

The Australian Industry Group  
**NATIONAL CEO SURVEY:**  
Business Prospects in 2011

FEBRUARY 2011



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Australian Industry Group

# National CEO Survey:

## Business prospects in 2011

# Key messages

## Divergent business prospects in 2011



The Australian economy continues to build slowly on the recovery commenced in 2010 and this report suggests that despite the impacts of recent severe weather events some further improvement is expected in 2011. Flooding in Queensland has clearly disrupted activity in a number of areas in the near term. There is, moreover, a clear divergence in expected growth across sectors in 2011 that raises concerns about underlying competitiveness and the sustainability of Australia's growth prospects.

The services sector anticipates gains across all the economic indicators surveyed except for the important areas of capital investment and research and development expenditure, as it expects economic activity across the economy to pick up and consumers resume spending as wages grow and as the labour market strengthens further. The construction sector expects to perform more strongly in 2011, on the back of the resources boom and pent-up demand.

Manufacturers, in contrast, expect more difficult conditions as sales and exports are anticipated to only marginally improve in 2011. Further, the manufacturing sector expects a significant fall in capital investment, employment and minimal growth in expenditure on research and development in 2011.

The outlook for manufacturers highlights the significant challenges associated with a high exchange rate, competition for resources from the mining sector, higher interest rates and the cumulative impact of slow productivity growth over the past decade or so. The impacts of the poor productivity performance over this period are now being felt in the trade-exposed sections of the economy.

The report identifies risks to the economic outlook over and above the multi-speed nature of growth. These risks, which are particularly salient for trade-exposed manufacturers and businesses in the services sector, include the risk of slower demand growth in the face of ongoing caution on the part of consumers and businesses; an uncompetitive exchange rate; higher domestic interest rates and the ongoing burden from government regulation.

It is only with concerted policy action from governments and cooperation with the business community to raise productivity and competitiveness that these impediments can be tackled and a more balanced and sustainable growth path achieved in 2011 and beyond.

A handwritten signature in black ink, which appears to read "H. M. Ridout". Below the signature is a horizontal line.

**Heather Ridout**

Chief Executive  
Australian Industry Group

# Deloitte Foreword



This Ai Group National CEO Report, sponsored exclusively by Deloitte, highlights that 2011 will represent a potential growth story for business. While this message is tempered by patchiness across sectors, individual organisations have a greater opportunity to secure their share of the growth than was the case last year.

These findings reinforce the messages that Deloitte is receiving from the market, with strong evidence that business focus has shifted away from concerns regarding the slow pace of recovery towards the way in which growth prospects can be realised.

There are mixed findings across the sectors considered in the Report in regard to key indicators, but clear overall themes regarding how businesses should seek to position themselves to achieve their growth prospects.

These areas represent potential opportunities for businesses to secure a competitive advantage.

Firstly, a greater focus on new product and process innovation represents a key opportunity. Product innovation can result in a shift up the value chain, which will also work as a foil to higher exchange rates. Ongoing process innovation will ensure opportunities for improved productivity and competitiveness are delivered. The report highlights a real opportunity in this area.

The report also indicates that business commitment to training differs significantly across sectors, while concerns regarding skills shortages are evident more broadly in the market. All companies, including manufacturers should utilise training to harness and improve the skill sets of their people.

Finally, the on-going role for government not only in ensuring an optimal operating environment, but also in working with business to attract footloose, productive investment activity to Australia should remain a focus.

The year ahead presents growth prospects and more positive business sentiment than 2010. Those businesses embracing the opportunity to improve their competitive position in this climate will stand a greater chance of realising this growth.

A handwritten signature in black ink, appearing to read 'Damon Cantwell'. The signature is fluid and cursive.

**Damon Cantwell**  
Partner, Deloitte

# Executive Summary

## Business prospects in 2011

### Cross-sectoral results

This report canvasses the views of Chief Executive Officers (CEOs) from approximately 530 businesses across Australia, together employing around 90,000 people with a collective annual turnover of \$26.8 billion in 2010. Notwithstanding preliminary Reserve Bank of Australia estimates of the impact of the floods which suggest gross domestic product (GDP) growth in each of the December 2010 and March 2011 quarters could be around 0.5 percentage points lower, CEOs across the economy are expecting mixed growth prospects in 2011.

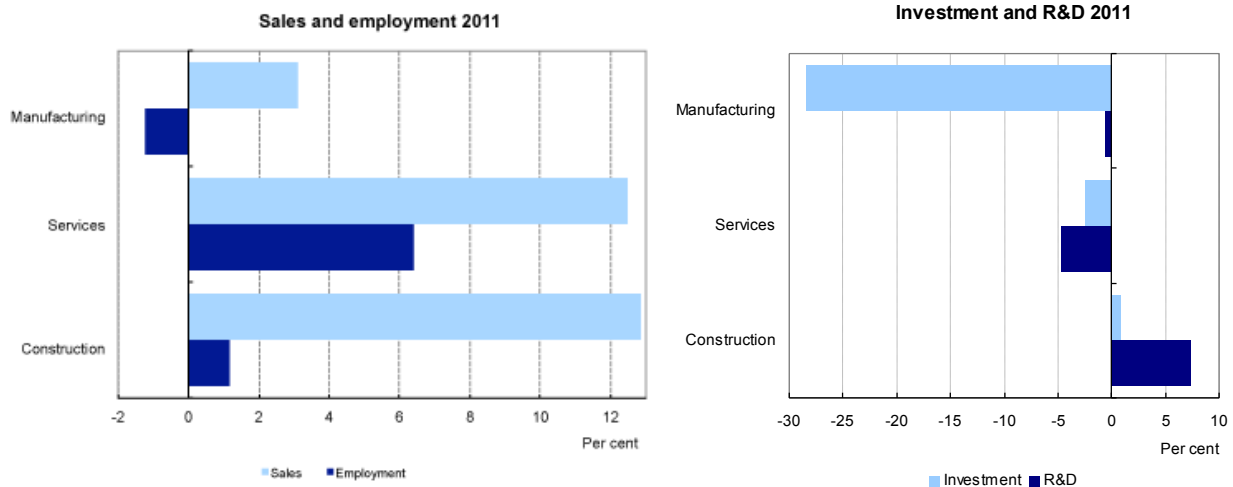
The business outlook for the manufacturing sector is expected to lift only marginally in 2011. There are a number of areas of concern. First, there is an expectation of a significant decline in capital investment; a decline in employment within the sector in 2011; and weak real growth in sales. Second, expenditure on both research and development (R&D) and training is expected to remain flat in this sector.

