Performance of large companies

This article updates and revises estimates of company performance[1] drawn from the published accounts of a sample of the largest UK companies, and is intended to complement and supplement estimates based on national accounts data.[2]

The article concludes that, measured on the conventional historical cost basis, the performance of large non-oil companies continued to improve in 1986. The oil and gas sector, however, showed a significant decline and this has led to a downturn in the performance of the sample overall. The improving trend, particularly in some service sectors, may have been enhanced by the increased incidence of goodwill which is discounted in the definitions of profitability used in this article. It remains impossible to produce meaningful analyses of performance on a current cost basis as so few companies now trouble to report on that basis.

This article updates the figures on historical cost profitability reported in the September 1985 and September 1986 *Bulletins.*

The statistics are derived from the published accounts of a changing sample of over 1,700 of the largest UK companies, mainly listed but, since 1980, including some 300 unlisted companies. These accounts are made available in a computerised form by Datastream Limited. These companies represent only a small proportion by number of the total population of companies but some three quarters in terms of assets and income; their exact number varies as new companies are added to the database and existing companies fail or merge. Because of the delay in the submission by some companies of their latest annual accounts, the statistics for the most recent year (1986) are again based on a sample of about two thirds of the total number of companies on the Datastream database and should, therefore, be regarded as provisional.[3]

When comparing these figures with national accounts data, it is important to bear in mind that the Datastream statistics cover both domestic and overseas activities of large UK companies: in contrast, national accounts data cover UK activities only—but in principle cover all companies in the industrial and commercial sector.[4]

As reported last year, so few companies now furnish current cost accounts that reporting this measure of performance would be of little value. It remains disappointing that this should be so, given the different and often more illuminating light which current cost accounts have in the past frequently shed on companies' performance. The DTI are redeveloping a method of estimating real rates of return on a current cost basis at an industry level and hope to publish some numbers in *British Business* next year. This method was developed by the Bank and described in a ***Discussion paper*** which included estimates of sectoral profitabilities for the years 1961–77.[5]

The industrial classification of companies used follows the recent changes made in the FT-Actuaries all-share index. In particular, companies in the old tobacco and office equipment sectors are now included in miscellaneous, while three new sectors, agencies, conglomerates and telephone networks, have been separated out from the old miscellaneous sector. Other sectors remain largely unchanged.

Profitability: return on capital employed

The rate of return on capital employed (that is, profitability on both trading and non-trading activities) for the sample as a whole fell to just over 16% in 1986, reversing the improvement to over 18% the previous year (Table A). The major determinant was the halving of profitability in the oil and gas sector, which is heavily weighted in the mean figures: a hardly surprising development in view of the fall in the oil price over the period and the inevitable knock-on effects. On the other hand, for the non-oil industrial groups, average profitabilities continued to improve in general.

There are one or two other noteworthy developments. Agencies (including advertising agencies and estate agencies) show, on the face of it, good and sharply rising profitability. Many companies in this sector have grown

(1) The previous article in this series was published in the September 1986 *Bulletin*, page 390.
(2) See 'Company profitability and finance' in the August 1987 *Bulletin*, pages 386-91.
(3) The statistics reported for a calendar year include all companies whose financial years end between April of that year and March of the next. (Thus '1986' means all financial years ending between April 1986 and March 1987.)
(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) 'Influences on the profitability of twenty-two industrial sectors' by N P Williams (Bank of England ***Discussion paper*** No 15, March 1981).

