NATIXIS BEYOND BANKING

Flash Economics

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What have companies done with their cash flow generation?

We look at the situations of the United States, the euro zone and Japan.

In these countries, companies' cash flow generation has increased considerably over the past 20 years. This raises two questions:

- Are companies generating too much cash, for which they may not have a use? Would it not be better if wages were higher?
- What have companies done with the cash flow they have generated? The answer to this second question obviously determines the answer to the first question.

Companies may have:

- Reduced their debt;
- Invested more;
- Remunerated their shareholders (with dividends or share buybacks);
- Made acquisitions;
- Built up cash reserves.

We find that the additional cash flow generation has primarily been used to finance acquisitions and build up cash reserves.

Investment has not been increased, while debt has been reduced only in Japan.

This suggests that cash flow generation has been used quite inefficiently.

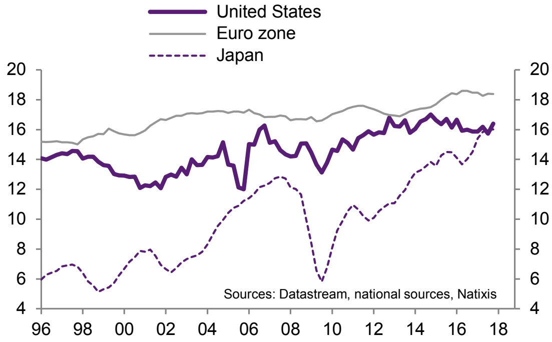
Patrick Artus
Tel. (33 1) 58 55 15 00
patrick.artus@natixis.com
@PatrickArtus

Companies' growing cash flow generation

We will look at non-financial corporations in the United States, the euro zone and Japan.

Chart 1 shows the **cash flow generated by these companies.**

Chart 1
Profits after tax and interest, before dividends
(as % of nominal GDP)



We see that **the cash flow generated by companies has increased strongly since the beginning of the 2000s.**

We will seek to determine:

- **Whether this increase in cash flow has been efficient.** Would it not be better if wages had increased faster **(Charts 2A, B** and **C)**? **Do companies have a use for this sharp increase in cash flow?**

Chart 2A
United States: Per capita real wage and productivity
(Y/Y as %)

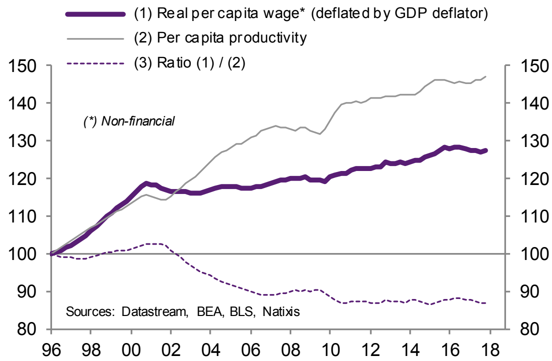


Chart 2B
Euro zone: Per capita real wage* and productivity
(1996:1 = 100)

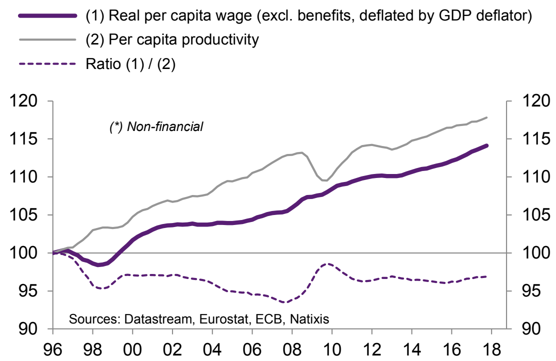
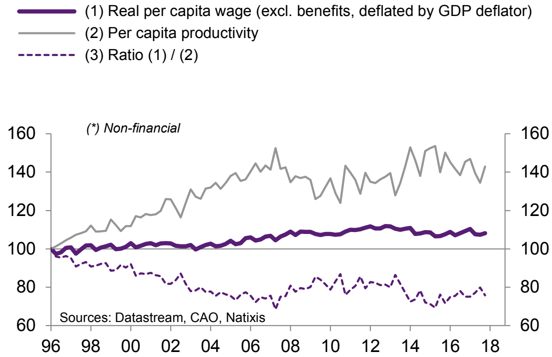


Chart 2C
Japan: Per capita real wage* and productivity
(1996:1 = 100)



- And, **to answer the first question, how have companies used the increase in their cash flow?**

How have companies used their cash flow?

