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Running scared

Some of Britain's top companies are sitting on £130bn while the country's economy is starved of investment. We find out why

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Maggie Turpin thrust two albums of photographs into David Cameron's hands. Look at these people, she urged him. "If you don't do something, they will end up on the scrap heap."

As the wife of an engineer threatened with redundancy at BAE Systems' plant in Brough, east Yorkshire, where the Hawk fighter jet is made, Turpin was determined that Cameron should hear the workers' side of the story.

At a meeting in Downing Street just before Christmas, she, with several other workers and their families, got to put her case. Cameron "actually listened to us", Turpin told the Hull Daily Mail, her local paper.

While the prime minister was sympathetic, what makes the situation particularly bewildering for the 3,000 staff who face the axe at BAE is that the company is not strapped for cash — far from it.

The defence giant is sitting on more than £3 billion, making it among the biggest hoarders of funds in the FTSE 100. Excluding the banks and financial groups, which are obliged to hold capital, companies in the FTSE 100 are sitting on cash and short-term investments totalling £130 billion, according to figures from Thomson Reuters Datastream.

But while the government urges companies to invest that cash to kickstart an economic recovery, firms are unwilling to open their wallets. Spending on new factories, acquisitions and other big projects is the last thing on their minds.

Cash is king. Fears of a double-dip recession are mounting thanks to the seemingly interminable debt crisis in the eurozone. Defence giant BAE is sitting on more than £3 billion, making it among the biggest hoarders of funds in the FTSE 100

Money markets have been frozen for months, making it harder than ever to get bank loans.

The steady march of economic power from West to East dictates that cash has to be deployed very carefully.

BAE said the issue of how to use its cash is distinct from the future of its British plants, which don't have enough work to sustain them.

"We have to take these difficult decisions now," BAE said. "That's something we are going to have to do whatever our current cash position. Injecting more cash [into the factories] would not resolve the issues."

Perhaps. But even the CBI, the employers' lobby group, is calling on companies to invest to help change Britain's fortunes. In its new year message, the CBI argued that "the onus is on the private sector to deliver", echoing a sentiment espoused by George Osborne in a speech to business leaders at the World Economic Forum a year ago.

Despite these calls, companies are acting as conservatively as possible. Aside from sitting on it, the most popular way to use cash has been to hand it back to investors in the form of dividends and share buybacks. The latter allow companies to acquire their own shares, reducing the number in circulation and therefore driving up earnings per share, a key performance measure.

Cash-rich BAE launched a £500m buyback last July, two months before announcing its huge job cuts programme. Other companies with big share buyback programmes include Glaxo Smith Kline and Astra Zeneca, the drug makers, and Vodafone, the mobile-phone operator. Last week, Next, the fashion chain, said it would buy back a further £200m of its shares.

"Share buybacks had a noticeable pick-up in 2011," said Karen Olney, European equity strategist at UBS, the investment bank. "They totalled £15 billion last year, up from £7 billion the year before."

In contrast, the outlook for capital expenditure is pretty bleak, at 0% growth for the next two years, said Olney. This will probably remain so as long as there is a threat of defaults in the eurozone.

The emphasis on buybacks is welcomed by the big institutional investors that have received the cash. “Share buybacks point to management discipline,” noted Jamie Clunie at Scottish Widows. “They hint that management has looked at the calculations and risks and thought it in shareholders’ interests to return capital to them rather than risk it on marginal projects.”

Critics take a different view. They point out that not only do buybacks have the potential to boost bosses’ bonuses, which may be partly based on earnings per share, they are also a sign of lazy thinking. They are what companies do when they can’t think of anything else to do with their cash, or when the alternatives are deemed too risky or unlikely to deliver sufficiently attractive returns. “They are the easy way out,” said one City analyst.

Deep in the Australian outback BHP Billiton has started a project that rivals any in human history. By the time it is completed, the open-cast mine at Olympic Dam in South Australia — the world’s largest uranium deposit and one of the biggest of copper — will be a giant hole two-and-a-half miles long, two miles wide and more than half a mile deep. The mountain of sand and rock BHP will dig up to get at the ore will cover 25 square miles and have enough material to build the equivalent of 3,800 Great Pyramids of Giza. The development plan also calls for a new airport, a village and a desalination plant that will be connected to the coast by a 200- mile pipeline.

The huge project is just one of many in an $80 billion (£52 billion) spending plan that the world’s biggest miner has laid out for the next five years.

It, like its rivals in the resources world that have benefited from a boom in everything from oil and copper to wheat and gold, is cash rich. Oil companies, miners and commodities traders hold more cash than any other sector barring banks and financial institutions, many of which are required by statute to have big cash reserves in case the economy crumbles.

Some of the biggest share buybacks and dividend payouts in the FTSE 100 have been those by the mining giants. BHP and its rival Rio Tinto have delivered huge cash returns to shareholders.

At least they have been trying to do deals as well. Although BHP spent $15 billion on smaller acquisitions last year, a mega-deal has proved elusive. For example, an attempt to buy Potash Corporation in 2010 was thwarted by the Canadian government.

The mining industry could yet see some significant takeover activity, however. William Rucker, chief executive of Lazard, the investment bank, said: “In sectors where there are continued prospects for mergers and acquisitions, such as metals and mining, we would expect to see some of that cash used on deals.”

Excluding banks, insurers and other financial firms, BP is the FTSE 100 company with the most cash at its disposal. It is sitting on holdings totalling $24.4 billion. The oil giant, however, is a special case. Next month in America a trial begins that could saddle it with tens of billions in damages over the 2010 Gulf of Mexico oil spill. That is before potential charges from the US Department of Justice, and the outcome of a legal duel with Halliburton, the contractor.

