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Treasury Products for Mid-Size to Small Corporates

James S. Sagner

School of Business, University of Bridgeport,

Bridgeport, CT 06601, USA

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Treasury Products for Mid-Size to Small Corporates

by James S. Sagner, Sagner/Marks and Metropolitan College of New York

The treasury and non-credit services market[1] for the mid-size and smaller corporate ("mid-to-small") is significantly different than for the Fortune 500 company, although the latter has received nearly all of the attention and interest of bankers in the past three decades. The problems and concerns of the mid-to-small manager usually focus on certain factors that are often only of marginal interest to the banker accustomed to the MBA-educated, $80,000 a year, big company treasury manager.

As a result, bankers and other financial service professionals typically approach a mid-to-small business prospect using the wrong assumptions and techniques, while ignoring the critical factors of the bank's treasury products and services that are particularly appealing to that market. This article discusses this situation and suggests other avenues for mid-to-small corporates and bankers in establishing relationships.

What Are the Critical Factors?

The critical factors for mid-to-small corporates are the "C's" of banking for mid-to-small companies:

- ***C**onvenience* in obtaining needed services at a reasonable cost. The mid-to-small business manager is required to perform numerous tasks during the work day and, consequently, has little time to travel to a banking center, do paperwork, or even talk to bankers about his or her problems.

- ***C**ontrol* over loss from theft or fraud and in complying with Sarbanes-Oxley Act internal control requirements.[2] Employee theft in particular has become a significant issue in this age of desktop publishing and electronic/computer fraud. It is relatively simple for funds to be misappropriated, and months may pass before an audit uncovers the theft.

- Faster access to ***c**redit and **c**ollection* information. As mid-to-small businesses typically sell to customers of equivalent size experiencing greater credit and cash flow problems than do larger corporations, particularly during an economic recession, the sales and/or credit manager is constantly in need of timely information.

Do Float or Pricing Matter?

[1] Non-credit services are those activities that support lending, assist a company in transacting its business, and enable the financing of the balance sheet, including payment and collection, risk management, investment banking, trade finance, and agent and fiduciary services.

[2] The Sarbanes-Oxley Act of 2002 applies to corporations that are publicly-traded, which are a minority of mid-to-small businesses. However, in addition to those mid-to-small that are public companies, many not-for-profits are reporting that their boards are requiring some degree of compliance with the Act's control mandates.

Bankers consistently misunderstand the importance of the C's of banking, and focus on such economic issues as float or pricing in their marketing of bank products. However, float is largely irrelevant to a company doing, say, $100 million in sales, because the annual gross value of a day's float at current interest rates is fairly nominal:

$100 million ÷ 365 calendar days X 6% interest rate = $16,450/year

Mid-to-small businesses will generally not purchase a banking service to save such a sum, particularly when there will be costs involved in capturing these savings.[3] However, bankers consistently try to sell treasury products on the basis of potential float savings because it has been a successful strategy with large corporations.

Bankers who encounter resistance using the float "button" frequently press the price "button." Price is a very effective attribute with a business doing thousands of transactions. When a few transactions occur, as is typical with mid-to-small businesses, price is irrelevant and may matter less than float savings. Consider a company disbursing 100 checks a day to vendors and 200 checks every two weeks for payroll. In the course of a year, some 30,000 checks are disbursed. Saving 10 cents per item for a $3,000 benefit will mean very little to most companies.

Do Banks Sell the "C" Factors to Mid-Size to Small Companies?

Interestingly, when these facts are explained and bankers are asked about the relative importance of the three "C" factors, they consistently choose *convenience* as the most important remaining factor in the sale of treasury services. This reflects the naivete of the banker in assuming that a premium price can be charged for faster banking transactions. In truth, many mid-to-small business people will forego a few seconds of speed for simplicity of operations, particularly given the relatively small number of transactions completed in a typical day.

Convenience is only an issue when the customer has to travel a significant distance for a banking service; for example, the depositing of daily check cash receipts. If this is too burdensome, the bank would simply be excluded from consideration. While *convenience is* certainly a factor, it is less important to the mid-to-small business person than the other "C" factors.

When faced with this dilemma, many bankers respond that *control* and *credit and collection* information are not in their satchel of products. This is simply not so. Many standard bank products possess exactly those attributes. For example, consider the standard lockbox product which bankers typically sell on the basis of float savings. Lockbox speeds up the physical receipt and subsequent collection of checks so that the company gets access to its money faster than it otherwise could have.

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[3] Assuming that a lockbox is the product used to attain these savings, the explicit cost is for the lockbox, typically about $100/month. Implicit costs include the re-direction of incoming mail to the box and the ongoing management of exceptions. In a lockbox environment, a company directs its customers to send their payments to a post office box. That box is monitored by the company's lockbox bank. The bank picks up the mail, brings it back to its processing center, and deposits the items into the company's account. The bank then notifies the company of the deposit totals and sends or transmits the payment detail information directly to the company.

As previously discussed, one day's float does not mean much to a mid-to-small company. However, there are appealing features of lockbox to mid-to-small businesses. As lockbox collects the items faster, it also collects the information that the items contain. Speeding access to payment information by one day allows the company to expedite the shipment of orders or to initiate the credit and collection process earlier.

