

**Quarterly SME Survey**
**March quarter 2014**

**SME business confidence eased for the first time in over a year – consistent with persistently soft conditions and trends seen by larger firms. Nevertheless, business activity has improved with conditions rising to their highest since mid-2010 – although still sub-trend. SME's still outperform larger firms in a number of industries, particularly in professional services and construction. Forward indicators are better, and suggest demand is returning close to trend, although firms are still cautious on the demand outlook.**

- SME business confidence dropped for the first time in over a year in the March quarter, but remains at a relatively positive level overall. The drop was consistent with what we have seen from larger firms in the quarter as the exuberance seen since last year gradually adjusts to more subdued (although improving) levels of business activity ([NAB Quarterly Business Survey](#)). Nevertheless, low interest rates (and strong foreign buyer interest) have seen property markets perform well, contributing to confidence in property, construction and business/financial services firms, which remain among the most optimistic. Transport recorded a significant improvement this quarter, possibly reflecting signs of improvement in other domestic industries. Confidence was down across all the states, although still positive, with South Australia continuing to lag farthest behind. Confidence fell in mid and higher-tier firms, with only low tier firms recording a modest lift.
- SME business conditions rose again in Q1, moving SME business activity up towards trend. Conditions improved for SME of all sizes, but low and mid-tier firms are still outperforming their larger counterparts. However, employment conditions deteriorated sharply for mid-tier SMEs in the quarter – despite higher capacity utilisation.
- Conditions were mixed across industries in the quarter, but construction and retail improved the most. Conditions facing financial/business services are the most positive, reflecting trends in confidence, while manufacturing and wholesale are under-performing. SMEs are performing better than their larger counterparts in a number of industries – particularly in business/property services and construction – as well as reporting better conditions overall. Conditions rose across all states except WA, but are still very weak in SA.
- Forward orders improved, suggesting a further lift in SME activity, although employment conditions remain weak despite some improvement.
- Responses to a special question suggest that in the past twelve months, more than half of SMEs developed or improved their websites to improve competitiveness and/or looked to develop new products. Research & development and offline marketing have also grown in popularity as a strategy, suggesting that cost cutting may be reaching its limits.

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

	2013q1	2013q4	2014q1		2013q1	2013q4	2014q1
	<i>Net balance</i>				<i>Net balance</i>		
SME business confidence	-5	<b>10</b>	<b>6</b>	SME trading conditions	-8	<b>6</b>	<b>9</b>
Low	-6	<b>6</b>	<b>8</b>	Low	-14	<b>7</b>	<b>10</b>
Mid	-6	<b>15</b>	<b>9</b>	Mid	-11	<b>10</b>	<b>14</b>
High	-3	<b>8</b>	<b>4</b>	High	0	<b>4</b>	<b>6</b>
SME business conditions	-8	<b>0</b>	<b>3</b>	SME profitability	-12	<b>-3</b>	<b>1</b>
Low	-11	<b>2</b>	<b>4</b>	Low	-12	<b>2</b>	<b>-1</b>
Mid	-10	<b>3</b>	<b>4</b>	Mid	-16	<b>-1</b>	<b>4</b>
High	-5	<b>-2</b>	<b>2</b>	High	-9	<b>-6</b>	<b>0</b>
SME cash flows (n.s.a.)	-6	<b>3</b>	<b>2</b>	SME employment	-5	<b>-3</b>	<b>-1</b>
Low	-13	<b>4</b>	<b>-2</b>	Low	-8	<b>-4</b>	<b>0</b>
Mid	-9	<b>4</b>	<b>2</b>	Mid	-6	<b>1</b>	<b>-7</b>
High	-1	<b>3</b>	<b>4</b>	High	-5	<b>-5</b>	<b>1</b>

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 24 Feb to 12 Mar 2014 covering over 700 SME firms across the non-farm business sector.

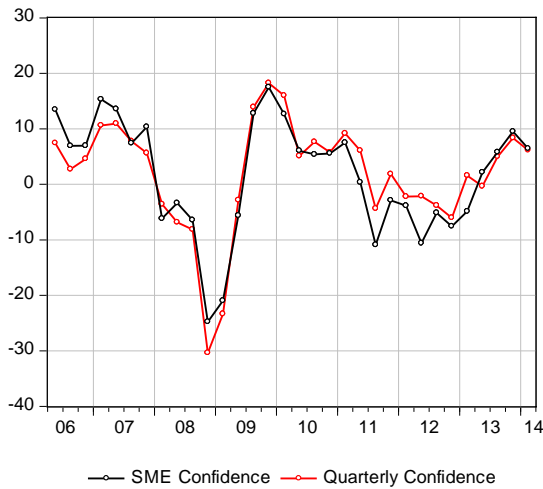
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Next release:  
12 May 2014 (April Monthly)

## Analysis

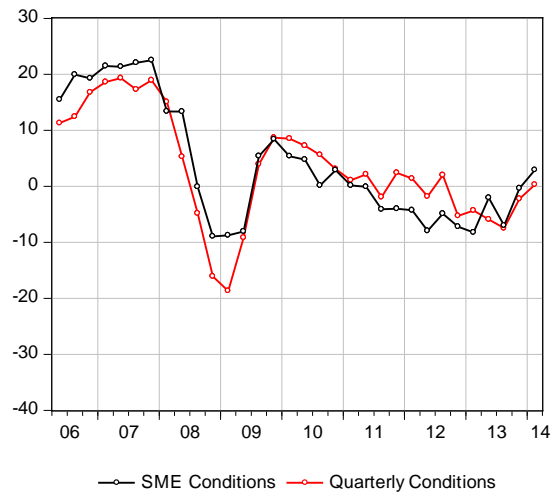
### Confidence ticked down in line with larger firms

