Australian CEO Survey 2023

Australian CEO Expectations for 2023

JANUARY 2023

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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Contents

Preface

After two years of pandemic-induced interruptions, 2022 was a more stable and successful year for Australian business. While Australian business leaders are cautiously optimistic for 2023, they are readying plans to adjust to the challenges expected in the coming year.

Now in its tenth year, Ai Group's annual *Australian CEO Survey* provides critical insights into business experiences over the past year, and how business leaders expect the coming year to evolve.

Our 2023 CEO Survey reveals that businesses consolidated the post-pandemic recovery in 2022. Business conditions, turnover, employment and investment all improved as the dislocations of the COVID era gradually abated.

However, business leaders also contended with a new set of 'supply-side' challenges, as rampant inflation, chronic labour shortages and supply chain disruptions weighed heavily on performance. Business leaders report declining margins due to these supply-side pressures.

It is a testament to the resilience, flexibility and innovation of Australian business that we successfully navigated the challenges of post-COVID recovery in 2022.

There is, as always, a wide range of views about how 2023 will play out. But our Australian CEO Survey reveals several common themes that Australian business leaders largely agree on.

On balance, employers go into 2023 with cautious optimism. They expect business conditions and performance to improve again on the strong results of 2022. Despite the headwinds facing the Australian economy, business leaders are undertaking ambitious investment plans to adjust to the new market realities of the post-pandemic era.

However, they also identify three challenges which will define their priorities in 2023:

1. **Historically tight labour markets,** which have exacerbated chronic staff shortages, particularly for skilled roles. 90% of CEOs expect to be affected by staff shortages in 2023. They intend to invest in staff training and development to grow their in-house skills base.
2. **Continuing inflationary pressures,** which have crimped business margins and eroded profitability. Investment in process improvements and technology are already underway to manage the effects of cost pressures on the balance sheet.
3. **Supply chain disruptions,** which have persisted through 2022. 88% of businesses will invest in supply chain resilience in 2023, by improving their logistics practices, cultivating new suppliers, and adjusting their product offerings to manage this ongoing challenge.

CEOs are deploying these strategies to fortify their businesses in the face of the challenges expected in 2023. In an environment of skills and labour shortages, investment in broader workforce strategies, reaching beyond human resource strategies to operational changes is a necessary response.

They will also help future-proof Australian business, and the national economy, for the major global economic uncertainty and challenges of the mid-2020s.

These strategies and investment priorities are critical for Australia to achieving the economic resilience needed for prosperity in a time of global economic uncertainty.

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Chief Executive, Australian Industry Group

Key findings of the 2023 CEO Survey

Australian business conditions continued their steady post-pandemic improvement in 2022. Business leaders reported buoyant demand conditions, which enabled improved turnover, employment and investment compared to the year prior.

2022 was one of the strongest years in the ten-year history of the Ai Group CEO Survey.

However, supply side pressures dragged on business performance. Tight labour markets have imposed skills shortages and seen wage growth take-off. Rampant inflation – particularly for energy – has crimped margins. And, despite the end of pandemic-era conditions, supply chain disruptions have stubbornly persisted throughout 2022.

While business conditions were strong in 2022, there is also indications of a "profitless boom". On balance, CEOs report declining gross profit margins throughout the year, as supply-side cost pressures have exceeded demand-side growth.

Australian CEOs are optimistic about the year ahead. 49% expect business conditions to be stronger in 2023 than 2022, while only 30% expect deterioration. Net optimism for 2023 (+19) is slightly down on the pandemic-exit conditions for 2022 (+23), but remains the third highest outlook result in the history of the survey.

Business leaders anticipate continued improvement in conditions in 2023. Turnover, employment and investment are expected to exceed last year's strong results. But they also expect inflationary pressures – for wages, energy and other inputs – will continue to climb.

Three core challenges – **inflationary pressures, labour shortages and supply chain disruptions** – are expected to be the main inhibitors to business growth.

There are also emerging concerns around uncertainty, as global economic headwinds, inflation and rising interest rates will see Australian economic growth slow in 2023.

Investment plans for 2023 are carefully calibrated to these expectations. Business investment will attempt to seize growth opportunities in a period of uncertainty by focusing on internal optimisation.

More efficiently managing workforces is a key theme for investment. Staff training, business process improvement and ICT are identified as 2023's top priorities. These workforce-oriented investments rank well ahead of traditional priorities such as capital expenditure and R&D.

Growth will be achieved through a focus on improving product and service offerings, as business models are adjusted to new market realities. There is a clear preference for developing Australian over international markets, given lingering uncertainties about the global environment.

Supply chain disruptions are expected to continue. They currently impact 78% of businesses, and 88% plan to invest to reduce their vulnerabilities in 2023. Nearly a quarter intend to change their product offerings in light of persistent supply chain disruptions.

90% of businesses expect to be affected by staffing shortages in 2023. To manage labour supply risks, they plan to raise wages and benefits, increase staff numbers, and invest in in-house training. With unemployment forecast to remain very low throughout the year, workforce management strategies have shifted from recruitment to retention and reskilling.

1. Business experience in 2022

2022 was a year of transition for Australia. The major disruptions occuring from the pandemic – closed international and domestic borders, periodic lockdowns, and stringent isolation requirements – were progressively removed. The economy continued its strong recovery from the short-lived COVID recession of 2020, registering 5.9% annual growth in the year to the September quarter of 2022.

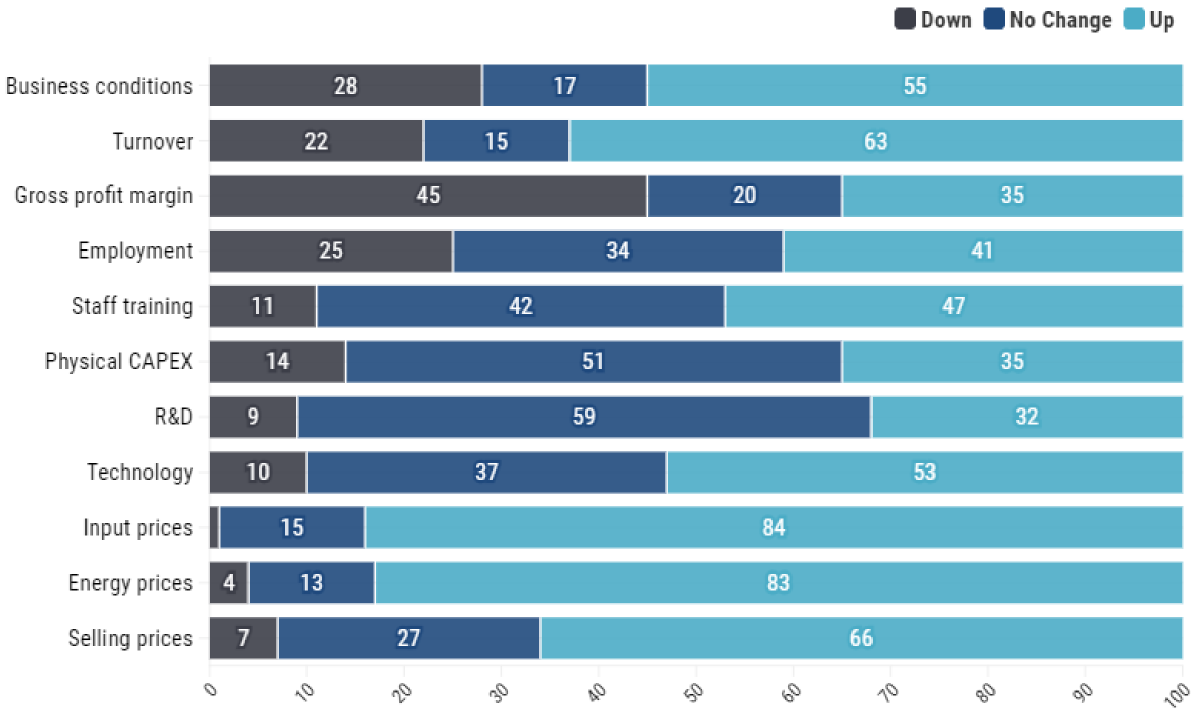
By the end of the year, businesses, workers and consumers could confidently go about their normal activities in a way they had not for over two years. And as Australia returned to a new kind of normal, so too did operating conditions for businesses.

Overall, a plurality of businesses report that **2022 was an improved year** compared to 2021 (Chart 1.1). Some 55% reported **improved general conditions**, 63% **improved turnover**, and 41% **improved employment**. Similarly strong results were reported across **investment activities**, including staff training, physical CAPEX, R&D and technology investments.

With one exception – **gross profit margins** – all our business indicators showed net positive results. This suggests that, on balance, Australian business conditions improved in 2022.

However, a deep dive into the CEO Survey indicators reveals the pressures Australian businesses faced in managing growth in the challenging post-COVID environment during 2022.

Chart 1.1 Business indicators in 2022 compared to 2021



Source: Ai Group CEO Survey

**Aggregate results for all surveyed industries, weighted by ABS estimates of output from each industry.*

Business conditions in 2022

Continued post-pandemic improvement in business conditions and performance

Business conditions in Australia continued their steady post-pandemic increase in 2022. Indeed, for some indicators they are the strongest conditions reported in the ten-year history of the Ai Group CEO Survey. Expressed in net balance scores – the sum of positive and negative responses – the 2022 survey results were:

- **Overall business conditions: +27 net balance.** 55% of business leaders reported improving conditions, and only 28% declining conditions. This is the highest net score in the history of the survey, and well above normal levels.
- **Turnover: +40 net balance.** 62% reported increased turnover, and only 22% decline. This is the highest turnover improvement recorded, and double the long-run average score of +20.
- **Employment: +16 net balance.** Despite very tight labour markets, 41% of businesses were able to increase their employment in 2022. This score is comparable to the three years prior to the pandemic.
- **Gross profit margins: -11 net balance.** Only 34% of businesses reported improved margins, while 45% saw them decline. This is the only general indicator to decline in 2022, and the second worst profit score in the history of the survey.

