Statistical bulletin

Profitability of UK companies: January to March 2016

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

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1 . Main points

The profitability of private non-financial corporations (PNFCs), as measured by their net rate of return, was estimated at 12.2% in Quarter 1 (Jan to Mar) 2016, up 0.2% from the revised Quarter 4 (Oct to Dec) 2015 rate.

Manufacturing companies’ net rate of return was estimated at 12.7% in Quarter 1 2016, 2.4 percentage points higher than the revised estimate of 10.3% in Quarter 4 2015.

Service companies’ net rate of return was estimated at 18.2% in Quarter 1 2016. This was 0.1 percentage points lower than the revised estimate of 18.3% in Quarter 4 2015.

UK continental shelf (UKCS) companies’ net rate of return was 0.2% in Quarter 1 2016. This is the lowest recorded quarterly estimate since the series began in 1997 and is 0.8 percentage points lower than the revised estimate of 1.0% in the previous quarter. This reflects falling oil and gas prices, which were partly offset by increased quarter-on-quarter sales.

To see this data in more context, data for earlier periods are shown in Tables 1 and 2, and are also presented in Figures 1 to 6.

2 . Understanding profitability

Profitability, and specifically the net rate of return, is a common way of measuring the economic success of a company or sector. The rate of return is calculated by expressing the economic gain, or profit, as a percentage of the capital used to produce it. In this case, “net” means the rate of return net of capital consumed, rather than net of taxes on company income. See section 2 of the background notes for a more comprehensive definition.

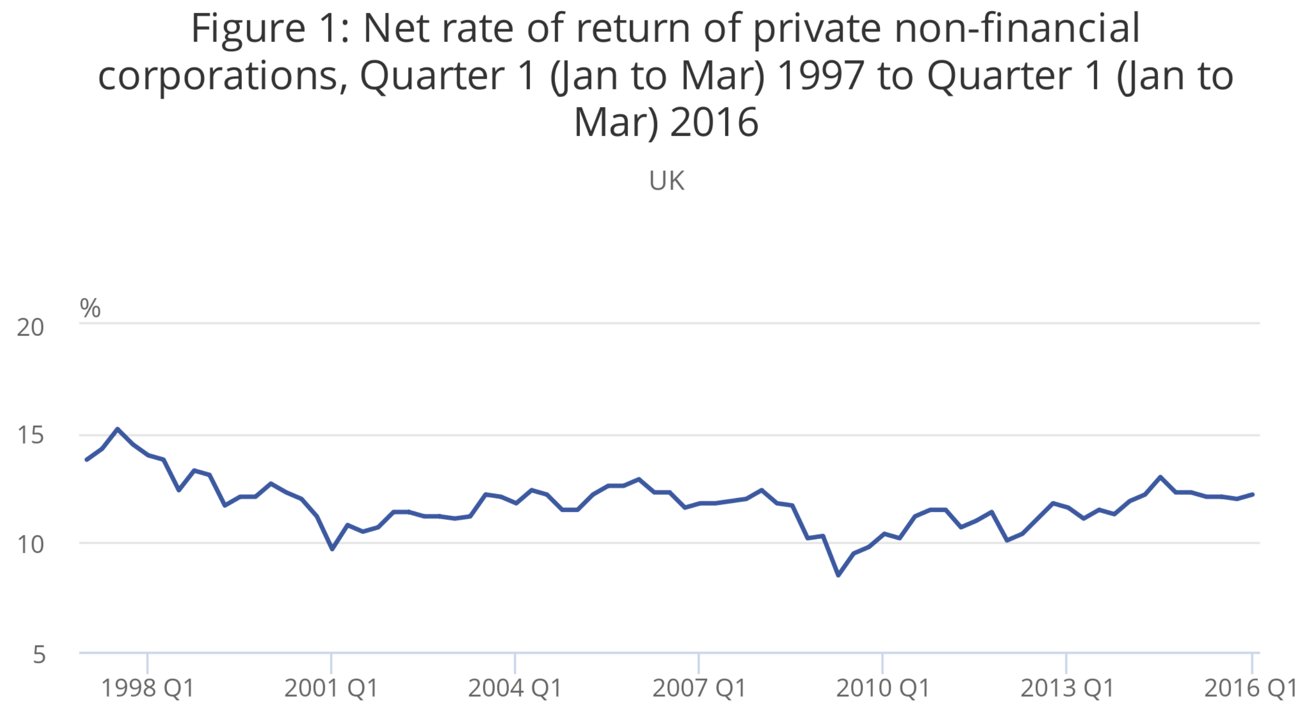
Revisions to the net rates of return for PNFCs have been made back to Quarter 1 (Jan to Mar) 1997 and are consistent with the Blue Book 2016, published on 29 July 2016.