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



### Conditions lift higher than larger firms, but still sub-trend

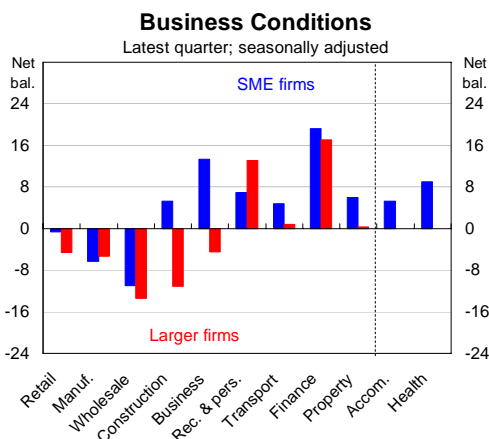
Business conditions (net bal., s.a.), SME & quarterly



**SME business confidence** dropped for the first time in over a year in the March quarter, down 4 points to (a still reasonably good) +6 index points; well above the series average of +1 point since mid-2006. This reflects an unwinding of some of the exuberance that firms exhibited in response to the Federal election, a depreciation of the AUD and very low interest rates. Property, construction and business/financial services firms remain among the most optimistic, reflecting the good performance of property markets in 2013, but transport also recorded a significant improvement possibly reflecting signs of improvement in other domestic industries (eg. construction and household consumption) along with the anticipated end to the carbon tax. Confidence of larger firms fell by a similar degree to SMEs, and both are around similar levels. Mid-tier firms appear to have been the most confident in the quarter, but low-tier firms actually recorded a modest improvement in confidence.

**SME business conditions** ticked up again in the March quarter, consistent with signs of improvement in some pockets of the economy. But despite the lift, conditions remain below long-run averages and continue to lag behind confidence, which could prompt confidence to ease further over coming quarters. Conditions were up 3 points to +3 points, which is the highest level since mid-2010, but still slightly below the series average of +4 points (since mid-2006). Conditions were mixed across industries in the quarter, but construction, retail and transport improved the most. Similar to trends in confidence, conditions facing financial/business services are the most positive, while manufacturing and wholesale remain the under-performers. Business conditions of SMEs rose a little more than their larger counterparts and are still higher, although both remain relatively soft.

### SME firms generally out performing their larger counterparts

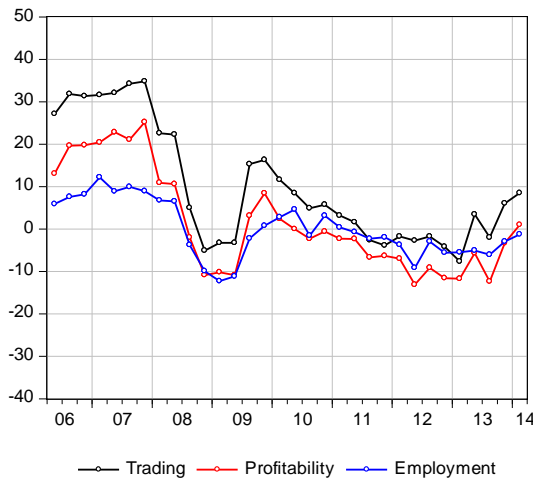


A comparison of industry conditions for SMEs and larger sized firms (taken from NAB's Quarterly Business Survey) suggests that smaller firms are performing better than their larger counterparts in a number of industries – as well as reporting better conditions overall. The largest disparities are occurring in business/property services and construction, where smaller firms are performing much better. The only industry where larger firms are reporting noticeably better conditions than their smaller counterparts is in recreation & personal services – although conditions are still positive in this industry for smaller firms.

## Analysis (cont.)

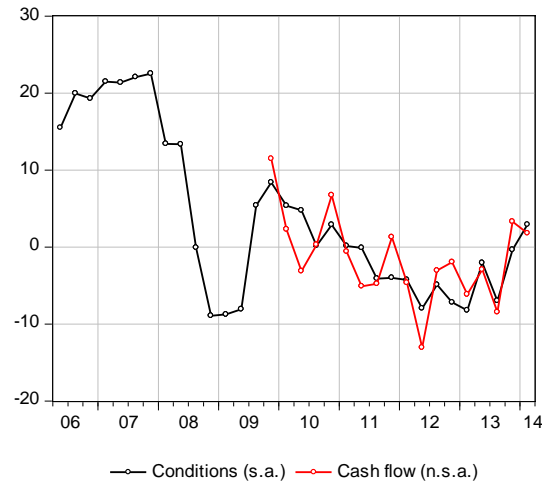
### Profits, trading and employment all rose, latter still negative

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



### Cash flows dipped, but still positive

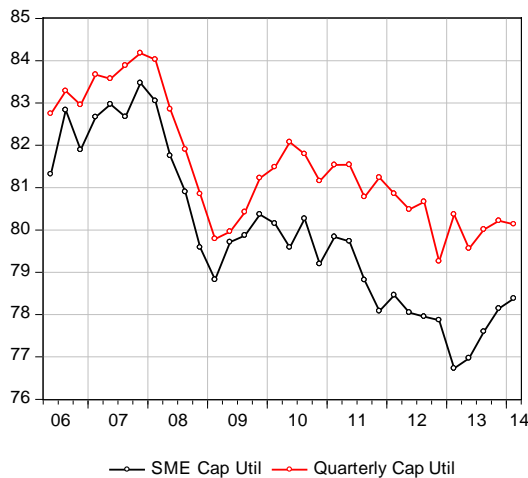
SME business conditions & cash flow (net bal.)



