Ai Group CEO Expectations Survey

Australian Industry Outlook for 2024

JANUARY 2024

About Australian Industry Group

The Australian Industry Group (Ai Group) is a peak employer organisation representing traditional, innovative and emerging industry sectors. We are a truly national organisation, and in 2023 we celebrate our 150th year supporting Australian businesses.

Our vision is for *thriving industries and a prosperous community*. We offer our membership strong advocacy and an effective voice at all levels of government underpinned by our respected position of policy leadership and political non-partisanship.

With more than 250 staff and networks of relationships that extend beyond borders, we have the resources and the expertise to meet the changing needs of our membership. We provide the practical information, advice and assistance members need to run their businesses. Our deep experience of industrial relations and workplace law, positions Ai Group as Australia's leading industrial advocate.

We listen and we support our members in facing their challenges by remaining at the cutting edge of policy debate and legislative change. We provide solution-driven advice to address business opportunities and risks.

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Foreword - Australian Super

AustralianSuper is very pleased to be associated with Ai Group's *Australian Industry Outlook for 2024* report.

Ai Group's annual survey of industry leaders' views about the coming year has a track record of providing important insights into the challenges and opportunities they face, their expectations about the commercial environment, and the future plans they have for their businesses.

Now in its eleventh year, this report provides a map for what industry should expect in 2024.

Even though the social challenges of the pandemic are now behind us, some of its economic challenges – including inflationary pressures and skill shortages – remain acute.

As this report highlights, industry leaders will focus on investing in technology, productivity and skills to manage these challenges.

It is very encouraging that despite growing global and national uncertainty, industry leaders are on balance expecting to increase their revenue, workforce and investment levels in 2024.

Such an outcome would be good news for their businesses and their shareholders (including, members of superannuation funds) and also for their employees, their families and communities.

As a leading investor in Australia's businesses, AustralianSuper has a strong interest in the success of the Australian business sector and in its continued contribution to employment, to wealth creation, and to the returns our investments generate for the members on whose behalf we invest.

We are very happy to support this report. We expect the insights it contains to be useful for policymakers, other businesses and the broader community as they also think about and plan for the year ahead.

Paul Schroder
Chief Executive, AustralianSuper

Introduction

After three years of pandemic-induced disruptions and volatility, Australian industry enjoyed much more stable business conditions in 2023. But as industry leaders look out into the new year, they have real worries about uncertainty and stagnation in 2024.

Since 2012, Ai Group has annually surveyed CEOs and business leaders from across Australian industry. These sectors – which include manufacturing, construction, technology and supply chain and technical services – provide the industrial foundation for national prosperity.

This year, over 300 senior leaders from Australian industry responded to our CEO Expectations Survey. This report, based upon their responses, provides critical insights into how industry leaders anticipate the coming year will evolve.

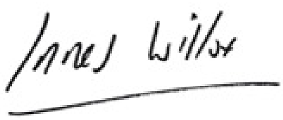
Australia's industry leaders go into 2024 with significantly more caution and concern than the year before. They expect business conditions and performance to be mediocre, and well below the strong results of 2022 and 2023.

They have identified three challenges which will define their priorities in 2024:

1. **Uncertainty**, as political and economic volatility cast a shadow over global and Australian economic performance;
2. **Ongoing supply-side challenges,** as persistent inflation alongside ongoing labour shortages pose cost pressures and further erode margins; and
3. **Weakening demand-side conditions**, as the slowing national economy offers fewer opportunities for growth.

Industry leaders are making productivity a focus to survive in this more difficult environment. They plan to invest in technology and innovation, focus on business improvement to better control costs, and will invest in upgrading the skills of their current workforce.

These productivity-oriented strategies are very welcome, given Australia's poor productivity performance in recent decades. They will also be instrumental in ensuring industry is best positioned to succeed in an uncertain, slowing but supply constrained economic context.



Innes Willox
Chief Executive, Australian Industry Group

Key findings of the 2024 survey

Productivity the key for industry success in an uncertain, supply-constrained and slowing economy

Australian industry leaders are concerned about the year ahead. 40% expect business conditions to be weaker in 2024 than 2023, while only 27% expect an improvement. Net optimism for 2024 (-13) is the lowest score seen in this survey since the end of the mining boom over a decade ago.

Expectations for 2024 are mediocre, with Australian industry expected to grow at an anaemic rate. The outlook is net positive for revenue, employment, margins, investment and technology. However, expected growth is low, with all indicators at or near their lowest levels in a decade.

Three factors – uncertainty, ongoing supply-side constraints and weakening demand – will be the main inhibitors in the coming year. While uncertainty and supply constraints have been common since the pandemic, a weak industrial demand outlook for 2024 is a concerning new development.

Industry plans for 2024 are adapted for a more challenging environment. Technology and innovation will be a top priority for industry leaders: either to drive cost savings in the face of inflation and rising wages, and/or to find and develop new markets in a slowing economy.

Investment efforts will focus on productivity over growth. Business process improvement and staff training top the investment priority list for 2024. These productivity-oriented investments rank well ahead of growth-oriented options such as capex, R&D and conventional business development.

Supply chain strategies will shift from managing disruptions to controlling costs. 78% expect their input prices to rise in 2024, but only 57% plan to raise sales prices. To defend margins, industry leaders will prioritise cost control in their approach to supply chain management in the coming year.

Growth strategies will focus on the product offering. Most industry leaders intend to introduce new products and services and/or improve their current offerings. There is a clear preference for developing Australian over international markets, given lingering uncertainties about the global environment.

Staff shortages will continue in 2024, with 87% of industry leaders expecting to be affected. To manage labour supply risks, they plan to invest in training, increase wages and benefits, and change operational processes to lower labour demand.