3 . Net rate of return of private non-financial corporations

The net rate of return of all private non-financial corporations (PNFCs) in Quarter 1 (Jan to Mar) 2016 was estimated at 12.2%, up 0.2 percentage points from the revised estimate for Quarter 4 (Oct to Dec) 2015.

Figure 1: Net rate of return of private non-financial corporations, Quarter 1 (Jan to Mar) 1997 to Quarter 1 (Jan to Mar) 2016

UK



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (January to March), Q2 refers to Quarter 2 (April to June), Q3 refers to Quarter 3 (July to September) and Q4 refers to Quarter 4 (October to December).

The net rate of return of PNFCs for 2015 as a whole was 12.1%. This was 0.3 percentage points lower than 2014.

Table 1: Annual net rates of return by industrial group, UK, 1997 to 2015

	Total	Manufacturing	Services	UK Continental Shelf (UKCS)
%				
1997	14.5	13.6	18.8	9.9
1998	13.4	11.2	18.3	7.2
1999	12.2	10.1	16.1	11.8
2000	12.1	9.4	14.7	26.7
2001	10.4	6.9	12.6	27.5
2002	11.3	7.9	13.5	27.3
2003	11.6	7.1	14.9	27.4
2004	12.0	8.7	14.4	29.0
2005	12.2	8.3	14.6	39.5
2006	12.3	7.8	14.1	47.4
2007	11.9	7.1	13.9	44.0
2008	11.5	7.0	13.6	46.2
2009	9.5	4.1	12.8	33.0
2010	10.8	4.9	14.0	44.1
2011	11.1	7.4	13.6	50.7
2012	10.8	6.2	14.6	36.6
2013	11.4	8.1	15.5	29.0
2014	12.4	11.4	17.7	14.2
2015	12.1	10.0	19.1	3.9

Source: Office for National Statistics

Table 2: Quarterly net rates of return by industrial group, UK, Quarter 1 (Jan to Mar) 1997 to Quarter 1 (Jan to Mar) 2016

	Total	Manufacturing	Services	UK Continental Shelf (UKCS)
%				
1997 Q1	13.8	13.1	17.3	12.5
1997 Q2	14.3	13.3	19.1	8.3
1997 Q3	15.2	14.2	20.0	9.5
1997 Q4	14.5	13.7	19.0	9.4
1998 Q1	14.0	11.9	17.9	8.4
1998 Q2	13.8	13.3	18.4	7.9
1998 Q3	12.4	9.2	18.2	6.5
1998 Q4	13.3	10.2	18.8	5.9
1999 Q1	13.1	11.5	16.4	6.0
1999 Q2	11.7	11.3	15.3	9.0
1999 Q3	12.1	8.7	16.7	15.7
1999 Q4	12.1	8.8	15.9	17.2
2000 Q1	12.7	11.5	14.4	21.6
2000 Q2	12.3	11.0	14.9	25.4
2000 Q3	12.0	8.9	16.1	28.4
2000 Q4	11.2	6.5	13.3	31.8
2001 Q1	9.7	7.3	10.0	30.3
2001 Q2	10.8	7.8	13.1	30.6
2001 Q3	10.5	6.6	13.7	26.1
2001 Q4	10.7	5.8	13.7	22.7
2002 Q1	11.4	10.8	11.6	23.6
2002 Q2	11.4	8.3	12.6	27.0

2002 Q3	11.2	7.1	15.0	25.4
2002 Q4	11.2	5.5	15.0	33.4
2003 Q1	11.1	5.9	13.3	32.0
2003 Q2	11.2	7.1	14.5	21.4
2003 Q3	12.2	7.1	17.0	27.3
2003 Q4	12.1	8.2	14.7	29.1
2004 Q1	11.8	9.0	13.8	27.2
2004 Q2	12.4	9.4	15.2	26.6
2004 Q3	12.2	8.5	15.1	31.6
2004 Q4	11.5	7.8	13.7	30.9
2005 Q1	11.5	8.2	12.9	35.3
2005 Q2	12.2	9.1	13.6	38.0
2005 Q3	12.6	8.5	15.9	40.4
2005 Q4	12.6	7.4	16.2	44.2
2006 Q1	12.9	9.5	14.6	54.1
2006 Q2	12.3	7.9	13.8	51.5
2006 Q3	12.3	7.5	14.5	44.2
2006 Q4	11.6	6.1	13.6	39.6
2007 Q1	11.8	9.0	13.4	31.8
2007 Q2	11.8	6.6	13.9	34.9
2007 Q3	11.9	7.0	14.5	42.5
2007 Q4	12.0	5.9	13.7	66.5
2008 Q1	12.4	8.4	14.5	52.5
2008 Q2	11.8	9.0	11.7	64.2

