THE
Board Chair Forum
Opening the door to new ideas

Gerrish Smith Tuck, Consultants and Attorneys
July 2023

As we continue to be in the midst of a heavy strategic planning season, both now and through the end of the year, we take a look at a number of topics that have been raised during some of those sessions. Is making a decision to continue your current strategies actually a strategic decision? Could you actually hold an entire strategic planning session and come away from it with the idea that you do not need to change anything that you are doing and that everything is okay? It may be that part of the strategic planning process is around deciding timing to engage in certain strategic activities, not so much deciding whether you should undertake them. So, we take a look at some of those unusual circumstances, and even take a look at other unique strategic planning decisions for your organization.

We also look at the process of further engaging your Directors and how you get the performance out of them that you would like. Do you set a list of Director requirements, do you simply come up with expectations or do you do a formal evaluation process? We give some ideas in that regard.

Finally, we look at perhaps how to handle activist shareholders. Do you think you would be better off fighting or would you be better off reaching some kind of agreement? Both options can prove beneficial and we give you some thoughts around those.

We hope your summer is going well and look forward to being in touch soon.

Happy Reading!

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Board Chair's Summary

- ***Making a Decision, and Then Waiting***
- ***Other Unique Strategic Decisions***
- ***Director Requirements or Director Expectations?***
- ***To Fight or Not Fight?***

Making a Decision, and Then Waiting

As Board Chair, your role revolves around trying to lead your organization through various big-picture strategic decisions, keeping the organization on course, and overseeing the overall management of the organization. As part of that process, the ultimate strategic question is whether an organization is going to consider a potential sale at any given time or simply desires to maintain its independence and day in and day out do the things necessary to preserve independence. Normally, that seems like a pretty black and white choice. Either you are going to sell and start the process, or you are going to stay independent and keep doing the things necessary to stay independent as part of your current strategy. However, consider the decision made by one recent board that proves there is something in between.

This particular organization is a healthy organization without any current regulatory problems, but it does have some of the standard operating difficulties of a community bank in that there is not a ton of management succession, the board is aging and they have not ever really taken steps to formalize board succession, and they have an aging shareholder base that, as shareholders have begun to pass away more frequently, the stock of the organization is passed down to children who no longer live in the area or have any connection to the organization, and they are often confronted with that family's desire for some immediate cash liquidity.

On behalf of this organization, we conducted a detailed study and analysis to help them determine if a potential sale of the organization as a current strategy would maximize stakeholder value and be the best decision the board could make. As you might suspect, going into the process, the board was a bit split, with some wanting to try to do everything they could to preserve independence, and others saying they had a fiduciary and business obligation to pursue a transaction. Ultimately, the board reached an interesting conclusion. The board determined that, as a long-term strategy, remaining independent for the next 20 years was really just not in their cards since they were already a bit behind on technology, and for the difficulties cited above. Honestly, this board also had concerns that, while they were a healthy organization now, mounting regulatory pressure in new and emerging areas would be a hinderance to their continued growth and prosperity. So, the Board of Directors made the decision that the organization needed to pursue a sale. The interesting part, though, was that the board also decided that now was not the time to initiate that process. In essence, it was an absolute decision to pursue a sale, but subject to the timing being "right".

Of course, a cynical person might suggest that some board members will never think it is the right time and therefore they will not be able to get a majority of the board, so this may never come to pass. But we believe this board might surprise us because they genuinely seem interested in a potential sale, but they want to make sure that the market is a bit more stable, they want to sell at a point of strength, and they probably also need to clean up a few items to shore up some succession and the like so that if and when they do get to the point of selling, it does not appear as though it is a "have to" situation, even though they have made the decision that they need to.

So, as you consider the strategic alternatives of remaining independent versus pursuing a sale, this was certainly an interesting dynamic to decide that a sale does need to happen in the near future (probably the next three years), but that right now they should not initiate that process. Therefore, we suggested that they revisit the idea at least quarterly and continue to ask "Is now the right time". That may be good advice for your organization as well.

