December 2006

Banking Costs and Benchmarking: Bringing Transparency to Banking Negotiations

By Bob Fisher

Someday, and it may be soon, your CEO is going to ask you a tough question: "How do you know that our banking arrangements are competitive?" Think about it. How would you respond?

Would you talk individual service charges – and explain how you fought to hold current account service charges to a 3% price increase? Would you talk about why you've never tendered the relationship – even though all other supplier relationships are tendered as a matter of course? Would you focus on the positive and point out that you delivered what's important – the needed credit line increase and covenants you can live with – not pricing. Or would you skirt the issue entirely?

Choose any of these answers and you miss the point.

Bank prices can be managed and, in most cases, they are an untapped source of value. To unlock these savings, you need a strategy and a tool. The strategy is called principled negotiating and the tool, benchmarking. In Canada, there's one company that brings offers both – CB intelligence Inc. I recently had the opportunity to talk to Dick Clark, President of CB Intelligence about his company.

Dick, first can you tell us a bit about "CB Intelligence"?

CB Intelligence is a Canadian company. We're owned and operated by three Chartered Accountants. Our business is market intelligence about bank pricing practices. Our mission is to make bank negotiations transparent. Companies use our reports to benchmark their bank pricing. In a very real sense, we make principled negotiating and fair banking agreements possible.

Are there similar companies in the United States?

Yes. Phoenix-Hecht publishes *The Blue Book of Bank Prices*. In the US, using benchmarking in bank fee negotiations is a well established and widely accepted business practice. Phoenix-Hecht's US data doesn't apply to the Canadian banking market.

Who are your customers?

If you're a company that operates in Canada, your revenues are greater than $15 million, and you have a relationship with a Canadian financial institution, then you're a potential customer. We have found that companies smaller than this don't have the size to generate leverage in fee negotiations.

What does CB Intelligence do?

CB Intelligence administers the **CBI National Banking Survey**. You can check out the survey and our business at www.banksurvey.ca We collect and analyze survey data and publish this data in a series of benchmarking reports.

Are there any other companies like CB Intelligence?

Yes and no. Stewart & Associates publishes a survey of bank fees. The last Stewart Survey was published in 2004.

Is CBI's National Banking Survey the same as the old Stewart Survey?

The concept is the similar but the execution is quite different.

First, the Stewart Survey was a paper based questionnaire. The questionnaire asked respondents to write in details of their bank pricing. The **CBI National Banking Survey** is more efficient. It's internet based and uses a "point & click" methodology. Our format lets us collect more data, more accurately, in less time. A typical **CBI National Banking Survey** can be completed in about half an hour.

Second, the reach of the **CBI National Banking Survey** is far greater. We track more variables in greater detail. The **CBI National Banking Survey** will report results on the basis of size, credit profile, industry type, credit worthiness, and location, as well as a variety of physical parameters.

Third, the reporting format will be quite different. The **CBI National Banking Survey** places far more emphasis on the results of regression analysis. This lets us get at the heart of causal factors that drive bank pricing. The **CBI National Banking Survey** will report results in pivot table format Pivot tables let us combine results for a single variable like operating line pricing for all banks in a single table. It also lets us report pricing for linked variables like operating line pricing and covenant requirements in a single table. This reporting methodology lets our customers benchmark their bank pricing very efficiently.

Let's back track for a moment. Do companies need really need borrowing cost and service charge benchmarking information?

You would expect us to say yes and that's the short answer.

Our experience says that when it comes to negotiating banking agreements, benchmarking will deliver a better banking deal, more efficiently, than any other negotiating strategy. To understand why you have to recognize that in fee negotiations the banks have been dealt face cards.

For starters, banks are shielded from pricing pressures that are commonplace in other supplier relationships. Companies that tender their banking relationship are the exception, not the rule. When companies do tender, they seldom include target pricing – an accepted practice in most other contract reviews. Without the threat of nose-to-nose reviews, bankers are insulated from price competition. In banking, the lowest price is seldom the law.

Banks are also masters when it comes to bundling. They know that fees are rarely a deal breaker in credit negotiations. Fees and service charges are marketed as part of the cost of obtaining credit. Financial executives and their advisors – be they chartered accountants or lawyers – seldom call the banks on this practice. Bundling establishes ground rules that give the banks a real edge at the negotiating table.

If structure and process advantages weren't enough, the banks have a third ace up their sleeve. They operate in an industry where switching costs are an issue. At best, banking arrangements are inconvenient to unravel. Few companies believe that borrowing cost and bank fee cost savings justify the effort and aggravation of a banking change. This inertia favours the status quo and tilts the negotiating table even further.

