Apple should spend money on innovation, not buybacks

By Eric Reguly
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Steve Jobs died seven years ago, and if he could peek down from the heavens, he would not recognize Apple Inc., the company he created and turned into the most successful gadget maker in the history of gadgetry. It's not because Apple's stock market value has more than tripled since his death to more than $1 trillion (all currency in U.S. dollars)—making it the first public company to join the 12-zeros club—but because his baby has undergone a profound and disturbing personality change.

When Jobs was at the helm, Apple was an innovation company that didn't much care about profits or its share price. "I want to put a ding in the universe," Jobs said, and he did. Of course, the profits also came gushing in, and the share price soared, because the product that did the most cosmic dinging—the iPhone—melded communications with entertainment and became a global fashion statement.

Today, under Jobs's successor, Tim Cook, Apple is a different beast: It has become a "financialized" company. Its executives have become obsessed with the share price, to the point that those hot shares are being propelled into the thermosphere not by clever, world-changing products, but by a legal form of share price enhancement called the share buyback.

That's when a company's treasury buys its own shares, boosting their price (at least in the short term) and earnings per share, because profits are spread over fewer shares. In May, Apple announced that it would vacuum up another $100 billion of its own stock, taking the total buyback since the end of the Jobs era to roughly $300 billion.

During Jobs's time, buybacks were small and infrequent. He was focused on turning out the iPhone, iPad, iPod, iTunes and the MacBook. He probably wasn't even aware what the treasury gnomes were doing. But, since the iPhone debuted in 2007, there haven't been any blockbuster products. Sorry, Apple, but AirPods and the Apple Watch don't make the cut.

True, many activist shareholders adore buybacks, and strategists and management gurus who support the concept argue that they are the ideal use for "surplus" capital.

Shareholders own the company, and if the extra loot isn't necessary to keep things running, why shouldn't it pay the money out to them?

But how do you define "surplus"? Every dollar devoted to buybacks is a dollar not devoted to uses such as research and development, employee training, acquisitions and community giving.

A company that soars on the stock market because of share buybacks doesn't necessarily deserve that success. There was a time when buybacks, while legal, were generally avoided because executing them would expose a company to charges of share manipulation under U.S. Securities and Exchange Commission rules. That all changed in 1982, when the commission adopted Rule 10b-18, which opened the buyback floodgates. On any single trading day, a company can buy up to 25% of a stock's average daily trading volume over the previous four weeks.

At first, buybacks were modest and used to scoop up shares with relatively low price-to-earnings ratios. That era is gone.

Buybacks are now the norm and are used to gobble up overvalued as well as undervalued shares. Executives adore them, because pay at many companies is geared toward stock and options. Buybacks also make the rich richer,

because the wealthy dominate the investment class.

William Lazonick, a Canadian economics professor at the University of Massachusetts Lowell, has calculated that, from 2008 through last year, 466 S&P 500 companies distributed $4 trillion to shareholders through buybacks, equal to 53% of their profits. The amount vastly exceeded their dividend payments.

The trouble is that after the short-term hit from a buyback wears off, it can leave a company in a much less competitive position. Take BlackBerry Ltd. In 2009 and 2010, just as its smartphones were starting to lose the war against the iPhone, it devoted $3 billion to buying back its own shares. BlackBerry might still be a contender if it had spent that loot developing a rival product.

Or consider the drug giant Pfizer Inc. Its CEO complained that high U.S. corporate tax rates were making the company globally uncompetitive, yet it also spent outrageous amounts on buybacks, not innovation. Lazonick calculated that from 2001 to 2015, the company paid out $95.5 billion in buybacks and $87.1 billion in dividends, equivalent to 117% of its profits.

Apple is still a superstar. But lavish buybacks suggest the company is more concerned with its share price than its product portfolio. Its long-term competitiveness is bound to suffer. Steve Jobs would not approve.