SMEs Business Optimism Survey

Q2 - 2013

AT A GLANCE

- The composite Business Confidence Index for the SME sector in Q2, 2013 is at 111.1 points with a y-o-y gain of 3.6 points, indicating that the SME outlook for the coming quarter (Q3, 2013) is rising when compared with the same period last year.
- The overall outlook on sales remains buoyant, with 82% of the businesses hopeful of either an increase or no change in sales volume in the next quarter. All the three key sectors have similar expectations with respect to volumes.
- 22% of the companies in the survey reported no hindrances to business this quarter (vs. 21% in Q1, 2013), reflecting stability in the ease of doing business in Dubai.
- Competition is the leading business concern for 44% of the SMEs, while 10% are concerned about the slowing demand for products/services.
- While key business expectations of SMEs are in line with the overall business community, the confidence of SMEs is seen to be lower than that of large companies.
- SMEs are more optimistic in their business expansion outlook over the next 12 months compared to large companies. Large companies are however more positive with respect to upgrading technology.

The Department of Economic Development (DED), a governmental agency, has the mandate to achieve the key strategic objectives of fostering ‘Sustainable Economic Development’ and strengthening the ‘Competitiveness of Dubai’. In order to gauge the perceptions of the business community, DED conducts Dubai’s Quarterly Business Survey, which provides a snapshot of Dubai’s current economic activity and the outlook for the quarter ahead.

This document presents a summary of the survey conducted in the second quarter of 2013 and highlights the future expectations of SME businesses in Dubai. The survey was administered to 441 SME businesses in Dubai. In addition, the survey also examines key challenges hindering the growth and development of SME businesses and summarizes their investment outlook over the coming twelve months.

METHODOLOGY

The quarterly business survey for Q2, 2013[1] was conducted on a total of 500 companies across the Emirate of Dubai. The survey included a mix of small, medium and large enterprises and ensured an adequate representation from the Manufacturing, Trading and Services sectors, in the same proportions as their respective contributions to Dubai GDP.

Distribution of survey respondents across industry groups

	Trading (166) Employees	Trading (166) Turnover	Trading (166) Number of Respondents	Manufacturing (72) Employees	Manufacturing (72) Turnover	Manufacturing (72) Number of Respondents	Services (219) Employees	Services (219) Turnover	Services (219) Number of Respondents
Micro	< = 9 &	< = AED 9 mn	76	< = 20 &	< = AED 10 mn	17	< = 20 &	< = AED 3 mn	75
Small	< = 35 &	< = AED 50 mn	56	< = 100 &	< = AED 100 mn	41	< = 100 &	< = AED 25 mn	85
Medium	< = 75 &	< = AED 250 mn	34	< = 250 &	< = AED 250 mn	17	< = 250 &	< = AED 150 mn	59

From the perspective of tapping 'business outlook' or expectations, the survey focused on key indicators, such as *sales, selling prices, volumes sold, profits and No. of employees.* Respondents were asked to suggest if they expect an 'increase', 'decrease' or 'no change' in these indicators.

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[1] *For the purpose of the survey, each quarter is defined as follows: Q1 is the period between January and March, Q2 is the period between April and June, Q3 is the period between July and September, and Q4 is the period between October and December of each year.*

SME Business Confidence Index Calculations

The SME Business Confidence Index (BCI) is calculated as a weighted average score of the following 'business outlook' indicators:

- Selling Price
- Volumes Sold
- Number of Employees
- Profits

For each indicator, 'Resultant scores' are calculated using the net balances method:
(% of positive responses - % of negative responses) + 100

For calculating the SME Composite Business Confidence Index for Dubai, the resultant scores are multiplied with their corresponding parameter weights to arrive at a weighted average Index score. The SME composite index score is finally rebased so that Q2, 2011 = 100.

