

**SME business confidence broadly unchanged – with no sign of the political kick in confidence seen elsewhere in business. That may in part reflect a significant fall in business conditions in the quarter. SME performance in poor sectors of the economy were similar to larger firms but were markedly different in the services sector – generally better. That said, overall forward indicators remain very subdued, implying still soft near-term demand. While cash flow readings among mid to low level SMEs were terrible.**

- SME business confidence was broadly unchanged in the September quarter, but did maintain a solid pick-up from the previous quarter – and is currently at a 2½ year high. While confidence of SMEs was at a similar level to larger firms in the September quarter, the upswing in sentiment for the latter was delayed by one quarter ([NAB Quarterly Business Survey](#)) and appears more political in nature. Confidence lifted significantly in retail and was moderately better in manufacturing and financial services – indicative of the impact of lower rates and the AUD. Confidence rose modestly in Victoria and Queensland. Confidence of low-tier and mid-tier SMEs improved in the September quarter, despite these SMEs experiencing much more difficult conditions than high-tier firms.
- SME business conditions weakened significantly in the September quarter, more than unwinding an improvement in the June quarter, with activity of smaller firms deteriorating to the same subdued level of their larger counterparts. High-tier SMEs generally outperformed low-tier and mid-tier SMEs. Cash flows results at very small and mid-tier SMEs were alarmingly low.
- SME conditions were markedly different across industry, with property and financial services and accommodation, cafes & restaurants holding up relatively well – and out performing their larger counterparts. But like their larger counterparts SMEs reported very poor conditions in retail, manufacturing and wholesale sectors. Business conditions weakened across all states except for WA, with activity slumping to a new low in SA.
- A pull back in forward orders and still weak employment conditions suggest little likelihood of a near-term strengthening in domestic demand, although capacity utilisation did lift from a low level.
- Responses to a special question suggest that in the past twelve months, almost two-thirds of SMEs developed or improved their websites to improve competitiveness, while one-third of respondents reduced their prices.

**Key quarterly business statistics\*\***

	2012q3	2013q2	2013q3		2012q3	2013q2	2013q3
	<i>Net balance</i>				<i>Net balance</i>		
SME business confidence	-7	3	4	SME trading conditions	-3	3	-3
Low	-5	1	4	Low	-7	-8	-13
Mid	-6	1	6	Mid	-3	6	-6
High	-8	3	3	High	0	6	5
SME business conditions	-5	-3	-7	SME profitability	-8	-6	-11
Low	-7	-9	-13	Low	-10	-11	-18
Mid	-5	-1	-9	Mid	-9	-2	-15
High	-3	0	-2	High	-8	-5	-6
SME cash flows (n.s.a.)	-3	-3	-8	SME employment	-2	-5	-5
Low	-6	-7	-20	Low	-3	-6	-7
Mid	-7	-8	-12	Mid	-3	-6	-6
High	2	3	1	High	-1	-4	-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 indices. Fieldwork for this Survey conducted from 26 Aug to 11 Sep 2013 covering almost 800 SME firms across the non-farm business sector.

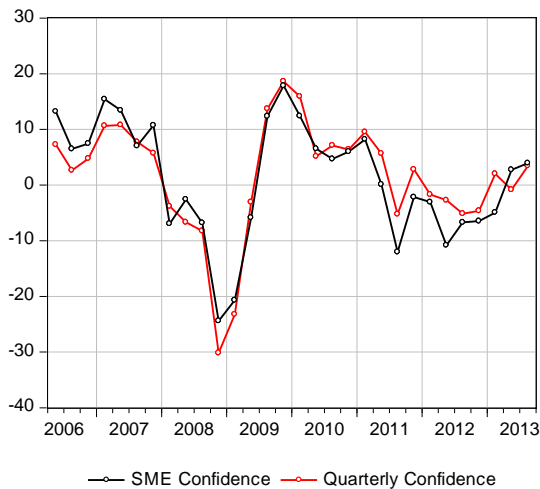
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# Analysis

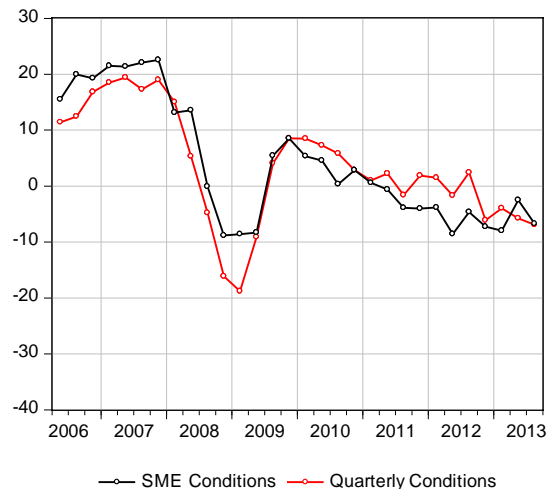
## Confidence broadly unchanged, maintaining previous quarter kick