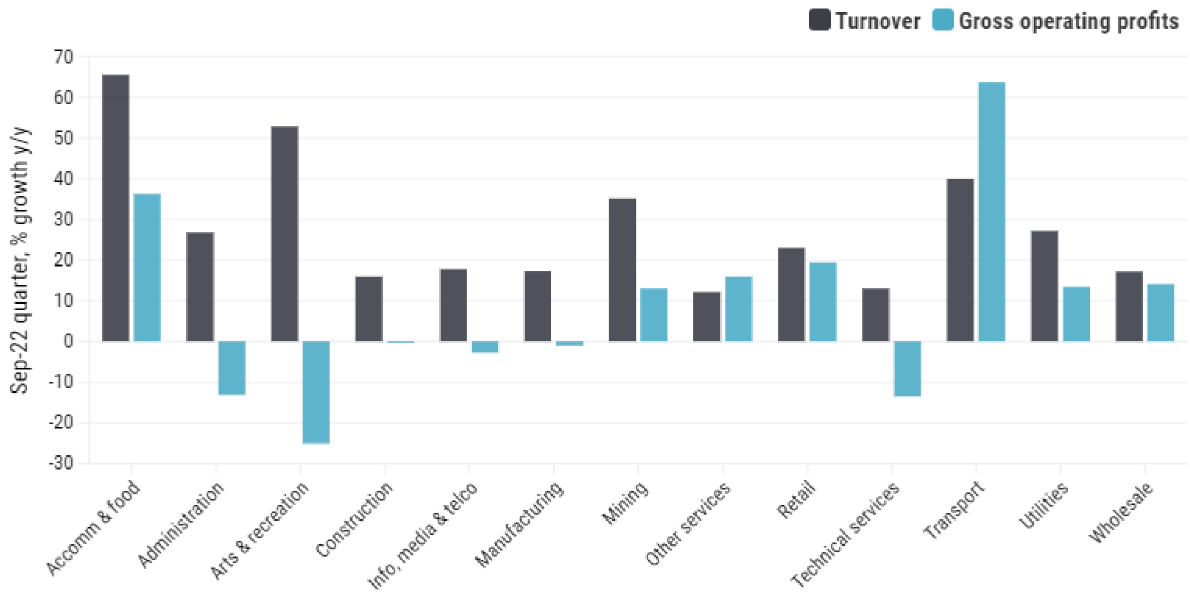
Chart 1.2 Conditions indicators in CEO Survey 2012-22

Source: Ai Group CEO Survey

These survey findings concur with official economic indicators (Chart 1.3). ABS data shows that in the September quarter of 2022, all sectors in the Australian economy saw **improved turnover** compared to a year prior. Turnover growth was extremely strong for pandemic-affected sectors, particularly accommodation & food services (up 66%), and arts & recreation (up 53%).

But increase in **gross profits were anaemic** in comparison. Overall gross profits only grew by 9.3%, in comparison to a 28% growth in turnover. For some sectors, gross profits declined despite turnover growing. Rising costs explains this “profitless boom” phenomenon:

Chart 1.3 Business turnover and gross operating profits by sector, year to Sep 2022

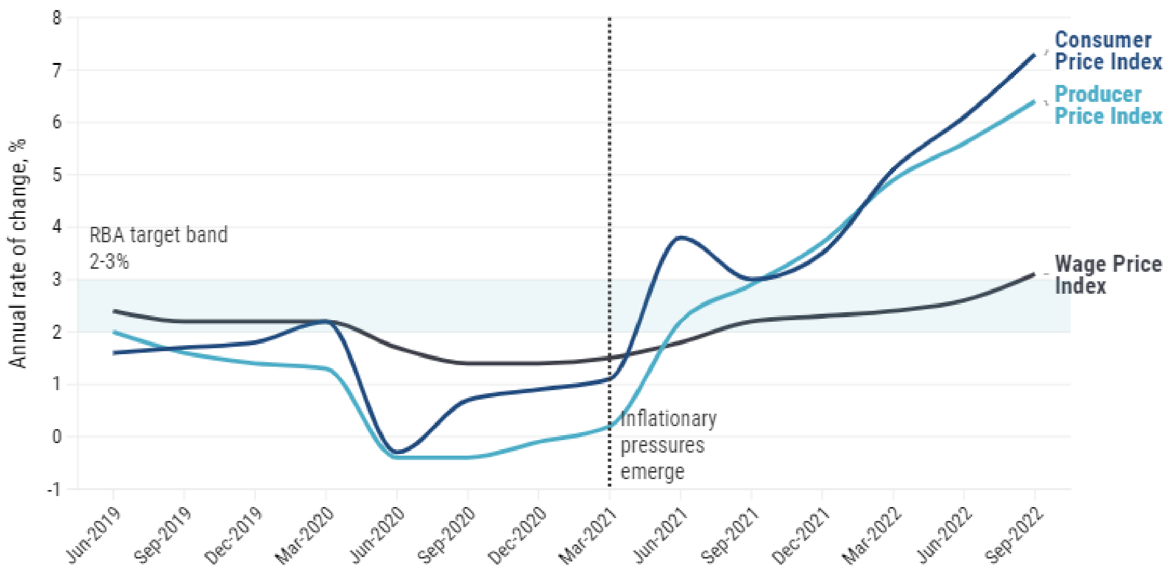


Source: ABS Business Indicators, ABS Monthly Business Turnover Indicator

Prices and inflation in 2022

The Australian economy is in the grip of an inflationary crisis. As economies recovered from initial recessionary shock of the pandemic in 2020, supply constraints soon emerged in the global economy and spread to Australia (Chart 1.4). In the September quarter of 2022, Australian consumer prices were growing at a 7.4% annual rate, and producer prices – the goods used by industry – at 6.4%. These inflationary pressures are well in excess of the RBA's preferred "target band" of 2-3%. While wages grew at a more modest 3.1% p.a., this is still the highest rate of wage growth in over a decade.

Chart 1.4 Inflation in Australia since the pandemic



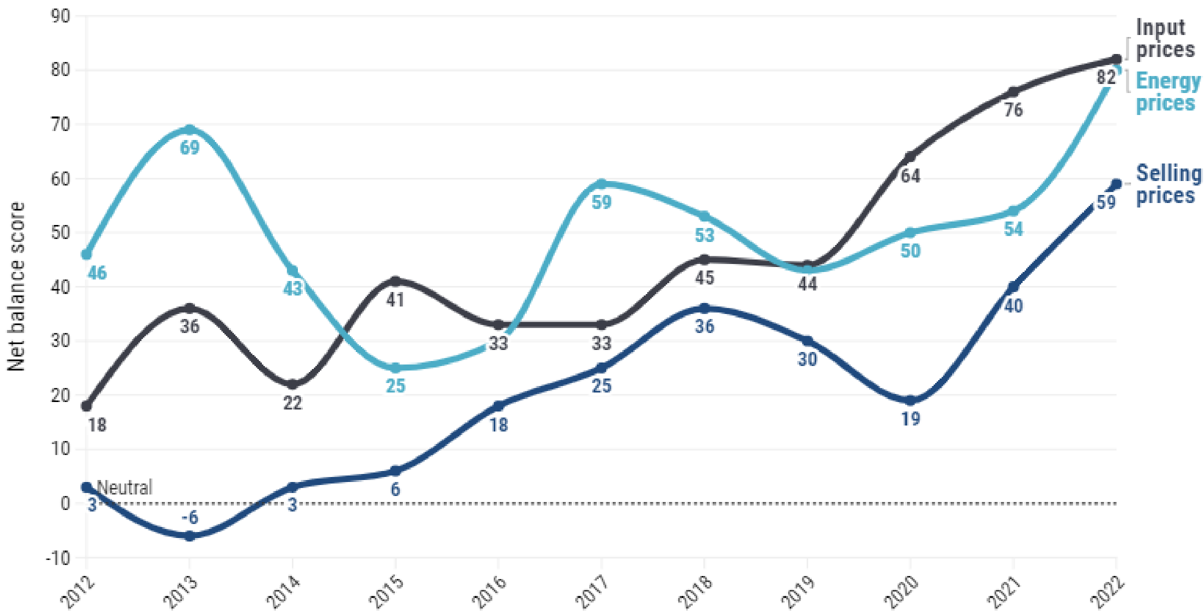
Source: ABS PPI, ABS WPI, ABS CPI

Inflation saw input prices rise faster than sales prices for business

Unsurprisingly given the national and global inflationary context, in 2022 business leaders reported the **fastest rises in industry prices** ever seen in the history of the Ai Group CEO survey:

- **Energy prices: +79 net balance.** 83% of survey respondents saw rising energy prices, while only 4% saw declines. While energy price net scores are usually elevated, this is the the highest score in the history of the survey, and exceeds the peak (+69) seen during the last resource boom in 2013.
- **Input prices: +82 net balance.** 83% of businesses faced rising input costs, and only 1% saw them fall. This result was only a mild increase over 2021 (+76), but reflects the ongoing effect of supply chain disruptions and labour shortages seen during the pandemic.
- **Sales prices: +59 net balance**. 66% of businesses increased their sales prices, 27% saw no change and for 7% they fell. This indicator is also at an all-time high, but remains below the input and energy prices indicator.

Chart 1.5 Pricing indicators in CEO Survey 2012-22



Source: Ai Group CEO Survey

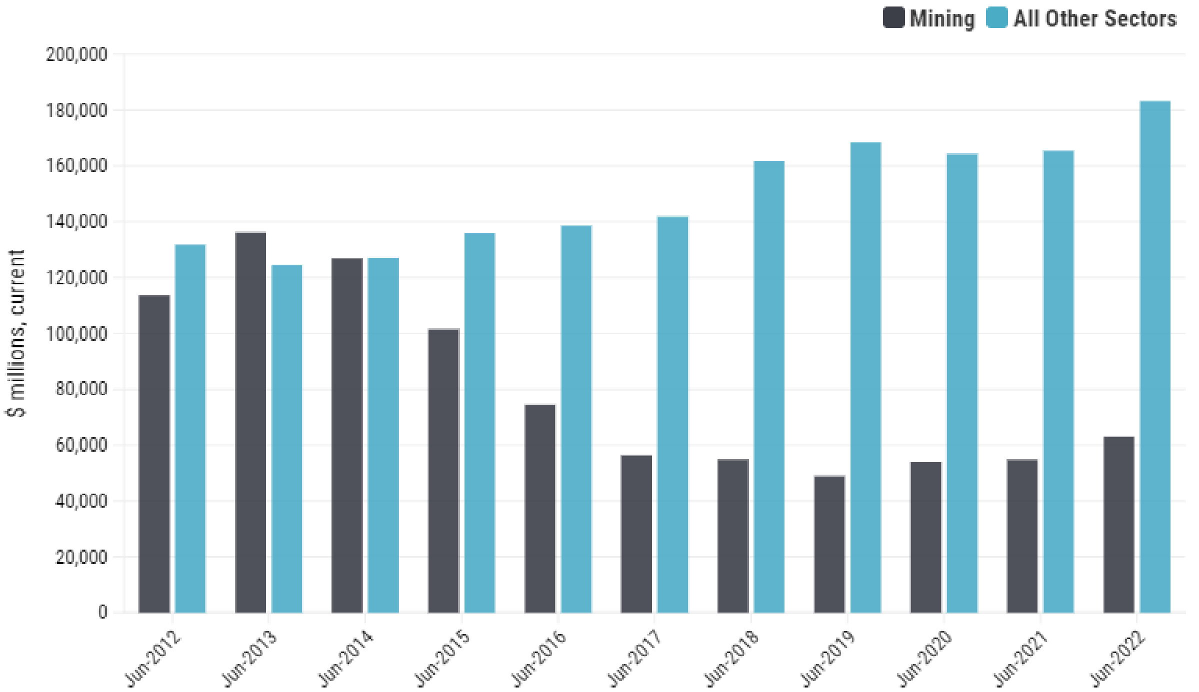
These pricing dynamics help explain the 'profitless boom' phenomenon in 2022. While all prices in the economy are rising, surveyed businesses report their input prices – labour, materials and energy – are rising at a faster rate than their sales prices. The inability to fully pass-on rising costs to customers has eroded business margins, leading to declining profitability even while turnover is increasing.