The quarterly rise in business conditions reflected rises in trading conditions and profitability, while employment conditions showed a slightly more modest increase. In contrast, SME cash flows (not seasonally adjusted) eased a little in the March quarter, but this has only partly unwound a sharp improvement in the previous quarter – the cash flow index is still positive.

### Utilised capacity increases but remains at very low level

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



### Orders gain momentum, highest since late 2009

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

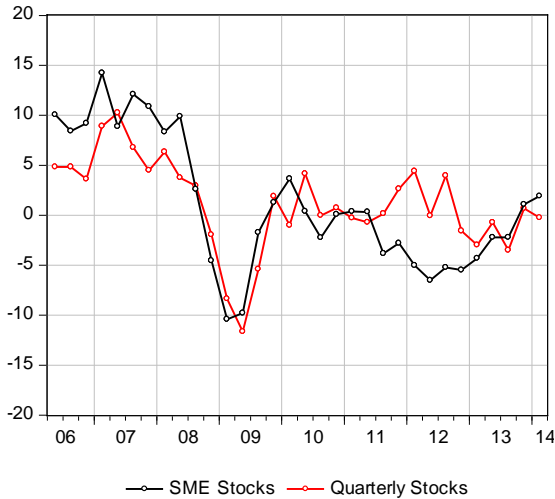


Capacity utilisation rose to 78.4% in the March quarter, up from 78.1%. Despite the rise, utilisation is still well below the series average of 80.0% since mid-2006, and significantly below the level of utilised capacity of larger firms (80.1%). In the quarter, solid increases in capacity utilisation of high-tier (up 0.4 ppts to 78.3%) and mid-tier firms (up 0.8 ppts to 79.1%) were partly offset by a decline in utilised capacity of lower-tier firms (down 1.7 ppts to 77.4%). Across industries, capacity utilisation was very high in health services (87.8%), as well as financial services (83.0%) and business services (82.7%), while it was very low in accommodation, cafes & restaurants (73.6%) and manufacturing (74.8%). Forward orders of SMEs improved further in the quarter, rising 2 points to +3 points, which is its highest level since late 2009 and is suggesting reasonably solid output from SMEs over the coming quarter. The improvement in the orders index was largely concentrated in transport and manufacturing, although at +1 index points for manufacturing orders, this still suggests headwinds from the elevated AUD, high costs and an uncertain global economy. Orders are strongest for transport and finance (+14 and +13 respectively). Orders are still very weak for health and retail, despite improvements in retail sales in recent months.

## Analysis (cont.)

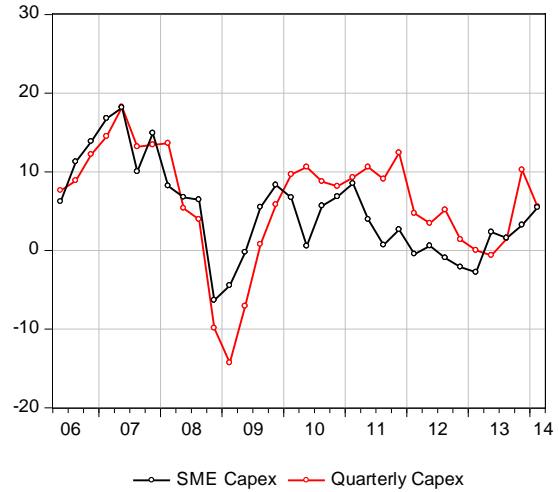
### **Firms are tentatively re-stocking in response to higher orders**

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



### **Investment activity rose further, while larger firms pull back**

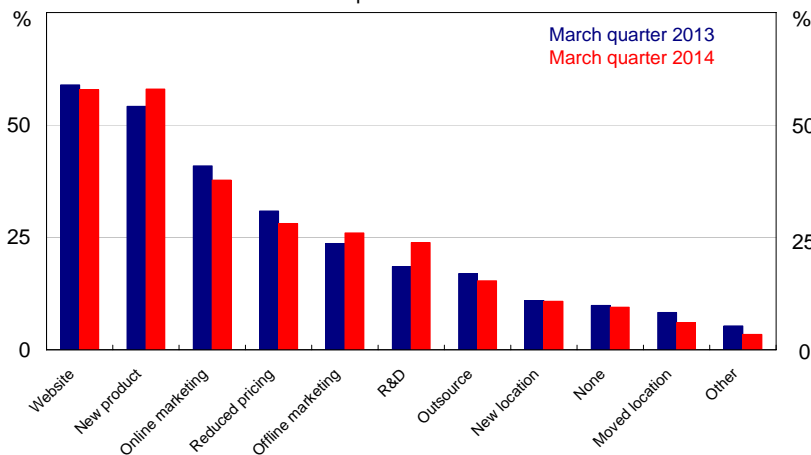
Capital expenditure (net bal., s.a.), SME & quarterly



The SME stocks index was up 1 point to 2 index point in the March quarter, a higher level of stock building than that recorded by larger firms over the same period. The positive reading for SME stocks – only the second since mid-2011 – implies a moderate build in inventories in the quarter, which could signal that the lift in orders and trading conditions is prompting firms to become more confident in the demand outlook. The stocks index is now close to a four year high. Capital expenditure also ticked up in the March quarter (excludes mining), lifting the index to its highest level since early 2011. Smaller firms lifted capex in the quarter as larger firms pulled back following a (surprisingly) sharp increase in their capex index last quarter.