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



## Conditions falls back to same level of larger firms

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



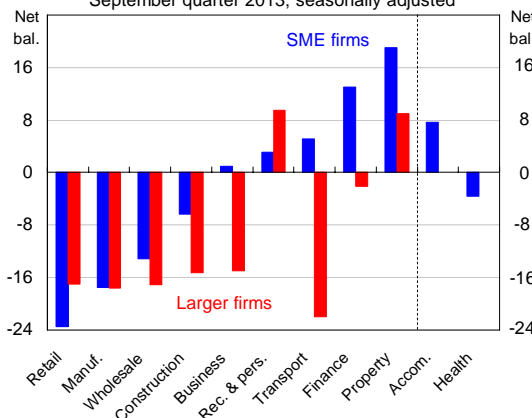
**SME business confidence** was a touch higher in the September quarter – up 1 to +4 points – maintaining a sharp rise in the June quarter and lifting to the highest level in 2½ years. At +4 points, the confidence index is now 3 points above the series average of +1 point since mid-2006. Property and financial services firms were the most optimistic, possibly in response to the recent improvement in housing market activity. SME firms remained marginally more confident than their larger counterparts, although confidence of larger firms rose more swiftly, helping to close the gap. It is possible that smaller firms confidence has been maintained at relatively higher levels as a result of the weaker AUD, better consumer sentiment and lower interest rates. Political factors however appear less relevant for SMEs. Mid-tier and low-tier firms became more confident in the quarter, while levels were unchanged for high-tier firms.

**SME business conditions** deteriorated considerably in the September quarter – down 4 to -7 points – more than unwinding a slight improvement in the June quarter, to be 11 points below the series average of +4 points (since mid-2006). While conditions improved in manufacturing, accommodation, cafes & restaurants – possibly assisted by the lower AUD – construction and transport, they fell back very sharply in health, business services and retail. Business conditions of SMEs deteriorated by more than their larger counterparts, to be at the same subdued level of larger firms.

## SME service firms out performing their larger counterparts

Business Conditions

September quarter 2013; seasonally adjusted

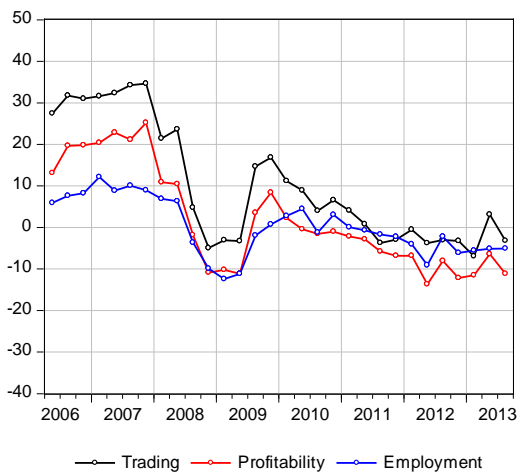


A comparison of industry conditions for SMEs and larger sized firms (taken from NAB's Quarterly Business Survey) suggests that there was only marginal variation between conditions of the very poor performing retail, manufacturing and wholesale industries across firm sizes, but variations between many of the service based industries were quite marked. Activity of larger construction, business services and transport firms was extremely subdued compared to their smaller counterparts, while larger recreation & personal services and financial services firms outperformed their smaller counterparts. Conditions of SME health services fell heavily in the September quarter.

## Analysis (cont.)

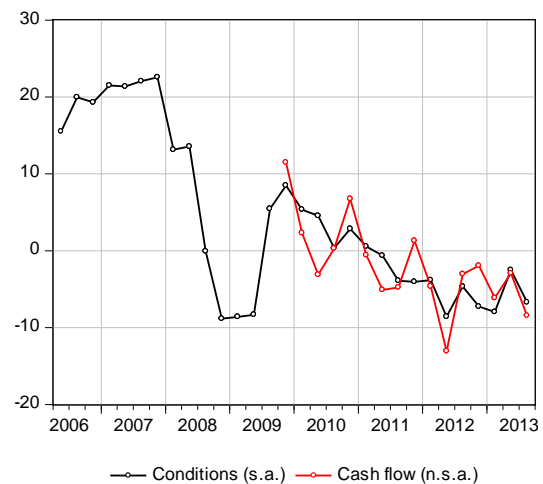
### Profits & trading conditions fall back, employment unchanged

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



### Cash flows fall to very low level

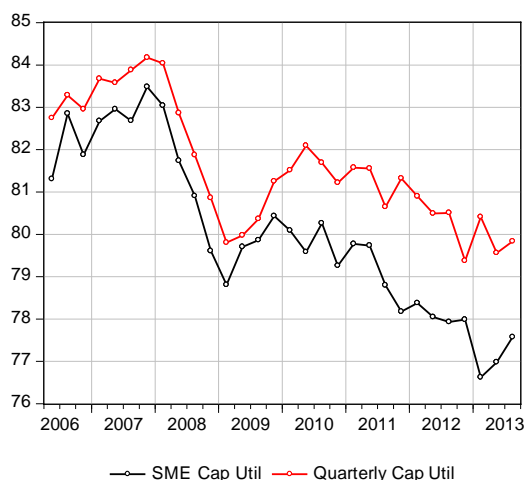
SME business conditions & cash flow (net bal.)



The deterioration in business conditions reflected modest falls in trading conditions and profitability, while employment conditions were unchanged. Worryingly, SME cash flows (not seasonally adjusted) weakened considerably in the September quarter, more than unwinding a notable increase in the previous quarter.

