Commonwealth Bank

# Future Business Index 2012

Edition 2:
April – September 2012

CommonwealthBank

# Contents

# Investment appetite returns

Things are looking far more positive for the next six months, as businesses choose to look past challenging market conditions and focus more on growth.

What a difference six months makes. We've certainly come a long way since our inaugural *Future Business Index* in September 2011. Business indicators are up across the board, with the *Index* staging a strong turnaround to now sit in positive territory; confidence is surging and importantly, that confidence looks likely to have a positive impact on future business investment.

Businesses in the mid-market and more broadly across Australia have faced a rocky road in recent times. Thanks to uncertainty in markets both at home and overseas, we have witnessed a large number of organisations putting off their expansion plans and hoarding cash; battening down the hatches and waiting for the storm to subside.

Whilst the storm clouds haven't completely disappated, a greater number of mid-market companies are now prepared to ignore the sporadic showers and put the focus back on how they can further grow their business. That fact alone is a promising sign for the economy.

The increased focus on investment also looks set to have a positive flow on effect to revenue and profit. Roughly half of businesses anticipate a rise in both areas, up 8% on net balance since September 2011. This is despite continued business challenges such as energy costs, fuel costs, wages and growing concern over a slowdown in China.

The sector story also continues to be a key theme for the Australian economy. Whilst industries such as Business Services and Health & Education remain strong performers, Retail and Manufacturing continue to face an uphill battle. Disparity also remains at a State level, with NSW/ACT staging a strong recovery to now sit in line with WA and share a more positive outlook, however in States such as VIC/TAS and QLD it's still clear that there is some work to be done.

An important takeout of this report remains the focus on risk management. Despite a change in many of the scores in the second *Future Business Index*, attitudes towards risk have remained steady – that is, businesses still aren't doing enough to protect themselves. If history has taught us anything, it's that things can change very quickly, particularly when you have a more fragile economy. Adverse changes in the market can have a large ripple effect to many parts of the Australian business landscape. Only by adopting proactive financial and business risk management strategies can companies ensure that they are well placed to stay dry in a future storm.

I trust you both enjoy reading and gain some key insights from this edition of the *Future Business Index*.

Symon Brewis-Weston
Executive General Manager
Corporate Financial Services

## About the survey

The Commonwealth Bank *Future Business Index* is based on a detailed quantitative survey of 437 financial decision-makers in public and private companies throughout Australia with turnover between $10 million and $100 million, conducted between 17 January and 15 February 2012. 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 and 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:

- 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

*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

Improved economic news is beginning to filter through and companies are taking notice.

The strong rise in the Commonwealth Bank *Future Business Index* highlights the impacts of the recent better news on the global economy on business confidence. News of an improving US economy, still the world's largest, has improved the international backdrop for Australian firms and bolstered their outlook.

Whilst there are a number of risks that could still threaten the global economy, the *Future Business Index* indicates that firms are now moving on from the GFC.

The patchy nature of the Australian economy is resulting in differences across regions and industries. But the survey suggests that firms are aware that conditions in some sectors of the economy are weaker than others yet consider the overall the outlook to be favourable.

Amidst the uncertainty, firms are expecting limited increases in salaries and other costs – partly from efficiency improvements. With diligence on costs, firms are expecting their more optimistic revenue outlooks to flow through to the bottom line.

Improving sales and profits are enabling firms to invest. Firms are forecasting increases in capital expenditure and hiring over the next six months, particularly in the Business Services, Transport & Logistics and the Health and Education sector.

However, firms' appetite for risk remains unchanged. An increase in the proportion of firms looking to diversify, both domestically and internationally, over the next six months suggests they are coming to terms with the risks to the outlook and rather than retreating, are starting to manage them. Whilst still limited, the net balance of firms looking to borrow to invest or expand over the next six months bodes well for the near-term economic outlook.

James McIntyre
Senior Economist
Commonwealth Bank

# Executive summary

Mid-market businesses have become significantly less pessimistic, with one in three saying business conditions will improve over the next six months. But business sentiment across different States and sectors of the economy remains mixed.

