

# AUSTRALIAN INDUSTRY GROUP / AMERICAN EXPRESS **CASH MANAGEMENT**

## Managing cash flow in troubled times



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AUSTRALIAN INDUSTRY GROUP / AMERICAN EXPRESS

# CASH MANAGEMENT

Managing cash flow in troubled times

November 2008





# Preface

## *Effective cash management is vital in troubled times*



The Australian Industry Group is pleased to be working with American Express on this important report on the cash flow management strategies of Australian industry.

Cash flow concerns are uppermost in Australian businesses' minds at the moment given the strong headwinds hitting the global and Australian economies.

**Cash Management – Managing Cash Flow in Troubled Times** examines how companies are managing cash flow in the wake of the rapid deterioration of business conditions just prior to the global economic and financial crisis entering its most intense phase. It includes results for a range of micro, small, medium and large firms in the manufacturing and construction sectors. It goes on to provide insight into the ways in which these firms address cash flow concerns in the short-term and the approaches they take to maximise cash flow over the longer-term.

**Cash Management – Managing Cash Flow in Troubled Times** discusses the extent to which changes in credit availability have affected Australian firms, including micro and small firms, and their responses in terms of accessing finance.

Two key ways to handle short-term cash flow squeezes have been to cut back on spending and effectively manage costs. The report discusses firms' expectation for spending, including capital investment.

I would like to thank all companies who took part in the survey which underpins the report.



**Heather Ridout**  
Chief Executive  
Australian Industry Group



Concerns about a slowing global economy are top of mind as Australian businesses look for ways to weather today's uncertain environment.

To that end, American Express Small Business Services joined forces with the Australian Industry Group to undertake this survey in order to compare the issues facing businesses of all sizes and in particular highlight the unique challenges for micro and small businesses.

As the growth engine of the Australian economy it is critical that micro and small business owners are given a voice and that their issues and challenges are heard amongst the noise of recent high profile corporate collapses.

Effective cash flow management has never been more important as it frees up business owners to continue investing in their future business growth. By spending time planning a cash flow strategy tailored to their business needs, micro and small business owners will be better placed to take advantage of long-term opportunities, while managing through the short-term challenges.

American Express Small Business Services provides expense management products and services that assist small business to manage cash flow more effectively. This survey is part of our ongoing effort to provide insight into the complex issues facing small business owners, benchmark best practices and share this information with our customers.

For more information please visit  
[www.americanexpress.com.au/smallbusiness](http://www.americanexpress.com.au/smallbusiness)



**Rachel Felton,**  
Vice President, Small Business Services  
American Express Australia

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# Executive Summary



# Executive Summary

## *Economic slowdown prompts concerns for cash flow – both incoming and outgoing*

### *Overview*

The rapid deterioration in business conditions in manufacturing, construction and services since the early part of 2008, has put increasing pressure on companies to better manage cash flow and finance. The global economic and financial crisis has heightened these needs, as Australian and global economic growth slows.

Firms of all sizes, particularly micro and small businesses, and from all industry sectors are experiencing a deterioration in confidence in the cash flow outlook.

Firms of all sizes are worried about their ability to maintain cash flow and have major concerns about the impact of economic conditions on accounts receivable. In turn, micro, small and medium-sized firms in particular, are apprehensive about their ability to pay bills on time being impaired by the slowdown in the economy.

The key strategic responses to these worries by survey respondents are straight to the point of this issue and similar across firm size. They will focus on more aggressive pursuit of accounts receivable; cutback on or control spending/expenses (particularly as firms get larger); and delay expenditures.

From a longer-term perspective, abstracting from the vicissitudes of this economic cycle, firms again focus on the management of accounts receivable. They will also attempt to track cash flow more effectively. Maximisation of special payment terms with vendors, particularly as firms get larger, is another key strategy for firms. Micro and small firms are more likely to have no specific strategy.

On the broader issue of business development strategies for the next six months, four key approaches dominate: improving sales of current product or service lines; investing in the current business; introducing new products/services; and developing new domestic markets. Micro firms are more likely to have no specific strategy than other firms.

Access to finance is yet to become a major concern for Australian firms, partly because many currently make use of existing overdraft arrangements; while others are already planning to borrow less or defer projects. That said, there are signs that access is becoming more difficult, particularly amongst larger firms. Many, notably larger firms, also noted an increase in finance costs over the year.

In terms of willingness to take on risk, micro firms overall reported that they are only willing to take on low risk activities over the next six months. This is reflected in the survey results that show that over half of micro firms have no plans to undertake capital investment over the next six months.

Profit margins are expected to ease over the next six months, with small firms being most pessimistic about the outlook. The key constraints on profitability across firm sizes are rising operational costs; limited demand for firm products and services; and a lack of skilled staff.

In total, 354 firms in the manufacturing and construction sectors responded to the survey on cash flow outlook and management. These firms account for total employment of around 25,873 employees and total annual turnover of \$13.9 billion. The survey was conducted in October just prior to the rapid deterioration in outlook brought about by the global economic and financial crisis. Given the companies had been responding to a rapid deterioration in business conditions since the first quarter of the year, the recent events act to add fuller weight to the findings and approaches being used by companies to manage cash flow.

### *Key Findings*

1. The greatest degree of concern around cash flow identified by respondents was in relation to accounts receivable outstanding (53.4% of respondents); capacity to pay bills on time (28.2% overall and 30.6% of micro and 34.4% of small firms) and availability of cash flow for business development (20.1% of respondents) (page 19).
2. A key major strategy to handle potential cash flow problems was a more aggressive pursuit of accounts receivable (77.1% of respondents). Cutting back or controlling spending was also seen as important in dealing with cash flow issues (65.0% of respondents), as was delaying of expenditure (38.4%) (page 20).
3. Key elements of respondents' strategy to maximise cash flow over the long-term are a focus on management of accounts receivable, (79.4% of respondents); effective tracking of cash flow (55.4%); and maximisation of special payments terms with vendors (24.6%). 11.7% of micro firms indicated that they have no specific strategy for cash flow maximisation. In addition, 20.7% of micro firms have no specific business development strategy for the next six months (page 21).
4. Around 17.7% of respondents said that borrowing from banks/other financial institutions had become more difficult over the past year. Similarly a modest number of firms found that raising finance was more difficult through corporate debt (13.1% of respondents); overdraft facilities (12.4%); and equity raising (11.9%) (page 23).
5. Firms are increasingly unwilling to take on risk with very few respondents saying they would be willing to take on significant (2.5% of respondents) or above average financial risk (9.7%). Most firms indicated they would be willing to take on only moderate risk (42.5%) or low risk (45.3%). Micro firms were more risk averse than others with over 50% reporting they would only be willing to take on low risk activities (page 26).

# Executive Summary

6. Reflecting the deterioration of consumer and business confidence, almost 40% of firms signaled they had no plans for capital investment over the next six months.
7. 75.4% of respondents cited operational costs as a major factor constraining profitability growth over the next six months. The next most commonly cited major factors were demand for products and services (51.7% of respondents) and a lack of skilled staff (46.0%) (page 31).
8. Only 7.4% of businesses have been able to fully pass on input costs increases to customers over the past six months (page 34).



# Background and Study Details



# Background and study details

## *An up-to-date report on how businesses will meet cash flow challenges in troubled times*

### **The context**

This joint Australian Industry Group (Ai Group)/American Express report on Australian businesses' cash flow prospects and management strategies was conceived before the sharp deterioration of global economic prospects during October 2008. The recent events have acted to accelerate the rapid deterioration in business conditions seen in Australia since the first quarter of 2008. Ai Group's three monthly indicators of business performance in the manufacturing, services and construction sectors all show that activity started to decline in the June quarter, and has continued to fall ever since. Given recent developments, this report is released at an opportune, though admittedly ominous, time for Australian firms.

The crisis that has enveloped global finance and credit markets over the past year has precipitated a sharp downwards revision in global growth forecasts. The financial crisis has the potential to become an economic crisis.

Though Australia's financial sector is in much better shape than its international counterparts, the turmoil in the world economy is having its effect on the climate facing Australian businesses.

Economic growth forecasts here have also been downgraded. The outlook for consumer demand and business investment as well as demand for our exports is significantly worse than the strong growth experienced in the years up to mid-2007.

In response to the deterioration in the Australian economic outlook, economic policy has been eased.

The Reserve Bank has cut interest rates aggressively and pumped liquidity into credit markets in a bid to avoid the contraction in credit availability that has affected American, British and European firms' ability to finance investment, working capital and payments for inputs.

The Federal Government has eased fiscal policy with a package of \$10.4 billion in spending over the short-term. Its deposit guarantee scheme was designed to put some certainty into the domestic banking system.

In addition, the Australian dollar exchange rate has eased significantly since its peak in mid-July, lifting the prospects for the export and import-competing sectors of the Australian economy to at least offset some of the negative impact of slower demand for their products and services.

Notwithstanding these positive policy and currency adjustments, the cash flow outlook for Australian businesses is under severe threat and this calls for effective management of issues such as business costs and margins, accounts receivable, investment in the business and access to finance and taxation.

### **Background**

Ai Group, in conjunction with American Express undertook a major survey of Australian businesses in October 2008. The survey aimed to gauge the outlook for business indicators such as production, employment and sales and, a key concern for many US, UK and European firms, accessibility to and costs of finance.

In addition, it surveyed cash flow management strategies, both in response to short-term cash flow concerns and for the longer-term. Also from a longer-term perspective, the survey canvassed business development plans and approaches to taxation. The survey drew 354 respondents from across the manufacturing and construction sectors and across micro, small, medium and large firms.

The survey was conducted just prior to the further deterioration due to the global financial crisis in mid-October. These recent developments would have seen companies move more rapidly to adopt the strategies outlined in this report.

### **Objectives**

In the light of the serious deterioration in business conditions seen since the early part of the year and worsened by recent events, the overall objective of the study was to examine the implications for Australian firms' cash flow and their use of finance.

The report canvassed businesses' key concerns for cash flow over the next six months and the types of strategies that they will deploy to deal with those concerns as they arise. It also deals with the longer-term strategies that firms use to maximise cash flow, abstracting from the short-term volatility that is facing firms in the current phase of the economic cycle.

Maintaining strong cash flow underpins firms' ability to finance, not just major investment in plant and equipment, takeovers or acquisitions and technology upgrades, but also the day-to-day working capital, input payments and employees' wages and salaries.

The potential for a credit squeeze that has paralysed some firms and institutions in other major developed economies is a disturbing prospect for Australian businesses. This report assesses developments in the availability and costs of financing for Australian firms over the past year or so.

Risk aversion among financial institutions, consumers and firms is a common feature of those overseas economies that are being most affected by the aftershocks of the global financial crisis. The report tests the extent to which firms are willing to take on more financial risk and expectations for major expenditures including capital investment.

### **The report**

The report outlines the findings of each of the questions asked in the survey and presents these in broad sections:

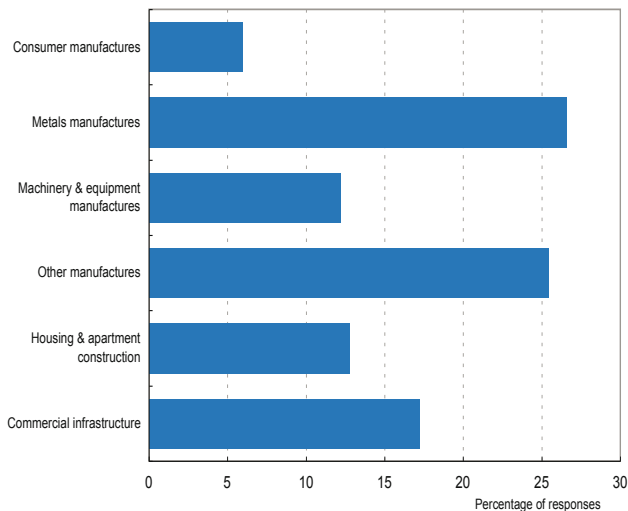
- Cash flow outlook and cash flow and business development strategies;
- Access to finance and finance costs;
- Risk taking and spending patterns; and
- Profitability outlook, constraints and cost developments.

Analysis is carried out at the firm size and sectoral level.

# Respondents by sector and company size

*The study includes a varied range of sectors and companies*

**Chart 1: Survey respondents by sector**



This section of the report outlines the characteristics of respondents to the survey of manufacturing and construction firms' views on the cash flow and profitability outlook and their cash flow management strategies.

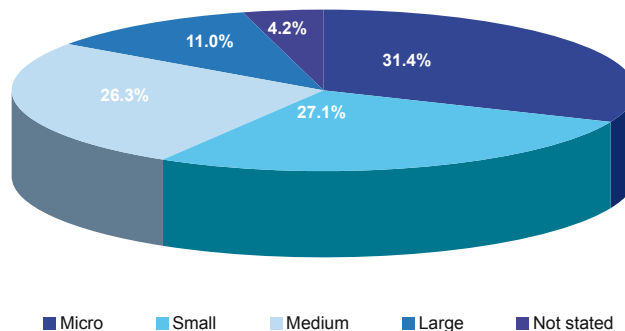
## Companies by sector

The survey generated responses from 354 companies with total employment of around 25,873 employees and total annual turnover of \$13.9 billion.

Data was collected on 14 sectors across the manufacturing and construction industries and these were aggregated to six individual sectors.

The metals manufactures sector provided the highest number of participants (26.6% of all respondents), followed by other manufactures (25.4%); commercial infrastructure (17.2%). housing & apartment construction (12.7%) machinery & equipment (12.1%); and consumer manufactures (5.9%).

**Chart 2: Survey respondents by size**



## Companies by size

The survey generated a relatively even distribution across firm sizes.

The largest proportion of respondents surveyed was from micro-sized firms of under 10 employees, representing 31.4% of respondents.

Small firms of 10-25 employees accounted for 27.1% of respondents, while medium-sized firms (26–100 employees) made up 26.3%.

Large firms of more than 100 employees represented 11.0% of respondents.

4.2% of respondents did not indicate the number of people employed.



