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FEATURE STORY

Take These Essential Steps to Establish an Effective Shareholder Strategy for Your Privately Held Bank

By Edward E. Schmidt

The financial health and future independence of your bank rests heavily on the ability to expand its shareholder base by attracting new investors and communicating consistent, increased value to existing shareholders over time.

Many institutions spend considerable time trying to establish a shareholder strategy that addresses both the short-term need for capital and new growth in addition to longer term needs such as addressing shareholder succession. However, the banks which succeed in managing their shareholder base effectively tend to have a commonality in using the following steps to establish and maintain their strategic shareholder program:

Step 1: Commit to exercising strong corporate governance over the growth and management of the shareholder base. Effective board-level management is necessary to meet the challenges of a changing business, regulatory, and economic landscape. In addition, the Board of Directors must be engaged in the oversight of the bank's operations in order to ensure increasing value to shareholders and ability to meet shareholder succession challenges.

Shareholder succession strategies for today's community bank investor is focused on liquidity and dividend strategy. Liquidity is driven by continual invitation to new investors while a dividend strategy is board level discussion and implementation of cash/stock dividends and frequency focusing on a minimum three year plan.

Increasing shareholder value is driven most often by an institution's ability to position itself to take advantage of market opportunities. Periodic updates to governance structures will keep your institution competitive in this capacity. Moreover, corporate governance is the practice through which all other elements of the bank's shareholder strategy are driven.

Step 2: Obtain and communicate regular and accurate stock valuations. There are three key factors underlying bank stock valuations – financial performance, risk, and growth. It is important for bank leadership to have a firm understanding of how these factors influence bank stock valuation. For example, when it comes to financial performance, "book value" is the key stock valuation benchmark for community banks.

In terms of growth, investors appreciate increased earnings and cash returns such as dividends or share repurchases. In order to provide these, a sustainable base of strong earnings is necessary. Since banks derive most of their revenues from interest spreads, it makes sense that bank investors focus on net income and earnings per share.

Most investors understand that there is some tradeoff between earnings today and investing for higher earnings in the future. While some near-term pressure on earnings from an expansion strategy is acceptable, strategic investments should not continually be used to explain below average profitability.

Risk management is an overarching responsibility of bank management and the board of directors. It is also crucial for long-term shareholder returns. Credit, liquidity, interest, and operational risk must be managed in order to provide investors with the highest return for the least amount of risk. An important observation is that in the minds of investors, banks with the lower risk profile would be worthy of a higher price/earnings multiple than those with more risk.

Step 3: Provide opportunities for shareholders to reinvest in your bank. An integral part of building long-term shareholder relationships that yield ongoing investments in your bank is to offer existing and new shareholders a straightforward path for additional investing and reinvesting in your bank stock. These plans in themselves become a strong liquidity component. Three key strategies for accomplishing this goal are:

a) Individual Retirement Accounts ("IRA") which can be positioned for the purchase of your community bank/ bank holding company stock. This option can increase your stock liquidity, the ability to address large block sales, and provide a funding source in support of capital offerings.

b) Dividend Reinvestment Plans (DRIPS) allow shareholders to reinvest their cash dividends for the purchase of additional shares in your bank. These shares are often purchased directly from the bank; therefore, they are acquired without any transactional fees, further increasing one's ownership. With a properly constructed DRIP cycle, dividend dollars go back into your bank's equity account.

c) Retirement/Ownership Plans can be developed through implementation of Employee Stock Ownership Plan (ESOP)(KSOP) and various iterations of employee compensation plans. Rewarding performance with ownership is a proven process of elevating company performance and shareholder return.

Conclusion

While the application of the above steps are generally universal to the majority of privately-held banks, it is important to understand the unique influences on your particular institution. Tapping into the expertise and experience of an objective third-party in the development of shareholder strategies and the implementation of supporting programs can help your bank establish a strong shareholder base now and facilitate its ongoing growth to ensure the future financial health and independence of your bank in the years ahead.

About the Author

CAMELS Consulting Group, LLC ("CAMELS") formed to support expansion of shareholder wealth. Mr. Schmidt, founder has worked for 40 years within the banking and securities sector holding director and executive positions.

Mr. Schmidt is recognized for his work in the community bank sector providing strategic planning, providing 'fairness opinions' and related bank valuation analysis, and has offered expert opinions in investment banking and shareholder related transactions. The firm's products; Stock Navigation Program; CAMELS Financial Optics Report (CFO), CAMELS Investor Focus (CIF), and CAMELS Valuation Reports (CVR), specifically designed for the community bank sector.

Mr. Schmidt is a doctoral candidate in Business Management; holds a graduate level degree in Commercial Banking from the Pacific Coast Banking School, Graduate School of Business, University of Washington and a Bachelor of Science in Business Administration.