Performance of large companies

This article presents updated and revised estimates of company performance derived from the published accounts of large companies.[1] *These statistics complement and supplement the estimates of company performance based on the national accounts.*[2]

The article concludes that, measured by historical cost accounting conventions, overall company profitability continued to improve in 1985, although the rate of improvement appeared to slow down. Unfortunately, the proportion of companies reporting current cost information has fallen to a negligible level and it is therefore no longer possible to report a meaningful current cost measure of profitability.

The article also finds that non-oil companies' capital gearing, which had been on a declining trend, increased in 1984 and remained stable in 1985. Income gearing declined in 1983 and 1984 from the historically high levels seen during 1980-82, but increased marginally in 1985.

This article updates the figures on historical cost profitability reported in the September 1985 *Bulletin* and also reports new estimates of corporate gearing.

The statistics are derived from the published accounts of a changing sample of over 1,500 of the largest UK companies; these accounts are made available in computerised form by Datastream Limited. These companies represent only a small proportion of the total population of companies but nonetheless account for the greater part of the assets and income of the corporate sector. The exact number of companies analysed varies from year to year as new companies are added to the database and existing companies fail or merge. Moreover, because of the time taken by some companies to report their results, the statistics for the most recent year reported in this article (1985) are based on a sample of about two thirds of the total number of Datastream companies, and should therefore be regarded as provisional.

Companies make up their annual accounts to a variety of dates and so no aggregation of their results can correspond precisely to a calendar year. However, because a majority of companies make up their accounts to the end of either December or March, the nearest approximation to calendar years is arrived at by aggregating financial years which end between April of one year and March of the following year; thus the aggregate statistics reported in this article for 1985 include all financial years ending between April 1985 and March 1986.

In comparing the statistics reported here with those based on the national accounts it should be borne in mind that the Datastream statistics cover the reported performance of both domestic and overseas activities of large UK companies, and that unlisted companies have only been included on the database since 1980;[3] in contrast, national accounts data cover UK activities only, but in principle they cover all companies in the industrial and commercial sector. There are also a number of other accounting differences between the two measures.[4]

Previous articles in this series have included measures of performance based on current cost as well as historical cost accounts. However, the number of companies providing current cost accounts has declined to the point where it is no longer meaningful to report the results: while some 70% of those companies analysed in 1981 and 1982 published current cost data, the proportion has fallen to 15% in 1984 and a mere 1% of the companies analysed so far for 1985. As previous articles in this series have shown, current cost accounts have frequently shed a different light on company performance and it is therefore particularly disappointing that so few companies have felt that it is worthwhile continuing to provide this information. The reporting practice of private sector companies is in marked contrast to that which has been recommended for the nationalised industries in a recent report to the Treasury by an advisory group.[5]

Profitability

The rate of return on capital employed in the sample as a whole improved further in 1985 to just over 18%, the continuation of an upward trend which started in 1980 for the capital goods and consumer groups, and in 1982 for the oil and other groups (Chart 1 and Table A).

(1) The previous article in this series was published in the September 1985 *Bulletin*, page 436.
(2) See 'Company profitability and finance': June 1986 *Bulletin*, page 230.
(3) For more details on sources of data see the appendix to the article in the September 1984 *Bulletin*, page 367.
(4) 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.
(5) *Accounting for Economic Costs and Changing Prices*. HM Stationery Office. 1986.

