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

SMEs Business Optimism Survey

Q2 - 2014

AT A GLANCE

- The composite Business Confidence Index for the SME sector for Q2, 2014 stands at 115.5 points, indicating that the overall business outlook is higher when compared with the same period last year (111.1) but lower when compared with the last quarter i.e. Q1, 2014 (126.4).
- Sales revenue outlook has strengthened y-o-y but has deteriorated vis-à-vis the last quarter; 46% of the firms expect an increase in sales revenues during Q3, 2014 compared to 62% and 42% predicting an increase in Q2, 2014 and Q3, 2013, respectively.
- Participants have indicated a softening in the ease of doing business related to Q2, 2014, with the number of survey participants expecting ‘no obstacles’ to their operations, registering a drop from 59% in Q1, 2014 to 47% for Q2, 2014.
- The key concerns for SMEs in the third quarter of 2014 are competition and cost of rental & leasing.
- SMEs are more confident compared to the large firms; with their respective index scores at 115.5 and 110.0
- SMEs are less optimistic about investment in technology upgrades and capacity expansion compared to large companies.

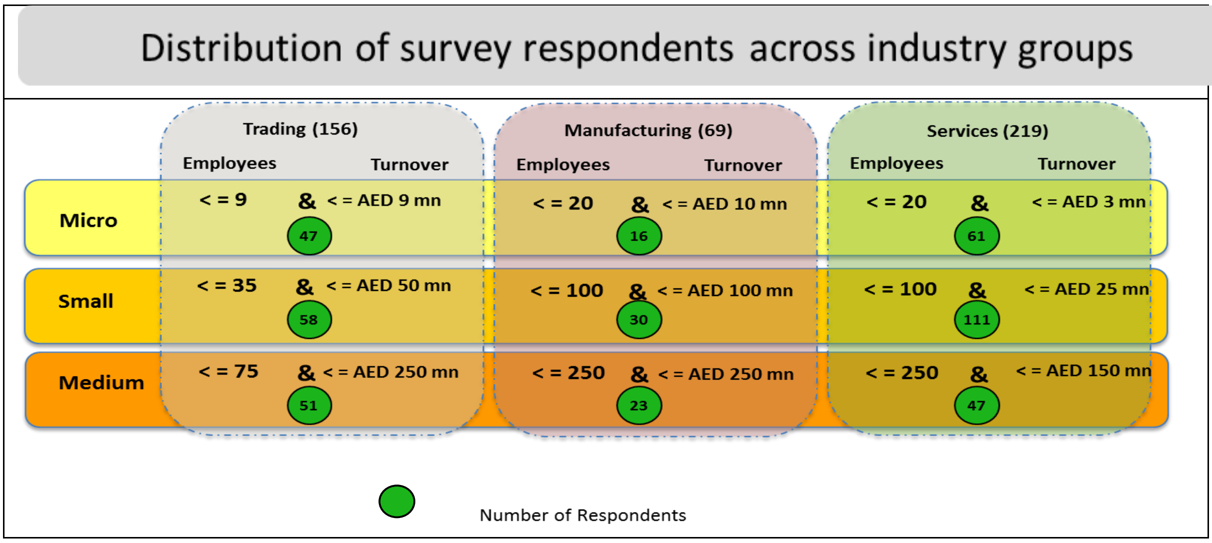
The Department of Economic Development (DED) is a Dubai Government Department that has the mandate to help achieve the key strategic objectives of fostering ‘Sustainable Economic Development’ and strengthening the ‘Competitiveness of Dubai’.

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 2nd Quarter of 2014 and highlights the future expectations of SME businesses in Dubai. The survey was administered to 444 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 Q2, 2014[1] was conducted for a total of 503 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.



