National Australia Bank

Quarterly SME Survey

March quarter 2013

SME confidence & conditions edge higher in March quarter but still near post-GFC lows; SMEs more pessimistic than larger firms and activity also more subdued. Capacity utilisation falls to lowest level in history, despite tick up in forward orders. Signs lower borrowing rates are helping interest rate sensitive sectors but offset by weakness elsewhere.

- SMEs business confidence improved only marginally in the March quarter and remained very poor relative to history and relative to levels reported by larger businesses in the NAB Quarterly Business Survey. SMEs appear less responsive to recent improvements in external factors, including equity price rises and easing European crisis concerns. SMEs are probably more affected by actual activity in their business, which remained subdued in early 2013.
- SME business conditions were slightly better in the March quarter, though remained very poor overall. However, changes in activity varied notably across industries. It appears that lower borrowing rates may have provided some support to interest rate sensitive sectors in early 2013 – property, finance services, construction and manufacturing – but this was broadly offset by weakness elsewhere. Business conditions weakened a touch in the mining states, a sign that the slowing in mining investment may be causing a widespread softening in activity in these regions, while they strengthened solidly in SA, albeit remained weak overall.
- Capacity utilisation slumped to the lowest level in the short history of the survey, despite an improvement in forward orders. Nonetheless, forward looking indicators remained subdued and still below weak levels reported by larger firms.
- By industry, confidence lifted strongly in finance and business services, likely in response to strong equity market performance and improved financial conditions, while it weakened considerably in property services, from a high level, and fell to depressed levels in retail. By state, confidence deteriorated modestly in the two largest mining states – WA and Queensland; while mining firms are not captured by the SME survey, the approaching peak in mining investment growth is likely to indirectly affect SME activity. Overall confidence was strongest in WA and by far the weakest in Queensland.
- The improvement in business confidence in the March quarter was entirely driven by high-tier SMEs ($5-10m p.a.), which were the least pessimistic of all SMEs; confidence of low-tier SMEs ($2-3m p.a.) was unchanged, while mid-tier SMEs ($3-5m p.a.) were marginally more pessimistic. Business conditions improved for low-tier SMEs and were unchanged elsewhere. Conditions were least subdued for high-tier SMEs and weakest for mid-tier SMEs.
- Responses to a special question suggest that two thirds of SMEs continued to improve or develop their websites in order to boost firms' competitiveness over the past 12 months, while more than half of firms launched new products to try to strengthen their position among their competitors.

Key quarterly business statistics**

	2012q1	2012q4	**2013q1**
	Net balance		
SME business confidence	-5	**-8**	**-6**
Low	-6	**-7**	**-7**
Mid	-2	**-6**	**-7**
High	-4	**-8**	**-4**
SME business conditions	-4	**-7**	**-6**
Low	-5	**-9**	**-7**
Mid	-4	**-9**	**-9**
High	-3	**-4**	**-4**
SME cash flows (n.s.a.)	-5	**-2**	**-6**
Low	-10	**-4**	**-13**
Mid	-7	**-10**	**-9**
High	-1	**5**	**-1**

	2012q1	2012q4	**2013q1**
	Net balance		
SME trading conditions	0	**-3**	**-7**
Low	-3	**-9**	**-11**
Mid	-2	**-5**	**-12**
High	2	**2**	**-2**
SME profitability	-6	**-11**	**-9**
Low	-9	**-13**	**-8**
Mid	-7	**-11**	**-14**
High	-5	**-11**	**-6**
SME employment	-4	**-5**	**-4**
Low	-4	**-5**	**-5**
Mid	-4	**-9**	**-4**
High	-4	**-3**	**-3**

Low: $2-3m p.a. Mid: $3-5m p.a. High: $5-10m p.a.

** Data are seasonally adjusted by NAB, except SME cash flow (insufficient time series available). All data are net balance indexes. Fieldwork for this Survey was conducted from 25 Feb to 13 Mar 2013 covering almost 700 SME firms across the non-farm business sector.

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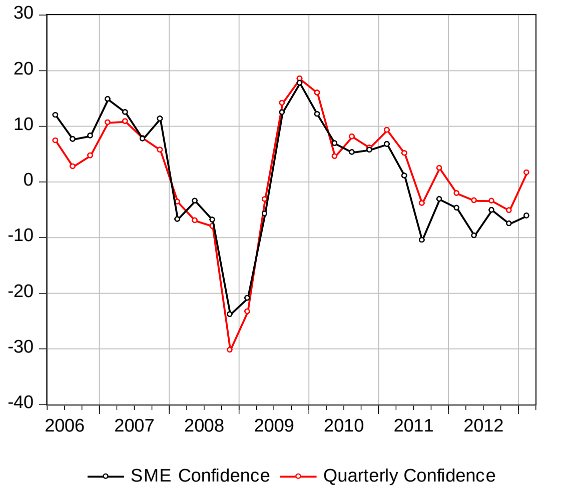
Next release:
13 May 2013 (April Monthly)

Analysis

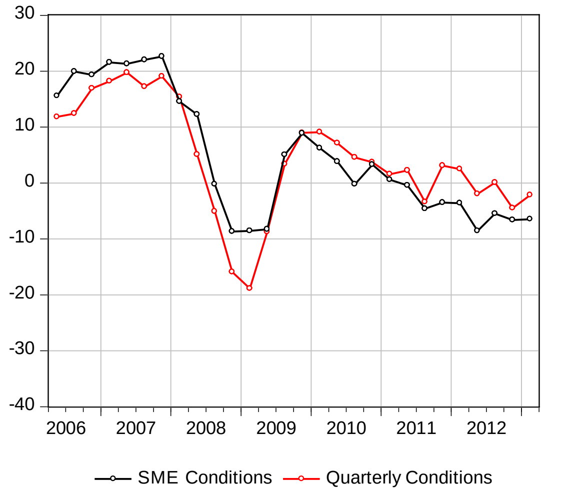
Confidence edges up but not as pronounced as for larger firms

Business confidence (net bal., s.a.), SME & quarterly



Conditions marginally better but still subdued

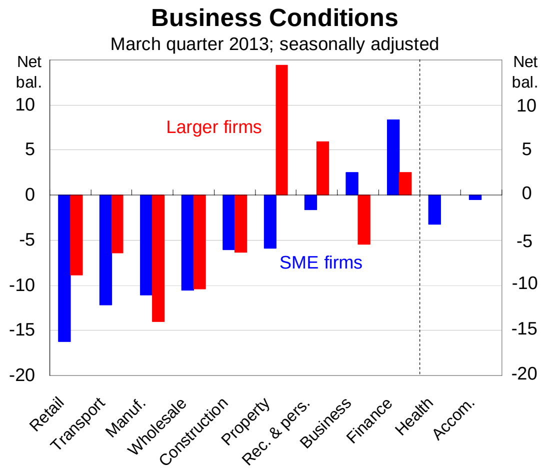
Business conditions (net bal., s.a.), SME & quarterly



SME business confidence improved only marginally in the March quarter – up 2 points to -6 points – and remained very poor. While smaller firms have tended to be less optimistic than their larger counterparts for the past three years, the divergence between confidence readings of SMEs and their larger counterparts widened considerably in the March quarter, highlighting the relative pessimism held by smaller sized firms. The relatively poor sentiment reading for smaller firms is consistent with the relative weakness in business conditions, forward orders and capacity utilisation. While it is possible that some unwinding of external risks since the end of 2012 – including the US fiscal cliff and concern about a Euro crisis – have positively affected confidence of smaller firms, the still high AUD and uncertainty about the consequences of the ending mining investment phase are likely to be worrying firms. High-tier firms became notably more confident, while confidence was broadly unchanged for low and mid-tier firms.

