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"Entrepreneurship on Global Economics Development in the Era of Society 5.0"

Firm's Motive in Stock Repurchase**Anggi Dermawan Purba^{1*}**¹Universitas Sumatera Utara

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***Email:** anggidermawan0614@gmail.com**ABSTRACT**

This research examined the motives of stock repurchase, especially the cash distribution, investment and corporate capital structure motives (increasing leverage ratio). The sample was selected using a purposive sampling method with certain criteria, namely companies listed on the Indonesia Stock Exchange in 2016-2020 and repurchasing stocks between 2016 and 2020. Data analysis in this study used multiple linear regression. This research found that the motive for cash distribution is the main motive for the company to repurchases their stock because this is in accordance with the company's goal of maximizing stockholder wealth. Stock repurchase was done for investment motives because the company has excess cash and does not have other profitable investment opportunities. This study proves that the motive to increase the leverage ratio is also one of the reasons companies repurchases their stocks. Companies with leverage ratio below the target tended to repurchases their stock.

Keyword: Stock Repurchase, Cash Distribution, Investment, Leverage

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INTRODUCTION

Brealey, et al., (2007) explained that stock repurchase is a company that buys back shares from its shareholders. Stock repurchase can also be interpreted as a buyback of shares by the company that issued the shares for various reasons, which will result in a reduction in the shares outstanding (Keown et al., 2005). This share buyback activity will actually provide many benefits to the company such as an increase in share prices which will certainly increase the value of the company and shareholder wealth. As of February 4 2022, the Indonesia Stock Exchange (IDX) has informed that there are 133 issuers that have completed the buyback period. Its realized value has reached IDR 9.3 trillion since SE OJK No. 3/SEOJK.04/2020 took effect on March 9 2020. The exchange also noted that as of February 4 2022, there were 11 companies that were still in the buyback period. Seven of them have carried out buybacks with a total implementation of IDR 2.3 trillion. Therefore, this study wants to reveal the things that motivate companies to repurchase stock in Indonesia.

There are many company motives in carrying out stock repurchase activities. One of the company's motives for repurchasing stock is to distribute excess cash to shareholders (Jensen, 1986). This cash distribution motive is one way to reduce agency conflicts that occur in a company due to excess cash flow. The company performs stock repurchase to distribute cash to shareholders. When a company has excess cash but there are no profitable investment opportunities, the company can share the excess cash with stock repurchase. This is supported by the excess capital hypothesis. This study proxies excess cash with free cash flow to stockholders, which is the company's free cash distributed to shareholders because it is not used for working capital or investment in fixed assets (Ross et al, 2015).

Several previous studies have supported the positive influence of excess cash on stock repurchase, such as research by Dittmar (2000), Mitchell and Dharmawan (2007), Lee and Suh (2011), Jiang et al (2013) and Teng and Hachiya (2013). It is different from previous studies which used free cash flow, where in the free cash flow there is still a part for creditors, namely interest income, so the part for creditors must be issued first. This study uses free cash flow to stockholders so as not to create a bias regarding free cash flow for stock repurchase. Based on the previous explanation, it can be formulated that the first hypothesis (H1), namely free cash flow to stockholders, has a positive effect on stock repurchase.

The motive for the distribution of excess cash is also related to dividends. Stock repurchase is an alternative to distributing cash to shareholders in addition to dividend distribution. The dividend substitution hypothesis states that stock repurchase is a way for companies to distribute cash to shareholders. This is because the capital gains tax when the stock repurchase is lower than the dividend tax, so the company will distribute more cash in the form of stock repurchase than dividends. This means that stock repurchase and dividends will have a negative relationship. This supports the research results of Grullon and Michaely (2002) and Jiang et al (2013) which state that stock repurchase is a substitute for cash distribution in the form of dividends. Based on the explanation above, it can be formulated that the second hypothesis (H2), namely the dividend has a negative effect on stock repurchase.

