



# CORK GULLY

Cork Gully on  
Financial and Business  
Services Outlook

**October 2013**

Based on a solid heritage we are an advisory firm bringing clarity to complex restructuring, recovery and insolvency situations.

The firm remains as committed to our founding principles today as we were a hundred years ago. Our partners and staff have worked together over many years, reorganising operations and structures to deliver sustainable stakeholder value. The current trading environment is increasingly complex, so the solutions we provide for our clients are more creative, more responsive and more effective than ever.

## Contents

Introduction	1
Economic update	2
Focus on the finance and business services sector	3
Outlook for business services	4
Outlook for financial services	5
Appendix 1	
- <i>Number of formal defaults in the financial and business services sector</i>	6
Appendix 2	
- <i>Forecast of annual formal defaults in the financial and business services sector in Great Britain</i>	7
The Scope of our Services	8

## Introduction

This report analyses trends in the UK's financial and business services sector. It also provides a brief update on the UK economic outlook.

The UK's economic prospects have continued to brighten significantly in recent months. Growth accelerated in the first half of 2013 and leading indicators suggest that the pace of economic expansion may have picked up even further in Q3 2013. Formal default numbers stand much lower than a year ago, reflecting this pick-up in economic prospects.

A key driver of the economic recovery appears to be a revival of business and consumer confidence, which is feeding through into greater consumer spending and business activity. Although the spending power of consumers is still being squeezed by earnings growth trailing behind inflation, the recovery in the housing market in recent months seems to be supporting consumer spending and confidence. Low interest rates, a result of the Bank of England Base Rate remaining on hold until 2015 at the earliest, will continue to support the recovery.

Significant question marks remain over the stability and sustainability of the current recovery, however, and there is a real risk of a mini-business cycle on the horizon, with economic growth slowing after the next general election. The economy at present is being propped up by the fact that the government has eased fiscal austerity in the short-term – with no deep cuts anticipated in real-terms government spending until 2016. Once these cuts kick in, economic growth could fall back. Too much growth at present is being driven by consumer and government spending, with business investment activity remaining extremely weak. The recession in the Eurozone appears to have ended in Q2 2013 and this should support exports going forward. However, slowing growth in the developing world – most notably in China – has the

potential to hinder the UK's ability to tap into export opportunities in emerging markets.

The overall financial and business services sector has seen a relatively robust recovery in recent quarters, and economic output in the sector now stands close to its pre-financial crisis peak level. Formal default numbers have fallen back accordingly – we expect the number of formal defaults in 2013 to be some 30% lower than in 2012. The sector is engaging in a significant rebalancing act, away from financial services and towards other businesses services. Excluding financial services – which remain in the doldrums – the sector's economic activity stands above pre-crisis levels. Overall, we expect formal default numbers in the financial and business services sector to continue falling over the coming years, as the sector's growth prospects remain relatively robust.

**“These are still the early stages of recovery. But we mustn't go back to square one. We mustn't lose what the British people have achieved. This is a hard, difficult road we have been following. But it is the only way to deliver a sustained, lasting improvement in the living standards of the families of this country.”**

**- Chancellor George Osborne, September 2013**

## Economic update

The UK economic recovery continues to gain momentum. Growth is becoming broader-based, with more sectors of the economy expanding. Business and consumer confidence has been on an upward trend.

UK economic growth accelerated in the second quarter of 2013, with a quarterly growth rate of 0.7%, up from the 0.4% seen in the first quarter of the year. The UK economy now seems almost certain to expand by over 1% this year, recording the strongest growth since 2010.

The GfK consumer confidence index stood at its highest level (since October 2009) in August 2013. In addition, the ICAEW Business Confidence Monitor stood at its highest level (since 2010) in Q3 2013. A recovery in confidence among consumers and businesses is starting to feed through into stronger real economic activity.

A strong recovery in business and consumer confidence has swept aside fears at the start of the year of another recession in the UK, and economic forecasts have become more upbeat to reflect this revival in confidence. In addition, forecasts have been upgraded to reflect a somewhat more benign global economic backdrop; the Eurozone economy returned to overall growth in Q2 2013, following six consecutive quarters of contraction. With the Eurozone remaining the UK's largest single export market, this tentative sign of recovery could pave the way for trade-led growth going forward.

In September, the Organisation for Economic Cooperation and Development (OECD) revised its UK economic growth forecast for 2013 to 1.5%, almost double its previous forecast of 0.8% growth for the year. The economy now looks set to grow by over 2% in 2014.

Economic growth has started to spread to more sectors of the economy, with the production industries and construction sector expanding in Q2 2013. However, the recovery continues to be heavily services-driven. While

economic output in the services sector broadly returned to its previous peak level in Q2 2013, the outputs of the production and construction sectors were 16.3% and 14.8% below their peak levels respectively.