Table A
Rates of return

Per cent

	Return on capital employed(a)							Return on trading assets(b)						
	Average 1970–79	1980	1981	1982	1983	1984	1985	Average 1970–79	1980	1981	1982	1983	1984	1985
Capital goods group	**16.1**	**12.0**	**12.3**	**12.6**	**14.1**	**15.6**	**15.3**	**17.0**	**11.4**	**11.8**	**12.3**	**14.7**	**16.3**	**16.4**
Building materials	16.5	13.6	13.0	12.6	14.4	14.9	14.3	17.0	12.8	12.0	12.4	14.4	14.8	14.0
Contracting and construction	17.2	14.6	14.1	13.3	11.9	13.0	14.3	19.2	15.1	14.8	15.1	13.5	15.5	17.7
Electricals	17.6	14.3	18.0	18.4	18.3	18.5	19.2	19.1	14.0	18.3	20.3	20.1	20.9	19.9
Electronics	21.5	23.7	24.0	24.4	23.9	23.8	18.2	26.8	26.5	31.3	32.1	32.5	28.1	21.3
Mechanical engineering	15.8	11.9	11.5	9.5	11.0	13.1	13.9	16.5	11.7	11.1	8.5	10.6	13.3	14.8
Metals and metal forming	14.9	10.4	8.5	9.2	11.0	13.9	16.6	15.6	9.8	7.9	8.9	11.7	14.7	17.8
Motor components and distribution	12.0	2.6	3.1	6.0	9.5	10.1	10.8	11.8	0.4	0.8	3.3	7.7	8.0	10.8
Other industrial materials	17.3	15.6	15.3	13.7	14.4	18.9	20.7	17.6	15.6	15.1	14.0	16.0	20.7	22.5
Consumer group	**17.0**	**15.3**	**15.9**	**15.8**	**17.2**	**17.6**	**18.0**	**18.6**	**15.6**	**16.3**	**16.2**	**18.0**	**18.7**	**19.4**
Brewers and distillers	14.7	12.8	12.8	14.0	14.2	14.5	13.6	15.4	12.7	12.9	14.3	14.4	14.9	13.8
Food manufacturing	16.7	16.4	17.2	16.6	17.1	17.1	17.8	18.3	16.6	17.8	16.8	18.0	18.1	19.3
Food retailing	22.9	21.5	20.5	21.1	22.8	23.6	22.0	25.0	21.7	22.2	23.1	25.0	24.8	23.2
Health and household products	24.3	20.4	23.8	24.6	25.5	25.6	30.9	27.0	21.7	25.7	26.7	29.2	28.7	37.0
Leisure	17.6	15.2	14.4	13.9	14.4	13.5	14.0	19.1	15.7	15.0	14.6	15.2	14.6	15.5
Newspapers and publishing	20.8	14.2	16.5	14.0	18.6	17.7	14.6	23.3	12.6	17.1	13.8	21.6	27.6	26.3
Packaging and paper	15.1	13.7	14.2	12.6	13.9	17.0	18.4	16.0	13.6	14.2	12.7	14.4	18.0	20.5
Stores	19.0	15.2	13.5	12.8	15.8	17.9	18.5	20.3	15.9	13.9	13.1	16.7	19.2	19.5
Textiles	14.6	10.4	13.8	14.1	16.5	17.1	19.3	15.2	10.0	14.0	14.8	18.5	18.9	22.0
Tobacco	17.6	18.2	20.9	21.1	21.7	20.1	19.2	22.3	19.5	21.5	22.0	23.1	21.2	20.0
Other consumer goods	17.9	13.9	13.1	11.5	15.2	13.6	16.2	19.4	13.9	12.6	10.7	15.2	13.7	16.3
Other groups	**14.6**	**13.2**	**12.5**	**11.4**	**14.0**	**16.7**	**18.0**	**14.5**	**12.4**	**12.0**	**10.8**	**14.3**	**17.8**	**20.1**
Chemicals	15.1	9.9	10.6	9.6	13.6	16.8	17.1	15.2	9.0	10.0	8.6	13.7	17.7	17.8
Office equipment	21.0	22.8	19.0	13.9	12.3	13.5	16.3	15.8	23.5	19.7	12.6	9.5	9.5	14.0
Shipping and transport	9.3	11.4	9.4	7.8	10.5	10.2	11.3	8.2	9.9	7.8	5.8	10.3	9.1	10.8
Miscellaneous	16.5	15.5	14.8	14.9	16.2	18.4	19.8	18.0	15.9	15.5	16.2	17.6	20.0	23.1
All industrial groups	**16.3**	**13.7**	**14.0**	**13.9**	**15.5**	**16.8**	**17.3**	**17.3**	**13.4**	**13.9**	**13.9**	**16.3**	**17.7**	**18.8**
Oil companies	27.6	26.6	19.2	17.3	19.6	20.0	21.1	31.3	27.4	18.2	16.0	19.2	20.1	20.2
Industrials and oils	**18.3**	**16.7**	**15.3**	**14.8**	**16.6**	**17.6**	**18.2**	**19.5**	**16.6**	**15.0**	**14.5**	**17.1**	**18.3**	**19.1**
Number of companies analysed	*1,219*	*1,765*	*1,729*	*1,683*	*1,638*	*1,574*	*1,187*	*1,219*	*1,765*	*1,729*	*1,683*	*1,638*	*1,574*	*1,187*