Investment trends in 2022

2022 a bumper year for investment in Australia

As pandemic era uncertainty eased and the economy grew strongly, business has responded by rapidly increasing investment levels in 2022. Total private sector business investment in Australia reached $246 billion in the 2021-22 financial year, the highest level since the end of the resources boom. The uptick is particularly marked for non-mining business investment, which was $183 billion in 2021-22, an all-time high. This is 11% higher than the year before, and the first year of significant growth in non-mining investment since 2017-18 (Chart 1.6).

Chart 1.6 Private business investment in Australia, 2012 to 2022



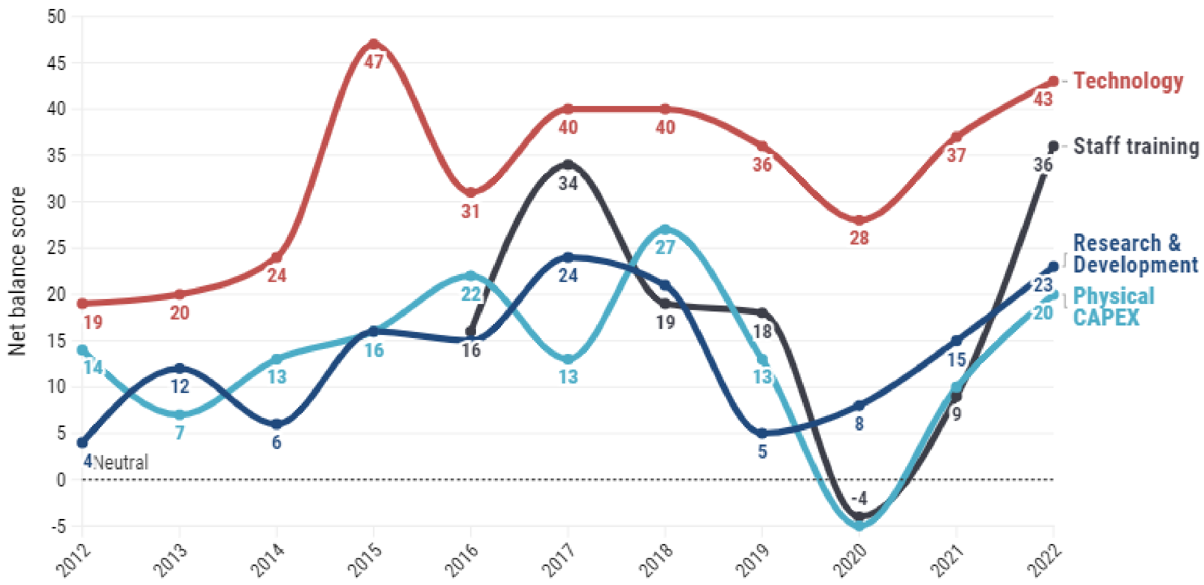
Source: ABS Australian National Accounts, Table 34

However, the Ai Group CEO Survey provides more detailed insights into how businesses are changing the composition of their investments. As our investment indicators show, there has been a **rebalancing in how businesses invest towards knowledge capital:**

- **Staff training:** **+36 net balance.** 47% of businesses reported increasing their investment in staff training in 2022. Staff training is now the second highest reported business investment priority, and at +36 the series is at an all time high. This is a consequence of very tight labour markets, where skills shortages have seen businesses invest aggressively in in-house training.
- **Physical capex:** **+20 net balance.** 36% of businesses increased their physical capex investments, and another 50% maintained 2021 levels. Despite this strong result, physical capex has fallen to be the lowest investment prority as others have grown more.
- **Research & development:** **+23 net balance.** 33% of businesses increased R&D, and another 58% maintained it. The R&D score has almost returned to the peak (+24) seen in 2017. Strong R&D investment reflects product innovations being made in response to changing market conditions during and after the pandemic.

- **Technology: +43 net balance**. Technology remains the highest ranked investment priority, with 53% of businesses upping their technology spend in 2022. Like R&D, technology investment has now fully recovered its pandemic-era losses and nearly returned to its all-time peak (+47 in 2015).

Chart 1.7 Investment indicators in CEO Survey 2012-22



Source: Ai Group CEO Survey

These changes reveal how businesses are **recalibrating their investment priorities** to focus on knowledge-based assets in the post-pandemic era. Staff training has become far more important, while R&D and technology spending continue to grow strongly. This new investment profile indicates that Australian businesses are using buoyant market conditions not simply to grow output, but also transform their operations with a focus on knowledge intensive priorities.

Supply chain disruptions in 2022

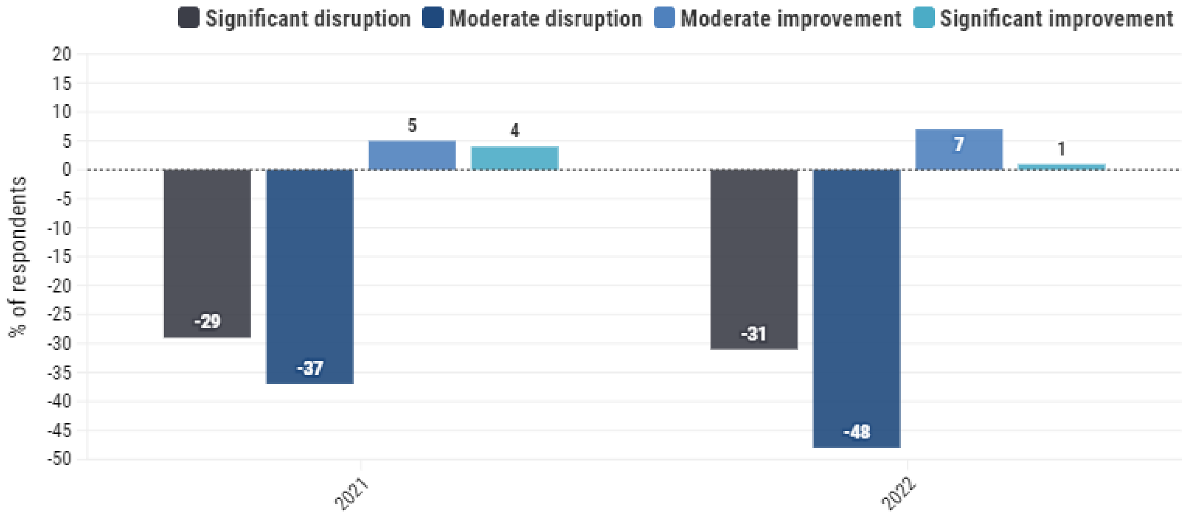
Supply chain problems persist post-pandemic

Supply chain disruption have been an ongoing drag on Australian business since 2020. With pandemic conditions easing in 2022 many expected that disruptions would ease this year. Unfortunately, the re-verse proved to be the case, with **supply chain disruptions becoming worse** (Chart 1.8):

- 79% of businesses reported supply chain disruptions in 2022, an increase of 13%
- The share of businesses facing significant disruptions was steady (rising from 29% to 31%)
- The share of businesses facing moderate disruptions rose by 11% to nearly half (48%)
- Very few businesses (only 9%) reported that supply chains improved in 2022

Manufacturers faced greater disruption to supplies (88% in total) than **services** businesses (78%) and **constructors** (77%). However, the fact that over three-quarters of services businesses – who may not be expected to be as exposed as manufacturers – faced disruptions shows the generalised nature of supply chain problems in the Australian economy today.

Chart 1.8 Supply chain disruption and improvement 2021 and 2022



Source: Ai Group CEO Survey

When pandemic conditions were easing in 2022, why did supply chain disruptions still increase? The answer lies in the multi-faceted nature of this unique economic shock. Broadly speaking, there have been five global drivers of supply chain disruptions since the pandemic:

1. Interruptions to domestic connectivity
2. Interruptions to international connectivity
3. Rising protectionism
4. Geopolitical shocks
5. China's COVID-zero policies

As COVID conditions improved in 2022, the first two factors – domestic and international connectivity –slowly began returning to normal. But the broader factors remain very much alive.

Protectionism has increased significantly in recent years, as governments restrict trade to support local industry. Russia's invasion of Ukraine in February has caused chaos in global supply chains for energy, metals and industrial goods. China's commitment to COVID-zero policies until December 2022 led to frequently factory and logistics shutdowns, interrupting any supply chain involving China.

