Mid Market Pre-Budget Pulse Check 2023

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Foreword

In a challenging economic environment, it is encouraging to see that over half of Australia's mid-market businesses surveyed in the KPMG Enterprise Mid-Market Pre-Budget Pulse Check 2023 still forecast solid growth in the next three years.

Clive Bird
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KPMG Enterprise, KPMG Australia

But there is no denying that our report reveals lower business confidence both in terms of growth and wage rise forecasts, compared to last year.

The survey of 160 mid-tier business leaders, found that over half (55 percent) forecast growth of up to 5 percent over the next three years, with 23 percent of respondents predicting growth of up to 10 percent or even above. But a larger minority (45 percent, compared to 34 percent last year) said they were either neutral or pessimistic on growth projections.

And on wages, this year less than a third of leaders (30 percent) felt these would go up between 4-8 percent in the next three years compared to 44 percent last year. Over half (54 percent) felt wage growth would be below 4 percent and 16 percent said it would be essentially flat, below 2 percent.

This may be explained by the finding that the battle for talent, which a year ago was the stand-out concern, was this year pushed into second place by fears over costs and margin pressures. These were the top two issues by some distance ahead of concerns over inflation and interest rates – although these latter two issues are far more prevalent this year than in the 2022 report. In an environment of rising costs, living standards are likely to fall.

Even here though, there is some good news. Three quarters of business leaders felt their debt levels were manageable and less than a quarter felt interest rates were having a significant impact at this stage. This indicates a resilience about the mid-tier sector, even in challenging times.

Interestingly, when asked what would boost economic growth, the top answer (52 percent) was re-establishing critical manufacturing in Australia. With supply chain problems in the pandemic being so fresh in the memory, this was still listed as the fifth highest concern among our respondents this year. Taking into account current geopolitical concerns, this means that a drive towards re-establishing critical manufacturing domestically would be popular.

Tax reform came second (44 percent) with greater investment in training programs to address skills and labour shortfalls the third top choice (40 percent). A commitment to retaining the stage three tax cuts came in fourth (34 percent). This would make some contribution toward the rising cost of living.

Similar to last year, the great majority said it was time for the Federal Government to start repaying debts, with over half nominating economic growth and increased productivity as their preferred way to achieve this. More than a fifth (21 percent) opted for spending cuts and only 5 percent preferred higher taxes. This latter figure is even smaller than a year ago and proves once more that Australia's medium-sized business leaders have no desire for taxes to rise.

If forced to choose between higher tax options, the two most popular choices were, perhaps surprisingly, more targeted anti-avoidance measures, followed by higher GST, as we have seen in previous years. Over a third of respondents refused to countenance higher taxes at all. Tax reforms, rather than increases, need to come out of the 'too hard' basket sooner rather than later.

In terms of tax compliance, around half were concerned at the additional ATO compliance activity while the other half felt well-prepared. In our experience people aren't always aware of the ATO's growing expectations around Tax Risk Management and the fully documented frameworks that are needed to meet these ATO expectations. We also feel greater market attention is warranted on some current ATO focus areas such as tax planning and trusts.

We wait to see what the May Budget will bring. With resources squeezed, this may not be the time to expect too many carrots. But our survey shows that business leaders in the mid-tier sector, the backbone of the Australian economy, do not want too many sticks as they attempt to manage their way through difficult times and hopefully emerge stronger.

Introduction

About this report

KPMG conducted a pulse check survey targeted at mid-market clients to gauge economic sentiment and salient issues for their business before the 2023 Federal Budget is announced. Australia's mid market is often referred to as the 'engine room of the nation's economy'. This annual survey uniquely captures the perspectives of both business directors and decision-makers from a variety of industries. The results are a valuable indicator of mid-market clients' opinions concerning the current business and Budget environment.

Methodology

The survey was hosted and distributed by KPMG Australia via EDM (email), LinkedIn, the Building Better Business newsletter, and social media channels.

Directors and decision-makers of mid-market businesses were invited to participate in the survey. A total of 206 participants started the survey and 161 completed the survey. The majority of responses were from private companies within the Corporates sector *(Figure 1)*.

