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Reprinted from AFP Exchange, 2008.

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Canadian Treasury

Canadian Banking Costs

A close-up photograph of a hand moving a white chess king piece on a chessboard. The piece is in sharp focus, while the other pieces and the board are blurred in the background. The lighting is dramatic, with strong highlights and deep shadows.

*Staying ahead of the game
in times of credit crisis*

Staff Writers

The economic slow down and subprime debt crisis is putting upward pressure on Canadian bank pricing and ushering in a period of credit rationing. CB Intelligence President Dick Clark discusses why managing banking arrangements is poised to become a “front burner” issue for Canadian CFOs and U.S. treasury executives managing Canadian banking relationships. He explains what you need to do to get ready.

How do you manage banking costs without access to borrowing cost and bank fee benchmarking data? The Canadian experience says, “With great difficulty.” Canadian CFOs and U.S. treasury executives managing Canadian banking relationships have never had access to borrowing cost and bank fee benchmarking data that’s taken for granted in the United States. Absent this key tool, few Canadian companies manage their banking costs properly and fewer still make managing Canadian bank pricing a priority.

The economic slowdown and subprime debt crisis will change this. With debt rationing and upward pressure on bank pricing in the wings, managing the banking relationship is poised to become a front burner financial issue with long term cost consequences for Canadian companies.

In the following interview Dick Clark explains why managing Canadian banking costs is problematic, and what you need to do to get on top of this issue. Dick Clark is the president of CB Intelligence Inc (CBI), a Canadian market research company that specializes in benchmarking bank pricing.

What’s changed that makes managing the banking relationship a front burner issue for Canadian CFOs?

The major and most obvious change is the subprime debt crisis and the recession threat it is creating.

Canadian banks, though they are better off than their U.S. counterparts, have been hard hit by the subprime debt crisis. At the CIBC, for example, subprime debt related write downs exceed \$4 billion and there are rumblings of potentially more to come. Canadian banks have not proven immune to the subprime debt write down problem.

Both globally, and in Canada, there is concern that we’ve only seen the tip of the iceberg. The best scenario we’re looking at is an economic slowdown and an economy that won’t slip into a recession. However, even if we avoid the worst, bank credit is going to be rationed. For many Canadian companies, tighter bank credit will come at a time when they can least afford it. And it will be more expensive.

Why do you think that banking costs are also slated to increase?

Bank balance sheets have been rocked by subprime debt write downs and growing loan loss provisions. Collectively, they are under tremendous pressure to reverse the slide in profits, rebuild their balance sheets, and restore billions in market cap that have been lost. Having said this, we can also say that bankers have limited options. When it comes to jump starting banking profits, commercial customers are an easy place to start.

What makes the banks’ commercial customers such an attractive starting point?

When it comes to negotiating bank pricing there are four conditions that place banks in the driver’s seat.

First, banks are immune from pricing pressures that are commonplace in other supplier relationships. In Canada, companies that tender their banking relationship are the exception, not the rule. Without the threat of nose-to-nose competitive reviews, banks are insulated from price competition.

Second, banks are 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. Most CFOs are reluctant to put the credit relationship at risk to deliver borrowing costs and bank fee cost savings.

The third factor is switching costs. Few companies believe that borrowing cost and bank fee cost savings justify the effort and aggravation of a banking change. This inertia favors the status quo and tilts the negotiating table even further.

The final factor is motivation. Bankers and their customers approach borrowing cost and fee negotiations with different agendas. For most CFOs, credit availability, not managing banking costs is the priority. Bankers look at pricing from a different perspective. They understand that price increases have more leverage on bank profitability than either volume increases or cost reductions. When it comes to price increases, bankers are highly motivated negotiators. They recognize that price is an important driver in the bank profit model.

Why is it important for Canadian CFOs to tackle the pricing issue now?

Managing bank pricing is not a “pay me now or pay me later” choice. Bank pricing is “sticky”. For most companies, today’s price increases represent tomorrow’s baseline pricing. This annuity effect gives bank pricing decisions multi-year impact. Borrowing cost and bank fee negotiations have long term cost consequences – particularly if the banks use their dominant negotiating position to leverage premium pricing as part of a recovery strategy.

CFOs who understand the “pay me now and pay me later” quality of bank price increases ascribe a minimum 5x multiplier to approximate their real cost. The value creation yardstick gives bank price increases much needed visibility and highlights the true cost of letting fee negotiations slide. It also underscores a negotiating reality. Bank price increases represent a permanent value transfer from companies to their banks.

U.S. CFOs are quite familiar with the use of benchmarking data in negotiating bank pricing. Can you explain how benchmarking will benefit Canadian CFOs?

Currently, bank price negotiations have been one-sided, particularly in the smaller company and mid market segments. Benchmarking remedies this situation through disclosure. When companies have access to benchmarking data they can see whether or not their banking deal is competitive. Benchmarking brings transparency to a negotiating table that has until now been anything but.

How do you believe that the banks will react to benchmarking?

There’s a short term and long term answer to this question.

In the short term, banks that have played fair with their customers have little to worry about. If, however, they have leveraged a strong negotiating position into premium pricing, they will feel the pinch. Savings that result from leveling the playing field will accrue to their customers.

In the long term, benchmarking will benefit the banks. Benchmarking will enable banks to publicly justify their pricing policies – an important consideration in a regulated industry that, until recently, was reporting record profits. By referencing a standard that’s independent of the bargaining strength of either party, benchmarking will also remove much of the grumbling that tarnishes current fee negotiations. In time, it will drive both productivity and market share gains. When banks are pitching new customers, benchmarking data will provide a more believable and compelling rationale for switching. When banks are looking inward, benchmarking will highlight where they’re competitive and where they’re not.

Borrowing cost and bank fee benchmarking is new to Canada. Can you describe the “next steps” in its introduction?

There’s a cliché that says the longest journey begins with a single step.

For bankers, the first step is deciding whether to view benchmarking as a problem or an opportunity.

Bankers who turn their back on the transparency that benchmarking promises will validate the suspicion and grumbling that’s traditionally been part of fee negotiations. Long term, no banking relationship will survive negotiations in which one party feels deliberately disadvantaged.

Bankers that take the high road should fare much better. By justifying bank pricing in terms of an external independent standard, they will demonstrate that, when it comes to relationship banking, they are prepared to “walk the talk.” This can only strengthen their position.

For financial managers responsible for managing a Canadian banking relationship, the use of benchmarking in fee negotiations is the first step in managing a cost that has heretofore managed itself. In benchmarking companies finally have a tool that makes bank pricing anomalies obvious. The bigger question is will Canadian companies take advantage of this new tool and be as diligent protecting their shareholder interests as the banks have been protecting theirs?

CBI hosts the CBI National Banking Survey and publishes the CBI National Banking Survey Report. More information on CBI and managing Canadian bank pricing is available at www.banksurvey.ca.