

Untapped Capital:

Understanding the retail investor pool



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Executive summary

- Europe has witnessed a recovery in retail ownership of listed companies since the 2008 financial crisis. European households own 15.6% of listed shares across EU and UK stock exchanges, up from 13.3% in 2013 and 12.7% in 2007¹
- Companies and investment banks have traditionally left retail investors out of most initial public offerings (IPOs) and all follow-on share offerings due to regulatory and logistical issues
- Corporate governance best practice encourages companies to include all shareholders, including retail, in follow-on share offerings where possible
- Regulators around the world are working to improve retail access to capital markets and to lighten the burden for smaller companies raising funds
- With the growth of passive investment, retail investors are becoming an increasingly important part of the active demand pool for IPOs and follow-on share offerings. More demand raises tension in the book-building process and helps to improve the final share price
- In a financial world dominated by high-frequency trading and quantitative strategies, retail investors are loyal, long-term minded providers of capital and offer vital liquidity for small and mid-cap quoted companies
- Retail investors are especially important shareholders for small and mid-cap companies. For example, they own on average 25.1% of companies listed on London Stock Exchange's growth market, AIM²
- The use of technology by stock exchanges and financial brokerage firms is helping to democratise access to the capital markets for retail investors

About this report

Untapped capital: Understanding the retail investor pool is written by The Economist Intelligence Unit and sponsored by PrimaryBid. In-depth interviews with financial market experts were conducted in addition to extensive desk research and data analysis.

The Economist Intelligence Unit would like to thank the following individuals for their time and insights:

- Paul Frankfurt, head of equity blocks, BNP Paribas
- Thomas Kudsk Larsen, head of investor relations, AstraZeneca
- Guillaume Morelli, head of SME listing France, Euronext
- Charlie Walker, head of equity primary markets, London Stock Exchange
- Tim Ward, CEO, Quoted Companies Alliance
- Andrea Wentscher, investor relations manager - retail investors, BASF

¹ Eurostat database, annual sector accounts, financial flows and stocks, CEIC: <https://www.ceicdata.com/en/indicator/european-union/market-capitalization--nominal-gdp>

² <https://www.ons.gov.uk/economy/investmentpensionsandtrusts/bulletins/ownershipofukquotedshares/2018>

Introduction

With equity markets mainly dominated by large, institutional and increasingly passive holders, retail investors have traditionally been treated as second-class shareholders. Few companies proactively engage with their retail segment. Commonly viewed as uninformed, inaccessible and too fragmented to be included in capital raisings, retail investors are often overlooked as potential shareholders. They are also considered to be minor actors on the corporate governance scene.

This is despite the fact that retail investors—which hold an aggregated €1.35 trn in listed shares across the UK and the EU’s 27 markets³—can offer substantial benefits

for issuers. They represent a major source of potential capital for IPOs and follow-on share offerings. Furthermore, they are typically long-term minded shareholders and provide much-needed liquidity for small and mid-cap companies.

“I think the value of retail shareholders is clear,” says Paul Frankfurt, managing director and head of equity blocks at BNP Paribas. “Every company should be interested in a higher level of liquidity and accessing the broadest range of investors. And whilst retail investors tend to be quite sticky — they are often less inclined to trade in and out of stocks — the downside to having retail involved has to be pretty limited.”



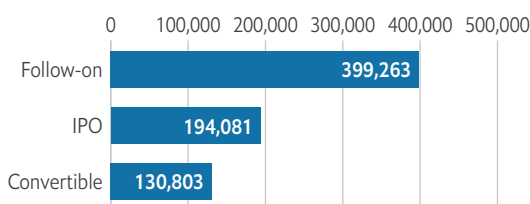
³ Ibid., Eurostat database, annual sector accounts, financial flows and stocks

Unequal access

Historically, listed companies and investment banks have been put off by the additional regulatory and administrative demands of including a retail segment in capital raisings, choosing instead to focus their efforts solely on the financial market heavyweights that are institutional investors.

But on the follow-on issuance side, specifically around accelerated bookbuilds, the timetable for those transactions makes it very difficult to include intermediary offers and to access retail brokers, Mr Walker explains. “Bookbuilds are often conducted over a matter of hours, and trying to reach thousands of investors in a dynamic pricing situation is logistically very challenging,” he says.

Chart 1: Global equity issuance by deal type in 2019
(US\$ m)



Source: Dealogic.