BCI scores are classified in the following three groups:

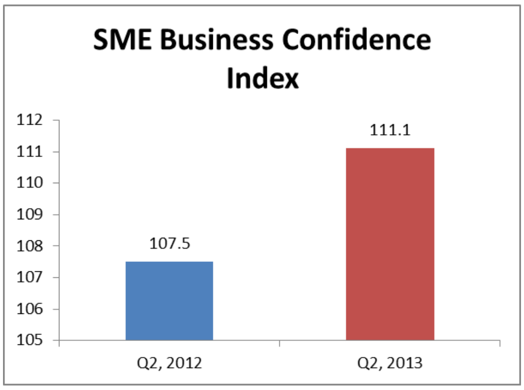
- ***BCI < 100, business expectations are negative***
- ***BCI = 100, business expectations are stable***
- ***BCI > 100, business expectations are positive***

When expressed with reference to the base quarter Q2-2011, the following interpretations hold: t and t-1 referring to two consecutive quarters.

- ***BCI(t)< BCI(t-1): business expectations are declining***
- ***BCI(t) =BCI(t-1): business expectations are stable***
- ***BCI(t)> BCI(t-1): business expectations are rising***

SME BUSINESS CONFIDENCE INDEX – Q2, 2013

The IMF has predicted slower global growth until the end of 2014 as Europe's recession drags on and economic growth slows in key BRIC countries. The IMF cut its expectation for global economic growth in the current year from 3.3% to 3.1%, and from 4.0% to 3.8% in 2014. New risks to global growth have emerged; including the possibilities of a drawn out economic slowdown in developing countries and that the US will scale back pumping of cash to stimulate the economy in the coming months.

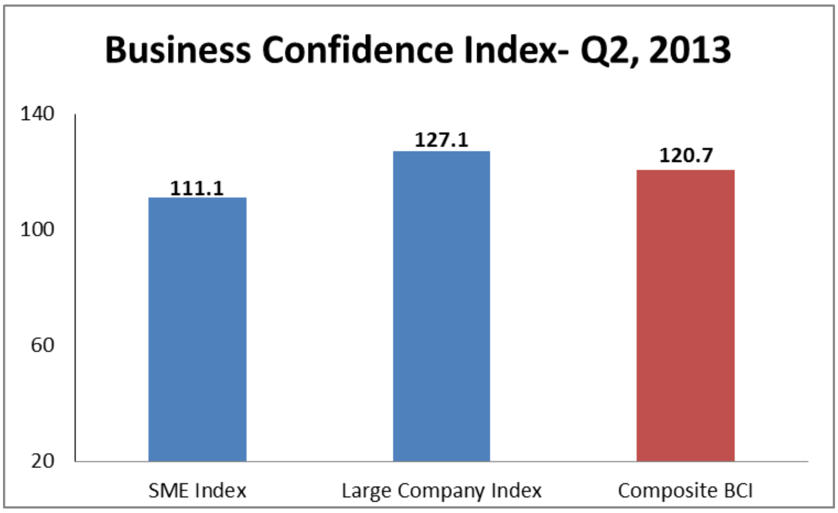


According to recent official data, Dubai's real GDP grew by 4.1% in the first quarter followed by a growth of 4.7% in Q2 2013, driven by momentum in the trade and other non-hydrocarbon sectors.

This is affirmed by a solid business confidence index reading, which at 111.1 points, shows that the overall business outlook for SMEs in Dubai is positive for the third quarter of 2013. (A score of 100 indicates stable/neutral sentiments).

A year-on-year comparison reveals an increase of 3.6 points over the index value during the same period in 2012. Quarter-on-quarter comparison however shows that the current quarter composite index is 8.4 points lower than the index in the previous quarter. For Q2

