Nicolosi Galluzzo, LLP

WHITEPAPER:

MIDDLE MARKET PERSPECTIVES

I. Introduction: America's middle market

America's middle market accounts for approximately 40% of the U.S. GDP.[1] It has always been the most resilient segment of the American economy and has historically accounted for a larger proportion of employment growth than other sectors. Although America's economic engine, the middle market faces shifting economic trends in 2013, most notably from uncertainty stemming from tax and fiscal policies and health care reform, it nevertheless appears ready for growth.

II. The survey

In order to examine and understand the economic outlook and the expectations, challenges, and priorities of middle market executives, Deloitte conducted surveys of mid-market executives. For 3 years, Deloitte surveyed 525 senior executives at mid-sized companies with annual revenues between $50 million and $1 billion about their expectations, experiences and plans for becoming more competitive in the current economic environment. Of the companies surveyed, 81% were privately held and 19% were public. Companies surveyed represented diverse industries. The five largest represented were professional/business services, retail and distribution, consumer products, technology and health care providers.

III. Survey results

Results of the survey showed a more tempered expectations of overall economic growth, with companies taking prudent steps to position themselves for success. The sectors appear to have a better sense of the challenges and opportunities of the current environment. The survey report identifies three overarching themes: (1) cautious optimism; (2) continued uncertainty about economic outlook; and (3) greater focus on fundamentals of their business.

a. Increasing optimism tempered by realism

While understanding the reality of the U.S. economy in 2013, mid-market executives nevertheless report that their own businesses are positioned for growth. This belief is supported by three key findings. First, mid-market executives who were surveyed appear to be less worried about housing crisis and other economic issues. Only 24% of respondents cited housing as a top obstacle to

---

[1] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 2.

growth this year, compared to 59% from 2012. Further, only 31% of executives listed the European debt crisis as a key obstacle in 2013, compared to 50% in 2012.[2]

Second, although fewer executives reported increasing revenues and fewer expect higher revenues over the next 12 months compared to 2012, there is improvement in financial health of mid-market companies. 34% reporting higher cash balances in 2013, compared to only 15% reporting that cash balances have decreased. Looking ahead, 27% expect cash balances to rise, compared to only 13% who expect balances to fall. Additionally, debt ratio has stabilized, allowing for higher capital investment levels.[3]

Finally, access to capital is not an obstacle for most mid-market executes' investment plans. Almost one-third of companies surveyed increased their capital investments in the last 12 months and plan to do so again in 2013.[4] These investment priorities appear to be focused on longer time horizons. This year, 47% reported a mix of short and long term investment; an additional 25% defined their investing as focused on the longer term.[5]

b. Continued uncertainty about economic outlook

Executives continue to express a high degree of uncertainty about the economic outlook. 59% of respondents ranked uncertain economic outlook as the biggest obstacle for growth, compared to 50% in 2012. Results indicate that private company executives are more uncertain than their public counterparts.[6]

The lingering uncertainty stems largely from government budget challenges, tax rates, and health care reform costs. These executives believe that such obstacles will affect their ability to plan strategically or make investment decisions in the future. Survey results show that more than 40% of companies are deferring major investments.[7]

Moreover, the uncertainty is affecting mid-market companies' decision to go public. In 2013, only 6% expect their companies to go public in the next 12 months, and only 8% sometime after that. The top reasons for this reluctance is the desire to control and/or flexibility in making decisions, the desire to keep financial information private, and the burden associated with of regulatory requirements. However, of those companies that do expect to go public, four key factors support that decision: (1) cost effectiveness of equity capital; (2) the need for capital to fuel growth; (3) the potential to broaden the exposure of brand and products; and (4) the desire to provide liquidity for owners.[8]

---

[2] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 4.
[3] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 5.
[4] Id.
[5] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 8.
[6] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 10.
[7] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 10-13.
[8] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 9.

