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

Q2 - 2012

AT A GLANCE

- The composite Business Confidence Index for the SME sector for the second quarter of 2012 stood at 107.5 points, indicating that the overall business outlook for the coming quarter (Q3, 2012) continues to be positive.
- Buoyant sales outlook reflects a growing economy, with 73% of the businesses expecting either an increase or no change in sales volume in the next quarter. In terms of economic activity, expectations are the highest among manufacturing firms followed by trading and service firms.
- The severity of challenges, as perceived by businesses, has changed from the previous quarter (Q1, 2011). In the current quarter (Q2, 2012), competition has been reported as the most important challenge by 18% of the firms. In the previous quarter, government fees were the most important challenge. Insufficient demand is the next most severe challenge (as in Q1), followed by high government fees and frequent changes in government regulations. There has been a marked increase in the severity of these challenges compared to Q1 with 46% of the respondents reporting an increase.
- Compared to the previous quarter, the outlook of businesses with respect to future expansion plans has moderated in Q2, 2012 due to low business volumes, excess capacity and instability in the market.

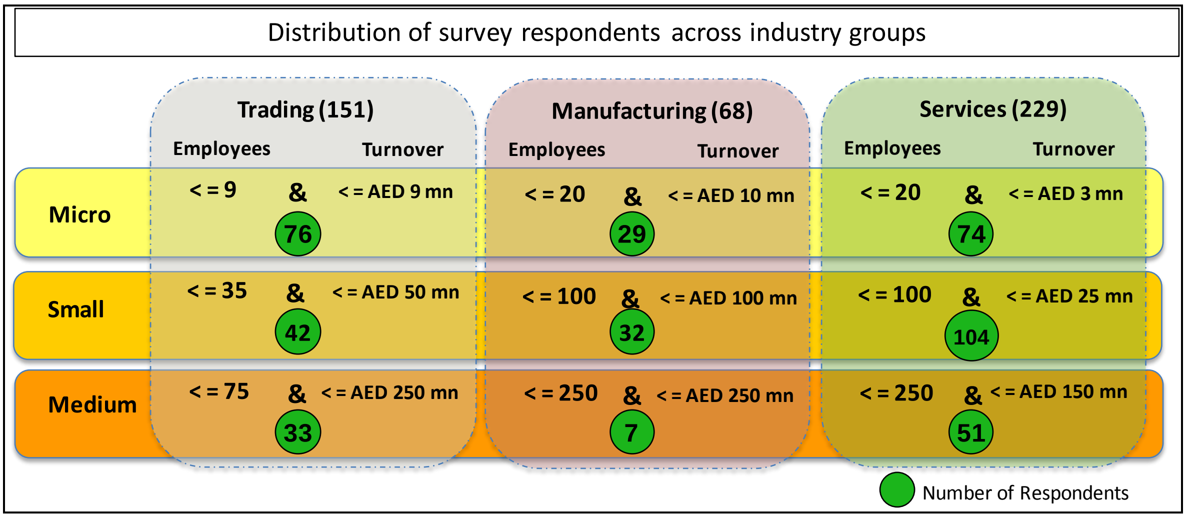
The Department of Economic Development (DED) has been mandated to help achieve the key strategic objectives of fostering 'Sustainable Economic Development' and strengthening the 'Competitiveness of Dubai'. In order to gauge the perceptions of the business community, DED has launched Dubai's Quarterly Business Surveys with the key objective to providing a snapshot of Dubai's current economic activity and the outlook for the following quarter.

This document presents a summary of the survey conducted in the 2nd Quarter of 2012 and highlights the future expectations of SME businesses in Dubai. The survey was administered to 448 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, 2012[1] was conducted on a total of 510 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.

[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.*



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.

