مؤسسة محمد بن راشد لتنمية المشاريع الصغيرة والمتوسطة
DUBAI SME

An Agency of the Department of Economic Development – Government of Dubai

SMEs Business Optimism Survey

Q4 - 2013

AT A GLANCE

- The composite Business Confidence Index for the SME sector for Q1, 2014 stands at 134.3 points, signifying that the overall outlook is rising when compared with the same period last year (127.8) as well as in comparison with the last quarter Q4 2013 (127.2).
- The overall outlook on sales continues to advance, with 97% SMEs expecting either an increase or no change in sales volume in Q1 2014 (compared to 95% in the last quarter and 94% in the same period last year).
- 64% of the companies in the sample reported no hindrances to their business operations this quarter (versus 65% in the previous quarter), reflecting stable conditions with respect to doing business in Dubai.
- Competition remains the leading business challenge for 11% of the SMEs, while 10% are concerned about the rising cost of rental/leasing.
- SMEs hold a lower optimism compared to large companies on selling prices and hiring.
- SMEs remain less optimistic about investment in capacity expansion and technology upgrades compared to large companies.

The Department of Economic Development (DED) is a Dubai Government Department that has the mandate to help achieve the key strategic objectives of fostering ‘Sustainable Economic Development’ and strengthening the ‘Competitiveness of Dubai’.

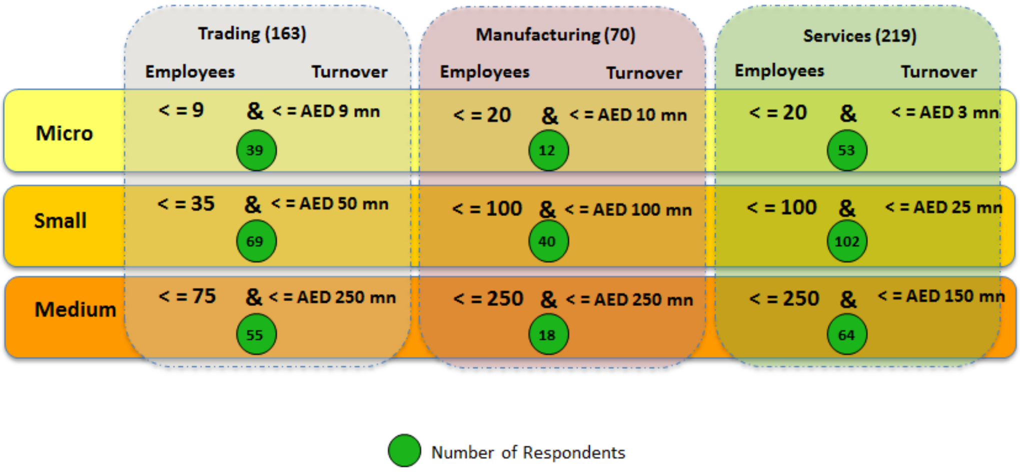
In order to gauge the perceptions of the business community, DED conducts the Dubai’s Quarterly Business Survey, which provides a snapshot of Dubai’s current economic activity and the outlook for the quarter ahead.

This document presents a summary of the survey conducted in the 4th Quarter of 2013 and highlights the future expectations of SME businesses in Dubai. The survey was administered to 452 SME businesses in Dubai. In addition, the survey addresses challenges that may impact business growth and development and assesses the investment outlook for the coming twelve months.