Industry sentiments: Uncertainty dominates the outlook

In the Ai Group CEO Expectations Survey this year, we asked respondents what they are most optimistic or concerned about for their business in 2024. This open-ended question gave industry leaders the opportunity to identify the factors they believe will enable and inhibit growth in the year ahead.

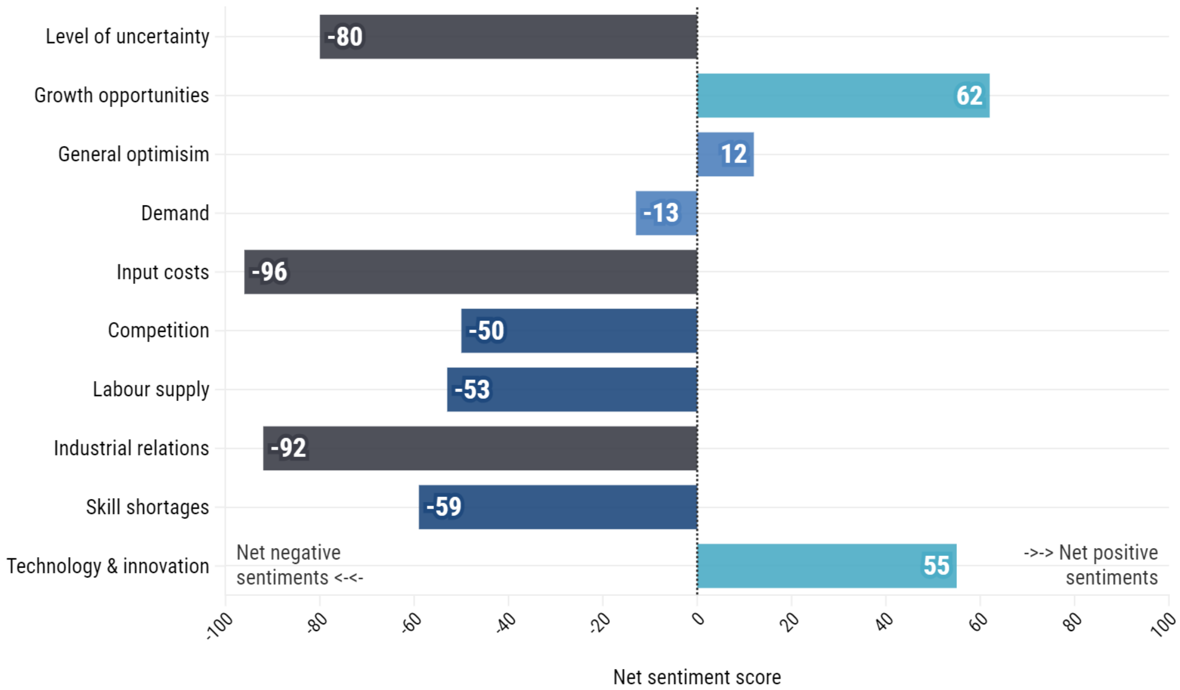
The responses coalesced around ten factors, relating to all aspects of business operations: demand, market opportunities, costs, industrial relations, skills and technology. Eight of the ten identified factors carried a negative sentiment, indicating there are more domains of concern than confidence.

Expressed in net balance scores – the sum of positive and negative responses:

Uncertainty about the economic outlook (-80 net balance) was the factor most identified as shaping industry experience in 2024. An overwhelming 90% of those identifying uncertainty felt it was a negative for their business, while only 10% saw it improving. International geopolitical tensions, sluggish global growth, persistent inflation and high interest rates were all identified as the 'known unknowns' that will make life challenging for industry in 2024.

Growth opportunities (+62 net balance) were the second most cited factor for 2024, and came with an overwhelmingly positive sentiment. There was also a positive level of **general optimism (+12 net balance)** for the year. Both sentiments were tied to expectations of revenue growth, efficiency gains through process improvement, sustained employment and high levels of technology investment.

Chart 1: Ai Group CEO Survey Industry Sentiments for 2024



Source: Ai Group CEO Survey

Another area of strong optimism strong is **technology and innovation (+55 net balance).** This is a natural response to expectations of persistent inflation and high wage growth, with industry leaders viewing technology as important in driving cost savings. Others pointed to innovation and the commercialisation of new products as an opportunity to create new markets. For some respondents, growth and innovation associated with the energy transition were also cited as an opportunity.

Despite positive sentiments regarding technology and growth, those regarding **the outlook for customer demand (-13 net balance)** are mixed**.** This slightly negative score signals a clear shift to downside expectations compared to this time last year. Since 2020, Australian industry has faced a dynamic where strong demand drove growth, but supply disruptions and labour shortages constrained it. This data suggests that industry leaders do not expect the demand side to remain as strong into 2024.

However, this does not mean the supply side constraints of previous years will disappear. Rising **input costs (-96 net balance)** and **industrial relations (-92 net balance)** were identified as the two most negative factors for industry in 2024, with **skills shortages (-63 net balance)** and **labour supply (-53 net balance)** also strongly negative. Recent industrial relations reforms by the Federal Government were frequently cited as making labour markets less flexible and labour shortages worse.

What are you most optimistic or concerned about for 2024?

