Office for National Statistics

Statistical bulletin

Profitability of UK companies: April to June 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

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18 January 2019

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1 . Main points

- Private non-financial corporations' (PNFCs') net rate of return rose to 12.7% in Quarter 2 (Apr to June) 2018, from a revised estimate of 12.5% in Quarter 1 (Jan to Mar) 2018.

- The net rate of return for manufacturing companies fell for the second consecutive quarter, standing at 15.1% for Quarter 2 2018, down 0.6 percentage points from the Quarter 4 (Oct to Dec) 2017 position of 15.7%.

- Services companies' net rate of return recovered moderately in Quarter 2 2018 to 17.2%, from a revised estimate of 16.6% in Quarter 1 2018.

- UK continental shelf (UKCS) companies' net rate of return increased to 13.1% in Quarter 2 2018, from a revised estimate of 8.2% in Quarter 1 2018, the largest quarter-on-quarter percentage point increase since Quarter 2 2015.

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) 2017 and are consistent with the Quarterly national accounts, published on 28 September 2018.

How do we measure profitability?

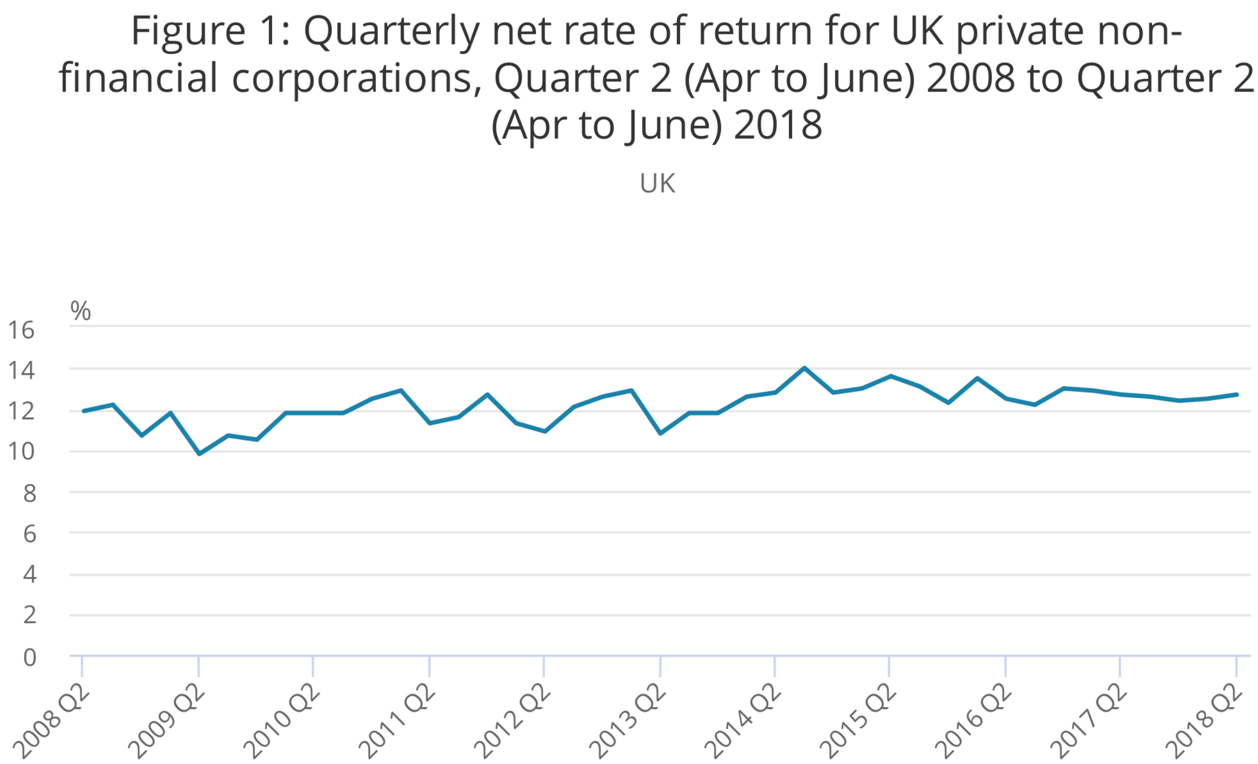
Net rate of return is used as the measurement of company profitability throughout this bulletin, except in the international comparisons section. The rate of return is calculated as the economic gain (profit) shown as a percentage of the capital used in production. "Net" refers to the rate of return 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 . Private non-financial corporations’ net rate of return increased slightly in Quarter 2 2018 compared with last quarter

The net rate of return for private non-financial corporations (PNFCs) rose in Quarter 2 (Apr to June) 2018 to 12.7%, from 12.5% in Quarter 1 (Jan to Mar) 2018 (Figure 1). The growth in profitability is also reflected in [Ernst and Young’s report] of 58 issued profit warnings during the period, compared with 74 in Quarter 1 2018. The Financial Times Stock Exchange (FTSE) sectors issuing the most profit warnings in Quarter 2 2018 were general retailers (7), software and computer services (6), and travel and leisure (5). Beyond falling sales, which were driven partly by the inflationary squeeze on household incomes, the most common reasons for warnings amongst FTSE general retailers were weaker consumer confidence, pressure on pricing, and increasing competition.