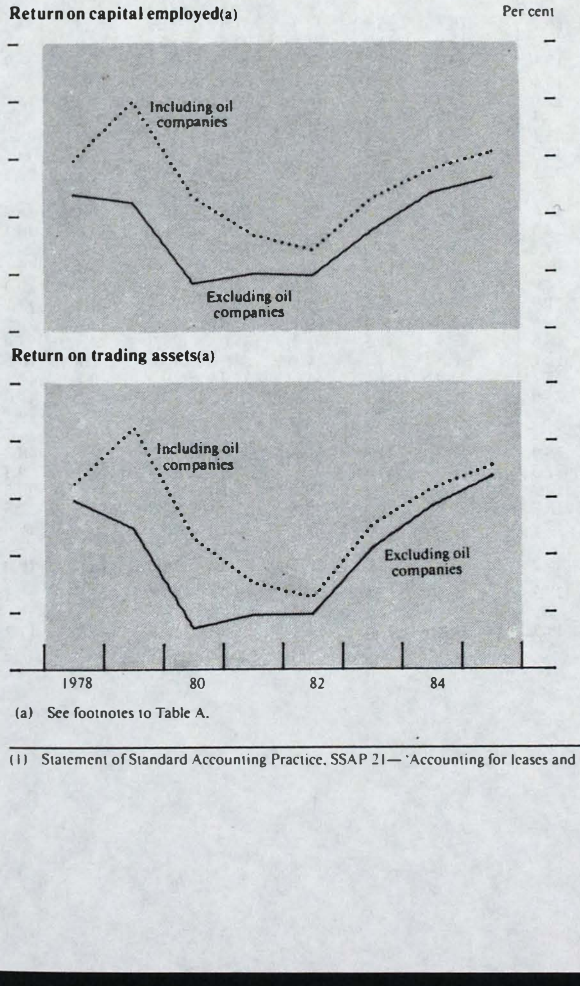
Source: Datastream Limited.

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

(b) Weighted averages of the historical cost profit before interest and tax, *excluding* the profit from associated companies and investments in liquid and other non-trading assets, on closing tradingassets.

However there are signs that the rate of recovery of non-oil companies is slowing: the overall increase in profitability was smaller in 1985 than in the previous two years, while profitability in the capital goods sector appeared to fall slightly. All these trends may be distorted to the extent that reported capital employed will have been increased as companies have begun to implement the accounting standard on leasing; this will make capitalisation of all finance leases mandatory from next year.(1)

Chart 1
Profitability



(a) See footnotes to Table A.

A similar pattern is shown by the profitability of non-oil companies' trading activities. As in the past two years, the return on trading assets in 1985 was higher than that on total capital employed. However, as discussed in last year's article, this may be a distortion caused by the inadequacies of historical cost accounts; when available, current cost accounts have typically shown the reverse, namely that the current cost return on trading assets was lower than that on total capital employed. The historical cost convention inflates the return on trading activities by not providing adequately for the replacement at current cost of physical capital consumed.

Gearing

There has been some debate recently about what has happened to the proportion of debt in companies' balance sheets. Data drawn from national accounts suggest that corporate gearing has been increasing since 1980 while some commentators have suggested that gearing has been flat or declining. The differences are likely to arise both from the definition of gearing and from the companies

