies in order to maintain the shareholding structure.

Macroeconomic crises (such as Covid-19 or the oil crisis) that adversely affect the capital markets can accordingly cause significant decreases in value of company shares, although they generally do

11 Phil Oakley, *How to Pick Quality Shares: A three-step process for selecting profitable stocks* (Harriman House, 2017).

12 Fatih Erdem, *The Suppression of Innovation: Testing the Open Nature of Article 102* TFEU (Onikilevha, 2021).

13 Oakley (n 11).

14 Young and Yang (n 6) 703-33; Baker, Powell and Veit (n 6) 483-504.

15 Rammohan Yallapragada, 'Stock Buybacks: Good or bad for investors?' (2014) 12(2) Journal of Business and Economics Research 196; P La Monica, 'Love, but verify these buybacks' (2005) 34(8) Money 6-8.

16 Justin Pettit, 'Is a share buyback right for your company?' (2001) 79(4) Harvard Business Review 141.

not seriously affect company financials. In this case, the company can buy its shares to protect the true value of its shares and to create confidence for investors as far as concerned that the financial condition of the company is stable. Otherwise, panic sales by the shareholders will cause the decrease in comany's share values. The benefits of share buybacks are not limited to those mentioned hitherto. For example, some tax advantages may also be obtained, since capital gains are obtained by repurchasing the share instead of the dividend to be paid in cash. However, it should be noted that companies deciding to acquire their shares without an increase in earnings may prevent them from making a conscious investment as they inform their investors asymmetrically and may also cause wastage of company resources.[17]

Despite all the above-mentioned benefits, the company's acquisition of its own shares should not be seen as a mere safe harbor. The acquisition of their own shares by companies carries the risk of manipulating the shares traded in the capital market. Malicious company managers may mislead investors and existing shareholders by showing that they have sufficient financial strength by deciding to acquire company shares even though there is no obvious truth to it. This situation, in particular, causes a man-made increase in the company's share values, where investors actually incur losses by purchasing shares with a much lower real value at higher values.[18] In addition, another current risk factor is that companies are increasingly adopting short-term approaches. That is, when the EPS, as one of the most used data by analysts that is constantly updated in short time intervals, is below expectations, companies can manipulate the profitability of the company's economic activities (and consistency with regard to the target).[19]

Stock buybacks also entail the risk of violating the principle of equal treatment for all shareholders. For example, the acquisition of the shares of partners who want to leave the company by determining a price above the market price will be a violation of this principle. Likewise, the principle of equal treatment must be complied if the shares acquired on behalf of the company are resold to the remaining partners. For these reasons, all transactions regarding the repurchase of shares should be carried out transparently; information such as purchase amount, price, payback period and form of payment should be presented to all partners. Apart from all these, the proportionality principle for the share repurchase offer should be taken into account, as all partners should be treated equally on the basis of their basic capital ratios. In this context, for example, submitting a proposal for the resale of the acquired shares only to the (pre)determined shareholders would be a violation of this principle.

## III. STOCK BUYBACKS IN COMPARATIVE LAW

In markets where the stock buyback is not allowed, those who want to seize control of the company with under-priced stocks can act more easily. On the other hand, in markets where the stock buyback

17 Rammohan Yallapragada, 'Stock Buybacks: Good or bad for investors?' (2014) 12(2) Journal of Business and Economic Research 193, 196.

18 Mathias Siems and Amedeo De Cesari, 'The Law and Finance of Share Repurchases in Europe' (2012) 12 Journal of Corparete Law Studies 33-36.

19 For more discussion, see Erdem (n 8) 1-18.

is allowed, it is possible to dissolve the idle cash within the company to return share price to its real value, thus, the buyers can be forced to go over the idea of taking over the company with its new share value. In civil law, stock buyback was prohibited until the 1970s due to its negative aspects (later, its application was allowed under exceptional circumstances),[20] while in the US buybacks have never been prohibited as it was considered always advantageous for the shareholders and ensuring continuity in dividend distribution.[21]

## A. STOCK BUYBACKS IN GERMAN CORPORATE LAW

In German corporate law, the application of repurchasing the company's own shares was abstractly prohibited in 1870 with the third paragraph of Article 215 of the Allgemeines Deutsches Handelsgesetzbuch (ADHGB). The main reason behind this prohibition was the thought that the basic principles and theories regarding company law would be violated. That is to say, for a long time in German commercial law, the assumption that a company's legal entity has only one personality, and that companies cannot have rights and obligations against themselves, was embodied as a theory that is difficult to prove. In this context, the company's acquisition of its own shares has been prohibited until 1931, when Article 215d ADHGB stipulated exceptions to this prohibition. In this context, it has been accepted that the company can acquire its own shares through donations or