SME business conditions improved only marginally in the March quarter – up 1 to -6 index points – and remained well below the series average (of +5 points since mid-2006). It appears that lower borrowing rates may have provided some support to interest rate sensitive sectors in early 2013 – property, finance services, construction and manufacturing – but this was broadly offset by weakness elsewhere. While lower borrowing rates may help to boost activity further in coming quarters, it appears that either lower interest rates need more time, or more stimulus (eg. RBA rate cuts) is needed to build positive momentum in the economy. Business conditions of larger firms improved modestly and are stronger than their smaller counterparts.

All consumer & trade dependent firms depressed; small finance very weak relative to large firms

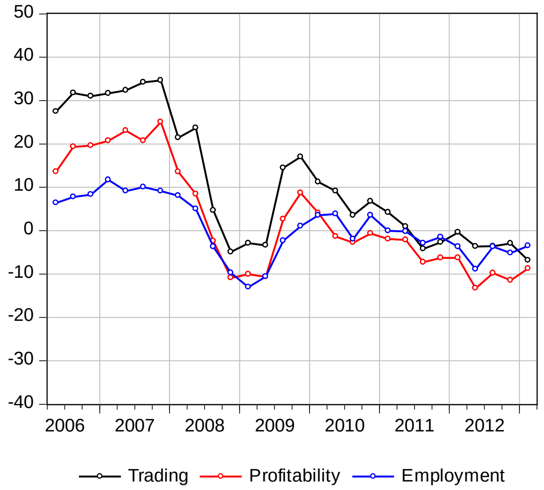


A comparison of industry conditions for SMEs and larger sized firms (taken from NAB's Quarterly Business Survey) suggests that there was only marginal variation between conditions of the very poor performing consumer and trade dependent industries across firm sizes, but variations between the service based industries were quite marked. Larger property and recreation & personal services industries outperformed their smaller counterparts, while smaller finance and business services firms were relatively stronger than their larger counterparts. Conditions of smaller health services and accommodation firms have deteriorated notably over recent quarters.

Analysis (cont.)

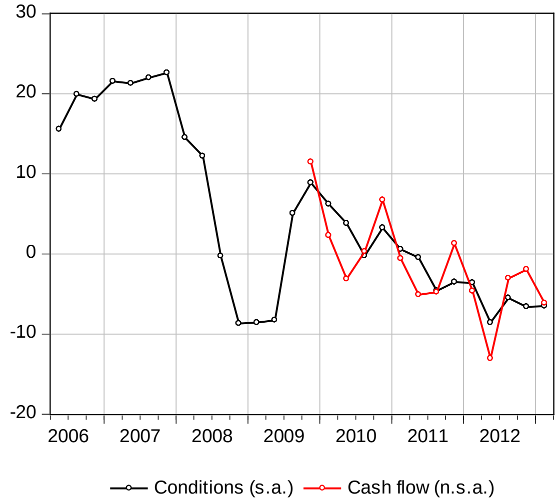
Profits & employment lift but trading weakens

SME business conditions components (net bal., s.a.)



Cash flows trending down

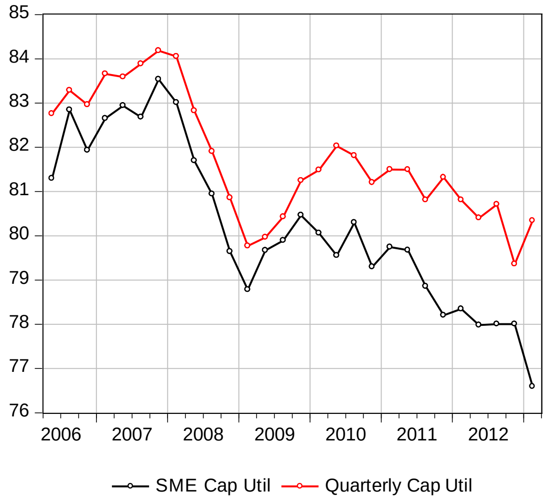
SME business conditions & cash flow (net bal.)



The improvement in SME business conditions reflected slight improvements in profitability and employment conditions, partly offset by a deterioration in trading conditions. SME cash flows (not seasonally adjusted) fell back in the March quarter, remaining firmly in negative territory.

Utilised capacity slumps; in contrast to larger firms

Capacity utilisation (per cent, s.a.), SME & quarterly



Orders improve; converge to levels of larger firms

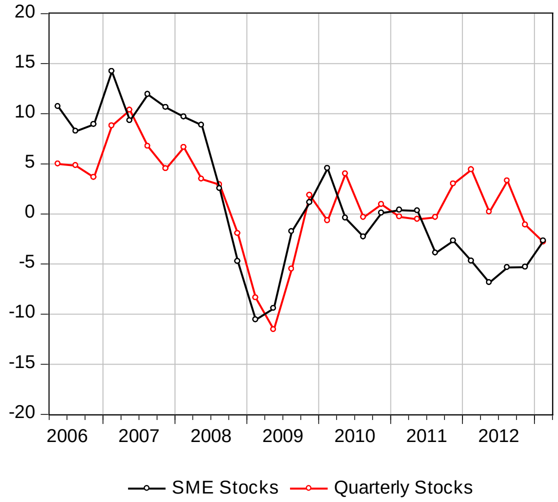
Forward orders (net bal., s.a.), SME & quarterly

Capacity utilisation fell very sharply to the lowest level in the (short) history of the survey in March quarter 2013 – down 1.4 ppts to 76.6%. This outcome is well below the series average of 80.2%, and is in contrast to the pick up in utilised capacity experienced by larger firms – where capacity was much higher (albeit still below average), at 80.3% in the March quarter. The fall in utilised capacity was broadly based across firm sizes, with the largest deterioration reported by low-tier firms and mid-tier firms (both down 1.5 ppts, to 75.9% and 75.6% respectively), followed by high-tier firms (down 1.3 ppts to 77.7%). Across industry, capacity utilisation was very low in accommodation, cafes & restaurants, wholesale, retail and construction (ranging from 73.8% to 75.4%), while it was highest in health services (86.3%). Forward orders of SMEs were modestly better in the quarter, though remained very subdued at -8 index points, which is marginally weaker than their larger counterparts. The weak level of forward orders across all firm sizes implies little indication of an improvement in near-term domestic demand.

