

March 4, 2008

Unlike Consumers, Companies Are Piling Up Cash

By [DIANA B. HENRIQUES](#)

At least someone knows how to fill a piggy bank.

Unlike most American consumers, whose failure to save has exasperated economists for years, the typical American corporation has increased its savings so sharply that it probably has enough cash on hand to completely pay off its debts.

That should be good news in an economy unsettled by rising energy prices, tightening credit, gyrating stock prices and declining values for the dollar and the family homestead. Indeed, the Federal Reserve chairman, [Ben S. Bernanke](#), cited strong corporate balance sheets as a bright spot in the darkening forecast he presented to Congress last week.

Some analysts also speculate that these cash-rich companies may start sharing their wealth with investors through special dividends, providing welcome stimulus for the economy.

Corporate spending on equipment and other capital expenditures has declined as savings have soared, suggesting that companies could stimulate the economy now by going on a hiring and spending spree. But that raises worries among some analysts that companies will spend their cash unwisely, making them more vulnerable in the future.

The increase over the last decade in the amount of cash, as a percent of total assets, for the companies in the Standard & Poor's 500-stock index has been steep. One study shows that the average cash ratio doubled from 1998 to 2004 and the median ratio more than tripled, while debt levels fell. According to S.& P., the total cash held by companies in its industrial index exceeded \$600 billion in February, up from about \$203 billion in 1998.

[René M. Stulz](#), who holds the Reese chair in banking and monetary economics at the Fisher College of Business at [Ohio State University](#), said [research](#) he conducted with two [other professors](#) on corporate cash levels since 1980 indicated that growing cash holdings over that period most likely reflected the simple fact that the world became a much riskier place for business.

"Companies responded to those rising risks by saving more," said Professor Stulz, whose study excluded utilities and financial companies because their cash reserves are monitored by regulators.

An even longer savings trend was spotted by [Jason DeSena Trennert](#), managing partner and chief investment strategist at Strategas Research Partners in New York, who said his own rough examination of corporate balance sheets shows that "cash, as a percent of total assets, is as high as it's been since the 1960s."

The ledgers of many individual companies bear out these findings. For example, the cash ratio at [Paychex](#) — cash and short-term investments as a percent of total assets — has more than doubled, from less than 30 percent in 1988 to more than 70 percent by last summer. Over the same period, Apple's cash ratio grew to more than 60 percent, from just over 38 percent.

The cash ratio at [Avon Products](#), just under 3 percent in 1988, was nearly 17 percent by last December. And [Microsoft](#)'s savings account is so large that its chief financial officer has observed that the company could, if it wished, cover most of the \$20 billion cash component of its pending \$44.6 billion offer for [Yahoo](#) from its own reserves.

This cash-saving trend may have a downside, though. Because companies can spend from their own account without scrutiny from the investment bankers or commercial bankers who might otherwise lend them money, corporate executives can do some really dumb things with their cash, said [Amy Dittmar](#), an assistant professor at the Ross School of Business at the [University of Michigan](#), who has studied corporate spending habits in the United States and abroad.

“There is a subtle line between having enough money to do what you have to do versus having enough money to do anything you want to do,” Professor Dittmar said.

Manny Weintraub, a former managing director and top-performing money manager for Neuberger Berman who formed his own investment advisory firm in late 2003, agreed. “Like your mother told you, the rule should be that if you don't have anything nice to buy, don't buy anything,” he said.

The Stulz team's study showed that this trend of rising cash ratios was not limited to very large corporations — indeed, the average increase is more pronounced among firms below the top one-fifth of the sample.

Over the same time, the study found, one measure of corporate debt — the net debt ratio, or debt minus cash as a percent of total assets — fell so sharply that, by 2004, it was below zero, where it stayed at least through 2006.

“In other words,” the researchers noted, “on average, firms could have paid off their debt with their cash holdings.”

Those who study corporate balance sheets suggest that several factors have contributed to this change in corporate savings patterns.

In the last 25 years, the speed and scale of globalization have increased sharply. That shift to worldwide markets confronted companies with increased currency risks, political risks and new competition — all adding to the overall risk of doing business.

During the same period, conglomerates and similarly diversified companies fell out of favor, as Wall Street looked for “pure plays” and companies narrowed their focus to a few core businesses — in effect, putting more of their eggs in fewer baskets.

That left those companies more vulnerable to any event that shook those baskets, Professor Dittmar

explained. “When firms become less diverse and more focused, they become more volatile,” she said. And when that happens, they need cash to cushion the bumps.

While rising risks may explain most of these changing patterns, other business trends may also have had an impact.

For example, the Stulz team’s paper shows that rising cash levels were, to some degree, influenced by a drop in capital spending on hard assets, which can be used as collateral for borrowing. Similarly, the study found, as companies increased their focus on research and development investments, which are not as useful for borrowing purposes, cash levels rose.

Moreover, cash has traditionally been just one component of “working capital,” along with inventories and accounts receivable. But innovations like “just in time” supply chains and faster payment systems have reduced the role of inventories and accounts receivable and, conversely, raised the role of cash on corporate balance sheets, Professor Dittmar said.

