

Statistical bulletin

# Profitability of UK companies: October to December 2018

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

- Private non-financial corporations' (PNFCs) net rate of return was 12.2% in Quarter 4 (Oct to Dec) 2018, down from the revised estimate of 12.4% for Quarter 3 (July to Sept) 2018.
- The net rate of return for manufacturing companies fell to 14.3% in Quarter 4 2018, down 0.9 percentage points from the previous quarter's revised net rate of return of 15.2%.
- Services companies' net rate of return was 17.8% in Quarter 4 2018, an increase of 0.7 percentage points from the revised estimate of 17.1% in Quarter 3 2018.
- UK continental shelf (UKCS) companies' net rate of return decreased to 13.1% in Quarter 4 2018, down from a revised estimate of 17.4% in Quarter 3 2018.

## 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) 2018 and are consistent with the [GDP quarterly national accounts](#), published on 29 March 2019.

### 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 fell slightly to 12.2%

The net rate of return for private non-financial corporations (PNFCs) fell to 12.2% in Quarter 4 (Oct to Dec) 2018 from the revised estimate of 12.4% in Quarter 3 (July to Sept) 2018 (Figure 1).

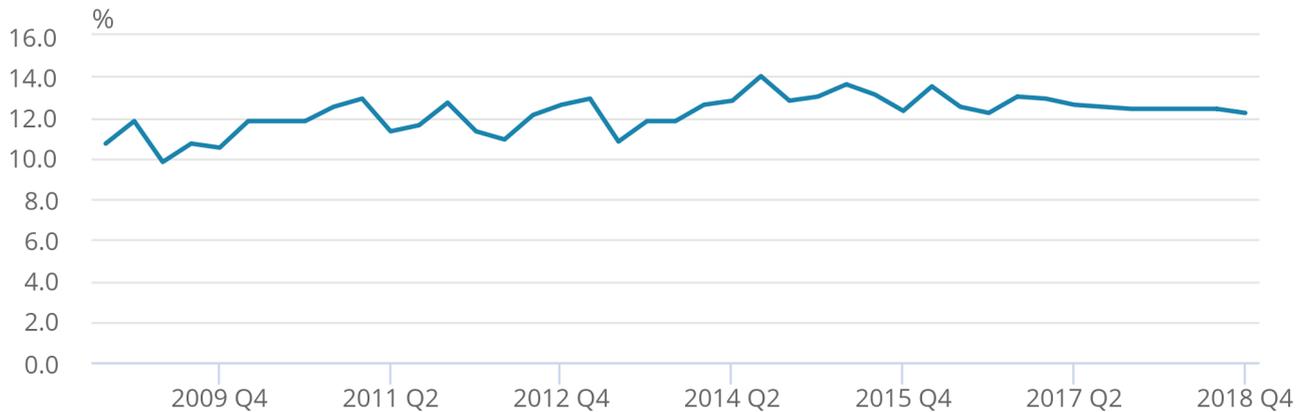
The fall in profitability is reflected in [Ernst and Young's Report](#) of 88 issued profit warnings for Quarter 4 2018, showing an increase from the previous quarter and following a trend that has been present for the previous eight years. The Financial Times Stock Exchange (FTSE) sectors issuing the most profit warnings in Quarter 4 2018 were travel and leisure (12) and general retailers (8). Of the companies who issued a profit warning, 35% reported the reason as sales short of forecasts, whilst 31% reported delayed or discontinued contracts.

## Figure 1: Quarterly net rate of return has generally been stable for the past two years

Net rate of return of UK private non-financial corporations, Quarter 4 (Oct to Dec) 2008 to Quarter 4 (Oct to Dec) 2018

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Net rate of return of UK private non-financial corporations, Quarter 4 (Oct to Dec) 2008 to Quarter 4 (Oct to Dec) 2018



Source: Office for National Statistics - Quarterly Operating Profits Survey

#### 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 fell to 14.3% whilst services rose to 17.8%

### Manufacturing companies

In Quarter 4 (Oct to Dec) 2018, the net rate of return for manufacturing companies fell to 14.3% from the revised estimate of 15.2% in Quarter 3 (July to Sept) 2018 (Figure 2). This decrease of 0.9 percentage points follows a similar trend to the [Index of Production](#) or manufacturing companies, which also fell by 0.9% compared with Quarter 3.

The [British Chambers of Commerce \(BCC\) quarterly economic survey for Quarter 4 2018](#) indicates the level of manufacturers that expect to raise prices, is at its highest in a year. This also highlights the rising labour shortages they face as 81% of manufacturers reported difficulty in finding the right staff.

## Services companies

The net rate of return for services companies in Quarter 4 2018 increased to 17.8% from a revised Quarter 3 estimate of 17.1% (Figure 2). This is the largest quarterly percentage increase since Quarter 4 2016.