Analysis (cont.)

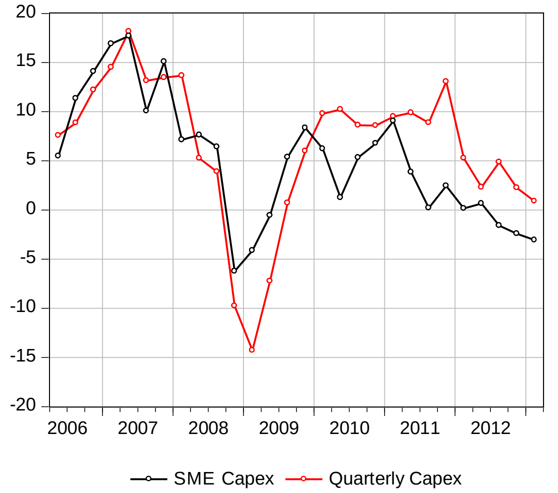
Implied SME stock levels pick up

Stocks (net bal., s.a.), SME & quarterly



..but investment still trending down

Capital expenditure (net bal., s.a.), SME & quarterly

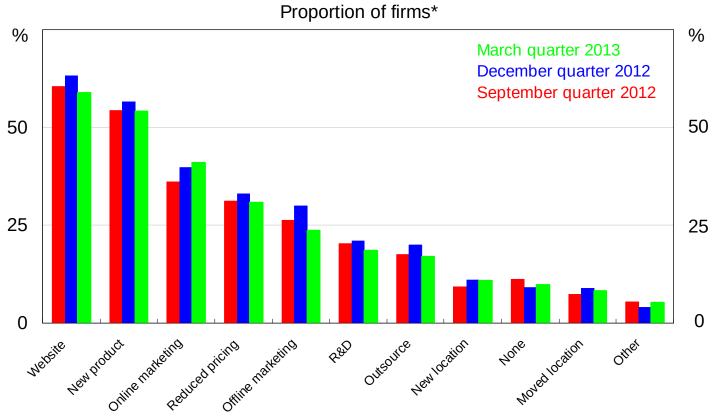


The SME stocks index picked up in the March quarter – at odds with a slight fall in the index for larger firms. Nonetheless, the overall level of stocks reported in both surveys was consistent, at -3 points, suggesting inventories were run down across all firm sizes in the quarter. The implied fall in inventories of larger firms is consistent with improved trading conditions; similarly, a deterioration in SME trading conditions is consistent with the rise in the SME stocks index, implying a degree of involuntary stock rebuilding may have taken place in the quarter. The capital expenditure index eased in the March quarter, for both smaller and larger firms, though the overall level of capex implied by the surveys is lower for smaller firms, possibly reflecting the exclusion of heavily investing mining firms from the SME survey.

A majority of firms continue to increase their online presence to boost their competitiveness in the market

Strategies employed over past 12 months to improve competitiveness

Proportion of firms*



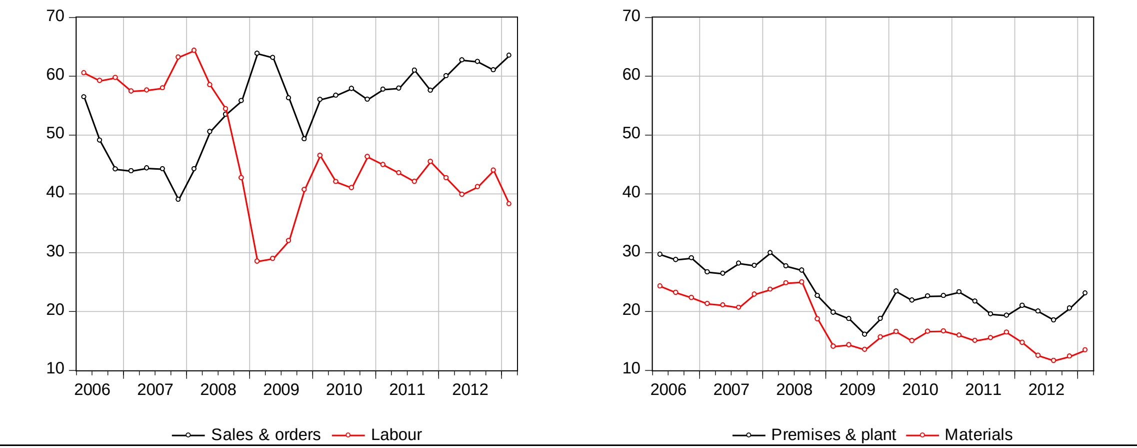
* Multiple responses allowed; will not sum to 100%
Source: NAB Quarterly SME Survey

In the March Quarter SME Survey, we again asked firms whether they had employed any new strategies over the past 12 months in an attempt to improve competitiveness in the market. The results show that firms employed less strategies in all categories, with the exceptions of online marketing, 'other' and new location (the latter was unchanged), over the year to March, compared to over 2012. However, the overall results were little changed from the December quarter outcomes. The results show that almost two thirds of all respondents developed or improved their websites, while more than half of firms launched new products to try to strengthen their position among their competitors (see Graph). One interesting trend is the consistent focus on online marketing to try to improve competitiveness, with the proportion of firms reporting this as a strategy rising to around 41%, compared to just 24% of firms employing offline advertising strategies. Only a small proportion of respondents either moved or opened new locations to try to improve competitiveness.

Analysis (cont.)

