The heart of the matter

AN ACT ROUNDTABLE ON HOW CORPORATES VIEW AND MANAGE THEIR BANKS DELIVERED SOME HOME TRUTHS ABOUT RELATIONSHIP BANKING. **PETER MATZA** REVEALS ALL.

Whether readers believe that the recent financial crisis in Western economies has receded or not, there is no doubt that the political climate has fostered a step-change in new regulation in financial services and banking. While we try and quantify its relevance and impact in the corporate world, it seems appropriate to take stock of the state of the relationships between banks and corporate UK across the whole range of banking services.

The ACT was therefore delighted to host a roundtable, chaired by the ACT's Martin O'Donovan, between treasurers from a cross-section of UK companies (see box), Steve Pateman of event sponsor Santander, and the BBA's Irene Graham. They debated the trends and attitudes around relationship banking and how corporates view and manage their relationships with banks.

BUILDING RELATIONSHIPS The ACT's long-standing view is that the approach to bank relationships should be at the core of a treasurer's agenda and, where appropriate, form part of an overall financial strategy. It is also a very personal part of a treasurer's job as links between corporate and bank will be enhanced by good personal relationships. Quite often individuals can carry the bank or corporate with them to new relationships based on previous roles.

There was a widespread acceptance that regulation was in part a driver of relationships. If the bank's capital had become a scarce resource, then lending decisions were being taken out of the hands of the relationship manager and even away from a pure credit decision. Finding your bank blowing hot one minute and cold the next at the height of a crisis in what appears to be an arbitrary fashion is not helpful. It's a great time-waster for the customer and the bank – a fact the corporate customer will remember in future years. The preferred route was for greater openness up-front so that if credit was just not available – or if, for example, a particular sector was not in favour, for ethical, reputational or green-related reasons – the corporate would rather be told that that was the case.

In general UK corporates have had a preference for relationship banking over the years although some large-cap businesses have at

times used a deal-driven approach as their access to financial markets and services has been both broader and easier than it has been for smaller-cap organisations. There was some evidence in the mid-2000s that overall corporate treasury business was moving towards deal-based pricing, but that has been rudely interrupted by the financial crisis. There has also been evidence that the size of bank groups rose slightly during the crisis although not back to the levels of the mid-to-late 1990s from which they had declined by 25–30%. The panel agreed that this reflected a need by corporates to reduce elements of risk in activities such as cash pooling as well as banks exiting or reducing some aspects of their offering or their geographical presence.

The panel, however, expressed a differentiated approach to relationship management, introducing a number of important issues which they expected should feature in a relationship. The key determinant for all the treasurers on the panel, however, was the availability of credit.

FOLLOW THE MONEY According to Pateman: "Simple lending has not gone away – there are still banks seeking corporate exposure – but overall tenors, flexibility and availability of credit have all reduced." None of this is new but, as Pateman continued: "Banks simply can't get the 25-year money of yesterday, which means they can't satisfy everyone's longer-term funding needs."

New capital management regulations will require banks to hold sufficient liquid assets to withstand a 30-day period of stress. Committed but undrawn facilities are included in these calculations. The rules will impact any bank's ability to provide support and finance for its clients and inevitably feed through to pricing. There will be variability depending on specific corporate need although the panel recognised that the small and medium-sized enterprise (SME) sector would be under greater pressure in any lending scenario.

There was general agreement that banks are being forced to prioritise between opportunities and returns (even if some treasurers think lower returns for banks might not be a bad outcome). This is most likely to be a function of scale but also of gross returns and net margin to the banks. There was also consensus that Basel III won't help and even in a modified or delayed format there is no reason to expect that analysis to change.

The question that followed was this: are there other investors or markets which will fill the long-term space? Have treasurers been sufficiently diligent for their companies to dig into other areas that may have been overlooked for funding – for example, equity investors, retail bonds or making their supply chains more efficient? One aspect of the financial crisis has seen treasurers offered some of these alternatives either by their existing banks, which have beefed up somewhat dormant operations, or by new, non-bank financial providers, such as some of the better-known asset finance players expanding their operations.

However, the "alternative funding" space is one many treasurers seem reluctant to enter. That may be because they have plenty of cash, because they are loath to depart from traditional finance practice, or perhaps because the market has not fully defined the opportunities and benefits for corporates and engaged with treasurers and finance managers.