*"Optimistic that we have reached the bottom of **consumer demand decline**; pessimistic about the **cost of doing business**".*

*"**Wage movements** are a big concern and the inability to pass on the cost inputs to clients".*

*"**Increased cost** - labour, electricity, transport, increased government regulations and low barriers to entry for overseas suppliers in Australia".*

*"The **energy transition** is creating a once in a generation opportunity for our business to achieve a step change in scale and product range expansion."*

*"Developing **new technologies** that can generate higher margin income."*

*"Concerned about the likelihood of a depressed market both locally and globally, especially in the face of global **geopolitical uncertainty**."*

*"Aggressive procurement of government **infrastructure works driving up demand** (e.g., wages) and the flow down from Tier 1 contractors **driving costs down**. Uncertainty in labour demands from key costumers due to **IR uncertainty**."*

*"**IR policies** and other poor government policies that have increased inflation and put pressure on profits and **personal pressure on business owners**."*

*"Diminishing numbers of available **skilled tradespeople** in the manufacturing sector."*

*"**New technology products** commercialised but concerns of **a deep recession** due to high inflation."*

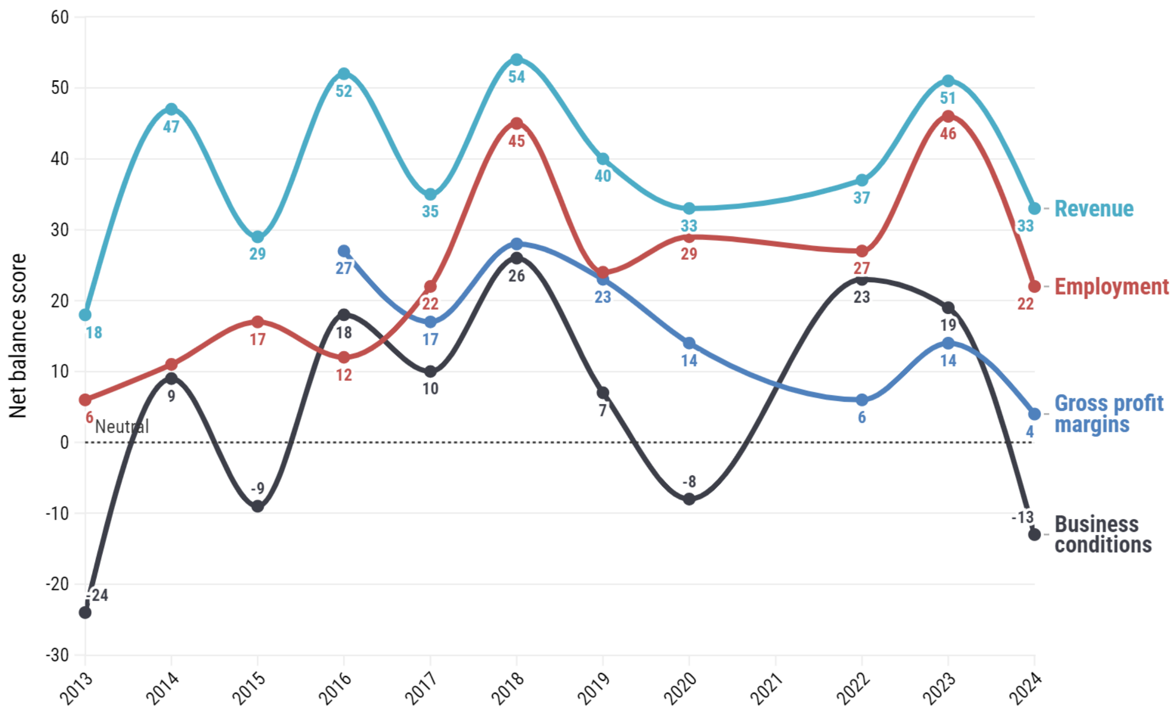
Business conditions: Industry leaders report lowest outlook expectations in a decade

There are considerable levels of concern about Australia's relatively weak economic outlook. Industry leaders have mildly positive expectations regarding 2024. However, when compared to previous Ai Group CEO Expectation surveys, their expections are some of the lowest we've seen in the last decade.

- **Overall business conditions: -13 net balance.** 40% of business leaders expect deteriorating conditions, and 27% expect an improvement. This is lower than the net expectation reported in late 2019, when Australia and many peers were facing rapidly slowing economies.
- **Revenue: +33 net balance.** 54% anticipate an increase in revenue, and 21% think it will decline. This is a low score for the revenue expectations indicator, and similar to that seen during the pessimism of 2019.
- **Employment: +22 net balance.** 40% of businesses plan to expand their workforce while 18% plan to reduce it. This is a moderate score for this indicator – weaker than recent years, but stronger than the years of slower employment growth following the mining boom.
- **Gross profit margins: +4 net balance**. This net score is the lowest in the history of the survey, and indicates industry expect very little improvement in margins in 2024 due to sustained inflationary pressures.

In sum, this data paints a picture of **mediocre expectations for 2024** – that growth will continue, but at anaemic rates in comparison to recent years.

