

# International comparisons of Company Profitability

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## Introduction

In the third of an annual series of articles,<sup>1</sup> data are presented on the profitability of UK companies, compared with companies in 33 other countries. Data for 14 countries are presented here for the first time. The Office for National Statistics measures the profitability of private non-financial corporate sector operations in the United Kingdom, using rates of return on capital employed. These data are issued by the Office for National Statistics in First Releases (4 July and 3 October 2002) and are consistent with profits and capital stock data in the Quarterly National Accounts (28 June and 27 September). Sources and coverage of country data are discussed in a separate article, "Sources of data for international comparisons of company

profitability (methodology)"<sup>2</sup>. The views expressed in this article are those of the authors and do not necessarily reflect those of the Bank of England or the Office for National Statistics. The authors would like to thank the staff of statistical offices and central banks in the countries who contributed to this article.

**Table 1.1 Top counties, by recent profitability**

All Companies		per cent
1	Norway*	20.8
2	Finland*	14.0
3	Belgium	11.9
4	UK*	11.6
5	Estonia	11.4
6	Italy	11.3
7	Australia*	10.3
8	Canada	9.7
9	South Africa*	9.6
10	Israel*	9.4
11	Spain	9.3
12	Mexico*	9.2
13	Denmark	8.4
14	Japan	7.7
15	US*	6.9
16	France	6.7
17	Germany*	6.5
18	Latvia	6.0
19	Netherlands*	5.2
20	China**	5.1
21	Slovenia	3.9
22	Hungary	2.7
23	Iceland	0.8

\* indicates that data is for 2001, the rest is 2000.

\*\* ratio of profits to sales

**Table 1.2 Top counties, by recent manufacturing profitability**

Manufacturing		per cent
1	Belgium	21.0
2	Australia*	20.3
3	Finland*	18.9
4	Spain	13.8
5	Denmark	12.0
6	Netherlands*	12.0
7	Canada	10.6
8	Mexico*	7.4
9	Norway*	6.7
10	Korea*	5.5
11	Hungary	5.0
12	US*	4.4
13	UK*	3.6

\* Indicates that data is for 2001, the rest is 2000.

**Table 1.3 Top counties, by recent services profitability**

Services		per cent
1	US*	17.5
2	Norway	16.6
3	Finland*	15.9
4	Spain	14.8
5	UK*	12.9
6	Mexico*	12.6
7	Canada	9.0
8	Belgium	8.8
9	Australia*	6.3
10	Denmark	5.4
11	Netherlands*	2.1

\* Indicates that data is for 2001, the rest is 2000.

For the purposes of this article, profitability is defined as the ratio of profits to capital employed. Profits are defined fairly precisely in international manuals and it is likely that they will be measured reasonably consistently. On the other hand, capital employed is not defined so precisely and there is more scope for variations in the detail of its definition and the methods used to estimate it. We have not sought to impose a common detailed definition. Of the 34 countries (including the UK) providing data, 29 countries have provided rates of return, 4 countries profits data only and one country a measure of competitiveness. 16 countries have provided rates of return for the manufacturing sector and 13 for the services sector. Four countries provided quarterly data – UK, US, Canada and Spain. Quarterly data are provided from a smaller sample of companies than the survey providing the annual data, but have been used where annual data are not yet available.

It follows that differences between countries can reflect a mixture of real differences in profitability and the results of differences in the calculations. In virtually every case, countries will, however, have calculated profitability consistently over time. Rises and falls will reflect real changes in their

economies. Estimates for the latest year may be subject to revision. The statistics presented here have to be interpreted accordingly.

### Outline of the article

1. League tables
2. Why hasn't profitability in the Euro-area countries converged?
3. Why are the rates of return for manufacturing and service companies different?
4. Individual country analysis
  - UK
  - US
  - Japan
  - Euro-area countries
  - Rest of Europe
  - Rest of World
  - Continental Shelf Companies

**Table 1.4 International comparisons of all companies' profitability**

	per cent															
	Major trading partners				Euro-area countries											
	UK	US	Euro-area	Japan	Germany	Italy	France	Spain	Belgium	Portugal	Finland	Netherlands				
1990	11.1	7.8	..	13.3	..	11.0	7.3	8.1	11.3	..	6.9	..				
1991	9.5	7.2	..	13.1	..	10.7	6.9	4.4	10.3	..	3.6	..				
1992	9.1	7.0	..	11.1	..	10.7	6.9	3.0	9.4	..	3.9	..				
1993	9.8	7.4	..	10.4	..	10.1	6.6	1.7	8.8	..	5.5	..				
1994	11.7	8.3	7.3	9.3	5.7	11.5	6.7	4.8	10.5	..	7.7	..				
1995	12.0	8.6	7.6	9.4	6.0	12.6	6.8	6.8	11.1	6.4	9.7	5.1				
1996	12.7	9.1	7.8	10.0	6.1	12.8	6.3	7.2	10.7	6.4	9.7	5.1				
1997	12.9	9.5	8.1	9.4	6.3	12.3	6.6	8.4	12.1	6.2	11.6	5.4				
1998	13.0	8.9	8.1	8.8	6.6	11.8	7.3	9.9	12.2	5.9	13.3	5.4				
1999	12.6	8.6	8.1	7.7	6.4	11.5	6.9	9.1	11.6	..	13.0	5.2				
2000	12.5	7.7	8.1	7.7	6.4	11.3	6.7	9.3	11.9	..	15.1	5.4				
2001	11.6	6.9	..	..	6.5	..	..	..	..	..	14.0	5.2				
	Rest of Europe								Rest of the World							
	Denmark	Norway	Czech Republic	Hungary*	Estonia*	Slovenia	Latvia*	Slovakia	Australia	Israel	S. Africa	Canada*	China**	Iceland	Singapore	Mexico*
1990	6.0	..	..	..	..	..	..	..	8.5	..	8.2	..	..	..	17.9	..
1991	5.8	12.5	..	..	..	..	..	..	7.7	..	8.0	..	..	..	16.5	..
1992	6.4	12.1	..	..	..	..	..	..	8.1	..	7.4	..	..	..	14.9	..
1993	6.2	12.6	9.2	..	..	..	..	..	8.6	..	7.3	..	..	..	17.1	..
1994	7.2	13.0	7.8	..	..	..	..	..	9.1	..	7.9	..	..	..	16.0	..
1995	7.3	14.0	9.0	..	5.4	..	..	7.2	9.3	13.5	8.5	8.1	..	..	14.8	7.6
1996	7.3	16.1	7.7	..	6.2	..	..	6.2	9.6	11.9	9.0	8.5	..	..	13.8	13.5
1997	7.6	16.8	7.3	..	6.9	2.9	9.8	6.2	9.8	11.4	9.1	8.4	..	..	13.1	14.9
1998	6.4	12.6	8.3	2.2	6.1	3.5	7.2	5.6	10.2	11.4	7.8	8.1	..	9.0	11.0	6.3
1999	6.9	14.5	7.2	2.0	1.6	3.9	6.2	6.4	9.6	10.7	7.5	9.3	3.3	9.5	13.1	10.9
2000	8.4	22.4	..	2.7	11.4	..	6.0	..	10.4	11.3	8.8	9.7	5.2	0.8	..	10.2
2001	..	20.8	..	..	..	..	..	..	10.3	9.4	9.6	..	5.1	..	..	9.2

\* Ratio of Profits to Equity.

\*\* Ratio of Profits to Sales.

See Methodology Paper by Richard Walton (Bank of England) for further details.