		CLIENT PROPORTIONS	# INDIVIDUAL RESPONDENTS
	Total Responses	**100**	**161**
BUSINESS TYPE	Private Company/Startup	57%	92
	Publicly Listed Company (ASX)	18%	29
	Family	13%	21*
	Not-for-profit/Government	12%	19*
INDUSTRY	Corporates	55%	88
	Financial Services	16%	26*
	Infrastructure, Government & Healthcare (IGH)	14%	23*
	Energy, Mining & Property (EMP)	15%	24*

Figure 1. Profile of client segments who completed the survey. Base n=161

**Sample of less than 30 means the results need to be interpreted as indicative only of these types of client segments.*

Overview of findings

1. More than half (55 percent) of mid-market businesses feel optimistic that they will see growth of at least up to 5 percent in the next three years. But this represents a fall in confidence on last year's survey when two-thirds (67 percent) felt optimistic about growth prospects. Over half (54 percent) predict moderate wage growth of up to 4 percent, while 30 percent believe wages will rise between 4-8 percent in the next 12 months.

2. Cost and margin pressure has edged ahead of the recruitment and retention of skilled staff as the biggest concern of business leaders, but these are still clearly the two major challenges. Rising inflation and interest rates are next on the list of issues for mid-market businesses.

3. Most mid-market businesses (75 percent) have a pragmatic view on their own debt levels being low or manageable if interest rates rise further in 2023.

4. In terms of boosting the economy, just over half of mid-market businesses (52 percent) think sector growth can be generated by the re-establishment of critical manufacturing in Australia. Major tax reform is the second most popular option.

5. There are mixed levels of concern in the mid-market sector on the influence of the ATO on businesses. Just over half of businesses (52 percent) claim to be prepared for any ATO review. However one-fifth (20 percent) believe now is not the time for the ATO to add further burdens to business.

Detailed findings

Economic sentiment

More than half (55 percent) of mid-market businesses feel optimistic they'll see growth in the next three years of up to 5 percent. This represents a decline since last year (67 percent in 2022 vs 55 percent in 2023) with an increase in businesses who feel neutral or pessimistic about the prospect of business growth *(Figure 2)*.

Figure 2: How mid-market businesses feel about the prospects of growth for the next three years

Q3. The economy is expected to slow this year. How do you feel about the prospects for your business for the rest of 2023 and for the next 3 years? Base n=161

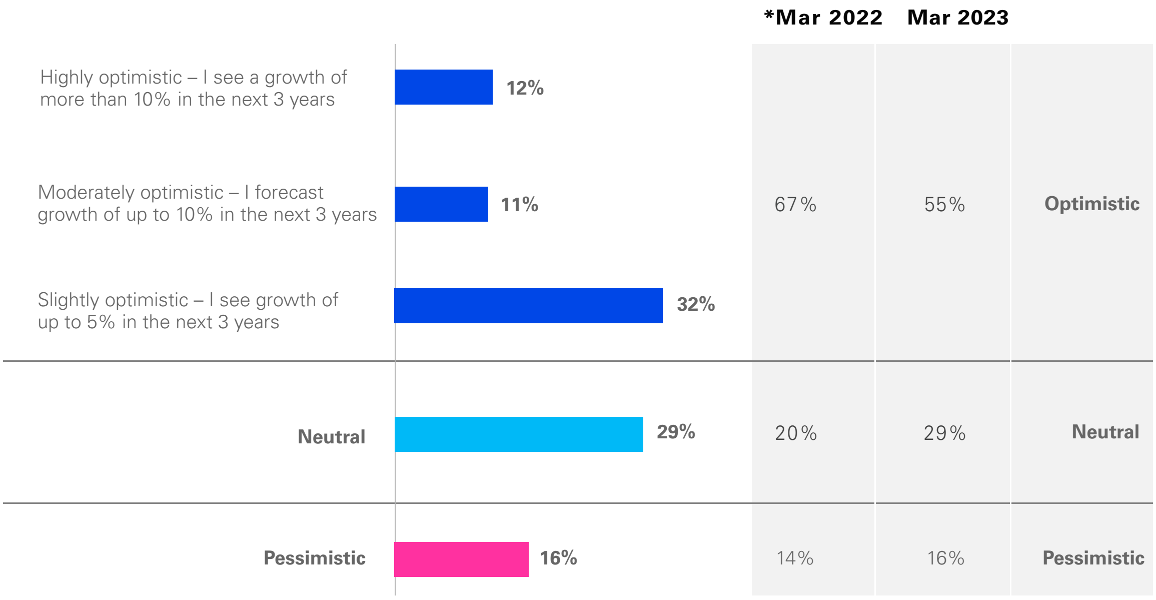
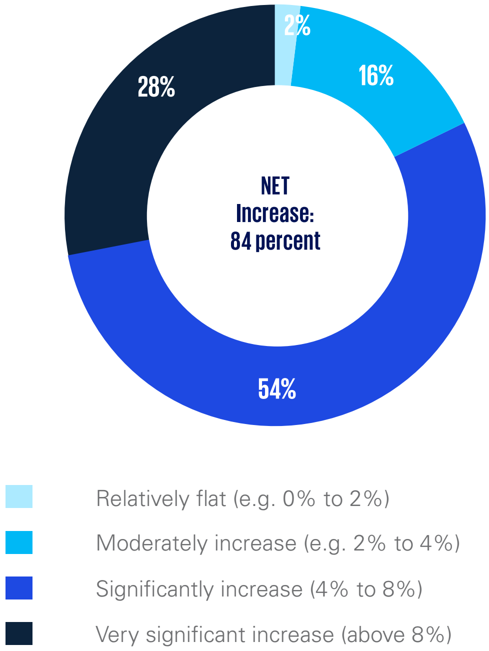


