

# Companies are leaking cash - that's bad news for jobs

MoneyWeek

By Associate Editor [David Stevenson](#) Oct 31, 2008

Britain's businesses are eating up cash. Fast. And the latest data shows the problem is only getting worse.

When UK plc runs low on readies, the rest of us feel the pain. So whatever the headlines about share prices rallying, or people telling you that "it's really not too bad out there", don't believe them.

In the real world, it's about to get even tougher. Investment and advertising spending will keep falling, for one thing. But the worst news of all will be on the jobs front...

## **Why British companies are leaking cash**

This isn't the first time we've written about the cash squeeze afflicting British companies. But recently things have become a whole lot harder.

The latest numbers from the Bank of England reveal that one of the key gauges of the amount of money in the system has shrunk by 3.8% over the last year. This measure is known as 'adjusted M4', and records the amount of cash that so-called 'non-financial' businesses - i.e. not banks, but the ones that make or sell real things, or provide services - are holding.

And the speed of the decline is accelerating. Over the last six months alone the measure is down by 3%. In other words, these firms' balance sheets are now starting to leak cash very badly.

Why? The recent mayhem in the money markets, when banks wouldn't lend to each other, let alone their customers, may have had something to do with it. There's no doubt that companies as well as consumers have been finding

money harder to borrow. Lending to the business sector has slowed down to an 8.1% annualised growth rate, its lowest pace of increase for 3 ½ years.

Yet although money market interest rates are dropping, which should make borrowing easier, there's nothing to get too excited about. Capital Economics still expects a sharp slowdown in bank lending growth "if not an outright contraction".

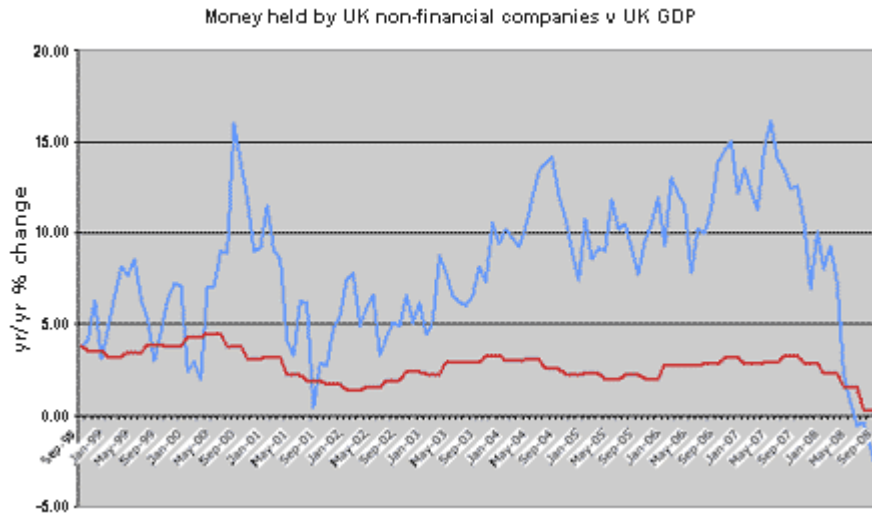
But there are two other, much more worrying, explanations for the company cash drain. Firstly, some firms are finding that their customers, who in turn are also running short of money, are paying their bills more slowly. The mighty Tesco for example, has just told its suppliers that they would have to wait another 30 days to be paid. With Britain's biggest retailer in such a dominant position, taking at least £1 for every £8 passing through the country's shop tills, that's bound to hit many businesses' working capital hard.

It's certainly stirred up the boss of household goods maker Reckitt Benckiser, who has called Tesco's move "irresponsible". And the damage hasn't even started yet.

### **Businesses just aren't making the profits that they used to**

But the main reason is likely to be chillingly simple. It looks like companies just aren't making the profits, and collecting the cash flow, that they used to. Tesco itself has just cut its estimate of UK sales growth to 2%. And like-for-like sales growth at chemist chain Boots in the six months to September was just 0.5%.

To see what this all means, take a look at the chart below.



The upper line is the measure of company cash, and the lower is the real - i.e. inflation-adjusted - rate of growth in UK GDP, in other words, annual output. As you can see, the two have plunged in tandem, to their lowest levels in the last ten years. In fact, looking back even further would show that companies' cash deposits are now at their lowest since the early 1980s, according to the Bank.

It's very clear what's on the cards for GDP. Annual output could soon plummet to a big minus number. Which in turn will set up a vicious circle, with both company profits and cash flows being hammered again.

Britain's employers are facing the sort of cash squeeze that typically precedes a severe recession, says Michael Saunders at Citigroup. He notes that the last time deposits and borrowings saw similar declines was in 1974, and that the corporate liquidity ratio - the ratio of deposits to borrowings - is now the lowest since 1991: "If you look back at previous recessions, you will see that corporate cash flows get strained. Cash doesn't lie."

And the Bank's data confirmed "the dramatic negative shift in the economic outlook" after the Lehman Brothers collapse in September, says Simon Ward at New Star Asset Management. The decline in both lending and deposits is very worrying for employers: "their access to credit has been curtailed at a

time when working capital needs are likely to have been boosted by the economic downturn."

The rating agencies are also fast catching on. Moody's has just downgraded 52 European debt issuers and upgraded just 15 in the third quarter of this year, resulting in a -37 ratings gap, the worst outcome since the first quarter of 2003.

So as company cash falls, spending on investment and advertising will go the same way. The boss of the major 'ad' maker WPP, Sir Martin Sorrell, warned yesterday that "2009 will be a very tough year".

### **Lots more jobs are about to vanish**

But worse, the FT reports today that more than a quarter of employers are preparing to make redundancies over the next 12 months, according to the Chartered Institute of Personnel and Development, with the labour market "on the verge of a torrent of bad news".

Further, lots more businesses will be going bust and many more jobs will vanish. So anyone who tells you that the British economy's wealth-creating companies will 'muddle through' is in complete denial.

They won't - and nor will we.