

NAB Quarterly SME Survey

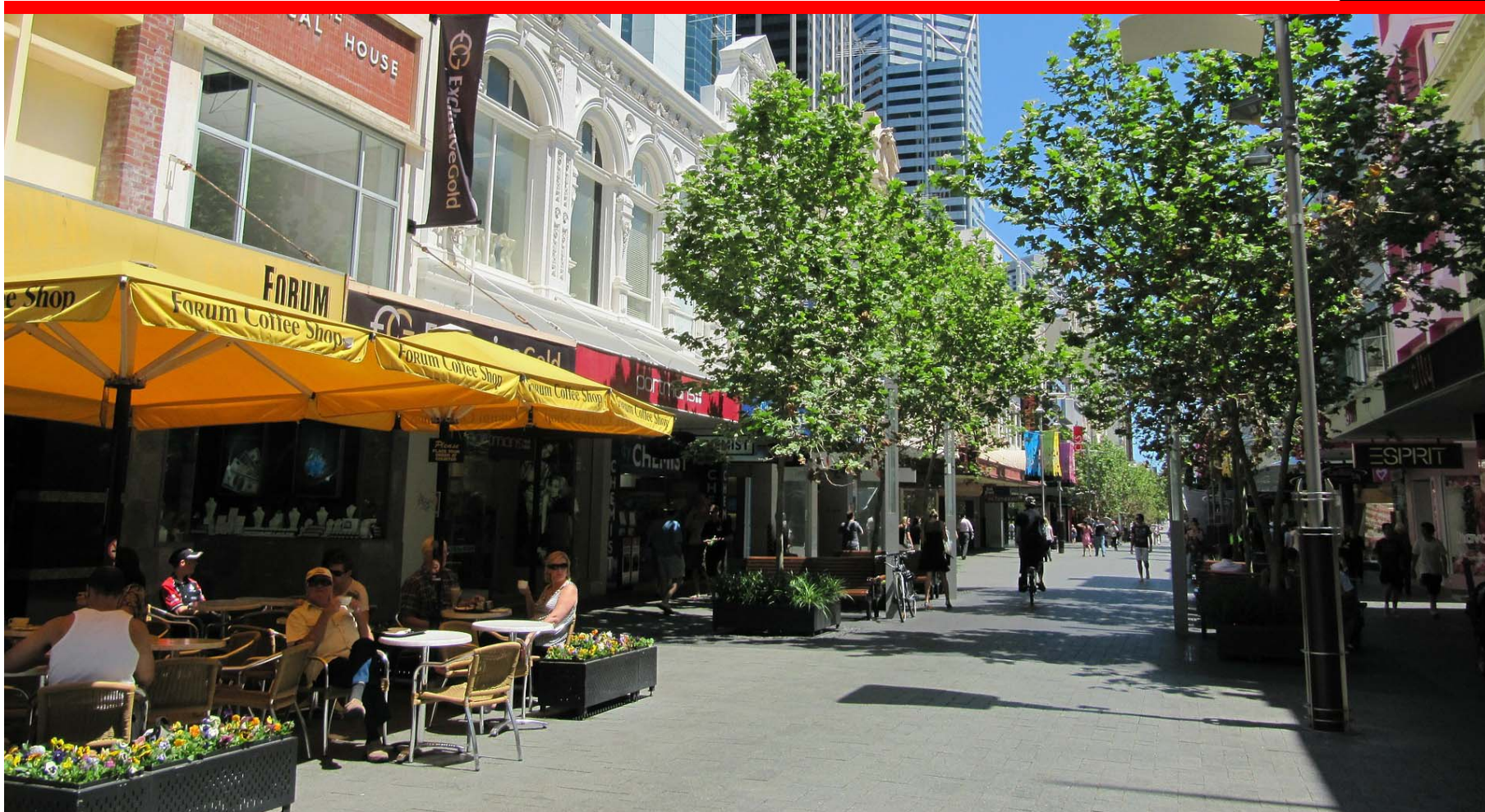
by NAB Group Economics

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June Quarter 2015



National
Australia
Bank



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Key Points: SME business conditions and confidence lift

- In the June quarter, SME quarterly business conditions and confidence appeared to have benefited from the tax measures targeted at micro businesses in the Federal Budget, with the conditions and confidence indices rising by 2 points to +4 and +5 index points respectively.
- Within the sub-indicators of SME business conditions, trading conditions stood out to be the strongest, which flowed into better profitability conditions. However, SME firms' continued reluctance to hire was reflected in the sustained lull in the employment conditions index, which lapsed into negative territory in the quarter.
- Analysis by the size of SME businesses suggests that firms have generally experienced better conditions and confidence in the quarter, with the exception of conditions for mid-tier firms. Despite a recent improvement, low-tier firms with an annual turnover of \$2-3m continued to under-perform consistently across major indicators relative to their larger counterparts. In particular, these firms fared poorly in their cash flow conditions, with their cash flow index falling by 11 points to -17 index points.
- Conditions by industry continued to paint a mixed picture, with service-oriented industries maintaining momentum ahead of non-service industries in general. Property, business services and finance firms continued to do well, although conditions of property firms have moderated compared to last year. Conditions in manufacturing were largely unchanged around the neutral mark. Meanwhile, retail and construction (which includes residential, non-residential and mining-related construction) overtook wholesale and transport as the worst-performing industries in the quarter, with conditions in the latter two improving significantly, albeit still marginally negative.
- SMEs' overall confidence improved slightly in the quarter to +5 to be at similar levels with that of general businesses' as measured by the NAB Quarterly Business Survey (QBS). Most industries recorded an improvement in confidence in the quarter except for manufacturing and accommodations, cafes & restaurants. Property and construction firms were the most confident in the quarter, while finance experienced the weakest. Confidence by health SME firms rebounded sharply from -21 to around the neutral mark this quarter, but this could prove to be a blip in the data due to a small sample size.
- Conditions across states were mixed in the quarter, with NSW continuing to claim the top spot, while a 10-point surprise jump in the conditions for South Australia (to +6) propelled it to a tie second position with Victoria. Meanwhile, WA (-7) and Qld (-6) fared the worst in the quarter.
- Forward orders leapt into positive territory at +4 index point in the quarter, with the positive reading largely driven by high-tier SME firms. SMEs' capacity utilisation (78.2%) diverged further away from that of general businesses' (80.9%), to decrease further below its long-term average of 79.8%.

Table 1: Key quarterly business statistics*

	2014q2	2015q1	2015q2		2014q2	2015q1	2015q2
	<i>Net balance</i>				<i>Net balance</i>		
SME business confidence	5	3	5	SME trading conditions	8	6	10
Low	3	-6	-2	Low	4	-3	5
Mid	6	8	9	Mid	11	5	8
High	4	3	5	High	8	12	14
SME business conditions	4	2	4	SME profitability	2	-1	1
Low	2	-6	-2	Low	1	-10	-4
Mid	8	3	2	Mid	6	-1	-2
High	2	5	8	High	-2	3	4
SME cash flows (n.s.a.)	-4	1	-4	SME employment	2	0	-1
Low	-7	-6	-17	Low	0	-9	-7
Mid	-4	0	-8	Mid	9	2	-1
High	-2	6	4	High	1	0	5

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

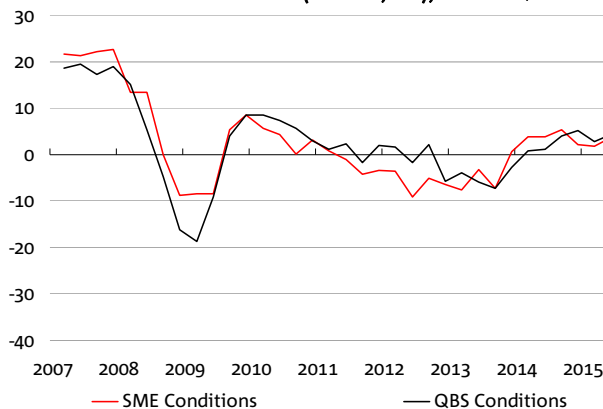
** Data are seasonally adjusted by NAB, except SME cash flow (insufficient time series available). All data are net balance indices. Fieldwork for this Survey conducted from 25 May to 11 June 2015 covering around 703 SME (non-farm) firms.