The acceleration in economic growth according to the latest data raises questions over sustainability. While the UK economy is projected to perform even more strongly in 2014 than in 2013, supported by cooling global commodity prices, there is a real risk of growth slowing beyond this period. Economic growth could fall back in 2016, after the next general election, as government spending cuts become more severe. Spending is expected to decline only marginally in 2014 and 2015 – by just 0.2% in real terms in each year. The incumbent government has effectively postponed significant spending cuts until after the next election. Whoever wins the next election will have to make difficult spending decisions to prevent a loss of credibility in government commitment to restoring the public finances to good order. Businesses may need to prepare themselves for a mini-business cycle once these spending cuts kick in.

Formal default numbers stand significantly lower than a year ago on the latest data. In Q2 2013, the number of formal defaults was 10.0% lower than the same quarter a year ago. Nevertheless, business failure numbers remain elevated and stood 28.9% higher than in Q2 2007 on the latest data.

## Focus on the financial and business services sector

Since the financial crisis, the UK's services sector has rebalanced away from finance and focused on certain parts of the business services sector. This is likely to continue over the coming years.

Since the financial crisis, economic activity in the financial & business services (FBS) sector has recovered at a reasonable pace, and now stands broadly in line with its pre-crisis peak level of output. In Q2 2013, output stood just 0.4% below the peak in activity seen in Q1 2008. In contrast, total UK GDP stood 3.3% below its peak level. As the following sections of this report show, there is a significant difference in economic activity in financial services versus business services, with the former sector faring much worse in economic terms than the latter.

The recovery in FBS sector activity has led to a decline in formal defaults in the sector. The number of FBS business failures is expected to stand 30.0% lower than a year ago in 2013. We expect formal default numbers to fall further next year, by 6.2%, as economic growth continues to pick up and economic conditions improve in the Eurozone.

The UK's current economic recovery is being driven heavily by the services sector, particularly the business services sector. Despite all the rhetoric from politicians at the time of the last election, Britain is not "making things again" in the sense of rebalancing its economy away from services and towards manufacturing. But to say that the UK economy is therefore not adjusting is untrue. What we are seeing is a significant rebalancing within the UK's services sector, away from traditional strongholds such as financial services, and towards a range of other business services which offer the potential for the UK to achieve sustainable, robust economic growth in the future.

Nevertheless, a number of challenges remain for the UK's FBS sector. Despite a reasonable growth

performance, the sector's average growth rate remains lower than in the years preceding the financial crisis. Going forward, growth could be derailed by a worsening of the global economic environment in the short-term. While the economic situation in the Eurozone seems to at least be getting better, a slowdown in key parts of the developing world - most notably China - has the potential to curb growth prospects across the globe. Some 16% of the UK's services exports now go to Asia, and the Chinese economic slowdown, rippling through to the economies of the region, could pose a challenge to the FBS sector. In addition, an austerity drive after the next election, to deal with what still looks set to be a stubbornly high budget deficit, could lead to central and local government reining in use of financial and business services.

## Outlook for business services

The UK's business services sector has performed strongly in recent quarters, and economic activity now stands at a record high. While turnover in the management consulting sector has seen strong growth over the past year, the accounting sector has seen turnover fall from its 2011 peak.

Formal defaults in the business services sector have fallen back sharply in recent quarters and, on the latest data, stand at levels broadly comparable with that seen before the UK economy entered recession in 2008.

Indicators for the sector suggest that the level of economic activity has picked up in recent months. For many business services subsectors, turnover on the latest data is higher than before the financial crisis.

Turnover in the management consultancy sector was some 34.7% higher in July 2013 than in the same month of 2007. Research by the Management Consultancies Association (MCA) shows that international work among smaller specialist consulting firms contributed to growth last year, and many management consultancies expect overseas income to increase going forward. Many management consultancy firms believe that Asia and the Middle East are important areas for growth, suggesting that these firms will be looking to the developing world for new work opportunities over the coming years. On the downside, public sector austerity could weigh on domestic demand for management consultancy services going forward, as government demand diminishes. Although research by the MCA suggests that public sector fee income rose in 2012, income could start to fall back beyond 2015 as difficult decisions on public sector spending need to be addressed.

While turnover in the accounting, bookkeeping & auditing sector rebounded strongly in 2011 to reach an all-time high, turnover has fallen back from this peak since then. There are signs that the audit segment of the accountancy sector is becoming more price competitive, and this has placed downward pressure on

income for many firms in the industry.

The legal sector has seen a recovery of revenues in recent months following a relatively lacklustre recovery. Legal sector turnover in July 2013 was 16.7% higher than the same month a year ago, and 13.6% higher than in July 2007. The current recovery in the UK housing market, with transaction activity picking up, should support prospects for smaller firms in the legal sector through greater demand for conveyancing services.

Business services exports have risen relatively strongly in recent years, despite periods of economic downturn. This is especially true for the UK's high-tech sectors - the value of exports of computer and information services stood at £9.4 billion in 2012, 7.6% higher than a year ago and 38.2% higher than that seen in 2007. The value of exports of other business services increased much more modestly last year, by 0.5%, but growth should start to pick up given the somewhat more benign global economic backdrop at present.