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

[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:

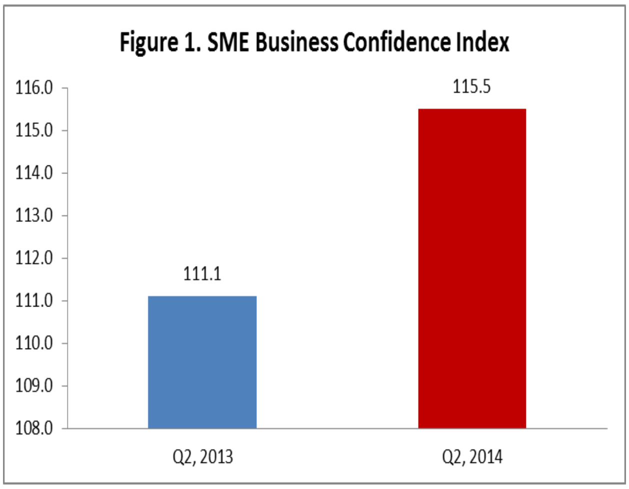
- ***BCI < 100, business expectations are negative***
- ***BCI = 100, business expectations are stable***
- ***BCI > 100, business expectations are positive***

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***

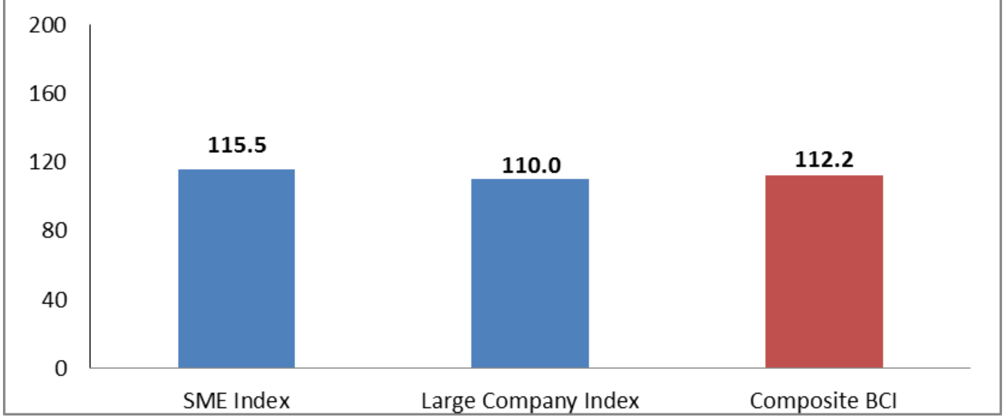
SME BUSINESS CONFIDENCE INDEX – Q2, 2014

Dubai's Statistics Centre expects the Emirate's economy to grow around 5% in 2014, as it continues to expand its role as a hub for retail and wholesale trade, as well as a major tourism and real estate investment destination for the wider region. Dubai's successful bid for the World Expo 2020 is expected to further increase confidence and growth in the medium term. The current D&B survey reflects expansion in economic activity for SMEs, with the composite business confidence index in Q2, 2014 at 115.5 (A score of 100 indicates stable/neutral sentiments).



The composite SME BCI is modestly higher by 4.4 points on a y-o-y basis from 111.1 in Q2, 2013. In comparison to the previous quarter, the composite SME BCI for Q2, 2014 has slipped 10.9 points, with participants citing key reasons as competition, reduced demand owing to the summer vacations, fewer tourist footfalls, Ramadan season, expectations of fewer contracts and slowdown in activity or no new projects in export markets.