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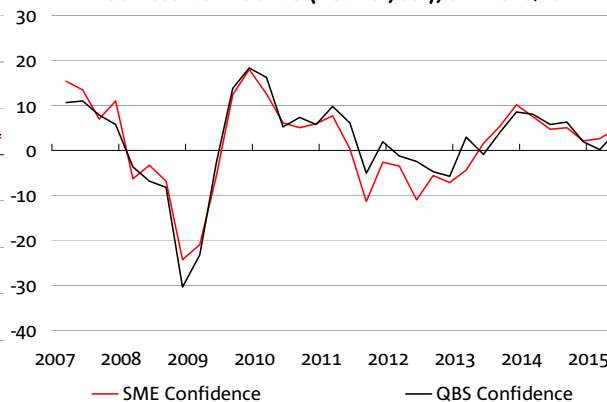
What is driving business conditions and confidence?

- SME business conditions rose modestly by 2 points to +4 index point in the June quarter, partly reflecting the confidence-lifting effects of the Small Business Package announced in the Budget and favourable monetary conditions. SME firms' conditions were broadly similar to that of general businesses indicated by NAB Quarterly Business Survey (QBS) at +4. The rise was mainly attributable to improved trading conditions, which recorded a rise of 4 points to +10, while profitability and employment conditions have been stabilising around the neutral level for the past few quarters.
- The disparity between the much more favourable trading conditions but weak profitability suggests that an increase in trading activity could be accompanied by weaker margins, as reflected in poorer cash flow in the quarter. This likely reflects intense competition among firms and higher import costs due to a weaker exchange rate. Meanwhile, soft hiring intentions were reflective of a high level of spare capacity within SMEs, as evidenced by low capacity utilisation.
- Spurred by strong momentum in the housing markets of Sydney and Melbourne, the property services sector maintained its lead as the best performing industry by business conditions at +16 index points. This is followed by finance (+11) and business services (+10). In contrary, construction, retail, wholesale and transport were the main underperformers. Manufacturing conditions held on to their significant gain last quarter to be around the neutral level, pointing to the pass-through of stimulatory effects from a low AUD.
- Compared to the larger businesses in the Quarterly Business Survey (QBS), SME business conditions were superior in most of the represented sectors: property, finance, business services, wholesale, manufacturing and transport. Meanwhile, poorer performances were reported by SMEs relative to their larger counterparts in retail and construction.
- Within the SME space, low-tier firms continued to report significantly weaker conditions relative to the mid and high-tier SME firms across all measures : cash flows, capacity utilisation, employment, trading conditions, forward orders and profitability. The sharp deterioration in the cash flow index was particularly concerning.
- Perhaps unsurprisingly, SME confidence ticked higher in the quarter on the back of the pro-business tax measures in the Budget, however the gain was somewhat modest at 2 points and unlikely to influence SMEs' business behaviour unless sustained. Amongst the most confident were SME businesses in the property and construction sectors, which have benefited greatly from the pick-up in residential activity in Sydney and Melbourne. Confidence of the health sector recorded a jump of 21 points in the quarter to the neutral point, but this is likely to reflect some statistical noise due to its small sample size. Finance was the least confident in the quarter at -3. Analysis by the size suggests that mid-tier SME firms continued to outperform the high-tier firms in terms of confidence, but that low-tier firms remained the least confident of all categories.

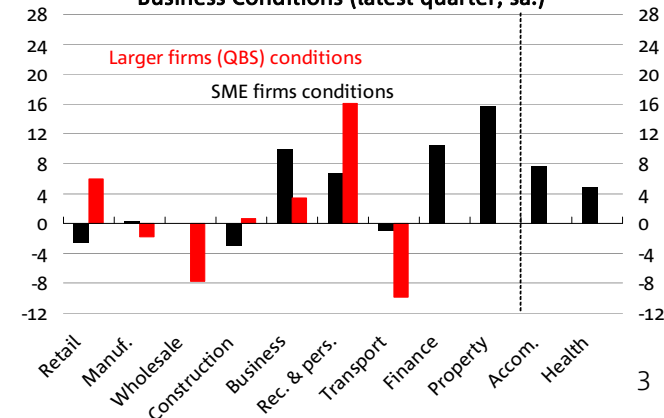
Business Conditions (net bal, sa.), SME & QBS



Business Confidence (net bal, sa.), SME & QBS



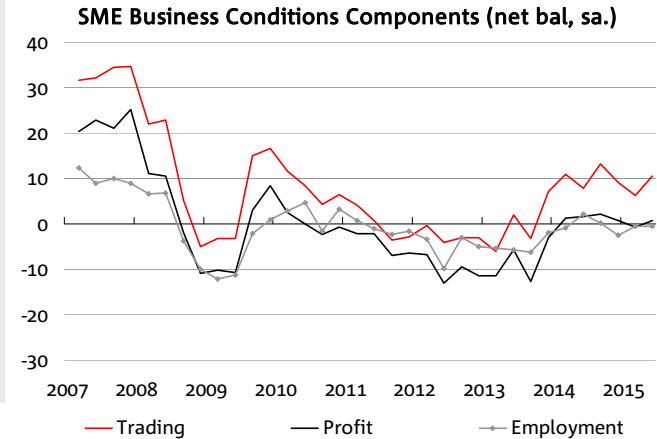
Business Conditions (latest quarter, sa.)



Other key indicators

- SME forward orders rose notably in the quarter to be in positive territory and above that of general businesses indicated by the Quarterly Business Survey, indicating some tentative signs of a pick-up in real activity in response to the announced Budget measures targeted at micro businesses. Orders were the strongest in business services (at +9), followed by wholesale and property services (both at +7), with all three categories reporting stronger orders in the quarter, and wholesale recording the biggest jump of all industries. On the contrary, retail (0) as well as accommodation and manufacturing (both at +1) reported the weakest forward orders.
- Reflecting better demand conditions in Q1, the SME stock index rose slightly in the June quarter to be above larger firms over the same period. It is difficult to assess at this point if the post-Budget euphoria will be sustained in the coming quarters.