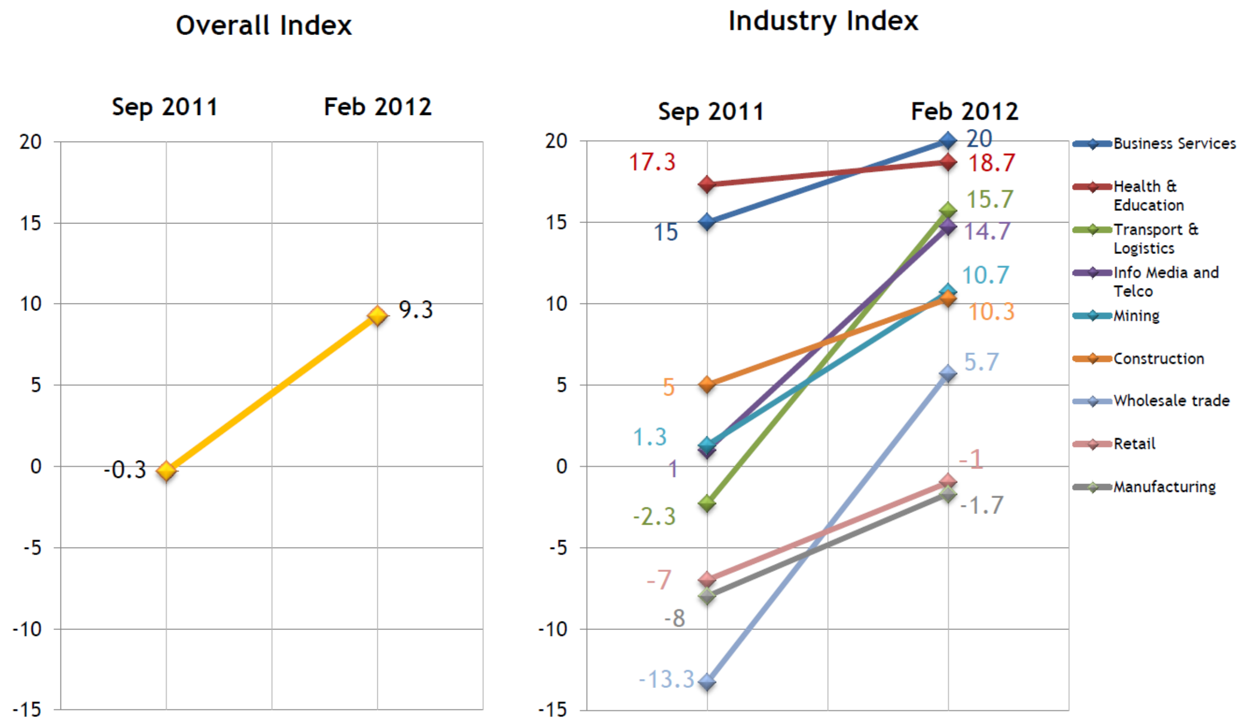
## Confidence rebounds

The second Commonwealth Bank *Future Business Index* shows a significantly improved outlook for mid-market organisations over the next six months, with the overall index rising 9.6 points from –0.3 to 9.3. But while businesses from all States and industry sectors reported improved conditions, the level of improvement varied significantly, with some sectors still in negative territory.

Looking across sectors and States:

- Organisations from the Business Services, Health, Education and Construction sectors are the most positive, while those in Retail and Manufacturing still have a marginally negative outlook.
- Transport, Logistics and Wholesale businesses have enjoyed large improvements in business confidence, with the index for the Wholesale Trade sector leaping 19 points.
- Businesses in Western Australia, New South Wales and the ACT are the most optimistic about future business conditions, with New South Wales and ACT businesses experiencing the greatest increase in business confidence levels since September 2011.
- Foreign owned companies continue to be more negative than Australian owned companies.

While the overall Index has risen significantly, results across industry sectors remain mixed



## Cost pressures ease

Contributing to the increase in confidence was a reduction in cost pressures, with a growing expectation that salaries, wages and operating costs will remain steady, driving better profitability. However, rising energy and fuel costs are still expected to have an impact, although the severity of that impact has declined.

Meanwhile, businesses have become more concerned about increased domestic and international competition. Organisations also remain wary of the possible effects of any economic slowdown in Asia, as well as the ongoing impact of the European debt crisis, but they are now more optimistic about economic conditions in the US.

## Organisations remain under-prepared for volatility

Analysis of the *Index* continues to suggest that organisations are underprepared for further volatility in business conditions, with only 43% saying they are well prepared for continuing fluctuations — the same level as in September 2011. Businesses in the Manufacturing, Mining, Information, Media and Telecommunications sectors are more likely to be well prepared in 2012, while those in Construction and Business Services are less prepared.

The use of hedging is expected to decline over the next six months, particularly by businesses with turnover in the $50 million to $100 million range. While businesses remain ready to hedge against currency fluctuations, they are now less concerned to protect themselves against rising energy and fuel costs, reflecting the easing of cost pressures in those areas.

The percentage of organisations with business continuity and succession plans in place has also declined marginally in the last six months, with smaller businesses most likely to have no plans in place.

## Risk-averse companies look to consolidate

While confidence in business conditions has improved, companies continue to be somewhat risk-averse, with the level of mergers, acquisitions and international expansion initiatives largely unchanged since September 2011.

Instead, most organisations have sought to consolidate their financial strength and market position over the last six months by driving increased business efficiencies. Increased investments in the current business, domestic expansion and diversification will continue to be the focus of business development activities over the next six months.

# Sector outlook

## Key findings

- Business Services and Health and Education remain the most confident sectors, while Manufacturing, Retail and Wholesale Trade are the least confident.
- Nonetheless, Wholesale Trade businesses have enjoyed the largest improvement in business confidence from a very low base, while Transport and Logistics companies have also improved markedly with the easing of fuel cost pressures.
- Meanwhile, the Retail sector continues to lag, with revenue and profit anticipated to fall further. But while appetite for risk has declined among retailers in the last six months, they anticipate higher levels of capital expenditure in the six months ahead.
- Organisations with an annual turnover of $20 million to $49 million have become significantly more confident, while larger businesses have become less so.

