

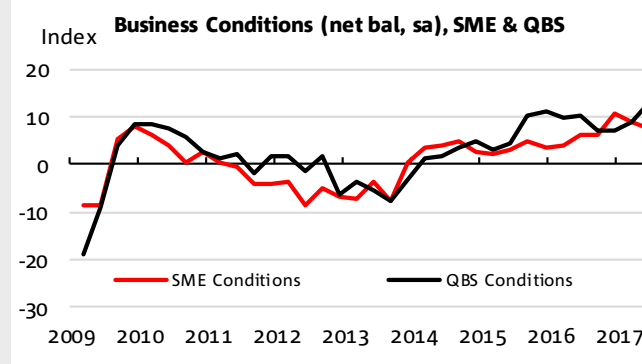
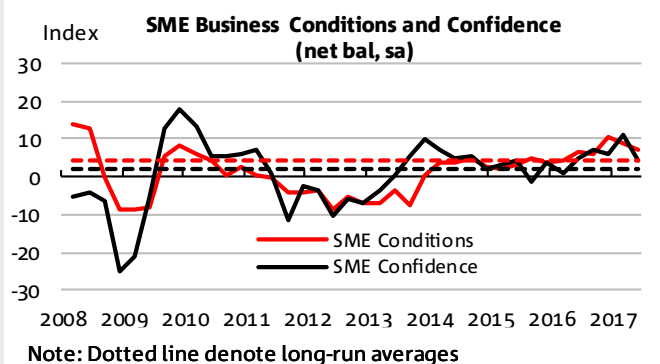
NAB QUARTERLY SME SURVEY

JUNE 2017



Key points:

- Small businesses reported **lower business conditions and confidence** in the Q2 NAB Small and Medium Enterprises (SME) Business Survey, pulling back most of the gains since the second half of last year. This is in contrast to larger businesses in the Quarterly NAB Business Survey (QBS), where business conditions continued to improve strongly while confidence also remained above average. Overall however, SME confidence and conditions remained above their respective average level since the survey started in 2006.
- While the **weakening in SME conditions and confidence was largely broad-based across industries and firm sizes, leading indicators were mixed**, pointing to improving capital expenditure and capacity utilisation, but declining orders and cashflow. Whether this worsening in conditions for SMEs is the start of a renewed downward trend or a temporary pull-back remains to be seen.
- The declines in business conditions and confidence were especially pronounced for the smallest SMEs (turnover \$2-\$3 m p.a.). **Trading conditions** declined the most at the low-tier firms, moderately at mid-tier firms while improving slightly at high-tier firms. **Profitability** has fallen across firm sizes from their Q4 2016 peak while **employment** conditions have been mixed and lower than for larger businesses in the QBS, although remain above the average since 2006.
- **Across states**, conditions fell in all three major eastern states, while improving strongly in South Australia and Western Australia. Business confidence fell across all states.
- **By industry**, finance and health services again reported the strongest business conditions, leading other industries by a large margin. Business conditions fell across most industries, except for finance, manufacturing and business services. Business confidence also fell across the board (except for transport), albeit remaining positive for most industries except retail. Retail business conditions were the weakest and deteriorated further in Q2. This result was different from the recent improvement reported by larger retailers (as seen in both the NAB monthly and quarterly business surveys) and together with negative retail confidence remained worrying.
- Firms again identified a lack of demand and new orders as the biggest **constraints** on business performance, which perhaps explains the subdued growth in final product prices. Faced with a higher overheads growth, margins were squeezed and profitability declined.



	2016	2017	2017
	q2	q1	q2
Business Confidence	5	11	5
Low-tier firms	4	9	-3
Mid-tier firms	7	10	6
High-tier firms	5	12	8
Business Conditions	6	9	7
Low-tier firms	1	6	3
Mid-tier firms	10	9	8
High-tier firms	6	11	9
Trading Conditions	14	16	14
Low-tier firms	5	9	5
Mid-tier firms	18	18	16
High-tier firms	17	18	19
Profitability	6	8	6
Low-tier firms	2	7	3
Mid-tier firms	9	8	6
High-tier firms	5	9	7
Employment	-1	2	2
Low-tier firms	-5	0	1
Mid-tier firms	3	-1	1
High-tier firms	-1	5	5

Note:

Low-tier firm: turnover \$2 – 3m p.a.;
Mid-tier: \$3 – 5m. High-tier: \$5 – 10m

CONTACTS

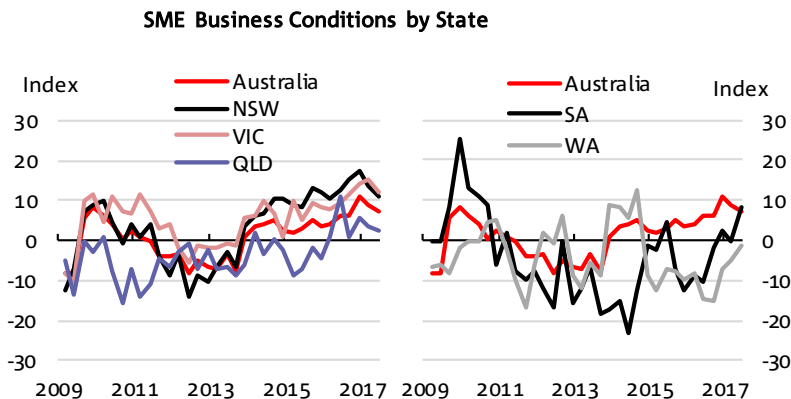
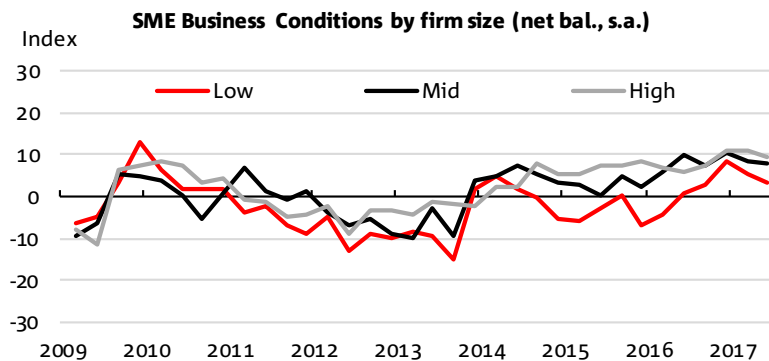
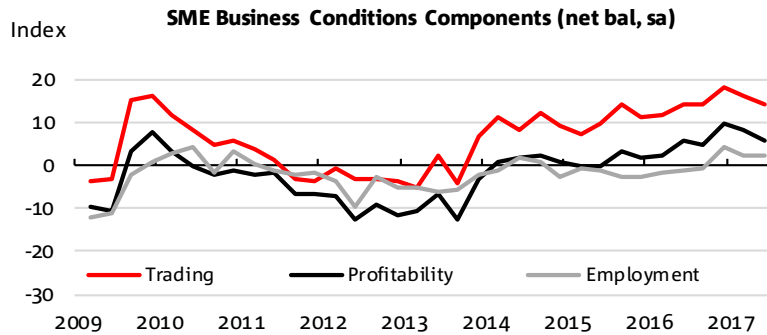
Alan Oster, Chief Economist,
+61 3 8634 2927

Riki Polygenis, Head of Australian
Economics, +61 475 986 285

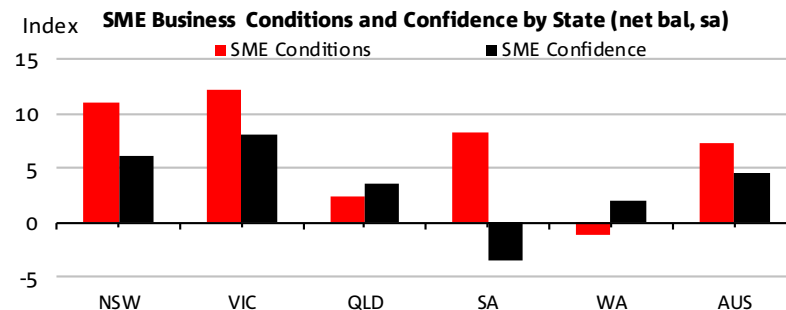
Amy Li, Economist, +61 3 8634 1563

COMPONENTS OF BUSINESS CONDITIONS

Trading and profitability both fell back in Q2



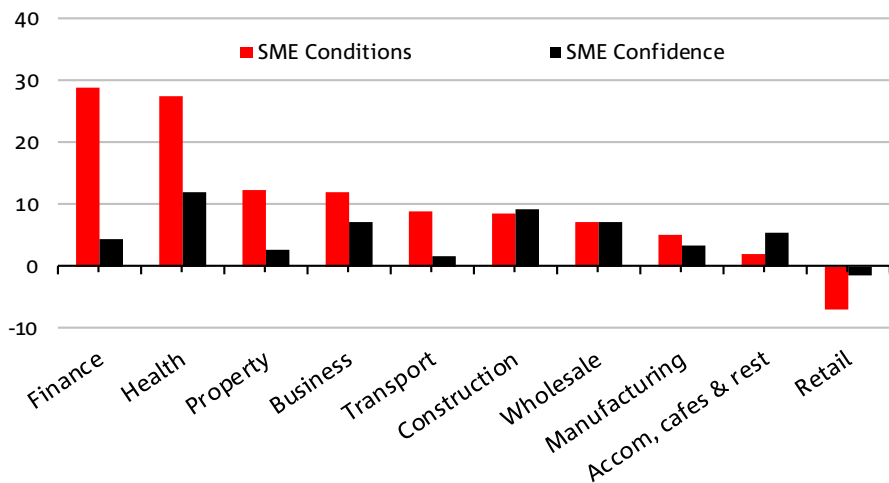
- Business conditions continued to pull back in Q2 from the recent peak in Q4 2016. While at lower levels, trading conditions, profitability and employment (+14, +6 and +2 points respectively) remained above respective average levels since the survey started in Q2 2006.
- The biggest decline in **trading conditions** was reported by the smallest SME firms (with turnover of \$2-3m p.a.), while mid-sized SMEs (turnover \$3-5m) only reported a slight deterioration and the largest SMEs (turnover \$5-10m) continued to experience improving trading conditions. The continual improvement in trading conditions at mid-sized and large SMEs is consistent with the overall trend observed in the QBS survey of larger firms. On the other hand, trading conditions at the smallest SMEs tend to be volatile and that may be due to their less diversified business models which could expose such businesses to single factor risks. **Profitability** fell across firm sizes from their Q4 2016 peak. The opposite was observed in the main QBS sample, where profitability continued to improve. SME firms reported feeling the squeeze between subdued final product price growth and higher overheads growth. **Employment** conditions were mixed. While larger businesses reported much stronger hiring intentions in the QBS survey (a promising sign given the current slack in the labour market), the employment index in the SME survey is still above its historical average of 0. That said, SMEs account for the largest share of total employment in Australia by firm size, and until employment conditions show a sustained improvement at the smaller firms, labour market conditions will likely remain subdued.
- **Across states**, conditions fell in all three major eastern states, while improving strongly in South Australia and Western Australia. South Australian firms reported a strong bounce in conditions however confidence fell further, a similar result observed in the main QBS survey. Western Australian business conditions remained negative and confidence subdued too, despite showing some improvements. For more state details, see page 8.



