Performance of large companies

This article presents updated and revised estimates of company profitability derived from the published accounts of large companies. These statistics complement and supplement the estimates of company profitability based on the national accounts.[1]

The article concludes that overall company profitability continued to improve in 1984; individual industrial sectors, however, display widely differing performances and trends. The improvement in real profitability based on current cost accounts is much more marked than the improvement in nominal profitability based on historical cost accounts. The number of companies reporting current cost information, however, is diminishing, and this is reducing the reliability of the current cost series.

The article also finds that, since 1980, the current cost return on trading assets has generally been lower than the current cost return on total capital employed. The series based on historical costs shows the opposite result, but it is suggested that this may simply reflect the weaknesses inherent in historical cost accounting.

As described more fully in an earlier article,[2] the published accounts of most larger companies have been available in computerised form for some years. The Bank has analysed the financial statements of major industrial and commercial companies compiled by Datastream Limited in order to produce aggregated statistics for all such companies and for individual industrial sectors. The companies analysed represent only a small proportion of the total population of companies. However, according to Department of Trade and Industry estimates,[3] over 80% of aggregate capital employed in 1981 was accounted for by the largest 2,000 or so companies, which broadly correspond with the companies covered by Datastream.

Despite statutory reporting deadlines, it is apparent that many companies, particularly smaller ones, tend to report late. Estimated measures of profitability are inevitably revised as data on more companies become available. The historical cost figures in this article for 1984 (which include the results of companies with financial years ending in the first quarter of 1985) are based on about two thirds of the Datastream companies and must therefore be regarded as provisional. The current cost figures for 1984 must be treated with even greater caution since the number of companies presenting current cost accounts in accordance with the Statement of Standard Accounting Practice, SSAP 16, has fallen sharply, to the point where these may no longer be representative of all companies.

Since the introduction of SSAP 16 on a trial basis in 1980, the lack of consensus within the accounting profession, the opposition of many preparers of accounts and the limited vocal support from users of accounts have combined to prevent so far the finalisation of a replacement standard. Compliance with SSAP 16 has fallen from around 70% of all companies analysed in 1981 and 1982 to under 15% of companies analysed in 1984. Given also that not all the Datastream companies have reported their results for the latest year, the current cost estimates of profitability for 1984, particularly for individual industrial sectors, are likely to be much less reliable than in previous years. For the future, any replacement accounting standard which does not require disclosure of current cost balance sheets will render all such analyses of real profitability impossible.

In interpreting the statistics in this article, it should also be borne in mind that these cover the reported performance of both domestic and overseas activities of larger UK companies. Unlisted companies (including some owned by overseas parents) have only been included on the database since 1980.[4] The statistics differ from those based on the national accounts, which measure the performance of UK activities only but cover the industrial and commercial company sector as a whole. There are also a number of other differences in accounting bases and definitions between the two measures;[5] in particular, the measures of profitability in this article are taken before extraordinary items and thus exclude profits and losses on asset disposals and costs of rationalisation, which may have been significant in certain years.

While previous Bulletin articles have looked at the overall profitability of major companies as measured by the rate

(1) See 'Company profitability and finance': June 1985 *Bulletin*, page 224.
(2) 'Performance of large companies': September 1984 *Bulletin*, page 360.
(3) *Business Monitor MA3*, sixteenth issue, Table 14.
(4) See also the limitations described in the appendix to the article in the September 1984 *Bulletin*, page 367.
(5) The results of a study which attempted to reconcile the two measures of company profitability were reported in *Economic Trends*, August 1984, pages 97–100.

of return on total capital employed, this article also analyses the rate of return on trading assets—that is excluding the profits of associated companies and excluding the return on investments in liquid and other non-trading assets.