## Sector findings at a glance

| | Net business conditions | | Net revenue | | Net preparedness | | Future Business Index | | |
|---|---|---|---|---|---|---|---|---|---|
| | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Change |
| **Overall** | **11** | **–10** | **31** | **23** | **–14** | **–14** | **9.3** | **–0.3** | **9.0** |
| **By sector** | | | | | | | | | |
| Business Services | 26 | –8 | 54 | 40 | **–20** | 13 | **20** | **15** | **5** |
| Construction | 24 | –2 | 39 | 19 | **–32** | –2 | 10.3 | 5 | **5.3** |
| Health and Education | 25 | 9 | 39 | 33 | –8 | 10 | 18.7 | 17.3 | **1.4** |
| Information, Media and Telecommunications | 18 | **–13** | 30 | 38 | –4 | **–22** | 14.7 | 1 | **13.7** |
| Manufacturing | 1 | **–15** | 7 | 32 | **–13** | **–41** | –1.7 | –8 | **6.3** |
| Mining | 7 | 16 | 37 | 46 | **–12** | **–58** | 10.7 | 1.3 | **9.4** |
| Retail | –9 | –8 | 18 | 9 | **–12** | **–22** | –1 | –7 | **6** |
| Transport and Logistics | 19 | **–16** | 42 | 26 | **–14** | **–17** | **15.7** | **–2.3** | **18** |
| Wholesale trade | 1 | **–30** | 24 | –5 | –8 | –5 | 5.7 | **–13.3** | **19** |
| **By annual turnover** | | | | | | | | | |
| $10m–$19m | 12 | –9 | 25 | 22 | **–16** | **–23** | 7.0 | –3.3 | **10.3** |
| $20m–$49m | 8 | **–15** | 37 | 21 | –9 | –8 | 12.0 | –0.7 | **12.7** |
| $50m–$99m | 15 | –2 | 41 | 35 | **–22** | 3 | 11.3 | 12.0 | **–0.7** |

The outlook for each sector was analysed using three key metrics:

- **Net business conditions** shows the net percentage of businesses in the sector which 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 which forecast that their revenue will increase, calculated by subtracting the percentage of businesses forecasting a fall from the percentage forecasting a rise.
- **Net preparedness** shows the net percentage of businesses in the sector which are well prepared for future volatility, calculated by subtracting the percentage of businesses which say they are underprepared from the percentage which are well prepared.

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

# State outlook

## Key findings

- WA keeps its title as the most optimistic State, with the highest *Future Business Index* score across the country, adding another 9 points in the last six months. But while businesses in the West have become more relaxed about the US and Chinese economies, concern is rising over the possible impact of a wider Asian economic slowdown.
- NSW and ACT businesses are the most improved, jumping into second place with an impressive 14 point rise in their Future Business Index. NSW and ACT businesses reported higher expectations for both revenue and profits than in our last survey, although they remain poorly prepared for future fluctations in business conditions.
- Queensland businesses have become only marginally more optimistic over the last six months, with confidence impacted by natrual disasters and expectations of an increase in wages.
- SA and NT businesses are looking to trim headcount and increase profits in the face of falling sales.
- VIC and TAS business conditions have improved significantly, but from a low base, with businesses on balance expecting wages to decline.

## State findings at a glance

| | Net business conditions | | Net revenue | | Net preparedness | | Future Business Index | | |
|---|---|---|---|---|---|---|---|---|---|
| | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Change |
| NSW and ACT | 16 | **–1** | 41 | 25 | **–15** | **–24** | 14.0 | 0.0 | 14.0 |
| QLD | 9 | **–22** | 35 | 26 | **–26** | 5 | 6.0 | 3.0 | 3.0 |
| SA and NT | 15 | 2 | 32 | 36 | **–25** | **–26** | 7.3 | 4.0 | 3.3 |
| VIC and TAS | 4 | **–18** | 17 | 14 | –9 | **–17** | 4.0 | **–7.0** | 11.0 |
| WA | 15 | –5 | 37 | 29 | –8 | –7 | **14.7** | **5.7** | **9.0** |

## Outlook for business conditions by State

| | Conditions will improve | | Conditions will decline | | Net balance | | Change in net balance |
|---|---|---|---|---|---|---|---|
| | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Sep 2011 to Feb 2012 |
| **Overall** | **32%** | **24%** | **22%** | **34%** | **10** | **–10** | **20** |
| NSW and ACT | 36% | **25%** | 20% | 26% | 16 | –1 | 17 |
| QLD | 28% | 24% | **19%** | **46%** | 9 | –22 | 31 |
| SA and NT | 40% | 36% | 25% | 34% | 15 | 2 | 13 |
| VIC and TAS | 30% | 20% | **26%** | **38%** | 4 | –18 | 22 |
| WA | 29% | 23% | 14% | 28% | 15 | –5 | 20 |

