Registered shareholders: How to manage the millennial challenge

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Synopsis:
The "Millennial Generation," born in the 1980s and 1990s, is driving powerful changes across many industries. However, **Millennial investors who are registered shareholders—i.e., hold shares directly in their own name on the company register—are behind an unusual pattern of change; slow but steady attrition.** Each year, a company's registered shareholder base gradually declines as older shareholders pass away, sell shares, or move their accounts to brokerage platforms. Millennial investors follow a different path in that they value the services provided by brokers (including online), where securities are held in street name. The trend is clear and inevitable. Adding to the challenge for issuers, Millennial Investors favor "baskets" (e.g., mutual funds or ETFs) as a means of achieving "one-click" diversification.

No company is immune from a shrinking registered shareholder base, and every public company must consider the impact and develop an action plan.

Two viable strategic options are to: 1) retain registered shareholders as long as possible, to leverage their loyalty to the company; or 2) accelerate attrition in the registered shareholder base to maximize service efficiency and reduce costs.

The best practices include: an in-depth analysis of the company's shareholder base and corporate goals; and a plan for managing the registered shareholders, while continuing to deliver best-in-class service to those who remain.

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The millennial challenge

The "Millennial Generation," born in the 1980s and 1990s, is driving powerful changes across many industries. Several technology companies have grown hugely successful by interpreting Millennials' needs and tapping into their economic energy. For example, Millennials prefer to use cellular phones and mobile devices instead of landline ("hard-wire") telephones, and they are driving a decline in landline phone penetration that some surveys have pegged at about 5% per year. Apple interpreted this trend and developed the iPhone to capture it, taking cell phone industry leadership and market share away from other companies.

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Public companies should accept the fact that registered shares are similar to landline phones, at least for Millennials. As younger investors gradually overtake Baby Boomers and Generation X investors in numbers and influence, the attrition in registered shareholders will continue and perhaps accelerate.

Currently, we estimate that about 98% of all shares of U.S. public companies are held by institutions or retail brokerage accounts in "street name," leaving just 2% registered through transfer agents. Over approximately the next two decades, we can project that registered shares will fall below 1% as registered shareholders pass away, sell, or move their accounts to brokerage platforms. This slow attrition (arguably a generational transformation) will challenge public companies to rethink how they manage their shareholders, including a viable future strategy for working with the transfer agencies that remain.

Why, specifically, are younger people less likely to hold registered shares? Although detailed data is lacking, we believe the answers include:

- **Investment experience** – Surveys have shown that a majority of younger people now gain their first exposure to investments through workplace retirement plans, such as 401(k)s. Most 401(k) participants invest in packaged products (e.g., mutual funds) and have online access to consolidated account data and investment services. Retirement plans don't expose young investors to registered share ownership.
- **Company loyalty** – In general, younger investors lack the loyalty of prior generations to companies they own. They may focus on ticker symbols more than company identities and hold for shorter time frames in search of quicker profits. Even when young people invest in a company's shares and also consume its products, they are more likely to buy shares through brokerage firms than to own registered shares.
- **Lack of company promotion** – Many large companies do not even promote registered share ownership, in part because of its cost. Instead, they guide potential shareholders to purchase from just about any brokerage firm, including discount or online brokerage services. Industry sources estimate that a company's cost to serve each registered shareholders is up to 10 times the cost to handle each street-name account.

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- **Speed, convenience and consolidation** – Younger investors enjoy the trading speed, convenience and consolidated reporting offered by brokerage account platforms, especially online brokers. Both online and full-service brokerage firms are promoting consolidated reporting and portfolio analytics to capture client relationships and assets under management. Online brokers have committed huge resources to national advertising campaigns aimed at younger investors, such as E*Trade's "talking baby" campaign. Because there is no similar marketing effort behind registered shares, many younger investors don't even know it is an option.

Despite these realities, many public companies still have thousands of registered shareholders to serve. Although traditional tactics for proactively reducing their number—such as a reverse-forward share split—are not logistically easy to implement, new shareholder-friendly solutions are emerging.

Thus, the challenge created by a younger generation of investors will continue, and every public company should devise a response to it. **The best practices for responding to the Millennial Challenge include: 1) in-depth analysis of your company's shareholder base and corporate goals; and 2) a plan for managing the costs and complexities of inevitable attrition in registered shareholders.**

Evolution of transfer agency

When the U.S. stock market began functioning in the late 19th century, shareholders held paper certificates, which most companies registered through in-house units. As shareholder bases expanded in early 20th century, some companies began outsourcing this role to specialized transfer agents. The introduction of federal securities laws in the 1930s gave momentum and legitimacy to a growing transfer agent industry, which consisted of several hundred companies at its peak. From then through the present, the SEC has required transfer agents to register and meet regulatory standards.

Over the past two decades, the transfer agent industry has been steadily consolidating due to increased regulatory, technology and cost burdens. Now, after several rounds of consolidation, the U.S. industry has contracted to a handful of transfer agent outsourcers with few remaining in-house agents. The most recent round came in response to increased requirements for cost-basis tax reporting, which were complex and expensive for transfer agents to meet.