Rates of return

Real rates of return on capital employed based on current costs (Table A) show a marked and consistent improvement in the five years to 1984, with the profitability of non-oil companies as a whole reaching 11.4%, nearly double the level in 1980. The capital goods and 'other' groups have outperformed the consumer group in restoring their profitability over the five years to 1984, to 11.3% and 13.2% respectively, albeit from very low bases in 1980. As in 1981, the profitability of the oil companies (10.5%) appears to have fallen below the average for industrial companies, but the small number of companies for which there are data for 1984 renders this conclusion rather uncertain.

The general improvements in current cost returns reflect not only the increase in historical cost profitability as the economy came out of recession and as the benefits of the extensive rationalisation carried out by many companies fed through, but also the falling rate of inflation experienced in recent years. There may also be some degree of upward bias in the trend, to the extent that companies which have stopped reporting current cost accounts may include a disproportionate number of companies with low rates of return. No figures are available for years before 1980 when companies were not required to publish current cost information.

Rates of return on capital employed based on historical costs have continued to improve and, for non-oil companies as a whole, reached 17.0% in 1984, a level higher than the average achieved in the 1970s, though below the peak of 17.9% achieved in 1976. Within this overall performance, it is clear that companies in the capital goods group (with an average return of 15.8%) have not recovered to the same degree, while the consumer group (17.7%) and 'other' groups (16.9%) have more than recovered the ground lost in the last recession. Profitability in the oil sector (18.7%) remains significantly below the high levels achieved in the 1970s.

Taking into account companies' trading activities only (Table B), both the current cost and the historical cost rate of return on trading assets show that profitability has improved steadily over the last five years. For the non-oil companies, the average historical cost rate of return in 1984 of 18.1% is significantly higher than the levels typically achieved in the 1970s. Again, it would appear that the capital goods group has failed to recover to the same extent as the consumer and 'other' groups, while the oil companies appear to be faring much worse than during the 1970s.

On average, the current cost return on trading assets has been significantly lower than the current cost return on