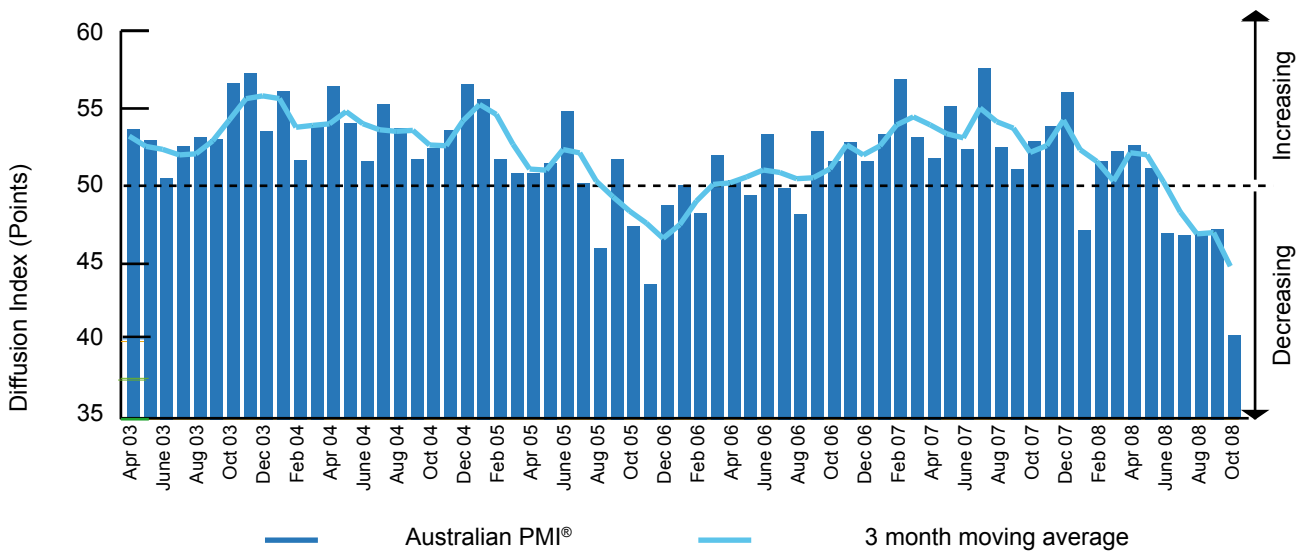
# Study Results



# Economic context for the study

**Business conditions have deteriorated since the early part of 2008 and worsened with the global economic and financial crisis, requiring companies to focus more on cash management**

**Chart 3: Australian PMI®**

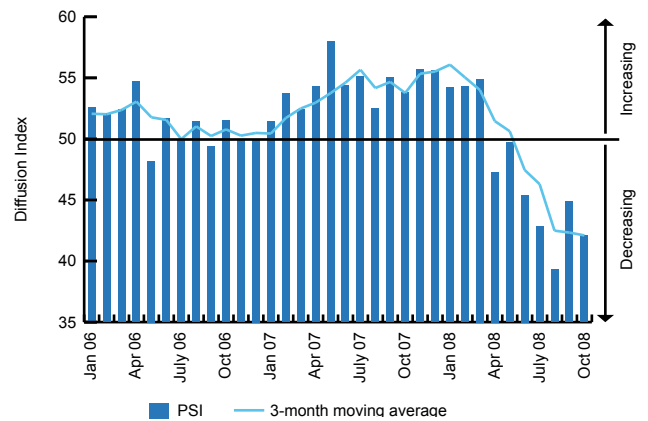


Business conditions for manufacturing, construction and services have experienced a rapid deterioration from the first quarter of 2008. This has been due to a combination of factors, including the impact of interest rate rises (now being rapidly unwound), weakness in housing activity, weakening consumer confidence and a decline in household wealth, an appreciable slowing in the rate of household and business borrowings, slowing retail sales, and a declining stock market.

A similar story was unfolding in the construction sector with the Ai Group/Housing Industry Association Australia Performance of Construction Index®, although the downturn can be dated from January 2008, with the index falling from 58.6 points (representing strong growth) to 36.4 in October, the month of the survey (representing a significant decline in activity). Outside of mining and infrastructure activity, construction activity for housing, apartments and commercial buildings was deteriorating rapidly.

The recent events surrounding the global economic and financial crisis that unfolded in mid-October has contributed to acceleration in this deterioration, both globally and within Australia.

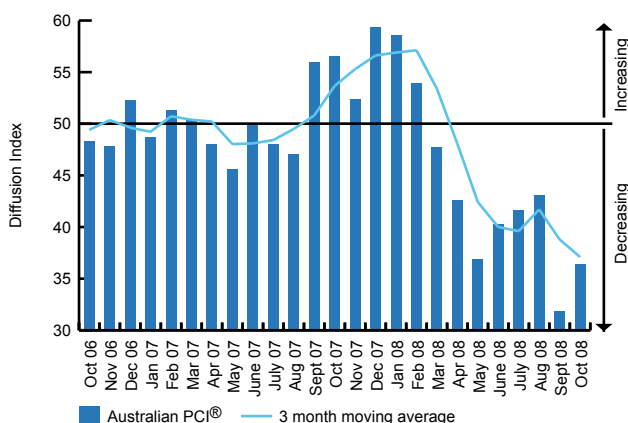
**Chart 5: Australian PSI®**



The rapid turnaround can be seen in the Ai Group-PricewaterhouseCoopers Australian Performance of Manufacturing Index®, which showed that from March 2008, the index fell from 52.3 points, representing marginal growth, to 40.4 points in the month of the survey, representing declining activity. This deterioration mirrored much of what was being experienced across the globe with manufacturing activity in both developed and developing economies, with Australia recording the fifth weakest results of 22 countries where monthly data is available.

Finally, unlike previous downturns in business activity, the slowdown in 2008 was particularly being hard felt by the services sector, which started to weaken from March 2008. The Ai Group/Commonwealth Bank Australian Performance of Services Index® fell from 54.4 points (representing moderate growth) to 42.1 points in October, putting the sector in decline during the survey period. Weakness in retail, finance and business and property had impacted in business activity and confidence across much of the services sector.

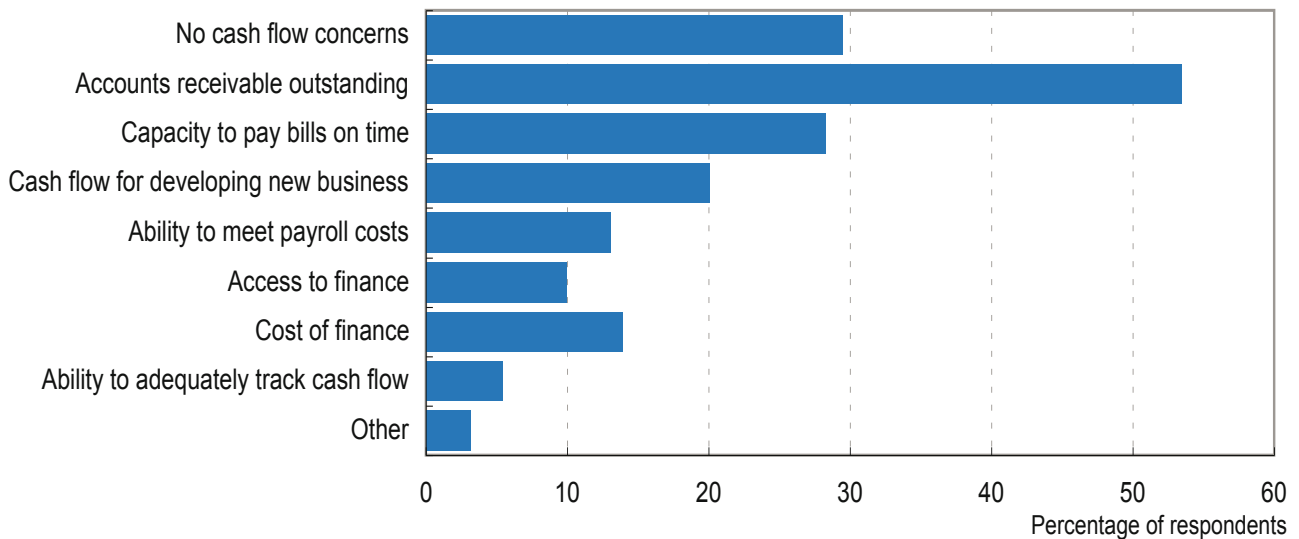
**Chart 4: Australian PCI®**



# Major cash flow concerns over the next six months

## Accounts receivable and bill-paying capacity are the major concerns

Chart 6: Key cash flow concerns for the next six months

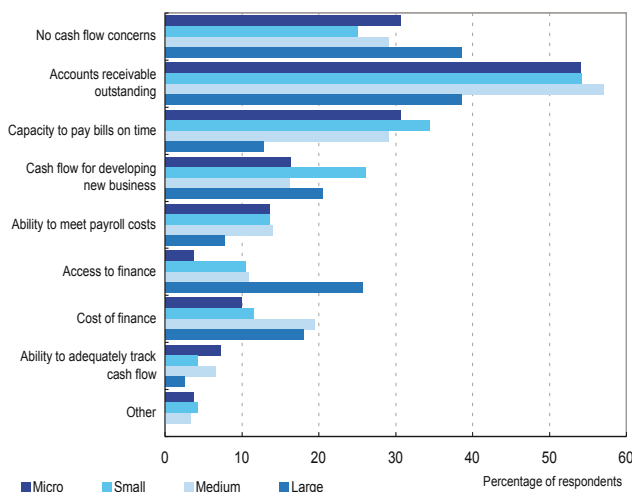


Micro, small, medium and large firms were asked to identify up to three major concerns relating to their business' cash flow over the next six months.

Reflecting current economic uncertainty, the greatest degree of concern identified by respondents overall was in relation to accounts receivable outstanding (53.4% of respondents); capacity to pay bills on time (28.2%) and availability of cash flow for business development (20.1%).

Perhaps a little surprisingly given recent economic data and business confidence surveys, 29.4% of firms indicated no cash flow concerns.

Chart 7: Key cash flow concerns by size



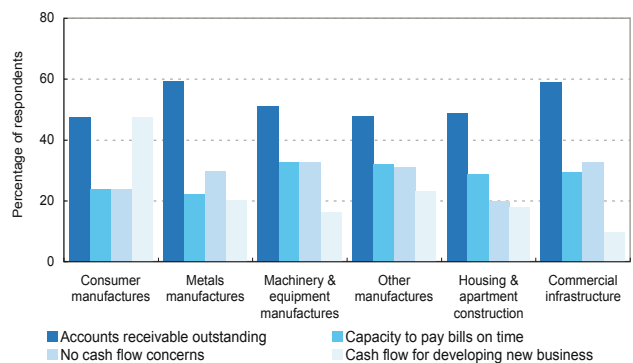
Unsurprisingly, given the uncertainty surrounding the economic outlook, 54.1%; 54.2%; 57.0%; and 38.5% of micro; small; medium; and large firm respondents respectively, indicated accounts receivable outstanding as a major concern.

Micro, small and medium firms indicated that the capacity to pay bills on time is a key concern (30.6%, 34.4% and 29.0% of respondents respectively) to a larger extent than large firms (12.8% of respondents).

Access to finance was an important concern to a major degree only for large firms (25.6% of respondents). This may reflect the fact that larger firms source a larger proportion of their finance from overseas whereas smaller firms utilise retained earnings and draw finance from the local, well capitalised financial sector, including through existing overdraft lines.

Concerns over costs of finance appear moderately related to firm size, with 17.9% and 19.4% of large and medium firm respondents indicating major concern on finance costs compared to 11.5% and 9.9% of small and micro firms.

Chart 8: Key cash flow concerns by sector



All sectors nominated accounts receivable outstanding as a major cash flow concern, with the commercial infrastructure and metals manufactures sector firms (59.0% and 59.6% of respondents respectively) most concerned. Capacity to pay bills on time was also a major concern across all sectors.

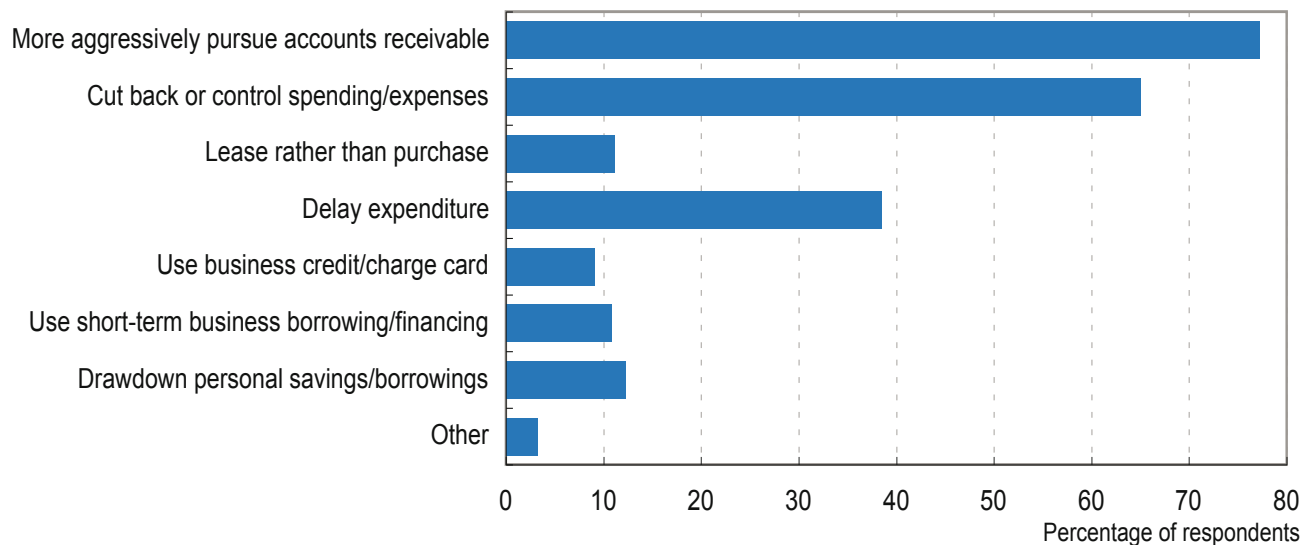
The consumer manufactures sector cited cash flow for developing new business (47.6% of respondents) to a significantly greater degree than other sectors.

The greatest degree of concern over the cost of finance was in the consumer manufactures; housing & apartment construction; and machinery & equipment manufactures sectors (23.8%, 22.2% and 20.9% of respondents). Access to finance was a major concern to a significant extent only in the housing & apartment construction sector (17.8% of respondents).

# Strategies to manage cash flow concerns

*In troubled times firms will focus on accounts receivable and costs*

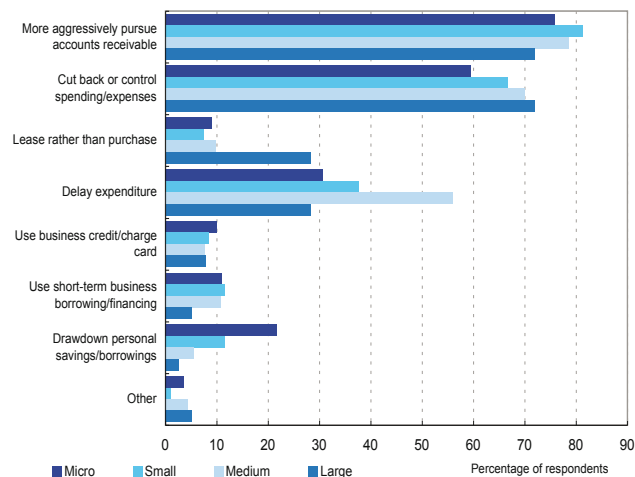
**Chart 9: Cash flow management strategies**



Survey respondents from micro, small, medium and large firms were asked to identify up to three major strategies to manage cash flow concerns if they arise.

Reflecting the concern over accounts receivable discussed previously, a key major strategy identified by respondents overall was a more aggressive pursuit of accounts receivable (77.1% of respondents). Cutting back or controlling spending was also important (65.0% of respondents), as was delaying of expenditure (38.4%).

