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The Impact of Share Buyback Announcement to Stock Return and Market Return:

Case Study of Share Buyback Program Conducted by PT Telekomunikasi Indonesia, Tbk at Bursa Efek Indonesia (BEI) in 2006 to 2012

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***Abstract**:*
Share buyback or share repurchase is a form of corporate actions conducted by issuers to buy their shares back from existing shareholders. One objective of share buyback program is to return excess cash to shareholders besides dividend option. PT Telekomunikasi Indonesia, Tbk (Telkom), whose stock is one of the blue chip stocks in Indonesia Stock Exchange (BEI), decided to choose share buyback and has conducted 4 share buybacks programs within period of 2006 to 2012. The purpose of this research is to analyze the impact of Share Buyback Announcement to stock return and market return. Market return was analyzed since the object of this research, Telkom, has relatively high portion in BEI capitalization. This research applied Event-Study with estimate and windows period of 40-days before and 20-days after Announcement Date. Statistical experimental used t-Test Wilcoxon Signed Ranks Test with significance level of 0.10. The result of this research shows that there is no significant difference in stock return and market return before and after the announcement of Share Buyback

Keywords: Publisher buyback announcement, stock return, market return.

1. Introduction

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PT Telekomunikasi Indonesia, Tbk (Telkom) is the biggest telecommunication operator in Indonesia, which offered the most complete, one-stop services for individual and corporate clients. The services include: fixed wire line, cellular, internet & data services, pay TV, backbone connectivity and others. The company listed its stock at Indonesia Stock Exchange (BEI) and New York Stock Exchange (NYSE) in 1995. Currently, it becomes the only Indonesian company whose stock listed at NYSE. Government of Republic of Indonesia held 52.55% of Telkom ownership and the rest is owned by public.

In 2006, the maturity of telecommunication industry caused fewer opportunities for Telco operator to invest their capital in feasible Telco-related projects. Meanwhile, the revenue and profit margin kept going well. Those factors created “nice-problem” for the company: excess-cash. While it was a good thing for Telkom, both investor and analyst saw it with different point-of-view. Combining with a very low Debt-to-Equity Ratio, they labeled Telkom as a lazy company and start to demand of returning those excess-cash to shareholders. Instead of paying higher dividend, Telkom decided to opt share buyback.

Share Buyback or stock repurchase is a type of corporate action conducted by stock issuer as a method for returning excess-cash to shareholders besides dividend [1].

Compared to dividend, share buyback has several advantages, such as: lower tax rate for investors, implying a positive signal to the market, greater flexibility in managing liquidity, as well as a preparation for Employee Stock Ownership Program.

Telkom has conducted share buyback four-times since 2006 as may be seen at Table 1.

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Table 1. Table example.

Table 2. Period of Share Buyback

Share Buyback	Periods
Share Buyback I	May 2006 - June 2007
Share Buyback II	August 2007 - June 2008
Share Buyback III	October 2008
Share Buyback IV	May 2011 - October 2012

According to BAPEPAM-LK No. X.K.I, share buyback must be disclosed to the public, because it is a form of corporate action. Corporate action is an activity conducted by issuer who will affect numbers of outstanding stocks as well as the stock price [2]. The announcement of share buyback will send positive signal to the market that the company has good profitability and business prospect, creating higher demand from investors which result in increasing stock price.

Previous research [3,4,5,6,7,8,9] concluded that share buyback had positive impact to stock price. On the contrary, some research [10,11,12,13] summarized that there was no impact of share buyback to stock price.

This research is conducted to analyze the impact of the announcement of Telkom share buyback program to stock return (TLKM) and market return (IHSG). The impact to market return is also being analyzed since TLKM market-capitalization has a relatively high portion in that of Indonesia Stock Exchange.

2. Literature Review

2.1. Objective of a Company

Every company should have objective to make as much profit in order to increase and maximize value to its shareholders, who've already taken risk in investing their capital into the company[14]. For public or listed company, total return to shareholders comprise of capital gain and dividend.

2.2. Agency Theory

In practice, shareholders as principal will appoint management as agent to manage their company, creating an agency-relationship [15]. A problem usually occurs from this relationship, due to lack of control capability of principal to their agents.

This agency problem emerges because of conflict interest between principal and agent. Instead of maximizing shareholder value, agent might manage the company for their own interest, resulting in lower than expected project return, excessive spending and high level of excess-cash.