2008 Q3	11.7	5.3	14.0	49.8
2008 Q4	10.2	5.2	14.1	18.1
2009 Q1	10.3	4.7	13.9	29.9
2009 Q2	8.5	3.4	12.0	21.8
2009 Q3	9.5	4.0	12.9	31.6
2009 Q4	9.8	4.2	12.4	48.9
2010 Q1	10.4	4.8	13.5	37.9
2010 Q2	10.2	4.9	13.1	39.4
2010 Q3	11.2	4.9	15.1	46.9
2010 Q4	11.5	4.8	14.3	52.3
2011 Q1	11.5	8.1	13.5	53.5
2011 Q2	10.7	7.9	12.5	53.2
2011 Q3	11.0	6.7	14.3	47.9
2011 Q4	11.4	6.8	14.2	48.6
2012 Q1	10.1	5.3	12.7	44.3
2012 Q2	10.4	5.4	14.3	36.8
2012 Q3	11.1	5.8	16.3	33.7
2012 Q4	11.8	8.4	14.9	32.1
2013 Q1	11.6	6.1	15.9	32.1
2013 Q2	11.1	7.2	15.3	29.5
2013 Q3	11.5	9.1	16.3	28.6
2013 Q4	11.3	9.9	14.3	26.0
2014 Q1	11.9	8.1	16.9	21.5
2014 Q2	12.2	14.0	16.2	16.3

2014 Q3	13.0	11.4	20.0	10.9
2014 Q4	12.3	12.0	17.7	8.8
2015 Q1	12.3	10.7	19.1	3.7
2015 Q2	12.1	11.3	18.3	8.8
2015 Q3	12.1	7.7	20.5	2.0
2015 Q4	12.0	10.3	18.3	1.0
2016 Q1	12.2	12.7	18.2	0.2

Source: Office for National Statistics

4 . Economic context

The net rate of return of UK companies – which is the ratio of operating surplus to capital employed – increased slightly to 12.2% in Quarter 1 (Jan to Mar) 2016, from 12.0% in Quarter 4 (Oct to Dec) 2015. This is slightly above the average estimate of 12.1% for 2015 as a whole. This coincided with an increase in UK GDP in volume terms of 0.4% between Quarter 4 (Oct to Dec) 2015 and Quarter 1 (Jan to Mar) 2016, as reported in the bulletin Second estimate of GDP: Quarter 1 (Jan to Mar) 2016.

While the aggregate net rate of return grew slightly on the quarter, this masked some disparities between industries. The net rate of return for manufacturing companies increased from 10.3% in Quarter 4 2015 to 12.7% in Quarter 1 2016. This was driven by a substantial increase in operating surplus and a slight decline in capital employed, as firms made larger profits from a reduced capital base. This occurred despite a decrease in the volume of output in the manufacturing industry by 0.2% between Quarter 4 2015 and Quarter 1 2016 (UK GDP (O) low level aggregates dataset).

In contrast, the net rate of return for service sector companies fell from 18.3% in Quarter 4 2015 to 18.2% in Quarter 1 2016 – a further movement away from the record high of 20.5% seen in Quarter 3 2015. This was driven by a small fall in operating surplus and a slight increase in net capital employed, as services firms expanded their use of capital and experienced a fall in the level of profits. This occurred despite an increase in the volume of output in the services industry, with growth of 0.6% between Q4 2015 and Q1 2016 (UK GDP(O) low level aggregates dataset).

The net rate of return for UK continental shelf (UKCS) companies – which are mainly involved with the extraction of oil and gas from the North Sea – fell from 1.0% in Quarter 4 2015 to 0.2% in Quarter 1 2016, the lowest rate since comparable records began in 1997. This was mainly driven by a decline in operating surplus (from £174 million to £36 million on the quarter). Furthermore, the volume of output fell by 1.5% between Quarter 4 2015 and Quarter 1 2016 (UK GDP(O) low level aggregates dataset). The profits of these companies were also likely influenced by the sterling oil price, which in Quarter 1 2016 was 32% below levels seen in Quarter 1 2015 (ICE Brent Crude Oil Front Month). In support of these estimates, the Ernst and Young profitability warning release also reported that 18% of all firms that issued profit warnings in Quarter 1 2016 had mentioned weakness in commodity and oil prices.

According to Ernst and Young, UK companies issued 76 profit warnings in Quarter 1 2016 (24 fewer than last quarter) – and almost half of these companies issued a profit warning in the previous year. Support services, general retailers and media were the FTSE sectors with the most profit warnings in Quarter 1 2016 (9, 8 and 7 warnings respectively).

