Office for National Statistics

Statistical bulletin

Profitability of UK companies: January to March 2018

The net rate of return on capital employed for UK private non-financial corporations related to their UK operations.

Contact:
David Summers
profitability@ons.gov.uk
+44 (0)1633 456602

Release date:
22 August 2018

Next release:
19 October 2018

Table of contents

1 . Main points

- Private non-financial corporations' (PNFCs') net rate of return rose slightly to 12.6% in Quarter 1 (Jan to Mar) 2018, from an estimate of 12.5% in Quarter 4 (Oct to Dec) 2017.

- The net rate of return for manufacturing companies fell from a revised estimate of 15.9% in Quarter 4 2017 to 15% in Quarter 1 2018, but still posted its third-highest value since comparable records began in 1997.

- Services companies' net rate of return fell from a revised estimate of 18.4% in Quarter 4 2017, to 17.2% in Quarter 1 2018; its lowest level since Quarter 4 2013.

- UK continental shelf (UKCS) companies' net rate of return increased to 7.3% in Quarter 1 2018, from a revised estimate of 6.7% in Quarter 4 2017.

2 . Things you need to know about this release

This bulletin provides estimates of the profitability of UK-based private non-financial corporations (PNFCs). PNFCs comprise UK continental shelf (UKCS) companies and other non-financial UK (non-UKCS) companies. Non-UKCS companies are further split into manufacturing companies, companies providing non-financial services and other industries (including construction, electricity and gas supply, agriculture, mining and quarrying).

UKCS companies engage in oil and natural gas exploration or extraction. This only includes companies operating on the UK continental shelf – the area where the UK claims mineral rights beyond the territorial waters. Owing to the nature of the industry, UKCS companies tend to be very capital-intensive and so require high levels of capital investment to operate. They also report high levels of depreciation of their fixed assets. For these reasons, the net rate of return for UKCS companies is not directly comparable with those for other sectors.

Revisions to the net rates of return for PNFCs have been made back to Quarter 1 (Jan to Mar) 1997 and are consistent with the Blue Book 2018, published on 31 July 2018.

How do we measure profitability?

Net rate of return is used as the measurement of company profitability throughout this bulletin, except in the international comparisons section. The rate of return is calculated as the economic gain (profit) shown as a percentage of the capital used in production. "Net" refers to the rate of return after having accounted for the current value of capital consumed and capital stocks. Capital consumed refers to the decline in the current value in the stock of fixed assets (for example, due to depreciation). Gross rates of return are available in the Annex tables of this release.

3 . Profitability of private non-financial corporations increased in Quarter 1 2018 after five quarters of decline

The net rate of return for private non-financial corporations (PNFCs) rose slightly in Quarter 1 (Jan to Mar) 2018 to 12.6% from 12.5% in Quarter 4 (Oct to Dec) 2017 (Figure 1). While the IHS Markit UK Business Outlook indicates that UK private sector firms are more optimistic than they were at the end of last year, uncertainty continues to dampen investment plans and consumer confidence. Exporting manufacturers thrived in Quarter 1 2018 but adverse weather conditions hampered consumer services, according to the Bank of England's Agents' summary of business conditions. The minimal change in profitability is also reflected in Ernst and Young's report of 73 issued profit warnings during the period, which matches the four-year rolling average.

