

**Quarterly SME Survey**
**June quarter 2014**

**SME business confidence eased again in the June quarter, but is holding up against heightened consumer anxiety with the support of positive sentiment in property and construction. Conditions rose slightly, but are still at levels suggesting sub-trend growth. SME's are outperforming larger firms, particularly in construction and professional services. Forward indicators are mixed, but generally point to ongoing expansion in the near-term, although SME's are becoming a little more concerned about factors affecting their 12-month outlook (especially government policy).**

- SME business confidence eased again from the peaks seen around last year's Federal election – consistent with ongoing sluggish domestic demand (including headwinds from tighter public spending and anxious consumers). These factors are far reaching, with confidence of larger firms falling by a similar degree in the quarter ([NAB Quarterly Business Survey](#)). Nevertheless, SME confidence is still positive, supported by enthusiastic property and construction firms. How long confidence levels can be sustained will largely hinge on how consumers respond to concerns about their financial wellbeing (particularly in light of the Commonwealth Budget). Despite some recent improvement, consumer confidence measures are very weak, while NAB surveys of consumer behaviour suggest a degree of spending restraint is on the way. It seems unlikely that firms will maintain current confidence levels if this manifests into a significant pull-back in consumer spending. In contrast to property and construction, health and retail firms are most concerned, both recording falls in confidence during the quarter.
- SME business conditions rose again in Q2, pushing the index back towards the series average; these levels still suggest only moderate growth in business activity. The improvement mostly stemmed from a rise in employment, while trading conditions fell. Conditions only improved for mid-tier firms, while low-tier firms declined, but SME's are outperforming their larger counterparts.
- Conditions were mixed across industries in the quarter, but trends are broadly consistent with confidence. Construction and professional services are performing well, with SME's in these industries also doing better than their larger counterparts. Retail recorded the largest fall in the quarter (followed by manufacturing and health). Conditions rose only in Victoria.
- Forward orders eased, but still suggest a moderate lift in SME activity. However, capacity utilization remains at soft levels, even after a solid improvement in employment conditions.
- 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. Meanwhile, price discounting and offline marketing have fallen in popularity as a strategy, suggesting that competitive pricing may be reaching its limits.

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

	2013q2	2014q1	2014q2		2013q2	2014q1	2014q2
	<i>Net balance</i>				<i>Net balance</i>		
SME business confidence	2	7	5	SME trading conditions	3	10	9
Low	1	8	3	Low	-7	11	6
Mid	1	10	6	Mid	5	16	10
High	2	5	5	High	6	7	8
SME business conditions	-3	3	4	SME profitability	-5	1	2
Low	-8	4	2	Low	-11	-1	1
Mid	-2	5	8	Mid	-3	5	6
High	-1	2	2	High	-5	-1	-2
SME cash flows (n.s.a.)	-3	2	-4	SME employment	-6	-1	3
Low	-7	-2	-7	Low	-6	1	0
Mid	-8	2	-4	Mid	-5	-7	8
High	3	4	-2	High	-4	1	1

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 May to 12 June 2014 covering around 700 SME firms across the non-farm business sector.

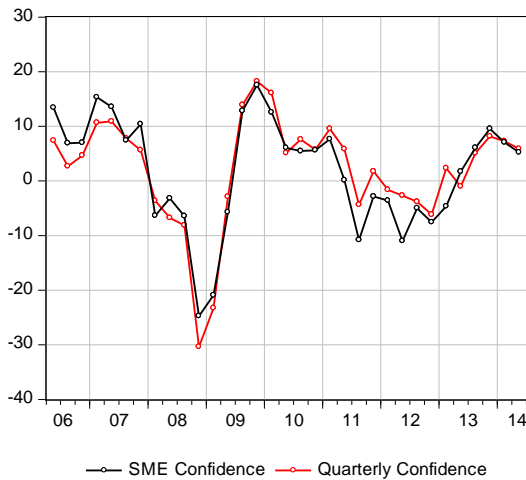
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Next release:  
12 August 2014 (July Monthly)

## Analysis

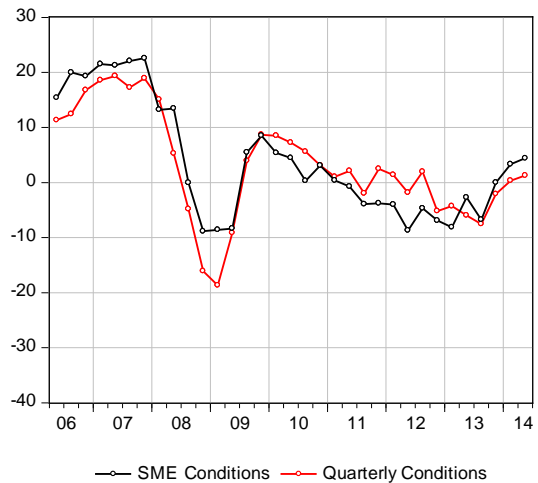
### Confidence ticked down in line with larger firms

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



### Conditions rose and remains above larger firms

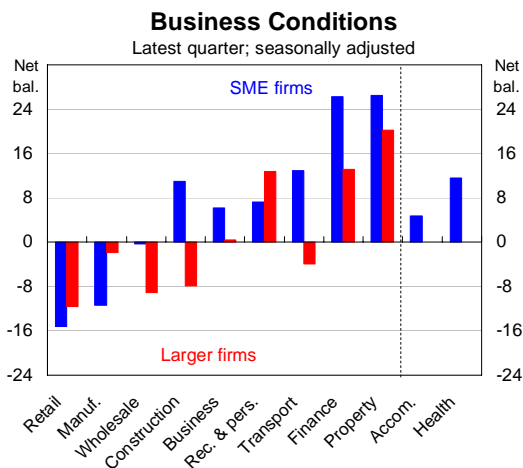
Business conditions (net bal., s.a.), SME & quarterly



