THE Board Chair Forum NEWSLETTER

Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys
July 2021

For the past 30 plus years, we have preached the idea of enhancing shareholder value as a way to maintain independence. In this month's edition of *The Board Chair Forum Newsletter*, we give you a complementary component to that core principle that may serve you well as you look to the future and begin focusing on the relevance of your organization. Additionally, we look at the changing role of the branch and geography, as well as core liquidity needs of organizations.

Travel across the country has greatly increased as we have noticed in our flights to see many of you and in our preparations for Fall strategic planning and Fall conferences. We are already starting to see strategic planning sessions filling up and being pushed into the early part of 2022, so don't hesitate to reach out to us as soon as possible if we can fulfill those roles for you. We hope you enjoy this month's edition of *The Board Chair Forum Newsletter* and we look forward to hearing how we can help you.

Happy Reading!

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THE

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NEWSLETTER

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Board Chair's Summary

- What is the Key to Survival?
- How Important is Location?
- The "Pink Sheets" and Shareholder Liquidity

What is the Key to Survival?

Most everyone is aware that the financial services industry is continuing to go through a period of consolidation. Pricing is generally favorable for sellers, buyers have large amounts of cash or a fairly strong stock to use as currency, and outside pressure such as technological and regulatory pressure may be moving more community banks into the merger and acquisition arena. So, if your organization wants to preserve its independence, what is the real key to survival?

Many of you probably know the constant refrain we have preached for the past 30 plus years that survival is not merely a function of asset size, location, having the right people, or other typical things commonly expected. Rather, historically, the primary focus has been on the organization's ability, as led by its Board Chair and Board of Directors, to continue creating, enhancing and driving shareholder value. That premise, as measured by earnings per share growth, an adequate return on equity, liquidity for stockholders, cash flow to stockholders, and operating in a safe and sound manner, continues to serve as a bedrock principle. So, that remains your first line of defense in maintaining the independence of your organization.

We are also happy to report, perhaps partly through our constant preaching of that message over the past three decades, that it does appear most community banks recognize those fundamental principles and are no longer merely focusing on asset growth, for example, to try to promote independence. So, now that most community bankers have mastered those fundamental concepts, we want to introduce you to a new and emerging principle that we believe is complementary to enhancing shareholder value as a core element of maintaining independence. That is the principle of staying relevant in a rapidly changing and evolving financial services industry. In essence, to remain independent, you must also remain relevant!

Historically, the focus on shareholder value, as measured by the elements described above, is to keep your organization healthy and profitable so that it does not have to, or does not feel the pressure to, accept the alternative, which is normally merging with or being acquired by another institution that is offering you something pretty positive in return (their cash or their stock). However, in today's evolving environment, we are encouraging boards to also focus on maintaining relevance if that is not a key part of the organization's strategy. Unlike the principle of enhancing shareholder value, where the alternative may be a merger or sale, the alternative to maintaining your relevance may not be to merely accept a cashout offer, but rather, the alternative of obsolescence, where no one wants what you have to offer. From the Board Chair's standpoint, therefore, if you are doing all of the things to create and enhance shareholder value and drive the profitability of your organization (which still remains job one), then take the next step toward cultivating relevance for your organization so that your strategy of maintaining long-term independence does not also put you on an island with only a small core group of loyal customers and stockholders, where the organization's obsolescence will be evidenced as those groups die off or cease to do business with the organization. We will explore in future newsletters ways to cultivate relevance for your organization, including focuses on your customers, technology and other key factors.

How Important is Location?

In case any of you are wondering, most of our community bank clients are still discussing ways to grow and expand their banks and continue to discuss that in traditional ways such as creating new branches. They may not look like branches of the past, and we might be much more strategic about their size and physical location and staffing issues, but branches nonetheless are still important to most community banks, and we think rightfully so.

Interestingly, if you look at surveys conducted of why customers do business with a particular financial institution, you will still find that for all of the discussion of technology and digital uses, that customers still point to physical location, physical convenience and the like in selecting a financial services provider. The old saying that a customer chooses a bank because it is "on the way home" still applies to some extent. However, we need to constantly be challenging our thoughts about how and where to locate our branches.