Agency problem will be more severe for a company with a large free cash flow as well as a company in matured industry or industry with limited growth opportunity. There is no guarantee that the principal will have a fair return for their invested capital. The agent will take an advantage at cost of their shareholders [16].

2.3. Signaling Theory

The theory describes that there is an asymmetric information among market players, therefore a specific company information might not known well by all investors. Therefore, by announcing of share buyback program, a company shares the information to all market player that their stock has intrinsic value higher than its current price [17] or sending information that their stock is undervalued [18]. The announcement of share buyback will give positive signal to the market, implying that the company has a lot of free cash flow and good profitability [14].

2.4. Efficient Market Hypothesis

The efficient market hypothesis (EMH) is an investment theory that states it is impossible to "beat the market" because stock market efficiency causes existing share prices to always incorporate and reflect all relevant information. According to the EMH, stocks always trade at their fair value on stock exchanges, making it impossible for investors to either purchase undervalued stocks or sell stocks for inflated prices [19].

There are three types of EMH:

2.4.1. **Weak Form Efficiency**

The weak form of EMH says that investors cannot predict future stock prices on the basis of past stock prices, since all historical price information have been reflected on current stock price

2.4.2. **Semi strong Form Efficiency**

The semi-strong form of EMH says that investors cannot use any published information, because all published information is already reflected in a stock's price.

2.4.3. **Strong Form Efficiency**

The strong form of EMH says that everything that is knowable - published and even private information - has already been reflected in current stock prices.

2.5. Concept of Capital Market

Capital market is a market provided for suppliers of capital and users of capital to buy and sell equities and debt instruments. Suppliers of capital could be individual or institutional investors, while users of capital are business and government. For a company, capital market is a means to fulfill its long-term capital requirements by issuing stocks or bonds [20].

The objectives of formation of capital market in Indonesia are [21]:

2.5.1. Accelerating the involvement of society in the ownership of stocks

2.5.2. Equalizing community income through equalizing ownership of stocks;

2.5.3. Encouraging fund raising for productive activities.

Based on those principles, the Indonesian capital market was dedicated to democratize economy in order to achieve an equal economy to its citizens.

2.6. Concept of Stock

Stock is a proof of one's ownership in a public or listed company [22]. Investors are motivated to invest in company stock with expectation that they will earn a fair return from their investment [12].

There are two types of stock [22], which are:

2.6.1. **Common stock**

The owner of common stock has voting right in general shareholder meeting but the last claim on company assets in case of insolvency

2.6.2. **Preferred Stock**

The owner of preferred stock has no voting right in general shareholder meeting but will be paid prior to the owner of common stock assets in case of insolvency. The price of preferred stocks usually is less volatile than that of common stock.

2.7. Concept of Share Buyback

Share buyback or share repurchase is a corporate action in which the company that issues the share (issuer) is buying back the share from existing shareholders [1]. Share buyback is an option for the issuer to distribute excess cash back to its shareholders, instead of paying dividend. Besides distributing excess cash, issuers also execute share buyback program when they confident that their current stock price is lower than the fair value.

In Indonesia, share buyback was regulated by BAPEPAM-LK, which stated that an issuer must disclose their planned share buyback program as well as regulated the utilization and maximum holding period of shares that have been bought back (treasury stocks).

2.8. Advantages of Share Buyback

Share buyback has several advantages compare to dividend [23], such as:

2.8.1. Capital gain is taxed lower than dividend for investors;

2.8.2. Less transaction cost especially for those investors who do not need liquidity;

2.8.3. Better flexibility in managing financial liquidity for company since share buyback do not need to be executed on regular basis;

2.8.4. Treasury stocks could be used as ESOP (Employee Stock Ownership Program) for employees;

2.8.5. Optimizing financial ratio by improving leveraged for relatively under-leveraged company, therefore optimizing WACC (Weighted Average Cost of Capital), leading to higher company valuation

2.9. Share Buyback Methods

There are several ways for a company to do share buyback:

2.9.1. Tender Offer, the company announces share buyback program within certain period of time and price range, which usually higher than current maret price. Then, shareholder will decide whether to sell their stocks.