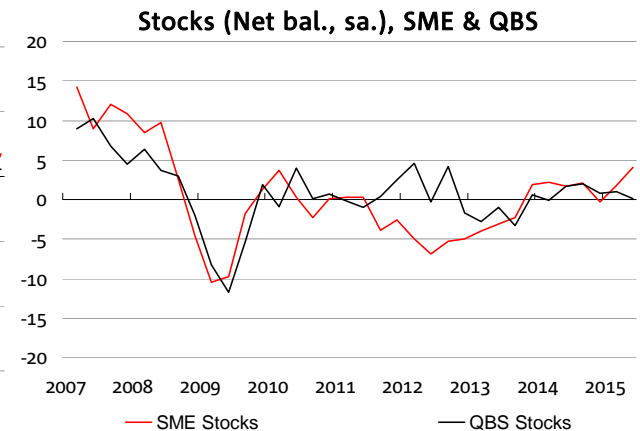
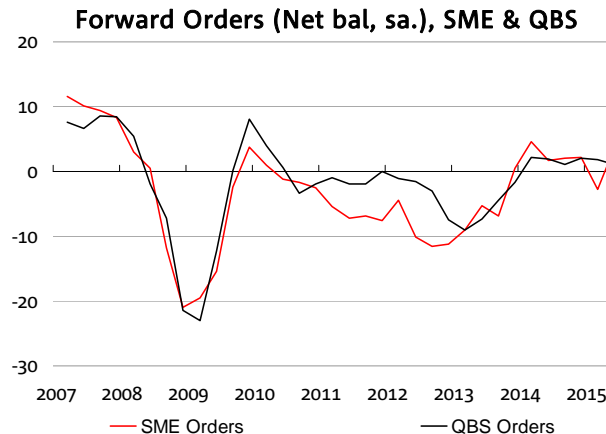
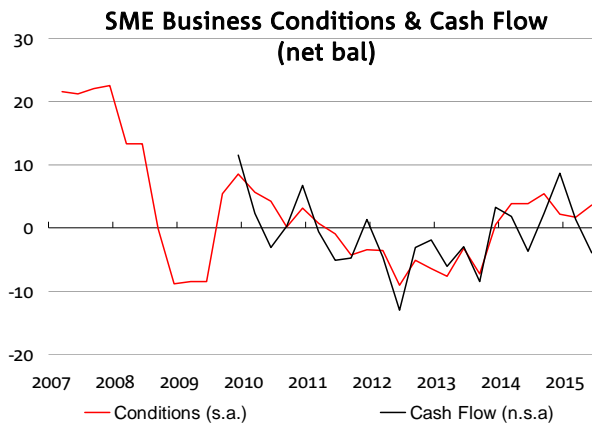
Trading conditions was the key driver for overall conditions, employment and profitability still soft



Cash flow index fell notably to be in negative territory

SME forward orders rose notably

Better conditions and confidence encouraged some inventory restocking

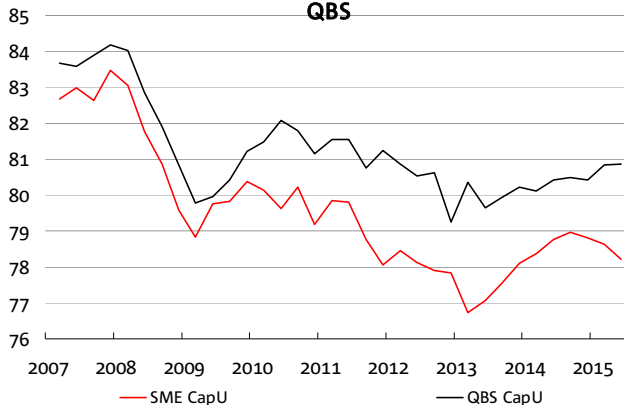


SME Investment

- In Q2, SME capacity utilisation fell for the third consecutive quarter to 78.2% to be below its long-term average of 79.8% and increasingly divergent from that of general businesses' (80.9%). This result was somewhat surprising given a pick-up in orders and stocks relative to the previous quarter. This was in turn driven by a broad-based fall in capacity utilisation by SME firms of all sizes, with high-tier firms leading the fall of 0.7 ppts to 79.2%. More moderate contractions were recorded in mid-tier (down 0.3ppts to 77.8%) and low-tier SMEs (down 0.5ppts to 76.4%).
- Across industries, capacity utilisation fell by the most in the quarter in manufacturing (down 4ppts to 71.8%), property (down 3.3ppts to 78.4%) and health (down 3ppts to 85.3%). As a result, manufacturing had the largest amount of spare capacity in the quarter, followed closely by the accommodation, cafes and restaurant sector with capacity utilisation of around 75.8%. Meanwhile, health and business services (83.5%) sectors continued to outflank the other industries.
- Capital expenditure (capex) by SMEs moderated slightly in the June quarter to be below the capex reading for larger businesses as indicated by the QBS. Falling capacity utilisation in the past few quarters appear to have weighed on SMEs' capital spending. Nevertheless, positive readings for both SMEs and QBS capital expenditure indices indicate that firms continue to operate in an expansionary mode on balance, albeit a modest one.
- By industry, capex was the strongest in the accommodation, cafes and restaurants sector (+20 points), followed by health (+17), as well as property services and finance (both at +16). Meanwhile, manufacturing (-4) and retail (-2 points) were the main detractors from the index. Since Q1 2009, capex in the retail sector has recorded negative readings in 19 out of 26 quarters, a direct reflection of the poor business conditions plaguing the sector since the GFC. Meanwhile, all-industry longer-term capex intentions have weakened, with 12-month capex expectations retreating to +13 in the quarter from +21 the same quarter last year.

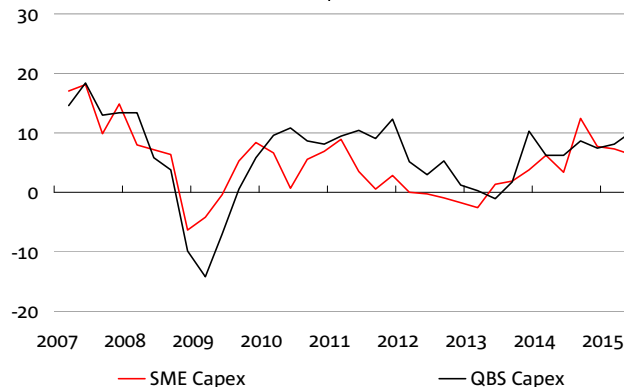
SME capacity utilisation diverged from that of general businesses'

Capacity Utilisation (per cent, s.a.) SME & QBS



Capex pointed to moderate expansion in near-term activity

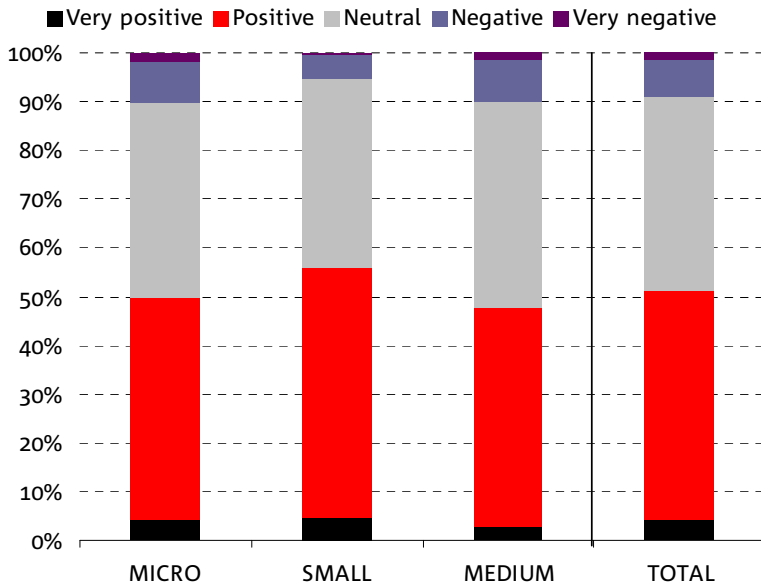
Capital Expenditure (net bal., sa.), SME & QBS