Sales and orders increasingly constraining output

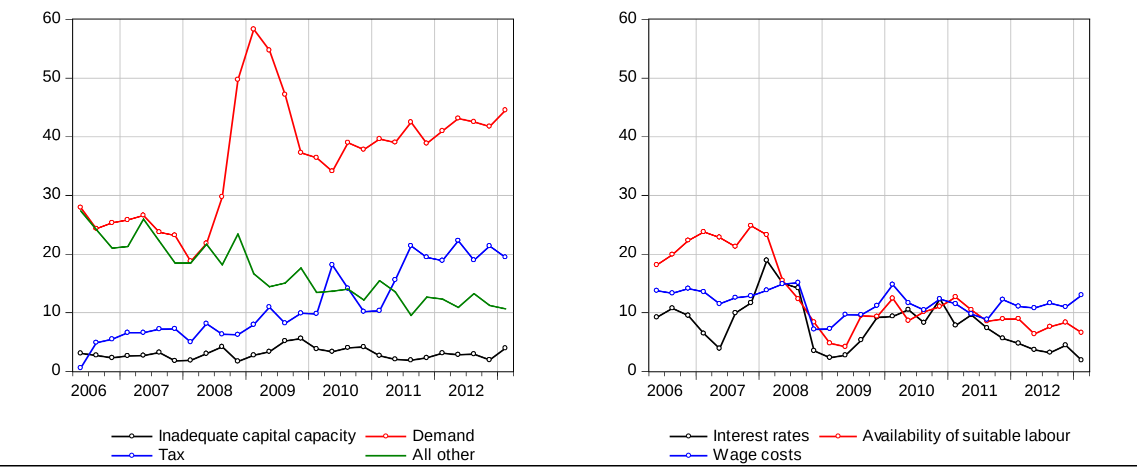
Constraints on current output (% of firms)



Sales & orders were a constraint on output for a larger proportion of SMEs in the March quarter compared to in the December quarter, remaining the most constraining factor overall. This outcome is consistent with subdued indicators of near-term demand, including capacity utilisation and forward orders. While still relatively constraining, the availability of suitable labour became less of a constraint on output in the March quarter – possibly reflecting a reduced reliance on labour in the current soft business environment. Labour availability appears to be less of an issue for smaller firms than for their larger counterparts, possibly reflecting smaller firms experiencing relatively weaker business activity in the quarter. Nonetheless, the labour market remains in a soft patch at present and the difficulty of obtaining suitable labour appears fairly benign for all firms sizes compared to pre-GFC levels. The importance of premises & plant and materials as constraints lifted, perhaps reflecting businesses reluctance to upgrade and maintain existing equipment. Nonetheless, these remained relatively unimportant constraints, broadly similar to larger firms.

Lack of demand expected to increasingly constrain profitability; interest rates and lack of capacity less important

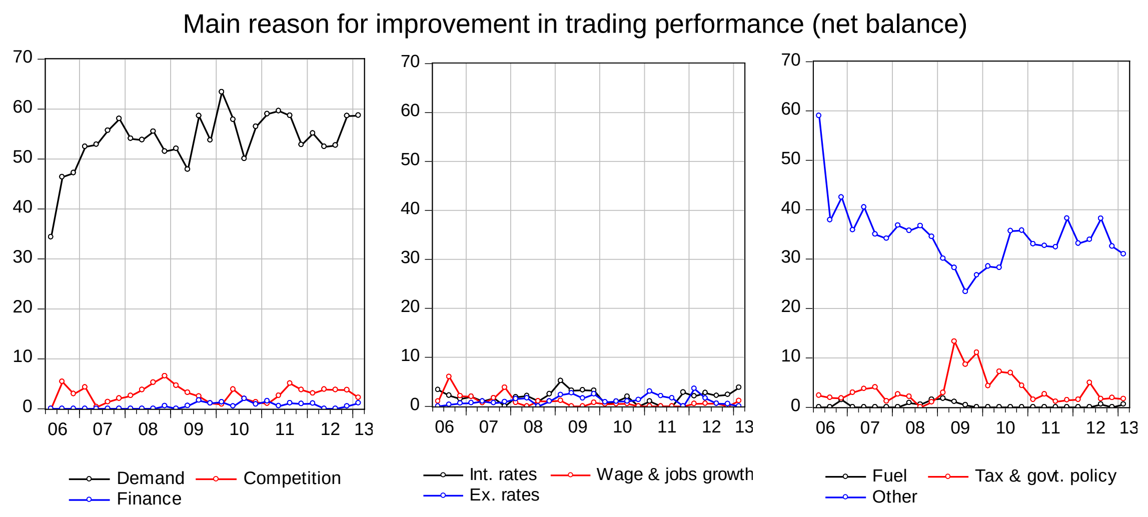
Main constraint on profitability in next 12 months (% of firms)



In the March quarter, lack of demand remained the number one factor expected to constrain profitability over 2013 – there has been a clear upwards trend in the proportion of firms indicating lack of demand as a constraint over the past three years, consistent with a general deterioration in trading activity over this time. The proportion of firms concerned about the impact of changes to tax policy on future profitability has stabilised at a relatively elevated level over the past two years. Only a very small proportion of firms are concerned about the impact of interest rates on future profitability, with this factor declining in line with the fall in borrowing costs. The availability of suitable labour and wage costs also appeared of little concern to business.

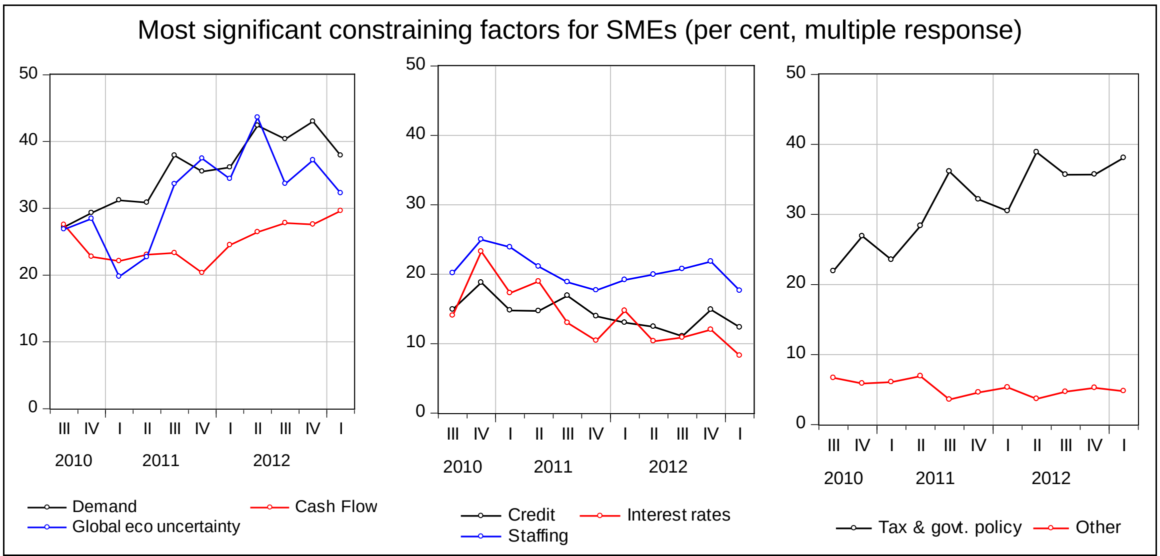
Analysis (cont.)

Demand still driving improvement in trading performance – tax & government policy provides little support to trading activity



While trading performance weakened in the March quarter, overall trading continued to be supported by demand, with the proportion of firms noting this as a driver lifting trading performance firmly in the quarter. "Other" reasons as a contributing factor to improved trading eased further in the quarter though remained relatively significant overall; the significance of this factor largely reflects seasonal and company specific factors. Tax & government policy appear to have provided very little support to trading performance in the December quarter, with businesses likely to be affected by the tight stance of fiscal policy.

