

Australian businesses post the GFC

Entering a new year with continuing financial uncertainty and the World Bank warning of the potential for a new financial crisis, business journalists continue to be somewhat pessimistic. We interviewed some of Australia's most senior business journalists to find out what they felt was happening to Australia's economy and which segments were faring best and worst.

No admired companies in this environment.

Business journalists are unable to nominate a company that has a strong reputation in this financial environment, beyond the mining giants BHP and Rio Tinto. External events are tending to dominate the media headlines.

This is in stark contrast to previous years when journalists nominated companies such as Wesfarmers, Macquarie and Woolworths. In the UK, despite the doom and gloom of the economy, business successes are still highlighted in the media. John Lewis department store stands out in a sector in real trouble, finding the right formula in its range, pricing and service.

In the UK supermarket sector Waitrose and Marks & Spencer find the sweet spot at the top of the market while former supermarket darling and middle market success story Tesco is on the decline. In supermarkets positioning is key, with the market polarizing with Aldi at one end and Waitrose and M&S at the other.

"...domestic issues are playing a part (in Australia's financial uncertainty) but they are probably a secondary part – offshore developments are driving our market a lot more than they normally would."

At a glance summary

- Australia's economy in a precarious position
- Resources sector not impervious to international pressures
- Strong \$ impacting exports, retail and tourism particularly
- Small business to bear the brunt of the downturn – implications for selling to and servicing this sector
- Survival about balance sheet strength

In Australia, the domination of bad news opens up both a challenge and an opportunity for companies with stories to tell to achieve cut through. The NBN related strategies are potential areas of interest.

Smart defensive strategies for coping in this challenging environment are another area for news making.

Australia's economy is in a precarious position.

The situation is not impacting the country uniformly. Some areas and sectors are experiencing a boom while others are struggling.

Overall, however, business journalists can see few opportunities and lots of challenges.

Economic sluggishness is being driven by numerous factors:

- Impact of severe climatic conditions (the 2011 floods, cyclone Yasi)
- Higher consumer savings (debt reduction)
- Weaker retail spending
- Slowing property prices

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- Uncertainty over interest rate changes
- Continuing difficulty for business to borrow
- General uncertainty - particularly regarding European and Chinese economies
- Effects of GFC and concern about a second one
- Strong Aussie dollar, which is impacting exports, tourism, retail
- High reliance on the buoyancy of overseas economies, especially China and India

"In the west [of Australia], where you have a very strong economy, that's foreseeing a lot of inflation pressures and then you have the other part of the country, particularly the eastern seaboard which has been hit very hard by weather conditions but also consistently weak data on retail sales, property prices, home sales etc."

Journalists do express some optimism regarding the potential of the NBN to revitalise the Australian market – foreseeing new industries developing as a result:

"The blue sky notion is that there will be a lot of industries and services that we don't even have yet, which would spin off the fact that these speeds are available. And that's not unrealistic, that's quite a feasible notion when you see the speeds which telco or social media services grow and take off overseas, it gives you some idea; or a group buying, for instance, this sort of economic activity can accelerate at quite a dramatic pace, once it takes off..."

"It's a heavy load that the resource industry is bearing ."

Mining will continue to boom despite mining tax.

Journalists' views are demonstrated by the mining sector and others with similar advantages.

While the mining economy is affected by the same challenges as other industries, mining has the over-riding advantage of very high prices for its products.

The long term prospects for Western Australia are very positive and underpinning the economy.

"Offshore gas area is booming obviously. You've got the big guys like Chevron and Conoco with very big projects and the next 10 or 12 years there is going to be an enormous construction boom."

The positive impacts of some big investment projects in the west are yet to be realised.

Growth does not only affect the resource industry but also benefits those who service it. Where there are strong economies in Western Australia and in parts of Queensland, this is building employment as well as fuelling inflation.

"There are construction companies that do a lot of work for the miners. They're going pretty well."

Wide differences within and between states in economic growth is a major contributor to Australia's economic position.

"You see some states expecting three percent plus [growth], even four, in the mining regions. Then you're talking under three percent in areas like Sydney and Melbourne that are not exposed to the mining boom. And so you have this two speed divide and that would seem to be causing some problems, some serious problems now."

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Queensland is believed to be experiencing a two speed economy within its state boundaries with some locations forging ahead and others falling behind.

Again, areas associated with mining are faring well while regions dependent on tourism are suffering through the high Australian dollar value and flat market.