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:

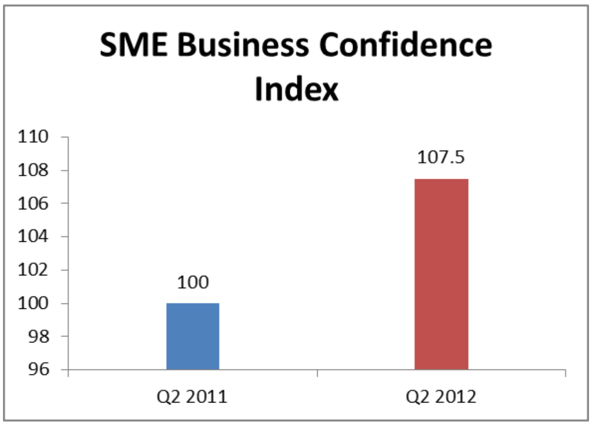
- ***BCI < 100, business expectations are negative***
- ***BCI = 100, business expectations are stable***
- ***BCI > 100, business expectations are positive***

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 – Q2, 2012

Q2 2012 witnessed weakness in global economic recovery due to fiscal slippage, banking downgrades, and political and financial uncertainty in the Euro Area. In the US too, growth was slow with European troubles threatening to derail the recovery. Additionally, real GDP growth in several emerging economies was weaker than projected. The IMF has forecast that the world economy will grow at 3.5% in 2012, while the MENA region will grow at 5.5%. The UAE economy, in particular the Emirate of Dubai, has shown resilience to the recent global economic volatility and uncertainties. Following the 2009 crisis, growth has been steadily picking up and the country has been repairing its balance sheets. The recovery in non-hydrocarbon economic activity looks set to continue in 2012, led by the tourism, trade, logistics and manufacturing sectors. Dubai is benefitting from its economic diversification into these sectors as well as its safe-haven status in the wake of the turmoil in the MENA region that began last year. Some estimates place Dubai's GDP growth at 4-5% in 2012.

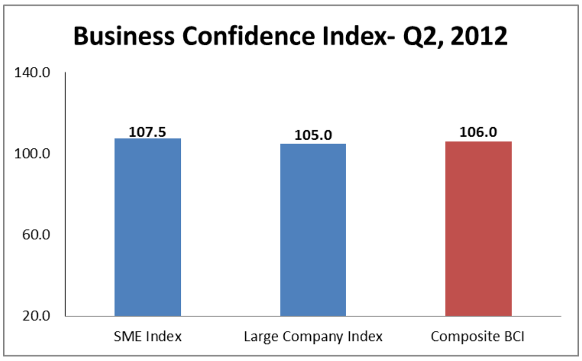


(Base Quarter, Q2, 2011)

The survey shows that Dubai's SME community continues to maintain an overall positive outlook with respect to economic activity in the coming quarter. This is reflected in the composite confidence index score of 107.5 in Q2, 2012 (a score of 100 indicates neutral sentiments).

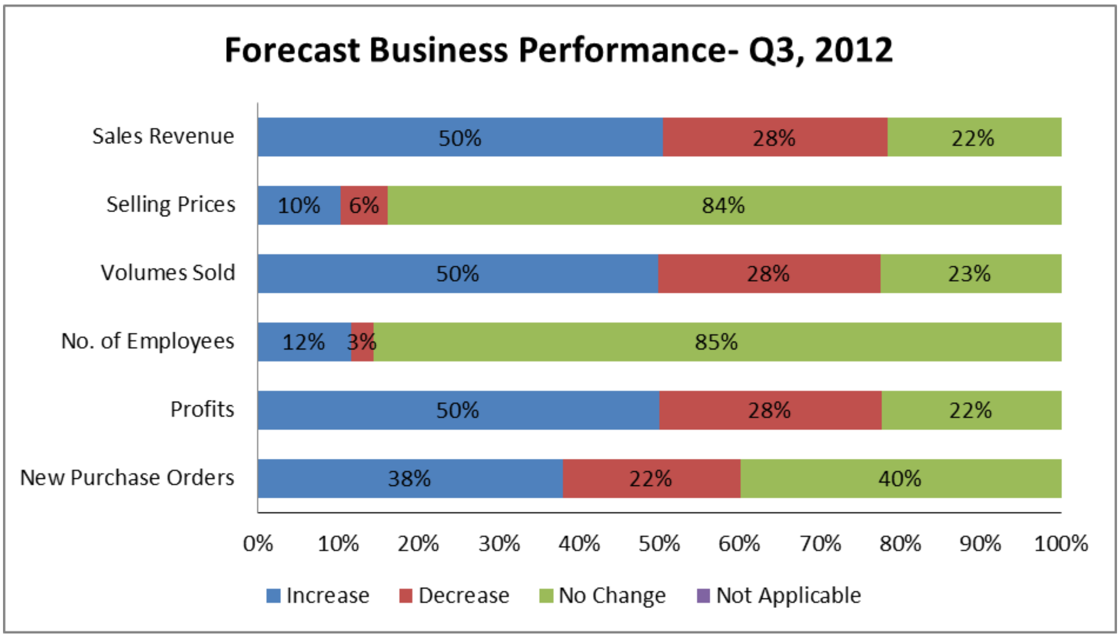
Quarter-on-quarter comparison shows that the current quarter composite index is only 4% lower than the index in the previous quarter. This is largely due to the expected slowdown in economic activity in some sectors because of summer vacations and Ramadan during

