ONS survey underlines importance of the retail investor

By Keith Hiscock, Chief Executive, Hardman & Co

The latest Office for National Statistics (ONS) survey, 'Ownership of UK quoted shares: 2016', shows that retail investors are more important than most company managements realise or most capital markets professionals admit. When it is also appreciated that the data shows that retail investors set the share price for most quoted companies, most days, it becomes clear that engaging with such an audience enhances a company's standing, whilst ignoring them courts disaster.

- Individuals form the largest component of share registers by value after the Rest of the World for every size of company from AIM to FTSE 100;
- Of all investors, individuals have the highest propensity to hold non-FTSE 100 shares;
- Recent years have seen a reversal in the long post-war decline of the retail investor;
- 82% of AIM companies have an average trade size of less that £10,000.

Why retail investors matter

Most people in the capital markets underestimate the importance and impact of retail investors. They would rather spend their efforts on institutional investors, with whom they may have strong and long-lasting relationships. Often, advisors tell company managements to focus on their institutional investors and pay lip service to the retail investor. Understandably, managements, with little experience of capital markets, listen to what they are told. Unfortunately, this advice is wrong. Is this because most brokers do not themselves understand the data, or because they have little or no interaction with retail investors? Whatever the reason, such advice flies in the face of the facts and does a disservice to companies and retail investors alike.

Companies should carefully consider how they communicate with retail investors. Perhaps the percentage owned should direct how companies spend the money they allocate to the 'capital markets budget'. If they followed this principle, then AIM companies would devote 29.7% of such expenditure to addressing retail investors, and even FTSE 100 companies would apportion 12.3% to them. Our guess is that nowhere near these amounts are employed, with the lion's share going to institutional investors. In most cases, retail shareholders in companies cannot even read the research note that their own house broker has produced, paid for in effect by the shareholders!

All too often, there is a vacuum of information for the retail investor and, at worst, he ends up making up his mind from bulletin boards. If this were just inequitable, it would be bad enough, but what most company managements do not appreciate is that, most days, their share price is set by these very investors, as we demonstrate below. Managements should also realise that retail investors are not all the same. They vary from very long-term holders (generally more loyal than institutions, because they do not have quarterly benchmarks to beat) to those for whom investing is something to be done when the horse racing is rained off. Engaging with the former generally helps a company; involvement with the latter can end in tears.

Last month's publication by the ONS on the ownership of shares, combined with the data the London Stock Exchange publishes on average trade size, underline why these attitudes are wrong.

The ONS has published a survey of share ownership every two years since 1963. Its latest statistical bulletin, 'Ownership of UK quoted shares: 2016', was published at the end of November 2017. It employed a statistical sample of UK quoted companies and interrogated shareholder registers at 31st December 2016 to determine who the beneficial owners were. For more detail, please see the methodology section below.

The big picture at the end of 2016

Figure 1: Beneficial ownership of UK shares

%	Total Market	FTSE 100	Other Quoted	AIM
RoW	53.9	56.0	48.5	42.8
Individuals	12.3	9.5	19.4	29.7
Unit trusts	9.5	9.1	10.4	11.3
Other financial institutions	8.1	8.1	8.3	8.3
Insurance companies	4.9	5.0	5.0	1.8
Pension funds	3.0	3.0	3.0	2.8
Public sector	1.1	1.5	0.0	0.0
Private non-financial companies	2.2	2.6	1.1	0.2
Investment trusts	2.1	2.0	2.3	2.4
Banks	1.8	2.0	1.2	0.4
Charities, churches, etc.	1.0	1.1	0.7	0.4
Total	**99.9**	**99.9**	**99.9**	**100.1**

Source: ONS, Hardman & Co Research

Figure 1 demonstrates that, in terms of the categories defined by the ONS, the individual investor is the second most important in every index universe (FTSE 100, other companies and AIM) after the RoW, accounting for nearly 30% in the case of AIM. The total for individuals excludes their holdings in unit trusts, pension funds, etc, where they have no control over investment decisions (see the methodology section below for more detail). Understandably, institutional brokers will argue that their clients are the managers of unit trusts, other financial institutions, insurance companies, pension funds, investment trusts, charities and even some of the RoW, which together account for more of the share register of the typical company.

