operations

BANK RELATIONSHIP

Changing relationships

GRAHAM BUCK EXAMINES WHAT HAS PERSUADED SO MANY CORPORATES TO USE FEWER BANKS.

It will be several weeks before the findings of this year's ACT/JPMorgan Asset Management Global Cash Management Survey are revealed, but it will be a shock if they do not show a continuing trend for investment-grade companies to make use of fewer banks. The trend has implications for treasurers' relationships, both with banks they stop using and those they retain.

The size and geographical spread of a company has a bearing on how many banks it uses. For a mid-sized company the number may be fairly limited – possibly just two or three main relationship banks.

But the recent uncertainty in the markets could breed uncertainty in the treasurer-banker relationship, says Richard Dakin, Managing Director and Head of Major Corporates at Lloyds TSB Corporate Markets. He believes that in periods of uncertainty, companies look towards relationship banks rather than transactional banks to stick with them throughout the cycle.

"Lower margins over the past few years have underpinned the trend for companies to use fewer banks in an effort to share out their available ancillary business," Dakin adds.

Over the same period, acquisition-led facilities have increased borrowing requirements. In the current environment, some transactional banks may be closed for business in certain debt markets, making it more difficult for companies to raise funds, particularly in the leveraged market.

With fewer banks capable of backing these transactions, companies will look to relationship banks to up their hold levels.

"The motivators for refinancing have been an acquisition, maturity of current facilities, or when the company seeks to take advantage of lower market pricing," Dakin says. "Now we're in a different market as a result of the recent turmoil, we could find that companies have less appetite for making acquisitions and raising leverage levels any further."

CONDUCTING A REVIEW Treasurers running a facility with several banks will usually conduct a review with their colleagues well in advance of any refinancing. The process will involve assessing each bank they use in the facility, deciding which ones they want to continue using and any new ones they might wish to bring in.

If the process results in a bank being discarded, the decision is down to a range of considerations. The underlying factor is what the company plans to do in the near term. The products offered by some banks may no longer be considered broad enough; in other cases, they may simply have served their purpose and are no longer needed.

Other triggers for change include a disposal, demerger or buy-out and the arrival of a new treasurer at the company. All help determine how many banks are used.

"There is a variety of factors, most depending on the circumstances of the company concerned. Personally, I have always gone for the minimum practical and prudent, and am not certain why this isn't the rule generally," says Paul Delaney, Director of Group Treasury at advertising group WPP.

And Andrew Foulkes, Group Treasurer at packaging and materials handling group Linpac, says that changing banks still presents huge difficulties. Despite technological advances, the process is both complicated and time-consuming. He believes that a better course of action for a company is to change the amount of business placed with each of its banks, rather than dropping one completely.

"If you're dissatisfied with your existing bank, it's probably easier to give them a warning by shifting some business away from them," he suggests. "It creates relatively little upheaval but serves its purpose well.

"Once you're embedded in day-to-day treasury activities, you don't want to change bank unless you have the support of a big team – or a lot of time on your hands. And having at least one other bank in the wings acts as insurance, so that you're not left high and dry if the relationship does deteriorate."

Some companies nonetheless opt to concentrate a large volume of business with no more than a couple of banks. The policy carries the risk of putting all your eggs in one basket, but gives greater clout in setting the price of the products and services purchased.

It would take a greatly accelerated pace of consolidation – such as that witnessed in the accountancy sector – to change this environment and companies still have the luxury of being able to choose from a wide range of market players. Despite this, there are still "significant" differences in the capabilities offered by each bank, says Foulkes.

"Some have a technological platform that's 10 to 15 years behind the times," he says. "And even those that did update back in the 1990s would do well to consider now making a further investment.

"The other area is service. It's quite stunning how levels can differ between one bank and another. Some are completely wrapped up in

Executive summary

- The relationship between treasurers and banks is changing; due in part to the impact of private equity.
- Any decision by a corporate to discard a bank should not be taken lightly. An alternative course of action is to review the amount of work placed with each bank.
- Service levels and capability of banks differ significantly, and some argue the relationship manager role has changed.

red tape, while others may have admin problems but still set out to be helpful."