CONDITIONS AND CONFIDENCE BY INDUSTRY

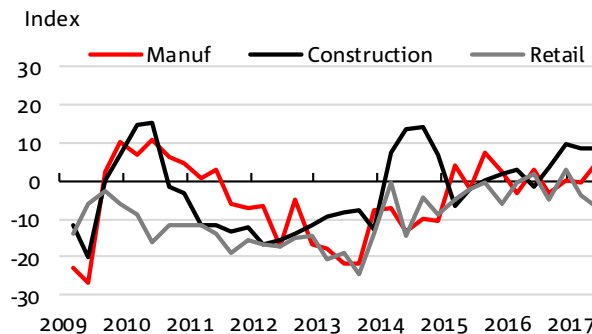
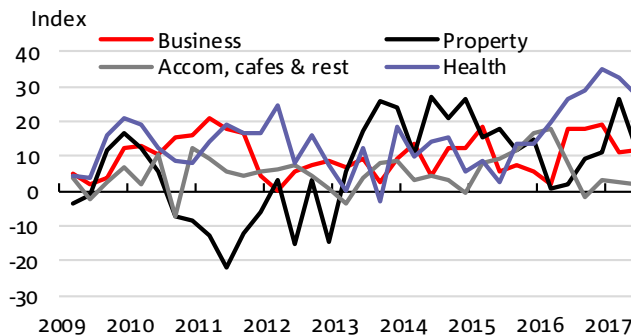
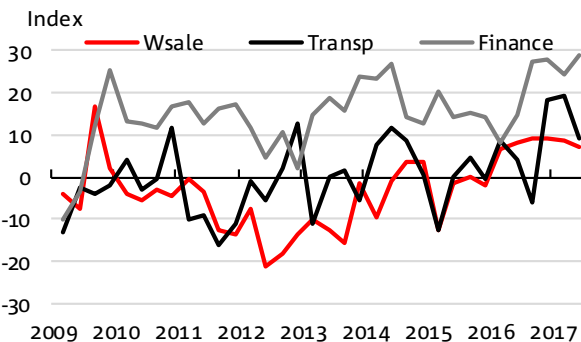
Finance and health services conditions strongest, while retail lags

Index **SME Business Conditions and Confidence by Industry (net bal, sa)**



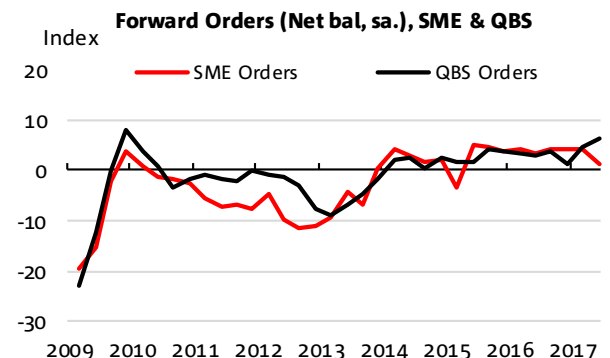
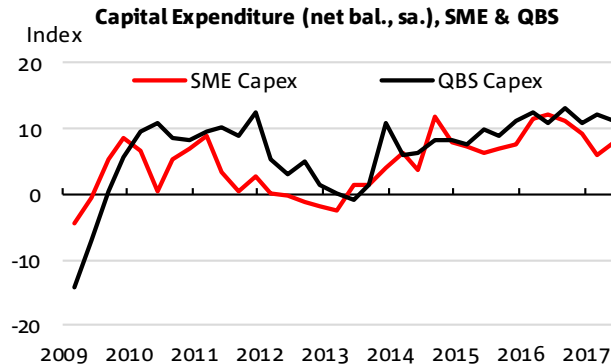
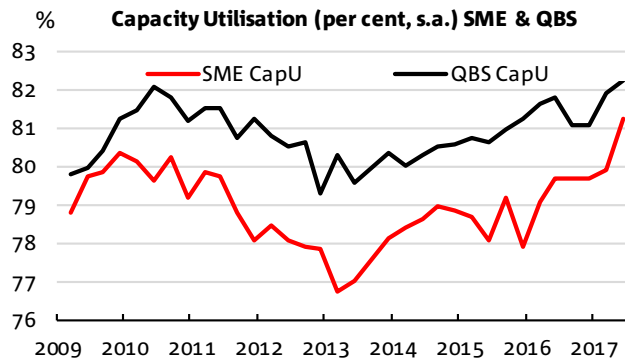
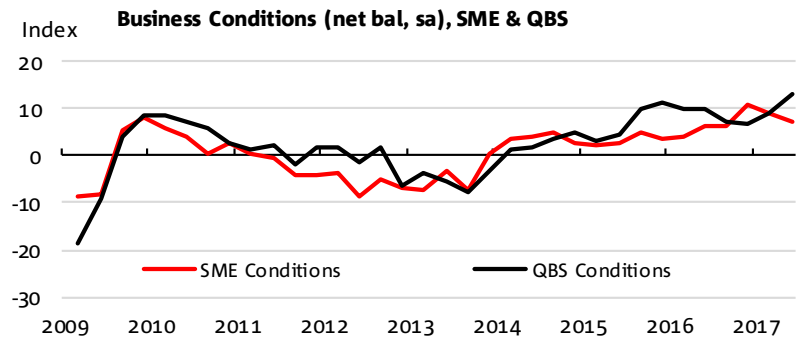
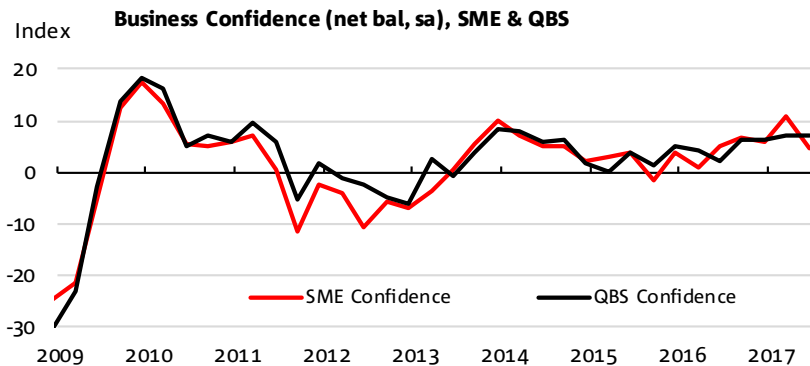
- Finance and health services again reported the strongest business conditions, leading other industries by a large margin. Businesses in these industries often offer services such as accounting, financial planning and ancillary healthcare. Positive business conditions were also reported in the QBS for businesses in these industries. SMEs in business and property services have also been reporting healthy business conditions, although property business conditions tend to be more volatile.
- In Q2, business conditions fell across most industries, except for finance, business services and manufacturing. Finance has been reporting improving conditions, as the economy transitions away from mining towards services industries. It remains to be seen whether the improvement in manufacturing is short-lived, especially given a decline in manufacturing confidence.
- Business confidence also fell across the board (except for transport), albeit remaining positive for most industries except retail. Health again reported the strongest business confidence.
- At the other end of the spectrum, retail, hospitality and manufacturing have been battling with subdued and often negative business conditions. The further deterioration in retail conditions is especially worrying. This is different from the recent improvement reported by larger retailers (as seen in both the NAB monthly and quarterly business surveys). It may be that SME retail businesses are more constrained to a single location and/or product/service offering and therefore face a greater level of risk. Retail business confidence has also been struggling in negative territory, a lower reading than in the QBS. The results indicate SME retailers are particularly pessimistic about their business outlook, perhaps worried about the entry of Amazon, global competitive pressures and the increasing movement towards online platforms, to name a few. For more industry details, see page 7.