**SME business confidence** eased further from its Federal election induced peak late last year, but is managing to hold up at reasonable levels, especially in the context of a significant deterioration in consumer confidence that followed the Commonwealth Budget in May. The confidence index fell 2 points to a level of +5 index points, well above the series average of +2 points since mid-2006. Confidence of SME firms are likely being supported by pockets of strength in the economy – particularly in construction and property services – as well as very low interest rates, which are expected to remain around these levels for an extended period. Transport is following close behind, despite easing in the quarter and headwinds from the retail and wholesale sectors (where conditions and confidence are weak). Confidence of firms economy wide – from the Quarterly Business Survey (QBS) – 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 higher-tier firms were the only ones not to record a fall in confidence.

**SME business conditions** ticked up again in the June quarter, despite mixed signs over the strength of the domestic economy (which excludes exports). This has brought SME conditions back into line with long run average levels for the series and has helped to almost close the gap with confidence (the gap remains much larger for firms economy wide (QBS) where conditions are much lower). Conditions were up 1 point to +4 points, which is the highest level since mid-2010, but the situation is still quite mixed across industries. Property and wholesale improved the most, although conditions are still soft in the latter. In levels terms, conditions facing financial/property services are the most positive, while manufacturing, retail and wholesale are the main under-performers. Business conditions of SMEs are still higher than their larger counterparts.

### SME firms continue to out perform in most industries

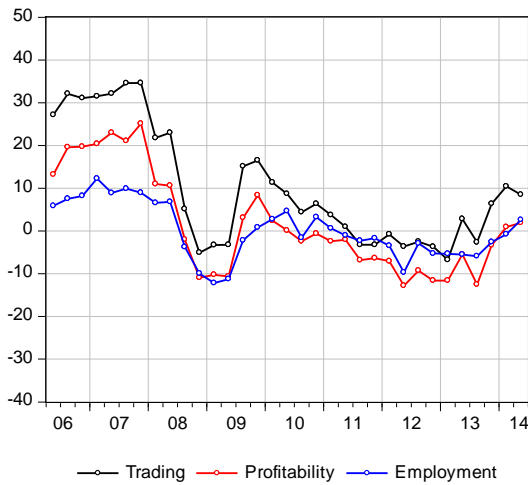


A comparison of industry conditions for SMEs and larger sized firms (taken from NAB's Quarterly Business Survey) suggests that smaller firms are performing better than their larger counterparts in a number of industries – as well as reporting better conditions overall. The largest disparities are occurring in construction (probably reflecting the larger role of house building in SMEs) as well as transport and the professional services (finance, property etc.), where smaller firms are performing much better. Industries where larger firms are reporting noticeably better conditions than their smaller counterparts include recreation & personal services, manufacturing and retail – although conditions are still negative for larger firms in the latter two industries.

## Analysis (cont.)

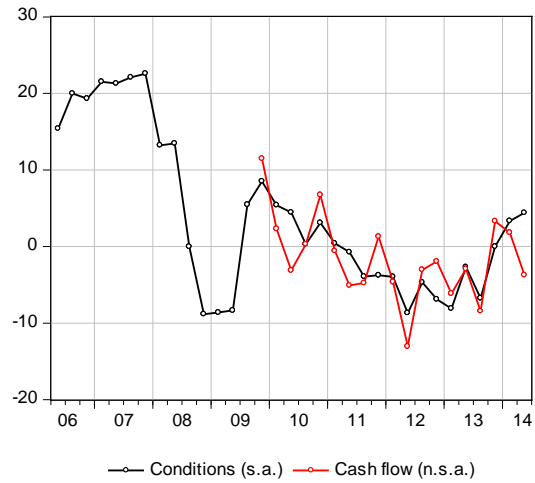
### Profits and employment rose; trading eased but is highest

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



### Cash flows dropped, despite better profitability

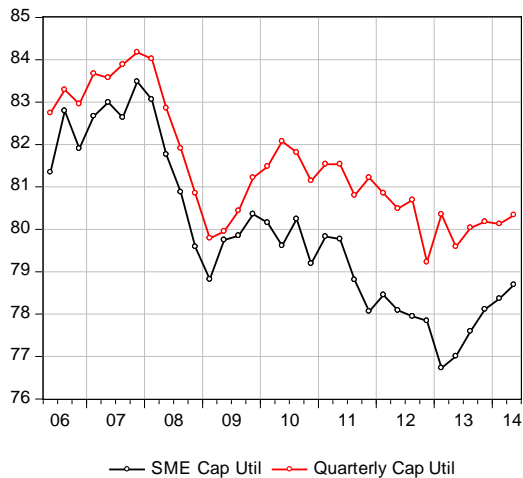
SME business conditions & cash flow (net bal.)



The quarterly rise in business conditions reflected rises in employment conditions and profitability, while trading conditions showed a slightly decline (but remains highest). In contrast, SME cash flows (not seasonally adjusted) dropped in the quarter, further unwinding a sharp improvement late last year – the cash flow index is now negative.