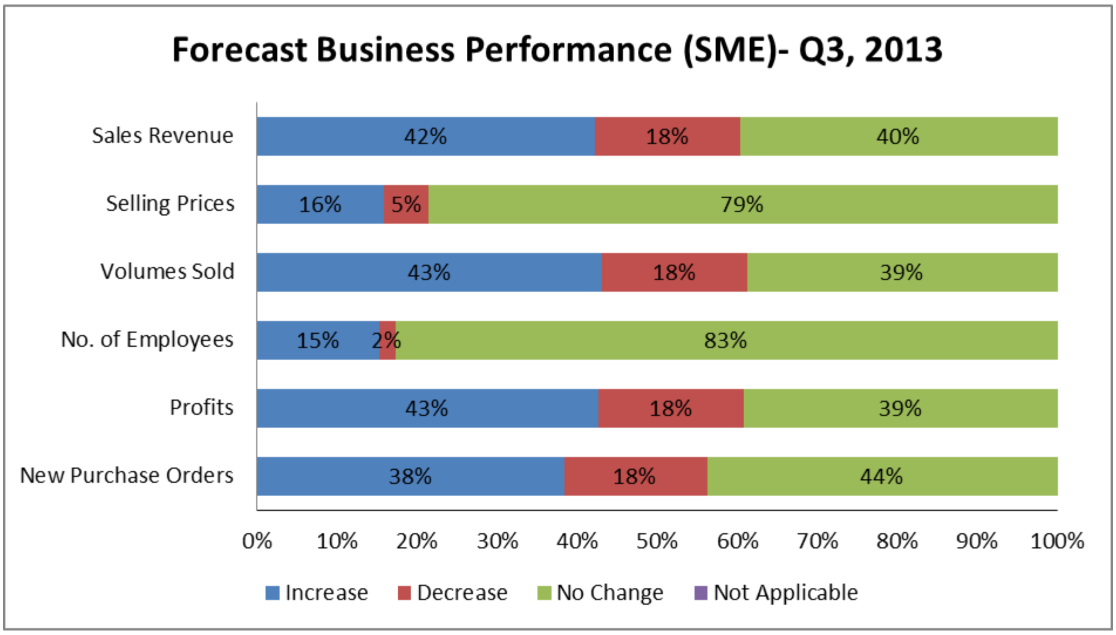
2013, there is a rise in optimism levels for all parameters compared to the levels observed in Q2, 2012.



A comparison between large companies and SMEs shows that SMEs are not as confident as the large companies. This reverses the trend from the previous quarter, when SMEs were more optimistic than large companies. Large companies have outperformed the SME community, which is reflected through an index score of 127.1 (versus an index score of 111.1 for the SME segment). The higher confidence among large companies is due to their relatively strong outlook with respect to prices, volumes sold, hiring, and profits.

The positive business confidence revealed in the survey is affirmed by the UAE PMI for the month of June. The PMI pointed to improvement in operating conditions in the non-oil producing private sector, but the rates of expansion eased slightly from May. The PMI, a composite indicator designed to provide a single-figure snapshot of the performance of the non-oil private sector, posted 54.1 in June, down from May's 55.3. Businesses in the UAE reported increased output and new order levels in June. Non-oil producing private sector companies in the UAE hired additional workers in June, and linked the increase to higher new business.

SME BUSINESS OUTLOOK – Q3, 2013



Given the dominant share of SMEs in Dubai's total business composition (95% of the total number of firms), 441 of the 500 respondents who were interviewed as part of the survey were SMEs. These included micro, small and medium enterprises as per Dubai's SME definition.

SMEs echo the overall business sentiments with the survey showing positive expectations for the upcoming quarter, as 42% of the respondents expect an increase and 40% report no change in sales revenues for Q3, 2013. A year-on-year comparison reveals a modest improvement in the net balances for sales revenues, rising from positive 22% in Q3, 2012 to positive 24% in Q3, 2013.

The hopefulness for revenues in this quarter is led by optimistic expectations for volumes (the net balance on sales volumes stands at positive 25% compared to positive 22% for Q3, 2012), indicating growth in business activity. The outlook for sales volumes for the current quarter has however toned down when compared with the previous quarter, with a net balance of positive 25% this quarter versus positive 42% last quarter.

A comparison between SMEs and large companies shows that once again there is a reversal of trend from the previous quarter. SMEs are less optimistic than large companies in this quarter with respect to sales revenues, as shown by their respective net balance scores of positive 24% and positive 37%. The higher buoyancy in large companies is driven by a more optimistic outlook with respect to sales volumes (53% of large companies vs. 43% of SMEs expecting an increase in Q3, 2013).

The overall business sentiment is upbeat across all sectors. Businesses in the manufacturing sector are more hopeful with respect to profits and volumes sold, whereas service sector firms are more sanguine regarding hiring. Also, with respect to selling prices, the trading and services sectors are most optimistic. For this quarter, expectation for volumes sold among large companies is highest in the trading sector, followed by manufacturing and service sector companies.

