

**Scottish Financial Enterprise**

**Quarterly Survey of Scotland's Financial Services Industry**

**Sponsored by Capgemini**

---

**Quarter 3, 2006**

# This survey assesses, on a regular basis, the views of leaders of financial services businesses based in Scotland

---

## *Scottish Financial Enterprise – Q3 2006 Survey*

### **Objectives**

- To provide a snapshot of the views of financial services companies based in Scotland
- To gain insight into their performance over the last quarter and how this may change in the next
- To show how views differ between sectors
- To understand medium and long-term trends in the industry in Scotland

### **Quarterly Approach**

- Survey is undertaken across the Scottish Financial Enterprise membership base
- Questionnaire is issued to all participants at the end of each quarter
- Results are collated and aggregated by Capgemini for Scottish Financial Enterprise
- Findings refer to this and previous quarters' surveys to measure perceived vs. actual performance
- No weighting is applied to differentiate between responses received from companies of different sizes

# Six out of 10 companies anticipate improved business prospects over the next 12 months

## *Summary results from across the financial services industry*

### General Business Confidence

- Business confidence continues to be high, with over half (54%) of respondents expecting improved prospects for Q4 2006
- The outlook for the year ahead is even more positive, with 63% of companies expecting prospects to improve further
- Asset Servicing companies and Investment Managers are again the most confident about future business prospects

### Business Volumes

- Ahead of the expectations set in the last survey, nearly two thirds of businesses saw increased business volumes during Q3 2006
- 94% of the companies who took part in the survey expect their business volumes to be maintained or improve in the current quarter
- Respondents in the General Insurance, Life Assurance and Pensions sector are the most optimistic that business levels will rise in Q4 2006

### Profitability

- One third of respondents reported improved profit margins in Q3, while the majority (58%) said that profitability had remained level
- Two thirds of Investment Managers reported an increase in profitability in Q3 2006 compared to the same period the previous year

### Geographical Source of Business

- Reported turnover growth for Scotland and the Rest of the UK was higher than expected in the last quarter, while turnover over from the other regions were largely static or down
- With the exception of Asia, Q4 expectations for turnover growth for all other regions is down on the last quarter

### R&D Spend and Business Investment

- More than a quarter of respondents increased their R&D spend in Q3 2006, which was some 20 percentage points higher than the expectations from the last survey
- Most companies kept their capital expenditure level, while around a fifth (18%) increased it

### Employee Levels

- Over half (51%) of businesses increased their employee numbers in Q3 2006 which was higher than expected
- The employment outlook for the present quarter continues to be positive, with most companies (91%) expecting level or increased headcount

### Other Factors affecting business

- Level of demand continues to be the issue of greatest concern for companies and was highlighted by 88% of respondents
- Customer confidence, other economic factors (such as interest rates and market performance) and the availability of professional staff are increasing concerns for businesses