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

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



### Positive orders suggest moderate activity growth

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

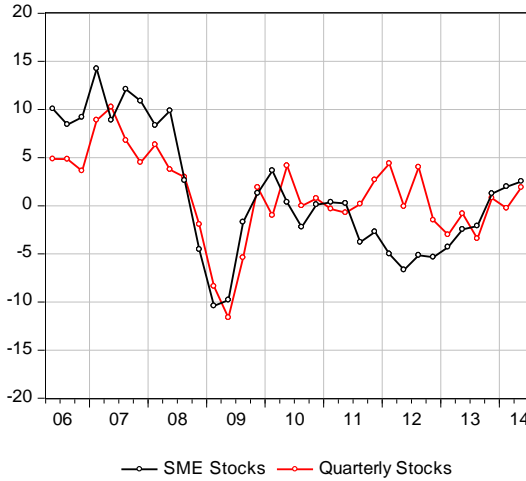


Capacity utilisation rose to 78.7% in the June quarter, up from 78.4%. Utilisation has been trending steadily higher over recent quarters in line with more positive trading conditions, but it is still well below the series average of 80.0% since mid-2006, and significantly below the level of utilised capacity of larger firms (80.3%). In the quarter, falls in capacity utilisation of low-tier (down 0.6 ppts to 76.7%) and mid-tier firms (down 0.1 ppts to 78.9%) were more than offset by a solid increase in utilised capacity of higher-tier firms (up 1.1 ppts to 79.5%). Across industries, capacity utilisation was very high in health services (86.1%), as well as personal services (85.3%), business & financial services (81.4%), while it was very low in manufacturing (73.4%). Forward orders of SMEs eased a little in the quarter, but the positive index suggests moderate activity growth will continue in the near term – orders are down 1 point to +3 points, which is well above the series average. The fall in the orders index was largely concentrated in transport (down 13), wholesale (down 8) and finance (down 6). Orders are now strongest in the construction industry (+12 points) and property services (+10 points), consistent with the pipeline of residential construction that has accumulated and activity in housing markets. Orders are still very weak for wholesale (-7), manufacturing (-4) and retail (-2), which may be a reflection of the high AUD and its impact on firms' competitiveness and domestic demand.

## Analysis (cont.)

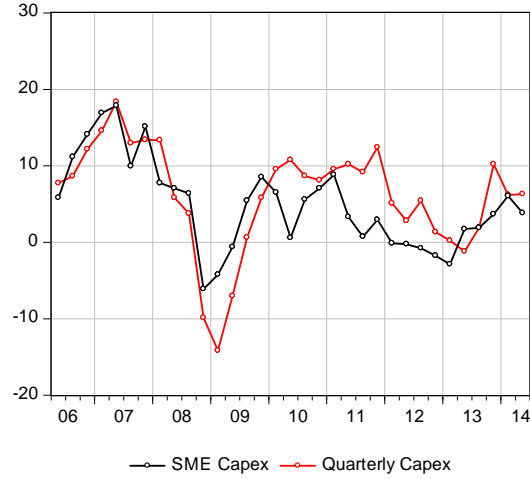
### **Firms are tentatively re-stocking in anticipation of demand**

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



### **Investment activity eased, while larger firms unchanged**

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

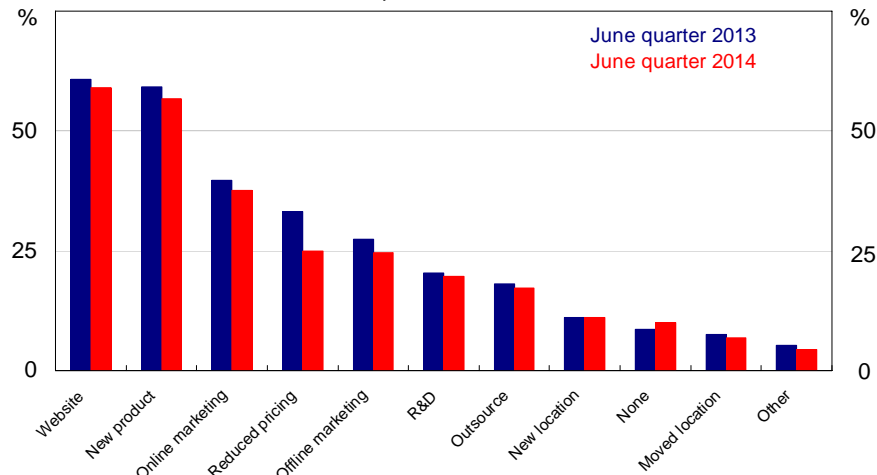


The SME stocks index was up 1 point to +3 index point in the June quarter, a slightly higher level of stock building than that from larger firms over the same period. The positive reading for SME stocks implies a moderate build in inventories in the quarter, which could signal some anticipation of a stronger lift in demand (despite both orders and trading conditions easing). The stocks index is close to a four year high. Capital expenditure on the other hand ticked down in the June quarter, consistent with the subdued capital expenditure levels that suggest capital expenditure by SME's will remain lacklustre for some time. Smaller firms lowered capex in the quarter as larger firms' capex index held steady.

