

Credit is the backbone of the corporate's relationship with its banks, if not in the short term, almost always over the long term.

# In sickness and in health?

## The key to a happy corporate-bank relationship

When it comes to credit, the playing field is rarely flat. In fact it is so uneven that banks are often accused of aiming their lending services at those who need them least. This has an ironic ring to it in these times of the 'credit crunch'. Whilst not wishing to focus on the extremes, it is the extreme that shows that the corporate-bank credit relationship is almost always biased one way or the other.

### **Negotiating a crunch-proof credit facility**

In good times a large, strong corporate has little need for bank borrowing, usually preferring to access the cheaper public debt markets. What little bank lending is needed, is at rates that banks can hardly make an adequate shareholder return on.

In bad times, some corporates will inevitably be at risk of failure and because banks are unable to determine which ones are vulnerable, they cut back lending across the board. This situation really tests the relationship and in many cases the value of a strong and well negotiated loan agreement is invaluable. Great care should therefore be taken when negotiating agreements with banks and this includes clarifying the details for extreme scenarios, as well as the more comfortable status quo.

Although not all corporate-bank relationships are based on credit, it is fair to say that the first and most important relationships for most corporates should be founded on their credit



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requirements. Only after these are properly arranged and structured should other more transactional relationships be developed.

In fact, the best time for the corporate to negotiate the credit facilities is when they are not needed. Admittedly, this means paying for something that is not required. While we are prepared to do this for fire insurance, the past years of easy money have led us to believe that when bad times were coming there would be plenty of warning and time to make arrangements. It didn't work out like that.

The first principle of managing a corporate-bank relationship is to ensure that the appropriate credit facilities are in place, that they are properly priced, correctly documented and thenceforth, properly managed on a continuing basis.

#### **Credit and other services**

Even though banking services are theoretically purchased separately, in practice banks that provide credit are usually looking at the returns they make on the overall relationship. The bankers may well expect the corporate borrower to purchase other banking services (almost invariably non-asset based services) to improve the overall relationship return. In some cases it can be investment banking and advisory services but in most cases it is the provision of operational services that enable banks to improve their profit from the relationship.

Operational services are based on money handling. Banks make money on these services in two, or sometimes three, ways. They charge fees on

co-ordinate and orchestrate their organisation's delivery of services to the corporate. Corporates create banking managers to do the same in reverse.

#### **Feedback and communication**

For the relationship to work well it has to work at every point of contact, right down to the clerk in the payments department. In order to achieve this, some formality of reporting is necessary within the corporate organisation. Ideally the company undertakes a formal annual banking review whereby everyone who has contact with the banks completes a feedback form which is summarised and used in the annual review. The review should score the banks on the services they provide. It should provide positive and negative feedback. It should not be a price negotiation forum, nor a selling opportunity for the bank. This is a key part of developing an open and honest relationship with the bank.

Annual reviews are the minimum advised. Some companies have semi-annual meetings. But it is also important to have an escalation process whereby one-off events (unfortunately these are usually due to transactional problems) are reported to a senior level for communication to the bank at a senior level. The bank will want to correct relationship issues as quickly as possible but often these get hidden from view.

Equally important is for the corporate to provide the bank with an annual review of its credit standing and business outlook. This may also be an opportunity to alert the banks to forthcoming business opportunities, either for extending the relationship with additional services or in new geographies. But again this should not be a sales discussion.

## “Relationships have to work and be effective”

payments and sometimes receipts, they earn on balances, and they may also make spreads on captive FX. However, as well as being a supplement to the banks' earnings on assets, these services also provide efficient day-to-day operations for almost all corporate customers. Whereas a loan may be drawn and used for some investment and hardly considered from one quarter to the next, transactions are processed constantly and typically every transaction earns a small fee for the bank. Though the individual fees are small, errors can be expensive, both in charges and in operational disruption.

#### **Keep the faith**

The nature of this transaction service relationship is very different from the borrowing relationship. It typically impacts the corporate in multiple subsidiaries, often at a clerical level, in areas that are usually off the senior management's radar. The compensation taken by the bank is virtually impossible to track, for although fees are visible, float and FX spreads can be well hidden. When things go wrong they are fixed by relative juniors in the organisation, and the costs are never calculated. If the bank puts a lot of faith in the corporate with a lending relationship, the corporate puts an equal amount of faith in the bank with a transactional relationship.

This faith must be based on honesty and openness. This is therefore the fundamental requirement for a good corporate-bank relationship. However, in reality the relationship is between many people in the bank and the corporation and all these relationships have to work and be effective. Both organisations appreciate this. Banks create relationship managers to

Such conversations should be a part of a continuous communication process, but it is good to have one formal review usually after the annual results are announced. These days the corporates are well advised to request the same of their banks. In fact the more alert corporate may decide to take the initiative first and win first mover advantage.

#### **The banking service 'bundle'**

In conclusion, credit is key to the corporate-bank relationship, but transactional services are also very important in this increasingly “bundled” banking world. Effort has to be made to ensure that comprehensive reviews take place and the nature of the relationship is properly evaluated throughout the organisations. Open communication is vital.

Zanders has assisted its corporate clients in various aspects of bank relationship management, from structuring reviews and feedback to undertaking pricing evaluations and assisting with negotiations. <



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