### **A majority of firms are developing new products or increasing their online presence to boost their competitiveness in the market**

Strategies employed over past 12 months to improve competitiveness  
Proportion of firms\*

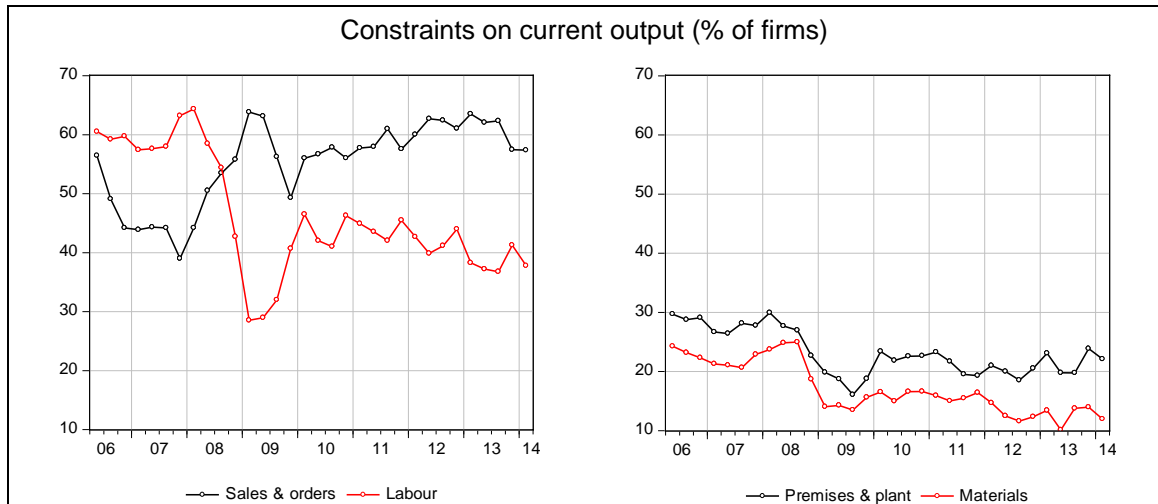


\* Multiple responses allowed; will not sum to 100%  
Source: NAB Quarterly SME Survey

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. There were very few changes to the responses, which suggest a degree of consistency in how firms are reacting to competitive pressures. New product development has become noticeably more common, while less are focussing on 'offline' marketing, cost cutting and outsourcing. The heavy focus on creating an online presence and online marketing is consistent with firms focussing less on the (disruptive) strategies of moving (or establishing new) locations.

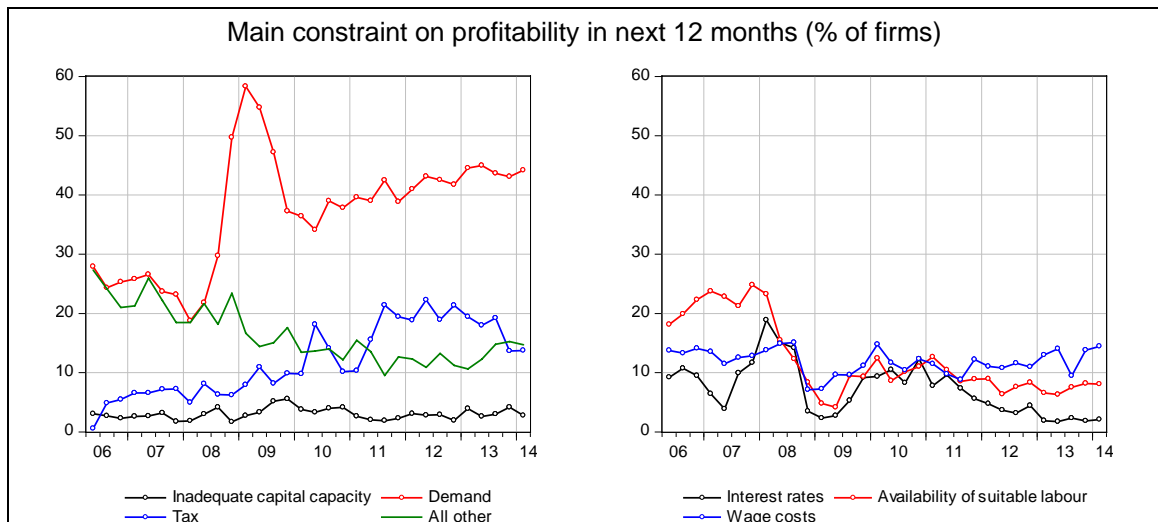
## Analysis (cont.)

### **Demand is the biggest constraint on output, despite rising sales**



There were further improvements in trading conditions and orders in the March quarter, but a majority of firms still see demand as the biggest constraint to output – likely to remain the case for some time given the degree of excess capacity remaining in the economy (including labour markets). Nevertheless, the proportion of firms reporting demand as a constraint was at its smallest share in over three years (57.4%) – broadly consistent with that reported by larger firms. Soft labour market conditions are keeping the proportion of firms reporting the availability of labour as a constraint at low levels relative to the pre-GFC period, although it is still a major concern for SMEs. With labour markets expected to remain soft and mining investment passing its peak (freeing up factor inputs for non-mining sectors), supply side constraints are expected to remain secondary for the foreseeable future. Consistent with this, the importance of premises & plant and material both edged down, and remain low overall.