20 "To the extent that the acquisitions are permitted, Member States shall make such acquisitions subject to the following conditions:
(a) authorisation is given by the general meeting, which shall determine the terms and conditions of such acquisitions, and, in particular, the maximum number of shares to be acquired, the duration of the period for which the authoris ation is given, the maximum length of which shall be determined by national law without, however, exceeding five years, and, in the case of acquisition for value, the maximum and minimum consideration. Members of the adminis trative or management body shall satisfy themselves that, at the time when each authorised acquisition is effected, the conditions referred to in points (b) and (c) are respected;
(b) the acquisitions, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his or her own name but on the company's behalf, cannot have the effect of reducing the net assets below the amount referrred to in Article 56(1) and (2); and
(c) only fully paid-up shares can be included in the transaction. Furthermore, Member States may subject acquisitions within the meaning of the first subparagraph to any of the following conditions:
(a) the nominal value or, in the absence thereof, the accountable par of the acquired shares, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf, does not exceed a limit to be determined by Member States; this limit may not be lower than 10 % of the subscribed capital;
(b) the power of the company to acquire its own shares within the meaning of the first subparagraph, the maximum number of shares to be acquired, the duration of the period for which the power is given and the maximum or minimum consideration are laid down in the statutes or in the instrument of incorporation of the company;
(c) the company complies with appropriate reporting and notification requirements;
(d) certain companies, as determined by Member States, can be required to cancel the acquired shares provided that an amount equal to the nominal value of the shares cancelled is included in a reserve which cannot be distributed to the shareholders, except in the event of a reduction in the subscribed capital; this reserve may be used only for the purposes of increasing the subscribed capital by the capitalisation of reserves;
(e) the acquisition does not prejudice the satisfaction of creditors' claims. " See, further, Directive (EU) 2017/1132 of the European Parliament and of the Council relating to certain aspects of company law (2017) OJ L 169/46, Art. 59-67.

21 Dimitris Andriosopoulos and Meziane Lasfer, 'The Market Valuation of Share Repurchases in Europe' (2015) 55(C) Journal of Banking and Finance 327-39.

inheritance. This amendment, together with Article 226 ADHGB, has been reflected in practice with the idea that partnerships can get their shares back as long as they do not aim to make a profit. As a result, company's acquisition of their own shares has turned into a defense mechanism that has been frequently used to eliminate both the company's own economic difficulties and the macroeconomic irregularities. This practice gained momentum especially after the First World War by that companies acquired their shares (provided that the prices were fully paid) as purchasing brokers, through capital reduction to prevent potential heavy losses. This freedom lasted until 1998 but was revised to adapt to global competition conditions. Since the convenience of buying their own shares provided to companies subjected to American law, the prohibition of acquiring own shares was a major disadvantage for German companies. Thus, due to the need for an environment where there are fair conditions in the global competition of companies, with the regulation "Gesetz zur Kontrolle und Transparenz im Unternehmensbereich", it has been regulated that the board of directors can be authorized for German companies to repurchase their own shares by not exceeding 10 percent of the company's registered capital. The only prerequisite for this is that the financial resource allocated for repurchase must be from distributable assets.[22]

### *B. STOCK BUYBACKS IN SWISS CORPORATE LAW*

In Swiss corporate law, company's acquisition of their own shares was prohibited by Article 628 of the Swiss Code of Obligations (Obligationenrecht) in 1881, parallel to the German legal order, by specifying exceptional circumstances. These exceptions are the acquisitions made for the purpose of depreciation of shares or capital reduction, provided that the purchase and sale of shares is one of the company's fields of activity stipulated in the articles of association or stipulated in the articles of association for the collection of shareholders' receivables. The company acquiring its own shares has to comply with the conditions that affiliated shares are not represented in the general assembly and that these shares are extinguished within the statutory period. In this context, the company is obliged to dispose of its shares immediately in case of amortisation or capital reduction, and obliged to dispose of them at the earliest convenient time in other cases. The repurchase of shares has been regulated in Articles 659 and 659b Obligationenrecht. Accordingly, the board of directors is allowed to decide on the acquisition of shares up to 10 percent of the basic capital without the need for any authorization by the general assembly. The determined upper limit can be increased up to 20 percent if the acquired shares are registered, but the shares acquired over 10 percent of the company's shares must be disposed of within two years or through capital reduction.[23] However, it should be noted that the board of directors will only be able to fulfill this acquisition with reserve funds. Otherwise, the purchase will be deemed to be made over the participation shares, and consequently, the acquisition

22 The German Stock Corporation Act (Aktiengesetz), Art. 71; For a general reading, see Alihan Aydın, *Anonim Ortaklıkların Kendi Paylarını Edinmesi* (Arıkan Yayıncılık 2008); Tilman Bezzenberger, *Erwerb Eigener Aktien Durch die AG* (Verlag 2002).

23 Obligationenrecht, Art 659/2.

would be deemed as null and void. Regarding the voting rights arising from the shares acquired by the company, it is clearly regulated that these rights will be frozen.[24]

## STOCK BUYBACKS IN THE ANGLO-SAXON TRADITION

The concept of company's acquisition of its own shares represents the Anglo-Saxon tradition, and it is a concept that is not sufficiently familiar with the civil law. In terms of US law, since there is no prohibitive provision regarding stock buybacks, the opinion prevails that the company can acquire its own shares on the condition that purchasing transactions are made in good faith.[25] The application of US law differs from other legal systems with the fact that the maximum limit, which companies can acquire their own shares is not determined by a certain rate, but by the companies' surplus assets that can be distributed as dividends.[26] Hence, the company may repurchase shares as much as the portion of its assets exceeding its basic capital.[27] It should be noted that there is no uniform commercial law practice in American commercial law. Due to the different laws of states, there are many different applications.

