SME Growth Index

October 2023

ScotPac
Business Finance

Research completed in partnership with East & Partners, surveying Business Owners and Decision Makers in Australia.

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Executive Summary

SME growth forecasts continue to widen
The six-month revenue growth outlook for Australian SMEs has ballooned to its largest margin in the near-decade long history of ScotPac's SME Growth Index (SMEGI) Report, with forecasts ranging from growth of 13% to a decline of 22%.

With the fog of the pandemic having lifted after three years of uncertainty and disruptions, SMEs were able to express a much clearer picture of their growth in this round of reporting.

The good news is that a remarkable 57% of SMEs are forecasting growth to March 2024 – the highest figure in seven years – by a healthy average of 8%. Conversely, a record 32% of SMEs are predicting their revenues will contract, up 18% year on year. The downturn in the construction sector, which is the largest SME category in the country, was no doubt a significant factor.

A helicopter view of the nation shows that Western Australia based SMEs are the most bullish about their short-term prospects. Nine in ten businesses in the west are projecting revenue growth, compared with just 17% in Victoria, which is yet to experience a post-COVID bounce back. New South Wales, home to a third of the nation's SMEs, sat comfortably in the middle at 53%.

The positive outlook reported by SMEs in regional Australia, which exceeded metro-based SMEs on all markers, was particularly pleasing given the concerns about the impact of a population drift back to our major cities.

Investment intent strong as lender loyalty falls
The proportion of SMEs planning to imminently invest in their businesses has hit a four year high. Undeterred by high inflation and a large reduction in the Instant Asset Write-Off Scheme cap, 61% of SMEs said they will spend money to support their business objectives over the next six months.

The preference for non-bank lending remained at a record high as SMEs prioritise sharper pricing, ease of credit approval and increased headroom on spending limits.

In a clear sign that loyalty to one lender is in demise, the SMEGI Report confirms that four in five SMEs now have a secondary working capital provider. It also highlights the increasing rate of lending health checks being conducted by SMEs compared to the lower cost environment of 2015.

Both indicators above should be welcomed by brokers who were nominated by a growing proportion of SMEs as being central to their decision making on lending.

Wages growth a key concern
Spiking wage costs strengthened as the key concern for SMEs of all sizes following considerable increases to national minimum wage and award rates that took effect from 1 July 2023. The changes affect the wages of almost three million Australians, many of them employed in SMEs, and business owners have reacted strongly.

While unions celebrated the Fair Work Commission rulings, two-thirds of SMEs responded by saying they intend to hire less new staff, reduce the number of people they employ, and / or the cut the number of hours employees are working. Around one in five flagged they would move to a contractor model, and 4% said the added wage costs had "pushed them over the edge" to the point of closure.

With SMEs accounting for 97% of all Australian businesses, policymakers will be acutely aware that changes to employment patterns like those flagged above could have serious ramifications for our unemployment rate.

Too early for AI
In a surprising result, 85% of Australian SMEs have no plans to adopt AI technology in the next six months. While more than half of respondents said they were generally aware of AI, 28% said they had no or little understanding of its practical applications.

With wages on the rise and technology costs falling, it will be interesting to compare results on AI adoption and investment in future years.

SMEGI turns 10
The bi-annual ScotPac SMEGI Report is Australia's longest established survey of SME business confidence. We trust the enclosed insights from the Round 19 Report will be of interest and value. We also look forward to presenting a special 10th anniversary edition of the SMEGI in 2024.

Jon Sutton
Chief Executive Officer
ScotPac Business Finance

SME business investment plans rebound to four-year highs

Preference for non-bank lending remains at an all-time high of 47%

Overview

Almost two thirds of Australian SMEs plan to invest in their business in the next six months, a substantial 15% increase year-on-year. It is the highest level of investment intent for SMEs in four years and represents a major rebound in confidence from the 52% recorded in September 2020.

The findings correlate with the latest data from the Australian Bureau of Statistics which reported a 6.3% year-on-year capital expenditure increase by Australian businesses in June 2023.

In terms of funding new investment, nine out of 10 SMEs said they would consider using their own funds, while the appetite for non-bank lenders remained at a record high 47% - up 50% since March 2022.