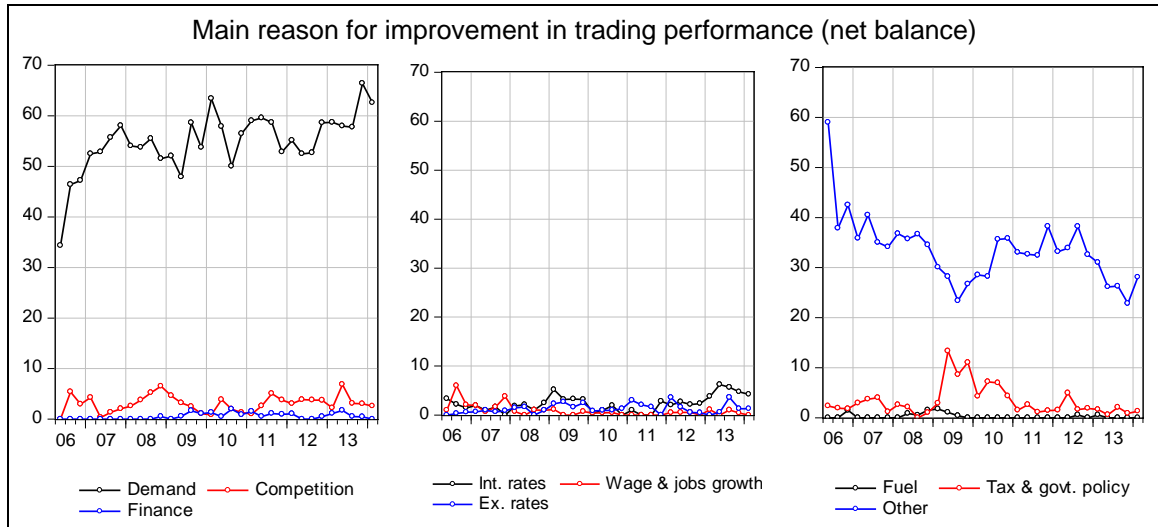
### **Similarly, lack of demand to constrain profitability the most over the next 12 months; tax & govt policy less important (even as budget approaches)**



In the March quarter, a lack of demand remained the number one factor expected to constrain profitability over the next 12 months. This ticked up slightly from the previous quarter, which is surprising given the apparent improvement in the broader economy in recent months and the lift in trading conditions and orders in the March quarter survey. This suggests that firms still have some reservations about the demand outlook and has been reflected in a drop in both firm's employment and capex expectations over the next 12 months. The proportion of firms concerned about the impact of changes to tax policy is elevated, but still down on recent years, consistent with the incoming government's pledge to scrap the carbon and mining taxes – suggesting limited concern over the upcoming 'tough' budget. Firms were slightly more worried about wage costs in the quarter, despite current weakness in the labour market.

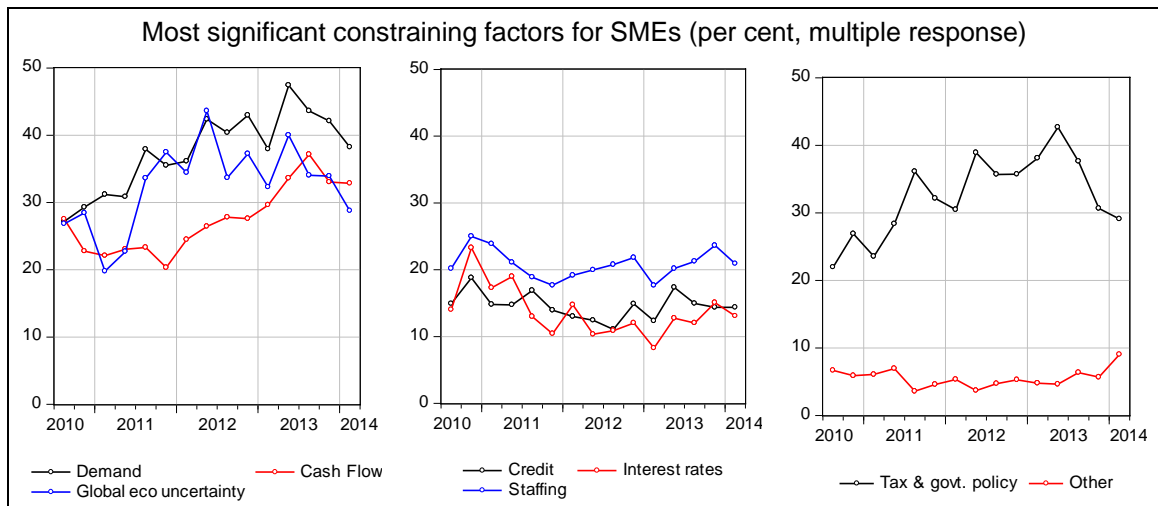
## Analysis (cont.)

### **Improving trading performance driven by demand and 'other' factors – exchange rate and interest rates apparently very little help**



Trading performance lifted in the March quarter, with a majority of SMEs reporting that stronger demand was the main reason behind the improvement. “Other” reasons as a contributing factor to improved trading remained reasonably significant – largely reflecting seasonal and company specific factors – and lifted to its highest level in a year, stalling the steady declining since mid-2012. 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.