2.9.2. Open Market Offer, the company buy their share back gradually at secondary market at current market price

2.9.3. Dutch Auction, buyback will be done at the best price offered by shareholders

2.9.4. Private Repurchase, the company will buyback their stock by negotiating directly from one or few shareholders who have large share-ownership

Telkom has done all of their share buyback programs with open market offer mechanism by appointing only one brokerage firm.

2.10. Abnormal Return

An *abnormal return* is a term used to describe the *returns* generated by a given security or portfolio over a period of time that is different from the expected rate of *return*. The expected rate of return itself could be determined by 3-models:

2.10.1. Mean Adjusted Model

2.10.2. Market Model

2.10.3. Market Adjusted Model

3. Method

The type of this research is event study research. Event study research is determined to evaluate market reaction to certain event which information is published as an event [24]. Market reaction was measured by evaluating the difference of both stock return and market return before and after event date, which was the announcement of share buyback program [25].

The range of estimate-period was 40-days to 21-days before event date, while window-period were 20-days to 1-day before event date and 1-day to 20-days after event date.

The event date used in this research is the announcement date of Telkom share buyback program since 2006 to 2011, based on information received from Telkom Investor Relation Unit.

Table 2. Announcement Date and Max Numbers of Share Buyback

	Announcement Date	Maximum Amount
Share Buyback I	*NA*	*NA*
Share Buyback II	May 31st, 2007	1.58%
Share Buyback III	Oct 12th, 2008	1.59%
Share Buyback IV	Mei 23rd, 2011	3.20%

The operational variable is market reaction which represent by abnormal return (or excess return), a return generated by a given security or portfolio over a period of time that is different from the expected return. Stock return was represented by TLKM return, while IHSG was a representation of market return

To determine whether there are significant differences in stock return and market return before and after the announcement of share buyback, this research applied a non-parametric statistical hypothesis, Wilcoxon Signed Ranks Test with significance-level of 0.10 to compare those two-related samples.

4. Discussion

4.1. Stock Return and Market Return

During observation period, the highest stock return was +9.80% and the lowest was -9.90%. Both events occurred during Share Buyback III.

For market return, the highest stock return was +7.60%, while the lowest one was -10.40%. Those two events also took place during Share Buyback III.

Table 3. Stock Return and Market Return

Period	Stock Return		Market Return	
	Highest	Lowest	Highest	Lowest
Share Buyback II				
Estimate	4.00%	-2.40%	1.40%	-1.20%
Pre-Event	3.20%	-3.00%	1.40%	-1.90%
Post Event	2.10%	-1.50%	2.00%	-3.90%
Share Buyback III				
Estimate	6.10%	-3.20%	2.10%	-3.60%
Pre-Event	5.60%	-9.80%	5.80%	-10.40%
Post Event	9.80%	-9.90%	7.60%	-6.90%
Share Buyback IV				
Estimate	4.10%	-2.10%	1.70%	-0.70%
Pre-Event	3.40%	-2.60%	1.10%	-0.90%
Post Event	2.20%	-3.50%	1.80%	-1.40%

Share Buyback III was conducted when there was a global economic crisis caused by subprime mortgage crisis, resulting in relatively high volatility in all market around the world. At that moment, the main objective of share buyback program was to withhold stock price for further depreciation caused by global market correction.

4.2. Normality Test

P-Plots Graph and One sample Kolmogorov Smirnov Test have been applied to determine whether all samples is distributed normally. The P-Plots Graph shows that all samples are scattered around and follow the direction of a diagonal line.

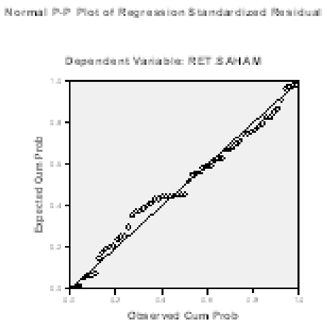

Figure 1. P-Plot of Share Buyback II Samples

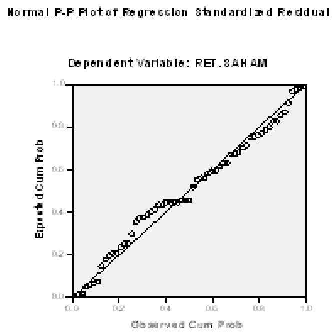

Figure 2. P-Plot of Share Buyback III Samples

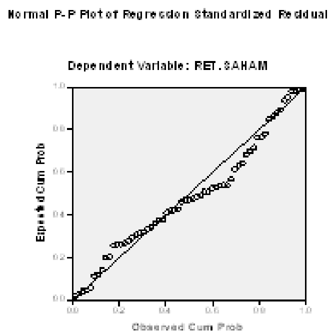

Figure 3. P-Plot of Share Buyback IV Samples

One sample Kolmogorov Smirnov Test with significance level 0.10 also shows that all samples has Asymptotic Significance (2-tailed) > 0.10. Therefore, it can be assumed that all samples is distributed normally.