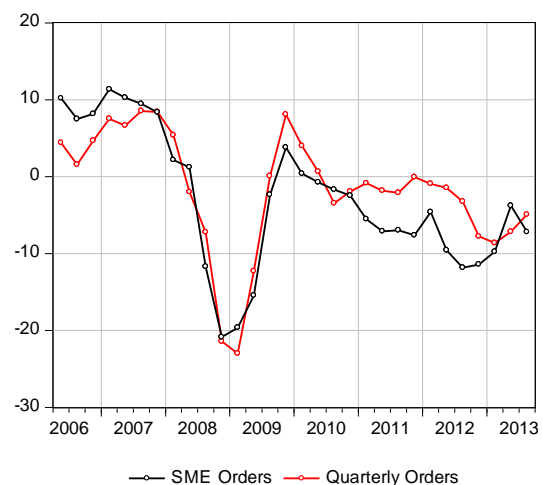
### Utilised capacity increases but from a very low level

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



### Orders weaken, edging below that of larger firms

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

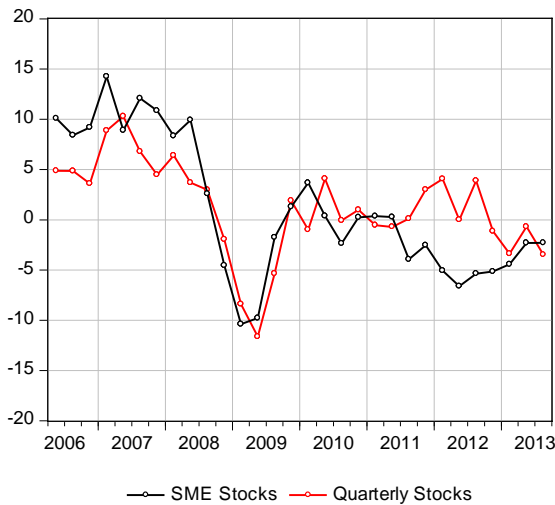


Capacity utilisation rose to 77.6% in the September quarter, up from 77.0%. This outcome is well below the series average of 80.0% since mid-2006, and significantly below the level of utilised capacity of larger firms (79.8%). In the quarter, modest increases in capacity utilisation of low-tier (up 1.0 pts to 76.2%) and high-tier firms (up 0.9 pts to 78.8%) were partly offset by a decline in utilised capacity of mid-tier firms (down 0.5 pts to 76.5%). Across industries, capacity utilisation was very high in health services (87.3%), as well as business services (82.3%) and financial services (81.8%), while it was very low in manufacturing (71.5%) and accommodation, cafes & restaurants (74.8%). Forward orders of SMEs fell back in the quarter, falling 3 points to -7 points. The deterioration in orders was broadly based across industries, with only transport (up 24 to +16 points) and manufacturing (up 5 to -15) reporting better orders. Orders fell heavily in retail (down 8 to -23 points) and accommodation, cafes & restaurants (down 7 to -2 points). The pull back in forward orders across most firms implies little likelihood of a near-term improvement in domestic demand.

## Analysis (cont.)

### De-stocking continues

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



### Investment activity stabilising

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

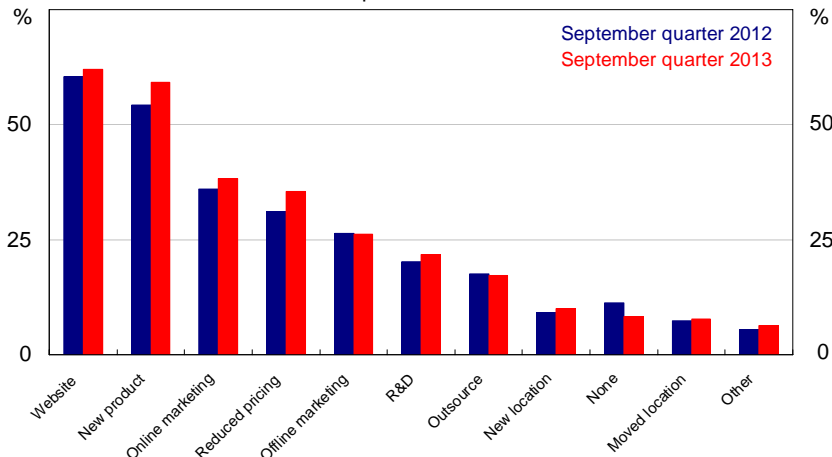


The SME stocks index was unchanged at -2 points in the September quarter, while stocks of larger firms fell over the same period. The still negative reading for SME stocks implies further reduction of inventories in the quarter – presumably voluntary given trading conditions remained difficult. Nonetheless, the stocks index remained at a two year high. Capital expenditure ticked down in the September quarter (excludes mining), partly unwinding a sharp increase in the June quarter, but the index remained in positive territory and above the index of larger firms.