The services sector expects gains across a range of the economic indicators surveyed but not in the important areas of capital investment and research and development expenditure. The lift in sales in this sector is built on the expectation of economic activity across the economy to pick up and for consumers to spend as wages grow and as the labour market strengthens further. The construction sector expects to perform more strongly in 2011, on the back of the resources boom and pent-up demand.

The Ai Group National CEO Survey results give some credence to official economic forecasts for Australia suggesting improvement in the economy over the course of 2011, however the survey results point to less optimistic growth prospects than in the official data. One area where this survey differs to official economic forecasts relates to capital investment. Official forecasts are much more optimistic than the results presented here, which suggest that both the manufacturing and services sectors are expected to experience a decline in capital investment in 2011 while for the construction sector, growth in investment is expected to be subdued. Moreover, given the weak forecasts for capital investment growth across all three sectors surveyed, if market forecasts regarding the aggregate improvement in capital investment in 2011 are to be realised, this survey implies such a boost will be concentrated in the mining sector.

### Multi-speed economy

Moreover, while the overall prospects are positive, the results clearly indicate some evidence of unbalanced growth between sectors. The prospects of a 'multi-speed' economy in 2011 is summarised by the charts below comparing the 2011 nominal sales, employment, capital investment and R&D expenditure forecasts across the three sectors.



## Impact of floods

The immediate impact of the floods in Australia was reflected through the cut in coal production, loss of agricultural output, disruption to businesses in manufacturing and services sectors and a decline in tourist arrivals, particularly to Brisbane.

Preliminary Reserve Bank of Australia estimates suggest GDP growth in 2010-11 will be 0.5 percentage points lower in the December 2010 and March 2011 quarters because of the floods. The potential impact on inflation is a consumer price index (CPI) rise of 0.25 percentage points in the first quarter of 2011.

Ai Group consultation with businesses affected by the floods also provides some qualitative evidence of the impact, including:

- Loss of critical infrastructure: temporary closures of business premises, inadequate and unreliable energy supplies and transport infrastructure (rail and road).
- Human capital: traumatised staff and labour availability to be somewhat lower.
- Loss of agricultural produce and inputs.
- Disruption to the supply of coal and steel inputs.
- Associated delays and problems throughout the production supply chain.

## Impediments to growth prospects

This report also identifies potential impediments to growth prospects in 2011, particularly for sectors such as manufacturing that are not direct beneficiaries of the mining boom. The potential impediments identified in the survey include cautiousness regarding the ongoing level of demand in the economy; an uncompetitive exchange rate; higher domestic interest rates and the ongoing burden from government regulation. For example, while the Australian dollar could remain near parity relative to the US dollar for an extended period, this could restrain exports further in 2011 as 64.4% of manufacturing sector respondents indicated that a USD/AUD exchange rate of between 80 and 100 cents was already making exports uncompetitive.

## Impact of higher exchange rate

This report identifies the negative impact of the high USD/AUD exchange rate on competitiveness. The table below identifies the USD/AUD exchange rate ranges that exports and import competing becomes uncompetitive for businesses across the sectors.

Level of USD/AUD:	Exports:			Import competing:		
	Manufacturing	Services	Construction	Manufacturing	Services	Construction
0.5-0.6	4.7	3.3	0.0	9.3	3.6	0.0
0.61-0.7	2.3	6.7	0.0	17.1	10.7	16.7
0.71-0.8	25.6	6.7	18.2	28.6	28.6	41.7
0.81-0.9	32.6	53.3	45.5	25.7	39.3	33.3
0.91- 1.00	27.9	16.7	18.2	15.7	17.9	8.3
1.01-1.10	5.8	13.3	9.1	2.9	0.0	0.0
1.11-1.20	1.2	0.0	9.1	0.7	0.0	0.0
Total %	100	100	100	100	100	100

The table shows that 93% of manufacturing CEOs indicate their exports are uncompetitive at the prevailing USD/AUD exchange rate of approximately \$1 USD/AUD. This compares to 87% of services sector CEOs and 82% for construction. Put another way, only 7% of manufacturing CEOs indicate their exports are competitive at an exchange rate above \$1 USD/AUD.

The negative impact of a high exchange rate on competitiveness is also evident when we compare the results for import competing production.

This survey indicates 100% of services and construction sector CEOs indicate that their import competing production is uncompetitive at the prevailing USD/AUD exchange rate of approximately \$1 USD/AUD. Approximately 96% of manufacturing CEOs indicate their import competing production is uncompetitive at the prevailing USD/AUD exchange rate of approximately \$1 USD/AUD.

## **Sector specific results**

### **Manufacturing sector**

- Manufacturing sector activity will remain weak in 2011. Nominal sales are forecast to rise 3.1% in 2011 and employment is expected to decline by 1.2% (although the pace of decline is smaller than in 2010).
- Capital investment is anticipated to decline 28.4% in 2011 as manufacturers remain tentative about investing for the future as they are cautious about the economic outlook. The availability and cost of credit also remains a constraint on investment plans.
- R&D expenditure is forecast to decline 0.7% in 2011, potentially putting at risk the relative productivity and cost competitiveness of Australian manufacturers.
- Export earnings in 2011 are forecast to be largely unchanged from 2010, rising by a mere 0.2%. Exports could be restrained further in 2011 should the Australian dollar remain near parity relative to the US dollar for an extended period, as 64.4% of respondents said that a USD/AUD exchange rate of between 80 and 100 cents was already making exports uncompetitive.
- On a positive note, selling prices are anticipated to rise 4.7% in 2011. However, non-labour costs and wages are also expected to rise significantly.
- From a business strategy perspective, 20% of manufacturing CEOs report that improving sales of current product/service lines is the key business strategy that will be implemented over 2011.
- For the manufacturing sector potential impediments to growth in 2011 include: cheap imports; lack of demand (suggesting manufacturers are some way from full capacity); a high exchange rate; and skills shortages.

### **Services sector**

- Services sector (nominal) sales are forecast to expand by a significant 12.5% in 2011 with employment to expand by a solid 6.4%.
- Capital investment is forecast to decline in 2011 by approximately 2.5%.
- Services export earnings are expected to accelerate by 9.3% despite an elevated exchange rate; R&D expenditure is set to drop by 4.7% in 2011; and selling prices to grow by a solid 3.6%.
- The services sector is expected to increase its investment in skills by 6.4% in 2011.
- From a business strategy perspective, a majority of services sector business CEOs indicate that improving sales from current product/service lines is a critical strategy they plan to implement over 2011.
- For the services sector potential impediments to growth in 2011 include skills shortages and a lack of demand. Government regulatory burden is also mentioned amongst respondents from the services sector.