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Table 4. Normality Test Result

	Stock Return		Market Return	
	Asymp. Sig.	Result	Asymp. Sig.	Result
SBB I	0.669	Normal	0.653	Normal
SBB II	0.250	Normal	0.350	Normal
SBB III	0.259	Normal	0.884	Normal

4.3. Wilcoxon Signed Ranks Test

Based on Wilcoxon Signed Ranks Test with significance level□ 0.10, the comparison of samples from different period of observation produce Asymptotic Significance (2-tailed) greater than 0.10. Hence, it can be assumed that there are no differences of stock return as well as market return for period before and after the event date (the announcement date of share buyback program).

Table 5. Normality Test Result

	Stock Return		Market Return	
	Asymp. Sig.	Conclusion	Asymp. Sig.	Conclusion
Share Buyback II				
Estimasi vs Post Event	0.468	No Difference	0.201	No Difference
Pre-Event vs Post Event	0.147	No Difference	0.432	No Difference
Share Buyback III				
Estimasi vs Post Event	0.936	No Difference	0.765	No Difference
Pre-Event vs Post Event	0.867	No Difference	0.271	No Difference
Share Buyback IV				
Estimasi vs Post Event	0.055	Difference	0.150	No Difference
Pre-Event vs Post Event	0.554	No Difference	0.448	No Difference

There is an exception for estimate vs. post event in Share Buyback IV, in which the Asymptotic Significance (2-tailed) is lower than 0.10 (0.055). The most probable cause of this exception is another corporate action conducted by Telkom that occur during post event period.

5. Conclusion

Initial objectives of Telkom in undertaking share buyback programs were:

5.1. Returning excess-cash to shareholders;

5.2. Providing positive signal to the market, implying that current stock price is still undervalued compare to its business prospect;

5.3. Improving demand for their stock, leading to an increase in stock price;

5.4. Demonstrating the performance and the governance of Telkom as a leading company in the region;

5.5. Sustaining stock price from further correction at the time of global crisis (Share Buyback III)

However, this research concludes that:

a. Statistically, there is no difference of both stock return and market return between estimate period vs post event period and pre-event period vs. post event period.

b. There was no evidence that share buyback programs conducted by Telkom were able to boost investor's demand to accumulate stock which lead to price appreciation

c. There was also no evidence that share buyback program could withstand further price correctionat the time of global crisis

Several factors could be the reasons underlying the above conclusions:

a. Market players are more concern to sustainable company performance rather than one time corporate action with uncertain profitability;

b. The maximum numbers of stocks to be bought back are perceived to be too small to affect stock price for a company with large market capitalization;

c. The planned-execution time is considered too long, raising uncertainty in the market;

d. Uncertainty in utilizing plan of treasury stocks. Most investors expect that the company will cancell the treasury stocks, while actually company re-sell it back to the market.

The exception result of estimate period vs. post event period of Share Buyback IV could be explained with the fact that another event occurred during post event period, which was an Ex-Date Dividend date. This event itself has caused negative stock return of -8.05% within 4-trading days.

Based on this research, it is suggested that Telkom management take more focus on an effort to enhance product and service quality in order to defend their position as a market leader as well as keep trying to expand their business to a new region outside their existing market. Those efforts combine with the ability to improve cost and resource efficiency will create an outstanding financial performance, therefore enticing existing and new investors to start collecting their stock, leading to an appreciation of their stock price.

For the next research on share buyback, it is recommended to account for other factors that might affect share buyback program such as:

a. The maximum numbers of stock to be bought back

b. The realization of numbers of share that have been bought compare to the planned numbers

c. Certainty in utilizing of treasury stocks: Re-sale, Cancellation, Conversion of equity-linked securities & EMSOP (Employee & Management Share Ownership Program).

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