Misvaluation of stocks, namely situations where stocks are undervalued and overvalued can be used as a reason for companies to repurchase stocks. The intended misvaluation is the difference in valuation of the company's shares. This means that shares can be said to be undervalued if the market value is lower than the book value. Stocks can also be said to be overvalued if the market value is higher than the book value. Stock repurchase provides flexibility in its implementation. Flexibility in question is the time of

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implementation. Stock repurchase can be done when the company's stock price is undervalued. This is also a signaling motive, if the company feels that the shares are undervalued, the company can repurchase stocks which can be used as a signal to the market that the company's shares are undervalued.

Mitchell and Dharmawan (2007) and Teng and Hachiya (2013), stated that the signaling motive for stocks that experience undervaluation is a common motive for companies to carry out stock repurchases. This is supported by Stephens and Weisbach (1998) who show the results of their research that there is a negative relationship between stock repurchase and stock prices. That is, undervaluation is one of the company's motives for stock repurchasing. The company's stock price is undervalued, the company uses it to repurchase stock, so that the company's share value can increase. This is one of the investment motives for the company, because the company will buy when the stock is undervalued and sell when the stock is overvalued so that the company benefits from the price difference. Previous studies such as Dittmar (2000), Mitchell and Dharmawan (2007), Teng and Hachiya (2013), Jiang et al (2013) have also proven that companies that carry out stock repurchases are companies whose shares experience undervalued conditions. Based on the explanation above, it can be formulated that the third hypothesis (H3), namely misvaluation has a negative effect on stock repurchase.

Not only that, several previous studies also revealed that the company's motive for repurchasing stock is to increase the company's leverage ratio (Dittmar, 2000; Mitchell and Dharmawan, 2007; Jansson Larsson-Olaison, 2010; Lee and Suh, 2011; Jiang et al, 2013; El Houcine, 2013; Yarram, 2014). The motive for increasing leverage is related to the company's capital structure policy. When a company performs a stock repurchase, the number of outstanding shares will decrease, which of course will reduce the company's equity. Reduced equity, will increase the leverage ratio (debt to equity ratio). This study uses leverage deviation, namely the difference between company leverage and the median of industry leverage which is used as a target in knowing the effect of leverage on stock repurchase.

Dittmar (2000) revealed that companies prefer to do stock repurchase if the company's leverage ratio is below the target. The target in question is the leverage target of the industry where the company is located. This suggests that the condition of the company's capital structure will have an impact on the company's decision to repurchase stock, because companies will always want to achieve an optimal capital structure, one of which is by repurchasing stock through increased leverage. Research by Dittmar (2000), Mitchell and Dharmawan (2007), Jansson and Larsson-Olaison (2010), Lee and Suh (2011), Jiang et al (2013), El Houcine (2013), and Yarram (2014) previously also received the result is that companies with low leverage (below the target) tend to repurchase stock. Based on this explanation, the fourth hypothesis (H4) can be formulated, namely leverage has a negative effect on stock repurchase.

METHOD

The type of research used is explanatory with a quantitative approach. The sample was determined using the purposive sampling method with certain criteria, namely a manufacturing company listed on the Indonesia Stock Exchange in 2016-2020 and repurchasing stock between 2016-2020. Data was collected using literature and documentation methods by collecting secondary data in the form of financial reports and annual reports. The sample obtained a number of 34 observations. The stages of data analysis

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are to calculate all the variables studied, to test the classical assumptions, to perform multiple linear regression, to test the hypothesis, and to test the coefficient of determination.

RESULT AND DISCUSSION

In this study, the classical assumption test has been carried out and has fulfilled the four classic assumption tests, namely the data is normally distributed, the data does not contain multicollinearity, there is no heteroscedasticity and there is no autocorrelation.