The exclusion of retail from capital raising activity occurs despite the significant funding needs of listed companies. Global equity capital markets issuance reached US\$724.1bn in 2019 according to data from Dealogic, a financial markets platform. Notably, follow-on offerings account for the majority of capital raised: during 2019, follow-on offerings made up 55% of total equity issuance, compared with 27% for IPOs and 18% for convertibles.

“The challenge has always been that, from a company’s perspective, facilitating retail investor participation brings with it added obligations and complexities,” says Charlie Walker, head of equity primary markets at the London Stock Exchange (LSE). “That’s both from a regulatory and practical perspective.”

When retail investors are included in an IPO, it is usually through an intermediary offer, where the coordinating banks allow retail brokers to input orders into a bookbuild on behalf of clients.

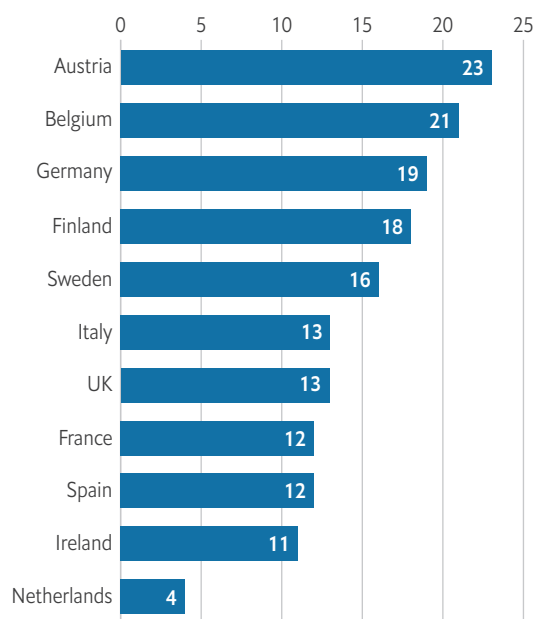


European households' return to the stock market

While institutional investors capture most of the attention, retail continues to make up a significant proportion of European equity investment. In fact, in countries such as Austria, nearly a quarter of listed shares are held directly by local households. Retail ownership is also high in Belgium (21%), Germany (19%) and the Nordic countries (Finland 18% and Sweden 16%).



Chart 2: Retail ownership of listed shares in Europe (%)



Figures have been rounded up/down.
Sources: Eurostat; CEIC.

Individual investors held 13.5% of UK quoted shares in 2018, up from a historic low of 10.2% in 2008, according to the Office for National Statistics (ONS).⁴ The figures exclude more passive retail ownership through vehicles such as unit trusts and pension funds. Actual individual ownership will be slightly higher because the figures do not include individuals based overseas, who own a further £17.5bn (US\$ 22.8bn) of UK equity, estimates ONS.

Companies with popular brands have a significantly higher proportion of their shares held by individuals. For example, retail investors hold 20% of British retail chain Marks & Spencer and 11.6% of French tyre manufacturer Michelin.⁵

⁴ <https://www.ons.gov.uk/economy/investmentpensionsandtrusts/bulletins/ownershipofukquotedshares/2018>

⁵ <https://www.michelin.com/en/finance/michelin-share/capital-breakdown/>



In November 2019 the privatisation of Française des Jeux, France’s national gaming operator, was subscribed by a record-breaking 500,000 retail investors according to Guillaume Morelli, head of SME listing for France at Euronext, a European stock exchange group. “We are seeing a significant increase in the volume traded by retail investors, and most of the IPOs or secondary offerings realised since then have been very successful,” he says, adding that on average retail investors represent 25% of the demand.

The conventional wisdom holds true that dividends drive a large amount of retail investment decisions. Companies with attractive dividend policies, such as utilities, real estate investment trusts and energy firms, tend to see a higher-than-average level of retail ownership.

A case in point is BASF: the German chemicals company has added 200,000 more retail investors to its share register over the past nine years, says Andrea Wentscher, the firm’s investor relations manager who has specific responsibility for retail shareholders. “We

are convinced that our progressive dividend policy plays a decisive role,” she says.

With interest rates close to historic lows, some traditionally risk-averse investors have turned to the equity market in search of returns. In Germany, where the stock market is often viewed with suspicion by retail investors, the number of people investing in shares and equity funds has grown from 8.4m in 2010 to 10.3m in 2018, according to a study by Deutsches Aktieninstitut, a group that lobbies on behalf of capital market participants.⁶

“Since the financial crisis of 2008, we experienced that private investors are better informed and more interested,” says Ms Wentscher. “The events that we hold especially for retail investors are always very well attended and there are good and numerous questions asked. More and more, banks realise that they can create added value for their customers by facilitating such events.”

