THE COMMUNITY BANK SURVIVAL GUIDE: MAINTAINING INDEPENDENCE IN A CONSOLIDATING ENVIRONMENT

We all continue to hear the stories that a wave of consolidation is coming in the community bank market. That is all well and good, but what if you are a bank that is not positioned to be able to be an acquiror, but you also do not want to be acquired. We believe more attention needs to be paid to the traditional community bank looking to maintain independence, increase stockholder value and meet the needs of its community. In this article, we outline five key tools community banks can use as a survival guide to maintain independence in a consolidating environment.

1. Get the regulators off your back.

If you have been hit like most community banks with some regulatory concerns in the past several years, even if those are minor, we find many community banks continuing to linger with the Board Resolutions, MOUs, Consent Orders and the like. If you do not become aggressive now in having that regulatory burden removed, you are going to miss the upcoming opportunities when the economy rebounds more dramatically and, therefore, miss a key opportunity to continue to perpetuate independence. If a community bank wants to not just survive, but thrive, and keep would-be acquirors at bay looking to prey on their regulatory problems, clean up your house immediately, even if that means going ahead and taking all of those losses on the loans you keep hoping are going to pay off, funding the loan loss reserve more, getting the problem assets off the books and then setting 2012, 2013 and beyond as years of core profitability.

2. Return to core profitability.

The value of a financial institution is historically determined based on its current and future earnings performance. Unless you can demonstrate to your stockholders that your bank can generate core profits in the near term, your stockholders will have no other alternative but to take the first offer that comes down the pike, whether it is a publicly traded stock of another institution or another community bank that pays dividends and turns a profit. It is time for community banks to return to a focus on core profitability and stockholder value. If you want to be independent, the key way to stay independent is to “earn” your independence by being as profitable as possible. In that fashion, if a suitor comes knocking, your stockholders will be of the mindset that they would be foolish to exchange this stock which is generating a healthy return, paying a positive dividend and has great growth prospects, for another bank looking to make a quick buck. The best way to ensure your independence in this regard is to convert to Subchapter S.

3. Make sure your bank is in the right structure.

In terms of striving toward greater stockholder value and enhanced profitability as described above, one of the key things organizations can do is ensure that they have the right stockholder and organizational structure. For many community banks to perpetuate their independence that may mean cashing out unprofitable blocks of stockholders, shrinking the stockholder base, electing Subchapter S status, finally completing that bank holding company formation you have been contemplating, removing your public company...
status to alleviate unnecessary reporting burdens and extraneous cost, improving the structure of your board of directors, appropriately planning board and management succession, and other similar structuring techniques. For most of us, over the past several years, we have not had the luxury of being able to really take a critical look at our internal structure in terms of our stockholder bases, our board organizational structure, our overall corporate structure with S corp status, holding companies, public company status, and the like, but, as we move into 2012 and beyond, it is time for organizations that want to perpetuate their independence and, again, avoid the opportunistic buyer from taking advantage of a less than perfect structure, to take the time to ensure the appropriate corporate structure.

4. Create liquidity in your stock and know its value.

The number one reason stockholders want to sell their shares of community banks is that they need and desire liquidity or cash out of the shares. If your community bank is not providing appropriate liquidity mechanisms, does not provide stockholders a way to extract the value out of their shares, then the first time someone comes knocking, they will jump at the chance to liquidate their shares. So, to perpetuate independence and as a survival guide technique, community banks need to provide liquidity in their own shares. However, that does not mean going public. Rather, that means implementing stock repurchase programs where appropriate, using the holding company to be the purchaser of first resort to repurchase shares from stockholders any time they desire to sell, keeping stockholders aware of what the intrinsic value of their shares is and how the board and management continues to grow the value for non-traded stocks, and appropriate capital planning to have the cash resources available to do so.

5. Adopt specific antitakeover measures.

A final legal point as a key tool to preserving independence is to ensure you are taking advantage of all legal opportunities to do so. That often means reviewing your Articles and Bylaws to implement appropriate antitakeover mechanisms or at least to have your Articles and Bylaws structured in a way that does not make it easy for a third party to make a run at the bank on an unsolicited basis. Many of our clients have even gone so far as to not only adopt certain antitakeover measures in their Articles and Bylaws, but also to have a board-developed unsolicited offer policy. This may mean outlining the criteria by which offers have to be further considered, thresholds below which transactions will not even be considered, and appropriate ways to handle public relations and press issues related to unsolicited offers and similar matters. It, perhaps, is one of the tools you may never need, but it is always good to be prepared.

The next two to three years present an opportunity for many community banks to take advantage of acquisition opportunities as buyers and also to position themselves as potential sellers. However, for the vast majority of community banks that are looking to perpetuate long-term independence, we hope these five key points will serve as a community bank survival guide to help you improve the organization of your bank, drive it toward further growth and profitability, and maintain your independence. Let us know if we can help.

Philip K. Smith
psmith@gerrish.com

Gerrish McCreary Smith
Established 1988
Our Mission
The Client’s Needs Come First
www.gerrish.com