

## CBI/PricewaterhouseCoopers Survey

September 2000

### “Muted optimism despite low business volume growth”

The downturn in overall business confidence reported in the previous survey was only partially redressed in the third quarter. The 44<sup>th</sup> Confederation of British Industry / PricewaterhouseCoopers quarterly survey shows that this very fragile sense of optimism owed much to a slowdown in overall business volumes, which grew at the lowest rate since December 1997. The level of confidence remains very variable across the different financial sectors, with underlying optimism amongst insurers, fund managers and securities traders more than counterbalanced by a less confident outlook amongst banks and building societies.

The last quarter has seen a surprising collapse in confidence in the **banking** sector. A balance statistic of minus 27% said that the volume of business was down over the last quarter – the largest number of banks reporting a decline since March 1992. The decline was underpinned by a sharp downward trend in the volume of business to private individuals, signalling primarily an end to the boom in mortgages. Figures from the British Bankers Association (BBA) showed that mortgage lending plunged 17% in July to its lowest level for seven months. More recent figures from the BBA show that personal lending did edge up in August – mortgage lending rose by £2,175 million and was much in line with the average underlying monthly rise of £2,100 million over the previous six months. Therefore, although August was solid rather than spectacular, it would appear that it was not sufficient to compensate for the July shortfall.

Against this backdrop of tougher market conditions, the emphasis is still on cutting costs, with the long heralded wave of staff reductions finally starting to kick in across the sector. This trend is unlikely to abate in the face of ongoing consolidation activity, with Barclays' proposed takeover of Woolwich and the proposed merger between J P Morgan and Chase Manhattan proving the latest moves to undermine job security in the banking sector. In the survey, a balance statistic of 54% said that the number employed had declined in the last quarter. Paradoxically, more and more banks (33% versus 17% a year ago) are citing the lack of professional staff as a major factor in their inability to increase the level of business. This apparent contradiction would seem to suggest that staff with specialist skills are voluntarily migrating amidst the uncertain business environment - leaving the banks in the unenviable position of having a surplus headcount, but a skills shortage in critical areas such as IT.

Also of significance is the steadily increasing number of banks that are pointing to inadequate systems capacity as a major constraint on future business growth. This highlights the fact that banks are increasingly aspiring to develop their business in new areas, such as client relationship management, but are hindered in their efforts to do so by their legacy systems.

Typically, many of the trends in banking are also prevalent amongst **building societies**. A decline in the volume of business, most notably on the personal rather than the industrial and commercial side, continues to fuel a pessimistic outlook across the sector. The sector tends to distinguish its business as either 'Back Book' (established) or 'Front Book' (new). Both ends are currently under threat – 'Front Book' is being affected by ever intensifying levels of competition, whilst even the traditionally more stable 'Back Book' is suffering as consumers increasingly look to re-mortgage. Amidst this unfavourable environment, there is an underlying concern that average spreads could continue to fall even more dramatically.

Where the building societies differ from their banking counterparts is in their level of cost control. Whereas the latter are increasingly keeping a lid on costs, this trend has yet to manifest itself amongst building societies. A net figure of 36% said that the trend in operating costs was up over the last quarter and a slightly higher percentage believe that this trend will continue over the next three months. The indication is that the sector has, thus far, failed to dispel the complacency that arose from the mortgage boom. With volumes and spreads in decline, building societies need to be tougher on cost control.

Business confidence is strongest amongst **general insurers**, with a balance statistic of 30% saying that they were more optimistic about the overall business situation in their sector. Growth in volume of business and value of fee/premium income both outstripped expectations in the last quarter, particularly in regard to private individuals. Rates are evidently holding up and effective cost-cutting continues to impact positively on underlying profitability. However, there remains a strong message that general insurers will continue to invest heavily in information technology, primarily to reach new customers and develop client relationship management programmes. All respondents said they expected capital expenditure authorisation in the next 12 months to focus on increasing efficiency/speed.

Optimism remains more cautious amongst **life insurers**. On the surface, this would seem surprising, given the recent high levels of volume growth. However, life insurers remain extremely wary of the challenges that may be awaiting them further down the line, in particular intensifying competition in the pension and investment markets. Some 94% of life insurers said that they expected domestic competition to be a major factor limiting their ability to increase the level of business over the coming year. The £6bn in cash released by Scottish Widows beginning in the last week of August came too late to have an impact on the survey – this may manifest itself more tellingly in the next quarter, with banks and fund managers likely to be the main beneficiaries.

Sentiment remains fickle amongst **securities traders**, mirroring the volatile performance of the technology sector over recent months. The correction of technology and dot.com stocks, which dramatically dampened business confidence in the last survey prompted securities traders to fear the worst for the third quarter. In the event, this pessimism was overstated, with the last quarter stronger than most would have expected. A net figure of 46% of securities traders expect business volumes to be up in the final quarter. On the basis that the fourth quarter is traditionally a quiet time of the year, this figure may seem artificially high. In essence, it reflects widespread optimism that the recovery from the second quarter is a sustainable one.

