THE UPPER HAND

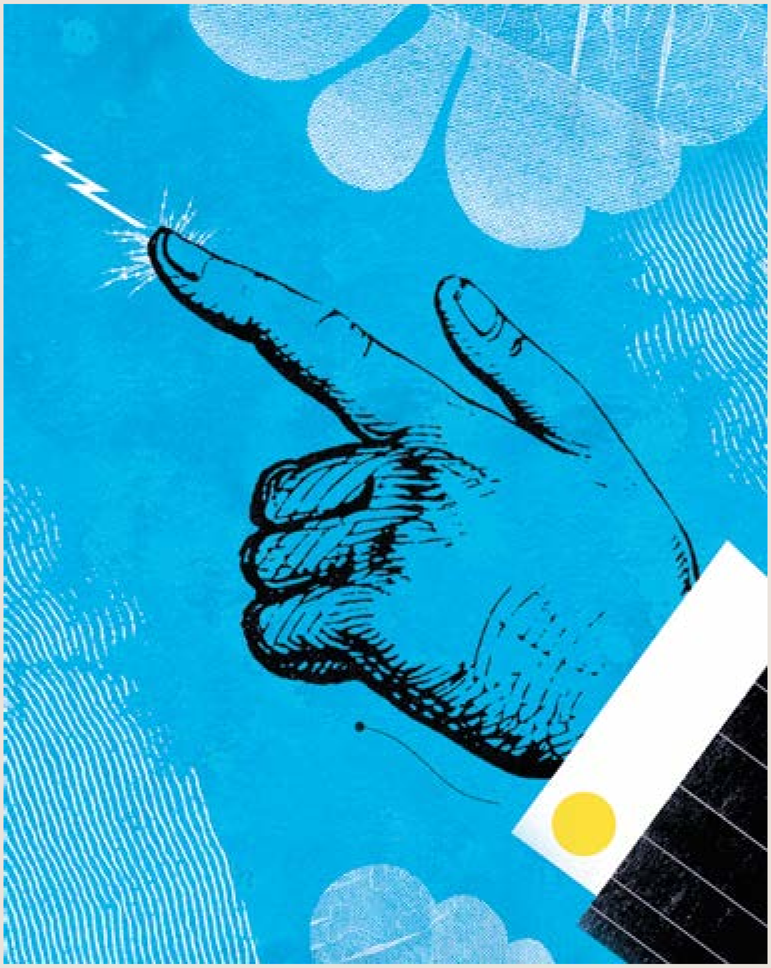

ILLUSTRATION: FRAZER HUDSON/IKON IMAGES

MARKET CONDITIONS HAVE GIVEN CORPORATE TREASURERS AN ADVANTAGE IN THEIR RELATIONSHIPS WITH BANKS. THIS MAY CONTINUE THROUGH 2015, BUT IT WON'T STAY THIS WAY, WARNS HARRY BRIGHT

Despite the market correction in October that saw the main equity indices fall by more than 10% within a month, most corporate treasurers have enjoyed an exceptionally benign funding environment this year. And the good news for them is that these conditions will probably continue – in the short term, at least.

A poll of the audience at the Loan Market Association's annual conference in London in September found that over two-thirds (68%) of loan market professionals in attendance believed that the syndicated loan market would grow by at least 10% over the next 12 months. Meanwhile, half (50%) cited competitive pressure as the greatest influence on the market over the coming year and over a third (38%) thought that corporate M&A would offer them the best opportunities.

Nevertheless, this upbeat assessment belies some uncomfortable truths about the global economy, which are now starting to surface. While the worst turmoil of the financial crisis is starting to seem a distant memory, these remain extraordinary times. Both the US and the UK are racking up steady economic growth, yet interest rates in these countries are still rock bottom and likely to remain so well into 2015. Meanwhile, the correction of the equity markets is an indication of the recent irrational exuberance where excessive levels of money have flooded the system, as investors search relentlessly for yield.

At present, institutional investors appear to be adverse to risk but, with interest rates expected to remain at very low levels, the likelihood is that this may reverse in the new year. As a result, excess liquidity will need to find a home once more, leading to a further 'hunt for yield'.

Holding the cards

Today, corporates are in the fortunate position of having plenty of choice in the banks they want to do business with. Whether they are looking to fund, or to buy derivatives to hedge interest rates, inflation or currency, corporates are benefiting from a very healthy level of competition among banks. This is the result of significant overcapacity that is due, in part, to banks having largely restored their balance sheets and finding they have more money to lend than they have clients to lend it to. Therefore, corporates are managing to secure products from banks at practically all-time-low prices. And it's not just large corporates that are benefiting. SMEs with good credit quality can also take advantage of compressed pricing.