**Table 1.5 International comparisons of manufacturing companies' profitability**

per cent

			Euro-area countries					Rest of Europe				Rest of the World				
	UK	US	Nether-lands	Germany	Spain	Belgium	Finland	Denmark	Czech Republic	Hungary	Norway	Australia	Korea	Singapore	Canada	Mexico
1990	6.8	15.2	..	..	9.7	16.0	8.4	9.7	..	..	..	15.6	..	23.4	..	..
1991	4.1	9.3	..	..	3.8	11.3	3.3	8.8	..	..	7.4	13.2	..	24.8	..	..
1992	5.3	15.7	..	..	-0.4	9.6	5.5	10.3	..	..	8.3	14.3	..	20.0	..	..
1993	5.8	11.3	..	..	-3.4	8.3	9.4	8.8	9.7	..	10.5	16.6	..	23.9	..	..
1994	8.7	21.9	..	10.1	6.1	14.9	11.4	11.6	8.7	..	11.4	19.8	..	19.5	..	..
1995	10.0	22.2	11.9	10.1	10.9	17.7	14.1	11.8	11.4	..	14.3	20.1	8.3	21.0	9.1	6.4
1996	11.1	22.8	11.2	10.3	9.5	15.5	11.2	10.4	9.5	..	12.0	19.7	6.5	18.3	9.4	12.9
1997	11.9	25.2	11.9	10.9	11.7	19.1	13.9	12.3	10.1	..	11.9	20.5	8.3	18.3	9.0	20.5
1998	10.5	21.2	12.3	12.2	13.4	18.8	16.5	10.9	10.7	5.7	11.1	22.8	6.1	15.0	9.5	5.1
1999	9.3	22.7	11.6	11.8	13.3	17.3	15.7	10.9	9.8	4.9	11.7	21.9	6.6	19.3	9.9	9.2
2000	8.6	20.8	13.3	..	13.8	21.0	21.1	12.0	..	5.0	9.9	20.3	7.4	..	10.6	8.3
2001	3.6	4.4	12.0	..	..	..	18.9	..	..	..	6.7	20.3	5.5	..	..	7.4

**Table 1.6 International comparisons of service companies' profitability**

per cent

			Euro-area countries					Rest of Europe			Rest of the world		
	UK	US	Germany	Finland	Netherlands	Spain	Belgium	Denmark	Norway	Czech Republic	Australia	Canada	Mexico
1990	13.6	15.1	..	5.8	..	17.1	9.2	5.4	..	..	5.8	..	..
1991	13.0	14.0	..	6.0	..	11.5	9.2	5.3	15.7	..	5.8	..	..
1992	11.0	11.3	..	5.7	..	6.9	10.1	5.4	17.6	..	6.1	..	..
1993	11.5	16.5	..	6.5	..	6.9	9.3	5.6	18.6	3.7	6.2	..	..
1994	13.3	21.8	6.5	9.2	..	8.8	9.6	6.1	18.2	3.6	6.8	7.4	9.0
1995	13.2	16.7	7.9	11.3	2.1	11.6	9.2	6.0	17.6	4.4	6.9	8.2	12.9
1996	13.7	18.6	6.8	13.2	2.1	12.2	9.0	5.8	17.5	3.8	7.2	7.8	16.0
1997	14.7	19.2	7.0	15.7	2.5	12.4	9.9	5.7	18.1	3.8	6.4	7.7	12.6
1998	16.2	23.3	7.2	17.4	2.4	14.8	10.5	5.1	17.4	6.2	6.8	7.0	13.2
1999	15.6	24.4	6.9	17.0	2.3	16.1	10.0	5.2	17.2	5.4	6.9	7.9	14.4
2000	14.0	19.3	..	16.8	1.9	14.8	8.8	5.4	16.6	..	6.9	9.0	14.4
2001	12.9	17.5	..	15.9	2.1	..	..	..	16.6	..	6.3	..	12.6

## 1. League tables

The league tables give the latest available data (2000/2001) from each country for all companies, manufacturing and service sectors. Some data has been revised since the last edition of this article, so comparisons are made on the basis of a 1999 league table using current data, and not as it was last published in December 2000.

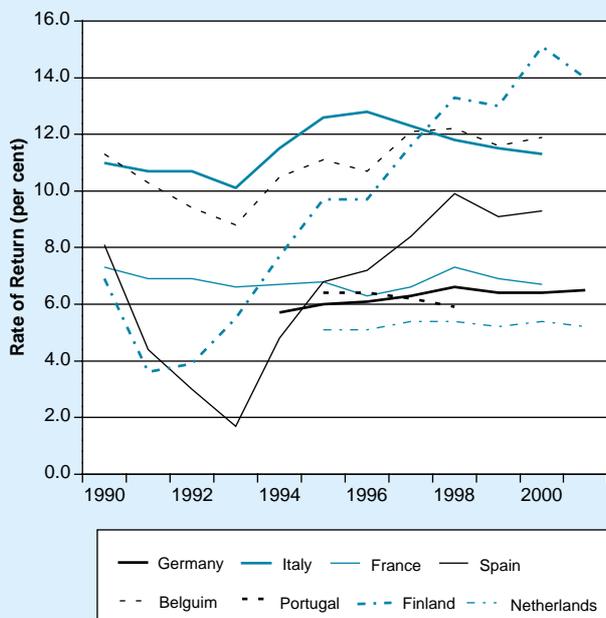
Norway topped the latest PNFC profitability league table, coming in nearly 7 percentage points above second-placed Finland. Belgium is the most profitable manufacturer followed by Australia and the US retailers were the most profitable service sector. The biggest jump was by Estonia who moved from bottom of the league to fifth overall.

The UK maintained its overall ranking as the fourth most profitable country among the 23 countries with data for 2000/2001 that are compared in Table 1.1. The UK's manufacturing profitability has fallen to the bottom of the league table (Table 1.2), whilst in services the UK retained its fifth place (Table 1.3).

Private non-financial corporations in the US fell two places to fifteenth place, just below Japan in fourteenth position. Europe was more profitable than the US and the gap could be over one per cent in 2001.

Figure 2.1

Euro-area countries rates of return



## 2. Why hasn't profitability in the Euro-area converged?

Economic theory suggests that where direct investment can move freely between countries, profitability rates will be equal, as investment will flow to where its return is greatest. Since the creation of the European Monetary Union, one might expect a convergence in profitability ratios among the 20 million companies in the member countries.

However, Figure 2.1 shows little evidence of convergence. Setting aside Finland's spectacular profitability growth, the remaining countries have more or less maintained their relative levels for the past five years. This article briefly put forward three answers.

First, investment does not appear to have been flowing to reduce profitability differentials. Despite a generally low level of domestic investment, intra-EU foreign direct investment (FDI) grew 50 per cent in 2000. In 2000 in particular, Germany (with one of the lowest profitability ratios in the Euro-area) was the biggest net receiver of intra-EU FDI. The UK was the biggest net investor. By 2001, the flows were moving more generally in the directions suggested by the profitability data. However, a proportion of countries' FDI leaves the Euro-area, for the US and UK. This could be attributed to the higher rates of return that were available in the US and UK and could, in turn be slowing the convergence process within Europe.

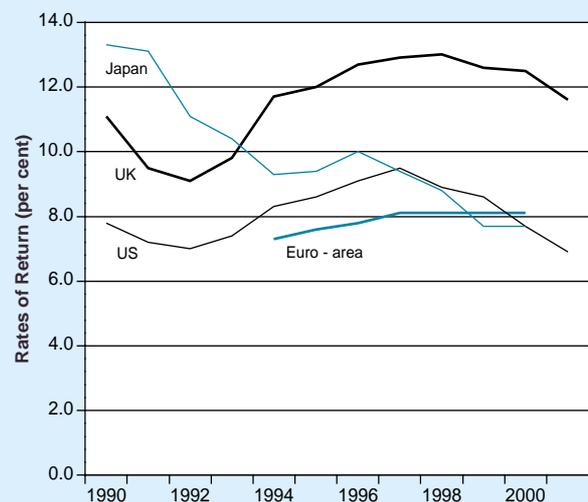
Second, an explanation is that the markets are not completely integrated. A lack of comparable information and structural obstacles

may mean firms do not seek investment opportunities in other EU countries, or in those with the highest profitability ratios.