Q3. However, a year-on-year comparison reveals an increase of 7.5 points over the index value during the same period in 2011.



Comparison between large companies and SMEs shows a reversal in trend this quarter since SMEs are slightly more upbeat than large companies in their expectations, as shown by their respective index scores of 107.5 and 105. The higher confidence among SMEs is due to their more optimistic outlook with respect to volumes sold and profits. In the previous two quarters, large companies were more optimistic about their profits.

SME BUSINESS OUTLOOK – Q2, 2012



Reflecting the expectations of the overall business community, the survey reveals a positive outlook for the coming quarter; with 50% of the SMEs expecting an improvement in sales revenue and 22% foreseeing no change in Q3, 2012.

Increase in real business activity (volumes) will continue to drive the rise in sales revenues as prices are expected to remain largely stable. A year-on-year comparison for the SME sector outlook reveals a marked improvement in the net balances for volumes sold, rising from positive 8% in Q3, 2011 to positive 22% in Q3, 2012 indicating a significant increase in real business activity in the SME sector.

A comparison between SMEs and large companies shows that the former are moderately more optimistic about sales revenues than the latter, with a positive net balance[2] of 23% and 8% respectively. The higher optimism in SMEs is driven by a more optimistic outlook with respect to volumes, since expectations regarding selling prices are very similar.

[2] *Net Balance = % of respondents citing an increase - % of respondents citing a decrease*

The overall optimistic SME sentiments are driven by the upbeat expectations of the manufacturing SMEs on all key parameters (sales volume, selling prices, profits, employees), closely followed by SMEs in the trading sector. In contrast, respondents in the service sector have a comparatively lower outlook for the coming quarter. Expectations for large companies continue to be driven by the trading sector, followed by manufacturing and service sector companies.

In line with the overall business outlook, manufacturing SMEs are more optimistic in terms of expected sales volumes for Q3, 2012, followed by trading and then service SMEs (positive net balance of 53% for manufacturing SMEs, 7% for services SMEs and 32% for trading SMEs)

Within the manufacturing sector, sales volumes expectations are relatively higher for companies engaged in the manufacture of glass, garments, furniture, chemicals, plastics and cement. Companies engaged in these sectors are expecting new projects and deals in the coming quarter. In contrast, companies in engaged in metal & fertilizer manufacturing are not as optimistic due to expectations of fewer new projects during the summer.

Although positive, the outlook for the overall service sector has moderated for Q3, 2012, compared to the last quarter. Year-on-year comparison for the overall service sector also reveals a decline in the outlook for volumes sold. Within the service sector, the most optimistic sub-sectors are education, IT & communication, construction services and transport & logistics.

The positive outlook of transportation & logistics companies is due to the expectation of an increase in shipments from new clients and more customers due to the festival season. Some firms in this sector anticipate an increase during Ramadan because they have clients from the food industry. On the other hand some companies anticipate an increase in business activity after the month of Ramadan is over.

Companies engaged in construction too have indicated a positive outlook, with around 35% of the respondents expecting to get new contracts. However, architecture firms do not share this level of optimism.

Tourism & hospitality firms foresee a decline in business performance for the coming quarter. Restaurants & hotels are anticipating a decline in volumes of guest bookings during Ramadan, coupled with limited business during the first half of the day, commensurate with fasting times. Companies engaged in car rental are very cautious about their outlook due to the low tourist season during summer. On the other hand, travel agencies and tour operators are relatively more optimistic as it is the peak outbound travel season in the region at this time of the year.

