

# Publications

## Be Prepared: Strategic Planning for M&A Activities

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As the M&A environment heats up and industry chatter increases, banks and their boards need to be prepared to take advantage of strategic opportunities. Boards should consider and discuss their M&A strategy on an ongoing basis in light of changing circumstances, and the board's consideration and any related preparation needs to take place before the situation arises. Ongoing advance preparation will enable the board to exercise appropriate control of the process so that the directors are able to exercise their obligation to act in the best interests of the institution and their constituencies without having to react with the proverbial "gun to the head."

Preparation is critical, whether the institution plans to be a buyer, a seller, or to remain independent. A last minute scramble under the pressure of an unforeseen acquisition opportunity as a buyer, receipt of an unexpected offer or "bear hug" from an interested acquirer, or other unexpected opportunity can take away options and alternatives that the institution might otherwise have if the board has a unified and cogent strategy. Having an M&A strategy in place is not necessarily intended to thwart otherwise appropriate opportunities, but rather provide a strategy and framework for the directors to exercise their best business judgment and act in the best interests of their constituencies.

While the classic "hostile" takeover approach is rare in banking, the interests of shareholders and shareholder groups may vary and situations can and do arise where boards are placed in difficult positions of having to address divergent and conflicting interests. Hedge fund and activist investors are becoming more prevalent in the community banking space too, and may enter in the form of a "Trojan horse" investor whose intentions appear altruistic at first.

A number of mechanisms are available to prepare an institution to address the resurgence in M&A activities and the possibility of unexpected acquisition opportunities or undesired or surprise approaches by potential acquirers. Boards should be in a position to

demonstrate that they have reviewed and considered these various mechanisms and developed plans to deal with these activities. Mechanisms adopted and implemented by the board should provide maximum flexibility for the board to carry out its strategic vision while at the same time allowing for potential unforeseen changes in opportunities and situations. While an institution may be poised to be a buyer, an unforeseen and desirable opportunity to sell may arise and the board needs maximum flexibility to be able to respond in a manner that enables it to fulfill its fiduciary obligations. Likewise, while an institution may have a strategic plan to be a seller, unforeseen acquisition opportunities may arise which may be in the best long-term interest of the institution and its constituencies. Therefore, maximizing board flexibility to react to situations as they arise, and to better control the destiny of the institution in the best interests of its constituencies, is critical to provide the board with appropriate options and alternatives.

The purpose of preparation is not to thwart potential acquirers who may have an interest in the institution or to entrench the board and management, but rather to provide appropriate tools for the board to maximize its ability to deal with such situations in the best interests of the institution and its constituencies. Attention to the institution's existing shareholder base and good shareholder relations, as well as a strong stock price, are some of the most important tools for defending against an unwanted approach by an acquirer. However, boards also need the appropriate structural and legal tools to do the job if the situation in fact arises. These situations can and do sometimes escalate quickly and unexpectedly, simply as the result of a curious inquiry, "lunch" with a potential partner, or because of an unknown concern of a major shareholder or disgruntled family member. Institutions can inadvertently be "put in play" without the board ever intending to be placed in that position. "Bear hug" letters from interested acquirers are not unheard of in the banking industry, and a cohesive and informed board is critical to address unexpected and possibly unwanted overtures.

Preparation is critical, and a last minute scramble may place the institution and its board on the worst possible footing to deal appropriately with situations that may arise.

## Governance Preparation

Initially, the board should conduct a comprehensive review of the governance mechanisms in place and already adopted for the institution, and evaluate their adequacy and appropriateness. This is important to establish a baseline for the institution and should be done in advance of a situation arising in order to allow the directors to exercise their fiduciary obligations and to control the process in the best interests of the institution. Having the discussion for the first time when the board is facing a potential transaction can result in the board losing control of the situation, and can provide fodder for shareholder activism and potential claims of breach of fiduciary duty.

Directors should be educated and updated with regard to takeover preparedness so that they can develop an appropriate long-term strategy. This can help to avoid last minute scrambles and help keep the board informed, involved, and better able to address issues as they arise.

