

# Slash in corporate investment creating long-term problems

February 3 2009

---

A deep and lingering credit crisis is throttling investment in moneymaking projects that could help jump-start a U.S. economy mired in its worst downturn in decades, a new survey of corporate executives shows.

University of Illinois and Duke University researchers found that nearly 60 percent of 569 U.S. firms surveyed are financially strapped by the credit crunch, netting layoffs and other cost-cutting moves that weaken an already hobbled economy.

The survey also shows that tight lending is forcing nearly 90 percent of those credit-constrained firms to pass up potentially lucrative projects that could boost earnings, employment and the overall economy.

"We see what firms are doing in the aftermath of the credit crisis, but we don't see what they're not doing," said U. of I. finance professor Murillo Campello. "And what this research shows is that what they're not doing is pursuing projects that could help build and sustain the U.S. economy for the next 10 years."

As part of a survey project conducted jointly with CFO magazine, chief financial officers of 1,050 companies in the U.S., Europe and Asia were polled in December, asking whether their firms have been pinched by an ongoing credit crisis and how tight lending is affecting operations.

The study, co-written by finance professors John Graham and Campbell

Harvey of Duke's Fuqua School of Business, found stark contrasts between U.S. firms constrained by the financial crisis compared with those with easier access to credit.

Among the findings:

- Just a few months into the crisis, constrained firms had burned through an average 20 percent of their cash holdings to pay suppliers, salaries and other operating expenses. Companies with access to credit had not touched cash reserves, keeping those firms on more solid financial footing
- Nearly 17 percent of constrained firms have drawn on lines of credit - stockpiling cash out of fear that access could be limited in the future - compared with just 5 percent of unconstrained companies.

"This is a frightening trend," Harvey said. "Yes, credit is limited, but firms that hoard funds right now, instead of using them for investments and operations, are directly contributing to the downward cycle of the economy."

- Constrained firms plan cuts in operating costs this year that are roughly twice as deep as unconstrained firms. That includes slashing employment by 11 percent, research and development by 22 percent, marketing by 33 percent and dividends by 14 percent. Campello says the forecasts are likely conservative.

"Typically, CFOs are confident, they have a positive bias," he said. "So if they say the cut will be 10 percent, it's probably more like 20 percent."

- A whopping 86 percent of constrained firms say they bypass attractive value-building investments because of the credit crisis, compared with about half that many among unconstrained firms. The study also found

that 56 percent of constrained firms reported they would cancel investment projects if external financing were unavailable, compared with 31 percent of unconstrained firms.

"In the scramble for short-term cash flow, firms are sacrificing long-term value," the researchers wrote. "This implies lower future growth opportunities and lower future employment growth."

- Financially constrained firms in Europe and Asia are making many of the same cost-cutting moves as their U.S. counterparts, according to the survey.

Campello says the findings signal that the recession might linger longer than once thought, perhaps stretching into 2010.

"What this reveals is that the damage the credit crisis is causing to the corporate sector is perhaps much bigger than just the latest unemployment figures or stock-market prices would tell you," he said.

Researchers say the study is likely the first to directly assess the impact of credit limitations through self-reports from CFOs. Typically, affects are gauged through a retrospective review of financial statements.

"Having this information helps us learn more about how companies make investment and financing decisions, and in this case revealed some startling details about the way corporations are responding to the crisis," Graham said.

Campello says the unique survey could help guide the government's efforts to ease the flow of credit.

"A one-size-fits-all solution that treats constrained and unconstrained firms the same might prolong the crisis," he said. "Targeted solutions

may be more effective, helping banks identify sectors most in need of money, the sectors that are throwing away good projects by the dozens."

Source: University of Illinois at Urbana-Champaign

Citation: Slash in corporate investment creating long-term problems (2009, February 3) retrieved 18 April 2024 from <https://phys.org/news/2009-02-slash-corporate-investment-long-term-problems.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.