GETTING THE MOST FROM YOUR BANKS

TAKING THE TIME TO FIND OUT HOW YOUR BANKS OPERATE CAN HELP BUILD A RELATIONSHIP THAT'S BETTER FOR EVERYBODY, SAYS **JOHN STEEDMAN** OF JOHN STEEDMAN TRAINING.

A tale of two treasuries: introduction

I felt exhausted, it was well past nine in the evening and I'd just put down the phone after a 20-minute call with the treasurer of SupaStores, one of the UK's largest retailers. Trying to explain to an irate, tired and bruised treasurer why the decision on SupaStores' credit request to Anglobank was taking so long, never topped my list of 'favourite things for a banker to do an a Friday evening'. SupaStores was a single-A credit on the slide and was looking to restructure its £1bn of committed facilities as quickly as possible.

Putting my files away before heading for Waterloo, I could not help contrasting this last call with the one that morning with the treasurer of Hotel International, which also needed £1bn in its case for a major US acquisition. In sharp contrast to SupaStores, I felt extremely confident about shepherding the approval through, well before the six working day deadline. Furthermore, I hoped Anglobank could underwrite 50% of the deal.

How could companies of similar size and with identical public credit ratings be so different to deal with?

WHAT DOES 'THE MOST' MEAN? When I set about designing a course for treasury staff entitled 'Getting the most from your banks'[1], I had several goals in mind. Twenty-five years of working with treasuries in the UK, the US and continental Europe had convinced me that if companies had a better idea of how banks worked, and how their bankers were trained and motivated, they would be in a much better position to deal with them on a day-to-day basis and get the very best service. In addition, when the big deal appeared or they needed support, then their core banks would be able and willing to respond quickly. The fictional situation above is the first section of a case study designed to illustrate the best and worst management of a banking group. As well as ensuring that their organisation has adequate funding over time, a treasurer is also under pressure to demonstrate that his or her department is cost-effective and not overspending on banking services. While this is comparatively easy to do for funding products, where there are clear market benchmarks related to credit quality, it is much more difficult for complex projects such as cash management or trade services, which have a large 'service' element. Using a tendering process and judging solely on price can have unintended consequences.

The debate over whether treasuries should adopt a 'relationship' approach to its banks or a more hard-nosed 'transactional' philosophy based on cost is, I believe, largely artificial. Virtually every company now claims to believe in relationship banking; it would be difficult to fill the chairs at its next 'general syndication' if it did not. The key, however, is in the execution. How effectively does an organisation manage its relationship bank group to achieve its goals. From a banker's perspective these goals should include:

- assembling a manageable core group of banks to handle the majority of the company's business;
- ensuring the relationship is sufficiently important to each bank that the company can negotiate terms and conditions from a position of relative strength; and
- ensuring that each bank is compensated in line with product expertise, service levels and, most importantly, the level and nature of its credit facilities.

This approach to a bank group should also mean that there is active price and service competition for new business and that a customer can reasonably expect its banks to perform many services for which there is no direct charge. Most banks have considerable financial, economic, product and country expertise available to good customers and will undertake what amounts to unpaid consultancy work, if they feel that new business may result from the work or it is needed to retain a valued client.

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HOW ATTRACTIVE AM I? Do you know how much your company spends on banking services? Do you know roughly how much goes to each bank? Is this allocation a planned process? In my experience, most UK treasurers would not be able answer "yes" to all these questions. I think they would agree that this knowledge would be useful, but they would probably venture that they did not have the time and resources to do the calculations.

My contention is that without this information it is very difficult to shape a satisfactory and satisfied bank group. Having been through this exercise many times on the bank side, where we have much less information than the company itself, I can vouch for the fact that a satisfactory estimate can be made without shutting the treasury department down for a week.

The bank revenues on certain products (loans, letters of credit fees, advisory fees and the like) are very easy to determine. How much banks make on other services, such as cash management, asset management, securities services, are more difficult to estimate – in fact, many banks have a difficulty in calculating the true returns on cash management.

However, with a few assumptions, it can be done. If overseas business is an important part of the company's operations, then the local treasury staff will probably be able to come up with some good estimates of their banking spend.

Once armed with this data, the next task is to determine the optimum size of the bank group. The trick is to ensure that a well performing bank has enough revenue to keep it highly motivated, while ensuring the group is large enough both to support a major bank funding for a commercial paper (CP) backstop or acquisition budge and to include banks with specific strengths important to the company.

HOW MUCH REVENUE IS ENOUGH? The easiest way to find out is to ask the banks; most will have a target hurdle for their important relationships. They will also probably add that "it depends what the product mix is". As Basel II approaches, not all revenues are equal.

WHERE ARE THE PLUMS? Over the past 10 years banks have been under increasing pressure to refine their calculation of returns on their overall business, individual portfolios of assets and even on individual relationships. Basel II has focused their attention on the level of bank capital required to be allocated each loan and the resultant margin needed on these loans to meet the growing drive for 'shareholder value'. Price competition dictates that the majority of corporate loans cannot be priced at a sufficient level to meet risk-adjusted return targets, hence the huge pressure to supplement loan business with non-funds collateral revenues.

In essence, corporate loans have become loss leaders for the banks so that they can tap the treasurer's more attractive banking spend. So what are the services that banks are anxious to compete for in order to offset the capital requirements associated with loans, financial letters of credit or leasing?

Well, the prize plum is any type of advisory work, most notably mergers and acquisitions (M&A). This is followed by asset management, equity capital markets business, purchase/travel and entertainment cards, securitisation, cash management and so on. So to get the 'most' from your banks, it is essential to reward the ones that use their balance sheets to support you by giving them pole position when it comes to tendering for the attractive business.

This particularly applies to firms that do not access the public debt or private placement markets and which rely on committed bank funding, either bilaterals or syndicated loans for their core funding requirement. In the UK, most organisations with sales below £2bn fall in to this category.

It is also very relevant to companies with non-investment grade risk profiles. Risk-adjusted return calculations show that, once a company has moved to a rating below BBB or its equivalent, then the capital requirements for their loans start increasing exponentially. In the case of these companies, whose comparatively low ratings are often the result of higher gearing levels, it is even more important to let the major lenders have all the plums.

STRENGTHENING THE RELATIONSHIP. Getting the most from your banks is really a question of attaining a state where both parties feel that they have a mutually beneficial relationship. The treasurer feels he or she is getting good service at a reasonable price, while the bank, having run all its complex return models, is happy that the blend of services provided gives its own shareholders a reasonable return. This state is never achieved instantaneously, all bankers are aware that the 'entry ticket' to a new relationship is usually a position in the group's highly unattractive committed revolving credit. They are, however, prepared to work for several years in search of a few plums to compensate for paying for admission.

The case study that introduced this article concludes with the following observations gleaned from my interviews with bankers, which summarises their feelings about treasuries. They particularly like the ones:

- where there is overall sense of order;
- where responsibilities are defined;
- which have a plan for the coming year;
- which make clear their 'rules of engagement';
- which have written treasury policies;
- which limit the number of core banks and reward balance sheet use;
- which reward banks that bring them new ideas;
- which do not 'lead you up the garden path';
- which provide reasonable access to senior management;
- where bad news is flagged as soon as possible;
- where hospitality is occasionally returned; and
- where phone calls are always returned.

For these treasuries they will do whatever it takes.

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Note

[1]John will be leading the ACT training course 'Getting the most from your banks' on 9 September 2003. Contact mrahman@treasurers.co.uk