NAB SME Clients' Responses to Federal Budget Measures

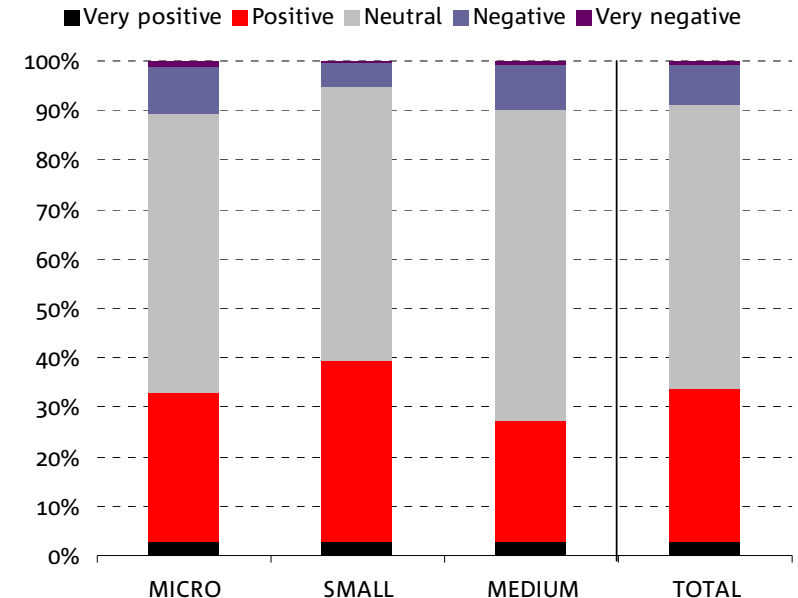
- As part of NAB's customer experience monitoring programs – known as nabBusiness Service Experience Research Program (SERP) and Customer View (CV) – a survey was conducted amongst the bank's SME customers in June to assess their perceived confidence and business impact of the announced tax measures in the Federal Budget.
- The key results are as follows:
 - Among NAB's SME business customers, half the respondents cited that the recent Federal Budget will have a positive impact on their business confidence. Within individual business segments, the share of respondents with positive answers was the highest among small business customers (with turnover ranging between \$1m and \$5m) at 56%.
 - A third of customers (34%) across the turnover spectrum also believed that the budget measures will have a positive impact on their businesses. At 40%, small business customers with turnover between \$1m - \$5m recorded the highest share of positive responses, while the share was the lowest among medium businesses with turnover of \$5m - \$50m (27%).

Question : What impact do you think the recent Federal Budget will have on business confidence in general?



Source: nabBusiness SERP, Small Business Managed Customer View - June 2015, no. of respondents : 1686
 Turnover bands = Micro \$0-\$1m, Small \$1m - \$5m, Medium \$5m - \$50m

Question : Overall what impact do you think the budget measures will have on your business?

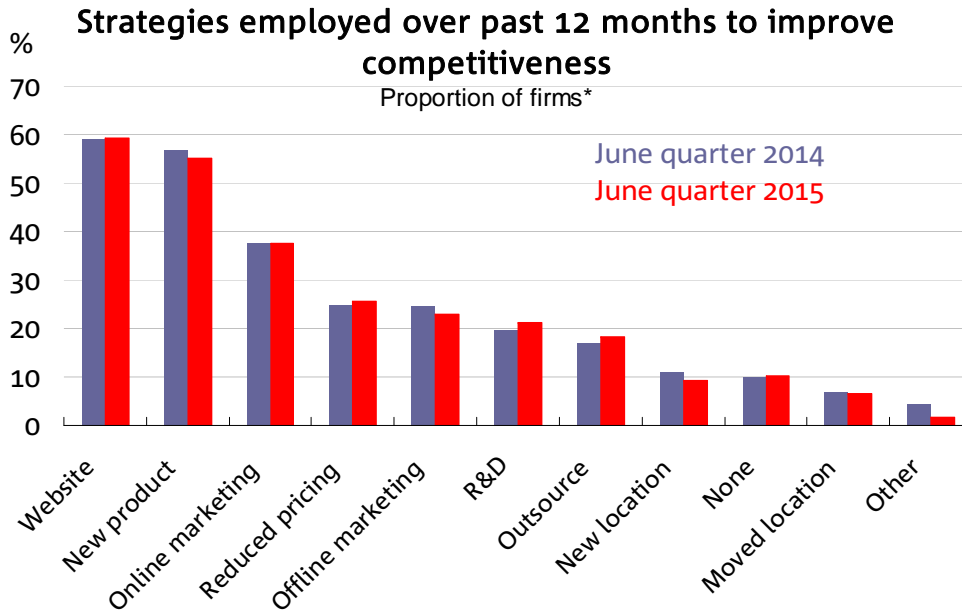


Source: nabBusiness SERP, Small Business Managed Customer View - June 2015, no. of respondents : 1749
 Turnover bands = Micro \$0-\$1m, Small \$1m - \$5m, Medium \$5m - \$50m

SME business strategy

- In the June quarter, we again asked firms whether they had employed any new strategies over the past 12 months to improve their competitiveness in the market.
- There were no significant changes in their strategies in the quarter compared to the same quarter last year. This potentially signals an improvement in underlying demand conditions over the last twelve months which requires a lesser need for firms to significantly change their competitiveness strategies.

Firms remain focussed on less disruptive (and sometimes costly and/or risky) strategies to improve competitiveness

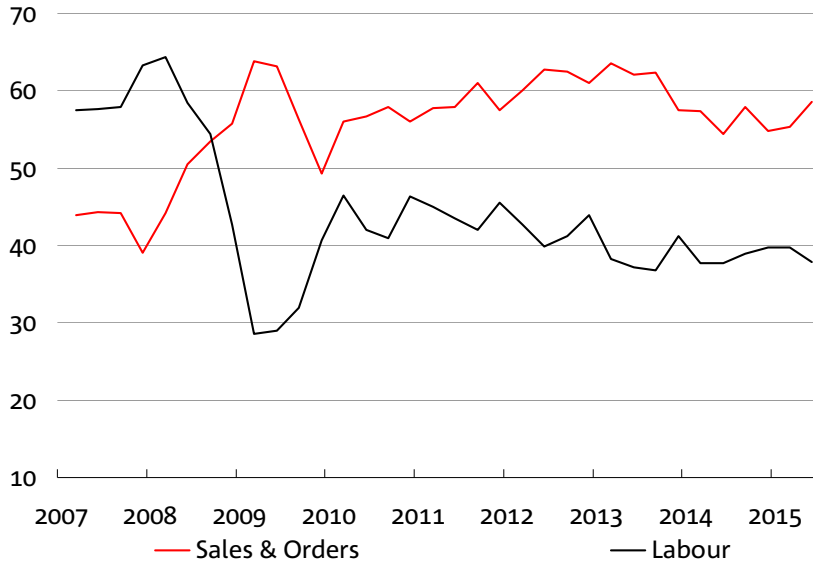


* Multiple responses allowed; will not sum to 100%
Source: NAB Quarterly SME Survey