Retail participation is set to grow further as barriers to entering the stock market are

⁶ <https://www.dai.de/en/what-we-offer/studies-and-statistics/statistics.html?d=634>

lowered. The cost of trading is decreasing as online brokerages embrace zero-commission trading. Meanwhile, retail investors have growing access to stock market information and analysis tools.

Yet many retail investors are “disenfranchised” because their shares are held in brokers’ nominee accounts and they have limited contact with the company, says Tim Ward, CEO of the Quoted Companies Alliance, an organisation which supports listed, small and medium-sized enterprises (SMEs).

“Technology is going to play a huge part because it will start to break down some of

the barriers that some of the intermediaries have built,” he says, predicting it will offer retail investors better access to shareholder communications, corporate management and share offerings.

Furthermore, other markets demonstrate the potential for individual ownership in listed companies. The number of US retail investors overall stands at around 100m, making up 40% of the adult population, according to estimates from Celent, a consulting firm.⁷ Of those 100m, Celent classes 59m as self-directed investors, ie investors who make their own buy and sell decisions.

⁷ <https://www.celent.com/insights/134077073>

Doing the right thing

Around the world, there are regulatory tailwinds that support the greater involvement of retail investors in capital markets. This is part of a broader trend for markets to embrace more openness, transparency and fairness, and for companies to adopt stronger corporate governance practices.

In Europe, the updated Markets in Financial Instruments Directive (MiFID II), implemented in January 2018, brought in new protections for retail investors. For example, financial advisors must now offer more detailed information about their products and charges. Historically, investment banks have been incentivised to sell shares to their best clients. MiFID II has increased transparency in the capital raising process, requiring intermediaries to produce a justification for the share allocation made to each investor client and to keep records of the allocation process.⁸

The legislation also created a new category of multilateral trading facility, termed the “SME Growth Market”, which has tailored capital raising and disclosure obligations for smaller companies,⁹ and has become a popular investment option for retail investors.

Another boost for retail investors will come from Europe’s Capital Markets Union (CMU) initiative, which aims to bolster the cross-border flow of savings and investments among EU member states.

At a meeting of EU finance ministers in September 2019, a discussion paper outlined plans for the next cycle of the CMU. The

paper highlights the importance of retail investors in meeting the long-term funding needs of the European economy. Greater retail access to capital markets could help alleviate pressure on pensions caused by demographic change¹⁰ while generating higher returns over the long term.¹¹



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Tim Ward, Quoted Companies Alliance

The CMU paper also advocates the promotion of financial literacy which could help “facilitate direct investment without high intermediation costs typically charged of retail investors”, fair access to information for all types of investors, and “targeted and proportionate regulation” for “smaller markets and smaller market participants”.

Europe’s revised Shareholder Rights Directive offers further support to retail investors. The directive places new demands on listed companies and intermediaries in the investment chain to ensure shareholders are properly identified in order to exercise their rights, for example through voting electronically at annual general meetings.¹²

⁸ <https://www.esma.europa.eu/databases-library/interactive-single-rulebook/mifid-ii/article-16>

⁹ <https://www.esma.europa.eu/databases-library/interactive-single-rulebook/mifid-ii/article-33>

¹⁰ https://eu2019.fi/documents/11707387/15400298/CMU+Reboot+Informal+ECOFIN+final+Issues+Note+2019-09-09_S4.pdf

¹¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52019DC0136&from=EN>

¹² <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017L0828&from=en>

In the US, the Securities and Exchange Commission (SEC) has recently made protection of retail investors a priority. “Our first goal is focusing on the interests of long-term Main Street investors,” said the financial regulator in recent testimony to the House of Representatives Committee on Financial Services.¹³

As regulators look for ways to ensure equal treatment and access for retail investors, the pressure is growing on listed companies to do the same.

Legislation in the UK, Ireland and France protects shareholders against dilution by granting them pre-emptive rights over new share issuance in proportion to their existing stake. But in reality a large number of companies can conduct new share issuances of up to 20% of their existing capital without having to seek shareholder approval. And in many other European markets, there are no such pre-emptive rights at all.

In addition, retail shareholders’ power to weigh in on corporate strategy has been declining drastically. This is a direct consequence of the widespread ownership of mutual funds and passive instruments which see voting rights transferred to financial intermediaries.