SME Business Conditions by Industry



COMPARISON WITH LARGER BUSINESSES

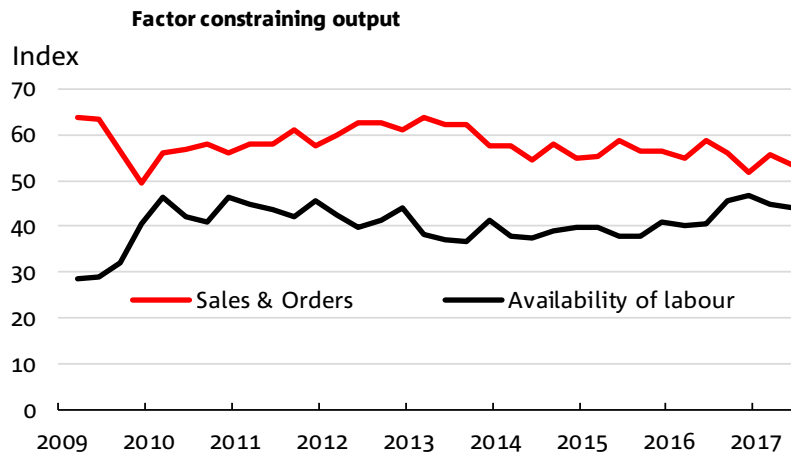
Pullback saw SMEs underperforming larger businesses



