Financial Services Firms Upbeat as Business Volumes Rise

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The UK's financial services firms saw another rise in business volumes in the three months to June, and optimism continued to pick up across the sector, according to the latest CBI/PwC survey.

The survey of 98 firms revealed that business volumes rose across many industry sub-sectors, with the exception of finance houses and parts of the insurance industry. However, overall profitability fell unexpectedly after six quarters of robust rises, with pricing power under pressure and costs rising in many sub-sectors. At the same time, employment was scaled back.

But looking ahead to the next quarter, financial services firms expect business volumes to grow at a solid pace, profitability to rebound, and numbers employed to increase slightly.

Firms' confidence in the longer-term outlook is underlined by plans to invest more in marketing and IT over the year ahead. The most important elements in firms' growth strategies in the next three months are attracting new customers and cross-selling to existing ones. For the year ahead there are several areas of focus: among them, improvements to sales & distribution and customer relationship management.

Respondents highlighted the increased regulatory burden and inadequate systems capacity to meet demand as factors likely to limit their business over the next year.

Matthew Fell, CBI Director for Competitive Markets, said:

"Despite a surprise fall in profitability, financial services firms are upbeat about their prospects, with business volumes rising across most sectors.

"Firms are focusing on two key strategies for growth in the near-term: finding ways to retain existing customers, by offering them more products and services, and investing in marketing, sales and distribution to attract new customers.

"But the sector is still facing a number of significant challenges. The adverse impact of regulation on business expansion has crept up the agenda and concerns about the ability of firms' business systems to cope with new demand has risen to its highest level in thirteen years."

Respondents to the survey indicated that headcount fell in the quarter to June, with a slight rise expected next quarter. On the basis of ONS data, employment in the financial services sector is forecast to stand at around 1,132 by the end of Q3 2014, almost 13,000 higher than a year earlier. This would leave employment 79,000 lower than its peak in Q4 2008, but 35,000 above the trough in Q1 2010, implying that just under one third of the ground lost during crisis will have been recovered.

Kevin Burrowes, Financial Services leader at PwC, said:

"The financial services industry is benefiting from the effects of economic recovery, but that is proving to be a double-edged sword for some. The prospect of growing volumes and revenues is tempered by concerns about competition.

"However, the banks are increasingly optimistic about the economic outlook, especially in the retail arena.

"Most of those surveyed have pinpointed domestic market share gains as crucial to achieving growth.

"Banks and insurers see a growing competitive threat from non-financial services companies and new entrants are also trying to capitalise on the improved conditions. This suggests that UK financial services will see increasing pricing pressure. There is now a growing willingness to partner with technology firms and emerging rivals."

"Regulation will remain a major concern and a key driver of operating costs."

Key findings:

- 37% of financial services firms said they felt more optimistic about the overall business situation compared with three months ago, while 9% said they were less optimistic, giving a balance of +28%
- 48% of firms said that business volumes were up, while 15% said they were down, giving a balance of +33%
- Looking ahead to the next quarter, 44% of firms expect business volumes to increase, while 7% said they will decrease, giving a balance of +37%.

Incomes, costs and profits:

- Income from fees, commissions or premiums fell in the three months to June (-10%), disappointing expectations for rapid growth (+34%)
- In contrast, income from net interest, investment or trading grew (+15%), beating expectations (+8%)
- Average spreads were largely unchanged for the third consecutive quarter (0%), while average commissions/fees & premiums fell (-21%)
- Total operating costs rose slightly (+7%), much less than expected (+41%), but still pushing up the average operating cost per transaction (+15%)
- Profits fell slightly (-5%), contrary to expectations of a robust rise (+30%).
- Nevertheless, firms are confident that profits will return to growth next quarter: 42% of respondents expect profits to increase, while 12% expect them to decrease, giving a balance of +30%.

Employment:

- 19% of financial services firms said they increased employment, while 32% said it decreased, giving a balance of -12%
- Firms expect employment to increase slightly next quarter (+5%).

The next 12 months:

- Financial services firms plan to increase their marketing spend over the next 12 months, relative to the past year (+17%)
- They also plan to raise capital spending on IT (+49%)

But they expect to spend less on other areas:

- vehicles, plant & machinery (-23%)
- land and buildings (-13%).

The main factors driving investment are:

- Increasing efficiency and speed (85%)
- Dealing with statutory legislation & regulation (66%)
- Reaching new customers (47%).

Factors likely to constrain business over the next year:

- Statutory legislation & regulation (70%)
- Adequacy of systems capacity (37%).