***The majority of companies reported that business volumes exceeded expectations for the sixth consecutive quarter***

SUMMARY RESULTS

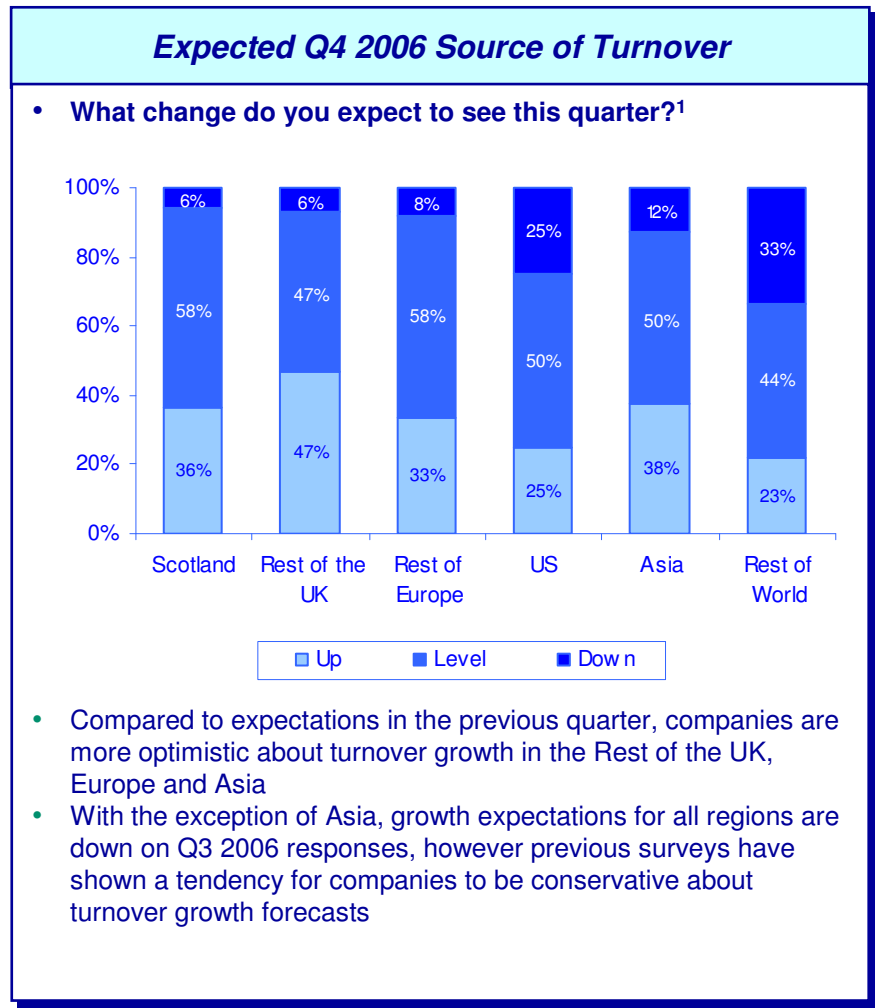
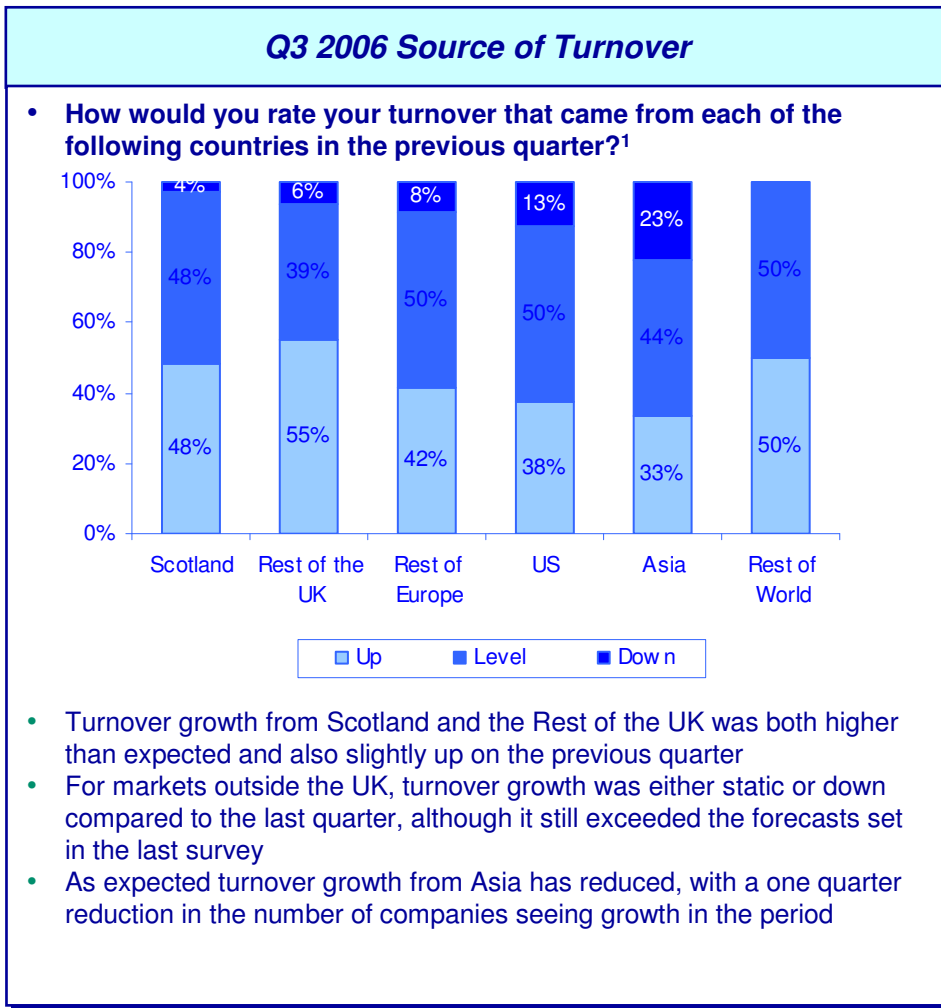
# Business confidence remains high with nearly two thirds of companies expecting their prospects to improve in the 12 months ahead