Companies may have used the sharp increase in their cash flow to:

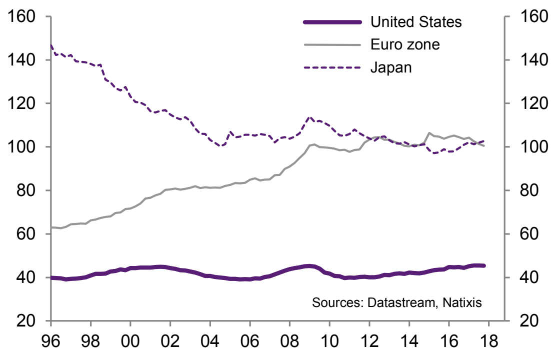
- Reduce their debt;
- Invest more;
- Remunerate shareholders;
- Finance acquisitions;
- Build up cash reserves.

What have companies done in the United States, the euro zone and Japan?

1- Corporate debt

Chart 3 shows that **companies have deleveraged only in Japan**.

Chart 3
Debts of non-financial corporations
(as % of nominal GDP)



2- Investment

Charts 4A, B and **C** show that self-financing rates have risen above 100% everywhere, and therefore that the **cash flow has not been used primarily to invest more**. In **Chart 4A**, the data for the last quarter of 2017 reflects the tax reform but has no enduring significance economically.

Chart 4A
United States: Profits after tax and interest, before dividends, total corporate investment and self-financing rate

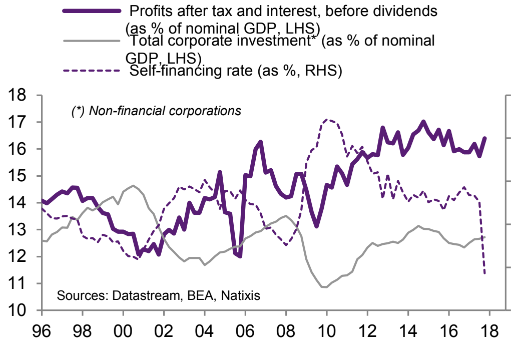


Chart 4B
Euro zone: Profits after tax and interest, before dividends, total corporate investment and self-financing rate

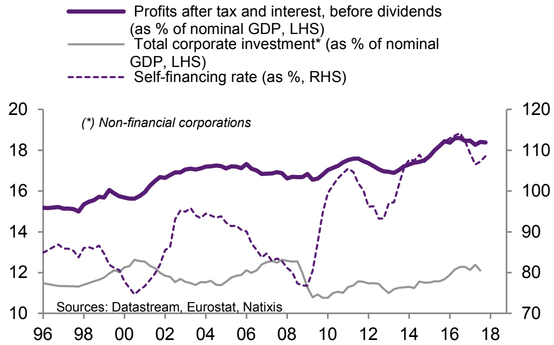
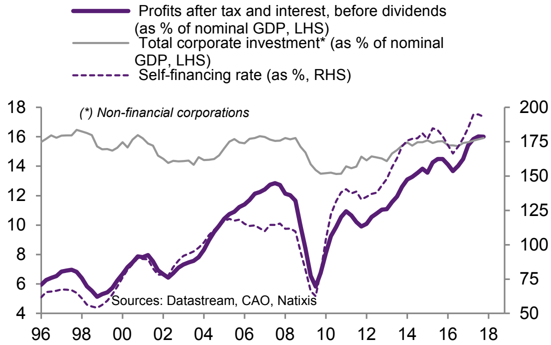


Chart 4C
Japan: Profits after tax and interest, before dividends, total corporate investment and self-financing rate



3- Shareholder remuneration

Shareholder remuneration is **the sum of dividends and share buybacks**.