Private non-financial corporations' revisions

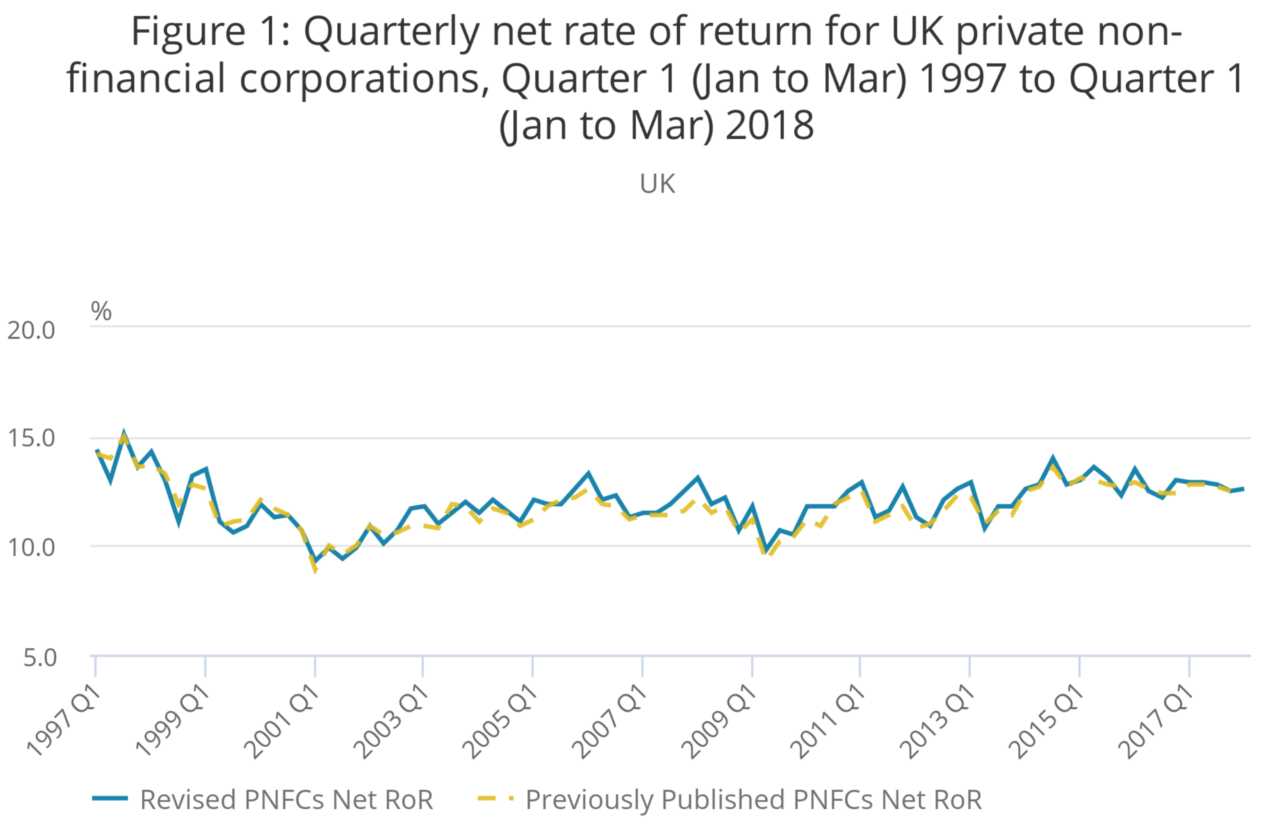
The revisions seen in Figure 1 (yellow line) have mainly been due to changes to gross operating surplus for PNFCs through Blue Book 2018 changes to gross domestic product (GDP). The change with the most impact is the further improvement to gross fixed capital formation (GFCF); changes were previously made in Blue Book 2017, which removed double-counting of purchased software. However, this was not fully implemented and the counterpart adjustment was not applied, which Blue Book 2018 corrected. The other notable change is the improvements made to pensions data and the methods used to impute social contributions.

A reclassification of English housing associations also impacted both gross operating surplus and consumption of fixed capital. English housing associations were reclassified from private non-financial corporations to public corporations from Quarter 3 (July to Sept) 2008 onwards. In Quarter 4 2017, English housing associations were reclassified back to private non-financial corporations from public corporations, impacting both gross operating surplus and consumption of fixed capital again.

For a detailed explanation of all the changes, please see National Accounts articles: Impact of Blue Book 2018 changes on current price gross domestic product estimates, 1997 to 2016.