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

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

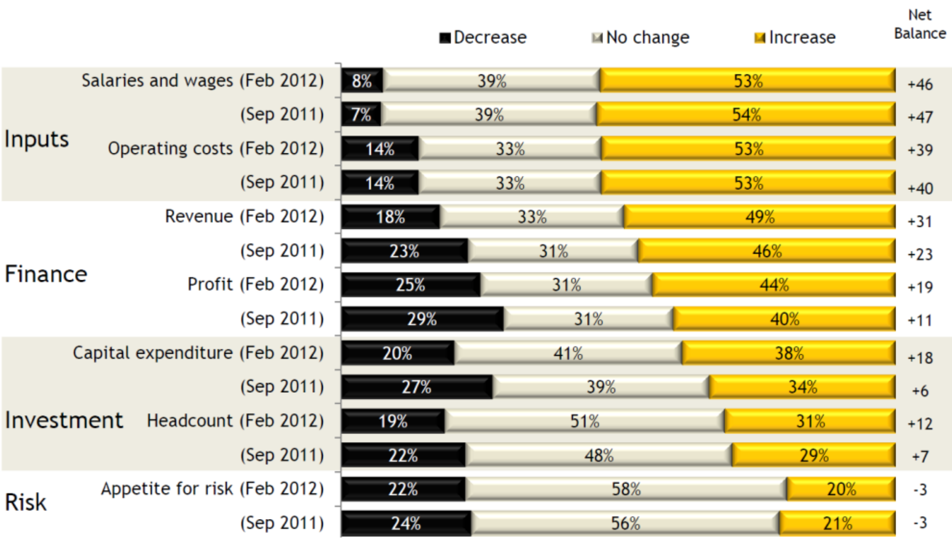
# Business conditions

## Key findings

- The pendulum has swung from pessimism to optimism since September 2011, with around one-third (32%) of businesses now predicting improving business conditions over the next six months, and only 22% predicting a decline.
- In keeping with this more upbeat assessment, almost half of the businesses surveyed expect revenues to increase, while 44% expect profits to rise. Fewer than one-in-five now expect revenues to fall over the next six months.
- While most businesses still anticipate rising operating costs, around 38% also say they will increase capital expenditure.
- Global economic weakness remains a significant concern, especially in the Mining, Wholesale Trade, Information, Media and Telecommunications sectors.

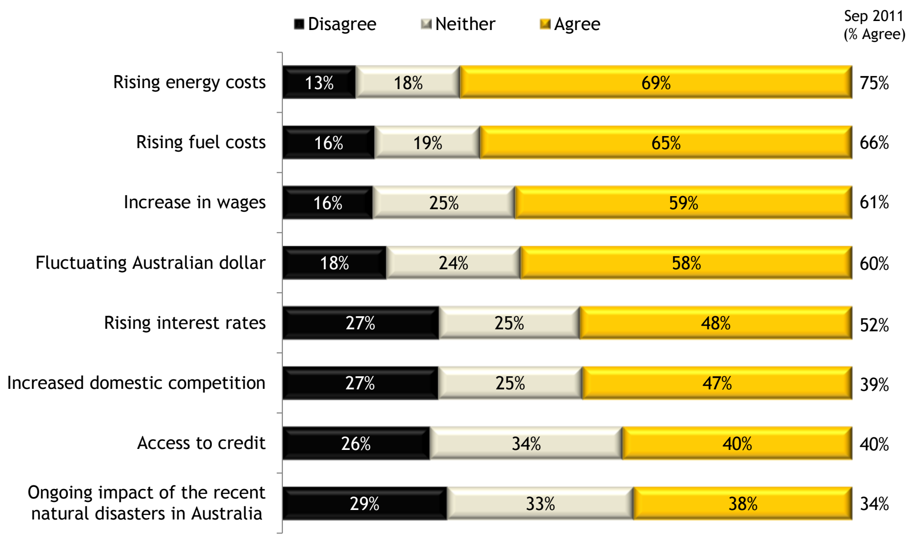
## The outlook for the next six months

More businesses now expect both revenue and profits to rise, despite increasing wages and operating costs. As a result, they are significantly more likely to increase capital expenditure, and somewhat more likely to add headcount.



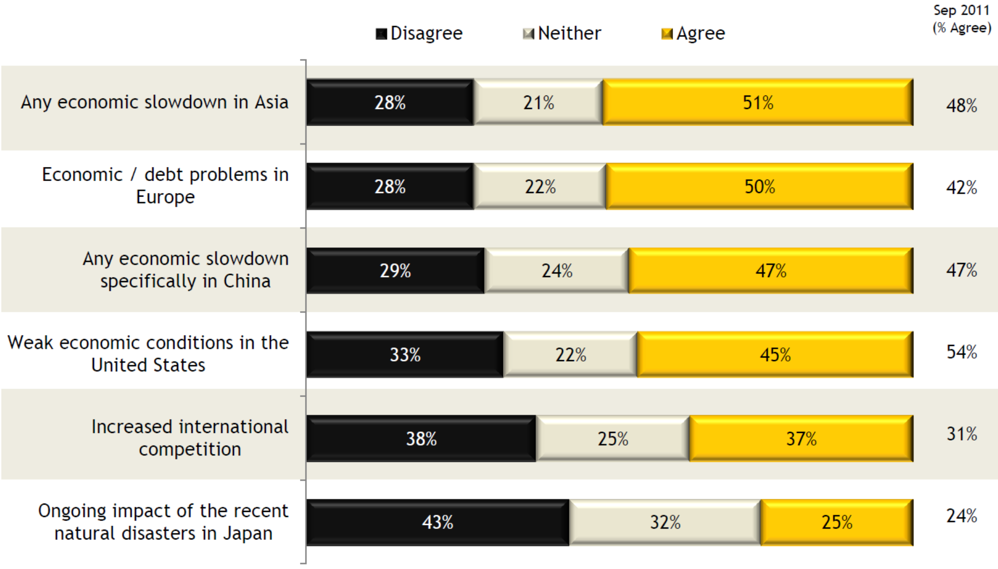

## Domestic factors

Concerns about rising energy prices have eased slightly, although the majority of businesses still expect increases in energy, fuel and wage costs. Since September 2011 there has also been an 8% jump in the percentage of businesses who believe increased domestic competition will have a significant impact over the next six months.