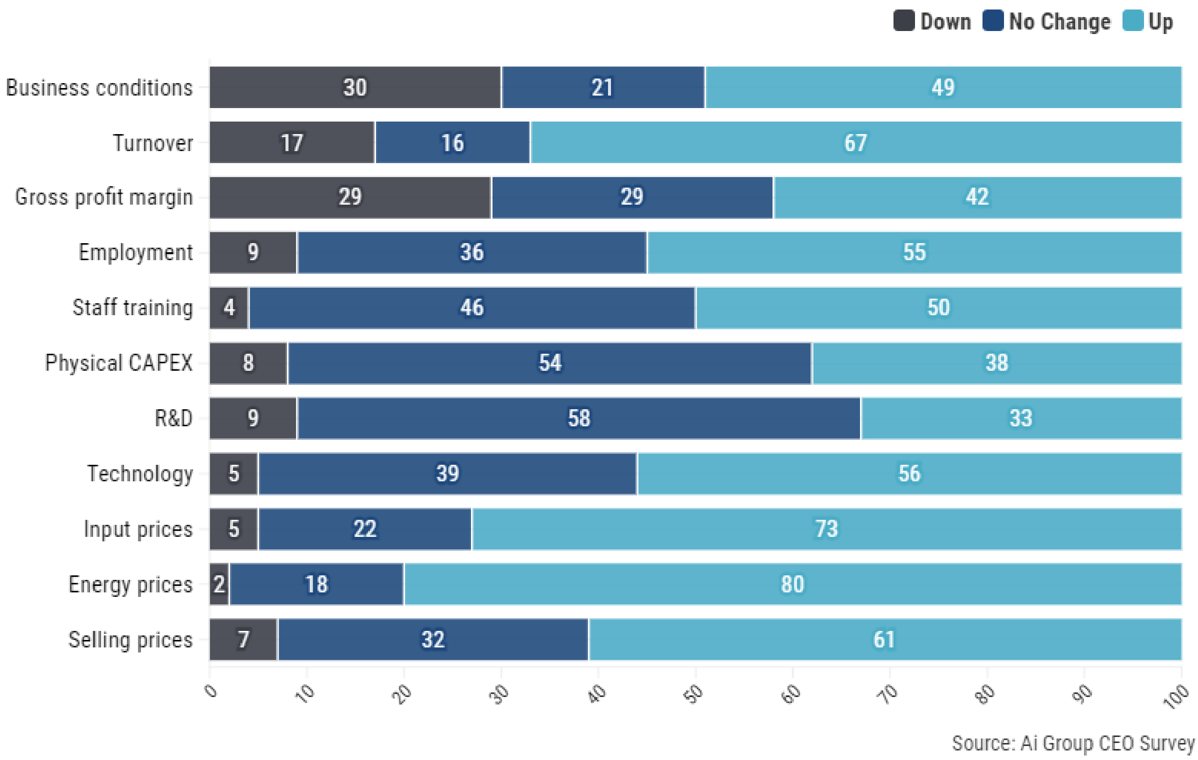
Supply chain disruptions are not simply a COVID-era challenge, which will pass as pandemic conditions ease, but a **lasting challenge driven by global political factors**.

2. Business expectations for 2023

Australian businesses are **optimistic about the year ahead**. Following the strong improvement in business conditions in 2022, most respondents to the Ai Group CEO Survey expect conditions to be as good or stronger in 2023.

Just under half (49%) of surveyed businesses expect **general conditions to be better** than 2022, and another 21% expect they will remain the same. Two-thirds expect **turnover to lift**, and 55% **plan to increase employment**. These positive expectations have led businesses to pursue **strong investment programs**, with the majority indicating they will either raise or maintain levels of staff training, physical CAPEX, R&D and technology investments in 2023.

Chart 2.1 Business expectations for 2023 compared to 2022



** Aggregate results for all surveyed industries, weighted by ABS estimates of output from each industry.*

Interestingly, 42% of businesses expect **some recovery in gross profit margins** in 2023, and only 29% expect margins to decline. This reveals expectations of profitability improvements from 2022, where the figures were 34% increasing and 28% declining.

An overwhelming majority expect **prices to increase** across the year for inputs and energy, and in response indicate they will be **lifting sales prices**. However, with a higher proportion of businesses expecting input prices to rise than those who expect to raise their sales prices, it may prove difficult to raise margins in these pricing conditions.

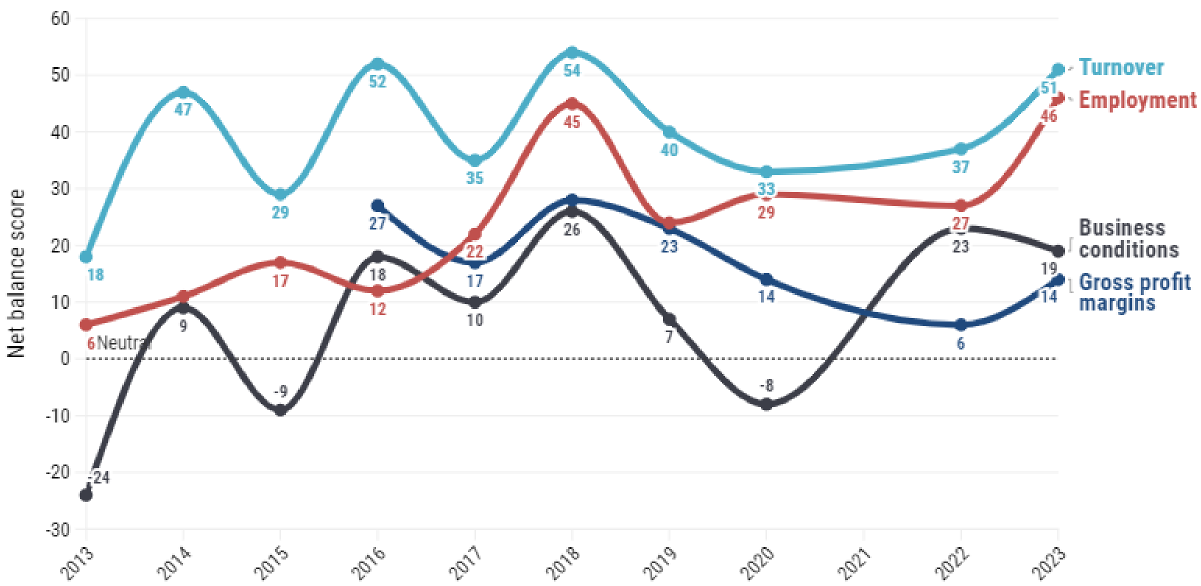
Conditions expectations for 2023

Australian business leaders positive about the year ahead

There is a high level of optimism for 2023, with survey scores indicating that businesses expect conditions will return to the positive levels last seen in 2018. Expressed in net balance scores – the sum of positive and negative responses – the 2023 results were:

- **Overall business conditions: +19 net balance.** 49% of business leaders expect improving conditions, and 30% expect conditions to deteriorate. This is below expectations a year ago (+23), when Australia and many parts of the world emerged from tight activity restrictions. But it remains strong compared to long-term trends in general expectations.
- **Turnover: +51 net balance.** 67% anticipate increased turnover, and only 17% decline. This is the highest result since 2018, and indicates businesses expect the buoyant sales conditions of 2022 will continue into this year.
- **Employment: +46 net balance.** Despite the tightest labour market conditions since the 1970s, 46% plan to increase their employment in 2023. This score is comparable to the peak in expectations in 2018, albeit a time when the unemployment rate was 5.3% rather than 3.4% today.
- **Gross profit margins: +14 net balance.** 42% of businesses anticipate improved margins, while 29% expect them to stay the same and 29% predict deteriorating. While this net score indicates overall expectations for improved margins in 2023, it is still one of the lowest scores in the history of the survey.

Chart 2.2 Conditions expectations in the CEO survey, 2013 – 2023



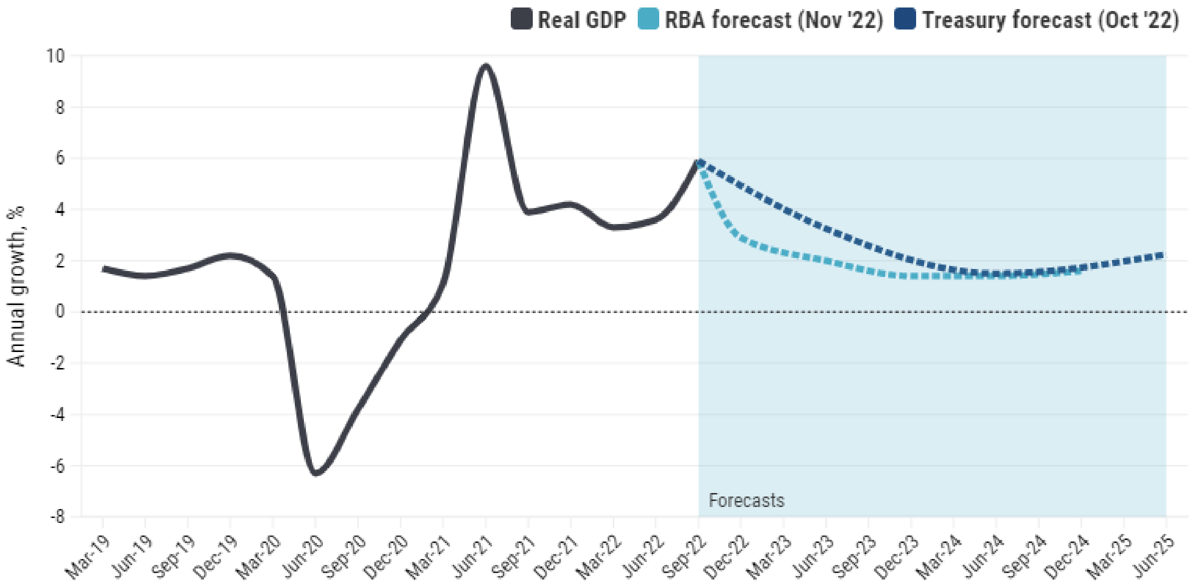
Source: Ai Group CEO Survey

This high level of optimism for 2023 is surprising, as it **runs against the grain of current forecasts** for the Australian economy. Both the Reserve Bank of Australia and the Treasury expect GDP growth to dramatically slow over the next two years, falling from current levels (5.9% y/y in the September quarter of 2022) to around only 1.5% by the middle of 2024. These forecasts are based on a combination of economic headwinds, including:

- **Slowing global growth,** as the post-pandemic recovery in services demand has run its course, record-high energy prices weigh on industry, and Chinese growth slows as it grapples with managing a transition out of COVID-zero settings.
- **Very high and broad based inflation,** which is greatly in excess of wage growth and is therefore eroding consumers' purchasing power.
- **Interest rate rises to fight inflation**, with Australia's cash rate rising from 0.1% in April to 3.1% in December 2022.

While official forecasts do not currently predict a recession in Australia, they also show that the buoyant macroeconomic conditions of the last year are unlikely to continue into 2023. Business leaders will need well-focused strategies to realise their expectations in a weakening economic environment.