However, other sub-sectors are very cautious in their outlook for the third quarter. These include advertising (since the 2nd and 3rd quarters are off season, while in the other months the demand for service is quite constant, as there are a lot of promotions throughout the on season months); cleaning services (due to Ramadan); financial services firms (due to the vacation period and hence low trading activity); hospitals (since there are fewer people in town) and printing (dull season due to vacations and Ramadan).

The outlook for the trading sector has improved over the last quarter with 55% of the respondents anticipating an increase in volumes during the third quarter. Another 14% of the respondents do not anticipate any change in volumes in Q3. The outlook for the trading sector is more optimistic compared to service businesses, but less than that of the manufacturing sector.

- Fashion-oriented businesses (jewelry, footwear & cosmetics trading) remain bullish on their expected sales volume as they will benefit from high demand during the Eid season and also because of the discounts & promotions which these businesses plan to offer customers.
- Garment and textile trading businesses also expect higher sales in the next quarter, as demand is expected to go up during the festive Ramadan season.
- Traders of spare auto parts are optimistic about the third quarter as they anticipate higher exports to Africa.
- Sales of electronics & computer trading businesses are expected to be higher on account of new orders.
- Food & beverage trading businesses as well as grocers have higher optimism on their sales performance due to Ramadan and Eid, while exporters in this sub-sector are optimistic on higher levels of exports to Africa.
- Furniture traders also anticipate higher demand due to the festive season.

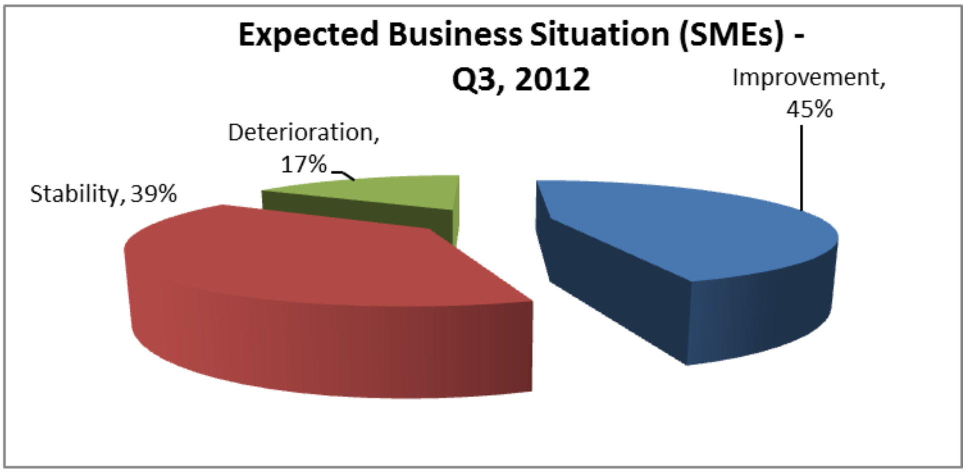
In terms of selling prices, a majority of SMEs (84%) intend to keep the same prices as in Q2, which is identical to the previous quarter findings where a similar number of SME respondents expected price stability. Manufacturing SMEs (net balance of positive 18%) are more optimistic than trading (net balance of positive 1%) and service SMEs (net balance of positive 3%) with respect to their selling prices.

SMEs have positive expectations on new purchase orders with 40% of them expecting no change (same number as in the previous quarter) and another 38% of the SMEs planning to increase their purchase orders in Q3, 2012 as they need more raw materials for production or to match expected increase in sales. Manufacturing and trading SMEs hold a more optimistic outlook compared to service SMEs for new purchase orders in Q3. Compared to SMEs, large companies are more optimistic on new purchase orders with 45% of the respondents expecting an increase in the next quarter.

On the hiring front, the outlook continues to remain stable, with 85% of the businesses expecting no change in their employee count in Q3, 2012. Manufacturing firms continue to be the most optimistic on increasing their workforce in the coming quarter. However, the proportion of SMEs planning to increase their workforce has declined from 28% in Q1 to 21% in Q2 and 12% in Q3, 2012. Reversing last quarter's trend, SMEs are slightly more optimistic than large companies on hiring new employees with just 10% of the large companies planning to hire additional workers in Q3, 2012.