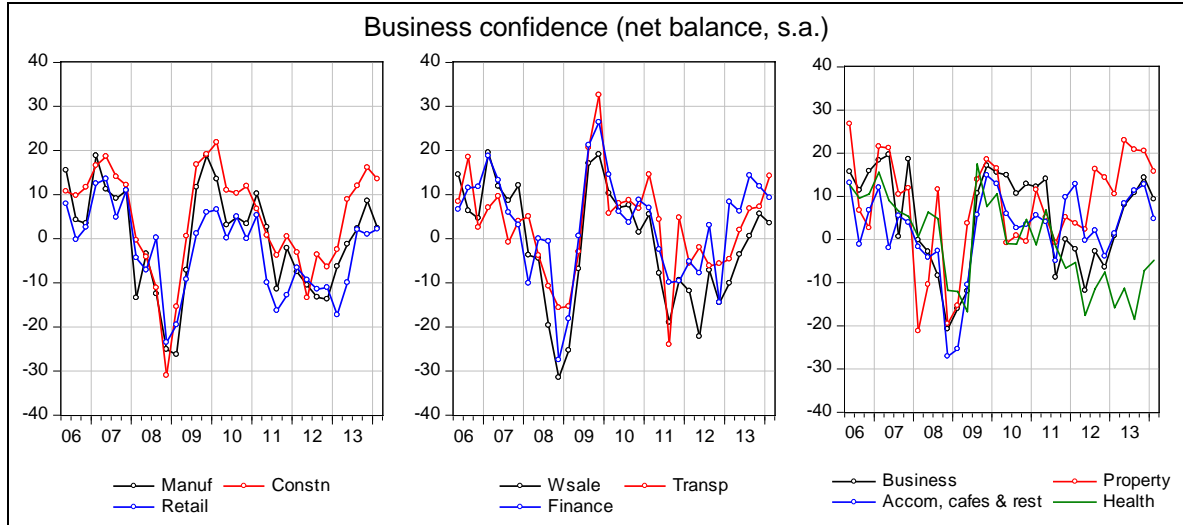
### **Most major constraints on SMEs are easing. Staffing dropped for the first time in 12 months. Global uncertainty improved notably**



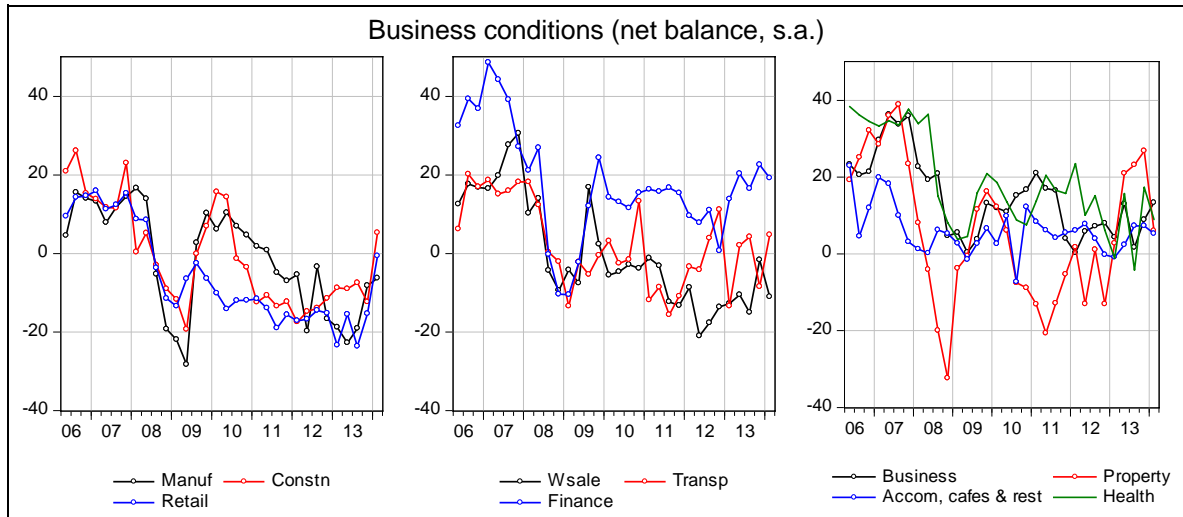
The major constraints affecting SMEs ability to make longer term decisions are generally easing, with ‘other’ factors – largely company specific factors – the only response reported by a greater proportion of firms in the quarter. Nevertheless, demand, cash flows, global economic uncertainty and government tax/policy all remain the most significant. It is possible that the change in government is still helping alleviate SME concerns about tax & government policies, while improved trading conditions are helping the demand outlook. However, firms growing confidence in the global economy likely reflects more stability in the US, but is inconsistent with ongoing signs of slowing in the Chinese economy (Australia’s largest trading partner). Firms were a little less constrained by interest rates (credit was broadly unchanged), which is likely to remain the case over coming months with the Reserve Bank of Australia expected to remain on hold for the time being.

## Industry analysis

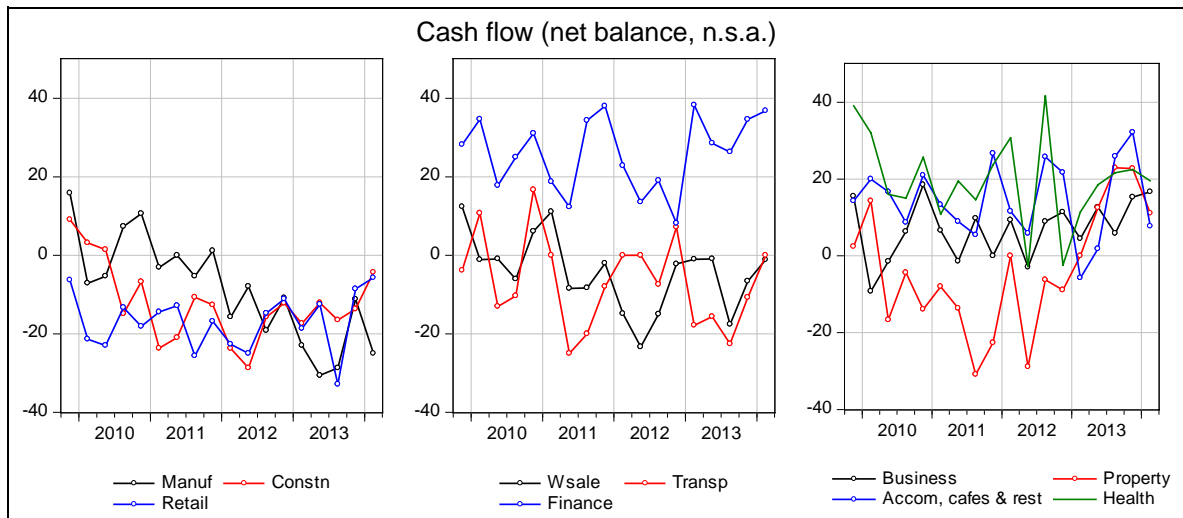
**Property, transport and construction are most confident; health services still very pessimistic, but improving**



