On Governance: Do You Know Who Your Shareholders Are?

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On Governance is a series of guest blog posts from corporate governance thought leaders. The series, which is curated by the Governance Center research team, is meant to serve as a way to spark discussion on some of the most important corporate governance issues.

Do board directors know who their shareholders are? Should they care? In years past, corporate ownership was monitored by investor relations. Today, corporate counsel is involved as proxy voting and governance become increasingly important discussion topics. Even in today's increasingly indexed investment landscape, the active portfolio manager including hedge funds remain prominent owners and can signal to the company what the current sentiment of the stock may be.

While quarterly 13F filings of stock ownership are somewhat dated, the change of ownership may indicate a shift in sentiment. For example, some investors may want to own the stock for income (high dividend payout). If the company is contemplating a change in its dividend policy how would that decision impact its ownership structure once the information is absorbed in the marketplace.

Perhaps the company is perceived to be a high-growth stock. However, as the company matures and its growth profile shifts, how will that shift affect its shareholder base and what can the company do to shore up its ownership of long-term investors?

Another increasingly important investment strategy is stock-shorting. Importantly, does the board understand which firms may be shorting the stock and why. While this data is more difficult to sort out it can be obtained through mutual fund portfolio holdings of investment advisors who are required under SEC rules to publish their holdings. Even if the data is out of date, understanding the rationale for an investment short may provide

an informed opinion about the stock. For example, a short could be a “relative value” trade – i.e., company A in the same industry is too expensive relative to company B. In this case, a portfolio manager may short company A in favor of a long position in company B. The portfolio manager is paid for the performance of A vs. B even if both stocks move in the same direction. As long as A underperforms B the bet pays off. Other short strategies may reflect a pure negative view of the company, important information for any company to understand.

Often missed is why a reputable investment firm does not own the stock. The reasons may include a high valuation relative to the peer group. But the reason may also be a lack of confidence in the management of the company and/or the lack of confidence the company’s execution of its stated business strategy.

There is another portfolio permutation to consider – ”under-ownership.” Why would a reputable investment firm that may own shares of the company under-own the stock? This is a subtle but important point. If, for example, the stock is represented in an index, active managers may own shares for risk control purposes (in this context risk management is relative to the index weighting of the stock in order to control portfolio volatility). For example, at the end of 2018, Microsoft represented 3.7 percent by market capital weight of the S&P 500 index. An investor may own only 2 percent of the stock in the portfolio representing an underweight relative to the index. This may signal a lack of confidence in the stock story. In my experience as an investor and governance professional, I have never been asked by company management why I “under-owned” the stock.

In this heightened environment of activism, quantitative investing and shorting, understanding who owns your company and why and even more importantly which firms do not own the stock is information that company management and the board should have in their arsenal to improve shareholder relations and investment communications.

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