Figure 2: Business Confidence Index- Q2, 2014

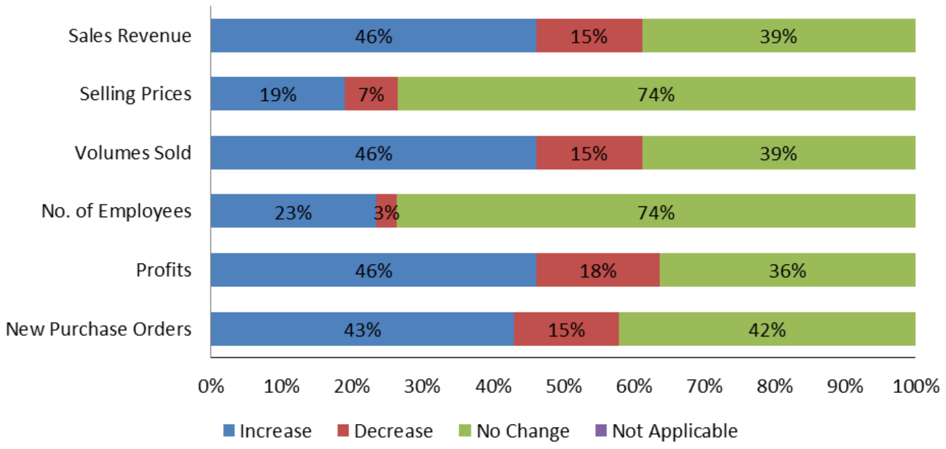


Reversing the trend observed in the last quarter, SMEs in Dubai are more confident in Q2, 2014 compared to the large firms; this is reflected in their respective index scores of 115.5 and 110.0. SMEs hold a stronger optimism on all the business activity indicators recorded in the survey.

SME BUSINESS OUTLOOK – Q3, 2014

SMEs account for a dominant share in Dubai's total business composition (95% of the total number of firms). In the current survey, 444 of the 503 firms that were interviewed as part of the survey were SMEs. These included micro, small, and medium enterprises as per Dubai's SME definition. The current survey indicates that SMEs are marginally more optimistic compared to the same quarter last year with the composite BCI at 115.5 in Q2, 2014 and 111.1 in Q2, 2013. Additionally, the SMEs have a relatively stronger outlook compared to large companies.

Figure 3: Forecast Business Performance (SME) - Q3, 2014



The outlook for volumes sold has strengthened on a y-o-y basis, with 46% of the firms anticipating higher volumes during Q3, 2014 against 43% expecting an increase in Q3, 2013. Comparison with the last quarter shows a significant decline in expectations since 63% of the respondents had forecasted an increase in volumes during Q2, 2014. SMEs are more confident about sales volumes than large companies, with net balances of 31% and 14%, respectively.

The current survey shows that traders are most confident with respect to volumes for the third quarter with 54% of them expecting an increase compared to 49% of manufacturing firms and 39% of service sector companies that are forecasting an increase. A comparison of outlook (net balances) according to the key economic sectors shows that manufacturing firms are most confident about hiring, net profits and new purchase orders, while traders hold the strongest outlook for sales revenues and volumes sold.

Manufacturing Sector:

The present survey shows that manufacturing firms are considerably more optimistic when compared with the same period a year ago, with the net balance for sales volume up from positive 26% in Q3, 2013 to 37% for Q3, 2014. A q-o-q comparison indicates that the manufacturing sector has sharply lower expectations for sales volumes as indicated by positive net balances of 37% and 65% for Q3, 2014 and Q2, 2014, respectively. 49% of manufacturing firms are confident of selling higher volumes during Q3, 2014 owing to expectations of new projects/orders from existing as well as new customers.

Within the manufacturing sector, the most optimistic sub-sectors are cement, chemicals, furniture and metal. However, 12% of the companies have forecasted a decline in volumes due to increased competition.

Services Sector:

Of the three key sectors, the services sector is the only one that has displayed a weaker outlook for Q3, 2014 compared to the same quarter a year ago (positive net balance of 22% for Q3, 2014 versus 25% for Q3, 2013). Within the services sector, hotels & restaurants are most impacted by the seasonal decline during summer with 40% of the firms in this sub-segment forecasting a decline in volumes, while 25% are anticipating a rise. Other hospitality sub-segments such as car rentals and travel agencies / tour operators also have a weak outlook, with 25% of the firms foreseeing a decline in the sales volume.

