

Commonwealth Bank

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# Future Business Index

October 2011 – March 2012



**Commonwealth**Bank



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## What lies ahead?

In an increasingly uncertain economic environment, this report examines some of the key questions confronting Australian business leaders. We asked financial decision-makers across Australia for their insights on the factors affecting their businesses — and whether they are prepared for more volatility.



In the aftermath of the global financial crisis, we live in a very different world, one fraught with uncertainty and a decline in both consumer and business confidence. This time around we face a different type of crisis, with tensions focused on the sovereign debt issues across Europe and the US. Volatile international markets continue to be driven by sentiment, making it difficult for Australian businesses to gain a clear line of sight and develop clear strategies for the future.

With all of this uncertainty, many businesses are asking themselves what lies ahead and how can they bolster their performance, their revenue and profit. With that in mind, we are pleased to bring you the inaugural *Commonwealth Bank Future Business Index*.

This study, based on a survey of businesses operating in mid-market corporate Australia, seeks to identify:

- The level of confidence in business conditions over the next six months
- The challenges and threats businesses face over the next six months
- How prepared businesses are to navigate volatile conditions
- The use of financial facilities and risk planning
- Expected sources of growth and opportunities

Australia's mid-market businesses play an essential role in driving our economy. By understanding the views of financial decision-makers within these organisations, we can gain a valuable insight into this sector's view of the economy, the impact of domestic and international conditions on day-to-day operations, where pressure is coming from, and where new opportunities exist.

By combining these findings with analysis from our economics team, this report aims to bring you an understanding of what the next six months will look like and, most importantly, how prepared these businesses are to survive the uncertain road that lies ahead. We trust that you will find it valuable.

Symon Brewis-Weston  
Executive General Manager  
Corporate Financial Services

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## About the survey

The Commonwealth Bank *Future Business Index* is based on a detailed quantitative survey of 427 financial decision-makers in public and private companies throughout Australia with turnover between \$10 million and \$100 million, conducted between 26th July 2011 and 15th September 2011. Conducted by ACA Research\*, the *Future Business Index* is an indicator of what the business landscape will look like over the next six months, based on business confidence, predicted future activity and an organisation's ability to manage fluctuating business conditions. The survey sample includes businesses from a range of sectors including Retail, Business Services, Construction, Health & Education, Information Media and Telecommunications, Manufacturing, Mining, Transport and Logistics and Wholesale Trade. The data has been weighted to reflect the latest Australian Bureau of Statistics Business Counts.

The Index seeks to identify:

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- How prepared businesses are to navigate volatile conditions
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### *How the Index is calculated*

- The Commonwealth Bank Future Business Index has been calculated by taking a net balance of future business conditions, net revenue and risk as indicated by businesses with an annual turnover of \$10 to \$100 million.
- Net Business Conditions is a net balance of those that indicated that business conditions will improve minus those who see business conditions will decline.
- Net Revenue is calculated by those that see an increase in revenue of the next six months minus those that foresee a decline.
- Net Well Preparedness is a net balance of those that are Well Prepared minus those that are Somewhat and Not Well Prepared.

### *About ACA Research*

ACA Research is a full-service market research consultancy, with particular expertise in customised business-to-business thought leadership, executive research and syndicated multi-client studies throughout Australia, New Zealand and Asia. Through a high level of business and research experience, industry expertise and focus on high-quality outputs, ACA Research effectively supports business thought leaders in their decision-making activities.



## Economic perspective

Despite the negativity witnessed amongst businesses in mid-market corporate Australia, the story across the country remains mixed.



The Commonwealth Bank Future Business Index highlights the mixed conditions affecting Australia's economy. On the whole, the index paints a picture of a downbeat outlook overall for the next six months. However there are extreme divergences between industries, and also across regions.

The strongest industries are those linked to the major long running trends in the economy – health, education and of course, the mining boom. The ageing of the population provides a strong support for the health sector, and the lift in births in the second half of the 2000s is beginning to boost school enrolments. Construction and mining firms are also stronger, reflecting the boom in commodity prices and construction of new mining projects.

Those industries on the other side of the structural change coin – retailing and manufacturing – were among the sectors with very weak outlooks.