### 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\*

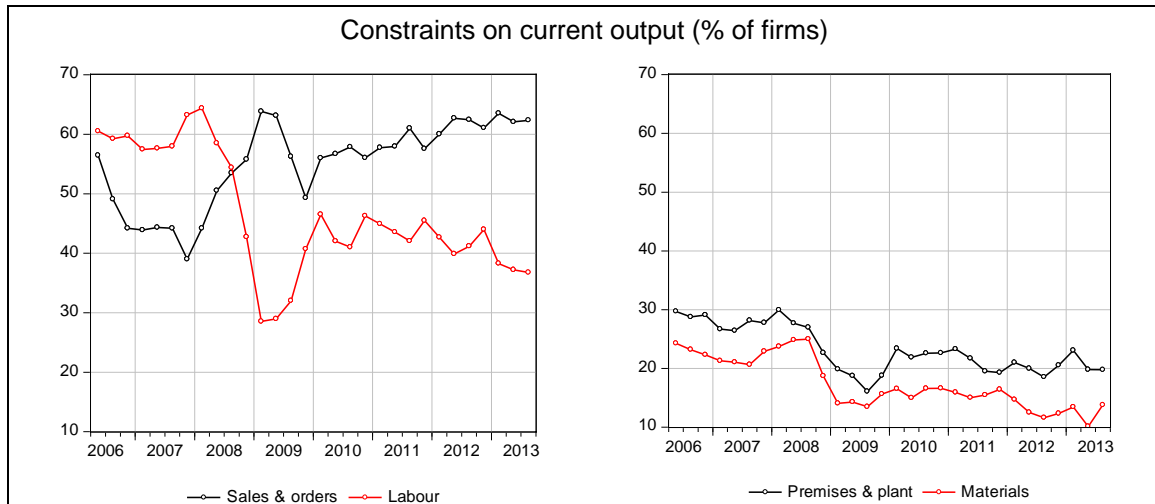


\* Multiple responses allowed; will not sum to 100%  
Source: NAB Quarterly SME Survey

In the September 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 almost two thirds of all respondents developed or improved their websites, while more almost 60% of firms launched new products to try to strengthen their position among their competitors (see Graph). Firms are increasingly reducing their prices in an effort to improve competitiveness. Only a small proportion of respondents either moved or opened new locations to try to improve competitiveness.

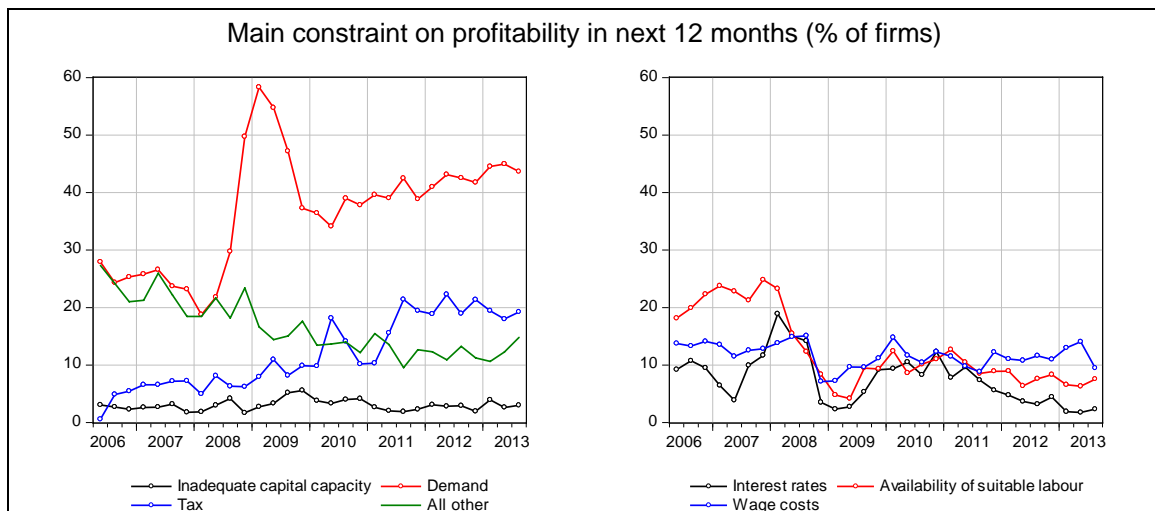
## Analysis (cont.)

### **Sales & orders continue to constrain output, labour not as big a problem**



Sales & orders were again the most constraining factor for SMEs in the September quarter, with around the same proportion of firms reporting it as a constraint this quarter compared to in the June quarter. This outcome is consistent with difficult trading conditions. While still relatively constraining, the availability of suitable labour became less of a constraint on output in the quarter – possibly reflecting a reduced need for new labour in the current soft business environment. Labour availability appears to be more of an issue for SMEs than for their larger counterparts. The labour market has deteriorated over 2013 to date and we expect conditions to remain difficult over the next year. Consistent with this, the difficulty of obtaining suitable labour appears fairly benign for all firms sizes compared to pre-GFC levels. The importance of premises & plant as a constraint was unchanged, while materials became more of a constraint but remained relatively unimportant overall.

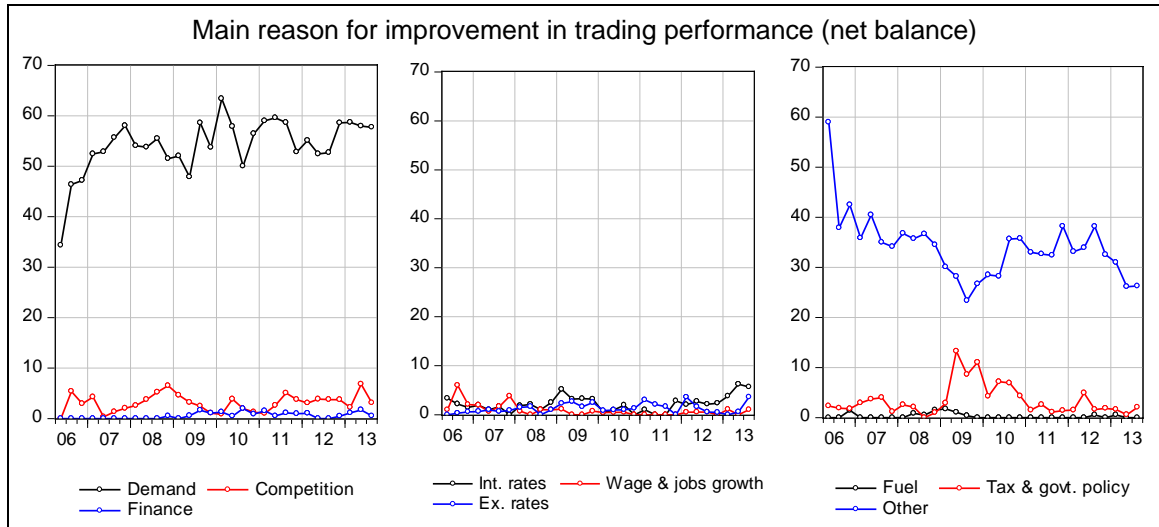
### **Lack of demand expected to constrain profitability the most; wage costs less important**