Data on Business Confidence, Volume and Profitability	Comment																																												
<p><b>General Business Confidence:</b> What is your overall confidence in your company's business prospects?</p> <table border="1"> <caption>General Business Confidence Data</caption> <thead> <tr> <th>Period</th> <th>Up</th> <th>Level</th> <th>Down</th> </tr> </thead> <tbody> <tr> <td>Q4 2006</td> <td>54%</td> <td>40%</td> <td>6%</td> </tr> <tr> <td>12 Month Forecast (to Q4 2007)</td> <td>63%</td> <td>31%</td> <td>6%</td> </tr> </tbody> </table> <p><b>Volume:</b> Excluding seasonal variations, how would you rate the level of business?</p> <table border="1"> <caption>Volume Data</caption> <thead> <tr> <th>Comparison</th> <th>Up</th> <th>Level</th> <th>Down</th> </tr> </thead> <tbody> <tr> <td>Q3 2006 vs. Q2 2006</td> <td>63%</td> <td>31%</td> <td>6%</td> </tr> <tr> <td>Q3 2006 vs. Q3 2005</td> <td>71%</td> <td>20%</td> <td>9%</td> </tr> <tr> <td>Q4 2006 Forecast</td> <td>51%</td> <td>43%</td> <td>6%</td> </tr> </tbody> </table> <p><b>Profitability:</b> How would you rate your margin?</p> <table border="1"> <caption>Profitability Data</caption> <thead> <tr> <th>Comparison</th> <th>Up</th> <th>Level</th> <th>Down</th> </tr> </thead> <tbody> <tr> <td>Q3 2006 vs. Q2 2006</td> <td>33%</td> <td>58%</td> <td>9%</td> </tr> <tr> <td>Q3 2006 vs. Q3 2005</td> <td>48%</td> <td>39%</td> <td>12%</td> </tr> <tr> <td>Q4 2006 Forecast</td> <td>30%</td> <td>64%</td> <td>6%</td> </tr> </tbody> </table>	Period	Up	Level	Down	Q4 2006	54%	40%	6%	12 Month Forecast (to Q4 2007)	63%	31%	6%	Comparison	Up	Level	Down	Q3 2006 vs. Q2 2006	63%	31%	6%	Q3 2006 vs. Q3 2005	71%	20%	9%	Q4 2006 Forecast	51%	43%	6%	Comparison	Up	Level	Down	Q3 2006 vs. Q2 2006	33%	58%	9%	Q3 2006 vs. Q3 2005	48%	39%	12%	Q4 2006 Forecast	30%	64%	6%	<p><b>General Business Confidence:</b></p> <ul style="list-style-type: none"> <li>General business confidence remains high with over half of respondents stating that their overall level of confidence had increased in Q3</li> <li>Nearly two thirds of companies believe their prospects will improve over the next 12 months – 13 percentage points higher than the forecast in Q2 2006</li> </ul> <p><b>Volume:</b></p> <ul style="list-style-type: none"> <li>Almost two thirds of companies reported improved business volumes, which was higher than expected</li> <li>71% of respondents reported an increase in business volumes compared to the same quarter last year</li> <li>Nearly all companies (94%) expect volumes to rise or stay level for the current quarter</li> </ul> <p><b>Profitability:</b></p> <ul style="list-style-type: none"> <li>Most companies reported level or improved profit margins in Q3 2006, while few (9%) saw a fall</li> <li>Almost half of survey respondents (48%) increased profit margins in Q3 compared to the same time last year with just 12% reporting a fall, which is down from 28% in the last survey</li> <li>Around one in three companies expect to increase profit margins in the coming quarter, double the expectations set in Q2 2006</li> </ul>
Period	Up	Level	Down																																										
Q4 2006	54%	40%	6%																																										
12 Month Forecast (to Q4 2007)	63%	31%	6%																																										
Comparison	Up	Level	Down																																										
Q3 2006 vs. Q2 2006	63%	31%	6%																																										
Q3 2006 vs. Q3 2005	71%	20%	9%																																										
Q4 2006 Forecast	51%	43%	6%																																										
Comparison	Up	Level	Down																																										
Q3 2006 vs. Q2 2006	33%	58%	9%																																										
Q3 2006 vs. Q3 2005	48%	39%	12%																																										
Q4 2006 Forecast	30%	64%	6%																																										
<p><b><i>Over half of companies expect their business volumes to increase in the coming quarter</i></b></p>																																													

Note: Percentages may not add up to 100% due to rounding

SUMMARY RESULTS

# The number of companies reporting an increase in turnover was higher than anticipated across all regions for Q3 2006



**Significantly reduced turnover from the US and Rest of World are anticipated for Q4 2006**

Note: Percentages may not add up to 100% due to rounding

SUMMARY RESULTS

# Over half of companies reported an increase in headcount and one on four increased their R&D expenditure in the last quarter