Table A
Rates of return on capital employed[(a)]
Per cent

	Historical cost						Current cost				
	Average 1970–79	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Capital goods group	**16.1**	**12.0**	**12.3**	**12.6**	**14.0**	**15.8**	**4.6**	**5.9**	**6.4**	**8.3**	**11.3**
Building materials	16.5	13.6	13.0	12.6	14.4	14.4	6.9	6.8	7.0	9.0	8.4
Contracting and construction	17.2	14.6	14.2	13.3	12.0	13.5	8.4	8.3	8.8	11.0	7.0
Electricals	17.6	14.3	18.0	18.4	17.7	18.0	7.2	9.8	10.0	12.2	19.8
Electronics	21.5	23.7	24.0	24.4	23.9	23.4	16.5	17.5	23.1	23.2	18.7
Mechanical engineering	15.8	11.9	11.5	9.5	10.8	13.4	3.4	4.3	3.4	5.5	8.7
Metals and metal forming	14.9	10.4	8.6	9.2	11.5	13.6	5.1	3.6	5.5	8.3	
Motor components and distribution	12.0	2.6	3.1	6.0	8.5	9.8	−5.1	−2.9	0.1	2.8	6.8
Other industrial materials	17.3	15.6	15.3	13.7	14.4	19.1	7.2	8.1	7.8	8.0	
Consumer group	**17.0**	**15.3**	**15.9**	**15.8**	**17.2**	**17.7**	**7.8**	**8.7**	**9.4**	**10.6**	**11.0**
Brewers and distillers	14.7	12.8	12.8	14.0	14.1	13.9	6.5	7.0	8.3	8.9	11.8
Food manufacturing	16.7	16.4	17.2	16.4	17.0	17.1	9.1	9.5	9.2	9.3	9.2
Food retailing	22.9	21.5	20.5	21.4	23.0	23.4	10.1	12.2	13.5	14.6	16.0
Health and household products	24.3	19.9	22.5	24.6	25.6	26.1	11.5	12.0	14.5	15.3	17.5
Leisure	17.6	15.2	14.4	13.7	14.7	13.5	9.8	10.9	10.8	10.8	8.9
Newspapers and publishing	20.8	14.3	16.6	13.7	18.2	17.7	3.6	7.4	8.8	12.9	9.2
Packaging and paper	15.1	13.8	14.2	12.6	13.7	16.9	3.8	4.8	6.0	7.6	10.0
Stores	19.0	15.2	13.5	12.8	16.4	18.3	8.3	8.7	8.5	11.6	17.7
Textiles	14.6	10.4	13.8	14.1	16.5	17.3	2.4	5.6	6.5	9.9	13.6
Tobacco	17.6	18.2	20.9	21.1	21.4	20.5	9.9	10.3	11.8	13.1	
Other consumer goods	17.9	13.9	13.1	11.3	17.7	16.7	4.8	6.9	5.0	10.5	13.4
Other groups	**14.6**	**13.2**	**12.5**	**11.6**	**14.1**	**16.9**	**5.0**	**5.6**	**6.0**	**8.4**	**13.2**
Chemicals	15.1	9.9	10.6	9.6	13.4	16.4	3.2	3.6	4.1	7.0	10.5
Office equipment	21.0	22.8	19.0	13.9	12.3	13.6	7.7	8.5	5.1	6.6	2.9
Shipping and transport	9.3	11.4	9.4	8.2	10.8	11.0	6.3	3.7	2.3		..
Miscellaneous	16.5	15.5	14.8	15.0	16.8	18.6	7.5	8.7	10.7	12.9	16.0
All industrial groups	**16.3**	**13.7**	**14.0**	**13.9**	**15.5**	**17.0**	**6.2**	**7.2**	**7.8**	**9.5**	**11.4**
Oil companies	27.6	26.6	19.2	17.6	19.8	18.7	10.8	5.8	7.8	11.3	10.5
Industrials and oils	**18.3**	**16.7**	**15.3**	**14.9**	**16.7**	**17.4**	**7.2**	**6.9**	**7.8**	**10.0**	**11.0**
Number of companies analysed	*1,219*	*1,771*	*1,729*	*1,605*	*1,446*	*1,181*	*957*	*1,214*	*1,061*	*532*	*161*

.. not available.

Source: Datastream Limited.

(a) Weighted averages of the pre-interest and pre-tax profit, *including* the profit from associated companies and investments in liquid and other non-trading assets, on closing capital employed.