A better deal on interest rates is the dominant driver for SME owners when considering adding or switching to a non-bank lender. Four out of five rated it a top three factor, followed by easier onboarding which was favoured by 55%.

Rounding out the top three was higher credit limits, nominated by more than a third of respondents who are seeking more headroom to invest in growth and manage rising costs.

61%

SMEs planning to invest in their business in the next six months

47%

SMEs considering non-bank lenders to provide new business investment

37%

SMEs that rated higher credit limits a top-three reason to consider non-bank lending

Top takeouts for SMEs and brokers

Despite macroeconomic headwinds including rising inflation and interest rates, Australian SMEs are continuing to invest in their businesses at near record levels.

While some of the growth in capital expenditure can be attributed to higher input prices, the strength of SME investment intent goes beyond this factor alone.

An emerging driver of SME investment decision making is choice. Non-bank-lending has doubled in the past 18 months as SME owners and brokers have become increasingly aware of lenders in the market who can tailor finance solutions to specific needs.

With 15% of SMEs reporting they are unsure of how to fund new business investment, there is an opportunity for brokers to help thousands more SMEs while growing their own business.

ScotPac has the breadth of products and experience to support more SMEs in more situations than any other non-bank lender.

Whether SMEs are looking to invest in assets, inventory or expertise, our team can quickly package the right combination of business and commercial finance products to suit.

Wage increases prompt SMEs to change approach on staffing

Rising cost of employment is forcing some SMEs to consider closure

Overview

Recent legislated increases to minimum wages and award rates are having a major impact on the business plans and growth projections of Australian SMEs.

Effective from 1 July 2023, the national minimum wage rate increased by 8.65% to $23.23 per hour, while award rates - which apply to 2.8 million employees - jumped 5.75%.

SMEs account for 97% of all businesses in the country and employ millions of workers entitled to these new wage rises. They have understandably prompted a change in approach for many.

More than two-thirds of SMEs indicated they will hire less new staff, and a similar proportion will reduce employee hours and / or headcount.

A third of SME owners said wage rises would prevent them from growing their business, while 17% said they were considering outsourcing to contractors.

At the extreme impact end, four percent of SMEs said wage pressures had 'pushed them over the edge' and they were considering closing their business.

69%

SMEs that intend to hire fewer new employees to combat wage growth

64%

SMEs that plan to reduce existing employee hours and / or headcount

33%

SMEs that said recent wage increases negatively impacted their ability to grow their business

Top takeouts for SMEs and brokers

Wages growth has strengthened as the greatest concern for Australian SMEs in the past six months, with many now prepared to act to rein in ballooning costs.

The average Full Time Equivalent (FTE) employee number for Australian SMEs has fallen in all 19 rounds of ScotPac's Growth Index Report, from 88 in May 2014 to just 57 in September 2023.

The coping strategies outlined by SMEs in the report are likely to see an acceleration of this trend, and potentially impact the national unemployment and underemployment rates.

For SME owners, ensuring there are available funds to pay wages and other payroll commitments can be time consuming and stressful, particularly with new award frameworks to implement.

ScotPac's experienced lending specialists have been providing businesses with working capital strategies to optimise their payroll since 1988.

Before making major changes to staffing structures, SMEs and their brokers should speak to us about our working capital solutions.

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SME growth forecasts hit seven-year highs in wildly fluctuating market

Regional SMEs are more bullish about short-term growth prospects than their city counterparts

Overview

More than half of Australia's SMEs are forecasting positive revenue growth over the next six months, but projections vary wildly by geography and sector, and a record 32% of SMEs are flagging a decline in revenue.

SMEs in Western Australia and Queensland – two states with large exposure to our booming resources sector – were the most optimistic in the nation with revenue growth forecasts of 92% and 84% respectively.

Conversely, SMEs in Victoria remained Australia's most pessimistic, with just 17% flagging revenue growth. The worrying figure was well below the outlook for SMEs in other States which all recorded growth projections above 50%.

The picture was much better for SMEs in regional Australia, with growth projections on a level footing with metropolitan-based businesses, but revenue contraction forecasts running at less than half city levels.