Of course, bank finance is not the only funding option open to corporates. They can also turn to peer-to-peer lending, public bonds and more direct institutional activity, for example, the private placement market. And while the availability of cheap and diverse funding options might suggest this is a prime time for corporates to undertake M&A activity, CFOs are still cautious about spending. They have concerns that either their own company's share price is overinflated or that the value of the target company is overstated, which could land them in trouble further down the line.

Overall, with so many banks competing heavily to secure the limited business of corporates, there is a risk that they are

MANAGING YOUR BANKING GROUP

◆ If you want to attract new banks to your banking group just to get price compression, traditionally, the most efficient way is to invite them to join your revolving credit facility.

◆ But you may want to take advantage of the current market dynamics by adopting a more strategic approach to your banking group by considering the mixture of geography and skill set you require. Which banks fit best with your business, not only today, but potentially in the near future? Do you have subsidiaries in a foreign country that would benefit from having a banking partner with operations on the ground? If your company has international operations, it is likely to need a good mix of local and global banks in its syndicate.

◆ Don't be afraid to bring in a new bank in order to replace a bank that isn't giving you a good service.

◆ The implementation of the Single Euro Payments Area will tempt some corporates to rationalise their bank relationships. But corporates will still need to show that they have a liquid and stable financial position with sufficient undrawn banking commitments, etc, to call upon. If they were to reduce their banking group to much smaller numbers (four, for example), corporates would need to ensure that they give a decent return to those same four banks – each of which will probably be very highly regulated and bearing the increased cost of regulatory capital that the new world dictates.

not properly valuing risk. And while the big increases in their regulatory costs continue to stack up, banks have so far been very reluctant to pass the costs on to their clients, for fear of losing them. The challenge for banks, then, is that they need to balance the requirement to have a sound capital model with the need to be able to price credit accurately and persuade the client to pay appropriately for it. In this market, that remains a tall order.

On a positive note, the fact that pricing is competitive means that corporates are increasingly rewarding banks on the grounds of the advice and services that they provide rather than just rewarding them for making their balance sheet available to them. This is a healthy development because it means that banks are increasingly being challenged to focus on enhancing the quality of their service.

Relationship matters

While corporate treasurers mostly have the upper hand in this market, the majority of them do genuinely value the relationship that they have with their banks. They know that the bankers need to earn a return just as the bankers know that they need to provide a high-quality service. The vast majority of treasurers treat their banks fairly and openly, and proactively nurture their relationships with their bankers.

So how do you nurture a relationship with a bank? Firstly, it is essential to establish a good degree of trust on both sides. Secondly, if one bank is failing in quality relative to another, this should be made clear to the bank relationship manager. In this respect, some multinationals carry out annual evaluations of their banking partners, which set out where each bank stands in relation to its competitors in terms of the quality of service that it offers. Each bank receives an individual evaluation and, although the other banks on the list are anonymous, the relationship manager is able to see where the bank is on the scale and how it has performed compared with the previous year. Although potentially cumbersome for the treasury team, this is, nevertheless, a useful tool for nurturing relationships.

> While corporate treasurers mostly have the upper hand in this market, the majority of them do genuinely value the relationship that they have with their banks

Banks have had a tendency to overestimate the amount of business that a corporate has available (ie the 'wallet'). So for the many corporates that want to nurture an open relationship with their bank, it is very helpful to give a strong indication of how much business they have placed with the financial institution market. This will relate to which products they use and the share that any bank has of those products. Corporates are also increasingly likely to make sure that the share of wallet they give to a bank is proportionate to the strength of the relationship they have with that bank. Consequently, banks that are able to offer superior services, or have a particular geographic fit, should get a larger share of the wallet over time.

Looking ahead, and unless the recent correction sets in and develops into the type of wide-reaching systemic problem that we witnessed at the start of the financial crisis, 2015 is likely to be another good year for corporate treasurers to achieve what they want to achieve and to get competitive pricing on the products that they want to buy. The market for banking services should remain extremely competitive, and this can only be good for treasurers.

But treasurers need to keep a watchful eye on the fact that the operation of the markets generally looks, and feels, imperfect. If a corporate is funded well in advance, then it is unquestionably in a good position. If a corporate has refinancings that fall due in 2016/17, then it should look at doing this in advance. It's hard to foresee a situation where a corporate could fund itself much cheaper in future than it could today.

In conclusion, the factors highlighted above mean that corporate treasurers would be well advised to keep a close eye on market developments throughout 2015.

Harry Bright is head of financing solutions and advisory UK, Santander Global Banking & Markets

The views of the author are his own and do not necessarily reflect the views of Santander