At a recent strategic planning session we were conducting, the discussion of future growth and branch development was robustly debated by the Board and management. While there was unanimous agreement that the organization needed to expand its footprint geography-wise, the discussion turned to a recognition that the scope of the geography that we can cover with our locations may no longer be limited to physical geography. How widely can you reach customers through your mobile app? Does your online platform allow for lending relationships to be developed across the U.S.? As you consider those types of questions it becomes obvious that typical "geography" for branch locations is no longer limited by physical distance. The result is a recognition by organizations that the best location it may can select for its next branch would be to simply "put a branch in every single person's pocket." In essence, this bank took the approach to modify the Capital One question of "What's in your wallet?" Their question was "What's in your pocket?" The answer? Our branch is in your pocket through our mobile app.

So, as we position our organizations for the future (with an eye toward maintaining relevance), rather than us trying to figure out where the greatest number of potential customers will be and then trying to build a physical branch there, let's also consider simply putting a branch in everyone's pocket and taking the branch services to the customer in a mobile and personal way rather than hoping they merely drive by our new location, notwithstanding its beautiful time and temperature sign.

The "Pink Sheets" and Shareholder Liquidity

What is shareholder liquidity? Simply stated, it is the ability to provide cash to a shareholder anytime the shareholder has a need or desire for cash. It is being able to instantly convert share ownership into cash. For the largest organizations with thousands or tens of thousands of shareholders, that liquidity need is most easily met by the organization being listed on a large national stock exchange like the New York Stock Exchange or NASDAQ. But what's the benefit of having your shares listed and traded on an exchange if you are a smaller organization? Does it really create liquidity?

Candidly, we find that for practically any of our clients that are $3 billion or less, and probably all of those with less than 5,000 shareholders, even if their stock is listed and traded on an exchange, there is little, if any, true liquidity. This lack of liquidity is evident because there are many days, if not most every day, when there is little to no trading at all in the stock, notwithstanding that it is "listed" on an exchange. In essence, those organizations have no more liquidity than does a smaller bank holding company that simply agrees to buy back shares from shareholders at a negotiated price anytime the shareholder desires.

This disconnect between having a security listed on an exchange and true liquidity has come to light recently for those listed on the "Pink Sheets" where there has been an attempt to have those organizations pay a fee to continue to be listed. Apparently, the "scare tactic" being employed by the OTC is to send a letter to these organizations indicating that if a company does not pay the fee, then their stock *may* no longer be listed on the Pink Sheets. For community financial institutions, most every organization that is listed on the Pink Sheets did not voluntarily choose to be on the Pink Sheets, but simply had a broker list their securities since the Pink Sheets is nothing more than an inter-broker quotation system. The counsel we have provided to most of our clients facing this situation and receiving that letter is simply not to pay the fee and not to worry that their shares may be "delisted." Liquidity is not created by merely being on an exchange, but by having a ready, willing buyer for a ready, willing seller. An organization structured properly, where its holding company acquires shares as shareholders desire to sell them, creates enough of its own liquidity that being removed from an inter-broker exchange should not be a concern. The alternative of focusing on creating your own liquidity rather than using the somewhat "false market" of the Pink Sheets is likely better for your organization and refocuses the organization on appropriate stock repurchase planning, stock repurchase programs, maintenance of appropriate capital and other value-enhancing techniques. If you are running into that situation and have questions, please let us know. But, continue to look for ways to provide liquidity as a core fundamental shareholder need.

Meeting Adjourned

We look forward to seeing many of you in some of the Fall conferences around the country where we will be speaking and in the many Fall strategic planning sessions we have scheduled. At the conferences, please do not hesitate to come up and speak directly with us at any time, as we love to meet our readers and hear their stories. Keep up the good work you are all doing through these hot Summer months and we will all look forward to a cooler Fall. Here's to hoping you all stay independent and stay relevant!

Until next time,

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