*Figure 2. *Differences in question framing and code options between 2022 and 2023 which were adjusted for to allow for comparability.*

In a challenging economic environment, over half (54 percent) of mid-market businesses are expecting a moderate increase in wages of 2-4 percent *(Figure 3)*. In comparison to last year, mid-market businesses are no longer as unified in expecting wage growth. In March 2022, 97 percent believed wages would increase, compared to 84 percent of businesses in March 2023. Most businesses in the IGH (70 percent) and EMP (63 percent) industries are expecting a moderate increase of 2-4 percent. Over a third (38 percent) of businesses in the Financial Services industry are expecting a significant increase in wages of above 4 percent.

Figure 3: Mid-market businesses expectations of wage growth in the next 12 months

Q4. Unemployment rates are at historically low levels and there are still skill shortages across various areas of the economy. Nominal wages are going up, but still below inflation, so real wages are falling. In respect of your business in the next 12 months, do you expect wages growth: Base n=161

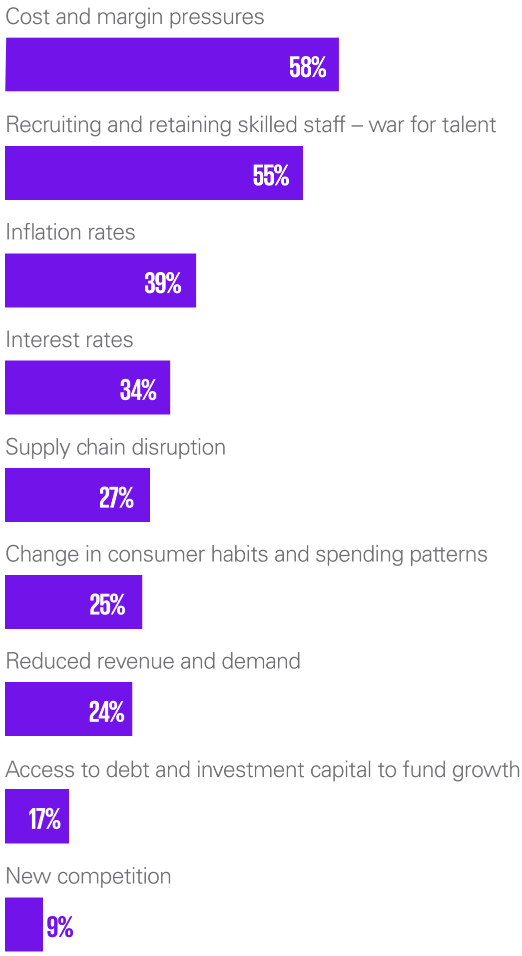


Business and sector challenges

The two top challenges for mid-market businesses in the next 18 months are again cost and margin pressure and the recruitment and retention of skilled staff *(Figure 4)*, although they have switched round in priority order. Cost and margin pressure is a challenge for an overwhelming number of businesses in the Corporates sector (65 percent), as is consumer spending habits (38 percent). Rising inflation and interest rates are secondary challenges for all mid-market businesses.