## International factors

The ongoing European debt crisis and the possibility of a general economic slowdown in Asia have overtaken US economic weakness as the most significant international concerns, perhaps reflecting more recent signs of a US recovery.



# Revenue and profit

## Key findings

- Just under half of the businesses surveyed forecast that revenues would increase over the next six months (49%), with 44% also expecting an increase in profits — an increase of 4% since September 2011.
- The last six months have seen an upsurge in revenue growth expectations across a range of sectors, including Business Services, Transport and Logistics, Wholesale Trade, and Construction, which experienced a 16 point jump in the percentage of businesses expecting revenues to rise.
- In contrast, only around one in three manufacturers expect higher revenues and profits over the next six months. The proportion of miners forecasting higher revenues has also fallen, reflecting a possible dip in commodity prices, although 63% of miners still expect profits to increase.
- Larger organisations are universally more optimistic than smaller organisations, with 56% of those in the $50 million to $100 million turnover range forecasting increased revenues, compared to just 46% in the $10 million to $19 million range.

## Revenue and profit outlook

| | Revenue | | | | Profit | | | |
|---|---|---|---|---|---|---|---|---|
| | Expect increase | | Expect decrease | | Expect increase | | Expect decrease | |
| | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 | Feb 2012 | Sep 2011 |
| **Overall** | **49%** | **46%** | **18%** | **23%** | **44%** | **40%** | **25%** | **29%** |
| **By sector** | | | | | | | | |
| Business Services | 63% | 54% | 9% | 14% | 59% | 53% | 23% | 15% |
| Construction | **56%** | 40% | 18% | 21% | 49% | 42% | 30% | 23% |
| Health and Education | 51% | 42% | 12% | 9% | 37% | 30% | 15% | 18% |
| Information, Media and Telecommunications | 55% | 51% | 25% | 13% | **62%** | 42% | 28% | 27% |
| Manufacturing | **35%** | 53% | 28% | 21% | **34%** | 39% | 29% | 34% |
| Mining | **51%** | 59% | 15% | 13% | **63%** | 52% | 15% | 24% |
| Retail | 39% | 41% | 22% | 32% | **29%** | 36% | 29% | 39% |
| Transport and Logistics | 54% | 49% | 12% | 24% | 39% | 42% | 22% | 34% |
| Wholesale trade | 45% | 36% | 22% | 41% | 47% | 31% | 28% | 38% |
| **By annual turnover** | | | | | | | | |
| $10m–$19m | 46% | 46% | 21% | 24% | 43% | 41% | 23% | 30% |
| $20m–$49m | 51% | 43% | 14% | 22% | 45% | 34% | 27% | 30% |
| $50m–$99m | 56% | 55% | 14% | 19% | 46% | 49% | 28% | 25% |

