Candor

The Hidden Costs of Implementing Share Buy-Backs

Summary: Boards and senior management have a responsibility to protect their shareholders' interests when deciding on a share buy-back, this responsibility continues until the share buy-back is implemented or cancelled. Our study reveals that at least 20% (by value) of share buy-backs are implemented using execution products that are damaging to shareholders interests. Corporates are assuming more risk and being charged larger fees than necessary for these straightforward services. It is the company's shareholders who ultimately pay the price. This issue has spanned over 25 years and is caused by a subset of execution products that are not fit for purpose. We need to build awareness and make change in the financial services industry and through regulation to correct this.

Extent of the Problem: Over the past five years, companies in the US, UK, and Europe have bought back $5.6 trillion worth of their own shares. We believe that roughly $1.12 trillion of this sum has been mis-managed during the execution phase of share buy-backs. Certain execution products have led to excess execution fees being charged which we estimate amounts to over $8 billion in this period. Moreover, this mis-management potentially escalated the initial risk exposure of companies during share buy-backs to an astounding $643 billion. The cumulative effect of this combination of risk mis-management and unwarranted fees has caused significantly larger capital and income losses which continue to accumulate.

Case studies on fees: A FTSE 250 company carried out a share buy-back of £200 million using an execution product that cost the shareholders a fee of £15.8 million (8.6%). In another case, a FTSE 100 company bought back shares worth £435 million at a cost of £10 million. Our estimate of the fair fee for these services is £0.18 million and £0.4 million, i.e., less than 1/20th of the actual fee incurred.

Digging deeper into the Issue: Companies often underestimate the shareholder value they are conceding by agreeing to terms that incentivise brokers to beat a specific execution benchmark, which neither aligns with the company’s buy-back objective or serve the shareholders' best interests. These incentive fee structures are in return for guarantees or insurances that have very little or no value to their shareholders.

Why it matters: Over the past 11 years, a minimum of 20% of Apple Inc's share buy-backs were executed using financial products that are a subset of the issues we are highlighting. We estimate that brokers have extracted at least $550 million in fee/profits from these operations. Had this money been used to buy-back more shares as Apple had intended, we estimate that their shareholders would have benefitted from an additional $6 billion in capital gain alone. This isn't just an Apple issue; it's been happening across the market for at least 25 years. The accumulated shareholder losses are staggering.

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