Table 1. Descriptive Statistics

Variable	N	Min	Max	Mean	Std. Dev
Stock Repurchase	34	15.19938	33.41129	2.1504	0.943284
FCFS	34	22.63876	35.00764	251.5436	0.691547
DPR	34	1.042629	0.887654	31.5223	0.078765
MTBR	34	0.009888	12.09766	5.1810	2.225751
PLEV	34	-2.00011	14.89000	58.250	2.085338

Source: The data is processed by the author

Table 1 is a descriptive statistic of this research. The sample of this research is 34 observations. The stock repurchase variable has an average of 2.1504 with a low standard deviation. Likewise, free cash flow to stockholders and dividends have an average of 251.5436 and 31.5223 respectively with a low standard deviation, which means they have a low variety of data. The average variable market to book ratio and leverage deviation are 5.1810 and 58.2500 with a high standard deviation, which means that the data variety is high.

Table 2. Multiple Linear Regression Results

	Koef.	Sig.
Variable Dependent : Stock Repurchase		
Variable Independent		
FCFS	6.880**	0.020
DPR	2.867**	0.526
MTBR	0.764*	0.001
PLEV	-0.653*	0.001
Determinant Coefficient R ²	0.730 (73%)	
* Significance at 1%		
** Significance at 5%		

Source: The data is processed by the author

Table 2 is the result of multiple linear regression with stock repurchase as the dependent variable. The results prove that free cash flow to stockholders and dividends have a positive effect on stock repurchase with a significance level of 5%. Misvaluation proxied by the market to book ratio has a positive effect on stock repurchase with a significance level of 1%. Meanwhile, leverage proxied by leverage deviation has a negative effect on stock repurchase with a significance level of 1%.

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DISCUSSION**The Effect of Free Cash Flow for Stakeholders on Stock Repurchase**

Based on the results of the analysis, it was found that free cash flow had a positive effect on stock repurchase. This can be seen from the coefficient of 6.88 with a significance of $0.020 < 0.05$. This finding proves the first hypothesis H1. This means that the greater free cash flow for stockholders, the higher the stock repurchase. The company's goal is to increase the value of the company, the value is reflected in the company's stock price, so the company will always try to increase its share price so that shareholder wealth also increases. With regard to the company's goal of increasing shareholder value and wealth, the company conducts stock repurchase. Implementation of stock repurchase will distribute free cash flow to shareholders, this distribution is the company's way of increasing shareholder wealth, so that the company's goals are achieved. Based on this, prove and explain that the distribution motive, namely the distribution of excess cash, which in this case is related to free cash flow to stockholders, is a motive that influences the implementation of stock repurchase by companies in Indonesia in the period 2016 to 2020.

The Effect of Dividend Payout Ratio on Stock Repurchase

This distribution motive is also related to dividends. The results of the analysis prove that the second hypothesis H2 in this study is accepted. The results show a dividend payout coefficient of 2.867 with a significance of $0.526 < 0.05$. The results show that dividends have no effect on stock repurchase. In Indonesia, stock repurchase is not a substitute for dividends. In Indonesia, the distribution of cash by the company to the main shareholders is through the distribution of dividends. The company will think more deeply if the company reduces the amount of dividend distribution to carry out stock repurchase. This is because the market will react negatively if companies that previously paid dividends reduce or do not pay dividends. Companies with high dividends tend to increase stock repurchase. If the company does not have the confidence to increase dividends, the company will do stock repurchase to distribute excess cash. Usually, this depends on the nature of the cash flow. If the excess cash is temporary, the company will tend to repurchase stock rather than increase its dividend. This illustrates that stock repurchase does not replace dividend payments, but complements dividends in cash distribution. Therefore, this proves that the cash distribution motive is the main motive for the company in repurchasing stock.

The Effect of Market to Book Ratio on Stock Repurchase

The results of the analysis show that the market to book ratio, which is a proxy for misvaluation, has a positive effect on stock repurchase. The regression results show that the coefficient value of the market to book ratio is 0.764 with a significance of $0.001 < 0.01$. This means that the results do not prove the third hypothesis H3. Previously it was said that stock repurchase was carried out only when the company's share price was undervalued. Stock repurchase is used as a signal to the market that the company's shares are undervalued. In fact, in Indonesia stock repurchase is not only carried out by companies that experience undervalued shares, but companies with overvalued shares also carry out stock repurchases. This does not fully support the statement that stock repurchase is only carried out by companies with undervalued shares, because even overvalued companies do it. Companies whose shares are undervalued in Indonesia use stock repurchase as an investment. The investment in question is that the company benefits because it buys shares when it is undervalued and sells its shares again when the stock price starts to rise after a stock repurchase is carried out.