For the third straight SME Growth Index report, the spread of positive / negative revenue projections grew to its largest ever margin, stretching from +13% to -22%.

57%

SMEs forecasting positive revenue growth in the next six months by a record average of 8%

92%

Western Australia SMEs projecting revenue growth compared to just 17% in Victoria

17%

Regional SMEs projecting revenue contraction in the next six months compared to 38% for metropolitan based SMEs

Top takeouts for SMEs and brokers

Since the first round of the SME Growth Index almost a decade ago, there has never been a wider divide recorded between the strongest growing and hardest hit SMEs across the country.

While stark, the divergence in growth expectations is not surprising as Australian SMEs transition from pandemic recovery to a climate of rapid wages growth and stubbornly high inflation.

There is clear evidence that SMEs in some markets and some parts of Australia are thriving - including our booming regional economies – while others with more exposure to rising business and cost of living pressures are feeling the pinch.

Over 35 years of operation, including previous periods of high inflation, ScotPac has helped thousands of businesses attain fast and flexible finance to suit their needs.

The best advice for SMEs at all points of the growth projection scale is to talk regularly with your broker to ensure you are getting the right support, as and when you need it.

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Four in every five SMEs now have a secondary working capital provider

The proportion of SMEs with all lending in one place continues to dwindle

Overview

80% of Australian SMEs now have more than one finance provider as the trend towards 'multi-banking' picks up speed in the high interest rate environment.

When considering spreading their wallet across multiple lenders, around half of the SME respondents said they wanted more support from their lender's relationship management team, and of course sharper pricing.

When it came to attributes a secondary lender needed to demonstrate to win more of their business, two-thirds of SMEs said the ease of attaining credit facilities was a major factor, while more than half said they were persuaded by a lender's level of proactivity.

One in ten SMEs said their impulse for multi-banking was to expand their product coverage.

Of the 20% of SMEs that do not have a secondary working capital provider, two thirds preferred to keep their cash management accounts in one place; a similar proportion noted Treasury policy over securities; and 60% said onboarding hoops and other new account requirements were too difficult.

80%

SMEs that maintain a secondary lending relationship as lender loyalty declines

67%

SMEs that nominated ease of credit approval as the leading factor for choosing a secondary provider

60%

SMEs without a secondary lender that said opening a new account was 'all too hard'

Top takeouts for SMEs and brokers

As SME owners have become more price-sensitive and digitally savvy, they have become more inclined to explore alternative funding options, leading to a decline in their loyalty to their 'traditional' lender.

With so many SMEs adopting a deliberate strategy to spread their finances across multiple providers, there has never been a better time for informed brokers to grow their business.

SMEs have spoken loud and clear. They increasingly want a more responsive relationship with their lenders, in the form of fast and easy onboarding and approval processes and tangible support from relationship managers.

There is also a growing recognition of the benefit of working with experienced providers of specialty lending solutions like Invoice Finance, Asset Finance and Trade & Supply Chain Finance.

ScotPac's Partner Portal gives brokers easy access to a raft of technologies and resources that help them quickly deliver what SMEs are looking for in an adviser and a finance partner.

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Cost of doing business drives more regular financial health checks for SMEs

SME owners are increasingly turning to brokers for advice on lending decisions

Overview

Rapidly rising interest rates and core business costs have prompted SMEs to increase the rate at which they review their primary lending relationships.

In 2015, almost half (47%) of Australia's SMEs had not reviewed their lending relationship for several years. Eight years on, that figure has now dropped to just 22%.

Asked to expand on how often they now review their business lending requirements and existing relationships, SMEs nominated the following frequencies:

- Annually 7%
- Biennially 5%
- Triennially 9%

Almost 30% of SME Chief Financial Officers, Treasurers and business owners nominated interest rates as a key driver for planning to switch lenders, and 12% cited the influence of their broker channel – both significantly higher results than in 2015.

A small proportion of SMEs sought a new credit provider after reaching current credit limits.

22%

SMEs that had not reviewed their primary lending relationship for many years

7%

SMEs now review their existing business lending requirements annually

6%

SMEs that were forced to seek a new credit provider after maxing out their credit

Top takeouts for SMEs and brokers

The increased frequency with which SMEs are reviewing their lending relationships is a win-win-win for businesses, brokers and specialty finance providers like ScotPac.