With respect to capacity utilization, SMEs in manufacturing and services continue to be more optimistic than large companies (net balance of positive 2% for SMEs versus a net balance of negative 8% for large companies).

The survey reveals a rise in the number of SMEs that foresee an improvement in profits for Q3, 2012; 50% of SMEs are expecting an increase for Q3, 2012 against 44% for Q2, 2012. Manufacturing SMEs are more optimistic about third quarter profits compared to trading and service SMEs. Also, reversing last quarter's trend, SMEs are more optimistic than large companies about Q3 profits, with a net positive balance of 22% for SMEs against 6% for large companies.



According to SMEs' overall assessment, the business outlook for Q3, 2012 remains positive, with 84% of the SME respondents reporting either improvement or stability in comparison with Q2 of this year. A comparison between large companies and SMEs shows that the former expects a better business situation during Q3. Businesses anticipate improvement in the coming quarter due to the following reasons: expectations of getting new projects, anticipation that fuel costs will decrease in Q3, expectation of better market trends, anticipation of stability in global markets, and higher revenues due to promotions and resultant higher sales during Ramadan.

SME PERFORMANCE – Q2, 2012

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 was stronger in Q2, 2012 compared to the previous quarter as a higher number of respondents reported an increase rather than a decrease in sales volumes**.** Also, the manufacturing sector performed better than the services and trading sectors in terms of volume sold in Q2. In addition, large companies reported a much better business performance in the current quarter with a positive net balance of 48% compared to the positive net balance of 3% for SMEs.

Selling prices remained largely stable in Q2, 2012 with 74% of the respondents reporting 'no change'. However, 17% of the respondents reported a reduction in their prices in order to boost sales in sectors that have experienced increasing competition and reduced demand. The activities reporting price reduction are cement, food & beverages and metal manufacturing; restaurants & hotels, firms engaged in advertising, construction services, consultancy, IT & communication, printing, rental & real estate and travel; and trading in building & construction, cosmetics, electronics, food, footwear, furniture, garments, groceries, pharmacies and textiles.

- Echoing last quarter trends, manufacturing SMEs performed better than their services and trading counterparts.
- The positive performance of manufacturing was driven by chemicals, glass, paper, plastics and food & beverages sub-sectors. However, firms producing or dealing in cement and furniture faced challenges due to the continuing slowdown in construction activity.
- The main factor accounting for a negative net balance for the trading sector is the decline in sales in auto spare parts (due to fewer projects and low demand from the

transport industry); building & construction (due to reduced demand), cosmetics (because demand is directly related to tourists & exports and there was less flow of tourists in Q2); furniture (due to rising competition, slow economy, decrease in exports to Africa and decline in international trade); garments (low demand); pharmacies (reduced demand) and textiles (reduced business activity).

- The positive performance of services was led by an improvement in activity of the following sectors: tourism & hospitality (higher number of tourists), construction & architecture (new projects), transportation (improvement in demand and slight reduction in fuel costs), IT & communications and financial services. In contrast advertising firms did not do as well due to slower demand during Q2 and Q3, while cleaning firms cited competition as the reason.

Hiring was by and large stable in Q2, 2012, although a proportion of businesses reported new hiring as shown in a positive net balance of 4%. A majority of firms (80%) reported 'no change' in their employee count for this quarter. Hiring was more prevalent in the manufacturing sector with a positive net balance of 13%, followed by services (positive net balance of 4%) and trading (negative net balance of 1%). Companies that reported a decline in workforce were traders of auto parts and industrial equipment and construction services firms. However, a higher proportion of large companies reported an increase in their employee count compared to SMEs, 15% for the former against 12% for the latter.

Mirroring the overall performance of the business community on sales volumes, new purchase orders also increased in this quarter, as reflected by a positive net balance of 9%. 35% of the respondents reported an increase in new purchase orders and 38% reported no change. 46% of the respondents in the manufacturing sector, 37% in services and 28% in trading reported an increase in new purchase orders during Q2. Large companies reported a much better performance on new purchase orders as reflected by the positive net balance of 42% in Q2, 2012.