### **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\*

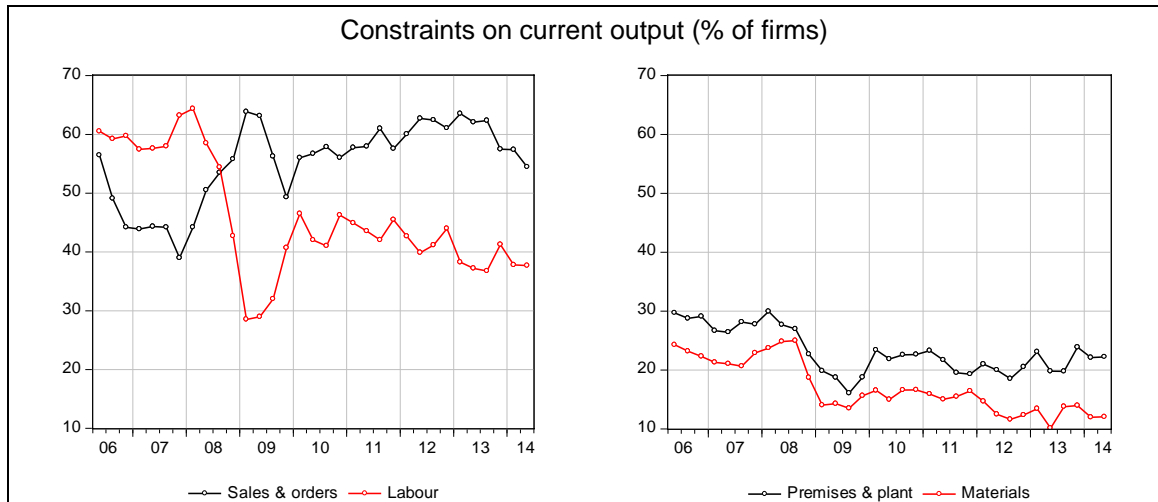


\* Multiple responses allowed; will not sum to 100%  
Source: NAB Quarterly SME Survey

In the June 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. Reduced pricing has become noticeably less common, while there was a slight increase in the proportion of firms not taking any specific action to improve competitiveness. The heavy focus on creating an online presence is consistent with firms preference for less disruptive (and sometimes costly and risky) strategies.

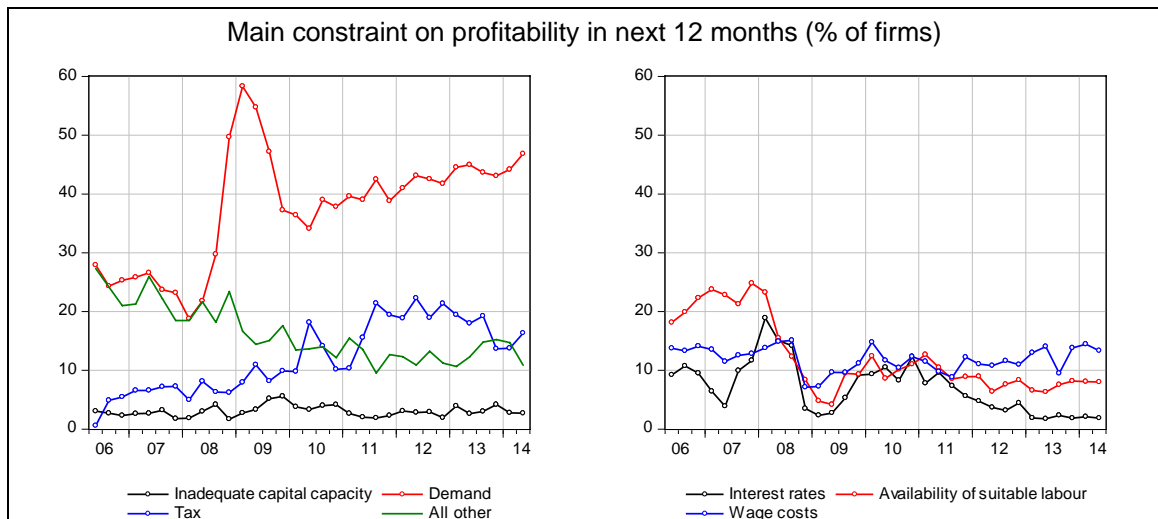
## Analysis (cont.)

### **Demand is the biggest constraint on output, but steadily easing**



Even though trading conditions and orders eased a little in the quarter, they have remained positive. Consequently, firms are gradually starting to consider demand as less of a constraint on their output than previously, although it is still the most widely cited (around 55% of firms, down from over 62% a year earlier). However, capacity utilisation will need to rise much further before factors of production (labour and capital inputs) become the most binding on production. 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 remain low overall.

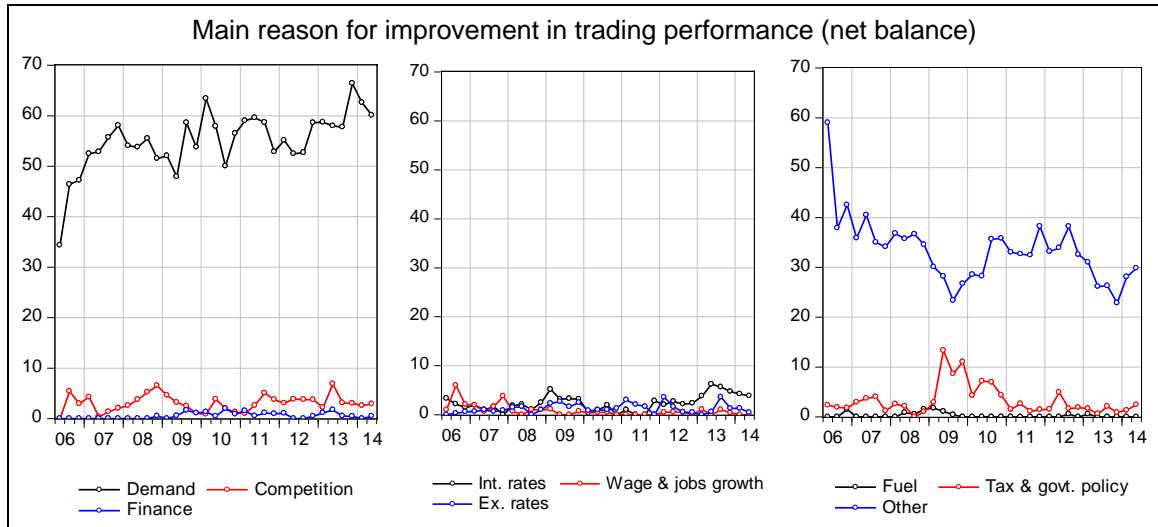
### **However, lack of demand a rising constraint on profitability over the next 12 months; tax policy only up slightly after budget**