Table B
Rates of return on trading assets[a]
Per cent

	Historical cost						Current cost				
	Average 1970–79	1980	1981	1982	1983	1984	1980	1981	1982	1983	1984
Capital goods group	**17.0**	**11.4**	**11.8**	**12.4**	**14.7**	**17.1**	**3.2**	**4.5**	**5.0**	**7.6**	**11.1**
Building materials	17.0	12.8	12.0	12.4	14.4	14.4	5.8	5.4	6.2	8.3	7.3
Contracting and construction	19.2	15.1	14.8	15.2	13.8	16.2	7.5	7.6	9.7	13.1	6.3
Electricals	19.1	14.0	18.3	20.3	19.4	20.3	6.7	9.2	10.0	12.3	24.5
Electronics	26.8	26.5	31.3	32.1	32.5	28.9	17.5	21.3	26.9	29.1	19.6
Mechanical engineering	16.5	11.7	11.1	8.4	10.3	13.7	2.3	3.2	1.7	4.6	8.1
Metals and metal forming	15.6	9.9	7.9	8.9	12.3	15.0	4.3	2.8	4.8	8.5	
Motor components and distributors	11.8	0.4	0.8	3.2	6.6	9.5	−7.7	−5.4	−2.8	0.3	5.9
Other industrial materials	17.6	15.6	15.1	14.0	15.9	21.1	6.3	6.9	6.9	7.9	
Consumer group	**18.6**	**15.6**	**16.3**	**16.1**	**18.1**	**18.8**	**7.4**	**8.3**	**9.0**	**10.6**	**11.3**
Brewers and distillers	15.4	12.7	12.9	14.3	14.3	14.3	6.2	6.9	8.4	8.8	12.3
Food manufacturing	18.3	16.6	17.8	16.6	17.8	18.0	8.8	8.8	8.5	9.2	9.0
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Health and household products	27.0	20.9	24.1	26.7	29.6	29.8	11.6	11.9	14.7	16.9	18.8
Leisure	19.1	15.7	15.0	14.4	15.5	14.9	9.7	11.1	11.1	11.9	9.9
Newspapers and publishing	23.3	12.7	17.3	13.4	21.1	27.3	0.8	6.5	7.8	15.1	9.6
Packaging and paper	16.0	13.6	14.3	12.7	14.2	18.0	3.1	4.3	5.4	7.0	9.2
Stores	20.3	15.9	13.9	13.1	17.6	19.0	8.0	8.4	8.2	12.0	17.8
Textiles	15.2	10.0	14.0	14.9	18.5	19.2	1.3	4.5	6.0	10.5	14.9
Tobacco	22.3	19.5	21.5	22.0	22.9	22.0	9.3	9.4	11.1	12.3	
Other consumer goods	19.4	13.9	12.6	10.5	19.4	18.2	4.3	6.1	3.9	10.5	13.8
Other groups	**14.5**	**12.4**	**12.0**	**10.9**	**14.4**	**17.9**	**3.3**	**4.3**	**4.8**	**7.7**	**13.0**
Chemicals	15.2	9.0	10.0	8.6	13.5	17.2	2.0	2.2	2.7	6.7	10.0
Office equipment	15.8	23.5	19.7	12.6	9.5	9.6	2.9	7.4	3.2	3.4	1.7
Shipping and transport	8.2	9.9	7.8	6.4	10.4	8.9	4.5	2.4	0.8		
Miscellaneous	18.0	15.9	15.5	16.3	18.6	20.5	6.2	8.1	10.5	12.8	16.7
All industrial groups	**17.3**	**13.5**	**13.9**	**13.9**	**16.3**	**18.1**	**5.2**	**6.3**	**7.0**	**9.2**	**11.5**
Oil companies	31.3	27.4	18.2	16.4	19.7	18.7	10.5	4.2	6.2	11.0	10.2
Industrials and oils	**19.5**	**16.6**	**15.0**	**14.6**	**17.3**	**18.3**	**6.4**	**5.8**	**6.8**	**9.7**	**10.9**
Number of companies analysed	*1.219*	*1.771*	*1.729*	*1.605*	*1.446*	*1.181*	*957*	*1.214*	*1.061*	*532*	*161*

not available.

Source: Datastream Limited.

(a) Weighted averages of the pre-interest and pre-tax profit, *excluding* the profit from associated companies and from investments in liquid and other non-trading assets, on closing trading assets.

total capital employed, except in 1984 when the two measures almost coincide. During the years of recession at least, companies generally obtained a better return on their holdings of financial and other non-trading assets than they did on their trading activities. Unless they foresaw improved trading prospects in future, companies thus had an incentive to keep any surplus cash in the form of liquid assets rather than reinvesting it in trading assets. This observation does not, however, apply to the electronics sector; against the general trend, this sector achieved, until 1984 at least, higher returns on its trading activities than on total capital employed.

At first sight, the two series measuring profitability on historical costs appear to contradict the conclusions drawn from the current cost series since, under the historical cost convention, average returns on trading assets have generally been higher than returns on total capital employed. It is likely, however, that this is caused by the known weaknesses of the historical cost convention. While returns on financial assets are generally little different whether stated under the current or historical cost conventions, the profitability of trading activities is flattered by the historical cost convention because this does not adequately provide for the replacement at current costs of physical capital consumed.