In the September quarter, a lack of demand remained the number one factor expected to constrain profitability over the next 12 months. This outcome is consistent with difficult trading activity in the quarter, although it became marginally less constraining than in the previous quarter. The proportion of firms concerned about the impact of changes to tax policy remained elevated while 'all other' factors have also increased – the rise in this category partly represented an increase in the proportion of firms worried about the exchange rate being too low (presumably reflecting low pricing power in the retail / wholesale sectors). Fewer firms were worried about wage costs in the quarter, consistent with the current softness in wages growth and the expectation for employment conditions to deteriorate further over the year ahead. Only a very small proportion of firms were concerned about interest rates, while the availability of suitable labour also appeared of little concern to SMEs.

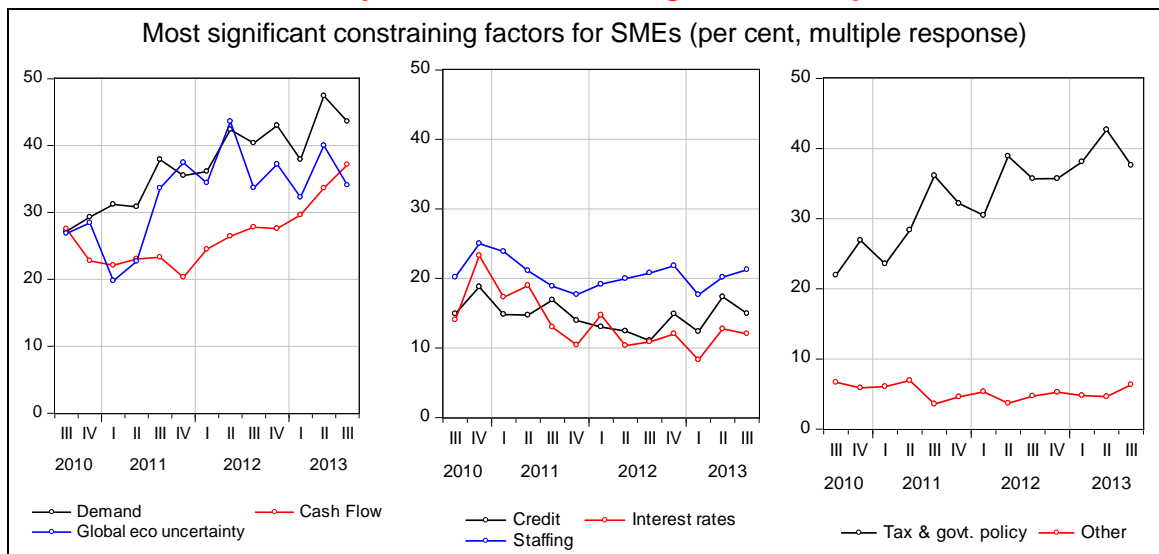
## Analysis (cont.)

### **Demand still driving improvements in trading performance – lower interest rates also helping**



Trading performance fell back in the September quarter, but for the SMEs that did experience better trading activity, demand was the key driver. “Other” reasons as a contributing factor to improved trading remained reasonably significant; this largely reflects seasonal and company specific factors. Access to finance, fuel costs, wage & jobs growth and tax & government policy appear to have provided very little support to trading performance in the quarter.

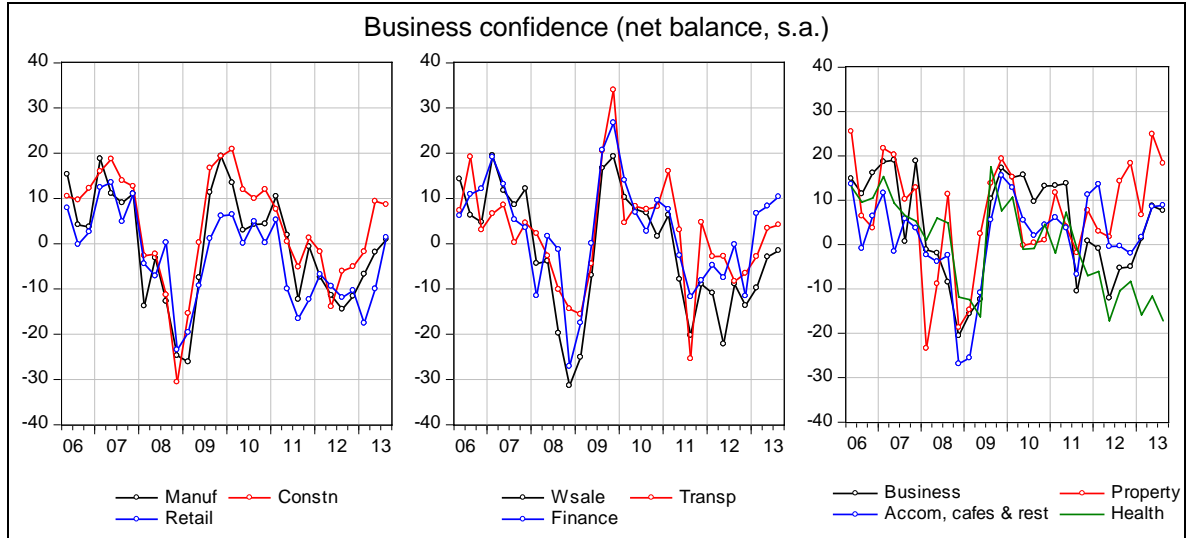
### **SMEs increasingly constrained by poor cash flow, global economic uncertainty not as constraining but still important**