Figure 1: Quarterly net rate of return for UK private non-financial corporations, Quarter 2 (Apr to June) 2008 to Quarter 2 (Apr to June) 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 profitability fell for the second consecutive quarter, whilst services made a moderate recovery in Quarter 2 2018

Manufacturing companies

In Quarter 2 (Apr to June) 2018, the net rate of return for the manufacturing industry fell to 15.1% from the revised estimate of 15.6% in Quarter 1 (Jan to Mar) 2018. Despite the fall, it still stood above the 2017 average of 14.6% and was 0.9 percentage points higher than Quarter 2 2017. This is consistent with the Index of Production, which fell by 0.8% compared with Quarter 1 2018. This was due to a fall of 0.9% in manufacturing output, with 8 of the 13 subsectors decreasing.

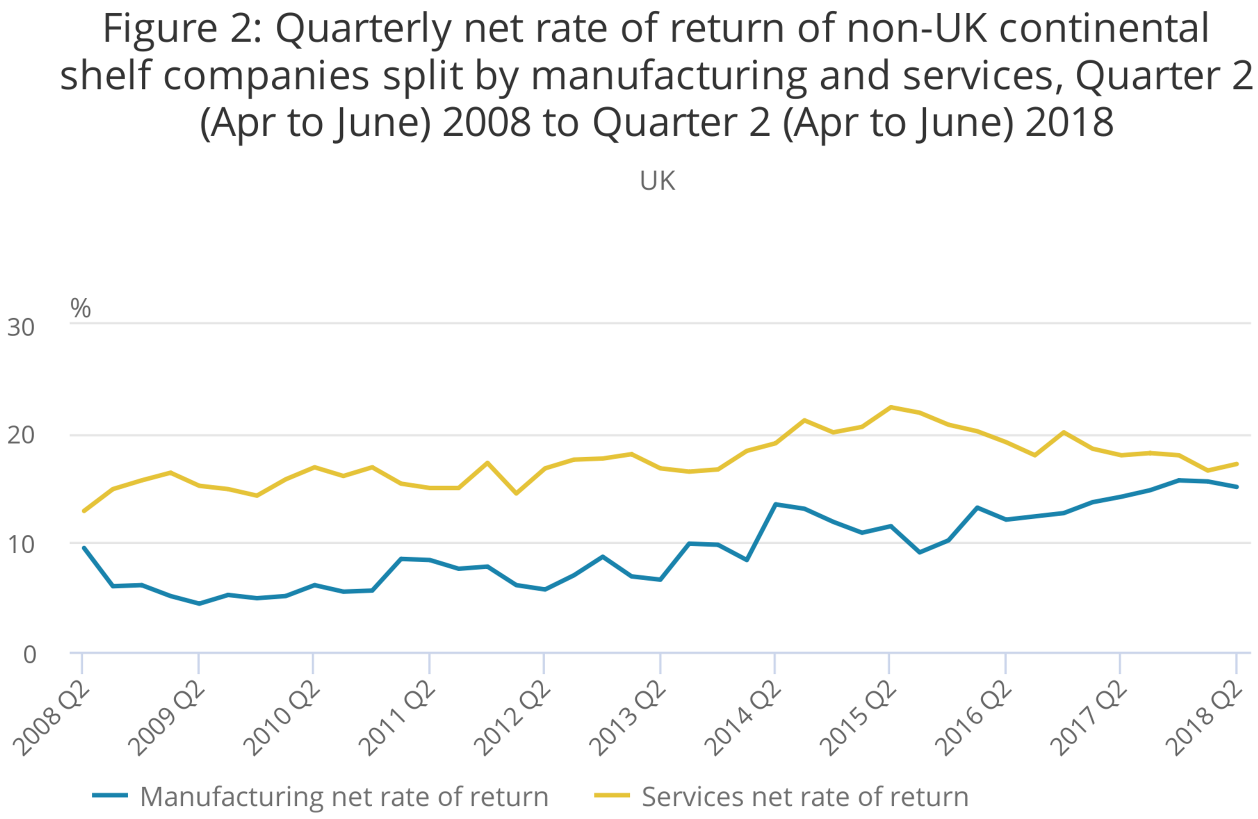
Although there was a dip this quarter in the manufacturing rate of return (ROR) position, the industry remained in a comparatively strong position. The Bank of England’s Agents’ summary report for Quarter 2 2018 (PDF, 99.5 KB) found that growth in domestic manufacturing output edged up, due to potential tariff and non-tariff barriers along with concerns about global trade protectionism. This has caused exporters to examine their supply chains, resulting in them looking to source goods in the UK, rather than importing them from elsewhere, benefitting manufacturers who produce domestically. The report also suggests that the output price inflation caused by the past depreciation of the sterling had decreased; however, there were some significant increases in manufacturing costs, namely in construction materials, metals and oil-derived products.