The panel

- **Michaela Booth**, group treasurer, the Guinness Partnership
- **Irene Graham**, managing director, business finance (taskforce) and strategic initiatives, British Bankers' Association
- **Martin O'Donovan**, deputy director, ACT policy and technical
- **Steve Pateman**, head of UK corporate, commercial and business banking, Santander
- **Fiona Rose**, assistant group treasurer, Ladbrokes
- **Jonathan Slade**, global head of corporate finance, Rio Tinto
- **Oliver Whiddett**, assistant group treasurer, Anglo American

STAND AND DELIVER In terms of how the banks deliver on relationships, the treasurer panel was most concerned that banks had a demonstrable capacity to deliver in terms of the services promised. There is the possibility of banks becoming specialists in some markets while exiting areas they do not feel they can compete in. Other institutions (such as boutique investment banks, pension funds, insurers) are likely to enter into markets historically inhabited by banks. This could lead to corporates having more relationship banks/providers. One of the panel felt quite strongly that "some banks are being hollowed out and that, by acting as a conduit for other service providers, quality standards might suffer and capability for redress become diminished".

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The ACT has certainly seen a growth in "white label" service providers wanting to address the corporate treasury market, especially but not exclusively in the cash management space. There is something of a paradox here in that where customers want technological efficiency they may have to sacrifice the personality in a relationship. Can the banks successfully deliver both?

One of our treasurers questioned "whether banks will reduce their offering to core products, and will that mean a possible reduction in competition?" The treasurers on the panel felt that there could be a role for other suppliers of (mainly transactional) services to make inroads in the corporate sector although this disintermediation can bring the risk of chasing technology for its own sake.

The treasurers also felt that a bank's geographical reach remained important and was a factor that could affect businesses of all sizes, although the UK is fortunate that its banks have traditionally had excellent and far-flung international networks. Some concern was expressed around the table that the uncertainty surrounding international banking regulation could have an impact on banks providing cross-border services, especially in operational areas such as payments processing or account management and reporting.

For larger corporates there is a sense of business as usual, but that may be false. The investment-grade space is well served and there are sufficient banks with scale, but there is uncertainty about whether the banks will want to continue with this if the capital cost is not sustainable. The question of bank scale was addressed, with O'Donovan commenting on the ACT's view that "generally companies do not need super-large banks and even for global cash management, companies tend to restrict a single bank to only a part/region/hemisphere of its group business to avoid concentration risk". Arguably the crisis has dramatised a movement of banking towards utility and specialisation rather than a universal model.

Treasurers welcome a diversity of providers in order to access a diversity of products, ideas and expertise. Competition is important too, so market dominance may not be helpful. For some very large companies it will occasionally be convenient to be able to deal with one or two super-large banks with correspondingly large balance sheets and ability to take or underwrite significant risks – for example, a large acquisition financing commitment – but even then the risk is normally rapidly distributed out. Companies could easily learn to transact with a group of banks rather than rely on a sole underwriter and some already do this as a matter of policy, recognising they must manage confidentiality issues more actively.

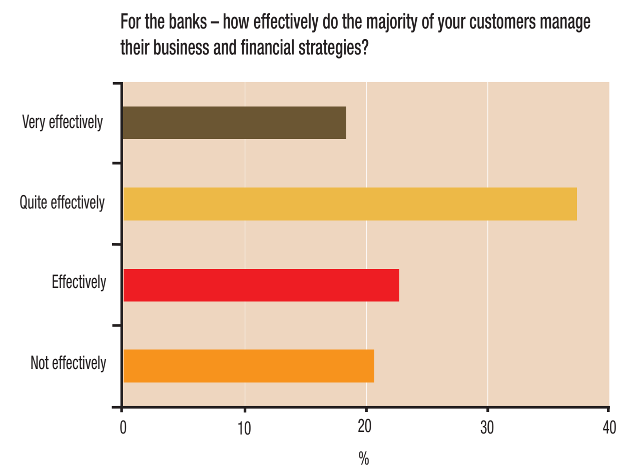
Although the super-large banks are not essential to a financial system, a good number of large banks is important to allow a proper level of competition. For example, on a major contested takeover by the time each side has appointed advisers and underwriters the field of likely candidates to back a rival bidder will be getting pretty limited. For a large-cap corporate there may be an increased need to look for banks with compatible alliances – similar to the way airlines associate globally.