Other Unique Strategic Decisions

As noted above, a decision to pursue a sale may be more than just a one-time strategic decision; it may be a timing and environmental decision based on the circumstances that your community bank is facing. Similarly, an interesting dynamic we are seeing in the current market environment is that we are meeting with a lot of organizations to discuss detailed strategic plans, but sometimes what comes out of those discussions is a decision to basically "keep doing what we are doing". So, is "standing still" a strategy? In our opinion, it is, and oftentimes it might be the right strategy given the circumstances, even though it is appropriate not to assume it is the right strategy, but to conduct a strategic planning session.

Far too often, we facilitate strategic planning sessions for organizations that believe something new, different, or earth-shattering has to come out of the session. But for every organization, changing things up every single planning session is not necessarily the right course of action. So, if you do the analysis and you are honest in your strategic planning approach and you have an open discussion of all issues, but what comes out of that discussion is a recognition that you are on the right path, that you are making progress, that you are meeting your organizational objectives, whatever those might be, then the ultimate strategy to keep pursuing what you are pursuing is absolutely the correct decision. It should not be viewed as a fault or as an embarrassment to conduct strategic planning where the result is a decision to stay the course. But that decision should only be made after a thorough process.

Director Requirements or Director Expectations?

We often get asked what the typical requirements are to serve as a bank director. Based on our travels around the country, we are tempted to say the requirements are occasional breathing, being half awake, and new hearing aids! In reality, there are very few actual director requirements. Historically, some statutory provisions required directors to also be shareholders, but that has even gone by the wayside in most places. Some of our clients have historically written in their own requirements to be a director, such as living in the community, having a loan or deposit relationship with the bank, or something like that. More recently, some organizations have imposed mandatory board education requirements.

What we think often works much better than trying to outline actual requirements for directors (because then there are normally exceptions and excuses, etc.) is to rather set forth a detailed list of director expectations. These are not mandated, but they are the elements outlined that make for the very best directors. That might very well include an expectation of continuing education for the director, it might very well include stock ownership, having a loan or deposit relationship with the bank, and some of the other traditional items. It is just that we do not actually mandate those, which might limit the pool of potential candidates.

Along those lines, some of the old notions of who is an effective director may need to be updated. If a director who has served on the board for 30 years is finally to the point of retiring and that director also happens to be a large shareholder and wants his daughter to serve on the board because she has a Masters degree in finance and would bring great skills to the organization, does it matter if the daughter lives out of state and can only participate in half of the meetings in person, but the other half would be via Zoom? In the same way your management team is having to rethink employment roles and duties, and occasionally allow people more flex time or remote working, it may be time for us to rethink that at the board level as well. We certainly need engaged directors, but being engaged may no longer equate to living in town.

So think about outlining a list of expectations, which are the objectives you would like for board members to achieve, because there are things that define what a good board member is for your organization, but using them as limiting characteristics that might limit the pool of available candidates might be hurting you more than helping you.

To Fight or Not Fight?

As the Board Chair, and as a Board of Directors in general, one of your key fiduciary obligations is to run the organization in a manner which creates greater value for your shareholders. In addition, we have spent quite a bit of ink over the years in this newsletter talking about those fiduciary duties and ways in which you can exercise your fiduciary duties to create more shareholder value and otherwise protect yourself from legal liability, as well as from shareholders simply being disgruntled with the way the organization is being managed. But, what do you do if you find yourself in a situation where one or more shareholders are not happy with the direction the Board is taking the organization? Do you automatically do anything that a shareholder asks you to do, do you automatically argue with any shareholder that they do not know what they are talking about and that the Board will do whatever it wants? In short, do you fight and stand up for what you are doing or do you try to appease the shareholder?