Adding to that, the corporate universe now contains a higher percentage of the companies that have traditionally held lots of cash, notably technology companies. These companies now make up about 45 percent of the economy, up from less than 30 percent in 1980. That would inevitably increase the overall averages for cash ratios.

The study by the Stulz team, however, specifically allowed for that change — and found that even among technology companies, the ratio of cash on the balance sheets has grown sharply over that period.

According to Mr. Trennert, the cash ratios at technology companies have doubled since 2000.

With cash levels this high, Mr. Trennert said he expected that some companies — those that also have high levels of insider ownership — may elect to pay a special dividend in the coming year, ahead of any future change in the favorable tax treatment those dividends now receive. “If I were a C.E.O.’s tax lawyer, that would certainly be my advice,” he said.

As the Stulz team noted, this trend is in many ways paradoxical and unexpected. In the last 25 years there has been an explosion in financial products intended to help companies manage risk — from currency devaluations to commodity shortages.

“We would expect improvements in financial technology to reduce cash holdings,” the researchers noted.

And yet, corporations have continued to cope with risk the old-fashioned way: by saving for a rainy day. That suggests that either corporations are not making sufficient use of risk-management tools, or that the tools themselves — while helpful — are inadequate to cope with the increased levels of risk that companies now confront, Professor Stulz said.

Some veteran investors also suggest another factor that may have encouraged the growth in cash ratios. Mr. Weintraub, the money manager, pointed out that in the years examined in the Stulz team’s study, Wall Street started giving greater weight to balance-sheet strength.

Though that focus clearly faltered during the technology stock bubble of the late 1990s, it is coming back into vogue in today's uncertain times, said Quincy Krosby, an economist and chief investment strategist at the Hartford, an insurance and financial services company.

With the markets so unsteady, companies with soft stock prices and solid balance sheets are attracting attention from institutional investors, she said, in part because the companies, especially in the technology realm, have enough cash to expand their market share through acquisitions.

But won't big cash cushions turn these companies into sitting ducks for leveraged-buyout firms or foreign buyers spending today's remarkably cheap dollars?

Maybe not — or, at least, maybe not yet.

Professor Dittmar noted that the credit squeeze has made it less likely that highly leveraged private equity funds can go gunning for cash-rich companies, as they have in the past.

Political pressures, meanwhile, are likely to protect American companies from hostile foreign buyers — certainly through an election year, and even longer if the Democrats take the White House and make gains in Congress, Mr. Weintraub noted.

But, with the debt-burdened American consumer cutting back, wouldn't the risk of a recession decline if companies with overstuffed wallets took their cash out and spent it?

Emphatically not, said Professor Stulz. Research strongly suggests that companies are holding more cash because they need it to operate more safely in a risky environment, he said.

“If they spend it, they will become more fragile,” he added. “And an increase in the number of fragile firms is not in the best interests of the economy.”

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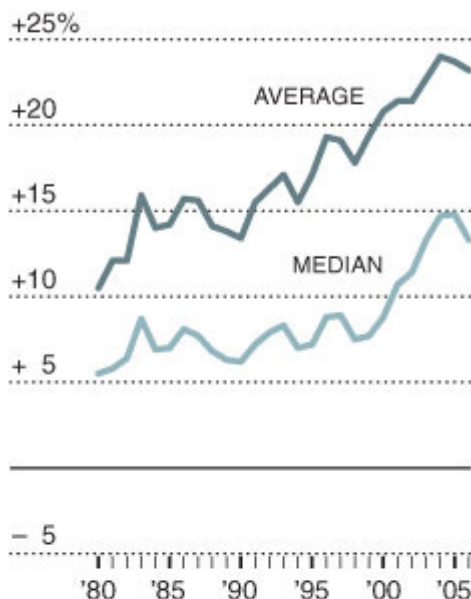
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Feeling Flush

Since the early 1980s, cash on hand for companies has steadily increased while their debt has fallen.

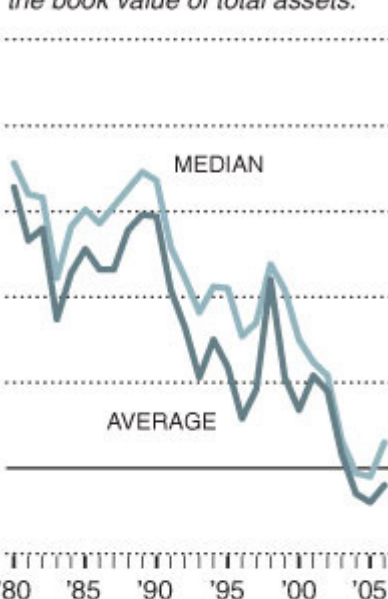
CASH RATIOS

Cash and marketable securities, divided by total assets.



