Choosing Change

Many more capital options are available today than even five years ago

I have had the good fortune of meeting many ICBA member banks and their management teams over the past several months. One theme that I continue to hear from these bankers is their struggle with what to do next.

Among other things, bankers are contemplating major decisions, from taking their bank private to electing Subchapter S corporation status to going public and raising or lowering their capital base. Working through these decisions can be a great opportunity for a management team and a board of directors to hone the bank’s strategic plan and set its direction for the coming years.

The current environment has forced many community banks to analyze their strategic plan. Years ago many banks passed the threshold for being an SEC reporting company and accepted this as part of the company’s natural progression. But with the onset of the complex corporate governance requirements brought by the Sarbanes-Oxley Act, casual decisions about becoming publicly traded have disappeared. Given the cost and time related to today’s compliance for publicly trade companies, community banks must deliberately chose whether they want to be a public company or not.

Many community banks that seek to reduce their shareholder base are weighing the impact of a tender offer or are contemplating an S corporation conversion. Others, despite the costly regulatory environment, are eyeing the public market and weighing the positives of having access to capital and liquidity for shareholders. On top of all this, continued competitive and margin pressures are adding to the equation of community bankers thinking harder about their options.

New Capital Tools

What CEOs of community banks need to understand is that they have significantly more capital tools at
their disposal than they did even five years ago. Understanding what these tools are and how to effectively use them can alleviate much of the stress when faced with these strategic decisions.

Historically, one of the advantages large national banks had on community banks was access to capital and innovative structures that they could change to drive returns. Until recently, banks under $250 million in total assets had a difficult time issuing trust preferred securities. The pools that are now available to these community banks to issue trust preferreds have had a dramatic impact on their profitability.

The market for private equity has matured over the last five years as well. We see many funds created for the sole purpose of investing in privately held community banks. Now banks that need equity capital for continued growth have another option besides the public market. Private capital gives a bank the flexibility to decide when it wants to go public as opposed to when the capital needs dictate taking the IPO route.

Community banks now also have access to capital hybrids such as subordinated debt and convertible preferred stock. Having many options is a great opportunity but can be overwhelming nonetheless. Picture a kid staring at a wall of candy knowing he can only choose one.

**Get Focused, Move Forward**

Community bank CEOs are not expected to understand all of the capital market options available in the capital markets. That is
why finding the right adviser, who can lay out multiple options and then help debate the benefits and drawbacks of each, allows for better decisions. A right adviser can help narrow the range of options as well and model out what each scenario would mean to the bank over the long term. An adviser should be able to listen to a management team or board of directors’ vision and tailor a plan the company can execute effectively.

Once a decision is made, communicating the vision to the employees and shareholders is critical. One trait that high-performing community banks display is a singular message. From frontline tellers to high level executives, all employees of these companies understand the organization’s goals and what their individual role is in achieving those goals.

Today many community banks are making very different strategic capital market decisions. Whatever strategic path a particular bank chooses, its management leaders must understand all their capital options before they can make decisions that will benefit shareholders in the long term. These decisions can help increase return on equity, a key component to building shareholder value and keeping community banks independent and prospering.

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