We can’t let bosses hold us to ransom again

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John McDonnell, eat your heart out. In July last year, when a Labour government still seemed a plausible prospect, the shadow chancellor told us he wanted to “transform” capitalism “completely”. “It’s evolving anyway,” he added. “It’s a system I think will evolve out of existence.”

The events of the past week have been more revolutionary. A Conservative government with a thumping majority has gone further than McDonnell and Jeremy Corbyn ever dared propose, first pledging to bail out business with £330bn of loan guarantees, then nationalising payrolls with a vow to compensate staff put out of work by coronavirus disruption. Now ministers are considering injecting equity into airlines, including British Airways, as they did with banks in the 2008 financial crisis.

The implications for private enterprise are many and profound, but the most striking this weekend is that the old model of paying huge cash returns to shareholders while loading the balance sheet with debt — the “efficient” model — needs to change in swathes of industries. It turns out that moral hazard, where the unspoken safety net of taxpayer support encourages excessive risk-taking, is not unique to banking. When the whole system comes under attack at once, everything becomes too big to fail, from the corner shop employing three people to the national flag carrier. The state is forced to step in, as it has — and is.

Many businesses have gone into this crisis, after 10 years of relatively benign conditions, with threadbare finances. Most families try to save a few months’ pay in case the worst happens; it is unsettling to think how few companies were prepared to weather a three-month shutdown. In some cases, as with retailers such as Debenhams, this is understandable: certain industries have been under pressure for years from forces such as the rise of the internet. In other cases, it is inexcusable. Having paid billions of pounds to shareholders while the sun was shining — or at least before the storm clouds gathered — profitable companies are now queuing outside the Treasury, cap in hand.

Take International Airlines Group (IAG), BA’s parent. In late February, even as the number of Covid-19 infections in Europe spiked, the Anglo-Spanish giant declared a dividend of €1.3bn (£1.2bn), bringing its total cash distributions, including share buybacks, to more than €4.4bn since 2015. After the collapse in its share price over the past few weeks, IAG’s market valuation is £4.3bn. It has net debt of €7.6bn. Years of cost-cutting under Willie Walsh hollowed out IAG, leaving it exposed to a slowdown in what is a cyclical industry even before the coronavirus effect. IAG may be reluctant to take government cash, and it may be better capitalised than some of its stretched American peers, but it is likely to end up in the bosom of the state.

EasyJet has paid out £1bn since 2015. It has a market capitalisation of £2.4bn and net debt of £326m. It will also struggle to fund itself through a shutdown. Utilities such as Thames Water are in a similar position, having been milked for dividends and loaded with debt.

There is the possibility of government intervention across an extraordinary range of sectors. **If and when the Treasury takes stakes or makes loans, it should demand a radical change in behaviour. Airlines and others could find their room for manoeuvre constrained, as Lloyds Banking Group and Royal Bank of Scotland have done. The swashbuckling days of old would be gone; investor returns would be lower. The aim should be to ensure that companies crucial to the operation of the economy will never again need bailing out after they return to private hands.**

A longstanding plc chairman with the rare stance of refusing to gear up his balance sheet notes that he is often grilled by shareholders about his taste for inefficiency. The institutions that own the likes of IAG bear as much responsibility as the management for the problems they are in. They have enjoyed generous returns by pushing executives to run companies too "hot", with thin capital buffers, and cannot expect taxpayers to write no-strings cheques.

Ministers should ask investors to stump up fresh equity alongside bailouts or face serious dilution. Allowing them to emerge from this turmoil intact would only encourage more moral hazard. If capitalism is to be saved from the likes of McDonnell, it needs to be reformed. We can't allow so many companies to teeter on the brink so suddenly again.

Test of the City's nerves

How do you feel? After a week like that, the right words don't come easily. Anyone affected by the coronavirus must have experienced dread and fear — and perhaps loneliness, too.

Investors in public markets are battered, bruised and confused. The FTSE 100 has now fallen more than 30% since the start of the year and £91bn of dividends are under threat.

"The market's very, very gloomy," says one fund manager. "We're getting incredible swings — it's on acid."

We may be about to find out how investors are feeling more precisely. The City jungle drums are beating to the rhythm of imminent rights issues. There are plenty of companies not in state bailout territory that could still do with raising extra equity funding.

The coronavirus crisis is one of cashflow rather than balance sheets — for now. But corporates have been bingeing on debt. Net borrowing by listed companies rose for the eighth year in a row in 2018-19 — by 5.8% to £443.2bn, says Link Asset Services. That could become a problem in a steep downturn.

Rights issues would be a test of the City's nerves. "These are exceptional circumstances and supportive investors understand the need for prudence," remarks an investment banker. "But that's different to being asked to put your hand in your pocket."

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