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Different motives are found in companies whose shares are overvalued, namely stock repurchase as an investment vehicle because the company has excess cash and lacks other investment opportunities that can provide benefits to the company, so companies are better off investing by buying their own shares through the stock repurchase program. However, this study concludes that the more precise thing about the company's motives in overvalued stock conditions and stock repurchasing is that the company wants to give a signal to the market and investors about the company's condition. Companies that are able to buy at high prices and offer high premiums show that the company is in very good financial condition and is not afraid of losses. Therefore, companies that are overvalued but do stock repurchase will give a positive signal. In conclusion, the results of this study do not support the existence of a signaling undervaluation motive, because in Indonesia not all companies that carry out stock repurchases experience undervalued shares.

The Effect of Leverage Deviation on Stock Repurchase

Regression results show that leverage deviation from the target has a negative effect on stock repurchase. The coefficient value is (-0.653) with a significance level of $0.001 < 0.01$. The results of the analysis prove that the fourth hypothesis H4 can be accepted. The results of research in Indonesia are in line with research by Dittmar (2000) which revealed that companies prefer to do stock repurchases if the company's leverage ratio is below the target. Companies that have a leverage ratio below the target will reduce their equity with stock repurchase, so that the leverage ratio will increase and achieve optimal capital structure. This statement and the results of this study support that the company's motive for repurchasing stock is to increase the leverage ratio. The coefficient of determination (R^2) in this study shows a value of 0.730483. This means that 73% of the stock repurchase variable is influenced by free cash flow to stockholders, dividend payout ratio, market to book ratio, leverage deviation while the remaining 27% is influenced by variables other than those used in this study. Indirectly, this means that there are motives other than cash distribution motives, investment motives and leverage increasing motives which are the reasons companies carry out stock repurchases, especially in Indonesia.

IMPLICATIONS

Free cash flow to stockholders has a positive effect on stock repurchase. Dividend payout has no effect on stock repurchase. This proves that the cash distribution motive is the company's main motive for repurchasing stock because it is in line with the company's goal of maximizing shareholder wealth. Misvaluation has a positive effect on stock repurchase. Companies do not only buy shares when they are undervalued and sell their shares when the stock price starts to rise, because companies that are overvalued also do stock repurchases. Companies that are overvalued use stock repurchase as a signal that the company's fundamentals are good. This study also proves that the motive for increasing the leverage ratio is one of the reasons companies carry out stock repurchases. This is because in Indonesia there is a negative effect of leverage on stock repurchase. Stock repurchase is carried out if the company's leverage ratio is below the target.

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CONCLUSION

Motives for cash distribution and increased leverage are the reasons or motives for companies to carry out stock repurchases, especially for companies in Indonesia. The investment motive is only used by companies with undervalued stock conditions, whereas in Indonesia companies with overvalued stocks also repurchase stocks. Companies that are overvalued carry out stock repurchases as a signal that the company's condition is in good condition. This research is limited in the number of samples and the period used (5 years), so it is hoped that further research can increase the research period and research sample so that the results obtained are more extensive. In addition, the motives discussed are also limited to a few motives, namely distribution motives, investment motives, undervaluation signal motives and leverage increase motives, so that it is expected to be able to review other motives such as takeover defense motives. Future research that can compare Indonesia and other countries can be used to add to the wealth of research results because it will provide a broader view. This research is also limited to the assumption of free cash flow to stockholders, so it is hoped that further research can discuss debt used as funding in the implementation of stock repurchases in order to provide another perspective regarding the motives for implementing stock repurchases.

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