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# Forming A Cost Effective Relationship with Your Service Provider

A Presentation to  
The Windy City Summit

May 24, 2000



# Agenda

## ➡ The Need for Financial Relationships

- The Banking Perspective
- The Treasury Perspective
- Relationship Trade-offs
- Guidelines for a Cost Effective Relationship

# The Need for Financial Relationships

- Gain Access to Financial Markets
  - Investments
  - Capital Markets - Debt / Equity
- Serve as Fiduciary / Custodian
- Reduce Sensitivity to Market Rates - FX, interest rate contracts
- Provide Operating Services
  - Process transactions - via Fed / ACH / Credit Cards
  - Provide balance Information - cash position / S.T. liquidity
  - Pool or net x-border cash flows or transactions

# Types of Relationships

- An Efficient Relationship is One that is Often:
  - Process Oriented - less interested in the final outcome
  - One Sided - focused only on one partner's goals
  - Measured in terms of output vs. input
  - Examples:
    - Prints out all financial reports by deadline, doesn't use electronic formats, not concerned with system interfaces
    - No tolerance for any errors, regardless of the error rate
    - Needs "one-off" services but only focuses on unit costs (i.e. wants to pay standard prices for custom service)
    - Never speaks to vendor unless there is a problem

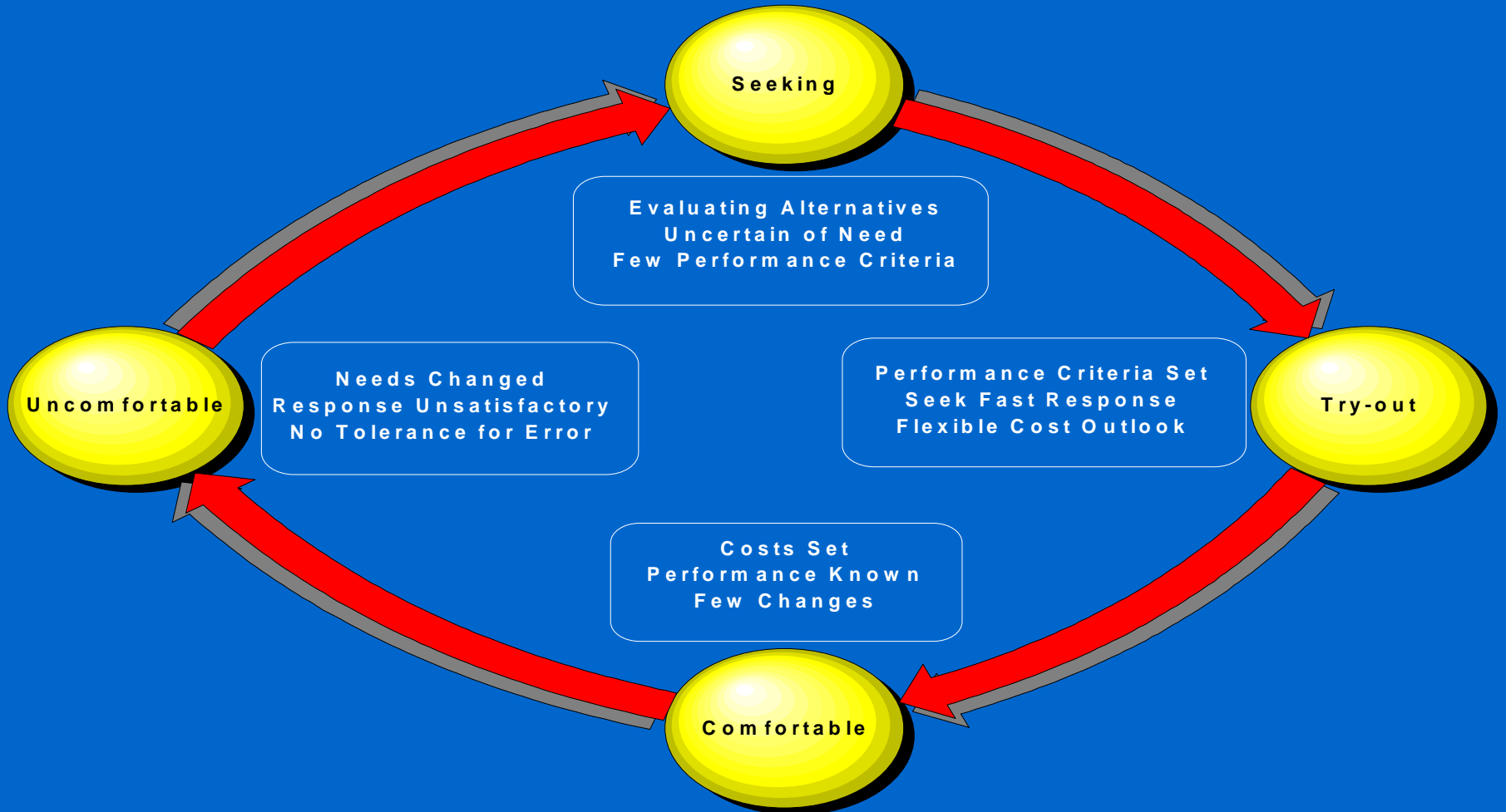
# Types of Relationships (2)

- An Effective Relationship is usually:
  - Outcome Oriented - considers the goals of both relationship partners
  - Focused on the Future
  - More Difficult to Measure - expresses performance in quantitative (e.g. price) and qualitative terms
  - Examples:
    - Seeks delivery of customized services to achieve corporate goals
    - Recognizes need for adequate ROI by service provider
    - Looking to vendor for advice and solutions, not just products
    - Meets periodically with vendors to exchange market perspectives

# Relationship Evaluation Criteria

- Size - number of relationships or bank accounts?
- Service Selection - Make or buy? Features?
- Costs - one-time, transaction or maintenance?
- Performance - errors, process deadlines, response, etc.
- Access to Services
  - Who? (HQ, business units, other financial units)
  - How? (Bank, 3rd party or in-house systems)
- Maturity of the Relationship