Chart 2.3 Australian GDP growth and forecasts, 2019 to 2024-25



Source: ABS National Accounts, RBA SoMP, Treasury Budget Papers

Investment expectations for 2023

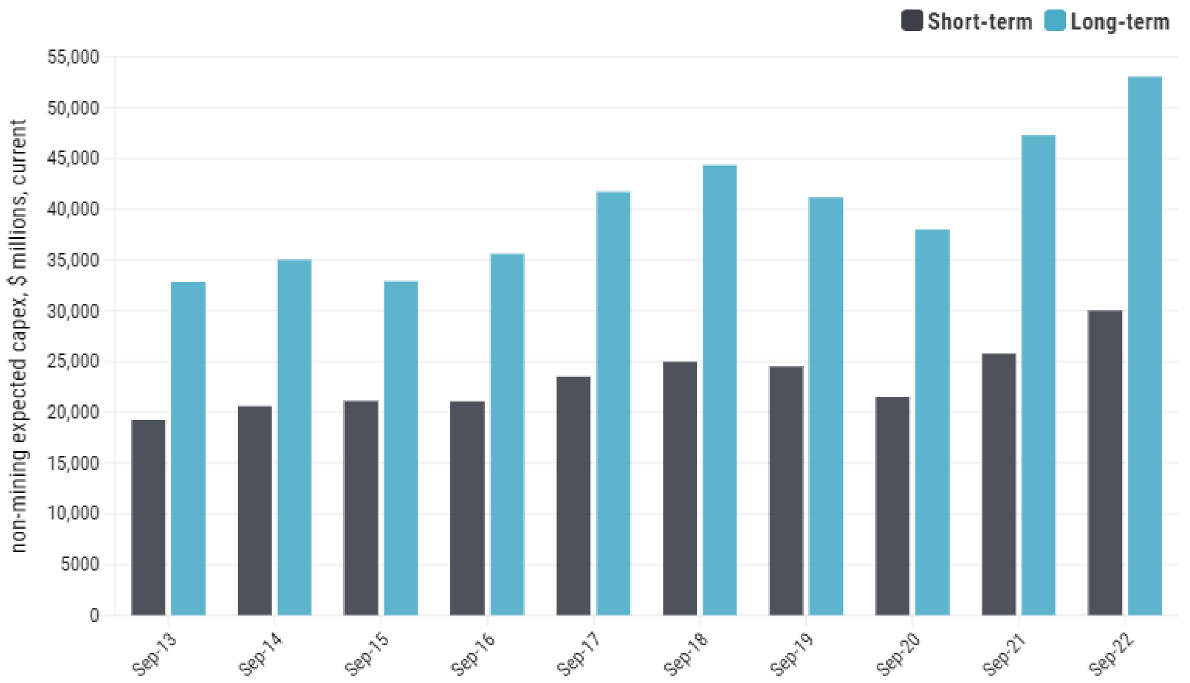
A strong investment pipeline, focused on workforce and technology

Given quite favourable expectations for 2023, many businesses have already begun **raising investment levels**. ABS data on expected private capital expenditure reveals progress in these investment plans (Chart 2.4). In the September quarter of 2022, non-mining businesses reported that they expected to make $30 billion of short-term and $54 billion of long-term capital expenditure[1]. These are **the highest non-mining capex expectations on record**, and a full 20% higher than the previous peak (in the corresponding quarter of 2018).

[1] Short-term capital expenditure measures the capex expected to occur in the next two quarters, and long-term capital expenditure measure that which will occur in the subsequent year (future quarters three through six).

These capex figures only measure physical investments – such as buildings, plant and equipment – and not the broader range of investments in intangible assets. However, they speak to the **significant investment commitments already** made on the back of strong expectations for 2022.

Chart 2.4 Non-mining expected CAPEX in Australia, Sep-2013 to Sep-2022



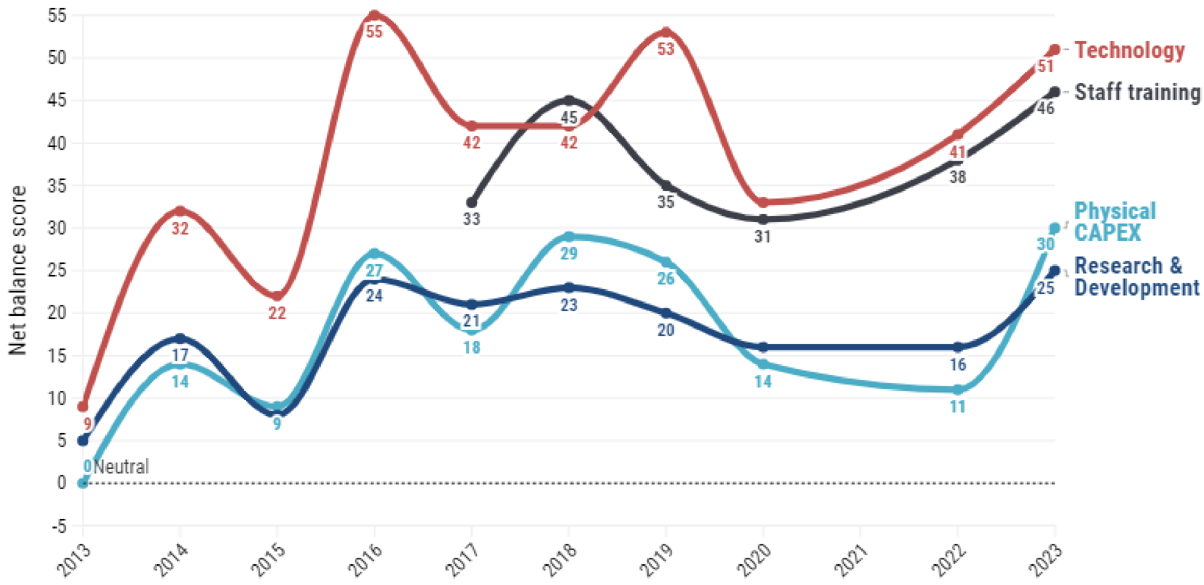
Source: ABS Private New Capital Expenditure and Expected Expenditure, Tables 2 & 3

The Ai Group CEO Survey provides detailed insights into how businesses are planning to focus these upgraded investment efforts in 2023:

- **Technology: +51 net balance**. Technology remains the highest ranked investment priority, with 56% of businesses intending to raise their spend in 2023 and only 5% cutting it. Investment intentions for technology have now recovered to their pre-pandemic peak.
- **Staff training: +46 net balance.** Half of businesses (50%) will increase their investment in staff training in 2023. Staff training is the second highest reported business investment priority, and at +46 the series is at an all time high. In the context of tight labour markets, businesses are expanding in-house training to fill skills gaps.
- **Physical capex: +30 net balance.** 38% of businesses plan to increase their physical capex investments, and another 54% plan to maintain 2022 levels. While physical capex ranks well behind technology and training, investment intentions in 2023 are at an all-time high.
- **Research & development: +25 net balance.** 33% of businesses plan to increase R&D, and another 59% expect to maintain it at 2022 levels. Despite this strong result, research and development has fallen to be the lowest investment prority as others have grown more.

Overall, these are the **strongest investment intentions** reported in the ten-year history of the Ai Group CEO Survey.

Chart 2.5 Investment expectations in the CEO survey, 2013 – 2023



Source: Ai Group CEO Survey

Price expectations for 2023

Inflation to continue for foreseeable future

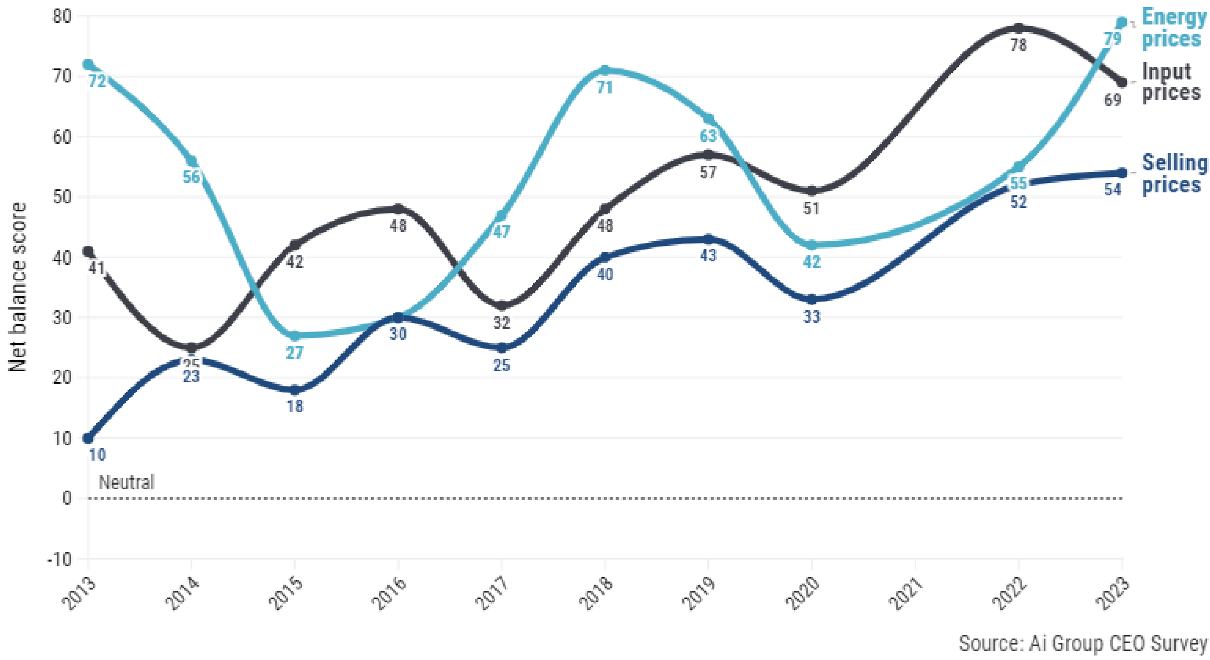
While business leaders expect the strong conditions of 2022 to continue into 2023, they also expect inflationary pressures to persist as well. The Ai Group CEO Survey found the highest expectations for price increases in its ten-year history:

- **Input prices: +69 net balance.** 74% of businesses expect input costs to rise, and only 5% anticipate they will fall. This is below the result for 2022 (+79), but is still highly elevated. It reflects the ongoing inflationary effect of supply chain disruptions.
- **Energy prices: +79 net balance.** 80% of survey respondents expect energy prices to keep rising across 2023, 18% to hold steady, while only 2% expect them to decline[2]. This is the the highest score in the history of the survey, and exceeds the peak (+72) seen during the last resource boom in 2013.
- **Sales prices: +54 net balance**. 61% of businesses plan to increase their sales prices, 33% expect no change and 7% anticipate falls. This indicator is also an all-time high, but remains below expectations for energy and input prices.

Expectations for continuing inflationary pressures have already been built into Australian business plans for 2023.