METHODOLOGY

The quarterly business survey for Q4, 2013[1] was conducted for a total of 502 companies across the Emirate of Dubai. The sample 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



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 indicate 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 Prices
- 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:

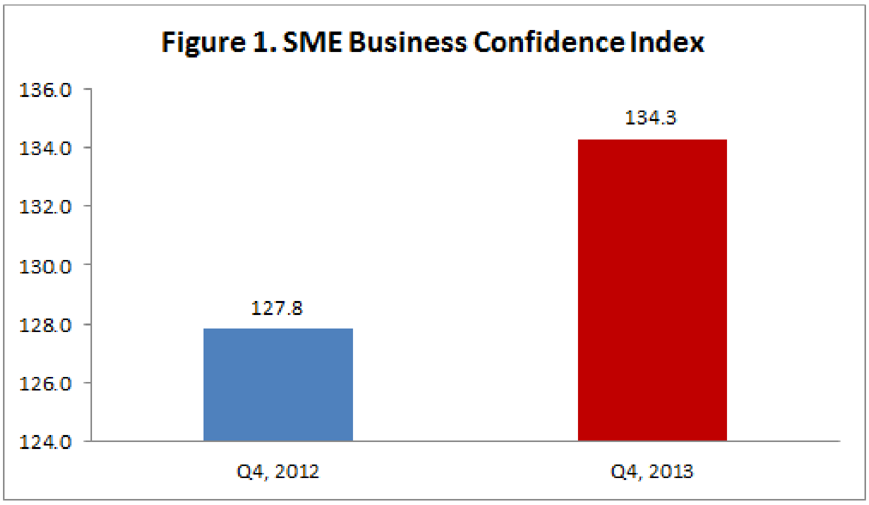
- ***BCI < 100, business expectations are negative***
- ***BCI = 100, business expectations are stable***
- ***BCI > 100, business expectations are positive***

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***

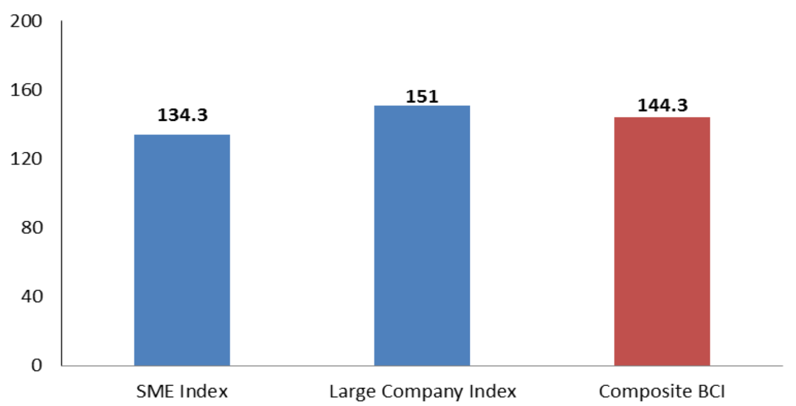
SME BUSINESS CONFIDENCE INDEX – Q4, 2013

GDP growth in Dubai is set to pick up in the current year to 4.7% as the emirate starts gearing up for hosting the Expo 2020 exhibition and the imminent prospect of an upgrade to the emerging market status will add dynamism to the economy that is already on an upward trajectory, spurred by huge non-oil sector investments, the buoyant trade and services sector, and the booming tourism industry. At 134.3, the composite business confidence index for Q4 2013 highlights strengthening economic growth for Dubai's SMEs. (A score of 100 indicates stable/neutral sentiments).



Quarter-on-quarter comparison shows that the current quarter composite index is 7.1 points higher than the index in the previous quarter due to business expectations of rising demand on account of anticipation of new contracts/projects and also due to the positive uptrend experienced during the winter season and the Dubai Shopping Festival. This period usually witnesses a large inflow of tourists and is also the peak season for exhibitions and promotions. A year-on-year comparison reveals an increase of 6.5 points over the index value during the same period in 2012. The outlook for Q1 2014 shows that there is either a rise or stability in optimism levels for all parameters compared to the levels observed in the previous quarter as well as the same period a year ago.