All key sectors have similar expectations in terms of expected sales volumes for Q3, 2013, (positive net balance of 26% for manufacturing SMEs, 25% for services SMEs, and 24% for trading SMEs)

Among the manufacturing firms, those engaged in the production of chemicals and cement are more confident compared to the other sub-sectors. A majority of the businesses forecasting an increase in volumes are hopeful of getting new contracts or orders during the coming quarter. Manufacturers of glass, marbles, metals and plastics are also quite optimistic with respect to the sales outlook during Q3 2013, while food & beverage manufacturers are least optimistic. 47% of the respondents from manufacturing expect their volumes to increase (compared to 68% in Q3, 2012), while 32% anticipate no change and 21% expect a decrease. A majority of the businesses forecasting an increase in volumes are expecting to get new contracts or orders during the coming quarter.

For the services sector, year-on-year comparison reveals a strong gain in the outlook for volumes sold (positive net balance of 25% for Q3, 2013 versus positive 7% for Q3, 2012). However, the scenario for the overall service sector has become less optimistic in Q2, 2013, compared to the previous quarter. Within the services sector, sales volumes expectations are relatively higher for companies engaged in real estate and ICT, with the key reasons being strengthening market conditions and therefore higher demand.

The architecture and construction sectors are expecting new projects/contracts in the local as well as regional markets, which would lead to an increase in their overall business activity. Driven by increased demand from all major sectors during this period, 47% of the transportation service providers are also hoping for an increase in their contract volumes in the coming quarter.

Hotels and restaurants are not as optimistic on their business performance in the next quarter. Around 21% businesses expect an increase in volumes, while a higher proportion i.e. 29% expect a corresponding decrease in their sales volumes in the next quarter. Respondents have attributed this to the seasonal nature of demand linked to tourism. The third quarter coincides with the onset of summer holidays, when many families travel abroad and the number of tourists is also quite less.

The survey also reveals that optimism in the trading sector is lower than that for Q3, 2012, with a net positive overall balance of 24% (positive 32% in Q3, 2012), and 41% of the respondents anticipating an increase in volumes against 17% who are expecting a decline. Key sub-sectors hoping for an increase in demand in the next quarter include the following:

- Traders of auto parts remain very optimistic about sales volumes in Q3, with 54% anticipating an increase in Q3. They are hopeful that new projects/orders or improved market conditions will lead to higher sales.

- Traders in the building and construction sub-sector have positive expectations on sales volumes as they expect to get new projects. Of these 29% hope to increase their volumes in Q3.
- Cosmetics traders are also expecting a good third quarter with respect to sales volumes; 63% are anticipating higher sales in Q3.
- 57% of the traders in the electronics sub-sector foresee higher volumes in Q3, citing new orders/projects or an increase in exports.
- Food trading businesses are optimistic about the third quarter as they expect more demand on account of Ramadan.
- Traders of footwear are hopeful of an increase in demand; 50% expect an increase in sales in Q3.
- Two-thirds of the garment traders are looking forward to higher sales in the next quarter on account of new orders.

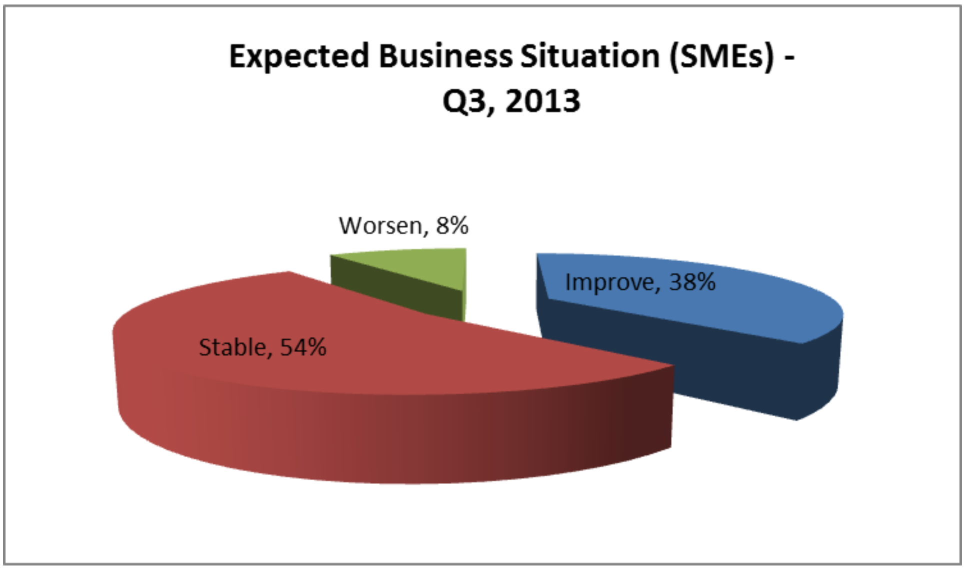
Selling prices are presumed to remain stable in the coming quarter as well, with 79% of the companies saying that there will be no change in the selling prices of their products or services, similar to the level in the previous quarter (82%). However, the selling price outlook for Q3, 2013 is much stronger than the outlook in the same quarter a year ago (net balance of positive 11% this year versus positive 4% last year). 16% of the SMEs are looking ahead to raising their prices, in order to compensate for increased raw materials or operating costs or because they can hike up their prices given the prospect of higher demand for their products/services. Services SMEs (net balance of positive 11%) as well as trading SMEs (net balance of positive 11%) are more upbeat than the manufacturing SMEs (net balance of positive 9%) with respect to their selling prices.