Charts 5A, B and **C** show that **shareholder remuneration has risen only in the United States**.

Chart 5A
United States: Profits after tax and interest, before dividends and shareholder compensation*
(as % of nominal GDP)

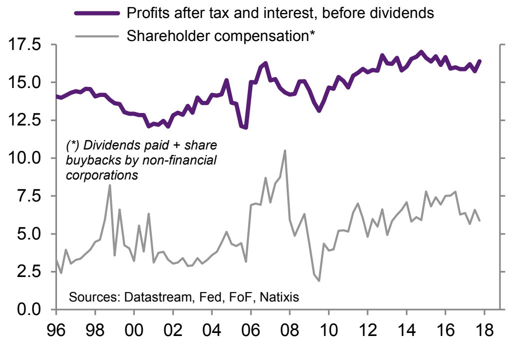


Chart 5B
Euro zone: Profits after tax and interest, before dividends and shareholder compensation*
(as % of nominal GDP)

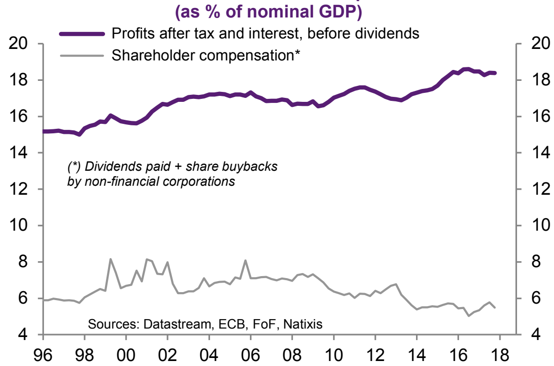
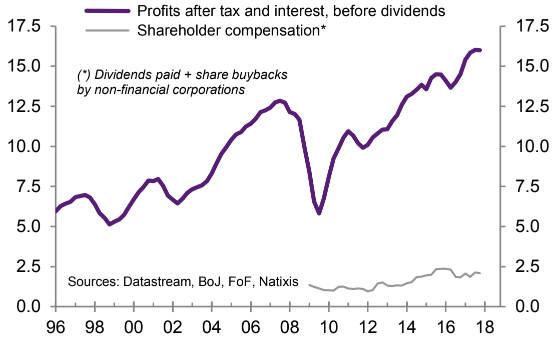


Chart 5C
Japan: Profits after tax and interest, before dividends and shareholder compensation* (as % of nominal GDP)



4- Financing of acquisitions

The use of cash flow to finance acquisitions can be seen in an **increase in outstanding shares (listed and unlisted) held by companies**.

Charts 6A, B and **C** show **this increase in the three countries**.

Chart 6A
United States: Profits after tax and interest, before dividends and outstanding equities* in the assets of non-financial corporations (as % of nominal GDP)

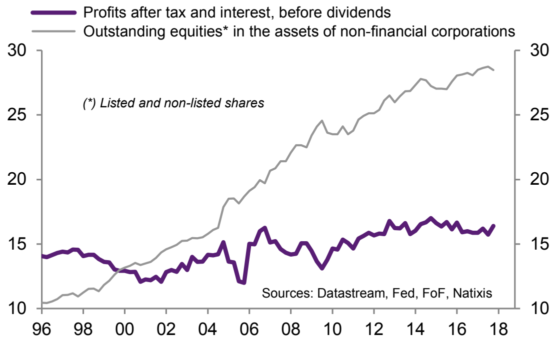


Chart 6B
Euro zone: Profits after tax and interest, before dividends and outstanding equities* in the assets of non-financial corporations (as % of nominal GDP)