Figure 4: Mid-market top business challenges for the next 18 months

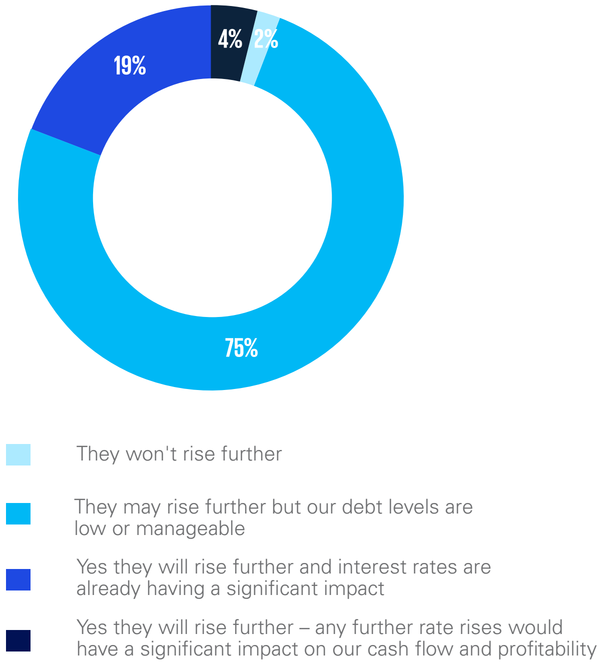
Q5. From your perspective, which of the following are the biggest challenges for businesses over the next 18 months? Multi response. Base n=161



The majority of mid-market businesses (75 percent) have a pragmatic view on their own debt levels being low or manageable if interest rates rise further in 2023 *(Figure 5)*. The attitude is held by a higher portion of businesses in the Government and not-for-profit (84 percent) and EMP (88 percent) industries. Nearly three-quarters (23 percent) of private companies said that interest rates are already having a significant impact.

Figure 5: Mid-market business perceptions of impact interest rate rises will have on their business in 2023

Q6. Do you think interest rates will rise in 2023, and if so, how would this affect your business? Single response. Base n=161

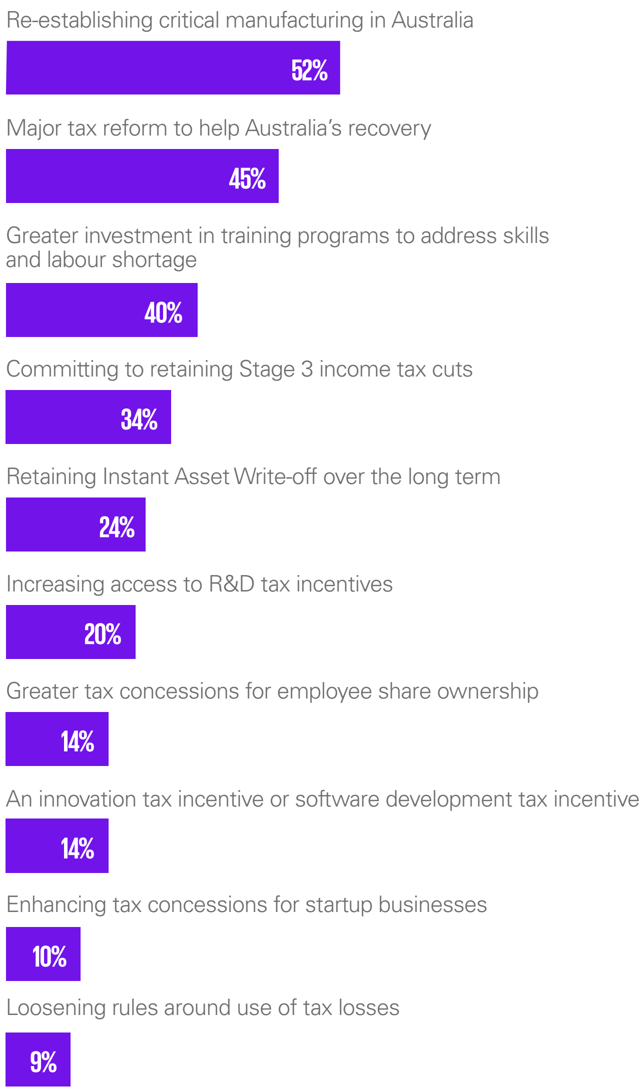


> **"We need to work on efficiency and productivity, vs just raising taxes. Taxes are already incredibly high (when all added up) and this just increases the cost of doing anything and it just cycles. How as a country can we be more efficient and cost effective in all that we do?"**
>
> SURVEY RESPONDENT - PRIVATE, MANUFACTURING, CONSTRUCTION, TRANSPORT, LOGISTICS BUSINESS

Just over half of mid-market businesses (52 percent) think sector growth can be boosted by the re-establishment of critical manufacturing in Australia and 45 percent supporting major tax reforms *(Figure 6)*. A smaller proportion of businesses in the Government and not-for-profit industry endorse tax reform (32 percent). Compared to last year, tax reform has slipped down in priority for some businesses (March 2022 61 percent compared to March 2023 52 percent).

