ACT LEADING TREASURY PROFESSIONALS

GIVING DIRECTION

CORPORATE CASH AND LIQUID INVESTMENTS

SURVEY
JULY - AUGUST

SEPTEMBER 2014

Survey report

Corporate Cash and liquid investments

The Association of Corporate Treasurers
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The quick read

What do non-financial companies plan to do with all that cash?

Most have positive plans to run down balances.
Companies around the world have tended to hold more cash since the financial crisis. Cash has been built up naturally as lower activity levels reduced working capital but mostly defensively as companies took opportunities to raise finance – particularly as interest rates fell. Indeed, since 2006 the ACT has urged companies to "fund early and fund long" when possible in anticipation of coming financial industry problems and we have not changed that advice since.

What do treasurers expect will happen to the cash?

72% of firms' business plans are to use the cash but 43% expect to hold more cash than in the past.
6% of the treasurers surveyed say cash would run down naturally as the economy recovers, 29% say that it would naturally build up from cash generative businesses. But what of companies' plans?
Most companies, 72%, say their companies' business plans are already for using existing cash. 18% go as far as to say that they are running down cash "aggressively, returning funds to shareholders, not replacing maturing debt, etc." *(Figure 1, right-hand bar).*

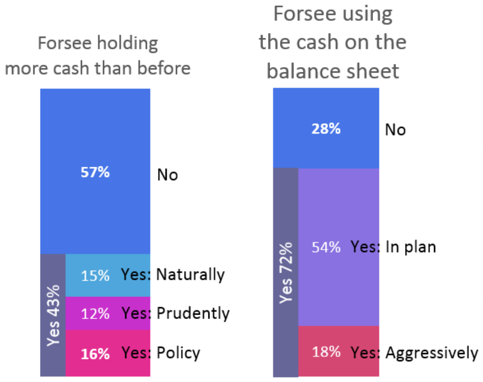


Figure 1, What do treasurers expect?

However, 43% of firms foresee holding higher levels of cash than they used to (Figure 1, left-hand bar). 16% now have a formal policy on this. 12% of the 43% don't have a formal policy (yet?) but prudently recognise the need to hold more cash for flexibility – banks being unlikely to provide funding as and when they wish and capital markets bring open episodically. For the remaining 15%, it is foreseen happening naturally.

15% of respondents planning to run balances down from present levels (in the 72% on the right-hand bar in Figure 1) are also included in the 43% in the left-hand bar, running down to a higher level than in the past.

As to what future developments might make treasurers hold less cash, higher or sustained lower/negative interest rates, greater access to committed borrowing facilities and increased concern over where to invest cash holdings were most cited. On the other hand, future increased political and economic uncertainties and regulation or other factors further reducing banks' lending capacities were the principal contingencies that might bring about even higher cash holdings.

The survey was conducted in July and August 2014

The context

Background to the rise in corporate cash holdings

How much cash do companies hold collectively?

UK National Accounts estimates for cash held by private non-financial companies have been around £½ tn in recent quarters.[1] By way of comparison, US companies hold around $2 tn and Eurozone companies around €2 tn[2]. In all three regions, cash holdings have a little more than doubled since 2000.[3] Japan is the only major developed country in which listed companies' cash holdings are out of line with its peers according to a recent review – See Figure 2 on the right.[4]

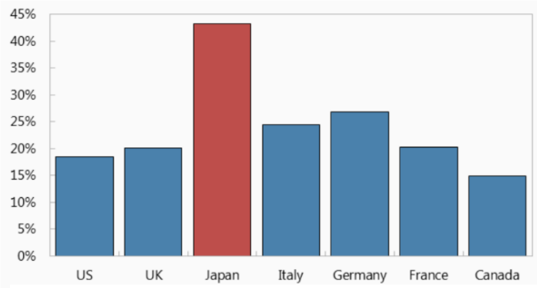


Figure 2 Listed companies' cash and cash equivalents holdings (% of market capitalisation, average between 2004 and 2012).Aoyagi and Ganelli, 19 August 2014 [4]

Why, generally, do companies hold cash? Prudence!

