Performance of large companies

This article updates and revises estimates of company performance[1] taken 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 companies continued to improve in 1987. The exceptional improvements in some sectors may have been exaggerated by accounting practices which reduce capital employed without a corresponding reduction in profits, such as the increased incidence of goodwill written off following acquisitions and the increased use of off-balance-sheet finance.

It remains impossible to produce meaningful analysis on a current cost basis as so few companies now report on that basis.

This article updates the figures on historical cost profitability reported in the September 1985, September 1986 and November 1987 *Bulletins.*

The statistics are derived from the published accounts of a changing sample of 1700 of the largest UK companies, mainly listed but, since 1980, including some 400 unquoted companies and around 50 USM companies. These accounts are made available in a computerised form by Datastream Limited. The 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. Moreover, because of the delay in the submission by some companies of their latest annual accounts, the statistics for the most recent year (1987) are based upon a sample of about three quarters of the total number of companies on the Datastream database, and should therefore be regarded as provisional.

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 '1987' means all financial years ending between April 1987 and March 1988.)

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 UK companies: in contrast, national accounts data cover UK activities only but in principle cover all companies in the industrial and commercial sector.[3][4]

As has been the case in the previous two years, so few companies now furnish current cost accounts that reporting this measure of performance would be of little value. It is disappointing that this is the case, given the different and often more illuminating light which current cost accounts have in the past shed on companies' performance. The DTI's most recent estimates (based on national accounts data) are that the net rate of return on capital employed for all industrial and commercial companies rose from 10% in 1986 to about 11.5% in 1987. It should, however, be noted that these figures are provisional.

The industrial classification of companies follows the classification used in the FT-Actuaries all-share index. As noted last year, companies which used to be in the old tobacco and office equipment sectors were reclassified as miscellaneous, while three new sectors (agencies, conglomerates and telephone networks) were separated out from the old miscellaneous sector. Other sectors were left 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 has increased to just over 19% (Table A), suggesting that the 1986 reversal in the previous trend was only a temporary setback. The oil and gas sector, which is heavily weighted in the mean figures, has recovered slightly, but the increase in profitability also reflects a general improvement in the non-oil industrial groups. Indeed, it should be noted that the result for all industrial groups excluding oil and gas was at the highest level recorded in the fourteen years covered by the current survey and, indeed, higher than at any time since 1970, the first year for which the exercise was performed.

(1) The previous article in this series was published in the November 1987 *Bulletin*, page 556.
(2) See 'Company profitability and finance' in the August 1988 *Bulletin*, page 356.
(3) 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.
(4) In this context, see also 'Trends in real rates of return', in the August 1988 *Bulletin*, pages 376–81.