### **Construction sector**

- Construction sector (nominal) sales are forecast to grow substantially by 12.9% in 2011 with employment rising 1.2% but capital investment to remain subdued in 2011.
- Exports in the construction sector are expected to lift by 10.5% over the year in 2011, R&D expenditure is expected to rise by 7.3%, and selling prices to rise by 6.2%.
- Wages are expected to rise by an average of 5.3% in 2011, the highest rate increase amongst the three sectors surveyed.
- Like the services sector, the construction sector is expected to increase its investment in skills, with training expenditure to increase by 5.7% in 2011 (again the highest amongst the three sectors surveyed).
- From a business strategy perspective, the most frequently cited plans for 2011 are to improve sales of current product and service lines (23% of CEO respondents), followed by investing in the current business and reducing costs (17% and 16%, respectively).
- For the construction sector potential impediments to growth in 2011 include a lack of demand (14% of CEO respondents); skills shortages (13%); wage pressures (10%); higher interest rates (9%) and government regulatory burden (including taxation) (8.6%).

# Impact of floods on business prospects

This report is based on a comprehensive survey of Australian business CEOs conducted in December 2010, before the onset of the devastating natural disasters affecting Australia, particularly floods which have been severe in Queensland. The forecasts outlined in this report have not been revised in light of the impact of the floods. Nonetheless the impact of the floods will have a negative impact on businesses and communities directly impacted by the floods and broader macroeconomic implications for Australia, which are outlined in this section.

The immediate impact of the floods in Australia was reflected through the cut in coal production, loss of agricultural output, disruption to businesses in manufacturing and services sectors and a decline in tourist arrivals, particularly to Brisbane.

The Australian Bureau of Agricultural and Resource Economics and Sciences estimated the Queensland floods to cause agricultural production to fall by \$0.5-\$0.6 billion and coal exports to decline by \$2.0-\$2.5 billion (approximately 0.2% of GDP). These costs do not take into account the impact of the floods in New South Wales and Victoria, the cost of lost farm infrastructure, the adverse impact on consumer confidence and disruptions to the non-commodity sectors of the economy, such as retail trade and manufacturing. So the economic cost of the floods is likely to be significantly higher.

Against this backdrop, the broad growth profile of the Australian economy is likely to be a much weaker than expected start to the year followed by a stronger second half, as key infrastructure and housing are rebuilt. Preliminary Reserve Bank of Australia estimates of the impact of the floods suggest GDP growth in each of the December 2010 and March 2011 quarters could be around 0.5 percentage points lower. The potential impact on inflation is a consumer price index (CPI) rise of 0.25 percentage points in the first quarter of 2011.<sup>1</sup>

The rebuilding efforts and loss of tax revenue following the floods are expected to strain the Commonwealth Government's Budget by approximately \$5.6 billion, although the subsequent rebound in economic activity and higher coal prices (in part triggered by disrupted coal supply from Queensland) should help revenue inflows in 2012.

As the rebuilding work gains momentum, the Commonwealth and State Governments will be competing with the private sector for already scarce workers and construction materials. This could lead to a further tightening in the labour market, higher wages and inflation. Consequently, further increases in interest rates, over and above that anticipated prior to the floods, could not be ruled out in the later part of this year.

In an economy that is expanding at full capacity, fiscal policy needs to be conducted in a way that does not contribute to inflationary pressures. In light of this and the commitment to return the budget to surplus by 2012-13, the Commonwealth Government has announced spending cuts and imposing a temporary and progressive levy on people earning over \$50,000 to cover its share of the rebuilding efforts.

Ai Group has been assisting businesses immediately affected by the floods and some of the immediate qualitative responses regarding the economic consequences of the floods include:

- Loss of critical infrastructure: temporary closures of business premises, inadequate and unreliable energy supplies and transport infrastructure (rail and road). In one example, a small northern Victorian food manufacturer was facing an additional \$18,000 a week cost impost from having to use alternate transport of goods.
- Human capital: traumatised staff and labour availability to be somewhat lower.

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<sup>1</sup> Reserve Bank of Australia, Statement on Monetary Policy, February 2011.

- Loss of agricultural produce and inputs: while directly impacting on the agriculture industry, also negatively impacting regional food manufacturers through inputs. In some cases, half of crop yields have been destroyed. One major regional producer has experienced a loss of 300,000 livestock.
- Loss of coal/steel inputs: As an example, a manufacturing/engineering business in Queensland expects significantly higher steel input costs.
- Associated delays and problems throughout the production supply chain: Dairy product manufacturers have been severely affected both in terms of upstream and downstream industry linkages. Delays of up to 3 months with respect to usual production levels have also been cited.



# Manufacturing Sector

## Business prospects for manufacturing in 2011

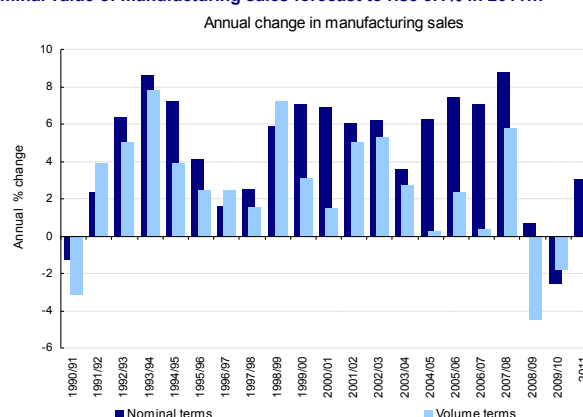
### Manufacturing sales, investment and employment outlook remains weak

#### Sales

- The subdued global economic recovery, rising interest rates and strengthening Australian dollar constrained Australian manufacturing activity in 2009-10.
- Australian nominal manufacturing sales, based on Australian Bureau of Statistics (ABS) data<sup>#</sup>, contracted 2.5% in 2009-10, a significantly steeper decline compared to the 1.3% fall recorded during the 1990-91 economic downturn.
- Nonetheless, sales are anticipated to grow slowly in 2011, rising by 3.1% in nominal terms but declining by 1.6% in real terms. Higher interest rates, the stronger Australian dollar and soft demand pose downside risks to the growth forecasts for this sector.