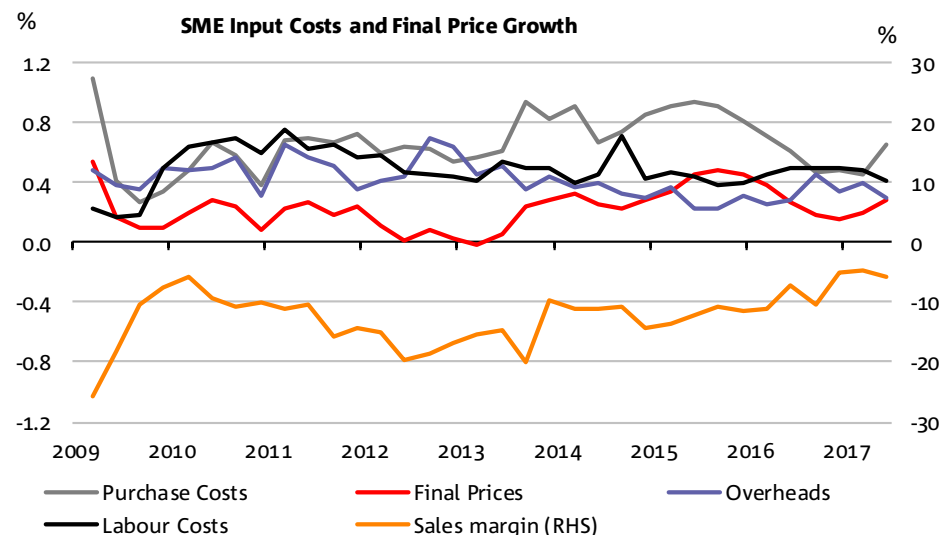
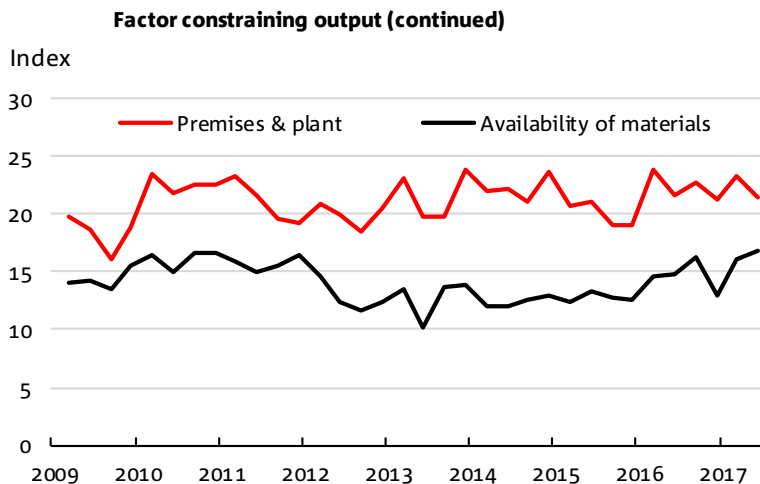
- A pull back in both business conditions and confidence saw SMEs underperform compared to larger businesses in Q2. As discussed previously, the retreat in conditions and confidence was broad based across industries, firm sizes and states (with the exception of SA and WA). The decline was especially pronounced for the smallest SMEs (turnover \$2-\$3m). These are in contrast to the positive results seen in the QBS, which saw business conditions jump to the highest level since 2008 and confidence also steady at above average levels.
- Leading indicators were mixed. Capacity utilisation continued to improve strongly and the gap between SME and QBS businesses closed further. A capacity utilisation of 81% indicates SME firms were operating at a good level of capacity (just above the average of 80%) and also have room to produce more should demand rise. Capital expenditure also improved in the quarter. While still lagging behind QBS, an increase suggests firms might be expecting better operating conditions and therefore increased their capital spending.
- On the other hand, orders at SMEs fell to near zero, suggesting little growth, while QBS orders improved strongly in the quarter. Cashflow also weakened in the quarter while stocks remained steady at subdued levels.
- Overall it seems there is still a level of uncertainty facing small businesses in the current economic environment, especially as wages and consumer spending growth remain subdued.

CONSTRAINTS ON OUTPUTS AND PRICE MEASURES

Concern over weak demand and availability of inputs saw margins squeezed



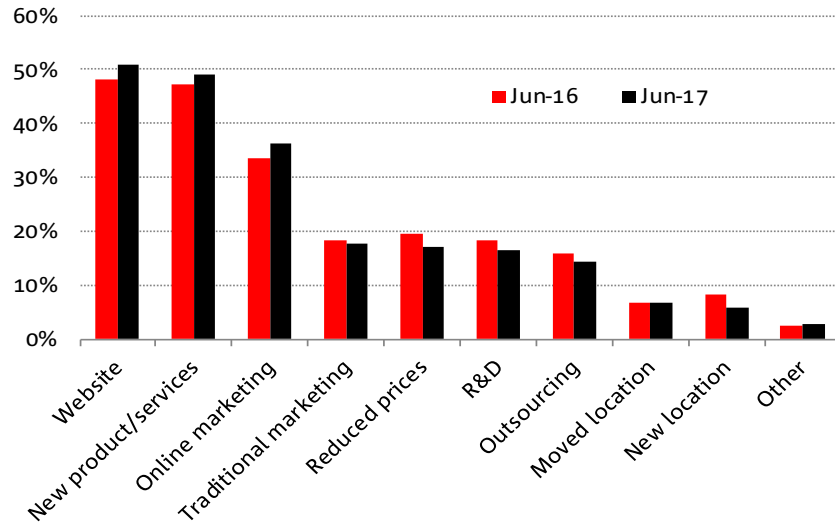
- When asked which factors were currently **constraining output**, sales & orders remained the biggest constraining factor, followed by the availability of labour, premises & plant, and finally the availability of materials. Looking ahead, firms were most worried about the impact on their profitability from future demand conditions, followed by wage costs, government policy and the availability of suitable labour, while the concern over interest rates remained low in this current low interest rate environment.
- **These constraints are reflected in input costs and final product price growth.** Final product price has been quite subdued, as demand conditions remain weak (see bottom right chart). Although final product price growth picked up somewhat this year, it lags behind purchase costs, overheads and labour costs growth. As a result, sales margins have been squeezed and been growing at negative rates for quite some time. This has possibly impacted on firms' profitability, with SME firms of all sizes reporting worsening profitability this year.



STRATEGIES

Website and new product/services the most popular strategy

Strategies employed to improve competitiveness

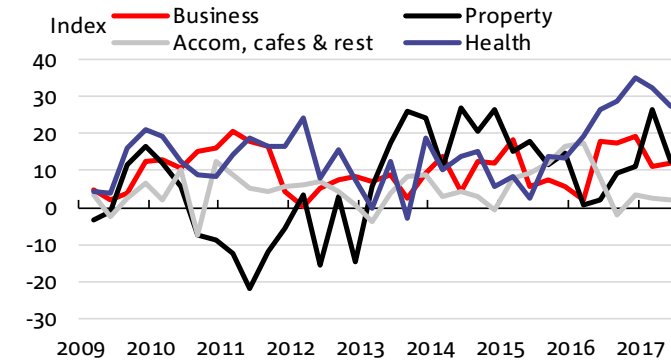
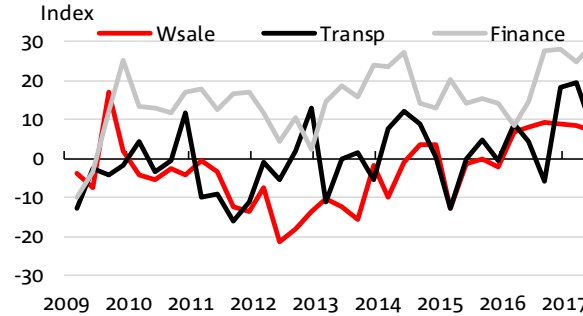
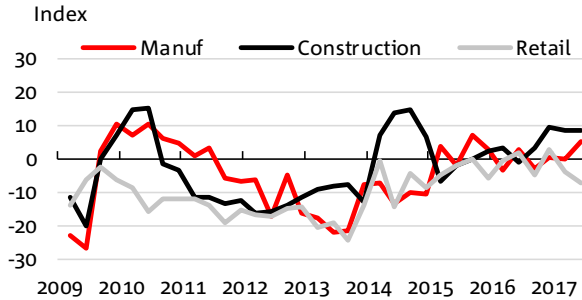