Figure 2: Business Confidence Index- Q4, 2013

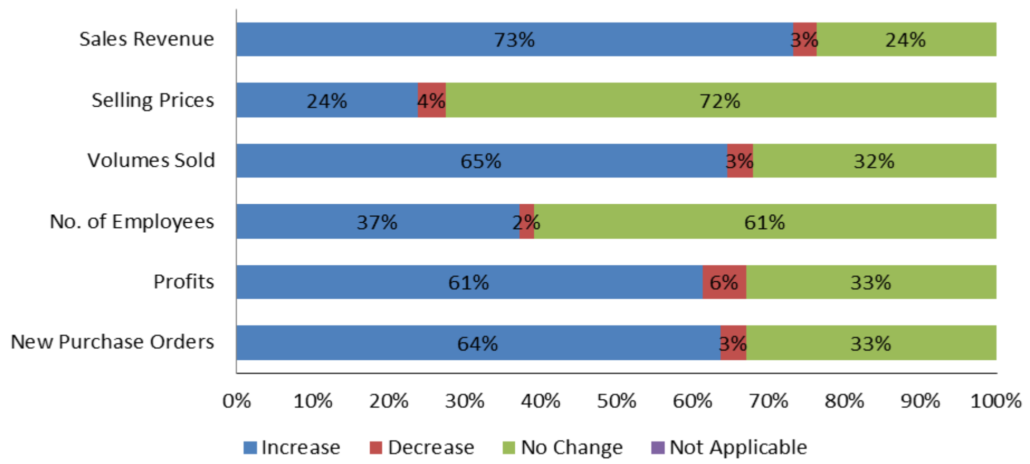


As observed in the previous two quarters, large companies are more confident than the SME community. This is reflected in the large companies' index score of 151 versus an index score of 134.3 for the SME segment. The higher confidence among large companies is due to their more optimistic outlook with respect to selling prices and hiring.

SME BUSINESS OUTLOOK – Q1, 2014

SMEs account for a dominant share in Dubai's total business composition (95% of the total number of firms), 452 of the 502 firms that were interviewed as part of the survey were SMEs. These included micro, small, and medium enterprises as per Dubai's SME definition. SMEs display a strong outlook for Q1 2014 as the survey results shows that the composite BCI is higher than the index value in the previous quarter as well as the same quarter a year ago.

Figure 3: Forecast Business Performance (SME) - Q1, 2014



Strong sales revenue expectations underscore this positive outlook, as 73% of the respondents anticipate an increase and 24% cite no change in sales revenues for Q1, 2014. Y-o-y comparison shows that net balances for sales revenues is up by 12 points to 70% in Q1 2014 compared to 58% in Q1 2013.

Sales revenues are expected to be driven by an increase in real business activity (volumes) as well a rise in selling prices. The survey shows similarity in net balances for volumes sold and growth in business activity when expectations are compared y-o-y; positive 59% in Q1, 2013 versus positive 62% in Q1, 2014. Q-o-q comparison shows an improvement from positive 53% in Q4 2013 to 62% in Q1 2014.

The two segments, SMEs and large companies show similar expectations for sales revenues in Q1 2014, a positive net balance equal to 70% for SMEs against 72% for large companies. Similarly, expectations for volumes sold for the two groups are comparable: a positive net balance of 64% for large companies versus positive 62% for SMEs.

A comparison between the key sectors shows that the manufacturing and services sectors hold stronger expectations than the trading sector. Additionally, businesses in the manufacturing sector are more optimistic with respect to revenues, volumes and new purchase orders, while service firms are more optimistic on selling prices, hiring and profits.

The survey shows that manufacturing and services SMEs are more confident about sales volumes, with 71% and 66% of them respectively expecting an improvement in Q1, 2014, versus 60% in the trading sector.

Manufacturing Sector:

The sales volume outlook for the manufacturing sector for Q1 2014 compared to Q1 2013 reveals a sharp increase in net balances, rising from positive 52% in Q1, 2013 to 67% in Q1, 2014. The optimism has strengthened compared to the previous quarter also, with the net balances increasing from positive 56% in Q4 2013 to 67% in Q1 2014. This improved outlook is driven by the high tourist season in the first quarter, seasonal uptick in demand and upbeat expectations about getting new projects/orders.