Keeping in mind the positive expectations on sales, 38% of the businesses hope to augment their new purchase orders in the next quarter. This is based on the expectations of acquiring new projects, coupled with rising demand typically witnessed after the end of the Ramadan season. 44% of the businesses that will maintain the same level of purchase orders reason that they had made their purchases in the previous quarters and currently hold sufficient stocks. Respondents in the manufacturing sector are more optimistic compared to the trading and service sectors with respect to their new purchase order activity: 46% of manufacturing firms versus 36% of the trading firms and 38% in the services sector expect to increase their new purchase orders in Q3. SMEs hold a less sanguine outlook than large companies on new purchase orders with 38% of SMEs compared to 49% of large companies expecting an increase in the next quarter.

The y-o-y outlook on hiring has improved for Q3, 2013, with 15% of the businesses expecting to increase their employee count compared to 12% in Q3, 2012. Service and manufacturing sectors SMEs hold a stronger hiring outlook compared to trading SMEs (net balance of positive 17% for services, positive 16% for manufacturing and positive 7% for the trading sector). The survey also revealed that a marginal 2% of the businesses expect to decrease their workforce in the next quarter. A comparison between large companies and SMEs shows that the former have a more upbeat outlook with respect to hiring (net balance of positive 22% for large companies compared to positive 13% for SMEs). In Q3, 2012 SMEs and large companies had a similar outlook; with a net balance of positive 9% for SMEs and positive 8% for large companies.

With respect to capacity utilization, SMEs in manufacturing and services are less optimistic than large companies, reversing the trend in the previous quarter (net balance of positive 22% for SMEs versus a net balance of positive 37% for large companies).

The survey shows that 43% of the SMEs foresee an improvement in profits for Q3, 2013, with manufacturing (positive net balance of 29%) firms indicating a stronger outlook compared to services and trading firms (positive net balance of 24% in both). Profitability outlook has improved y-o-y for SMEs, with a net balance of positive 25% for Q3, 2013 versus positive 22% for Q3, 2012. Finally, reversing last quarter’s trend, SMEs are now less optimistic compared to large companies about Q3 profits, with a net positive balance of 24% for SMEs against 36% for large companies



The overall business outlook for Q3, 2013 remains steady with 92% of the respondents reporting either an improvement or stability in business conditions (a similar proportion i.e. 91% was recorded as reflecting strong optimism and / or stability in terms of business conditions, in the previous quarter survey), while 8% fear a worsening of the business situation in Dubai. Furthermore, a comparison between large companies and SMEs shows that the former are more optimistic, with 51% of them anticipating an improvement in Q3, 2013, against 38% of the SMEs. Some of companies that expect the business environment to worsen have mentioned high competition and lack of demand as the key reasons.

SME PERFORMANCE – Q2, 2013

Although the main purpose of the survey is to gauge business expectations for future activity, it also tries to capture the actual changes in business performance of SMEs from one quarter to another.