**Chart 10: Cash flow management strategies by size**

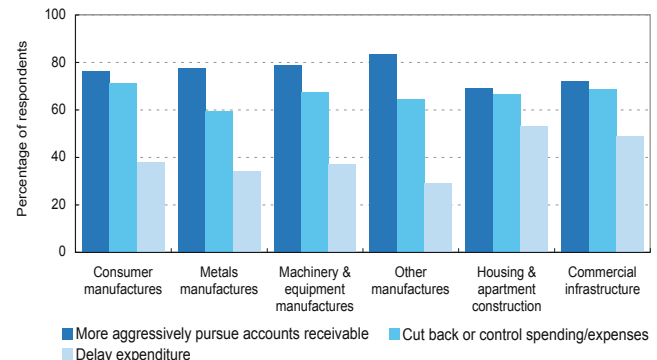


Pursuit of accounts receivable was highly favoured at similar levels across firm sizes. Cost cutback/control is also a major response with it being used to an increasing degree as firms get larger.

Delays in expenditure were favoured more heavily in medium and small firms (55.9% and 37.5% of respondents) than among large and micro firms (28.2% and 30.6%).

Large firms are more likely to pursue lease rather than purchase strategies, (28.2% of respondents), compared to an average across all firms of 11.0% of respondents.

**Chart 11: Cash flow management strategies by sector**



There is some mild variation across sectors in terms of preferred key cash flow management strategies should the need arise.

The metals manufactures (77.7% of respondents); machinery & equipment manufactures (79.1%); and other manufactures (83.3%) sectors are moderately more likely than other sectors to pursue accounts receivable more aggressively.

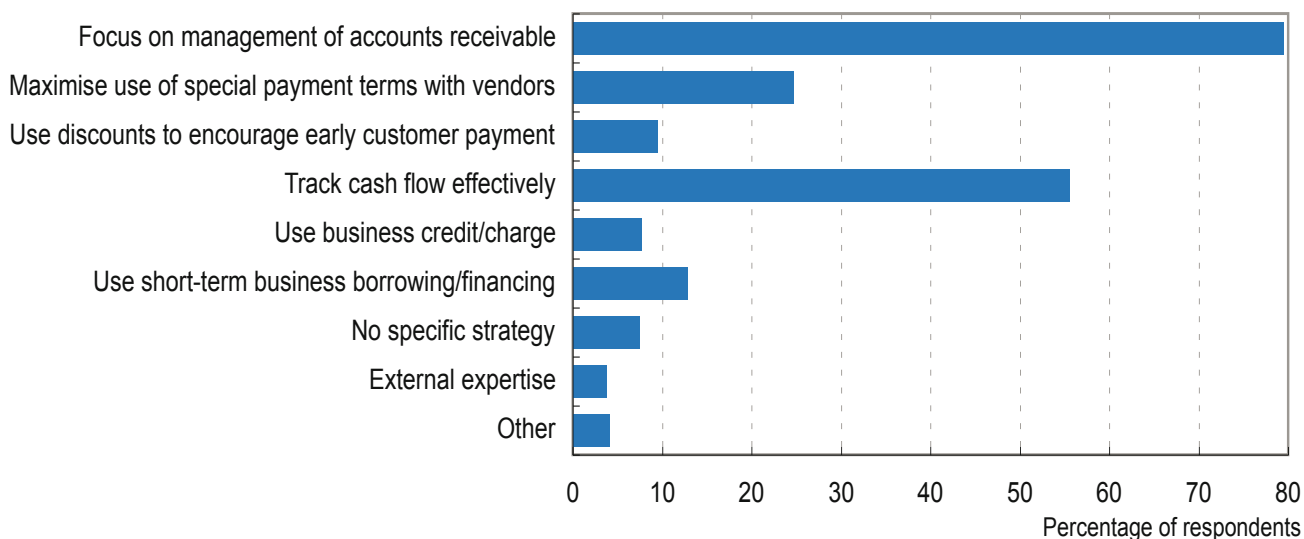
The pursuit of cutback/control of costs is fairly equally favoured across sectors.

One difference in approach identified in the survey is that the housing & apartment construction and commercial infrastructure sectors put a greater emphasis on the use of expenditure delay than the average, 53.3% and 49.2% of respondents compared to an all firm average of 38.4% of respondents.

# Long-term strategies to maximise cash flow

Accounts receivable management and effective cash flow tracking are favoured for the long-term

Chart 12: Long-term cash flow management strategies



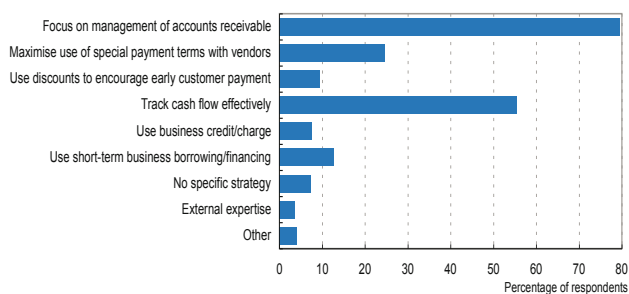
Survey respondents from micro, small, medium, and large firms were asked to identify up to three strategies they use to maximise cash flow over the longer term.

In line with responses to earlier questions, a focus on management of accounts receivable is a cash flow maximisation strategy for 79.4% of respondents.

Effective tracking of cash flow is also important with 55.4% of respondents indicating use of this strategy.

The maximisation of special payments terms with vendors also plays a role for 24.6% of respondents.

Chart 13: Long-term cash flow management strategies by size

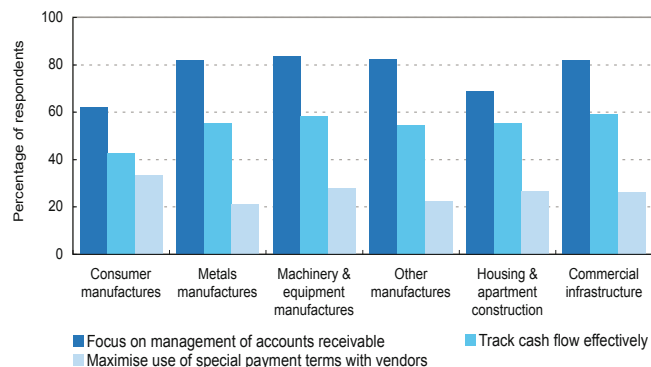


Variations in key strategies identified across firm-size groups were relatively small, particularly in terms of focus on accounts receivable and cash flow tracking.

The use of maximisation of special payment terms with vendors appears related to size – as a firm becomes medium/large the more it uses this strategy to maximise cash flow. This likely reflects the fact that larger firms tend to buy a larger share of individual vendor production, giving them some ability to set more favourable terms.

Firm size also seems to have a bearing on the extent to which firms set specific strategies for cash flow management. 11.7% of micro firm respondents indicated no specific strategy is undertaken compared to 2.6% of large firm respondents. This difference may reflect differentials in the skills and resources available to carry out strategy setting.

Chart 14: Long-term cash flow management strategies by sector



Variations in long-term cash flow management strategies are not large across sectors but there are some interesting features in the pattern of responses, particularly in terms of the consumer manufactures sector.

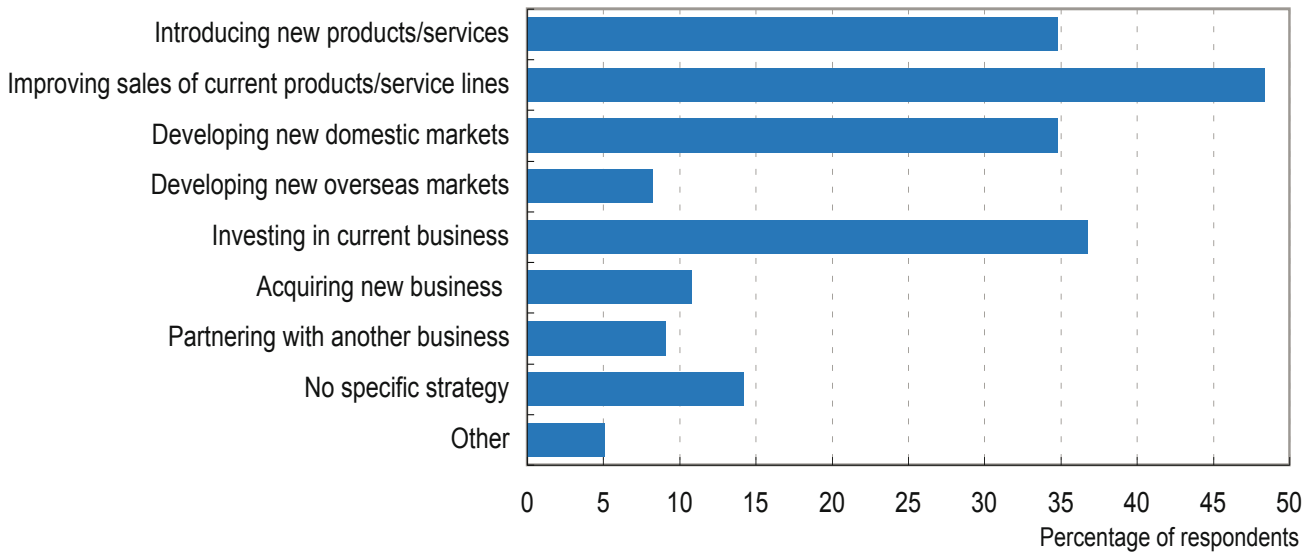
The consumer manufactures (61.9% of respondents) and housing & apartment construction (68.9%) sectors exhibit less focus than the firm average (79.4%), on management of accounts receivable. The former also focuses to a lesser extent than the firm average on effective tracking of cash flow (42.9% of respondents), compared to 55.4% for the average of all firm responses.

The consumer manufactures sector makes greater use of special payment terms from vendors, (33.3% of sector respondents), compared to the average of all firm respondents, (24.6%). The sector also uses discounts to encourage early customer payment to a greater degree than the all firm average, 23.8% of respondents compared to 9.3%.

# Key business development strategies over the next six months

*Improving sales, new domestic markets, investment and new products and services dominate*

**Chart 15: Key business development strategies over the next six months**

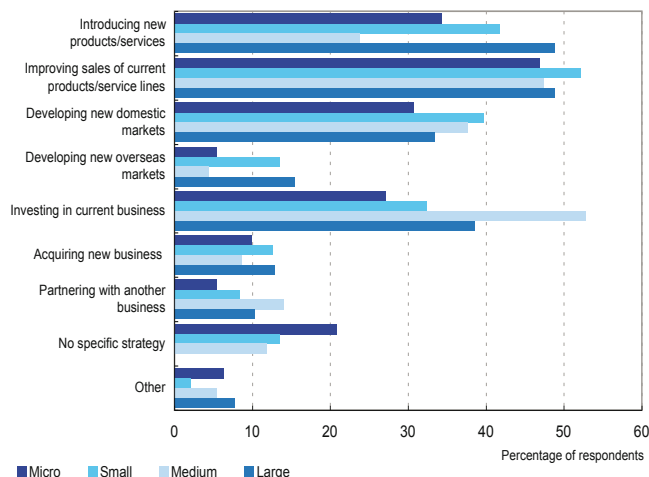


Survey respondents were asked to identify up to three major strategies being undertaken over the next six months to develop their business.

Four key strategies dominated the near-term business development approach of respondents. The most popular major strategies were improving sales of current production (48.3% of respondents); investing in the current business (36.7%); development of new domestic markets (34.7%); and introducing new products and services (34.7%).

Possibly reflecting the ongoing turmoil in global financial markets and expectations of a significant easing of global economic growth, developing new overseas markets was a major strategy for only 8.2% of respondents.

**Chart 16: Key business development strategies by size**



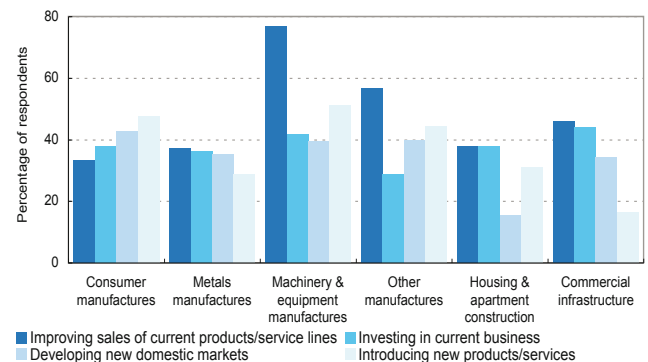
Micro, small and large firms will focus on improving sales of current production (46.8%, 52.1% and 48.7% respectively of respondents) and introducing new products/services (34.2%, 41.7% and 48.7%).

Medium firms will also focus on improving sales of current production (47.3% of respondents), but investing in current

business, is the most popular major strategic approach for this firm size group (52.7% of respondents). Development of domestic markets figures similarly across all firm sizes.

Size has an impact on the prevalence of business development planning – the smaller the firm the less likely that specific strategies are identified. The ‘no specific strategy’ response made up 20.7% of respondents among micro firms compared to 0.0%; 11.8%; and 13.5% of large, medium and small firm respondents respectively.

**Chart 17: Key business development strategies by sector**



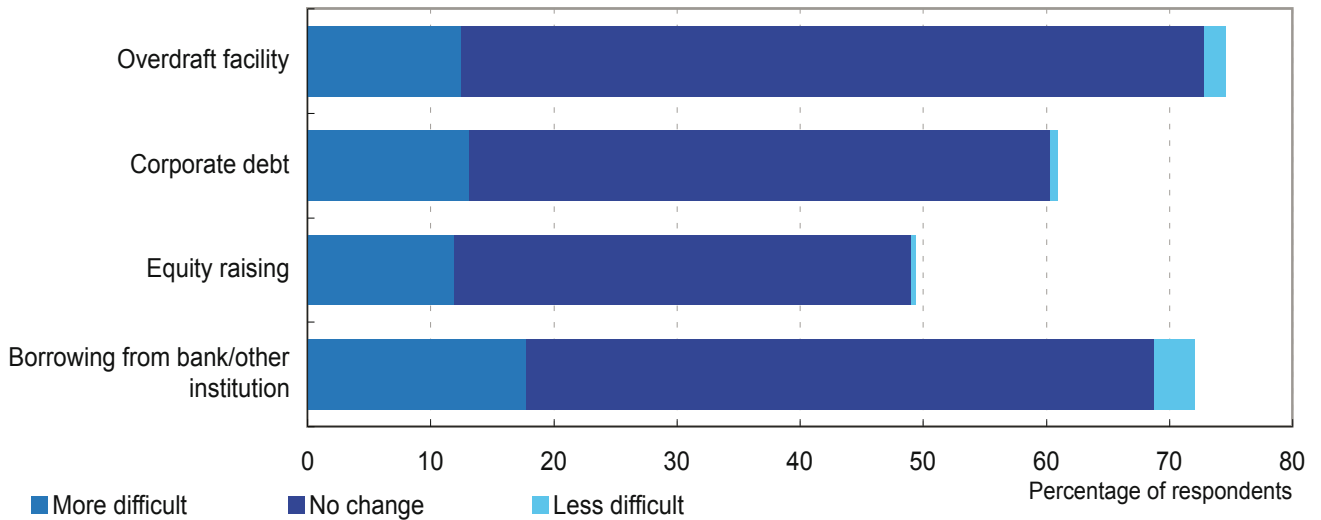
The same four key development strategies feature across industry sectors, with some variance in emphasis. The machinery & equipment and other manufactures sectors will be focusing more heavily on improving sales of current production (76.7% and 56.7% of respondents respectively) compared to the average for all firms (48.3%). The consumer manufactures sector will be putting least emphasis on this major strategy (33.3% of respondents).

