Capitalism won’t be killed by the coronavirus

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A reader accused me of peddling “socialist tosh” last weekend when I said that companies such as the parent of British Airways had flown into the coronavirus having borrowed too heavily and paid out too much to shareholders (in the case of International Airlines Group, €4.4bn or £3.8bn since 2015).

I actually think the end result of our predicament will be more capitalism, not less, but for the next few paragraphs readers of a similar inclination might like to reach for the smelling salts.

The huge state intervention required to keep the economy from the precipice has set the left rampant. Len McCluskey, the Unite union boss who has seen his wildest dreams come true over the past fortnight, has told our deputy editor John Collingridge it is “time to reset our economy, reset our society and how we approach work”. Even in the City, many acknowledge that there needs to be restraint — at least for a while. John Cronin, an analyst at the stockbroker Goodbody, says dividends and share buybacks will be seen as “socially unacceptable” until the extent of the damage is known.

Cash returns to shareholders are indeed on hold: £4.4bn has been cut or deferred since January, according to Russ Mould of AJ Bell. Sir John Vickers, who chaired the Independent Commission on Banking, is urging the Bank of England to block £7.5bn of payouts by financial groups, including £1bn due to be paid by Barclays.

Painful as it may be for those used to the income, investors need to accept this direction of travel is inevitable in the short term. And in the medium term, they should try to tilt the system towards investment and risk-taking, and away from complacency and over-distribution. The past decade has seen too many managerial executives rewarded too richly for doing too little while placating shareholders with cash returns.

Buybacks, where companies spend money repurchasing their own stock and making it scarcer, are emblematic. They are a more tax-efficient way of returning money than dividends, which incur capital gains. Yet they amount to an admission that a board has no better ideas. Over the past decade, the biggest buyers of American equities have been companies themselves, spending $4.3 trillion (£3.4 trillion) on their own stock, including a record $806bn in 2018. FTSE 350 companies have spent a more modest amount — £15bn-£20bn a year — although at the peak in 2015, dividends and buybacks accounted for more than 60% of operating profits.

Bosses are sometimes accused of using buybacks to game earnings-per-share metrics in bonus schemes by concentrating earnings in a smaller number of shares; a study by PwC and the London Business School last year suggested this is moot. But they are funded via cashflow or borrowing — tax relief on debt interest encourages the latter — and divert money that could be used for investment into propping up share prices. And they are of very little value if performance deteriorates.

Excessive dividend payments also funnel money away from research and development that could produce leaps into the future. Since 2010, dividends paid on the London market have grown by 10% a year, outstripping profit rises. Dividend cover has fallen as boards have chosen to sedate shareholders rather than invest or maintain resilience, leaving them exposed in the case of a sharp downturn, like the current one.

This is the environment that has allowed managerial executives such as Jeff Fairburn of housebuilder Persimmon to earn £75m without taking any personal risk, and the bosses of property giants such as British Land and Hammerson to rake in tens of millions of pounds while missing the impending meltdown in the retail sector. In reply to last weekend's correspondent, changing this does not have to mean socialism: it can mean better capitalism. Higher-quality managers allocating capital more smartly should improve long-term returns. If we are to escape global recession quickly, we need more value

creators such as Jeff Bezos of Amazon or Nick Robertson of Asos and fewer passive custodians of capital.

Ah, boards and shareholders will say — that's all very well. What if an activist such as Elliott pops up on our register and agitates for a more efficient balance sheet? Well, the leftwards shift in sentiment caused by the coronavirus should put lead in the pencils of those inclined to stand up and argue against short-termism. In that respect, the pandemic might change the way we do business in the foreseeable future.

In other respects, I suspect the impact of the coronavirus on capitalism will fade as the disease recedes, despite modish talk of the free market being vanquished. The utopia envisaged by McCluskey will not come to pass: workers will emerge from this crisis with less leverage, not more. Although we have been reminded about the importance of low-paid staff who deliver food and stock shelves, many employers in the services sector will probably look at staff who leave and realise they didn't need so many in the first place. Flexible working and video meetings are turning out to be more adequate for many purposes than we might have thought. Efficiency gains will result in lower headcounts.

Companies will invest more in automation to save money and protect themselves against further pandemics. The gap between educated workers able to think creatively and those performing repetitive tasks that can be replaced with robotics will widen at a frightening rate. This is the free market, red in tooth and claw, and it will bring serious societal problems that businesses and governments will need to address.

So the hand of the state may curb corporate excess in the medium term — for the better, if companies and investors react in the right way. In the end, the coronavirus is likely to accelerate capitalism's progress at brutal speed.