Analysis by sector:

Banking

Optimism among banks strengthened further last quarter, amid solid growth in business volumes. While profitability was flat, expectations for a robust increase in the quarter ahead were undiminished, underpinned by predictions of a further rise in volumes, stable costs and a sharp fall in impairments. Numbers employed fell back in the three months to June, having expanded steadily over the previous three quarters, and a similar decline is expected next quarter. Investment plans remain focused on IT, motivated by a desire to increase efficiency and ensure compliance with statutory legislation & regulation. With demand uncertainty diminishing, banks are gearing up for a period of organic growth in the year ahead, through enhancements to their sales & distribution channels and CRM/marketing capabilities.

Building societies

Building societies' confidence in the outlook continues to improve. The pace of growth in business volumes picked up a little in the three months to June, although it was less strong than had been expected. However, the level of business was still deemed to be well above normal and profitability increased strongly for the seventh successive quarter, with further robust growth expected next quarter. Against this background, employment in the industry expanded further with another solid rise in headcount expected over the next three months.

Finance houses

Optimism among finance houses rose at a brisk pace in the three months to June, despite mixed results. Business volumes were flat, defying expectations of a pick-up in growth. Having declined in the previous quarter, profitability stabilised as cost pressures eased. But with volumes expected to rise across most customer groups next quarter, profitability is also expected to recover.

Life insurance

Optimism among life insurers improved for a fourth consecutive quarter, during the three months to June, though at the slowest pace over this period so far. Business volumes fell unexpectedly for a second consecutive quarter. Market conditions remain challenging for life insurers, weighing on investment incomes, and with pricing power also under pressure profits fell markedly. Although respondents expected a recovery in business volumes, profits are expected to fall at a similar pace next quarter, as costs growth picks up and investment income remains flat. Life insurers reduced employment slightly in the quarter to June, with headcount expected to edge down at a similar pace in the three months to September.

General insurance

General insurance was the only sector in the survey where respondents were less optimistic relative to three months ago. Business volumes fell for the first time since early 2013, driven by a decline in business with overseas customers. However, business volumes are expected to recover somewhat in the three months to September. Profitability fell for a second consecutive quarter, in part reflecting a sharp increase in the value of insurance claims. Profits are expected to be broadly stable next quarter. In spite of better predictions for the next quarter, general insurers nonetheless appear cautious over their hiring plans and are expecting to cut back investment across the board in the year ahead.

Insurance brokers

Optimism among insurance brokers revived last quarter, having weakened in the previous three months. Growth in business volumes picked up a little and is expected to accelerate further next quarter. Profitability was broadly stable over the three months to June, following a marked increase in the previous quarter. With profits expected to pick up over the next quarter, insurance brokers are expecting to increase headcount in the coming three months, and raise investment in the year ahead.

Jonathan Howe, PwC's UK insurance leader said:

"General insurers are the only key sector to report lower confidence. Competition and demand are major concerns and although economic recovery is driving an uptick in demand, this is unlikely to be sustainable.

"Customer acquisition is becoming a 'zero sum game' in the mature UK general insurance market - any wins are cancelled out by the losses. Insurers are looking for new ways of increasing market share other than reducing price.

"General insurers are the only major sector expecting to reduce capital investment. Despite this, investment in technology is seen as increasingly crucial to growth in this highly competitive market.

"On a more positive note, life insurers remain upbeat about their outlook despite an unexpected fall in volumes of business. The sector is hoping for a pick-up in new business over the summer as customer confidence grows."

Securities trading

Sentiment improved further in the quarter to June, but less strikingly than during the previous six months. Profitability increased comfortably for the third quarter running, reflecting strong growth in business volumes and income, as well as the fall in total costs. Profits are expected to grow at the same robust rate over the next three months. Numbers employed declined for the first time in a year and at the fastest

rate for five years, but headcount is expected to rebound next quarter.

Investment management

Sentiment about the overall business situation rose for the tenth consecutive quarter, but at the weakest pace seen over this period (10 consecutive querters). Business volumes expanded at a brisk pace, exceeding already strong expectations, driven by rising demand from industrial & commercial companies, financial institutions and overseas customers. Profitability was flat, following two quarters of strong growth, but the outlook for future profits growth remains favourable. Against this backdrop, investment management firms expect to continue taking on more staff in the coming quarter, and to boost capital spending in the year ahead.

Paula Smith, PwC's UK asset management leader, said:

"Investment managers are upbeat about their prospects after a steady performance during the last quarter. Growth in business volumes and fee income is expected to continue over the coming months. Growing risk appetite is expected to boost activity with both retail and wholesale investors.

"Firms see the development of new products and services as increasingly important to growth. This reflects increasing investor demand for low fee products such as exchange traded funds. Investment in new post-retirement products could also grow over the coming quarters.

"Interest in international expansion as a source of growth continues to climb. This is matched by increasing interest in M&A and a continuing focus on strategic partnerships.

"The importance of recognised brands when entering new markets is only likely to grow. Investment managers will be hoping that inflows to European equities continue."

Download "CBI PwC Financial Services Survey June 2014" (628kb)

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