# ABS, National Accounts, Cat. No. 5206.0

Nominal value of manufacturing sales forecast to rise 3.1% in 2011...

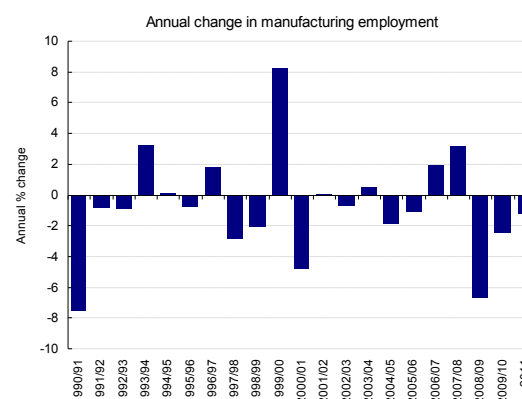


#### Employment

- Employment in the manufacturing sector dropped 2.5% in 2009-10 according to ABS data<sup>#</sup>, in line with the fall in activity in the sector during the year.
- The decline in manufacturing employment is forecast to continue in 2011 albeit at a slower pace, with manufacturing employment anticipated to fall 1.2%.
- The continuing decline in manufacturing employment is likely to be due to weak growth in sales, together with higher costs and the ongoing challenges of the high level of the exchange rate.

# ABS, Labour Force, Cat. No. 6202.0

Rate of decline in manufacturing employment to ease to 1.2% in 2011...



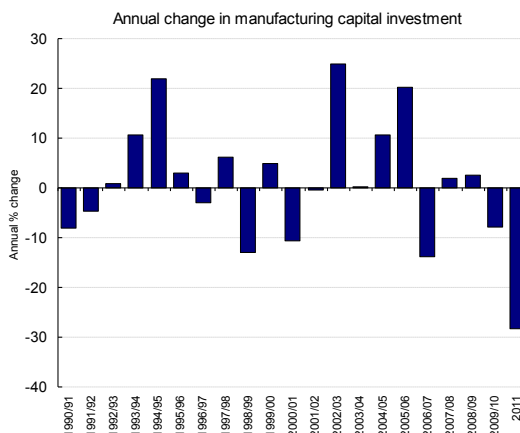
# Business prospects for manufacturing in 2011

## Capital investment

- Manufacturers plan to reduce their capital investment by a significant 28.4% in 2011, on top of the 8.0% decline in such investment in 2009-10<sup>#</sup>.
- This suggests that the manufacturers are currently operating below capacity and they remain tentative about investing for the future as they lack confidence in the economic outlook.
- Credit availability and costs continue to remain a constraint on investment plans.

<sup>#</sup> ABS, National Accounts, Cat. No. 5206.0

Capital investment to decline 28.4% in 2011...



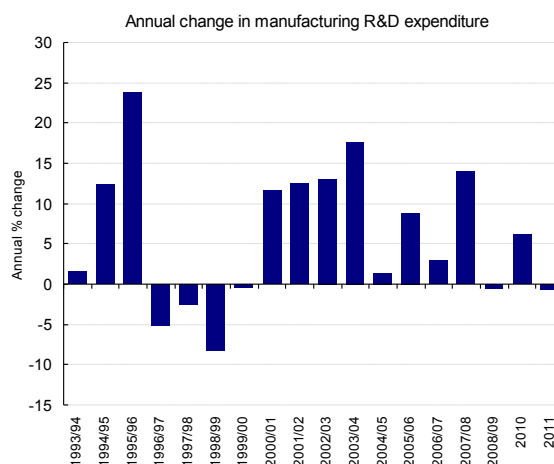
## R&D expenditure and exports to remain flat

### Research and development

- The latest ABS data<sup>#</sup> shows that R&D spending in the manufacturing sector contracted 0.6% in 2008-09 and has grown by less than 9.0% in four out of the last five years.
- Manufacturing expenditure on R&D is expected again to decline, by 0.7% in 2011. This is way below the average annual growth rate of 8.9% achieved over the period from 1999-00 to 2008-09.
- These figures indicate that manufacturers have reduced their emphasis on R&D investment over recent years, as the combination of competitive pressures; uncertain global conditions; and the higher Australian dollar have taken their toll. There is a clear risk that the relative productivity and cost competitiveness of Australian manufacturers may worsen further, weakening their ability to compete.

<sup>#</sup> ABS, Research and Experimental Development, Businesses, Australia, Cat. No. 8104.0

R&D expenditure\* to decline 0.7% in 2011...



\* 2010 figure is Ai Group forecast

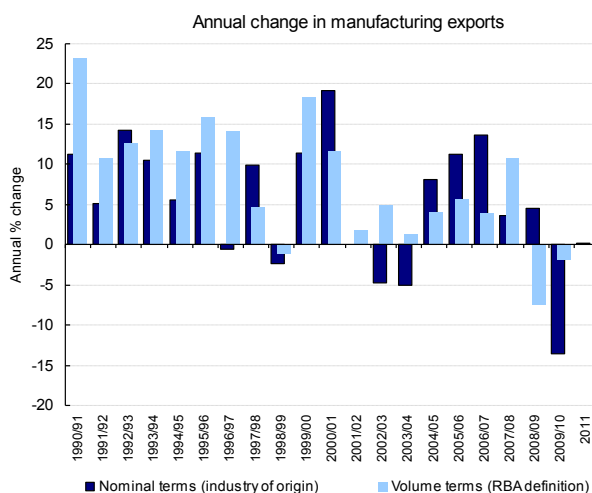
## Business prospects for manufacturing in 2011

### Exports

- The strengthening Australian dollar led to a 13.5% drop in the nominal value of manufacturing exports in 2009-10<sup>#</sup>. While this was mainly due to the fall in Australian dollar receipts, the volume of manufacturing exports declined 2.0%, reflecting weak global demand.
- In 2011, manufacturers are forecasting exports in nominal terms to be largely unchanged from 2010, rising by a mere 0.2%.
- The Australian dollar could remain near parity relative to the US dollar for an extended period, reflecting rising interest rates in Australia and expansionary monetary policies in many other developed economies.
- This could restrain exports further in 2011 as 64.4% of respondents indicated that a USD/AUD exchange rate of between 80 and 100 cents was already making exports uncompetitive.