Academic studies suggest many reasons for companies' cash holdings, but the general conclusions of Opler and others in their 1999 paper still ring true:

> In particular, firms with strong growth opportunities and riskier cash flows hold relatively high ratios of cash to total non-cash assets. Firms that have the greatest access to the capital markets, such as large firms and those with high credit ratings, tend to hold lower ratios of cash to total non-cash assets. At the same time, however, we find evidence that firms that do well tend to accumulate more cash than predicted by the static tradeoff model where managers maximize shareholder wealth. [5]

Risk and concerns about access to finance clearly increase during a financial crisis. That UK corporate cash has increased by about 25% since Q1 2008 is, then, little surprise[1]. The crisis has emphasised to companies that banks may not be willing (or able) to lend just when the company needs it – or at all. And, of course, availability of market based finance (from bonds, for example) can never be assumed, depending as it does on investor demand. In recent years company boards have also adopted a more cautious approach toward financial risk resulting in heightened exposure on the boardroom agenda. The ACT's The Contemporary Treasurer 2014 and 2013 surveys[6] demonstrate this trend.

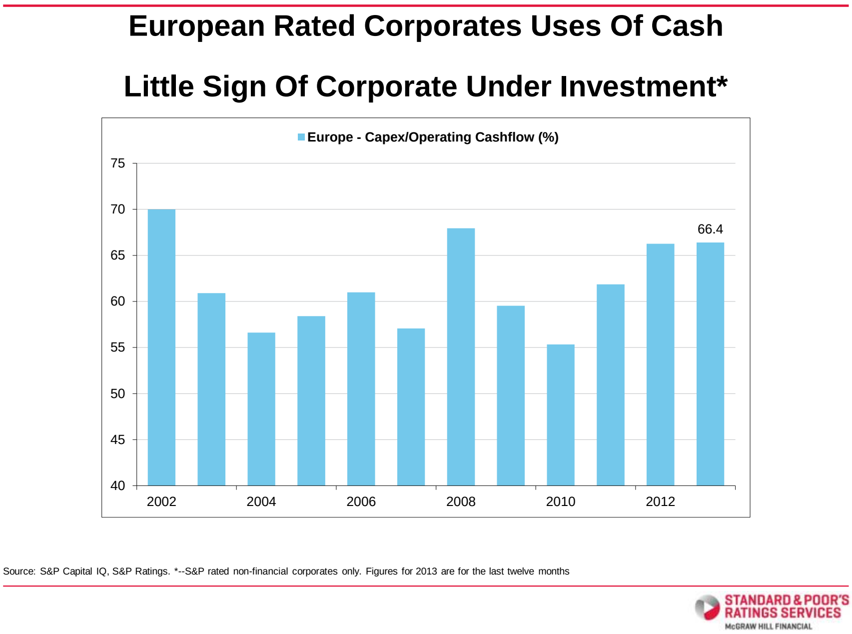
This high-level focus on financial risk adds to the incentives for greater cash holdings. Cash holdings were already elevated by the modern phenomenon of intellectual property becoming more important to firms, bringing material increases in some types of risk.[7] A review article by the Federal Reserve Bank of St. Louis earlier this year presents this simply (https://www.stlouisfed.org/publications/re/articles/?id=2314).

That cash holdings of non-financial companies are mostly precautionary also corresponds with the ACT's experience as treasurers and with the survey responses.

Has holding cash affected aggregate capital spending?

Caution in investment may have been a small factor in corporate cash accumulation but precautionary holdings – "fund early and fund long" – seem to have been the more important factor.[8] Standard and Poors found "Little sign of corporate under investment" among European corporates it rates earlier this year. It presented this chart *(Figure 3)* at the ACT Annual conference in Glasgow in May 2014:

Figure 3



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[1] ONS estimates, http://www.ons.gov.uk/ons/rel/naa1-rd/united-kingdom-economic-accounts/q1-2014/rft--reference-table-3--sector---non-financial-corporations.xls

[2] Treasury Strategies estimate, http://www.treasurystrategies.com/sites/default/files/TSI_CorpCashBriefingApril2014.pdf, at slide 5.

[3] Idem at slide 4.

[4] *Unstash the cash! Corporate governance reform in Japan*, Chie Aoyagi, Giovanni Ganelli 19 August 2014, http://www.voxeu.org/article/corporate-governance-reform-japan.

[5] *The determinants and implications of corporate cash holdings*, Opler, Tim C.; Pinkowitz, Lee; Stulz, René M. and Williamson, Rohan, Journal of Financial Economics, 52 (1999) 3-46.

[6] The Contemporary Treasurer 2014 (http://www.treasurers.org/node/10129). The Contemporary Treasurer 2013 (http://www.treasurers.org/node/9033).