Business activity in Q2, 2013 was stronger compared to the previous quarter as a higher number of respondents reported an increase rather than a decrease in sales volumes (net balance of positive 6%, which is higher than the positive 4% reported in Q2, 2012). All sectors conveyed a positive performance with respect to volumes sold in Q2, with a net balance of positive 17% in manufacturing, positive 2% in trading and positive 6% in services. In addition, large companies described a much better business performance in the current quarter with a positive net balance of 26% compared to the positive net balance of 6% for SMEs.

- In the manufacturing sector, the sub-sectors that showed positive activity were cement, chemicals, electronics, food and beverage, metals, and paper. However, firms dealing in furniture, marbles and plastics manufacturing faced a slowdown in activity, explained by increased competition, retraction in projects and reduced consumer demand.
- The positive performance of the trading sector in Q2 was led by an increase in activity in the following sub-sectors: building and construction (new orders), computers (increase in demand and introduction of new brands), food and groceries (new orders, lower prices to attract new customers and new products), garments (launch of new products) and others.
- The positive performance of services in Q2 was led by an increase in activity in the following sub-sectors: printing (higher demand), cleaning (higher demand), construction (more projects), financial services, hospitals, marketing, real estate (pick up in the market) and transport (new markets, higher exports).

Selling prices remained largely stable in Q2, 2013 with 65% of the respondents reporting ‘no change’. However, 19% of the respondents reported a reduction in their prices in order to boost sales in sectors that have experienced increased competition, reduced demand and fluctuations in currency.

Workforce numbers improved during Q2, 2013, with 15% of the businesses reporting an increase in their workforce during the quarter, higher than the 12% reporting an increase in Q2, 2012. Still, a majority of the firms (78%) reported ‘no change’ in their employee count for this quarter. Firms in the services and manufacturing sectors were more upbeat, with 17% in services and 16% in manufacturing reporting an increase in workforce compared to 12% in the trading sector. Also, a higher proportion of large companies (25%) compared to SMEs (15%) reported an increase in their employee count.

Replicating the overall performance of the business community on sales volumes, new purchase orders also increased during Q2, 2013, as reflected in a positive net balance of 11%, higher than the 9% in Q2, 2012 and the positive 5% in Q1 2013. All key sectors reported an increase in new purchase orders during the second quarter, with the manufacturing sector reporting a net balance of positive 19%, trading with positive 5% and services with positive 13%. As in the previous quarter, large companies reported a much better performance on new purchase orders as reflected by the positive net balance of 31% in Q2, 2013.

The unit cost of labor remained stable for majority (66%) of the SMEs in Q2, 2013. However, 34% of the businesses reported an increase in labor costs, citing the following reasons: revision of salaries, increments, employee demand for higher salaries, increase in labor accommodation rent as well as increase in other costs of living, increase in the number of employed people at higher salaries. In Q2, 2012, just 19% of the SMEs reported an increase in labor costs. In the case of large firms, 41% reported a hike in labor costs in Q2, 2013.

The rising cost of raw material, which has been a cause for concern amongst several businesses, was reported to have increased according to 28% of the respondents, which is 11 percentage points lower than in Q1, 2013 and 10% lower than in Q2, 2012. This rise impacted manufacturing firms the most, with 41% indicating an increase in Q2 against 30% for trading and 22% for services. The impact of such costs affected 32% of large companies in Q2, 2013.