Similarly, many bankers ignore the growing problem of *control* that now plagues American business. Large companies generally take care of their own control problems, spending millions of dollars buying or building sophisticated systems to encrypt data and requiring multiple approval/release mechanisms to manage potential loss situations. Mid-to-small companies need bank products like lockbox, which eliminate the handling of cash and checks by employees.

Which Products Have the "C" Factors?

Table 1 provides a selected group of bank products matched against the "C's," with a symbol (●) at each interface where the product assists in meeting the "C" need. In addition to the three "C" factors, a fourth "C," the opportunity for ***c****oordination* with other bank products, is included. Coordination is important as many bank products are not stand-alone but require integration with other treasury services. In fact, because mid-to-small businesses maintain one or just a few banking relationships, a single critical product adaptation can cause the entire relationship to transfer to another bank provider.

[put Table 1 about here]

Are Corporates Informed About Appropriate Treasury Products?

Corporates want certain product attributes, yet bankers often try to sell their own *idee fixe* of what they need. Frequently the same product sold to the large corporate, when explained differently, satisfies the requirements of the mid-to-small business customer. In selecting those products for the mid-to-small business, it is important to develop a review process using a methodology as described later in this article. Bankers should consider offering those products that either meet many or all of the "C" needs or that earn large profit margins for the bank, and mid-to-small corporates should become sufficiently knowledgeable about these products to inquire about their suitability.

If the adaptation of treasury products were prioritized based on the number of "C" interfaces, the rankings would be as follows:

- *Top Priority*
    - Lockbox (3 interfaces; coordination with sweeps and investment services)
    - Balance reporting (3 interfaces; coordination with various treasury products)
    - Disbursement services (3 interfaces; coordination with sweeps and investment services)

- *2nd Priority*
    - Sweeps, investment services (2 interfaces; coordination with lockbox and disbursement services)
    - Account reconciliation (2 interfaces; coordination with disbursement services)

    - Funds transfer (2 interfaces; coordination with various treasury products)

- *3rd Priority*
    - Payroll services (2 interfaces)

These rankings indicate the emphasis that corporates and bankers should give to specific products in terms of advantages to a business and coordination with other treasury activities. While bank profitability models are proprietary, it is general knowledge that the "top priority" products tend to have a higher return-on-equity (ROE) than those in the 2nd and 3rd tiers of priority.

What Are the Barriers to a Mid-to-Small Business/Bank Relationship?

It should be clear that bankers often fail to understand the needs of mid-to-small businesses. In addition, our experience is that neither the banker nor the customer understands the mechanics and features of treasury products. While it is not the corporate's responsibility to have to know how a lockbox works or its specific features, it is inexcusable for a banker to be deficient in this area. Thus, the major impediment to relationship development is the calling officer's lack of understanding of the products.

Other barriers include the following:

- *Disdain for treasury products.* Although credit continues to be widely perceived as more important or more professional than other banking activities, the ROE for credit is a fraction of the ROE opportunity for treasury services, as high as 12 to 14 percent. The result is an image problem, and so treasury products are not discussed.

- *Fear of treasury products.* Once basic product information is conveyed (for example, how a lockbox works), some knowledge is required of technical data, including transmission protocols, MICR or OCR standards, formats, and so forth. Credit experience does not prepare bank calling officers to discuss such topics, and some actually fear being embarrassed in a client contact situation. The result is that reasury products are perceived as too "technical," and so they are not discussed.

- *Lack of sufficient incentive.* Many banks have calling officers on straight salary with a bonus opportunity based on overall bank performance. The result is that there is no incentive to sell treasury products, and so they are not discussed.

- *Conflict between calling officer and product specialist.* A calling officer may jealously guard the corporate relationship for which he or she feels ownership. In fact, the calling officer may believe that any joint calling will result in a dilution of power and threaten his or her position in the bank. The result is that the product specialist is taken along begrudgingly and often to weak prospects.

- *The corporate "owns" processing activities and refuses to relinquish possession.* Certain corporates feel that the essence of mid-to-small business success is domination over the flow of funds and data from collection and/or disbursement activities. In this situation the bank may be perceived as disrupting the power or authority of the mid-to-small business manager. The result is that the corporate's objections may interfere with the successful presentation of the product's benefits.

These barriers can be overcome through a structured analysis of the competitive situation.

Which Data Are Required?

Data should be collected to establish the current status of bank, customer, and competitor activities in treasury products. This effort should focus on the perception of quality and price for the bank and its competitors, with particular reference to the needs of mid-to-small business customers. Table 2 indicates the mechanisms and data sources for this information.

[put Table 2 about here]

How Should the Data Be Analyzed?

Bankers should develop a project plan to analyze the mid-size to small corporate market; as an example, see the project plan included at the end of this article. This review should focus on:

- target market customer wants and needs
- competitive environment issues
    - service quality
    - pricing information
    - technology
- review of revenue opportunities by product and by market
- assessment of bank organizational structure and incentive compensation program relative to treasury product sales and delivery strategies.