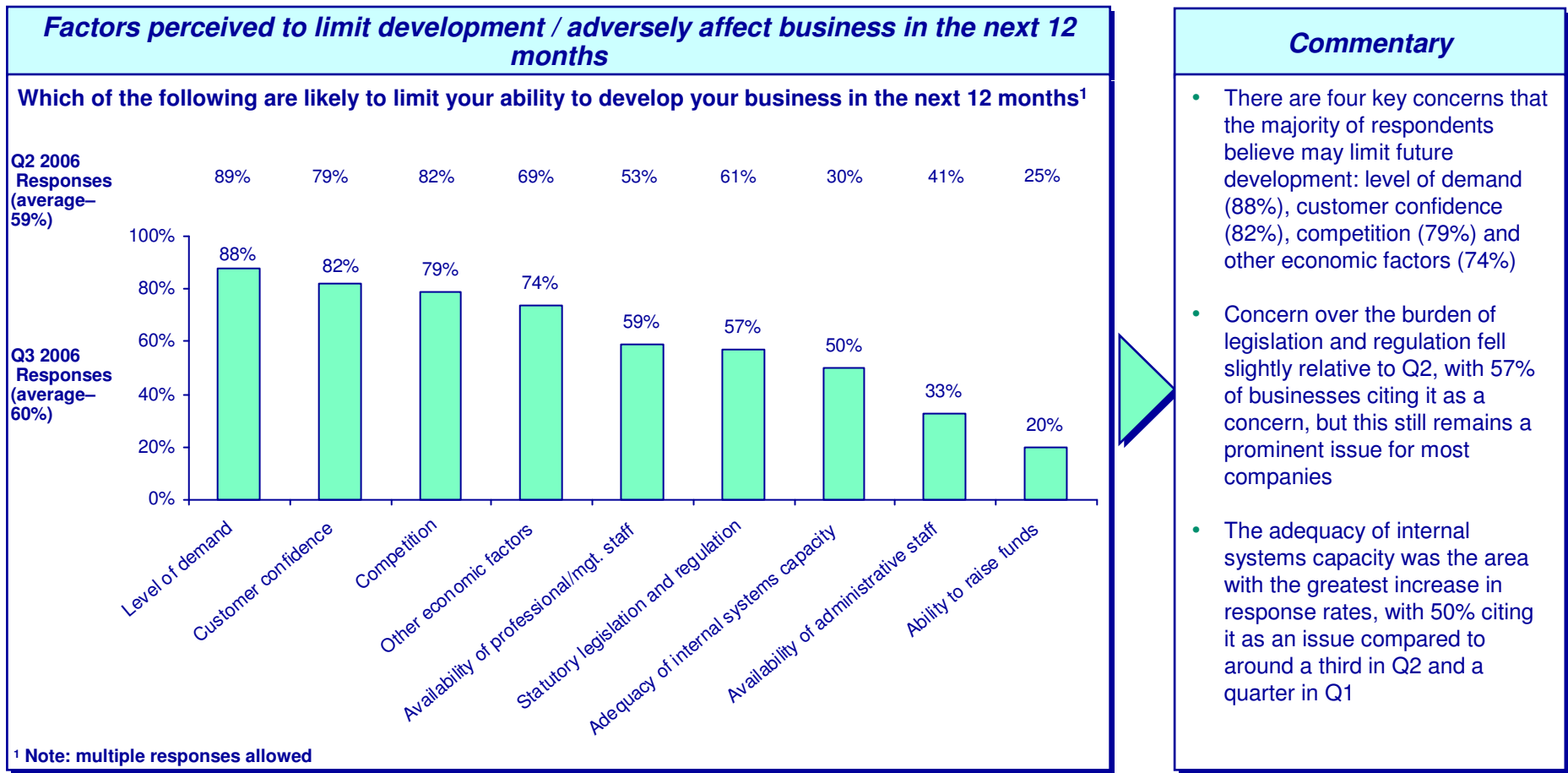
Data on Business Investment, R&D and Employment Levels	Comment																																				
<p><b>Business Investment:</b> How would you rate your levels of capital expenditure?</p> <table border="1"> <caption>Business Investment Data</caption> <thead> <tr> <th>Period</th> <th>Up</th> <th>Level</th> <th>Down</th> </tr> </thead> <tbody> <tr> <td>Q3 2006 vs. Q2 2006</td> <td>18%</td> <td>71%</td> <td>12%</td> </tr> <tr> <td>Q4 2006 Forecast</td> <td>24%</td> <td>68%</td> <td>9%</td> </tr> </tbody> </table> <p><b>R&amp;D:</b> How would you rate your R&amp;D spend?</p> <table border="1"> <caption>R&amp;D Spend Data</caption> <thead> <tr> <th>Period</th> <th>Up</th> <th>Level</th> <th>Down</th> </tr> </thead> <tbody> <tr> <td>Q3 2006 vs. Q2 2006</td> <td>26%</td> <td>74%</td> <td>0%</td> </tr> <tr> <td>Q4 2006 Forecast</td> <td>13%</td> <td>77%</td> <td>10%</td> </tr> </tbody> </table> <p><b>Employment Levels:</b> Excluding seasonal variations, how does your headcount compare with the previous quarter?</p> <table border="1"> <caption>Employment Levels Data</caption> <thead> <tr> <th>Period</th> <th>Up</th> <th>Level</th> <th>Down</th> </tr> </thead> <tbody> <tr> <td>Q3 2006 vs. Q2 2006</td> <td>51%</td> <td>43%</td> <td>6%</td> </tr> <tr> <td>Q4 2006 Forecast</td> <td>37%</td> <td>51%</td> <td>11%</td> </tr> </tbody> </table>	Period	Up	Level	Down	Q3 2006 vs. Q2 2006	18%	71%	12%	Q4 2006 Forecast	24%	68%	9%	Period	Up	Level	Down	Q3 2006 vs. Q2 2006	26%	74%	0%	Q4 2006 Forecast	13%	77%	10%	Period	Up	Level	Down	Q3 2006 vs. Q2 2006	51%	43%	6%	Q4 2006 Forecast	37%	51%	11%	<p><b>Business Investment</b></p> <ul style="list-style-type: none"> <li>The proportion of respondents increasing their levels of investment was in keeping with Q2 forecasts, while most (71%) maintained their expenditure</li> <li>In line with expectations, 12% of companies reported reduced capital expenditure in Q3 2006</li> <li>Nearly a quarter of businesses expect to increase their capital spending in Q4 2006</li> </ul> <p><b>Research and Development</b></p> <ul style="list-style-type: none"> <li>The increase in R&amp;D spending was much higher (20 percentage points) than anticipated in the Q2 survey</li> <li>No respondents reported a reduction in R&amp;D expenditure for the past quarter; 10% of companies anticipate that spending will fall in Q4 2006</li> </ul> <p><b>Employment Levels</b></p> <ul style="list-style-type: none"> <li>Over half of all respondents (51%) reported an increase in headcount, which is 13 percentage points higher than the expectation set in Q2</li> <li>The outlook for Q4 2006 remains positive, with around 9 out of 10 businesses anticipating employee levels will increase or stay the same</li> <li>37% of companies expect to increase staffing levels in Q4 2006</li> </ul>
Period	Up	Level	Down																																		
Q3 2006 vs. Q2 2006	18%	71%	12%																																		
Q4 2006 Forecast	24%	68%	9%																																		
Period	Up	Level	Down																																		
Q3 2006 vs. Q2 2006	26%	74%	0%																																		
Q4 2006 Forecast	13%	77%	10%																																		
Period	Up	Level	Down																																		
Q3 2006 vs. Q2 2006	51%	43%	6%																																		
Q4 2006 Forecast	37%	51%	11%																																		