Finally, it is, of course, possible that the data does not reflect the reality of profitability ratios. For several countries, ratios net of tax or depreciation are unavailable. Investors will be concerned with post-tax profits and depreciated capital values. We might expect to see rather more convergence in post-tax rates of return.

Figure 2.2

Euro-area and major trading partners rates of return



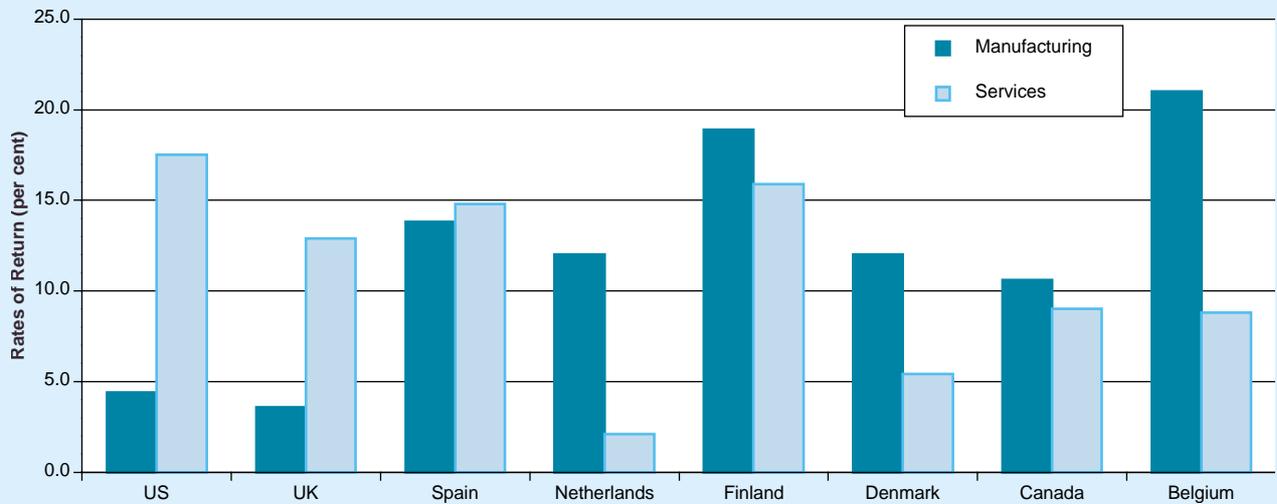
### Euro-area

A Euro-area wide indicator was calculated in order to make comparisons with other countries. The indicator weights profitability from the eight Euro-area countries that provided data, according to the GDP of each country. Rates of return have been consistently higher in the US in the second half of the 1990s. But, this positive differential in profitability with the Euro area moved from 0.5 percentage points in 1999 to a negative differential of close to one per cent in 2001.

Figure 2.2 shows that the Euro-area had lower profitability ratios than UK, US and Japan, until 2000 when Japan and the US fell below it. Profitability is showing a gradually rising trend which could be explained by better capital mobility and the benefits of trade within the area. It could also be due to the stable growth in manufacturing industry in the Euro area in the past two years. In the US on the other hand, profitability in the manufacturing industry in 1999 and

**Figure 3.1**

**Manufacturing and services profitability (latest data) for selected countries**



2000 was dominated by chemicals, computer and electronics products and motor vehicle parts. These were the same industries which were responsible for the dramatic drop in US profits in 2001. Nevertheless, the Euro-area's slow growth in rates of return could be due to structural issues, such as labour market rigidities or high corporate tax rates.

### 3. Why are the rates of return on manufacturing and service companies different?

The most striking feature of corporate profitability across countries is the difference between the manufacturing and service sectors (Figure 3.1). The UK, US, Spain and Norway have more profitable service than manufacturing sectors, but the majority of economies' manufacturing sectors outperform their service sectors. One of the most extreme examples is the Netherlands, where manufacturing profitability has exceeded service profitability by an average 10 per cent since 1995. Manufacturing industry in the Euro area has been dominated by chemicals, machinery and equipment and food.

In some economies, the relationship has changed over recent years. In Finland, for example, the mobile phones boom (Nokia) caused spectacular climbs in services profitability, allowing the service sector to match the traditionally profitable manufacturing sector.

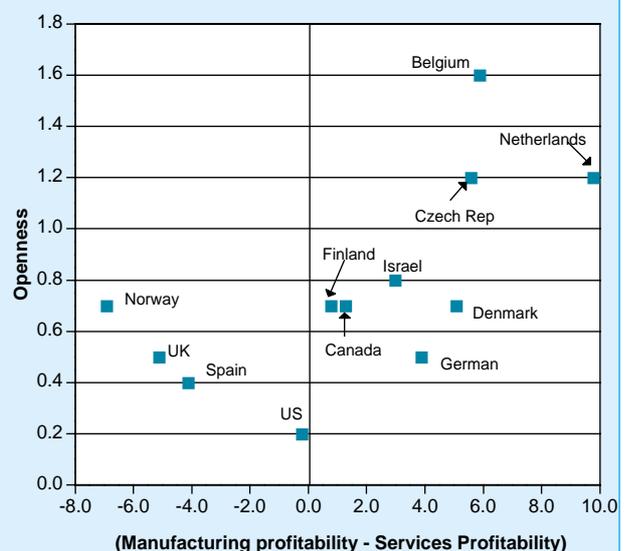
Economic theory suggests that disparities between the sectors should close as capital flows to its most profitable use. However, the data suggests that most countries have maintained a historical gap between manufacturing and services profitability. Two possible explanations will briefly be outlined.

Firstly, it is difficult to measure the capital of service sector firms, as it is often intangible. This might suggest higher than expected profitability of service sector firms if their capital is underestimated. However, services have not performed consistently better than manufacturing in all countries – quite the opposite. The majority of countries in this survey have historically higher profitability ratios in manufacturing than services.

Second, it has been suggested that the difference between manufacturing and service sector profitability represents a risk premium because manufacturing firms tend to be more export-focused and therefore more exposed to external shocks. In the UK, the percentage of exports to the output of manufacturing is 25 per cent. Figure 3.2

**Figure 3.2**

**Openness and (manufacturing minus services) profitability for selected countries**



Note: Openness is defined as total trade (exports + imports) as a per cent of GDP.

plots manufacturing profitability minus services profitability against openness for 12 economies. On the horizontal axis, a positive number indicates manufacturing profitability greater than services profitability. The data are averages from the years available for each country. Openness, on the vertical axis, is total trade (exports + imports) as a percentage of GDP, and is a long run average.

There is a positive correlation between the two variables. Open economies such as Belgium, the Netherlands and the Czech Republic have much higher manufacturing than service sector profitability. The relationship is less clear on the other side. The US – the most closed economy – does not have the difference between service sector and manufacturing sector we would expect. In the centre, several economies (UK, Spain, Germany, Canada, Israel, Germany and Denmark) all have similar degrees of openness, and yet are widely spread in manufacturing – services differentials. Other variables (like productivity, fiscal and investment incentives) could, therefore, be affecting the relative profitability in these countries.