5 . Manufacturing and service companies

Manufacturing companies

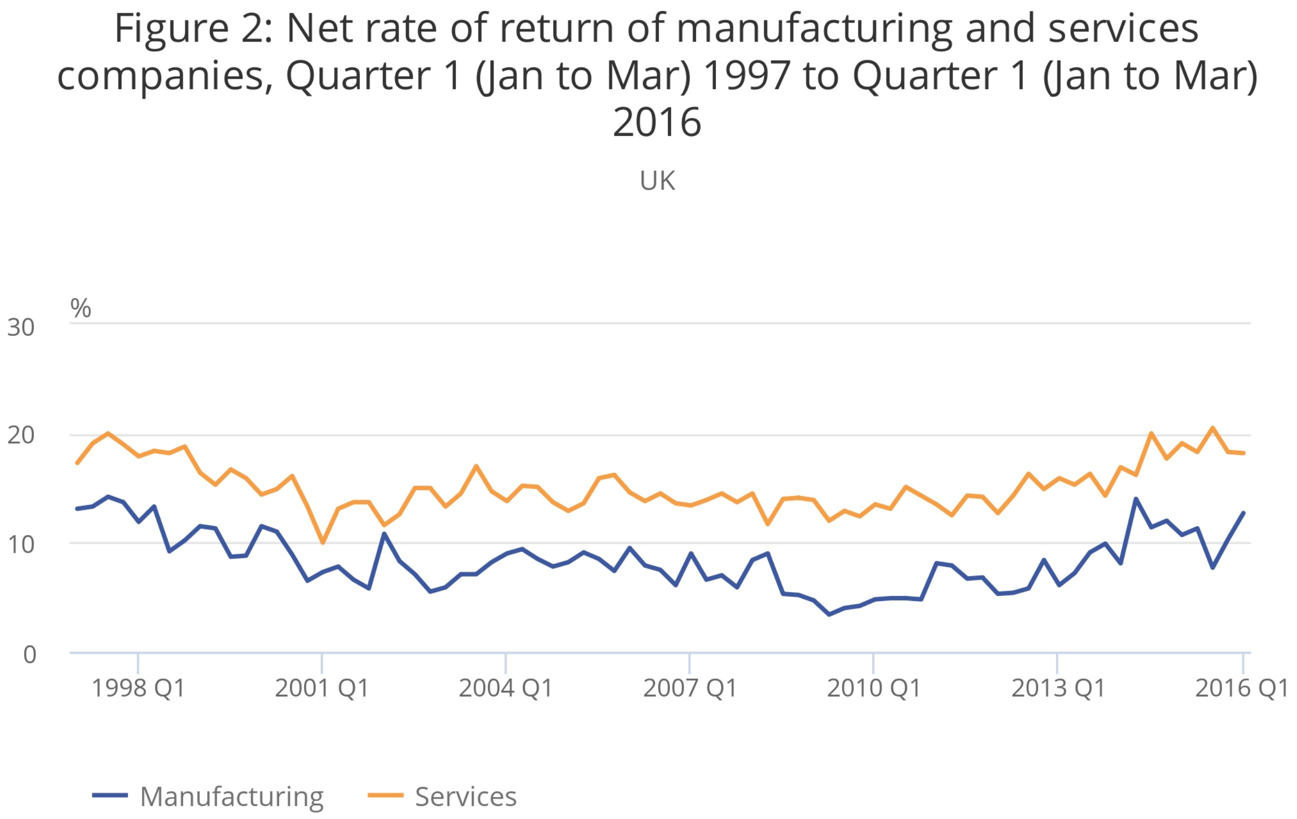
The estimated net rate of return for manufacturing companies in Quarter 1 (Jan to Mar) 2016 was 12.7%. This was 2.4 percentage points higher than the revised estimate for Quarter 4 (Oct to Dec) 2015 (10.3%). Profitability for manufacturing companies in 2015 as a whole was 10.0%, down from 11.4% in 2014.

Service companies

The estimated net rate of return for service companies in Quarter 1 2016 was 18.2%. This was lower than the revised Quarter 4 2015 rate of 18.3%. The net rate of return of service companies in 2015 as a whole was 19.1%, the highest annual rate since the series began.

Figure 2: Net rate of return of manufacturing and services companies, Quarter 1 (Jan to Mar) 1997 to Quarter 1 (Jan to Mar) 2016

UK



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (January to March), Q2 refers to Quarter 2 (April to June), Q3 refers to Quarter 3 (July to September) and Q4 refers to Quarter 4 (October to December).