# Relationship Life Cycle



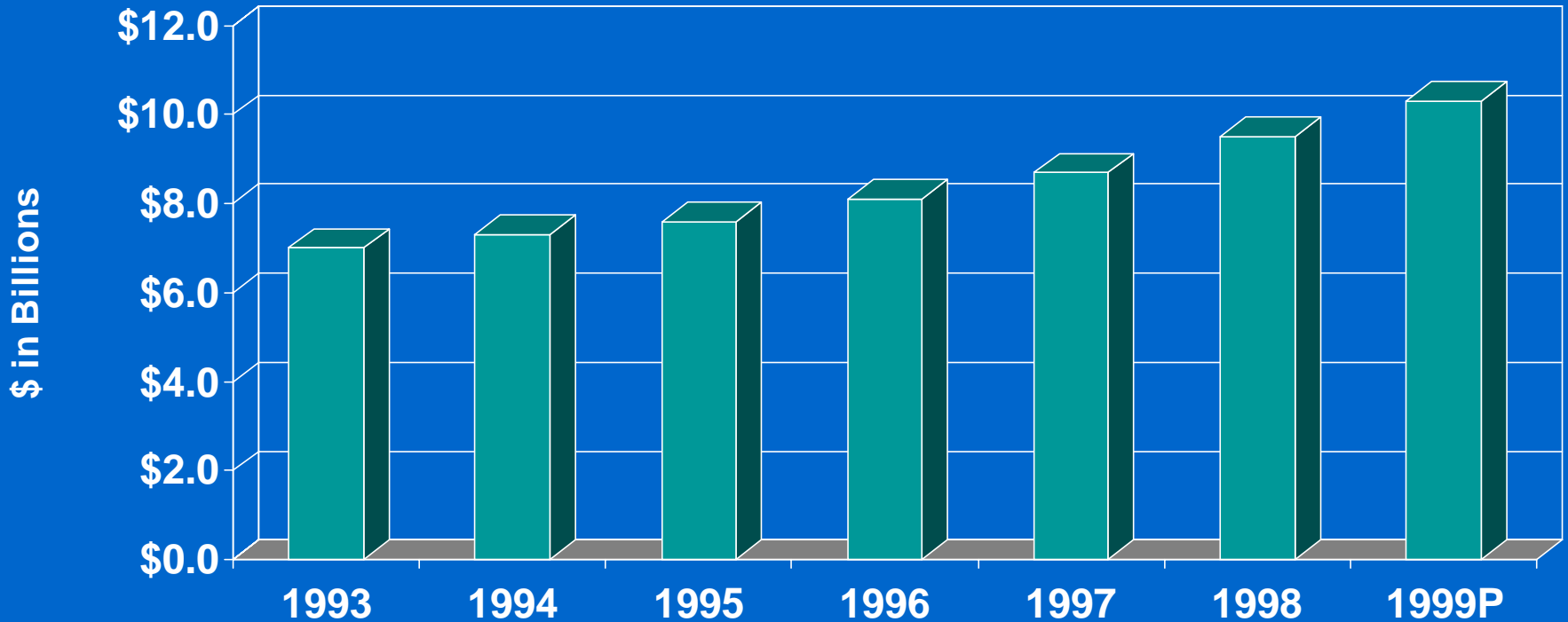
# Agenda

- The Need for Financial Relationships
- ➔ **The Banking Perspective**
- The Treasury Perspective
- Relationship Trade-offs
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# The Banking Perspective

- Require Large Markets & Standard Product Lines
  - Credit / Guarantees - credit facility, L/C
  - Trust/ Fiduciary - transfer agent, pension fund manager
  - Operating - processing transactions, information
- Looking for Growth Potential
  - Function of customers, services, volume, price
  - Want barriers to entry - regulators ? internet?
  - Market Concentration - one-stop shopping ?
- Profitability
  - On investment (i.e. technology, people, etc)
  - On sales or marginal costs
  - On risk adjusted return to capital