- Regarding **strategies employed to improve competitiveness in the past year**, over 50% of businesses utilised websites, an rising trend observed over the years. The second most popular strategy was launching new products or services. Better marketing, both online and tradition, was also a preferred strategy.
- While price discounting was still used by 17% of firms, it has been losing popularity over time. So has R&D, outsourcing and moving to a new location.

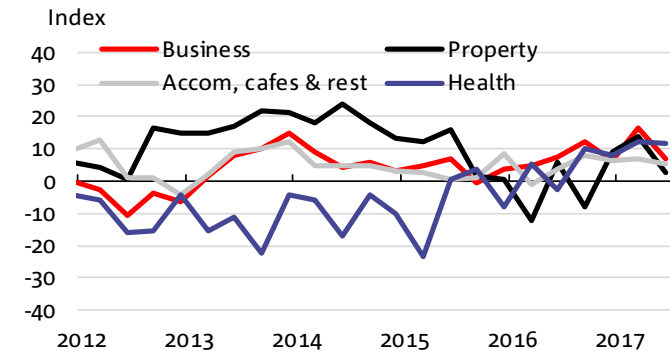
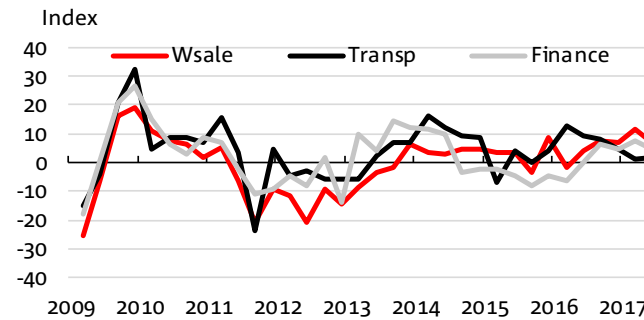
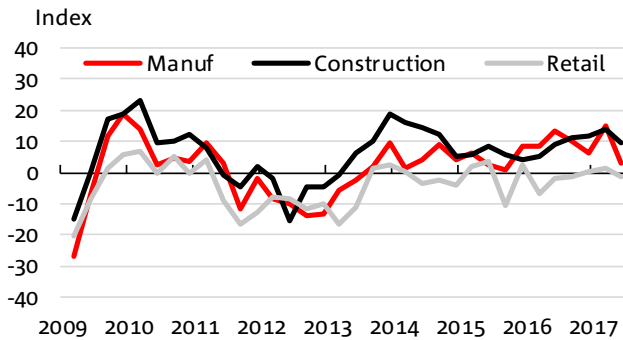


INDUSTRY

BUSINESS CONDITIONS BY INDUSTRY

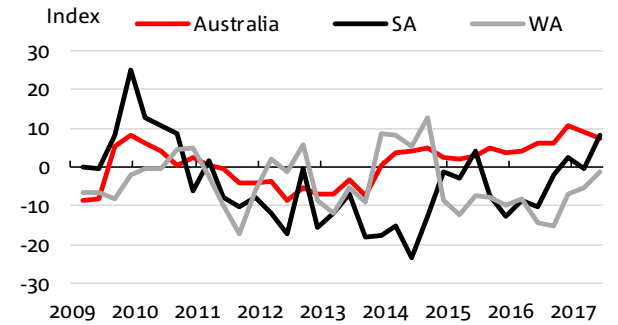
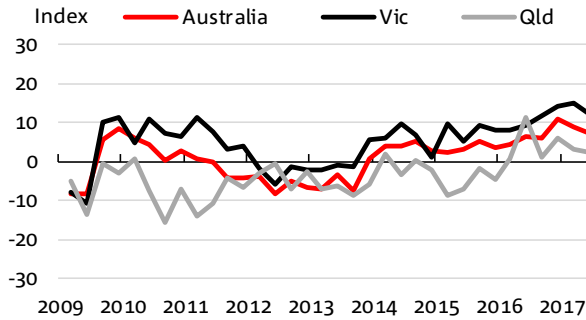
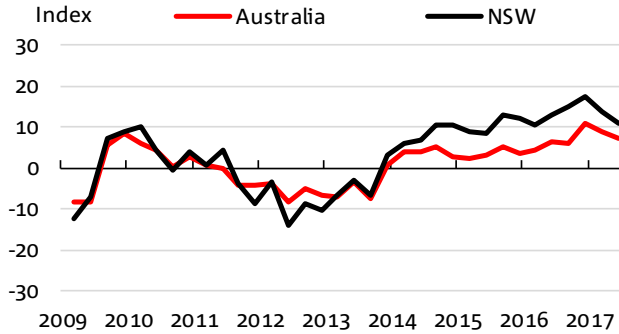


