THE

Board Chair Forum

Opening the door to new ideas

NEWSLETTER

Gerrish Smith Tuck, Consultants and Attorneys

May 2022

As you are reading this month's newsletter it should be the month of May for you. However, depending on your part of the country it may feel like the dog days of summer, it may feel like it is going to snow at any minute or it may feel like a crisp spring or fall morning. As we have been traveling these last few weeks, we have encountered a bit of everything. But we can assure you it is May and that means most are gearing up for the summer months and even thinking ahead to fall planning.

So, in this month's edition, we want to set your sights as directors or the board chair on ways to look at your organization a bit differently and to challenge you with some new thoughts and ideas. We also will do something a bit unusual for this newsletter which is to take a peek at some bank performance statistics to highlight some of the greater issues of how to ensure success for your organization going forward. We also touch briefly on the ongoing robust (though constantly changing) merger and acquisition market and raise some common questions your board should ask as it considers buying, selling or simply remaining independent.

We hope each of you find something useful that will spur your thoughts as we approach summer and, as always, if we can be of assistance to you, please do not hesitate to contact us.

Happy Reading!

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Board Chair's Summary

- ***Should the Board Chair Shake Things up on Purpose?***
- ***Know the Secret of Top Performing Banks***
- ***Should We Remain a Private Company or Become a Public Company?***
- ***How Do You Analyze the Current M&A Environment?***

Should the Board Chair Shake Things up on Purpose?

As the board chair, should you "shake things up" on purpose just for the purpose of doing so? If you did, would you be concerned that would make your board members feel uncomfortable? This thought occurs to us from a recent saying we saw which we thought was appropriate as it relates to board members in particular and banks in general going forward. The comment was that as we move into the future, you should "get comfortable with being uncomfortable".

Consider that statement for a moment. We believe that directors should strive to get comfortable in one sense, by understanding their roles to run a safe, sound, stable organization where you know your fiduciary duties and are comfortable exercising them. But, as the statement points out, the dynamics of the changing market where directors and the board chair are constantly being faced with new pressures and challenges, being uncomfortable may be the norm even as we strive for stability. Therefore, consider challenging your board as to whether they feel comfortable being uncomfortable.

As board chair, consider promoting “uncomfortableness” (if that is a term) as a strategy. Are we constantly challenging our board members to actually use the technology that our bank provides and promotes? How many of our directors are using the bank’s mobile app? How many of your directors know what a peer-to-peer payment transfer system is, and are they using something like Venmo or perhaps what the bank has on its own platform such as Zelle? Should you require every board member to make a least one money transfer using a peer-to-peer platform before the next meeting? We can already hear a number of your responses of “that will not work for my board - they do not even have smart phones and they would not know how to use them if they did”. If something like that is your answer, take a minute to ask yourself what that is telling you. If may not be a call to throw out your current board but it certainly may be a call to add a bit more technology or age diversity to your group.

Are directors comfortable in their positions as directors? Should they perhaps be a bit more uncomfortable knowing that there are some minimal expectations they need to meet before next year’s evaluation? Should you shake things up with a new approach toward strategic planning? We love when clients that we have done strategic planning for over a number of years challenge us to make the process new and fresh. Perhaps we schedule some breakout sessions, perhaps we take up entirely different kinds of topics, perhaps we bring in individuals with subject matter expertise to address the board, etc. A strategic planning approach that does not occasionally shake things up may itself become a problem of being too “comfortable”.

So, let’s consider occasionally shaking things up at least a little, (maybe order salads for everyone for lunch rather than the club sandwich!) and see if it promotes a better board in the long run.

Know the Secrets of Top Performing Banks

As mentioned in the cover letter, we are going to do something a bit different by giving you some bank stats. These were recently published as the key stats of the two-hundred top performing publicly traded community banks (defined as those with two billion dollars in assets or less). What we want to do is show you some commonalities that we think apply to privately held community banks as well. In fact, you may look at these stats and realize that privately held organizations probably are performing at an even better level than these organizations.