Among the manufacturing firms, those engaged in the manufacture of chemicals, cement, glass, metals and food & beverages reflect a higher optimism compared to the other sub-sectors. A majority of the businesses anticipating an increase in volumes are expecting to get new contracts / orders during the coming quarter. 71% of the manufacturing sector firms foresee an increase in their volumes, while 25% expect no change and the remaining 4% anticipate a decline.

Services Sector:

Service sector firms have a higher optimism compared to the previous quarter and similar confidence levels when compared to the same quarter a year ago for volumes sold (positive net balance of 63% for Q1, 2014 versus 60% for Q1, 2013 and 57% for Q4 2013). Companies across all service sub-sectors have indicated high optimism with regards to sales volumes as only a minimal 3% of all firms in this sector anticipate any decrease in volumes. Expectations are highest for companies engaged in architecture and real estate (anticipation of new projects) and restaurants & hotels (increase in customers as numbers of tourists are expected to increase in the next couple of months i.e. January – March).

Hotels and restaurants are very optimistic on their business performance in the next quarter as the tourist inflow typically increases during the winter season. Around 85% of the respondents in the sector expect an increase in volumes; while the remaining, do not anticipate any change. Strong expectations are highlighted by the fact that none of the respondents in this sub-sector expect a decline in volumes in Q1 2014.

The optimism and confidence of companies in the architecture and construction sectors has been boosted by Dubai's successful bid for hosting the Expo 2020 due to which companies are expecting new projects & contracts. Driven by increased demand from all major sectors during this period, 64% of the transportation service providers are also expecting an increase in their contract volumes in the coming quarter.

Trading Sector:

The trading sector outlook is stronger for Q1 2014 than the previous quarter but has moderated compared to a year ago (positive net balance of 56% for Q1 2014 versus 46% in Q4 2013 and 59% in Q1 2013). 60% of the firms expect an increase in volumes, while 4% anticipate a decline.

Key sub-sectors hopeful of an increase in demand over the next quarter include:

- 82% of the traders in the building & construction sub-sector anticipate an increase in sales volumes on the back of expectations of new projects boosted by Dubai's successful bid on hosting the Expo 2020
- 73% of the auto traders foresee an increase in sales in Q1 on expansion of new exports markets, new projects/orders expected due to the Expo 2020 and peak seasonal demand during Q1
- 56% of the traders in the food & beverages sub-sector expect higher volumes in Q1 due to expectations of increase in exports or higher seasonal demand during the first quarter
- 56% of electronics traders are upbeat about the first quarter as they expect more demand, boosted by the DSF

The survey shows that the selling price outlook for Q1, 2014 is much stronger than that for the same quarter a year ago (net balance of positive 20% this year versus positive 10% last year). 72% of the respondents expect selling prices to remain unchanged in Q1 2014; however, almost a quarter (24%) of the firms anticipate their selling prices to increase due to one or more of the following reasons: increasing raw material or operating costs, rising demand for their products which implies that they can charge more, new projects or because they can charge higher prices during the high demand tourist season. Services SMEs (net balance of positive 29%) are much more optimistic than the manufacturing and trading SMEs (net balance of positive 13% each) with respect to their selling prices.

In line with the positive expectations on sales, 64% businesses are also planning to increase their new purchase orders in the next quarter, due to positive expectations of new project wins / increase in demand for products and services. 33% of the businesses have said that they currently hold adequate stocks and hence are planning to maintain the same level of purchase orders as in the previous quarter. Manufacturing firms have a stronger outlook compared to the services and trading SMEs on new purchase orders with positive net balances of 66%, 62% and 56% respectively. SMEs and large companies hold a similar outlook for new purchase orders in Q1 2014, with 64% of the respondents in each group planning an increase.

On hiring, the y-o-y as well as the q-o-q outlook has improved for Q1, 2014, with 37% of the businesses expecting to increase their employee count compared to 26% in Q1, 2013 and 25% in Q4 2013. Service firms are more optimistic with respect to hiring compared to manufacturing and trading companies (positive net balance of 40%, 33% and 29% respectively). A marginal 2% of businesses plan to reduce their employee count in the next quarter. Large companies maintain their higher optimism level compared to SMEs on hiring, with positive net balances of 56% and 35% respectively.