Regionally, WA and Queensland firms were optimistic in their sales outlooks.

Surprisingly, the *Index* for SA and NT was strong, with the most optimistic outlooks for sales and business conditions. Firms in the regions on the other side of the two speed economy – NSW / ACT, VIC / TAS – were downbeat.

The outlook for the US economy was the major international uncertainty firms were concerned about over the next six months. In contrast to financial markets, firms were more concerned about a slowdown in Asia, and China specifically, than the European sovereign debt crisis.

But firms aren't standing still and ignoring the potential risks. Some 43% of firms stated they were well prepared to handle fluctuations in business conditions over the next six months, with 26% of firms stating that their strong financial position was key to their preparedness.

James McIntyre  
Senior Economist  
Commonwealth Bank



## Executive summary

Organisations across Australia have a generally negative outlook for business conditions over the next six months, with a third of all mid-market organisations saying that conditions will decline.

### Salary and cost pressures drive negative outlook

Although mid-market organisations expect revenues to increase over the next six months, they expect there to be significant upward pressure on salaries and operating costs, impacting profits.

In particular, businesses believe they will be affected by rising energy and fuel costs. Other significant concerns include the fluctuating Australian dollar and the fact that weak economic conditions in the US and a potential slowdown in China and other parts of Asia may affect demand.

Looking across sectors and states:

- Companies with a turnover between \$20 million and \$49 million are most negative.
- Businesses in Victoria and New South Wales are more negative than those elsewhere in the country.
- Wholesale trade, Retail, Transport and Manufacturing sectors are more negative than other sectors.
- Foreign owned companies are more negative than Australian owned companies.

The general lack of confidence looks likely to result in a low appetite for risk and capital investment over the next six months. In particular, businesses in the Business Services, Mining and Wholesale sectors do not anticipate an increased appetite for risk during 2011.

### Many organisations are under-prepared for further volatility

Although the majority of organisation claim to be prepared for continuing fluctuations in business conditions, less than half (43%) say they are well prepared. Those companies in the Business Services, Health and Education sectors are most likely to be well prepared, while those in Manufacturing and Mining are less likely to be prepared. A significant number of companies do not have risk, business continuity and succession plans in place to mitigate any unexpected events or further economic downturns.

Those organisations that are well prepared are more inclined to indicate that business conditions will improve over the next six months.

The majority of organisations (79%) claim to have access to adequate finance to overcome any negative fluctuations in business conditions. However, those in the Information, Media and Telecommunications sector, and those with a turnover of \$10 million to \$19 million are less confident about their access to credit.

To minimise exposure to ongoing economic fluctuations, many organisations will increase their use of hedging (particularly Manufacturers) and their use of debt facilities for capital investment and cash flow management (particularly Mining and Transport companies).

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## Companies continue to seek new opportunities

Despite their lack of confidence in business conditions, companies are still looking for opportunities to expand, diversify and acquire.

Companies in the Business Services sector are more likely than others to be considering diversification, mergers and acquisitions, and international expansion. The Mining sector is also likely to consider mergers and international expansion, with organisations in Western Australia particularly likely to consider increasing investment.

Organisations in the Information, Media and Telecommunications sector, and those with a turnover of more than \$20m are most likely to expand domestically.



## Sector outlook

### Key findings

- Companies in the Health and Education sector and Mining sector have some of the highest levels of confidence about business conditions over the next six months. In contrast, the Wholesale, Retail and Manufacturing sectors are more negative than other sectors.
- In the Mining sector, confidence continues to be driven by international demand for resources. As a result, mining companies anticipate an increase in capital expenditure, headcount, investment and international expansion.
- The Health and Education sector is relatively insulated from international economic uncertainty, with the sector anticipating an increase in investment in their existing businesses.
- Companies with turnover between \$50 million and \$99 million turnover are more confident than those with a lower turnover. Accordingly they are more likely to expect an increase in both profit and headcount..