The most prominent of these are the 1977 California Corporations Code and the Model Business Corporations Act, which is regulated by the American Bar Association and quoted in several states' legal systems, where no minimum capital is required for companies. In light of these regulations, the repurchase of shares has been evaluated in the same status as the profit distribution and has been subject to similar restrictions.[28] In most basic sense, this limitation arises during profit distribution or acquisition of company shares in cases where the assets of the company cannot meet its due debts.[29] In companies that do not comply with the relevant financial limitation, the responsibility is evaluated within the scope of the duty of care of the BoD and the business judgement rule. Members of the board are held jointly and severally liable for share repurchases performed against duty of care and law. However, if the members of the BoD oppose the repurchase decision by recording their negative vote in the official minutes book, they cannot be held responsible.[30]

24 In this context, with regard to the tax aspect of the share repurchase is examined, the purchased shares are taxed as dividend income and not as a pseudo dividend rather than a tax examination for capital gains. See, Theo Vermaelen, 'Share Repurchases' (2005) 1(3) Foundations and Trends in Finance 214; Obligationenrecht, Art 659-a.

25 For example, in the *Taylor v. Miami Exporting Co.* decision, the court ruled that the company may acquire its own shares in return for a receivable. *Taylor v. Miami Exporting Co* (1831) 5 Ohio 162.

26 For example, in the *Hartridge v. Rockwell* decision, a bank acquired its own shares with excess liquid resources to sell them at a premium later on, and this was seen as a lawful action by the court. According to this decision, it has been taken into consideration that the creditors of the company will not suffer any loss since there will be no change in the value of the assets, which they have obtained in return for the amount they have paid. In terms of shareholders, the claims that the company managers could abuse the stock buyback mechanism were rejected by the court, as examining the purpose of stock buyback was seen extra judicial. See, *Hartridge v. Rockwell* (1828) R. M. Charlton 260; Erwin Esser Nemmers, 'The Power of a Corporation to Purchase Its Own Stock' (1942) 1942(2) Wisconsin Law Review 161-97; Irving Levy, 'Purchase by a Corporation of Its Own Stock' (1930) 15(1) Minnesota Law Review 1512-1551.

27 New York Business Corporation Law, §513(b)(1).

28 California Corporations Code CORP § 166; Model Business Corporation Act (2016), 1.40(6).

29 California Corporations Code CORP § 501; Model Business Corporation Act (2016), 6.40(c).

30 Delaware General Corporation Law (Title 8 Chapter 1 of the Delaware Code), § 160(a); New York Business Corporation Law, §719(a), (b); California Corporations Code CORP §316(b); Model Business Corporation Act (2016), §8.24(a), §8.33(d)

In terms of transactions related to capital market law, it should be noted that although corporate law in American law is regulated and implemented differently by states, capital market law is a federal law that is applied above the federal provisions with the 1934 Securities and Exchange Act. Regarding the buybacks made on the stock market, it is envisaged that it is necessary to prevent manipulation, to inform the investors continuously within the framework of the disclosure requirement, and to ensure that investors (and shareholders) are treated equally.[31] If companies wish to acquire their shares on the stock market, four points must be taken into account: (1) in order not to create a false impression of company shares, companies shall purchase their own shares through a single broker, (2) companies cannot make transactions at the beginning of the trading day or in the last half hour of the session, (3) the price to be paid to the share shall not be higher than the price at which the highest independent bid or independent purchase is made, and (4) the amount to be paid for the purchase of shares should not exceed 25 percent of the average of the last four weeks.[32] As long as these conditions are complied with, it is considered that a manipulative action is not executed in the stock market. In terms of public takeover offers subjected to capital market law, when the company acquires its own shares, the company must inform the shareholders in detail within the scope of the public disclosure obligation by presenting the detailed financial status of the company and the purchase schedule so that they can evaluate the situation comprehensively.[33] The takeover bid must last at least 20 business days from the time of its announcement; if changes are foreseen in the share purchase program in terms of quantity or price, the period is extended for at least 10 more working days as of this change.[34] Finally, it is important to note that share repurchases are generally subject to bankruptcy law rather than corporate law in the US, as they create debts related to the company.[35] As a final remark, the determinants of the share repurchase should be enlightened in terms of specifying whether there is a need for stricter norms on this surplus distribution mechanism.[36]

31 However, the disclosure requirement is not the only tool to safeguard creditors. For example, federal fraudulent transfer laws are introduced to protect creditors, but the creditor's primary tool is the contract, which could protect their rights against shareholders. Apart from that, regarding the protection of creditors, the concept of stated (aka stipulated or subscribed) capital is not at the forefront for a large portion of the US Accordingly, stated capital as a legal criterion becomes more of an issue in several States including Delaware when it comes to stock buybacks or distributing dividends. See, Bayless Manning & James Hanks, *Legal Capital* (Foundation Press, 2013) 9; Richard Booth, *Capital Requirements in United States Corporation Law* in Marcus Lutter (ed), *Legal Capital in Europe* (De Gruyter Recht, 2006) 620-45; Louise Gullifer and Jennifer Peyne, *Corporate Finance Law Principles and Policy* (Bloomsbury, 2015) 148; Luca Enriques and Jonathan Macey, 'Creditors versus Capital Formation: The Case against the European Legal Capital Rules' (2001) 86(6) Cornell Law Review 1165; Andreas Engert, 'Life Without Legal Capital: Lessons from American Law' in Marcus Lutter (ed), *Legal Capital in Europe* (De Gruyter Recht, 2006) 646-94; Securities Exchange Act of 1934 (48 Stat. 881, 15 U.S.C. 78a-78kk) §9(a)(2), 10(b).

