Statistical bulletin

Profitability of UK companies: October to December 2017

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

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22 August 2018 (as provisional)

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1 . Main points

- Private non-financial corporations’ (PNFCs') net rate of return fell to 12.5% in Quarter 4 (Oct to Dec) 2017, from a revised estimate of 12.7% in Quarter 3 (July to Sept) 2017.

- Manufacturing companies’ net rate of return increased from a revised estimate of 13.8% in Quarter 3 2017 to 15.8% in Quarter 4 2017, the second-highest value to date.

- Services companies’ net rate of return fell in Quarter 4 2017 to 18.2%, from 19.3% in Quarter 3 2017, while the annual rate of return fell to 18.3% in 2017, from 18.8% in 2016.

- UK continental shelf (UKCS) companies’ net rate of return increased to 6.2% in Quarter 4 2017, from a revised estimate of 3.9% in Quarter 3 2017, the highest point since Quarter 2 (Apr to June) 2015; this could, in part, be caused by an upturn in oil prices.

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.

This bulletin includes new data for the latest available quarter, Quarter 4 (Oct to Dec) 2017; revisions made to previously published UK profitability data are available in the datasets accompanying this bulletin. This is consistent with the Quarterly national accounts for Quarter 4 2017, published on 29 March 2018. This bulletin follows the National Accounts Revisions Policy.

How do we measure profitability?

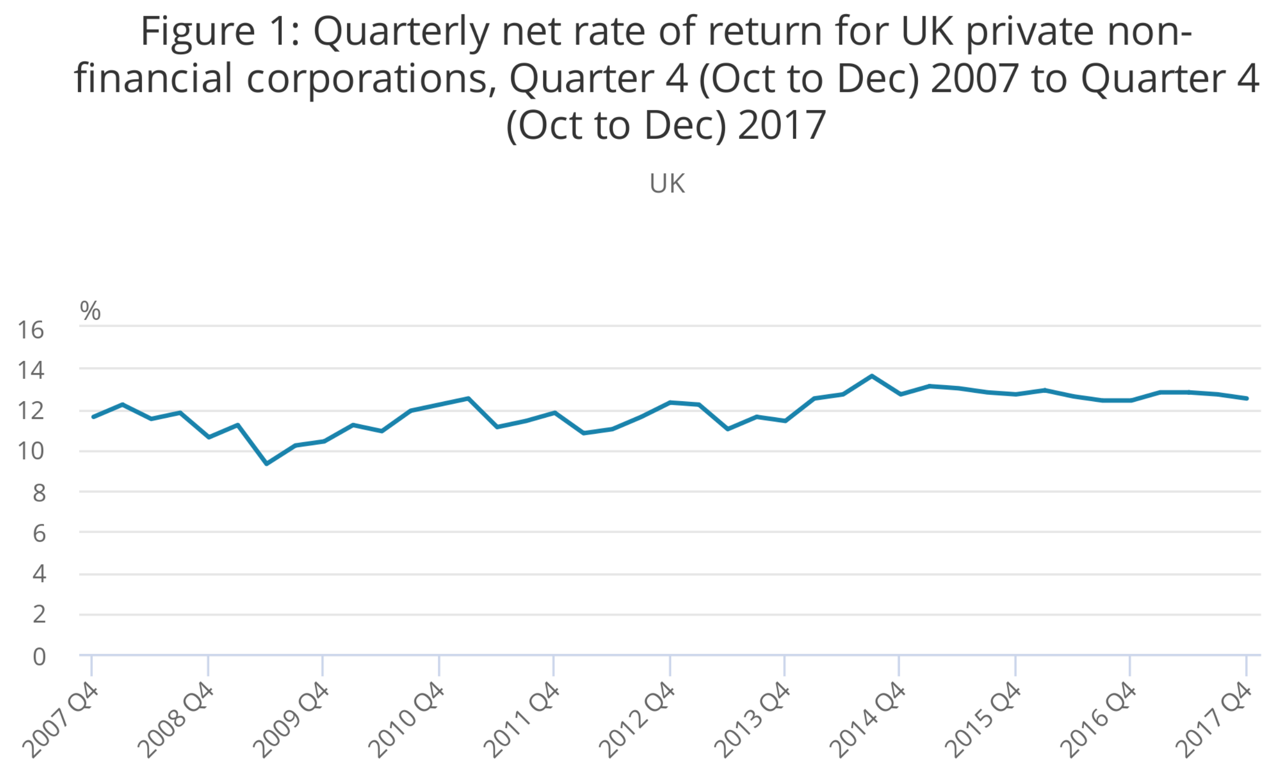
Net rate of return is used as the measurement of company profitability throughout this bulletin, except in the international comparisons section. The rate of return is calculated as the economic gain (profit) shown as a percentage of the capital used in production. “Net” refers to the rate of return 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 dataset accompanying this release.