### Sector findings at a glance

	Net business conditions	Net revenue	Net preparedness	Future Business Index
<b>By sector</b>				
Health and Education	9	33	10	17.3
Business Services	-8	40	13	15
Construction	-2	19	-2	5
Mining	16	46	-58	1.3
Information, Media and Telecommunications	-13	38	-22	1
Transport and Logistics	-16	26	-17	-2.3
Retail	-8	9	-22	-7
Manufacturing	-15	32	-41	-8
Wholesale trade	-30	-5	-5	-13.3
<b>By annual turnover</b>				
\$10m–\$19m	-9	22	-23	-3.3
\$20m–\$49m	-15	21	-8	-0.7
\$50m–\$99m	-2	35	3	12

We analysed the outlook for each sector using three key metrics:

- **Net business conditions** shows the net percentage of businesses in the sector who forecast that overall business conditions will improve, calculated by subtracting the percentage of businesses forecasting a decline from the percentage forecasting an improvement.
- **Net revenue** shows the net percentage of businesses in the sector who forecast that their revenue will increase, calculated by subtracting the percentage of businesses forecasting a fall from the percentage forecasting a rise.

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- **Net preparedness** shows the net percentage of businesses in the sector who are well prepared for future volatility, calculated by subtracting the percentage of businesses who say they are underprepared from the percentage who are well prepared.

The Commonwealth Bank *Future Business Index* for each sector is the average of these three metrics.



## State outlook

### Key findings

- While Western Australia recorded the highest Index score across the country, the outlook for business conditions in the west has been negatively impacted by a forecast increase in wage costs and the potential for an economic slowdown in Europe and Asia.
- Victorian and Tasmanian businesses expect to be strongly affected by rising energy costs and increased domestic competition, contributing to the lowest Index score across all of the states.
- While Queensland businesses expect operating costs to rise, they are among the best prepared for future economic volatility.
- Overall, businesses across the country forecast rising revenues, with Western Australia and Queensland businesses most likely to forecast a revenue increase.

### State findings at a glance

State	Net business conditions	Net revenue	Net preparedness	Future Business Index
NSW and ACT	-1	25	-24	0
QLD	<b>-22</b>	26	<b>5</b>	3
SA and NT	<b>2</b>	<b>36</b>	<b>-26</b>	4
VIC and TAS	-18	14	-17	<b>-7</b>
WA	-5	29	-7	<b>5.7</b>

### Outlook for business conditions by state

State	Salaries and wages	Operating costs	Revenue	Profit	Capital Expenditure	Headcount	Appetite for risk
NSW and ACT							
▪ Expect increase	<b>48%</b>	<b>49%</b>	45%	40%	33%	29%	21%
▪ Expect decrease	11%	14%	20%	27%	22%	29%	<b>17%</b>
Queensland							
▪ Expect increase	<b>50%</b>	61%	52%	46%	32%	28%	<b>24%</b>
▪ Expect decrease	5%	11%	26%	24%	32%	23%	<b>28%</b>
SA and NT							
▪ Expect increase	61%	47%	51%	34%	32%	39%	14%
▪ Expect decrease	4%	9%	15%	35%	35%	16%	24%
VIC and TAS							
▪ Expect increase	54%	<b>50%</b>	40%	40%	32%	28%	<b>25%</b>
▪ Expect decrease	7%	17%	26%	35%	27%	19%	24%

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WA							
▪ Expect increase	<b>70%</b>	66%	53%	36%	40%	30%	<b>11%</b>
▪ Expect decrease	5%	10%	25%	27%	31%	16%	<b>32%</b>

Indicates value is significantly higher than other subgroups within the column.

Indicates value is significantly lower than other subgroups within the column.