Chart 2: Ai Group CEO Survey Conditions Expectations



Source: Ai Group CEO Survey

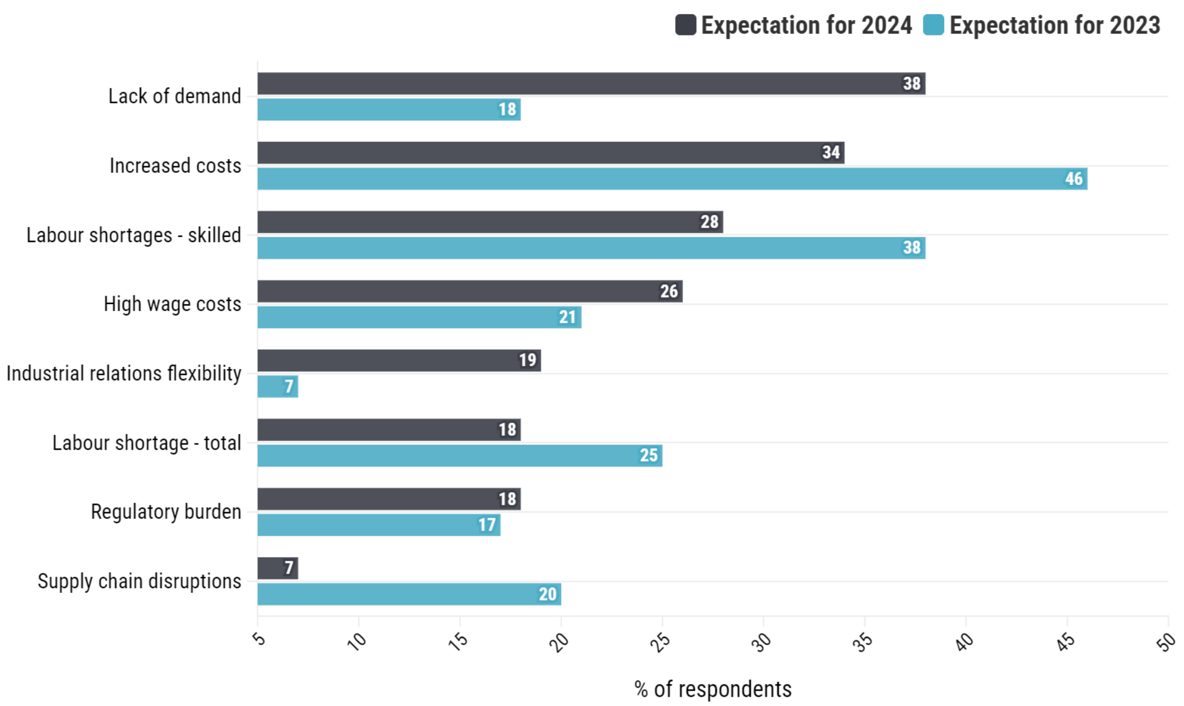
Business challenges: Slowing demand and cost pressures will inhibit industry in 2024

The Ai Group CEO Survey asked industry leaders what factors were most likely to inhibit their growth in 2024. Falling demand, inflationary pressures and tight labour markets were identified as the greatest barriers to growth in the year ahead:

- **Lack of demand** was identified as the greatest constraint for business in 2024. 38% of respondents consider it their primary concern– much higher than the 18% in 2023.
- **Increased costs** were the second highest constraint, identified by 34%. This is down from 46% last year, reflecting the view that inflation has peaked but is still expected to remain high.
- **Skilled labour shortages** were the third highest constraint (28%), due to ongoing skills gaps caused by very tight labour markets.
- **High wage costs** are the fourth greatest constraint, a prime obstacle for 26% of businesses. This aligns with RBA forecasts that wage rates are expected to rise by 3.7% across 2024.
- **Industrial relations flexibility** was identified by 19% of businesses, a large jump from the 7% in 2023, indicating concern regarding new federal industrial relations legislation.

Importantly, there has been a **marked shift towards demand side factors** in identified business inhibitors. Several pandemic-era issues – such as supply chain disruptions and aggregate labour supply – have fallen in their importance. They have been replaced by slowing demand and cost pressures as the principal inhibitors facing industry in 2024.

Chart 3: Ai Group CEO Survey Inhibitor Expectations 2023 and 2024



Source: Ai Group CEO Survey

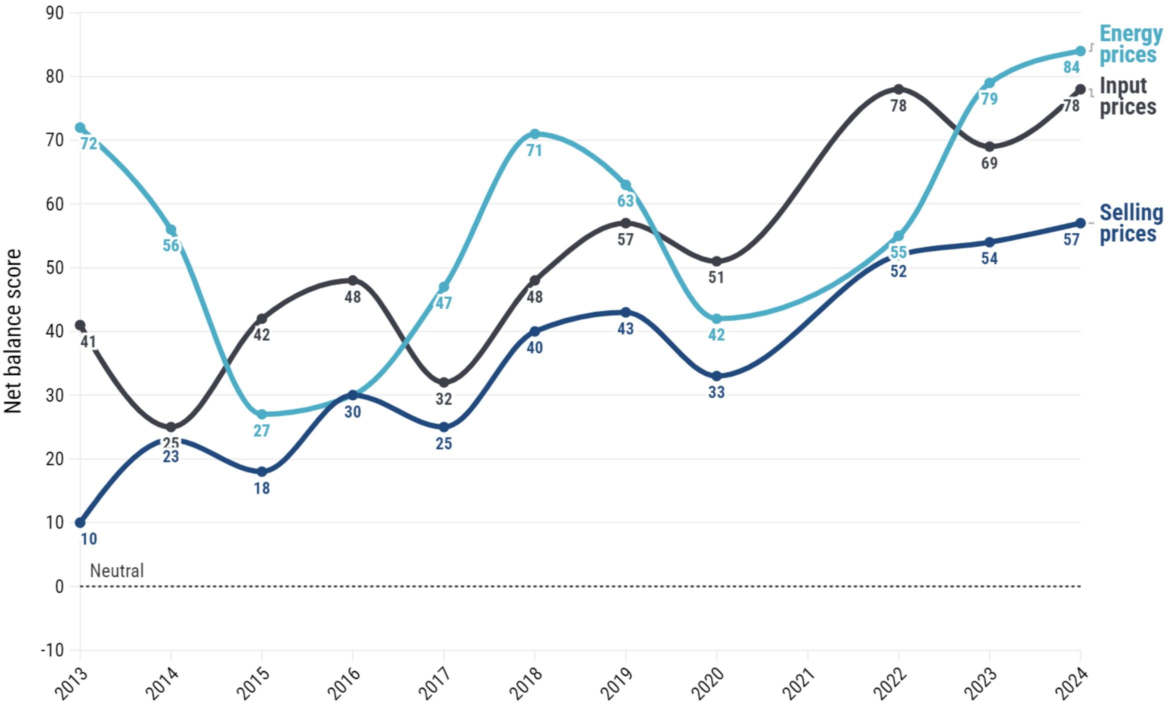
Inflation: Higher-for-longer expectations are broadly entrenched

Industry leaders expect that inflationary conditions will continue to affect their business in 2024. The Ai Group CEO Survey found the highest expectations for price increases in its eleven-year history:

- **Input prices: +78 net balance.** 80% expect their input costs to rise, and only 2% anticipate they will fall. This is higher than the result for 2023 (+69) and the same as 2022 (+78) indicating very broad expectations for further industrial goods inflation in 2024.
- **Energy prices: +84 net balance.** 85% expect energy prices to keep rising across 2024, 14% to hold steady, while only 1% expect them to decline. This is the highest score in the history of the survey, and exceeds the previous peak in expectations for 2023.
- **Sales prices: +57 net balance**. 61% plan to increase their sales prices, 36% expect no change and 4% anticipate falls. This series is also at an all-time high, but remains below the expectations for energy and input prices.