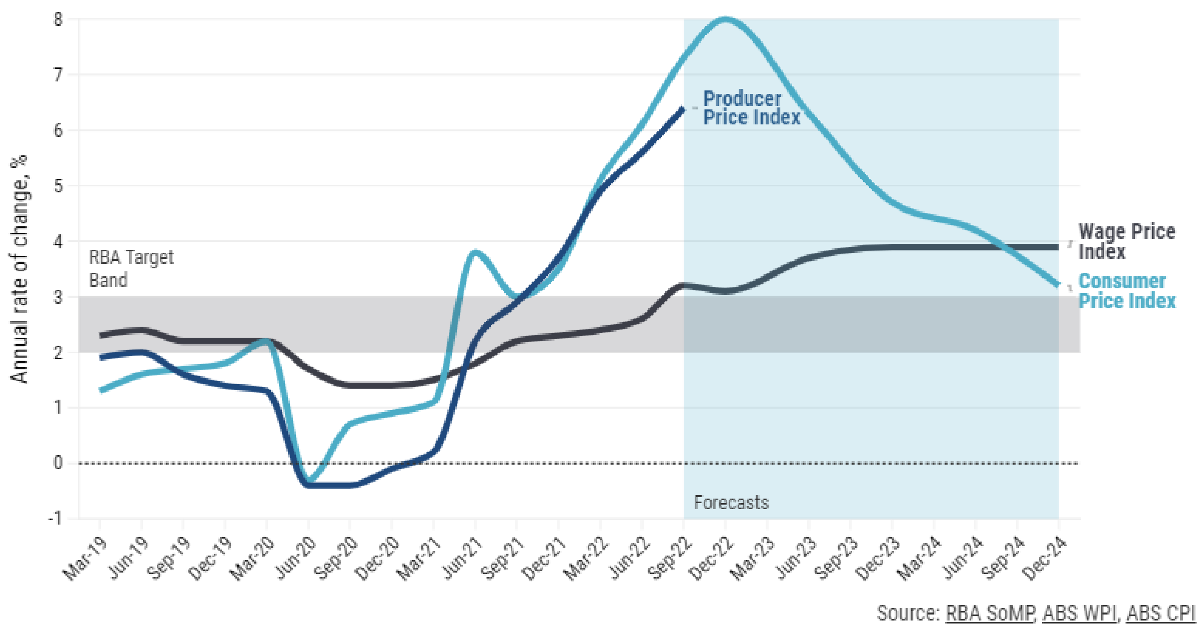
[2] It should be noted that the Ai Group CEO Survey was conducted in October and November 2022, prior to the Commonwealth Government's announcement of temporary prices caps on domestic coal and gas prices on December 9 2022.

Chart 2.6 Pricing expectations in the CEO survey, 2013 – 2023



Business expectations of ongoing inflationary pressures largely conform to official forecasts. According to the most recent RBA forecasts, consumer inflation (CPI) is expected to average 4.7% across 2023 – lower than 2022, but still well above the RBA's 2-3% target band for inflation. While the RBA does not forecast producer prices – the goods used by industry – they tend to follow the same track as CPI, at between half to one percentage point lower. The RBA also expects wage growth to accelerate, from 3.1% in 2022 to 3.9% this year – adding further pressures to business balance sheets.

Chart 2.7 Australian wage and inflation forecasts, 2019 to 2024



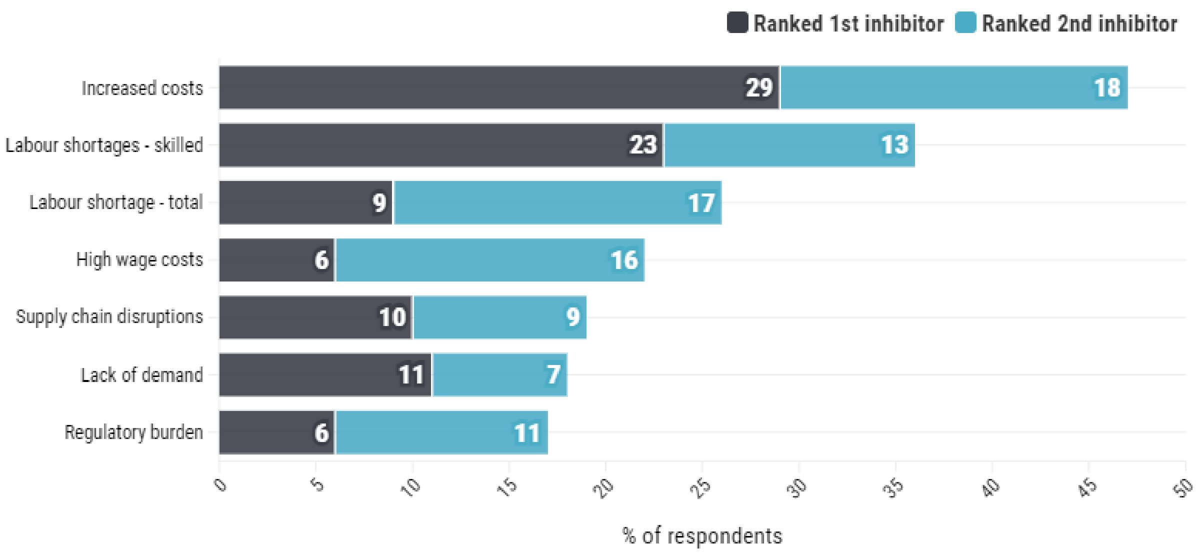
Business inhibitors in 2023

Inflationary pressures and labour shortages will inhibit business growth

The Ai Group CEO Survey asked business leaders what factors were most likely to inhibit their growth in 2023. Inflationary pressures, tight labour markets, and ongoing supply chain disruptions were identified as the greatest growth inhibitors in the year ahead:

- **Increased costs** were identified as the greatest constraint. This is the first year this factor was included in the survey, and it dominated responses with just under half (47%) ranking it their first or second inhibitor.
- **Skilled labour shortages** were the second highest constraint, identified by 36% of businesses. This reflects the growing number of skills gaps caused by very tight labour markets.
- **Overall labour shortages** – including both skilled and non-skilled labour – were ranked third at 26%. This suggests that labour shortages are now so acute they are affecting all occupational classes, not only skilled jobs.
- **High wages costs** were ranked first or second by 22% of businesses. This accords with forecasts that predict wage rates will rise by 3.9% next year.
- **Supply chain disruptions** were identified by 19% of businesses. This is a similar share to previous years and reflects expectations that supply chain disruptions are likely to continue.

Chart 2.8 Expected inhibitors to business growth, 2023



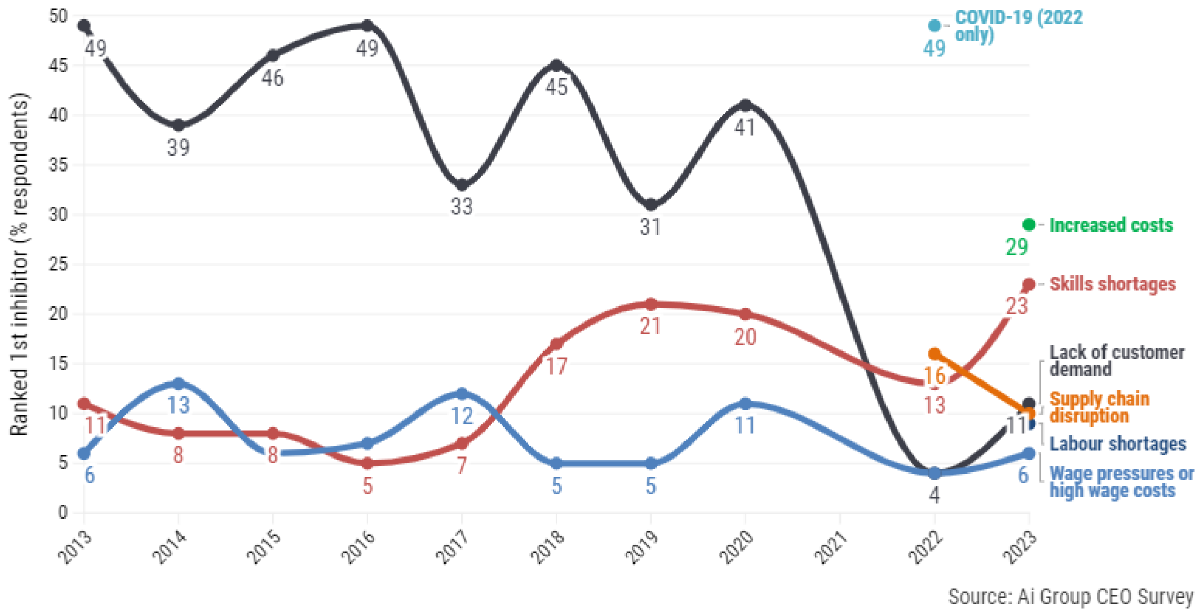
Source: Ai Group CEO Survey

*Percentage of respondents who ranked each factor first or second out of a list of possible inhibitors.

Importantly, there has been a **marked shift since the pandemic** in the constraining factors identified by businesses. Demand-side and regulatory factors have become relatively less important, while supply-side constraints have risen in importance.

Lack of customer demand has historically been the dominant inhibitor identified by businesses. In pre-pandemic years, between one-third and one-half of businesses identified it as their top concern, far more than any other factor (Chart 2.9). But in the buoyant post-pandemic conditions, it has now fallen to only be the sixth highest factor. Only 11% of businesses identify lack of demand as their top concern for 2023 – slightly higher than the 4% in 2022, but well below long-term expectations.

Chart 2.9 Expected inhibitors to business growth, selected factors 2013 to 2023



* Percentage of respondents who ranked each factor first out of a list of possible inhibitors.

Government regulatory burden has also fallen to be the lowest-ranked factor. Prior to the pandemic, between 10-15% of businesses consistently named it as their top inhibitor – this has now fallen to 6%. While this does not indicate that regulatory burdens have necessarily become lighter, it does suggest their impact is less in light of other more pressing growth challenges.

Inflationary pressures have become the dominant inhibitor of Australian business. 29% of businesses ranked rising input costs as their top inhibitor, and another 6% rising wage costs. A further 11% identified supply chain disruptions, which indirectly add to costs by inhibiting operational efficiency. Combating inflationary pressures will be critical to supporting business growth in 2023.

Tight labour markets are a close second. 23% of businesses ranked skills shortages as their top inhibitor, and another 9% identified general labour shortages. This is the first year we have asked about general labour shortages in the Ai Group CEO Survey, but the skills shortage result is the highest on record. Alleviating labour market pressures – at the skilled and general levels – will be equally important.