## Outlook for financial services

The UK's financial services sector remains in the doldrums. But a return to growth looks likely as business and consumer lending picks up.

Since the financial crisis, the outlook for the financial services sector has been very weak. Economic output in the sector has tumbled in recent years and on the latest data (for Q2 2013), stands at its lowest level since 2005. Labour market data also illustrate the decline in activity in the financial services sector. Employment in the sector in Q2 2013 was some 7.0% lower than at its pre-financial crisis peak. That's some 85,000 fewer jobs in financial services in the UK.

Trading activity in many markets remains much lower in than before the financial crisis. And the level of merger and acquisition (M&A) activity also remains subdued; the Q2 2013 estimate for the total number of domestic and cross-border merger and acquisition (M&A) transactions involving UK companies was 111, a 42% decrease on the volume recorded in Q2 2012 (191 transactions).

Despite poor performance in recent years, there are tentative signs emerging that the economic situation for the financial services sector has at least bottomed out. The number of formal defaults in the financial services sector has fallen back to levels last seen before 2008, Business lending is likely to pick up as the recovery gains momentum, while government policy measures to support the housing market - in particular Help to Buy - have led to a sharp increase in mortgage market activity. The number of mortgage approvals for house purchase in July 2013 stood 29.9% higher than the same month a year ago, according to Bank of England data. This increase in mortgage lending activity - albeit from a relatively low base - should support a return to growth in the financial services sector.

Britain's financial services sector is likely to see structurally weaker growth than before the financial crisis, even in the medium-term. Although the 2013 Z/ Yen Global Financial Centres Index continues to place London as the most desirable financial centre in the world, questions remain over how this desirability can be maintained as the global economic balance shifts from the West to the East. The survey used to construct the Global Financial Centres Index shows that, while London continues to be well regarded by survey respondents in North America (and respondents in Latin America and the Middle East), London is less well rated by respondents from offshore centres and Asia & Pacific centres. This could pose challenges for London going forward.

Scandals in recent years, such as the Libor rate fixing, PPI, high interest rate hedging and some retail product mis-selling scandals also continue to have an impact on the reputation of the UK's - particularly London's - financial services industry. Combined with ongoing negative rhetoric from politicians regarding the size of bank bonuses, the UK's relative desirability as a hub of global finance remains fragile. Potential future moves to increase taxes on bank bonuses, while popular with the electorate, risk damaging a sector that remains crucial to the UK economy. Despite the decline in economic output in recent years, the UK's financial services industry continues to account for approximately 9% of GDP.

## Appendix 1

Number of formal defaults in the financial and business services sector

	Business services	Financial Services	Total
Q3 2007	801	61	862
Q4 2007	705	64	769
Q1 2008	937	64	1001
Q2 2008	988	70	1058
Q3 2008	1105	110	1215
Q4 2008	1950	141	2091
Q1 2009	1386	107	1493
Q2 2009	1405	140	1545
Q3 2009	1396	93	1489
Q4 2009	1309	105	1414
Q1 2010	1287	82	1369
Q2 2010	1278	100	1378
Q3 2010	1085	74	1159
Q4 2010	1125	67	1192
Q1 2011	1256	74	1330
Q2 2011	1353	71	1424
Q3 2011	1306	63	1369
Q4 2011	1262	190	1452
Q1 2012	1328	78	1406
Q2 2012	1179	73	1252
Q3 2012	925	61	986
Q4 2012	774	55	829
Q1 2013	670	51	721
	-49.5%	-34.6%	-48.7%

Source: The Insolvency Service

## Appendix 2

Forecast of annual formal defaults in the financial and business services sector in Great Britain

	Number	Annual % change
2008	5,365	
2009	5,941	10.7%
2010	5,098	-14.2%
2011	5,575	9.4%
2012	4,473	-19.8%
2013f	3,131	-30%
2013f	2,938	-6.2%
2015f	2,767	-5.8%
2016f	2,616	-5.5%
2017f	2,462	-5.9%

*\*Definition: A formal default is defined as a company entering into administration, receivership, company voluntary appointment or liquidation.*

## The Scope of our Services

### Corporate Advisory

- M&A
- Refinancing
- Fundraising
- Valuation
- Risk management

### Financial Advisory

- Debt advisory
- Independent business reviews
- Strategic reviews
- Contingency planning
- Advice to the board
- Pension advisory

### Operational Restructuring

- Chief restructuring officers
- Cash management
- Profit enhancement
- Stakeholder management

### Financial Restructuring

- Debt buy back
- Debt equity swaps
- Compromise agreements
- Demergers
- Managed exits
- New money requests
- Recapitalisation
- Return of capital
- Settlements with creditors
- Workouts

### Insolvency Solutions

- Administrations
- Company voluntary arrangements
- Insolvent liquidations
- Receiverships
- Schemes of arrangement



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