While less firms are seeing demand as a constraint on their output, more firms see it as a significant constraint on profitability. This could suggest that while firms expect demand to stabilise in terms of output, it will not strengthen enough to reverse competitive pricing (discounting) that took place during previous soft patches. There may also be less scope for cost savings, given the high degree of consolidation and rationalisation that has taken place in some industries. Indeed, some firms could be responding to this situation by trying to capture market share – supported by a lift in firms' capex and employment expectations over the next 12 months. The proportion of firms concerned about the impact of changes to tax policy lifted slightly following the Commonwealth Budget, although business (especially small business) managed to come through relatively untouched (at least in terms of direct tax changes).

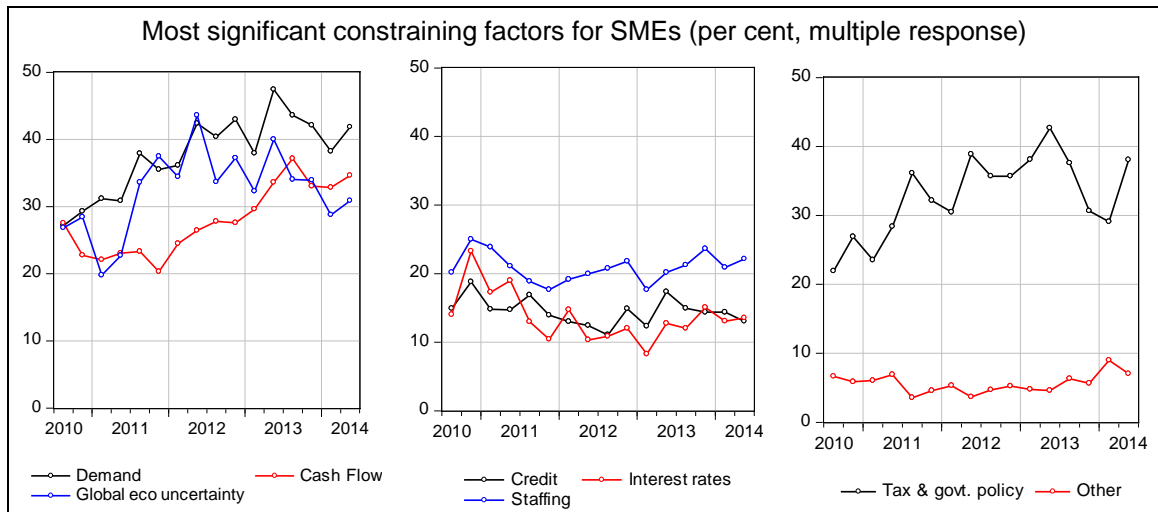
## Analysis (cont.)

**Demand still drives trading performance, but less than 6-months previous. 'other' factors rising, but not exchange rates or interest rates**



Trading performance eased in the June quarter, with SMEs reporting a little less assistance from demand. In contrast, more firms indicate that “Other” factors are contributing positively to trading outcomes – largely reflecting seasonal and company specific factors – and lifted to its highest level in over a year. Access to finance, fuel costs and wages & jobs growth remained relatively insignificant, as did tax and government policy – although this lifted slightly in the quarter.

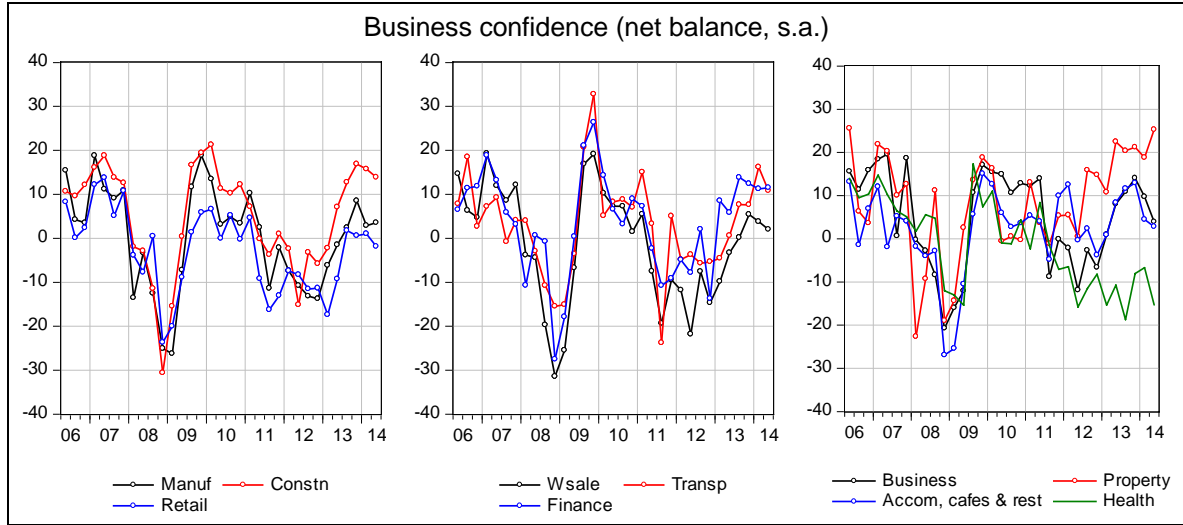
**Following a steady decline in previous quarters, a number of constraining factors for SME's lifted in the quarter**