32 Securities Exchange Act of 1934 (48 Stat. 881, 15 U.S.C. 78a-78kk) §10(b)-18.

33 ibid, §13(e)-4.

34 ibid, §13e-4(f)1(i), (ii).

35 Richard Booth, 'Capital Requirements in United States Corporation Law' (Villanova University School of Law Working Paper Series, 102 <https://digitalcommons.law.villanova.edu/wps/art102> last accessed 9 August 2021; Jonathan Rickford, 'Legal Approaches to Restricting Distributions to Shareholders: Balance Sheet Tests and Solvency Tests' (2006) 7 European Business Organization Law Review 139; Wolfgang Schön, 'The Future of Legal Capital' (2015) 5 European Business Organization Law Review 429-48.

36 Ioannis Chasiotis, Andreas Georgantopoulos and Nikolaos Eriotis, 'Determinants of Share Repurchases a Quantile Regression Approach' (2021) 10(1) Economics and Business Letters 27-36.

As in US law, there are certain regulations in both positive and case law for the protection of existing shareholders and company rights in UK corporate law.[37] The most basic legal basis in this context is the *Trevor v. Whitworth's* decision. In this decision – taken by the House of Lords in 1887-, it was emphasized that the company could not acquire its own shares, otherwise an attitude would likely be incompatible with the ultra vires principle and the capital would be imperiled. Exceptions to this situation are the cases where the company acquires its shares for receivables that cannot be collected in any other way, or when it acquires its shares as a result of a donation or will.[38] In the decision, Lord Watson emphasized the importance of the paid-in capital of the company by stating that both the company's creditors and shareholders had the right to assume that this capital was not spent.[39] Hence, it has been evaluated that the company's acquisition of its own shares is against the principle of capital maintenance. In line with this idea, it has been revealed that the acquisition of the company's own shares may pose a problem, since the responsibilities of the shareholders towards the company are limited to the capital shares they have paid and the creditors must apply to the company assets, not the shareholders', in case the company debts are not paid.[40] It can be said that this approach, which was adopted in 1887, still continues with the first paragraph of Article 658 of the Companies Act 2006. The relevant article in Chapter 18 titled "Acquisition by limited company of its own shares" prohibits the company from acquiring its own shares, except for the cases stipulated in the law.[41] In other words, as a general rule in positive law, the acquisition of its own shares by the company has been determined as unlawful. In case of violation of this provision, the company and its partners will be punished with imprisonment or a fine.[42] Regarding exceptions of this provision, companies are able to purchase their own shares for a reasonable price, provided that shares are fully paid.[43] The legislator has determined three basic exceptions regarding the repurchase of shares. The first exemption is provided for the acquisition of its own shares if the company applies for a capital reduction.[44] The second exception is occured when the company's acquisition of its own shares is mandatory as a result of a court decision.[45] Finally, it is regulated that the company can acquire its own shares in case of non-payment of an amount due for the share.[46]

## IV. THE WAYS FOR A COMPANY TO ACQUIRE ITS OWN SHARES

Companies can acquire their own shares in many ways. Since these ways will serve different purposes, it is expected from managers to choose the most appropriate way with a prudent decision. In other words, a balance should be established between all the expected benefits and drawbacks

37 The Companies Act 2006, Part 10, Ch 2, Sections 170-181.

38 533 Trevor and Another v Whitworth and Another House of Lords (1887) 12 App. Cas. 409.

39 ibid.

40 Ellis Ferran, *Principles of Corporate Finance Law* (OUP 2008) 212-3; Bernard McCabe, 'The Desirability of a Share Buy-Back Power' (1991) 3(1) Bond Law Review 1991.

41 Companies Act 2006, c 46, part 18, Ch 1, Section 658(1).

42 ibid, sections 658(2), 658(3).

43 ibid, section 659(1).

44 ibid, section 659(2)(a).

45 ibid, Section 659(2)(b).

46 ibid, Section 659(2)(c).

in terms of repurchasing decisions. Firstly, 'open market repurchase' is one of the most frequently used ways of acquiring shares through the stock market. This scheme can be defined as the most convenient way in which the share transfer can take place in accordance with the equal treatment principle because the transaction is realised through the intermediary institution and the parties making transactions of their shares remain anonymous.[47] Secondly, another common way to adopt for repurchasing is 'fixed-price offer', which is an offer proffered to all shareholders to buy back a certain number of shares at a fixed price. In this way of acquisition, the company announces to the public the proportion and number of shares planned to be repurchased along with the duration of purchasing. Shareholders who want to sell their shares apply for this acquisition offer, which is valid within the announced period, and if applications are below or equal the number of shares desired to be purchased, the company evaluates all requests. In case of excessive interest, managers are generally authorized to increase the purchase, but if they do not, they will purchase shares on a pro rata basis.[48] Finally yet importantly,[49] the 'Dutch auction share repurchase' way is popular among other ways. In this way, instead of a fixed price, a price range is determined for the shareholders. This range has the lower and upper limit prices that the company intends to pay for the shares to be acquired. After the announcement of the company, an acquisition price is determined from the average of the prices proposed by the shareholders. Consequently, shares that are equal to or below the determined price are acquired. In this case, each shareholder gets the same determined price. By this way, the price is not determined unilaterally by the company in advance, but according to the market conditions and the proposals of the shareholders.[50]

