

Abstract

Firms are commonly assumed to repurchase their shares to signal they are undervalued in the financial markets (underpriced) or take advantage of underpricing to enhance share value. However, recent empirical evidence suggests that actual repurchases are often performed when the stock is overpriced. This paper explains why firms may repurchase overpriced shares and characterizes the situations in which this is likely to happen. Focusing on agency costs of free cash flow, we show that benefits to insiders from waste have a substantial role in affecting the decision to repurchase and highlight the importance of having good corporate governance in place when managers get approval from the board to repurchase stock.