Relationship Still Matters

By Jeffrey A. Steigelman

When you have three kids in the span of two years, two of which are twins, you tend to lose track of time, which was the case when I referenced the financial crisis the other day and someone said to me, “but Jeff that was nearly a decade ago”. A decade ago? Really? But in fact it has been nearly a decade and yet it does not seem that long ago. Probably because we are all still dealing with the ramifications of the financial crisis one way or another. One of the ramifications, is the difference in how customers and banks define and view a “relationship”. Increased regulation, focus on capital preservation versus capital creation, and a trend towards risk avoidance from risk management, have all had a negative impact on the relationship between commercial customers and their banks. Think about it . . . how many times have you heard a banker use increased and/or new regulation as a reason for not being able to accommodate a request and/or the reason for a change in your existing relationship? Despite these changes, relationship banking and bankers still exist and can add tremendous value to your business, but finding it has become a little harder despite every bank out there saying that they are a relationship bank. This may be true during good economic times, but I can’t help but think about Warren Buffet’s quote of, “Only when the tide goes out do you discover who is not wearing any pants”. This is why I thought I would provide you with some ideas to determine if you have a true banking relationship, before the tide rolls out because as we all know it is not a question of if the tide rolls out but when, which is when you need your banking relationship the most.

- **Know your Credit Officer(s) and evaluate your relationship banker based on her/his ability to be the best advocate for you within the bank.** Pre-financial crisis you may have known someone on the customer facing side that was at a high enough level who could approve your requests. One of the changes that occurred as a result of the financial crisis was the bifurcation of Credit from the customer facing side of commercial banking. Approval authorities were significantly cut and in some cases eliminated for all customer facing bankers and the approval authority moved primarily to the Credit Department for new and existing credits. As a result of this change, some red flags in this area include banker apprehension about introducing you to the Credit Officer, the Credit Officer being unwilling to meet with you, and/or requests coming back significantly changed from what your relationship banker initially laid out to you.

- **Signature or Committee Approval Process?** A voting Committee process is preferable as typically a Credit Committee has representatives from both the Credit Department and the customer facing side of the bank who vote on new and existing credit requests with a simple majority “yes” votes resulting in approval. If a Bank has a signature authority, a potential red flag is that the person at the top of the signature approval tree alone may be able to override the multiple sponsorship and approvals below her/him.

- **Financial Covenant Management.** Understand how your financial covenants are defined and calculated. Then model these covenants along with your banker taking into account revenue, margin decline, increased line utilization, planned distributions and tax distributions, and/or planned capex. Financial covenants should only trip when there is a material change in these items. A potential red flag would be if when modeling these covenants only a slight change in the aforementioned categories results in a covenant trip. If you have a minimum fixed charge covenant and you are a Sub-S Corp. pay very close attention to how tax distributions are accounted for in the fixed charge definition. For example, tax distributions are based on previous year's earnings while current year earnings could be lower, thus paying your taxes could result in a default. Attention should also be paid to capex as it is typically calculated net of an increase in LTD. Therefore, if you use idle cash for capex, the total amount of capex is counted against your fixed charge covenant which can also create an issue.

- **Long-Term Commitment**. As you put together several solid years of operating performance, consider requesting a two or three year line of credit. Upon maturity, Banks are able to make changes to your existing credit facility, which could potentially be during tough economic and/or industry conditions, at a time when you need your credit facility the most. In order to implement a long-term facility, a bank may require tighter financial covenants and/or charge you an unused fee, but you should be able to negotiate the unused fee lower and/or eliminate it all-together depending on your cash balances held at the bank. Depending on the amount of the fees, it may be something to consider to ensure the credit facility is in place long-term.

- **Does your bank have a formal lending policy to your industry and what are the details of that policy?** Given the turnover in bankers and credit officers as well as potential acquisitions, it is important that the bank you are working with has a formal policy in place so that a change in banker, credit officer, and/or ownership does not have the potential to negatively impact your relationship.

- **Out of town versus local bank.** There is a philosophy that you want to work with a bank headquartered locally as its performance is ultimately tied to your success whereas a national, super regional, and/or foreign owned bank can be less reliant on the success of a particular customer, industry, and/or a particular area given their geographic, customer, and business line diversification. If you do work with a bank headquartered out of town ask where the decisions are made, what is the influence of the bank headquarters on credit decisions, what is the financial impact and relative size of the local division/bank/office to the overall organization, meet the senior executives and credit managers from the bank headquarters, and inquire as to if the bank supports the industry you are in across all of its banks and locations and what is its view of the industry you are in.

- **Consider fixing a portion of your debt**. Interest rates are expected to rise 2-3 more times this year and if current economic activity holds up, will continue to increase into 2018. As such it is a good time to consider fixing a portion of your floating rate debt via an interest rate hedge. Please note that you may have "permanent working capital" debt on your line of credit wich is a minimum amount of line outstandings that you do not expect to drop below for an extended period of time. There are strategies to fix a portion of this debt as well, which are strategies that your banker should be bringing to you, especially in this environment.

- **Does my banker add value and bring ideas outside of banking products?** Does your banker take the time to understand the goals and objectives of your business and then make recommendations and/or introductions that can help you to achieve these goals and objectives? Many bankers have a great deal of knowledge and a large network base, which can be helpful in meeting potential new clients, acquisition targets, acquirers, as well as address other strategic initiatives of your company, including ownership transition.