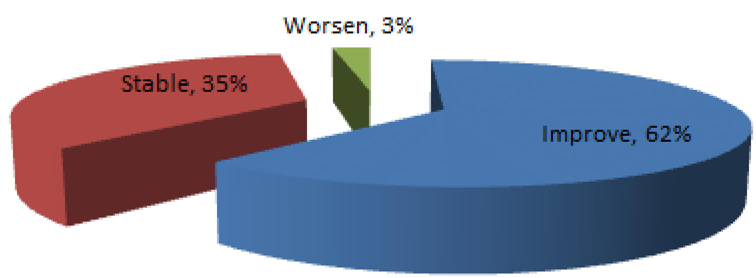
With respect to capacity utilization, SMEs and large companies hold similar outlooks (net balance of positive 59% for SMEs versus a net balance of positive 60% for large companies).

Profitability expectations are consistent with the overall sales expectations, with 61% of the SMEs expecting an increase in net profits based on their anticipation of strong demand with better margins. Service and manufacturing sectors are more optimistic about their profit levels in Q1 compared to traders (positive net balance of 58%, 56% and 52% respectively). The profitability outlook for SMEs is similar compared to the same period a year ago, with a positive net balance of 55% in Q1 2014 against 52% in Q1 2013.

Additionally, SMEs and large companies have a comparable outlook for profits: positive net balance of 55% and 58% respectively.

The overall business outlook for Q1, 2014 has improved with 62% respondents reporting an improvement in business conditions versus 57% in Q4 2013. A minimal 3% of the SMEs anticipate worsening of the business situation in Dubai in Q1 2014, down from 5% in the previous quarter.

Figure 4: Expected Business Situation (SMEs) - Q1, 2014



Additionally, large companies are slightly more optimistic than SMEs, with 66% of the former hopeful of an improvement in Q1, 2014, against 62% of the SMEs. While 3% of SMEs expect deterioration in the business situation, none of the large companies anticipate deterioration.

In Focus: Dubai Foundation for the development of investment

The Law:

His Highness Sheikh Mohammed bin Rashid Al Maktoum, UAE Vice President and Prime Minister (may Allah protect him) in his capacity as Ruler of Dubai recently issued a law establishing "Dubai Foundation for the development of investment" as a public institution enjoying legal personality and legal capacity attributed to the Department of Economic Development in Dubai.

Aims:

The Foundation aims to strengthen Dubai's position as a center of global economic attracting investment, and create the appropriate investment climate for the establishment of investment projects, and the consolidation of confidence in the investment environment, and the promotion of projects and opportunities in the emirate.

Terms of Reference:

- To formulate the general policy and the strategic plan for investment and attract and develop investment projects in the long term in line with the emirate's economic development plan.
- Coordination with the government agencies concerned with the investment sector and the organization of economic activities on the proposed preferential advantages that enhance the implementation of programs and initiatives to promote investment, and consider requests from investors to get those advantages.
- Review and analyze the investment climate, and identify investment opportunities, and impediments to growth, as well as consideration of any obstacles and to seek appropriate solutions in coordination with the concerned authorities.

Functions:

- Proposal of economic sectors that need to attract investment projects, and in line with the emirate's strategic plan.
- Building a database include existing projects in Dubai, and the provision of information and statistics necessary for those wishing to invest.
- Provide services to investors to facilitate the completion of all transactions and simplify the procedures for their projects, as well as monitoring and evaluating the performance of the investment sector in Dubai, in coordination with the concerned authorities.

SME PERFORMANCE – Q4, 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, as reported qualitatively by responding firms.

