

Adding Value to the Banking Relationship.

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It is, perhaps surprising that bank financing, typically representing some 15% of company overheads very often receives little critical attention, being accepted as a necessary but largely immutable cost centre. Similarly, the treasury function tends to be viewed internally as a function apart, having little reference to the main business of the company. Banking and Treasury should on the contrary be seen (and evaluated) as essential props to the main business of the company, to which they should be fully sensitive.

Which Bank?

When first selecting (or later reviewing) ones bank, whether for domestic or foreign operations, one should ensure that it meets the following essential requirements.

- That it has a necessary understanding of the nature and vagaries of ones industry and ones business.
- That it has a branch network appropriate to ones business trade - for clearing and cash management requirements (at 7.5% p.a., one day lost in money transmission of £100m costs £30k annually!)
- That it has a full range of services (and, if dealing internationally, of foreign relationships)
- That it has a readily understandable and efficient screen-based system for money management.
- Finally, that it has an acceptable scale of tariffs

The Cost of Funds.

Corporate treasurers should familiarise themselves with their bank's credit rating criteria, viz. Net Worth, Cashflow capacity, Profit/Interest cover etc. As corporate-banking relationships tend to be singular and of long duration, it is often a good idea, when renewing or securing new finance and before concluding an arrangement, to invite two or more banks to provide indicative quotations. It is otherwise difficult for corporate treasurers to 'benchmark' borrowing rates (or, indeed, rates on deposits and investments). Banks may usefully be asked to explain their rate structures e.g. 'Prime' and 'AA', also funding margins vis a vis EURIBOR (formerly DIBOR). In this way one can note the 'spread' between the cost and the return on ones funds. A common source of banking cost noted is that of the spread between concurrent company savings and borrowings. The first rule of borrowing must be first to use ones own money! Thereafter, to secure any additional liquidity required, loan commitments can be discussed and arranged with banks - the cost, say 1/4 to 1/2% will always be lower than the spread between concurrent borrowing and savings rates.

The Overdraft.

Despite associated surcharges (and some of its curiosities), the overdraft, justly remains the most popular form of corporate finance. However, to achieve cost efficient utilisation, one should ensure that:

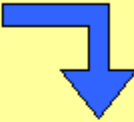
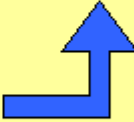

- The level of overdraft negotiated is fully adequate to monthly and seasonal fluctuations and to

- other contingencies (and will not need to be supported by e.g. 'lagging' company creditors)
- That the rate is negotiated at the minimum, by reference to company credit rating.
 - That the local bank is convenient to the main source of cash receipts.
 - When trading involves foreign currencies, whether at home or abroad, that the overdraft is denominated in the appropriate currency.
 - That the rules of the clearing system are understood and observed e.g. the forward dating of lodgements and the back dating of a company's own cheques (see diagram - but note that AIB has recently introduced revised clearing arrangements for its customers).

Further,

- That inappropriate surcharges or covenants do not appear in the facility letter.

Illustration of Irish Bank's Clearing Cycle - 'A' Lodges 'B's Remittance* Cheque on Monday

	Monday	Tuesday	Wednesday
A (Creditor)	'A' Lodges 'B's Cheque	'A' Receives Value	
Banking Treatment Of Transaction	Lodgment appears on 'A's Statement		Cheque appears on 'B's Statement
B (Debtor)		'B' loses value (i.e. Value is Backdated)	

*Remittance cheque - a cheque drawn on another branch or bank

Overdraft Interest Surcharges.

It is not unusual to note bank interest surcharges which greatly increase the basic cost of borrowing. These surcharges can be managed and minimised.

1. The Excess Penalty

This can be reduced by arranging an appropriately high overdraft limit, by negotiating a standby facility for exceptional events or periods and by managing ones account by reference to the value

balance rather than the statement position. (See diagram).

2. Set-Off

Charged on the lower of concurrent debit and credit balances, this charge can generate a high cost, even when ones net bank position is in a credit surplus. It can be avoided by monitoring balances and by making account transfers.

3. The 30 Day Rule

Increasingly, this stipulation is being dropped by Irish banks, who recognise that the overdraft has become a year-round funding instrument.

Illustrating the Relationship of the Three Bank Balances and Interest Calculations

	£K	Interest Charge Say @ 10% p.a.
Statement Balance, say,	100,000 OD	£27.40
Add back that day's Lodgment	40,000	£11.0
= Cleared Balance	(140,000) OD	
Add following day's incoming Cheque	50,000	£13.70
= Value Balance	(190,000) OD	
Total Interest Charge		£52.10

Other Overdraft Terms.

The other terms of the facility letter e.g. regular reviews, furnishing management accounts and advance notice of foreseen difficulties should be observed and will assist in promoting a supportive banking relationship.

Account Grouping.

All current accounts should, of course, be grouped, not only for overdraft permission, but also for interest. Again, it is not unusual to find current accounts which are 'grouped' for permission - but not for interest. A word with your manager will eliminate costly confusion.

Bank Screen Based Systems.

Each of the four main clearing banks has its own screen-based system. When managing the overdraft one should ensure that one is managing to that banks' value balance - not simply to the 'ledger balance' or to the 'cleared balance'. Here, one should avoid confusion between balances which are cleared 'for value' (after 1 business day) and funds which are cleared 'for fate' (generally after 3 business days). It is not unusual to find major companies controlling to the incorrect clearing positions.

Significance of the Overdraft

Properly managed, the overdraft is a highly cost efficient mode of finance, used in conjunction with longer term finance it also adds considerable flexibility and strategic value.



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