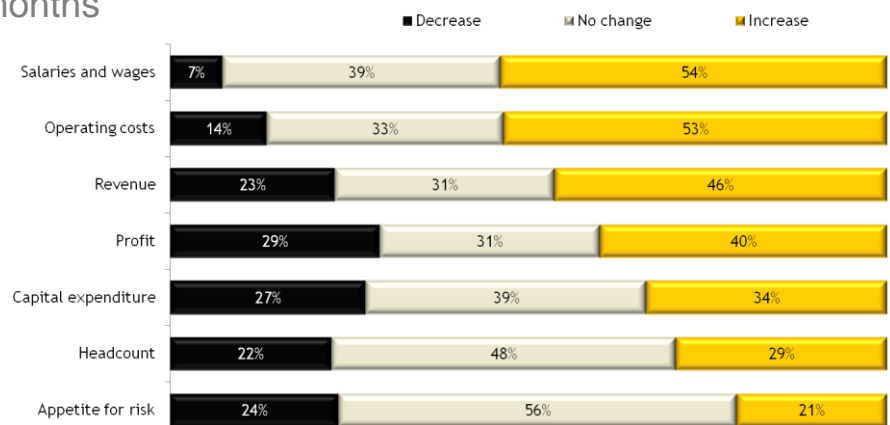
## Business conditions

### Key findings

- Organisations across Australia have a generally negative outlook for the next six months, with 34% expecting a decline in business conditions and only 24% expecting improvement.
- Almost half of the businesses surveyed expect revenues to increase over the next six months. However, most also forecast rising salaries, wages and operating costs.
- Rising energy and fuel costs were the most frequently cited drivers of higher operating costs, particularly in the mining, transport and logistics sectors.
- Global economic weakness remains a significant concern, especially in the Mining, Information, Media and Telecommunications sectors.

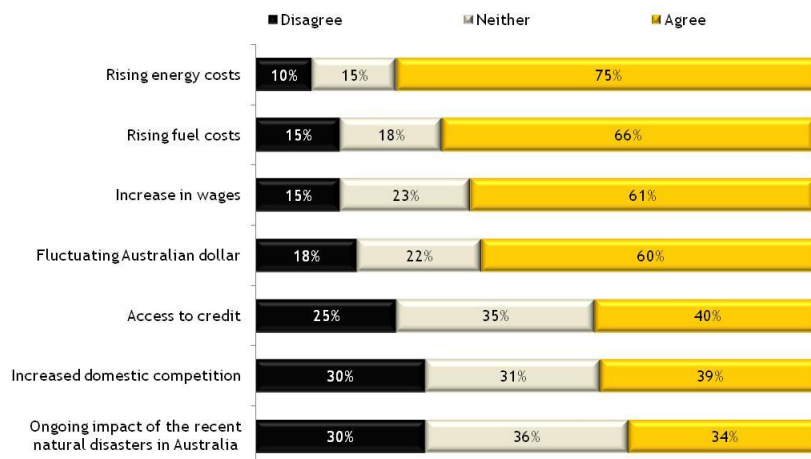
### The outlook for the next six months

While the majority of businesses expect revenues to either increase or remain steady over the next six months, most also forecast rising salaries, wages and operating costs, lowering profit expectations.



### Domestic factors

Rising energy and fuel costs are forecast to be the largest contributors to higher operating costs, alongside higher wages, the buoyant Australian dollar and rising interest rates.



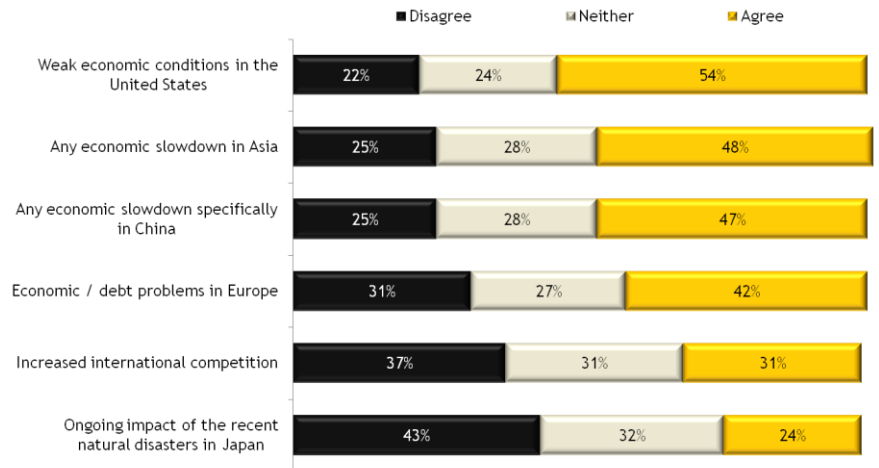
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## International factors

Continued weakness in the US economy tops the list of international concerns, especially in the Mining, Information, Media and Telecommunications sectors. Miners also anticipate that any slowdown in China and Asia more broadly will have a significant impact.