[7] For example, Bates, Thomas W.; Kahle, Kathleen M.; and Stulz, René M. *Why Do U.S. Firms Hold So Much More Cash than They Used to?* Journal of Finance, October 2009, Vol. 64, No. 5, 1,985-2,021. Available online at http://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2009.01492.x/pdf (August 2014).

[8] The Contemporary Treasurer 2013 (http://www.treasurers.org/node/9033) – last paragraph on page 7.

The Survey: Questions and Responses

Page (Ctrl and click page number to go to page)

Cash held

The future

Effects of re-regulation of the financial sector

Respondents

The survey: responses

The survey was targeted at just over 100 treasurers and conducted in late July and early August 2014. 68 responded, almost all UK based. More information on the respondents is in questions 12 to 0, starting on page 13.

Cash held

1. How much cash are respondents responsible for?

Cash and cash equivalents held by the respondents varied from nil to more than £10 bn.

We asked repondents to select the applicable size "bucket" rather than disclose a number.

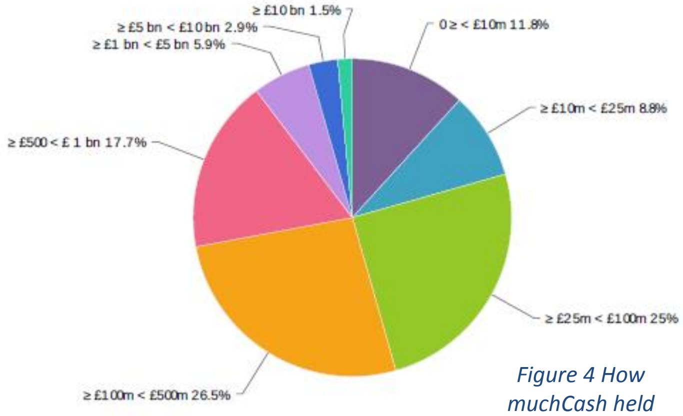


Figure 4 How muchCash held

2. What proportion of cash held domestically?

A majority of respondents hold cash mostly domestically. The chart shows domestic percentages.

Again we asked respondents to select a range rather than disclose actual percentages.

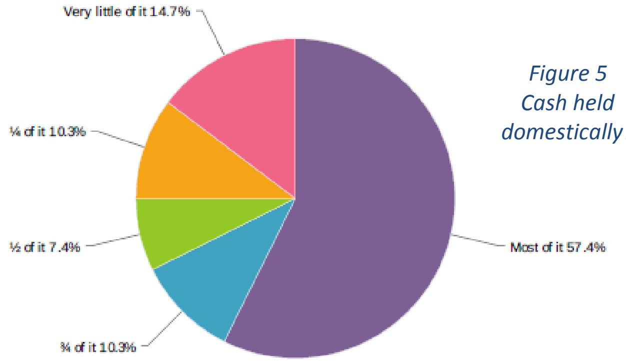


Figure 5 Cash held domestically?

3. Was cash "trapped" overseas?

Little of the cash was actually "trapped" overseas – not remittable perhaps because of foreign exchange controls, regulations or similar issues although 1/3 of respondents indicated this was at least a consideration.

Again respondents selected "buckets", not giving actual percentages.

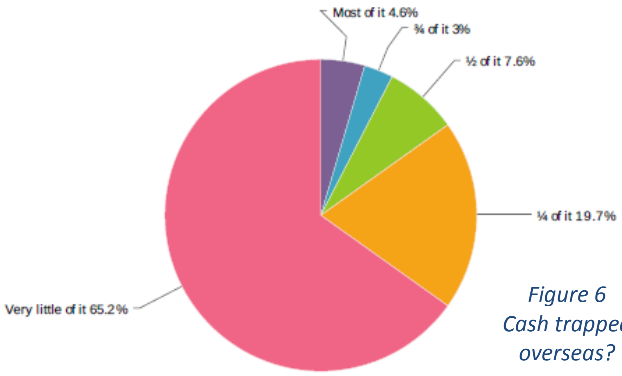


Figure 6 Cash trapped overseas?

4. How did cash held relate to total assets?

Cash held represented more than 20% of the firm's assets for less than 30% of companies.

Again respondents elected buckets, not disclosing actual percentages.