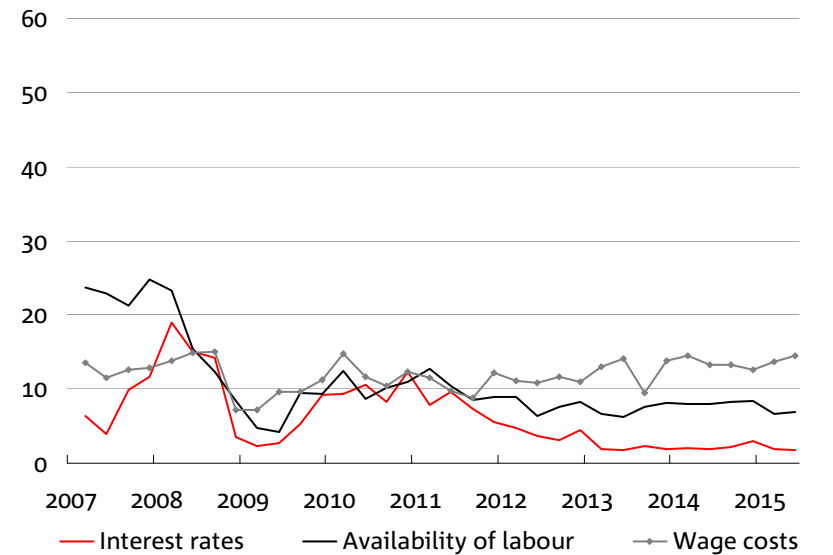
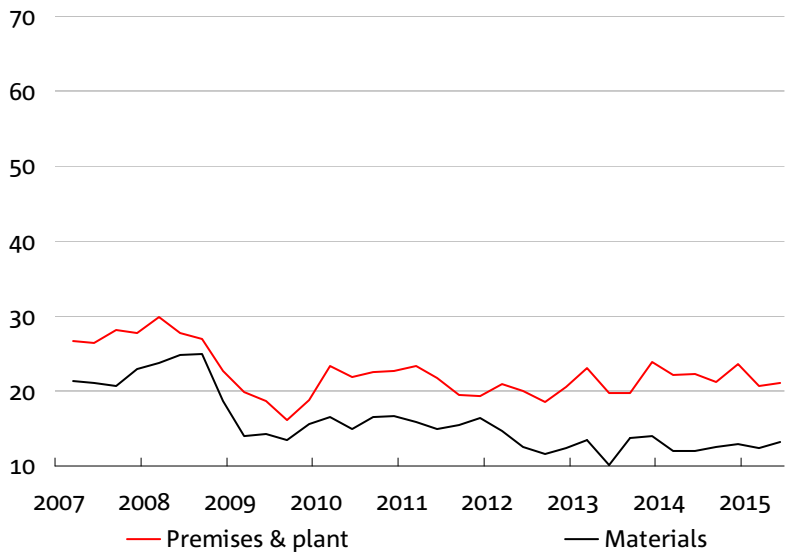
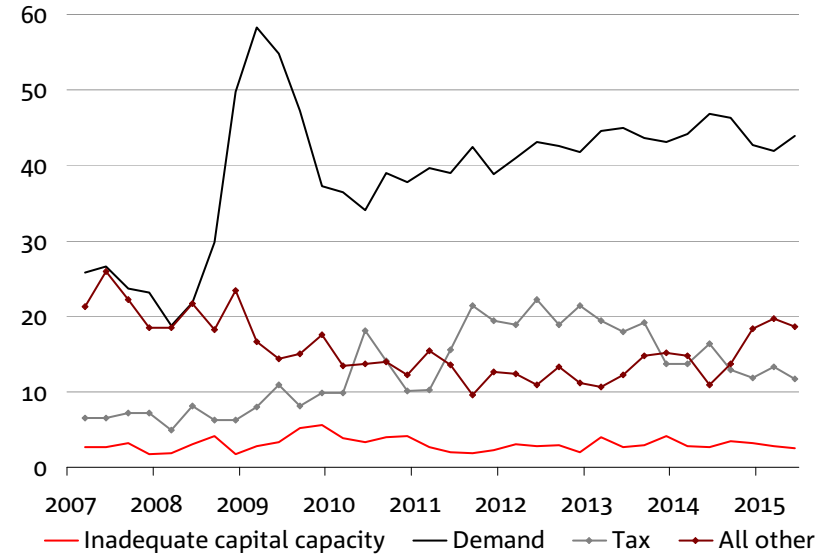


Constraints facing SMEs' output and profitability

Constraint on output (% of firms)



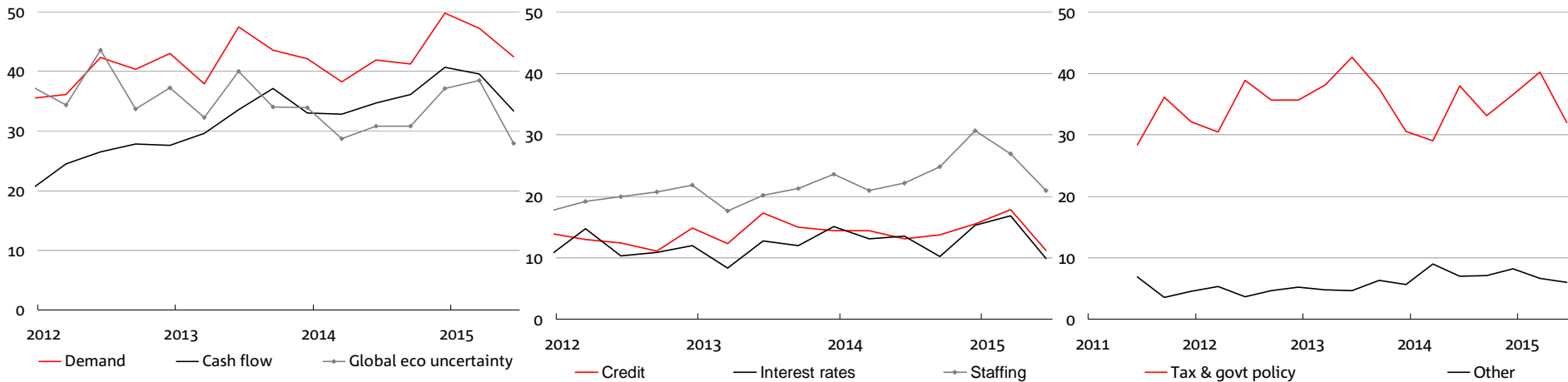
Constraint on profitability (% of firms)