The other manufactures sector will be putting least emphasis on investing in current business (28.9% of respondents), compared to the all-firm average (36.7%). Reflecting the poor outlook for the housing & apartment market, this sector will be putting significantly less reliance on developing new domestic markets (15.6% of firms).

# Access to external finance over the past year

*Almost one in five firms said that borrowing from banks/other financial institutions had become more difficult over the past year, though less so in the case of smaller firms*

**Chart 18: Access to external finance over the past year**

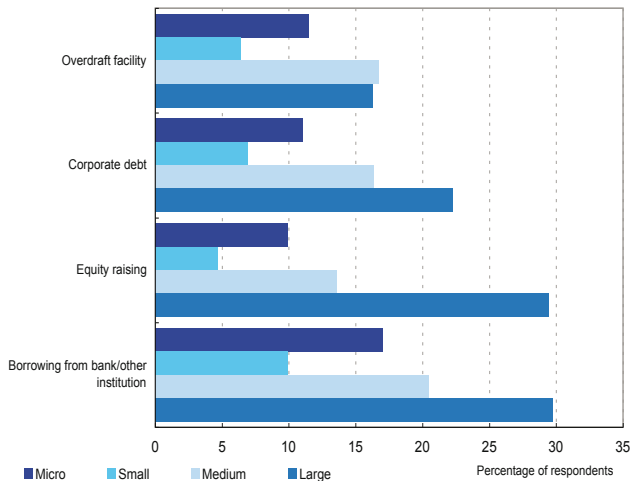


Firms were asked whether their access to external finance had become more or less difficult over the past year.

Almost one-fifth of respondents (17.7%) said that borrowing from banks/other financial institutions had become more difficult over the past year.

Respondents also cited greater difficulty in accessing external finance from: corporate debt (13.1% of firms); their overdraft facility (12.4%), and equity raising (11.9%).

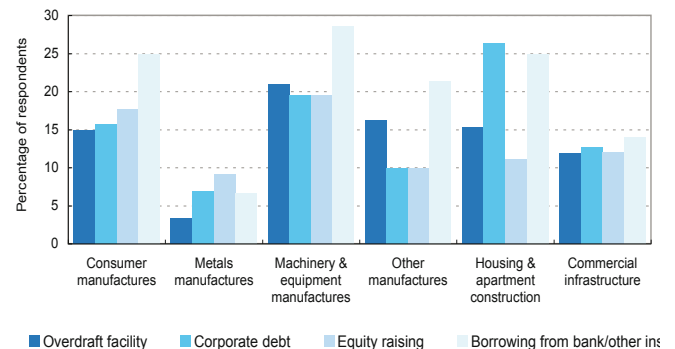
**Chart 19: Firms citing increased difficulty in access to external finance over the past year by size**



By business size, large businesses were more likely to state that access to external finance had become more difficult than smaller firms.

For example, a relatively high number of large businesses said it had become more difficult to borrow from banks or other financial institutions (29.7% of respondents) or raise equity (29.4%).

**Chart 20: Firms citing increased difficulty in access to external finance over the past year by sector**



Borrowing from banks and other financial institutions is more likely to be cited as being more difficult to access over the past 12 months than other forms of finance for most industry sectors.

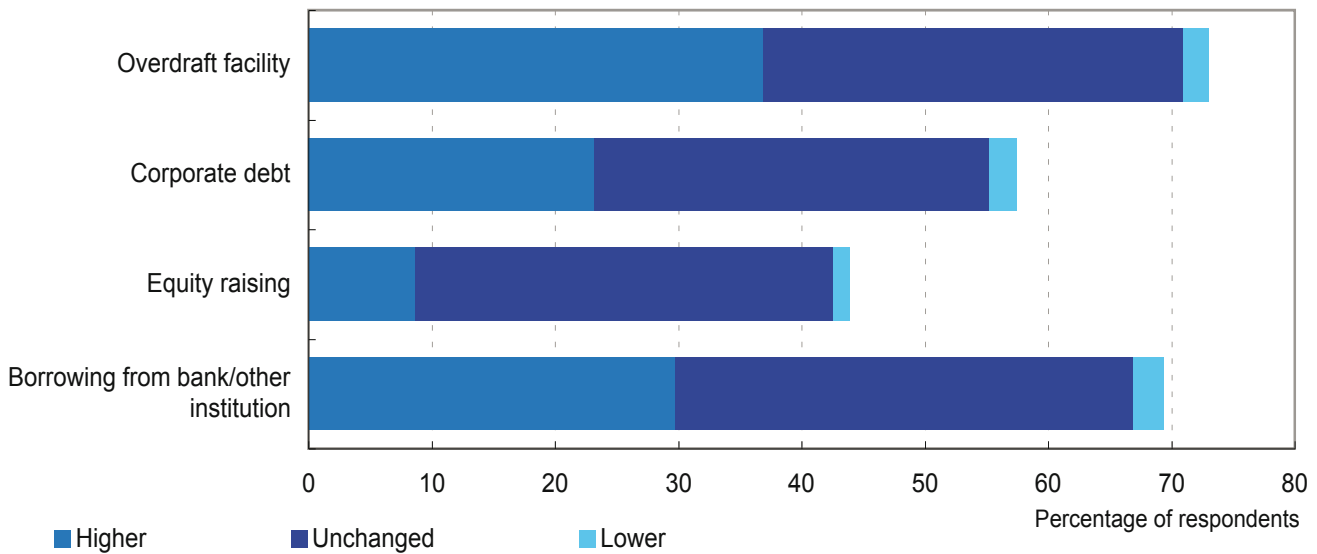
Firms in the machinery & equipment manufactures; consumer manufactures; and housing & apartment construction sectors are more likely to cite difficulties in gaining access to external finance than the other industry sectors.

Metals manufacturers were the least likely to cite difficulties in gaining external finance than other industry sectors – for all methods.

# External finance costs over the past year

Many firms, though less so for smaller ones, reported increases in external finance costs over the past year

Chart 21: External finance costs over the past year

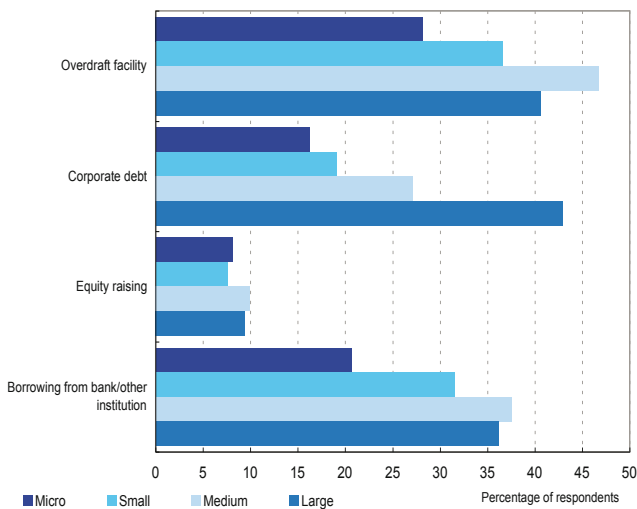


The survey asked respondents to indicate whether their external financing costs had risen over the past year.

Many firms reported increases in external finance costs over the past year.

This was particularly the case with overdraft facilities (36.8% noted higher costs), borrowing from banks and other financial institutions (29.8%), and corporate debt (23.2%).

Chart 22: Firms citing higher external finance costs over the past year by size



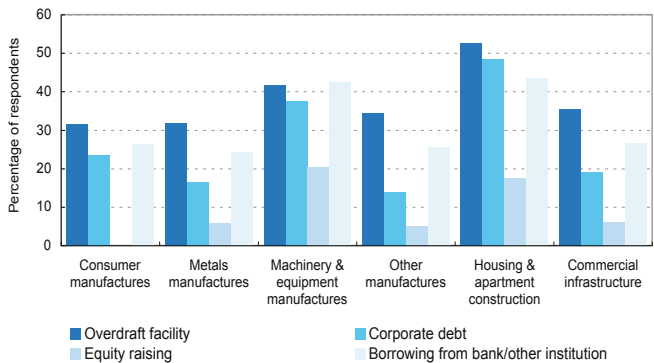
In general, large and medium-sized enterprises were more likely to have experienced higher external financing costs than small and micro firms over the past year.

Increased costs for overdraft facilities were cited by a large proportion of medium-sized (46.7%) and large businesses (40.5%).

Corporate debt costs increased for 42.9% of large businesses.

Firms were less likely to note increased costs for equity raising.

Chart 23: Firms citing higher external finance costs over the past year by sector



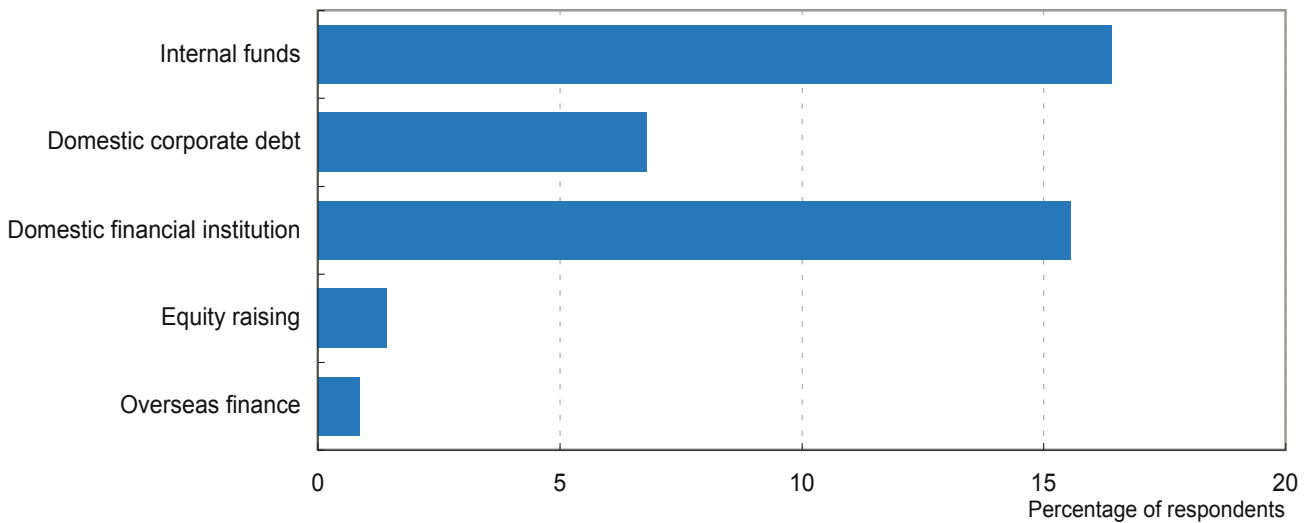
Higher financing costs were most often cited by firms in the housing & apartment construction sector, for all types of external finance except equity raising. In this sector, more than half of firms (52.6%) said they had experienced increased borrowing costs for overdraft facilities, and just under half (48.6%) had experienced increased costs of corporate debt.

Firms in the machinery & equipment manufactures sector were also relatively likely to note increased external financing costs. Over 40% of firms in this industry sector noted increased borrowing costs associated with borrowing from banks and financial institutions (42.5%) and via overdraft facilities (41.9%).

# Access to new forms of finance over the past year

*Internal funding and access to finance from domestic financial institutions were the key new forms of finance over the past year*

**Chart 24: Access to new forms of finance over the past year**

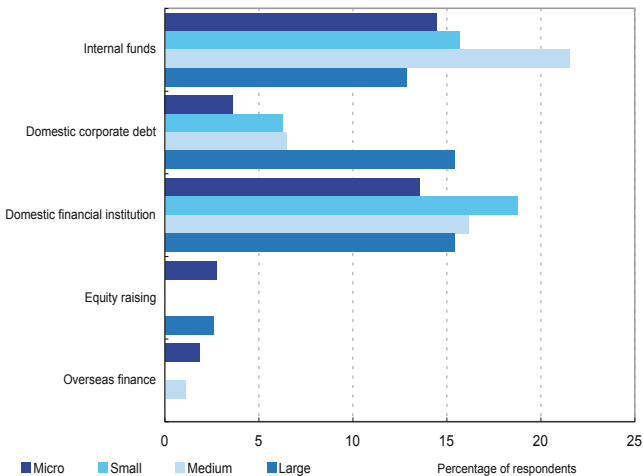


The survey asked firms whether they accessed any new forms of finance over the past year, and what type.

New forms of finance were more likely to include internal funds (16.4%), finance from domestic financial institutions (15.5%) and domestic corporate debt (6.8%).

Small firms were more likely to access domestic financial institutions (18.8% of respondents) and internal funds (15.6%) than other forms of finance. Micro firms were more likely to access internal funds (14.4% of respondents) and domestic financial institutions (13.5%).

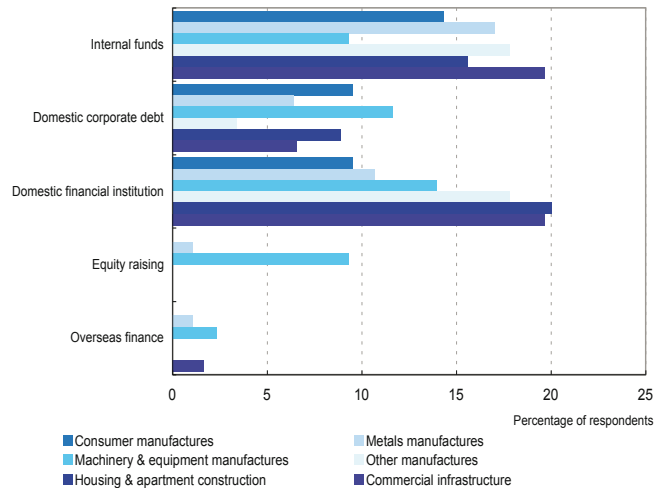
**Chart 25: Access to new forms of finance over the past year by size**



Reflecting their ability to access major financial markets, large firms were more likely than other firms to access domestic corporate debt (15.4% of respondents). They also sourced a significant proportion of their new financing (15.4% of respondents) from domestic financial institutions.

Medium-sized businesses were more likely to draw on internal funds (21.5% of respondents) than other firm sizes, while domestic financial institutions were also an important source of new finance (16.1%).

**Chart 26: Access to new forms of finance over the past year by sector**



New financing from domestic financial institutions was more commonly cited by firms in the housing & apartment construction (20.0% of respondents); commercial infrastructure (19.7%); and other manufactures (17.8%) sectors.

