Collective Banking: Leveling the Playing Field of Commercial Banking

There are more than 80 value elements a franchisee may experience from membership in a banking syndicate.

By John L. Szajna

According to the recent International Franchise Association's *Profile of Franchising* study, about 20 percent of franchise organizations offer financial assistance programs to their franchisees. All of these programs are centered on financing, either debt or leasing programs. While this support is crucial, especially in capital-intensive operations, it generates the question: Who is helping system franchisees with their banking and investment?

A new franchisee will usually select his banking relationship on proximity, credit relationship or family relationship. Some are undoubtedly drawn to the lure of free banking and free checking offers from banks seeking to add new small-business accounts.

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One large bank has even adopted a "Wal-Mart" approach. There are greeters by the front door and a separate teller line is reserved for small businesses. Community banks have always emphasized personal service, especially since they don't have the capacity to offer the full range of products and services available at a large commercial bank.

Is this personal touch all that franchisees should expect from their banking institution or can they find opportunities by studying how other services are purchased?

In *New York Times* columnist Thomas Friedman's book, *The World is Flat,* he identifies how UPS has "leveled the playing field" of shipping. Mike Eskew, the UPS chairman and CEO, says, "You know who the majority of our customers and partners are? Small businesses …" Those guys in the brown trucks are giving those small businesses the same services available to their large corporate clients. In fact, by assisting them with their global supply chain, they have helped many smaller firms go international. How do your franchisees' banks compare to UPS?

The insurance industry has developed multiple collective structures that allow firms and professionals the opportunity to leverage their collective purchasing power. Group captives, risk retention groups, purchasing groups, and "rent-a-captives" are different collective structures that are considered part of the alternative insurance market.

Collective banking can be defined as managing the collective bank transaction volume of a number of organizations as if they were members of a single organization.

For purposes of this article, refer to that single organization as a banking syndicate and the treasury professional who manages the activity as a banking syndicate manager.

There are more than 80 banking, investment and financing value elements that members can derive from participation in a banking syndicate. These can be broadly grouped into three areas: financial impact, improved control and professional management.

Financial Impact

The first financial impact derives from the collective transactional volume of the banking syndicate structure on bank service pricing. All banking services have elements that are volume-tier priced. As the transaction volume increases, the price per transaction goes down. Banks are inconsistent in how pricing changes when a higher volume tier is reached. Some banks reprice all the transaction volume at the new, lower price; others only apply the lower price to transaction volume over the volume hurdle.

> The average fraud scheme lasted 18 months.

Discounted bank pricing, while significant, is only one aspect of the financial impact. As with insurance professionals, the banking syndicate manager work to ensure members get the right services, at the right price, from the right bank. With the collective transaction volume of a banking syndicate, members will qualify for new banking services. The banking syndicate manager can perform the financial analysis to assure the benefits derived from the new service exceed the cost. This treasury professional can also manage the development project and spread the cost over the participating members.

Improved Control

Assuming the banking syndicate activity is managed on a treasury management system, the members will experience improved internal controls in addition to the significant financial impact.

Improved internal controls are very important to franchise operations since small firms are the predominant target of fraudulent transactions. The following statistics are taken from a study of discovered frauds in the *2004 Report to the Nation on Occupational Fraud, Association of Certified Fraud Examiners*. Nearly 50 percent of all frauds attacked businesses with fewer than 100 employees. These firms catch more of their frauds by accident (24 percent) than by internal controls (15 percent).

The limited number of employees means that franchise owners often place financial transactions in the hands of a trusted associate. More than 46 percent of the perpetrators in the study had more than five years of tenure and an extraordinary 83 percent were first-time offenders. Background checks would not have made a difference in all these cases.

The collective banking activity of a banking syndicate makes it possible to effectively implement a treasury management system and a TMS makes the implementation of a daily bank account reconciliation process an efficient alternative.

One more fraud statistic: the average fraud scheme lasted 18 months. While all businesses focus on the rare large-dollar transactions, the greater exposure is from a series of smaller transactions. A daily bank account reconciliation virtually eliminates the risk of a series of fraudulent transactions. This internal control improvement will also catch mistakes and detect both in a timely manner which will maximize recovery.

Members within a banking syndicate will also benefit from all the controls inherent in a TMS. These include electronic access controls, electronic file transfer controls, a full transaction audit trail and an independent audit portal. A banking syndicate, due to the collective activity, can more effectively accomplish adequate segregation of duties. Finally, a bonded, certified treasury professional is more adept at catching fraud and mistakes than a novice.

Professional Management

Membership in a banking syndicate can also be characterized as a "rent-a-treasurer" mechanism. This will assure that members get the right services, at the right price, from the right bank– with guaranteed quality. This treasury professional will take the member's banking investment and finance activity to a new level with leveraged developments in each of these areas.