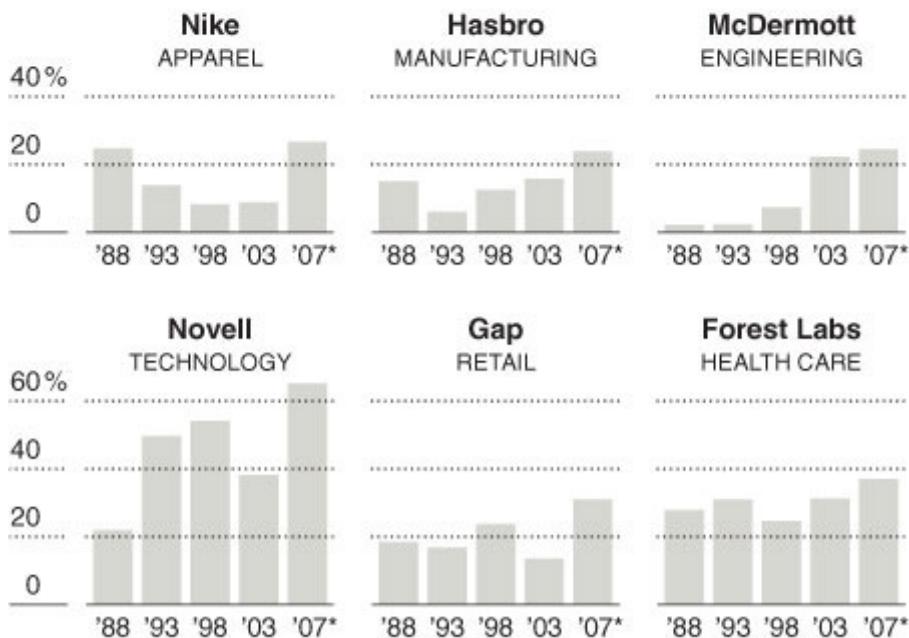
NET DEBT RATIOS

Total debt, less cash and marketable securities, divided by the book value of total assets.



The trend toward higher cash levels holds true at companies across a range of business sectors.

CASH RATIOS



*Latest available data.

Sources: Prof. Thomas W. Bates, Univ. of Arizona; Kathleen M. Kelly, Univ. of Arizona; Prof. M. S. ...

Table 1: Average and median cash and leverage ratios from 1980 to 2006

The sample includes all Compustat firm-year observations from 1980 to 2006 with non-missing data for the book value of total assets and sales revenue for firms incorporated in the U.S. Financial firms (SIC code 6000-6999) and utilities (SIC codes 4900-4999) are also excluded from the sample, yielding a panel of 117,438 observations for 13,599 unique firms. The cash ratio is measured as the ratio of cash and marketable securities to the book value of total assets. Leverage is defined as the ratio of total debt to the book value of total assets, where debt includes long-term debt plus debt in current liabilities. Net leverage is computed as the difference between total debt and cash and marketable securities, divided by the book value of total assets.

Year	N	Aggregate Cash Ratio	Average Cash Ratio	Median Cash Ratio	Average Leverage	Median Leverage	Average Net Leverage	Median Net Leverage
1980	3519	0.063	0.105	0.055	0.269	0.243	0.164	0.178
1981	3748	0.057	0.121	0.058	0.253	0.228	0.133	0.160
1982	3752	0.061	0.121	0.064	0.261	0.232	0.140	0.158
1983	4120	0.076	0.159	0.087	0.246	0.204	0.087	0.111
1984	4172	0.070	0.140	0.069	0.254	0.218	0.114	0.141
1985	4127	0.069	0.142	0.070	0.270	0.230	0.128	0.151
1986	4261	0.076	0.157	0.081	0.273	0.236	0.116	0.143
1987	4407	0.077	0.156	0.077	0.273	0.241	0.116	0.153
1988	4237	0.062	0.141	0.068	0.280	0.244	0.139	0.163
1989	4095	0.055	0.138	0.063	0.286	0.253	0.148	0.173
1990	4042	0.051	0.134	0.062	0.282	0.244	0.147	0.168
1991	4137	0.055	0.155	0.072	0.259	0.215	0.104	0.129
1992	4307	0.057	0.163	0.079	0.245	0.193	0.082	0.111
1993	4713	0.060	0.171	0.083	0.225	0.179	0.053	0.091
1994	4985	0.058	0.155	0.070	0.230	0.187	0.075	0.106
1995	5165	0.060	0.171	0.072	0.230	0.187	0.059	0.105
1996	5568	0.066	0.193	0.088	0.222	0.170	0.029	0.077
1997	5605	0.068	0.191	0.089	0.236	0.180	0.046	0.085
1998	5263	0.065	0.178	0.075	0.289	0.205	0.110	0.119
1999	4971	0.075	0.194	0.077	0.247	0.198	0.053	0.104
2000	4947	0.074	0.208	0.088	0.242	0.173	0.034	0.075
2001	4540	0.080	0.214	0.107	0.268	0.173	0.054	0.062
2002	4233	0.091	0.214	0.114	0.258	0.172	0.045	0.054
2003	3992	0.101	0.227	0.133	0.235	0.160	0.008	0.016
2004	3693	0.109	0.240	0.147	0.225	0.145	-0.015	-0.003
2005	3549	0.105	0.237	0.148	0.219	0.136	-0.020	-0.005
2006	3297	0.103	0.232	0.133	0.221	0.146	-0.010	0.015

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