A co-operative relationship

AS TREASURER FOR THE CO-OPERATIVE GROUP'S TRADING DIVISION, **ROGER MORGAN'S** ROLE RECONCILES CENTURY-OLD FOUNDING PRINCIPLES WITH MODERN TREASURY DEMANDS. HE EXPLAINS HOW RECENT MOVES HAVE BROUGHT REWARDING RESULTS.

Executive summary

- As a mutual society the Co-operative Group requires unique treasury solutions.
- The Group's borrowing structures means a key element of capital raising is through committed and uncommitted lines with banks.
- In 2004 the Group decided to seek a partner bank.
- To define the term 'relationship bank' a balance scorecard approach was developed.
- As was intended the relationship has matured in different areas.

Last year, the Co-operative Group decided to reassess its existing relationship banking to increase flexibility and support the current day needs of the Group. Over the past three years, the Co-operative Group's trading division embarked upon a series of expansions that resulted in an extensive review of the Group's treasury and funding arrangements. This recent expansion is only the latest chapter in an evolution that has kept the Co-operative Group successfully in business for almost 150 years. Indeed, from its roots as a nineteenth century movement to concentrate consumer power against poor quality produce sold by cartels of profiteering industrialists, the Co-operative Group has not only survived but has grown into one of the UK's most individual and recognisable brands.

The size of the current trading operation would be unrecognisable to the Rochdale pioneers, who founded the Co-operative movement in 1844. The Co-operative Group includes 1,800 food retail outlets, 600 funeral parlours, 370 travel agents, 350 pharmacies and 38 department stores, as well as one of the UK's largest farming operations. Yet this diverse range of interests still exists within the Co-operative's original mutual ownership structure and is guided by the same founding principles – open membership, democratic control, economic participation, independence, transparency and concern for the community. And this mutual society requires somewhat unique treasury solutions.

THE CO-OPERATIVE DIFFERENCE One obvious but unusual feature of the Co-operative Group is the lack of access to the traditional equity capital markets funding. Yet this is also partly true of large privately owned groups, not to mention the many companies that are being taken private with the aid of large amounts of leveraged debt and only minimal equity cushions. Despite being within the investment-grade credit bracket, the Group remains unrated, having only recently tapped the public bond markets with a successful £200m debut issue. And there is currently a single asset-backed debenture in the market with principal of £50m. This borrowing structure means that a key element of the Group's capital-raising is through committed and uncommitted credit lines with banks.

The Co-operative Group enjoys a major benefit – not least on the banking side. It is necessary to travel a long way further up the corporate spectrum before you find a group operating in such a diverse range of businesses that also owns its own clearing bank. The Co-operative Bank plays a central role in the cash management side of the Group's business, providing clearing services to all its trading activities and branches. It also provides the pooling structures that enhance liquidity, as well as helping with the management of foreign currency exposure and issuing the occasional Letter of Credit. For the day-to-day running of the business, a naturally strong relationship between the Co-operative trading division and The Co-operative Bank is therefore a great advantage. But when it comes to the wider corporate banking side, regulatory and commercial reasons stand in the way of a full service relationship. This is especially the case considering that the Co-operative Group, like all retailers, is subject to large fluctuations in the working capital needed to pay suppliers, maintain floats and meet seasonal demands.

The Co-operative Bank does maintain a credit line for the trading division but the Financial Services Authority limits this to a sum far below the Group's overall needs. It is therefore crucial that the Group establishes strong 'third party' banking relationships to access credit lines and treasury services other than those provided by The Co-operative Bank. In particular, the ability to draw upon the expertise and experience of lead arranging banks to establish syndicated loan facilities is vitally important to the Group.

RELATIONSHIP-DRIVEN BANKING The Group's recent expansion policy was partly stimulated by the unprecedented consolidation that has been taking place in the UK convenience food retail sector, which is our core business. The Co-operative Group has not fought shy in this environment, acquiring chains such as Alldays, Balfours and, most recently, the 64-store Conveco chain based in the South West of England. This expansion programme has allowed the Group to maintain a leading position in the chosen sector – namely top-up food shopping – but also brought financial demands that spurred the review of its credit relationships.

