



## November 2008

The single most important ingredient in business is cash. Bull markets obscure this fundamental truth, as values soar and money is plentiful. Banks and financial companies lost sight of this when their profits appeared to derive substantially from trading complex derivative packages, or sometimes just revaluing them in associate companies. It was a gigantic pyramid-selling exercise which has not yet been properly unravelled.

All this is evident to anyone who reads newspapers. What may not be evident to businesses thinking about their markets in the next couple of years is the extent to which things might get worse, and if so, what they can do about it. Historically, recessions have seldom lasted for more than a year before some signs of recovery are detected. The problem we face today is that the huge sums which governments have allocated to rescue the financial sector would normally have been borrowed from the financial sector itself. With banks, insurance companies and investment groups all facing difficulties, where is the money to come from?

Overseas lenders have hitherto sustained the American economy, and even Britain has had some success in attracting these funds. But the world has become more cautious, and the rise of the Yen and the Euro shows where funds are now going. A gap is now developing between the funding that US and UK governments need and what they can raise. And that gap can only be filled by printed money. So in the midst of deflation, we are stoking up a potentially huge inflation, possibly two years down the road. It may not be Zimbabwe, but the pointers are uncomfortable.

So is cash king?

In the coming recession, which many commentators have said might last 18 months to two years, money is going to be tight. The Bank of England's Financial Stability Review, published at the end of October, showed how banks had become over-borrowed, with hugely over-inflated balance sheets. Even after accounting for their recently announced capital raisings, the largest UK banks would have to shed a sixth of total assets to bring their capital ratios back to 2003 levels.

This means that the banks might have to reduce their lending by 5% and 15% depending on the write-offs they have already applied. That is a huge amount. If you are running a business which needs an overdraft, have a care. If you need capital for investment, you will be lucky to find it from the banks. If you are thinking of selling, do it sooner rather than later.

For buyers, there is a window now when cash will be at a premium. Cheap opportunities are likely to become increasingly plentiful. But the signs of a massive inflation some two or three years down the road are there. Assets acquired now will be worth very substantially more in money terms.

Both buyers and sellers should therefore be talking to brokers like Chesham as a matter of urgency.