#### 4. Individual country analysis

##### United Kingdom

Total company profitability fell to 11.6 per cent from 12.5 per cent in 2001, the third consecutive year it fell (Figure 4.1). Profitability in 2002 was broadly unchanged. Manufacturing profitability more than halved in 2001, dropping from 8.6 per cent in 2000 to 3.6 per cent in 2001. In fact, manufacturing profitability reached a low of 2.5 per cent in 2001 Q4. Rates of 2.5 per cent have not been seen for 20 years. Profitability also fell in the service sector, from 14 per cent in 2000 to 12.9 per cent in 2001. It then rose in 2002 Q2 to 14.1 per cent, the highest since 2000 Q2.

What are the causes of the decline of UK profitability in 2001? This article examines the effects of labour productivity, the exchange rate, and investment.

Figure 4.1

UK total, manufacturing and services profitability

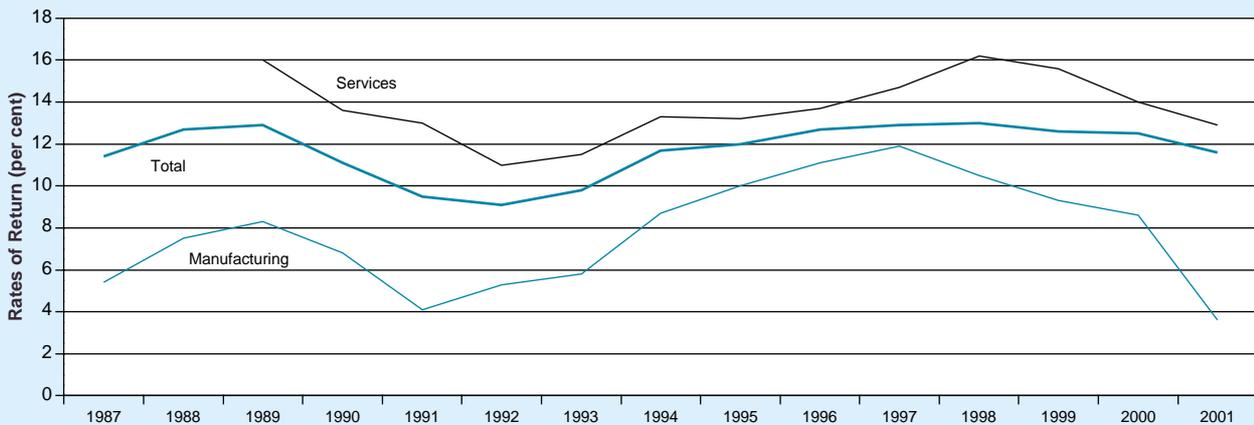


Figure 4.2

UK profitability and productivity growth

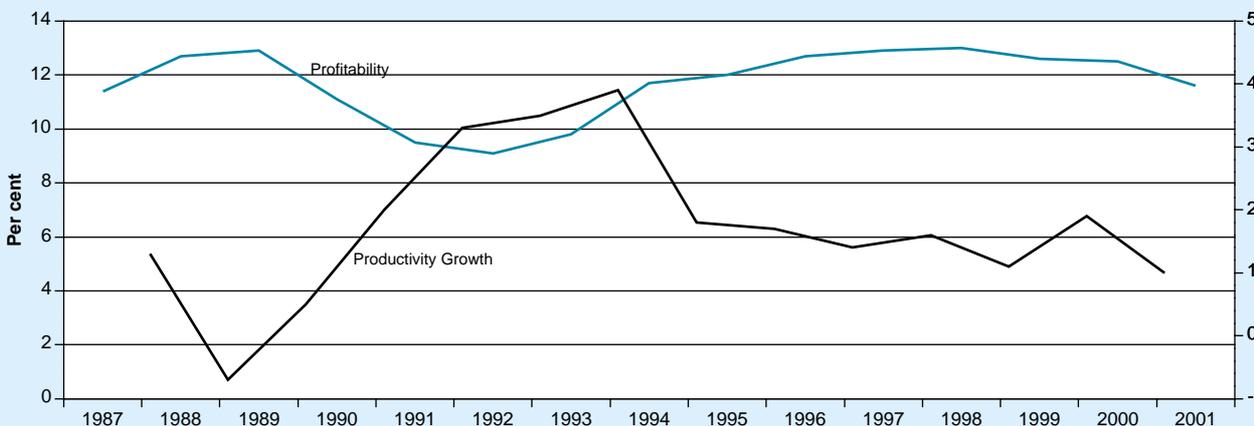
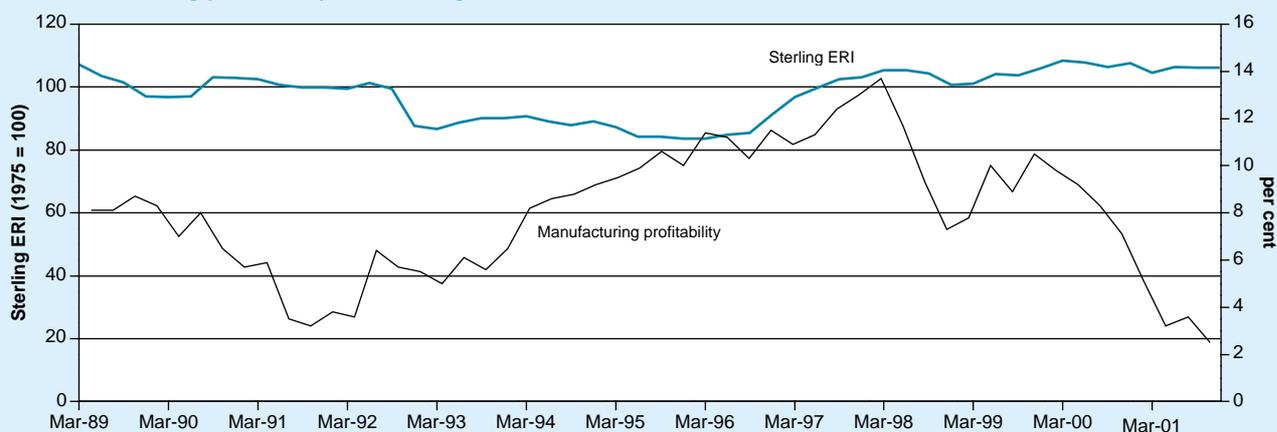


Figure 4.3

Manufacturing profitability and sterling ERI



A slowdown in productivity growth could have weakened profitability in 2001. Wages grew 3.3 per cent and productivity grew by only 0.9 per cent. Manufacturing productivity growth has deteriorated since 2001 Q1. When the share of labour income goes up, the share of corporate profits will go down. However, Figure 4.2 does not show a historical relationship between profitability and productivity. And, in services – a more labour intensive sector than manufacturing – the fall in profitability was only of the order of 1.1 percentage points in 2001.