This data reveals that industry leaders have **broadly entrenched expectations for inflation** to continue to impact their business in 2024. These expectations largely accord with official inflation forecasts. The Treasury currently expects CPI to return to within the 'target band' of 2-3% only by the middle of 2025, while the RBA forecasts it to be within that range by the end of 2025.

Chart 4: Ai Group CEO Survey Prices Expectations



Source: Ai Group CEO Survey

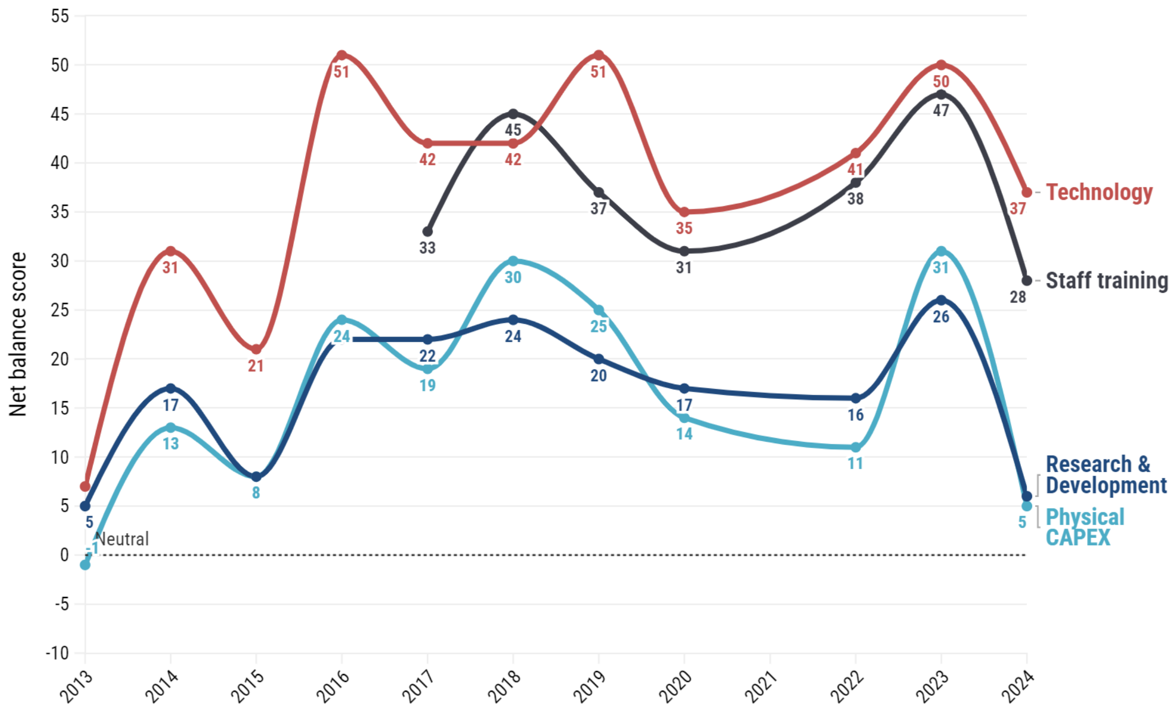
Investment levels: Plans for 2024 pulled back to manage uncertainty

Overall, Australian industry has a positive investment outlook for 2024, with all four investment expectation indicators returning positive scores. However, the investment intentions of industry leaders are down on the high levels seen in previous years.

- **Technology: +37 net balance.** Technology remains the highest ranked investment priority, with 49% of businesses intending to raise their spend and only 11% reducing. However, investment intentions for technology have fallen sharply from last year (+50).
- **Staff training: +28 net balance.** Half of (53%) of businesses will maintain, and 38% plan to increase their investment in staff training. But these intentions are well-down on last year (+47), and are the lowest recorded in the survey.
- **Research & development: +6 net balance.** Two-thirds of businesses (69%) will maintain their R&D investments at 2023 levels, while 19% plan to invest more. This is the lowest R&D expectation score in a decade.
- **Physical capex: +5 net balance.** 57% of businesses plan to maintain their physical capex investments in 2024. Capex investment intentions have fallen dramatically when compared to last year's +31 score.

Taken together, this is the **weakest set of investment intentions** in the Ai Group CEO Expectations Survey since 2015. While intentions remain net positive, they reflect businesses pulling back to hold steady in the face of increasing uncertainty about the economic outlook.

Chart 5: Ai Group CEO Survey Investment Expectations



Source: Ai Group CEO Survey

Investment orientation: Expectations for a slower 2024 lead to focus on productivity over growth

A majority (52%) of respondents ranked **business process improvement** as either their first or second priority for investment spending in 2024. **Staff training and development** was ranked second (41%), and **new business development** (35%) was ranked third.

These top three investment priorities are all related to improving and utilising the current capabilities within a business, a defensive strategy designed to consolidate in the face of uncertainty.

