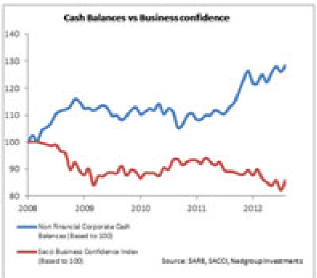
BIZCOMMUNITY

High corporate cash balances symptomatic of stunted business confidence

Corporate cash balances have been rising steadily since mid-2010, according to data released by the South African Reserve Bank (SARB) for September 2012, that non-financial corporate cash balances are sitting at R542 billion (marginally down from their August 2012 peak of R549 billion).

Meanwhile, business confidence has been falling - indicating a relationship between local business confidence and the confidence that corporates feel with regards to the local economy.

This is according to Sean Segar, head of product at Nedgroup Investments, Cash Solutions, who says corporate cash balances have been rising steadily since mid-2010. Segar says it is an anomaly that corporates have so much cash despite tough trading conditions and low interest rates and points to the relationship between business confidence and corporate cash balances as illustrated in the graph below.



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"The graph indicates that there seems to be a strong relationship between business confidence as reported by SA Chamber of Commerce and Industry (SACCI) and corporate cash balances," he says.

Corporates holding onto higher cash balances

Segar explains that corporates are holding onto higher cash balances as banks are not lending as freely as they used to. Furthermore, he says projects are being deferred due to political and economic uncertainty and companies are increasingly hesitant to invest their capital into local projects at the moment and are opting to hold the cash instead.

However, he urges corporates that, while it is understandable that many corporates are adopting an overly conservative balance sheet in the face of market uncertainty, there are opportunities to capitalise more effectively on the potential returns their cash piles generate. Segar warns that in the prevailing low interest rate environment, "fortress balance sheets"

- or surplus cash on balance sheets - creates significant drag on earnings and returns in equity.

"At some point business confidence will rise again from current low levels. This will only follow some domestic political stability and an improvement in both the local and international economies. When this happens it is likely that corporate cash balances will fall, but until then it is important that corporates make what cash they have work as hard as possible."

Segar recommends that companies improve their forecasting abilities so they no longer require immediate access to funds, but are able to invest their idle cash in higher-yield accounts with slightly longer notice periods.

"Call accounts offer around 4.75% for large deposits, with same day access. However, conservatively managed income funds, which require a day's notice in order to access funds, yield more than 1% higher than this and those treasurers that can plan one-day ahead will benefit significantly," he says.