Table A
Return on capital employed[(a)]

Per cent

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Capital goods group	**17.6**	**16.5**	**15.8**	**18.3**	**17.7**	**16.9**	**15.8**	**12.0**	**12.3**	**12.5**	**13.9**	**15.4**	**16.1**	**16.7**
Building materials	19.2	13.4	15.8	17.4	17.0	17.4	17.2	13.6	12.9	12.5	14.3	14.9	14.5	17.8
Contracting and construction	18.1	17.2	16.6	17.7	18.2	17.5	16.1	14.6	14.1	13.3	11.8	12.6	13.7	15.4
Electricals	19.0	16.8	16.4	18.7	17.2	18.6	16.7	14.3	18.0	18.4	18.2	18.5	18.6	19.1
Electronics	22.2	20.3	21.3	24.6	26.0	24.9	26.1	23.7	24.0	24.4	23.8	23.5	20.4	18.4
Mechanical engineering	16.5	17.5	17.1	18.7	18.0	17.0	14.7	11.9	11.5	9.5	11.0	13.1	14.1	15.5
Metals and metal forming	16.4	19.2	14.1	15.3	14.4	13.7	14.3	10.4	8.5	9.2	11.0	13.9	16.0	17.1
Motors	13.5	11.2	9.1	16.3	13.7	12.2	8.6	2.5	3.2	5.7	9.3	9.7	11.4	6.3
Other industrial materials	19.5	18.5	17.0	19.1	19.1	17.1	16.9	15.6	15.3	13.7	14.4	18.9	20.5	22.4
Consumer goods group	**18.5**	**16.8**	**15.6**	**18.1**	**18.0**	**17.5**	**17.0**	**14.9**	**15.2**	**15.2**	**16.5**	**17.0**	**17.4**	**18.1**
Brewers and distillers	15.3	12.6	13.3	14.9	15.7	15.6	15.3	12.8	12.8	14.1	14.2	14.5	13.5	14.5
Food manufacturing	18.1	17.4	16.6	19.4	17.4	17.0	16.8	16.3	17.1	16.5	17.1	17.1	17.7	15.2
Food retailing	20.5	18.0	18.8	22.1	22.0	19.8	19.5	21.5	20.5	21.0	22.7	23.6	22.5	23.4
Health and household products	24.4	24.4	25.4	27.6	27.2	23.7	21.4	20.4	23.8	24.6	25.0	25.6	30.1	30.3
Leisure	19.1	16.3	16.9	19.2	19.8	17.8	16.3	15.2	14.4	13.9	14.4	13.5	14.5	15.0
Packaging and paper	16.7	19.4	13.2	15.8	16.6	16.6	17.3	13.7	14.1	12.5	14.0	16.5	18.3	20.5
Printing and publishing	24.2	18.3	18.1	20.8	22.3	23.7	24.1	14.2	16.5	14.0	18.5	17.1	13.9	17.5
Stores	20.5	17.4	17.4	18.4	18.9	19.0	18.3	15.2	13.5	12.8	15.7	17.3	17.3	21.6
Textiles	19.4	16.6	10.7	15.4	15.1	15.2	14.1	10.4	13.8	14.1	16.5	17.0	18.8	21.4
Other groups	**16.2**	**17.1**	**15.0**	**17.0**	**16.8**	**15.3**	**16.4**	**14.2**	**14.2**	**13.6**	**15.7**	**17.3**	**18.1**	**18.6**
Agencies	19.0	16.4	14.1	23.1	28.1	23.0	23.1	21.7	18.1	18.0	26.3	32.6	34.2	39.0
Chemicals	16.8	21.3	15.6	18.4	16.6	13.1	14.8	9.9	10.6	9.7	13.7	17.0	16.9	18.1
Conglomerates	14.8	14.4	13.7	16.1	19.4	19.4	18.4	16.9	16.3	15.6	15.9	17.6	17.7	16.0
Shipping and transport	10.4	11.8	8.8	10.7	9.7	9.0	11.1	11.4	9.3	8.0	10.2	11.0	12.3	8.6
Telephone networks	—	—	—	—	—	—	—	—	21.4	18.3	22.5	18.4	19.5	21.3
Miscellaneous	18.5	17.5	17.6	18.6	18.5	17.8	18.4	17.3	17.5	17.1	17.9	17.9	18.5	20.4
All industrial groups	**17.6**	**16.8**	**15.5**	**17.9**	**17.6**	**16.7**	**16.5**	**13.6**	**13.9**	**13.8**	**15.4**	**16.6**	**17.3**	**17.9**
Oil and gas	28.0	45.7	29.4	29.0	29.4	22.9	34.3	27.5	20.1	17.7	18.9	20.0	21.0	10.0
Industrials and oils	**19.4**	**21.9**	**18.0**	**19.8**	**19.6**	**17.9**	**20.0**	**16.6**	**15.4**	**14.8**	**16.3**	**17.5**	**18.1**	**16.3**
Number of companies analysed	*1,297*	*1,323*	*1,325*	*1,327*	*1,335*	*1,347*	*1,454*	*1,754*	*1,736*	*1,722*	*1,722*	*1,716*	*1,478*	*1,184*