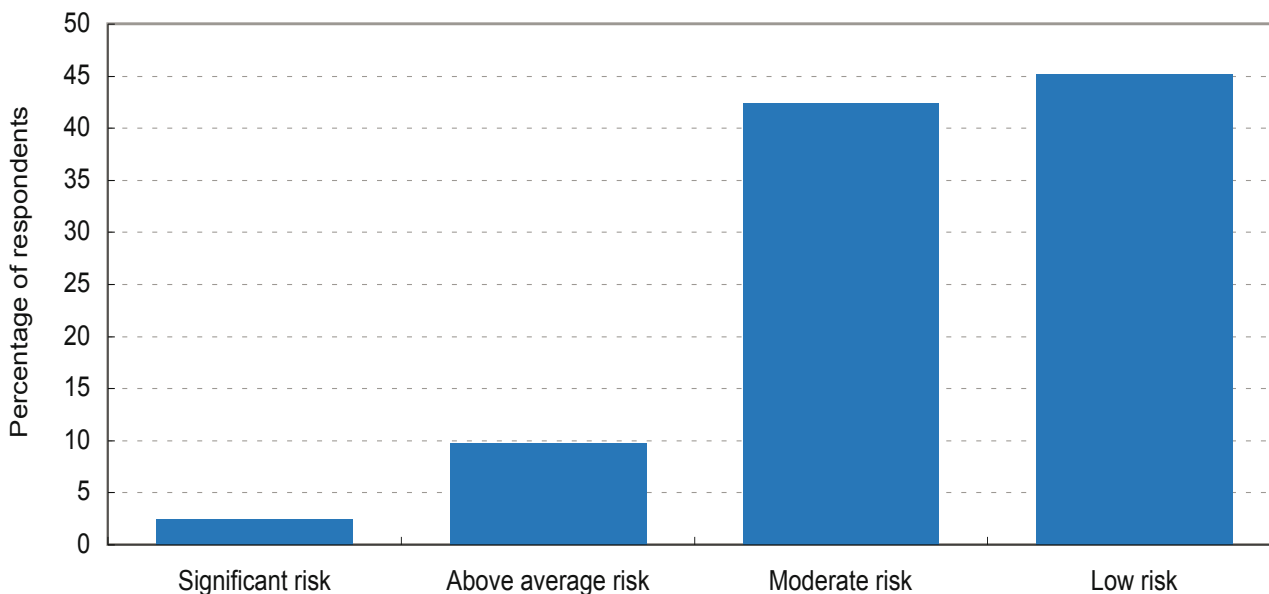
Internal financing was used more commonly as a new form of finance by the commercial infrastructure (19.7%); other manufactures (17.8% of respondents); and machinery & equipment manufactures (17.0%) sectors.

Domestic corporate debt was used more commonly (as a new form of financing) by machinery & equipment manufacturers (11.6% of respondents).

# Willingness to take on risk to grow in the next six months

*Very few firms are willing to take on significant financial risk to grow their company over the next six months – micro firms are the most risk averse.*

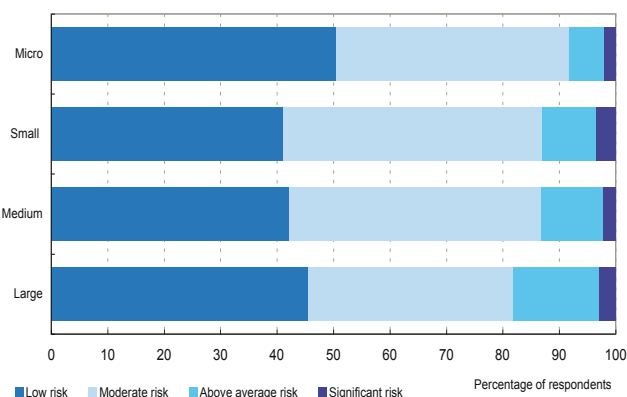
**Chart 27: Willingness to take on risk to grow in next six months**



Firms across the size spectrum were asked what level of financial risk they would be willing to take on (for example, a new bank loan) to grow their company over the next six months.

Very few respondents said they would be willing to take on significant (2.5% of respondents) or above average financial risk (9.7%), with most firms indicating they would be willing to take on either moderate risk (42.5%) or low risk (45.3%).

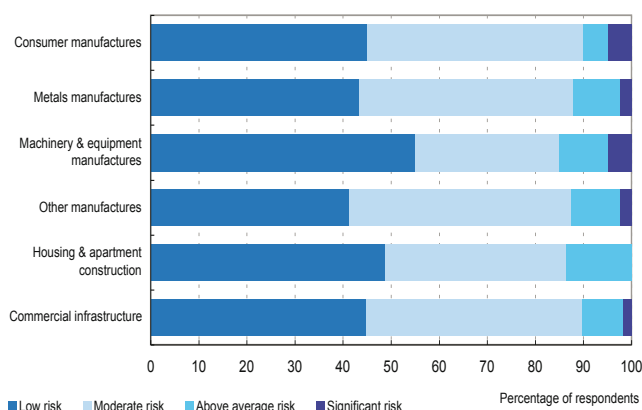
**Chart 28: Willingness to take on risk to grow in the next six months by size**



By business size, large firms said they were more likely to take on significant (3.0% of respondents) or above average risk (15.2%) than smaller firms.

Micro firms were more risk averse than other firms, with just over one-half of respondents indicating they would only be willing to take on low risk activities.

**Chart 29: Willingness to take on risk to grow in the next six months by sector**



Across industry sectors, firms indicated a varying level of risk they would be willing to face in financial decision-making over the next six months.

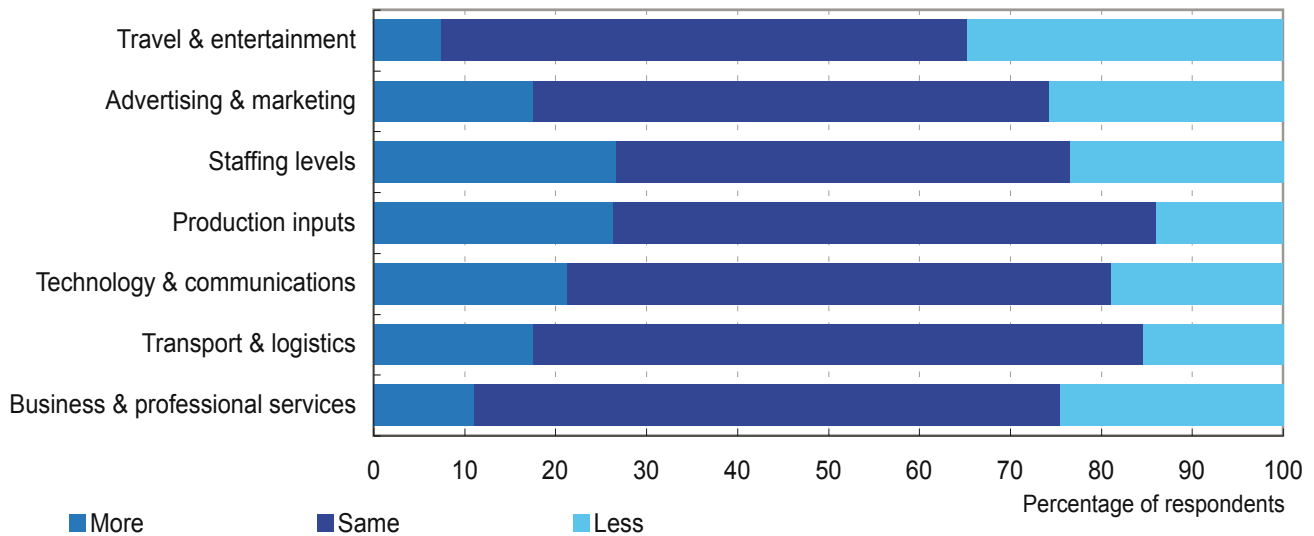
Whilst a comparatively higher proportion of firms in the machinery & equipment manufactures sector said they would be only willing to consider financial activities of a low-risk nature (55.0% of respondents), perversely a comparatively higher proportion said they would be willing to undertake activities of a significant (5.0%) or above average risk (10.0%).

In the housing & apartment construction sector, no firms said they would be willing to take a significant financial risk, although 13.5% indicated a willingness to take on above average financial risk.

# Expected change in purchases over the next six months

*Purchases of travel & entertainment items are the most likely to be cut back over the next six months*

**Chart 30: Expected change in purchases over the next six months**



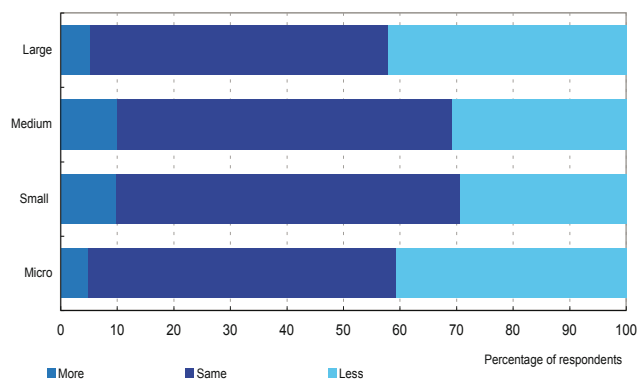
With economic conditions expected to deteriorate over the coming period, many firms will be reviewing the purchases they plan to make. The study sought from businesses an assessment of the likely change in their purchases of a range of items over the next six months.

While most respondents expect their purchasing levels to stay the same, more than one-third of businesses are planning to cut back their purchases of travel & entertainment items, with 34.7% expecting to purchase less of these items and only 7.4% planning on increasing purchases. Similarly, almost one-quarter of firms (24.6%) plan to reduce purchases of business & professional services over the next six months, compared with just 11.1% who expect to lift purchases.

Firms are least likely to reduce their purchases of production inputs (13.9%) and transport & logistics services (15.5%) over the next six months. Just less than one in five respondents (18.9%) expect to purchase less technology & communication items over the next six months.

A cut in purchases of staffing and advertising & marketing is expected by 23.5% and 25.7% of businesses respectively.

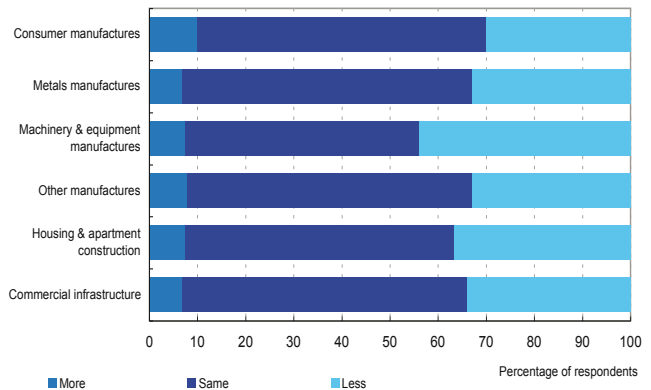
**Chart 31: Expected change in purchases of travel & entertainment over the next six months by size**



Large and micro firms are the most likely to cut back on the purchases of travel & entertainment items over the next six months, 42.1% and 40.8% of respondents respectively.

By contrast, just less than one-third of medium-sized and small firms, 30.8% and 29.3% respectively, plan to reduce their purchases of travel & entertainment items.

**Chart 32: Expected change in purchases of travel & entertainment over the next six months by sector**



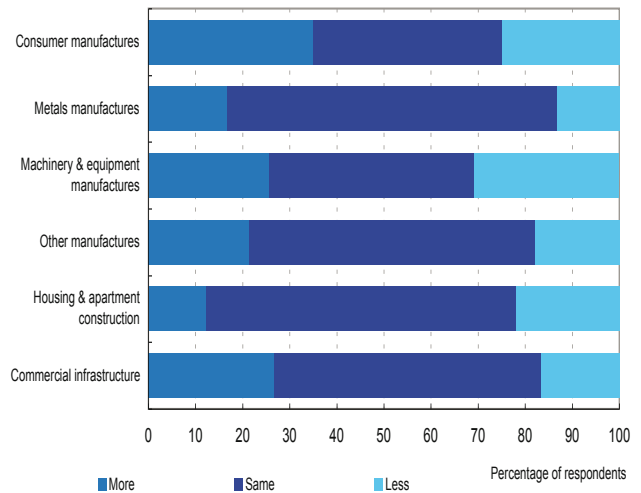
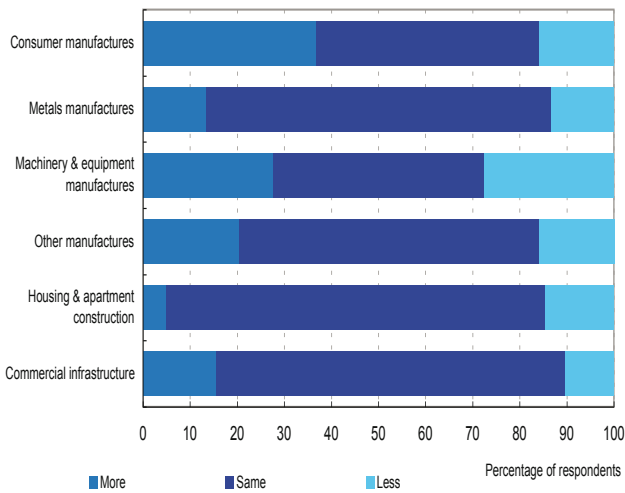
Machinery & equipment firms are the most likely to rein-in their purchases of travel & entertainment items over the next six months (43.9% of respondents). Firms in the housing & apartment construction sector are the next most likely to decrease travel & entertainment purchases over the coming period (36.6%).

Around one-third of firms in the commercial infrastructure (33.9%); metals manufactures (33.0%); other manufactures (33.0%); and consumer manufactures (30.0%) sectors plan to cut back on their purchases of travel & entertainment over the next six months.

# Expected change in purchases over the next six months

**Machinery & equipment manufacturers are the most likely to cut back on their purchases of transport & logistics and technology & communications over the next six months**

**Chart 33: Expected change in purchases of transport & logistics and technology & communications over the next six months by sector**



## Transport & logistics

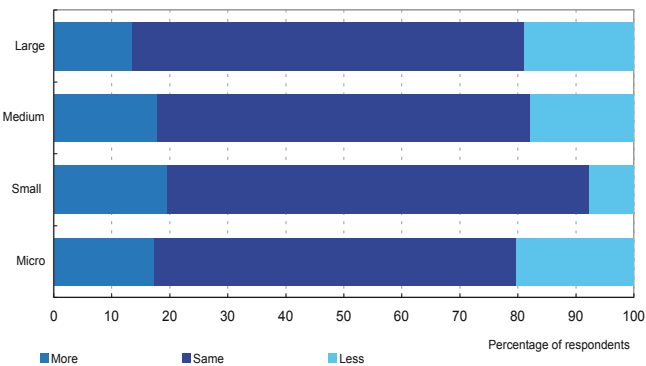
Machinery & equipment manufacturers are the most likely to decrease their purchases of transport & logistics services over the coming six months (27.5% of respondents).

Just under one in six respondents from the other manufactures (15.9%) and consumer manufactures (15.8%) sectors anticipate reducing their transport & logistics purchases over the same period.

Only 14.6% of firms in the housing & apartment construction sector and 10.3% of commercial infrastructure firms plan to increase their purchase of transport & logistics.

Micro firms are the most likely to cut-back on their purchases of transport & logistics over the next six months, (20.2%), compared with 18.9% of large firms; 17.8% of medium-sized firms; and just 7.6% of small firms.

**Chart 34: Expected change in purchases of transport & logistics over the next six months by size**



## Technology & communications

The machinery & equipment manufactures sector also contains the highest proportion of firms planning to reduce their purchases of technology & communications over the next six months, (30.8%).

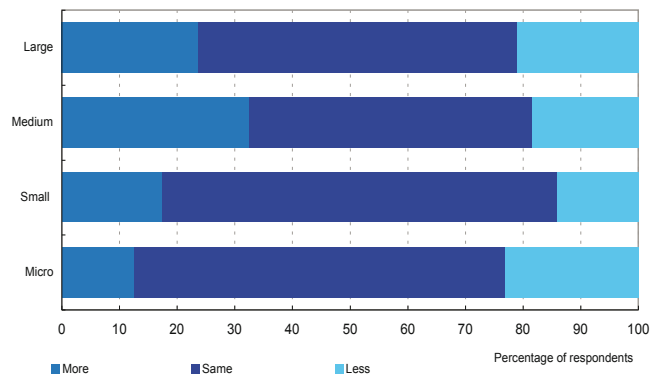
Around one in every four firms in the consumer manufactures sector and 22.0% of firms in the housing & apartment construction sector anticipate a decline in technology & communications purchases over the coming months.