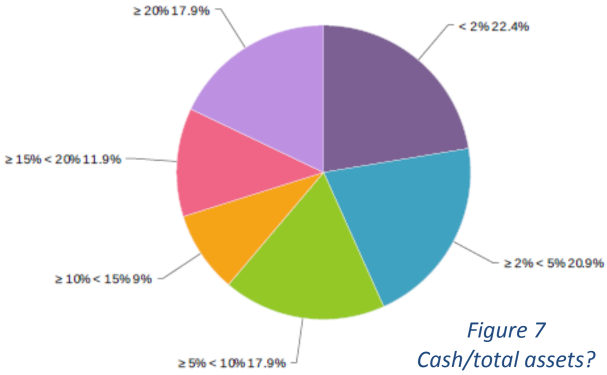


Figure 7
Cash/total assets?

5. Why was cash being held?

We asked respondents to specify as many reasons as they wished for their holding cash other than cash "trapped" overseas for exchange control and like reasons. The plot below shows all answers that had more than 3% of respondents choosing them.

Unsurprisingly, motives were many for each firm – the average number of choices being 5½. The various natural effects of a downturn and of precautionary funding were prominent as expected. The one that surprised us was the percentage choosing "Hedge against deflation" – but it is just another aspect of economic uncertainty. [Choices less than 3% not shown in the chart, *(Figure 8)*.]

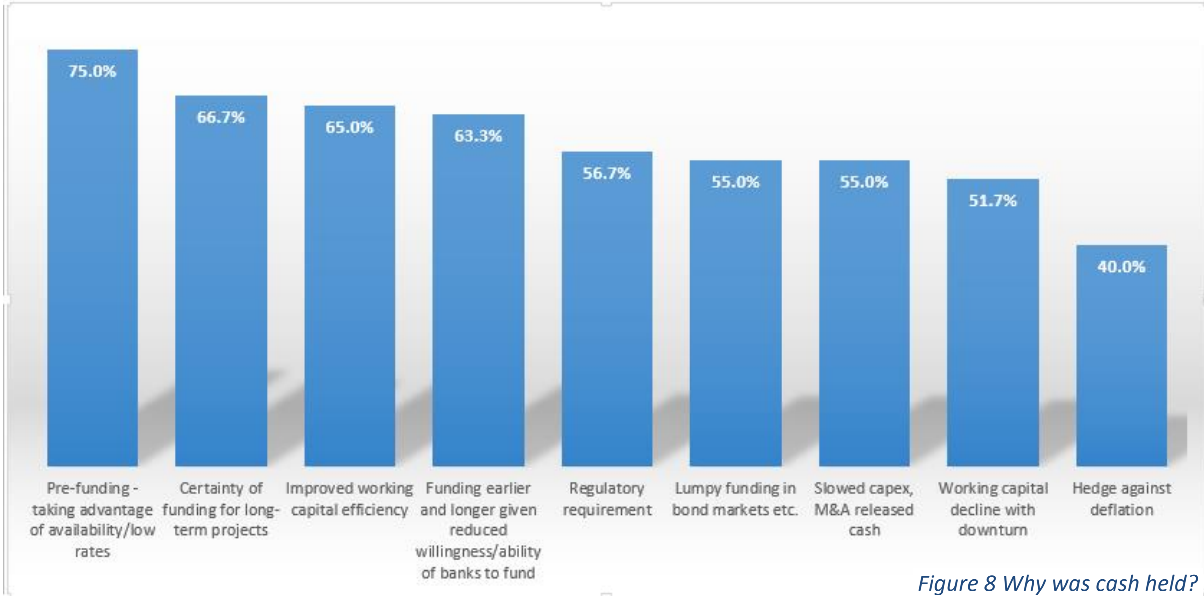


Figure 8 Why was cash held?

The future

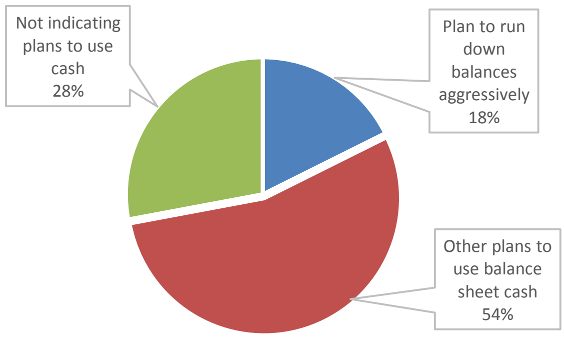
6. How do treasurers see cash balances in future?

We asked what treasurers see as happening to cash balances in the future. They could specify as many responses as they believed to be true.

6% of respondents said cash would naturally run down with economic recovery, 32% said it would build up as the business was cash generative. For the rest, we assume there would be no material effect. (We did not graph that result but focused on firms' plans.)