Consider these median financial metrics for the two-hundred top performing publicly traded banks with less than two billion in assets:

- Return on Average Assets - 1.19%.
- Return on Average Equity - 13.40%
- Net interest margin - 3.40%.
- Nonperforming assets to total assets - 0.33%
- Core deposits to total deposits - 86.72%

How does your organization stack up with those? Keep in mind, these were publicly traded organizations so their boards focus on meeting quarterly analyst estimates, have additional reporting burdens and costs, and the like. By being publicly traded they also may be subject to activist shareholders demanding even greater performance. So, without those pressures are you measuring up? In addition, we found it interesting that in discussing these banks the article seemed to hit on a "secret formula" for producing results that is shared by these banks. We think you will find this not so much of a secret at all, but here are the common factors of the best performing banks. Strong interest income (appropriate asset liability management), strong sources of fee income, sound underwriting and vibrant geographic market. So, the road to success is not necessarily paved with unique or risky products and services but apparently adherence to the core banking principles. What a relief!

In the Future Should We Remain a Private Company or Become a Public Company?

The section above talks about the performance of publicly traded banks. So, let's pause for a minute and ask the question of whether being publicly traded is better for a traditional community bank as opposed to remaining private. Our firm has always taken the position that there is nothing wrong with being a publicly traded organization as long as you have a strategic reason to do so and pursue public company status as a strategy that is in the best interest of your stockholders. But, historically we saw far too many organizations somewhat "accidentally" become public merely because their stockholder base had increased beyond the threshold or some broker listed the bank on the pink sheets and so the company then decided to go ahead and register their securities or perhaps even because some investment banker convinced the board that being "public" had more cache or made the bank have a greater value.

Here is our take on all of that. As mentioned above if you have a strategy for ultimately becoming public then pursue it. But for the overwhelming majority of most community banks there is absolutely no practical benefit or shareholder value benefit to being a public company. Rather, it increases your overall operational costs by being public, you begin to lose control of your stockholder base because you no longer know who all the owners are, and the idea that the public market creates "liquidity" because of all the trading volume you will now experience, rarely materializes. If you are a private company that utilizes your holding company periodically to buy back shares from stockholders you may find that shareholders have much more liquidity than an organization that is public but is very thinly traded. In fact, we have recently dealt with a number of circumstances where a board was frustrated that the trading price of their stock on whatever exchange that they may find themselves, is much lower than their appraised price or what the board thinks the stock is worth. The truth is that most smaller organizations, with a stockholder base of less than four or five thousand shareholders, typically has no trading volume or limited trading volume even if listed on an exchange. So, you get all the detriment of being on an exchange and losing control of your stockholder base without any of the upside benefit of true market liquidity.

If you find yourself caught in that situation, we would highly recommend you consider a "going private" transaction. We will not go into the details of that here but we have had the opportunity to assist a number of organizations with that and if you would like more information, please do not hesitate to contact us.

How Do You Analyze the Current M&A Environment?

As you might suspect, we are continuing to represent a number of buyers and sellers in all parts of the country as the current M&A cycle continues. In addition, we are increasingly speaking with boards of directors who are trying to address the core questions of should we buy another organization, should we consider a sale, or should we consider strategies that promote independence? In these circumstances, we have had the opportunity to work with banks to try to develop a set of core questions that are extremely fundamental. However, when given the time to explore the implications of each question in detail and arrive at an answer to each, the process helps the organization better define what its long term strategy ought to be. Accordingly, we thought it might be helpful for us to outline a few of these questions here (but of course we think you will find the questions much more beneficial if we discuss them with your board in person at a strategic planning session!). Consider these items:

1. Which primary decision (buying, selling or neither) best enhances shareholder value both currently and over the long-term period?
2. Which decision (buying, selling or neither) is in the best interest of our employees, customers and communities currently and over the long term?
3. On our current path, will we be able to maintain organizational relevance over the long term?
4. Are market conditions favorable for a potential acquisition or a potential sale or adverse to those strategies?
5. Are there pressures for growth and expansion into new markets or for greater economies of scale and are those pressures too great of a burden for us to manage the bank properly?
6. Do we need a greater investment in technology and, if so, is the amount of the investment that would be necessary to maintain relevance and viability more than we can afford or more than we are willing to invest currently?
7. Are there available targets or available buyers in the current market that would allow us to promote value to our shareholders by buying or selling?
8. If we are considering an acquisition or a sale, are there organizational structures or particular targeted parties that we would consider that we think both our board and our shareholders would approve?

There are probably thousands of other questions but we at least wanted to share some of these core ones with you. We hope they help clarify your approach on your future strategies.

Meeting Adjourned

Do not let the coming summer months and warm temperatures lull you into complacency. Let's get comfortable with being uncomfortable and continue to not make that a negative but a positive for our organizations. If we can help you in promoting any of these ideas or if you have questions, please do not hesitate to reach out to us. We look forward to hearing from you soon.

Until next time,

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