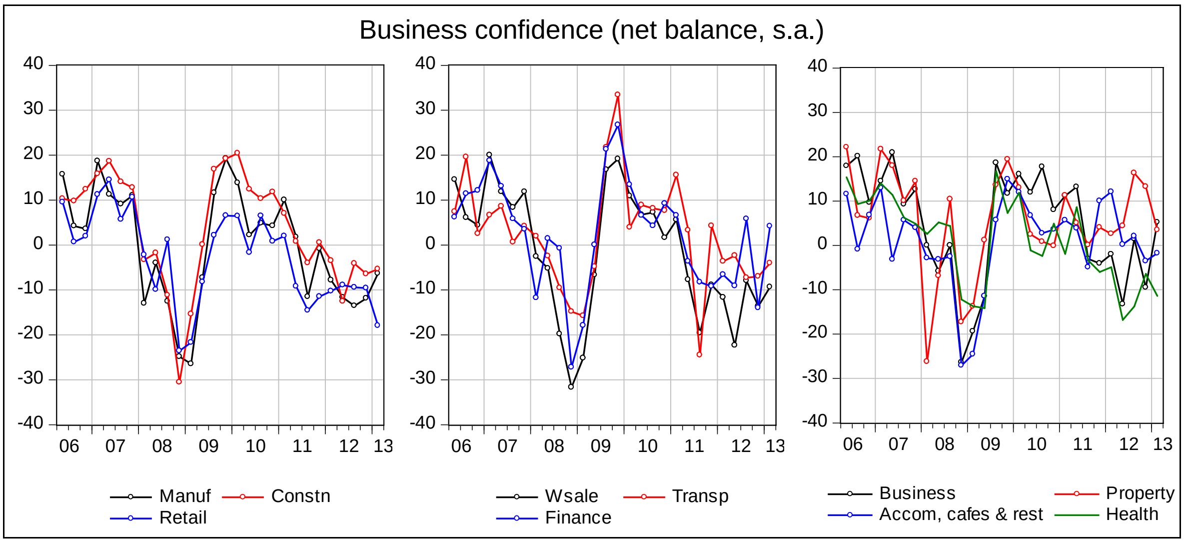
SMEs constrained by a lack of demand and tax & government policy



The ability of SMEs to make longer term decisions became increasingly constrained by tax & government policy and cash flow, with these factors increasing in significance in the quarter. Firms appear less concerned about global economic uncertainty – consistent with the passing of the US fiscal cliff and the general improvement in financial stability over recent months. Longer term decisions were also less constrained by demand, although this remained an important factor overall, staffing issues, credit availability and interest rates.

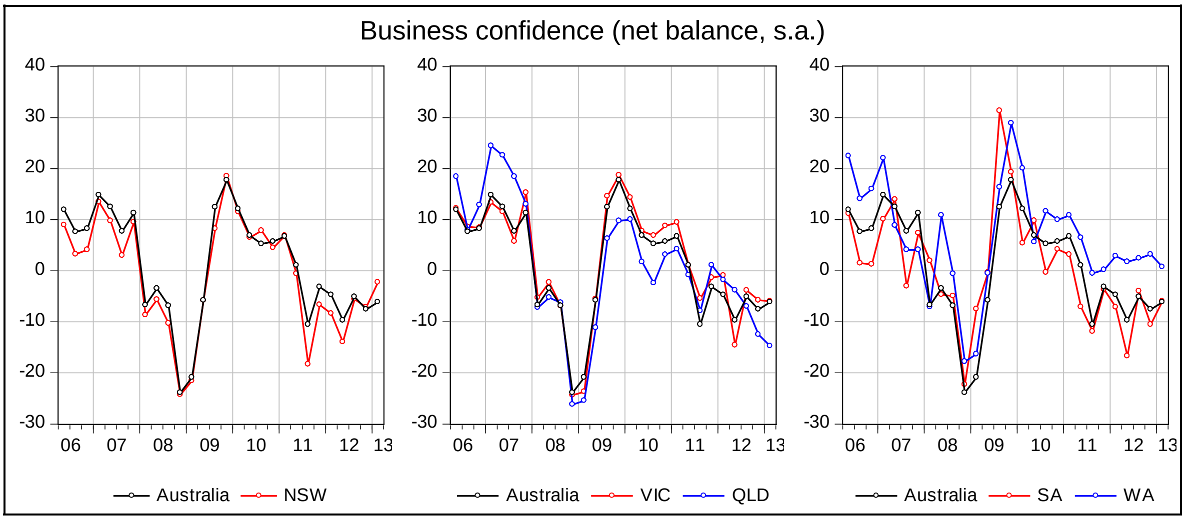
Industry and State analysis

Finance & business services more optimistic; retailers very depressed



Business confidence lifted across a majority of industries in the March quarter, with a particularly sharp rise reported in financial services (more than unwinding a heavy deterioration in the previous quarter); the rise may reflect strong equity market performance and improved financial conditions. Property services, retail and health services were the only industries to report a deterioration in confidence, with the latter two industries the most pessimistic overall. Despite a fall in confidence in property services, it remains among the most confident industries overall (with financial services; both with a net balance of +4 points), which may in part reflect historically low borrowing rates and steadily improving property market conditions. Confidence was by far the lowest in retail (-18), where activity remains very challenging, and health services (-11).

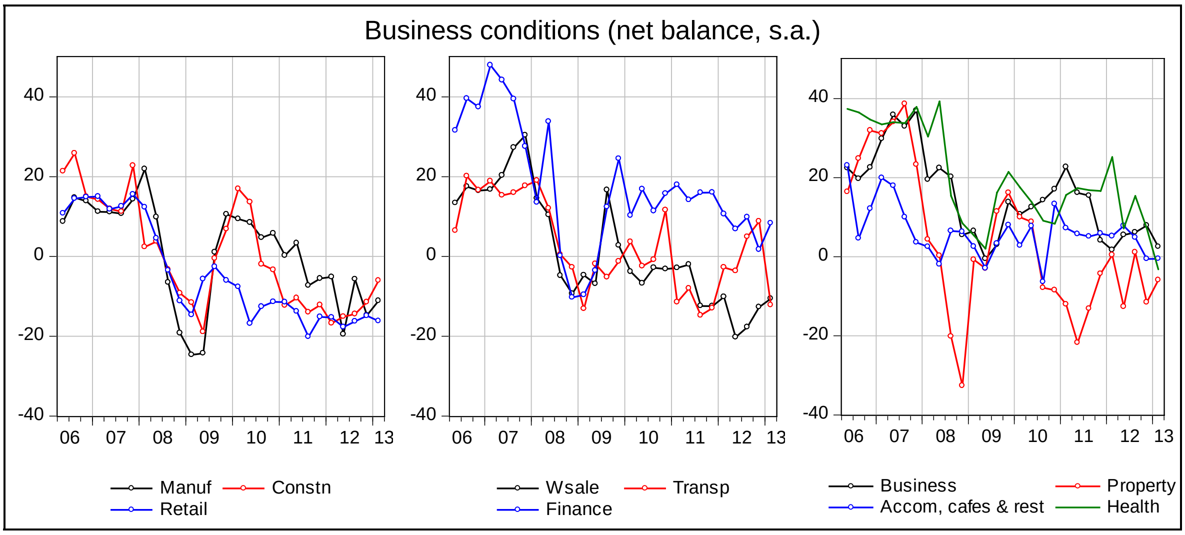
Business confidence slumps in Queensland, lifts in NSW and SA; WA remains most upbeat overall