3. Investment priorities for 2023

Investments attempt to seize growth opportunities in a period of uncertainty

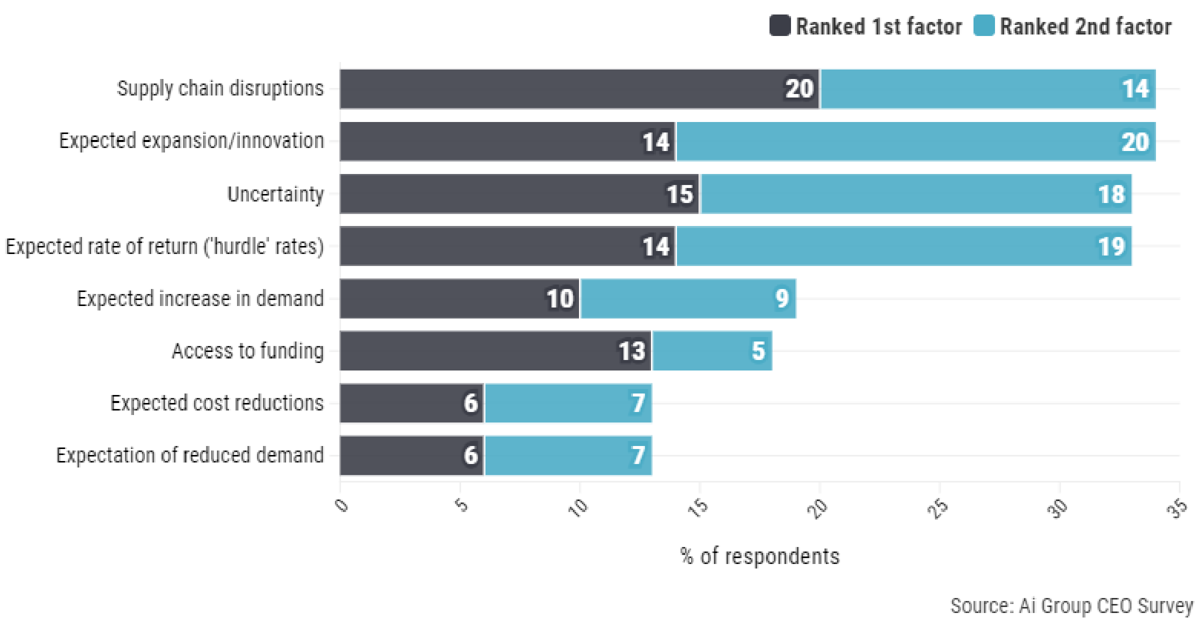
Investment plans for 2023 are carefully calibrated to address the challenges currently facing business. Respondents to the Ai Group CEO Survey identified four primary factors shaping investment decisions:

1. Ongoing **supply chain disruptions**
2. Expected **expansion and/or business innovation**
3. **Uncertainty** regarding future conditions
4. **Expected rates of return** on new investment

These factors were identified as a first or second ranking investment influence by around one-third of surveyed businesses. By contrast, **expected changes to demand** (either positive or negative), **access to funding,** or **cost reductions** were not ranked as having as high an impact on investment plans.

The focus on expansion in a context of disruption and greater uncertainty shows that while businesses are positive about the future, they are investing to **adjust their business models** to the new post-COVID operating environment.

Chart 3.1 Factors influencing investment in 2023



*Percentage of respondents who ranked each factor first or second, out of a list of possible type of factors.

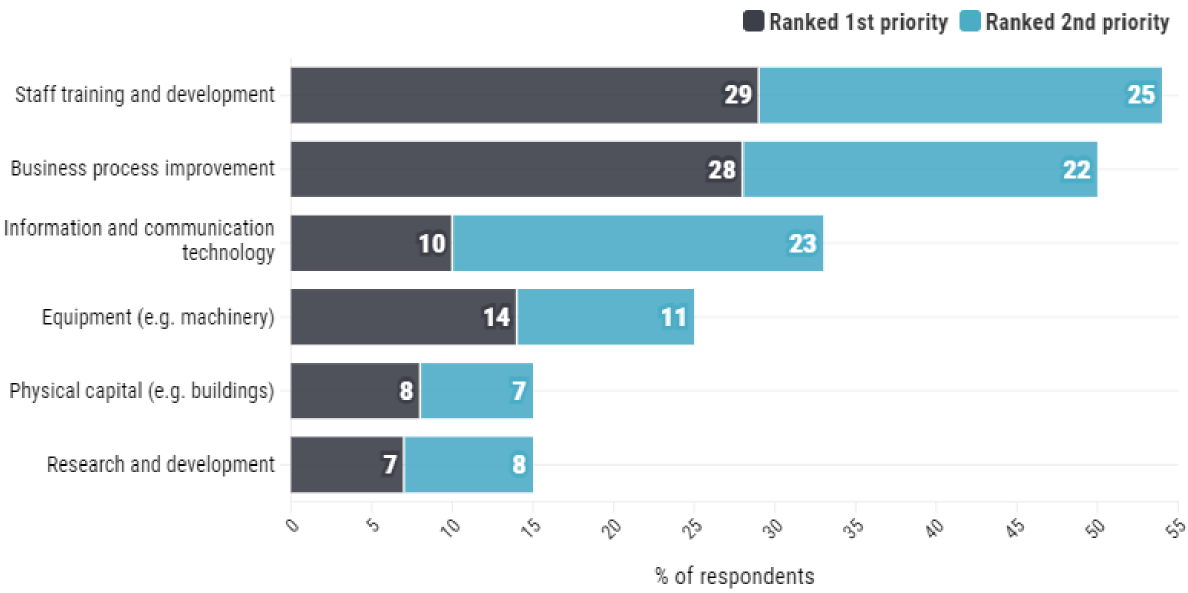
Staff training and development is the highest investment priority for 2023

The tightest labour market conditions since the 1970s have **sharpened the focus of investment budgets**. Only 8% of Australian businesses expect they will not be affected by staffing shortages in the coming year. As a result, workforce issues have been elevated to the top of the investment agenda.

A majority of businesses ranked **staff training and development** as either their first (29%) or second (25%) priority for spending. This reflects ongoing skills shortages, and the need to improve the quality of existing workforces rather than rely on new hiring.

Improving business processes was ranked second, while **ICT investments** were ranked third. While not strictly workforce, these investment priorities are very much related to skills shortages. Process improvement and ICT allows for a more effective deployment of a business's current workforce and helps adjust to conditions in which labour supply will remain constrained.

Chart 3.2 Investment priorities for business in 2023



Source: Ai Group CEO Survey

*Percentage of respondents who ranked each category first or second, out of a list of possible types of business investment.

By contrast, more 'traditional' forms of business investment were more-lowly ranked. Only a quarter listed **equipment investment** as a first or second priority, and 15% each for **physical capital** and **R&D.** The focus on building workforce capability ahead of physical investment is a further indication that labour will be the most-scarce resources in the Australian economy this year.

However, this redirection of investment towards workforce issues is not necessarily to be celebrated. It should be a **significant concern** that only one-sixth of Australian businesses rank R&D a top investment priority; and its low ranking is clearly due to the diversionary pull of tight labour markets. Relieving labour shortages will allow businesses to balance their investment mix more appropriately.

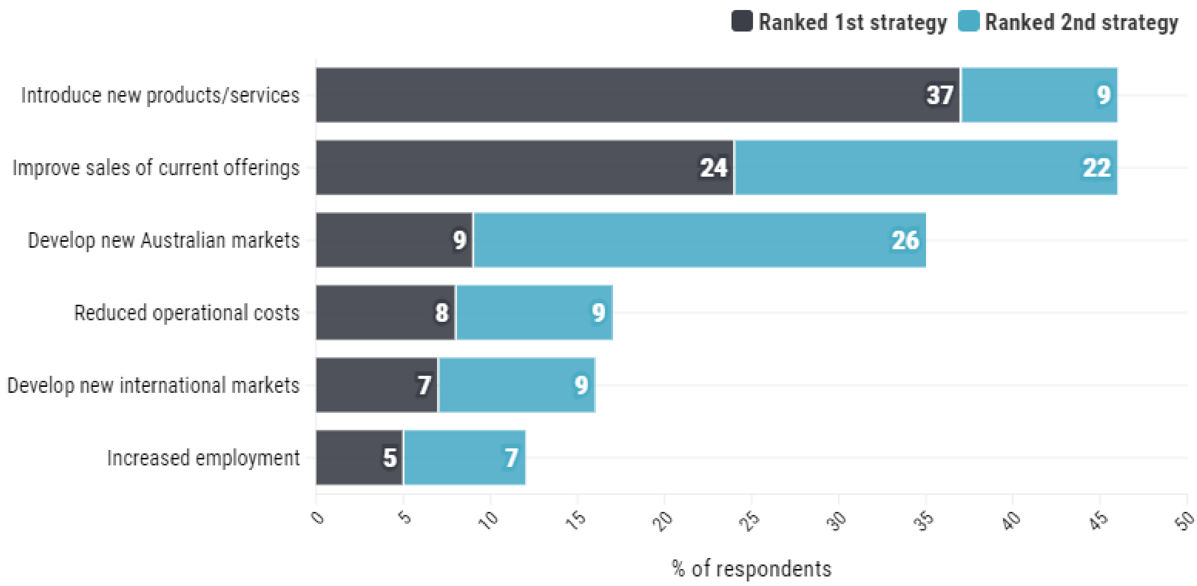
4. Business strategies in 2023

Improving the product and service offering is the focus for growth

In 2023, Australian business leaders plan to focus on their product offering as the key driver of growth. 46% consider **developing new products and services** their first or second growth strategy, while the same amount considers **improving sales of current offerings** important. This 'offering-led' growth strategy reflects efforts to adjust business models to the new market realities of the post-COVID era.

These strategies are very much focused on the domestic market. Some 37% of businesses identified **new Australian markets** as a priority, compared to only 16% for **international markets**. Freight costs and availability, exchange rate volatility and the increased uncertainty of international customer demand, make selling to local customers more appealing.

Chart 4.1 Business growth strategies for 2023



Source: Ai Group CEO Survey

* Percentage of respondents who ranked each factor first or second out of a list of possible inhibitors.

Reducing operational costs (17% first or second strategy) is ranked relatively lowly as a growth driver, suggesting that the focus in 2023 will squarely be on updating and improving the product offering. And a paltry 12% intend to grow through **increased employment**. 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.