Dwelling property approvals (a lead indicator) are flat for south east Queensland (Brisbane, Gold and Sunshine Coasts).

"It's basically people thinking they don't quite have the confidence to take out a mortgage... You've got the areas which have been traditionally solid or the fast growing ones in the past 20 years: that's Cairns, the Whitsundays, the Gold and Sunshine Coasts, they're all flat."

Housing approvals are up in Gladstone, MacKay and Toowoomba, and other towns such as Chinchilla are seeing growth in school enrolments.

"The vast majority of them come from families where a parent will be involved in the mining industry which is growing very quickly around that area."

This kind of growth has a flow on effect. It might result in the acquisition of another school teacher, a new shop or two opening.

Some parts of the agricultural sector are faring well – although others have suffered at the hands of locust and mouse plagues which has involved re-sowing crops.

"So that's going to have a big knock-on effect with regards to the size of the harvest, the amount of money generated for exports on a state basis and money going back into the regional economies."

Small and medium business to bear the brunt

Businesses selling or providing services to SMEs will need to be aware of the added pressures they are under with the extra hurdle of finding financing. Growth for these businesses is a challenge.

It is believed to be small business bearing the brunt of this economic downturn with banks reluctant to provide credit.

"A lot of average people and in small and medium businesses were really hard hit with the global financial crisis and a lot of people on the home front got a big shock at that. As a result they've been working harder to pay down debt and to reduce household debt, trying to pay more off their mortgage."

"Small and medium businesses are having to be more particular about the type of work they undertake because they're also finding it's still hard to get credit from banks."

"Despite what the banks say they're not providing as much credit to small and medium businesses because of the higher risk rating, and their greater attention to risk."

Small business are very exposed to banks and do not have the option to seek private equity or list on the stock market.

"It will affect every business. There'd be no exceptions to it."

Product and service offerings, terms and conditions will need to be adjusted to set realistic expectations in order to best attract these audiences.

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"Overseas demand is subdued because our dollar is so strong which means that assets in this country are relatively expensive right now."

Investment banking subdued

The investment banking sector is subdued as Australian assets are relatively expensive.

"Investment banks are going to have to knuckle under and just keep their heads down for a while. They depend on the deal flow and because they put money on advising on deals, bank rolling deals and so on. There are not that many deals happening right now."

The dollar's strength is a real concern for business because it has changed the terms of some of Australia's leading companies that have built a base of US revenue, including:

- Westfield shopping centres
- Finance groups eg CSL
- Building groups like James Hardie

With other economies slowing, demand for Australian exports in countries such as Japan has declined. The price of Australian goods overseas has added to the struggle, particularly in mining and agriculture.

Construction boosted by population growth & NBN

The residential construction industry is going through a subdued period as household demand has softened, forcing managers to review their business. However the long term outlook is felt to be more positive with relatively strong population growth.

"It depends what part of the economy you're angled into. There are construction companies that do a lot of work for the miners. They're going pretty well. The ones who are exposed purely in the residential sector are probably looking at a soft couple of years at least I'd say - although there's still strong, relatively strong population growth in this economy. The long term outlook is not bad at all."

Australia has some strong construction companies, such as Leighton with exposure to all sectors, and Thiess and Baulderstone in their group with solid work in front of them, including work on the NBN:

"They've got to look back to their own businesses and say 'Okay, well if revenue is not growing as strongly to where it was a year or two ago, what does that do to the shape of the business? How much free cash are we throwing on in a lower revenue environment?' So it is tough for them but it's nearly always tough in the building and construction industry, one way or another."

Face of tourism is changing

The tourism industry already trying to respond to the changing pattern of tourists with fewer Japanese visitors and more Chinese, impacted by the strength of the Australian dollar.

This is being felt in places such as Cairns, and the Gold and Sunshine Coasts which have enjoyed strong growth over the past ten years.

Unemployment in these areas is now higher than average.

"All three of those areas have very high unemployment. It's about 8% or 9% whereas the country is about 5%."

Journalists note that the industry is responding with increased international marketing to draw back the tourists.

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Interest rates likely to be held down

There is some sympathy for the Reserve Bank and its difficult role managing interest rates in the current environment.

The present resource boom is considered to have a different set of challenges to resource boom mark one during the Howard Government when the Australian economy and all sectors were strong.

"The normal policy response to that (inflation) is lifting interest rates but the rest of the economy is so weak that rising interest rates would be terrible for manufacturing and retail, and other areas of the economy." ... "It's really sort of split the country down the centre." ... "The impact of the Reserve's attempts to restrain inflation in the economy with the resources boom going on."

