DIVIDEND REINVESTMENT and DIRECT STOCK PURCHASE PLANS: POWERFUL TOOLS TO "OPTIMIZE" THE VALUE OF YOUR RETAIL INVESTOR BASE

A Special Supplement to The Shareholder Service *Optimizer*
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In our last special supplement on "the basics" of shareholder-servicing, we promised additional information to help readers improve their shareholder-mix and thus, "optimize"its value.

In our view, properly designed DRPs - and *especially* those *DSPPs* - are not only among the *most powerful* tools we know of, they're the *fastest-acting*, by far. And these days, they're among the *least-expensive tools out there* - if you use them properly - to help you improve your shareholder "mix".

Best of all, if you really design - or redesign - your program *optimally*, as we hope this article will help you do - and especially if your plans are properly internet-enabled - you can actually *save big money* on your shareholder servicing programs...and *raise big money* for your company...and also, the record shows, *improve your stock price relative to your peers.*

FOR STARTERS, A BIT OF BACKGROUND:

Dividend Reinvestment Plans, or DRPs for short (which we much prefer to their other, and sometimes all too appropriate nickname, "DRIPS") have been around since the early 1970s. The first ones were offered by closed-end mutual funds, but Allegheny Power, followed almost immediately by AT&T, were the first nationally known companies to offer them.

From the get-go, both companies realized that yes, it was a good shareholder "bennie"; one that didn't cost much more to administer than it did to mail and clear dividend checks, and one that allowed stockholders to gradually increase their personal, as well as their economic "commitment" to the company. But they also saw what a very cost-effective way it could be to raise equity capital. So, in addition to the dividend reinvestment feature, these plans also allowed stockholders to send checks if they wished (ACH was in its infancy then) in order to increase their holdings (and the flow of funds to the Plan) at a much more rapid rate. Hundreds of thousands of investors did so…and still do…and with a still surprising degree of regularity.

Within a year or so, virtually every electric and gas utility in the country had such a plan. And for more than twenty years, these capital-intensive industries were able to raise more than half of all the equity capital they needed, year after year, without having to pay the usual 6% underwriters fee…and without investors having to pay brokerage fees either. What a bargain all around! (In fact, for almost 10 years, participants in DRPs that were sponsored by "qualified" utilities enjoyed their reinvested dividends totally free of federal income tax, which made them more popular yet.)

Meanwhile, by popular demand, DRPs were spreading to a wide variety of dividend paying companies who saw that even in the *worst case*, they'd be "getting more for the money" they were spending on mostly-smallish holders, by helping them accumulate a bigger stake. And in the *best case*, consumer-oriented companies - or those with consumer "issues" of interest to regulators - saw very significant value in using these Plans to "better align" and significantly strengthen corporate and stockholder and consumer interests. The smartest companies also discovered that strong "affinity group ownership" would not only "lock-in" significant amounts of purchasing power (even where they were not selling directly to individual consumers, we say) it could help to create even more valuable amounts of "brand equity" that would be reflected in the stock price. (See our website for more articles that focus on, and provide evidence for these hard-dollar benefits.)

Smart companies soon realized that if they *really* needed more equity capital, they could increase the flow dramatically - very much like opening up a tap - by offering shareholders a discount of 2 ? - 5% or so on the shares they purchased, sometimes limiting the discount to the dividends alone, but often opening up the tap to include those "optional cash investments."

As far back as the '80s, your editor's *alma mater*, Manufacturers Hanover Trust, was raising about $500,000,000 a year in sorely-needed equity capital...without having to float a really big offering, which no one wanted to do just then because the stock-price was so low...and saving a cool $22.5 million a year on underwriting fees; the difference between a 6% commission and the 2 1/2% discount on cash investments we were offering. Plenty of others were and still are, doing the same.

Arbitrageurs caught on to this too - and often engaged in "dividend-capture schemes" or quick "ins-and-outs" with optional

cash, which can cause unwanted stock price volatility if issuers fail to apply appropriate "speedbumps." But, on the whole, everyone came out a winner (and still can) when issuers and their stockholders effectively "split" the savings in underwriting fees that arise from buying - and selling "direct". (An important note: DRPs that allow the sponsoring company to raise new capital through the plan must be "registered" with the SEC, along with the shares being set aside for the Plan. But "plain vanilla" Dividend Reinvestment and Systematic Stock Purchase Plans, where all the shares are purchased by the plan agent, in the open market - and where there is nor "reaching-out" to affinity-group investors, as was later permitted by the SEC - need not be registered. Back in the '80s this was often an important consideration, because of the then-considerable costs of such registration. These costs, however, as will be noted below, have come down considerably since then.)