Currently, U.S. transfer agents hold names of an estimated 50-60 million shareholders on their books, and we can trace a large number of them to specific events. For example, in 1982, AT&T divested seven independent Regional Bell Operating Companies, and each of the 1.5 million registered AT&T registered shareholders instantly became registered holders of eight stocks instead of one. Thus, about 10 million new registered shareholder accounts were created at once.

The last two decades produced a wave of U.S. life insurance company demutualization events, each of which added registered shareholders. When Prudential Financial demutualized in 2001, for example, four million policyholders became registered shareholders of the new public company.

In both the AT&T divestiture and insurance demutalizations, shareholders did not choose to become registered. These events created new registered shareholders by default. Subsequent to the events, the industry has seen many of these shareholders choose to move their shares into brokerage accounts.

The changing role of transfer agents

Clearly, the role of transfer agencies has changed over time. However, the core value proposition of these companies has continued intact, into the 21st century. To develop an effective transfer agent strategy for your company, it helps to understand why public companies still depend on transfer agents:

- **Providing shareholder services** – Transfer agents perform basic shareholder services, such as recording changes in share ownership, delivering and processing proxies, and paying dividends. They also handle less visible tasks, such as capturing Know Your Customer (KYC) data, performing anti-money laundering compliance functions, and accounting for stock dividends and splits. Leading transfer agents invest in advanced processes to maintain secure shareholder records and assure privacy.
- **Encouraging and rewarding shareholder loyalty** – Registered share ownership can increase investors' loyalty to the company, in part because the transfer agent communicates the company's identity and promotes share ownership.
- **Representing the company to shareholders** – When a registered shareholder calls a company for information or with a service request, the transfer agent often acts as a liaison by fielding the call. Transfer agents train their phone representatives to know their public companies as if they worked for them. As a result, most shareholders aren't even aware they are speaking with a third-party. With each shareholder interaction, the transfer agents aim to increase the investor's affinity with the company.

Models for managing the challenge

Given the inevitability of the Millennial Challenge, what is an effective strategy for meeting the needs of registered shareholders? Let's evaluate two models, each of which can be matched to a public company's shareholder base, objectives and transfer agency budget.

Model #1: Retaining loyal shareholders

For companies that see advantages in retaining registered shareholders as long as possible, transfer agents can help by implementing loyalty-building services.

Dividend statements can be designed to communicate the company information or offers. Offers of perks and discounts can be created to increase shareholders' sense of loyalty. Customer service training can help phone reps answer common shareholder requests or remediate complaints.

To strengthen consumer loyalty and encourage purchases of products and services, some companies offer coupons or incentives to registered shareholders. For example:

- A large consumer packaged-goods company traditionally has sent its registered shareholders 20 packs of free chewing gum at year-end holidays. This gives shareholders a feeling of importance and also helps to expose the company to their children, the next generation of shareholders.
- A wine company offers a free vineyard tour and tasting.
- A ferry company offers a half-off fare, and several retailers include discount coupons in shareholder communications.
- One bank offers registered shareholders a fee-waived credit card.

Without a defined plan and strategy, issuers will likely find that their last registered shareholder is exceptionally expensive.

Model #2: Encouraging registered shareholder attrition and cost-efficiencies

A company with a younger shareholder base, such as a technology firm, may wish to accelerate attrition of its registered shareholder base. Its goals might include: 1) delivering quality customer service to existing registered shareholders; and 2) monitoring and managing the inevitable attrition. Customer service reps can be trained to help shareholders evaluate trade-offs between registered share ownership and the transfer of shares into brokerage accounts. Oddlot programs can be structured to reduce the number of registered accounts.

For public companies concerned about the bottom-line costs of managing shareholder service, transfer agents can create a transition plan for serving a gradually shrinking shareholder base within clear cost parameters. The goals of this model can include: 1) maintaining transfer agent services and service quality; and 2) avoiding excessive cost increases (per-shareholder) as the registered shareholder base declines.

Without a defined plan and strategy, issuers will likely find that their last registered shareholder is exceptionally expensive. Transfer Agents without a path or plan to embrace this challenge will inevitably attempt to raise fees paid by the client company, to offset the dwindling shareholder-paid or volume-based revenue streams.

Summary

The choice of a transfer agent is just as important as ever, and the Millennial Challenge is changing the parameters for choosing a transfer agent. Public companies once had a choice among dozens of transfer agents. Now, industry consolidation and regulatory complexities have reduced the choice to a handful of companies.

As the number or registered shareholders continues to shrink, every public company needs a plan for managing this change. This plan should not be biased by the transfer agents' business model. Ideally, the transfer agent will have proven experience and resources on "both sides of the fence"—serving registered shareholders and brokerage account platforms alike.

The transfer agent must also be committed to helping each public company implement a plan so that it meets the needs of all registered shareholders, including Millennial investors who will soon represent a new mainstream.

About Broadridge

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