3 . Profitability of private non-financial corporations falls in Quarter 4 2017

The net rate of return for private non-financial corporations (PNFCs) fell to 12.5% in Quarter 4 (Oct to Dec) 2017, from a revised estimate of 12.7% in Quarter 3 (July to Sept) 2017 (Figure 1). The IHS Markit UK Business Outlook (PDF, 975KB) stated that UK business confidence continued to recover from the low recorded in June 2017. However, it also stated that UK business confidence remained among the lowest recorded over the past five years. In support of this, Ernst & Young reported 81 UK quoted companies had issued profits warnings (PDF, 913KB), the highest since Quarter 4 2015. More profit warnings were issued in the second half of the year (Quarters 3 and 4), evidence of which can be seen in Figure 1, with a decline from Quarter 2 (Apr to June) through to Quarter 4 2017.

Figure 1: Quarterly net rate of return for UK private non-financial corporations, Quarter 4 (Oct to Dec) 2007 to Quarter 4 (Oct to Dec) 2017

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 companies' profitability reaches second-highest value to date, services companies' profitability remains stagnant

Manufacturing companies

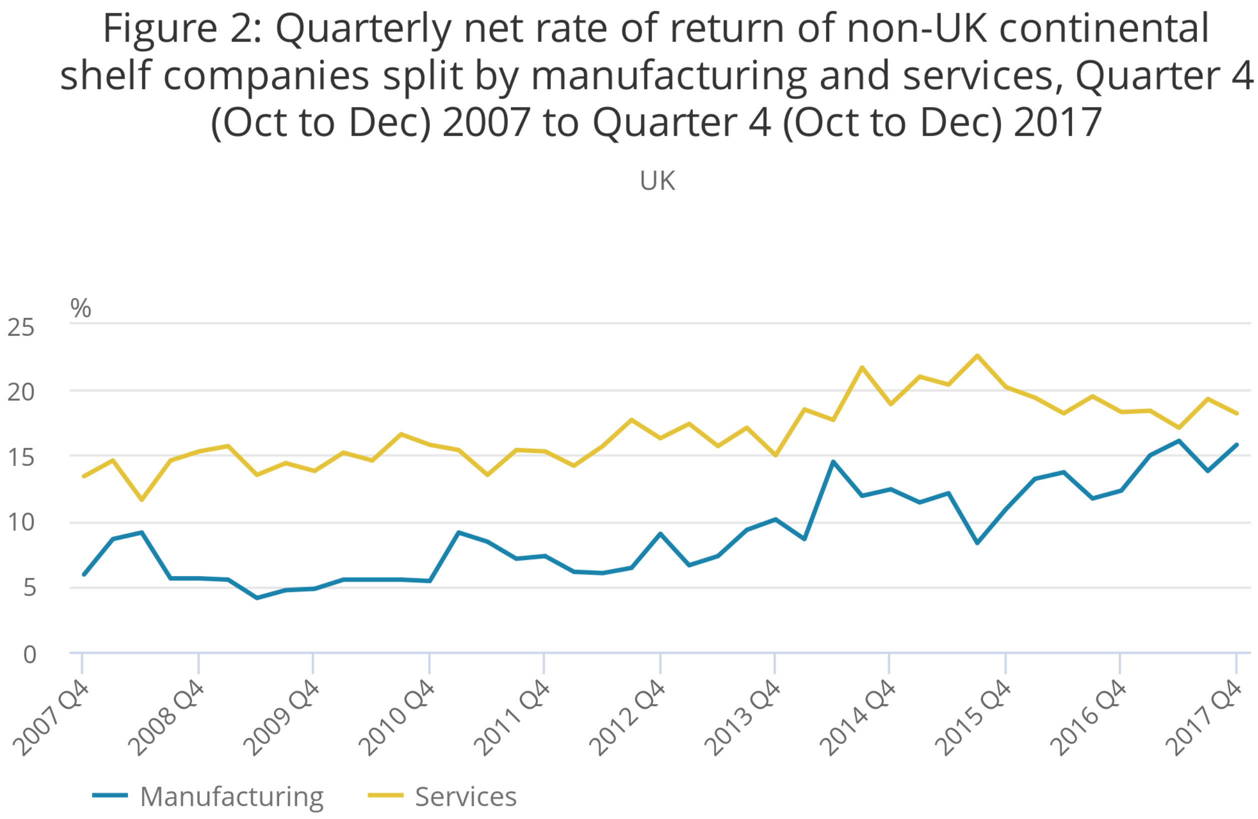
In Quarter 4 (Oct to Dec) 2017, the manufacturing sector rounded off a robust year, with the net rate of return rising to 15.8% from 13.8% in Quarter 3 (July to Sept). In support of this, the latest IHS Markit UK Business Outlook (PDF, 975KB) reports that manufacturers' growth expectations are the highest for more than two-and-a-half years. A possible reason for this could be increases in export sales, linked to the past sterling depreciation and improving global economic demand, which should improve profit margins.