Prompted by surging interest rates in the past 18 months, regular lending health checks are becoming more entrenched as cashflow management and business planning tools.

As businesses evolve and grow, their financial needs change. SMEs are increasingly looking to brokers to help them ensure their lending arrangements are aligned with current and future financial goals, and are enabling the best use of capital.

More regular lending reviews provide an opportunity for SMEs and brokers to communicate with lenders, discuss performance, and explore ways to strengthen partnerships.

ScotPac has the most flexible range of finance products in the market to help SMEs succeed. We have the tools and expertise to assist brokers and SMEs with regular lending reviews to ensure they are on track to meet their goals.

Most SMEs yet to benefit from Artificial Intelligence (AI) productivity gains

Low understanding and security fears hamper AI adoption rates

Overview

Less than one in seven Australian SMEs have either implemented Artificial Intelligence (AI) technology or will soon do so, a figure dwarfed by 85% of respondents with no plans to use AI in their near future.

Delving deeper into the insights, more than half the SMEs surveyed said they were aware of AI technology but were unsure about its potential applications or impacts for their sector. Meanwhile, 28% of SMEs said they had no knowledge of AI technology.

While most SMEs did not offer a view on what areas of business AI is most likely to influence, the top three applications identified by those who did respond were customer service, identifying new business opportunities, and sales / BDM management.

Less than 5% of SMEs said they understand AI and its potential uses but were not considering implementing it yet. A further 4% saw AI as a threat to their business, either in a competitive sense or as a cybersecurity (e.g., deep fake) risk.

15%

Australian SMEs have either implemented AI already (5%) or plan to implement AI (10%)

51%

SMEs that are aware of AI technology but did not yet grasp its potential impact

4%

SMEs that said they felt AI was either a competitive threat or cybersecurity risk

Top takeouts for SMEs and brokers

While most SME owners remain sceptical of AI technology, its potential to increase productivity and reduce wages costs make it inevitable that more will soon focus on planning for AI adoption.

Aside from justified concerns about job displacement, data privacy and workflow changes, one of the largest upfront impediments for SMEs in implementing AI technology will be cost.

Investment in areas like hardware, software, IT talent acquisition and employee education will all be required upfront before AI efficiency gains are realised in the longer-term.

In coming years, it will be vital for SMEs to seek planning and financing advice on AI implementation, to ensure existing operations are not impacted as new technology is soon introduced.

Whatever type of investment in AI is required, ScotPac's team of experienced lending specialists can deliver a working capital solution to help SMEs acquire the assets or expertise they need to be fit for the future.

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Two-thirds of SMEs take advantage of FY23 Instant Asset Write-Off Scheme

Almost 70% of Declining Growth and Stable SMEs used the generous tax relief measure before it was scaled back

Overview

Almost Two-thirds of Australia's SMEs took advantage of the extended Instant Asset Write Off (IAWO) Scheme in the 12 months to 30 June, claiming an immediate tax deduction on assets valued at an average of $91,500.

Declining Growth or No Change SMEs were the biggest users of the IAWO Scheme, with 68% purchasing eligible assets worth 75% of the $150,000 cap. That compared with 59% of Growth SMEs who participated with average purchases valued at 49% of the cap.

In terms of location, three quarters of New South Wales & Australian Capital Territory SMEs used the IAWO Scheme, easily the highest rate in the country. Victorian & Tasmanian (combined) SMEs were the next most prolific -right on the national average of 63% - while just Western Australia SMEs were the least reliant at 54%.

On 9 May 2023, as part of the 2023–24 Budget, the Albanese Government announced a revised IAWO Scheme threshold of $20,000 would apply from 1 July 2023 until 30 June 2024. The threshold will apply on a per asset basis, so SMEs can instantly write off multiple assets.

63%

SMEs used the Instant Asset Write-Off Scheme (IAWO) for purchases averaging $91,500

68%

Declining Growth or Stable SMEs used the IAWO compared with 59% of Growth SMEs

75%

New South Wales & Australian Capital Territory SMEs used the IAWO Scheme compared with 54% in Western Australia

Top takeouts for SMEs and brokers

There was something of a rush to the exit door for SMEs looking to take advantage of the generous IAWO Scheme before a significant reduction in the cap took effect at the start of FY24.