Bob Dudley, BP's chief executive, has pledged to sell about $18 billion of assets, which would certainly help, but until there is clarity, BP isn't likely to splash out on takeovers.

Royal Dutch Shell, which has £8.6 billion of cash and investments on its balance sheet, is also unlikely to be going after big deals, but it is spending. The oil giant plans to invest more than $100 billion over the next four years on new oilfields from the Gulf of Mexico to China. That's before the tens of billions it pays out in dividends.

Away from the resources sector, some companies insist they are doing their bit to invest and so boost the economy. Glaxo Smith Kline, for example, spent about half its £4 billion research and development budget in Britain in 2010. It also invested £1.3 billion worldwide on building factories and buying equipment, £300m of which was spent in the UK.

Vodafone says it increased UK capital expenditure in the first half of its financial year to £219m, up from £178m in the same period a year earlier. 'Why put your head above the parapet? There's still a storm raging,' HSBC's Robert Parkes

And National Grid is investing to upgrade its gas and electricity networks, having spent £1.5 billion in the first half of its financial year. This is forecast to rise to more than £3 billion by the end of the year.

Can these investments by Britain's private sector titans spark the economy back into life? It appears not. That, at least, was the stark message delivered by analysts at Barclays Capital last week.

"We expect the pick-up in business investment to be fairly modest and to lag rather than lead the broader recovery," wrote Chris Crowe, one of the investment bank's economists, in a note to clients.

He concluded: "We interpret firms' strong cash positions as reflecting a response to uncertainty and an absence of perceived investment opportunities, rather than representing a 'war chest' ready to spend on investment."

Other experts share this view. Gareth Evans at Deutsche Bank said: "The government might want companies to invest their cash, but it's unlikely to happen until market conditions improve."

And Robert Parkes at HSBC said: "Why put your head above the parapet? There's still a storm raging."

The amount of cash sitting on British balance sheets is at record levels. Experts suggest it is roughly double what it might be in more certain times, and this is unlikely to change while the outlook remains so challenging.

The Thomson Reuters total of £130 billion includes cash and cash equivalents, as well as short-term investments and financial derivative products listed as assets.

Companies point out that having huge amounts of cash does not necessarily mean they can afford to be free-wheeling in their spending. Cash balances must be set against bank loans and other obligations, meaning any reduction in cash will cause net debt levels to rise. This is not something that will please investors.

Richard Buxton at Schroders, the fund manager, said: “First and foremost this is not the time for being heroic with balance sheets, and nobody should be doing aggressive buybacks or indeed aggressive mergers and acquisitions.”

A survey of finance directors published last week by Deloitte, the accountancy firm, seemed to suggest that there is no danger of that happening. Those in charge of the company purse strings said their top priorities for this year were reducing costs and increasing cashflow. More than half of those surveyed expect Britain to fall back into recession.

Buxton argues that companies should not seize up. “If there are opportunities that won’t overstretch the balance sheet and will generate returns, go out and do them, because if you’re in a position to be able to, not all your competitors will be,” he said.

The word “overstretch” is the key. Last year, G4S, the outsourcing group, thought it could steal a march on its rivals with a transformational £5.2 billion takeover of ISS, a Danish peer. Unfortunately, investors thought the deal was far too risky and forced G4S into an embarrassing climbdown.

Two months later, G4S did make an acquisition, albeit a smaller one. On the penultimate day of 2011, it bought Trojan, the third-biggest security company in Botswana, for a mere £916,500, as well as a cleaning firm in the same region for £1.2m. That’s hardly going to make a dent in the group’s £433m cash pile or get many politicians excited. But it may be the shape of things to come.

Additional reporting by Danny Fortson, Iain Dey and Oliver Shah

FTSE’s bulging wallets

Here are the top 20 FTSE 100 companies, excluding banks and those in financial services, ranked by the amount of cash they are holding.

Thomson Reuters Datastream compiled the figures from each company’s most recent annual report. The cash pile totals include cash equivalents, short-term investments and financial derivative products. In some cases, the latter two items outweigh the amount of actual cash on the balance sheet.

Companies reporting in overseas currencies have had their totals converted into sterling using the exchange rate at the time of the company's financial year-end.

If the whole of the FTSE 100 were included, banks and insurers would take the first six places, with BP ranked seventh. Barclays would be first with £99 billion, followed by HSBC, Royal Bank of Scotland, Lloyds Banking Group, Standard Chartered and Aviva.
Britain is not the only country where companies are being cautious about spending their cash.

A report published last week by JP Morgan Chase suggested the situation in America is the same. It found that the companies that make up the S&P 500 index could be sitting on as much as $2 trillion (£1.3 trillion) of cash.

Like their counterparts on this side of the Atlantic, big American companies have preferred to use their resources to fund share buybacks and big dividend payments rather than make large acquisitions.

HOW THEY RANK

		£bn			£bn
1	BP	15.8	11	National Grid	3.8
2	Royal Dutch Shell	8.6	12	Rolls-Royce	3.4
3	Astra Zeneca	8.1	=	BAE Systems	3.4
4	Vodafone	6.9	14	Tesco	3.0
5	Rio Tinto	6.7	=	SSE	3.0
6	BHP Billiton	6.4	16	British American Tobacco	2.5
7	Glaxo Smith Kline	6.3	=	Unilever (UK)	2.5
8	Vedanta Resources	4.9	18	Antofagasta	2.3
9	Glencore International	4.8	19	BG	2.0
10	Anglo American	4.3	=	WPP	2.0