Table A
Return on capital employed[a]
Per cent

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Capital goods group	**16.5**	**15.8**	**18.3**	**17.7**	**16.9**	**15.8**	**12.3**	**12.6**	**13.0**	**14.3**	**15.6**	**15.9**	**16.4**	**18.9**
Building materials	13.5	16.0	17.7	17.2	17.7	17.3	13.6	13.0	12.9	14.8	15.2	14.7	18.1	20.7
Contracting and construction	17.2	16.6	17.7	18.2	17.5	16.1	14.6	14.1	13.3	11.9	12.7	13.5	15.3	16.7
Electricals	16.8	16.4	18.7	17.2	18.6	16.7	14.3	18.0	18.4	18.2	18.5	19.0	19.0	19.8
Electronics	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	19.5
Mechanical engineering	17.5	17.1	18.7	18.0	17.0	14.7	12.8	12.0	11.0	12.7	13.5	14.1	15.1	16.2
Metals and metal forming	19.2	14.1	15.3	14.4	13.7	14.3	10.3	8.3	9.1	10.9	13.8	15.6	16.8	19.9
Motors	11.2	9.1	16.3	13.7	12.2	8.6	3.0	4.1	6.2	9.2	9.6	11.4	7.8	15.8
Other industrial materials	18.5	17.0	19.1	19.1	17.1	16.9	15.6	15.3	13.7	14.4	18.9	20.2	22.2	24.2
Consumer goods group	**16.8**	**15.5**	**18.0**	**17.9**	**17.4**	**16.9**	**15.0**	**15.3**	**15.3**	**16.6**	**17.1**	**17.7**	**18.0**	**19.9**
Brewers and distillers	12.6	13.3	14.9	15.7	15.6	15.3	12.8	12.8	14.1	14.2	14.5	13.6	14.5	15.8
Food manufacturing	17.4	16.6	19.4	17.4	17.0	16.8	16.3	17.1	16.5	17.0	17.1	17.6	15.4	20.3
Food retailing	18.0	18.8	22.1	22.0	19.8	19.5	21.5	20.5	21.1	22.7	23.6	22.4	23.3	21.9
Health and household products	24.4	25.4	27.6	27.2	23.7	21.4	20.4	23.8	24.5	25.0	25.6	29.6	29.9	32.1
Leisure	16.3	16.9	19.2	19.8	17.8	16.3	15.2	14.4	13.9	14.4	13.5	14.1	15.2	15.5
Packaging and paper	19.3	13.1	15.6	16.3	16.4	17.7	13.8	14.3	13.1	15.3	17.4	19.6	21.6	19.9
Printing and publishing	18.3	18.1	20.8	22.3	23.7	24.1	14.2	16.5	14.0	18.5	17.1	14.0	17.5	15.4
Stores	17.3	17.4	18.4	18.9	19.0	18.4	15.2	13.5	12.8	15.7	17.3	17.4	19.8	21.0
Textiles	16.7	10.7	15.4	15.2	15.3	14.2	10.5	13.8	14.2	16.5	17.1	18.8	21.1	22.8
Other groups	**17.6**	**15.2**	**17.1**	**16.3**	**14.6**	**16.0**	**13.8**	**13.8**	**13.2**	**15.4**	**16.7**	**17.0**	**17.3**	**20.4**
Agencies	16.4	14.1	23.1	28.1	23.0	23.1	21.7	18.2	18.0	26.3	32.6	34.2	38.5	48.1
Chemicals	21.3	15.6	18.4	16.6	13.1	14.8	9.9	10.7	9.7	13.7	17.0	16.9	17.9	22.9
Conglomerates	14.9	14.4	16.9	20.0	20.5	19.3	17.6	16.4	15.7	15.9	17.6	17.8	16.0	20.8
Shipping and transport	11.8	8.8	10.7	9.7	9.0	11.1	11.3	9.3	8.0	10.1	11.0	12.2	10.5	13.0
Telephone networks	—	—	—	—	—	—	—	21.4	18.3	22.5	18.4	19.5	21.3	21.5
Miscellaneous	17.5	17.7	18.7	18.5	17.8	18.4	17.3	17.6	17.2	18.0	17.9	18.4	19.7	22.5
All industrial groups	**16.8**	**15.5**	**17.9**	**17.6**	**16.8**	**16.5**	**13.8**	**14.1**	**14.1**	**15.6**	**16.7**	**17.2**	**17.7**	**20.0**
Oil and gas	45.7	29.4	29.0	29.4	22.9	34.4	27.5	20.1	17.7	18.9	20.0	22.6	13.1	16.3
Industrials and oils	**21.9**	**18.0**	**19.9**	**19.6**	**18.0**	**20.0**	**16.8**	**15.5**	**15.0**	**16.5**	**17.5**	**18.4**	**16.7**	**19.2**
Number of companies analysed	*1,306*	*1,308*	*1,310*	*1,318*	*1,330*	*1,432*	*1,724*	*1,711*	*1,700*	*1,708*	*1,717*	*1,608*	*1,497*	*1,245*

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.

Sectors showing marked rises in profitability include agencies (including advertising agencies and estate agencies), which have shown good and sharply rising profitability. However, many companies in this sector have grown rapidly by acquisition; 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.

Other sectors which show marked increases in profitability are building materials, which shows a three percentage point increase, almost certainly reflecting the buoyant conditions in the construction industry, and chemicals, which shows a five percentage point increase. The motors sector, which shows an eight percentage point increase in profitability, to some extent reflects the recovery of the one major company which had contributed massively to the fall in profitability for the sector last year, but also shows an encouraging increase in return on capital employed for most of the other companies within the sector.

Return on trading assets

The figures for return on trading assets tell a similar story to those for return on capital employed, with improvements in the ratios for all aggregations (Table B). Again, the figure for all industrial groups excluding oil and gas stands at the highest level in the survey period. The motor sector—which had the most marked fall last year—has recovered by twelve percentage points: the reason for this was partly the recovery of one major company but it also reflects an improved return on trading assets for most companies in the sector.

There were sharp rises in profitability for agencies, health and household products and chemicals. As mentioned earlier, in the case of agencies this is, to a large extent, the consequence of takeover activity and subsequent writing-off of goodwill straight to reserves, leaving a very small trading asset base.

As indicated last year, meaningful comparisons of the relative performance of different companies and sectors is made more difficult because of the different accounting practices which are currently permitted and which may have a significant effect on reported profitability. In particular, methods of accounting for mergers and acquisitions, for goodwill and for off-balance-sheet finance may lead to a lack of direct comparability. These are all areas which are currently under review by the Accounting Standards Committee.