Significant constraints affecting SMEs' long-term decisions

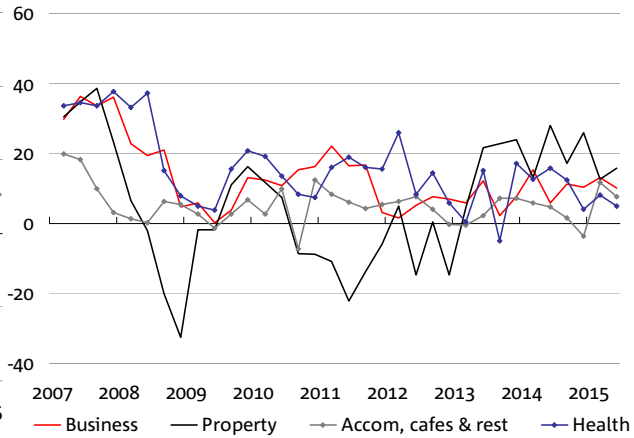
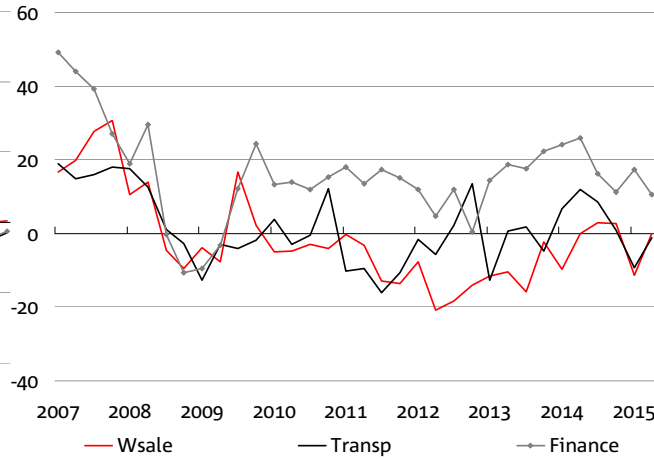
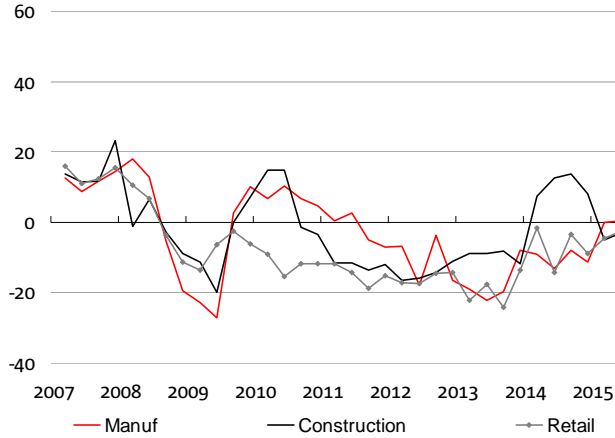
- Over 2014, there was a general rising trend in a number of key constraining factors affecting SMEs' long-term decisions. However, some of these factors have shown signs of moderation since the start of this year, and this improvement has become more broad-based in the June quarter. This was generally consistent with improving business conditions and confidence.
- In the June quarter, all significant constraints affecting SMEs' long-term decisions showed an amelioration, with global economic uncertainty, tax and government policies and interest rate showing the greatest improvements. Credit and interest rates were also cited as being less restrictive to SMEs' long-term decisions in the quarter, but they have been relatively contained in the last few years due to accommodative monetary settings.

Most significant constraining factors for SMEs (per cent, multiple responses)

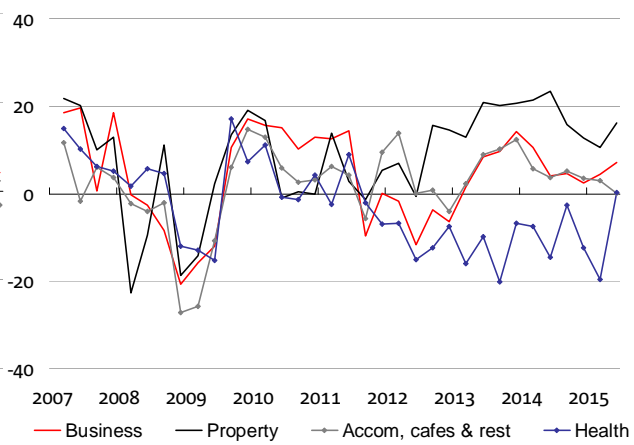
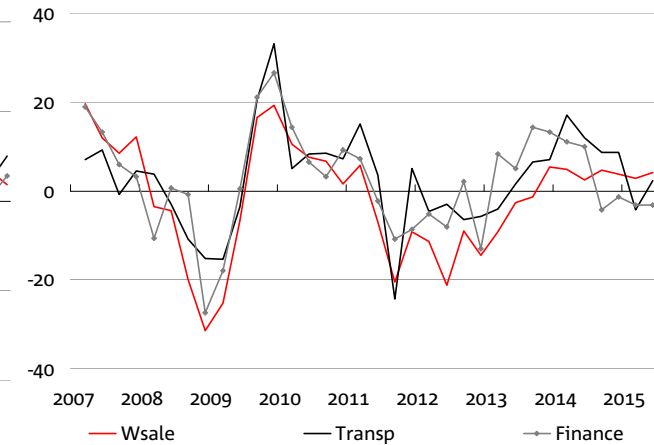
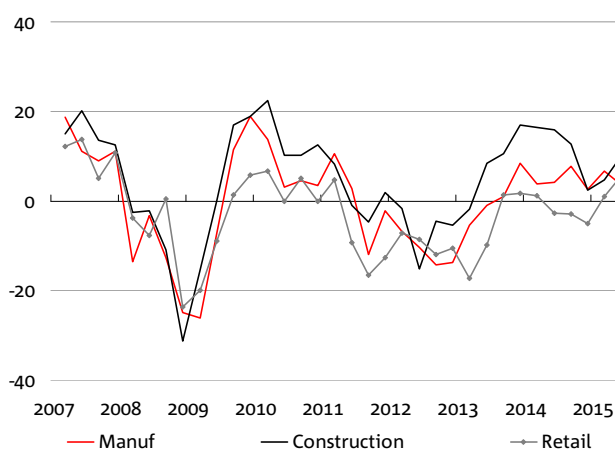


Detail by industry

Business conditions by industry (net balance)

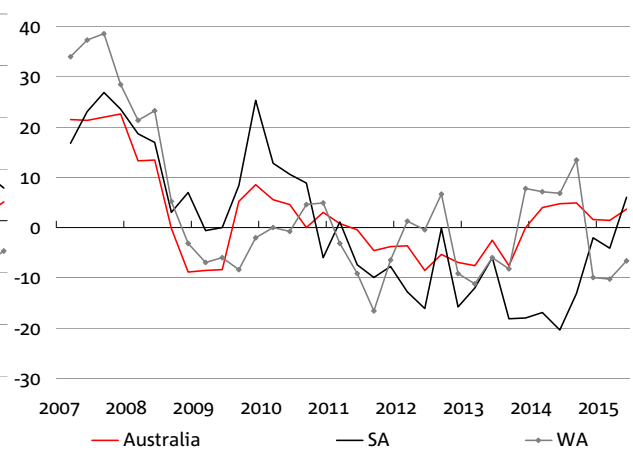
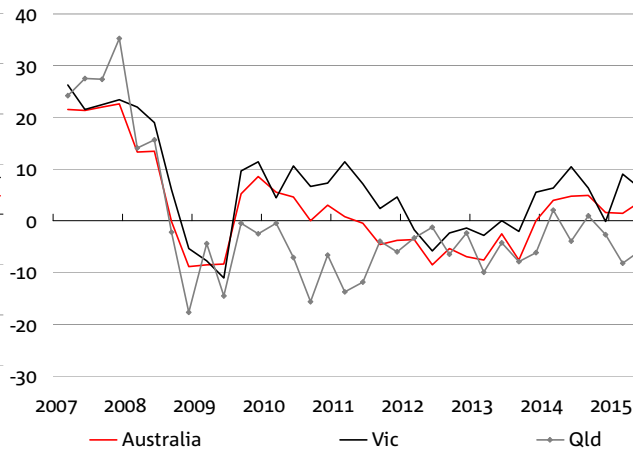
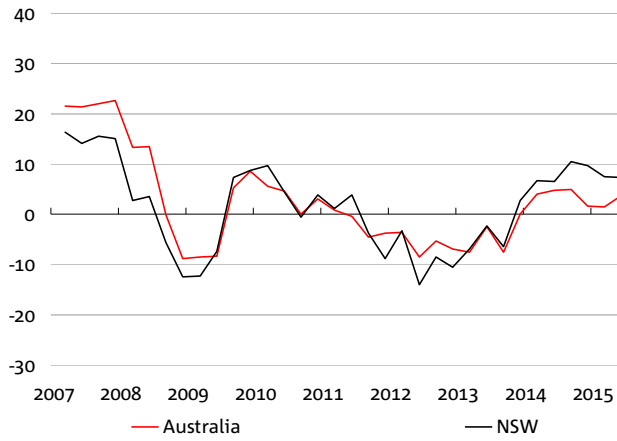