A common complaint levied against banks is that their keenness to expand business by selling new products and services to clients too often produces a focus on sales at the expense of maintaining service levels for existing facilities.

Although bank consolidation has so far had a limited impact on the treasurer-bank relationship, potential acquisitions of banks may change that. The impending acquisition of ABN AMRO has caused many companies to review the banks they use.

One such company is waste and resource management group Shanks, which sold its UK landfill business to private equity group Terra Firma in 2004. Following the deal, Shanks moved from a typical syndicated facility consisting of two lead banks and 14 followers to a five-bank deal. The five included ABN AMRO, Barclays and Royal Bank of Scotland, says Bob Cartwright, Group Treasurer at Shanks. Barclays and RBS subsequently engaged in a bid battle for ABN AMRO from which RBS emerged victorious.

"We realised from the outset that someone would end up overexposed, so we've already talked to a number of banks to suggest who might help with the excess exposure as we would rather know the transferee," Cartwright says.

The group's current facility runs to 2010, but as part of its annual strategic review each autumn it reviews whether the facility will continue to meet future needs. This year's review had input from Shanks' new chief executive, who joined in September.

"We've had discussions internally on our likely refinancing and banking partners already in advance of 2010, although any changes will actually take place in 2009 to prevent being at the mercy of the market at the last moment," Cartwright says.

Other deals, such as Société Générale taking over rival BNP Paribas, would trigger similar reviews in many companies across Europe.

PRIVATE EQUITY'S IMPACT In recent years, the appetite for ever bigger merger and acquisition deals has had a significant impact on relationships as treasurers have dealt with banks bringing private equity into the facility.

A leveraged buy-out is a major instigator of change. Before the buy-out a company may have relatively low debt and regard its banks as suppliers and service providers. It may also have relationships with several banks to secure the keenest pricing.

After the buy-out the banks have a new role. The high level of lending by those that are part of the loan syndicate is given with the *quid pro quo* of physical security and a high degree of control. The company accepts the obligations to provide extensive reporting to the syndicate banks, meet minimum performance requirements and ask their permission on what was previously a wide range of standard business activities, such as disposing of assets.

"The process of a leveraged buy-out naturally limits the number of relationship banks, but once completed it's difficult for you either to lose one or for one to drop out," says Foulkes.

He says that Linpac's own arrangement suits it well, with the group having one major bank for each global region in which it operates and a number of secondary relationships in addition to the lead relationship.

However, a syndicated loan agreement may impose restrictions. It potentially makes it difficult for a company to maintain business with any bank that is not a syndicate member. So it's important that its main operating banks are within the syndicate, in order to maintain basic activities such as cash management.

What's more, banks outside the syndicate are unlikely to prove willing to extend credit when syndicate members will head the queue in the event of the company defaulting. So relationships with non-syndicate banks that are less than central to day-to-day operations are likely to fall away.

Among syndicate members actively seeking a banking relationship there will be competition to win the company's ancillary business, such as interest rate hedging. This potential may be part of the justification for the bank lending to the company, creating a difficult situation for the treasurer who must attempt to meet the needs of multiple banks.

Another possible downside of this arrangement is that the treasurer could find it very difficult to reduce or terminate the day-to-day banking relationship with a syndicate member bank whose levels of services fell short of requirements.

However, the likelihood of such a dilemma arising has lessened in recent years. As institutional investors have upped their stakes, so the typical participation of banks in leveraged loan syndicates has reduced, from around 75% of the total loan to less than 50%, although it remains to be seen if this proves a lasting change.

When it comes to refinancing – or perhaps a sale to a new private equity owner and a new syndicated loan – the banks most likely to join the new syndicate are those with whom the private equity house and the lead arranging bank have strong relationships. With luck, the company's own main operating banks will also feature in the new syndicate. If not, the change of financing could lead to significant upheaval in the business, with the resulting disruption created by a change of bank.

The impact that private equity taking over the control of a company has on the treasurer's activities is considerable and one that we plan to explore more closely in a future article.

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