Fourth, borrowing costs and service fees are an important component in the banks' profit model so they take renewal negotiations seriously. They know your company's credit needs and limits. They know the competition – yours and theirs. They know the deals on the street. They're masters at balancing returns over a broad range of products and services. Lots of companies have the knowledge to negotiate terms in one area. Typically we find that companies will concentrate on getting favourable terms in one or two areas that are important to them. Without benchmarking data, they will often pay for those concessions in other areas with the net result being the bank still comes out even or ahead. When it comes time for the banks to negotiate their compensation package, bankers get it.

The final advantage hails from an unexpected source. The banks' own customers. Simply put, managing banking costs is not a priority to most companies. Corporate banking concerns typically start and stop with credit availability. The banks benefit from this constraint. In many companies banking fees are an unmanaged cost. In many negotiations, the banks prevail by default.

So if banks have dealt face cards, does this mean that they will try to profit from their preferred negotiating position?

Again, the short answer is yes. This doesn't mean that bankers are scoundrels or villains. They are simply smart business people who make the most of their negotiating opportunities.

In business you get what you deserve and you deserve what you negotiate. Banks are tough negotiators because they understand the importance of price in the marketing mix. They recognize that small price increases yield disproportional growth in operating profits. They also understand that price leakage can shrink profits just as quickly. When McKinsey & Company calls "pricing the fastest and most effective way for companies to grow profits", banks get it. Price increases are an important component in the bank's profit model. Banks understand the profit potential of managing prices. When it comes to managing prices, banks are proactive. Their customers should expect nothing less. They should be equally proactive managing banking costs.

What savings can companies expect to realize by using benchmarking data in their bank fee negotiations?

Savings depend on the bank and specific circumstances of specific companies. Our experience says the savings of $25,000 for medium and large companies are not uncommon.

Can you give us a cost saving example that our readers could relate to?

Certainly. Consider Bankers Acceptances. A 20 basis point saving in BA stamping fees translates into a $20,000 savings for a company that has outstanding debt of $10 million. Benchmarking data is the only way to determine whether the relationship between operating line pricing and BA stamping fees tally and whether the proffered stamping fee is competitively priced.

What about foreign exchange (FX)? FX is something that's important to many companies.

FX is more difficult. It's hard to get benchmarking information for foreign exchange pricing.

Many companies report that they trade at "spot" and assume that this represents good pricing. It doesn't. Spot is a settlement convention that says nothing about the spread over interbank rate that a company is being charged. It also ignores the pricing impact of fees and wire charges that are routinely added to many FX bills.

Transparency in FX pricing is notable by its absence. We've not seen a banking agreement that offers fixed mark up pricing. Bank spreads vary by institution, transaction size and volume. Companies that don't actively shop their FX business routinely pay a premium.

In the area of FX pricing, CB Intelligence has tried to simplify matters. We have an arrangement with Laurentian Bank that gives our clients fixed markup FX pricing. This pricing is “big box” lean. Markups start at 25 basis points for $100,000 transactions and drop to 5 basis points on transactions of $1 million or more. There are no fees or wire charges.

CBI’s web site has an FX Calculator that lets companies compare the mark up rates they are charged against this standard. If the FX calculator reports a variance of 5 basis points or less, then they know their pricing is good. If the difference is larger, then their FX pricing deserves a second look. A 50 basis point spread on annual FX transactions of $5 million represents $25,000 cost savings opportunity.

These two examples underlie an important principle. In negotiations, it’s not unusual for one party to be better informed than another. Economists call this condition information asymmetry. For banks, it’s a source of competitive advantage. The savings that accrue from benchmarking prices across a whole range of banking services are cumulative.

What do you say to CFO’s who claim they have bigger fish to fry than chasing borrowing cost and bank fee savings?

Executives who think this way are using the wrong yardstick. Benchmarking zero bases your fee structure. Cost savings that result from this exercise offer a multiyear return. $25,000 in annual cost savings may not be an annuity, but its close.

CB Intelligence estimates that bank cost savings have a 10x multiplier effect on shareholder value. A $25,000 cost saving opportunity that yields a $250,000 shareholder value increase is an opportunity that doesn’t come along every day.

It's clear there's a benefit for companies. What about the banks? Do they benefit too?

The short answer is yes, though there may be some growing pains.