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

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

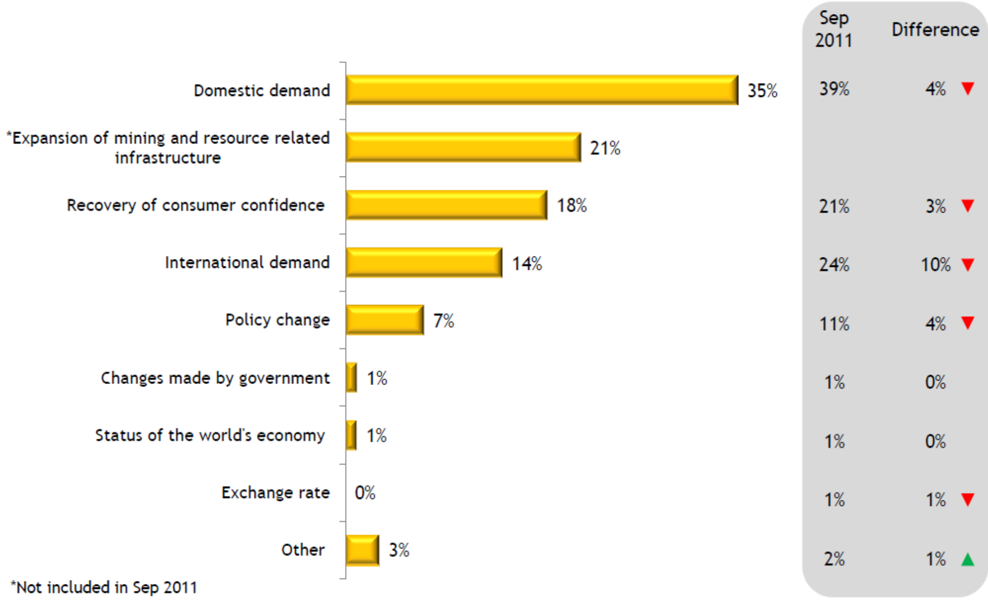
# Growth

## Key findings

- Increasing confidence in future business conditions seems to have led many businesses to revise their growth plans, with over one-third (38%) of midmarket organisations now looking to increase capital investment over the next six months, and 31% anticipating an increase in headcount.
- Companies in sectors that have experienced the largest upsurge in confidence have also become significantly more likely to seek growth opportunities, including those in the Health and Education, Transport and Logistics, Construction and Wholesale Trade sectors.
- Mining companies have become somewhat less inclined to increase capital investments or expand domestically or overseas, perhaps reflecting the very high level of investment already committed by that sector.
- Despite their relatively positive outlook, WA businesses have become somewhat less likely to expand, concentrating more of their surplus cash flow on delevaraging. SA and NT businesses are also looking to deleverage.
- Businesses in VIC and TAS seem ready to consolidate, with an increase in the proportion contemplating a merger, acquisition or business sale.
- Businesses with a turnover between $20 million and $49 million also show an increased propensity towards merger and acquisition activity over the next six months.

## Drivers of growth over the next six months

Organisations continue to see domestic demand as the single biggest driver of economic growth over the next six months, although investment in mining infrastructure is also important. International demand has declined significantly as a growth driver, reflecting continued economic weakness offshore.



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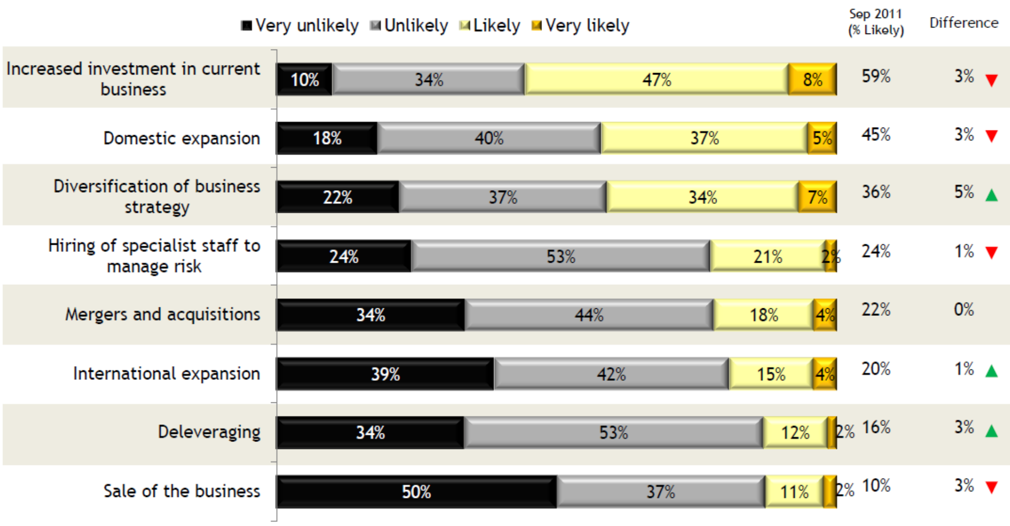
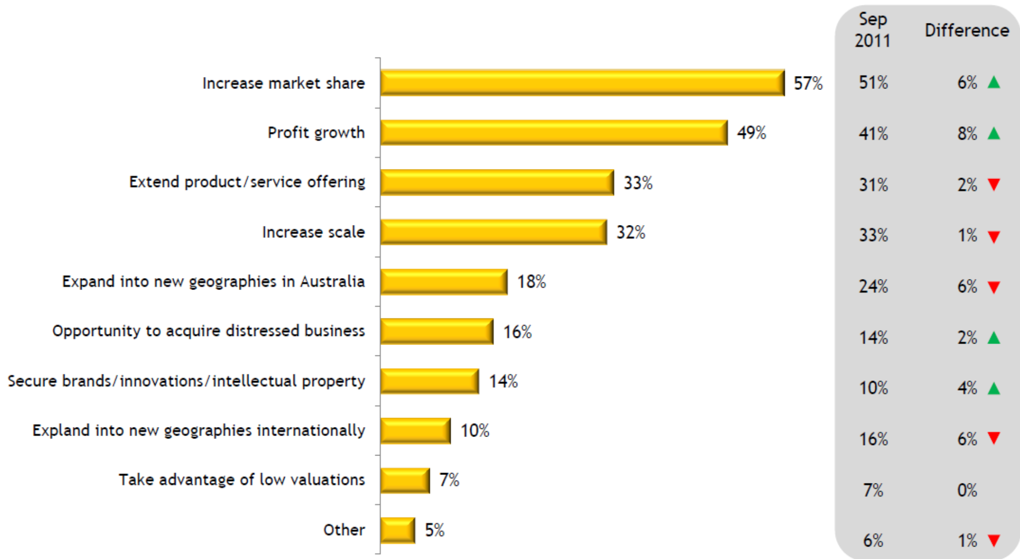
## Expansion activities

While increased investment in the current business is still the preferred growth option overall, businesses have become more likely to diversify into new business areas. Merger and acquisition intentions have remained steady.