Figure 6: Mid-market businesses Budget preferences for boosting growth

Q7. If finances allowed, which of the below measures would you like to see in the Budget to boost growth in the mid-market sector? Please select up to 3. Base n=161



Debt repayment and taxation attitude

With the rise in interest rates, most mid-market businesses (81 percent) believe it is time the Government focuses on significant debt repayment, with over half (55 percent) wanting the debt to be managed through economic growth and increased productivity *(Figure 7)*. In comparison to 12 months ago, there has been an increase in businesses who want government to introduce spending cuts (March 2023 21 percent vs March 2022 14 percent) rather than tax increases (March 2023 5 percent vs March 2022 12 percent).

If tax increases were applied by the Government, mid-market businesses typically think that the most effective approaches would be more targeted anti-avoidance very closely followed by an increase in GST *(Figure 8)*. This may be partly driven by a perception that anti-avoidance is always an issue for others while GST is a matter for consumers. Businesses in the Financial industry are more likely to endorse targeted anti-avoidance (73 percent), while most businesses in the EMP industry (67 percent) endorse increasing GST. Overall the survey reveals that there is no meaningful support for any increase in business taxes.

Figure 7: Mid-market businesses attitudes toward the need for government debt repayment

Q8. Given rising interest rates and a slowing economy, is now the time for the government to focus on significant debt repayment? And how do you believe that debt can best be repaid? Single response. Base n=161

> **"The whole tax structure in this country both federal/state and local should be reviewed, restructured and simplified but with strong anti-avoidance provisions and then consistently applied so business and government can complete strategic longer-term planning with certainty."**
>
> SURVEY RESPONDENT – PUBLIC LISTED, HEALTH, AGEING & HUMAN SERVICES BUSINESS

Figure 8: Mid-market businesses preferences around potential tax increases

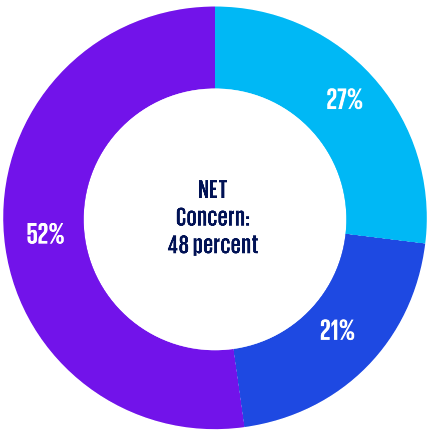
Q9. Which of the following tax increases do you think would be most effective? Multi response. (2 responses only). Base n=161

The ATO has increased its compliance activity in recent years with a heavy focus on its Top 500 and 'Next 5000' programs. This is a concern for nearly half (48 percent) of mid-market businesses *(Figure 9)*, with one-fifth (20 percent) who believe it is not the time to add further burdens to businesses. Half of mid-market businesses (52 percent) claim to be prepared for any ATO review.

The ATO has been specifically targeting the use of trusts by business groups, but this is not a concern for the vast majority (88 percent) of mid-market businesses *(Figure 10)*. For a small portion of businesses (12 percent) they perceive a noticeable toughening by the ATO in the approach to trusts and tax planning, particularly businesses in the Financial Services industry (23 percent). A high proportion of Family businesses (62 percent) are confident in their structures and advice and are not concerned about the ATO's focus on trusts. Time will tell whether this high level of confidence is well founded.

Figure 9: Mid-market preparedness for increased ATO audit activity

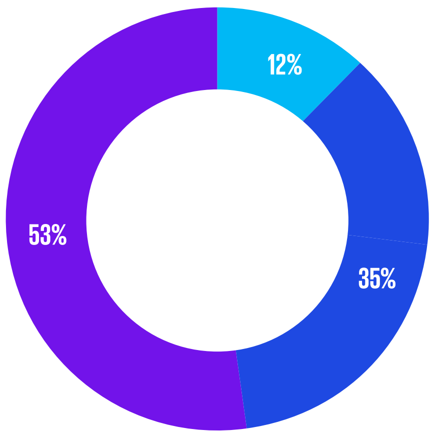
Q10. The ATO has increased its compliance activity in recent years with a heavy focus on its Top 500 and "Next 5000" programs. Are you concerned about the prospect of increased audit activity? Base N=161



- Yes, a potential downturn is not the time to add further burdens on business
- Yes, but additional compliance activity is inevitable
- No, we are well prepared for any ATO review

Fig 10: Mid-market businesses level of concern around ATO targeting the use of trusts by business groups

Q11. The ATO has been specifically targeting the use of trusts by business groups. Is this a concern for your business? Base N=161



- Yes, there has been a noticeable toughening of ATO approach to trusts and trust and tax planning
- No, we are confident in our structures and advice and are not concerned about the ATO's focus on trusts
- No, we don't use them

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