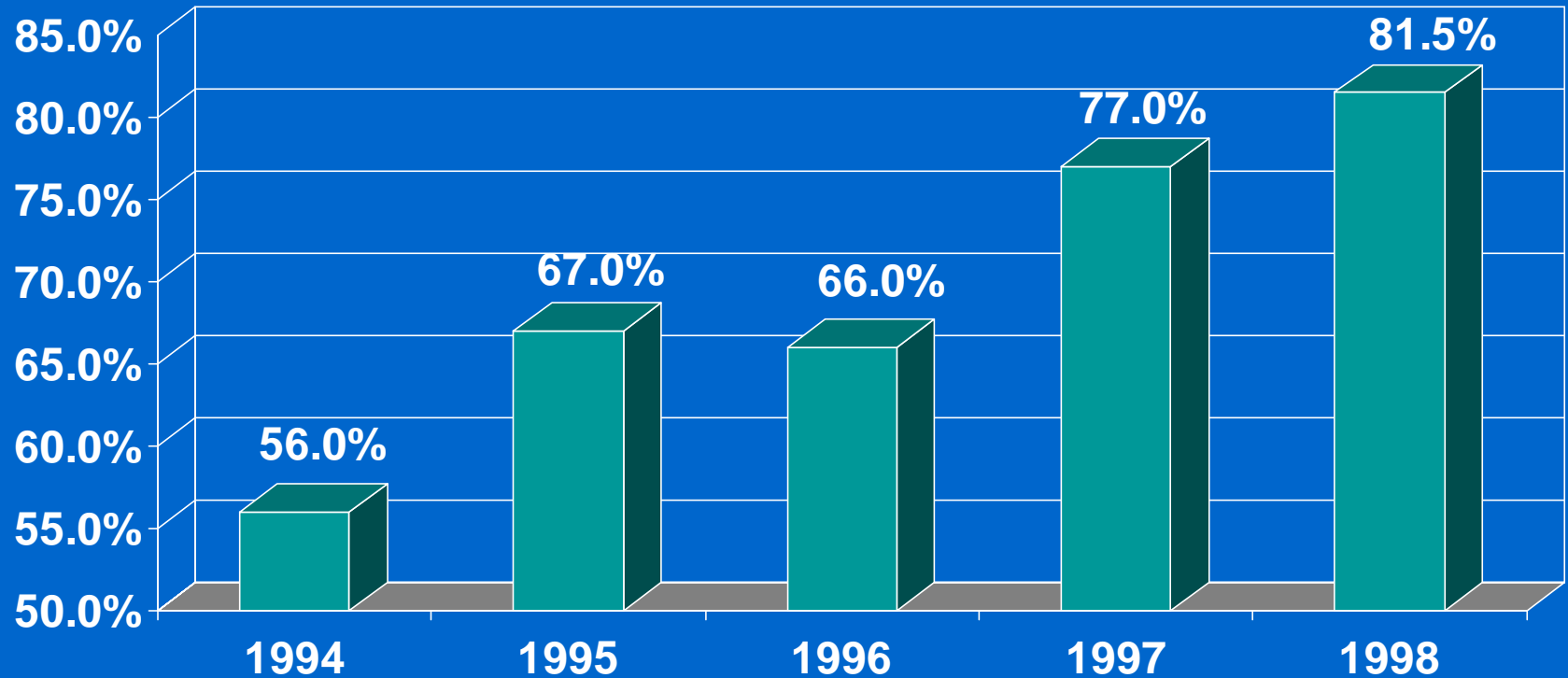
# Size of Cash Management Market



Source: 1999 Ernst & Young Cash Management Services Survey of 61 banks

■ Fee Equiv. Revenue

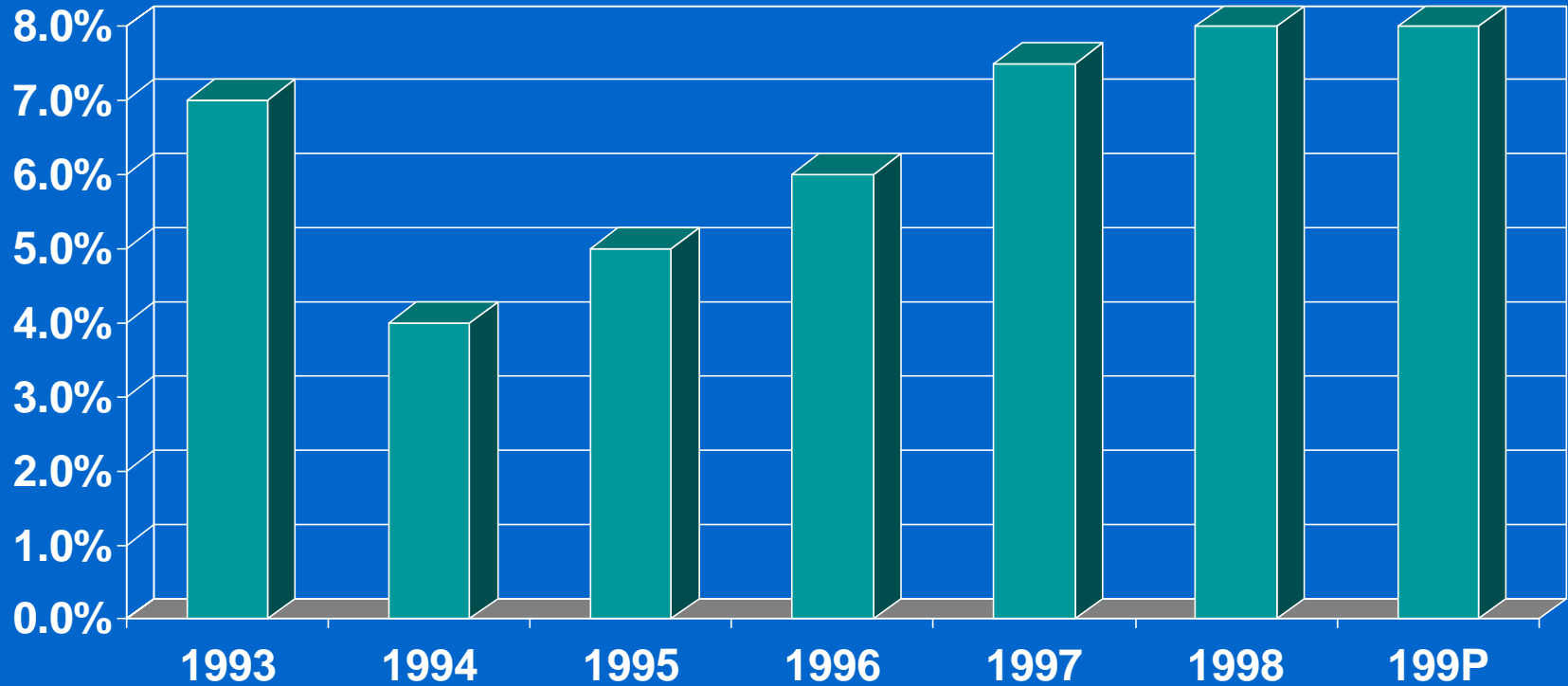
# Market Concentration



Source: Ernst & Young Cash Management Services Survey of 61banks

■ Fee Equiv. Revenue - Peer 1 or Largest Banks

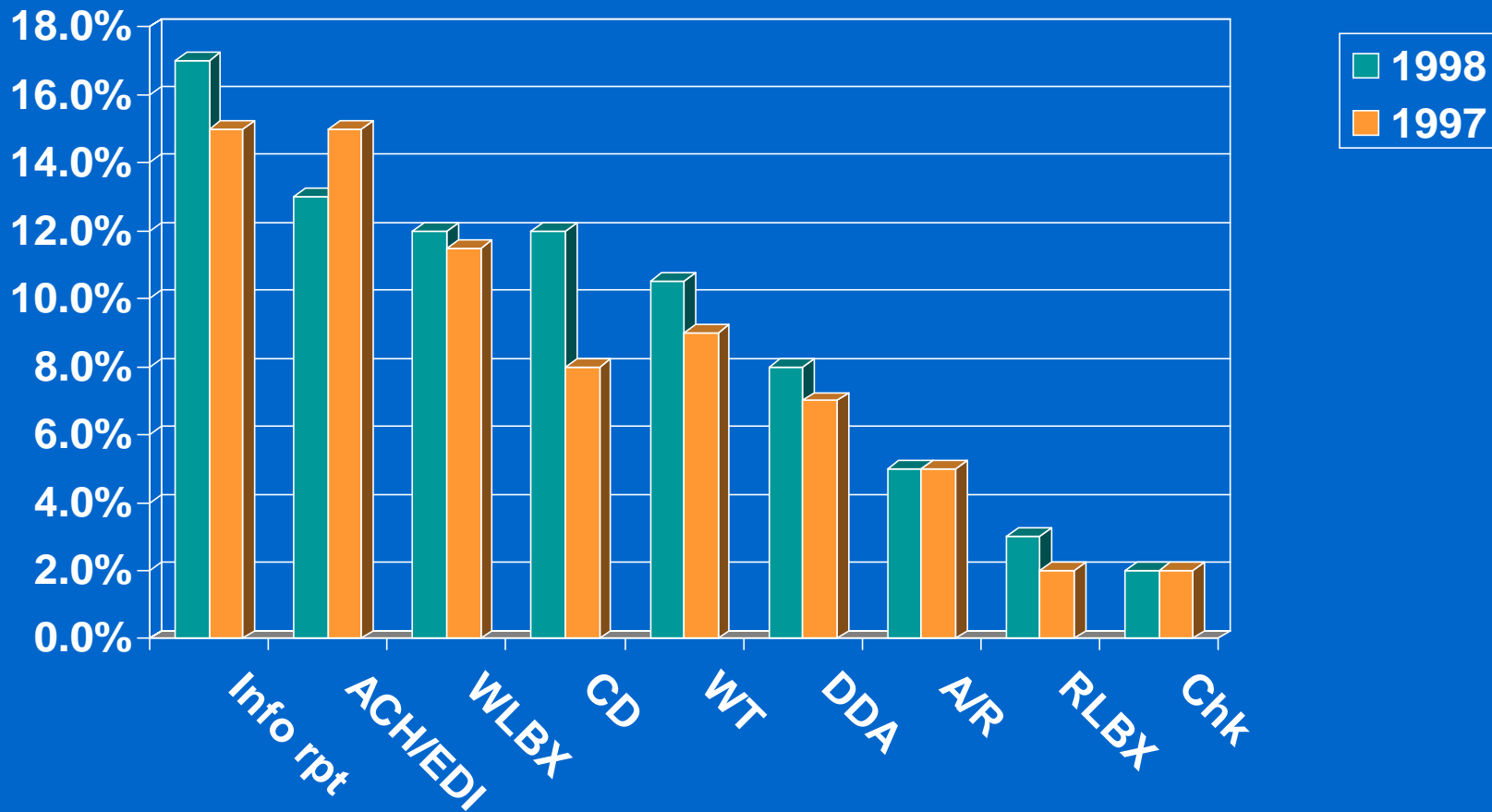
# Cash Management Fee Growth



Source: Ernst & Young Cash Management Services Survey of 61 banks

■ Fee Equiv. Revenue Growth

# Product Revenue Growth

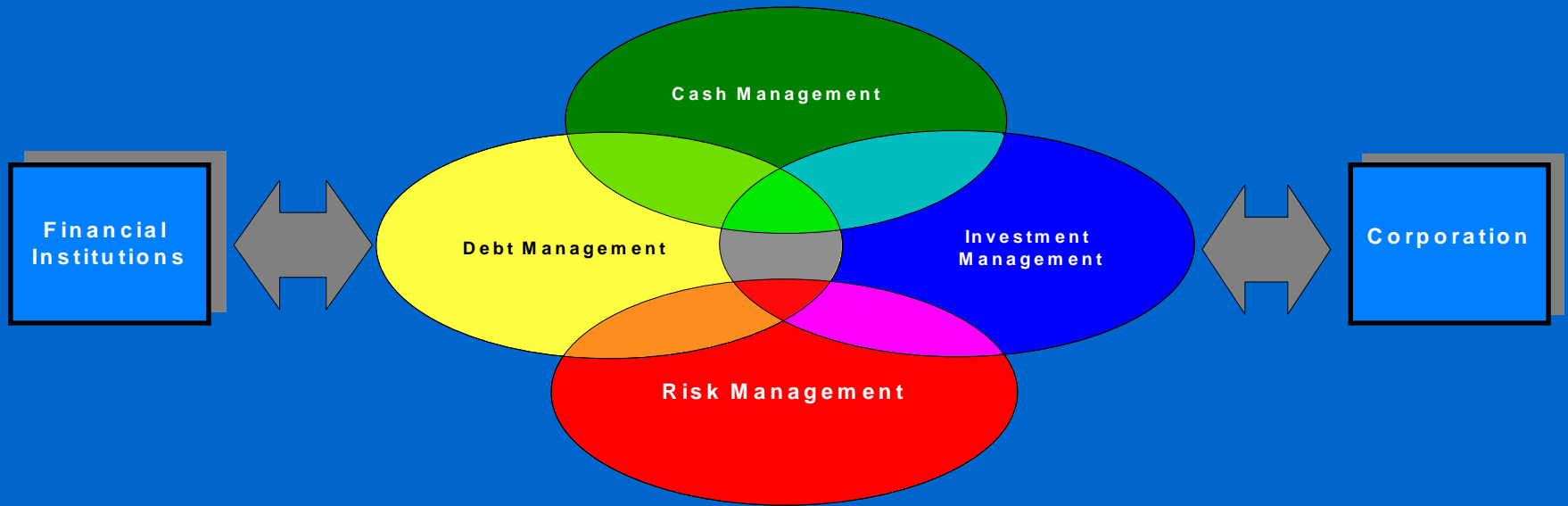


Source: Ernst & Young Cash Management Services Survey of 61 banks

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- ➔ **The Treasury Perspective**
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# The Treasury Perspective



● **Integrated Treasury Systems**  
to efficiently process transactions

● **Clear Lines of Communications**  
Between Treasury & Operating Areas

● **Standard Performance Measures**  
to determine process success /  
failure

● **Uniform Policies & Procedures**  
to control processes

● **Simple Financial Reporting & Accounting**  
to plan & compare results

# Treasury Perspective(2)

	Transaction Costs	Admin/Ops Expense	Opportunity Cost
Planning	Services Req. RFP & Bids	Treasury / Vendor Budgets	Borrowing Investing
Execution	Bank Service FX	Cash Position A/R A/P	Hedging
Analysis & Reporting	Account Analysis / Invoices	Trends Plan vs Actual	Risk Mgt.
Issues	Unit of Production?	Quality of Service?	Time Value of Funds?

# Treasury Perspective (3)

	<b>\$ Amt / mnth</b>	<b>% of total</b>
<b>Acct Recon</b>	5,600	4.5%
<b>ACH / EDI</b>	9,200	7.4%
<b>Deposit</b>	8,200	6.6%
<b>Disbrsmnt</b>	12,700	10.3%
<b>Fnds Trnfr</b>	19,200	15.5%
<b>Info</b>	32,500	26.2%
<b>Wlbx</b>	28,500	23.0%
<b>Overdraft</b>	6,800	5.5%
<b>Other</b>	1,300	1.0%
<b>Total</b>	124,000	100%

- Service Costs @ 1,000 Co.
  - Are you important ?
  - Median = \$8,700 / mnth
  - 90th Prcntle = \$40,000 / mnth
- Where does the money go?
  - Information Services
  - Wholesale L/B + ACH/EDI
  - Funds Transfer
  - Disbursements + ACH/EDI