**Capital expenditure in Q4 2006 is forecast to be up on the previous quarter**

Note: Percentages may not add up to 100% due to rounding

SUMMARY RESULTS

# Worries over customer confidence continue to increase, while level of demand remains the factor of greatest concern to businesses



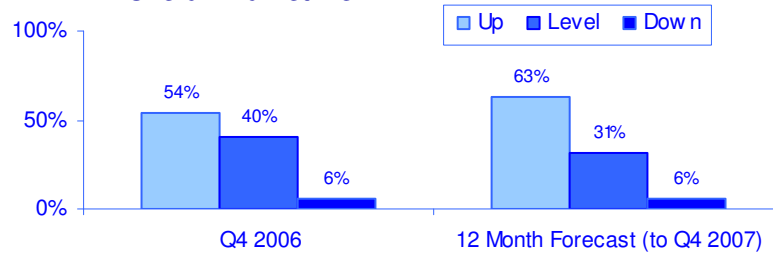
Note: 'Other economic factors' include interest rates, global market performance and other global events that might have an economic impact

***The availability of professional/management staff and other economic factors, such as interest rates and global market performance, have become increasing concerns for companies over the last quarter***

# The majority of companies across the sectors are confident about their business prospects for Q4 2006

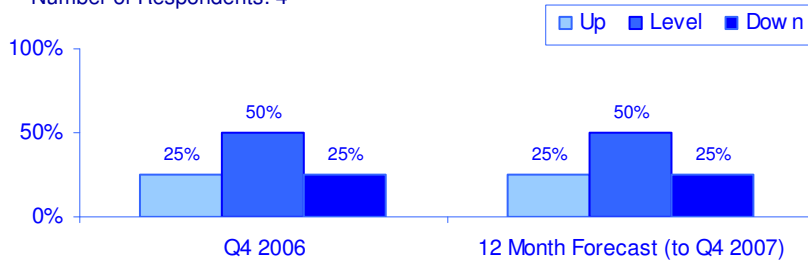
*What is your overall confidence in your company's business prospects?*

Overall market view



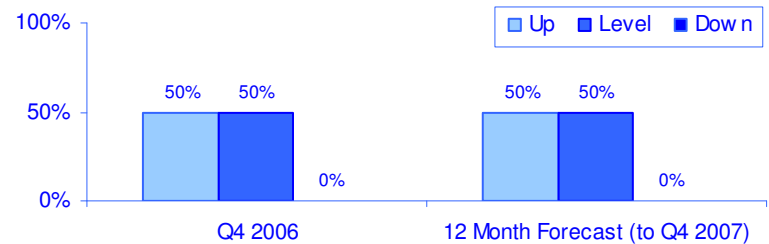
## Banks and Building Societies

Number of Respondents: 4



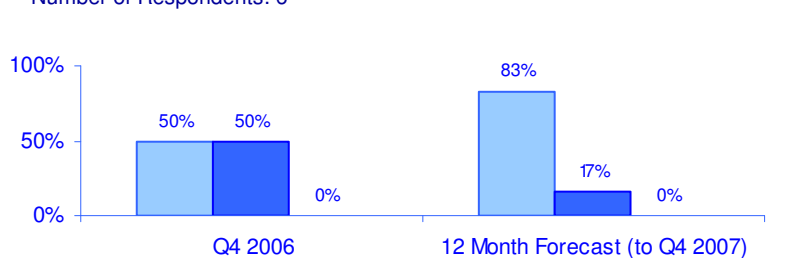
## General Insurance, Life Assurance and Pensions