Voting rights are further diluted during most follow-on offerings which hand institutional investors new shares at a discount while preventing perhaps long-standing, supportive retail investors from taking part. Including a retail segment—where logistically possible—is a way to treat all shareholders equally during the transaction.

“Typically, good practice—and this isn’t just for retail—is for companies to make follow-on issuance available to their shareholders wherever possible,” says Mr Walker. “There are always restrictions: sometimes there are investors based in certain geographies where it’s not realistically practical to provide that opportunity to them. However, the starting point should be that companies try to offer their follow-on issuance to their own shareholder base. For companies that have meaningful retail components, it is something we would always encourage them to think about carefully.”

“The issuers with the best performance over a long period almost always have a clear focus on retail investors,” adds Mr Morelli. “These investors need to feel considered to build trust. To include retail investors in follow-on share offerings when it doesn’t imply more complexity for the issuer is part of the best practices we aim to promote.”



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Good practice is for companies to make follow-on issuance available to their shareholders wherever possible

Charlie Walker, London Stock Exchange

¹³ <https://www.sec.gov/news/testimony/testimony09-24-2019>

Loyalty, liquidity and demand

In a financial world dominated by algorithmic trading and passive strategies, retail investors can provide a variety of benefits for listed companies.

Firstly, market structure changes are increasing the importance of retail investors as a potential source of capital. The popularity of low-cost investment strategies means that passive and quantitative funds manage an increasingly large proportion of global equity assets. Yet these investors do not take part in IPOs or other share offerings. That makes self-directed retail investors even more important for issuers considering the pool of active investors who can add to demand during a transaction. More demand raises tension in the bookbuilding process and therefore helps to improve the final share price.

“Retail is a demand source that isn’t being properly accessed in a number of cases,”

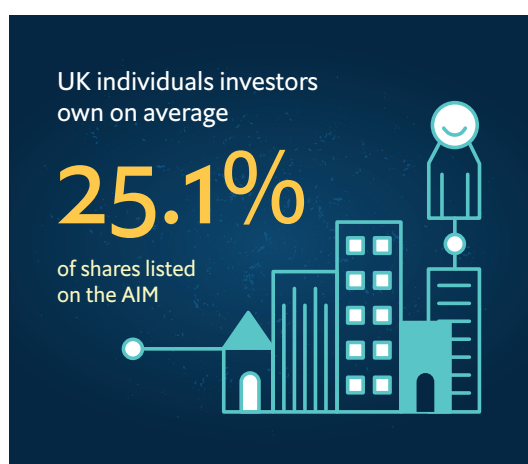
says Mr Frankfurt. “If you want to try and raise primary capital, or even secondary sell-downs, and you can increase the demand pool from people who are perfectly legally entitled to trade those shares anyway, then I think that has to be a good thing.”

Studies also show many retail investors are long-term orientated shareholders who stick with investments even when share prices are volatile and institutions are selling out. Loyalty also means retail investors can provide valuable support through their votes when a company is under threat from an activist investor.

In the US, almost half (47%) of self-directed retail investors follow a buy-and-hold approach, making three or fewer trades a month, reports Celent.¹⁴ A separate study by the Investor Education Fund finds that just over half (51%) of Canadian retail investors hold onto their investments even after suffering major losses (at least 20% of the value of their investments).¹⁵

Ms Wentscher from BASF agrees that individual investors are sticky. “Having a large number of retail investors gives you a stable base. They tend to buy our stock and hold it over a long period of time. Even if the price does not develop so well, they remain loyal to the company and thus to the stock,” she says.

For smaller companies, retail investors can also be a vital source of liquidity. Studies show that retail investors make up a



¹⁴ <https://www.celent.com/insights/134077073>

¹⁵ <https://www.getsmarteraboutmoney.ca/resources/publications/research/investor-risk-behaviour-beliefs/>



Retail investors tend to buy our stock and hold it over a long period of time

Andrea Wentscher, BASF

larger part of the share register at smaller companies. For example, UK individual investors own on average 11.3% of FTSE 100 companies compared with 25.1% of those listed on the AIM, according to ONS.¹⁶

These companies are more likely to be held by a small group of institutions who rarely trade. As a result, it is up to retail investors to provide the daily trading volume that sets the share price and removes barriers for other investors to come on board. In France, for instance, retail investors are responsible for up to 50% of the volume traded on SMEs, according to Mr Morelli.

“It’s brilliant to build a share register of long-term institutions, but the problem is you don’t have any liquidity because nobody wants to buy or sell. So where does that liquidity come from? It comes from people with different time horizons, different ways of looking at the market. And that is likely to come from the retail environment,” says Mr Ward.