- What are the “all-in” costs?
  - Operational (A/R, A/P, T/E)
  - Financing (borrowing)
  - Investing

# Treasury Perspective (4)

<i>Pricing Actions</i>	<i>&gt;\$2.5Bn</i>	<i>\$500MM–2.5Bn</i>	<i>Upper Middle</i>	<i>Middle Mkt</i>
Co. seeks bids	74.5%	59.3%	43.8%	36.2%
Co. buys new services from existing bks	53.9%	64.1%	66.2%	70.1%
Bk wins due to prices	34.0%	5.8%	20.5%	17.8%
Co. changes bk. due to prices	20.2%	10.2%	8.4%	10.1%
Co negotiates price guarantee.	70.2%	64.0%	43.2%	38.3%

Big Co. always bid

Big Co. willing to buy from new banks

Pricing is important, but not always

Get long term price guarantee

Source: 1999-2000 Phoenix Hecht Blue Book of Bank Prices

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# Relationship Trade-offs



- Relationships are like icebergs
- The parts that show :
  - Types of services purchased
  - Cost of services
  - Quality of services
- Masks the parts that are hidden.
  - Inefficient processes
  - Unknown internal costs
  - Inertia to change
  - Out of date technology

# Relationship Trade-off Issues

- Transaction Costs
  - For Corporates - What transactions add value ?
  - For Banks - What transactions are most profitable ?
- Quality of Service
  - For Corporates
    - Low service quality is a “hidden” cost
    - RFP process too infrequent / difficult to compare
  - Corporate & Bank - service criteria seldom agreed to
- Time Value of Funds
  - Corporate & Banks - Funds availability should consider internal as well as mail / bank processing delays
  - For Corporates - setting target balances to prevent lost investing / borrowing opportunities

# Trade-offs (2)

- Compare Service Offerings to Treasury Goals
  - Corporates - Few have quantitative goals for cash management
  - Banks - All have customer relationship management (CRM) systems
- Bank Relationships
  - Corporates - seek fewer moving parts (i.e. # of banks)
  - Banks & Corporates - relationships, how important ?
- Use of Treasury Resources
  - Corporates - what is core vs. non-core staff? Outsource?
  - Corporates & Banks - Are systems a constraint or a contributor to an effective relationship?