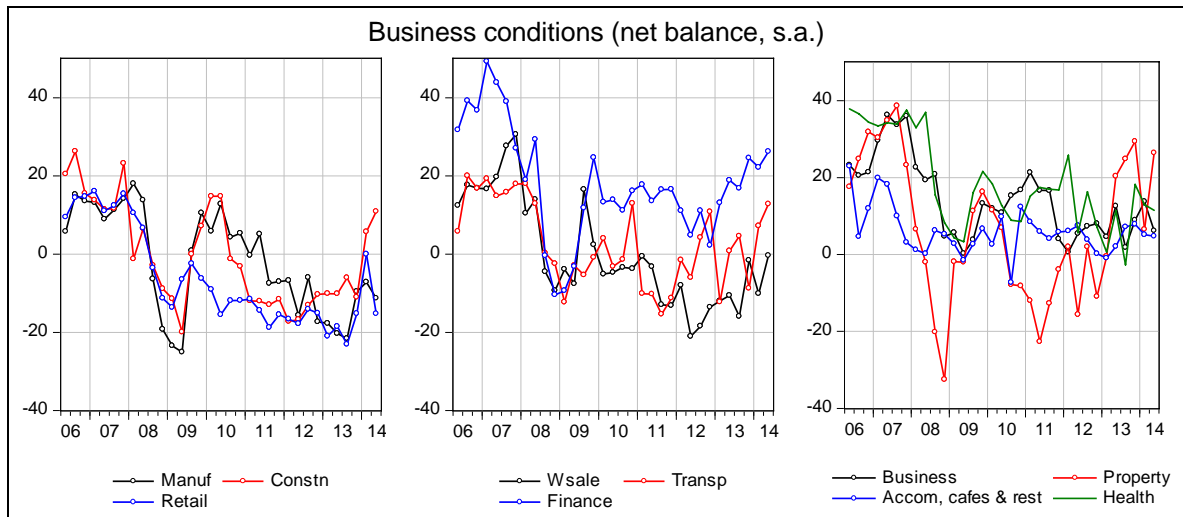
The major constraints affecting SME's ability to make longer term decisions eased over the second half of 2013 and early 2014. However, with some of the better performing segments of the economy during that period (eg. retail sales) starting to cool, this has resulted in a greater number of SME's reporting factors that negatively impact their long term decisions. Uncertainty over the political and budget situation is particularly apparent in the responses, with the proportion of SME's citing tax & government policy jumping nearly 10 pts in the quarter. Demand, cash flows, staffing and global economic uncertainty all got a greater mention from SME's. Geopolitical tensions and some mixed economic data from major global economies in recent months likely contributed to apprehension about the global economy. In contrast, credit and interest rates have remained accommodative and are not expected to pose a significant constraint on future decisions by SME's for quite some time; the Reserve Bank is expected to remain on hold until late next year, while markets are even pricing in the possibility of a cut.

## Industry analysis

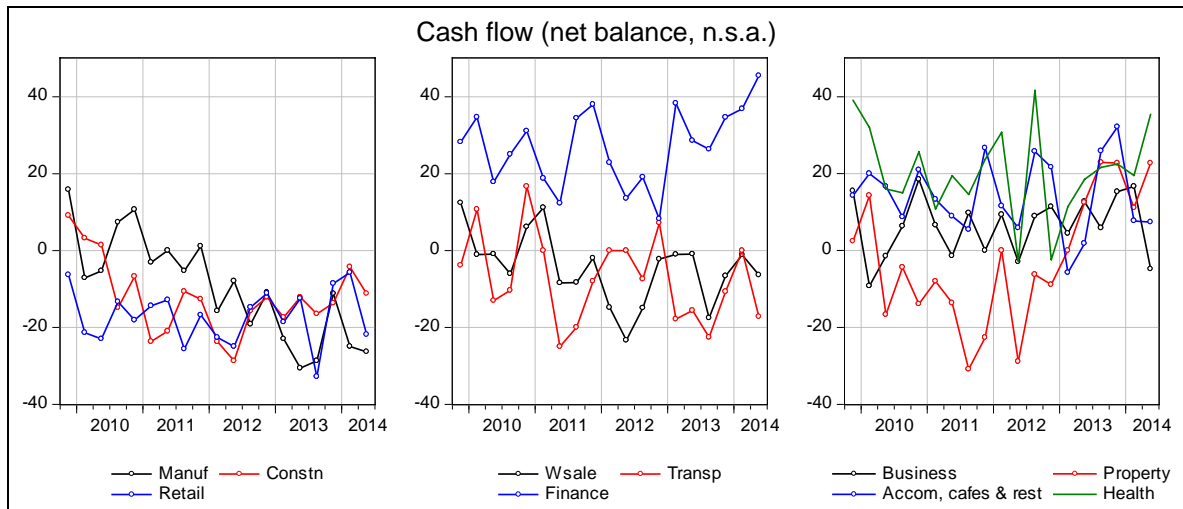
**Property and construction are most confident; health services still very pessimistic, followed by retail**