As lawyers, perhaps our initial knee jerk reaction to any confrontation between a disgruntled shareholder and the Board would be for the Board to simply fight to the death and come out as the "winner". As you might imagine, though, we take a bit more of a reasoned (and hopefully rational) approach. If you are confronted with that kind of situation, you might take the opportunity to look at some of the public companies who encounter those kinds of issues with an activist shareholder or disgruntled shareholder and look at how that normally plays out. Candidly, the way it normally unfolds is with some activist shareholder claiming that the Board is not doing its job, that the organization is underperforming and, therefore, the activist shareholder is pushing for the organization to either pursue a sale where the shareholder can get more money, or the shareholder wants to put its own representatives on the Board of Directors to protect its interest and, therefore, drive the organization in the direction the shareholder wants it to go (most commonly a sale) or take some other action.

Normally, the Board Chair leads the organization in putting up a vigorous defense that, of course, includes hiring lawyers and consultants (we have a good recommendation in mind if you want to do that), perhaps initiating litigation against the shareholder, putting up borders around the Board of Directors to prevent anyone else from getting in, amending the articles or bylaws to stop any activity they now find is inappropriate from the shareholder and maybe even waging a proxy battle against the activist shareholder for control of the Board of Directors. Let us suggest that the one guaranteed result from doing all of that is a decrease in profitability from all of the money you will spend on the advisors and lawyers. Again, though, if you like that strategy, please call us.

We are not suggesting that is necessarily the wrong strategy. We have been involved in plenty of situations where the right thing for the Board to do was to simply tell its story publicly, and aggressively pursue the accumulation of proxies in order to vote against any proposal or recommendation from the outside shareholder who only had his or her personal interest in mind and not the best interest of the organization. But, occasionally a big dose of practical reality can help the Board of Directors, preserve earnings and often teach the activist person or group a thing or two.

Consider, for example, if a shareholder or shareholder group owning 1% of the outstanding shares begins making demands on the Board of Directors to change the composition of the Board, change its strategic posture to pursue a sale or something else. Is there really even a major battle to fight here? Why not simply thank the shareholder for their concerns, indicate what you are doing that you think is in the shareholders' and the organization's best interests and move on. Can a 1% shareholder really influence the vote at a shareholders meeting? Probably not. What if a larger shareholder who does not have enough shares to really control the votes of the organization, but does have enough shares to perhaps change some of the composition of the Board of Directors, demands a seat on the Board or demands that their representative be placed on the Board? That is normally where the Board gets nervous and begins to fight but, what harm is there in adding an additional Board member if they are truly qualified to serve on the Board? Every single time a vote comes up, if the individual opposes what the rest of the Board wants, then the new Director simply loses that vote and a majority of the Board controls. We do not have to have unanimous votes to conduct our activity, so you save yourself a lot of time and effort by allowing the person to be added to the Board, yet marginalizing their importance and significance or influence.

If you are a publicly-reporting company, this becomes a bit of a more public battle and some interesting headlines point this out. One well-known activist shareholder group recently bought a fairly large block (about 9%) of an organization in the northeastern part of the country. In its filings, the group specifically stated that the purpose of its common stock purchase was to profit from the appreciation in the market value of the shares by asserting shareholder rights. To us, that is a fancy way of saying because we are an activist group and everybody knows it, we are going to acquire stock, which is going to make everyone else think that we are going to push for a sale, that will drive the value of the publicly-traded shares up on the speculation of an impending sale and then the organization will either sell or the activist group will then dump its stock at a profit once the price floats up high enough. At least they are honest about what they want to do. So, we agree that the organization should be focused on shareholder value, but in the current environment, that board should also be focused on stakeholder value which includes the impact of value on customers, employees and our communities.

So, if your Board is keeping all of those things in mind, you are able to defend against any unwarranted attack, and fighting back might certainly be appropriate. If, however, circumstances warrant it, you might also be well-served to simply find common ground, add a new Board member or take other action that does not materially disrupt the organization and can actually demonstrate to the new party the effort that is being undertaken to promote value for the organization as a whole.

Meeting Adjourned

The calendar continues to fly by and it is hard to believe we are already into August. Our late summer, fall and winter calendars are already pretty full with strategic planning sessions across the country and with the completion of numerous transactions with which we are involved. As a result, we continue to see lots of activities for financial institutions into next year, notwithstanding perhaps increasing regulatory headwinds. So, keep working hard and keep letting us know how we can help.

Until next time,

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