Figure 1: Quarterly net rate of return for UK private non-financial corporations, Quarter 1 (Jan to Mar) 1997 to Quarter 1 (Jan to Mar) 2018

UK



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

4 . Manufacturing and services both saw decline in Quarter 1 2018

Manufacturing companies

In Quarter 1 (Jan to Mar) 2018, the net rate of return for the manufacturing sector fell to 15% from the revised estimate of 15.9% in Quarter 4 (Oct to Dec) 2017. Despite the fall, this is still the third-highest value for manufacturing since comparable records began in 1997. The IHS Markit UK Business Outlook found that manufacturers remained confident, as export growth has been aided by the depreciation of the British pound, although growing fears of trade wars and uncertainty surrounding the UK's departure from the EU tempered optimism. The Bank of England's Agents' summary also found that while domestic manufacturing output has eased slightly, exporters continued to report strong growth.

Services companies

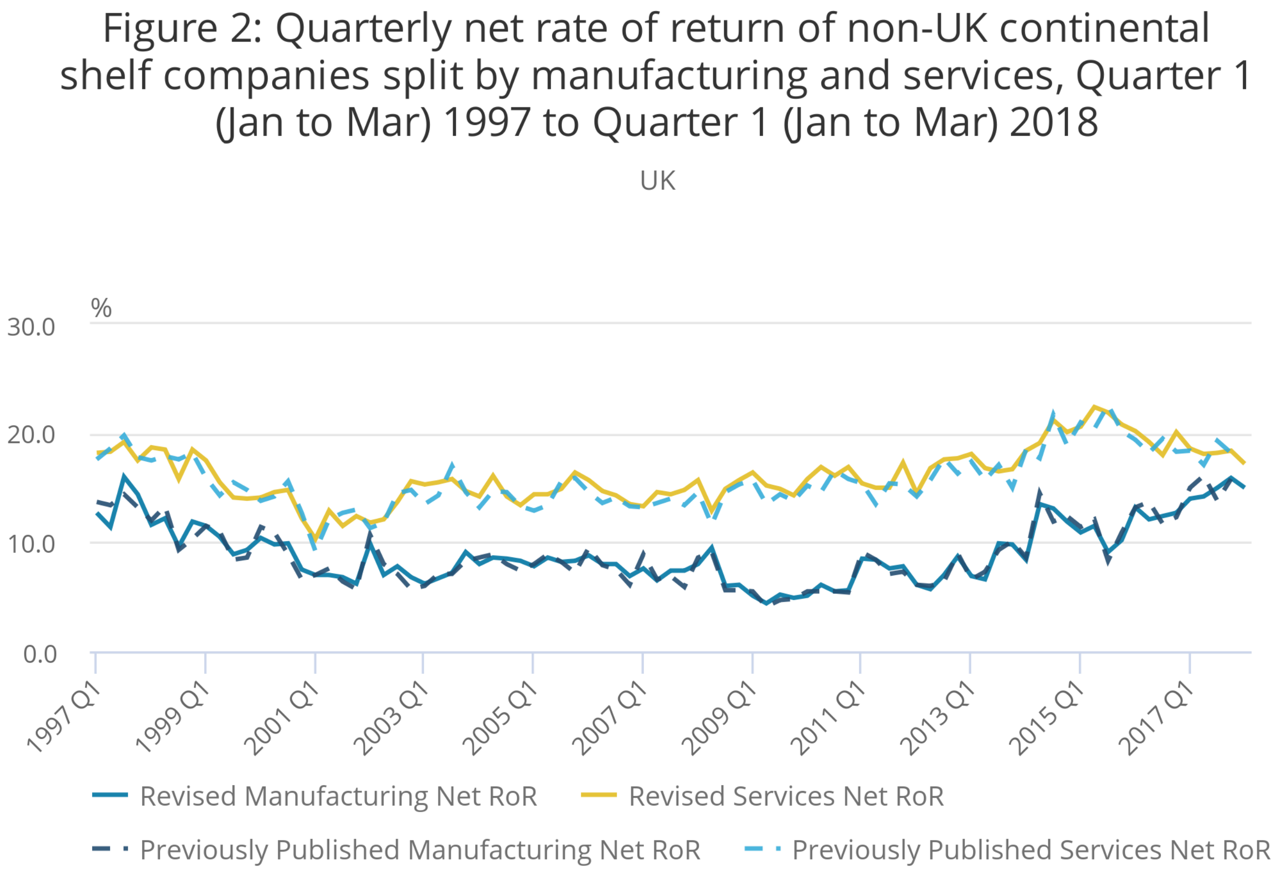
The net rate of return for the services industries fell from the revised estimate of 18.4% in Quarter 4 2017 to 17.2% in Quarter 1 2018; the sharpest decline in a year and its lowest level since Quarter 4 2013. The slowdown is reflected in Ernst and Young's report of a seven-year high in profit warnings from the Financial Times Stock Exchange (FTSE) Consumer Service Sector. This appears to have been driven by general retailers, 13 of whom issued profit warnings, as wage growth is yet to translate into spending due to high levels of unsecured debt and low levels of savings. The Bank of England's Agents' summary also found that growth in retail sales value of products such as white goods and homewares had slowed. The ONS retail sales publication for March 2018 stated: "In the three months to March 2018 (Quarter 1), the quantity bought in retail sales fell by 0.5% when compared with Quarter 4 (Oct to Dec) 2017, with declines in all sectors except for department stores and non-store retailing."