A clear majority, 72%, said that their business plans were actually for utilising the cash, 18% saying they will run down balances aggressively – returning funds to shareholders, not replacing maturing debt, etc. *(Figure 9)*

Figure 9 Plans to use cash?

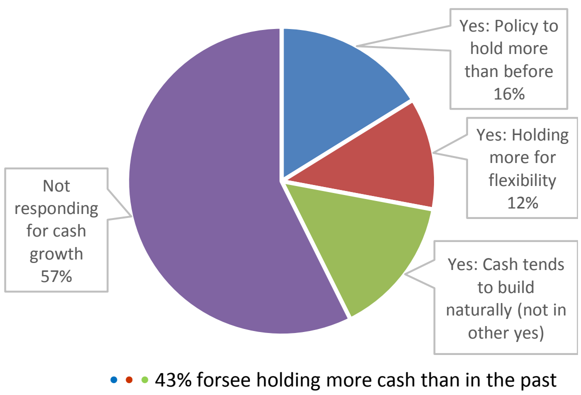


However, 43% planned to hold more cash than in the past *(Figure 10)* . Of that 43%, 16% now have a formal policy for holding more cash and a further 12% are doing so pragmatically for flexibility in view of both the doubtful ability of banks to lend when required and that debt markets are not always available.

Interestingly while a higher percentage of companies holding smaller amounts of cash as a percentage of total assets (or of turnover) were expecting to increase cash holdings than the percentage of those holding more, the effect was not marked.

See also an alternative graphical presentation of the data in Figure 1, page 3.

Figure 10 Plans to hold more cash?

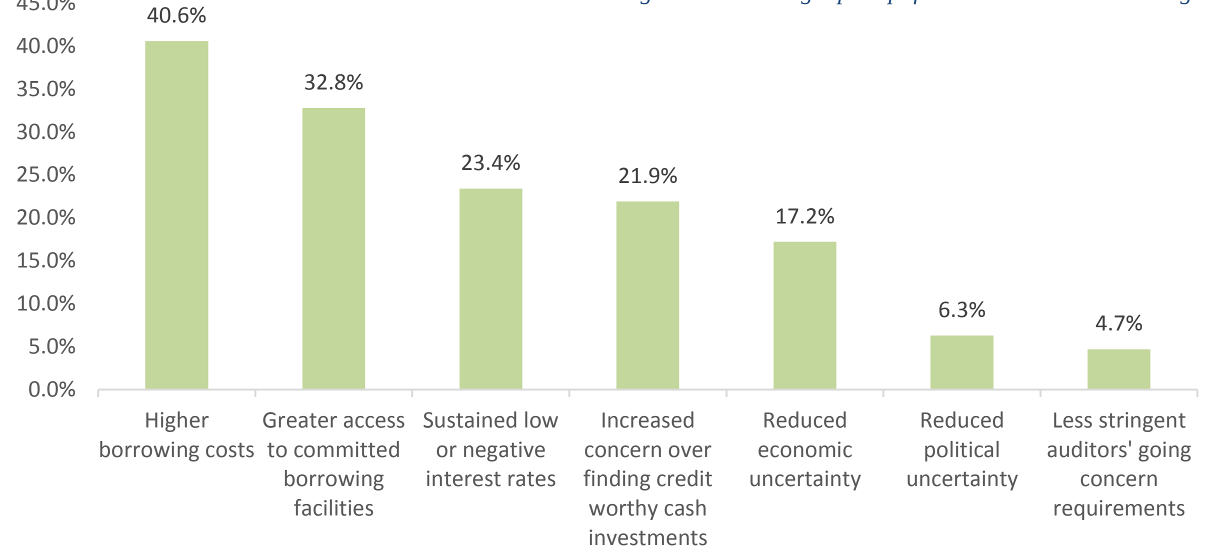


7. What might lead treasurers to reduce cash more?

Again we asked people to specify as many responses as they wished. The bar chart *(Figure 11)* below shows choices greater than 2%. Higher, or sustained lower/negative interest rates, greater availability of committed borrowing facilities and reduced economic uncertainty were the main choices – together with the possibility of increased concern over finding credit worthy cash investments.

(The next question asks what might cause the holding of yet more cash thean currently).