**Conditions deteriorated sharply for property services; Finance now highest**

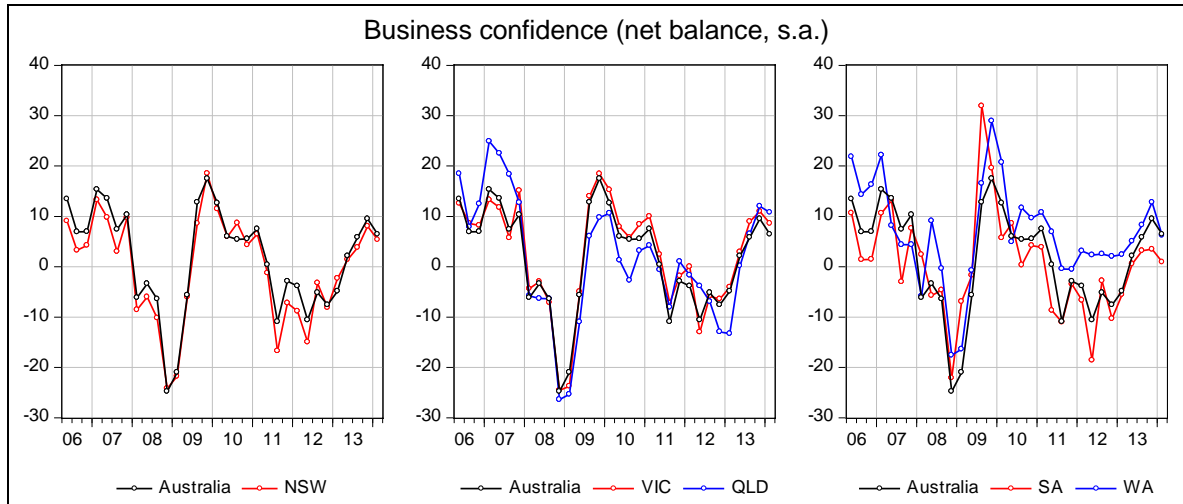


**Cash flows were mixed; down heavily in accommodation, cafes & restaurants; Best in finance, worst in manufacturing**

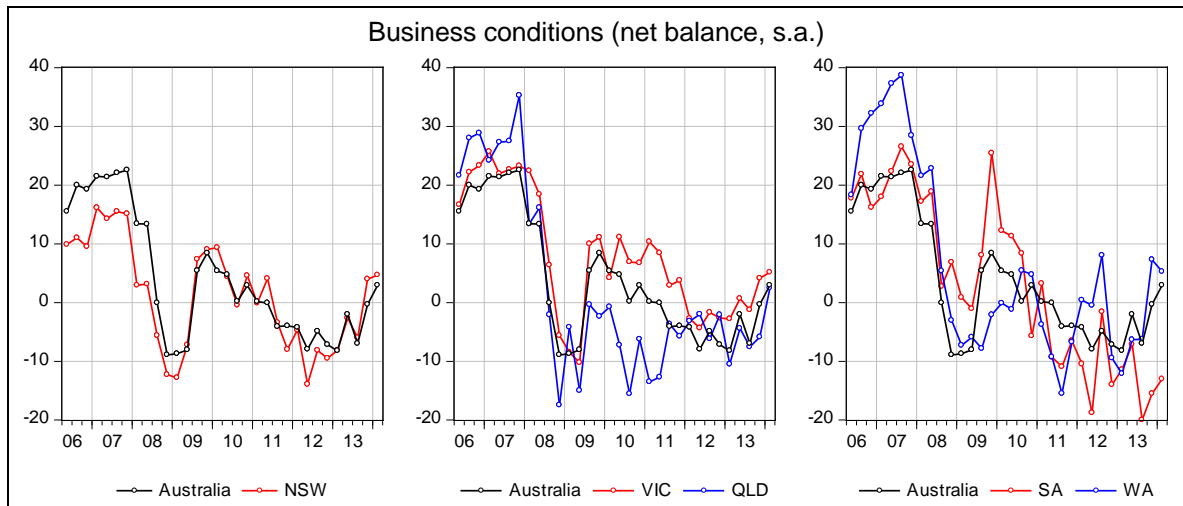


## State analysis

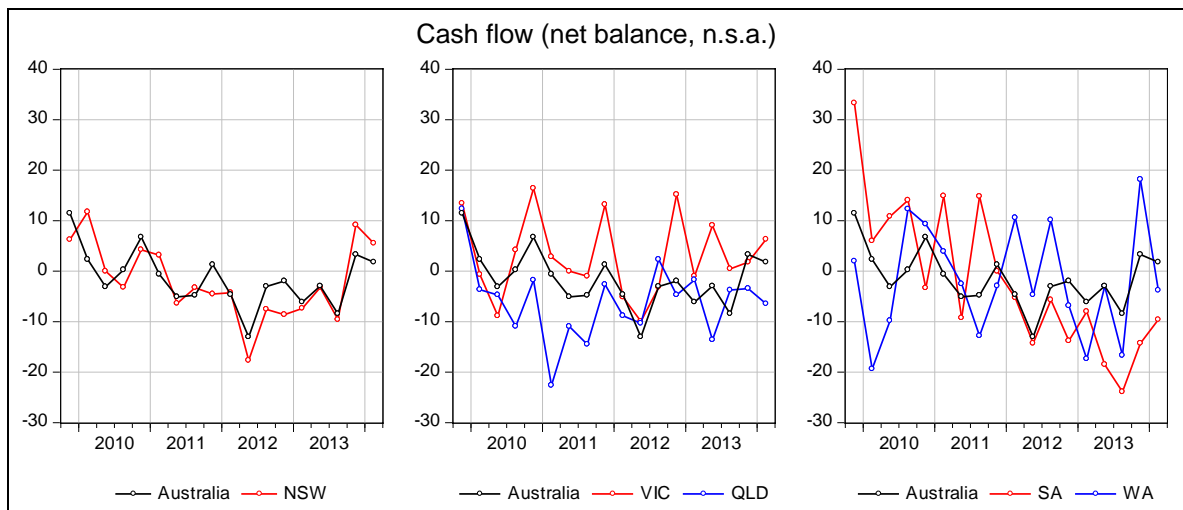
**Business confidence down across all states; South Australia still trailing behind other states**



**Conditions rise across all states except WA; still very weak in SA**



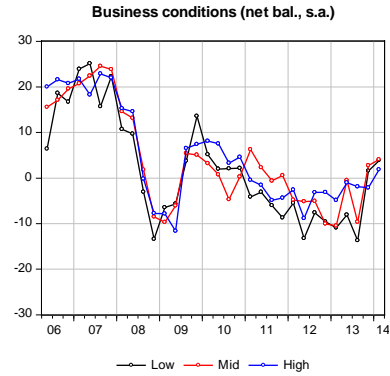
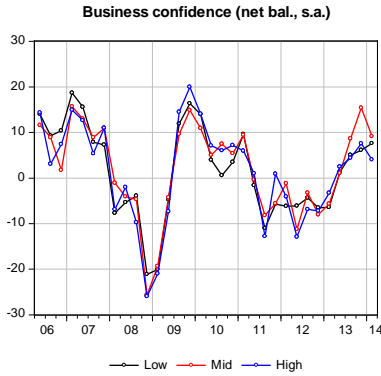
**Cash flows are strongest in Victoria and NSW, negative in South Australia, Queensland and Western Australia**



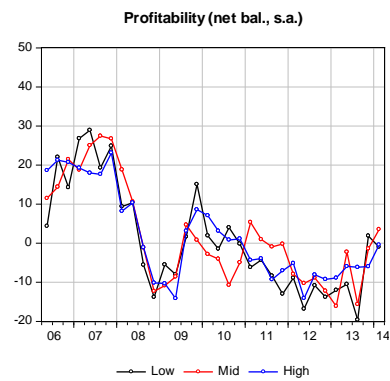