## Revenue and profit

### Key findings

- Almost half of the businesses surveyed forecast that revenues would increase over the next six months (46%), with 40% also expecting an increase in profits.
- Large organisations (with turnover of \$50–100 million) showed the most optimism, with 49% expecting to increase profits in this period, compared with only 34% of mid-range corporations (\$20–49 million).
- The outlook for the Mining and Business Services sectors are unusually strong, with a majority of businesses expecting both revenue and profits to rise.
- Expectations for Wholesale trade were more restrained, with just over 30% predicting an increase in profit or revenue. Health and education services and retail were similarly cautious, with 30% and 36% of these businesses expecting their profits to increase.
- This was mirrored in the state results, with the resource rich states of Western Australia, Queensland, South Australia and Northern Territory showing the most optimism in relation to revenue, with over half expecting revenue to increase.

### Revenue and profit outlook by sector

	Revenue		Profit	
	Expect increase	Expect decrease	Expect increase	Expect decrease
<b>By sector</b>				
Business Services	<b>54%</b>	<b>14%</b>	<b>53%</b>	<b>15%</b>
Construction	40%	<b>21%</b>	42%	23%
Health and Education	42%	9%	<b>30%</b>	<b>18%</b>
Information, Media and Telecommunications	51%	<b>13%</b>	42%	27%
Manufacturing	<b>53%</b>	<b>21%</b>	39%	34%
Mining	<b>59%</b>	<b>13%</b>	52%	24%
Retail	41%	32%	36%	<b>39%</b>
Transport and Logistics	49%	24%	42%	34%
Wholesale trade	<b>36%</b>	<b>41%</b>	<b>31%</b>	<b>38%</b>
<b>By annual turnover</b>				
\$10m–\$19m	46%	24%	41%	30%
\$20m–\$49m	43%	22%	<b>34%</b>	30%
\$50m–\$99m	<b>55%</b>	19%	<b>49%</b>	25%

**Indicates value is significantly higher than other subgroups within the column.**

**Indicates value is significantly lower than other subgroups within the column.**



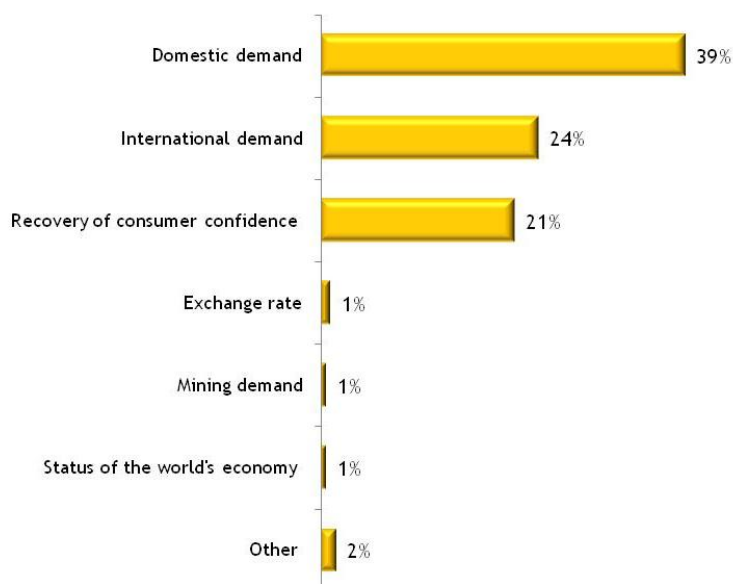
## Growth

### Key findings

- Although confidence in business conditions is low, companies are still looking for opportunities to grow. Most see domestic demand as the single biggest driver of growth over the next six months.
- Companies in the Business Services sector are more likely than others to be considering diversification, mergers and acquisitions, and international expansion.
- The Mining sector is also likely to consider mergers and international expansion, with organisations in Western Australia particularly likely to consider increasing investment.
- Organisations in the Information, Media & Telecommunications sector, and those with a turnover of more than \$20m are most likely to expand domestically.
- The general lack of confidence is forecast to result in a low appetite for risk and capital investment over the next six months. In particular, business services, mining and wholesale do not anticipate increasing appetite for risk during this time.

### Drivers of growth over the next six months

Asked which factor they believed would be the single biggest driver of economic growth over the next six months, most businesses nominated domestic demand, although two-thirds of companies in the mining sector cited international demand.