Despite - or perhaps because of the success of DRPs, one annoying "fly in the ointment" remained: SEC rules allowed these plans to be offered only to existing shareholders and active employees of the company.

Thus, unless you were an employee, *you needed to have at least one share* - which you'd have to obtain from a broker…unless you were lucky enough to find an accommodating friend or relative to sell you a share privately…in order to buy *more* shares and/or reinvest dividends. And most of the people who were the best candidates for DRPs (because they didn't have or didn't want or couldn't cost-justify having a broker...or who felt they didn't *need* a broker to tell them whether the company was a "good buy" or not) didn't have a broker!

Finally, in late 1994, the SEC saw the light: Issuers who registered their plans - and the shares to be offered through them - were allowed to offer them to any interested party who found out about the plan and requested appropriate written materials (a plan prospectus). They were also allowed to "reach out" to "affinity groups" such as customers, suppliers, former shareholders…in short, anyone where they could demonstrate a preexisting relationship, tell them there was a Direct Stock Purchase Plan (DSPP) available and enclose the necessary materials to sign up.

In March of 1997, the SEC's Reg-M allowed transfer Agents to offer "Bank Sponsored" DSPPs to the general public. But, because the rules strictly limited the kinds of "marketing" they could do (and, WE say, because they haven't used much imagination either) the public basically has to find its own way to these plans, and, given the lack of such imagination to date, it rarely does so in impressive numbers.)

But Reg-M - and several other developments - made it easier than ever to launch a DSPP that could and would attract "serious investors" with "serious money" at low cost.

For one thing, these plans were becoming so common that most corporate law firms didn't have to reinvent the wheel (at what, previously, was an incredibly time-consuming, frustrating and expensive process). The development of the "shelf registration" concept also made it easy - and essentially cost-free, in terms of legal expense, to have the plan, and the necessary shares included. Still further, the Securities Markets Improvement Act, in October 1996, essentially took the "blue sky laws", and their state regulators, out of the picture; another major moneysaver. (See the article by Dan Schneider, Esq., posted on our website, for more information about the Act and Reg-M)

But, sadly - and oddly - interest in these plans began to flag, rather than to grow! Partly, it was because their biggest users - those gas, electric and the new telephone utilities…and lots of others too… went on an equity-capital "diet." And many of them began to disappear altogether, in a decade-long round of mergers. To top things off, many companies began to think that individual investors were simply not worth the time, trouble and money they cost the corporation…so why spend scarce time and money to attract them?

Then, even sadder to say, many transfer agents began to encourage their customers to "put" the costs of such programs to the investors themselves. While this seems fair enough if the company really sees no benefits to itself in having such a program, all too often, the fee-schedules that resulted totally negated the original, cost-free - or very-low-cost aspect of such programs - which is their primary "attractant." (Some agents even began to offer "rebates" or "incentives" to add or increase Plan fees in structuring their fees for *regular transfer agent services*; something which we consider to be *a highly questionable practice.)*

The upshot of all this - despite the many advantages that well-designed and well marketed programs offer publicly traded companies - is that a large number of existing DRPs and DSPPs have become largely populated by "hangers on," who "maybe" will buy more "some day"; by "dabblers," who buy the minimum number of shares required by the plan, fully intending to buy more "someday", but who never quite get around to it, and by the "lost and confused" who, more often than not, sold all their full shares…and either forgot about the fractional share in the plan, or see it as their "free readmission ticket" in case they may want to buy some more shares, "some day."

The "flip-side" however, is that the field is wide open for the savviest companies to capitalize on the huge...and wealthy...and sophisticated population, we would note, of "self-directed investors"...and they do!

Our 1997-98 Benchmarking program, in which 14 mostly large companies participated, found that the best performing Plans did an incredible *fifteen-times better* than the worst performers in such key areas as the percentage of the oustanding shares where dividends were reinvested and in the percentage of plan participants who sent additional money to reinvest. Our 1999 Study, covering 18 companies showed similar results.

In fact, the 1999 study showed that one large and well-known company could draw over a half-billion-dollars to its Plan by racheting up participation by just a few percentage points...which still would have put it's participation-percentage below the median!

