OCTOBER 2019

FACTSHEET

Stock Buybacks Are a Key Example of Extractive Corporate Power

Corporate profits and executive pay are sky high today, while wages for most American workers have remained low and largely stagnant over the past several decades. Today's high-profit, low-wage economy is, in part, a result of rules and policies that shape corporate decision-making. These rules have allowed CEOs, shareholders, and executives to move more and more profits up and out of US corporations—at the expense of workers, business investment, and long-term economic growth. Stock buybacks are the tip of the spear of the larger trend in which profits are extracted from corporations by shareholders, rather than reinvested back into the company in a virtuous loop of continuous productivity growth, in which multiple stakeholders—including workers, smaller businesses along the supply chain, and the public—benefit.

UNDERSTANDING STOCK BUYBACKS

Open-market share repurchases, frequently called "stock buybacks," occur when a company buys back its shares on the open market. This reduces the number of outstanding shares available in the market, resulting in an increase in the price per share. In essence, stock buybacks raise share prices artificially. The value of the stock goes up as a result of a stock buyback, but without companies making the kinds of changes that would improve the actual value of the company—through more efficient production, new products, or better customer experience.

Stock buybacks have exploded in recent years. Over the past decade, stock buybacks accounted for 75 percent of how nonfinancial companies used corporate profits (Palladino 2018). And, following passage of the Tax Cuts and Jobs Act (TCJA), corporate executives authorized over $1 trillion in stock buybacks (Palladino 2019). Companies now buy back more stock (through open-market buybacks and share retirement due to mergers and acquisitions) than they issue; in 2016, net equity issuance was minus $580 billion dollars (Federal Reserve 2017).

Prior to 1982—when the Securities and Exchange Commission (SEC) relaxed the rules that governed stock buybacks—buybacks were widely considered impermissible because they opened companies to threat of liability for market manipulation. Under the "safe harbor" rule (Rule 10b-18) adopted in 1982 and largely intact today, corporate executives may execute buybacks without fear of liability for market manipulation as long as they stay within a few broad boundaries. However, the SEC does not presume that stock buybacks that fall outside of these boundaries are market manipulation, nor do they attempt to track when a company's transactions are outside the confines of the safe harbor.

THE OPPORTUNITY COSTS OF STOCK BUYBACKS

When companies engage in stock buybacks, they are choosing not to spend that corporate cash on investments in their employees, higher wages, or research and development (R&D)—investments that are the foundation of long-term innovation and economic growth. Despite proponents' claims that stock buybacks are prioritized only after other spending opportunities have been exhausted, evidence shows that buyback spending undermines other critical areas of corporate investment. Companies that underperform on earnings per share forecasts—a quarterly Wall Street projection of expected stock value—commonly use buybacks to boost share price. The companies that engage in buybacks after missing these forecasts tend to significantly reduce employment, capital expenditures, and R&D the following year (Almeida et al. 2015). Below are some examples that illustrate the opportunity costs of stock buybacks:

- Following passage of the TCJA, 10 major drug companies spent nearly $75 billion on stock buybacks. In comparison, these same companies spent less than $72 billion on R&D that year (Milani 2019). Thus, despite the pharmaceutical industry's claim that its role is to "discover and develop medicines that enable patients to live longer, healthier[,] and more productive lives" (PhRMA 2018), the industry directs a higher percentage of its profits to enriching shareholders and CEOs than it puts towards R&D.
- Between 2015 and 2017, the top five restaurant-industry buyback spenders directed an average of 172 percent of their profits toward buybacks. If these companies had instead redirected those funds toward worker wages, low-wage workers would have seen a dramatic increase in their pay. For example, McDonald's would have been able to pay all of its 1.9 million workers almost $4,000 more if the company had redirected the money it spent on buybacks to workers' paychecks instead. Similarly, if Starbucks had reallocated money from share repurchases to compensation, every worker would have received $7,000 more (Tung and Milani 2018)
- In the retail industry, companies spent 79.2 percent of their net profits on share buybacks during the same period. Had these funds been redirected to workers rather than spent on buybacks, employees at Lowe's, CVS, and Home Depot would have received an additional $18,000 (Tung and Milani 2018). These numbers stand out, given that many workers at these companies barely receive that much in yearly earnings.
- In 2018 and 2019, Walmart—America's largest corporate employer, with over 1.5 million employees nationwide, and the largest private employer of women and Black and Latinx workers—was authorized to spend $20 billion on stock buybacks. By ending the practice of stock buybacks and spending $10 billion on increasing wages instead, 1 million low-wage Walmart employees could see an hourly wage increase of over $5.66 that year. For a full-time worker at the starting wage, this increase in their hourly rate would mean an annual salary of $29,455 (Palladino 2018).

STOCK BUYBACKS AND THE RISE OF EXECUTIVE PAY

One of the major problems with stock buybacks is that corporate executives often hold large amounts of stock themselves, and their compensation is often tied to an increase in the company's earnings per share metric. This gives executives a personal incentive to time buybacks so that they can profit off of a rising share price, and it means that the decision of whether and when to execute a stock buyback can affect his or her compensation by tens of millions of dollars. SEC Commissioner Robert Jackson found that corporate executives use buybacks to exploit their insider status and grossly inflate returns on their own stock holdings. In the week after a buyback announcement, executives on average sell five times as much corporate stock as they do during periods without an announcement, and twice as many companies have insider transactions during the week following a buyback announcement than compared to non-announcement weeks (Jackson 2018; Jackson 2019).

IT IS TIME TO REWRITE THE RULES

Stock buybacks are a clear example of how the rules of the economy have been written to benefit wealthy shareholders at the expense of American workers. By privileging shareholder payouts over productive investment and employee compensation, buybacks contribute to innovation stagnation, pay inequality, and potentially market manipulation. This extractive corporate behavior hurts workers and families and is hollowing out our economy. Ending the practice of stock buybacks is a bold but crucial step in reversing this.

Of course, simply curbing or ending the practice of open-market share repurchases will not, in and of itself, cause firms to productively invest or raise employee compensation. Rebalancing power within corporations will require a broad range of needed policy proposals. However, the long-term project to end the dominance of shareholder primacy within America's largest public corporations—our biggest employers—is necessary in order to build sustainable prosperity for all in the 21st century. It is time we rewrite the rules that govern corporate behavior.