The company's acquisition of its own shares gains currency when there is a risk of a hostile takeover, which is derived from the fact that the capital owners, whose aim is not to get return on the company's earnings, but to put the company management in a deadlock through the majority of their shares, force the company to repurchase its shares at a premium. It is a common problem frequently appeared in the US and UK financial markets, but also seen in other legal systems. Hostile takeovers, which usually pose a strong risk in cases where publicly traded shares are priced lower than company valuations, are not generally considered as blackmail, but as a lawful imposition (greenmail) since they do not constitute a crime in US law. Under these cases, there are two ways: to buyback shares at high prices or to give up the control of company (take it or leave it). However, as indicated in following section, there are some sidetracks prior to takeover attempts instead of company's acquisition of its own stocks.[51]

47 James Miller and John McConnell, 'Open-Market Share Repurchase Programs and Bid-Ask Spreads on the NYSE: Implications for Corporate Payout Policy' (1995) 30(3) Journal of Financial and Quantitative Analysis 365-82.

48 Grullon and Ikenberry (n 8) 32.

49 There are some other stock buyback methods such as employee share scheme buybacks and negotiated repurchase. See, Bolko Hohaus, 'Share Buybacks and Employee Stock Options' (2016) 16(4) CESifo Forum 79-81; Larry Dann and Harry DeAngelo, 'Standstill agreements, privately negotiated stock repurchases, and the market for corporate control' (1983) 11(1-4) Journal of Financial Economics 275-300.

50 Grullon and Ikenberry (n 8) 32; Peter Oh, 'The Dutch Auction Myth' (2007) 42 Wake Forest Law Review 853-910; Anita Anand, 'Regulating Issuer Bids: The Case of the Dutch Auction' (2000) 45 McGill Law Journal 133-54.

51 Allen He, 'Buybacks: Look Before You Leap' (Harvard Law School Forum on Corporate Governance, 26 July 2021) <https://corpgov.law.harvard.edu/2021/07/26/buybacks-look-before-you-leap/#comment-1208429> last accessed 9

## V. POISON PILLS

It is emphasised throughout the paper that the company can repurchase its own shares as a response to hostile takeover attempts, which is one of the most dangerous occasions that companies might face, over the shares quoted on the stock exchange. Apart from stock buyback route, companies have other defensive strategies to be implemented before (pre-bid) being taken over. What these strategies have in common is to maximise the value of stocks and depict the company as unattractive for bidders. With this way, the company can protect itself to some extent against hostile takeovers. Strategies such as greenmail put offeree companies (as takeover targets) at a disadvantage, and consequently, force them to repurchase their stocks. However, since the 1980s, companies have developed several defence mechanisms, but this study limits itself to discuss only poison pills despite other mechanisms such as shark repellent[52] leveraged recapitalisation, [53] and employee stock ownership plans[54] exist.

Poison pill, which is also known as a shareholder rights plan developed by Lipton,[55] refers to a formidable defensive strategy used by a target company to prevent or deter a potential hostile takeover initiative by making itself unattractive to the bidder. This strategy forces prospective buyer companies to negotiate directly with the target company management rather than receiving offers from stockholders.[56] Poison pills, on that sense, limit bargaining power of purchasing company aversively, since stockholders are provided with a low cost to increase their share ownership and/or voting rights by dint of poison pills. These rights granted to shareholders are generally exercised

August 2021.

52 Nancy Meade and Dan Davidson, 'The Use of "Shark Repellents" to Prevent Corporate Takeovers: An Ethical Perspective' (1993) 12(2) Journal of Business Ethics 83-92.

53 See, Urs Peyer and Anil Shivdasani, 'Leverage and Internal Capital Markets: Evidence from Leveraged Recapitalizations' (2001) 59(3) Journal of Financial Economics 477-515; Michael Ryngaert and Ralph Scholten, 'Have Changing Takeover Defense Rules and Strategies Entrenched Management and Damaged Shareholders?' The Case of Defeated Takeover Bids' (2010) 16(1) Journal of Corporate Finance 16-37.

54 Stock buyback occurs when large companies purchase their shares with the intent of distributing these to their employees, that is, they are spreading the wealth. It can be defined as a tool for offsetting dilution. Yardeni and Abbott argued that the general attitude of politicians is against stock buyback and that they even tend to ban it by suggesting that it creates wealth inequality. In this context, two US senators Schumer and Sanders stated that the way to return to the old glory days is to restrict stock buybacks with the aim of 'curtail[ing] the overreliance on buybacks while also incentivizing the productive investment of corporate capital.' However, since the 1980s, stock buyback has emerged as an increasingly common route for returning capital to shareholders in the US, and as of 1998, the amount of stock buybacks has exceeded cash dividends. Within the employee stock ownership plan, the company makes it difficult for any changes in corporate control to take place because of the expectation that employees evaluate every takeover attempt as a threat to their employment security and working conditions. Edward Yardeni and Joseph Abbott, *Stock Buybacks: The True Story* (YRI Press 2019); Chuck Schumer and Bernie Sanders, 'Schumer and Sanders: Limit Corporate Stock Buybacks' (The New York Times, 3 February 2019) <https://www.nytimes.com/2019/02/03/opinion/chuck-schumer-bernie-sanders.html> last accessed 9 August 2021; Gustavo Grullon and Roni Michaely, 'Dividends, Share Repurchases, and the Substitution Hypothesis' (Rice University and Cornell University working paper, 2000); Michael McGinley, 'Standing at the Crossroads: An Integrated Approach to the ESOP Repurchase Obligation' (2011), 2011(Winter) Insights 12-18; Andrew Oringer and Michael Segal, 'Winding Down Employee Stock Ownership Plans' (2017) Transactions & Business 33-41.

