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# The importance of institutional ownership intelligence in M&A transactions

BY GEORGE RUBIS

**M**&A is a critical component of corporate growth and exit strategies. According to research by Morgan Stanley, M&A transactions could rise by half in 2024, with sectors as varied as banking and real estate enjoying a boost.

While Q1 2024 has already seen a 36 percent increase in global deal value, driven by soaring corporate confidence and easing inflation, an increasing number of transactions are threatened by activist investors who can block, delay or test boards when it comes to these transactions.

As Diligent has found, 2023 saw a 20.8 percent jump in the number of contested deals, with activist arbitrage just one of several tactics disrupting deals in industries ranging from MedTech to energy.

Yet the situation is not hopeless. By utilising cutting-edge institutional

ownership intelligence (OI) to understand exactly which investors are active, dovetailed with targeted shareholder engagement to get doubters onside, leaders can significantly increase success rates on even complex M&A transactions.

## **Institutional OI**

OI is streamlined market surveillance that identifies and tracks the true institutional shareholders holding a direct financial interest hiding behind custodians in a company's stock. OI can make or break an M&A transaction.

While many companies claim they know who owns their stock, in an M&A transaction a company can literally see its shareholder profile change overnight and continue to shift with news cycles and external market factors. The C-suite and board's understanding of who owns shares

in their company – and how many shares they own – allows them to flag potential activist investors ahead of time and see where the stock is moving.

This, in turn, provides the opportunity to address any potential issues and develop a strategy before an M&A vote, while also providing insight into the market reaction to any announcement.

Many companies are ill-equipped for today's fast-paced trading environment, relying on outdated Form 13F filings or high-priced, mediocre results from legacy providers that report in hindsight. This is especially problematic in a market where institutions own about 78 percent of shares across the Russell 3000 companies.

## **Stock loan analysis**

Successful deals face other barriers too, such as stock loaning. In this \$10bn sector,

many shareholders have less voting power than their nominal stock holding implies.

Executives may believe the vote is in 'friendly to management' hands, but in fact the stock has been lent to a short seller, reducing the shares available to vote with management. Knowing this in advance is crucial for tight M&A votes.

Every company facing an M&A transaction should conduct a stock loan analysis. In today's environment of minimal management fees, institutions are increasingly relying on revenue from lending shares to short sellers, particularly as higher interest rates make the short rebate more lucrative.

However, when shares are lent out, the institution loses its voting rights in corporate elections and shareholder proposals. If a vote becomes highly contested, it is crucial for the lender to recall the shares before the record date to regain voting power.

In a recent M&A transaction, for example, it was determined that the target company's top 15 institutional investors held approximately 60 percent of the outstanding shares. After the stock loan analysis was conducted it was determined that 58 percent of those shares had been lent to short sellers. This translates to 34 percent of the outstanding shares that will not be voting the shareholder meeting. When 50 percent of the outstanding share votes are needed to pass the merger, this is a big problem. Since the voting rights temporarily go along with the borrower, the lender loses the ability to vote on those shares.

Typically, the interests of short sellers and institutional shareholders are not aligned, therefore a company can engage with its institutions to request that they reconsider their stock loan policy during a short attack. This happens rarely and is complicated, but it is possible to get an institution to recall its stock.

In cases where a stock loan analysis identifies a large number of lent shares, the solicitation strategy must be adjusted on the fly. This means that the 'lost' votes of lent shares must be replaced from other shareholders, which would include an outreach to smaller institutions, to retail,

and to non-objecting beneficial owner (NOBO) shareholders.

In close campaigns, retail and NOBO shareholder votes can make the difference between success and failure. Retail outreach campaigns can be costly, especially if a company has a large retail shareholder base. In addition, these campaigns require planning and lead time, so the sooner a company is aware that it will need a retail campaign, the better off it will be. These retail shareholders, once reached and voted through either televote, text to vote or email to vote platforms, typically back management on a 9 to 1 ratio.

A stock loan analysis can identify the top institutions lending their shares and summarise the effect on voteable shares. This streamlined report is a valuable resource for issuers to incorporate into their planning for campaigns requiring shareholder votes.

To put the size of this market into context, it is estimated that globally securities lending makes up around \$3 trillion in outstanding loans. Some of the major participants in this market include pension funds, mutual funds and insurance companies, as well as hedge funds, broker-dealers and custodial banks. Put another way, it is usually the top 10 institutions at the top of any company's 13F listing.

In addition to stock loaning being a huge obstacle, it hardly helps that so-called 'bumpitraging' is a rising tactic across M&A. Here, activist investors buy shares in a company targeted for takeover, then argue that the offer is too low, which delays some deals and derails others altogether.

OI can leverage tens of thousands of annual solicitation campaigns to provide a deep database that maps custodian profiles to investors, including data on sector-wide short selling. Even before a transaction is announced, OI can help companies predict how key shareholders might react based both on their activist history and current shareholder profile.

Once an M&A plan is publicly announced, OI remains even more critical as it creates a continuous log of shareholder analysis, helping companies gauge market reaction to the news and prepare to win future votes.

While OI is a critical part of the process, its true value lies in its integration with other shareholder management tools. For instance, if OI alerts a company to an investor with a history of blocking M&A or causing disruption, the company can immediately engage through meetings and proactive shareholder communications to address concerns in advance. If OI uncovers stock loaning or bumpitraging, leaders can quickly recalibrate the number of votes they will need.

OI also provides more comprehensive insight, such as whether shareholders are genuinely at risk of voting against a resolution or simply unhappy at the moment.

Beyond offering executives and board members peace of mind and preventing costly M&A failures like those experienced by Brookfield and ABRDN, robust OI enables boards to keep shareholders satisfied once an initial merger is approved. Given that a deal is only the first step toward a long and successful partnership, this approach is essential. ■

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