Why Community Banks Go Public

By Laura Hamilton, OTC Markets Group

As the names suggest, community banks are integral to the local communities and businesses they serve. As active members within their communities, they understand the capital needs of local businesses and supply the economic fuel they need for growth and development. Now, more than ever, community banks are the financial strongholds main street needs to thrive. In addition to supporting their communities, banks have a fiduciary responsibility to their shareholders -- an obligation to make corporate decisions that will drive growth and fund the bank's operations. In this three-part series, I will take a closer look at going public from a community bank perspective, discussing why community banks go public, how it's accomplished and when is the best time to make the move.

Choosing to go public is not an easy decision. By providing strategic growth opportunities, independence, and sustainable investors, a local bank going public can benefit both the community and its shareholders in the long run.

There are several reasons a community bank might choose to become public. In our experience, with close to 200 banks having traded on our OTCQX market, most go public to address three main challenges: to strengthen their "buy side" position for future acquisitions, their shareholders need greater liquidity, and when loan growth is outpacing their funding ability. Oftentimes, banks simply realize that public trading of their stock is the next logical step in their growth cycle.

Strategic Growth

Going public can foster and support a bank's growth strategy and can be a fundamental part of the bank's long-term strategic expansion plan. In recent years, regulatory changes have made the process and options for banks to access the public markets less burdensome and more affordable. This makes it especially appealing for smaller community-oriented institutions.

When lending outpaces growth, scaling via public investment can be a way to sustain and build on that momentum. Most often, community banks are the primary capital source for entrepreneurs and small- to medium-sized businesses. They provide over half of all U.S. small business loans, including the finances to establish and maintain local businesses. When banks are experiencing growth in lending, but not an influx of deposits, going public can provide them with the capital needed to maintain a growth trajectory and solidify their financial position.

Community banks can look to increase their lending limits or reserve thresholds by incorporating a shift to public markets into their strategic growth plans. As the burden of going public, both financially and in terms of the time and resources expended by executive management, has eased in recent years, the decision to go public has become much easier to make. More importantly, the JOBS Act has reduced regulatory burdens on small business making it less burdensome to remain public.

A common misperception is that once a community bank goes public, it must continue a rigorous, and oftentimes, duplicative process of reporting to the SEC. However, if a bank can maintain less than 1,200 shareholders, those obligations are suspended. As most community banks meet this threshold-- they can go public without the burden of building a larger management team and group of expensive advisors to meet reporting requirements.

Independence and Consolidation

The number of community banks nationwide is at its lowest point in recent history. Since 1985, the number has decreased by 72% going from 18,000 to just over 5,000 today. Consolidation has been a primary driver. As this number continues to decrease, going public can allow a bank to retain its desired independence. Having a strategic growth plan that fully enhances shareholder value will, as a result, enhance future earnings potential, which is the surest way to maintain independence for your organization.

Many community banks have sold to larger institutions as investors continue to show interest in their value. In 2019, the national average rate of consolidation was 4.4% with some states nearing a 7% rate. Going public can also position a bank for the growth potential associated with long-term acquisition or even the potential to acquire smaller banks.

Similarly, when a bank is public, the stock provides an alternative to an all-cash acquisition deal. All-cash deals are an expensive undertaking for the acquiring bank and can often drain a bank of its available capital. Oftentimes, acquisition deals include a mix of cash and stock to mitigate the need for all-cash capital - thus alleviating expensive transition costs.

Investor Scrutiny & Diversification

In the same way going public can offer a share value for a buyer or seller in an M&A transaction, having a public market history can help a community bank appease investors who are looking to liquidate or determine the value of their investment. It can also help diversify the investor base and be a catalyst for improving financial strength.

Many community banks are funded by and formed with capital from local investors. When these investors, or their next of kin are ready to liquidate, privately-held banks have the disadvantage of not having a clear, publicly available valuation or path to liquidation. On the other hand, investors in public banks can rely on the publicly available price of the security to determine the value of their holdings and can easily sell their position on the open market through a broker of their choice.

Additionally, a community bank that has public investors tends to have more investors. When an investor chooses to liquidate, he or she is potentially selling to someone outside the original investor base. Rather than relying solely on local investors, the publicly traded community bank is open to a larger, more geographically diverse group of investors. This path towards investor diversification can signal a strong growth trajectory for the bank.

A Forward-Thinking Community

Financial institutions are for-profit. As such they have a responsibility to maximize the returns of their shareholders and investors. After completing the go-public process, banks often report that they are better equipped to serve their community. Their executive management teams are encouraged by having built an asset that public investors find attractive, and by diversifying the investor base, they expand their ability to continue being a secure source of working growth capital. Amidst the economic uncertainty from the COVID-19 pandemic, community banks can stay true to their names and remain the stalwart support that local businesses need.

While community service and economic development initiatives are tangible goals, the board and management are primarily tasked with finding, creating, and sustaining value for shareholders. If that end is pursued, community-minded goals and initiatives will fall into place.

In part two of this series, I dive into explaining **how community banks evaluate their growth options**, and we explore how banks should weigh several capital raising options while staying laser-focused on their mission to fuel their local economies.

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