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# Guidelines for a Cost Effective Relationship

- Use “all-in” pricing evaluations
  - Focus on “units of production” (i.e. value added services)
  - Know internal costs for comparisons to bank prices
  - Include all costs (transaction, internal, opportunity)
- Establish COF measures to evaluate alternatives
  - Opportunity cost : Bank ECR vs. investing or borrowing rate?
  - Check O/D rates - most are  $>$  your borrowing rate
  - Not all bank ECRs are equal (“hidden cost”)

# Guidelines - Unit of Production

<b>Lockbox Services (w/ check clearing)</b>			
<b>Service Element</b>	<b>Unit</b>	<b>Total Cost</b>	<b>Unit Cost</b>
Maintenance Charges	month	\$560	\$70.000
Wholesale Item	payment	\$1,181	\$0.320
Wholesale Item - photo	payment	\$369	\$0.100
Data Entry	keystroke	\$672	\$0.007
Stapling	payment	\$37	\$0.010
Mailing	payment	\$111	\$0.030
Deposit	deposit	\$211	\$0.600
Transmission	month	\$198	\$9.000
Transmission	item	\$185	\$0.010
Check Clearing	payment	\$314	\$0.085
<b>Total Charge</b>		<b>\$3,838</b>	
<b>Key Volume</b>	payment	3,700	
<b>Transaction Price</b>		<b>\$1.037</b>	per payment
Opportunity cost - 10,000 pmt @5% for 1 day		\$1.370	
<b>All - In Price</b>		<b>\$2.407</b>	

# Guidelines (2)

- Set target balances to reduce idle funds in
  - Corporate accounts
  - Regional / local accounts (vendor payables, payroll, etc)
- Use RFPs to bid / re-bid business
  - Use RFP as report card for next performance review
  - Warning - prices in RFPs are not “the market”
- Communicate with the bank frequently
  - Review / update goals at least annually
  - Solve small problems before they become large ones
- Acquire solutions, not just products

# Guidelines - Suggested Goals

- Cut bank lockbox costs by  $x\%$  next year
- Increase proportion of EDI payments by  $y\%$
- Reduce number of banks by  $x\%$
- Reduce number of bank accounts by  $y\%$
- Calculate the daily cash position 30 minutes earlier to catch market movements
- Cut average idle cash balances to \$100,000
- Cut the number / amount of unintentional overdrafts by 50%

# Peer I Bank List

- BankAmerica
- BankBoston
- Bank of NY
- Bank One
- Bankers Trust
- Chase Manhattan
- Citicorp
- First Union
- Fleet Financial
- Key Corp
- Mellon Bank
- National City
- PNC
- Republic NY
- State Street
- SunTrust
- US Bancorp
- Wachovia
- Wells Fargo

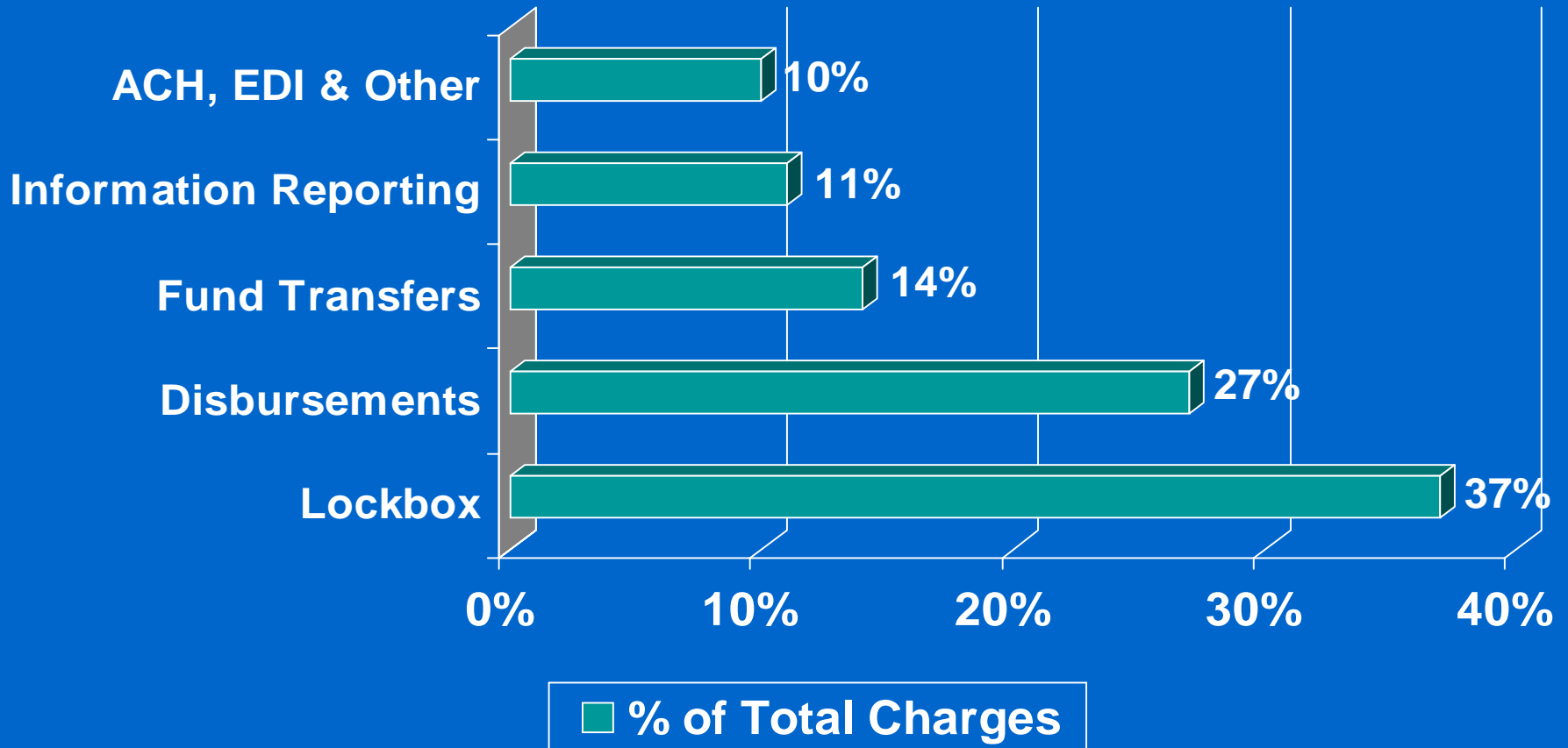
Source: 1999 Ernst & Young Cash Management Services Survey of 61 banks

# Medium / Long Term Treasury Goals

Goals	% of Companies Responding
Reduce prices paid for bank services	95
More automation of routine cash transactions	92
Use / increase use of EDI	91
Increase cash management role with US units	86
Achieve / maintain specific debt rating	83
Increase cash repatriation from foreign units	80
Increase cash management role with non-US units	78
Upgrade in-house risk analysis capabilities	77
Integrate domestic / international treasury	76
Centralize management of global FX risks	74