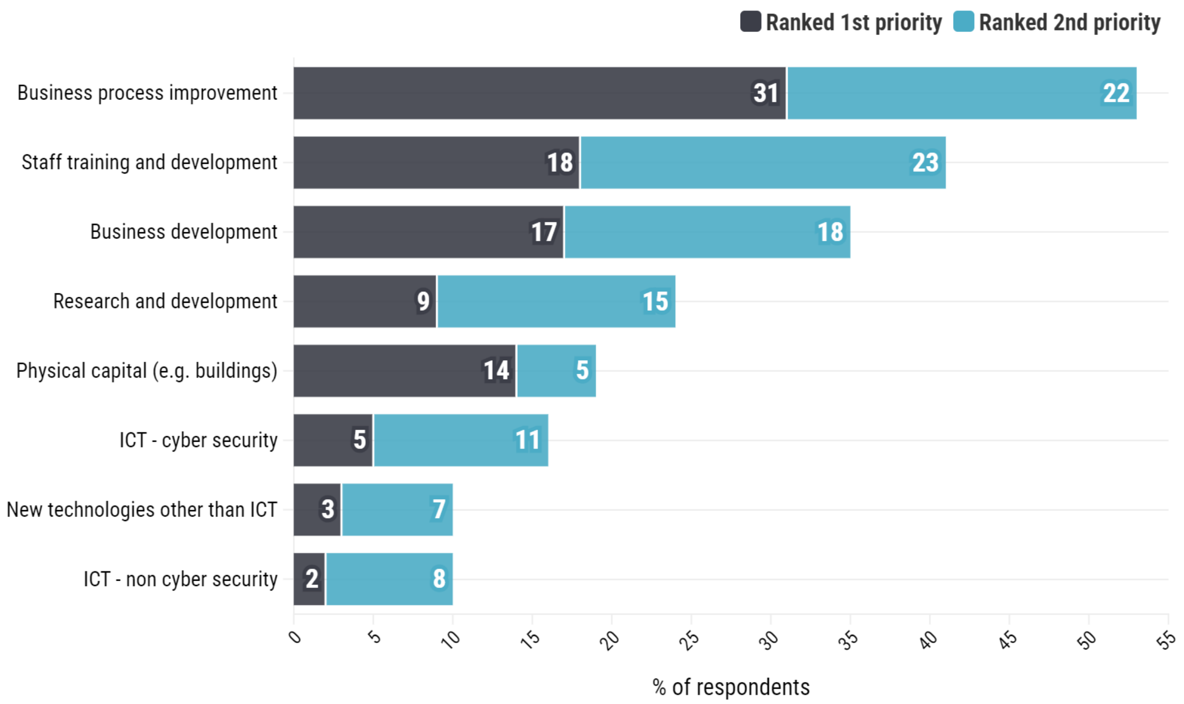
By contrast, more growth-oriented forms of investment ranked lower this year. Just 24% listed **R&D** as their first or second priority, and another 19% **physical capex.**

36% of industry leaders listed **technology** as one of their top investment priorities. But to understand what exactly 'technology' means, we adjusted this year's survey to split the category into three distinct components. We found that **cyber-security related ICT** was the highest-ranked technology priority (16%), reflecting growing concerns around the impact of cyber security incidents on industry.

These investment priorities reveal an inherent defensiveness going into 2024. Most industry leaders are focused on productivity enhancements, with fewer orienting their investment plans towards growth opportunities.

This approach is entirely understandable in a context of uncertainty and rising costs. But it also means that many industry leaders will not be confident enough to make the major investments needed for technological transformations in 2024.

Chart 6: Ai Group CEO Survey Investment Priorities for 2024



Source: Ai Group CEO Survey

Supply chain strategies: Cost pressures managed through internal efficiency measures

While the number of industrial businesses facing supply chain *disruptions* fell from 73% to 44% in 2023, some 86% still had to contend with pressures in the form of *rising prices*. In this year's survey, we asked how businesses plan to manage both disruptions and inflation in their supply chain strategies.

The most common strategy to manage supply chain risks was **changing operational practices** (37% of respondents). This includes measures such as better management of stock and inventories, digitisation of supply chain management tools, and the optimisation of business processes.

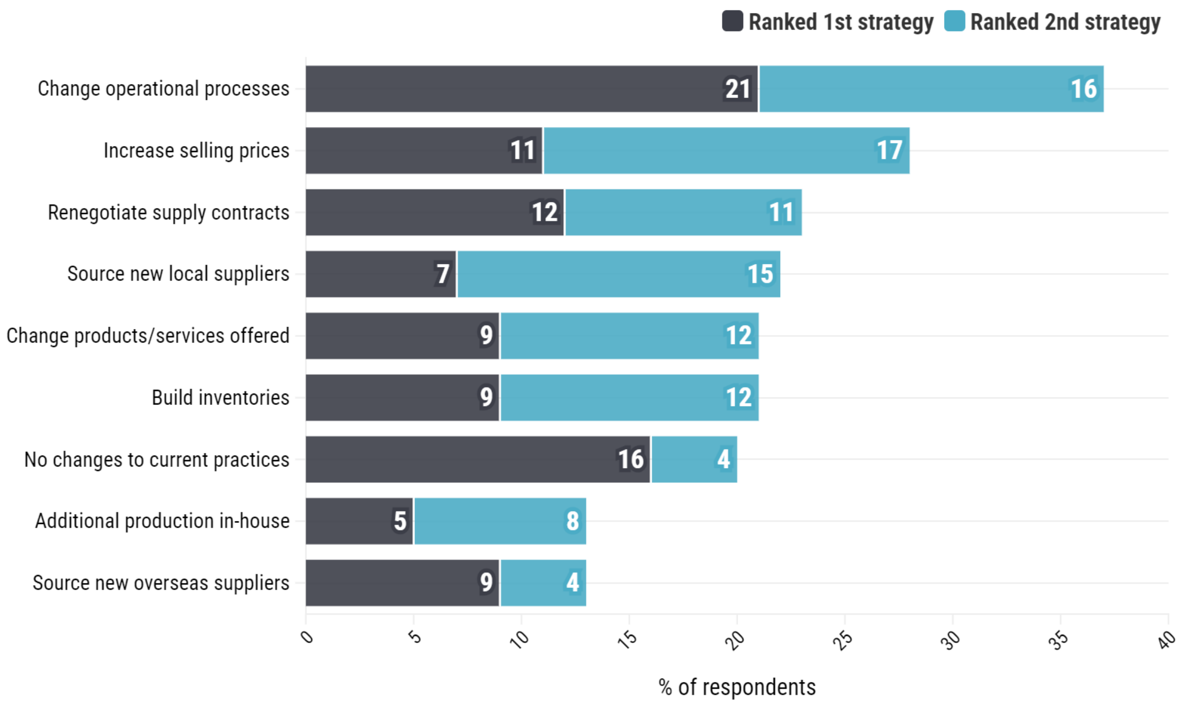
This shows that conventional cost control measures are clearly back in the sights of industry leaders.