On the other hand, companies in the construction, architecture and real estate sub-segments maintain a buoyant outlook for the third quarter on expectations of new projects/orders. 46% of these firms are forecasting higher volumes during Q3, 2014 compared to 13% that are expecting a fall.

Among the transportation firms, 39% anticipate an increase in volumes during Q3, 2014, but 14% expect a decrease due to slowdown in demand from the other sectors during the summer months.

Trading Sector:

Mirroring the overall economy, the trading sector has displayed stronger expectations for sales compared to the same quarter last year, but lower optimism when compared to the previous quarter (net balance for sales volumes at 40%, 24% and 52% for Q3, 2014; Q3, 2013 and Q2, 2014, respectively). The survey shows that 54% of the trading firms are predicting a rise in their volumes, while 14% anticipate a fall, indicating slow demand during the summer months.

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

- 58% of the electronics traders are optimistic about the third quarter due to improving demand, while none of the firms in this sub-segment expect a decline in volumes as in the previous quarter.
- 78% of the traders in the food & beverages sub-sector anticipate a rise in volumes during Q3, 2014.
- 44% of the auto traders are expecting to sell higher volumes during the third quarter of 2014 due to a rise in demand from both domestic and export markets.

- 50% of the traders in the building & construction sub-sector anticipate an increase in sales volumes during Q3, 2014.
- 60% of the computer traders are upbeat about volumes during Q3, 2014.

Selling prices remain tilted towards stability as 74% of the participants are predicting no change in the parameter during Q3, 2014. However, 19% expect to increase their prices to cover the rise in material costs, rentals and labor or to improve profit margins; and the remaining 7% foresee a decline owing to competition in the market, fewer customers and more promotions during the month of Ramadan. Manufacturing SMEs (net balance of positive 13%) and services SMEs (net balance of 12%) are slightly more optimistic than trading SMEs (net balance of 10%) with respect to their selling prices.

Consistent with the trend in sales volumes, 43% of the participants are expecting an increase in new purchase orders during the third quarter, while 42% have cited current holding of stocks as sufficient. In Q3, 2013, 38% of the respondents had forecasted an increase in new purchase orders, while the corresponding percentage in Q2, 2014 was 62%. Manufacturing firms remain more optimistic compared to the services and trading SMEs on new purchase orders with positive net balances of 38%, 23% and 32% respectively. Large companies are not as confident as SMEs for new purchase orders for Q3 2014, with positive net balances of 15% and 28% respectively.

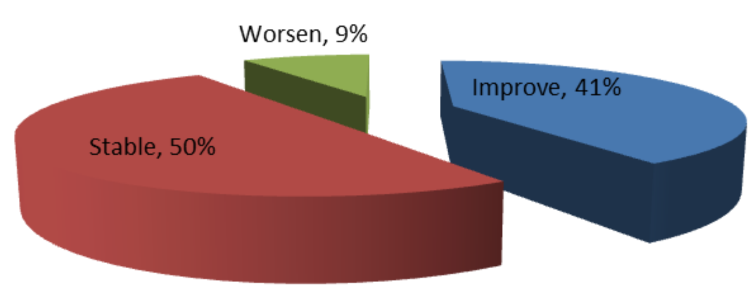
The current survey also shows a y-o-y improvement in the hiring outlook, but moderation when compared to the previous quarter. 23% of the firms expect to increase their staff count during Q3, 2014 for new projects, compared to 15% in Q3, 2013 and 29% in Q2, 2014. Manufacturing firms are most optimistic with respect to hiring, followed by service sector firms and then traders. Reversing the trend in the last quarter, large companies are now less optimistic than SMEs on hiring, with positive net balances of 15% and 20% respectively.

43% of manufacturing SMEs and 37% of service oriented SMEs have forecasted an increase in capacity utilization during Q3, 2014. In comparison, 19% of the large companies expect a rise in utilization levels.

