Financial Services Survey

PRICEWATERHOUSECOOPERS

CBI/PricewaterhouseCoopers Survey

June 2000

"The first fall in business confidence for one and a half years"

In the 43rd Confederation of British Industry / PricewaterhouseCoopers quarterly survey business confidence fell slightly for the first time since December 1998. Fund managers, general insurers and banks all reported a rise in confidence, but at a slower rate than in the last survey. Confidence fell for life insurers, building societies and, most sharply, for securities traders. In all the sectors, business confidence reflected the trend in the volume of business.

In the **banking** sector, business confidence rose, but only slightly, recording a balance statistic of 5%, a marked difference to last quarter's response of 67%. Optimism was no doubt undermined by a slowdown in volume growth. In particular, business volumes with private individuals rose over the past three months, but the spectacular growth rate expected in March did not materialise. This picture was mirrored in the building society sector, which actually reported a fall in the trend in business volumes with regard to private individuals. On a more positive note, banking respondents reported a rise in the trend in volumes with regard to Industrial & Commercial Companies. The CBI Manufacturing Survey reported an unexpected increase in confidence in its March survey and an improvement in business conditions is filtering through to the banking sector.

Against a backdrop of lower volume growth it is likely that banking respondents are taking a more realistic view of the new economy, which will have had a negative impact on confidence. In a quarter when a number of banks launched high profile e-business offerings the sector reappraised the likely growth in revenues against the costs of competing as more banks entered the Internet arena.

Employment is predicted to fall for the next quarter although, ironically, this was the first quarter since June last year that numbers employed have not reportedly fallen. So far the underlying fall in employment has been masked by growth in new jobs, but the continual shedding of staff by banks is starting to come through in the survey. The predicted fall in employment is a more accurate reflection of what we can already see in the marketplace.

If business confidence is weak in the banking sector, the picture is usually worse in the **building society** sector and this quarter was no exception. Again this is driven by a fall in business volumes with regard to private individuals. The sector's reliance on mortgages will be affected by a slowdown in the housing market and in May the Nationwide reported a month on month decrease in house prices. It said that recent economic growth is moderate, the number of houses being sold is lower and consumers are feeling less confident. It suggested that house price inflation will peak in the next few months. All of the respondents in the building society sector said that the level of demand was one of the factors likely to limit their ability to increase the level of business over the next 12 months.

General insurers are one of only two sectors covered in this bulletin to report an increase in business confidence. Unlike the retail banking sector, the volume of business increased over the past three months and at a faster rate than forecast. The increase in rates is still holding and although the value of premium income rose at a slower rate than reported in March, an increase in growth is expected over the next quarter. This cyclical business is clearly benefiting from an upswing in the insurance cycle.

To take advantage of a more favourable business environment, the sector is investing to maximise its effectiveness. Ninety nine per cent of general insurers said a main reason for any expected capital expenditure authorisation over the next 12 months was to increase efficiency/speed. Another 90% of respondents said that capital expenditure would also be targeted at reaching new customers. This is a much higher response than this time last year when only 55% of respondents said they were investing to reach new customers. It is likely that some of this investment will be directed to further e-business initiatives, although these are taking longer to penetrate the market than first thought. Like retail banking, the increase in investment and marketing expenditure in this area is outstripping the anticipated increase in revenues.

During the quarter, **life insurers** received another dose of negative publicity, this time concentrated on diminishing returns from endowments and fallout from the gradual shift in the burden of pension provision towards individuals. Continuing uncertainty about stakeholder pensions will also have affected business confidence. A balance of –3% of respondents were less optimistic about the overall business situation in their sector and business confidence fell back for the first time since March 1999.

In the previous survey life insurers forecast strong growth in both volumes and profitability, which did not materialise. A balance of 14% of life insurers said that in volume terms their present level of business is down, especially with regard to private individuals, where the volume of business fell for the first time in nearly five years. Life insurers are finding it hard to increase volumes at anything other than uncompetitive terms. The survey reports that over the next three months business volumes are expected to increase, which is surprising in the context of the sector's poor reputation and difficulties in demonstrating the attractiveness of its products. Eighty per cent of life insurers said the main reason for any expected capital expenditure authorisation over the next 12 months would be to expand capacity. This represented a substantial quarter on quarter change of 36 percentage points. The sector is clearly determined to get volumes up and in doing so drive costs down. During the next quarter, average costs are expected to fall sharply.

In the last bulletin, we reported high levels of optimism for **securities traders** buoyed by strong growth in business volumes. In particular, business with private individuals was fuelled by a strong interest in dot.com stocks. Since then, share prices in the technology sector have seen a correction and small investors who experienced a roller coaster ride are now more cautious. Continuing volatility may reinforce the lack of optimism in the next survey. Ninety eight per cent of securities traders said that the level of demand is a factor likely to limit their ability to increase business over the next 12 months. The collapse of the e-business boom has affected securities traders on two levels: as well as the reduction in trading, fewer IPOs have come to market. A number of flotations have been withdrawn and those that have proceeded, such as Egg, are priced well below market expectations.