Services companies

In Quarter 4 2017, the net rate of return for services fell to 18.2% from the revised estimate of 19.3% in Quarter 3 2017 (Figure 2). According to the IHS Markit UK Business Outlook (PDF, 380KB), some of the fall may be caused by inflationary pressures squeezing real household incomes and raising input costs, as well as consumers delaying "big ticket" purchases due to uncertainty.

Figure 2: Quarterly net rate of return of non-UK continental shelf companies split by manufacturing and services, Quarter 4 (Oct to Dec) 2007 to Quarter 4 (Oct to Dec) 2017

UK



Source: Office for National Statistics

Notes:

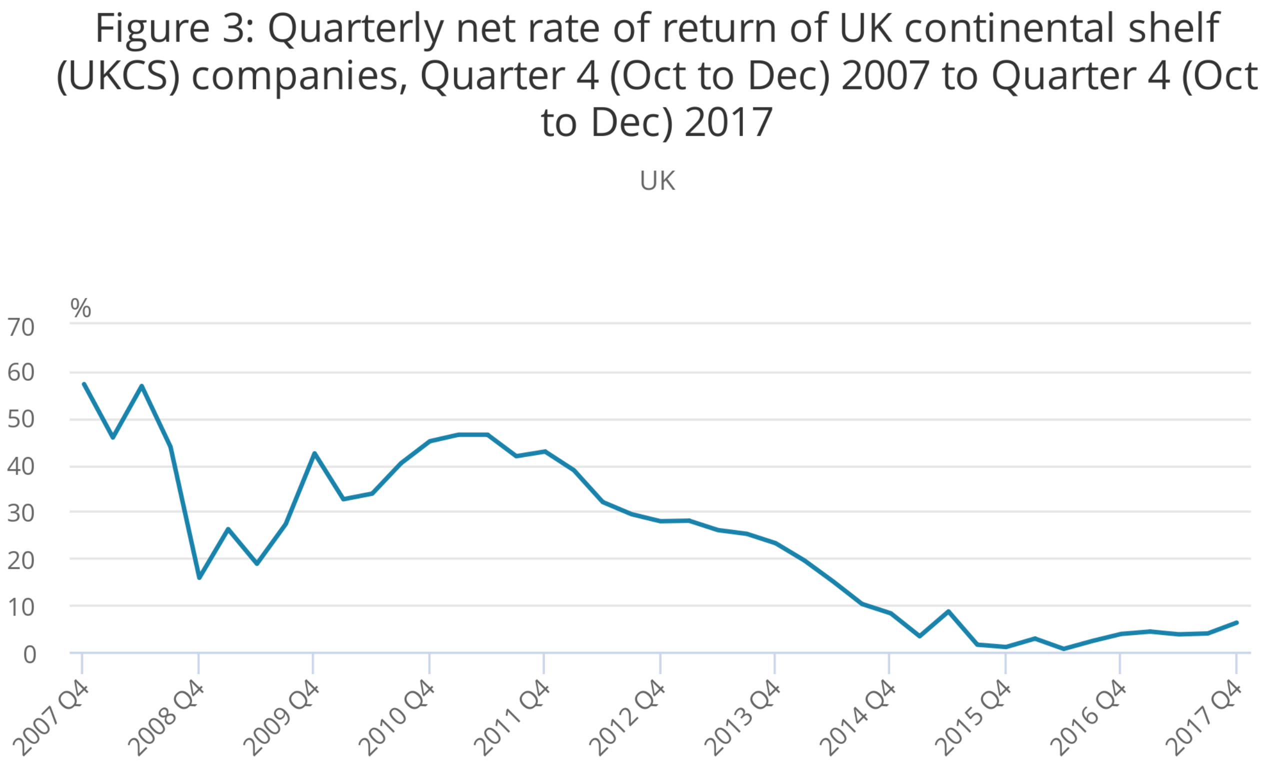
1. Q1 refers to Quarter 1 (Jan to Mar), Q2 refers to Quarter 2 (Apr to June), Q3 refers to Quarter 3 (July to Sept) and Q4 refers to Quarter 4 (Oct to Dec).