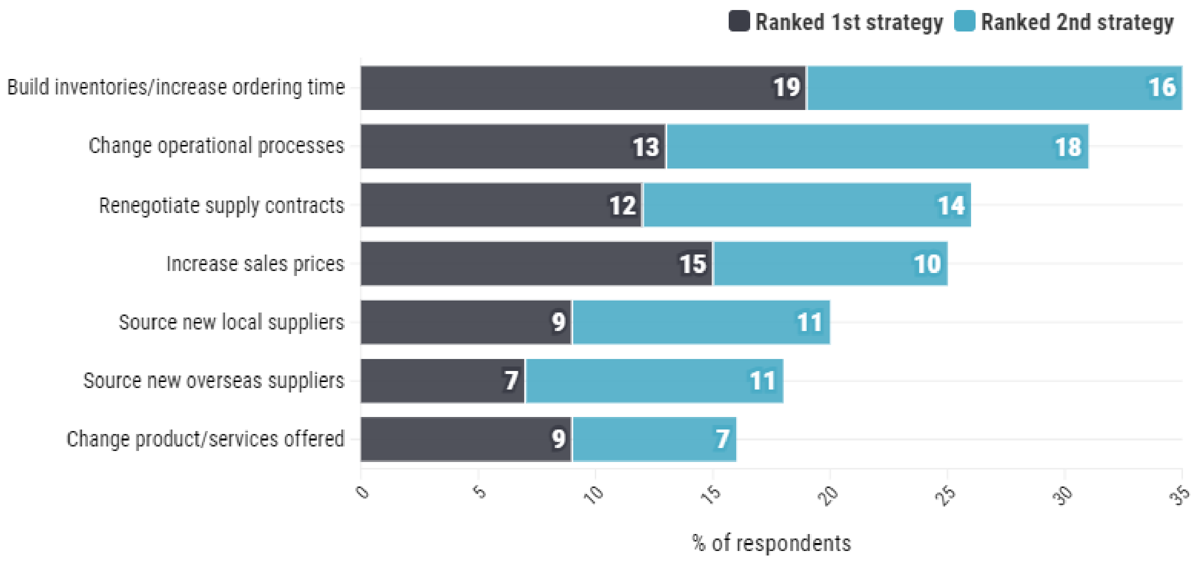
Businesses will manage supply chain risks through internal measures

78% of business leaders report being affected by supply chain disruptions in 2022, and 88% indicate they will take measures to reduce their vulnerabilities in 2023. In this year's Ai Group CEO Survey, we asked how businesses plan to address this ongoing challenge. In the main, businesses intend to focus on internal strategies to get a better handle on their supply chain risks.

The most common supply chain strategies include **building inventories/increasing lead times** (first or second strategy for 35% of businesses), and/or **changing operational practices** around supply chain management (31%). This reflects a recognition that supply chain disruptions will be an ongoing challenge, and that internal practices need to be optimised to reduce their effects on business operations.

A quarter of businesses intend to **increase sales prices** due to supply chain disruptions. This strategy reflects that these disruptions impose costs, in the form of operational delays and lost sales. But with 79% of businesses currently facing disruptions of some sort (Chart 1.8), the fact that only 25% expect to raise prices suggests that businesses are not confident these costs can be recovered from customers.

Chart 4.2 Supply chain strategies in 2023



Source: Ai Group CEO Survey

More significantly, one-sixth (16%) of businesses intend to **change their product offerings** to adjust to supply chain disruptions. While this is only a minority, it is also a significant step. In normal times, businesses would usually build their product offering around consumer demand patterns, not input or supply-side considerations. That such a proportion indicate this option speaks to the impact that supply chain disruptions are presently having on Australian industry.

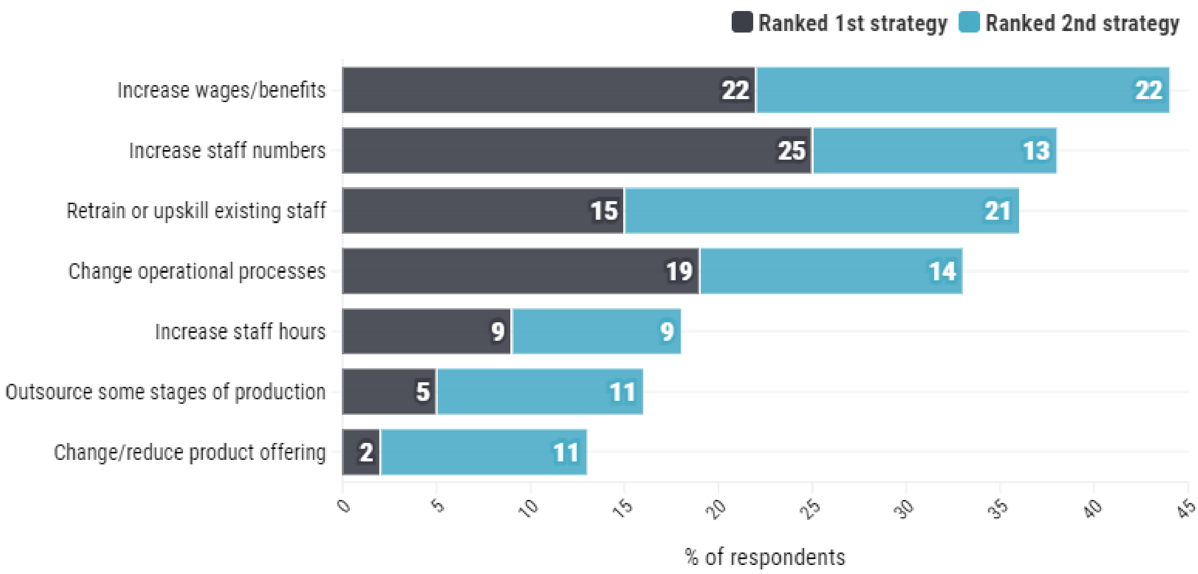
Staff shortages will impact almost all Australian businesses in 2023

90% of Australian business leaders expect to be **impacted by staff shortages** in 2023. Of these, 47% expect their business to be impacted to a great extent, and 43% to a small extent. Businesses across all industries expect to be impacted, with very little variation between different sectors.

With expectations that staff shortages will continue for the medium-term, businesses are adopting a three-pronged strategy to manage this chronic problem: wages, headcount and skills:

- Just under half (44%) intend to **increase wages and benefits** as their first or second strategy. In tight labour markets, the ability to offer attractive packages – including both remuneration and broader conditions – is key for attraction and retention.
- Just over a third (38%) will **increase staff numbers.** This is a type of 'latency' strategy – ensuring that overall headcount is sufficient to be able to cover shortages when they arise.
- Another 36% report **retraining or upskilling** as a staff shortage response. In-house skills development offers two benefits. It helps fill skills gaps without recourse to hiring, which has proven difficult in tight labour markets. It also aids with retention, as staff receiving training are less likely to leave an employer.

Chart 4.3 Strategies to manage staff shortages in 2023



Source: Ai Group CEO Survey

But staff shortages have gone beyond simply being a human resource problem. They are now also forcing operational changes to business models. 33% of businesses indicate they will **change operational practices to** adapt to staff shortages, 16% intend to **outsource some production**, and 13% will **change their product offerings**. While these were lower-ranked responses, the fact that a sizeable minority of businesses intend to make these changes speaks to the scale of the impact of staff shortages on Australian industry.

Appendix: Australian economic forecasts

The RBA offers the most recent forecasts for the Australian economy in its November *Statement on Monetary Policy*. Over the next two years it expects:

- **GDP growth to dramatically slow**, falling from 3.6% to 2.0% by the middle of 2023, and then to 1.6% by 2024.
- The **unemployment rate will fall** from 3.8% to 3.4% p.a. by the middle of 2023, before rising back to 4.0% during 2024.
- **Annual headline inflation** (CPI) will peak at 8.0% at the end of 2022, before gradually declining to 3.2% by the end of 2024. This remains well over the RBA's 2-3% 'target band'.
- **Wages growth** will accelerate from 2.6% to 3.7% in mid-2023, and then 3.9% by end of 2024.
- **Real household disposable income** will continue to contract for the next two years, as inflation will not fall below nominal wage growth until the second half of 2023.
- **Household consumption** and **public demand** will decline dramatically over the next two years, while **dwelling investment** will move into contraction.
- **Business investment** will remain robust and become the strongest component of GDP growth.

Table 1 RBA macroeconomic forecasts for Australia, November 2022

% change over the year	Jun 2022	Dec 2022	Jun 2023	Dec 2023	Jun 2024	Dec 2024
Gross domestic product (GDP)	**3.6**	**2.9**	**2.0**	**1.4**	**1.4**	**1.6**
Household consumption	6.0	6.6	2.8	1.3	1.4	1.7
Dwelling investment	−4.6	0.8	3.6	−2.8	−4.7	−5.6
Business investment	1.4	3.4	4.8	6.1	5.0	3.3
Public demand	5.7	3.7	0.2	−0.6	1.0	1.4
Gross national expenditure	4.4	4.3	1.5	0.7	1.4	1.5
Imports	10.0	16.6	6.4	3.9	2.8	2.0
Exports	4.9	7.8	8.4	7.0	2.8	2.6
Terms of trade	7.5	1.4	−13.7	−7.4	−6.0	−4.3
Real household disposable income	2.1	−2.6	−2.6	−1.2	0.3	2.3
Unemployment rate (qtr average, %)	3.8	3.4	3.5	3.7	4.0	4.3
Employment	3.3	3.8	1.4	1.2	1.0	0.9
Average wage rates (WPI)	2.6	3.1	3.7	3.9	3.9	3.9
Trimmed mean inflation (CPI)	4.9	6.5	5.4	3.8	3.4	3.2
Headline inflation (CPI)	6.1	8.0	6.3	4.7	4.2	3.2

= actual. = forecast. Source: RBA 'baseline scenario' in *Statement on Monetary Policy*, November 2022.

About the Australian CEO Expectations for 2023 Survey

Since 2012, Ai Group has annually conducted the *Australian CEO Expectations* survey. The survey asks leaders in Australian businesses regarding 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 2023 CEO Expectations Survey was administered in October and November 2022. Responses were received from leaders of 280 private-sector businesses across Australia. Collectively, these businesses employed 102,364 people (368 people in each business on average) and had an aggregate annual turnover of around $50 billion in 2022.

All Australian states, and all major non-farm private-sector industries, are represented in the 2023 CEO Survey. The manufacturing sector contributed the highest proportion of respondents (59%). The services sectors represented include: IT, communications & media services; transport, post & storage services; wholesale trade; retail trade; finance & insurance; real estate & property services; professional services; administrative services; health & welfare services; education; hospitality (food and accommodation services); arts & recreation services; and personal services.

Data presented in this report is weighted by sector (based on ABS estimates of their value-added contribution to GDP in 2021-22) in order to adjust for the characteristics of the sample.

Australian CEO Survey 2022	Manufacturing	Services	Construction & mining services	Total
Number of survey respondents	157	91	32	280
% of survey respondents	56.1%	32.5%	11.4%	100
Value-added output, % of GDP, 2020-21 **	5.5	52.6	7.1	65.2
Industry weighting (%)	8.4	80.7	10.9	100.0

*** Industries do not sum to 100% of GDP due to the exclusion of utilities (2.5% of GDP), public administration and safety services (5.2%), agriculture (2.2%), mining other than mining services (8.1% of GDP), ownership of dwellings (8.3% of GDP, taxes less subsidies on products (6.6% of GDP) and other additional statistical items that are included in GDP.*