<sup>#</sup> ABS, National Accounts, Cat. No. 5206.0

#### Export earnings to rise by 0.2% in 2011...



### Selling prices to rise further as manufacturers cushion impact of rising costs

#### Selling prices, non-labour costs and wages

- Manufacturers expect selling prices to rise 4.7% in 2011, faster than the 3.0% rise predicted in the previous year.
- The pick-up in selling prices is expected to partly offset cost rises as non-labour costs are anticipated to rise 5.2% and wages are expected to rise by 4.2%.
- Wages could rise significantly higher than forecast in 2011 if the resources boom and/or flood recovery efforts result in acute shortages of skilled labour, which would exert more upward pressures on wages.
- Manufacturers are likely to be forced to absorb some of the higher costs as they need to remain competitive, especially given the strengthening of the Australian dollar.

#### Selling prices to rise 4.7% in 2011...

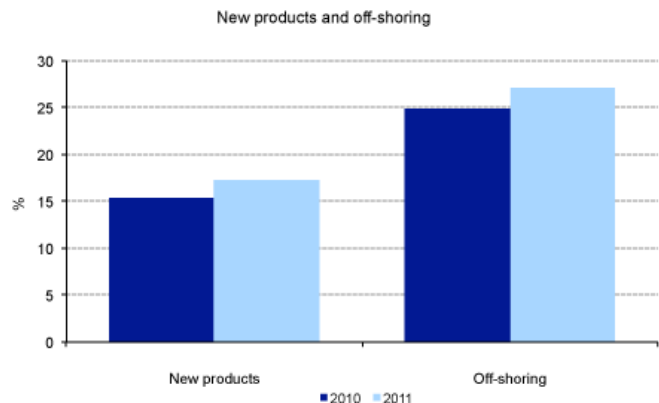


## Business prospects for manufacturing in 2011

### New products and offshoring

- New product intensity (the percentage of sales derived from new products that were introduced in the last 3 years) was 15.4% in 2010, and is expected to rise to 17.3% in 2011.
- Offshore intensity (offshore activity as a percentage of sales) was 24.9% in 2010, and is forecast to increase to 27.1% in 2011, possibly reflecting manufacturers' attempts to lower cost by relying more on imported materials as the Australian dollar strengthens.

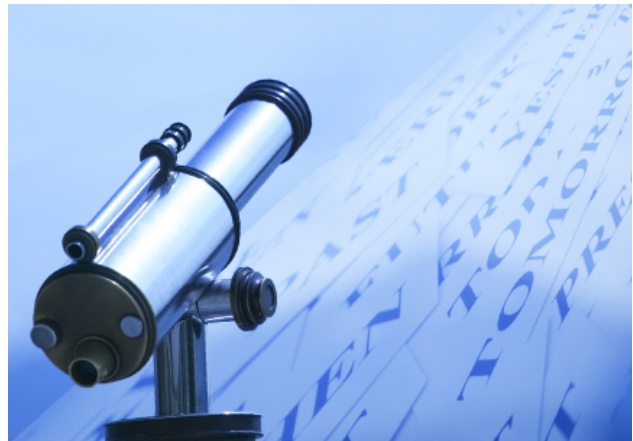
Offshore intensity to rise 2.2 percentage points in 2011...



### Training expenditure to remain flat while new products to drive business growth strategy

#### Training expenditure

- Training expenditure by manufacturers in 2011 is forecast to remain unchanged from the preceding year, despite the forecast increase in manufacturing sales.
- The survey results suggest that manufacturers are keen to maintain and/or reduce expenditure on key business areas, with staff training being one of them.
- Businesses are signaling that they want to focus on improving profit margins in the face of headwinds from weak domestic and foreign demand, the strengthening Australian dollar and higher interest rates.



### Manufacturing business strategies and potential impediments to growth

Approximately 20.0% of manufacturing CEOs report that improving sales of current product/service lines is an important business strategy to implement over 2011, while reducing costs is rated an important strategy by 16.6% of manufacturers. Introducing new products/services is an important strategy according to 16.3% of manufacturers.

Manufacturing CEOs also identified the factors that they expect to inhibit their business prospects in 2011. Approximately 15.2% of manufacturers suggest that cheap imports are an important factor, while 13.0% indicate the lack of demand is a key factor. Skills shortages are ranked a key factor by 9.4% of manufacturers.

# Services Sector

## Business prospects for services in 2011

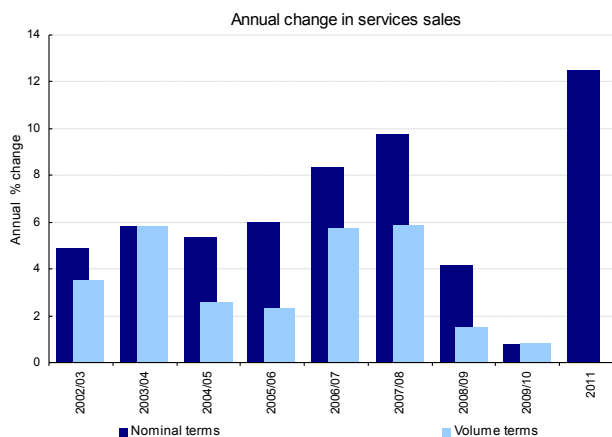
### Services activity forecast to improve although investment to decline

#### Sales

- Official ABS data indicates that nominal sales growth was weak in 2009-10 in comparison to the growth recorded over the past seven years<sup>#</sup>.
- Sales rose by only 0.8% in both nominal and volume terms in 2009-10. The fact that the same growth was recorded in nominal and volume terms suggests that a number of businesses needed to offer their customers discounts in order to stimulate demand.
- Businesses are more optimistic about 2011, however, with the nominal value of sales expected to rise by a significant 12.5%.

# ABS, National Accounts, Cat. No. 5206.0

Nominal sales to expand by a significant 12.5% in 2011...

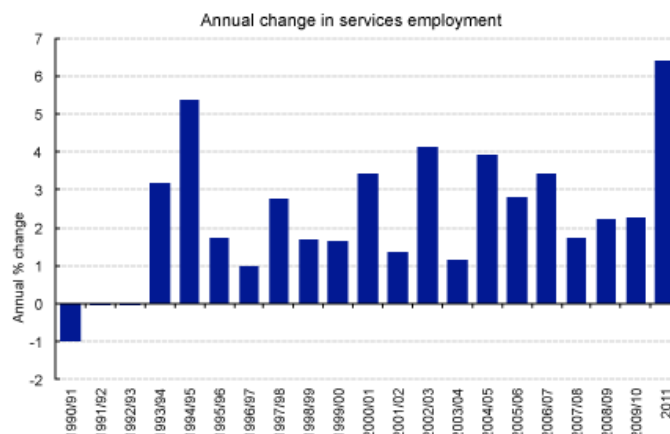


#### Employment

- Employment growth in 2009-10 was broadly in line with the growth recorded a year earlier.
- ABS data indicates employment grew by 2.3% in 2009-10, which is slightly below the average rate of growth seen over the past 10 years.<sup>#</sup>
- Growth varied significantly across the services sector during this period, with employment growing strongly in the professional, scientific & technical and administrative & support sub-sectors, while declining in the retail sub-sector.
- Employment growth is expected to pick-up in 2011 by 6.4% in line with the improved sales outlook.

