The

# Chairman's Forum

Opening the door to new ideas

Newsletter

**_Gerrish Smith Tuck, Consultants and Attorneys_**

_February 2019_

All board members should be involved in strategic planning and strategic thinking. However, it is not uncommon for directors to see that as management's job or someone else's job. Therefore, it may often fall to the Chairman of the Board to be the primary strategic thinker for the organization, to raise alternative points of view and to focus the board and management to think in new and different ways.

In this month's edition of *The Chairman's Forum Newsletter*, we take a look at some scenarios that bring about the strategic thinking of the Chairman and raise some new or different concepts for you to consider and decide whether those could be beneficial for your organization. As Chairman, don't be afraid to challenge conventional wisdom or to challenge the way your board has always thought about things. Even if that leads to a discussion reaffirming the way things are done, that is better than simply being in a rut of doing them because you always have. We hope the materials in this newsletter will allow you to think about things in some unique ways.

Happy Reading!

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## Chairman's Summary

- A shocking "new" revelation.
- How do you balance older versus younger directors?
- Do you prefer chess or checkers?
- What if directors did not own stock?
- How much capital is appropriate?

## A Shocking "New" Revelation

There is a large national conference held every year that recently concluded that we know many of you may have attended. Among other things, the conference purports to enlighten community banks on the current M&A market and various developments. A recent news article was describing somewhat of a "new revelation" articulated at the acquire or be acquired conference (often designated AOBA) which indicated, shockingly, that small banks can win more deals by evaluating them differently. The article went on to talk about how small banks should focus on the earnings performance of a target and not tangible book value. The article also went on to talk about the Small Bank Holding Company Policy Statement change and how regulators don't look at a holding company's consolidated leverage ratio and the ability to use debt to fund acquisitions. Additionally, the importance of social issues for small bank deals was touted.

All of these areas are very well known to community banks and are issues our firm has been espousing for 30 years. It's nice to finally see these big bank conferences stumble into what they think are new areas of focus for smaller banks, especially when the conference often seems primarily geared not toward maintaining independence, but on ways that small banks can sell themselves or ways that big banks can buy smaller banks. Perhaps rather than being labeled AOBA, it should more appropriately be labeled SOBS (sell or be sold). As one of our clients who attended the conference told us, "There sure was a lot of 'gloom and doom' for small banks and while it wasn't all bad, you certainly had to sift through the bias against small banks to find anything relevant". As Chairman, think strategically on your own. Don't listen to the large investment banking firms who, for example, would purport to give a small Midwestern bank their strategic options. Those options normally lead to only one result, a sale. As Chairman, keep your directors focused on the bigger picture, you can and will survive and thrive!

## ***How Do You Balance Differences in Directors?***

How different are your directors? In particular, how different are they age-wise, technology-wise or in other facets? Do you find that makes your job of managing them a bit more difficult? We recently encountered a situation that pointed this out where a board was trying to decide, in light of some of the bad weather we have been seeing across the country, whether to cancel or postpone a board meeting scheduled for the next day because of the likelihood of snow, difficult travel, etc. First, a director responded that it was really going to be difficult to know and that everyone would just have to "wait and see what the morning brings". Alternatively, one of the younger directors responded that he was looking at the weather app on his smart phone and could tell that the snow would stop by 3:00 a.m., the temperatures would warm to substantially above freezing by 7:00 a.m. and, therefore, the roads would be clear by 8:30 a.m. So, everyone would easily be able to make it in and he looked forward to the meeting. A bit of an old school versus new school approach. When the morning rolled around, the older director sent a follow up indicating that he had walked out to the end of his drive and the newspaper had been delivered. So, therefore, the roads must be fairly passable and he was probably going to make it to the meeting. Again, one of the younger directors, intentionally kind of poking fun in a good natured way at the older director, commented that he didn't know that newspapers actually still came in a paper format and were actually still delivered to your house. He mentioned that he thought the newspaper was only available in an on-line electronic version. He jokingly asked the director if he also was still having milk delivered to his front door.

What this humorous situation points out is probably reflective of many of your organizations as well. Community banks often have Boards of Directors that span generations, there are deep divides on the desire and ability for technological uses and other key differences. Your job as Chairman is to strike an appropriate balance between those and while it may point out the need not to have a board filled with entirely old people, it also points out the fallacy of kicking all the old board members off, because we wonder what the younger director would do when the snow and ice cause power outages that cut off Internet access! There's probably a benefit to all forms of information and all types of directors!

