Corporation with lots of cash

Finance

Corporations with Lots of Cash It is quite unusual for an economy such as the United s who is still struggling to recover from an economic slump yet it has as much as $ 2 trillion in cash sitting in the private sector. If we are going to use Obama's Stimulus Package as a benchmark which has saved and created over a million jobs with a mere $787 million, that $2 trillion dollars could have created over 3 million jobs. There is of course a reason why the non-financial sector in the U. S. is still holding that much cash. It is their reaction from the recent economic crisis which induced the non-financial companies' propensity to save rather to to reinvest and spend. Also, one of the major reason why these non-financial companies are not investing that money to create jobs is because they are still doubtful about the strength of the recent economic recovery of whether it can be sustained. The doubt about the economic recovery is even more compounded with the recent development of Standard and Poors' credit downgrade of United States from triple A credit rating to just double A. With how things are going, it is still not likely that the non-financial sector will be freeing that cash for reinvestment. To better understand why these companies are conservative with their spending, we have to consider the lessons they learned from the past financial crisis. Beginning with the dot com bust in 2000, companies with more cash were able to weather the crisis better than cash strapped companies hence is this conservative attitude. The same conservative attitude also helped them withstood the crisis when the recession broke in late 2007 and the eruption of financial crisis in 2008. Companies that were more liquid were able to get through the storm as they do not have to resort to lending which were not available then. Considering that the corporate landscape just recently came from these recent liquidity crunch, it will not be easy for them to shake off that “ conservative mindset”. Having more money in their balance sheets meant that they are in a better position to make payrolls and purchase inventory and thus assure them perpetuity in business should the economic climate turns unfavorable again. These companies just do not feel that it is the right time to re-invest and expand. To quote Bob Kierlin, Chairman and founder of Fastenal Co., a Winona, Minnesota based company that sells screws, nuts, bolts and other construction supplies, “ we’re saving our firepower for when opportunities might come up”. They are still in the stage of “ wait and see” attitude if business will really pick up. For them, excess funds serve as an insurance to have the necessary liquidity to purchase the necessary raw materials and other inventory when the economy really picks up. According to Larry Ryder, Chief Financial Officer of Hooker Furniture Corp., “ we don't want to tie our cash up to the point that we don't have the liquidity we need to accumulate inventory when we need it”. It may be a bad idea to keep so much money that does not create returns for the company. But considering the recent economic climate, there is also not much opportunity to deploy it. The economy is picking up painfully slow and the uncertainty is still there especially with the recent downgrading of the country’s credit rating. For now, company like Fastenal Co. is still peeved with reinvesting that it decided that it is better to pay dividends to shareholders than to expand. This overly conservative attitude might have been due to their skepticism of our policymaker’s ability to really resuscitate the company. The recent political debacle about the debt ceiling precipitated the recent credit downgrade of the U. S. which made the country a less attractive place to invest. The implication of this recent downgrade can also be disastrous to the economy as it will fuel further capital conservatism among companies as borrowing will become more expensive. The effect could be the same as the recent financial crisis in 2008 where financial institutions were anxious to lend to money for fear of loan default. Consumers' interest expense will also increase taking a significant slice in their purchasing capacity. In this case, companies will become anxious to expand knowing that the price of capital became more expensive with a shrinking domestic expenditure. This will make the economy contract as no new business is created. Unemployment will increase because no new jobs are created. Domestic expenditure will also decline which gives companies no incentive to expand thus justifying their conservative stance. If this trend will not be arrested, it will become likely that we will again be back from where we started.