The RoW has grown substantially as a proportion of the whole in recent years. It includes all non-UK investors, from big institutions to individual investors. In 1963, when the survey was first produced, this category accounted for a mere 7% of ownership. The change reflects the change in the shape of the UK stock market, with London becoming an increasingly attractive venue for 'foreign' companies, inevitably bringing with them non-UK investors. A detailed breakdown of this category can be found in the methodology section below.

Individual investors like small and mid-cap companies

Domestic retail investors seem to have a particular liking for companies outside the FTSE 100 (not just AIM), since the ONS survey shows their portfolios have the most pronounced skew towards these companies. 42.1% of their aggregate portfolio was held in such companies, way beyond the second-placed investment trusts, for whom non-FTSE 100 holdings represented 27.9%. It should be noted that 'other companies' in Figure 2 represent holdings of AIM and non-FTSE 100 companies combined, whereas the data in Figure 1 for other companies are for non-FTSE 100 and non-AIM-listed companies.

Figure 2: % portfolio allocation by value of beneficial ownership of UK shares

December 2016	Percentage invested in:	
%	FTSE 100	Other Companies
Individuals	57.9	42.1
Investment trusts	72.1	27.9
Unit trusts	72.2	27.8
Other financial institutions	74.4	25.6
Pension funds	74.9	25.1
Total	74.9	25.1
Insurance companies	76.5	23.5
RoW	77.8	22.2
Charities, churches, etc.	83.8	16.2
Banks	85.2	14.8
Private non-financial companies	88.5	11.5
Public sector	99.6	0.4

Source: ONS, Hardman & Co Research

Recent history

Recent history of the ONS data shows that the individual investor has become more important in recent years. While 2016 shows little movement on 2014, we have seen a significant increase from the historical low of 10.2% in 2008. Of course, for the historians, this is still way below the levels immediately after the Second World War. The first survey in 1963 showed that individuals accounted for 54%. Back then, London was essentially a domestic and local market, unlike today, and individuals were less likely to hold their wealth through collectives.

Figure 3: Beneficial ownership of UK shares by value over time

At 31 December (%)	2010	2012	2014	2016
RoW	43.1	53.3	53.7	53.9
Individuals	10.6	10.6	12.4	12.3
Unit trusts	8.8	9.5	9.1	9.5
Other financial institutions	12.3	6.6	7.1	8.1
Insurance companies	8.8	6.2	5.9	4.9
Pension funds	5.6	4.7	3	3
Public sector	3	2.5	2.6	1.1
Private non-financial companies	2.2	2.3	2	2.2
Investment trusts	2.1	1.7	1.8	2.1
Banks	2.5	1.9	1.4	1.8
Charities, churches, etc.	0.9	0.6	1.1	1
Total	**99.9**	**99.9**	**100.1**	**99.9**

Source: ONS, Hardman & Co Research

However, the private investor is even more important than the latest survey shows, because most days of most months, for most companies, these investors set the share price.

Another way to consider the influence of retail investors is to look at trading data. Figure 4 examines the average trade size on the AIM market for November 2017. It is the most recent data available as this article went to press.

Figure 4: Average trade size on AIM in November 2017

Average trade size	No. of Companies	% of all Companies
More than £110k	7	0.7%
£80-100k	5	0.5%
£60-80k	5	0.5%
£40-60k	20	2.1%
£20-40k	45	4.7%
£10-20k	89	9.4%
£5-10k	190	20.0%
£0-5k	590	62.0%
Total	951	100.0%

Source: London Stock Exchange, Hardman & Co Research

In this month, for 82% of AIM companies, the average trade on the market was worth less than £10,000. Is there something unusual about November 2017? The answer is 'no' – our last article using this dataset (published in winter 2015/16) showed that, in September 2015, the percentage of AIM companies with an average bargain size less than £10,000 was…82%.

Is there something unusual about AIM? Again, the answer is 'no'. Our analysis of the data for fully listed companies outside the FTSE 100 shows remarkably similar data.

Clearly, the data do not show what type of investor is responsible for each trade, but it must be sensible to draw the conclusion that the lower the average, the more important the retail investor probably is. A few companies get the issue. We have had managements tell us that the biggest part of their register is accounted for by institutions, which trade infrequently, often only when there is a placing or fund-raising. Yet the price at which these large trades occur starts from the trades in the days and weeks before – trades by retail investors.