Given the similarity of the cash flows of franchised operations, the banking syndicate manager can also develop accurate cash flow forecasts for syndicate members. An accurate cash flow forecast will allow members to retain a lower "safety stock" of cash, freeing more cash for investment or debt reduction. An accurate cash flow forecast will allow the banking syndicate manager to

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Franchisee Benefits

There are more than 80 value elements a franchisee may experience from membership in a banking syndicate. Here are some examples from the three areas of financial impact, improved control, and professional management:

- Financial impact
- Discounted banking services
- Leveraged investment and financing opportunities
- Improved cash management
- Improved control
- Daily bank account reconciliation
- Electronic controls of a treasury management system
- Accurate cash flow forecast
- Professional management
- Banking syndicate management
- Treasury development projects
- Investment and financing management

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utilize designated maturity investments in place of a "sweep account" with high transaction fees and a lower return.

Finally, an accurate cash flow forecast is another highly-effective internal control mechanism, especially when coupled with daily bank account reconciliation.

Franchisor Benefits

Franchise systems are in a unique position to utilize their leverage with a corporate banking relationship to bring the banking syndication benefits (financial impact, improved control, and professional management) to their members. The franchise organization banking represents a number of new accounts and balances. Bank studies have identified that small businesses tend to maintain significant balances and this is their impetus to offer "free banking." In a discussion with one large franchise organization, a major U.S. bank offered to customize a service package during a pilot implementation. This customized package would then be a standard offering to all franchisees. In treasury circles, getting a large bank to meet a firm's unique needs is not an easy task. The prospect of banking an entire franchise organization through banking syndicates is much more feasible. Franchisors have had no problem identifying how they could utilize this increased leverage with one or more of their corporate bankers.

This new franchise service, collective banking in a banking syndicate, can be offered at no cost to the franchise system and the benefits to the franchisee will be a multiple of their cost. This service will bring the franchisees' treasury activity up to corporate standards. Since franchisees with weak internal controls are a prime fraud target, the headlines from a discovered fraud at a franchisee would adversely reflect on a franchisor's image. Finally, franchise services are about enhancing a franchisee's chance of success and banking is a major component.

Implementation

The first step in implementing banking syndication for a franchise organization is bank selection. Normally, banking services are bid through a "Request for Proposal" with a limited number of highly-qualified candidates. The problem with using this approach with franchise banking syndicates is that it is difficult to project banking services required until the collective volume can be studied in a pilot initiative, which will be addressed later. Therefore, a franchise company may select a corporate banker to conduct a pilot initiative with the understanding that the customized banking services will be subject to an RFP process. While a corporate banker may complain about this approach, the bank conducting the pilot will have first-hand experience with the banking activity.

Some other considerations beyond the corporate relationship include:

- Geographic footprint: How does the bank's footprint compare to that of the franchise organization?

- Single vs. split structures: Will franchisees use a single bank or will the collective volume warrant separate receipt and disbursement banks?

- Future investment and credit capabilities: The banking syndicate manager will take the collective structure beyond banking.

As discussed, the franchise system will want to implement a pilot banking syndicate among a few franchisees. Voluntary participation will result in significant penetration of the franchise organization. However, without 100 percent participation, franchise operations will be utilizing two banking approaches. Franchise systems may need to consider partial subsidization to secure full participation in banking syndicates.

The assignment of franchisees to banking syndicates should be of little consequence to the franchisees as the collectivization operates mainly in the background. Further, a treasury management system gives the banking syndicate manager the opportunity to regroup members for developments as well as investments and financing. Finally, if the TMS and segregated bank account reconciliation unit were not established for the pilot, this infrastructure needs to be functional. Since the objective is to assure banking syndicate members have the same opportunities as a large public corporate treasury unit, the banking syndicate managers will need the wherewithal to benchmark their operations.

External Management

The implementation section has identified the significant infrastructure development a franchisor would need to effectively manage franchisee banking syndicates. This infrastructure would not be aligned with their corporate treasury mandate, and the activity would be a distraction from their corporate treasury activity.

External management of the banking syndicate activity should also be considered because the infrastructure can only be leveraged over the franchise's own banking syndicates whereas an external management firm could leverage the infrastructure over multiple firms.

Banks are in a natural conflict of interest when they advise clients about banking alternatives. This is especially true in the case of cash flow forecasting which could negate the need for current day reporting. When banks are left to measure their own quality, they tend to focus on items that are easy to measure and where their performance has been successful.

There are treasury consulting firms that will provide external management of treasury activity, but few have experience with this activity on a group basis and it is a sideline to their main consulting business. Some firms only offer external management as a vehicle for identifying consulting opportunities. There are firms that primarily engage in external management of treasury activity, but this is normally not done on a group basis. As the concept of collective banking is adopted by more franchise operations, more firms offering external management of treasury will have experience with this structure. ■

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