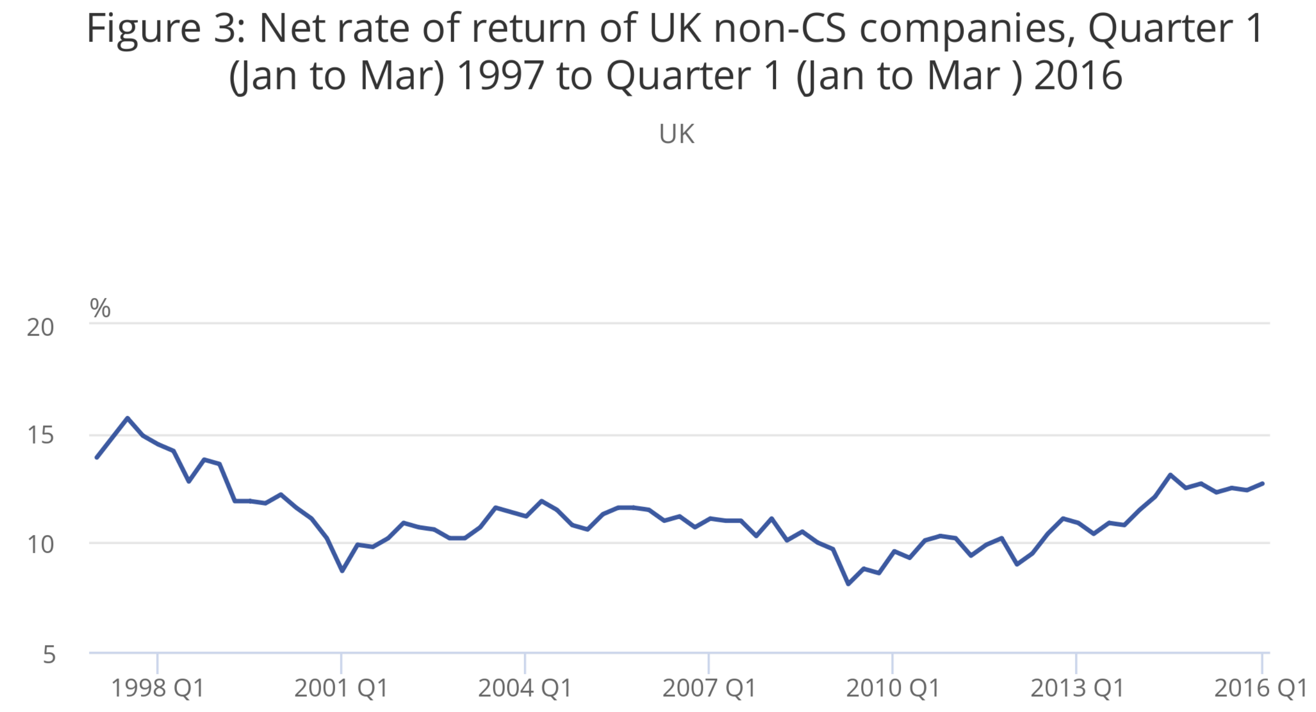
Figure 2 shows the net rate of return for manufacturing and service companies since Quarter 1 1997. Manufacturing profitability, after hitting a low in 2009, climbed gradually from 2010 to 2012 and then more rapidly in 2013 and early 2014, before falling in most of the last few quarters. In contrast, service companies' profitability has been on a generally upward trend over the same period.

UK non-continental shelf (UK non-CS) companies

UK non-CS companies comprise manufacturing, service and other UK non-CS companies (such as construction and power supply). The estimated net rate of return for UK non-CS companies in Quarter 1 2016 was 12.7%, which is 0.3 percentage points higher than the Quarter 4 2015 revised estimate of 12.4%. As the net rate of return of UK non-CS companies makes up the majority of private non-financial corporations (PNFCs), Figure 3 shows a comparable picture to that of all PNFCs (Figure 1).

Figure 3: Net rate of return of UK non-CS companies, Quarter 1 (Jan to Mar) 1997 to Quarter 1 (Jan to Mar) 2016

UK



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (January to March), Q2 refers to Quarter 2 (April to June), Q3 refers to Quarter 3 (July to September) and Q4 refers to Quarter 4 (October to December).

The annual net rate of return in 2015 for UK companies, excluding continental shelf companies, was 12.5%. This is 0.2 percentage points higher than in 2014 and the highest annual rate since 1998 (13.8%). This increase is greater than for UK PNFCs as a whole, as it excludes the fall in profitability in UK continental shelf companies, discussed in the following section.