Services companies

The net rate of return for the services industries rose from a revised estimate of 16.6% in Quarter 1 2018 to 17.2% in Quarter 2 2018; that is, 1 percentage point lower than the average for 2017 of 18.2%. The Bank of England’s Agents’ summary report (PDF, 99.5KB) found that growth in retail sales had picked up in Quarter 2 2018, due to an increase in sales of seasonal items. However, this still failed to completely reverse the decline in Quarter 1 2018, partly caused by the adverse weather conditions. The report also suggests business services had seen relatively strong growth due to an increase in mergers and acquisitions by overseas buyers and new regulatory changes being brought in such as General Data Protection Regulation (GDPR).

Figure 2: Quarterly net rate of return of non-UK continental shelf companies split by manufacturing and services, Quarter 2 (Apr to June) 2008 to Quarter 2 (Apr to June) 2018

UK



Source: Office for National Statistics

Notes:

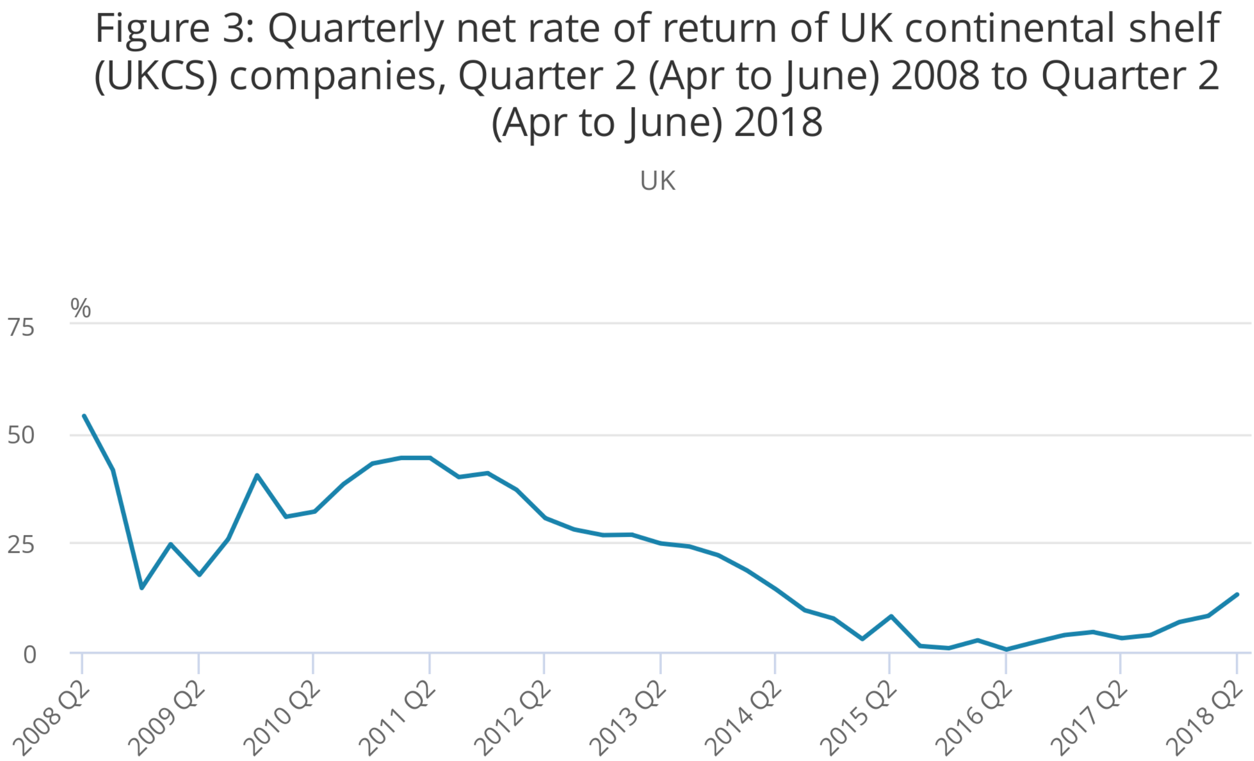
1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