There was an improvement in business activity in Q4, 2013 compared to the previous quarter as a larger number of firms reported an increase rather than a decrease in sales volumes (net balance of positive 25%, which is much higher than the 3% reported in Q4, 2012)**.** All three key sectors reported an expansion with respect to volumes sold in Q4, with a net balance of positive 21% in manufacturing (compared to positive 14% in Q4, 2012), positive 22% in trading (compared to negative 18% in Q4, 2012), 30% for construction, 15% in transportation, 57% in tourism & hospitality and positive 28% in the overall services sector (versus 15% in Q4 2012). Furthermore, large companies reported a much better business performance in Q4 2013 with a positive net balance of 46% compared to 25% for SMEs.

- In the manufacturing sector, the sub-sectors that showed positive activity were cement, food & beverage, glass & ceramics, furniture, metals and plastics. However, firms dealing in garments and machine & equipment manufacturing faced a slowdown in activity, possibly due to reduced consumer demand.
- The positive performance of the trading sector in Q4 was due to an increase in activity in the following sub-sectors: garments (rising demand from existing customers and booming Dubai market), general traders, food & beverage (rising demand), auto (new projects and improvement in demand), building & construction (favorable market conditions), computer (demand for new technology), industrial equipment and pharmacies.
- The promising performance of services in Q4 was led by an increase in activity in the following sub-sectors: construction (more projects), real estate (recovery in the real estate rental and buying market), tourism & hospitality and transport (new markets, higher exports).

Selling prices remained largely stable in Q4, 2013 with 77% of the SMEs reporting ‘no change’ against 9% that reported a decline due to low demand and competition.

Employment figures improved during Q4, 2013, with 25% of the businesses reporting an increase in their workforce during the quarter, higher than the 18% reporting an increase in Q4, 2012. However, a majority of the firms (70%) reported stability in their employee count for this quarter. Services and manufacturing firms experienced larger increases, 28% and 30% of firms respectively compared to 18% in the trading sector. In addition, a greater percentage of large companies (48%) compared to SMEs (25%) reported an increase in their employee count.

In line with the performance of the business community on sales volumes, new purchase orders also increased during Q4, 2013, as revealed in the positive net balance of 26%, higher than the positive 5% in Q4, 2012 and positive 18% in Q3 2013. The three main sectors reported an expansion in new purchase orders during the fourth quarter, with manufacturing reporting a positive net balance of 26%, trading 24% and services 26%. Large companies showed a slightly better performance on new purchase orders as reflected by the positive net balance of 30% in Q4, 2013.

The unit cost of labor/human resources increased for 41% of the SMEs during Q4 2013 on account of increase in employee accommodation costs, revision of salaries and increments given; while these costs remained unchanged for a majority 57% of the respondents. In Q4, 2012, 27% of the SMEs reported an increase in labor costs. In the case of large firms, 44% reported an increase in labor costs in Q4, 2013.

The cost of raw materials increased for 21% of the respondents in Q4 2013 against 34% in Q3. This rise impacted manufacturing firms the most as in the previous quarter, with 30% indicating an increase in Q4 against 21% for services and 16% for traders. The impact of such costs affected 20% of large companies in Q4, 2013.

Rental costs increased for 54% of the SMEs in Q4 2013 and remained stable for the remaining 46%. In Q4, 2012 rental costs increased for 24% of the respondents. The impact of rental costs increases was similar across the three key sectors: 55% of services and 53% each in manufacturing and trading reported an increase. Additionally, 58% of the large companies cited an increase in rental costs in Q4, 2013.