## Drivers of merger and acquisition activity

Increased market share and profit growth remain the most popular reasons for seeking a merger or acquisition, with fewer businesses seeking to expand into new territories at home or abroad.



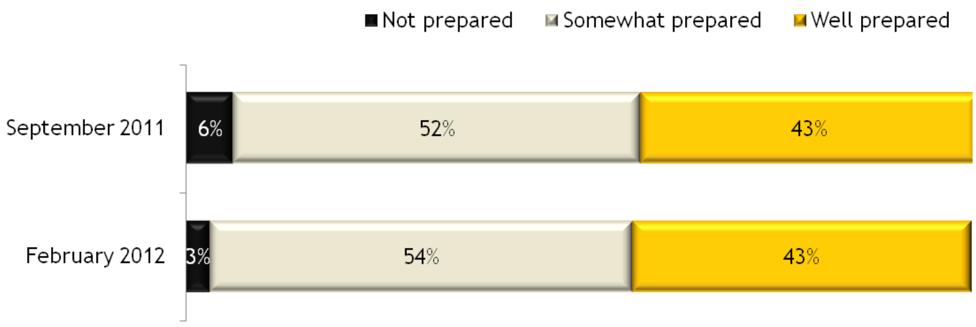
# Risk

## Key findings

- While most organisations claim to be prepared for continuing fluctuations in business conditions, only 43% say they are ‘well prepared’, the same proportion as in September 2011.
- Just 31% of businesses said they were well prepared or somewhat prepared because of their strong financial position, down from 15 points since 2011, while the proportion with long-term contracts in place has plummeted from 18% to 7% over the last six months. The proportion benefitting from a flexible labour force has also fallen, from 17% in September 2011 to just 5% today.
- While more than two-thirds of organisations (68%) have access to adequate finance to overcome any negative fluctuations in business conditions, that proportion has decreased since 2011. Those in Transport and Logistics are most confident about their access to credit, followed by the Wholesale Trade, Mining and Retail sectors.
- While organisations continue to hedge against a fluctuating dollar, they are somewhat less inclined to hedge against rising energy and fuel costs, with the rate of increase in hedging set to stall.

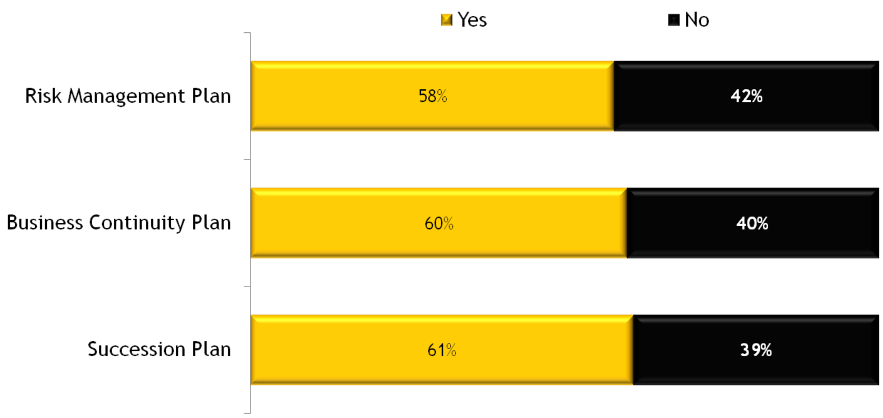
## Preparedness for fluctuations in business conditions

43% of businesses say they are well prepared for further fluctuations in business conditions over the next six months — the same proportion as in September 2011.