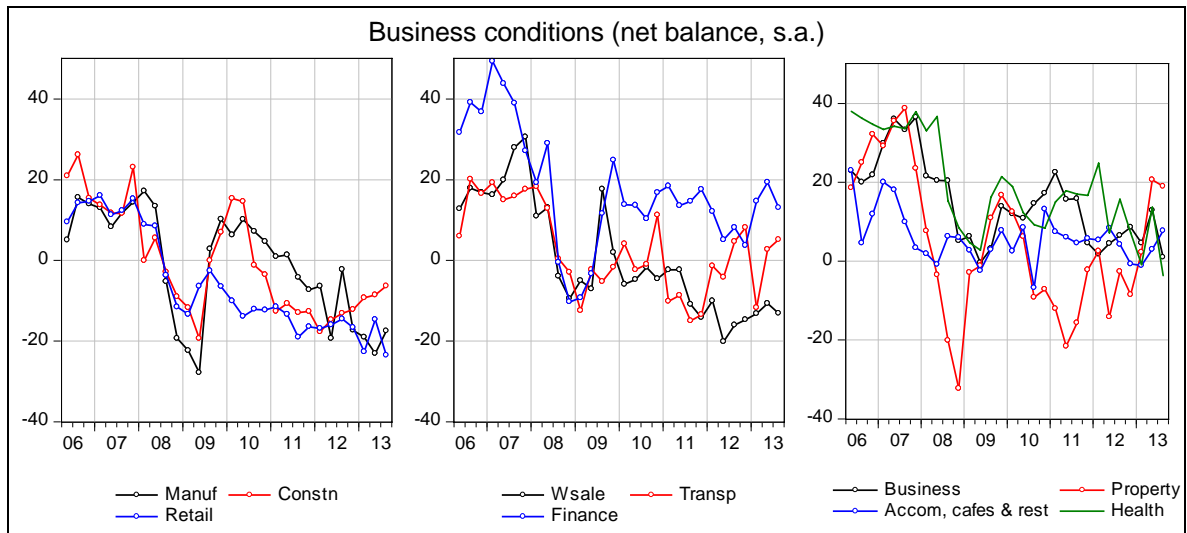
The ability of SMEs to make longer term decisions became increasingly constrained by cash flow – this is consistent with cash flow deteriorating to a very low level in the quarter. Staffing also became more of a constraint in the quarter, but remained at a relatively low level. In contrast, firms appeared less constrained by demand, global economic uncertainty and tax & government policy, though these constraints remained reasonably significant overall. It is possible that the election, which occurred during the survey period, alleviated SME concerns about tax & government policies. Firms were also a little less constrained by interest rates and credit, possibly helped by lower interest rates and relatively lower volatility in financial markets.

# Industry analysis

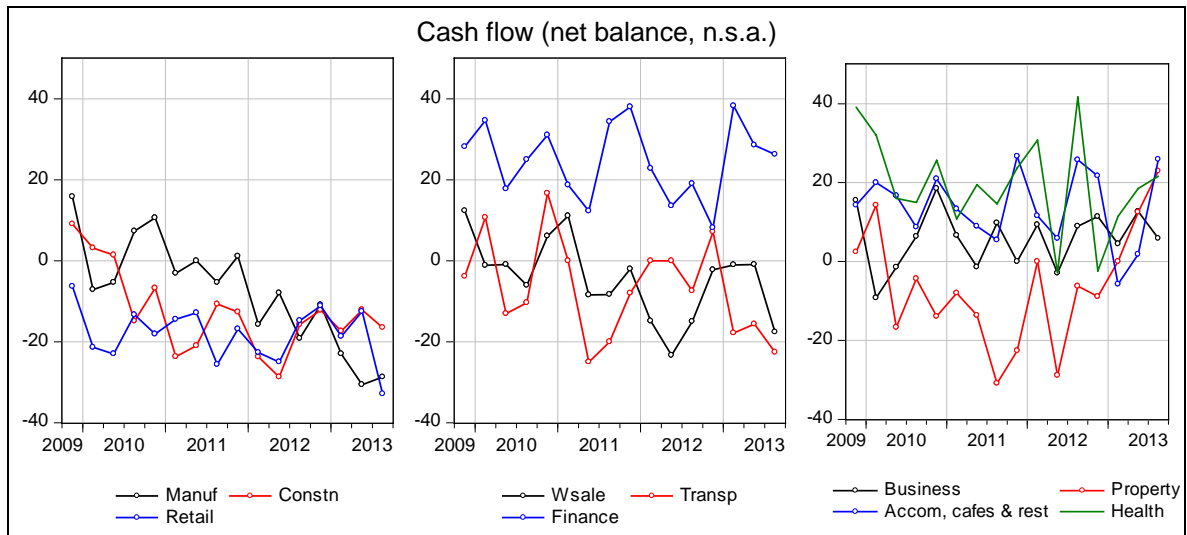
**Property & professional services most optimistic;  
health services very pessimistic**