# ABS, Labour Force, Cat. No. 6202.0

Employment to grow by 6.4% in 2011...



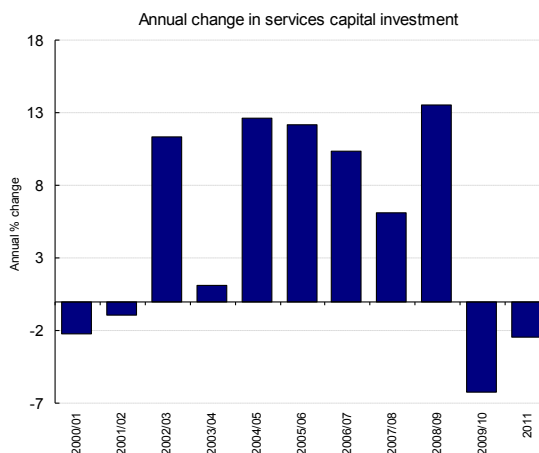
# Business prospects for services in 2011

## Capital investment

- In 2009-10, ABS data indicates capital investment in the services sector declined for the first time since 2001-02.<sup>#</sup> This reflected the recent weakness in services activity following the global financial crisis and tighter credit conditions.
- The decline in investment was driven by the wholesale, retail, and finance & insurance sub-sectors, where investment declined by more than 10%.
- In contrast, investment grew strongly in the professional, scientific & technical services sub-sector.
- Investment is expected to fall by a further 2.5% in 2011 in line with the soft conditions reported in Ai Group's Performance of Service Index.

# ABS, National Accounts, Cat. No. 5206.0

Capital investment to decline in 2011...



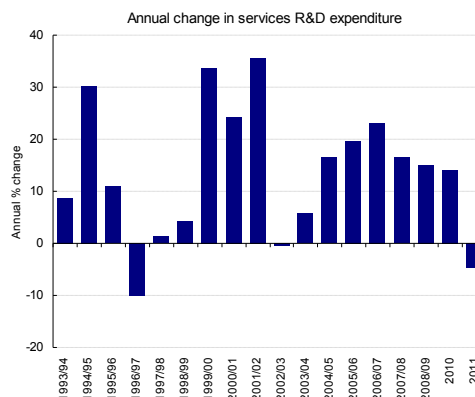
## Services exports are expected to grow solidly despite an elevated exchange rate

## Research and development

- The latest official ABS data<sup>#</sup> for 2008-09 shows that R&D spending in the services sector rose by 15.1% in 2008-09 and has grown by over 15% in each of the past four years.
- Expenditure on R&D in 2011 is expected to decline by 4.7% against the recent positive trend for this sector.

# ABS, Research and Experimental Development, Businesses, Australia, Cat. No. 8104.0

R&D expenditure to decline by 4.7% in 2011...



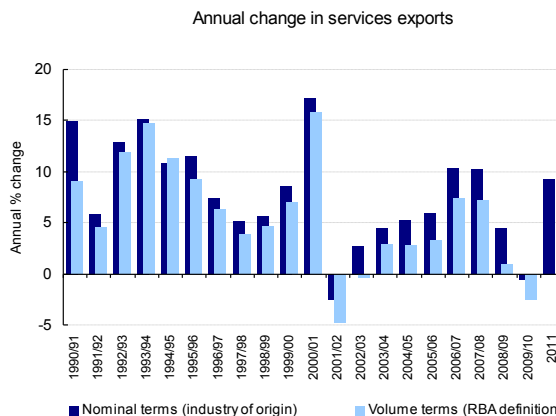
\* 2010 figure is Ai Group forecast

## Exports

- In 2009-10, exports declined in both nominal and volume terms for the first time since 2001-02.<sup>#</sup>
- Specifically, exports declined in nominal terms by 0.6% in 2009-10, while in volume terms, exports declined by 2.6%.
- Despite this weakness and the elevated level of the Australian dollar, over the next twelve months businesses in the services sector expect exports growth to recover to the rates seen prior to the global financial crisis. Export earnings are expected to grow by 9.3% in 2011.

# ABS, National Accounts, Cat. No. 5206.0

Export earnings to accelerate to 9.3%...

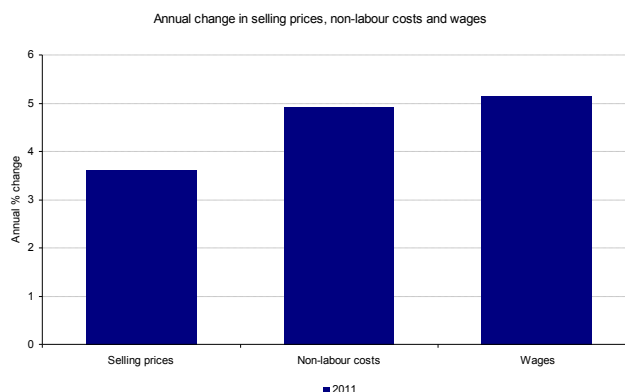


## Business prospects for services in 2011

### Selling prices, non-labour costs and wages

- Selling prices in the service sector are expected to increase by 3.6% in 2011. This is broadly in line with forecasts for 2010 that were recorded in last year's Ai Group National CEO Survey on business prospects for 2010.
- Non-labour costs and wages are expected to grow a little stronger, at 4.9% and 5.1%, respectively.
- It is encouraging that inflation expectations are broadly unchanged from last year, a period when the ABS measure of underlying inflation remained subdued.

Selling prices to grow by 3.6% in 2011...