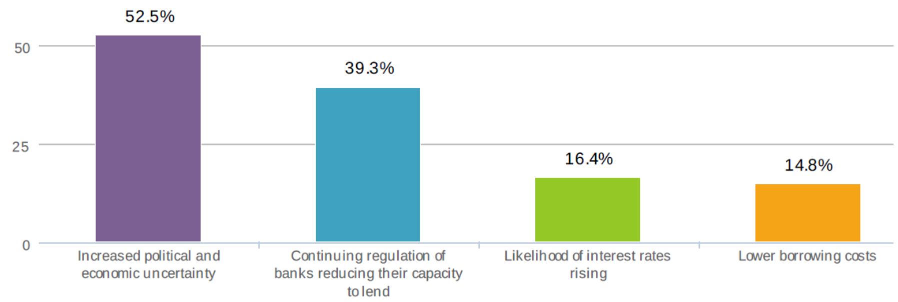
Figure 11 What might prompt further reduced cash holdings?



8. What might make treasurers want to hold yet more cash?

Respondents were asked to specify as many responses as they wished. This plot shows choices greater than 2%.

Figure 12 What might prompt increased cash holdings?



Increased political and economic uncertainties or further reduced bank capacities to lend together with rising or falling interest rates were the only material choices.

Of course companies face a cost of carry of cash. Their average or marginal cost of capital is certainly higher than the minimal returns on cash as an investment. The return in current conditions is in the perceived risk reductions or avoidance. We did not ask a question about that – but it is a significant factor, often coming up in ACT events and discussion of cash policy, and a major constraint on increasing cash.

Effects of re-regulation of the financial sector

We took advantage of the survey to ask treasurers if they had yet responded to changes in financial regulation. We gave them this background:

> "Post-crisis, re-regulation of banks and the intention to ensure that tax-payers' money is not used in bank rescues, the intended abolition of "too big to fail" institutions and the prospective changes to wholesale depositor creditor ranking in insolvency arising from bank "bail-in"/resolution measures, and application of "ring-fencing" ideas imply significant changes in the position of wholesale depositors and counterparties. Treasurers will face increased bank credit-risk and will need to understand more about their banks – down to the branch level."

9. "Do you think the coming into effect of these changes will change your business' targeted cash and near-cash levels?"

We think that it is early days for consideration of these issues in many companies and comments such as "policy under review" or "policy now being written" confirm this.

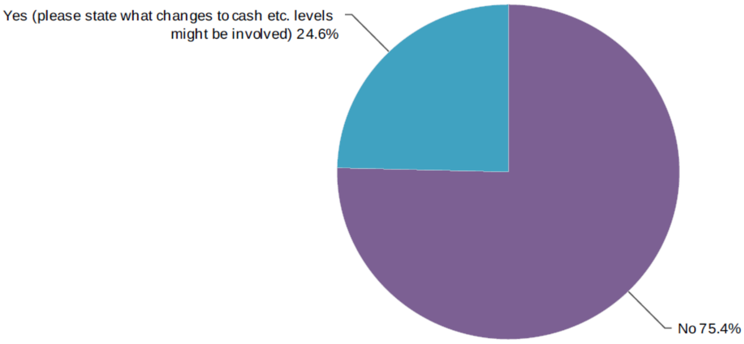


Figure 13 Does financial regulation affect cash holdings?

There were no particular trends among those that commented on what they had in mind other than references to relying on cash holdings rather than drawing un-used revolving facilities and to greater use of non-bank financing.

10. "Have you started to consider how you will think about organisational changes in treasury operations to reflect the banking changes?"

Over 30% of respondents had begun to consider the organisational implications on their operations.

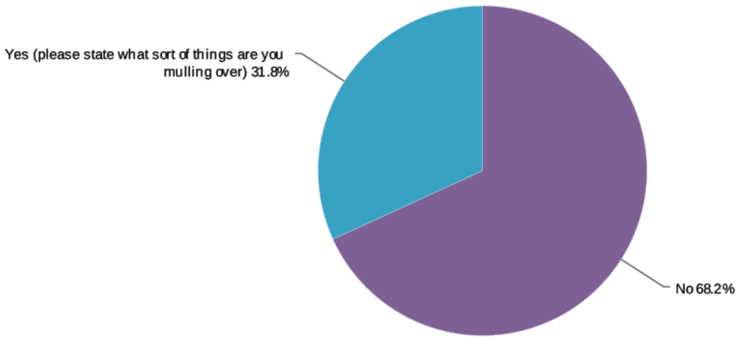


Figure 14 Have you started to consider organisaton a change?

Again, it is clearly early days in considering these issues.