BUSINESS CONFIDENCE BY INDUSTRY

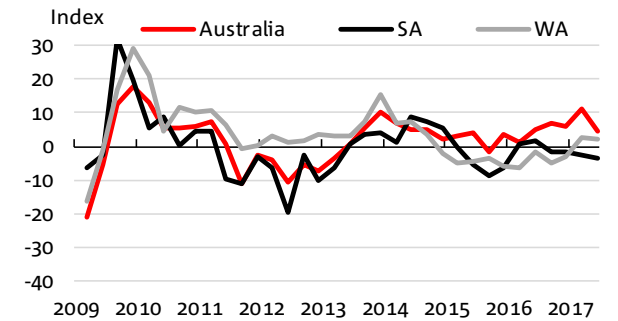
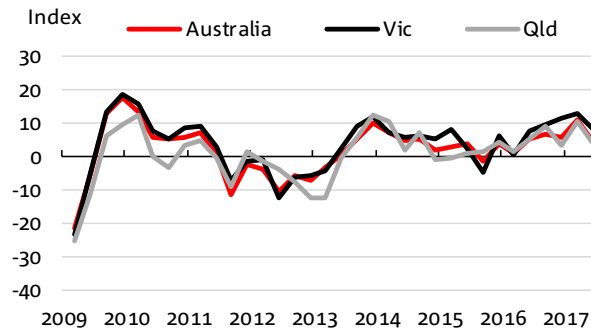
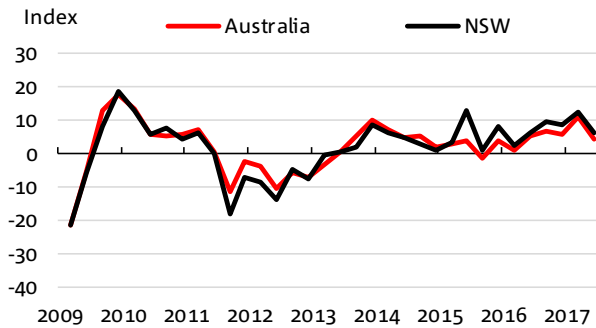


STATE

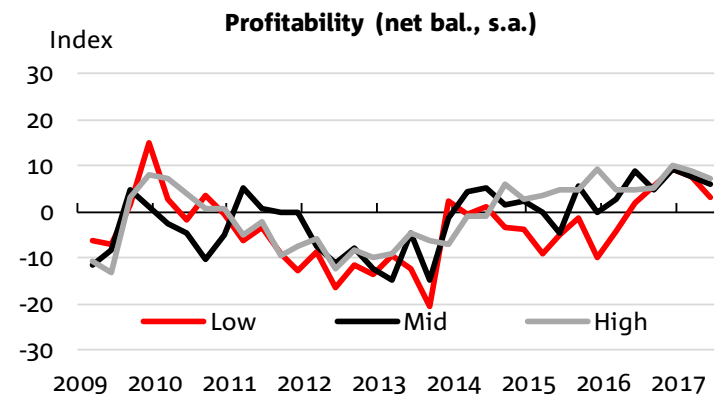
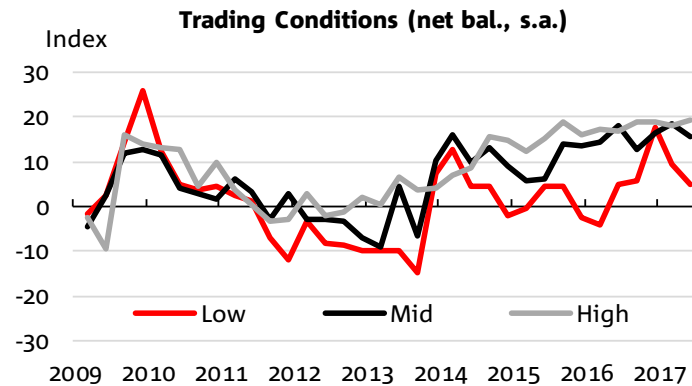
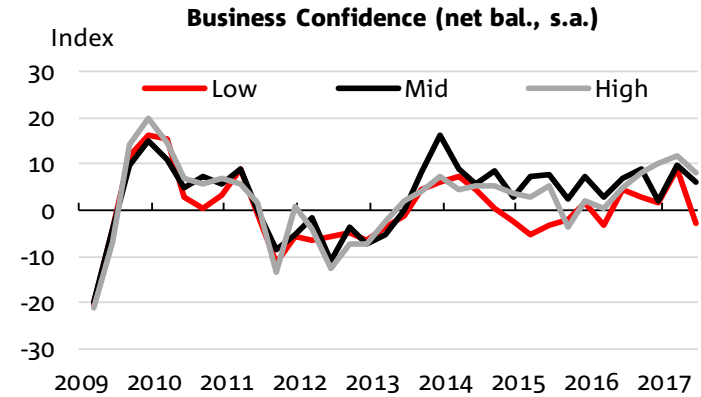
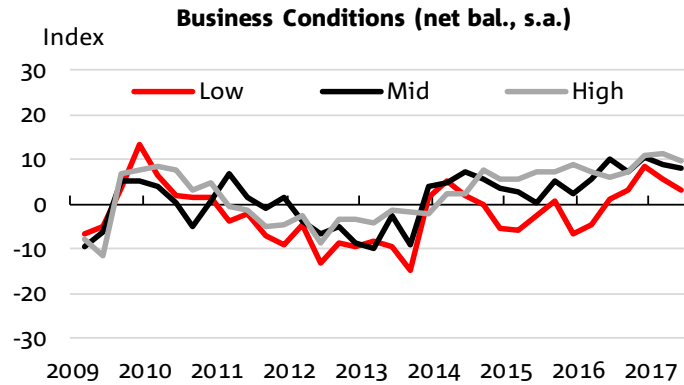
BUSINESS CONDITIONS BY STATE