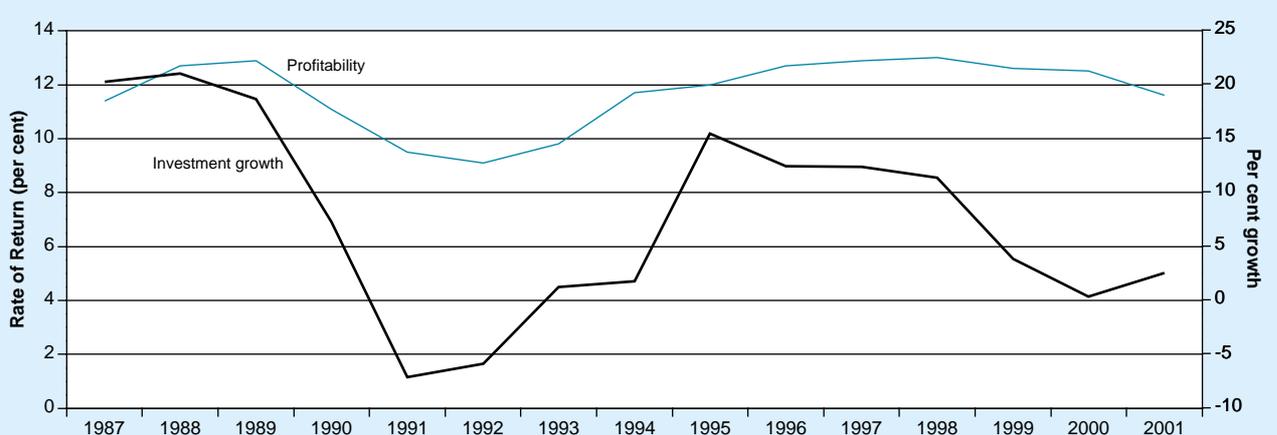
Non-labour inputs do not appear to be responsible for the falls in profitability. Producer input prices for materials and fuels purchased by manufacturing industry fell 2.2 per cent in the year to August 2002, whilst manufacturing output prices rose 0.3 per cent suggesting a small improvement in profit margins. Net operating surplus, (with capital consumption deducted) fell, however, in 2001 by 1.7 per cent.

There is also not a strong relationship between company profitability and the Sterling ERI exchange rate (Figure 4.3). In manufacturing which is more export orientated, it is difficult to discern any trend. However, the strength of the sterling exchange rate against the euro is often cited by UK firms as a reason for the difference between manufacturing and service sector profitability.

Investment intentions of firms may well respond to inadequate net returns and to uncertainty over future profit margins. Investment could have several effects on profitability. On the one hand, by increasing the capital stock profitability will be reduced. On the other hand, however, investment may raise productivity and lower running costs, thus increasing gross operating surplus. It does not appear that investment and profitability are correlated (Figure 4.4). Investors are likely to put capital into firms where the rate of return is high, and profitable firms are more likely to have retained profits to invest. It is more likely that weak corporate profits have reduced investment.

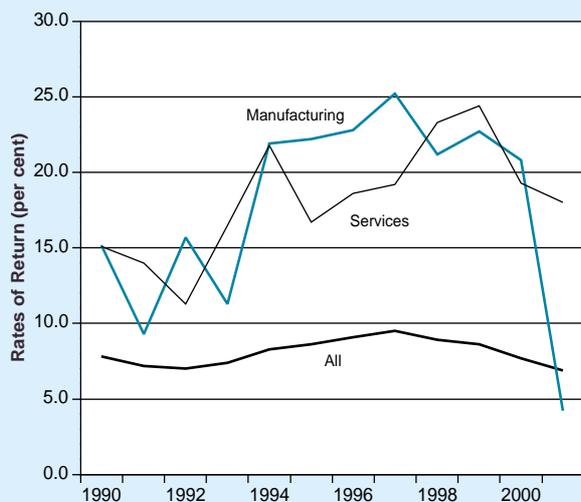
Figure 4.4

UK PNFC profitability and business investment



**Figure 4.5**

**US total manufacturing and retail company profitability**



In the UK manufacturing sector, profitability surged in the 1990s to 1998. The fall in 2001 in rates of return was marked. This was caused by a large fall in net operating profits, losing over one half of their value. The decline in manufacturing output since 2001 Q1 is the principal cause of a fall in profits. The falls in profits have been particularly marked in the pharmaceutical and high tech sectors. This includes the UK pc industry in which prices fell by over 20 per cent in the past year.

**United States**

Profitability of companies in the US peaked in 1997. Successive falls were recorded in 1998–2001 (Figure 4.5). The profitability of all private non-financial companies fell from 8.6 per cent in 1999 to 6.9 per cent in 2001. This is the lowest level since 1983 and lower than the average of 8.2 per cent for the decade 1990–2000 and the median for 1960–2001 of 8.4 per cent. Pre-tax corporate profits of non-financial companies fell by over US \$50 billion in 2001. This fall was led by the manufacturing sector in which high-tech industries felt the impact of the downward pressure on IT prices. Manufacturers of cars and food and chemical products all reported falling profit levels for the second year running. Retailers were one of the few sectors to report higher profits in 2001.

Pre-tax corporate profits of non-financial companies increased by 0.8 per cent in 2002 Q1 and were flat in 2002 Q2. Second quarter results reflected both decreases in prices received by companies and an increase in non-labour costs.

**Manufacturing**

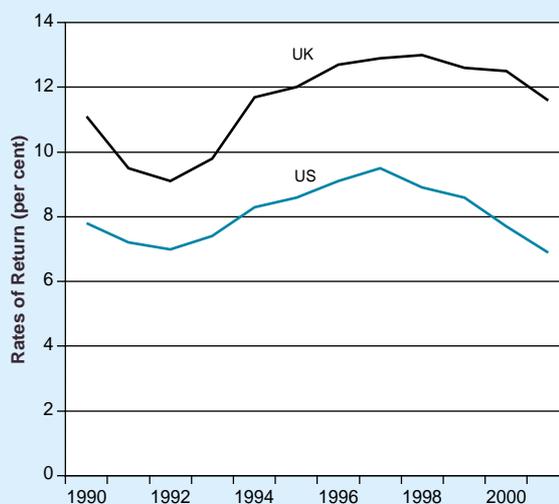
Manufacturing profitability fell to 4.4 per cent in 2001, compared with average rates of return of 18.8 per cent in the 1990s. In 2001 Q4, rates of return fell to 2.5 per cent, the lowest level recorded since 1992 Q1. In 2002, rates of return improved, but were still at levels 50 per cent of levels earned in 1995–2000. This reflected stronger profits by manufacturers of pharmaceuticals, motor vehicles, and petroleum and coal, offsetting continuing losses by manufacturers of computer and communications products.

**Retail Trade**

In retailing, profitability fell in 2001 to 17.5 per cent, a six-year low. In 2002 Q1, profitability was 19.1 per cent. Although this return was 4.5 percentage points below the previous quarter, it was higher than the return of 16.7 per cent recorded in 2001 Q1.

**Figure 4.6**

**US and UK PNFC profitability**



**UK and US Comparison**

Profitability of all companies in the UK and US follow each other closely, though the UK maintains a profitability lead on the US, an average 3.5 per cent since 1990 (Figure 4.6).

**Japan**

Corporate profitability in Japan was unchanged in 2000 at 7.7 per cent. In 2001, corporate profits rose by 2 per cent, although bankruptcies were the highest since the late 1980s. Profitability reached its lowest point over the past decade. Whether profitability would improve in 2002 depends in part on the restructuring of the

economy, in particular the traditional manufacturing industry. The effects of this in the short term could work both ways for firms. High and rising unemployment could keep wages low and falling, though it could also subdue domestic demand. In the long run, however, these changes are necessary for the economy to address structural excesses of labour and capacity.

Exports to the US and surrounding countries increased in 2002, in particular in capital and intermediate goods. Exports of semi-conductors and IT-related goods also showed a turnaround. This pick-up in exports is stimulating production, particularly in the manufacturing industry. Recovery in Japan could depend on the performance of the electronics sector which makes up 55 per cent of manufacturing. Restructuring should help to lower costs for electronics firms but competition from Asian rivals remains a risk. Rapid advances in technology and the wage gap with Japan could see China emerging as a threat to the Japanese recovery. Imports from China are contributing to a fall in prices and a squeeze in profits, as Chinese exports are undercutting Japanese exports throughout the Asian markets. The yen's appreciation against the dollar could also harm export competitiveness, particularly in export-orientated sectors such as motor vehicle production.

The next section analyses the rates of return in Euro-area countries.