The [Bank of England summary report \(PDF, 1.39MB\)](#) reports that the IT sector, for example those specialising in gaming and animations, have reported particularly strong growth.

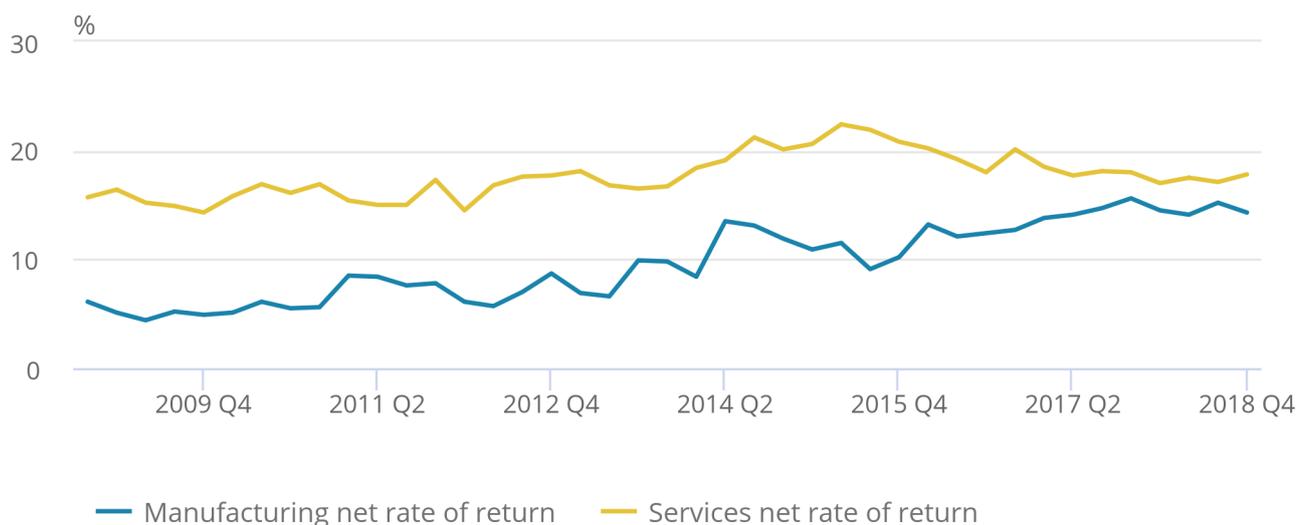
The [Index of Services](#) output increased by 0.4% in Quarter 4 2018 compared with Quarter 3 2018, driven by the professional, scientific and technical activities sectors.

### Figure 2: There is divergence between manufacturing and services companies in Quarter 4 2018

Net rate of return of UK non-continental shelf companies split by manufacturing and services, Quarter 4 (Oct to Dec) 2008 to Quarter 4 (Oct to Dec) 2018

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Net rate of return of UK non-continental shelf companies split by manufacturing and services, Quarter 4 (Oct to Dec) 2008 to Quarter 4 (Oct to Dec) 2018



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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' growth fell to 13.1% as oil prices steadily declined

The estimated net rate of return for UK continental shelf (UKCS) companies in Quarter 4 (Oct to Dec) 2018 was 13.1% (Figure 3). This was down 4.3 percentage points from the revised estimate of 17.4% in Quarter 3 (July to Sept) 2018. This is the largest fall since Quarter 3 2015, when the growth fell by 6.8 percentage points. However, on an annual basis 2018 saw the highest rate of return (12.7%) since 2013 (24.4%).

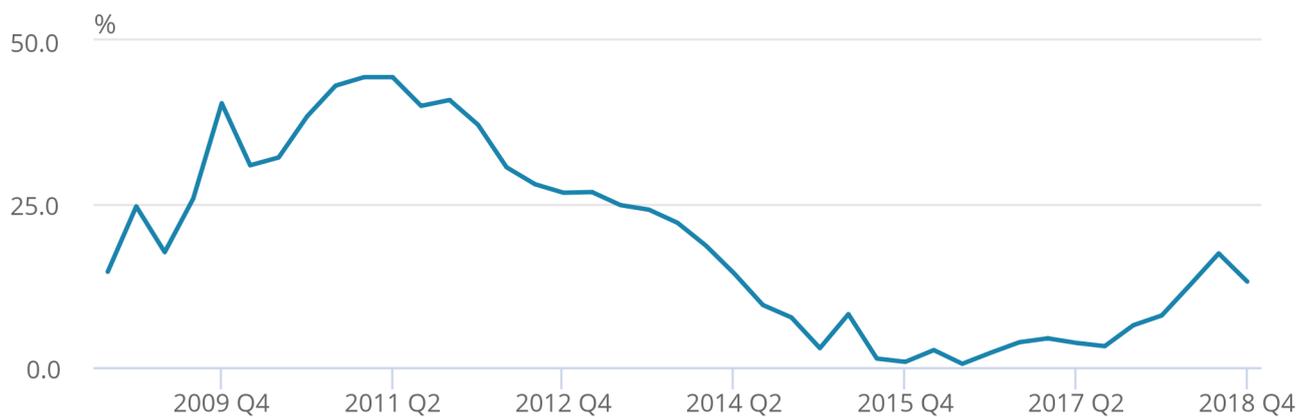
The price of oil fell steadily throughout the quarter from \$85 (US dollars) per barrel at the start of the quarter to \$53.8 per barrel by the end of the quarter. This represents a fall of 36.7%. Increased supply, particularly by Saudi Arabia, and a slowdown in the demand for oil, as [reported by CNBC](#), could partially explain the fall.