This time the Reserve Bank cannot look at national averages – the real stories are about different regions and sectors.

"Now the Reserve Bank and the government is facing those other pressures where on the surface if you look everything was aggregated into national issues and statistics, things were looking good but out there in the real world things are much harder."

"...the economy is so weak that rising interest rates would be terrible for manufacturing and retail, and other areas of the economy."

Lifting interest rates is risky when there is little economic growth behind it.

With the fragility in the economy, the voice of the Reserve Bank carries considerable weight and everything it announces is scrutinised.

"It makes the Reserve Bank highly important with the sort of signals they send out about the market."

Despite the increase in employment in resources, there is an expectation that overall unemployment will grow.

"There's a probability that as the economy slows that banks and (other non resource based businesses) will start offloading people."...

Weakness in the stock market

Lack of confidence in local investors has contributed to the poor performance of the stock market. Lack of options for local investors, beyond the mining and resources stocks, is also an issue.

Low growth global stock markets reflect negatively on general confidence – the markets are connected, despite Australia's relatively strong position.

Bank stocks are less attractive today than they were previously. The four term banks which dominate the financial services sector are not performing for investors in terms of their return on investment or their dividend yields.

"You've got softer credit now, you've got tighter bank regulations, and you have low growth – so those three things cool bank stocks."

Softer credit, tighter bank regulations and low growth are impacting on the value of bank stocks. They are still thought to be sound investment and attract a certain sort of investor that's looking for a 5% or 6% dividend.

"They've become stocks that are offering some sort of gentle growth prospect with a solid yield while for a decade they had both strong yields and strong growth prospects."

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INSIDE REPUTATION BULLETIN



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Need balance sheet strength to survive

Business journalists believe that companies which fared the GFC well are best placed to survive. Companies which are already lean going into this slower economy, will find the going tougher.

"You've got to have somebody to serve so the ability of companies to ride this out depends on, partly on how strong they were going into it."

With some predicting the current environment to last until late 2013, a strong balance sheet is needed to see the time through:

"...I don't see us rushing back to prosperity any time soon...I'd have thought you're looking at late 2013...that's a fairly reasonable prognosis."

The implicit message from journalists is for companies to maintain the right balance – keep lean within your ability to deliver.

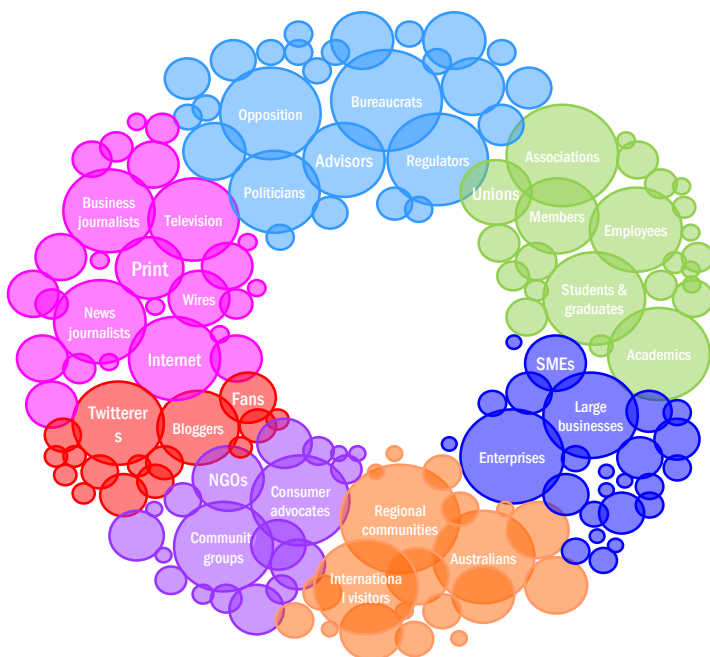
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The Inside Story has been a key player in the Australian research environment for more than 25 years. With a reputation for being innovative and at the forefront of insight techniques we launched our first Inside Reputation research study with journalists in November 1999. Since then we have conducted more than 30 studies with Australia's senior business media.

In addition, we have spoken to many other stakeholder groups for our clients, including government, business influencers, financial analysts, key bloggers and of course the general public.

If you are interested in hearing more about our studies, would like to brief us on your research needs or just want a chat, please get in touch!

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