## **Belgium**

Profitability in Belgium rose slightly in 2000 to 11.9 per cent from 11.6 per cent in 1999. Belgian manufacturing profitability leapt nearly 4 percentage points to reach 21 per cent in 2000, driven by the chemicals industry which accounts for close to 25 per cent of manufacturing value added. This gave Belgium the highest manufacturing profitability in the world in 2000, just ahead of the US at 20.8 per cent. Service sector profitability fell however, further widening the gap between manufacturing and services in Belgium. Service sector profitability was 8.8 per cent in 2000, a differential of 12 percentage points.

The profitability growth in Belgium went hand-in-hand with a period of robust economic growth from 1997 to 2000. High levels of business and consumer confidence stimulated domestic demand. Global demand is particularly important to Belgium, as it is a small open economy, with exports and imports equal to around 75 per cent of GDP each. Belgium's manufacturing sector is particularly export sensitive; the strong export conditions in 2000 were probably the key to the profitability increases in the manufacturing sector.

The outlook for Belgian corporate profitability depends on two factors: the world economy and labour market developments. Belgium, as an economy which specialises in intermediate goods, would benefit from a pick-up in world demand.

The labour market has undergone substantial changes in the past few years. Tax cuts for employers to encourage employment would no doubt have improved profitability. However, high headline inflation caused by energy and food prices in 2001 has filtered into wages via indexation.

Other government action which may affect profitability, includes reducing corporate taxes to attract foreign investment (particularly in the service sector). The telecoms and utility industries are in a process of liberalisation. Depending on the success of regulation, this may affect profitability if a period of intense competition ensues.

## **Finland**

Profitability in Finland fell across all sectors in 2001. However, Finland's performance is still unparalleled, and it was one of the world's most profitable countries in 2001. Company profitability fell from its high of 15.1 per cent in 2000 to 14 per cent in 2001. This is nearly double the Euro-area average. In the manufacturing sector, profitability fell from 21.1 per cent in 2000 to 18.9 per cent in 2001. Falls were also recorded in the service sector, bringing profitability down to 15.9 per cent.

It would not be possible to discuss Finland's corporate sector without mentioning mobile phone manufacturer Nokia. Nokia is the only Finnish company listed in the world's top 50 companies, and is estimated to provide up to half of Finland's GDP growth per year. Nokia began manufacturing tyres, tissue and wires. In the early 1990s it led the way in focusing on ICT and mobile technologies. Nokia is now the world's biggest mobile phone manufacturer, with a 38 per cent market share. Around Nokia, Finland has been able to build a highly efficient export-focused ICT industry. Its unique strength is in the Finnish commitment to R&D, and the highly educated workforce. Nokia has worn the falls in telecoms output well, recording a 46 per cent rise in profits for 2002 Q2.

Finland has been hailed as Europe's success story for maintaining GDP growth of nearly 5 per cent in 1994-2000. Inflation over the period was contained at between 1-3 per cent. However, Finland has been hit by the recent economic downturn – GDP growth slowed

to 0.7 per cent in 2001. The upturn in the world economy is now lifting the traditional export sectors of paper and machinery.

## France

Profitability in France fell slightly in 2000 to 6.7 per cent. This was despite high economic growth and export competitiveness which France enjoyed in 2000. The weak Euro stimulated exports which grew by 12.6 per cent. Domestic demand was also strong, growing at 2.6 per cent. It is possible that high investment costs in 2000 were in part responsible for the light fall in profitability – investment by non-financial corporations and unincorporated enterprises was 7.2 per cent higher than in 1999. Increases in the minimum wage in 2000 may also have reduced profitability slightly.

## Germany

Profitability of German non-financial companies was the same in 2000 as in 1999 and was led by the German exporting companies.

Manufacturing performed particularly well, with after-tax profits growing 15 per cent in 2000. Industry benefited from the strength of exports, especially chemicals and chemical products, motor vehicles and electrical machinery, which are particularly export focused and which are the three main manufacturing sectors. Germany was the EU's leading producer of machinery and equipment and one of the main net exporters.

In services, the transport sector was unable to translate high demand into profits, as rising fuel prices and a sharp rise in excise taxes eroded profits on the cost side. Another poor performer was the retail sector, which suffered excessive competition and unsustainable low prices as a foreign retail groups entered the market. Retail sales stagnated in 2000. Wholesalers, on the other hand, benefited from buoyant exports and capital goods and by handling a sharp rise in imported goods.

There is estimated to be very little change in overall profitability in 2001.

## Italy

Profitability in Italy fell 0.2 percentage points to 11.3 per cent in 2000, slightly below the 1990–1999 average of 11.5 per cent. The economic background was one of high GDP growth rates and low inflation. Manufacturing profitability was sustained by growth in machinery and equipment, chemicals and metal products. Italy is one of the

main net exporters of machinery and equipment in the EU. Profitability in the service sector has been affected by the Government's programme of liberalisation in the State-owned utilities.

## Netherlands

Company profitability fell slightly in 2001 to 5.2 per cent from 5.4 per cent in 2000. Manufacturing profitability in the Netherlands fell 1.3 percentage points to 12 per cent in 2001. Manufacturing profitability has been over 10 per cent for the past seven years, led by food, chemicals and printing companies. Profitability in the service sector remained at around 2 per cent, a differential with manufacturing of 10 percentage points. The service sector is a far more capital intensive sector than manufacturing and this mainly accounts for the lower rates of return.

In the Netherlands, high levels of growth were recorded in 2000. Exports stimulated manufacturing growth and widened the gap in rates of return with the service sector. The Netherlands was very successful in being able to combine record lows in unemployment with wage moderation, allowing firms to benefit from increased output.

Industrial production has been falling for many months, led by a recession in the metal industry which accounts for about a third of industrial production. However, many firms have reported shifting investment from 2001 to 2002. As a result, investment is projected to rise 21 per cent in 2002. This may reduce profitability in the short term as the capital stock grows, but it is an indicator of firms' optimism that business will improve in 2002.

## Spain

Profitability in Spain rose slightly from 9.1 per cent in 1999 to 9.3 per cent in 2000. Manufacturing sector profitability rose significantly from 13.3 per cent in 1999 to 13.8 per cent in 2000, the highest value on record. The main manufacturing industry is food production. The service sector, however, experienced a notable fall in profitability: the profitability of Spanish service companies in 2000 fell from a 10 year high of 16.1 per cent in 1999 back to its 1998 level of 14.8 per cent. These shifts represent a convergence in manufacturing and service sector profitability.

2000 was a strong year for Spanish corporations. Quarterly data suggest that the momentum was lost in 2001. Most corporations recorded similar or slightly reduced profits. Hardest hit were the energy and industry sectors, with falls in Gross Value Added (GVA) of –7.3 per cent and –3.3 per cent respectively. The nominal growth

rate of gross operating profit was 3.7 per cent in 2001 compared to 9.9 per cent in 2000. Much of this fall was caused by rising costs from two sources – wages and financial costs. Nominal wage growth outpaced productivity growth, as high inflation was factored into collectively bargained wage settlements. Financial costs grew 17 per cent in 2001 as firms increased their borrowing. This borrowing financed positions in new markets, and was used to purchase third generation telecommunications licenses.

### Austria, Greece, Ireland and Sweden

These countries were only able to provide data on profits, not profitability ratios. A brief summary of their results is given below in Table 4.7.

**Table 4.7 Percentage Change in Net Operating Surplus**  
per cent change

	Austria	Greece	Ireland	Sweden
1990	..	..	..	..
1991	..	..	-0.8	..
1992	..	..	0.4	..
1993	..	..	10.8	..
1994	..	..	8.5	64.6
1995	..	..	29.0	34.5
1996	8.7	..	12.9	-18.9
1997	7.5	..	23.3	-0.2
1998	7.6	..	26.8	-5.9
1999	2.7	..	20.3	-2.8
2000	8.4	..	18.7	-8.2 <sup>p</sup>
2001	..	-14.0	..	-25.6 <sup>p</sup>

<sup>p</sup> provisional data

In **Austria**, profits grew 8.4 per cent in 2000. Excluding a dip in 1999, this follows three years of strong growth for profits. Profits have risen from 10 per cent to 12 per cent of GDP since 1996.