It is also critical for the institution to have appropriate and up-to-date structural mechanisms in place in order to provide the best tools for the board to deal with M&A situations. Governance provisions contained in articles, bylaws, constitutions and codes of regulations, including provisions that provide for staggered boards, the availability of "wild card" preferred stock, prior notice for shareholder actions, "supermajority" vote requirements, "fair price" provisions, rights plans and director eligibility, as well as appropriate benefit

programs and change in control protections, can provide useful tools for the board to deal with unwanted overtures. Likewise, as noted below, the ability to raise equity, issue debt or borrow to finance an acquisition can provide important flexibility to enable an institution to act quickly to take advantage of potential acquisition opportunities.

The timing of an institution's adoption of these structural provisions is critical and is typically not best when the institution is already in play. Hence, it is important for a board to review these issues and make any appropriate changes for the institution in light of its strategic plans BEFORE it is facing the issues, as opposed to a scramble in the heat and pressure of battle.

## Shareholder Meetings

Even the conduct of shareholder meetings can be important in preparing for potential strategic opportunities. While it is important for an institution to provide appropriate shareholder accessibility, it should not open the door to abuse by those who would seek self-serving action that the board, in exercising its legal duties and responsibilities, deems inappropriate. Annual shareholder meetings are not typically the best venue for in-depth review and discussion of important governance matters because these matters require significant analysis and review and assessment of the best interests of the institution.

## Acquiring Institutions

Like potential targets, potential acquiring institutions need to plan ahead so they are able to move quickly as opportunities arise, especially knowing that they may be facing competitive bidders. Potential buyers need to be strategically positioned to take advantage and to be nimble when opportunities are presented, and to maximize their options for responding. This means having access to cash and/or the ability to issue stock to fund an acquisition. Thus, a board with growth as a strategic goal needs to review not only its governance documents to confirm that it has the ability to, for instance, issue shares and raise capital if appropriate, but to make certain that the board has sufficient latitude to move quickly when necessary. In addition, it is increasingly important that the board have preliminary discussions with its regulators to address any potential issues that could be a hurdle to obtaining regulatory approval for an acquisition. These advance planning steps can enable the board to be nimble when addressing potential growth opportunities and can place the institution in a position of strength when there may be multiple interested parties. And to avoid potentially embarrassing situations once the transaction is announced.

## Indemnification and D&O Insurance

As part of an overall review of governance protections, boards should continually review the adequacy and appropriateness of the indemnification provisions contained in their institutions' governance documents, as well as the appropriate level and coverage provided by their D&O insurance. Transactions historically provide the most significant opportunities for second-guessing by plaintiff's lawyers, shareholders and sometimes regulators. The board should continually review the indemnification and insurance protections in place to ensure that they are appropriate for the institution's needs and strategic vision. The M&A environment can be fraught with potential liability issues for directors and, therefore, the proper use of financial and legal advisors can provide important protections in the process.

## Conclusions

With appropriate preparation, boards of potential targets have significant latitude in dealing with unwanted advances, from “just say no” to taking the offensive, but that latitude is tempered by the need to always act in the best interest of the institution. Boards need to formulate a strategic plan and have in place the appropriate tools to deal with unforeseen issues as they arise in order to fulfill their obligations to the institution and its relevant constituencies.

Likewise, boards of potential acquirer should be prepared to act quickly and effectively when opportunities arise. By doing so, they can develop relationships with potential strategic partners and undertake approaches that avoid placing the potential partner in an awkward and unwanted position with their shareholders and/or regulatory authorities. Acquirers are wise to keep in mind that in most instances an acquisition results in the acquirer taking on the financial and other obligations and potential shareholder and other “baggage” of the seller. Thus, a good approach and good relationship will pay dividends to the acquirer and the combined organization.

Whether an institution is a buyer or target, or simply plans to stay the course independently, waiting until an unanticipated M&A situation is thrust upon the board is not the time to be planning and implementing the types of protections for the institution that are necessary and appropriate to enable the board to fulfill its obligations.