

CBI/PricewaterhouseCoopers Survey

March 2000

“Volumes remain strong with many of the sectors showing signs of capacity constraints”

Business confidence has now been rising for over a year and the 42nd Confederation of British Industry / PricewaterhouseCoopers quarterly survey reported the fastest increase since June 1999. All the sectors covered in this bulletin have maintained rises in business confidence for at least a year, although the building society sector is struggling to maintain its optimism. Volumes remain strong with many of the sectors showing signs of capacity constraints. Certain types of employee are in huge demand, in particular, IT professionals.

Business confidence in the **banking** sector surged ahead and this is the most optimistic sector covered in this survey. A balance of 67% of banks are more optimistic about the business situation, a statistic no doubt driven by a buoyant set of results in February. A cloud on the horizon was the expected unveiling of the banking review headed by Don Cruickshank, but this was published after the survey and does not appear to have affected overall business confidence. Statutory legislation did, however, increase as a factor likely to limit the sector's ability to increase its level of business over the next 12 months and recorded a balance statistic of 68%, up 33 percentage points. The review did not contain too many surprises and the suggested referral of the provision of small business services to the Competition Commission confirmed rumours circulating in the industry. However, the strength of some of the recommendations in respect of the money transmission system will have disappointed many bankers.

The banking review claimed that the sector was not sufficiently competitive, but the survey clearly states that banks see domestic competition as, by far, the factor most likely to constrain business growth over the next 12 months. The Cruickshank review underestimated the speed with which the Internet is bringing competition to retail banking when it concluded that change was not happening fast enough in the industry. This was highlighted in the PricewaterhouseCoopers report published in February called *“The Breaking Wave, Change in the UK Banking Industry and Implications for Policymakers”*.

Employment fell despite prior expectations of robust growth. This is more consistent with the reduction in employment that we can clearly see in the sector. A rise in employment is, however, expected during the next quarter, which would suggest the sector is operating at capacity and needs specialised employees in certain areas of its business.

Building societies are no more optimistic about the overall business situation than they were in the last survey and respondents are neither optimistic nor pessimistic. The volume of business rose only slightly and by less than previously predicted. A balance of 10% of building societies said the trend in the volume of business with private individuals was up over the quarter, a considerable decrease on December's findings. On a more positive note, the sector will not be affected by the banking review in the same way as the banks. It is not at the core of the payments system and its presence in the small business sector is minimal.

Business confidence remains positive in the **general insurance** sector and overall optimism has been positive for almost two years. The trend in the value of premium income is holding up and rate increases seem to have stuck. The volume of business is strong and the level of business is still considered to be above normal. Volume increases are expected in the next quarter, but at a significantly lower rate. Average commissions are expected to fall for the first time in three years after a significant period of continuous growth. This is logical. It suggests that insurers are taking advantage of higher volumes and insurance rates to manage commission costs down. Average costs fell and this trend is also expected to continue. The growth in total operating costs is also consistent with the current business environment. Volume growth will drive total costs up and the increase in total costs is expected to continue into the next quarter.

In both of the insurance sectors covered by this bulletin, expenditure on IT is increasing, probably reflecting an increasing urgency to get to grips with new technology. Seventy two per cent of general insurers said adequacy of systems capacity was likely to limit their ability to increase the level of business over the next 12 months. This is a significant increase over the last quarter, and combined with the expectation of 77% of respondents to authorise more capital expenditure on information technology, points to a realisation that the sector has to make substantial investments. The expected increase in the trend in numbers employed could reflect a desire to increase the number of Internet and IT specialists.

The **life insurance** sector tells a similar story and more players are waking up to the challenges presented by the Internet. Seventy three per cent of life insurers expect to authorise more capital expenditure on information technology. The availability of professional staff is now considered to be the factor most likely to limit the sector's ability to increase business over the next 12 months and it is highly likely that this relates to an acute shortage of IT staff in the job market.

Life insurers remain optimistic and business confidence has now risen for a year, with this quarter recording the greatest rise since September 1997. The trend in volume growth has been bullish and although the increase in growth was lower than that reported in December, the high rate of growth reported in the second half of 1999 is expected to resume in the next quarter. The volume of business continues to be driven by business from private individuals.

Securities traders remained optimistic and a contributory factor was undoubtedly the continued rise in business volume. A balance of 86% of securities traders considered that in volume terms their present level of business is above normal. What constitutes normal volume is being redefined in the marketplace and normal is now a much greater volume of transactions. A number of factors including more private investors actively managing their investments using Internet brokers have led to a large increase. Since November the number of trades on the London Stock Exchange has ballooned from around 50,000 a day to an average of 100,000 and on some days it has hit 140,000. Similar increases in volumes have been experienced in other stock exchanges. Business with private individuals rose strongly ahead of expectations, an increase fuelled by strong interest in dot.com stocks.

Systems capacity is an issue and there is evidence of stockbrokers being unable to answer all the calls they get. A balance of 92% of traders said that the trend in the level of employment was up and this is expected to rise considerably again. As well as IT staff, a large proportion of the increase is predicted to be clerical staff as the sector gets to grips with its capacity constraints. Schwab and Barclays, who are two of the biggest brokers for small traders in the UK, are building up capacity to deal with the trading increase. Schwab has opened a new customer service centre with 100 people and increased the number of people answering phones by 60%. At a time when many clerical workers in banks will be looking over their shoulder in the face of consolidation, there is clearly a demand for them in this sector.