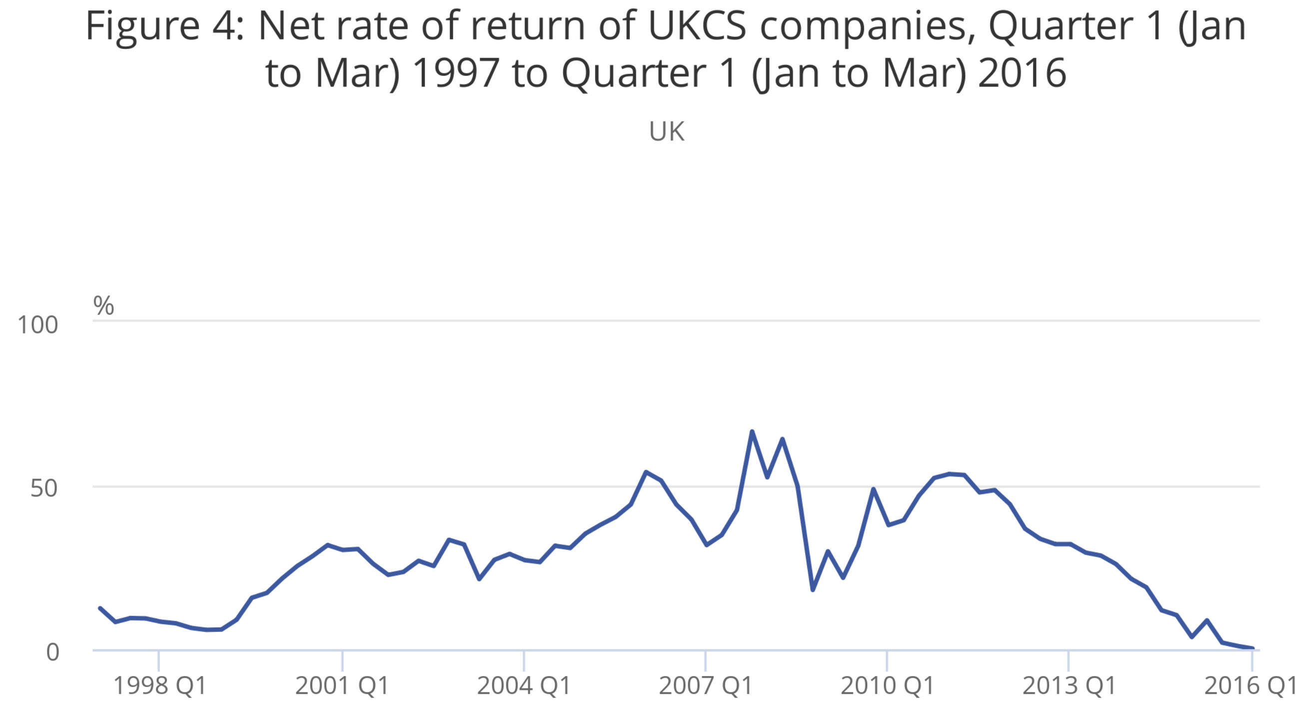
6 . UK continental shelf (UKCS) companies

UKCS companies are defined as those involved in the exploration for, and extraction of, oil and natural gas from the UK Continental Shelf, the area beyond the UK's territorial sea over which the UK claims mineral rights. Due to the nature of the capital assets employed, net rates of return for continental shelf companies are not directly comparable with those for other industries.

The estimated rate of return for UKCS companies in Quarter 1 2016 was 0.2%. This was down 0.8 percentage points from the revised estimate of 1.0% in Quarter 4 2015. This is the lowest quarterly estimate since the series began in 1997 and reflects falling oil and gas prices, which were only partly offset by increased quarter-on-quarter sales.

Figure 4: Net rate of return of UKCS companies, Quarter 1 (Jan to Mar) 1997 to Quarter 1 (Jan to Mar) 2016

UK



Source: Office for National Statistics

Notes:

1. Q1 refers to Quarter 1 (January to March), Q2 refers to Quarter 2 (April to June), Q3 refers to Quarter 3 (July to September) and Q4 refers to Quarter 4 (October to December).

The revised annual net rate of return of UKCS companies in 2015 was 3.9%, also the lowest since the series began in 1997.