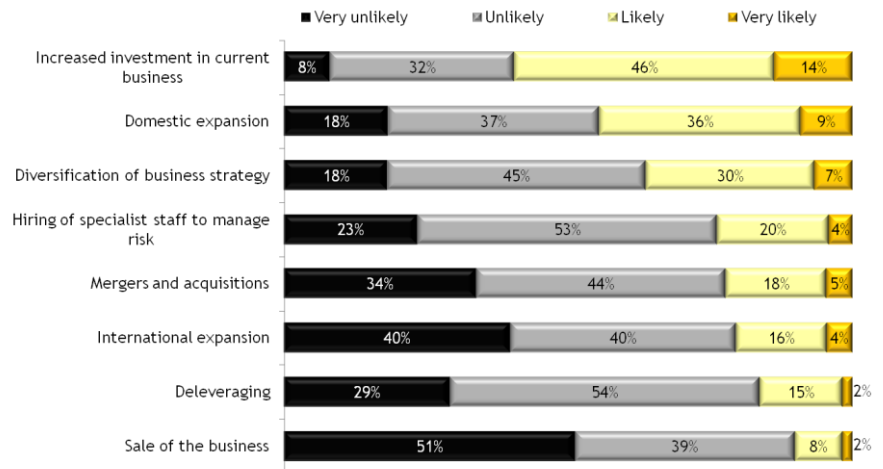
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## Expansion activities

While 60% of businesses say they are likely or very likely to increase investment in their current business over the next six months, less than a quarter are contemplating a merger or acquisition.



## Drivers of merger and acquisition activity

With many businesses focusing on consolidating their position in existing markets, the most common reasons for considering a merger or acquisition are to increase market share and grow profits, rather than expand into new territories.





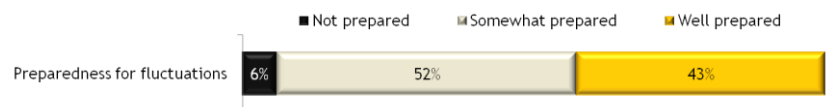
## Risk

### Key findings

- While most organisations claim to be prepared for continuing fluctuations in business conditions, only 43% say they are 'well prepared'.
- 26% of businesses said they were prepared because they had a strong financial position, while 22% said they had strategic plans in place. Those who considered themselves well prepared also tended to have a more positive outlook for business conditions for the next six months, with 50% of well-prepared businesses expecting conditions to improve.
- While most businesses had either a risk management plan, business continuity plan, or succession plan in place to mitigate issues caused by changing business conditions, less than one-third had all three. Victorian and Tasmanian companies were least likely to have all three (22%), with Western Australian businesses most likely (45%).
- The majority of organisations (79%) claim to have access to adequate finance to overcome any negative fluctuations in business conditions. Those in the Information, Media and Telecommunications sector and those with a turnover between \$10 million and \$19 million are least confident about their access to credit.
- Many of the organisations surveyed expect to increase their use of hedging to minimise exposure to ongoing economic changes — particularly the fluctuation in the value of the Australian dollar — over the next six months.

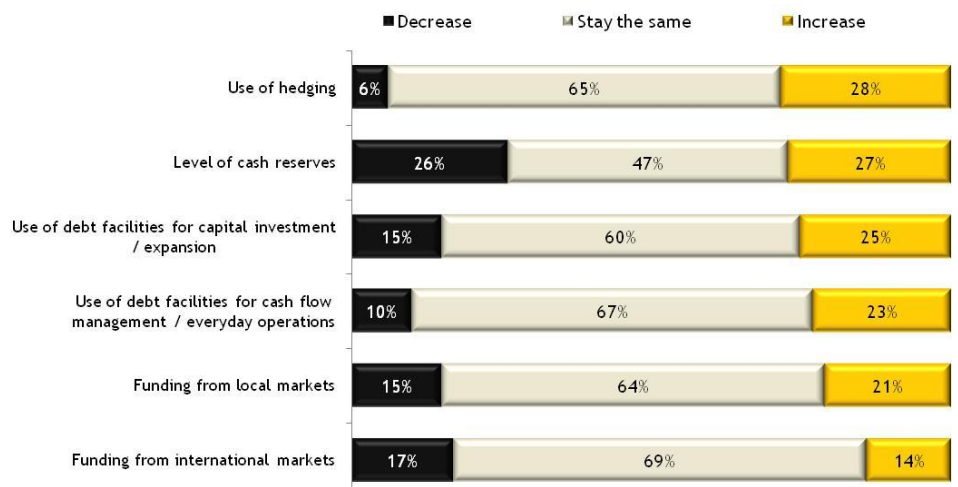
### Preparedness for fluctuations in business conditions