Profitability expectations show a weakening in comparison to the last quarter, but a modest uptick with respect to the same quarter a year ago; 46% of the SMEs are forecasting an increase in profits during Q3, 2014 (owing to higher sales expectations in domestic and foreign markets and export diversification into new markets) against 43% in Q3, 2013 and 54% in Q2, 2014. A comparison across sectors shows that SMEs in the manufacturing sector are the most optimistic about profits, with a net balance of 39% compared to 37% and 19% for the trading and services sectors, respectively. Large companies are less optimistic about net profits compared to the SME community; with a net balance of 28% for SMEs versus 9% for large companies.

Survey participants have indicated a further softening of the business situation outlook, with 41% of the firms expecting an improvement in business conditions versus 51% in Q2, 2014 and 62% in Q1, 2014. 9% of the SMEs anticipate worsening of the business situation in Dubai in Q3, 2014.

Figure 4: Expected Business Situation (SMEs) - Q3, 2014



The survey also shows that an equal proportion of SMEs and large companies expect the business situation to improve during the third quarter; 41% of the respondents in each group expect an improvement. While 9% of SMEs expect deterioration in the business situation, 8% of the large companies anticipate deterioration.

In Focus:

Dubai SME Services and Initiatives

Established in 2002, Dubai SME's mandate is to promote and develop entrepreneurs and small & medium enterprises based in the Emirate. Over the last ten years, Dubai SME has developed an array of initiatives and programs as follows:

Policy-level Programs and Studies:

- **Start-up Subsidies:** Represents a fee exemption for members of Dubai SME.
- **Government Procurement Program (GPP):** All Dubai Government departments allocate at least 5% of their annual purchasing budget to participants of the GPP
- **Dubai SME Definition:** Launched in 2009 to help stakeholders understand and adopt the definition of SMEs, and to determine their contribution to the Dubai economy
- **Dubai Industry Studies:** Six industries based in Dubai with a high composition of SMEs were completed to help stakeholders understand the structure, characteristics and business opportunities of these industries: Media, IT, Transport & Storage, Food & Beverage, Tourism and Hospitality
- **The State of SMEs in Dubai:** An analytical report of SMEs based in Dubai to help stakeholders understand the key characteristics of SMEs with respect to their degree of international orientation, innovation, corporate governance, access to finance, scalability, information and communication technology adoption and human capital development.

Support Programs and Services for Entrepreneurs:

- Development Advisory: Dubai SME has provided business development and advisory services to entrepreneurs and assisted in the launch of local businesses.

- **Business Incubation:** The Business Incubation Center helps entrepreneurs progress throughout the early stage of growth. The suite of services which are tailored and continuously delivered helps identify and remove obstacles and bottlenecks, and increase their survival rates.

- **Entrepreneur Relations (ER):** Serves entrepreneurs by accelerating business start-up through a variety of services such as guidance on type of business, mode and category of business licensing, reducing business start-up costs, and accessing reduced rate location real space.

- **Funding Support:** Provide debt funding to address the challenges of the funding gap for startups and make capital available to them on a per-need basis.

- **Entrepreneurship Capability Development:** Dubai SME launched the Entrepreneurship Academy in 2013 which offers practice-base Diplomas and short courses in entrepreneurship Development.

Outreach Initiatives

- **Young Entrepreneur Competition:** The yearly competition challenges participants to create a pop-up business and manage it over four days in local malls throughout the city. Students get the opportunity to learn about business planning, product and service conceptualization, marketing and customer service.

- **Mohammed Bin Rashid Award for Young Business Leaders (YBL):** The award recognizes outstanding business leaders in the Arab world who have shown creativity and perseverance to launch and develop their business.