**Conditions fall heavily in health & business services**

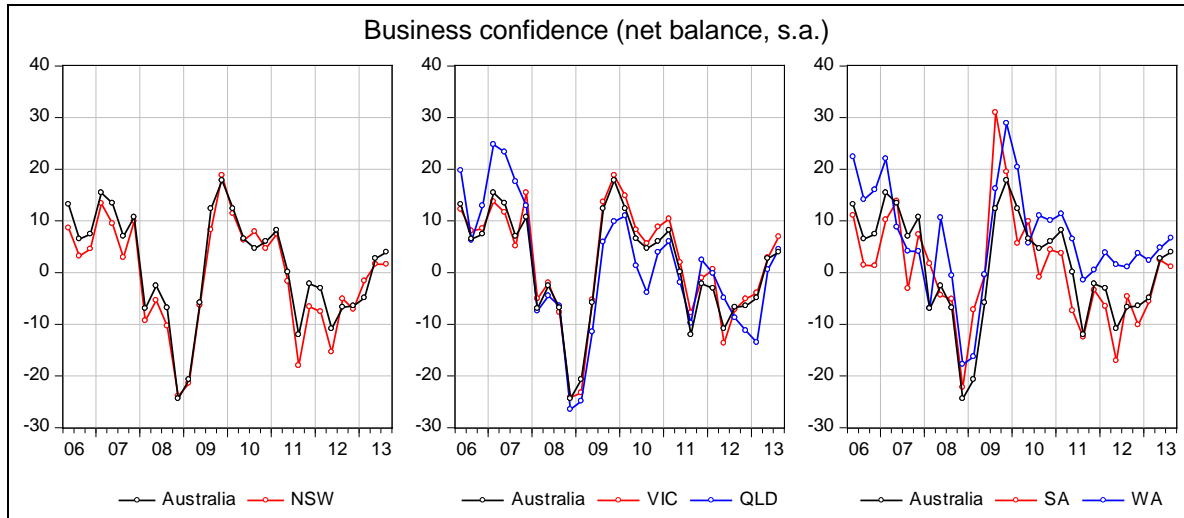


**Cash flows very poor in retail and manufacturing; much better in  
accommodation and financial services**

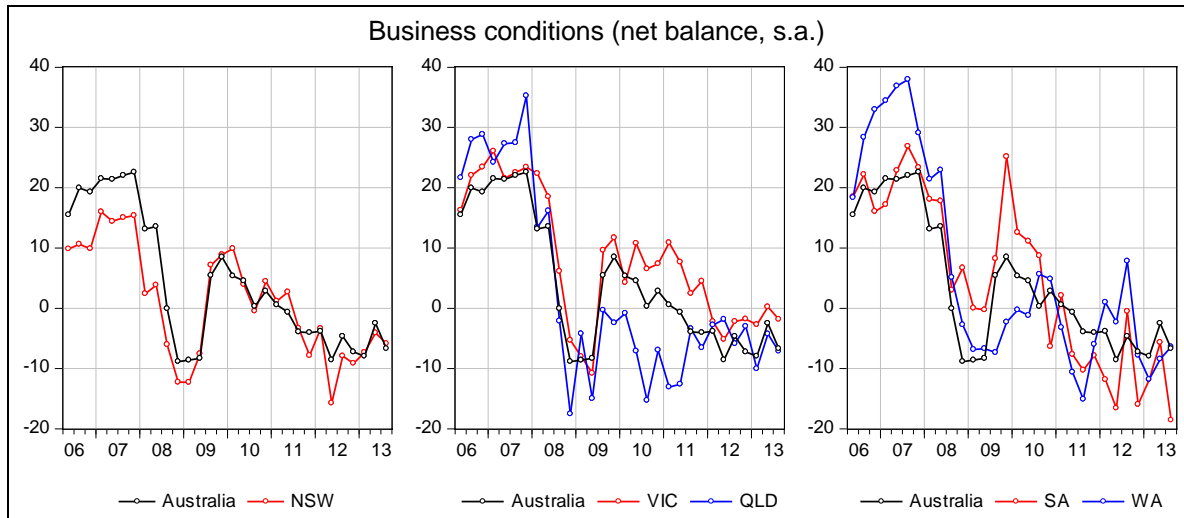


# State analysis

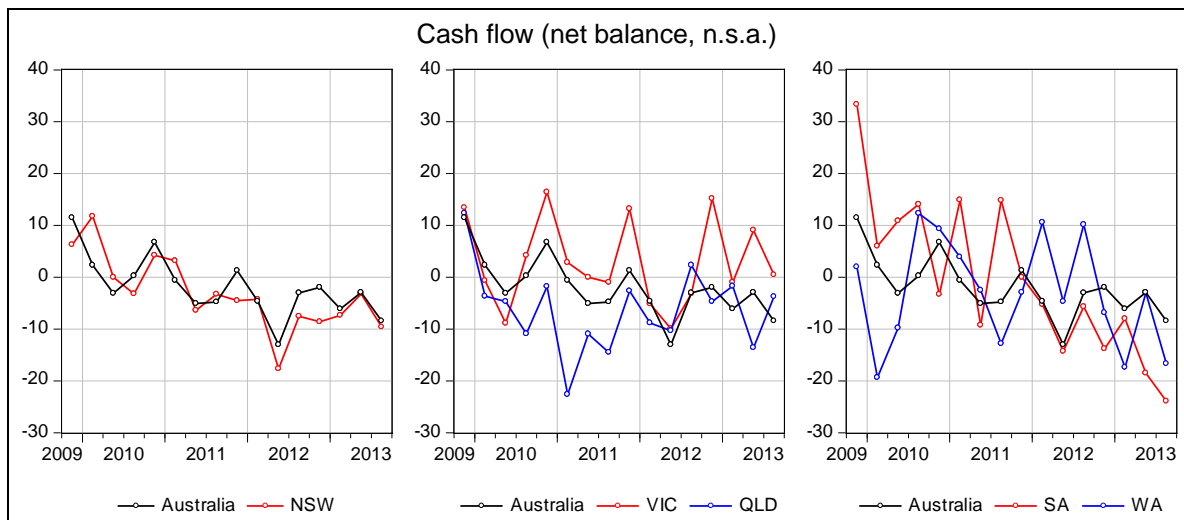
**Business confidence up across all states except for SA; level of confidence broadly similar across all states**