Continuing the trend in the last quarter, the cost of labor remained relatively stable in Q2, 2012 with 77% of the businesses reporting no change in unit labor costs and only 19%

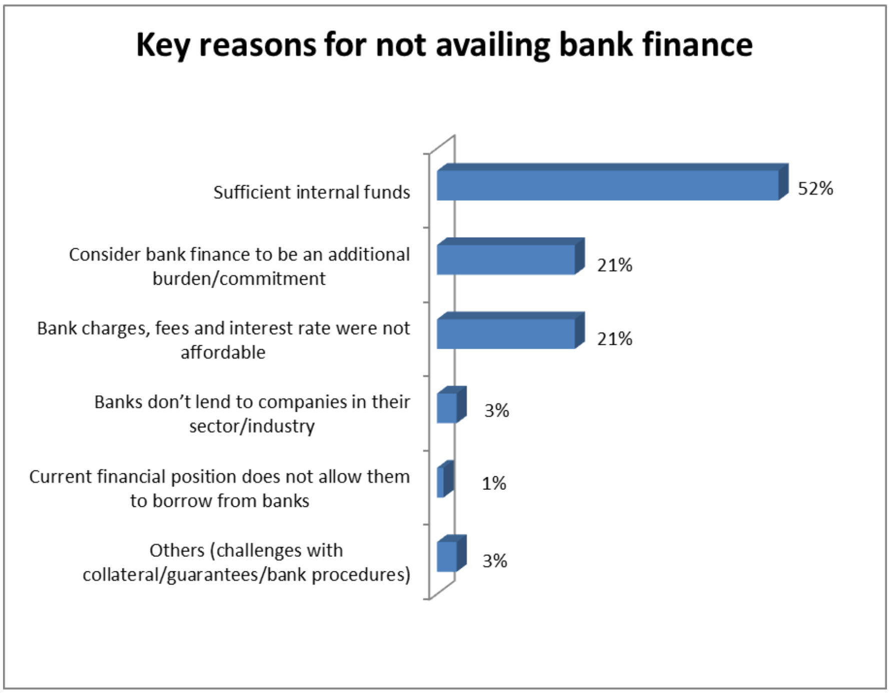
reported an increase imputed to an increase in the charges for visa renewals, annual increments & bonuses provided to employees at the beginning of the year. Some companies faced higher costs due to the higher salaries offered to the new employees.

The cost of raw materials, a growing cause of concern for several businesses, increased for 38% of the SMEs in Q2, 2012, 4 percentage points lower than in Q1, 2012 findings. Comparison between the three sectors shows that raw material costs influenced manufacturing firms the most, with 59% of the respondents indicating an increase in Q2. Within the manufacturing sector, the food & beverage and glass sub-sectors were most impacted by the increase in raw materials. The impact of such costs was lower for large companies with 32% of the companies reporting an increase in raw material costs in Q2, 2012. In Q1, large companies faced much higher costs for raw materials.

Rental costs remained stable in Q2, 2012 for 85% of the respondents, resonating findings from the last quarter which showed that for 73% of respondents rents didn't change. However, for a few respondents (10%), rents increased in the last quarter following expansion of premises or due to the signing of new contracts. Rental costs increased most for trading firms. Likewise, large companies also reported stability in rental prices, with 89% of them reporting that there was no change in these costs in Q2.

The current quarter survey also revealed that around 14% of the SMEs surveyed used bank finance out of which 59% reported no changes in the cost of finance and 38% reported an increase in this cost. Sector wise comparison shows that service (20%) and trading (19%) SMEs made more recourse to bank finance than manufacturing SMEs (15%). Among the large companies, 19% availed of bank finance, of which two-thirds reported no change in costs, while the remaining reported an increase.