SO WHERE ARE WE TODAY?

Today, about 1,000 companies still offer "plain-vanilla" Dividend Reinvestment Plans. They still require wannabe reinvestors to have, or to purchase one share (or sometimes 10 or 15 shares) and have them "registered" in their name(s) by having the broker order-up a stock certificate. (Yikes! Talk about the dark ages!)

The good part, however, is that almost all of these plans cost nothing to join - once you lay hands on a stock certificate that is - and reinvesting dividends is usually free (though some clueless companies have allowed their agents to charge investors for something that we think is a lot easier and cheaper to handle than issuing dividend checks…which, it should be noted, cost investors *nothing* to receive).

Most of these plans allow for "optional cash investments" and, while many companies make sure that such transactions are totally free (by absorbing agent-fees themselves) some companies (who apparently don't think its worth anything much to them to have existing investors buy more) allow their agents to charge stockholders amodest fee for processing checks, and typically, a slightly lower fee for processing ACH transfers with which to buy more stock.

At year-end 2002 about 315 US companies offer Direct Stock Purchase Plans. About 100 of these are "registered plans," which means that companies can use them to raise capital, if and when they may need it, AND to reach-out to their "affinity group investors" to tell them about the features and benefits of their DSPP.

Companies in this group - that "value" their individual investors,... and especially those companies who raise capital through their plans, or who think they might do so "some day" - typically absorb most of the costs associated with such plans. Because they do, clearly, "value" their investors…AND because the Plans are *"mostly free of charge"* as a result, these tend to be the largest and most active plans. (Many of these Plans have a "first-time setup fee" of $10 - $15 and almost all such plans charge investors a fee…plus brokerage commissions to SELL through their plans.)

The remaining DSPPs are "Bank Sponsored Plans" which, as noted above, don't allow companies to raise equity capital, are severely limited in terms of the information about the DSPPs - and about the issuers themselves - that can be put out for public consumption.

These plans don't even require the subject companies to consent to such plans being offered…although, since the "offeror" is usually the transfer agent, such consent is usually obtained. Most of these plans have a $10 or $15 initiation or setup fee, plus "optional cash purchase fees" that are usually capped at $5 per investment made with a check or one-time ACH transfer and $2.50 or so for *regularly scheduled ACH transfers* to the plan. Most such plans add brokerage commissions too - which are all over the lot, and which have no economic "rationale" that's readily apparent, at least to us. Fees to sell shares are typically $10, but more often $15 per transaction these days, plus brokerage commissions of 6 to 12 or 15 cents per share. (We were absoutely delighted to learn that at least two transfer agents have smartened up and stopped recommending such plans. These, as we've been pointing out since they first hit the street, are - with a few exceptions, but largely *by definition* - are being offered only where the companies themselves don't see enough value in them to pay the freight for registering and servicing them!)

Also worth noting, around 300 non-US companies also have DSPPs - most, but not all of them "Bank Sponsored" - that allow US citizens to buy their ADRs or "Global Shares." Some of these companies are very serious competitors of US companies - both for business, and for investor dollars - so you're foolish, we think, to ignore them in your own DSPP thinking.

BUT THE MOST NOTEWORTHY DEVELOPMENT BY FAR, HAS BEEN THE INTRODUCTION OF "INTERNET-ENABLED" DSPPs:

Currently, there are at least 100 Plans where investors can comparison-shop them at transfer agent websites - or find their way to YOUR Plan with a link from your corporate IR website - check out the terms and conditions, sign up if they so decide (and the best of these sites remember all their info if they've bought there before, to make it easier yet) and move the money from their bank account, right to the Plan agent - right then and there.

ASIDE FROM THE INCREDIBLE CONVENIENCE TO SHAREHOLDERS, HERE'S WHY INTERNET-ENABLED PLANS ARE GOOD FOR YOU AND YOUR COMPANY:

An internet-enabled plan provides instant access, 24x7, to the most sophisticated - and wealthiest segment of "self-directed individual investors" - virtually all of whom use the web to research investment opportunities - and it does so virtually for free: there's no expensive prospectus to print and mail...at least for the web-enabled folks.

(This is no small matter, economically: One company in our benchmarking study - and a "good investment" we'd say - was giving out over 37,000 sets of material a year - mostly to people who called a toll-free number to get one - and getting a mere 7% of them to invest...at a cost of $185,000 per year, just for "fulfillment." Not very fulfilling at all, we'd opine!)