55 Martin Lipton, 'Discussion Memorandum: Warrant Dividend Plan' (1982).

56 James van Horne, *Financial Management and Policy* (Pearson, 2001) 703; Julian Velasco, 'Just Do It: An Antidote to the Poison Pill' (2003) 52 Emory Law Journal 849-908.

without the approval of shareholders any given time determined by managers.[57] This represents a double-edged issue for shareholders. It renders helpless to shareholders by forcing them to take it more or leave it quickly, while there are studies showing that poison pills provide a positive mean cumulative abnormal return in short terms.[58] In line with this empirical evidence, Judge Richard Posner stated this issue as follows: *"The threat of hostile takeover plays a vital role in keeping management on its toes… All this sturm and drang seems a high price to pay for fending off a change of corporate control that may, for all that appears, benefit the shareholders greatly, though it will be a humiliation to the present officers and directors. It is defended as necessary to protect minority shareholders from a disadvantageous 'back-end' transaction."*[59] As demonstrated, poison pill often results in effective outcomes,[60] they are not always the first and best way to preserve the company; it comes with disadvantages. At the outset, the application of poison pills would likely impose a burden on stockholders, as they are forced to purchase more stocks to uphold their share proportion in the company. This burden would also potentially set institutional investors aback due to the difficulty of risk measurement. Moreover, poison pill strategy could be abused by an ineffectual executive team to stay on task.

It is ultimately worth noting that poison pills could be addressed in the US, whereas actions taken by tamping down actual/potential bidders through depicturing the target company as unattractive are restricted in the UK[61] However, there are two recent cases in the UK that gave the first signals of a new move towards the use of poison pills. First of all, special shares were designated in the context of £5 billion initial public offering of The Hut Group. Accordingly, these shares provide shareholders an opportunity to deter unwanted takeover attempts for a 3-year period. This quasi-poison pill defence mechanism, which enables the founder having special shares to exercise his voting rights to make a general offer to shareholders in terms of controlling the company, was confirmed by the UK Takeover Panel as per Rule 9 of the Takeover Code. A second case was related to the joint venture initiative of William Hill

57 Tatyana Sokolyk, 'The Effects of Antitakeover Provisions on Acquisition Targets' (2011) 17 Journal of Corporate Finance 612-27; Lucian Bebchuk, Alma Cohen and Allen Ferrell, 'What matters in Corporate Governance?' (2009) 22(2) Review of Financial Studies 783-827; Paul Gompers, Joy Ishii and Andrew Metrick, 'Corporate Governance and Equity Prices' (2003) 118 Quantitative Journal of Economics 107-55; Morris Danielson and Jonathan Karpoff, 'Do pills poison operating performance?' (2009) 12 Journal of Corporate Finance 536-59.

58 Katherine Fowlkes, 'Poison pills and their effect on shareholder return' (TRACE: Tennessee Research and Creative Exchange, 2019) <https://trace.tennessee.edu/cgi/viewcontent.cgi?article=3267&context=utk_chanhonoproj> last accessed 9 August 2021; Simon Hitzelberger, 'What effect do poison pills have on shareholder value' (2017) <run.unl.pt//bitstream/10362/26192/1/Hitzelberger_2017.pdf> last accessed 9 August 2021.

59 Nos. 86-1601, 86-1608 United States Court of Appeals, Seventh Circuit, *Dynamics Corp. of America v. CTS Corp.* (1986) 794 F.2d 250, 259.

60 John Pearce, 'Hostile takeover defenses that maximize shareholder wealth' (2004) 47(5) Business Horizons, 15-24; Randall Heron and Erik Lie, 'On the use of poison pills and defensive payous by takeover targets' (2006) 79(4) The Journal of Business 1783-1808; Paul Malatesta and Ralph Walkling, 'Poison pill securities: stockholder wealth, profitability, and ownership structure' (1988) 20(1) Journal of Financial Economics 347-76; Michael Ryngaert, 'The effect of poison pill securities on shareholder wealth' (1988) 20(1) Journal of Financial Economics 377-417; Gary Caton and Jeremy Goh, 'Corporate Governance, Shareholder Rights, and Shareholder Rights Plans: Poison, Placebo or Prescription?' (2008) 42(2) The Journal of Financial and Quantitative Analysis 381-400.

61 UK City Code on Takeovers and Mergers, Rule 21.

and Caesars.[62] William Hill, a betting company located in London, accepted Las Vegas casino operator Caesars' takeover request amounted around £2.9 billion. However, there has been an intense interest from Apollo Global Management in terms of acquiring William Hill's properties and rights in Europe.Due to the poison pill belonging to William Hill's shareholders, Apollo withdrew its attention to buyout.[63]

In short, this defence mechanism, as an extremely malleable instrument,[64] protects minority shareholders as well as business executives. Notwithstanding the foregoing drawbacks, it is commonly used by American public companies in different ways, which are under two types of poison pill strategies, namely flip-in and flip-over poison pills.[65]