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 excluding intangibles.

rapidly by acquisition and because the substantial sums of goodwill involved in the acquisitions are excluded from the measure of capital employed, with no corresponding reduction in the profits measure, the profitability ratios tend to be greatly inflated.

Profitability in food manufacturing appears to have fallen; however, this is a misleading consequence of a major acquisition by one company close to its year-end which inflated capital employed but without bringing in any of the profits associated with the acquisition. Adjusting

Table B
Return on trading assets

Per cent

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Capital goods group	**18.8**	**16.5**	**16.4**	**19.5**	**19.0**	**18.1**	**16.1**	**11.4**	**11.7**	**12.2**	**14.6**	**16.2**	**17.5**	**18.7**
Building materials	20.0	13.0	16.4	18.0	17.6	17.9	17.1	12.8	12.0	12.4	14.3	14.8	14.2	18.4
Contracting and construction	20.4	18.2	19.1	20.6	20.7	19.8	16.8	15.1	14.8	15.1	13.3	15.0	16.3	19.5
Electricals	20.8	17.5	17.3	20.5	19.0	19.0	16.6	14.0	18.3	20.3	20.0	20.8	20.3	20.7
Electronics	27.0	21.4	25.2	32.8	36.5	34.9	31.9	26.5	31.3	32.1	32.2	27.9	25.7	23.9
Mechanical engineering	17.3	17.3	17.4	19.2	19.3	18.5	15.5	11.6	11.2	8.5	10.6	13.4	14.6	17.2
Metals and metal forming	18.0	20.4	15.1	16.2	14.9	13.9	14.1	9.8	7.8	8.9	11.7	14.6	16.9	18.8
Motors	13.9	10.3	8.3	16.5	13.8	12.1	8.0	0.3	1.0	3.2	7.6	7.8	11.3	5.5
Other industrial materials	19.5	18.4	17.3	19.3	19.9	17.9	17.0	15.6	15.1	14.0	15.9	20.7	22.4	23.2
Consumer goods group	**20.2**	**17.6**	**16.6**	**19.6**	**19.5**	**18.7**	**17.7**	**15.2**	**15.7**	**15.6**	**17.4**	**18.2**	**18.8**	**21.5**
Brewers and distillers	16.5	12.8	13.5	15.7	16.4	16.2	15.6	12.7	12.9	14.4	14.4	14.9	13.8	14.9
Food manufacturing	20.1	18.6	18.4	22.0	19.6	18.0	17.4	16.6	17.7	16.7	17.9	18.1	19.0	21.7
Food retailing	22.1	19.2	20.5	24.2	23.8	21.8	20.5	21.7	22.2	23.0	24.9	24.8	23.6	23.4
Health and household products	27.2	25.7	28.0	32.5	31.0	27.4	22.2	21.7	25.7	26.7	28.6	28.4	35.3	41.7
Leisure	20.6	17.0	18.0	21.4	22.1	19.7	17.3	15.7	15.0	14.6	15.1	14.6	15.5	16.1
Packaging and paper	18.2	20.9	13.9	16.6	17.4	17.9	18.0	13.6	14.1	12.5	14.6	17.5	20.2	24.2
Printing and publishing	29.2	19.3	20.0	23.3	25.9	26.7	26.2	12.6	17.1	13.8	21.6	25.7	23.8	37.0
Stores	21.7	18.4	18.6	19.4	20.5	20.4	19.2	15.9	13.9	13.1	16.5	18.3	17.9	23.0
Textiles	21.3	17.1	10.9	15.7	15.7	15.7	14.4	10.0	14.0	14.8	18.5	18.7	21.5	25.0
Other groups	**17.5**	**17.4**	**15.7**	**19.0**	**18.1**	**16.3**	**16.7**	**13.9**	**13.9**	**13.3**	**16.3**	**18.2**	**19.7**	**20.8**
Agencies	20.0	16.9	14.8	27.2	42.6	30.7	28.8	29.9	24.8	32.7	50.0	65.5	71.1	93.9
Chemicals	17.3	21.5	15.3	20.4	17.8	13.1	14.5	9.0	10.0	8.7	14.0	17.9	17.5	18.3
Conglomerates	13.8	13.3	13.4	16.7	18.1	19.3	17.4	15.7	16.7	15.9	18.0	18.4	22.7	15.9
Shipping and transport	9.7	9.7	7.2	9.4	7.8	7.7	9.4	9.9	7.6	6.0	9.6	10.1	12.3	11.4
Telephone networks	—	—	—	—	—	—	—	—	35.2	34.4	26.4	19.7	21.2	23.2
Miscellaneous	22.1	19.0	20.4	22.4	21.9	20.8	20.3	18.1	17.8	17.4	18.4	18.1	19.2	23.7
All industrial groups	**19.1**	**17.2**	**16.3**	**19.4**	**19.0**	**17.9**	**16.9**	**13.4**	**13.9**	**13.9**	**16.2**	**17.6**	**18.7**	**20.5**
Oil and gas	34.8	55.5	31.3	28.8	26.0	21.0	35.9	28.6	19.0	16.3	18.3	20.0	20.2	7.7
Industrials and oils	**21.3**	**22.7**	**18.7**	**20.9**	**20.1**	**18.5**	**20.4**	**16.5**	**15.1**	**14.5**	**16.7**	**18.2**	**19.0**	**17.8**
Number of companies analysed	*1,297*	*1,323*	*1,325*	*1,327*	*1,335*	*1,347*	*1,454*	*1,754*	*1,736*	*1,722*	*1,722*	*1,716*	*1,478*	*1,184*