SME and Stakeholder Development Programs

- **Dubai SME100:** In line with the strategy to groom promising SMEs, the Dubai SME 100 was launched to act as a platform and catalyst to identify high potential SMEs based in Dubai - to groom them to become bigger, better and sustainable enterprises

- **Corporate Governance for SMEs:** An initiative aimed at promoting the importance of Corporate Governance to the SME sector to start early their corporate governance journey that will make them more investable and bankable as they grow their businesses.

- **SME Bank Friendliness Index:** To address the SME financing gaps in the market, an SME Bank Friendliness Index was launched in 2012 with the aim of identifying UAE banks that had the highest orientation towards supporting and developing the SMEs in the UAE. The Index also served as feedback to the banks on areas to improve their SME financing strategy and offerings.

SME PERFORMANCE – Q2, 2014

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.

The survey has signaled modestly higher levels of economic activity when compared to last year; 30% of all respondents reported an increase in sales volumes for Q2, 2014, while 20% have cited a decrease (net balance of 10%), versus 30% of firms that had indicated an increase and 24% a decrease during Q2, 2013 (net balance of 6%). However, economic performance was weaker when compared to Q1, 2014 (net balance of 18%). Manufacturing firms continue to outperform with a net balance of 17%, against 10% for services firms and 7% for traders. Within the services sector, the net balances for sales volumes are: 18% for construction, 6% for tourism & hospitality, and 3% for transportation.

A comparison between large companies and SMEs with respect to their business performance in Q2, 2014 shows that large companies performed better on volume of sales. 44% of the large companies reported an increase in volumes compared to 30% of SMEs.

- In the manufacturing sector, the sub-sectors that showed positive activity were cement, furniture and metals. Firms that reported a decline cited the following key reasons: competition, slow demand and summer season.
- The positive performance of the trading sector in Q2, 2014 was due to an increase in activity in the following sub-sectors: auto spare parts (more overseas business), computers (improving market conditions), electronics (rising demand due to Expo 2020) and food & beverage (more demand in summer).
- Within the services sector, the improvement in business performance during Q2, 2014 was led by the following sub-sectors: real estate & construction (booming market, new

orders from both domestic and foreign markets), and transport (growing economy and more customers).

With respect to selling prices, 20% of the respondents reported an increase during Q2, 2014, but 16% reported a decline mainly due to rising competition, discounts, summer season and decline in volume of customers. However, a majority (64%) of the respondents indicated stability on the parameter.

The survey indicates that 25% of the respondents raised their staff numbers, which is similar to the figure of 26% observed in Q1, 2014. The employment performance was better compared to a year ago, when 15% reported an increase in hiring. Services and manufacturing firms have reported a bigger rise in employment figures for Q2, 2014, with 27% and 28% respectively of them raising their head count compared to 22% in trading. In addition, a greater percentage of large companies (37%) compared to SMEs (25%) reported an increase in their employee count.

New purchase orders increased in accordance with the improvement in business activity. The net balance for the parameter stood at 13% in Q2, 2014, modestly higher than the 11% in Q2, 2013, but much lower than the 23% recorded in Q1, 2014. The rise in new purchase orders was the strongest amongst manufacturing sector firms, with 38% of them reporting an increase versus 31% in trading and 27% in services. Large companies showed a much better performance on new purchase orders as reflected by the positive net balance of 25% in Q2, 2014.

The survey also shows that capacity utilization increased for 29% of the firms in manufacturing and 26% of the firms in the services sector during Q2, 2014. For manufacturing firms, the increase in capacity utilization was similar to that during Q1, 2014 and higher than in Q2, 2013 at 30% and 33% respectively. Among service sector firms; 35% had increased capacity utilization during Q1, 2014 and 32% during Q2, 2013.

The unit cost of labor increased for 49% of the survey participants during Q2, 2014 due to the annual increments in salary, the rising cost of living (especially rentals) and hiring of additional staff at higher wages. 50% of the firms have reported steady labor costs, while a marginal 1% has reported a decline. A higher proportion of manufacturing firms faced an increase in cost of labor (58%) compared to trading and services firms (46% for trading and 48% for the services sector). In the case of large firms, 56% reported an increase in labor costs during Q2, 2014.