Seasonal adjustment review

This quarter, an annual seasonal adjustment review was carried out on manufacturing and services, revising figures from 1997 to Quarter 4 2017 (see Figure 2), which is the main reason for revisions to these industries. There are also Blue Book 2018 changes that affect gross operating surplus (covered in Section 3) and these have had a small impact to the net rate of return for these industries.

Figure 2: Quarterly net rate of return of non-UK continental shelf companies split by manufacturing and services, Quarter 1 (Jan to Mar) 1997 to Quarter 1 (Jan to Mar) 2018

UK



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

5 . UK continental shelf companies' profitability continued to improve after period of robust growth

The estimated net rate of return for UK continental shelf (UKCS) companies in Quarter 1 (Jan to Mar) 2018 was 7.3%. This was up 0.6 percentage points from the revised estimate of 6.7% in Quarter 4 (Oct to Dec) 2017, marking a third straight quarterly increase. Growing global demand and the Organisation of Petroleum Exporting Countries (OPEC) restricting supply saw the price of oil rise slightly from $67 (US dollars) per barrel at the start of the quarter to $70 by the end of the quarter.

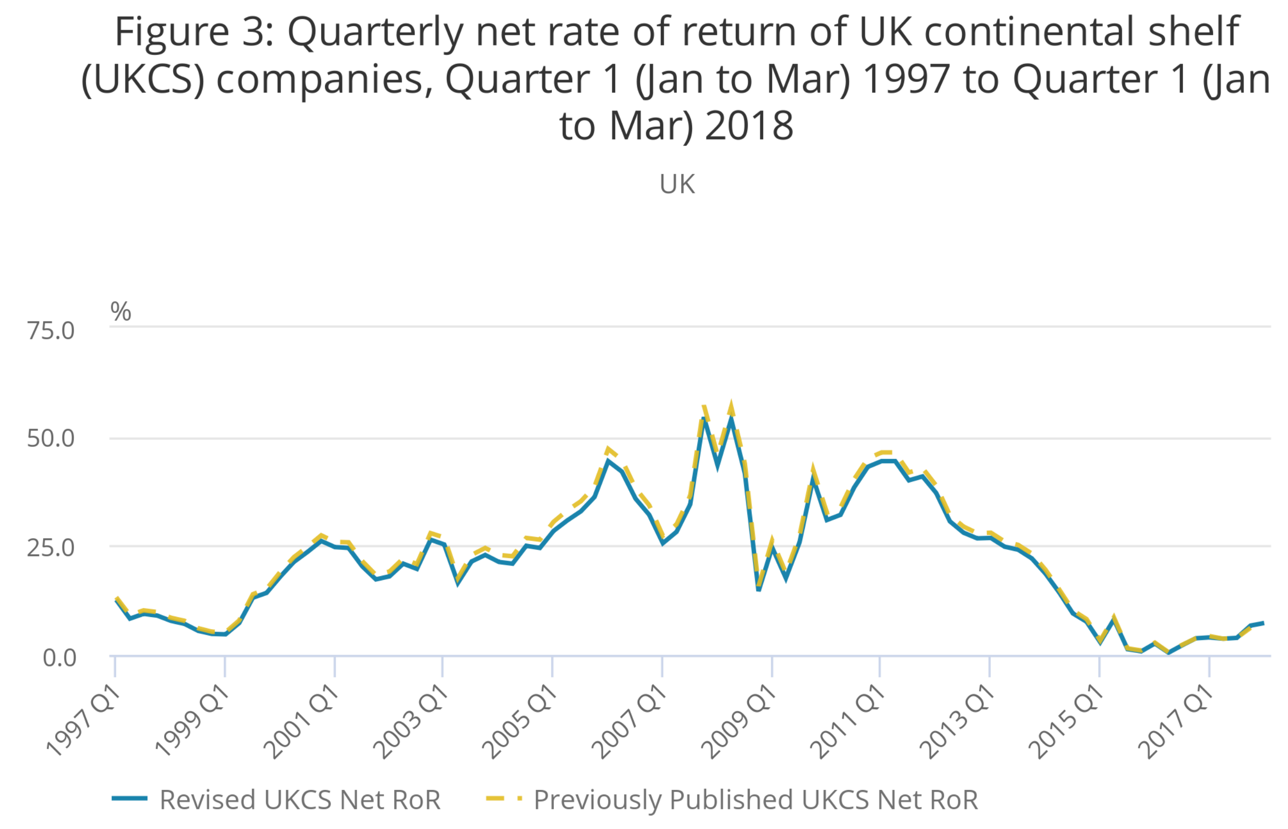
UK continental shelf companies' revisions

A correction was made to gross fixed capital formation (GFCF) in Blue Book 2017 to remove double-counting of purchased software. However, this was not fully implemented and the counterpart adjustment was not applied. This has now been corrected in Blue Book 2018 and these changes have been taken on in the capital stocks dataset. This has resulted in upward revisions to capital employed, impacting the net rate of return for UK continental shelf companies.

For more information on changes to capital stocks, please see the What's changed in this release? section of Capital stocks, consumption of fixed capital in the UK: 2018.

Figure 3: Quarterly net rate of return of UK continental shelf (UKCS) companies, Quarter 1 (Jan to Mar) 1997 to Quarter 1 (Jan to Mar) 2018

