

Market Reaction of Australian Share Buybacks

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ABSTRACT

Australian corporations currently view share buybacks as an effective capital management tool that has the potential to increase shareholder value. As a consequence, the level of buyback activity has intensified in recent years with many corporations engaging in this practice. This study uses event study methodology to examine the market reaction of a sample of 170 on-market buybacks announced between 1996-1999. In particular, this study aims to address the following research questions: (1) What is the dominant reason behind a company's decisions to buyback stock?, and (2) What drives investors when reacting to a company's decision to repurchase its own shares? Consistent with US studies, we find significant positive announcement abnormal returns of approximately 2%. Further, these companies tend to experience significant negative abnormal returns prior to announcing a buyback of approximately 8%. Finally, initial findings suggest that on average, a company's EPS increases in the years following the buyback announcement. These results provide evidence to support the information signalling hypothesis which states that companies buyback their shares when they believe, on the basis of inside information, that the company is undervalued by the market. Thus, this information causes investors to revalue these companies, forcing their share price to reach a new level of equilibrium.