Firms in the metals manufactures (13.3%); commercial infrastructure (16.7%); and other manufactures (18.0%) sectors are less likely to cut back on their purchase of technology & communications.

Micro (23.1%) and large firms (21.1%) have the greatest plans to decrease purchases of technology & communications.

By contrast, only 14.1% of small firms and 18.5% of medium-sized firms anticipate a fall in technology & communications purchases.

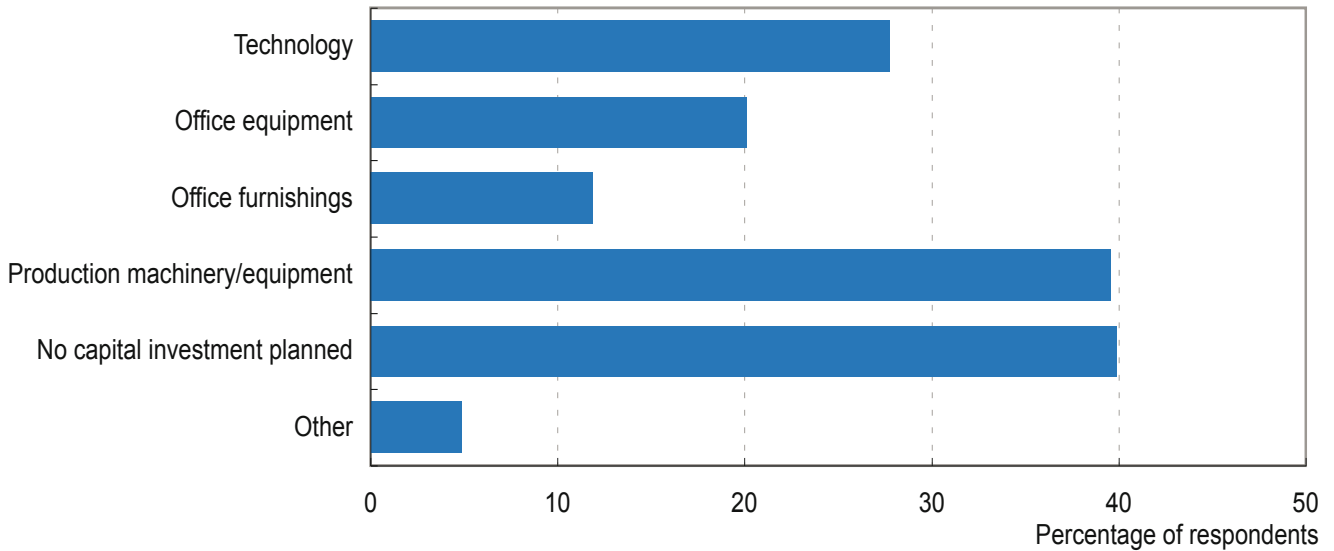
**Chart 35: Expected change in purchases of technology & communications over the next six months by size**



# Capital spending over the next six months

**Almost 40% of all firms and 53% of micro firms, have no capital investment plans for the next six months**

**Chart 36: Expected capital spending over the next six months**



The survey asked businesses about their plans for capital investment over the next six months.

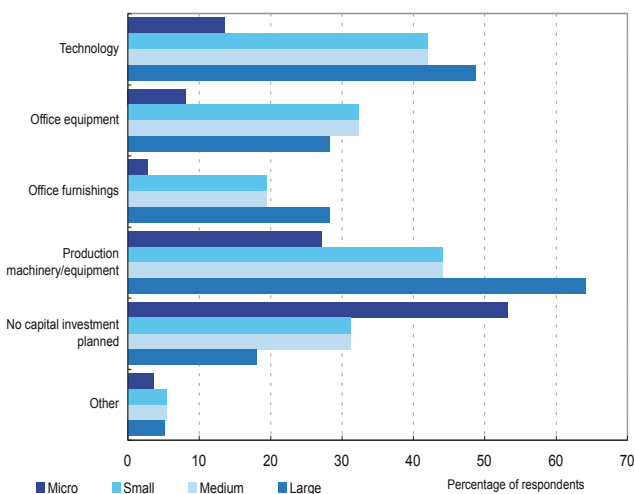
Reflecting the deterioration in consumer and business confidence, almost 40% of firms signaled they had no plans for capital investment over the next six months.

New capital investment is most likely to occur through expenditure on production machinery/equipment (39.5%).

More than one-quarter of respondents are planning to invest in new technology over the next six months.

Around one in five firms (20.1%) have plans to purchase office equipment over the coming two quarters, while 11.9% expect to invest in office furnishings.

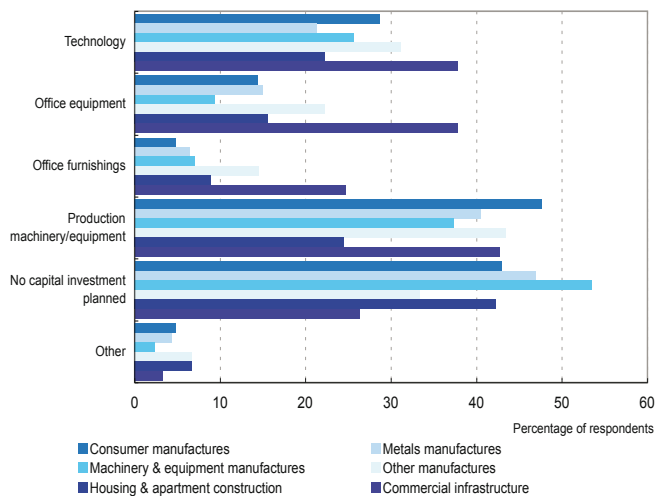
**Chart 37: Expected capital spending over the next six months by size**



More than half of micro firms have no plans for capital investment over the next six months (53.2%), compared with 31.2% of small and medium-sized firms and 17.9% of large firms.

Large firms are the most likely to undertake capital expenditure over the coming six months, with 64.1% planning to invest in production machinery/equipment; 48.7% planning to invest in new technology; and 28.2% planning to invest in both office equipment and office furnishings.

**Chart 38: Expected capital spending over the next six months by sector**



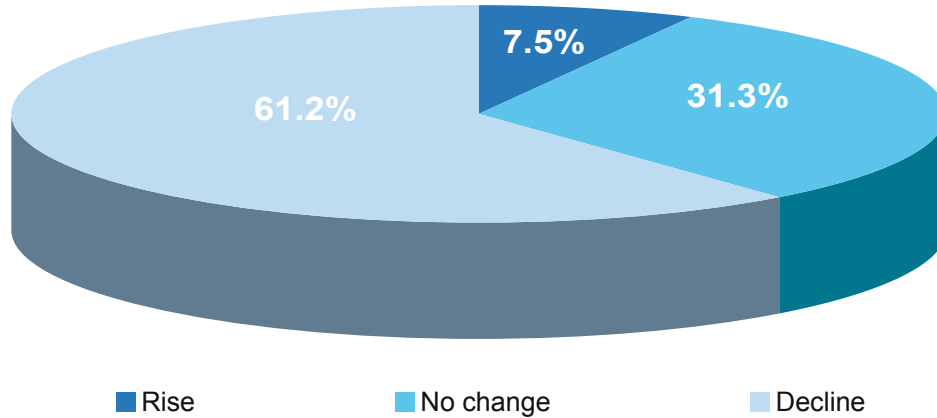
More than half of the firms in the machinery & equipment manufactures sector (53.5%) have no capital investment plans for the next six months, followed by the metals manufactures sector (46.8%).

Firms in the consumer manufactures sector are the most likely to invest in production machinery/equipment over the next six months, while firms in the commercial infrastructure sectors are the most likely to invest in technology (37.7%); office equipment (37.7%); and office furnishings (24.6%).

# Profit margins over the next six months

*Reflecting the weaker outlook, profit margins are expected to decline for more than half of the businesses responding – small firms are the most pessimistic*

**Chart 39: Expected change in profit margins over the next six months**



The survey asked business to indicate their expectation for their profit margins over the coming six months.

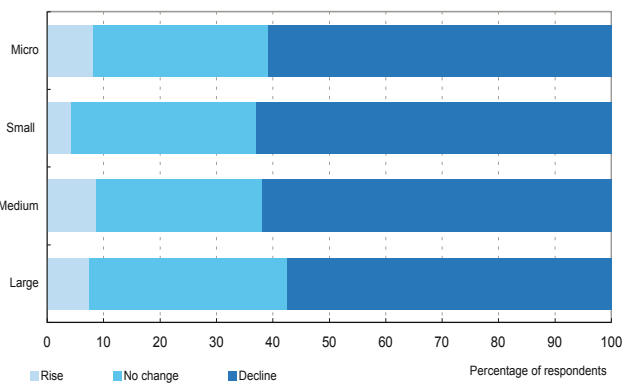
More than half of the respondents (61.2%) expect profit margins to decline over the next six months. By contrast, only 7.5% of businesses anticipate an improvement in profit margins, with the remaining 31.3% expecting margins to remain steady.

The deterioration in profit margins is likely to be driven by falling profits and strong growth in the cost of inputs, as discussed later in this report.

Less than 10% of firms for all size groupings (micro, small, medium-sized and large) anticipate a rise in profit margins in the next six months.

Small firms are the most pessimistic about future profit margins, with only 4.3% expecting a rise and 63.0% anticipating a decline.

**Chart 40: Expected change in profit margins over the next six months by size**

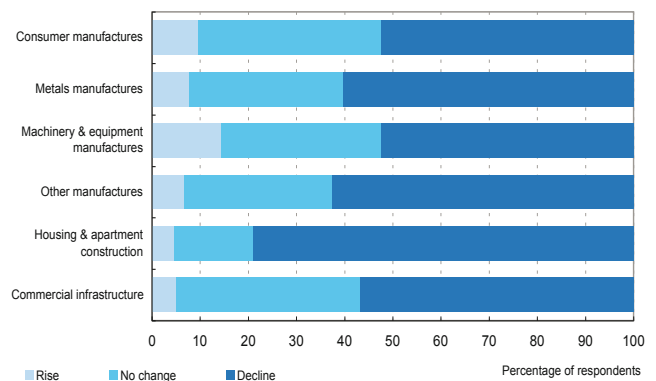


There is a greater degree of variation in the expectations for profit margins across sector.

Firms in the machinery & equipment manufactures sector are the most optimistic about profit margins over the next six months, with 14.3% expecting margins to rise and a little over half (52.4%) anticipating a decline.

Australia's weak housing market remains a concern to the nation's constructors, with only 4.7% of firms in the housing & apartment construction sector expecting a rise in profit margins over the next six months and a further 79.1% anticipating a decline.

**Chart 41: Expected change in profit margins over the next six months by sector**



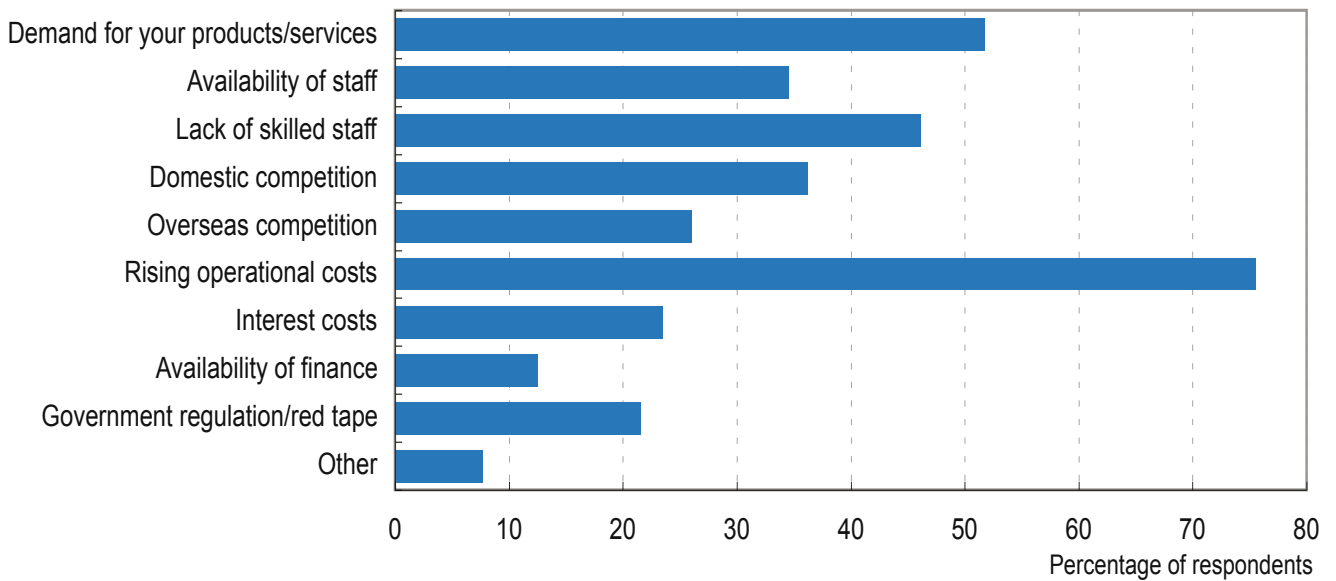
Firms from New South Wales and Victoria are the most pessimistic about the likely path for profit margins over the coming six months, with only 5.1% and 5.6% respectively anticipating a rise in margins.

By contrast, 14.0% of Queensland firms; 12.5% of South Australian firms; and 10.7% of Western Australian firms expect profit margins to increase over the period.

# Constraints on profitability over the next six months

*Rising operational costs are cited as the biggest constraint on profitability, especially for SMEs.*

**Chart 42: Major constraints on profitability over the next six months**

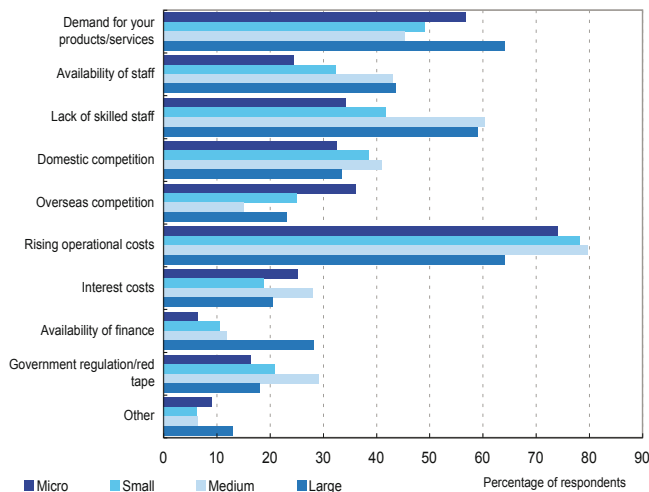


The survey asked firms to name up to five major constraints on their profitability growth over the next six months.

Rising operational costs was the reason most commonly cited by firms as being a likely major constraint on profitability. 75.4% of respondents cited this factor as a major factor constraining profitability growth.