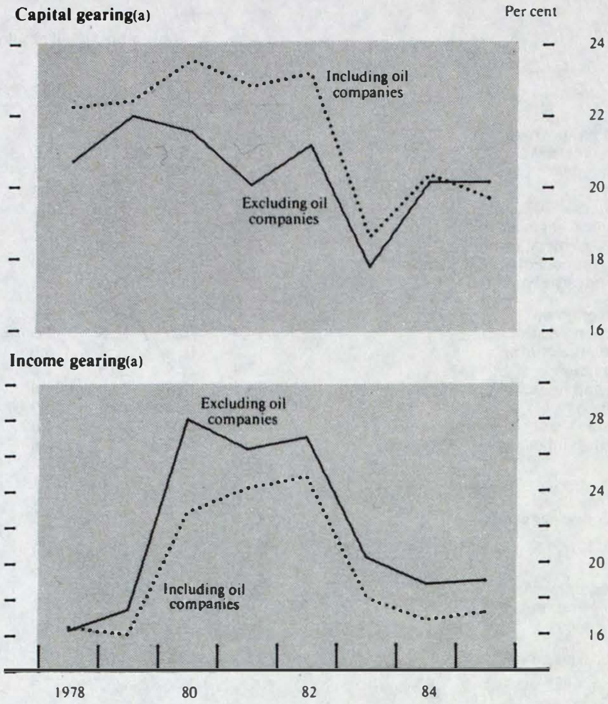
(1) Statement of Standard Accounting Practice, SSAP 21— 'Accounting for leases and hire purchase contracts'.

analysed; in particular it should be noted that the national accounts do not include the overseas operations of UK companies.

Chart 2 and Table B suggest that the percentage of net debt in total capital employed for non-oil companies has declined slightly since 1979, when it was 22%. Again, the capitalisation of finance leases as SSAP 21 comes into force may have distorted these results, although this distortion will have been offset to some extent by what appears to be the growing use of other devices to keep debt off companies' balance sheets. The decline was only evident until 1983, when gearing fell to about 18%: in 1984 gearing climbed back up to just over 20%, and remained at that level in 1985. For the non-oil groups, therefore, the overall change in gearing in recent years does not seem to have been particularly significant and the slight downward trend may now have disappeared. Nevertheless, at 20%, gearing is now significantly lower than the average during the 1970s.

Perhaps more interesting is the behaviour of income gearing—that is the proportion of profits absorbed by interest charges. Measures of income gearing avoid the distortions to capital gearing caused by year-end balance sheet window dressing or by seasonal factors which cause debt to vary. With the onset of recession, income gearing for non-oil companies rose sharply from 17% in 1979 (the average during the 1970s) to 28% in 1980, and remained high in 1981 and 1982. The ratio fell sharply in 1983, with a further decline in 1984 to just under 19%, as a result of improving profits, lower capital gearing and falling interest rates. However, there was a slight reversal in 1985, with income gearing rising, albeit marginally.

Chart 2
Gearing



(a) See footnotes to Table B.