With business groups leading the call for a continuation of the previous IAWO cap of $150,000 to help SMEs deal with mounting cost pressures, the Government provided some relief by increasing the new IAWO threshold from $1,000 to $20,000 for eligible businesses.

Given the rising cost of assets, and the averaging cap-ex spending levels of SMEs in the past 12-months, the reduction in the IAWO Scheme cap leaves a gap that SMEs need filled.

While the IAWO changes will have an impact on asset planning, there are complementary options available to SME owners, CFOs and procurement managers.

Whether it's machinery or vehicles, ScotPac is an established leader in supporting SMEs of all sizes with flexible, tailored Asset Finance to help them buy the assets they need.

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Methodology

ScotPac's bi-annual *SME Growth Index*, is Australia's longest running research report on SME sentiment towards revenue growth prospects.

This is the 19th consecutive round of ScotPac's SME Growth Index. Each index round includes a mix of core questions that are repeated biannually, and special questions, which are refreshed in line with changes in the SME environment.

The Round 19 research was conducted by East & Partners who interviewed 722 SME enterprises with annual revenues of A$1-20 million.

SMEs surveyed have operated continuously for 14.6 years and manage an average of 57 full time employees.

Sectors represented in the survey included Manufacturing (14%), Property & Business Services (14%), Retail (11%), Wholesale (12%), Personal & Other Services (10%), Construction (10%) and other industries including Transport & Storage, Mining, Agriculture, Media, Hospitality, Finance & Insurance (non-bank) and Electricity.

All interviews were conducted over the telephone or face-to-face by an accredited East interviewer, speaking with the company CEO, CFO, Finance Director or Treasurer. The sample was framed in accordance with ANZSIC codes to provide a natural sample of the Australian enterprise population.

east&partners

East & Partners is a leading specialist business banking market research and analysis firm. The firm's core expertise is in the provision of analysis and advisory services tailored for the commercial, business and institutional banking markets across Asia Pacific, Australasia, Europe and North America. The delivery of accurate quantitative analysis on businesses' exploding demand for sophisticated transaction, FX, debt, treasury, investment and advisory banking services and products has been uniquely addressed by East's "bottom up" research methodologies since 1987, based on many thousands of customer interviews with CEOs, CFOs, treasurers and business owners.

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About ScotPac

For 35 years ScotPac has helped thousands of businesses grow and succeed by providing fast, tailored and flexible funding solutions to small to medium enterprises (SMEs).

ScotPac is Australia and New Zealand's largest specialist provider of SME working capital solutions. We partner with businesses to convert the value of outstanding invoices and business assets into a powerful source of cashflow. For example, our *Boost Business Loan* is designed to offer online loans of between $10,000 and $500,000, funded within 24 hours of approval.

Our experienced team of business lenders understand that SME owners often require fast access to funds and personalised facilities to seize opportunities and manage their cashflow fluctuations. Increasingly, business owners are turning to non-bank lenders in preference to banks because of the comparative speed and ease of application and approval processes.

That's where ScotPac comes in. When it comes to working capital, many business owners simply are not aware of the assets they are sitting on – they might see unpaid invoices or equipment as overheads and inconveniences rather than potential sources of funding for their business.

ScotPac has unrivalled experience at funding businesses through all stages of the economic cycle – including periods of high inflation - and all stages of their existence from start-up to high growth. We work with our clients and their brokers and advisers to navigate supply chain and other challenges, and to scale up when opportunities arise. Our breadth of experience and suite of products means we can help more businesses in more situations than any other non-bank lender.

ScotPac initiated the *SME Growth Index* in 2014 and this is now the 19th index report. Our key objectives in producing the Report include:

- Deepening our understanding of what SMEs need to inform the development of new and enhanced financial solutions.
- Gathering data to help us act as advocates for SMEs and thought leaders within the business finance community.
- Sharing relevant insights with the SME community, brokers and advisers, policymakers, industry associations and financial / SME media.

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