Business confidence weakened a touch in WA and Queensland – the two largest mining states – in the March quarter; it is possible that the slowing in the mining investment phase has raised concerns about the flow on impact on other industries in those regions. In contrast, confidence lifted solidly in NSW and SA, while it was unchanged in Victoria. The overall level of SME business confidence was least subdued in WA (+1 point), while it was weakest in Queensland (-15), followed by SA and Victoria (both -6).

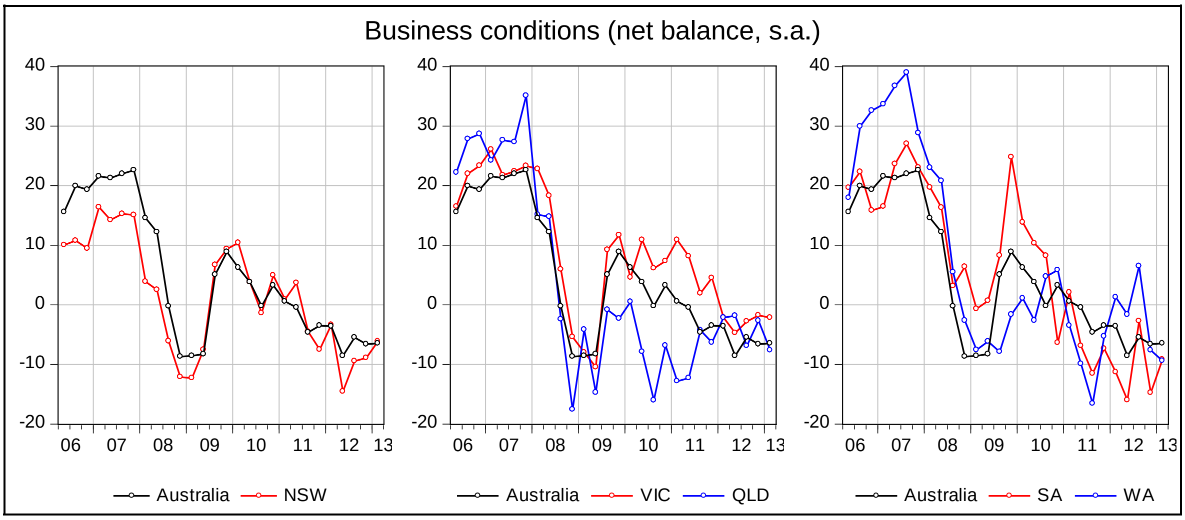
Industry and State analysis (cont.)

Conditions deteriorate sharply in transport & health – previous strong performers; activity in financial services holding up



Business conditions improved solidly in financial and property services, manufacturing and construction; while it slumped in transport and declined sharply in health services. It appears that better global financial conditions are having a positive impact on smaller finance firms, with this industry outperforming all other industries in the quarter (+8 points). Despite deteriorating in the quarter, conditions in business services were also relatively strong, at +3 points. In contrast, conditions were very poor in retail (-16), transport (-12), wholesale and manufacturing (both -11). The weakness in activity in these industries is fairly consistent with the outcomes for their larger counterparts, although the smaller retailers and transport operators appear to be doing it particularly tough.

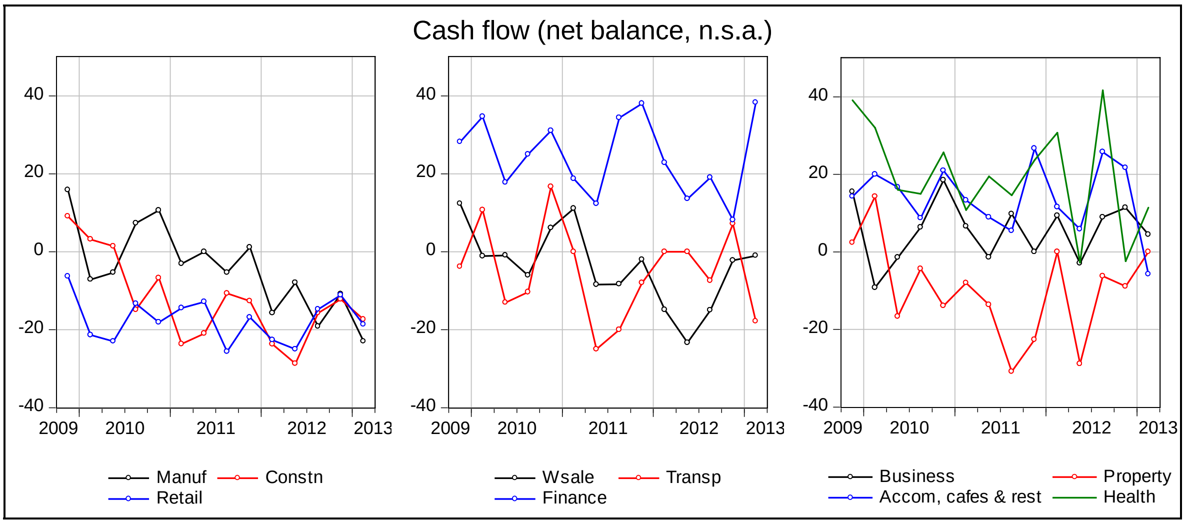
Conditions deteriorate in mining states; holding up better in Victoria



Business conditions weakened in the mining states in the March quarter, a sign that the slowing in mining investment may be causing a widespread softening in activity in these regions. In contrast, conditions strengthened considerably in SA, while they were modestly better in NSW and unchanged in Victoria. In levels terms, conditions of SMEs were most subdued in WA, SA (both -9) and Queensland (-8), while they were least subdued (albeit still negative) in Victoria (-2) and NSW (-6).

