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## YOUR COMMUNITY'S STAKE WHEN THE LOCAL BANK SELLS

Story of a choice that may be reenacted many places before long. Is it healthy?

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My blogging colleague Jeff Gerrish has been writing a series dealing with community bank M&A, now in its fourth installment. Quite coincidentally--but hardly unrelated in topicality--I had cause to see M&A from a community stakeholder's perspective. This brought up issues in my mind that community bankers ought to be thinking hard and long about. --Ed O'Leary

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The other day I learned the melancholy news that a long-lived bank I once knew well will be acquired by a bank holding company headquartered in El Paso during the first half of 2013.

A small group of investors accomplished a buyout a few years back, obtaining it from the ownership family that had controlled First National for many years. Everyone expected that this would preserve the bank as an independent entity for many years into the future.

The recession of the last few years probably undid the strategy.

When community, bank strategy, and regulatory fiat collide

The bank had a concentration in commercial real estate credit and examiners with their "one size fits all" mentality likely demanded a strategic course correction. I think it is instructive to consider that in communities like this bank's and many, many others like it around the U.S.A., the principal credit need is for real estate infrastructure.

To me and perhaps to some others, redirecting strategy in this way amounts to the allocation of a community's credit resources by the government. Over a great many years, the bank, in responding to the legitimate needs of its community, had created a strong market niche that it is now being forced to undo.

The bank is profitable and has consistently been so throughout the recession.

It seems, though, that the stockholders, those to whom the community had looked to maintain the bank as an independent presence, were forced to reconsider their options under the pressures of regulatory fiat and a concern with the longer-term prospects of an adequate Return on Equity.

The stockholders will be fine one way or another. But the community is likely the ultimate loser.

A lesson about ownership

The prospective new owners have promised that the bank will maintain its unique identity and that management and staff will continue in their current positions. I'm sure that these are sincere and truthful statements by the acquiror but something is being lost.

The city's borrowers, those entrepreneurs who have built this city, are losing a sure and reliable friend. This isn't to say that the city itself will disappear in a cloud of dust or suffer a major economic decline but it does tell me that a sympathetic and local voice within the business community will be muted.

There will be consequences over time. And those of us who value local autonomy and local influence over the economic futures of small to medium sized MSAs nationally are surely saddened at this news and similar stories occurring in dozens of American communities.

One lesson that this story teaches me is that it's not enough to have an independent group of shareholders. A stockholder with an asset in one state but living in another, far away, can hardly be expected to have a local orientation and affinity to an old hometown bank's business proposition.

Instead, the analysis revolves around the numbers and increasingly the controlling metric is Return on Equity.

If my principal concern is simply ROE as a stockholder, then that's a rational and consistent way to evaluate my investments. I don't need to be concerned about the local community and the local businesses. I am loyal to the discipline of maximizing my economic return.

But if I participate in the community's economic activity as well as live and raise my family there, ROE isn't necessarily the controlling metric and in fact, under those circumstances, it seldom is.

Will Pac Man vote your bank's shares?

I think what's missing in the national conversations we're having in recent years about community bank independence is who votes the proxies for the community.

We can all count, but are we counting the right things?

Do our criteria as concerned citizens trump the highest return of the shareholders?

The answer to that in a capitalistic environment is that it probably does not. The investors have the right to an honest and competitive return and consistent with law, they may do as they wish.

The real issue seems to be one of how do we get adequate representation of the interests of the community into the decisions of whether smaller banks should be permitted to survive.

For the last several decades, we seem to have been implementing a Pac man strategy. The small are gobbled up by the

larger and the process has its own inertia and logic.

The issue to me is whether it's the best strategy.

Return on equity versus return on community

Are the communities ultimately better off to lose their local bank participants?

Are the stockholders well served when their interests are viewed over a complete business cycle?

I wonder how BofA's shareholders, for example, those whose current holdings represent the rollup of many smaller predecessor companies since Glass-Steagall was repealed, feel their interests have been served.

And what of the communities whose borrowers now deal with their banks in less personal ways in the granting of credit-- those businesses whose credit applications are credit scored in loan centers hundreds of miles away? And where personal contact with a live lender is the exception rather than the rule?

I mentioned Jeff Gerrish's series earlier. I hope everyone is reading his guidance on merger deliberations by community bank boards of directors who are confronted with these very literal corporate life or death issues of survival. Jeff points out the dangers and pitfalls to the directors' duties to the shareholders.

Unfortunately, the community is often underrepresented in these deliberations.

It's not that the local boards of directors are not local citizens; rather, they seem focused on the numbers. Unfortunately, the numbers may not capture or reveal an adequate story of what's at stake. Yet, as Jeff explains in this week's installment, boards have less running room when the price is right, even if their feelings on nonmonetary factors might make them feel otherwise.

Something to think hard about

Often, a blogger's stock in trade is supposed to be glib solutions to the issues they write about.

I have no answers to this somber question as we close out this calendar year.

I know that the pressures to consolidate among smaller banks are as strong as ever and that the economic pressures are real and proximate.

I just hope that community bankers can figure out how to change the dynamic of the consolidation discussions so that the community gets a fair hearing and the analysis isn't driven by the sharp pencils that all too often seem to rip the paper.

What we really need to do as community bankers is to make the business case for the local, independent bank. Unfortunately, this case is seems most often made after the local bank is gone--rolled up into a faceless presence many miles away.

There's a real story to tell here and it's our job to tell it.

Perhaps we can rewrite the end of the story.

We should certainly try.

About Ed O'Leary

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

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