38% of the respondents reported that the cost of raw materials increased during Q2, 2014, versus 23% in Q1, 2014. This rise impacted manufacturing firms the most as in the previous quarters, with 59% indicating an increase in Q2, 2014 against 33% for services and 36% for traders. The impact of such costs affected 36% of large companies in Q2, 2014.

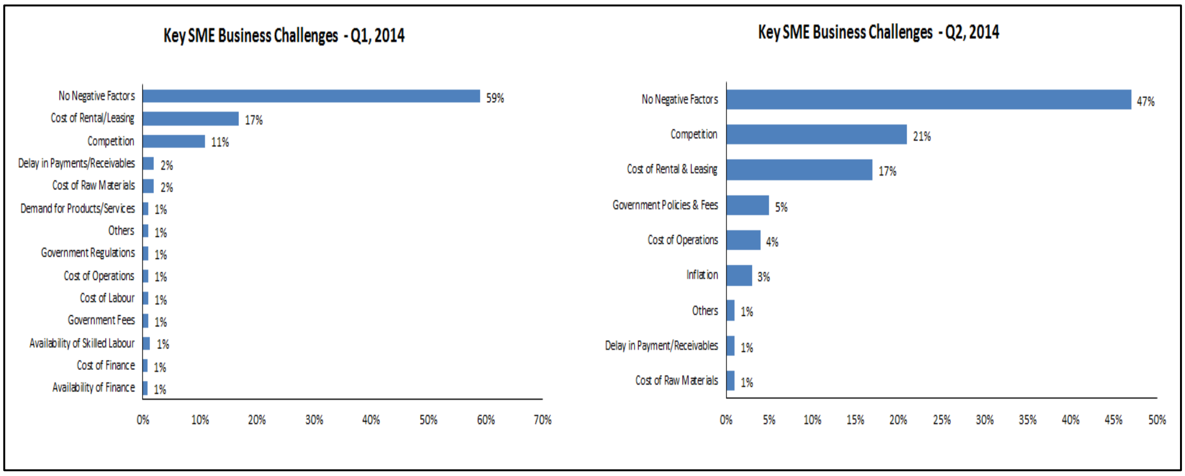
Rental costs increases were reported by 52% of the respondents during Q2, 2014 compared with 74% during Q1, 2014. As in the previous quarter, the impact of rental costs increases was most for traders: 56% of trading SMEs reported an increase in rentals versus 52% of manufacturers and 49% of services firms. For large companies, the corresponding proportion was 49%.

With respect to cost of finance, 29% of the firms made use of bank finance out of which 19% reported an increase in these costs while 70% reported ‘no change’. Among the large companies, 47% availed of bank finance, of which 72% reported no change in costs, while 21% reported an increase.

Additionally, 28% of the SMEs have stated an increase in their net profits during Q2, 2014 compared to 26% that cited an increase during Q1, 2014 and 30% in Q2, 2013. Profitability was strongest among manufacturing firms with a net balance of positive 3%, compared to negative 12% for trading firms and negative 5% for services. Among the large companies, 47% reported an increase in profits, while 27% reported a decline, resulting in a net balance of positive 20% (negative 6% for SMEs).

KEY BUSINESS CHALLENGES IN DUBAI

The survey also addressed key challenges perceived by businesses at the end of Q2, 2014 that may impact business growth and development. The moderation in the composite BCI and business situation compared to the last quarter is also reflected in the fall in proportion of SMEs indicating no obstacles to their business operations from 59% in Q1, 2014 to 47% in Q2, 2014.



The survey shows that competition is the key challenge facing Dubai's SMEs, followed by the rising cost of rental/leasing.