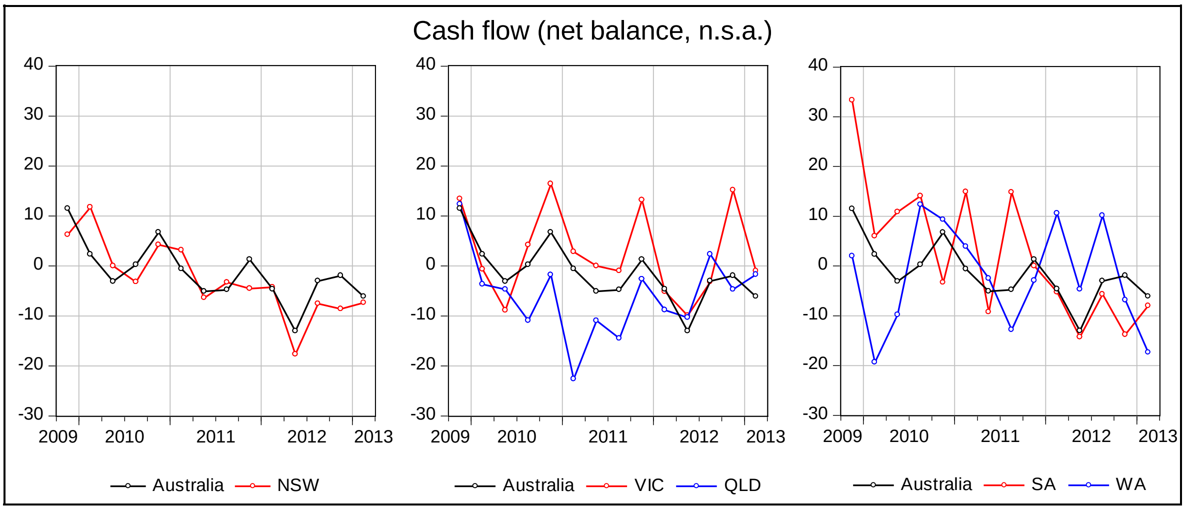
Industry and State analysis (cont.)

Cash flows very strong in finance; very weak in manufacturing, retail and construction, and now transport



Cash flows (not seasonally adjusted) lifted significantly in financial services in the March quarter, consistent with the rally in equity prices since late last year. Cash flows also improved in health services and property services. In contrast, cash flows deteriorated significantly in the transport industry, more than unwinding a solid improvement in the previous quarter. It may be the case that continued weakness in industries that are serviced by the transport sector (retail and construction, which experienced notable falls in cash flow in the quarter) are weighing on transport activity – this is also consistent with the current weakness in transport orders. Cash flows also weakened considerably in accommodation, cafes & restaurants. In levels terms, the cash flow index was by far the highest in financial services, followed by health services and business services, while it was lowest in manufacturing, retail, transport and construction.

Cash flows deteriorate in Victoria (but largely seasonal); cash flows weakest in WA

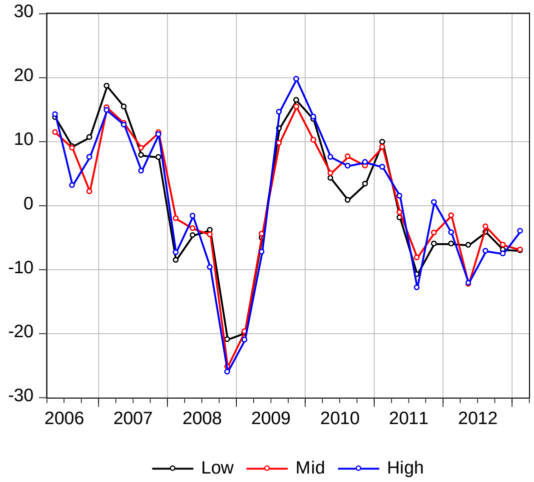


The deterioration in overall cash flows (not seasonally adjusted) in the March quarter was largely a result of weak outcomes in Victoria and WA, although the fall in Victoria appears to have been largely seasonal, with cash flows in Victoria exhibiting a similar pattern in the March quarter of previous years. Cash flows improved modestly in all other states. In levels terms, cash flows were least subdued in Victoria and Queensland, while they were by far the weakest in WA.

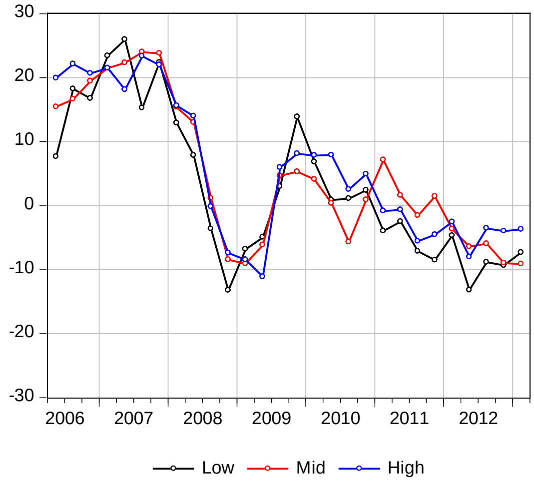
Firm size analysis

Confidence and conditions relatively better for high-tier SMEs

Business confidence (net bal., s.a.)



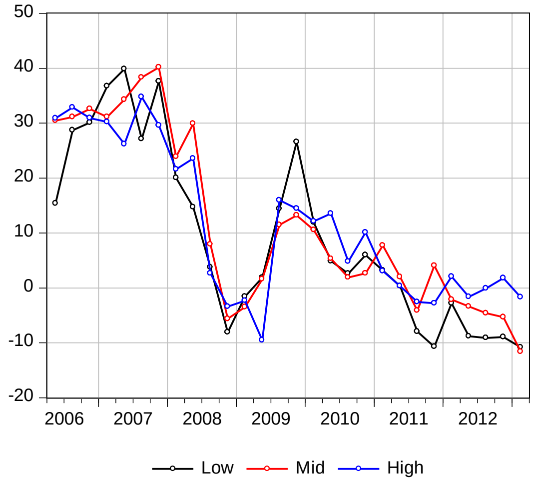
Business conditions (net bal., s.a.)