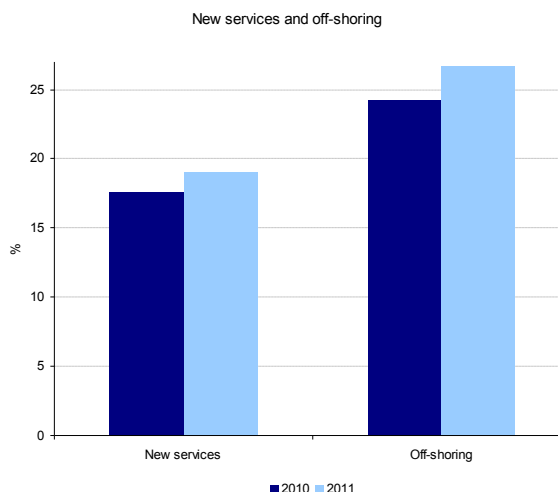


### New services and offshore intensity to increase as well as rising training expenditure

#### New services and offshoring

- New services intensity (the percentage of sales derived from new services that were introduced in the last three years) was estimated to be 17.5% in 2010 (based on the 2010 Ai Group National CEO Survey on business prospects) and is expected to rise to 19.0% in 2011.
- The level of offshore intensity (offshore activity as a percentage of sales) is forecast to rise slightly from 24.3% in 2010 to 26.7% in 2011.

Both new services and offshore intensity to lift in 2011...



#### Training expenditure

- Businesses expect to increase expenditure on training by 6.4% in 2011 in order to support the introduction of new products and investments.
- This is close to double the growth forecast by businesses in the 2010 Ai Group National CEO Survey on business prospects.

### Services business strategies and potential impediments to growth

Improving sales from current service lines is the most cited business strategy for 2011. Other important business strategies for services sector businesses include introducing new services in 2011 or developing new domestic markets.

Approximately 15% of services sector businesses identify skills shortages as an important factor that they expect to inhibit their business prospects in 2011, while 14% of businesses report that a lack of demand will inhibit growth in 2011. Services sector businesses also indicate that government regulatory burden is a key inhibiting factor.

# Construction Sector

## Business prospects for construction in 2011

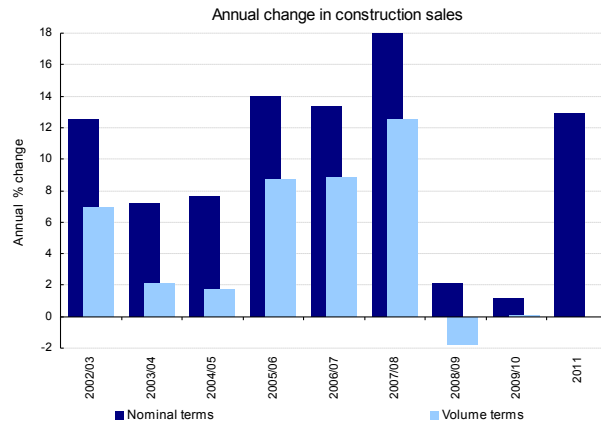
### Positive outlook for construction sector activity

#### Sales

- Nominal sales growth (based on ABS data) remained subdued in 2009-10, rising by just over 1.0% and falling in volume terms.<sup>#</sup>
- This reflected the continuation of constrained demand for construction projects, with the residential and private sector commercial building sectors under particular pressure from tight credit conditions, heightened risk aversion and weak consumer and investor sentiment.
- However, CEO expectations for 2011 point to a recovery with a very strong projected lift in nominal sales of 12.9%, mainly reflecting the expectation of stronger growth in mining and resource based construction.

<sup>#</sup> ABS, National Accounts, Cat. No. 5206.0

#### Nominal sales to rise by 12.9% in 2011...

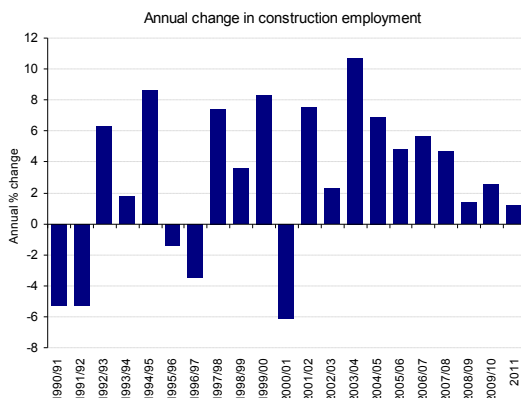


#### Employment

- Following eight years of employment growth, employment in the construction sector grew by 2.6% in 2009-10.<sup>#</sup>
- Growth in construction employment is expected to be slightly softer in 2011, rising by just 1.2%.
- Rising interest rates and constraints on land supply are likely to constrain growth in 2011.

<sup>#</sup> ABS, Labour Force, Cat. No. 6202.0

#### Construction sector employment growth of 1.2% expected in 2011...

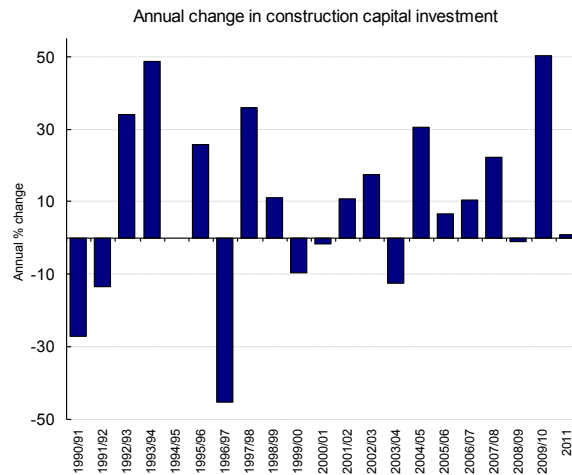


# Business prospects for construction in 2011

## Capital investment

- Capital investment in the construction sector is expected to lift marginally by 0.9% in 2011. This is a likely reflection of the increased level of spare capacity currently existing within key sectors of the industry which is expected to exert an overall dampening influence on demand for capital inputs.
- Spare capacity was identified in the latest Australian Industry Group Construction Outlook survey (October 2010) which revealed that the average level of capacity in use in the non-residential building industry was 80.3% in August/September 2010, the second lowest level recorded over the past eight years.

Construction sector capital investment growth to be subdued in 2011...



