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Cash-hoarding companies seem unable to splash out

By Tony Jackson

It is a notorious truth that western companies are hoarding cash. They are not hiring or investing as they should. They are not doing their bit – and cash-strapped governments are getting restive.

The official response could take various forms, starting with taxation. Unless, of course, companies resume spending off their own bat. But that looks increasingly unlikely.

The reasons lie partly in the one-off shock of the banking crisis, partly with more lasting changes in the financial system. This was recently put in stark form by Ewald Nowotny, head of Austria's central bank.

Perhaps, he said, corporates are going through their version of the Asian crisis of 15 years ago. Then, Asian countries were badly battered by the flight of hot money. Their response has been to build up formidable foreign exchange reserves to ensure that never happens again.

Whether corporate hoarding will last 15 years is another matter. But the Nowotny thesis brings immediate assent from several people I spoke to in the field.

What is striking is not merely the scale of hoarding – almost €2tn in the eurozone, by one estimate, and £750bn in the UK – but the form it takes. According to a survey by the US consultants Treasury Strategies, 77 per cent of liquidity across Europe and the UK is in overnight cash.

Two questions arise: where this cash came from, and why it is being held in this way.

In the early years of the crisis, when it became clear the banks could not lend as before, corporates turned massively to the bond market. So a chunk of that cash must eventually be repaid.

But increasingly, the hoard is being fed by operating cash flows. As a result, many companies now have net cash on the balance sheet. Ronan Carr of Morgan Stanley puts the proportion across the UK and Europe in 2010 at 29.5 per cent – the highest since 1988. And on projected cash flows, that figure is set to rise.

One important proviso. Corporate margins on both sides of the Atlantic are still improbably high. When they revert to the mean – as they eventually must – the cash mountain will be depleted.

But that is one of the reasons for companies building it up in the first place. Others are that revolving credit lines with the banks seem largely a thing of the past, and that bond markets cannot be relied upon to be always open in these troubled times.

In addition, as John Grout of the UK Association of Corporate Treasurers argues, the regulator-inspired switch of foreign currency and other swaps onto exchanges will mean corporates must hold much larger cash balances as collateral for their hedges.

Meanwhile, an increasing amount of the banks' funding is secured against their assets, in the form of covered bonds and the like. So unsecured deposits by companies are in a vulnerable position. Counterparty risk is the name of the game, and those deposits need to be held overnight in case of trouble.

As surveys from both Treasury Strategies and JPMorgan make clear, this kind of liquidity is the first priority of corporate treasurers worldwide. That is an ugly thought for regulators. A financial system awash with hot money is not a stable one.

Another reason, then, for the authorities to act on the hoarding phenomenon. This brings us back to taxation.

Charles Cara of Absolute Strategy Research calculates that since the trough of 2010, net income of eurozone corporates has risen sixfold, while the tax take is up only 17 per cent. Indeed, the effective tax rate across Europe has fallen in the past 15 years from an average of 33 per cent to 28 per cent.

The latter figure reflects official policy, prompted by the belief that capital is increasingly mobile. Hence the fact that recent tax increases have concentrated on immobile assets, such as utilities in Italy and mines in Poland.

But as Mr Cara also says, the crisis has led to greater government control of banking systems. As a result, capital is arguably less mobile than before.

The converse argument, as advanced by Lombard Street Research, is that tax increases will be frustrated by the boom in corporate profitability coming to an end. That may well be true; but it does not change the basic picture for corporates.

One way or another, those cash hoards will come under threat. In that case, companies may be faced with continuing insecurity without the means to combat it.

That would put paid to optimistic suggestions of a torrent of cash being unleashed on capital spending and acquisitions. Some, no doubt, will be spent on higher dividends and buy-backs. But even that may prove a temporary blessing.

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