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Edison Explains

The value of a shareholder register

How can the structure of a shareholder register benefit a company?

What is a shareholder register?

A company's shareholder register, or shareholder list, details the owners of the company's shares and is updated on an ongoing basis. Recognising the size of each investor's shareholding is vital when considering an investment's potential for success, especially large holdings that can affect the running and, ultimately, the success of a business.

Shareholders in certain regulatory geographies must disclose the extent of their investment in a business (their position), but the company is not required to identify its shareholders.

Shareholders are only required to disclose their position once they have met certain conditions, depending on the regulatory environment. For example, in the US a shareholder must disclose their position after the acquisition of more than 5% of a company's shares, whereas in the UK, a change of 1% in an individual's holdings must be disclosed if that individual has ever held more than 3% of the company's shares.

Understanding the different types of investor on a shareholder register is vital in understanding the company's strategic objectives. For example, special focus should be placed on large shareholders, as large holdings come with significant influence on the strategic objectives and market performance of a company, which is crucial in creating future value for investors.

How can shareholders add value to a company?

Issuing shares at higher prices is a result of the indirect role shareholders on the register play in improving the company's operating activities.

Additionally, investors stay away from companies that cannot meet earnings expectations, meaning companies must consistently beat earnings expectations for the newly issued shares to be bought.

Edison Insight

'IROs and management teams need to be aware of the precise mix of investors owning company shares. Evolving the composition of the register can help management teams achieve their capital market and operational goals. The days of relying on your broker to introduce you to the most appropriate investors are over. Take control or the market will take control of you.' – Elliot Berstock, European head of investor relations

The need to meet and beat expectations shows the indirect impact shareholders have on the operating activities of a company through shareholder expectations, as well as the importance of judging this effect by scrutinising shareholder registers.

Furthermore, generating cash flow from financing activities is achieved by issuing debt or equity (shares) to produce cash that either grows or improves business operations. In turn, growing or improving business operations improves the market value of a company, allowing more shares to be issued later, at higher prices.

Shareholders benefit from selling their shares at higher prices, as this generates a profit on the initial investment. As a result, the shareholder register is integral in both growing and subsequently increasing the value of the business.

This does not account for the effects shareholders can have on the leadership of a company and its subsequent financial status, which makes shareholder registers crucial to calculating a company's chance of success.

To what extent can shareholders influence the leadership of a company?

A company's shareholders have the right to vote when appointing new board members, which typically occurs when the board is deadlocked. In some circumstances, shareholders can reject the management's decisions, but this usually requires a two-thirds majority.

Shareholders' rights make the board accountable to the shareholders, not management, allowing shareholders to put pressure on the board with regard to its strategic goals and management style if the company is not generating the best performance required for effective returns on their investment.

Typically, institutions, rather than individual investors, call on the company to make strategic decisions, including selling the company after a mandatory offer has been made.

28/05/19

Shareholder registers are also important in gauging the potential for a hostile takeover due to underperformance. Hostile takeovers are the acquisition of one company by another, achieved either by directly purchasing the shares of the company's shareholders or by replacing management.

Shareholders, however, have the power to block a hostile takeover, if they are happy with the current management or they find the offer price too low. Potential hostile takeovers are most discernible in a company whose shareholder register is widely distributed across many investors, as there will be no resistance from a single majority shareholder. This is because a single majority shareholder has a greater strategic influence on the company than investors with smaller holdings, allowing more scope to block potential hostile takeover attempts.

However, in the UK there is a cap on the number of shares a single holder can retain, as an individual or an institution is required to make a mandatory offer on the invested company after acquiring a 30% holding.

What types of shareholders are listed on the register?

Institutions and retail investors are the two main categories in a shareholder register, split between professional and non-professional investors.

Retail investors manage their own money, whether they buy and sell shares through a broker, bank etc. They are driven by personal goals, such as planning for retirement, resulting in small holdings that rarely allow retail investors to influence the strategic objectives of a company. Due to limited purchasing power, retail investors are also often protected from making risky, complex investments.

Institutional investors invest other people's money on their behalf, allowing for large trade volumes that qualify them for preferential treatment and lower fees. Institutions have better access to complex investments not available to the retail audience, such as those with large minimum buy-ins.

Professional investors can be split into either large or smaller institutions, where large institutions are defined by assets of £1bn or greater. Professional investors also include pension funds and private client managers who invest in the funds created by both the large and smaller institutions. The interplay between the different types of investors in a register, and the balance between them, is incredibly difficult to quantify.

The effects of a shareholder register's composition on a company's price performance, volatility and liquidity are both relatively unknown and unstudied. Edison is in the process of conducting a study of FTSE 350 companies in a certain subset to ascertain optimal shareholder composition. The study will shed light on the trading characteristics of certain compositions of registers, eg whether a more diverse register results in less volatility and a fairer valuation.