**Conditions weaken across all states except for WA**



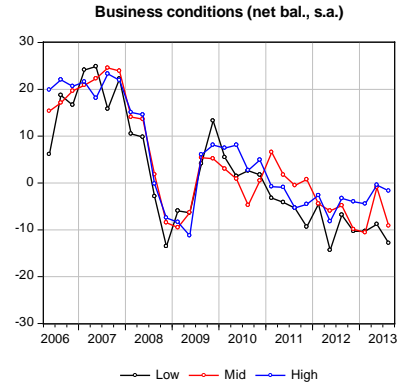
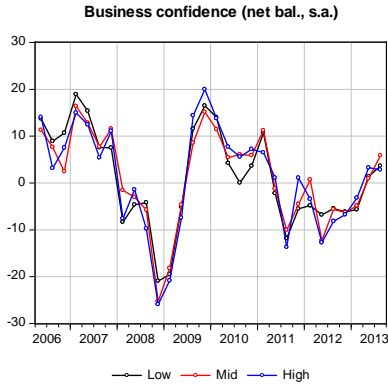
**Cash flows remain strongest in Victoria and weakest in South Australia**



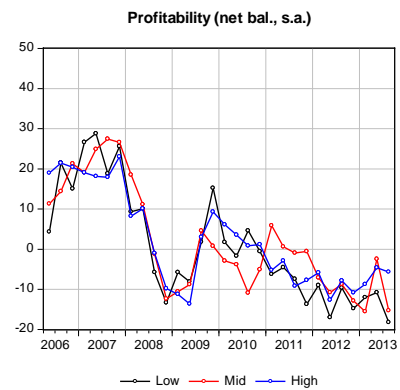
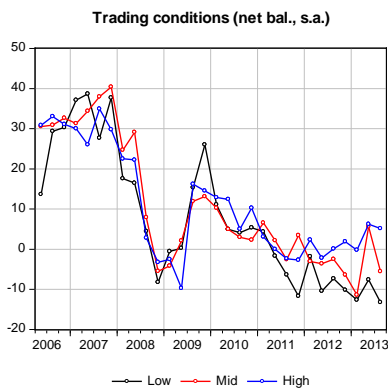


# Firm size analysis

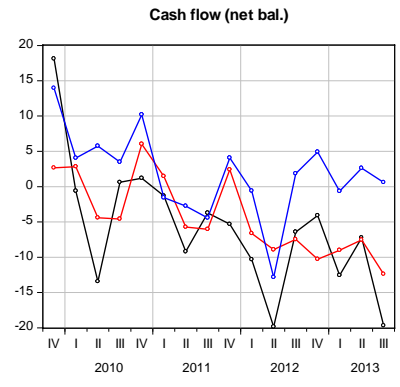
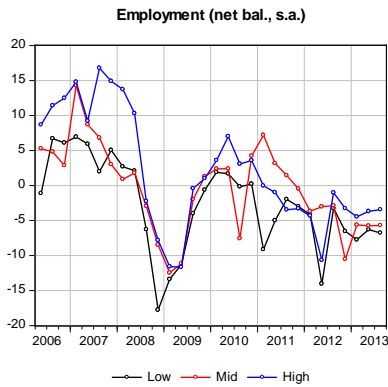
## *SMEs more confident but conditions still difficult*



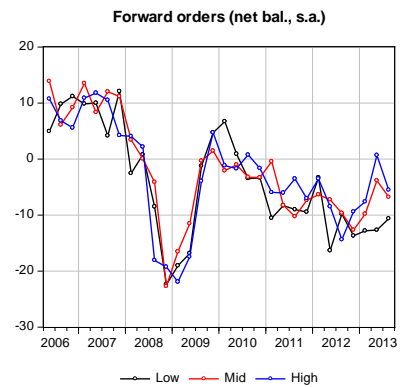
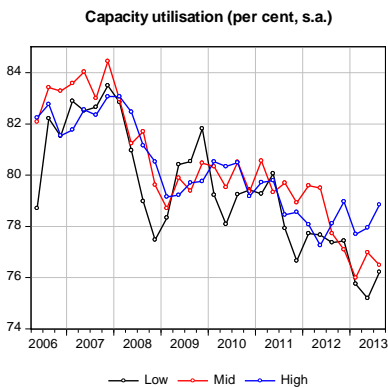
## *Mid-tier firms' conditions deteriorate significantly*



## *Cash flows deteriorate very sharply for low-tier firms*



## *Capacity utilisation rises for high-tier and low-tier firms; forward orders generally better than outcomes over past year*



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