Around a quarter of respondents (28%) intend to **increase sales prices** to keep pace with rising input costs. Some industry leaders report they have found it difficult to fully pass on increased input costs, but due to ongoing inflationary pressures it will become more necessary in 2024.

Some 23% of businesses intend to **renegotiate supply contracts** in order to manage cost pressures.

While some businesses will **seek new suppliers** in 2024, there is a definite preference for local sourcing: with 22% looking for new Australian suppliers, but only 13% looking overseas. This may reflect weakening in the Australian dollar during 2023 that have made imports more expensive, as well as rising transport costs associated with high fuel and energy prices.

Chart 7: Ai Group CEO Survey Supply Chain Strategies for 2024



Source: Ai Group CEO Survey

Growth strategies: Focus on improving market offering to compete in tougher environment

Industry leaders plan to focus on their product offering as the key driver of growth in 2024. Just under half (49%) consider **developing new products and services** their first or second growth strategy, while the same amount plan to **improve sales of current offerings.**

These 'offering-led' growth strategies reflect efforts to improve competitiveness in an environment of sluggish demand and uncertainty.

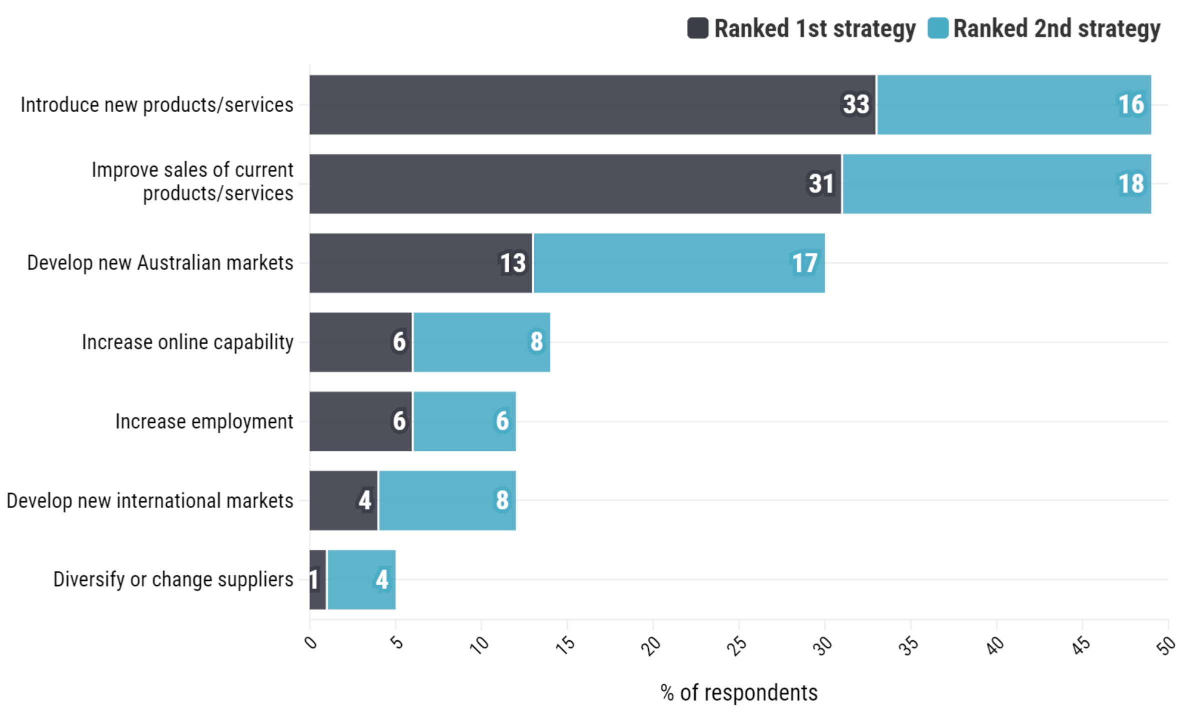
These plans are very much focused on the domestic market. Just under one-third (30%) of businesses identified **new Australian markets** as a priority, compared to only 12% for **international markets**.

Freight costs, exchange rate volatility and the increased uncertainty of international customer demand all make selling to local customers more appealing.

Only a small number of businesses (12%) intend to **increase employment** as part of their growth strategy. This reflects the reality of Australia's drum tight labour markets, and a recognition that growth will need to come by utilising the current labour force more effectively.

In a post-pandemic shift, only 5% of businesses indicate they intend to **diversify or change their suppliers.** This is considerably lower than in our 2023 survey, where 20% of businesses indicated they were seeking new suppliers. It reflects the fact that the focus has shifted from managing supply-side constraints to innovating product in an uncertain demand outlook.