UK



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

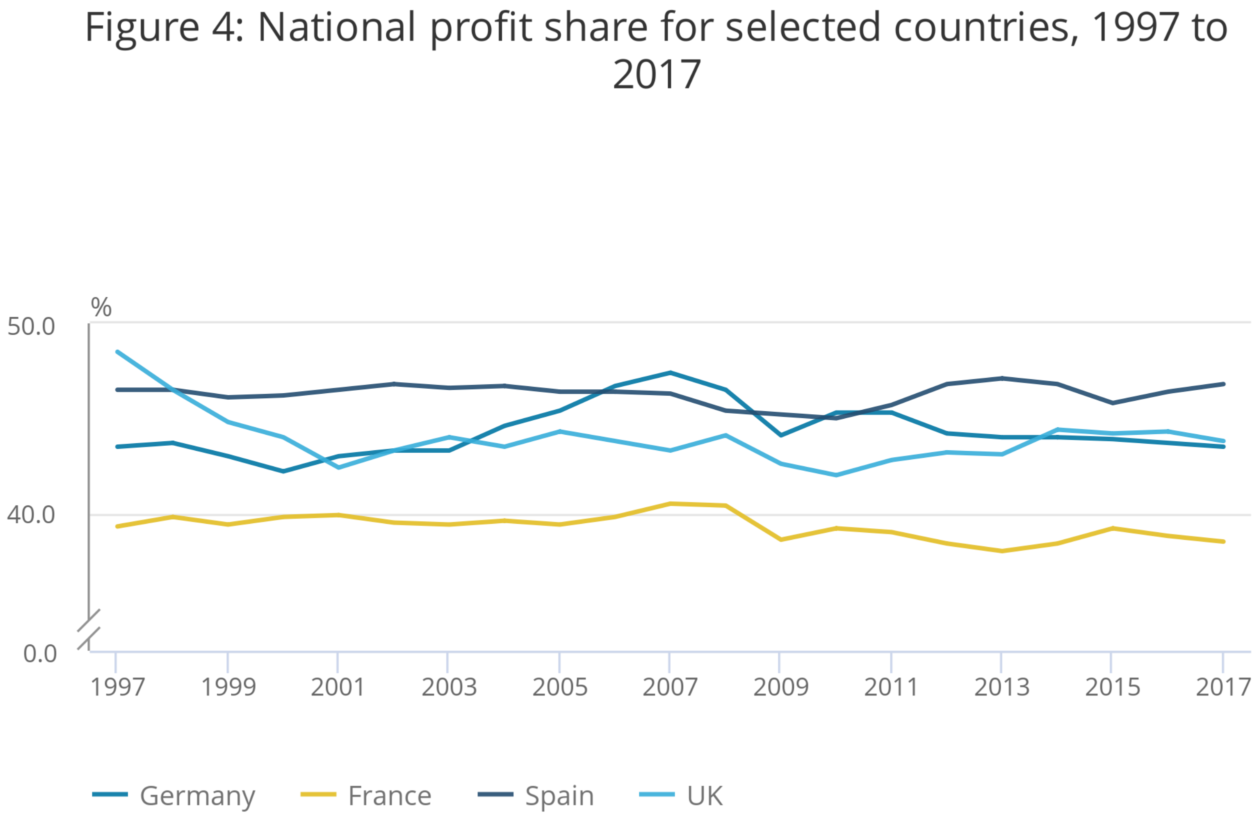
6 . How does UK profitability compare internationally?

Profitability is a relative measure of profit and how it was created. This bulletin shows the rate of return on capital employed. Unfortunately, other countries use a range of different measures, making international comparisons difficult.

It is possible to compare the aggregated national profit share, defined as gross operating surplus (GOS) plus mixed income (income made by the self-employed and other non-incorporated businesses) divided by gross value added (GVA) on a European System of Accounts 2010: ESA 2010 basis. GVA is the difference between the cost of inputs (whether capital or labour) and the cost of the output. The difference in the cost is due to the value added using labour and capital. GOS is the income earned from capital. The national profit-share measure includes the activity of other profit-making sectors, such as financial corporations and public corporations, whilst the rest of this bulletin refers to the activities of private non-financial corporations (PNFCs) only.

International data on an ESA 2010 basis are only available at the aggregate national level, shown for selected countries (Figure 4).

Figure 4: National profit share for selected countries, 1997 to 2017



Source: Office for National Statistics and Eurostat

Notes:

1. Calendar years are used for Figure 4.

While the UK, France and Germany experienced a decline in national profit share in 2017, Spain saw a second consecutive annual increase, rising by 0.4% to 46.8%. The UK saw the largest fall in profit share of the countries shown, as it fell to 43.8%, a decrease of 0.5% compared with 2016. This coincides with a period of slower growth in the UK, which saw gross domestic product (GDP) growth of 1.8% in 2017, that is, 0.6% lower than growth experienced by the European Union.