Table B
Return on trading assets[a]
Per cent

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Capital goods group	**16.5**	**16.5**	**19.5**	**19.1**	**18.1**	**16.2**	**11.8**	**12.1**	**12.9**	**15.2**	**16.4**	**16.9**	**18.0**	**22.3**
Building materials	13.1	16.5	18.3	17.9	18.3	17.3	12.9	12.1	12.8	14.8	15.1	14.4	18.7	23.0
Contracting and construction	18.2	19.1	20.6	20.7	19.8	16.8	15.1	14.8	15.1	13.4	15.1	15.9	19.2	19.7
Electricals	17.5	17.3	20.5	19.0	19.0	16.6	14.0	18.3	20.3	20.1	20.8	20.7	22.2	24.7
Electronics	21.4	25.2	32.8	36.5	34.9	31.9	26.5	31.3	32.1	32.2	27.9	25.8	23.5	27.7
Mechanical engineering	17.2	17.4	19.2	19.3	18.5	15.5	12.8	11.7	10.3	12.7	13.9	14.9	17.0	19.8
Metals and metal forming	20.4	15.1	16.2	14.9	13.9	14.1	9.8	7.8	8.9	11.7	14.5	16.4	18.1	22.1
Motors	10.3	8.3	16.5	13.8	12.1	8.0	0.9	2.0	3.7	7.5	7.6	9.5	5.6	17.7
Other industrial materials	18.4	17.3	19.3	19.9	17.9	17.0	15.6	15.1	14.0	15.9	20.7	21.8	23.1	25.2
Consumer goods group	**17.6**	**16.6**	**19.5**	**19.4**	**18.6**	**17.5**	**15.2**	**15.7**	**15.7**	**17.4**	**18.0**	**18.6**	**20.9**	**21.8**
Brewers and distillers	12.8	13.6	15.7	16.4	16.2	15.6	12.7	12.9	14.4	14.4	15.0	13.8	14.9	16.1
Food manufacturing	18.6	18.4	22.0	19.6	18.0	17.4	16.6	17.7	16.7	17.9	18.0	18.8	21.7	23.4
Food retailing	19.2	20.5	24.2	23.8	21.8	20.5	21.7	22.2	23.0	24.9	24.8	23.6	23.3	21.7
Health and household products	25.7	28.0	32.5	31.0	27.4	22.2	21.7	25.7	26.6	28.6	28.4	34.4	40.6	45.1
Leisure	17.0	18.1	21.5	22.1	19.7	17.3	15.7	15.1	14.6	15.1	14.6	15.1	16.2	17.2
Packaging and paper	20.7	13.8	16.3	17.1	17.5	18.2	13.5	14.1	12.9	15.4	17.8	21.1	24.7	21.9
Printing and publishing	19.3	20.0	23.3	25.9	26.7	26.2	12.6	17.1	13.8	21.6	25.7	24.2	36.1	41.1
Stores	18.3	18.6	19.4	20.5	20.4	19.2	15.9	13.9	13.2	16.5	18.3	17.9	20.9	22.4
Textiles	17.2	11.0	15.7	15.9	15.8	14.4	10.1	14.1	15.0	18.5	18.9	21.5	24.7	25.0
Other groups	**18.0**	**16.1**	**19.3**	**18.0**	**15.7**	**16.5**	**13.5**	**13.4**	**12.6**	**15.7**	**17.1**	**17.6**	**19.1**	**22.8**
Agencies	16.9	14.8	27.2	42.6	30.7	28.8	29.9	24.8	32.6	50.0	65.5	71.1	89.7	105.4
Chemicals	21.5	15.3	20.4	17.8	13.1	14.5	9.0	10.0	8.7	14.0	17.9	17.5	18.0	23.9
Conglomerates	13.9	14.6	18.1	18.6	20.7	18.4	16.6	16.7	15.9	18.0	18.5	22.7	15.9	29.4
Shipping and transport	9.7	7.2	9.4	7.8	7.7	9.4	9.9	7.6	6.0	9.5	10.1	12.1	13.8	14.9
Telephone networks	—	—	—	—	—	—	—	35.2	34.4	26.4	19.7	21.2	23.2	23.1
Miscellaneous	19.0	20.5	22.5	22.0	20.8	20.3	18.1	17.9	17.5	18.5	18.1	18.9	22.0	27.3
All industrial groups	**17.2**	**16.4**	**19.5**	**19.1**	**17.9**	**17.0**	**13.6**	**14.1**	**14.1**	**16.4**	**17.6**	**18.5**	**20.1**	**23.0**
Oil and gas	55.5	31.3	28.8	26.0	21.0	35.9	28.6	19.0	16.3	18.3	20.0	22.1	11.6	15.9
Industrials and oils	**22.7**	**18.8**	**21.0**	**20.1**	**18.5**	**20.5**	**16.7**	**15.2**	**14.7**	**16.9**	**18.2**	**19.3**	**18.1**	**21.5**
Number of companies analysed	*1,306*	*1,308*	*1,310*	*1,318*	*1,330*	*1,432*	*1,724*	*1,711*	*1,700*	*1,708*	*1,717*	*1,608*	*1,497*	*1,245*

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