Business confidence by industry (net balance)

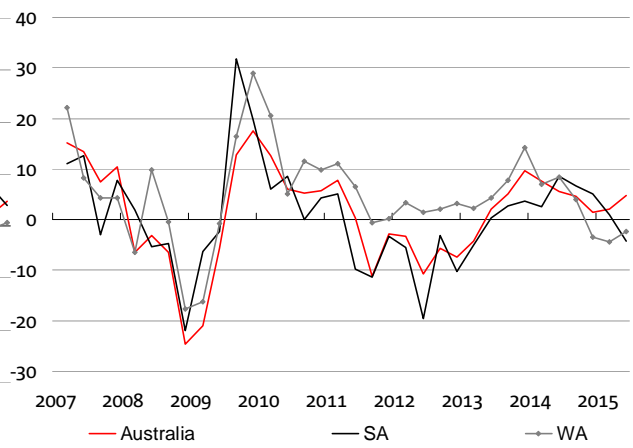
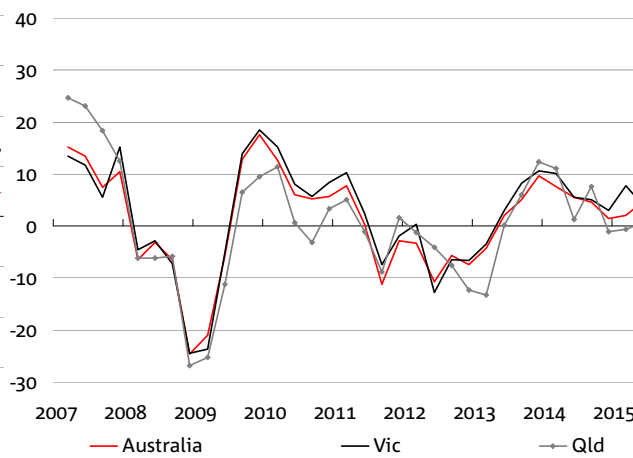
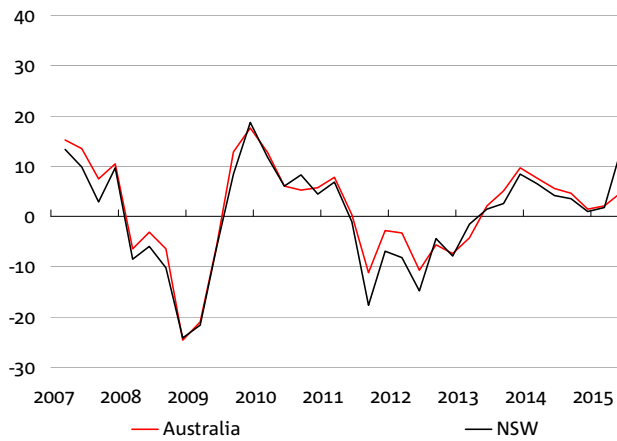


Detail by state

Business conditions by state (net balance)

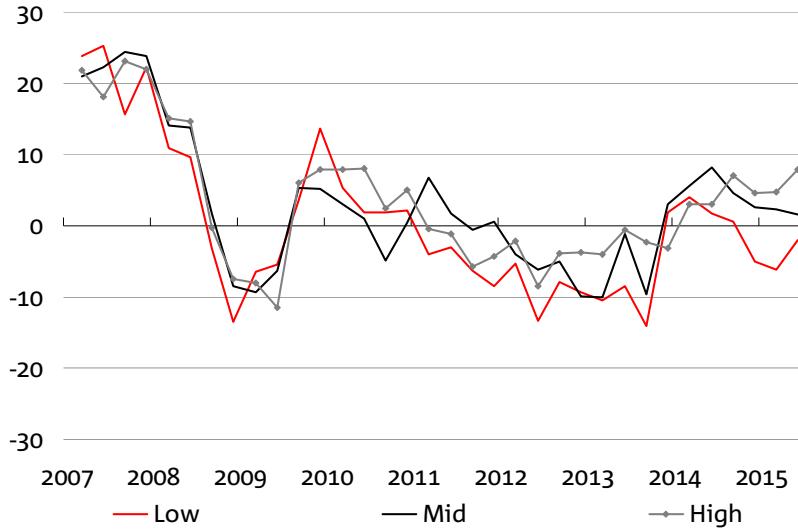


Business confidence by state (net balance)

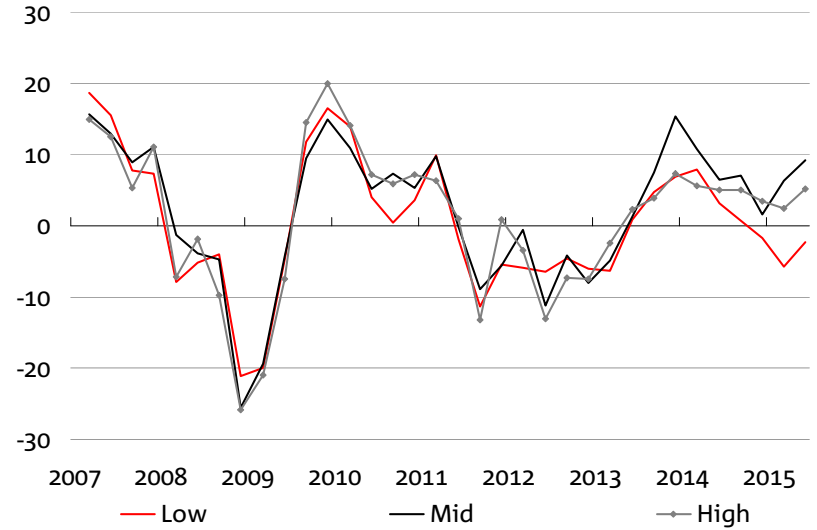


Detail by SME firm size

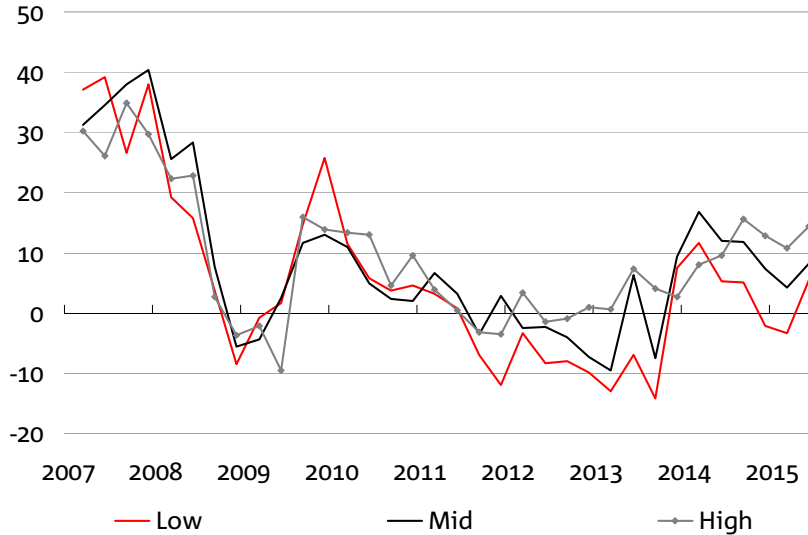
Business Conditions (net bal., sa.)