The next most commonly cited major factors constraining profitability were demand for products/services (51.7% of respondents) and a lack of skilled staff (46.0%).

**Chart 43: Major constraints on profitability by size**

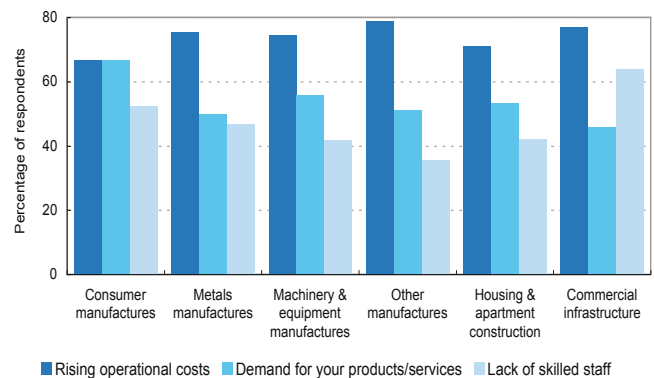


By business size, medium, small and micro firms cited rising operational costs as impacting on profitability more frequently than large firms.

Demand for products/services was more often cited as a major constraint on near-term profitability by large and micro firms, than other firms.

A lack of skilled staff was more commonly cited by medium-sized and large firms than smaller firms as a factor constraining profitability.

**Chart 44: Major constraints on profitability by sector**



There is limited variation in the major constraints affecting near-term profitability across sectors.

Rising operational costs were cited to a similar degree across most sectors with the exception of the consumer manufactures sector where they were cited by 66.7% of respondent firms compared to an all-firm average of 75.4% of respondents.

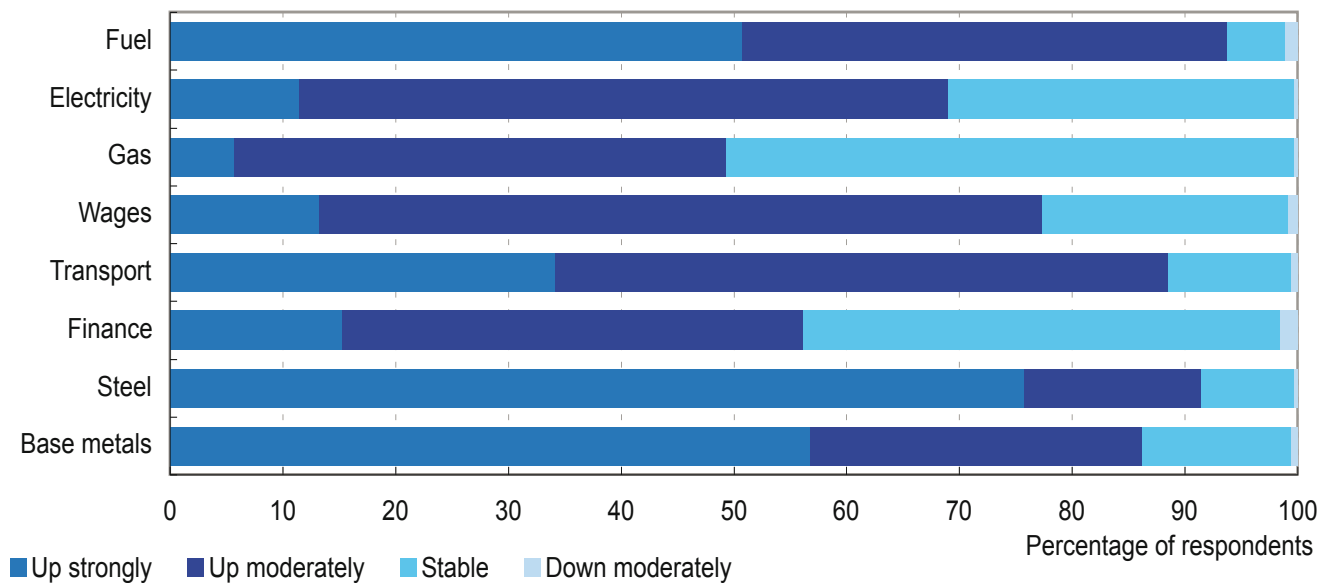
In relation to demand for products and services, this factor was cited more commonly by the consumer manufactures sector (66.7% of respondents) than the all-firm average of 51.7%.

A lack of skilled staff was cited more commonly by the commercial infrastructure sector (63.9% of respondents) compared to an all-firm average of 46.0%.

# Changes in input costs

*Fuel and steel have been the fastest growing input costs over the past six months*

**Chart 45: Change in input costs over the past six months**



The study sought from businesses an assessment of the degree to which a range of input costs have changed over the past six months. During this period of time, fuel and steel have been the fastest growing input costs.

Consistent with the high global price of oil in recent times, more than 90% of respondents reported that fuel costs had increased strongly (50.7%) or moderately (43.0%) over the past six months.

Businesses also reported very strong growth in steel costs over the past six months, with more than three-quarters of respondents (75.8%) citing strong increases over the period and an additional 15.6% reporting moderate increases.

More than 85% of respondents reported strong (56.7%) or moderate (29.5%) growth in base metal costs over the past six months.

The strong growth in fuel costs has flowed through to increased transport costs, with 34.2% citing strong increases and 54.3% citing moderate increases over the past six months.

At the other end of the spectrum, only 4.7% of firms reported strong growth in gas costs and 11.5% reported strong growth in electricity costs over the past six months. The fact that firms are generally locked into contracts for the future price of gas and electricity is likely to explain the higher proportion of firms citing stability for the costs of these inputs.

Despite the recent instability in global financial markets, only 15.2% of firms reported strong increases in the cost of finance over the past six months. While the reference period doesn't cover the most recent turbulence in global financial markets, the results, to some degree, point to the relative strength and flexibility of Australia's financial system.

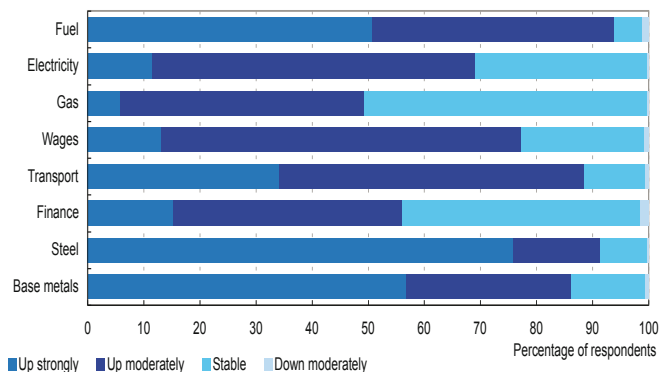
While 13.2% of respondents cited strong increases in wages over the past six months, almost two-thirds (64.2%) reported moderate increases.

## Fuel costs

The housing & apartment construction and commercial infrastructure sectors contain the highest proportion of firms citing strong increases in fuel costs over the past six months (61.4% and 59.0% respectively). Both sectors are generally heavy users of fuel in the production process.

By contrast, less than half of the firms in the metals manufactures sector (42.6%) and machinery & equipment manufactures sector (43.9%) reported strong increases in the price of fuel.

**Chart 46: Change in fuel costs over the past six months by sector**

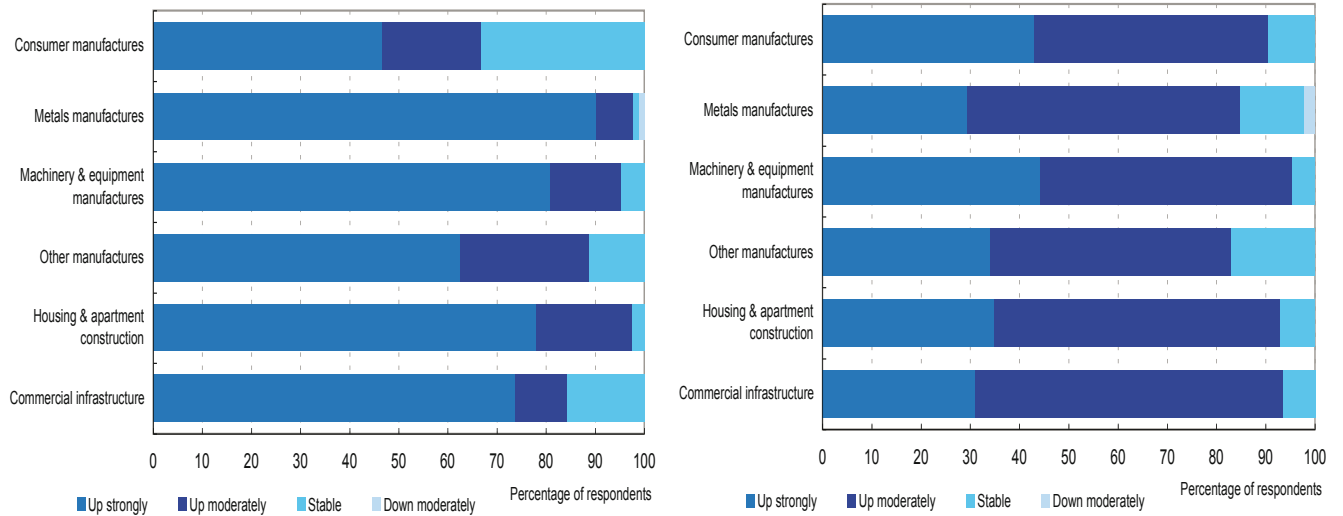


Medium-sized firms were the most likely to cite strong growth in the price of fuel over the past six months (63.4%), compared with 51.3% of large firms; 49.5% of small firms; and 42.7% of micro firms.

# Changes in input costs

**Machinery & equipment manufacturers have reported the strongest increases in transport costs over the past six months**

**Chart 47: Change in steel costs and transport costs over the past six months by sector**



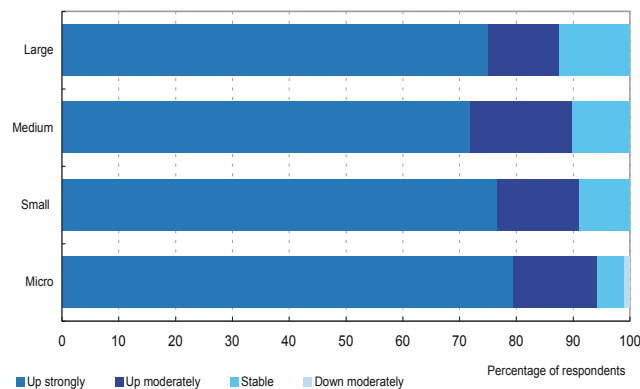
## Steel costs

Unsurprisingly, the metals manufactures sector contains the highest proportion of firms citing strong increases in steel costs over the past six months (90.1%). Other sectors reporting strong increases in steel costs include machinery & equipment manufactures (81.0%) and housing & apartment construction (78.0%).

By contrast, less than half of all consumer manufactures firms (46.7%) and just 62.5% of firms in the other manufactures sector reported strong increases in the price of steel over the preceding six months.

Micro firms are the most likely to cite strong growth in the price of steel over the past six months (79.4%), compared with 75.0% of large firms; 71.9% of medium-sized firms; and 76.7% of small firms.

**Chart 48: Change in steel costs over the past six months by size**



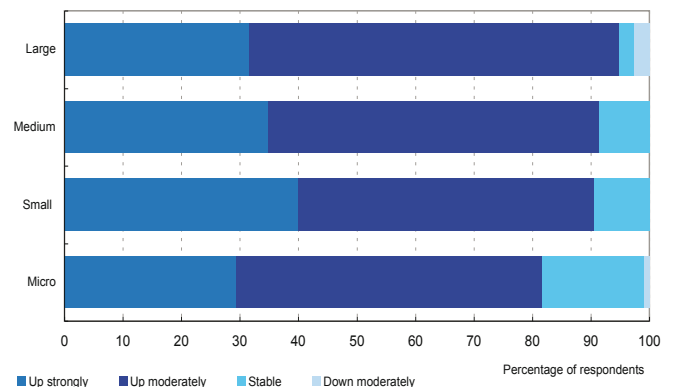
## Transport costs

The machinery & equipment manufactures and consumer manufactures sectors contain the highest proportion of firms citing strong increases in transport costs over the past six months 44.2% and 42.9% respectively.

Strong increases in transport costs were reported by around one-third of firms in the housing & apartment construction (34.9%); other manufactures (34.1%); commercial infrastructure (31.1%); and metals manufactures (29.3%) sectors.

Small firms were the most likely to report strong growth in transport costs over the past six months (40.0%), compared with 31.6% of large firms; 34.8% of medium-sized firms; and 29.4% of micro firms.

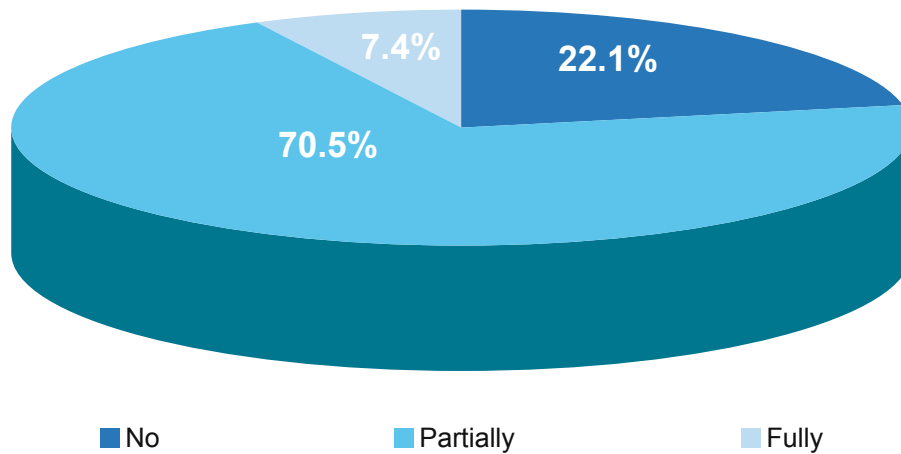
**Chart 49: Change in transport costs over the past six months by size**



# Cost pass through over the past six months

Only 7.4% of businesses were able to fully pass cost increases on to customers over the past six months

Chart 50: Cost pass through over the past six months



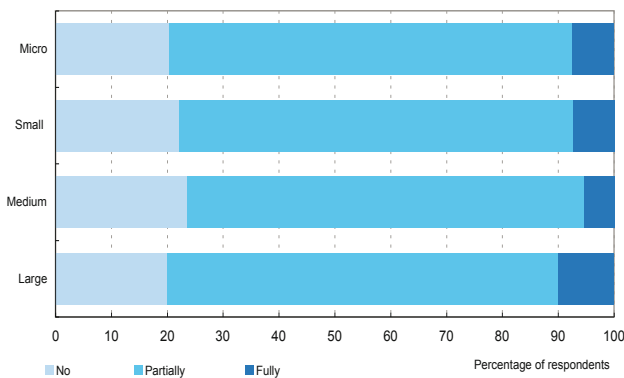
The survey asked businesses to indicate the degree to which they have been able to pass on the input cost increases discussed on pages 32 and 33 to customers over the past six months.

Only 7.4% of business indicated they had been able to fully pass these cost increases to customers over the past six months. However, an additional 70.5% suggested they had been able to partially pass these cost increases on to customers.