Flip-in poison pill is one of the most preferred ways when corporate raiders purchase a large number of shares from the company. By this way, the target company provides an opportunity for the shareholders, except for the acquirer, to purchase voluminous shares at a discounted rate to counter the offer. This eventually is expected to reduce the acquirer's control in the company, and consequently, its bargaining power.[66] In short, flip-in poison pill is a provision in the bylaws of the takeover candidate that gives the current shareholders of the target company, excluding the transferee, the right to purchase additional shares of the targeted company at the price minus the discount. This strategy, accordingly, includes allowing shareholders other than the purchaser to purchase additional shares. Although purchasing additional shares derives instant profits to shareholders, the practice would likely reduce the value of a limited number of shares, which have already been purchased by the acquiring company. As per this application, the interest of the acquiring company would be more restricted as much as the number of shareholders purchasing additional shares.[67] As new shares are distributed at discounted prices, the value of the shares held by the transferee decreases; and this makes the takeover initiative more expensive. If the bidder is aware of that such a scheme may be activated, the takeover attempt would not likely occur. Such clauses are often made publicly available in a company's contract, illustrating their potential use as a takeover defence.

Flip-out (flip-over) poison pill allows the target company's shareholders to purchase shares of the acquiring company at a greatly discounted price on the condition that the hostile takeover attempt is successful. This tactic reduces the share of the previous partners of the acquiring company after the takeover, as it gives the target company partners the right to buy the stock at less than the market price of the acquiring company's

62 Nigel Stacey, Sian Williams and SJ Beaumont, 'Are poison pills finally coming to the UK?' (Financier Worldwide, February 2021) <https://www.financierworldwide.com/are-poison-pills-finally-coming-to-the-uk#.YL-JGy2cbUo> last accessed 9 August 2021.

63 Pushkala Aripaka, 'Apollo formally ends bidding war for Britain's William Hill' (Reuters, 12 November 2020) <https://www.reuters.com/article/us-william-hill-m-a-apollo-idUKKBN27S0UX> last accessed 9 August 2021.

64 Guhan Subramanian, 'Bargaining in the Shadow of Peoplesoft's (Defective) Poison Pill' (Harvard Law School Discussion Paper No. 568, 2006) 5.

65 Poison pills are seen as one of the most effective tools for activist shareholders that use their shares and rights to put pressure on their existing or prospective companies.

66 Dingual Sunder, 'The Controversial 'Poison Pill' Takeover Defense: How valid are the arguments in support of it?' (2013) 23 NMIMS Management Review 48-49.

67 Patrick Gaughan, *Mergers, Acquisitions and Corporate Restructurings* (John Wiley and Sons 2007) 178; Guhan Subramanian, 'Bargaining in the shadow of takeover defenses' (2003) 113(3) The Yale Law Journal 621-86.

stock.[68] To put it in a different way, this way, as the opposite of flip-in poison pill, occurs when shareholders choose to purchase shares in the acquirer's company after the merger. Therefore, flip-out poison pill potentially reduces the acquiring company's interest, as it makes the deal more expensive and unfavourable.

## VI. STOCK BUYBACKS AS A RESPONSE TO SHORT-TERMISM

Short-termism serves as the driving force behind the case of shareholders forcing companies to purchase their own shares. Empirical studies show that shareholders' economic decisions are constantly changing in liberalised but fragile markets under adverse circumstances.[69] Accordingly, shareholders hold their shares in a much shorter period compared to previous periods. This behaviour can be expressed as a globally widespread and dominant trend. In other words, companies may resort to stock buybacks to meet the short-term expectations of their shareholders, reach the target amounts determined by analysts and reduce the pressure on company management. Note that the market prices of the shares are already priced in advance by considering the long-term (sustainable) earnings, in view of the information and expectations of investors. However, despite this condition, the share values may still be below their real values. In this case, companies may choose to acquire their own shares until the prices reflect the truth. Subsequently, they may not only eliminate the shares they have acquired but may also resell these shares when prices and expectations are balanced.

Economic analyses demonstrate that companies need to be innovative and allocate regular budgets for R&D activities to maintain their existence.[70] Otherwise, in the light of the theories known as creative destruction[71] or disruptive innovation,[72] the chance of survival for companies is very low. Therefore, further to the assumption that the purpose of companies is to grow continuously, instead of distributing dividends to their shareholders, the companies' acquisition of their own shares by using the assets allocated from distributable dividends can be based upon economically logical foundations. In Anglo-Saxon legal systems, the main purpose of corporate governance is to protecting the interests of shareholders,[73] while in other legal systems it is usually considered in a broader perspective (employees and customers are also prioritised).[74]

68 Richard Dowen, James Johnson and Gerard Jensen, 'Poison Pills and Corporate Governance' (1994) 4 Applied Financial Economics 305-13; Steven Bragg, *Merger and Acquisitions: A Condensed Practitioner's Guide* (John Wiley and Sons 2009) 36.

69 David Hunkar, 'Average holding period for U.S. Stocks is Just 5-1/2 months in 2020' (Top Foreign Stocks, 4 August 2020) <https://topforeignstocks.com/2020/08/04/average-holding-period-for-u-s-stocks-is-just-5-1-2-months-in-2020> last accessed 9 August 2021.

70 Erdem (n 12).

71 Joseph Schumpeter, *Capitalism, Socialism and Democracy* (Routledge 2003) 102; David Harvey, 'Neoliberalism as Creative Destruction' (2007) 610(1) The Annals of the American Academy of Political and Social Science 21-44.