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

1. Competition *(cited by 21% of the respondents):* Rising competition from local and international players is the most important challenge being faced by Dubai- based SMEs. In the previous quarter, 11% of the SMEs reported competition as a concern, when it was the second most important concern. Moreover, 36% 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 17% of the respondents):* This was reported as a key challenge by 17% of the SMEs in the previous quarter also. Moreover, 53% of the respondents that cited high cost of rental/leasing as a challenge stated that the severity of this challenge has increased in the current quarter.

3. Government policies and fees (*cited by 5% of the respondents):* Issues related to government policies and rising fees are a concern for some SMEs going into the third quarter of 2014.
4. Cost of operations *(cited by 4% of the respondents):* Dubai's SMEs have cited this as an important challenge for their business operations.
5. Inflation *(cited by 3% of the respondents):* Inflationary pressures are a cause for concern for some participants in the survey.
6. The remaining challenges are almost equal in severity, as reported by 1% of respondents in each case.

In terms of factors impacting businesses by firm size, the topmost challenges for SMEs are the same as the overall economy, i.se. competition, cost of rental/leasing, issues related to government policies and fees and cost of operations, while for large companies the leading challenges are cost of rental/leasing, competition, government policies/fees and inflation.

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?

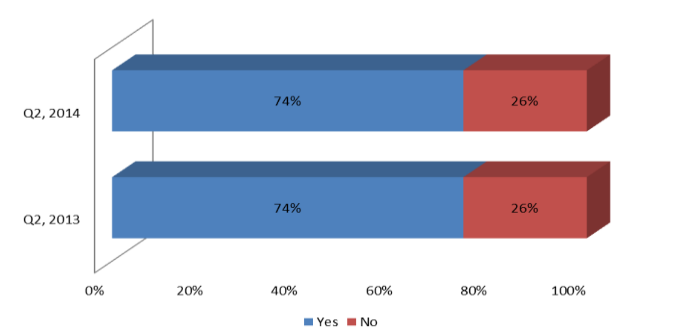
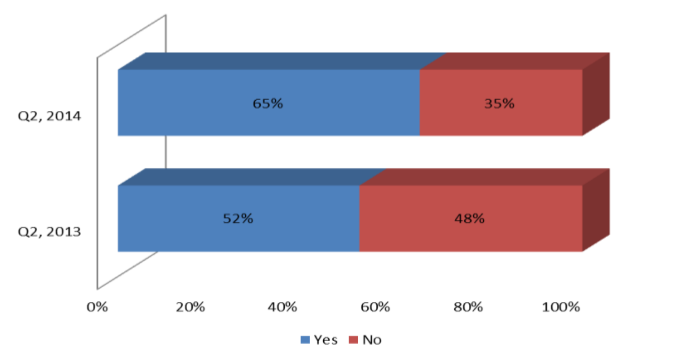


Figure 7. Do you plan to upgrade your technology?



The current survey indicates that plans to invest in capacity expansion remain steady in comparison to the previous quarter as well as the same quarter a year ago. 74% of the participants have indicated plans to undertake capacity expansion in Q2, 2014 compared to 75% in Q1, 2014 and 74% in Q2 2013.

65% of the firms have indicated plans to upgrade technology in Q2, 2014 vis-à-vis 60% in Q1, 2014 and 52% in Q2, 2013.

Companies planning capacity expansion have reported new capital investments for expansion of the current office premises and 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 a focus on achieving stability and profitability before adding to their capital expenditures, as the key reasons for no expansion plans on their part.

A comparison across the three key sectors shows that the manufacturing sector is the most optimistic with respect to capacity expansion (80% in manufacturing, 74% in services and 70% in trading are planning for such investments). With respect to technology upgrade as well, manufacturing firms (80%) are more inclined compared to service firms (68%) and trading companies (55%).

From a business size perspective, large businesses are more inclined towards capacity expansion and technology upgrades. With regards to market orientation, domestic market-oriented firms have slightly higher plans for capacity expansion as well as technology upgrades than export market-oriented firms.