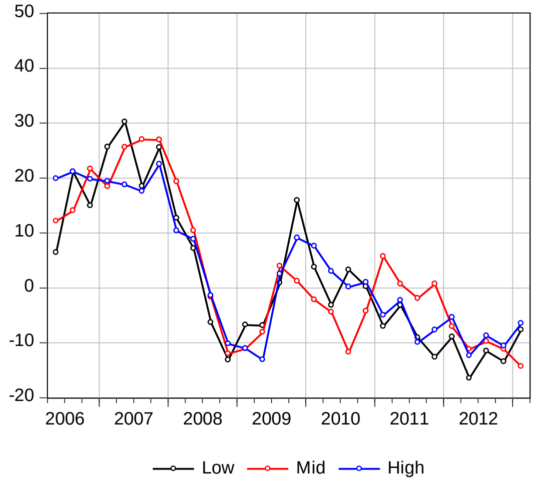
The improvement in business confidence was entirely driven by high-tier SMEs ($5-10m p.a.), which were the least pessimistic of all SMEs in the March quarter; confidence of low-tier firms ($2-3m p.a.) was unchanged, while it was marginally weaker for mid-tier SMEs ($3-5m p.a.). Overall, confidence of SMEs by firm size was broadly similar, ranging from -7 points for low-tier and high-tier firms to -4 points for high-tier firms. The generally subdued level of confidence among SMEs is consistent with fairly poor activity readings in the month, as well as fairly poor indicators of demand. Based on outcomes from the Quarterly and SME Business Surveys, it is apparent that larger firms tend to be more optimistic than smaller firms. Business conditions improved for low-tier SMEs and were unchanged elsewhere. In levels terms, conditions were least subdued for high-tier firms and weakest for low-tier firms. The overall (slight) pick up in SME conditions reflected modest improvements in profitability and employment conditions, which were partly offset by a deterioration in trading conditions.

Trading conditions weaken across all SMEs; profitability generally better except for mid-tier firms

Trading conditions (net bal., s.a.)



Profitability (net bal., s.a.)

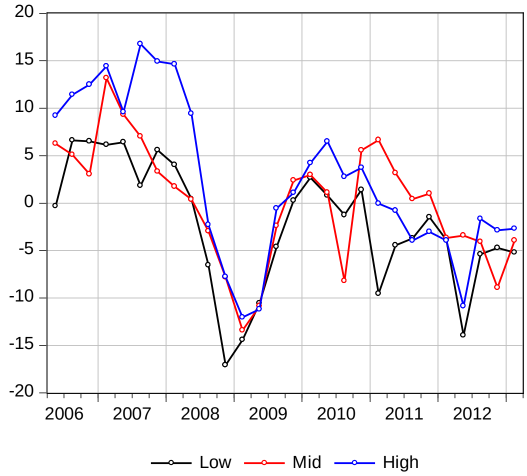


Trading conditions weakened across all SMEs in the March quarter, after showing signs of stabilising towards the end of last year. In levels terms, trading performance was particularly subdued for mid-tier and low-tier firms, while it held up better for high-tier firms. Despite the weakness in trading activity in the quarter, profitability strengthened across all SMEs except for mid-tier firms, where it weakened to the lowest level in the (short) history of the survey (-14). The improvement in profitability of low-tier and high-tier firms is consistent with a substantial softening in labour costs growth in the quarter – employment conditions were broadly unchanged for these SMEs suggesting wage pressure may have fallen in the quarter.

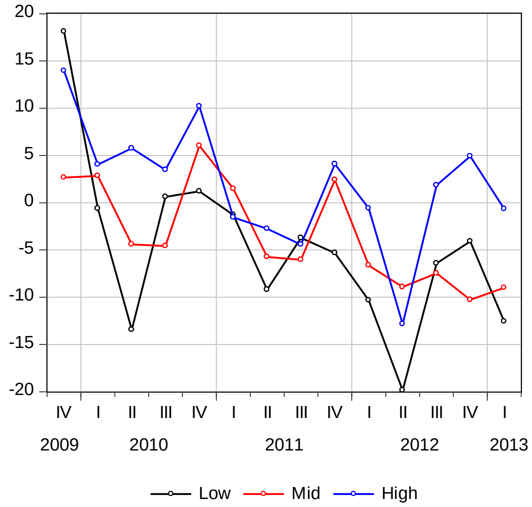
Firm size analysis (cont.)

Employment conditions & cash flows improve across mid-tier firms

Employment (net bal., s.a.)



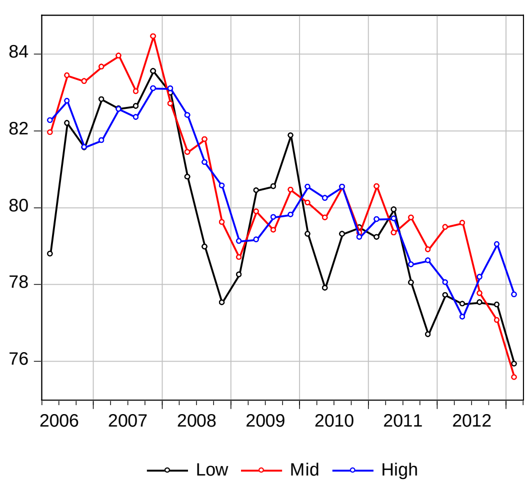
Cash flow (net bal.)



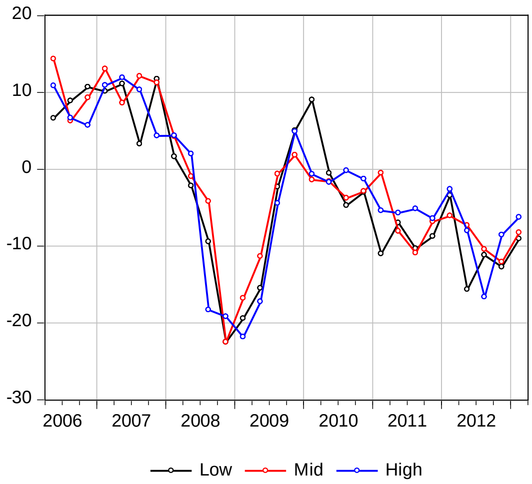
Employment conditions were little changed for low-tier and high-tier firms in the March quarter, while they strengthened considerably for mid-tier firms, entirely unwinding the fall in the December quarter. The overall level of employment conditions was not too dissimilar across firm sizes, ranging between -5 points for low-tier firms to -3 points for high-tier firms. Despite low-tier and high-tier firms experiencing little change in employment conditions, their cash flows deteriorated significantly in the March quarter. In contrast, they were marginally better for mid-tier firms. In levels terms, cash flows remained the strongest for high-tier firms and were much better than poor outcomes reported in mid-2012. Cash flows of low-tier firms have also improved notably since the middle of last year, though they were the weakest of all SMEs in the March quarter.

Capacity utilisation slumps across all SME sizes; despite broadly based improvement in forward orders

Capacity utilisation (per cent, s.a.)



Forward orders (net bal., s.a.)



Capacity utilisation of SMEs fell heavily in the March quarter, to the lowest level in the (short) history of the survey, and well below the level of their larger counterparts (76.6% compared to 80.3% for large firms). The fall in utilised capacity was broadly based across SMEs. Interestingly, capacity utilisation fell despite an improvement in SME forward orders in the quarter. Nonetheless, the level of SME forward orders – ranging between -9 points for low-tier firms and -6 points for high-tier firms – remained very weak overall, implying little improvement in near-term demand.

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