The Co-operative Group had previously tapped the syndicated loan market with a £250m facility in 2000, which was underwritten by a group of 18 banks. This was set to mature in a single bullet in 2005, yet had become partly undrawn following the bond issue, which diversified the investor base, along with smaller than expected capital expenditure demands in the intervening period. In order to smooth the maturity profile, as well as take advantage of the unusually benign loan-market conditions that prevailed last year, the Co-operative Group therefore decided to launch a second facility. The resulting £150m 2004 facility refinanced half of the previous one, as well as providing further working capital of £25m.

It was decided that the mandate for this facility would not simply be a loan mandate, but that the Group would actively seek to award 'partner bank' status along with it. This would mean allowing the partner bank to bid for ancillary services, using a position of close understanding of the Group's business. This followed the renewed trend for relationship banking – a model now reclaiming currency after the more transactionally-driven days of the 1990s. But for an organisation like the Co-operative Group, which is itself built on principled relationships, it has never lost its relevance.

FINDING THE RIGHT BANK In late 2003, when the banking market was highly liquid and – for all that is spoken about relationship banking – still very transactionally driven, Group Treasury created a tender process that would allow banks to demonstrate their depth of commitment to relationship banking.

But what does the phrase 'relationship banking' actually mean? In order to define this, and formalise the tender process, we developed a balanced scorecard approach. This allowed us both to establish the right match on paper and to identify a cultural fit that would allow the two organisations to work together more closely. Perhaps more importantly, it provided the framework for competing banks to demonstrate their appetite for this kind of working relationship.

The five fields on the balanced scorecard were:

- an understanding of the Group, its structure and its businesses,
- an assessment of the bank's relationship management team and fit with the Co-operative Group's culture – could we work together?
- the range and innovation in ancillary products,
- the bank's credit assessment, appetite, and pricing terms,
- the bank's desire to collaborate and provide support in an expansionary environment.

The tender process – conducted in the early part of 2004 – led to Lloyds TSB Corporate being awarded partner bank status. Whilst the product matches and credit appetite were there, a key factor was the desire to approach the relationship on every level. Lloyds TSB demonstrated this enthusiasm by investing time to develop a good understanding of the complexities of the Group, achieved by sending a wide variety of their representatives to our headquarters in Manchester. Led by relationship manager Alan Greenham, this allowed the bank to build a clear picture of the Co-operative Group.

CO-OPERATION FROM MACRO TO MICRO Following the mandate being awarded, the relationship team continued exploring opportunities to add value to both organisations, engaging each of the respective businesses within the trading division. This is crucial to the success of a relationship approach being applied to such a large organisation, as it allows a more organic interweaving to take place at different levels of the business. In this way, over 25 people within the Co-op's management have now met product experts from Lloyds TSB Corporate to explore financing opportunities.

As was intended, opportunities have arisen in a wide variety of different areas. At the core of the relationship is the £150m credit facility closed in June 2004 – notably the £43m retained on the bank's balance sheet. But from this initial commitment, the relationship has already extended in many directions – from the extension of other large credit facilities to more individual offerings such as exploring employee benefit programmes. And the service opportunities were matched by advisory input where requested.

The initial credit line was soon expanded to include further substantial commitments. This came firstly in the form of a 364-day uncommitted line, which provided a further £20m of working capital – accessible, historically, on a 24-hour basis to provide further responsiveness to liquidity demands.

More specialised, however, was the bank taking over required guarantee cover for the Association of British Travel Agents (ABTA) bonds that are issued by our travel agency, Travelcare, to provide performance cover on the provision of holidays. The depth of this credit line extends to a further £20m.

Lloyds TSB Corporate has therefore made the transition from being a passive member of our banking syndicate to stand alongside Barclays Bank PLC as a primary provider of banking services and support to the Co-operative Group.

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