An example to bear in mind

We are aware of examples of companies who ignored retail investors to find their share prices trashed by them. To cite one nameless example, in September 2015, a newly floated financial services company with a market capitalisation of £200m, announced its mid-year update. It was a relatively innocuous statement, save that the management felt that the revenues had probably moved to the right. This came as no shock to institutions, since the business was similar to other quoted vehicles that had delivered the same message in the weeks before. No doubt, on the day of the statement, the company's broker had phoned around institutional holders to put the statement into context.

Just 0.2% of the register changed hands that day – likely retail trades. The shares fell 20% on the day and, in the subsequent couple of weeks, they halved. Why? Because the retail investor did not see those other companies' results, had not had the brokers' notes and had not been rung by the house broker. He operated in a vacuum – all he could read was the statement, and it looked bad. Added to that, as retail investors started to sell, the price fell; market makers have much thinner books than they once did and didn't want to be left holding a baby, so they marked it down. A falling share price, no doubt, convinced retail investors that this was not good news, as they had suspected, and a vicious spiral started. Ignoring the retail investor cost the management dear – £60m, in fact, since they owned 60% of the company.

Conclusion

Retail investors remain more important to quoted companies than many of us in the capital markets realise or want to admit. If nurtured, they can be an important and loyal part of the share register, especially outside the FTSE 100. They are even more important to the daily pricing of shares. Ignoring them courts share price disaster.

Methodology

The aim of the ONS survey is to identify the beneficial owners of shares, i.e. the person or organisation that benefits from dividends and increases in the share price. Another approach is to consider them as investment decision-makers. For the survey, the ONS uses a sample of 200 companies listed on the London Stock Exchange. The 85 largest companies by market capitalisation are automatically included, with the balance of 115 being smaller listed companies. The ONS seeks to ensure that the sample broadly mirrors the sector makeup of the equity market, as well as the market capitalisation distribution.

Since the introduction of CREST, operated by Euroclear, it is compulsory for participants to specify in which National Accounts (NA) category the beneficial owner belongs. However, one of the NA categories is 'multiple ownership: pooled nominees', where more than one type of beneficial owner is present. ONS works with Equiniti and Orient Capital to identify the ultimate beneficiaries of pooled nominee accounts. The data are used to allocate the pooled nominee holdings across the types of holders used in the tables above.

Some shares are still held outside CREST in certificated form. ONS uses the Waterlow Stock Exchange Yearbook to find the appropriate beneficial categories. Included in non-CREST holdings are the UK Government stakes in Royal Bank of Scotland and Lloyds.

What is an individual?

The ONS methodology paper defines individuals as '… individual persons resident in the UK (whether registered in their own name, through a PEP/ISA, or as clients of a stockbroker or fund management group); shares held for employee share ownership schemes; and shares held in trusts with named individual beneficiaries'

RoW

The largest holders by geography in the RoW category are based in North America, and account for just under 50% of the category. The ONS provides an estimate of how the basket breaks down by type (shown in Figure 5). RoW individuals are clearly less interested in UK quoted shares than local investors, the data suggest, since only a small part of the UK market is owned by them (this does include small amounts by offshore UK holders in places such as the Channel Islands and the Isle of Man).

Figure 5: RoW holdings of UK quoted shares by beneficial owner

	North America	Other RoW
Unit trusts	50.1	13.7
Other financial institutions	27.6	24.0
Pension funds	17.7	9.1
Insurance companies	1.5	0.2
Individuals	1.4	1.2
Public sector	0.6	32.0
Charities	0.6	0.1
Banks	0.4	11.8
Private non-financial companies	0.2	7.8
Investment trusts	0.0	0.0
Total	100.1	99.9

Source: ONS, Hardman & Co Research

About the author

Keith Hiscock is the Chief Executive of Hardman & Co.

He is personally responsible for the firm's relationships with its corporate clients and also for corporate finance.

Keith has over 35 years' stockbroking experience and has developed long-standing relationships with many major institutional investors, including Private Client Brokers and Wealth Managers. He started his career at James Capel, at the time the top-ranked research house in London. He was a founding member of Schroder Securities and of Agency Partners, a leading research boutique and a member of the 5-man securities board at Evolution. Keith has also advised companies, large and small, on their relationships with the capital markets. Keith was part of the group of investors that acquired Hardman & Co in late 2012. He holds an MA in Philosophy, Politics & Economics from the University of Oxford.

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