Where banks have negotiated premium pricing, savings that flow from benchmarking will accrue to their customers. Given the multiplier effect that pricing has on earnings, this could be problematic. No bank wants to see profit erosion. Having said this, no bank want to be accused of shoring up record results by disadvantaging their customers. Temporary margin shortfalls may be a cost of principled negotiations in some accounts.

Problematic or not, pricing adjustments are a short term issue. Long term, benchmarking is good for the banks.

Benchmarking data will enable banks to publicly justify their pricing policies – an important consideration in a regulated industry that’s concentrated and reporting record profits. It will also remove much of the suspicion and grumbling that’s part of conventional fee negotiations. This can only strengthen the relationship between banks and their corporate customers.

Benchmarking will also influence how banks are perceived. When banks are pitching new customers, benchmarking data provides a more believable and compelling rationale for switching. When banks are looking at marketing opportunities, benchmarking will highlight where they're most competitive. For years investment dealers have used the results of the Brendan Wood surveys or the Euromoney magazine surveys to promote their organizations. Benchmarking data opens the same door for Canadian banks. Whether it's borrowing costs, cash management fees, or overall client satisfaction, being able to say 'We're Number 1' is a powerful marketing statement.

Some executives are going to be concerned about data confidentiality and leery about completing a questionnaire on the internet. How do you respond to their concerns?

This is a good question and one we've given a lot of thought.

For participants taking the survey, the survey is hosted on a secure server. That's why there is an "https" in the survey URL. The server is maintained in a secure facility to control physical access to the equipment. Access to the server from the internet is also controlled. The only way in to the survey is through the CBI website, past two firewalls. Finally survey information is stored in two data bases – one for contact information and the second for survey data. The key linking these two data bases is encrypted.

More generally, CB Intelligence has a strict privacy policy. We will not sell, share, or otherwise distribute the names of our survey respondents or customers to any third party. We will not authorize third parties to market ancillary products or services to survey respondents or customers. Finally, all survey data will be aggregated for purposes of protecting the anonymity of individual Survey respondents.

On the matter of credit card information that data is passed directly to our payment processing company. We do not retain credit card information.

Let's finish up with two final questions. First, what about products and pricing?

CB Intelligence offers several reports:

The *CBI National Banking Survey Report* provides an overview of bank fee practices along with pricing data, trend analysis, and commentary and is priced at $895 plus GST.

The *CBI Bank Benchmarking Report* and the companion *Bank Fee Calculator* contain the detailed information needed to negotiate a fair and equitable banking deal.

The *CBI Bank Benchmarking Report* is, at heart, a data table report. It provides detailed statistical information, in tabular format, about price ranges for bank borrowing costs, interest compensation and fees. This report does **not** include commentary and analysis. The *Bank Fee Calculator* is an input/output model that lets a company compare its banking cost and service fee profile to those of its peers. The calculator is based on a regression analysis of survey data.

The *CBI Bank Benchmarking Report* and *Bank Fee Calculator* are priced at $1895 plus GST.

The *CBI Value Pack Report Package* includes all three reports. This package of reports provides the analysis and data needed to level the playing field in banking negotiations. The CBI *Value Pack* is priced at $2,295 plus GST.

For companies who don't have the time to work through these reports, we offer the *Custom Report* option. Priced at $3,495 it includes the three *Value Pack* reports plus a formal written report detailing the company's banking cost and service fee positioning profile as well as negotiating recommendations.

Our last, and most comprehensive option, is a *Treasury Review*. Companies that select this option receive all the CBI Banking Reports, plus a full review of their bank pricing and treasury systems. *Treasury Review* assignments are undertaken on a contingency fee basis and require a $5,000 deposit.

Now the last question. Are there any special incentives for companies that participate in the survey?

Yes. If you complete the survey <u>and</u> your company subsequently purchases a CB Intelligence Survey Report we send you a free Mont Blanc pen or digital camera. For companies whose "Conduct" policies prohibit their employees from accepting incentives like this, we make an equivalent cash donation to the Kidney Foundation of Canada.

****

Well there you have it. CB Intelligence is currently in the process of recruiting companies to take its *National Banking Questionnaire*. Report publication is scheduled for October 2006.

Clark made a final point after the interview was completed. He said that the success of the CBI initiative depends on a large number of companies participating in the survey. The more respondents, the more reliable and robust the data. In his words, "A half hour investment of time is all we're asking. It could be the difference between having a tool to manage your banking costs and being a price taker next renewal." We agree. You have to help CB Intelligence to help yourself.