The main constraint on business prospects over the coming year is adequacy of systems capacity. While most players have upgraded the front end of their systems, the back office systems, in many cases, remain the same. This is another factor affecting capacity. The point is underlined by the finding that 82% of respondents said the main reason for capital expenditure authorisation over the next 12 months would be to increase efficiency and speed.

The **fund management** sector reported strong increases in business volumes and profitability, which drove optimism for the fifth consecutive quarter. Like the other sectors, total costs increased, but unlike the other sectors average costs also increased and this trend is expected to continue. It is clear that the increase in volume is not sufficient to cover the increase in costs. Fund managers are competing intensely for the same business, and as they are virtually all backed by substantial parent organisations, are able to fund the increased costs. At the same time, there is a possibility that investors are shunning more traditional investment and unit trusts in favour of more glamorous dabbling in Internet and technology stocks. Uncertainty about demand for their particular products is likely to be behind the fact that fewer fund managers expect to authorise more capital expenditure on information technology in the next 12 months than the last 12 months. In this environment, the decision by many players to expand into Europe is understandable.

Fig 1: "all the sectors covered in this bulletin have maintained rises in business confidence for at least a year, although the building society sector is struggling to maintain its optimism"

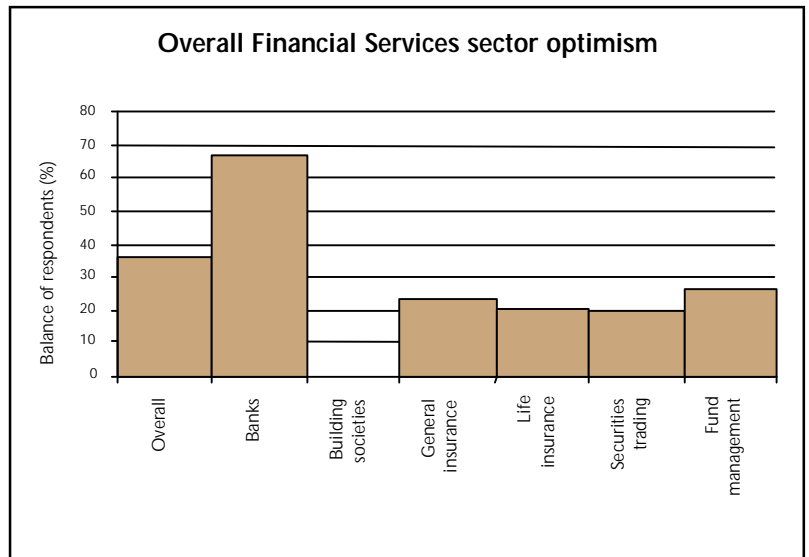
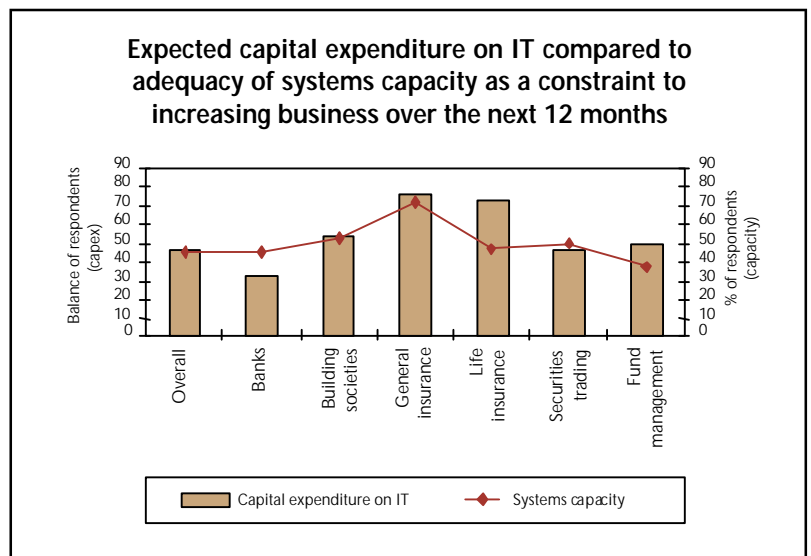


Fig 2: "in both of the insurance sectors covered by this bulletin, expenditure on IT is increasing; probably reflecting an increasing urgency to get to grips with technology"



About this survey

The survey was carried out between 25 February and 8 March 2000. A total of 150 companies responded including banks, building societies, finance houses, securities traders, fund managers, commodity brokers, venture capitalists, insurance companies and insurance brokers.

This bulletin is produced periodically to address important issues affecting the financial services industry. If any of your colleagues would like to be added to the mailing list or if you do not wish to receive further editions, please write to Angela Patel, PricewaterhouseCoopers, Southwark Towers, 32 London Bridge Street London SE1 9SY or send an email to angela.patel@uk.pwcglobal.com

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Further contacts

Copies of the full survey are available from the Confederation of British Industry, tel: 020 7395 8071, email address PubSales@cbi.org.uk. The price for a single quarter for members is £46 and for non-members is £83; an annual subscription for members is £180 and for non-members is £325.

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