**Conditions rose sharply for construction and property services; finance and property services now highest**

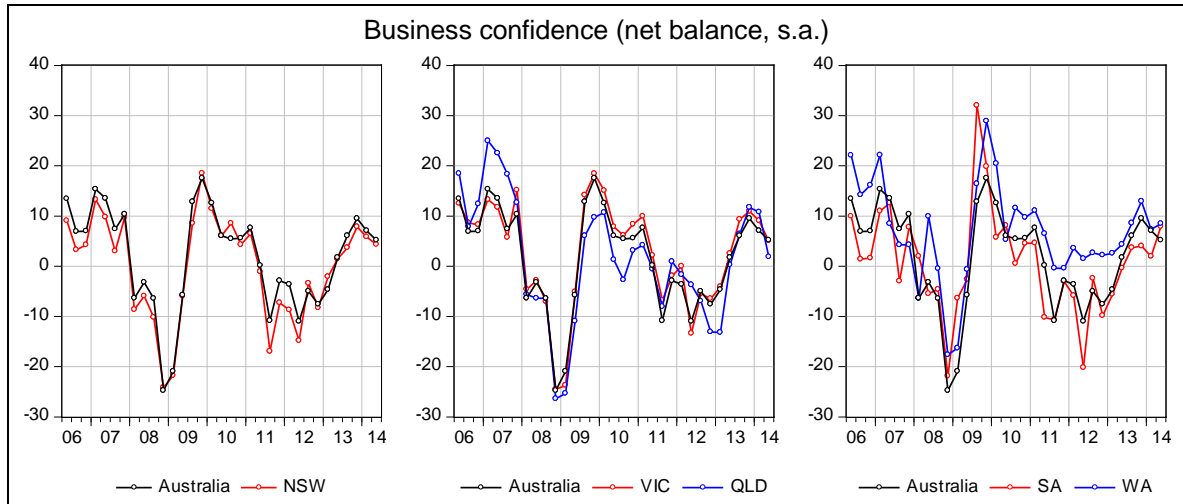


**Significant weakness in cash flows, but varying significantly across industries; best in finance, worst in manufacturing**

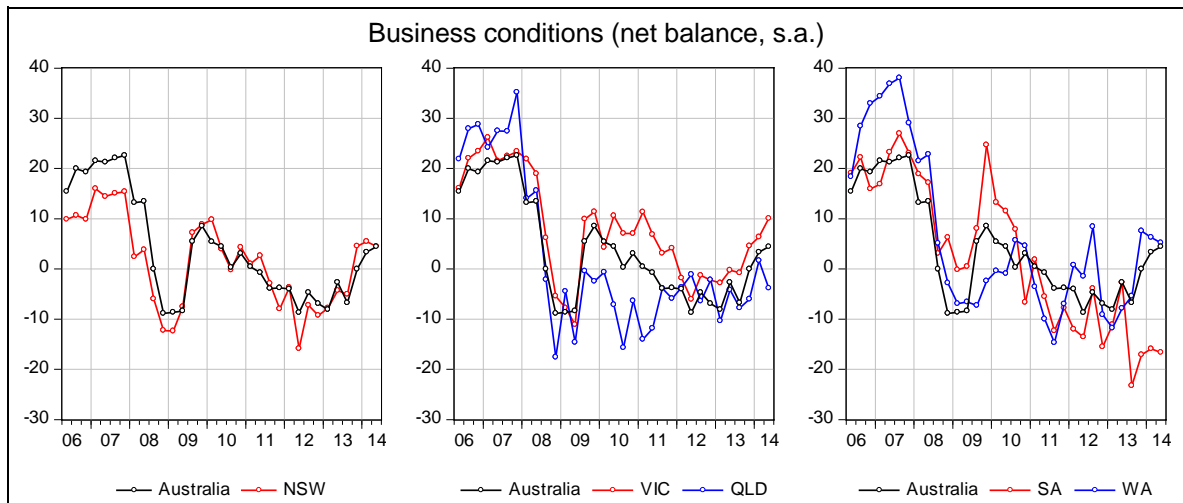


## State analysis

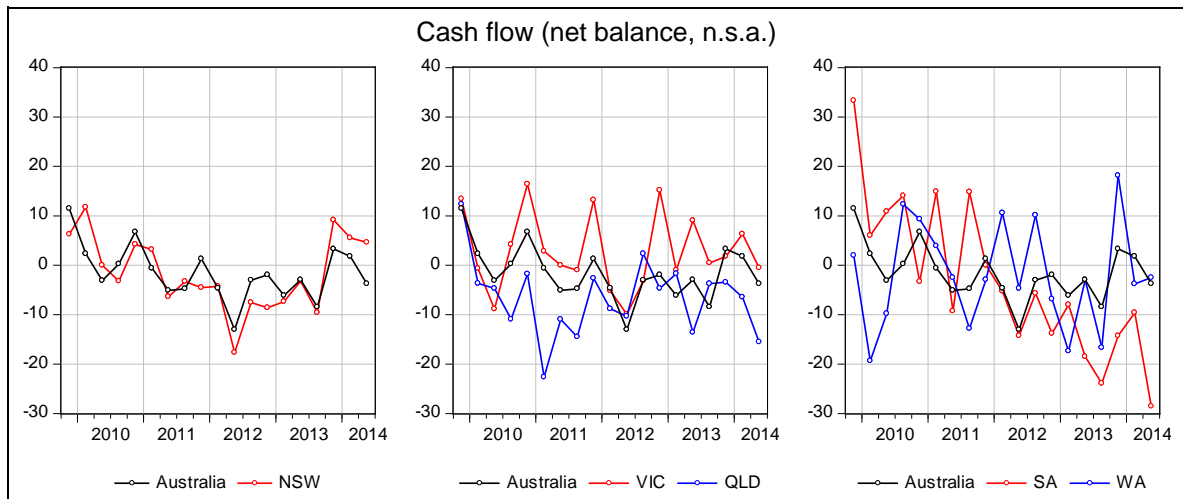
**Business confidence down across major eastern states, up in SA and WA; Qld now trailing the most, although all are positive**