Consideration of financing sources and relations with providers of funds, more analysis of financial counterparty (especially bank) credit standing were common comments. More interesting comments included putting contractual rights of set off against the bank into loan facilities and moving to making secured deposits with selected banks.

To gather more respondents, especially those that were at earlier stages in their thinking, we asked for all to check against a list of possible actions being factored into planning – see the next question.

11. Which of the following have you begun to factor into your planning? (Please select all that apply)

Diversification away from bank risk by switching to non-banks and diversification by increasing the number of banking relationships were common choices. Interestingly diversification by the country of the risk (the risk counterparty) was not as common. 11% were not taking account of these factors.

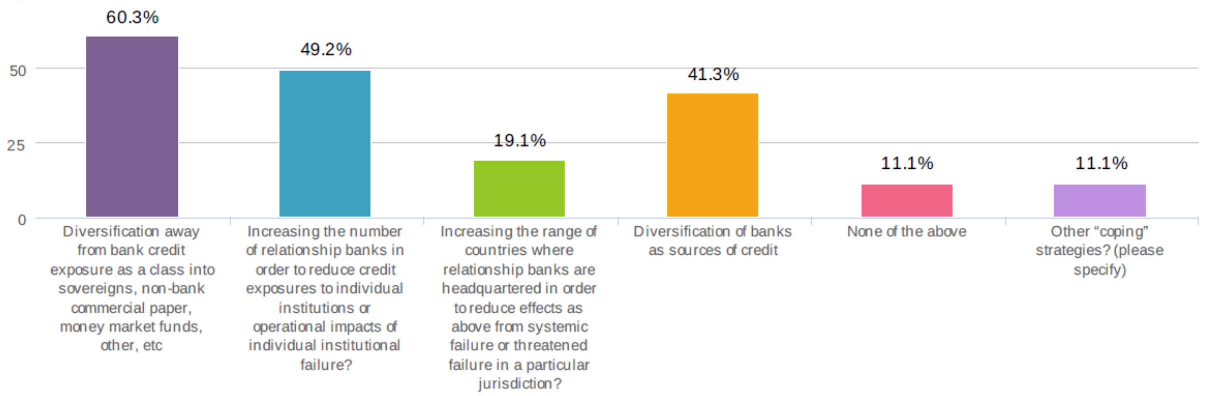


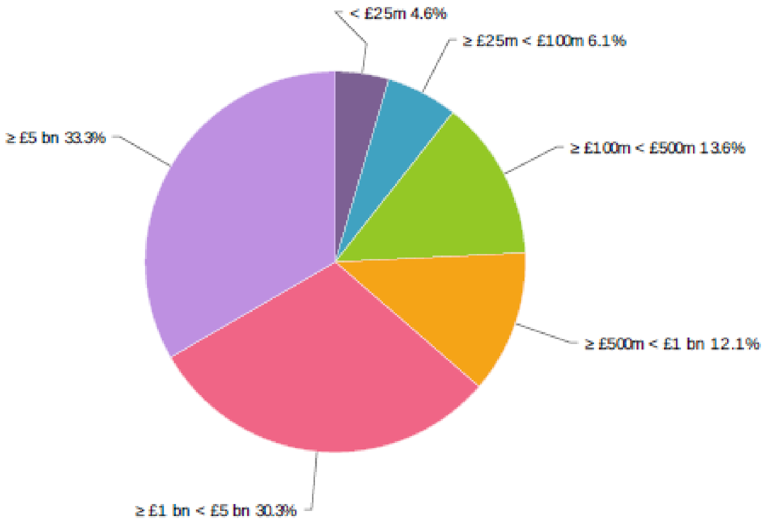
Figure 15 What factors are you incorporating into planning?

The factors listed by the 11% selecting the "none of the above" choice were various but noticeable were investing cash through separately managed funds, use of secured deposits and further reduced credit limits by institution. Corporates, of course, normally mark smaller credit limits for a banks than the bank would mark for the corporate – due to the corporates' undiversified credit portfolio and institutional lack of credit expertise in the firm as a whole even if there were a credit specialist in the treasury department (which there usually isn't).

Respondents

12. Respondent company size

Respondents ranged in turnover size from less than £25 m (SMEs) through mid (up to £500 m), mid+ (to £1 Bn) and large companies (to £1 bn) to very large companies turning over more than £5bn annually.



13. Industry sectors

Respondents were drawn from a wide variety of industries.