In this analysis, the bank should choose those treasury products that appeal to target market customers. Consideration should be given to how the product will be developed; for example, private-labeled by a correspondent bank or a third-party provider,[4] built internally, or as an extension of an existing product. Profitability and ROE forecasts are then prepared, and any necessary asset redeployment is considered.

How Should Strategic Plans Be Developed?

Strategic plans reflecting the data analysis should include the preparation of specific product development scenarios to accommodate the requirements of mid-to-small sized companies. These would include:

- *Growth into new geographic and customer markets.* Mid-to-small businesses may be the bank's new customer market, or the focus may be on a specific subset, such as the owners of professional corporations (for example, physicians).

- *Exit from existing markets.* In the present competitive climate, many banks are forced to make difficult capital allocation decisions, and the entry into a new market may involve a

[4] Various third-party providers develop and support the treasury products that are sold through banks, including P&H Solutions (Politzer & Haney) and Metavante. In addition, certain large commercial banks such as BNY Mellon often these products on a private-label basis to smaller banks.

concurrent exit from another market. These strategies must be closely coordinated as interrelated products and services may be affected.

- *Pricing strategies.* Mid-to-small businesses are relatively indifferent to price, as previously discussed. However, a new entrant to the mid-to-small business market may be forced to accept a slightly lower price than existing providers to gain some competitive advantage.

The development of prioritized implementation plans would examine automation requirements, delivery systems, and product costs and benefits. The completed recommendations and implementation steps and timing should include provision for training calling officers and product specialists in the process of selling treasury services to mid-to-small businesses.

What is the Market for Treasury Services?

Treasury management products provided by banks can add significant value to mid-to-small corporates by providing elements of the four "C's". The corporate should become knowledgeable about specific products and their interrelationships. Banks can sell quite profitably to mid-to-small businesses and, unlike in the large corporate market, the sale of a single product can lead to the capture of a company's entire banking relationship.

Table 1
Bank Products with "C" Factors

	Conven-ience	*Control*	*Credit/ Collection*	*Coordination*
Sweeps, Investment Services	●	●		Lockbox, Disbursement Services
Payroll Services	●	●		
Lockbox	●	●	●	Sweeps, Investment Services
Balance Reporting	●	●	●	Various
Disbursement Services	●	●	●	Sweeps, Investment Services, Account Reconciliation
Account Reconciliation	●	●		Disbursement Services
Funds Transfer	●	●		Various

Table 2
Data Sources for Bank Product Analysis

	Mechanisms	Data Sources
Current bank products	On-site/telephone interviews Market surveys	Bank calling officers Sales specialists Product and operations staff Customers
Target market customer needs vs. needs fulfillment capability		
Competitor bank marketing activity: products, pricing, delivery	Print/broadcast ads Promotional material Conference exhibits	On-site visits to competitors Interviews with key customers of the bank

Checklist for Corporates

- Periodically review your banking relationships in the same way you would check the invoices and product quality from your other vendors. While loyalty is an admirable quality, a competitor bank and its calling officers may be a better match for your current needs.

- Learn about your banker's invoice – it's called the "account analysis". It can be confusing, so have your banker explain the calculations and terms.

    - Periodically confirm your account analysis product quantities against your own records. For example, the number of check disbursements can be verified against the check number series used during a recent month.
    - Understand that when balances are left at the bank to pay for services, the credit you receive is a fraction of your cost of capital. Consider arranging for a sweep to move all balances into higher yielding overnight investments, and pay for bank services you use by fees.

- Consider using banking products to strengthen your internal controls, to find out about payments due but not yet received, and to simplify your business day.

- Gain knowledge of basic banking services from your calling officer or by attending a regional or national treasury conference.

Project Plan for Banks Serving the Corporate Market

- List all important corporate customers and the services that they buy from your bank
  - Do they use other banks?
  - Do they process cash and payments in-house?
  - Do they have control issues; e.g., check fraud, theft, the same individual managing cash and accounting?

- Create a survey for your calling officers
  - What is discussed on a typical call?
  - Who does the calling officer see at the company?
  - Are call reports regularly prepared and reviewed?
  - Have any prospects indicated that your bank not having a service was a factor in the relationship?

- Review the account analysis (the bank's invoice to the corporate customer)
  - Which treasury services are presently being bought by your customers?
  - What prices are being charged?
  - What are the volumes for each service?
  - Is payment accepted in fees and/or balances?
  - Do customers understand the account analysis?
  - Are logically interrelated services being cross-sold; e.g., controlled disbursement, positive pay and/or full reconciliation?

- Contact your correspondent banks or third-party providers
  - Do your correspondent banks private-label treasury services? (Note: Private labeling is the practice of selling and maintaining a service on behalf of a customer with the customer's name or brand on that service.)
  - Are there minimum volume requirements?
  - What is the reputation of the correspondent bank for quality and reliability?
  - What is the pricing structure of the private-label service?

- Economic analysis
  - What are your revenue and profitability expectations?
  - Would it be more efficient to buy these services from a correspondent bank or to build and maintain them in-house?
  - What are the costs and time commitments in investing in a set of treasury services?
  - Does the outcome meet your return-on-equity requirements?