The survey also captured reasons for not availing bank finance which are summarized as follows:

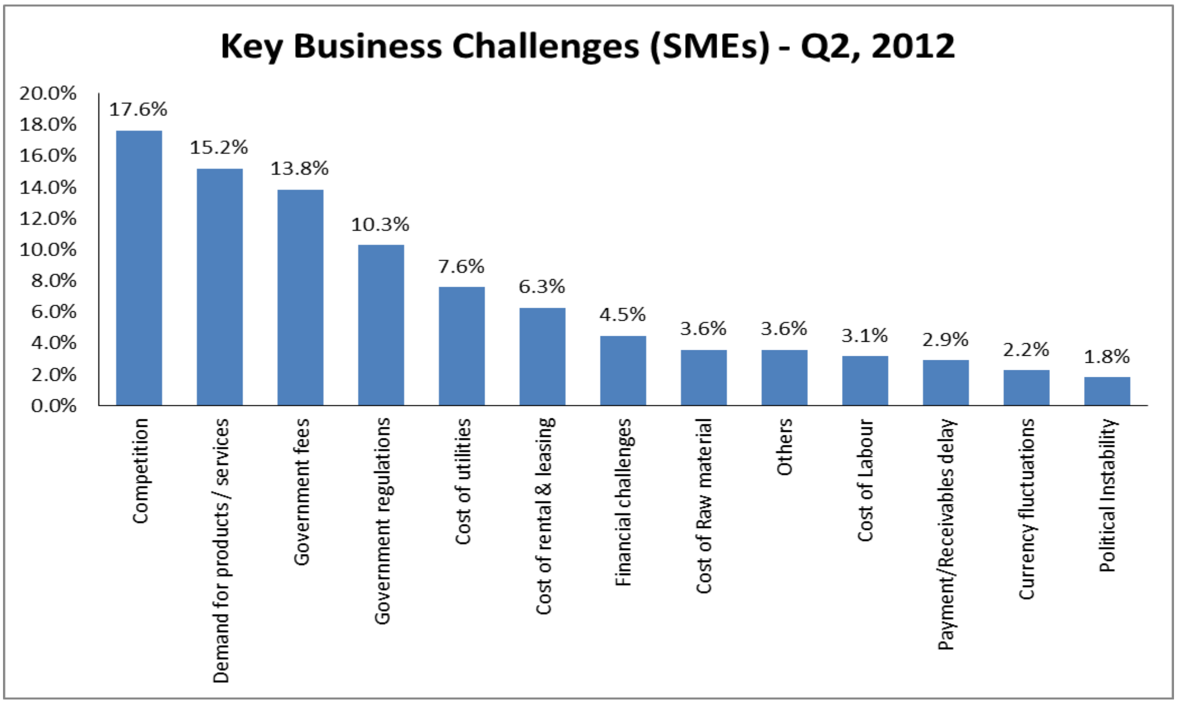


The top reason (cited by 52% of respondents) for not availing bank finance was availability of sufficient internal funds for managing the shortfall and growth & expansion plans. This was followed by businesses feeling that bank finance can be an additional burden or commitment which they would like to avoid due to the current market uncertainty. The third reason cited by 21% of the businesses is the perception of high bank charges, fees and interest rates. The remaining, 7% of respondents, cited other reasons for not availing bank finance including challenges with producing the required collateral, guarantees; bank not lending to certain sectors like trading in jewelry & electronics, advertising and transportation. A few businesses (1%) also cited their weak financial position as impediments to approaching banks for availing finance.

The survey revealed that 60% of the respondents reported an increase or no change in their profit levels during Q2, 2012. Manufacturing firms reported better performance with respect to profits (net balance of positive 9%) compared to service (net balance of positive 3%) and trading firms (net balance of negative 21%). However, large companies have reported a better performance on profits in Q2, 2012 compared to SMEs with 81% of the respondents indicating an increase or no change in business profits in the last quarter.

KEY BUSINESS CHALLENGES IN DUBAI

The survey also addressed key challenges faced, as perceived by SMEs at the end of Q2, 2012. It is interesting to note that the number of SMEs that have cited no hindrances to their business has steadily increased from 11% in Q4, 2011 to 23% in Q1 and 31% in Q2, 2012.