5 . UK continental shelf companies' profitability ends the year at its highest since Quarter 2 2015

The estimated net rate of return for UK continental shelf (UKCS) companies in Quarter 4 (Oct to Dec) 2017 was 6.2%. This was up 2.3 percentage points from the revised estimate of 3.9% in Quarter 3 (July to Sept) 2017 (Figure 3). The main reason for this recovery was an upturn in oil prices, which saw the price per barrel rise from $58 (US dollars) at the start of the quarter to $67 by the end. The change in price was likely due to Organization of the Petroleum Exporting Countries (OPEC) production cuts, restricting the supply of oil to put an upward pressure on the price per barrel.

Figure 3: Quarterly net rate of return of UK continental shelf (UKCS) companies, Quarter 4 (Oct to Dec) 2007 to Quarter 4 (Oct to Dec) 2017

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 . Services continue to slow annually whilst manufacturing and UKCS perform robustly

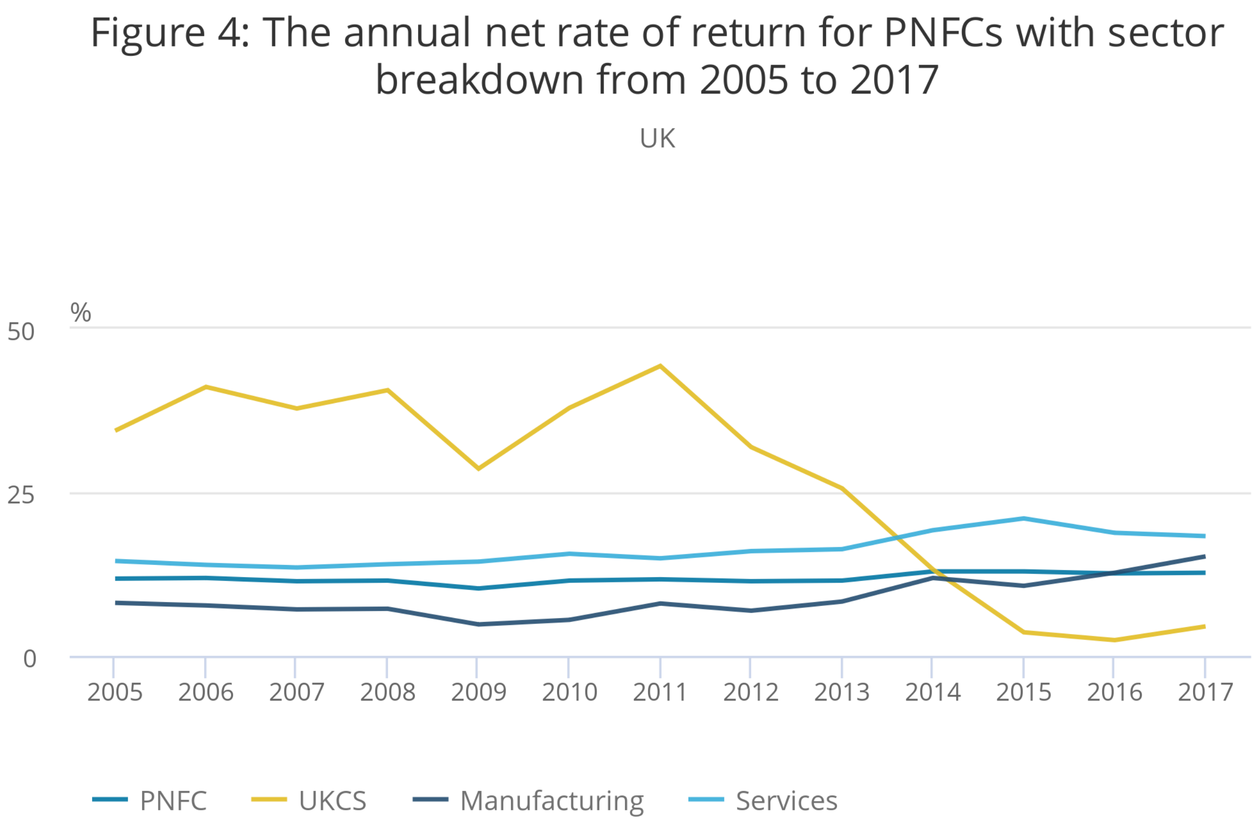
The annual net rate of return for services fell for a second consecutive year. After a record high of 21% in 2015, services now stands at 18.3% for 2017. This may reflect curtailed consumption of non-essential services by both households and businesses due to subdued growth in real wages and continued uncertainty.

In 2017, the annual net rate of return for the manufacturing sector continued to show strong growth, rising a further 2.5 percentage points from its 2016 mark. This is the highest annual figure for manufacturing to date, standing at 15.2% for the year. The strengthening of manufacturing could be explained by the depreciation in sterling, boosting export sales as they became cheaper in foreign currency terms, which boosted international competitiveness.

UK continental shelf (UKCS) companies’ annual net rate of return rose to 4.5% in 2017, a rise of 2.1 percentage points from its 2016 mark of 2.4%. Since 2012, falling oil prices and uncertainty in the market have seen the UKCS rate of return decrease year-on-year. However, the price of oil has since begun a relatively steady recovery towards its previous levels. An important influence in this recovery may have been an agreement amongst Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC suppliers who committed to reducing production. This cut down on excess supply and pulled the price of oil up from a low of $28 (US dollars) per barrel at the beginning of 2016, to roughly $67 by the end of 2017.

Figure 4: The annual net rate of return for PNFCs with sector breakdown from 2005 to 2017

UK



Source: Office for National Statistics

Notes:

1. Calendar years are used for Figure 4.

7 . How does UK profitability compare internationally?