Profits in **Greece** fell substantially in every sector between 2000 and 2001. Profits in manufacturing fell 26.4 per cent, and in trade they fell 29.9 per cent. Some of the biggest falls were recorded for paper printing (-99.3 per cent) and oil refineries (-66.5 per cent). However, there are signs that the 'new economy' is succeeding in Greece: profits for information companies grew 32.2 per cent and for electrical equipment by 14.4 per cent.

**Ireland's** growth in the past ten years has often been called an 'economic miracle'. An attractive economic package has brought vast foreign investment into Ireland, particularly from the US. Profits growth has been in double figures since 1995, peaking at 26.8 per cent in 1998. The growth has been well spread between

the industry and service sectors in which profits account for 25 per cent and 11 per cent respectively of GDP in Ireland. In 2000, profits grew 12.4 per cent in industry led by the chemicals and food sectors and an impressive 41.9 per cent in services led by the telecommunications sector, although the boom in industry began a little earlier than in the service sector. Since 1990, total profits have grown at an average 15 per cent per year and by 2000 represented 22 per cent of GDP.

In **Sweden**, profits for private companies are provisionally estimated to have fallen 25.6 per cent in 2001. The fall in profits could have reflected reduced output in the telecommunications industry.

### Rest of Europe

#### Denmark

Corporate sector profitability in Denmark rose 1.5 percentage points to 8.4 per cent in 2000. Manufacturing sector profitability (by 1.1 percentage points to 12.0 per cent) and service sector profitability (from 5.2 per cent in 1999 to 5.4 per cent in 2000) both rose slightly. The manufacture of machinery and equipment contributed 15 per cent of value added in the manufacturing sector and a positive net trade balance.

Denmark had a prolonged period of above-potential growth which has since slowed a little in 2001-02. Tightness in the labour market has led to wage growth slightly above Euro-zone levels, which might affect profitability in the labour-intensive service sector. Business benefited from interest rate cuts in 2002 which could mean profitability gains.

#### Norway

Norway achieved the highest profitability ratio of any country in this year's survey. A profitability ratio of 20.8 per cent was recorded in 2001, driven by companies in the service sector and oil and gas industry. Norway has also benefited from the growth of high tech manufacturing industry, but rates of return for this sector fell in 2001, as they did in the US and UK. Profitability has been particularly buoyant in 2000 and in 2001. The oil price and a competitive external trading environment have been major factors.

**Most Central European economies** are enjoying periods of growing profitability. As markets continue to liberalise and large utilities are privatised, competition is likely to increase. One of the principal threats to profitability in the Baltic countries, however, is that wages

will grow faster than inflation, especially since collective bargaining is common. This could reduce domestic profit margins and reduce competitiveness in vital export sectors.

### **Estonia**

Estonia experienced the greatest increase in profitability of any country that supplied data. Profitability of Estonian non-financial corporations rose from 1.6 per cent in 1999 to 11.4 per cent in 2000, putting Estonia at fifth in the world league table. This could be related to domestic investment, which grew 24.4 per cent in 2000. The current level of investment is 25 per cent of GDP. Companies in the IT and telecommunications sectors benefited from higher investment.

### **Hungary**

2000 saw a rise in non-financial companies' rate of return, from 2.0 per cent in 1999 to 2.7 per cent in 2000. Profitability improved in 2000, but the 2001 data could show a downturn. In May 2001, the Hungarian central bank widened the fluctuation band of the forint from 2.25 per cent to 15 per cent which resulted in an immediate and continuing appreciation of the currency. This was an attempt by the Central Bank to slow inflation, which had stagnated at around 10 per cent per year. Surveys have shown significant reductions in export profitability, particularly in the food and machinery sectors. One positive outcome for producers will be a reduction in input costs of imported raw materials and semi-finished goods.

### **Iceland**

Iceland's profitability dropped from 9.5 per cent in 2000 to just 0.8 per cent in 2001. This could have resulted from a change in the government's exchange rate policy which for years had maintained a high krona. This encouraged firms to borrow abroad: Iceland's net debtor position reached 280 per cent of exports in 2000. The krona fell from March 2001 and companies' interest payments soared. Private and non-financial listed companies suffered losses equivalent to 1.3 per cent of GDP in the first half of 2001, compared to profits of 0.8 per cent in the same period in 2000.

### **Latvia**

The profitability of Latvian businesses and enterprises fell slightly from 6.2 per cent to 6.0 per cent in 2000. Falls in profitability were recorded in the fishing, household goods, manufacturing, tourism and real estate sectors. Fishing and tourism are substantially loss making, with profitability of -10.6 per cent and -32.1 per cent

respectively. Construction experienced the greatest rise in profitability, reaching over 22 per cent in 2000, making it the most profitable private sector. The electricity, gas and water sector, which is the largest employer in Latvia, remains profitable at 12.3 per cent.

The Latvian economy is enjoying a period of strong growth (6.5 per cent in 2000). Inflation has remained low and exports and investment strong.

### **Russia**

Russia has contributed the profitability of products to the survey for the first time. On this basis of measurement, 1996 and 1997 were low points in the 1990s. 1999 was the most profitable year in the decade: overall industry profitability was at 25 per cent and in the fuel industry returns were as high as 45 per cent, double the levels reported in 1990. Chemicals and petrochemicals reported strong growth in 1999 and levels of returns had risen to over 20 per cent, after returns of less than 10 per cent in the period 1995-1998. The food industry, on the other hand, maintained a steady rate of return which at the end of the 1990s was around 13 per cent.

### **Slovak Republic**

Data on the Slovak Republic is only available until 1999. However, improving corporate profitability has led to strong domestic and foreign fixed investment – total fixed capital formation grew 11.6 per cent in 2001. GDP grew at 3.3 per cent in 2001 and is expected to grow by 4 per cent in 2002.

### **Slovenia**

There has been a gradual recovery in profitability of companies in Slovenia, to 3.9 per cent in 1999. One factor has been foreign investment in the domestic manufacturing industries. Slovenia has a diverse manufacturing base, from the traditional textiles industry to car production, brewing, chemicals and rubber. A high proportion (over 60 per cent) of exports are now to EU countries.

### **Rest of World**

#### **Australia**

In the past decade, there has been a steady improvement in the profitability of companies in Australia. The average rate of return for the 1990s was 9.1 per cent and in only one year – 1999 – did the rate of return fall. Profitability in 2000 and 2001 was stable at

10.3 –10.4 per cent. One key driver for the improvement in rates of return was in the manufacturing industry in which first estimates show rates of return in excess of 20 per cent for the past five years. As in many economies, manufacturers are export – focused: around 60 per cent of exports are manufacturing commodities. In Australia, the manufacturing sector accounts for 12 per cent of GDP and the services sector around 20 per cent. The services sector employs rather more capital, particularly in transport and storage. Consequently, services has not shown the same resilience in profitability, particularly in 2000 and 2001 as in the manufacturing sector. Another key driver of profitability was in property and business services, a sector which is now equally as large in GDP terms as in manufacturing. Profitability in this sector in 2001 at 18.5 per cent was just below returns in manufacturing.

