



Economic Influences

The broader market and its potential impact on insolvency levels

- The Reserve Bank of Australia (RBA) left the cash rate on hold in March at 2.25%, with the Board deciding that the recent easing warranted keeping rates steady for the time being. It noted that further cuts would be considered if appropriate to “foster sustainable growth in demand and inflation consistent with the target.”
- The Westpac Melbourne Institute Index of Consumer Sentiment fell by 1.2% in March to 99.5 from 100.7 in February. A softening of the Index had been expected following February’s rate cut by the RBA. The Index remains in line with levels seen prior to the May budget last year.
- National Australia Bank’s (NAB) Monthly Business Survey for March showed some tentative signs of improvement in business conditions and confidence, with the post RBA cut fall in confidence reversed in March. The lift was largest in mining, although confidence in that sector remains below all others. Business conditions posted an improvement in March across each component (trading, profit, and employment).
- The performance of the construction sector increased in March, with Australian Industry Group’s (AIG) Performance of Construction Index (PCI) increasing by 6.2 points to 50.1 points (50 points separates expansion and contraction). The services sector expanded again in March but at a slower pace, with the PSI at 50.2 points, down 1.5 points. Manufacturing recorded a fourth month of contraction, with the PMI at 46.3 points, up 0.9 points.
- Unemployment fell in March to 6.1% (seasonally adjusted), Australian Bureau of Statistics (ABS) data showed. Meanwhile, job advertisements fell 1.4% in March after nine consecutive months of rises, according to ANZ data. A fall in internet and newspaper job ads was seen as the driver of the falls. It was the first monthly fall in internet job ads since May 2014.
- ABS data showed new car sales in March were up an upwardly revised 0.7% (seasonally adjusted) from the previous month with 96,345 new car sales. Sales were up 4.4% on the corresponding period last year.
- National building approvals rose by 2.8% in March to a seasonally adjusted 19,419, following a 1.6% fall in the previous month. This represented a 23.6% increase on the same period last year.

Special Focus Q&A: Australian Professional Services Trends

With Ian Francis, Senior Managing Director, Corporate Finance/Restructuring

Where is the professional services industry at right now?

The professional services industry has gone through change in recent years, and continual change has now become the norm. It has also grown into a mature industry, certainly for the more traditional service areas such as accounting, legal, consulting and engineering. This has presented challenges for professionals operating in these fields as they aim to remain competitive and relevant in their respective markets.

It is important to recognise that service-based businesses are demand-led. When business confidence and economic conditions are on the rise, overall demand for services increases, leading to growth in the industry. Some areas have performed well in recent years; for example, those providing services on the back of the strength of mining investment have experienced strong demand and fared well. However, changing markets and softer economic conditions means many of those businesses are now facing difficulties.

What has been driving change in the industry in recent years?

In a mature industry, maintaining historic growth levels becomes more difficult. This is true even during buoyant economic times. Professional services companies will need to increase their market share in order to outpace their competitors. Alternatively, companies need to find new areas for revenue growth via expanding the addressable market for their skill sets. While neither method is easy to successfully execute, the overall result is that the industry has increasingly become more competitive.

How has this increase in competition come about?

For the professional services sector, the barriers to entry are low. It is not hard to set up your own business and it is not uncommon to see partners and directors of larger firms leaving these firms to form their own smaller boutiques, often taking clients and relationships with them.

Advances in technology have meant that there are fewer geographical barriers for service providers. Globalisation has added to the level of competition and the ability to work remotely from any location has also played a part. In any given service area there are more competitor firms that three to five years ago did not exist in their current form. Law firms are a good example, with many of the big global players now having a presence in Australia as they look to leverage their global contacts and skills across the Asia Pacific region.

In general, corporate clients' demands on the quality of services delivered are higher today. Clients have access to information and are better informed. Combine this with multiple service providers pitching for the same work, and an environment is created where clients have more options and buying power. Increased competition in the professional services industry has led to a pressured price environment for businesses.

What should professional services firms be focusing on for success?