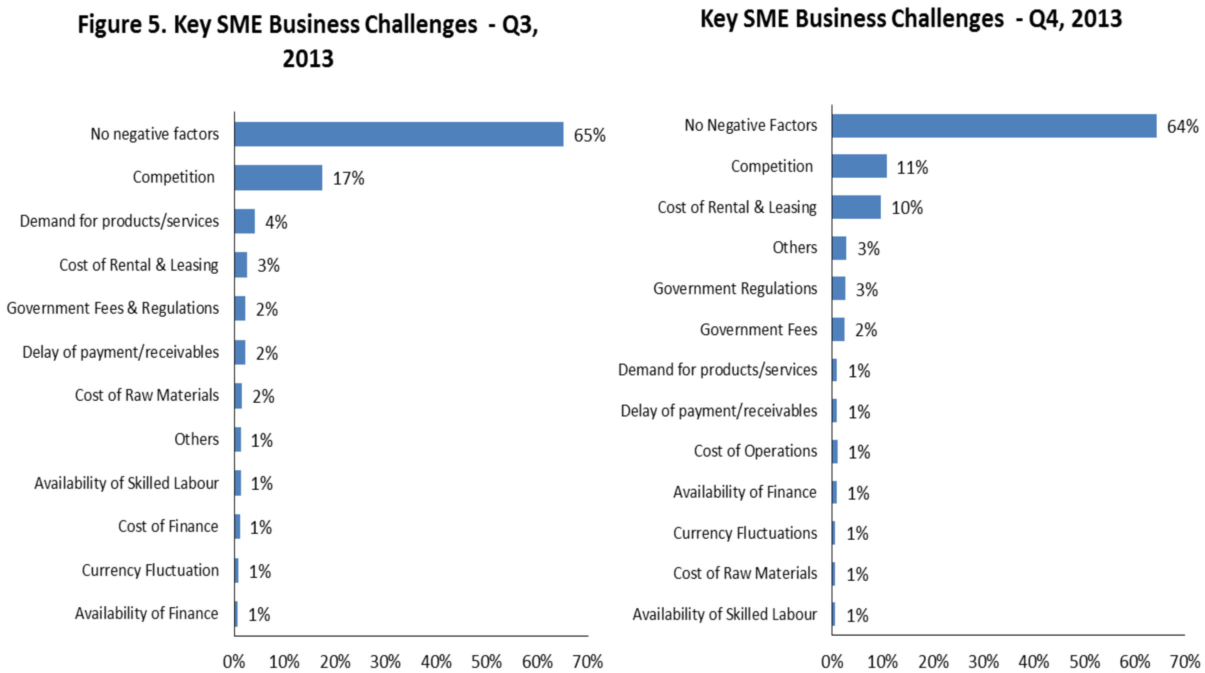
With respect to cost of finance, 71% of the respondents were making use of bank finance out of which 87% reported no changes in the cost of finance while 10% reported an increase. The top reasons cited for not availing bank finance remained the perception of high interest rates and charges and challenges related to collateral and guarantees requested by banks. Among the large companies, 78% availed of bank finance, of which 79% reported no change in costs, while 18% reported an increase.

With respect to profit levels, the survey showed that 36% of the SMEs reported an increase and 45% cited no change in their profit levels during Q4, 2013, compared to 28% and 22%

respectively in Q4 2102. Profit levels across the three sectors were comparable: positive net balance of 16% for manufacturing, 17% for trading and 18% for services. Among the large companies, 48% reported an increase in profits, while 18% reported a decline, resulting in a net balance of positive 30% (17% for SMEs).

KEY BUSINESS CHALLENGES IN DUBAI

The survey also addressed key challenges perceived by businesses at the end of Q4, 2013 that may impact business growth and development. 64% of the companies in the sample reported no hindrances to their business operations this quarter (versus 65% in Q3).



A comparison with the last quarter reveals that the top challenge remains competition, while cost of rental/leasing has become more pronounced and is now the second most important challenge facing SMEs in Dubai.

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

1. Competition *(cited by 11% of the respondents):* Rising competition from local and international players is the leading challenge facing Dubai businesses. In the previous quarter, 17% of the businesses reported competition as a leading challenge. Also, 61%

of the respondents that cited competition as a challenge stated that the severity of this challenge has increased in the current quarter.