72 Joseph Bower and Clayton Christensen, 'Disruptive Technologies: Catching the Wave' (1995) 73 Harvard Business Review 43-53; Clayton Christensen, 'The Ongoing Process of Building a Theory of Disruption' (2006) 23 The Journal of Product Innovation Management 39-55.

73 Andrei Shleifer and Robert Vishny, 'A Survey of Corporate Governance' (1997) 52(2) The Journal of Finance 737-83; Diane Denis and John McConnell, 'International Corporate Governance' (Purdue CIBER Working Papers No. 17, 2001) 1-2 <https://docs.lib.purdue.edu/ciberwp/17/> last accessed 9 August 2021.

74 Franklin Allen and Douglas Gale, 'A Comparative Theory of Corporate Governance' (Wharton Financial Institutions

This situation arises from the concept of *shareholders* in Anglo-Saxon understanding and *stakeholders* in European understanding. Therefore, it would be useful to examine dispersed ownership and concentrated ownership structures in terms of examining these conflicts of interest. In Anglo-Saxon systems, the majority of companies have non-dominant shareholders, known as the outsiders, who do not have enough power to control the company. This situation requires leaving the management of the company to a professional management team (managerial capitalism). It is also known as the separation of ownership from the control of a company. Although there are different factors for the motivation and risk-taking capacity of managers who make decisions because they are not shareholders, these problems can be overcome with a good institutional organisation. Failing this, managers can prioritise their own interests before those of the shareholders, and approach that would lead to managerial shirking. This issue is handled in the doctrine under the agency problem.[75] To eliminate this problem, the company needs to bear the monitoring cost of the investors, the cost of minimising the losses from the activities of the managers (bonding cost) and the residual losses.[76]

On the other hand, stockholder theory, which argues that the sole duty of corporations is to maximise the profits of its stockholders, has been at the forefront but been decreasingly influential in corporate law since the 1970s. This theory took its philosophical, economic and normative sources from the Friedman doctrine, which is in line with the notion that a company is only accountable to its stockholders. In this respect, stockholder is in a diametrically opposite position with the theories based on supporting corporate social responsibilities. Quite short, the Friedman doctrine alleges that a corporate executive should prioritise stockholders' demands.[77] Therefore, these executives are not dependent on fulfilling social responsibilities but on acting upon the desires of shareholders[78]

Center Working Paper No. 03-27, December 2002) <http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.202.2082> last accessed 9 August 2021.

75 Dan Dalton and others, 'The Fundamental Agency Problem and Its Mitigation' (2007) 1(1) The Academy of Management Annals 1-64; Meri Boshkoska, 'The Agency Problem: Measuring for Its Overcoming' (2015) 10(1) International Journal of Business and Management 205-6.

76 See, Michael Jensen and William Meckling, 'Theory of the firm: Managerial behavior, agency costs and ownership structure' (1976) 3(4) Journal of Financial Economics 310-1; James Ang, Rebel Cole and James Lin, 'Agency Costs and Ownership structure' (2000) 55(1) Journal of Finance 1-39.

77 Both US and UK corporate laws have evolved to employ stockholder-centric approach, as stockholders are capable of commending a company by appointing directors and approving critical decisions with the help of assigned executives, who have fiduciary duties to adopt course of actions to the best advantage for stockholders. This approach is termed as stockholder primacy. See, Gordon Smith, 'The Shareholder Primacy Norm' (1998) 23(2) The Journal of Corporation Law 277-8; John Matheson and Brent Olson, 'Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law' (1994) 78 Minnesota Law Review 1443-91; William Bratton and Joseph McCahery, 'Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation' (1995) 73(5) North Carolina Law Review 1861-1948; Stephen Bainbridge, 'In defense of the shareholder wealth maximization norm: A reply to Professor Green' (1993) 50 Washington and Lee Law Review 1423-1447; Also see cases, *Dodge v. Ford Motor Co* (1919) 204 Mich. 459, 170 N.W. 668; *Churella v Pioneer State Mutual Insurance Co* (2003) 671 NW2d 125; *Davis – Louisville Gas and Electric Co* (1928) 16 Del Ch 157; *Unocal Corp v Mesa Petroleum Co* (1985) 493 A2d 946 (Del 1985); *Burwell v Hobby Lobby Stores Inc* (2014) 573 US 682.

78 Milton Friedman, 'A Friedman Doctrine: The Social Responsibility of Business is to Increase its Profits' (The New York Times Magazine, 13 September 1970) <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> last accessed 9 August 2021; Milton Friedman, *Capitalism and Freedom* (University of Chicago Press 1962).

while they need to make adequate R&D research investment to avoid the risk of creative destruction and disruptive innovation. All in all, the company's acquisition of its own shares always hinges upon shareholder primacy in connection with the short-termism of the major shareholders.

## VII. CONCLUSION AND WAY FORWARD

The company takes on a more attractive role for investors when purchasing its circulating stocks because it boosts the EPS ratio. Therefore, short-term investors (i.e. those who want to derive profits in a short span of time) always keep a close watch for companies planning a scheduled buyback. This is because significant financial metrics such as the price to earnings ratio and the return on equity ratio automatically enhance the valuation of stocks. The company acquiring its own shares may be regarded as necessary so that its truly undervalued shares are not abused by third parties. However, if this repurchase is made to mislead investors and shareholders considering managerial optimism, then it will turn into a trap.

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