Managing The Bank Group – The Basics

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During my interaction with management at Latin American companies, there is often a discussion on how to manage their relationships with banks. How many banks should the company do business with, and which ones will make the best financial service providers? Whatever the nature of the company's business, banks are there to help – to provide funding, to offer advice, to reduce risk, to collect and disburse funds, among other things. There are numerous elements that can drive the relationships between companies and financial institutions, but management's objective should be to reach a balance within its bank group that is consistent with its current and future capital structure needs.

Many banks have the ability to offer multiple products to a particular company, and may charge less for individual products as a way to sell more to the company (known as cross-selling). These "relationship banks" tend to work toward a targeted share of the company's total banking business. They want be at the top of the bank group, and closely watch their share of fees earned in relation to the total paid out by the company.

On the other end of the spectrum are "transactional banks". These offer fewer products; but their attractiveness as financial service providers is a high level of specialization and market recognition. They view the company as one of many potential customers for a specific business deal. Transactional banks seek opportunities to compete when a company requires the products in which they specialize, and maintain relationships for this purpose.

Every bank is unique, and in reality, none are pure relationship or transactional banks, but rather a little of both with a tendency to act like one or the other. Most companies maintain a combination of relationship and transactional banks within their bank group, depending on the need for different financial products. Finding the optimal mix is not an easy process. And it is even more difficult when a company is mapping a future for itself in which its banking requirements differ from the past. For instance, if management is anticipating M&A activity, it may attract specific investment banking teams. Even if existing banks have M&A capabilities, their industry specialization may be different, or possibly they are already working with other companies within the same industry and have a conflict of interest.

Companies should not have too many relationships, because banks need to earn revenue. There must be enough interest margin, and possibly more importantly, fee income to go around. If a bank is not reaching its target in terms of profitability, there is a chance that it will abandon the relationship, or more likely, dedicate less resources, which could lead to thinner coverage or a banker with less experience. The bank group cannot be too small either. Healthy competition leads to lower interest and fees, and banks tend to be more creative when fighting for new business, which means more proposals for products and services that could reduce risk or increase efficiency.

It is also important to make changes periodically. As new financial institutions seek to enter the group, management can weed out any banks not performing as expected. The supply of potential new banks derives from the company's attractiveness as a banking client, which also feeds the competitive spirit within the existing group.

Finally, history is important. Companies remember when a bank helped it through a difficult time. Banks have memories also, and place a lot of weight on long-lasting relationships, mostly given the implications in terms of understanding the company's credit performance through hard times and the good. But a bank group and the relationship with each bank cannot be built on history alone. The financial industry has undergone enormous change over the years, and it is hard to predict if the future relationship with a particular bank will be consistent with the past, especially if it has been through a merger or if there have been substantial changes to the regulatory environment.

Companies should review their banking relationships frequently, and make gradual adjustments as necessary, consistent with the constant evaluation and optimization of the capital structure within the context of management's strategic business plan. Managing banking relationships is yet another example of a significant undertaking that is more of an art than a science, with serious and long-lasting implications for the company.

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