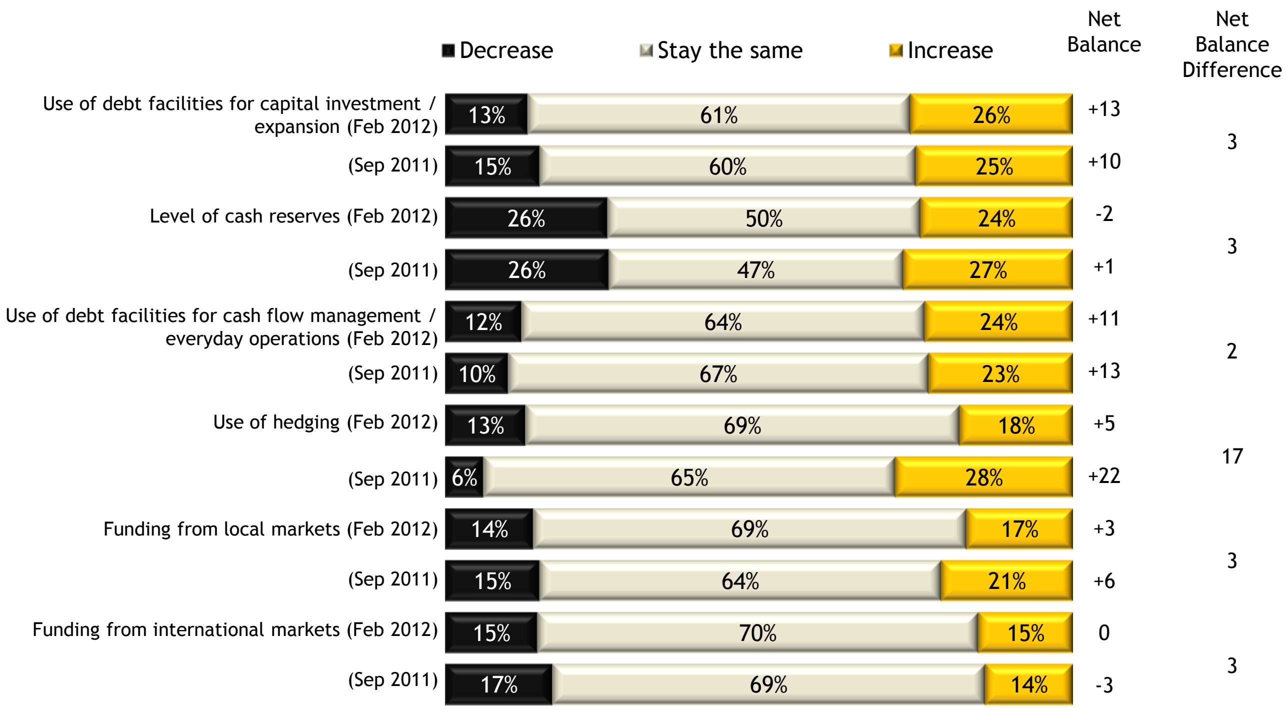

## Risk management planning

While most businesses have either a risk management plan, business continuity plan or succession plan, only 26% have all three — 5 points fewer than in our September 2011 survey. The proportion with business continuity or succession plans has also slipped by 4 percentage points.



## Use of finance

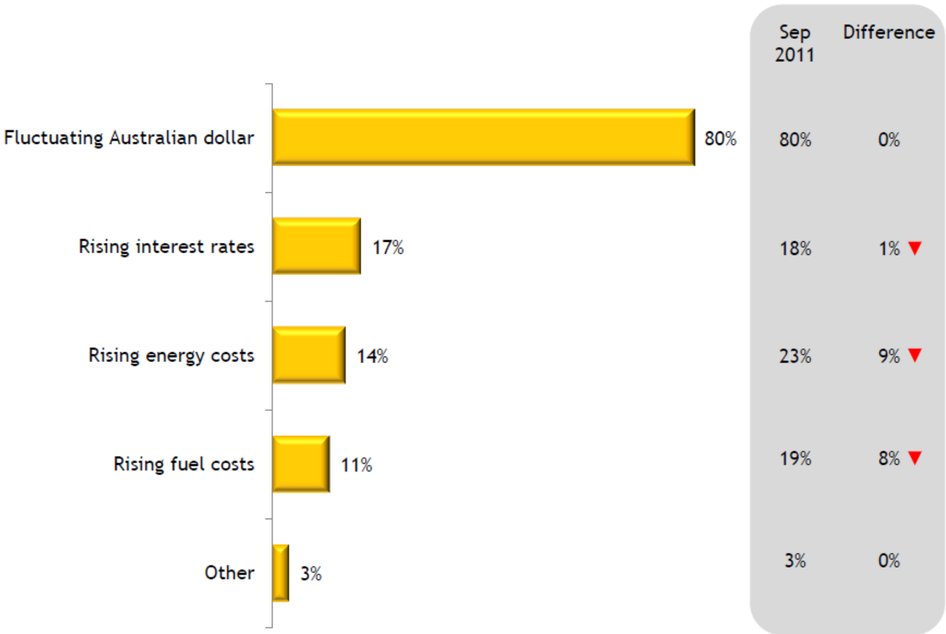
Sixty-eight per cent of midmarket organisations now say they have access to adequate finance to overcome negative fluctuations in business conditions — 11 points down on September 2011. They are also more likely to consider sourcing funds overseas.




## Use of hedging

The increase in hedging recorded in last year's report has tailed off, with 69% of businesses now seeking to keep hedging at its current level.

The proportion of businesses hedging energy and fuel costs has also decreased, in keeping with the lower number of businesses which believe they will have a significant impact over the months to come.



# Looking forward

Combining forecasts from hundreds of organisations around Australia in a single report, the *Future Business Index* provides a valuable insight into possible future directions for mid-market businesses across the country.

Forecasting the future is always difficult — but in the highly volatile economic environment of 2012, it's more difficult than ever. Ongoing structural changes continue to make themselves felt across the Australian economy, with mixed results for both large and small organisations, depending on the States and sectors to which they belong.

Those changes are very much reflected in the latest *Future Business Index*. While the outlook is generally more positive than six months ago, our survey also captures some of the challenges Australian financial decision-makers are struggling to overcome.

They include a high dollar; continuing competition for skilled labour; rising energy, fuel and operational costs; and the uneven growth performance of different regions. The *Index* suggests that forces like these could continue to impose a cap on growth for the foreseeable future.

More positively, the revenue and profit outlook for most businesses remains strong, with the vast majority planning to invest in their current business activities and many seeking other opportunities for growth. Many are also seeking to consolidate their financial position.

Overall, Australia's mid-market companies are well positioned for the future, although with some areas of weakness. Much will depend on how the Australian and global economies track over the next six months. It will be fascinating to see the results in the next issue of the *Future Business Index*, due in October 2012.

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