Number of Respondents: 4



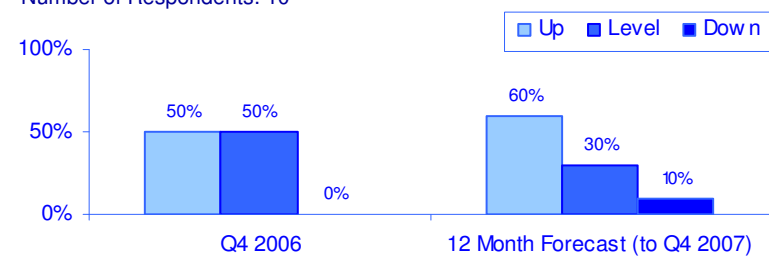
## Asset Servicing

Number of Respondents: 6



## Investment Managers

Number of Respondents: 10

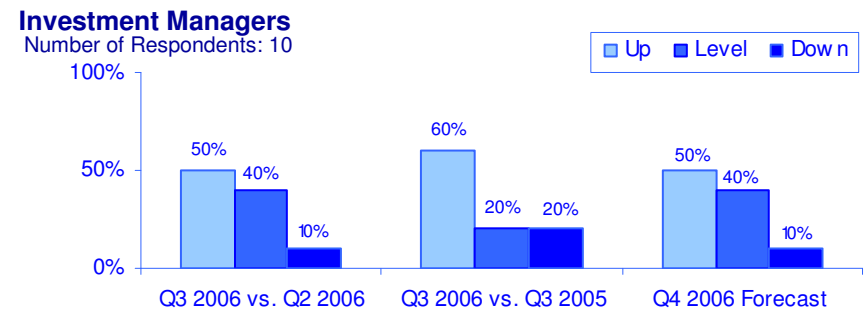
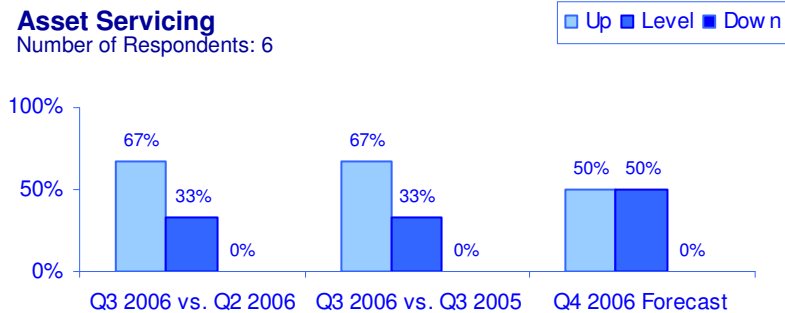
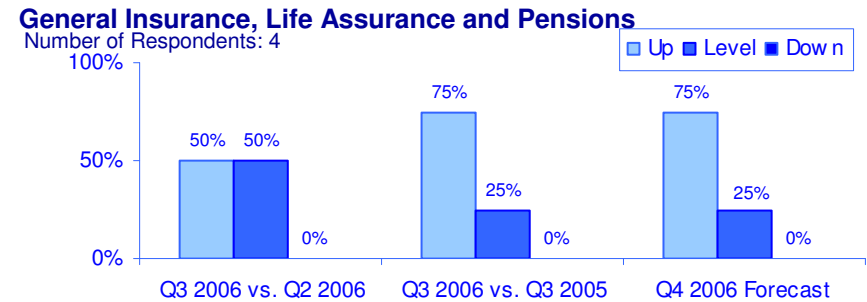
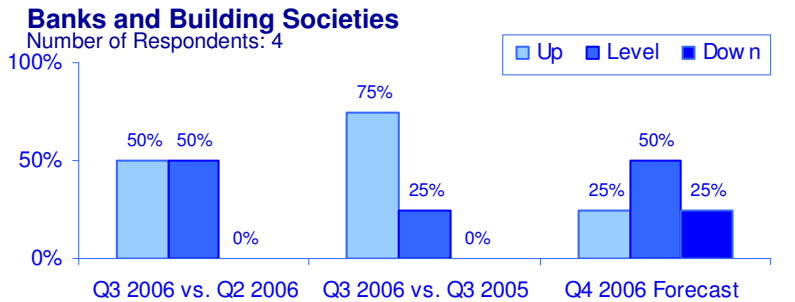
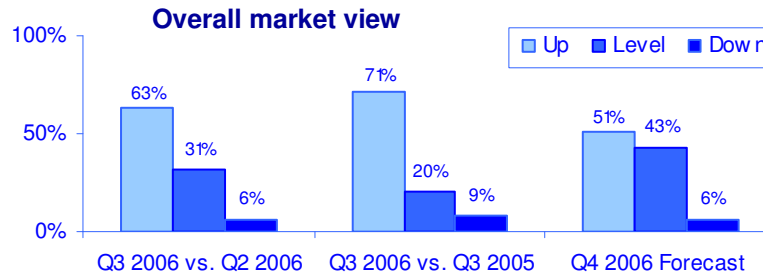