**Conditions mixed across all states; still very weak in SA, followed by Qld**



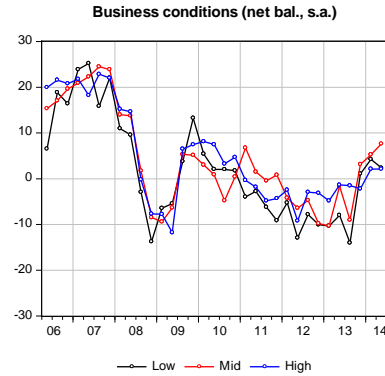
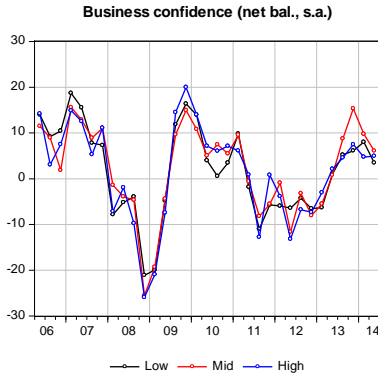
**Cash flows are strongest in NSW. All other states are negative – South Australia the worst by a significant margin**



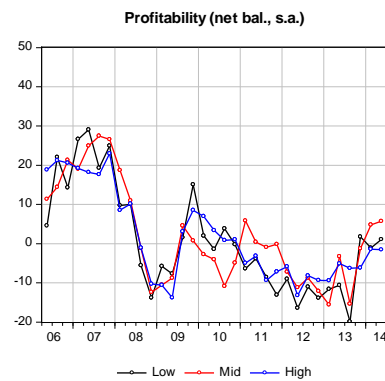
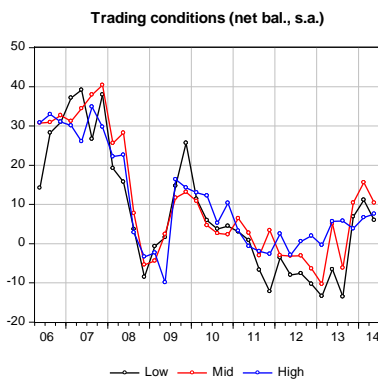


## Firm size analysis

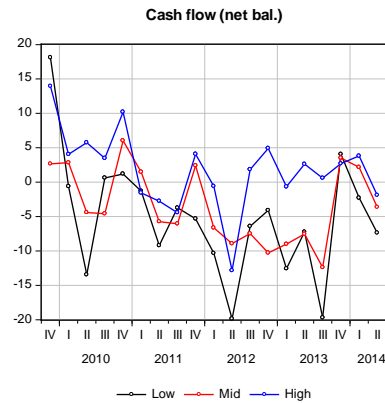
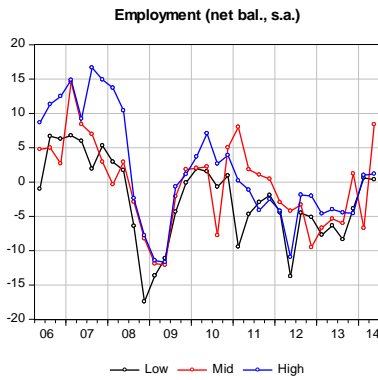
**SMEs still confident, but mid-tier eased; conditions up, but vary by size**



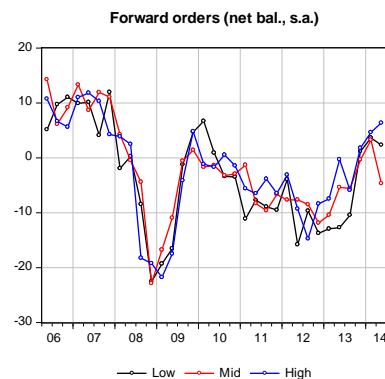
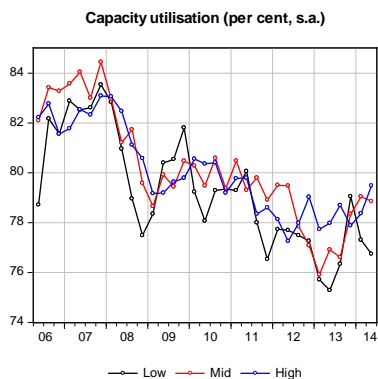
**Trading positive for all sizes; profitability strongest for mid-tier firms**



**Mid-tier employment up sharply; cash flows deteriorated across all sizes**



**Capacity utilisation rises solidly for high-tier firms; forward orders suggest moderate growth, but varies across firm size**



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