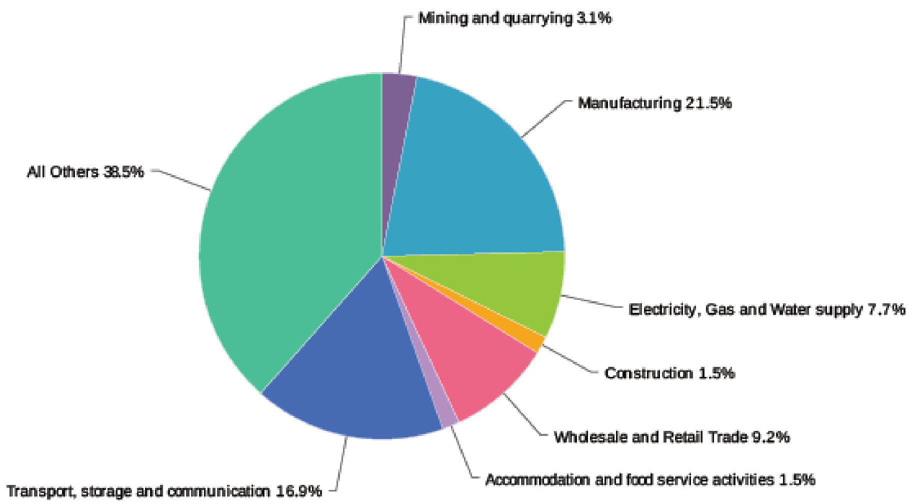


Figure 17 Industry sector?

14. Responses for groups or parts or groups

87% of responses related to cash levels of entire groups of companies. 13% of respondents were members of larger groups of companies – these were mostly subsidiaries of overseas companies.

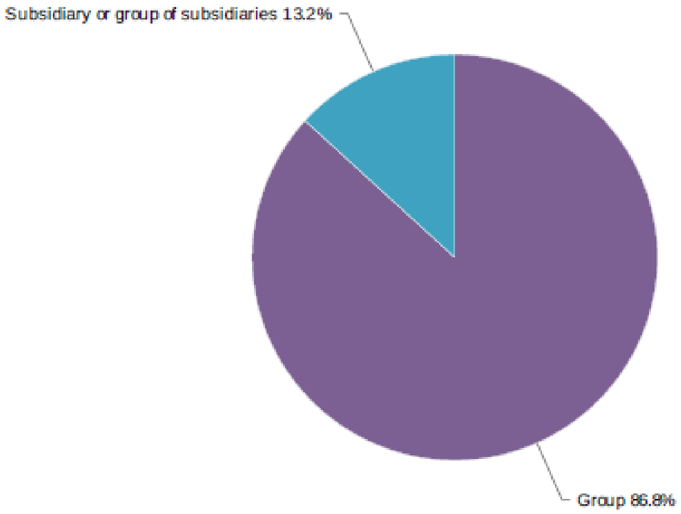


Figure 18 Responses for groups or parts of groups

Type of companies – listed, private, etc.

60% of responses were in respect of listed companies, 31% non-listed companies and 9% - mostly third sector – were not from companies.

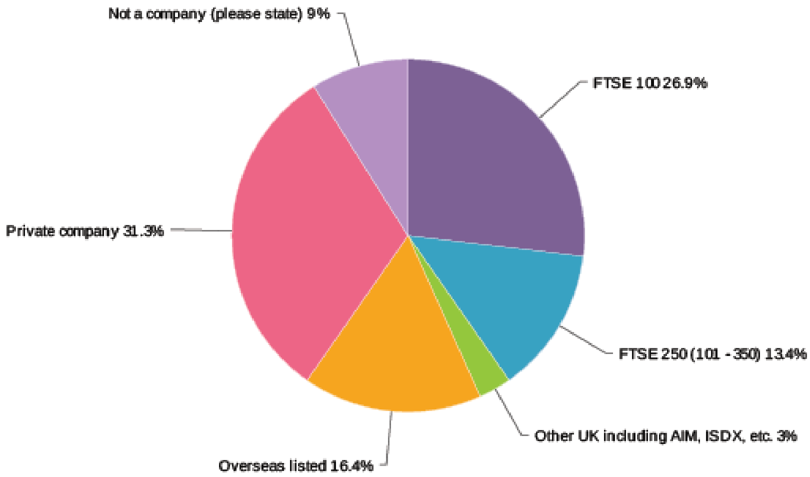


Figure 19 Type of company?

THE ACT WELCOMES COMMENTS ON THIS REPORT

Please send your comments to

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