***Confidence is high for the year ahead for most companies within the main sectors, with a particularly bullish outlook once more for Asset Servicing***

Note: Percentages may not add up to 100% due to rounding

# Levels of business are up on the previous year across all main sectors and higher generally higher than the expectations set in the last quarter

*How do you rate the level of business?*



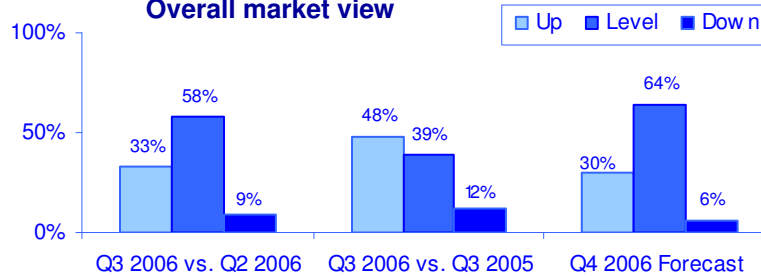
***The outlook for business levels in Q4 2006 is particularly strong for respondents in the General Insurance, Life Assurance and Pensions sector***

Note: Percentages may not add up to 100% due to rounding

# Profitability across the main sectors was broadly in line with Q2 forecasts, while General Insurance, Life Assurance and Pensions margins were higher than expected

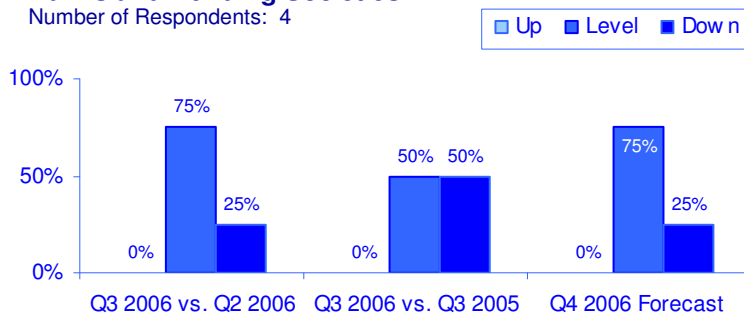
## How do you rate your profit margin?

Overall market view



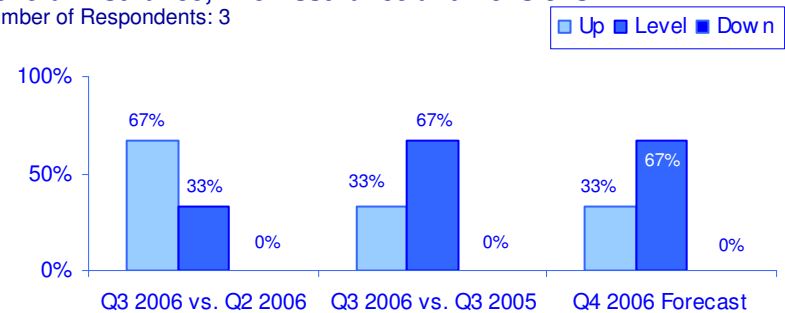
### Banks and Building Societies

Number of Respondents: 4



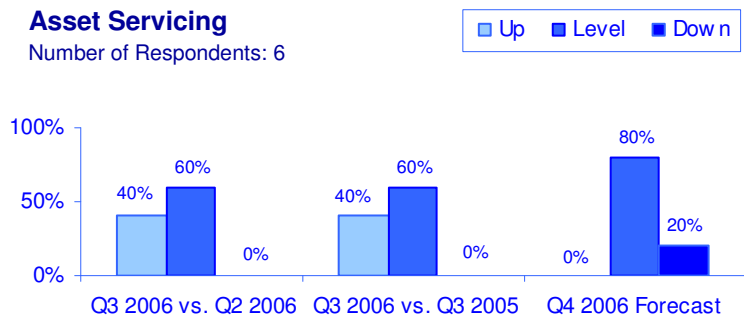
### General Insurance, Life Assurance and Pensions