Table B
Gearing
Per cent

	Capital gearing(a)							Income gearing(b)						
	Average 1970–79	1980	1981	1982	1983	1984	1985	Average 1970–79	1980	1981	1982	1983	1984	1985
Capital goods group	**23.7**	**20.6**	**18.5**	**18.7**	**15.1**	**16.2**	**18.4**	**18.6**	**35.9**	**32.7**	**31.9**	**22.9**	**20.3**	**23.3**
Building materials	22.0	15.1	16.7	18.1	18.0	17.5	19.3	15.9	21.7	21.9	21.5	17.4	18.0	19.3
Contracting and construction	24.5	18.3	11.6	9.7	11.4	12.9	13.1	19.2	27.2	24.8	25.2	23.1	21.3	23.9
Electricals	23.3	22.8	19.7	15.1	9.4	14.9	14.1	16.3	30.1	22.3	23.5	18.4	20.0	23.0
Electronics	10.3	5.6	−13.3	−14.1	−18.2	1.4	13.6	12.8	16.7	14.0	10.1	7.6	8.3	18.0
Mechanical engineering	21.2	17.2	15.6	17.3	13.6	12.0	7.3	16.9	31.9	32.6	42.6	29.8	24.1	20.8
Metals and metal forming	23.3	22.7	23.2	27.9	24.1	27.1	25.1	18.1	41.1	45.6	45.9	35.0	26.9	25.0
Motor components and distributors	34.6	32.8	35.9	37.1	30.5	25.6	32.9	37.9	235.4	197.7	105.1	52.2	44.4	44.4
Other industrial materials	25.2	24.1	27.7	30.6	29.9	27.1	27.5	16.7	26.8	28.3	35.6	24.2	20.7	22.5
Consumer group	**24.2**	**20.4**	**19.0**	**19.3**	**16.2**	**19.2**	**19.6**	**15.6**	**23.3**	**21.3**	**21.5**	**16.6**	**16.4**	**16.7**
Brewers and distillers	30.3	21.4	23.6	21.0	20.0	22.2	22.6	19.1	23.0	23.7	25.1	18.8	18.6	20.5
Food manufacturing	21.3	22.3	21.4	22.1	20.3	23.9	21.7	15.8	24.6	21.6	23.0	21.2	20.8	20.3
Food retailing	0.2	13.0	5.6	2.9	4.9	12.2	10.0	3.5	12.2	8.3	8.6	6.3	6.4	6.4
Health and household products	26.1	21.9	17.9	19.5	6.3	11.7	14.9	10.7	19.6	15.5	13.7	12.3	12.2	10.3
Leisure	31.9	23.8	22.1	27.3	26.6	23.7	21.9	17.1	27.8	25.9	26.1	20.8	21.1	17.7
Newspapers and publishing	14.1	12.6	14.4	14.7	11.9	7.9	34.5	11.4	21.9	20.1	23.6	13.9	12.4	16.9
Packaging and paper	35.5	26.9	27.5	27.5	24.7	20.9	18.6	23.9	31.5	31.3	35.0	28.9	22.9	21.4
Stores	11.1	8.1	7.2	9.9	5.9	4.5	12.1	8.8	14.9	14.7	17.0	10.8	9.6	10.6
Textiles	28.5	24.8	23.0	19.0	12.4	14.7	7.1	22.9	49.6	36.0	31.3	19.9	19.2	17.3
Tobacco	26.5	28.4	20.8	21.9	16.2	25.9	23.0	15.3	21.3	19.7	17.6	12.5	15.2	19.0
Other consumer goods	12.9	12.9	10.6	11.9	7.2	7.9	11.7	13.8	29.2	23.0	24.1	12.7	14.0	19.3
Other groups	**28.2**	**28.3**	**26.4**	**28.3**	**24.3**	**24.8**	**18.9**	**19.2**	**31.5**	**31.7**	**35.4**	**25.7**	**20.7**	**18.8**
Chemicals	25.9	30.1	29.3	29.9	24.3	22.8	22.3	18.0	37.8	36.8	39.9	24.3	18.0	19.5
Office equipment	32.1	18.5	18.9	23.5	24.6	23.4	12.2	13.9	13.1	16.4	27.1	27.6	25.3	20.8
Shipping and transport	31.8	32.8	30.8	34.3	25.9	25.5	18.7	29.4	39.0	40.4	53.2	37.3	28.8	22.8
Miscellaneous	27.4	26.0	22.2	24.2	23.5	26.0	17.9	18.7	31.5	29.6	29.1	23.8	20.8	18.0
All industrial groups	**24.6**	**21.6**	**20.1**	**21.2**	**17.8**	**20.2**	**20.2**	**17.1**	**28.0**	**26.3**	**27.0**	**20.3**	**18.8**	**19.0**
Oil companies	22.4	30.3	30.9	28.9	20.9	21.0	18.2	8.5	13.6	19.4	19.7	13.0	11.5	12.3
Industrials and oils	**24.3**	**23.6**	**22.8**	**23.2**	**18.6**	**20.4**	**19.7**	**14.7**	**22.9**	**24.2**	**24.8**	**18.0**	**16.8**	**17.2**
Number of companies analysed	*1,219*	*1,768*	*1,732*	*1,686*	*1,641*	*1,577*	*1,189*	*1,219*	*1,768*	*1,730*	*1,685*	*1,640*	*1,576*	*1,188*

Source: Datastream Limited.

(a) Total debt (less cash and equivalent) as a percentage of capital employed (historical cost, end-period measure).

(b) Interest charge as a percentage of historical cost profit before interest and tax.