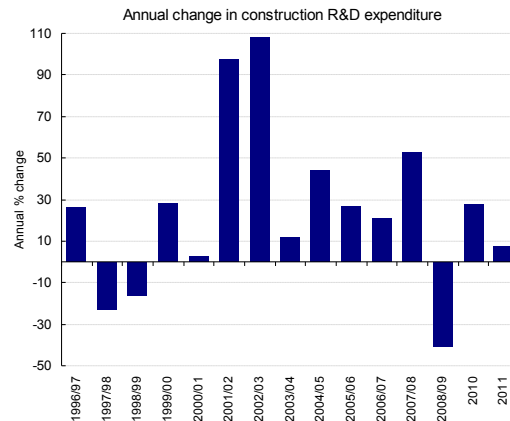
## R&D expenditure to rise along with exports and selling prices

### Research and development

- Expenditure data on R&D in the construction sector can be quite volatile.
- The latest official ABS data for 2008-09 shows that R&D spending in construction fell by 40.7% in that year.<sup>#</sup>
- While the forecast for 2011 is for a significant rise in construction sector expenditure on R&D of 7.3%.

<sup>#</sup> ABS, Research and Experimental Development, Businesses, Australia, Cat. No. 8104.0

R&D expenditure to rise by 7.3% in 2011...

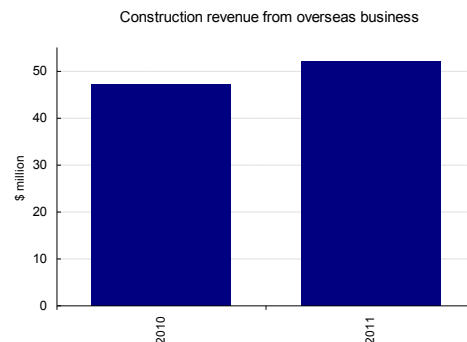


\* 2010 figure is Ai Group forecast

## Exports

- Consistent with the trend in recent years (particularly among major construction contractors) towards an increased engagement in overseas construction activities, revenue from overseas business is expected to expand solidly in 2011.
- Respondent businesses expect that overseas business will increase by 10.5% during the year. This will see respondents generate an additional \$5 billion of work through the year with the total value of overseas revenue expected to rise from \$47.1 million in 2010, to \$52.1 million in 2011.

Construction sector revenue from overseas business to rise by over 10% in 2011...

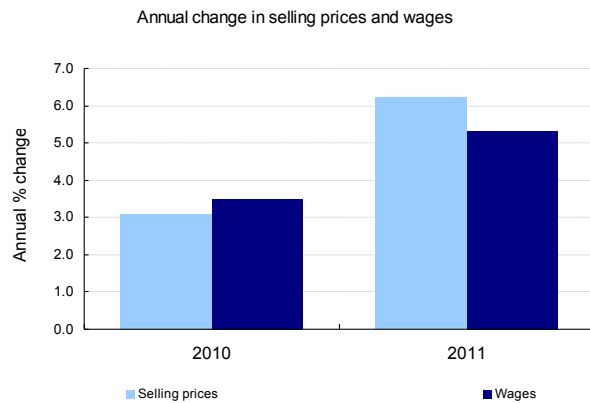


## Business prospects for construction in 2011

### Selling prices, non-labour costs and wages

- Constructors expect selling prices to rise by 6.2% on average in 2011, 3.2 percentage points higher than anticipated in the 2010 Ai Group National CEO Survey on business prospects.
- The expectation for average wage growth in 2011 is 5.3%, a rise from 3.5% in 2010 relative to expectations in the 2010 Ai Group National CEO Survey on business prospects.
- Non-labour costs are expected to rise 4.9% in 2011.

Selling prices to rise by 6.2% and wages growth expected to average 5.3%...



# Business prospects for construction in 2011

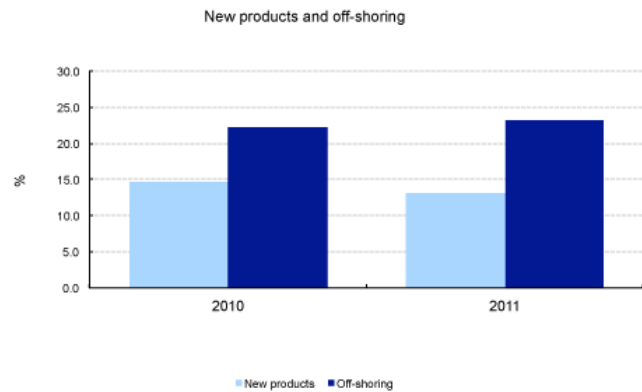
*New product intensity to remain largely unchanged while training expenditure is expected to rise*

## New products and offshoring

- New product intensity (the percentage of sales derived from new products introduced in the last three years) was 14.7% in 2010.<sup>#</sup>
- In 2011 new product intensity is expected to fall slightly to 13.2%.
- This reflects businesses continuing to concentrate on their existing products and services over the coming year as a key business strategy.
- The degree of off-shoring is forecast to rise slightly from 22.2% in 2010<sup>#</sup> to 23.3% in 2011 in the construction sector.

<sup>#</sup> Based on forecast in Ai Group National CEO Survey on business prospects for 2010

New product intensity to remain largely unchanged in 2011...



## Training expenditure

- Construction businesses are likely to raise expenditure on training by 5.7% in 2011, a slight increase from the previous two years, reflecting an improving but cautious outlook within the construction sector.

## Construction business strategies and potential impediments to growth

Construction businesses plan to implement a range of business strategies to improve growth over 2011. The most frequently cited plans are to improve sales of current product and service lines (23% of CEO respondents), followed by investing in the current business and reducing costs (17% and 16%, respectively) as well as developing new domestic markets (12%).

The key potential impediments to construction sector growth over 2011 are considered to be a lack of demand (14% of CEO respondents); skills shortages (13%); wage pressures (10%); higher interest rates (9%) and government regulatory burden (including taxation) (8.6%). Cheap imports, the availability of finance, an uncompetitive exchange rate and industrial relations flexibility are also cited as constraints to a lesser extent on construction businesses in 2011.

### About the National CEO Survey: Business Prospects in 2011

In order to identify the prospects for businesses in 2011, the Australian Industry Group undertook a comprehensive survey of Australian business CEOs in December 2010.

The findings of the survey are based on the responses of CEOs from approximately 530 businesses across Australia. Together these businesses employ around 90,000 people and have a collective annual turnover of \$26.8 billion in 2010.

The data covers approximately 20 industries and has been aggregated into the three key sectors of manufacturing, construction and services. Together, these three sectors represent approximately 74% of the Australian market sector.

The manufacturing sector contributed the highest proportion of respondents (61%); the services sector accounted for 29% of all respondents; while 10% of responses were provided by the construction sector. The high proportion of manufacturing businesses included in the final analysis means that the overall findings are weighted towards this sector.





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