Number of Respondents: 3



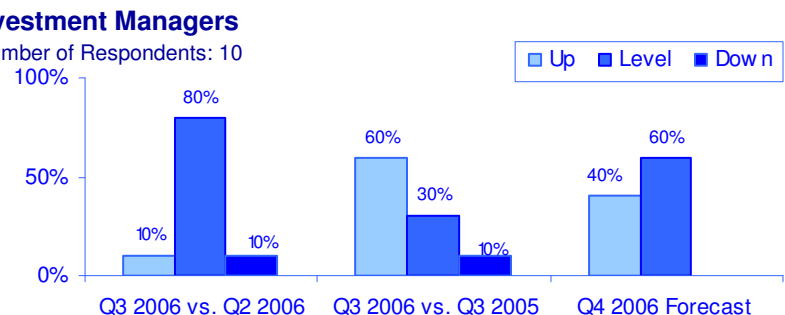
### Asset Servicing

Number of Respondents: 6



### Investment Managers

Number of Respondents: 10



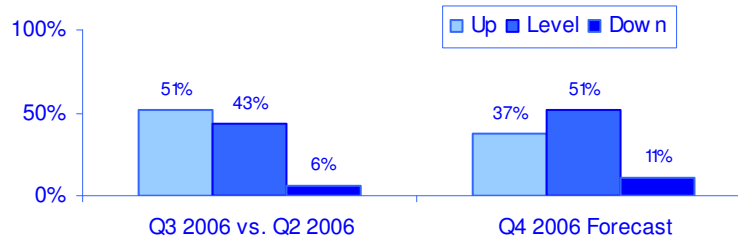
**Most companies in the main sectors expect to maintain their profit margins in the current quarter, with all Investment Managers and General Insurance, Life and Pensions respondents anticipating improved or level profitability**

Note: Percentages may not add up to 100% due to rounding

# All Asset Servicing respondents reported a rise in employee numbers, while most companies maintained or increased headcount

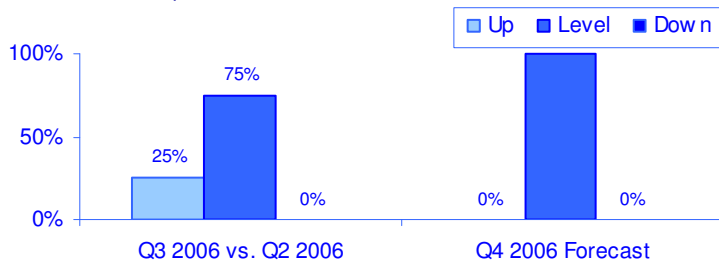
*How would you rate employment levels?*

Overall market view



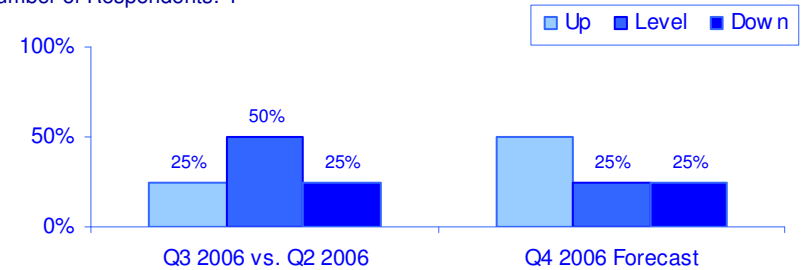
## Banks and Building Societies

Number of Respondents: 4



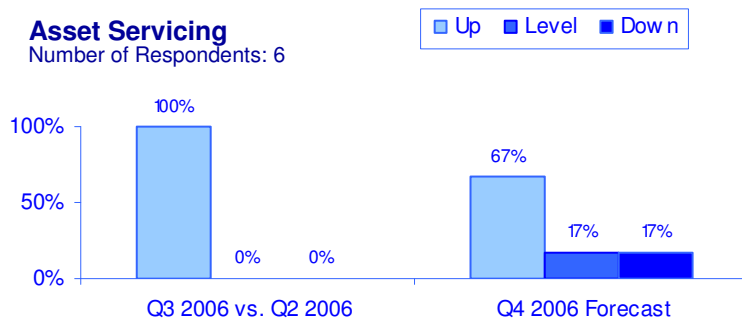
## General Insurance, Life Assurance and Pensions

Number of Respondents: 4



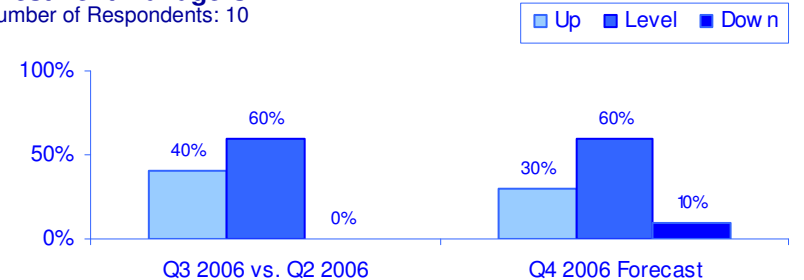
## Asset Servicing

Number of Respondents: 6



## Investment Managers

Number of Respondents: 10



***The outlook across the sectors for Q4 2006 is more mixed; 50% of General Insurance, Life Assurance and Pensions companies and 67% of Asset Servicing companies expect to increase staffing levels***

Note: Percentages may not add up to 100% due to rounding