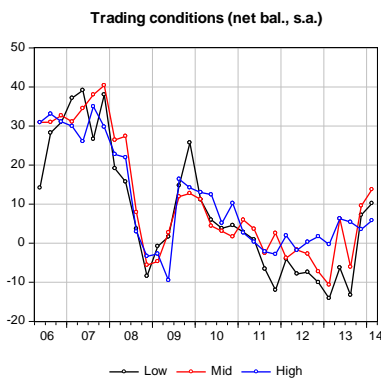


## Firm size analysis

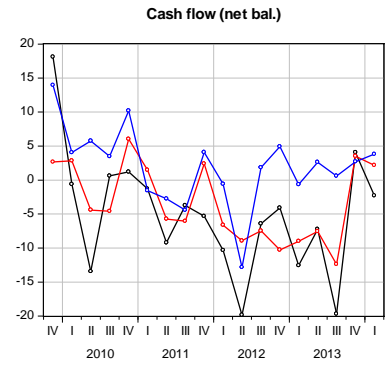
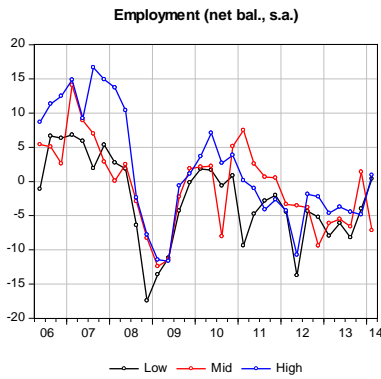
**SMEs still confident, but mid-tier eased; conditions up, but still difficult**



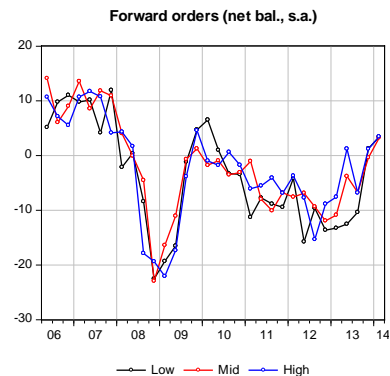
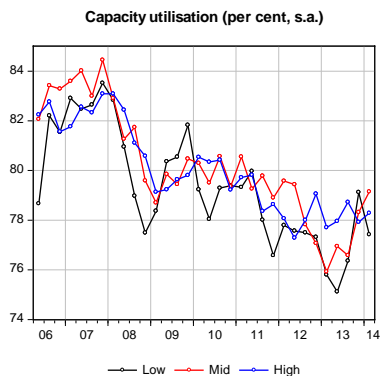
**SMEs of all sizes show similar trend in trading and profitability**



**Mid-tier employment down sharply; Low-tier cash flows deteriorated**



**Capacity utilisation rises for mid-tier firms; forward orders suggest rising demand**



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