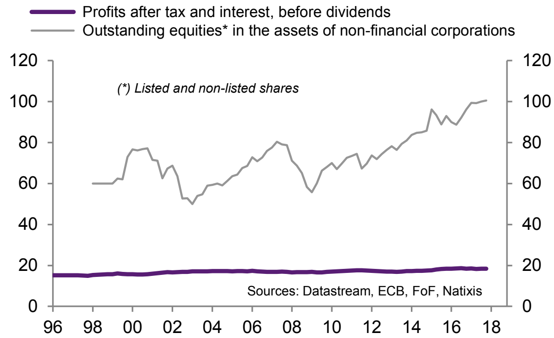
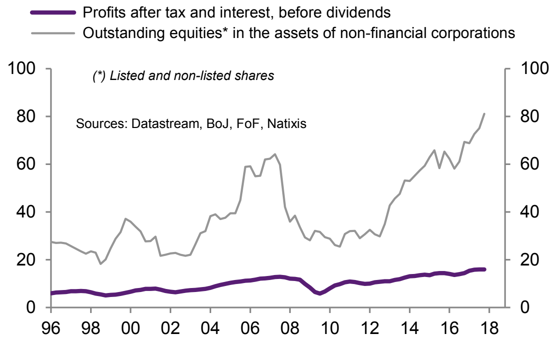


Chart 6C
Japan: Profits after tax and interest, before dividends and outstanding equities* in the assets of non-financial corporations (as % of nominal GDP)



5- Accumulation of cash reserves

Charts 7A, B and **C** compare non-financial corporations' cash flow generation and **their holdings of liquid and money market assets**.

We see that an **increase in companies' cash reserves** coincided with an increase in their cash flow in **the euro zone** and **Japan**.

Chart 7A
United States: Profits after tax and interest, before dividends and liquid and money-market assets held by non-financial corporations
(as % of nominal GDP)

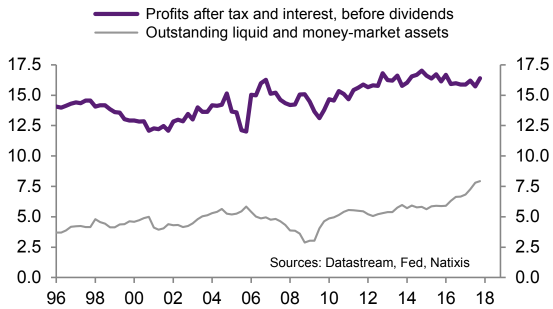


Chart 7B
Euro zone: Profits after tax and interest, before dividends and liquid and money-market assets held by non-financial corporations
(as % of nominal GDP)

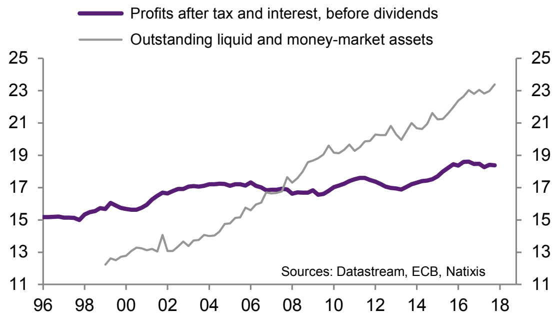
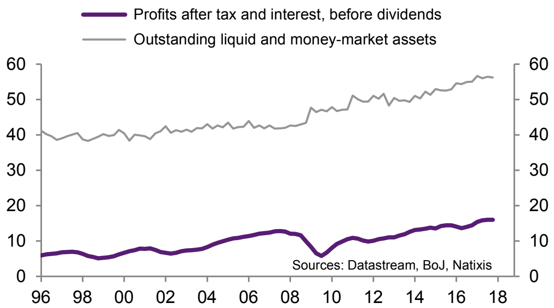


Chart 7C
Japan: Profits after tax and interest, before dividends and liquid and money-market assets held by non-financial corporations
(as % of nominal GDP)



Conclusion: What use have companies made of their cash flow generation?

Table 1 summarises the results obtained.

Table 1: Companies' use of cash flow generation

Country	Deleveraging	Increase in investment	Shareholder remuneration	Acquisitions	Accumulation of cash reserves
United States			X	X	
Euro zone				X	X
Japan	X			X	X

Source: Natixis

From a normative viewpoint, it would have been preferable for companies' cash flows to:

- Boost investment;

- Reduce corporate debt if it was too high initially;

- And not to increase excessively shareholder remuneration, acquisitions or corporate cash reserves.

Unfortunately, the main outcome has been the financing of acquisitions and the accumulation of cash reserves.

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