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‘Home Alone II’ - Exploring Strategic Alternatives (or lack thereof)

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With historic rate changes and new accounting rules, not to mention inflation, and with caution as the watchword in the financial services industry, bank M&A activity is “cautious” at best in the current environment. Institutions and their boards seeking strategic combinations today are often faced with few, if any, near-term alternatives, and must be prepared to face the reality that they may need to buckle in for a long ride and examine and implement measures to improve the operations and survivability, even if on an interim basis, while waiting for an appropriate partner. The “Home Alone” ongoing independence option, whether the result of strategic analysis and affirmative decision-making and policy, or whether simply the result of a lack of alternatives, is a very real scenario for many institutions.

For institutions exploring the potential for a sale without the certainty (or perhaps even the likelihood) of an acquisition by a stronger institution, it is important to be prepared to implement measures necessary to tough it out and to survive independently, at least on an interim basis until a viable transaction environment emerges. This “Home Alone” scenario can be a challenging environment in light of current or likely near-term prospective shareholder and regulatory pressures, but a scenario that needs to be carefully considered and planned for in light of the alternatives (or perhaps lack thereof) and the reality of the present marketplace.

A “Home Alone” scenario, whether short or long-term, includes undertaking a comprehensive objective self-assessment process and the potential for implementing difficult strategies and decisions with regard to market and business contraction; staff, board, and management changes; asset sales and branch divestitures; and a plethora of other measures that may be required to survive without a viable takeout merger partner.

The record of board exploration of strategic options leading to adoption of those strategies must be carefully documented to evidence the board's due diligence (including use of experts), analysis, deliberations, and objective due consideration of the issues and alternatives at hand. In reality, this process or something similar should take place on a regular basis in order to provide the board with needed information in order to remain mindful of the best interests of the institution, which may change from time to time.

Coupling current bank stock pricing with continued economic and political uncertainty in the present environment, boards must carefully consider the "Home Alone" scenario, even if they intend to eventually combine with another institution. Potential buyers are cautious and skeptical, and in many instances have issues of their own to address before they are in a position to undertake a combination. Capital may be unavailable or too expensive, and available acquisition cash can be thin. As bankers know all too well, any problems experienced very publicly by the large institutions tend to have a "splash" effect on all institutions, irrespective of size, location, charter, or portfolio quality, that can adversely impact strategic alternatives and opportunities otherwise available in a "normal" banking industry market. So far things remain relatively stable in that respect, however given the changes presently occurring in the market that may not last for long.

Influencing Factors

The "Home Alone" scenario, even if temporary, includes consideration of a number of important factors including availability of additional capital (if necessary), potential market divestitures and/or asset sales, potential board and management changes, customer issues, shareholder concerns (including potential dividend reduction or elimination), potential debtholder issues (where applicable), personnel retention and morale issues, potential adjustment of compensation structures and incentives, perceived weakness by competitors and customers, and a plethora of other operating and strategic considerations.

Regulatory and shareholder pressures can be overwhelming. Those pressures alone have been known to influence institutions and their boards to lean toward a quick sale with pricing that may or may not reflect the potential enhanced long-term value that could have been otherwise obtained with patience and some interim institutional "repair work."

Personal issues and concerns can and often do become paramount in a challenging business environment. Care should be taken to avoid internal rifts between the board and management, and among board members. It is important to recognize that all are in the situation together, and to proceed as a cohesive unit if the strategy is to be successful. If changes in the board or management are to be considered, they should be addressed carefully and thoughtfully with recognition of potential shareholder, regulatory, and community impact and perception.

None of it is easy, and keeping an objective "eye on the ball" is a challenge in what tends to be a stressful and emotional time for the institution and all involved.

Examining Alternatives

As usual, there is no “once size fits all” and each institution must analyze its strategic alternatives in light of individual circumstances and long-term plans and objectives. In their fiduciary role, directors are required to consider alternatives facing the institution in light of the long term best interests of their constituencies and plan accordingly. The analysis can be difficult in a normal operating environment, and becomes even more complicated when facing the excruciating real world pressures of a challenging business environment. While a quick sale can take the focus off of operations and provide a distraction for shareholders and regulators, the price at the present time may not provide compensation that is equal to, or better than, that which could have been secured by remaining independent and accepting the time, expense, and potential uncertainty of the “Home Alone” scenario. In certain instances, there may be no viable partners and no alternative. Boards should secure a detailed analysis of the cost and risk from experienced and objective independent advisors, and document those actions and resulting recommendations carefully in light of the second-guessing that is virtually certain to occur.

In all instances, the use of experienced advisors and consultants, including financial analysts, investment bankers, and legal counsel, is critical to provide independent and objective advice necessary to examine the relative pros and cons, and to assist the board in its decision-making process. Boards should carefully and strategically document their efforts and their analysis to create an appropriate record of the exercise of their fiduciary duties, while at the same time considering the fact that the record may be subject to shareholder access and scrutiny.

Communication

The “Home Alone” scenario requires careful attention to communication with shareholders, regulators, employees, customers, and the community to avoid inadvertent and unfortunate misunderstandings that can have a devastating impact on the institution’s plans. “Reputation risk” is a significant concern, and can result in a self-fulfilling prophecy. The process requires a careful balancing of interests and strong credibility on the part of management and the board to create an environment of continued patience by a number of constituencies, including shareholders and regulators, while the institution undertakes a difficult and challenging path to address issues necessary for its survival and/or preparation for eventual sale.

“Home Alone”

A successful “Home Alone” experience, whether temporary or permanent, can result in the institution becoming a stronger, healthier, and more profitable organization that is in far better condition to make objective decisions regarding its future in a thoughtful and less-pressured manner. It can cause the institution to carefully analyze and consider options and alternatives that it had not considered in the past and perhaps would not otherwise consider, and to take actions which it may otherwise not take that can have a strong positive impact. It is not without risk and some pain, however, and is subject to significant pressure and potential for failure. There may or may not be a viable alternative for the institution, and whether temporary or otherwise the “Home Alone” scenario is one of the many important alternatives to be carefully (and realistically) considered by the board as it analyzes the short and long-term prospects for the institution and the best interests of its constituencies.