From containment to growth.
Is there more to South African company cash hoarding than policy uncertainties?

Swellendam: - South African companies are sitting on a hoard of cash. They claim this is because of uncertainties around Government policy decisions implied in President Jacob Zuma's call for a "dramatic shift" to spread wealth and the so-called "second transition" – the new ANC catchphrase to placate the masses regarding lack of economic progress.

This could be so, especially for mining companies. But the general link to these latest developments is tenuous at best. So far, the stock- and foreign exchange markets have been relatively undisturbed by the rhetoric while the policy documents themselves do not quite live up to Zuma's "drastic change". In addition they still have a long way to go before becoming official policy.

Mainly due to economic recession, company reserves have been building up for some time in many developed nations, as they wait for the next government aid or stimulation package to give them easier markets through higher consumer demand. In the United States alone this hoard is estimated at $1.25trn. In South Africa at last count, it was R530bn – half of the Government's annual budget.

Unusual cash reserves reflect a lack of corporate entrepreneurial flair, hung up as they are on shareholder value, short term profit maximisation, and executive self-interest which all work against an essential ingredient of entrepreneurship – being able to look beyond calculable risk and not being blinded by immediate returns. In addition, large cash reserves facilitate share buy-backs which line the pockets of executives through share options and enhance share values without much effort or taking any risks.

These perspectives and the size of the cash hoarding make business vulnerable to populist rhetoric. It's only a matter of time before politicians cast their beady eyes on the hoard and explore ways of accessing it. Already there's a suggestion to revive prescribed assets for financial institutions to use private savings for development.

And all because business is not doing what it should do best – explore opportunities and invest in growth.

It's long been an insight in organisational theory that strategy is about maintaining *short term profitability for longer term wealth creation*. But for a number of years the second half of that vision – longer term wealth creation – was abandoned and companies, indeed individual behaviour and global economies generally became trapped in a vicious cycle of short-termism, impatience, quick-buck thinking and speculative wealth creation.

We all know the results. A frenzy of speculative froth created a bubble which burst in 2008, plunging the world into persistent recession and causing excessive levels of public debt. Most companies were caught up in the fervour. Competing for capital in a market which favoured quick returns, they were pushed into unsustainable levels of short term earnings growth and linking high levels of executive rewards to rapid increases in shareholder value. In turn this exacerbated unemployment and income disparities. Still today, executive returns are seldom linked to company performances beyond three years or so.

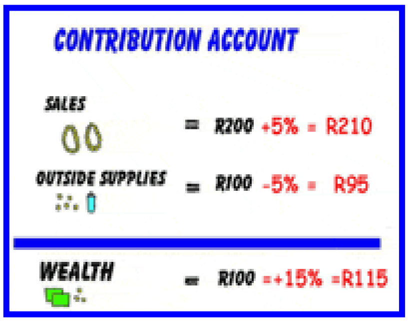
So how do we turn this around? I have argued before that it's all in the measurement: counting what counts. And now I want to argue the case for wealth creation, or value added, as the focal point rather than profit or shareholder value.

Sustainability has become a key strategic issue, but many see it more in a social and environmental context than from a company's longer term viability perspective. The two are clearly linked; as are the other key business concerns today of governance, transparency and accountability.

It was at a conference on sustainability that I became aware of the power of the value-added measurement to longer term growth. I was conducting a workshop for a group of senior and experienced accountants, and gave them an actual Contribution account (an adjusted value-added statement) to work with. The question was simple: what would the company in question have to do to increase wealth?

There were, of course many responses. But they all agreed on one crucial point: the exercise forced them to focus on growth rather than containment; to look outward rather than inward. If I had asked them what they would do to increase profit, they would automatically have paid more attention to costs and containment, particularly employment costs. As Business Leadership Chairman, Bobby Godsell, lamented recently, it's a focus that side-lines labour.

The answer is again quite simple. The Contribution account breaks up into two components: creating wealth and sharing wealth – or more behaviourally and philosophically – contribution and reward; or giving and receiving. The income statement and profit emphasis focus on a specific component of wealth distribution, making all else fair game in its maximisation without necessarily increasing wealth creation.



The simplicity of wealth creation is also its strength: it's the difference between the value of what you have sold and what you have used from outsiders. In accounting terms it is portrayed as sales, income or turnover, less outside supplies, including interest and depreciation. (The latter two are my adjustments because I believe it more accurately reflects real wealth creation).

The most important feature of the top three lines is that they do not include employees as an outside cost. As contributors to wealth creation, they are beneficiaries of wealth distribution. If the task is to increase value-added or wealth, you cannot have recourse to cutting staff. The illustration shows that an increase of 5% in sales and a reduction of 5% in outside costs lead to a 15% increase in wealth creation. Cascaded to distribution, it means that the three beneficiaries of wealth: capital, labour and state, should all receive 15% more.

Increasing wealth creation boils down to only three actions or a combination thereof: sell the most you can, get the best price you can, and cut outside costs. As my workshop accountants discovered, these are mainly the result of being outward looking, growth orientated and service driven. This by no means implies that they are easy to achieve. If they were, companies would clearly opt for wealth creation and growth before they go for rearranging wealth distribution to increase profit. In a tough economic climate and a focus on the quickest returns possible, it is clear that sharing the cake differently is a much easier option than to try and bake a bigger cake.

In the long run, containment is a self-defeating practice that unfortunately has become a matter of routine and automatic option for most big companies. The general decline in customer service is just one symptom of an inward looking focus. At the very least, increasing wealth creation and a regular serious exploring of the three actions mentioned should be the overriding element of any strategic agenda. Executive management should be held accountable much more for wealth creation than for shareholder value and rewards should be directly linked to the value-added measurement.

Wealth creation is the outcome of adding value to people’s lives. A much stronger focus on it will return business to its primary task – being of service to others. At the same time it ensures growth and sustainability.