5 . UK continental shelf companies continued to demonstrate strong growth as oil prices increased in Quarter 2 2018

The estimated net rate of return for UK continental shelf (UKCS) companies in Quarter 2 (Apr to June) 2018 was 13.1%. This was up 4.9 percentage points from a revised estimate of 8.2% in Quarter 1 (Jan to Mar) 2018, that is, 10 percentage points higher than for the same period last year. This represents the largest quarter-on-quarter percentage point increase since Quarter 2 2015. One contributing factor for the increase could be the growing global demand for oil. The Organisation of Petroleum Exporting Countries (OPEC) continued to restrict supply, which saw the price of oil rise significantly from $68.2 per barrel at the start of the quarter to $79.50 per barrel by the end.

Figure 3: Quarterly net rate of return of UK continental shelf (UKCS) companies, Quarter 2 (Apr to June) 2008 to Quarter 2 (Apr to June) 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).

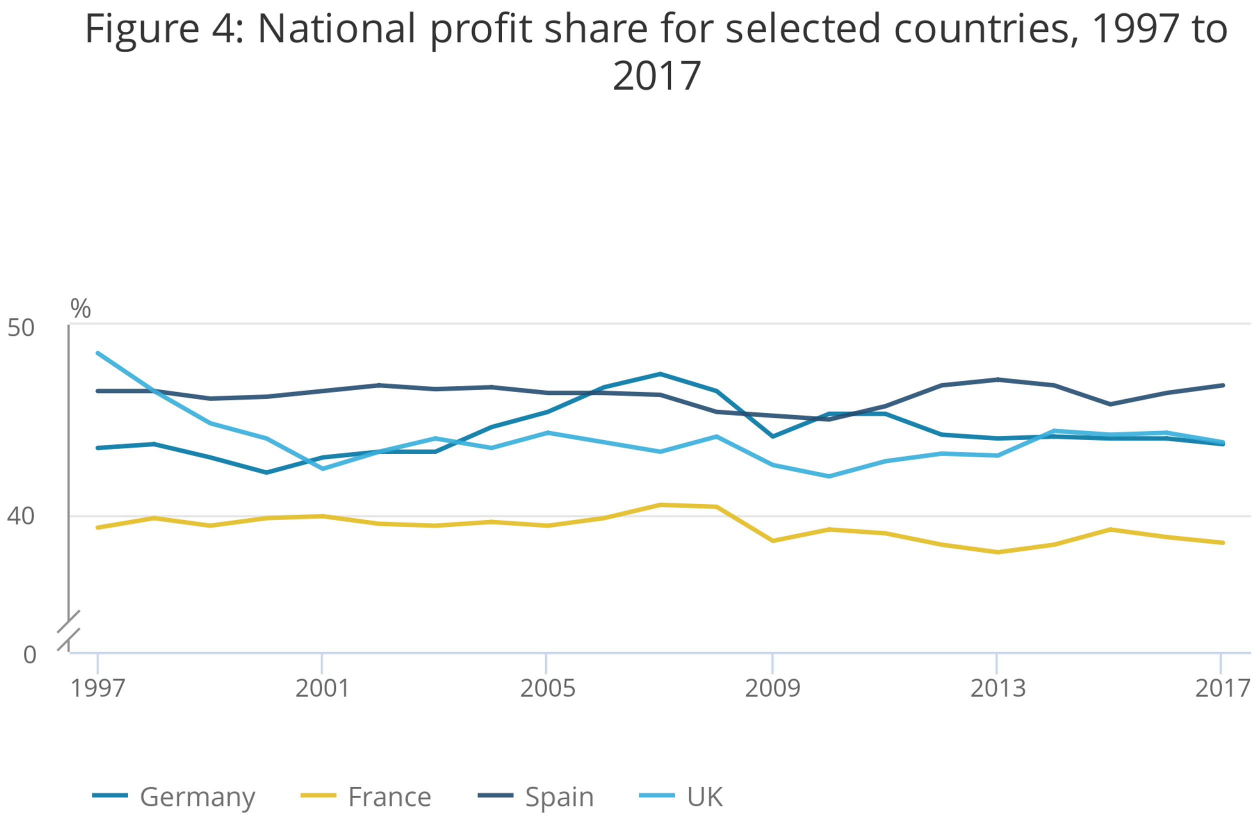
6 . How does UK profitability compare internationally?

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 percentage points to 46.8%. The UK saw the largest fall in profit share of the countries shown, standing at 43.8%, down 0.5 percentage points on 2016.

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.

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) 2017. This is consistent with the quarterly national accounts for Quarter 2 (Apr to June) 2018, published on 28 September 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 this 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 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) 2017. The revisions to the time series are presented in Table R1 accompanying this bulletin.

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 this 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

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