Against an industry background of consolidation, the high level of new recruitment amongst securities traders is surprising. In the previous survey, a net figure of 28% predicted a decline in numbers employed in the third quarter. However, some 44% said that headcount actually increased over

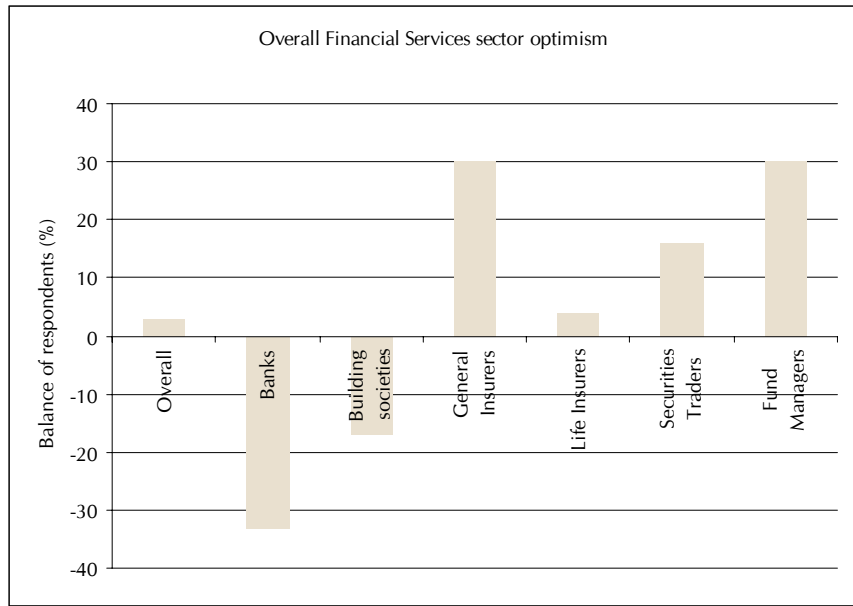
the last three months and a similar percentage are forecasting this trend to spill over into the final quarter.

The outlook for **fund managers** remains positive on the back of improving volumes of business and higher values of commission/fee income. A net figure of 42% of fund managers also said that overall profitability was up over the last quarter, reinforcing the findings of the PricewaterhouseCoopers Investment Management Survey 2000, *'Pursuing profitability: Fire on the Horizon'*. The survey shows that fund managers are currently riding out the storm of continued pricing pressure and an unprecedented agenda of operational change and disruption through improved cost management – the most significant improvement PricewaterhouseCoopers has seen in 12 years of conducting the analysis. However, the survey also warns that this is just the beginning – there is an accelerating shift in the profile of products and services towards retail style relationships and the industry structure is reorientating from vertically integrated businesses towards a network of specialist providers. The need to adjust, more than ever, to being a people business is evidently being heeded by fund managers, as demonstrated by heavy levels of recruitment and investment in training.

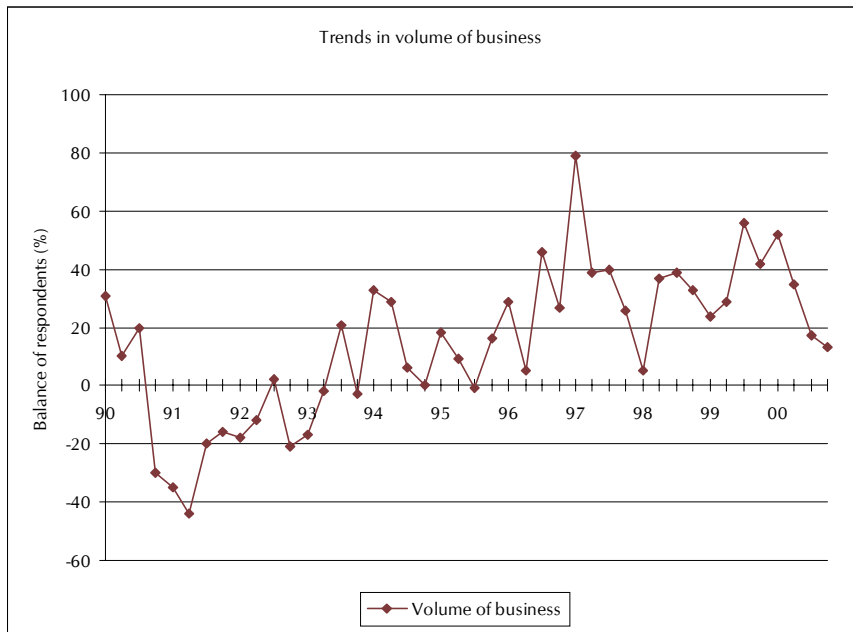
In contrast to previous surveys, not a single respondent believed that statutory legislation was a factor likely to constrain the level of business over the next 12 months. This is surprising, given the forthcoming Myners Review of Institutional Investment, whose preliminary results are due to be unveiled with November's Pre-Budget Report. The underlying objective of the Review is to make the market more liberal. Fund managers clearly believe that the Myners Review will impact favourably and ease matters, rather than give rise to any constraints. Whether this is the case remains to be seen, but nevertheless we find the universal lack of concern somewhat surprising.

Another significant finding of the survey as a whole is the increasing level of training expenditure across the various sectors. This is particularly true of fund managers and securities traders, with respective balance statistics of 87% and 47% expecting investment in training to increase in the next quarter. This underlying trend is firmly supported by PricewaterhouseCoopers's own Client Training Group (CTG). The recent experience of the CTG has been that there is an upturn in investment in training by organisations throughout the Financial Services industry. Training and other investments in human capital are increasingly seen as an important differentiator in terms of recruitment, staff retention and efficiency by many financial institutions in the banking, insurance and fund management sectors.

**Fig 1: “The downturn in overall business confidence reported in the previous survey was only partially redressed”**



**Fig 2: “Overall business volumes grew at their slowest rate since December 1997”**



**About this survey**

The survey was carried out between 23 August and 6 September 2000. A total of 143 companies responded including banks, building societies, finance houses, securities traders, fund managers, commodity brokers, private equity, 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:

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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](mailto: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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