Much more important to note, an internet-enabled plan allows investors to do what they set out to do in the first place, when they seek-out information about DSPPs...AND to do what you want them to do too... PURCHASE STOCK...and to do it right then and there!

(Ask yourselves if your own experiences are like ours, and those of most people we know when it comes to paperwork: With a "paper-bound plan" investors have to call or write away for info, and for a Plan Prospectus. When it comes, maybe a week or two later, it tends to end up in the "to-do" pile - or, more often, behind the toaster. By the time you get around to looking at it - and maybe filling out the paperwork...and write a check...and find a stamp - because most companies these days foolishly fail to provide post-paid envelopes - the "impulse" to purchase has probably passed. Most likely it's because you bought something else...like another stock that was simply easier to buy on the web, or by calling your broker!)

If your transfer agent is smart, it realizes that internet enrollments - and the automatic movement of the money that internet-enablement facilitates - is a whole lot easier and cheaper for THEM than dealing with and re-keying those handwritten enrollment forms, dealing with "deficient" items, processing paper-checks...and the occasional rubber ones. If so, it should have a much lower fee-schedule in place for such well-automated Plans.

(We would really urge you - and your transfer agent too - to work hard on the fees and fee structure: Not only is an internet plan less work, its convenience, plus its ability to "close the marketing loop" between offeror and buyer - and thus to close the sale - is much greater: Thus, many more people will be participating than otherwise. Still further, as we'll explain in more detail below, internet-enabled plans cost only a tiny fraction of what paper-bound plans cost...in terms of out-of-pocket and ongoing "account maintenance" expenses. This makes it much easier for issuers to offer these plans at no cost - or at very-low-cost - which, in itself, will give rise to many more "takers" than otherwise.)

The vast majority of people who sign up for your Plan on the web are perfectly happy to manage their accounts on the web: to receive confirmations, statements of account and all their Annual Reports and proxy materials too. What a bonanza for you!

(The cost of printing and mailing these materials is typically between $6.50 (for a really-low-budget package) and $11.50 these days. In fact, the postage alone - say for four statements, one transaction-confirm and the Annual Meeting package - is around $4.65. Thus, a new, internet-enabled stockholder costs your company significantly less to service than a "paper-bound" holder costs.)

The very best thing you could possibly do, we think, is to establish an Internet-Only Plan: This gets you out of the paper-pushing business from the get-go, and gets your out-of-pocket expenses down to zero, for all the new "registered holders" you add...while giving you all the benefits of a standard DSPP...plus a whole bunch more, we say, by putting you on the cutting-edge...and in touch with the savviest and wealthiest sector of the market.

(Recognizing both the cost-saving aspects in terms of "account maintenence" and the even bigger financial benefits of being able to raise equity capital at the "turn of a switch"... without that 6% underwriter's fee...INDYMAC (NDY) became the first company to offer such a plan... and offers it totally free of charge to buyers of INDYMAC stock.)

WHAT SHOULD YOU DO IF YOU'RE THINKING ABOUT REVIEWING YOUR PLAN - OR STARTING ONE FROM SCRATCH?

The very first thing to do, we say, is to figure who your "affinity group investors" are...and the absolute minimum amount of money they have to have in your stock for you to consider them a "good investor."

The first part is usually pretty easy; think customers, suppliers, existing stockholders, of course; employees and their families and friends (which, oddly, most people seem to leave out on the first go-round, but who typically give your plan the quickest and biggest bang-for-the buck) and "locals" in areas where you have a major presence. And please don't forget the huge number of self-directed investors - with serious money - who have a very special "affinity" for DSPPs because of their low costs vs. brokerage fees.

As to the investment it takes to be a "good investor," it depends primarily on what kind of company yours is: If you're a regulated utility, let's say, or you sell anything to consumers, the amount is usually quite low. If competitors are actively out to get your customers - like those phone-switchers, for eg. - and especially if customers have a cash-value of their own, in the M&A market - the amount should be lower yet. And if nobody much is interested in your stock to begin with, the amount will be *really low*.

Another big factor to consider, of course, is how much it will cost you each year for each investor you add, vs. the benefits: This is one reason we like those internet-only plans so much, since they dramatically lower the entry-point to qualify as a "good investor." In our experience, most companies, at least initially, grossly underestimate the benefits, so please see the additional articles referenced below.