The consequence of increased competition as mentioned above, also leads to downward pressure on revenue and profit means professional services businesses have started looking at ways they can differentiate themselves and leverage their branding, knowledge and expertise in different ways and in non-traditional markets.

While there are going to be factors pertaining to individual businesses, all professional service firms need to focus on their clients and their own people.

While quality work and technical competence is fundamental to any professional service business, they must provide a quality service in order to gain clients trust. This requires trained and experienced staff and a strong workplace culture. These attributes can help firms differentiate themselves in a highly competitive industry.

What role does strategy play in professional services?

Strategy is arguably the most important role in any professional service business as the plan underpins the services provided, and how it will be implemented. To execute on the strategic plan, it is important to be adaptable and agile as markets are dynamic, not static. If professional services companies are focused on what clients are looking for and what they value, it can help them to set their strategies accordingly.

In addition to client focus, what other areas should professional services firms be aware of?

Business succession and planning is important but it is often thought of as a longer term issue and forgotten. Succession is important for smaller firms that are highly dependent on just a handful of experienced people.

Managing work in progress and uneven workloads can be tricky particularly in an industry relying on project-based work. When staff aren't being fully utilised, it can have cash flow implications. It can be difficult to readily scale labour needs for highly skilled industries.

Concentration risk is prevalent, particularly among many mining services industries, but it does happen in other industries. Reliance on a couple of key customers can have a huge financial impact if a project is cancelled or delayed, or a competitor starts to make inroads into the account by offering different services. The reasons might have no correlation to the quality of work performed. This is happening in mining services, where mining companies are focussing on reducing supplier costs.

Other focus areas include retaining talent and key staff, sharing knowledge, having effective governance, compliance and customer relationship management systems, and managing legal and regulatory changes.

The professional services industry can no longer rely on doing business the way it was done ten or even five years ago. To be successful in today's market, businesses need to acknowledge that conditions are always changing. They must recognise this and be adaptive and accommodating.

Outlook

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- The RBA Board left rates unchanged in April, but voted in May to cut rates by 25 basis points to 2.0%. The RBA pointed to weakness in business capital expenditure in all sectors, as well as public spending, in the year ahead. It said lower interest rates are acting to support borrowing and spending and credit is recording moderate growth overall. Notably, RBA Governor Glenn Stevens told the meeting that the inflation outlook meant there was a possibility of further easing in the future.
- The RBA's rate cut and the Federal Budget saw the Westpac Melbourne Institute Index of Consumer Sentiment rise 6.4% to 102.4 in May, with optimists outnumbering pessimists, albeit marginally. It was the first positive reading since February this year and the highest level of the Index since January 2014. Prior to the Budget, in April the Index fell 3.2% to 96.2 from 99.5 in March.
- NAB's monthly business survey for April showed business conditions fell slightly with the Index at +4 points from +6 in March. NAB commented that lower interest rates were having a "notable impact on the most sensitive sectors of the economy like investor housing." Business confidence was mostly unchanged at +3 index points in April, with a broad based improvement in confidence across most industries.
- Construction, manufacturing and services sectors all recorded softer conditions in April. AIG's Performance of Construction Index (PCI) declined by 3.1 points to 47.0 points in April. This indicated an overall contraction in industry conditions following signs of a mild recovery in March. The services sector's PSI swung to a contraction in April, declining marginally by 0.5 point to 49.7 points. The manufacturing PMI contracted for the fifth month in a row, but showed an improvement, moving up 1.8 points to 48.0.
- The jobless rate edged higher in Australia in April, following two strong months of employment data in February and March. The seasonally adjusted unemployment rate for April increased 0.1 percentage points to 6.2%, versus 6.1% for March.
- Job advertisements swung to an increase in April after falling for the first time in nine months in March. Job advertisements increased 2.3% driven by internet job ads. Jobs ads are now at the highest level seen in 2.5 years.
- Sales of new motor vehicles fell 1.5% in April month-on-month, seasonally adjusted, to 94,888.

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