BUSINESS CONFIDENCE BY STATE



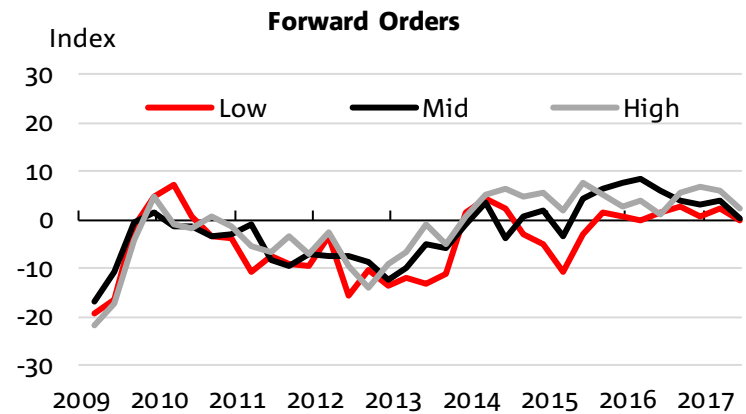
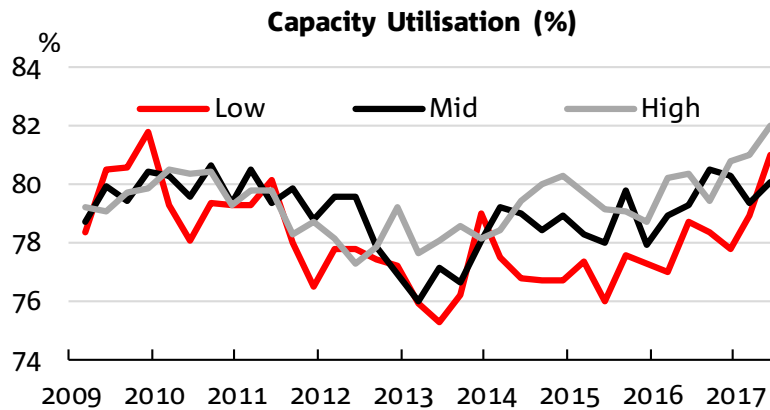
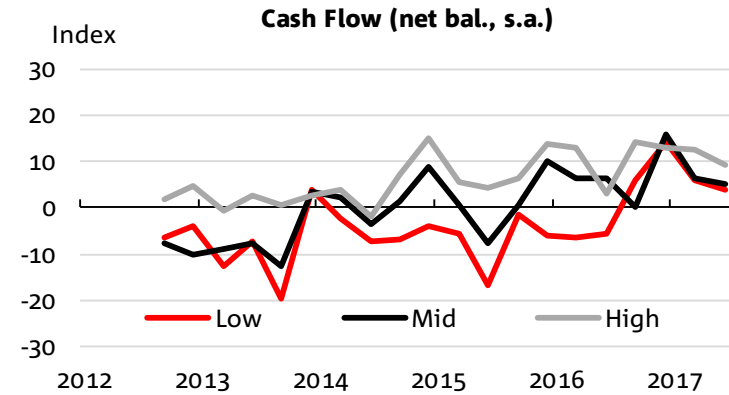
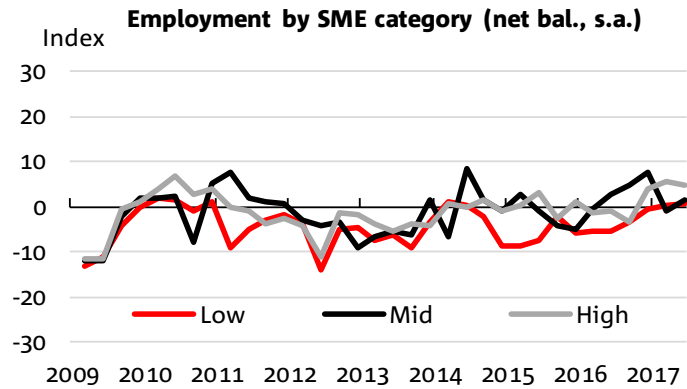
FIRM SIZE



Note:

Firm sizes are determined by their annual gross sales.
 Low-tier firms: \$2 million - \$3 million
 Mid-tier firms: \$3 million - \$5 million
 High-tier firms: \$5 million - \$10 million

FIRM SIZE (CONTINUED)



Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities

Riki Polygenis
Head of Australian Economics
+(61 3) 8697 9534

James Glenn
Senior Economist – Australia
+(61 4)55 052 519

Amy Li
Economist – Australia
+(61 3) 8634 1563

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Behavioural & Industry Economics

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

Robert De lure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

International Economics

Tom Taylor
Head of Economics, International
+61 3 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia

Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy

Ray Attrill
Global Head of FX Strategy
+61 2 9237 1848

Rodrigo Catril
Currency Strategist
+61 2 9293 7109

Interest Rate Strategy

Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Alex Stanley
Senior Interest Rate Strategist
+61 2 9237 8154

Credit Research

Michael Bush
Head of Credit Research
+61 3 8641 0575

Andrew Jones
Credit Analyst
+61 3 8641 0978

Distribution

Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand

Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Jason Wong
Currency Strategist
+64 4 924 7652

Caroline Down
Publications & Web Administrator
+64 4 474 9771

Asia

Christy Tan
Head of Markets Strategy/Research, Asia,
+ 852 2822 5350

Julian Wee
Senior Markets Strategist, Asia
+65 6632 8055

UK/Europe

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

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