One downside about retail investors that holds a little truth is that they can add to share-price volatility for smaller firms, says Mr Ward, but that’s a price companies should be willing to pay. “The question is: do you want to have liquidity with volatility, or do you want to have no liquidity and therefore a depressed share price?” he asks. “Employees with share

schemes will wonder: what’s the point? And you won’t be able to raise money for an acquisition because the share price is too low.”

While there is no ideal ratio between retail and institutional investors, investor relations professionals recommend that companies build a diversified shareholder base with a retail component. “From a company’s perspective, diversifying share registers is considered to be a good thing,” says London Stock Exchange’s Mr Walker. “It provides companies with optionality as to how they raise capital going forward.”

A further incentive to include retail investors in transactions is the branding opportunity: companies can increase their profile and create a large group of loyal followers. “It’s a great way not only to build brand awareness but also to reward or encourage customer loyalty as well,” says Mr Walker.

AstraZeneca, an English-Swedish biopharmaceutical company, has recently increased its efforts to target retail investors says Thomas Kudsk Larsen, head of investor relations at the firm.

“Our Swedish colleague Christer Gruvris [a member of the investor relations team] does a few events each year for retail holders in Sweden using intermediaries like investment clubs,” says Mr Kudsk Larsen. “We do not target a specific ratio, the market will decide over time, but we think being there for any shareholder is important. We are also looking to see how we can go deeper in the US market using the support we’re getting from our American Depositary Receipt bank. The UK may also be an option once Brexit uncertainty evaporates.”

¹⁶ <https://www.ons.gov.uk/economy/investmentpensionsandtrusts/bulletins/ownershipofukquotedshares/2018>

Conclusion: Towards democratisation

Despite significant advantages, involving retail investors in capital raising has been hindered by additional regulatory and administrative burdens.

The situation is starting to change, however. Firstly, new technology is democratising access to the capital markets, making it cheaper and easier for retail investors to participate in the same opportunities as institutions.

Within the online brokerage and wealth management sectors, financial technology firms have driven trading costs down substantially and expanded access to sophisticated research and tools. One success story is Robinhood, a US trading platform which launched in 2013 offering commission-free trading. In 2018, the firm's user base rose from 4m to 6m, prompting established market players to follow its lead by cutting their own commissions to zero.

Stock exchanges are also investing in technology to help improve the financial ecosystem for all investors, not just institutions. For example, London Stock Exchange launched its Issuer Services platform that allows companies to tailor their own information pages on its website. "That's available to all investors, but it's

retail investors that use it more often than institutionals," notes Mr Walker.

Euronext has introduced several tools to level the playing field between institutional and retail investors. In addition to Best of Book, its best execution service for retail orders, the exchange provides free equity analysis on SMEs and co-runs investor conferences dedicated to the retail segment. "We also promote new technologies such as webcasting in order to improve corporate access for retail investors," says Mr Morelli.

Meanwhile, a debate has sprung up globally around the conflicts of interest within IPOs, which see advisers incentivised to set listing prices that favour their institutional clients rather than issuers. The high profile direct listings—which cut out intermediaries altogether—of tech firms Spotify and Slack have underlined the dissatisfaction among many firms and their early backers with the traditional listing process.

Direct listings have their own drawbacks, such as the inability to raise new funds or allocate shares to chosen investors. But the discussion shows that issuers are interested in new ways to raise capital that are both fairer and lead to better outcomes.

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LONDON

20 Cabot Square
London, E14 4QW
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
Email: london@eiu.com

GENEVA

Rue de l'Athénée 32
1206 Geneva
Switzerland
Tel: (41) 22 566 2470
Fax: (41) 22 346 93 47
Email: geneva@eiu.com

NEW YORK

750 Third Avenue
5th Floor
New York, NY 10017
United States
Tel: (1.212) 554 0600
Fax: (1.212) 586 1181/2
Email: americas@eiu.com

DUBAI

Office 1301a
Aurora Tower
Dubai Media City
Dubai
Tel: (971) 4 433 4202
Fax: (971) 4 438 0224
Email: dubai@eiu.com

HONG KONG

1301
12 Taikoo Wan Road
Taikoo Shing
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
Email: asia@eiu.com

SINGAPORE

8 Cross Street
#23-01 Manulife Tower
Singapore
048424
Tel: (65) 6534 5177
Fax: (65) 6534 5077
Email: asia@eiu.com