### **Canada**

The profitability of Canadian firms rose from 9.3 per cent in 1999 to 9.7 per cent in 2000. This was the highest rate of return recorded by Canadian companies in the past five years. Preliminary data for 2001 (based on quarterly surveys) indicate a fall in the rates of return in both the manufacturing and service sectors. In the first six months of 2002, rates of return recovered, following four straight quarterly declines in 2001. However, corporate profits were far below the most recent peak in the first quarter of 2000.

Manufacturing has generally been more profitable than services in Canada. In 2000, the differential was 1.6 percentage points. In 2001, this differential was eroded, as profits of motor vehicles producers, chemicals, plastic and rubber products and primary metals all fell. In addition, electronics and computer manufacturers' profits were hit hard by the slump and global demand for electronics and telecommunications products. However, in 2002, the motor vehicles industry led a rebound in manufacturing rates of return. Low interest rates and strong US demand boosted margins. Wood and paper and steel producers' profits rebounded in 2002, but manufacturers of computer and electronic products registered losses again in 2002 caused by restructuring and downsizing costs. Operating profits of retailers were strong across all sectors in both the first and second quarters of 2002.

### **China**

Between 1999 and 2000 profitability increased 1.9 percentage points, as economic restructuring led to efficiency gains. However, economic reform is dampening profits of Chinese firms as imports rise and competition intensifies. In 2001, profitability in China (ratio of profits to sales of industrial enterprises) remained broadly constant at 5.1 per cent.

### **Ecuador**

Ecuador has contributed to the survey for the first time. A Competitive Trend Index (ICT) is published quarterly by the Central Bank which evaluates competitiveness and actions for economic policy. Data are available from 1995. The ICT turned down significantly in 1998 and 1999. While the median of the ICT during 1999 was 121.8, in the years 2000 and 2001 it stood at 138.9 and 152.9 points, respectively. In 2000, the improvement in competitiveness was due to a reduction in financial and labour costs. In 2001, the further rise was due to a sharp reduction in inflation and to the increase in investment in new technology. In the first quarter of 2002, a further reduction in inflation (but not in labour costs) pushed the ICT up 8.9 points over the quarter before.

### **Israel**

In Israel, corporate sector profitability rose slightly in 2000 to 11.3 per cent, but fell to 9.4 per cent in 2001, the lowest level recorded. The drop continues the trend of falling profitability throughout the 1990s. Domestic and export demand have both fallen, hitting traditional industries (agriculture and mining) particularly hard. The high-tech sector – which is a driving force in the Israeli economy – has seen a slight improvement since the downturn in the telecoms business.

### **Mexico**

Mexico has contributed to the survey for the first time. The return on equity for all companies listed on the Mexican Stock Exchange doubled between 1995 and 1997, to 14.9 per cent. In 1998, all sectors suffered a fall in profitability, particularly so in manufacturing in which returns fell from over 20 per cent to just 5 per cent. The overall rate of return earned by Mexican companies fell to just 6.3 per cent. 1999 was a year of recovery in all sectors and 2000 was a year of consolidation, with rates of just over 10 per cent recorded. In 2001, manufacturing, construction and retail companies all saw returns fall. As a result, profitability for all companies fell one percentage point to 9.2 per cent.

### **South Africa**

In South Africa, profitability rose from 8.8 per cent to 9.6 per cent in 2001, the highest level on record. South Africa's profitability goes hand in hand with a period of growth and stability since 1997.

The value of the rand is a key factor that has brought profitability to the levels it has reached now, and that will determine the future of South Africa's corporations. The rand depreciated sharply in late

2001 and supported exporters' margins. The level of the rand has underpinned South Africa's exports to resist the global slowdown. The gold industry, one of South Africa's major exporters, has recorded exceptionally high profits.

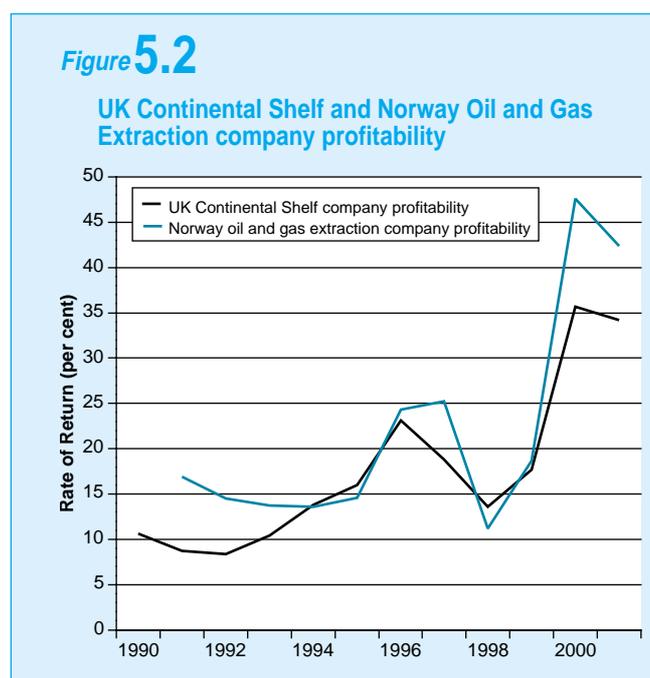
Wages are another key variable for South African business. In 2001, gross operating surplus as a percentage of total factor income grew, indicating that prices grew faster than wages. This was supported by increases in productivity. The growing industrial sector enjoyed much improved profitability this year thanks to interest rate cuts.

**Table 5.1 UK and Norway Continental Shelf Companies Rates of Return**

	UK	Norway
1990	10.6	..
1991	8.7	16.9
1992	8.4	14.5
1993	10.4	13.7
1994	13.8	13.6
1995	16.0	14.6
1996	23.1	24.3
1997	18.8	25.2
1998	13.6	11.2
1999	17.7	18.7
2000	35.7	47.6
2001	34.2	42.4

### UK and Norway oil and gas companies

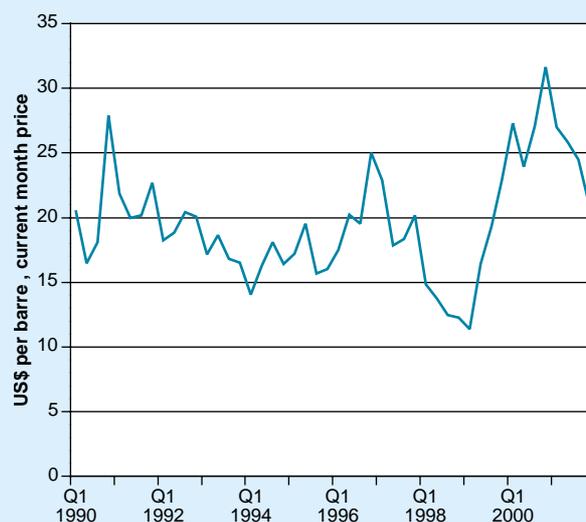
Profitability in UK and Norwegian Continental Shelf (CS) companies peaked at 35.7 per cent and 47.6 per cent respectively in 2000. Although profitability fell back in 2001, it was still well above the levels seen in the past decade (Table 5.1 and Figure 5.2).



UK and Norway oil company profitability ratios follow each other closely and are largely determined by oil and gas prices (Figure 5.3). Norway is the eighth largest producer of crude oil (the UK is tenth) and the second largest exporter (the UK is the seventh). In natural gas production, the UK is the fourth largest producer and Norway is the fourth largest exporter.

**Figure 5.3**

**Brent Crude Oil Price (US\$)**



### Notes

1. International Comparisons of Company Profitability. *Economic Trends* No. 554, pp. 33–46. International Comparisons of Company Profitability. *Economic Trends* No. 565, pp. 33–50.
2. 'Sources of data for international comparisons of company profitability (methodology)' is available from Richard Walton at the address above. Laura Citron, a summer student at the Bank of England provided the analysis of the data on international profitability.