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

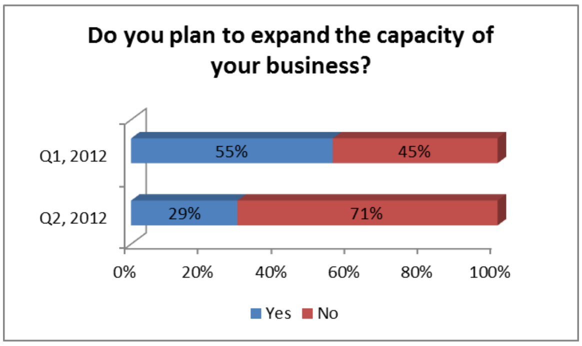
1. Competition *(cited by 18% of the respondents):* Competition from local and international players is the top most challenge facing Dubai businesses. Also, 66% of the respondents that cited competition as a challenge have said that the severity has increased. Firms in services (architecture, car rental, cleaning & transportation), manufacturing (glass & garments) and trading (food) seem to be the most affected by this challenge.
2. Insufficient demand for products and services *(cited by 15% of the respondents):* Among the respondents that cited low demand as a challenge, 35% of them said that the severity of this factor had increased in Q2, 2012. Insufficient demand constrained

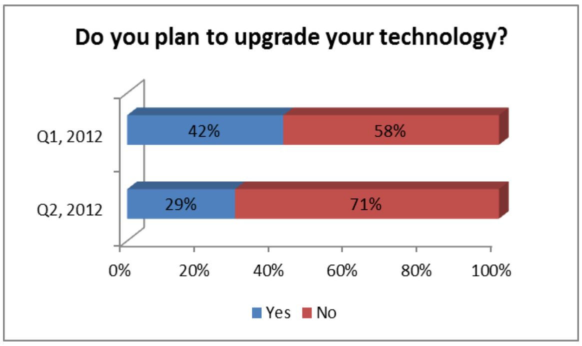
businesses in the manufacturing sector (food & beverages, metals and plastics), services sector (advertising, construction and financial services) and trading sector (garments).

3. Government fees (*cited by 14% of the respondents):* This has been reported as the third most serious challenge. Main reasons cited are the high cost of trade license renewal and the increase in employee visa fees (on account of reduction in tenure of visa from 3 to 2 years, mandatory Emirates ID requirement). Among the respondents that have cited this as a challenge, 50% have said that government fees increased in Q2. This challenge impacted the transportation and construction industries most.
4. Government regulations *(cited by 10% of the respondents):* Frequent changes in business regulations (relating to business licensing procedures, import-export procedures, municipality and traffic rules), coupled with a lack of communication of such changes, are considered the fourth largest challenge. 52% of the respondents that cited government regulation as a challenge think that its severity has increased in the last quarter.
5. Cost of utilities *(cited by over 8% of the respondents):* This challenge has increased in severity for 68% of the respondents that cited it as an important factor.
6. High cost of rentals & leasing *(cited by 6% of the respondents):* This was reported as an important challenge by businesses that had to renew their leases at higher rentals. Costs of rental and leasing increased for 68% of the respondents citing it as a challenge.
7. Financial challenges *(cited by over 5% of the respondents):* Though it is not rated as one of the top challenges, 55% of the firms impacted by it have said that the severity of this challenge increased in the second quarter.

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. Whereas the top two challenges remain the same for large companies, they cited cost of utilities as the next important challenge, followed by increasing government fees and rising political uncertainty in the region.

INVESTMENT OUTLOOK





The survey reveals that SMEs have a similar outlook regarding expanding capacity of their business and upgrading technology. Compared to the previous quarter, capital investment plans over a twelve-month horizon have moderated; with 29% planning to expand their capacity (vs. 55% of businesses in the Q1 survey) and 29% of firms planning to upgrade technology (vs. 42% of businesses in Q1).

Businesses willing to expand 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. Also, several businesses are planning to expand capacity by opening a new branch office in UAE or in the GCC region.

For businesses not willing to expand capacity, the primary reason cited is the unfavorable or unstable market conditions, due to which businesses are not willing to undertake capacity expansion and are continuing operations with existing capacity. Unavailability of the required funds / capital investment and existing investments in building the current capacity have been cited as other reasons for not expanding capacity. Key sectors not planning to expand capacity are transportation, construction, and trading businesses engaged in food, electronics, automotive and building materials sub-sectors.

Sector wise comparison shows that manufacturing and trading companies are slightly more optimistic about investing in capacity expansion. With respect to upgrade of technology, manufacturing firms (32%) are more optimistic followed by service firms (31%) and then trading companies (25%).

From a business size perspective, large businesses are more inclined to upgrading technology as well expanding the capacity of their business compared to SMEs.