The general view of the panel was that access to raising capital would remain a difficult process, the more so for smaller businesses. Operational banking will also become more complex. On the point of whether banks would adapt, Pateman said: "Smarter banks will be forced to understand their capital allocation process much better to see where the sweet spot of service provision will be."

SUPPORTING SMALL BUSINESSES So where does that leave smaller corporates? Pateman said: "Smaller companies need to be aware of concentration risk. Add in regulatory change and the picture two years out remains murky especially in respect of capital cost." The effect, however, is that the lower SME market is less well served. Irene Graham said: "The BBA is working hard to help small businesses in their working capital and supply chain finance needs, including access to alternative funding sources. Working with the major high-street banks, the BBA has established a series of initiatives under the Better Business Finance programme to support small businesses."

These initiatives (to be found at **www.betterbusinessfinance.co.uk**) include a new business mentor scheme, with banks working with mentoring organisations to provide free support and guidance to business owners as they seek to develop their enterprises, which can be accessed through **www.mentorsme.co.uk**, Britain's first online gateway to mentoring organisations across the country. There is also the establishment of the Business Growth Fund, a long-term equity fund supporting growing businesses whose turnover ranges upwards from £5m to £100m and the launch of a series of new export schemes with ECGD and government support.

Figure 1: How banks rate customers' financial management skills



LIFTING THE VEIL With much of the conversation swirling around relationships it is not surprising that one of the treasurers on the panel finally asked whether banking was a customer-friendly industry. The earlier allusion to potential airline-style associations begged the question of whether the industry was prepared to expose itself to objective qualitative measurement. One or two of the treasurers on the panel were concerned that banks had hidden behind process and regulation and that more transparency could be embraced – provided selling was restrained. There was also a view that the banking dislocation following the financial crisis meant some banks did not fully understand their offerings.

Our treasurers all said that formal and regular reviews with banks were essential to managing a relationship and that treasurers should have a solid view on wallet and share of wallet. One or two questioned whether that process was sufficiently two-way and whether banks were prepared to discuss the nitty-gritty of how returns are calculated. Pateman said: "Open, direct discussions are always positive so that both sides are clear on the aims and motivations of their partners. The key issue for Santander is for treasurers to appreciate the position between banks and their interpretation of regulation and capital allocation."

Our panel felt that treasurers should not be shy of having these regular conversations with their bankers and challenging the returns expected and derived from the relationship. For example, corporates should monitor their overall fees and spreads, volumes of business and fixed charges, and ask their banks to do the same and compare notes on costs, potential savings and performance enhancement.

Recent disruption in the social housing sector on loan costs – where a lender delved deep into the loan documentation to justify a margin increase – demonstrates the need for treasurers to be aware of the fine detail of their agreements and to challenge lending practice. However, banks have a reasonable expectation that treasurers and those looking after treasury should have the requisite financial and treasury skills. O'Donovan agreed and pointed out that the ACT was always eager to extend the reach of its qualifications. In a short survey conducted at the ACT's 2011 Annual Conference, bankers suggested that 21% of their customers were ineffective at managing business and financial strategies.

Graham said the recent independent SME Finance Monitor survey which BDRC Continental undertakes across 5,000 businesses every quarter, revealed low levels of financial management skills, which could make for a difficult relationship with a financial service provider when discussing costs and banking services. One of the report's key findings was that although they were experienced business people, four out of five financial decision-makers had no formal training in financial matters. Even in the largest SMEs just under a quarter had no such training or qualification.*

The treasurers on our panel also raised some concerns that the mix and volume of financial regulation might have unforeseen negative impacts on individual business sectors because of an uncertainty over the mix of wholesale/retail banking and potential reductions in credit exposure. These concerns were not limited to the UK but reflected global issues in regulation and competitiveness.

At the time of writing the Vickers report is still being digested but in general the ACT has been pleased to see that the Independent Commission on Banking (ICB) has been practical and balanced in what it has proposed. There are some remaining concerns on the likely detailed provisions but the ACT looks forward to the relevant consultations and discussions with relevant bodies on those. Too much can be made of instant judgement but the panellists' hope was we do not repent at leisure – especially as regards the competitive environment for UK business and banking.

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*Source: BDRC Continental SME Finance Monitor, July 2011, pages 13-16

Individual treasurers on the panel, which encouraged an open exchange of views, have not been directly quoted in this article. However, quotes from the ACT, the British Bankers' Association (BBA) and Santander are attributed as appropriate.