Eighty nine per cent of securities traders said that uncertainty about demand/business prospects was likely to limit their capital expenditure over the next 12 months. It is arguable whether the expected cutback in capital expenditure on IT is advisable considering that 47% of respondents said that adequacy of systems capacity is a factor likely to limit their ability to increase their level of business over the next 12 months.

For the sixth consecutive quarter, business confidence for **fund managers** rose on the back of increased business volumes. In March we were concerned that the increase in volume was not enough to cover the increase in costs. Average operating costs, however, fell significantly during the last quarter and it will be interesting to see if they remain broadly unchanged over the coming three months as predicted by the survey.

During the second quarter overseas competition emerged as a factor likely to limit the sector's ability to increase its level of business over the next 12 months. This may have been prompted by new offerings from overseas competitors, but is more likely to result from a realisation that competition through the Internet is becoming a reality, which is lowering barriers to overseas competition. The Internet allows financial supermarkets to sell competitor products as well as their own perhaps allowing them the upper hand in developing customer relationships for the future.

All of the fund managers surveyed said a main reason for any expected capital expenditure authorisation over the next 12 months would be to increase efficiency/speed and 90% said they expected to invest in the provision of new services. Eighty-eight per cent of fund managers also expect to authorise more expenditure on marketing over the next 12 months than they did in the past 12 months, a quarter on quarter increase of 51 percentage points. It is clear that the sector is building capacity in anticipation of business growth, which makes it vulnerable to a downturn.

Fig 1: "Business confidence fell slightly for the first time since 1998"

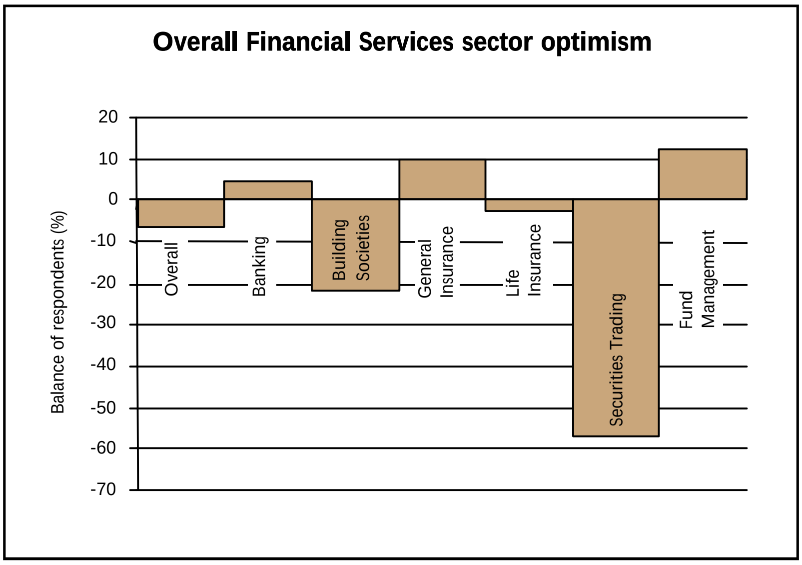
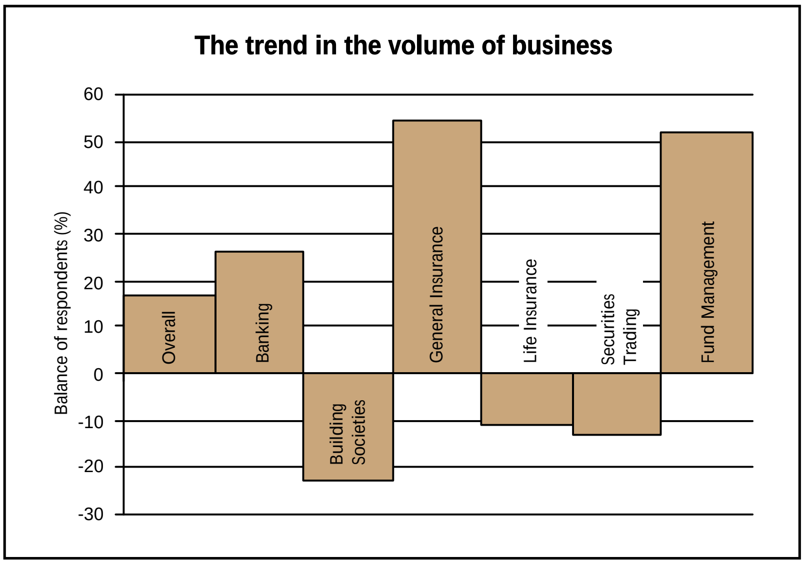


Fig 2: "In all the sectors, business confidence reflected the trends in the volume of business"



About this survey

The survey was carried out between 24 May and 7 June 2000. A total of 138 companies responded including banks, building societies, finance houses, securities traders, fund managers, commodity brokers, private equity, insurance companies and insurance brokers.

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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. 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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