The Cash to Compete

As cash-to-assets ratios grow, companies look to lock in talent and send a message to would-be poachers

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Cash acquired a bad rap in many circles of corporate finance scholarship where large cash holdings were seen as road blocks to innovation, research and development and other investments in organizational competitiveness. Between 1980 and 2012, a period of special interest to Paul College researcher Zhaozhao He, the average cash-to-assets ratio of U.S. firms more than doubled.

In a recent prize-winning paper, He analyzed some 8,000 U.S. companies' cash holdings and discovered a vital connection between cash holdings and the ability to recruit talent in that era's brutally competitive labor market.

"The tip off for me came in 2010 when Google gave its employees an across-the-board raise of 10 percent to prevent them from jumping over to Facebook," He recalls.

Her study overturned the widespread conventional wisdom that robust cash holdings signal stagnation or mismanagement. Instead, she showed that "the cash effect is stronger in knowledge-based industries, such as technology, manufacturing and pharmaceuticals, where greater liquidity enables firms to attract and retain talented workers."

Moreover, cash on hand communicates a message of "financial strength" to prospective talent, while, says He, "sending a warning to would-be poachers that your company has the resources to fight back."

He's paper followed closely on her influential study of cash holdings and R&D investment. In this paper, He tackled the question of why companies increased the amount of cash held for every dollar of R&D spending from four cents in 1980 to sixty cents by 2012. Her answer pointed to "intensified domestic and global competition" to explain the increased propensity of R&D-intensive firms to hoard cash.

"R&D is something that you want to hum along nicely, without long interruptions," she says. "You don't want to have things grind to a halt every time profits, cashflows or outside capital aren't there. Cash smooths out the ruffles during lean times." He's metric for measuring market performance gains derived from having cash was simple: "I looked at sales growth," she says.

Most recently, He is investigating the impact of non-compete agreements on profitability and shareholder value. Her findings, which she is preparing for publication, suggest that companies operating in states with weaker non-compete enforcement laws tend to be more profitable and more attractive to investors.

"Workers who are motivated by the freedom to pursue new opportunities perform better than workers companies lock into non-competes in order to protect secret information. And the financial markets seem to realize this as well," He says.

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