Source: Datastream Limited.

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

for this, the underlying performance of the food manufacturing sector continued to improve, as indicated by the return on trading assets in Table B. Another sector of interest is motors where profitability fell by almost a half, largely as a result of heavy losses by one major constituent company. Shipping and transport also experienced a significant downturn, again reflecting depressed performance by major companies which modest recovery by many at the other end of the scale could do little to offset.

A separate analysis of UK companies' accounts is published annually by the DTI.[1] An analysis of their latest data, which was summarised in *British Business* on 11 September 1987, includes only provisional figures up to 1985 but similarly concludes that, until then, overall profitability continued to improve. However, the absolute values estimated by the DTI are somewhat lower, probably reflecting definitional differences.

Return on trading assets

The figures here tell a similar story, with improvements in the ratios for all aggregations excluding the oil and gas sector: when oil and gas is included there is an overall fall (Table B). Of the other individual sectors, motors experienced the most marked fall. On the other hand, there were sharp rises in profitability for agencies, health and household products, and printing and publishing. In the case of agencies in particular, this is a somewhat anomalous consequence of the fact that several major constitutent companies have been trading profitably on a trading asset base which, after the elimination of goodwill, is very small or, in some cases, negative. Clearly, for the purposes of assessing company performance based on estimates of profitability, the presently allowed practice of eliminating goodwill from balance sheets with no corresponding effect on profits must be called into question.

(1) *Business Monitor MA3*, eighteenth issue.