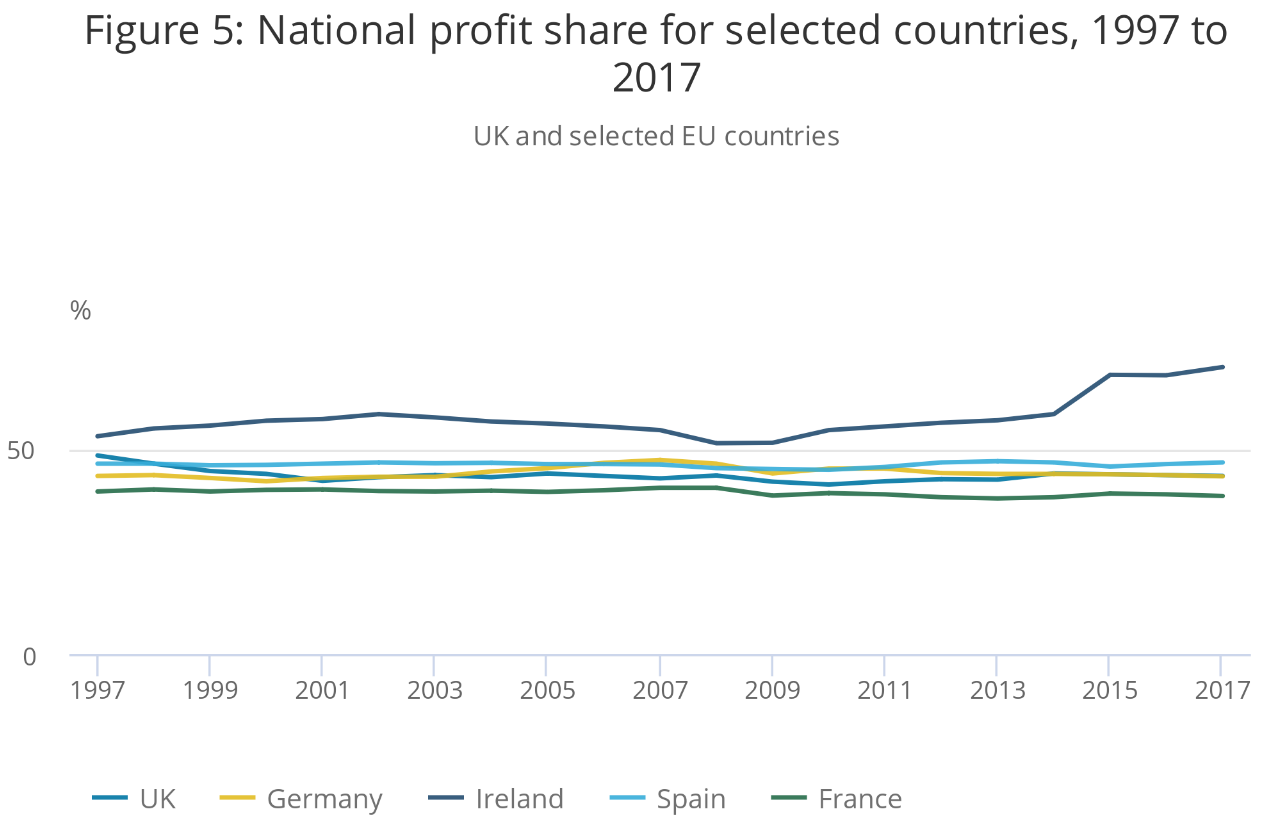
Profitability is a relative measure of profit and how it was created. This bulletin shows the rate of return on capital employed. Unfortunately, other countries use a range of different measures, making international comparisons difficult.

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 (PDF, 6.4MB) 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 5).

Figure 5: National profit share for selected countries, 1997 to 2017

UK and selected EU countries



Source: Office for National Statistics and Eurostat

Notes:

1. Calendar years are used for Figure 5.

The UK, France and Germany experienced a decline in the national profit share in 2017, whilst Spain reported a small increase in 2017. In Quarter 4 (Oct to Dec) 2017, the UK economy grew by 0.4% as recorded in the third estimate of GDP, weaker than 0.6% recorded across the European Union. Overall, annual growth for 2017 in the UK was 1.8%, which was the slowest rate of annual growth since 2012 and was lower than the 2.4% growth recorded in the European Union (Quarterly national accounts and Organisation for Economic Co-operation and Development).

8 . 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.

Like all government departments, we ensure all of 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.

9 . What's changed in this release?

Revisions to the net rates of return for PNFCs have been made back to Quarter 1 (Jan to Mar) 2017. This is consistent with the Quarterly national accounts for Quarter 4 (Oct to Dec) 2017, published on 29 March 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 have subsequently 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.

10 . 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 it compares 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

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.

11 . 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: Giles Andrews and Daniel Robertson.