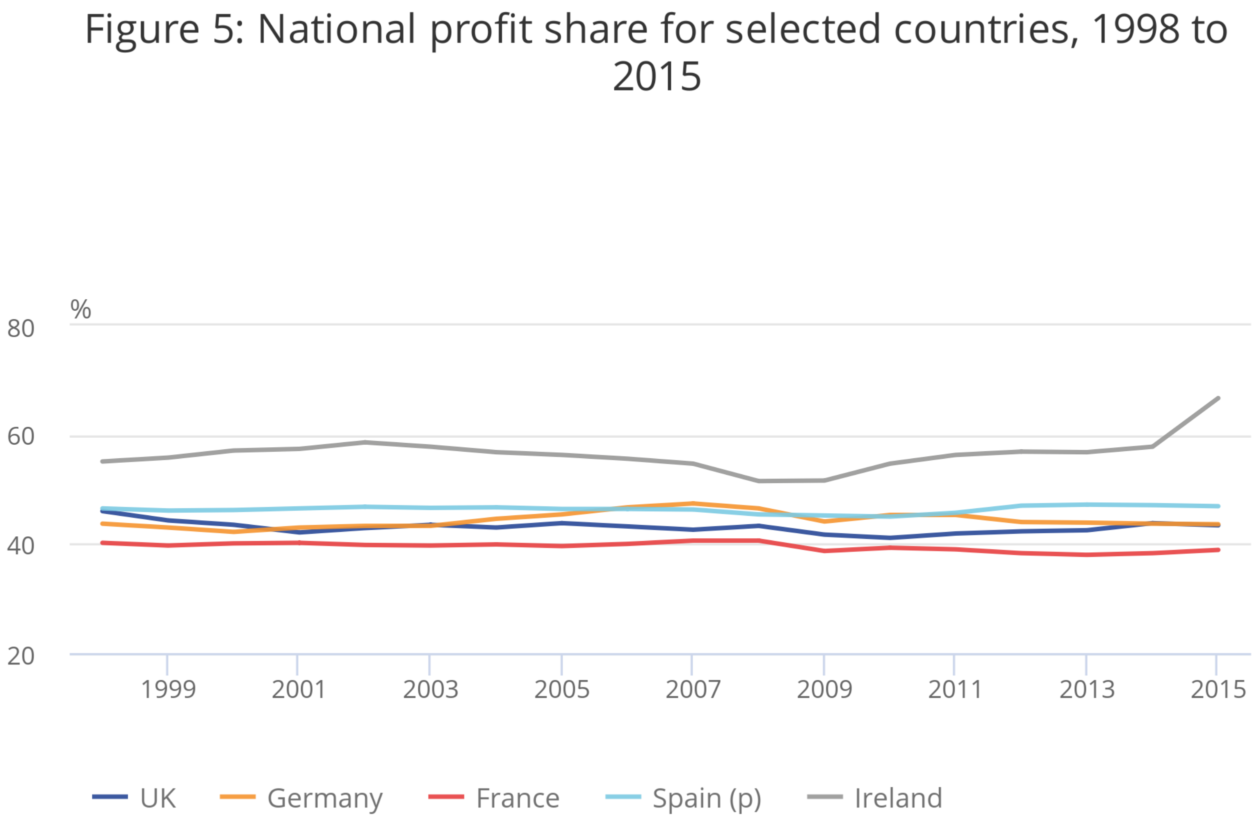
7 . International comparisons

Profitability is a relative measure of profit and what created it. 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 (ESA10) 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 by the use of 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, while the rest of this bulletin refers to the activities of private non-financial corporations (PNFCs) only.

International data on an ESA10 basis are only available at the aggregate national level, shown for selected countries below (Figure 5).

Figure 5: National profit share for selected countries, 1998 to 2015



Source: Office for National Statistics and Eurostat

The UK profit share (43%) in 2015 remains comparable with that of Germany (44%), but continues to be lower than that of Spain (47%) and higher than that of France (39%).

8 . Your views matter

We are constantly aiming to improve this release and its associated commentary. We welcome any feedback you have, and are particularly interested to know how you make use of these data to inform your work.

Please contact us using the contact details accompanying this release.

9 . Quality and methodology

The Profitability of UK companies and Quarterly Operating Profits Survey Quality and Methodology Information documents contain important information on:

- the strengths and limitations of the data
- the quality of the output: including the accuracy of the data, how it compares with related data
- uses and users
- how the output was created

10. Background notes

1. **What's new**

   Revisions

   Revisions to rates of return have been incorporated in this release from Quarter 1 1997 to ensure consistency with the Blue Book 2016. The revisions to the time series are presented in Table R1 accompanying this bulletin.

   Revisions to operating surplus include:

   - changes to the treatment of non-EU imports on natural gas
   - improved estimates of unrecorded activity
   - updates to data sources
   - Blue Book supply use, balancing and alignment adjustments

   Reasons for revisions to capital employed include:

   - improvement to Transport for London capital stock changes
   - improvements to own account construction
   - gross fixed capital formation, improvements made to dwellings
   - revised Annual Business Survey (ABS) data
   - gross fixed capital formation (GFCF), correction to agricultural data
   - changes to construction deflators from GFCF

2. **Understanding the data**

   Interpreting the data

   The rates of return presented are ratios of operating surpluses compared to capital employed, expressed as percentages. The ratios measure the “accounting” rates of return achieved in a particular period against total capital employed. The rates of return are on the basis of current replacement cost and relate to UK operations of private non-financial corporations (PNFCs). The net rate of return uses capital estimates that are net of capital consumption, and is more widely used than the gross rate of return. Rates of return are published for quarters and for years.

   The main sources of operating surpluses data used in the compilation of the rates of return are the Quarterly Operating Profits Survey (QOPS) and company profits data provided by HM Revenue and Customs (HMRC). The underlying capital data used to calculate these rates of return are based upon capital stocks and capital consumption data.