### Figure 3: UK continental shelf companies' profitability sees first quarter-on-quarter fall in over a year

Net rate of return of UK continental shelf (UKCS) companies, Quarter 4 (Oct to Dec) 2008 to Quarter 4 (Oct to Dec) 2018

#### Figure 3: UK continental shelf companies' profitability sees first quarter-on-quarter fall in over a year

Net rate of return of UK continental shelf (UKCS) companies, Quarter 4 (Oct to Dec) 2008 to Quarter 4 (Oct to Dec) 2018



Source: Office for National Statistics - Quarterly Operating Profits Survey

#### 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 \(PDF, 6.4MB\)](#) 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 only.

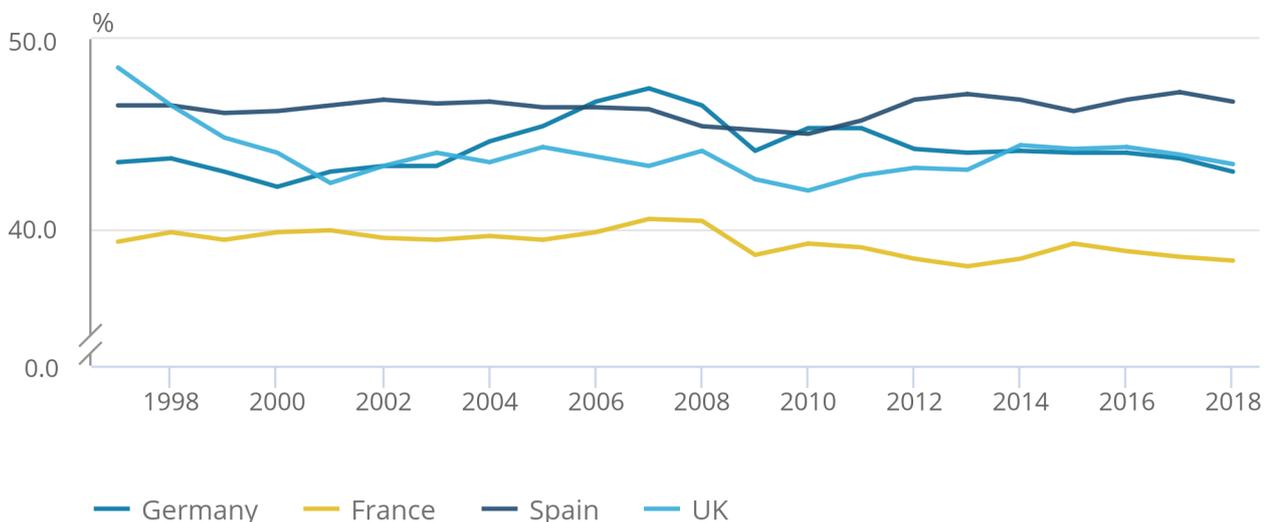
International data on an ESA 2010 basis are only available at the aggregate national level, shown for selected countries (Figure 4).

### Figure 4: UK's national profit share fell for the second consecutive year

National profit share for selected countries, 1997 to 2018

#### Figure 4: UK's national profit share fell for the second consecutive year

National profit share for selected countries, 1997 to 2018



Source: Office for National Statistics - Quarterly Operating Profits Survey, Eurostat

Notes:

1. Calendar years are used for Figure 4.

All four countries experienced a decline in national profit share for 2018 and for the UK, Germany and France this was a second consecutive annual decrease. Germany saw the largest percentage fall in 2018, down 0.7%. For the UK, Germany and France the decline coincided with a period of slower growth in 2018, where their respective gross domestic product grew at a lower rate than that experienced by the European Union. (Source: [Eurostat Tables](#)).

## 7 . Links to related statistics

The gross operating surplus (GOS) of private non-financial corporations 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 have been made back to Quarter 1 (Jan to Mar) 2018. This is consistent with the quarterly national accounts for Quarter 4 (Oct to Dec) 2018, published on 29 March 2019.

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](mailto: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 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) 2018. The revisions to the time series are presented in [Table R1](#) accompanying this bulletin.

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](#).

## 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: June Pupic, James O'Connor, Julie Morgan and Ross Shepherd.