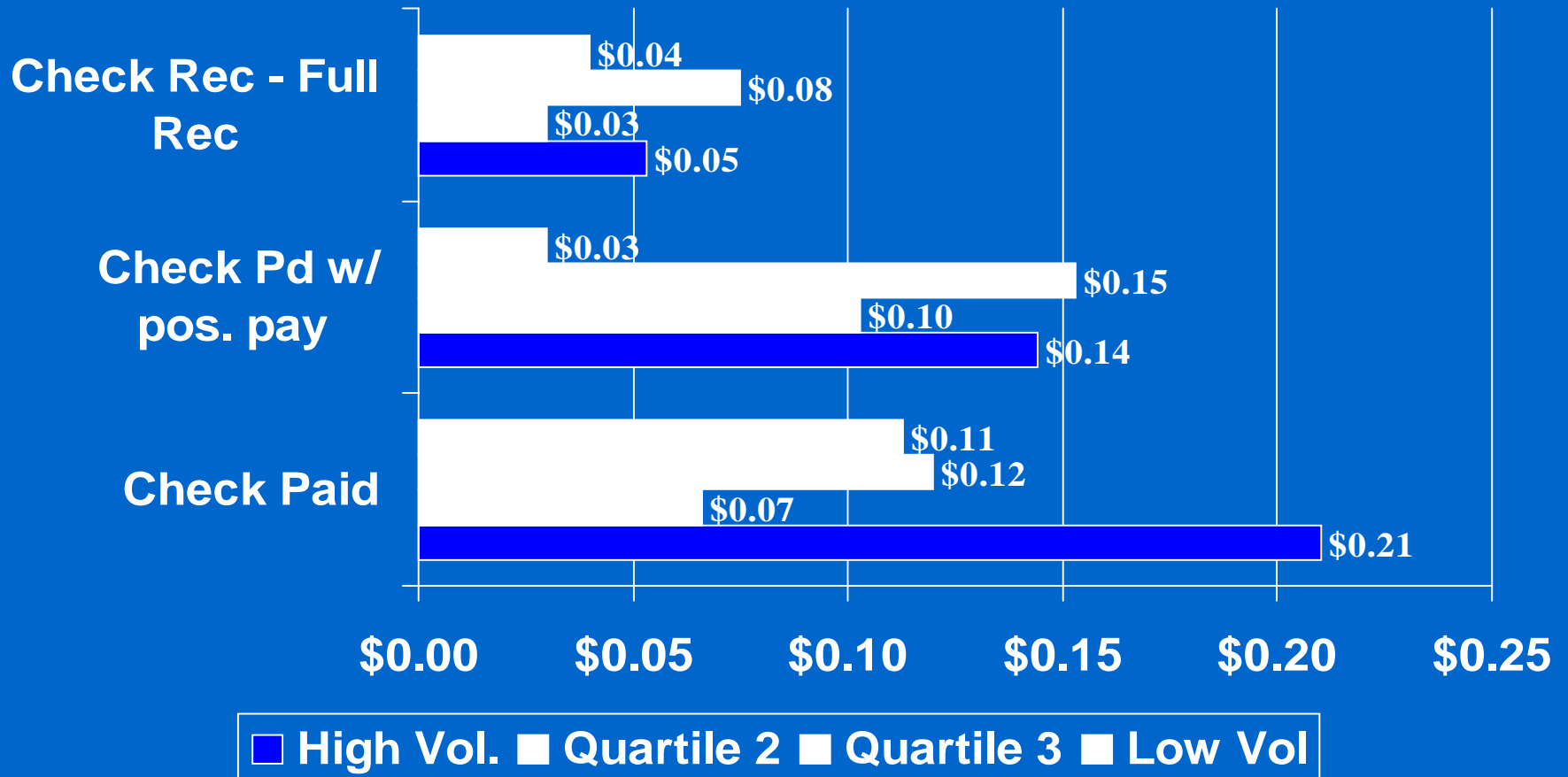
Source: GTA Benchmark Study of 66 companies. Median Sales = 5.4Bn