## ***Do You Prefer Chess or Checkers?***

Let us give you an interesting question to think about as Chairman that can be applied to a number of different situations. Is your bank playing chess or is your bank playing checkers? Arguably, they are both games of strategy and require strategic moves, anticipating what your opponent is going to be doing and looking for opportunities to make big moves and big plays when possible. But what is the primary distinction between the two games? The answer is in the moves that the various pieces can make. In checkers, each piece is restricted to making the exact same moves as every other piece. All the pieces look alike and act alike. However, in chess, there are multiple different types of pieces, each of which has its own unique moves. Therefore, there are a wider array of strategies needed for chess, more complication in the moves, but also the ability to move multiple pieces around the board, take advantage of multiple situations, etc. In checkers, it's pretty straightforward and plotting one or two moves at a time.

Compare that to your organization, for example, as it relates to technology. Is your bank structure more like a checkers match, somewhat older, antiquated and you look across at your competition and, rather than the competition playing with the same pieces that can do the same moves as you, they have the latest technology, more infrastructure and are moving pieces at a much greater pace in different positions around the board. That can also be applied to how we look at products and services, how we look at our branches and even how we look at our Boards of Directors. Are our boards composed of checker pieces, all of which look alike and make the same moves, or are our boards composed of chess pieces that look different, act different, have different moves and, as a result, bring to the table a much more dynamic playing experience or, in your case, a much more active and engaged board? Perhaps a silly analogy, but think about that in terms of the benefits that it can bring. You don't want to continue to operate a checkers bank in a chess environment!

## ***What if Directors Did Not Own Stock?***

We often hear, and our firm has even touted, that it is beneficial for directors to have "skin in the game". By this, we typically mean that they should have some vested interest in the form of stock ownership. However, some recent circumstances where we have been involved present an opportunity to challenge that way of thinking. Certainly, some or all directors should generally have stock ownership, but we are seeing some cases where, because the board is aging and because they are fairly significant stockholders, they are unwilling to take the entrepreneurial and strategic steps necessary to modernize their organization, move it forward and face the coming challenges. That is primarily because they are comfortable with the amount of growth (no matter how small it is), they are used to the steady dividend and, at this point in the organizations' and their personal life cycles, they don't want to do anything too risky. We are seeing some of those banks fail to take advantage of growth opportunities where they exist.

So, ask yourself, could there be a benefit to having directors on your board who are not stockholders or at least not major stockholders? Would they think a little more entrepreneurial? Would they be more likely to take calculated risks? Even if your directors all own stock, which is very typical, perhaps as Chairmen, you should begin leading discussions on key areas by asking “What would you do or how would you decide this question if you didn’t own any stock at all”? A little outside the box thinking and looking at things from a different perspective may help open up new avenues for new initiatives.

## ***How Much Capital is Appropriate?***

This is another question that came out of our Chairman’s Forum conference in Naples in January. The general question was how much capital is the right amount of capital to have. Of course, there is no one size fits all answer to this and our general comment is that you need enough to keep the regulators happy based on your organization’s risk profile, but not so much that it is an impediment to stockholder value. These days, most community banks are finding that that range is probably somewhere in the 8% to 11% range.

Normally, the Chairman and the board are attuned to the ideas of making sure they have enough capital. But occasionally the Chairman may be required to challenge the board on whether or not the organization has “excess” capital. Certainly, we want enough capital to support safety and soundness and to be ready for any loan losses, but does having a tier 1 leverage ratio in the teens return true value to stockholders? If you are going to sell the bank, would a buyer pay you a premium for that excess capital? The answer to those questions is that neither one is generally true. So, consider what level of capital is appropriate for your organization, but avoid the temptation of stockpiling capital just to see how high you can stack it. Continue to increase and enhance stockholder value by deploying capital to smart uses.

## ***Meeting Adjourned***

The cold is still lingering in most of the country, but we hope in our home state of Tennessee we can at least provide a little warmth for those of you who will be attending the ICBA's Annual Convention in Nashville. Please take the opportunity to come speak to us individually and attend our sessions. We would love to speak with you and to hear your comments on our newsletters. Also, be on the lookout for next month's edition where we hope to be able to make some exciting announcements about future Chairman's Forum conferences.

Until next time,

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**HOW TO CONTACT US:**
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