7 . Links to related statistics

The gross operating surplus (GOS) of private non-financial corporations (PNFCs) is a component of the income approach to measuring gross domestic product (GDP). GOS consists of gross trading profits, plus income from rental of buildings, less inventory holding gains (changes in inventory value caused by price). See the Quarterly national accounts for a detailed breakdown of the components of GDP, as well as main sector accounts aggregates.

The Quarterly sector accounts includes estimates of national production, income and expenditure, UK Sector Accounts and the UK Balance of Payments.

We, like all government departments, ensure all our outputs meet accessibility guidelines. As a result, from the Quarter 4 (Oct to Dec) 2017 (29 March 2018) release onwards we are no longer publishing a PDF file of the UK Economic Accounts (UKEA). The data contained in the current PDF file continue to be available within the UKEA datasets that are currently published.

8 . What's changed in this release?

Revisions to the net rates of return for private non-financial corporations (PNFCs) have been made back to Quarter 1 (Jan to Mar) 1997. This is consistent with the quarterly national accounts for Quarter 1 2018, published on 29 June 2018.

For more information, please refer to revisions to economic statistics, which brings together our work on revisions analysis, links to relevant documentation and revisions policies.

The estimates quoted in the international comparison section are the latest available estimates published by the respective bodies (referenced) at the time of preparation of this statistical bulletin and may subsequently have been revised. The data are sourced from Eurostat.

We welcome any feedback and are particularly interested in knowing how you use the data to inform your work. Contact us via email at profitability@ons.gov.uk or telephone David Summers on +44 (0)1633 456602.

9 . Quality and methodology

The Profitability of UK companies statistical bulletin reports the estimates for net rate of return on capital employed for UK private non-financial corporations (PNFCs) related to their UK operations.

The Profitability of UK companies and Quarterly Operating Profits Survey Quality and Methodology Information (QMI) reports contain important information on:

- the strengths and limitations of the data and how they compare with related data
- uses and users of the data
- how the output was created
- the quality of the output including the accuracy of the data

Revisions

Revisions to rates of return have been incorporated in this release from Quarter 1 (Jan to Mar) 1997 to ensure consistency with Blue Book 2018. The revisions to the time series are presented in Table R1 accompanying this bulletin.

Revisions to operating surplus include:

- English housing associations reclassification
- Motor Vehicle Duty
- gross fixed capital formation (GFCF) alignment change
- net spread earnings
- pensions
- Rail for London
- trade and services public sector finance alignment
- trade in goods

Reasons for revisions to capital employed include:

- taking on improvements to the GFCF source data for the assets ICT equipment (computer hardware and telecommunications equipment), other machinery and equipment, and computer software with effect from Quarter 1 1997
- implementing the devolved housing associations reclassification from PNFCs to public corporations with effect from Quarter 3 (July to Sept) 2008
- minor updates to the Blue Book 2017 English housing associations reclassification from PNFCs to public corporations with effect from Quarter 3 2008
- implementing the English housing associations reclassification back from public corporations to PNFCs with effect from Quarter 4 (Oct to Dec) 2017
- system changes to improve the method of rounding data, which has resulted in very small revisions throughout

For more information on the impact of method changes in Blue Book 2018, see National Accounts articles: Impact of method changes to the national accounts and sector accounts.

For more information, please refer to our web page dedicated to revisions to economic statistics, which brings together our work on revisions analysis, links to relevant documentation and revisions policies.

The estimates quoted in the international comparison section are the latest available estimates published by the respective bodies (referenced) at the time of preparation of this statistical bulletin and may subsequently have been revised. The data are sourced from Eurostat.

Perpetual inventory method

Underlying estimates of capital stock and capital consumption are produced using the perpetual inventory method. Further details are available in the Capital stocks and capital consumption QMI.

10 . Acknowledgements

The author, David Summers, would like to express his thanks to the following colleagues at Office for National Statistics for their contributions to this work: Curtis Sanders and Ross Stewart.