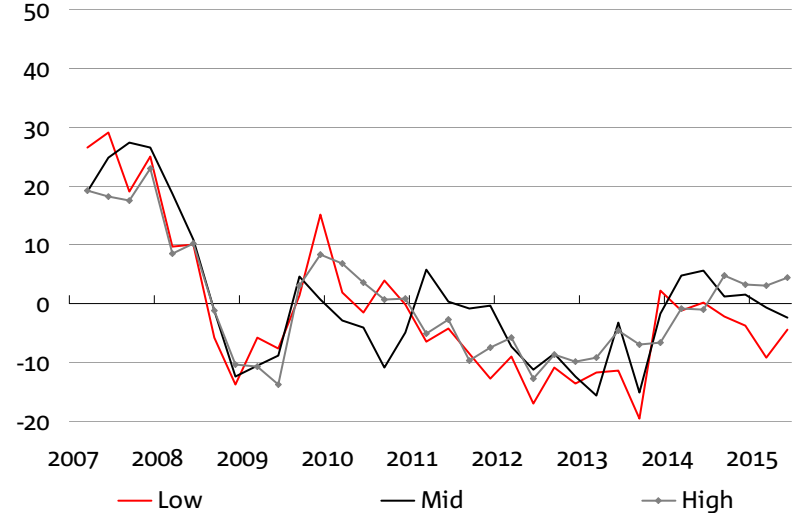
Business Confidence (net bal., sa.)



Trading Conditions (net bal., sa.)

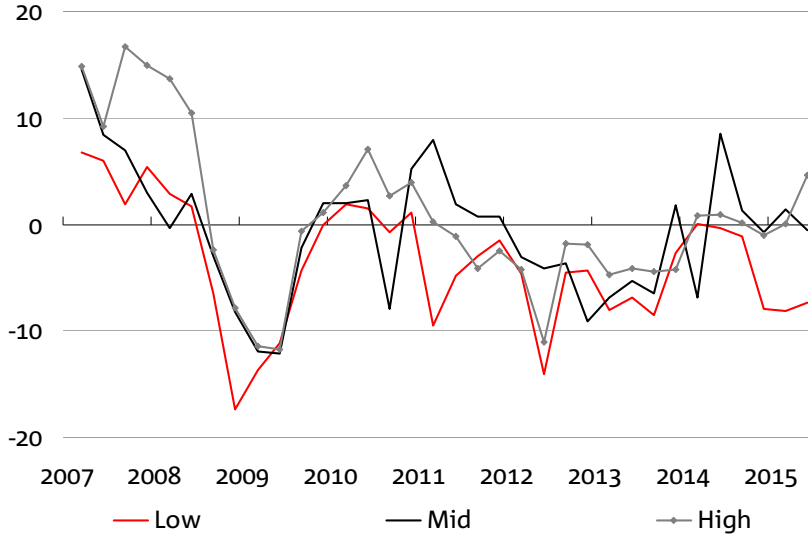


Profitability (net bal., sa.)

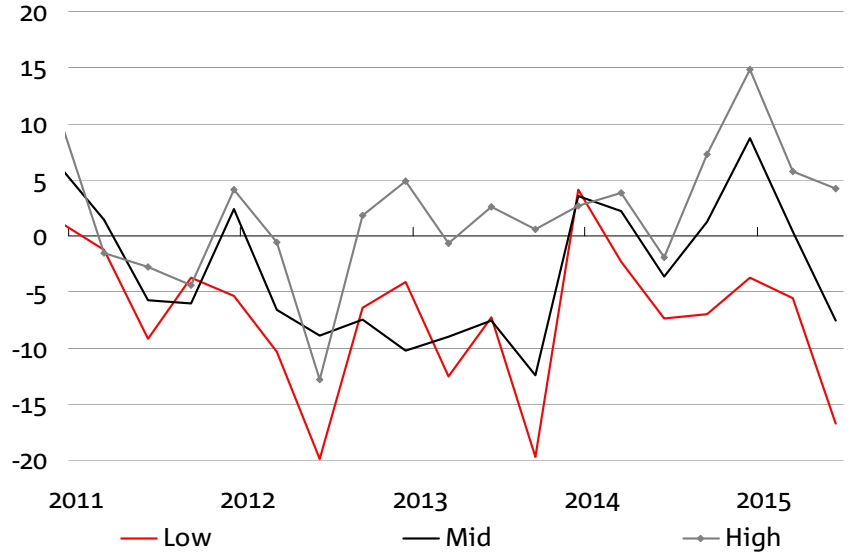


Detail by firm size (cont.)

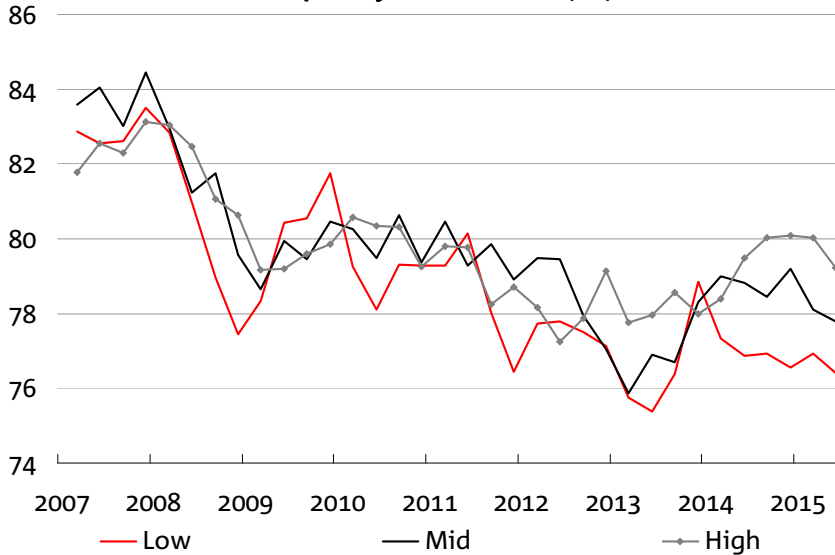
Employment by SME category (net bal., sa.)



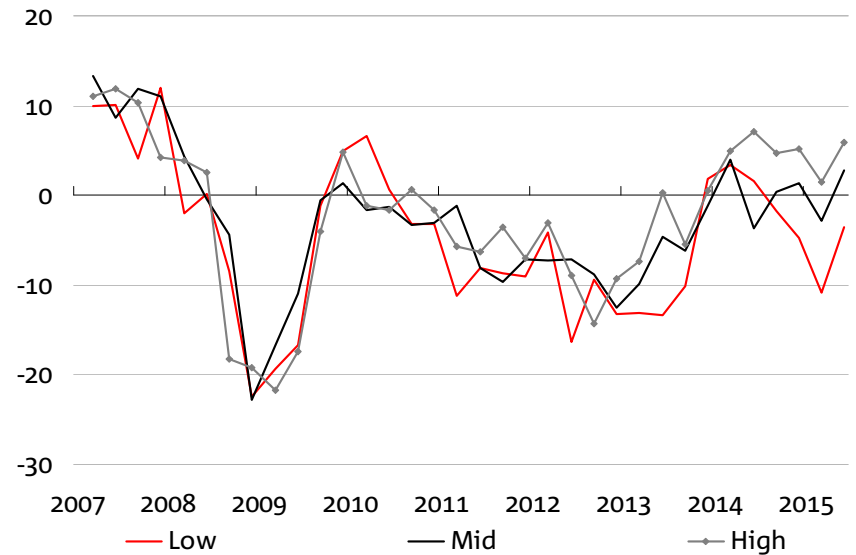
Cash Flow (net bal., sa.)



Capacity Utilisation (%)



Forward Orders



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