Almost one-quarter (22.1%) of respondents reported they were unable to pass cost increases on to customers to any degree over the past six months.

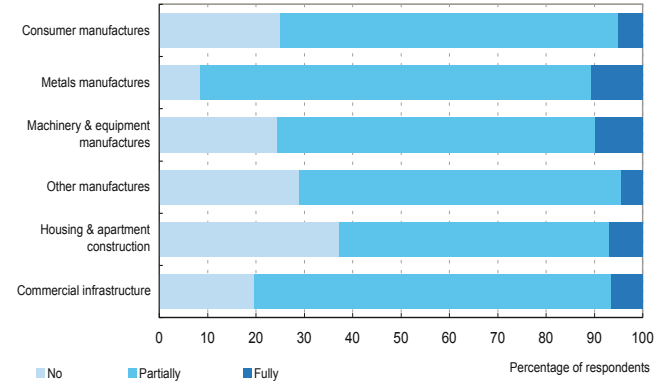
The ability to pass on cost increases to customers did not vary significantly across firm size.

Chart 51: Cost pass through over the past six months by size



Large firms were the most likely to be able to fully pass on costs increases to customers over the past six months, 10.0%, compared with 5.4% of medium-sized firms and 7.4% of small firms and micro firms.

Chart 52: Cost pass through over the past six months by sector



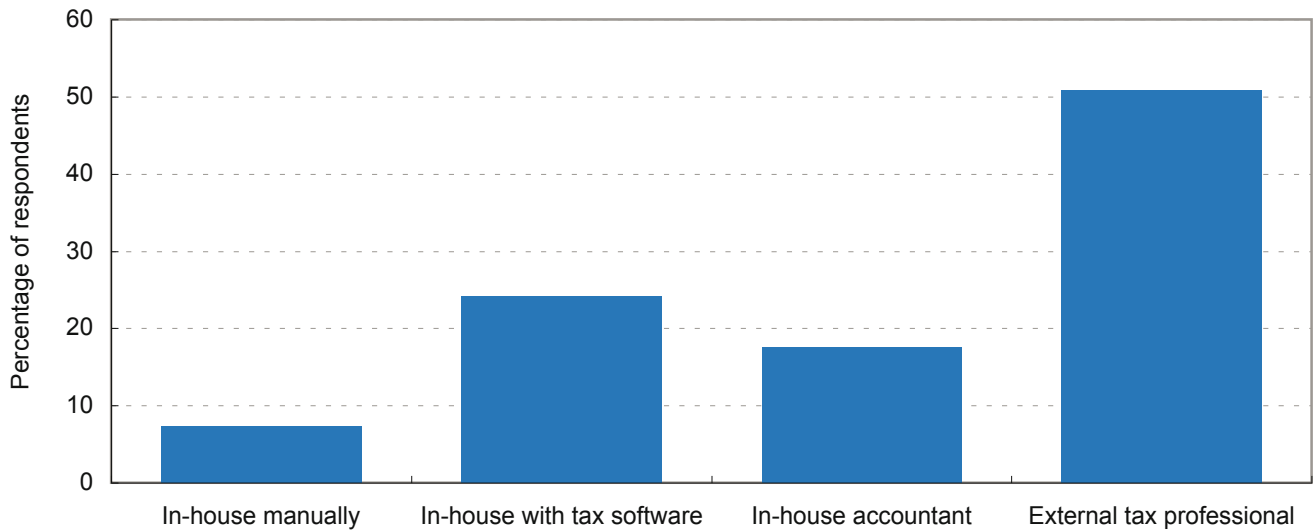
Firms in the metals manufactures and machinery & equipment manufactures sectors were the most likely to be able to fully pass on costs increases to customers over the past six months, 10.6% and 9.8% respectively.

By contrast, firms in the housing & apartment construction (37.2%) and other manufactures (28.9%) sectors were the most likely to be unable to pass on cost increases to customers over the past six months.

# Tax preparation practices

**External and internal approaches to tax preparation are favoured equally overall. Smaller firms are more likely to have tax dealt with externally**

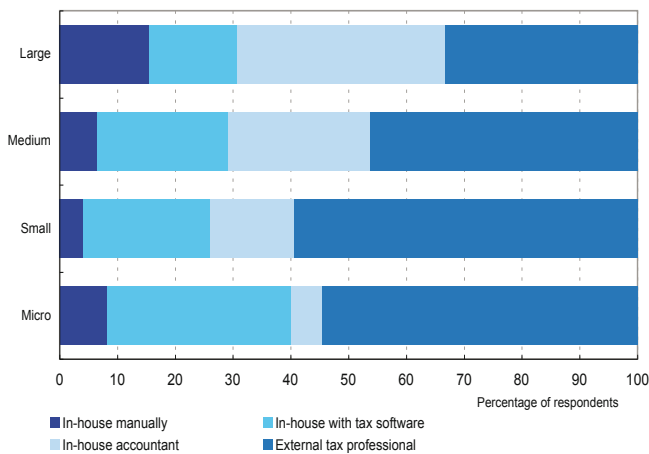
**Chart 53: Business approaches to tax preparation**



Overall, firms are split equally between those which prepare their tax material externally (50.9%), and those which prepare it internally (49.1%).

7.4% of firms carry out tax preparation in-house manually, 24.1% in-house using tax software and 17.6% using an in-house accountant.

**Chart 54: Business approaches to tax preparation by size**



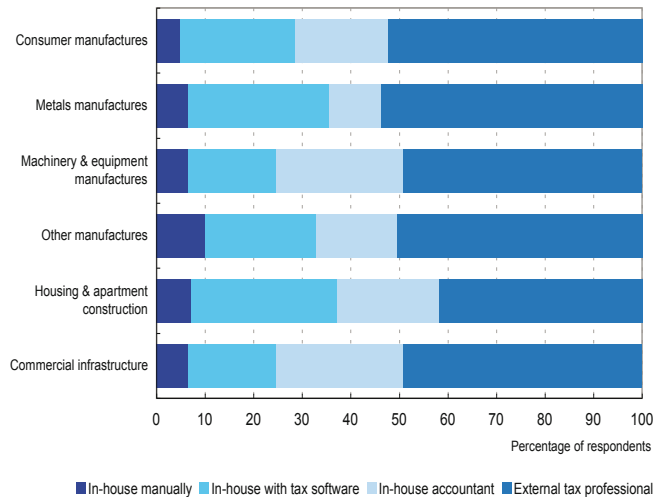
There are some reasonably predictable relationships between firm size and tax preparation approach.

Small and micro firms (59.4% and 54.5% respectively) are more likely to have tax materials prepared externally. For some firms in this group this likely reflects a combination of lack of expertise and constraints on time and cash resources. Micro firms carrying out tax preparation internally use tax software more extensively (31.8% of firms), than larger firms.

Of firms carrying out tax preparation internally, the larger a firm is the more likely it is to have an internal accountant.

35.9% of large firm respondents had internal accounting resources compared with 24.7%, 14.6% and 5.5% of medium, small and micro firms respectively.

**Chart 55: Business approaches to tax preparation by sector**

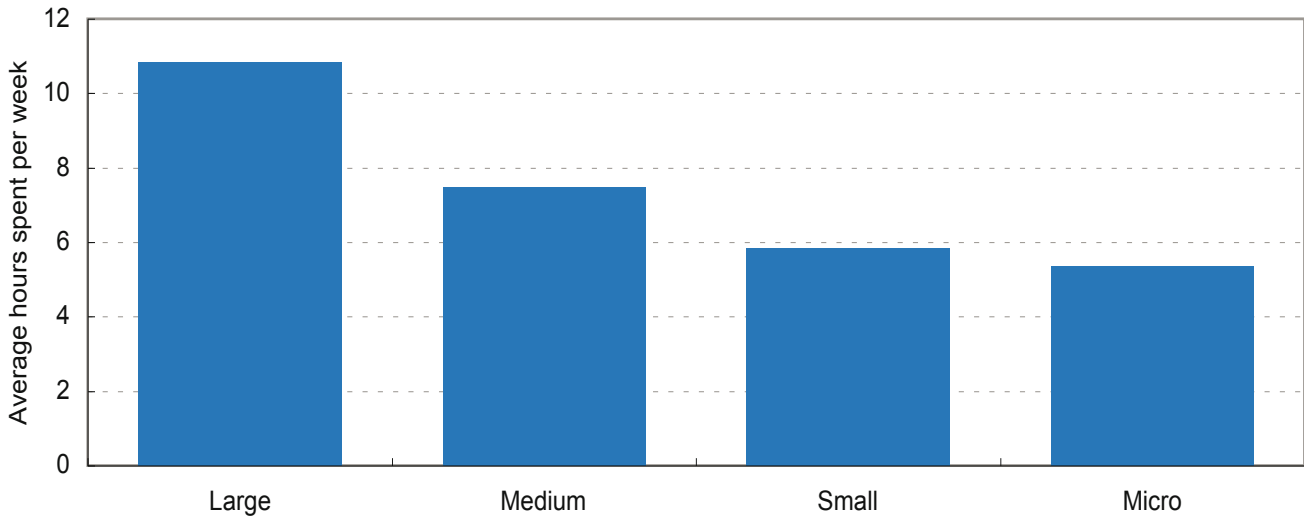


In sectoral terms, there is little significant variation across sectors in their approach to tax preparation.

# Hours per week spent on tax preparation

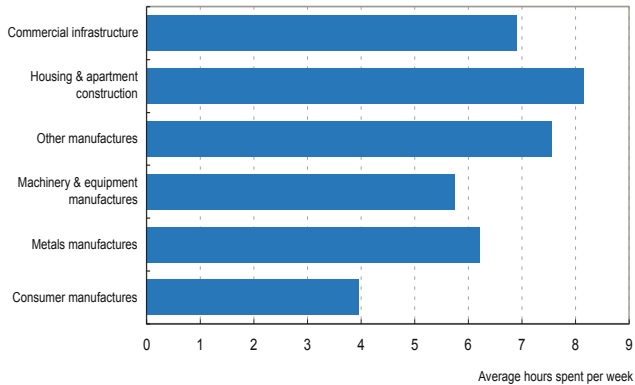
*Hours spent varies according to business size and their method of tax preparation, smaller firms spend less time than others*

**Chart 56: Hours spent on tax on average per week by size**



Time spent on taxation preparation by firms clearly reflects the methodology of preparation. Given that micro and small firms tend to use external tax professionals to a greater degree than other firms they spend less time per week on tax preparation.

**Chart 57: Hours spent on tax on average per week by sector**

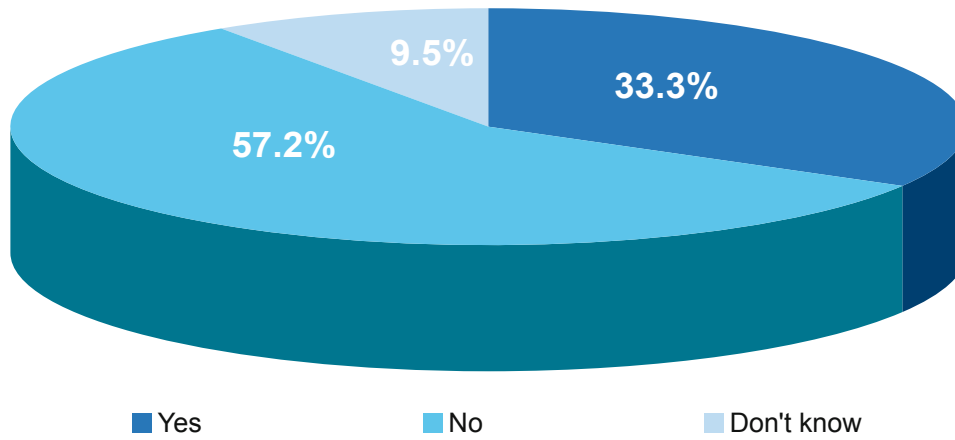


The sectors spending the most time on tax preparation are: housing & apartment construction (8.1 hours on average per week); other manufactures (7.5 hours) and commercial infrastructure (6.9 hours). The consumer manufactures sector spends the lowest time on tax preparation at 4.0 hours a week on average.

# Concerns on missing tax deductions/credits

*A third of respondents worry that they are missing out, 10% don't know*

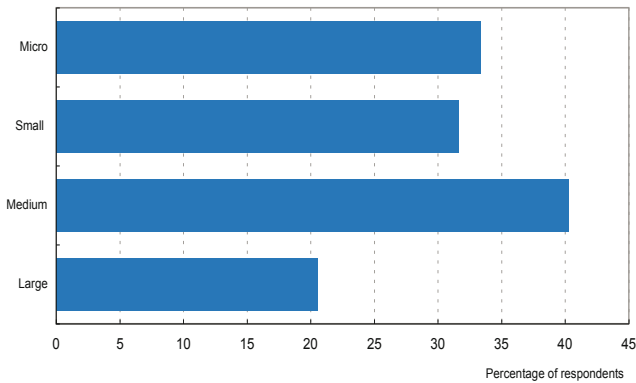
**Chart 58: Business concerns about missing out on tax deductions/credits**



Respondents were asked whether or not they are concerned about missing allowable deductions or tax credits.

Overall, a third of respondents are concerned that they may be missing some deductions or tax credits, with another 9.5% not knowing.

**Chart 59: Business concerns about missing out on tax deductions/credits by size**



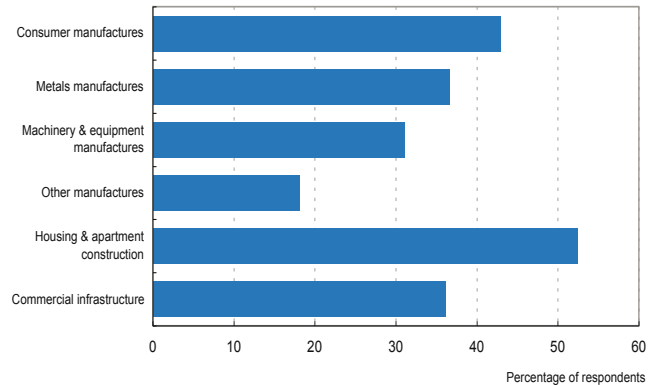
Medium sized firms are more concerned than other firm-size groups that they may be missing out, with 40.2% of respondents indicating concern. This compares with 20.5% of large firm respondents expressing concern.

This variation may reflect the fact that large firms are more likely to have an in-house accountant and therefore tax expertise, than medium sized firms.

Interestingly, small and micro firms are also less concerned than medium firms about missing deductions/tax credits. This may reflect the fact that despite being less likely to have an in-house accountant than medium firms, they are relatively more likely to use external tax professionals.

Use of and trust in the effectiveness of external tax professionals rather than preparing tax matters in-house, likely stems from their own views of their own relative expertise and avoidance of the time-consuming nature of tax-related matters.

**Chart 60: Business concerns about missing out on tax deductions/credits by sector**



There is reasonable variation across sectors in terms of concern about missing tax deductions/credits. The sectors with the greatest concern are housing & apartment construction (52.4% of respondents) and consumer manufactures (42.9%).

The other manufactures sector shows least disquiet with only 18.0% of respondents indicating concerns.

There seems to be no clear link between the levels of concern shown about the potential to miss tax deduction/credits across sectors and the types of approaches that they take to tax preparation.

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