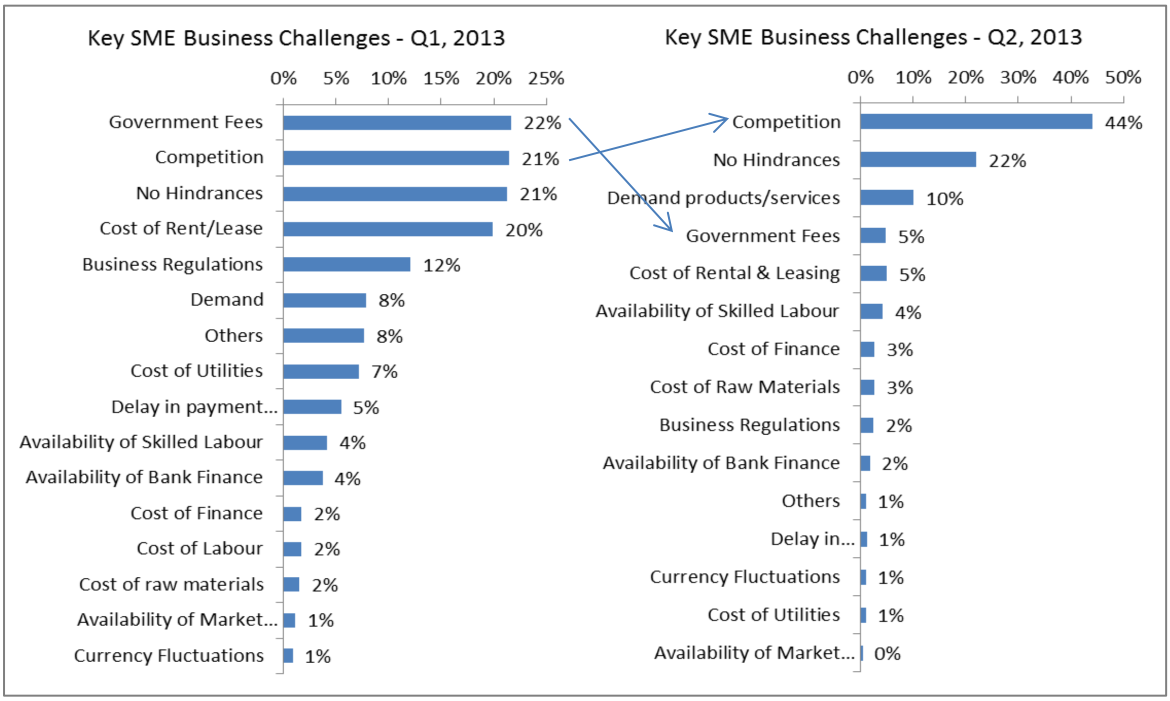
Rental costs rose in Q2, 2013 according to 17% of the SMEs and remained stable for the remaining 83% of the firms. In Q2, 2012 rental costs increased for 10% of the SMEs. The impact of rental costs increase was much higher for manufacturing and service sector companies. Roughly, 19% each of the manufacturing and service companies reported an increase in rents in Q2, 2013 compared to 13% for trading SMEs. With respect to large companies, just 8% reported an increase in rental costs in Q2, 2013.

The current quarter survey also revealed that around 37% of the respondents availed bank finance out of which 63% reported no changes in the cost of finance while 29% reported an increase. The top reasons cited for not availing bank finance remained the perception of high interest rates and charges and challenges related to collateral and guarantees. Among the large companies, 32% availed of bank finance, of which 58% reported no change in costs, while 26% reported an escalation.

The survey also revealed that 69% of the respondents reported an increase or no change in their profit levels during Q2, 2013, with the net balance at negative 1%. Approximately 19% of the SMEs reported a decline in selling prices in Q2, which may have negatively impacted profits. The manufacturing sector reported a net balance of negative 6%, but the balance was 0% for services and trading firms. Following the trend in the last quarter, large companies have shown a better performance on profits in Q2, 2013 compared to SMEs with 76% of the respondents indicating an increase or no change in business profits (net balance of positive 22%).

KEY BUSINESS CHALLENGES IN DUBAI

The survey also addressed key challenges faced, as perceived by businesses at the end of Q2, 2013. The survey shows that 22% of the businesses cited no challenges, indicating the ease of doing business in Dubai in the current quarter.



A comparison with the last quarter reveals that the two biggest business challenges in Q2, 2013 are competition and slowing demand for product/services while in Q1 the top challenges were government fees and competition. However, there has been an increase in the intensity of competition while government fees have declined in intensity.

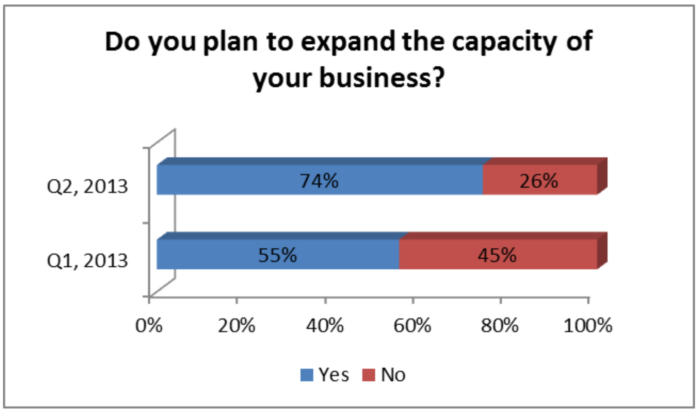
The following are found to be the major challenges impacting businesses in Dubai:

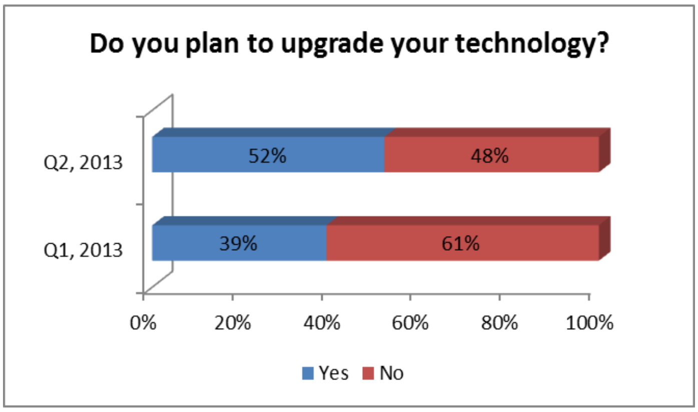
1. Competition (cited by 44% of the respondents): Competition from local and international players is the top most challenge facing Dubai businesses. In the previous quarter, just 21% of the businesses had cited competition as a leading challenge. Also, 48% of the respondents that cited competition as a challenge stated that the severity of this challenge has increased in the current quarter. This was common to all key sectors.

2. Lack of demand for products/services (cited by 10% of the respondents): This challenge has increased in importance and was reported as the second most important factor impacting businesses during Q2. 35% of the SMEs that have reported lack of demand as a challenge have said that its severity increased during Q2.
3. Government fees (cited by 5% of the respondents): This has been reported as the third most serious challenge in Q2 (second in Q1). The main reasons cited are high costs of trade license renewal and visa fees. Among the respondents that have cited this as the most important challenge, 48% think that the severity of this challenge has increased in the second quarter.
4. High cost of rentals and leasing (cited by 5% of the respondents): This was reported as a key challenge by businesses that had to renew their leases at higher rentals. Costs of rental and leasing increased for 62% of the respondents who said that it was a challenge.
5. Availability of skilled labor (cited by 4% of the respondents): This has become an important issue during the second quarter, taking fifth place. Approximately 47% of the respondents citing it as a challenge have indicated that its seriousness increased during Q2. A key reason cited was the issuance of fewer visas.
6. Cost of finance (cited by 3% of the respondents): Among the respondents that cited this factor as a challenge, 25% stated that the severity of this factor had increased in Q2, 2013.
7. Cost of raw material (cited by 3% of the respondents): Among the respondents that cited this factor as a challenge, 23% stated that the gravity of this factor had increased in Q2, 2013.

In terms of differences across business categories, it can also be observed that challenges cited by SMEs were similar to those faced by the overall business community. For SMEs the top three challenges are competition, demand for products/services, and government fees. Competition is also the topmost challenge affecting large companies; however the second most intense challenge faced by this segment is the availability of skilled labor, followed by demand for products/services.

INVESTMENT OUTLOOK





In comparison with findings from the last quarter survey, the outlook of businesses with respect to future expansion plans and plans to invest in technology upgrade has improved significantly in Q2, 2013. 74% of the respondents are planning to expand their capacity in Q2 2013 (vs. 55% in Q1 2013) and 52% of firms are hoping to upgrade technology (vs. 39% of the businesses in Q1 2013). From a business size perspective, large businesses are more inclined to upgrade technology (63%), whereas SMEs are more inclined to expand their capacity (71% of large companies plan expansion in capacity).

Businesses willing to enhance capacity are planning to undertake capital investments such as expansion of the current office premises and investments in business assets such as factory, warehouse, machinery and vehicles.

Businesses with no expansion plans have cited underutilization of present capacity, insufficient funds and poor market conditions as the reasons which will hamper their future plans.

Sector-wise comparison shows that manufacturing (79%) and services (77%) companies are more optimistic about investing in capacity expansion compared to trading firms (68%). With respect to upgrade of technology, manufacturing firms (59%) are more upbeat followed by service companies (58%) and trading firms (42%).