43% of businesses say they are well prepared for further fluctuations in business conditions over the next six months.



### Use of finance

79% of businesses say they have access to adequate finance. 27% intend to increase their cash reserves over the next six months, while 25% plan to draw down debt for capital investment.



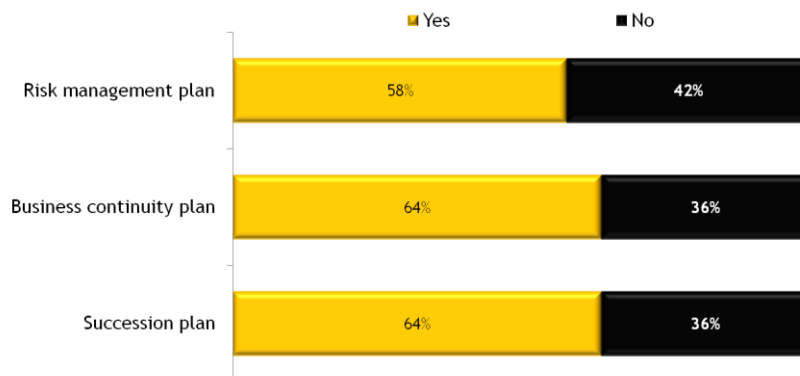
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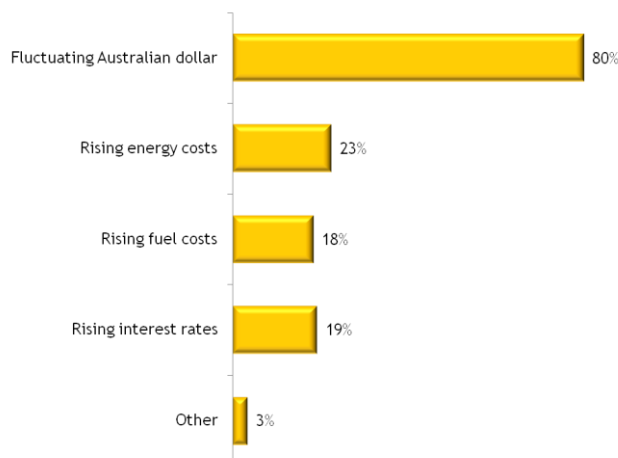
## Risk management planning

While most businesses have either a risk management plan, business continuity plan or succession plan, only 31% have all three. Fourteen per cent have no plans in place.



## Use of hedging

28% of businesses plan to increase their use of hedging over the next six months, including 44% of manufacturers. Among those who use hedging, 80% hedge against exchange rate fluctuations.





## Looking forward

### So what does the future hold?

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With business conditions continuing to fluctuate, gauging what lies ahead is no mean feat. What we do know, however, is that conditions aren't likely to dramatically improve any time soon. Businesses in mid-market Australia have highlighted this through the *Future Business Index* report.

What that does mean is that businesses will need to be prepared. Whilst no one can predict the future, it will be of paramount importance for managers throughout Australia to understand as much as they can when it comes to what lies ahead. More so, they will be required to be able deal with future changes in conditions, both through maintaining an understanding of what factors stand to affect them and through employing sound business, financial and risk management practices.

Although investment looks set to remain at lower levels over the coming six months, there are some key positives to take away from this report, including the fact that firms are still looking at growth opportunities. Revenue projections also remain positive, however we may see profits take a hit due to an anticipated increase in the cost of business inputs.

So despite the negative outlook, activity amongst Australian businesses looks set to continue to grow, albeit at a slower pace. It's clear, however, that for those companies which take a proactive approach to management and planning, opportunity is still very much alive.

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