If you're a capital-intensive company - or if it seems likely that you would benefit from a steady and very predictable flow of cash, however modest - calculate the value of those savings on underwriting commissions. And don't leave out the possible advantages of constantly issuing small amounts of equity instead of borrowing short-term from banks to cover working capital needs. You'll save on interest and keep your debt-to-euity ratio better than it would otherwise be.

With all the above in mind, we like to construct a few "strawman plans" and model the likely flow of funds...and the initial and recurring costs of generating them through the DSPP, under various scenarios. (Here's where our benchmarking data can really help you...by showing what is *possible*, with a well-designed, well-marketed and "attractively-priced" program. Here too, in our experience, *most companies greatly underestimate the flows of funds* that a really good plan can generate. And, as we've often pointed out, if you aim low, you can't possibly score high.)

Be sure to benchmark the minimum and maximum investment amounts you're thinking about...and especially the fees and fee structure you're thinking about, against your peers. A while back, we reported on a major oil company that launched one of the priciest DSPPs out there...while its two best competitors were offering totally free plans! Quite aside from the fact that DSPP investors DO comparison-shop the fees...which guaranteed that the new Plan would be a flop, the potential for damaging consumer backlash was huge! We know that if we'd fallen for the pricey deal - only to find out later that two competing companies offered totally free Plans, we'd be mad as hell. And we'd alter our buying habits accordingly.

If you already have a DRP...or a DSPP...collect some hard facts and figures about who's there *now* and how the current flow of funds compares to what you're looking for, or hoping for, from your new target-market. (Most times, in our experience, you'll be shocked by the sheer numbers of dabblers, hangers-on, lost and totally confused people you have now...unless of course you've been marketing your plan - and monitoring it all along.)

Decide what you're going to do with the folks you have now; like "grandfather them in," offer them a chance to round-up or cash-out (which a surprisingly large number will act on, if you market it correctly)...or force them out by changing the Plan rules.

THE MOST IMPORTANT THING TO DO AS YOU GO THROUGH THESE STEPS...AND THE MOST IMPORTANT THING TO KNOW ABOUT THESE PROGRAMS...IS THAT IT'S A MARKETING EFFORT: THE SUCCESS OF YOUR PROGRAM IS DIRECTLY PROPORTIONATE TO THE CLEVERNESS...AND THE FREQUENCY OF YOUR MARKETING EFFORTS. So get out your Marketing-I textbook, which will tell you to...

Carefully define, and strive to truly "understand" your target-market; in other words, who your affinity-group investors *are*...and the factors that will motivate them to invest.

Define and *price* your "offering", namely the features, benefits and costs (or lack thereof) to be really *attractive* to them.

Make sure the "features and benefits" of your "offering" are communicated clearly...and that the benefits come across as "compelling"

Repeat, repeat, repeat! Marketing messages take time to sink-in...AND time for buyers to act on them. Repeating not only helps, it's essential, we repeat.

Simplify and shorten-up the "marketing loop"...in other words, make it as easy, and as quick as possible for your target audience to make the purchase!

Keep careful track of progress, both in terms of the "strawman plan" you decided on AND in terms of your actual marketing efforts.

If you launch something, or issue a reminder, and the response is not what you expected.... RESCOPE... REFINE... REMARKET... THEN REPEAT

Keep those reminders coming! Remember our analogy, way at the beginning of this article, about your Plan being like a tap...where you control the flow? If you're runniug your Plan the right way, this is exactly how it works. As long as you keep reminding folks that it's out there - and about the features, benefits and no-or-low cost (assuming that your business itself is operating at a "steady state" or better) money will keep flowing in. If you offer shareholders a "sale"...say a 5% discount..money will flow in even faster...and will keep on flowing - as long as the "sale" is on and people know about it. If you cancel the "sale," the flow will slow. And if you stop marketing altogether, the flow will slow even more, until you turn up that "tap" again.

Some additional materials you may wish to review:

"Stockholders as Customers...'Show Me The Money' Readers Demand" (It's on our website)

"Top-Ten Reasons To Grow and Guard Your Retail Investor Base" (Also on our site)

"Creating Shareholder Value With Affinity Group Stock Purchase Plans"; from Directorship Magazine, (Call us for a copy of this article and copies of any of the others listed in our cumulative index, but not posted to the site)

Finally....if you have questions, or would like to discuss this subject in a bit more detail, feel free to call us. Ed.