

March 31, 2019

Economic Commentary

Corporate Stock Buybacks

During the first calendar quarter of 2019, more than a dozen Democrats declared their intention to seek the 2020 Democratic nomination to become President of the United States. In such a crowded and growing field of candidates, it is important that each candidate differentiate oneself from the others. As a result, the candidates are putting forth a whole range of ideas running the gamut from The New Green Deal, to free college education and Medicare for All, to very specific economic policy positions.

In the area of economic policy, there are several candidates who have expressed support for legislation that would restrict the ability of corporations to buy back their own stock.

The logic behind this proposal seems to be, that since corporations receive a substantial reduction in their corporate taxes under the 2017 Tax Cut Act, they should therefore direct that “windfall” into capital spending or employee hiring. Congress possesses expertise in spending other people’s money, so legislating corporate expenditures fits right into its strength. I believe this proposal is utterly without merit and I will explain why in the following paragraphs.

The decision by a corporation to buy back its own common stock usually comes after capital is allocated to, for example, plant and equipment or software system upgrades, to improve the corporation’s productivity and lower its costs. Corporations then rank potential financial investments such as stock buybacks by their expected future returns. For example, a corporate policy to buy back enough stock each year to cover stock option grants awarded to executives is a perfectly reasonable use of available corporate capital. Current investors in that corporation’s common stock would view such a policy favorably, as it protects their interest from being diluted by the issuance of new shares of stock.

Investors generally may look askance at a corporation that allocates a disproportionately high amount of its annual capital budget to stock buybacks, as that seems to indicate a lack of worthwhile projects to enhance the corporation’s operations. This is why legislating a one-size-fits-all directive on corporate capital expenditures, specifically on corporate stock buybacks, is destined to be a disaster.

I confess to being skeptical that our political leadership is really committed to understanding the complex factors that make up the decision by a corporation to continue or undertake a stock buyback program. Unless they are committed to the necessary level of understanding, they should leave well enough alone.

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