2. High cost of rental/leasing *(cited by 10% 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 82% of the respondents citing it as a challenge
3. Other *(cited by 3% of the respondents):* This group was the third most important factor impacting businesses during Q4 2103.
4. Government regulations *(cited by 3% of the respondents):* This has been reported as the fourth most serious challenge in Q4.
5. Government fees (*cited by 2% of the respondents):* This has been reported as the fifth most serious challenge in Q4. The main reasons cited are high costs of trade license renewal and visa fees.
6. The remaining factors have been given equal importance as challenges, reported by 1% of respondents in each case.

In terms of factors impacting businesses by firm size, the top three challenges for SMEs are competition, cost of rental/leasing and government regulations, while for large companies the leading challenges are cost of rental/leasing, competition and cost of labor.

As for exporters, the top challenges are the same as the overall economy.

INVESTMENT OUTLOOK

The survey also gauges the business community's investment outlook with respect to capacity expansion and technology upgrade plans over the coming twelve-month horizon.

Figure 6. Do you plan to expand the capacity of your business?

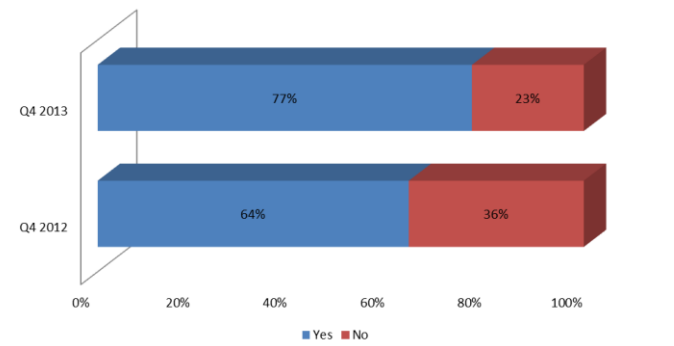
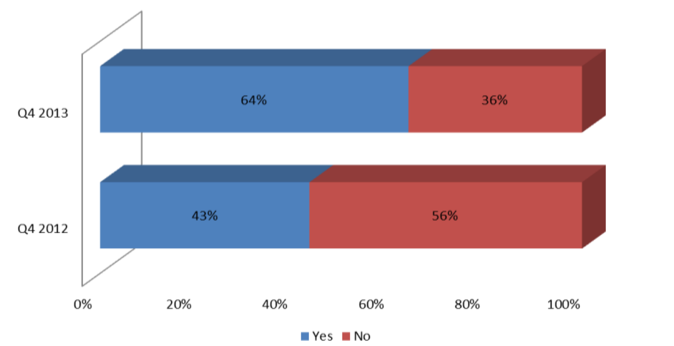


Figure 7. Do you plan to upgrade your technology?



In line with the strong business optimism for the next quarter, businesses are also buoyant on investing to enhance capacity expansion and upgrade technology linked to their business operations. Reflecting the improvement in overall business expectations for the next quarter, the outlook of businesses for future expansion has also improved significantly compared to the same period last year. 77% of the surveyed businesses intend to invest in expansion in Q4, 2013 compared to 64% in Q4, 2012. A q-o-q comparison shows some strengthening in expansion plans (77% in Q4 against 71% in Q3).

Similarly, plans to upgrade technology have also strengthened (64% of the businesses compared to the last quarter i.e. 59%). Y-o-y comparison also shows that plans to invest in technology up-grades have intensified (64% in Q4 2013 compared to 43% last year).

Companies that are planning for expansion reported new capital investments such as expansion of the current office premises and the acquisition of new assets such as factories, warehouses, machinery, and vehicles.

Businesses with no expansion plans have cited satisfaction with the current scale of their operations and / or are looking to achieve stability and profitability before adding to their capital expenditures.

A comparison across the three key sectors shows that all sectors are equally optimistic about investing in capacity expansion (79% in manufacturing, 78% in trading and 75% in services). With respect to technology upgrade, manufacturing (71%) firms are more inclined compared to service (64%) firms and trading companies (61%).

From a business size perspective, large businesses are more inclined to upgrading technology as well as expanding their capacity. With regards to market orientation, export market-oriented businesses have slightly better expectations on capacity expansion than domestic market-oriented firms.