Chart 8: Ai Group CEO Survey Growth Strategies for 2024



Source: Ai Group CEO Survey

Workforce strategies: Training, wages and efficiency all deployed to combat labour shortages

87% of industry leaders expect their business will be **impacted by staff shortages** in 2024. This is only marginally lower than the 90% who reported this expectation for 2023. This reflects the fact that despite the economy slowing, there has been little softening in the Australian labour market over the last year.

With expectations that staff shortages will continue for the medium-term, businesses are focusing on three major strategies to manage this chronic problem: skills, wages, and efficiency:

42% plan to **retrain or upskill** existing staff. In-house skills development offers two benefits. It helps fill skills gaps without recourse to hiring, which continues to be difficult in tight labour markets. It also aids with retention, as staff receiving training are less likely to leave an employer.

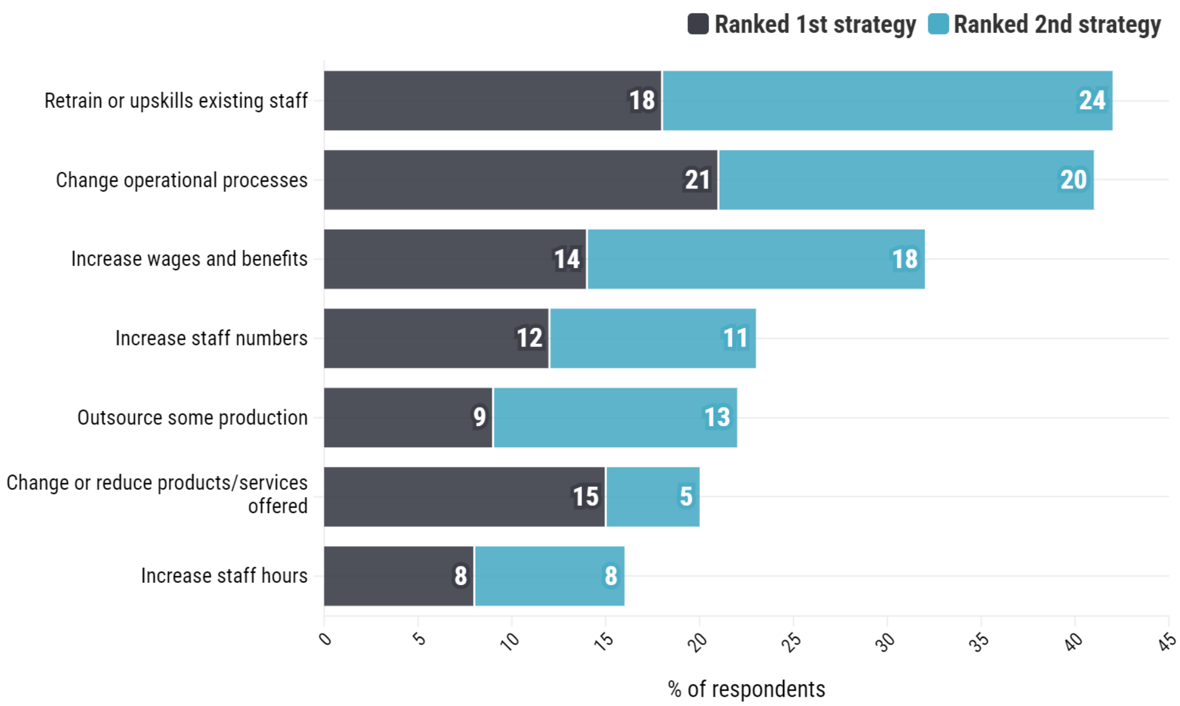
Around a one-third (32%) intend to **increase wages and benefits**. In tight labour markets, the ability to offer attractive employment packages is critical for both attraction and retention.

Chronic staff shortages are also forcing change to business models. 41% of businesses indicate they will **change operational practices** to adapt to staff shortages, 22% intend to **outsource some production**, and 20% will **change their product offerings**.

The fact that a sizeable minority of businesses intend to make these changes speaks to the impact of staff shortages on Australian industry.

Around one-in-four businesses (23%) intend to **increase staff numbers** in 2024, a decline from 38% in 2023. This is a response to growing uncertainty and lower expectations for growth in the year ahead.

Chart 9: Ai Group CEO Survey Workforce Strategies for 2024



Source: Ai Group CEO Survey

About the Ai Group Australian CEO Expectations Survey

Ai Group has conducted the *Australian CEO Expectations* survey annually since 2012. The survey asks leaders in industrial businesses about their experiences during the past year, and their expectations for the coming year. Its questions cover business conditions, performance, inhibitors, investment and growth strategies.

The 2024 CEO Expectations Survey was administered in October and November 2023. Responses were received from leaders of 320 private-sector businesses across Australia. Collectively, these businesses employed 126,338 people (approximately 0.9% of the Australian labour force) and had aggregate annual revenue of just over $56 billion in 2023 (approximately 1.3% of Australian business revenue).

All Australian states, and all major Ai Group member industries, are represented in the 2024 CEO Survey. Nine industrial sectors were included: construction, manufacturing, mining services, wholesale trade, transport, utilities, professional, technical and scientific services, administrative services and other services. This group collectively accounted for 38.7% of Australian industry value-add in 2022-23.

Data presented in this report is weighted by industry (based on ABS estimates of their value-added contribution to IVA in 2022-23) to adjust the sample to match the underlying population of businesses in the nine target industries.

Summary statistics of the survey sample, target population and weighting coefficients are below.

Ai Grroup CEO Survey 2024	Manufacturing	Industrial services	Construction	Others (not included in survey)	Total
Number of survey respondents	184	89	47	0	320
% of survey respondents	57.5%	27.8%	14.7%	0	100
Industry share of Australia industry value added, %, 2022-23	5.7%	25.9%	7.1%	61.3%	38.7%
Industry coefficient (%) for weighting	14.8%	66.8%	18.3%	0	100.0%

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