# Profile - Transaction Charges



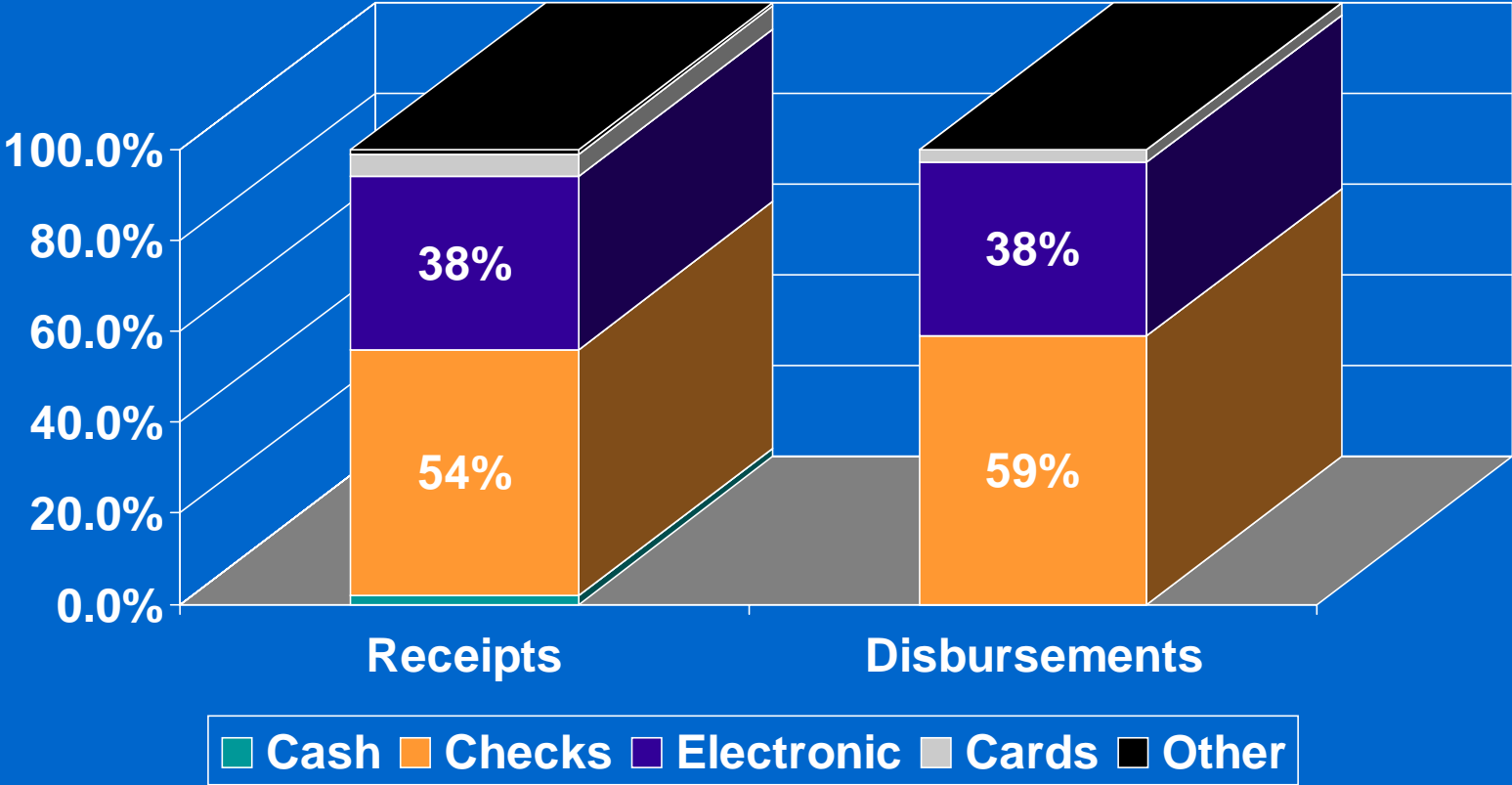
# Cash Management - Price Ranges

## High / Low Price Range - Disbursement Services



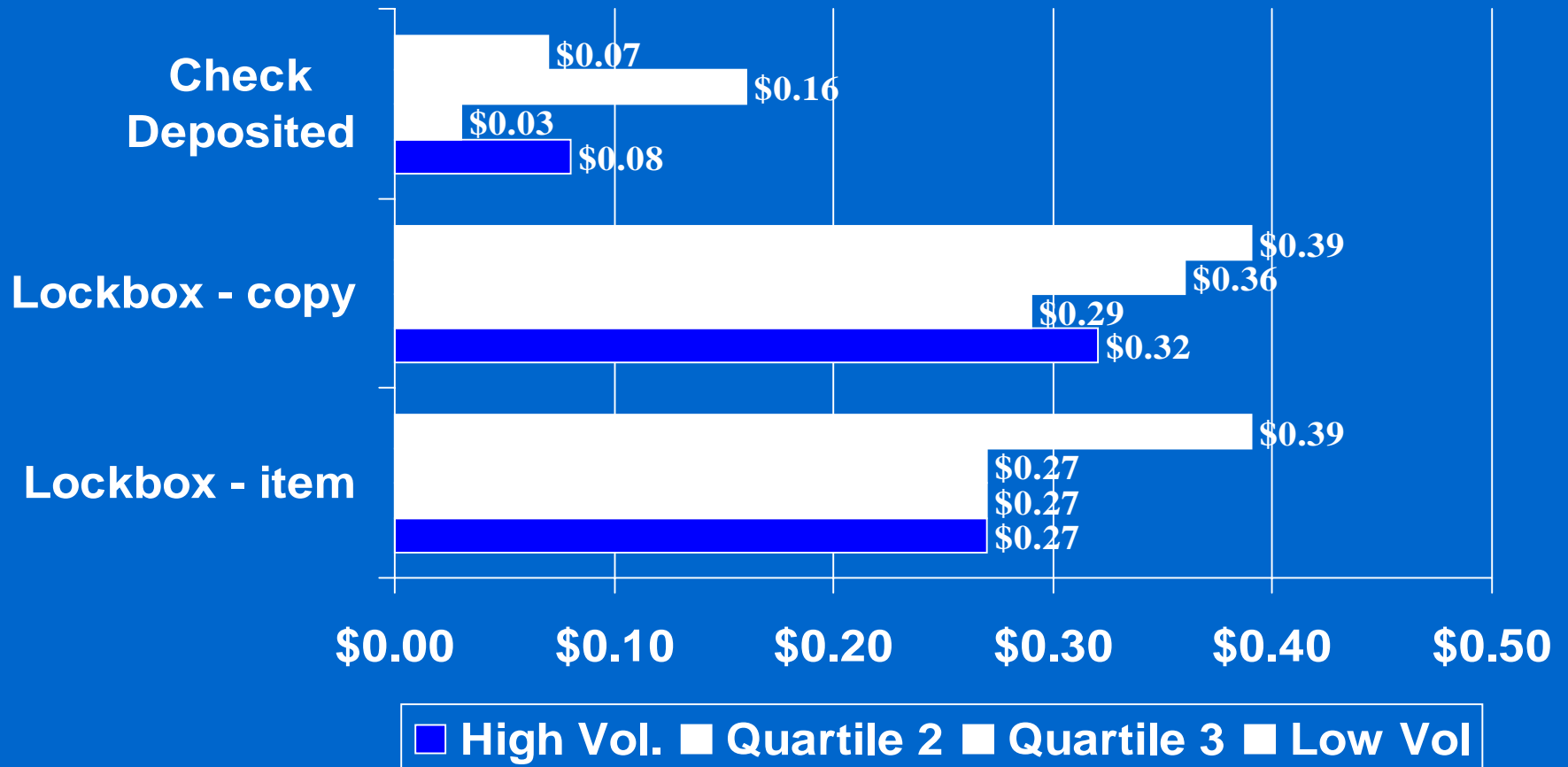
# Profile - Future Use of Services

62 Benchmark Companies



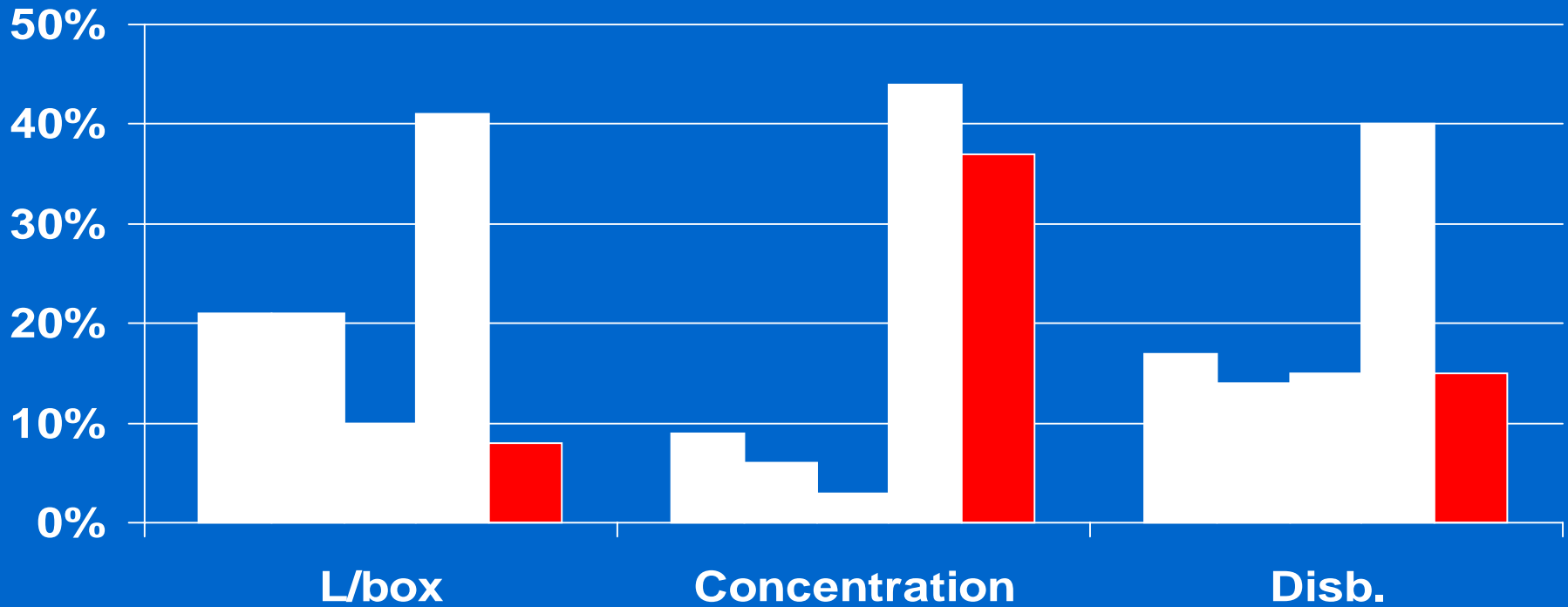
# Cash Management - Price Ranges

## High / Low Price Range - Collection Services



# Measures - Price Reviews

## Last Time Service was Reviewed



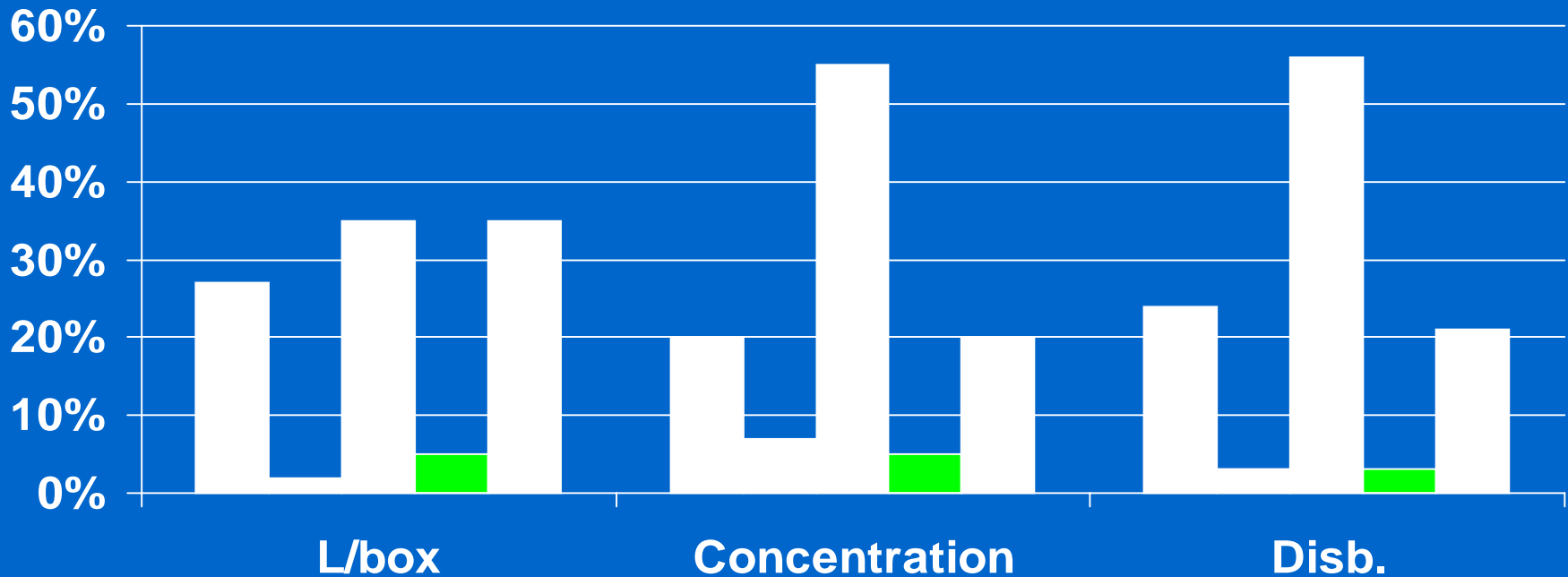
■ 1996 ■ 1995 ■ 1994 ■ 1993 & prior ■ Bid date Unknown

# RFPs Add Value

	Use RFPs	Not Using RFPs
Number of Companies	10	52
Avg. Sales (\$MMs)	3,419	10,423
Bank Fees as a % of Domestic Sales (basis points)	2.6BP	3.4BP

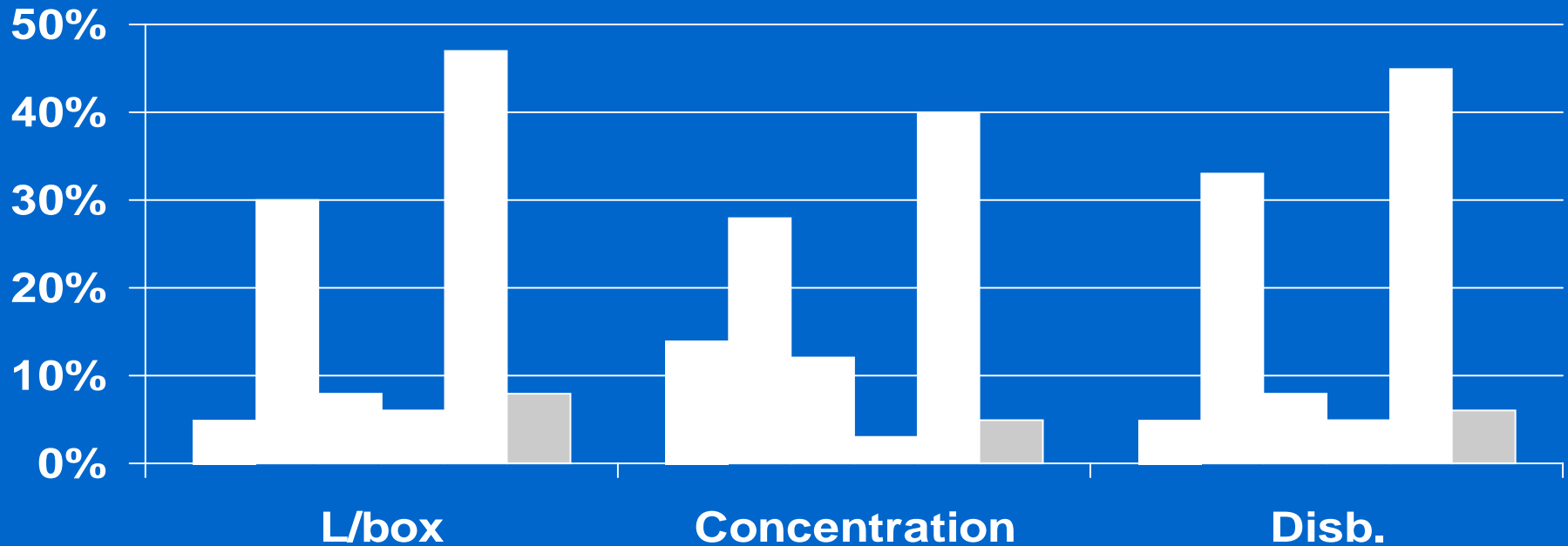
# Determining the Market

## Use of RFPs to Bid



# Measures - Bank Meetings

## Frequency of Bank Meetings



# Measures - Network Size & Cost

- Reduce bank accounts per operating unit to lower operational risks (fraud, funding, missed funds transfers)
- Cost per account can be a useful index - considers maintenance & activity costs. (negotiate a corporate wide price across all accounts?)

<b>Sales</b>	<b>Banks per Ops Unit</b>	<b>Monthly Charge per A/C</b>
< \$1.7Bn	1.8	\$800
\$1.7 – 4Bn	2.6	\$500
\$4Bn - 8Bn	2.6	\$1,400
> \$8Bn	1.0	\$1,200

# Measures - Treasury Operations Staff

- Are you lean or just mean? Review staffing for cash management and accounting as percent of core staff
- Look for economies of scale. Move non-essential tasks away from treasury. New systems or access?

Sales	Cash Mgt. + A/C Staff	Core Staff	Ratio
< \$3Bn	1.7	4.3	.40
\$3 – 5Bn	2.7	8.8	.31
\$5 – 12Bn	3.8	11.4	.33
> \$12Bn	23.0	49.0	.47

# Profile - 68 Benchmark Companies

Sales	Avg. No. Units	Avg. No. Banks	Avg. No. A/C	Mo. Charge
< \$ 1.7Bn	9	16	45	\$34M
\$1.7 – 4Bn	16	42	134	\$66M
\$4Bn - 8Bn	14	36	130	\$183M
> \$8Bn	186	182	535	\$631M