3. Definitions and explanations

Private non-financial corporations (PNFCs)

These are comprised of UK continental shelf (UKCS), manufacturing, non-financial service sector companies and others (including construction, electricity and gas supply, agriculture, mining and quarrying). UKCS companies are defined as those involved in the exploration for, and extraction of, oil and natural gas in the UK.

Gross operating surplus (GOS)

GOS of PNFCs consists of gross trading profits, plus income from rental of buildings, less inventory holding gains.

Gross trading profits

These include only that part of a company's income arising from trading activities in the UK. It does not include income from investments or other means, such as earnings from abroad. Gross trading profits are calculated before payments of dividends, interest and tax. The gross trading profits figures used in the calculation of gross operating surplus exclude the quarterly alignment adjustments applied to UK non-CS companies' gross trading profits, as published in the Quarterly National Accounts.

Inventory holding gains

The changes in the value of inventories due only to price. Book values are deflated to constant prices, and the constant price book value change (the difference between the value at the end of the period and the beginning) is estimated. This book value change is then reflated to give estimates of changes in inventories in current prices. This removes the effect of price changes between the 2 periods, which are the holding gains.

Capital stock

The value of all fixed assets used in production in the economy that are still in use, such as machinery, dwellings and intellectual property products such as software.

Capital employed

The average value of fixed assets, during the period, plus the value of inventories. This includes all tangible assets and intellectual property products that have been produced and are themselves repeatedly or continuously used in the processes of production for more than a year. Tangible assets include buildings, plant and machinery. Intellectual property products include computer software and mineral exploration costs. For UKCS companies, capital employed includes mineral exploration costs and oil rigs, but not the oil and gas reserves that are classified as non-produced assets. Inventories include raw material and fuel that are used up in production. Book values are used for levels of inventories.

Gross and net capital stock

This shows how much the economy's assets would cost to buy again as new, or their replacement cost. Estimates of net capital stock are net of accumulated consumption of fixed capital: that is, they are a measure of the written down replacement costs of fixed assets. A way of thinking about this is to consider a car owned by a household, which was bought as new. A reasonable estimate of gross capital stock would be the cost of replacing the car with a new model; net capital stock would be the value of the car at the current time (with wear and tear).

In the calculations for net rates of return, estimates of net operating surplus are net of the consumption of fixed capital (depreciation). The consumption of fixed capital is derived from capital stock and covers the depreciation of fixed assets over their service lives.

4. Use of the data

The underlying profits data used to calculate the rates of return are used within the UK National Accounts. They are consistent with the Blue Book 2016, published on 29 July 2016.

5. Methods

Sampling methodology

Details on the methods used for the Quarterly Operating Profits Survey are available in the Quality and Methodology Information document.

6. 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 Stock, Capital Consumption, Methodological changes to the estimation of capital stocks and consumption of fixed capital publication, published on 5 August 2016.

7. Quality

The net rate of return is defined as the ratio of the operating surplus compared with the capital employed, expressed as a percentage. The accuracy of the data in the numerator is likely to be high because the main component (profits) also draws upon definitive, comprehensive, HM Revenue and Customs data. The Quality and Methodology Information report for Profitability is available on our website.

8. Revisions

Table R1 accompanying this bulletin shows the revisions to the net rates of return made back to Quarter 1 1997. These revisions are consistent with the data published in the Blue Book 2016, published on 29 July 2016.

Estimates for the most recent quarters are provisional and, as usual, are subject to revisions in the light of updated source information consistent with the National Accounts Revisions Policy. We have a web page dedicated to revisions to economic statistics, which brings together our work on revisions analysis, links to relevant articles, revisions policies and key documentation.

Further detailed information on all changes to National Accounts can be found here:

- National Accounts changes: impact on real GDP 1997-2011
- National Accounts articles: The UK Flow of Funds Project: improvements to the Sector and Financial Accounts
- UK National Accounts, the Blue Book, 2016 Edition
- Capital Stock, Capital Consumption, Impact of the methodological changes to the estimation of capital stocks and consumption of fixed capital

9. Relevant links

Quarterly National Accounts

United Kingdom Economic Accounts

10. Publication policy and Code of Practice for Official Statistics

Details of the policy governing the release of new data are available from the Media Relations Office.

National Statistics are produced to high professional standards set out in the Code of Practice for Official Statistics. They undergo regular quality assurance reviews to ensure that they meet customer needs. They are produced free from any political interference.

11. Accessing data

The complete run of data in the tables of this statistical bulletin is available to view and download in electronic format through our time series data. Users can download the complete bulletin in a choice of zipped formats, or view and download their own sections of individual series.

12. Reproduction