c. Greater focus on fundamentals of business

Although executive are concerned about the ways public policy may affect their ability to expand their business and plan for the future, they are placing a stronger emphasis on the business fundamentals, including more focus on growth in core business areas, domestic growth, and training current employees rather than hiring new employees.

i. Revenue

43% of executives ranked sales as the area where they will be devoting the most time in 2013, which is significantly higher than any other priorities. In addition, 32% of respondents indicated domestic organic growth as their primary growth strategy. The business and professional service sector is even more focused on organic growth, with 54% of executives from that sector ranking it as the top strategic priority in 2013.[9] In addition, companies overwhelmingly chose the U.S. as the geographic market that contributed most to their growth in the last 12 months, with Canada being second. Over the next 12 months, executives surveyed expect U.S. and Canada to be the clear sources of mid-market growth; however, China and the Asia-Pacific region, Western Europe, and Mexico will also be contributors.[10] Focus on productivity; however, has decreased, perhaps of action taken over the past few years in favor of increasing sales.[11]

New product development and new market expansion was the second priority of executives in growth strategy. For example, in the manufacturing industry, 53% of named new product development as one of their top three strategic priorities over the next 12 months, compared to 29% of all respondents. Similarly, 51% of companies in the process and industrial products sector ranked new market expansion as a high priority, versus only 32% of all companies.[12]

Further, 37% said they engage in partnerships and alliances as another key strategy for growth, and 18% perceive it as part of their core business strategy. Among those who have engaged in partnerships and alliances, their perceived value is overwhelmingly positive: 97% perceive value in them, including 64% who perceive their value to be high or extremely high.[13]

ii. More focus on domestic growth

More mid-market companies are focusing on domestic growth compared to 2012, specifically growth within existing markets and a more domestic emphasis on merger partners or acquisition targets. Companies are increasingly looking among their competitors, participants in the company's own supply chains, or current business partners, for M&A opportunities. In 2013, 47% named a direct competitor as a likely target for M&A, compared to 37% in 2012. 24% cited their

---

[9] Mid-market perspectives: 201 report on America’s economic engine, Deloitte, 14.
[10] Mid-market perspectives: 201 report on America’s economic engine, Deloitte, 16.
[11] Mid-market perspectives: 201 report on America’s economic engine, Deloitte, 14.
[12] Mid-market perspectives: 201 report on America’s economic engine, Deloitte, 21.
[13] Mid-market perspectives: 201 report on America’s economic engine, Deloitte, 14.

own supply chains or current business partners as the most likely counter parties, up from 17% in 2012.[14]

iii. More emphasis on training than hiring

Due to concerns over finding sufficient workers with the right skills and training, there has been more focus on training as opposed to hiring new employees. In 2012, 49% of executives reported that they planned to increase their full-time workforce. In 2013, only 40% expected to add to their full-time workforce in the next 12 months. This concern affects some mid-market industries to a greater degree than others. While 14% of all respondents ranked the skills shortage as one of the greatest obstacles to their company growth, 29% of companies in the business and professional service sector ranked the skills shortage as an essential obstacle, an increase from 23% in 2012.

As concerns over fining skilled workers remains a challenge, companies are investing more in training to address their needs. When asked to choose their most likely investment in talent in 2013, over 50% of executives surveyed chose training as one of their top two priorities, with an increase in full-time employees coming in a distant second.[15]

d. Mergers and acquisitions outlook – cautious, but healthy

Executives are more cautious about M&A deals in 2013 than in 2012. In 2012, 42% said they would likely or quite likely make an acquisition in the coming year, whereas only 31% indicated so in 2013. Although executives remain cautious, they are not ignoring M&A opportunities entirely. When it comes to drivers of merger activity, executives are more optimistic about the economy. 24% identified renewed confidence in the economy as a factor, versus 15% in 2012. Additionally, 22% rank M&A as one of their top 3 areas of capital investment in 2013, and 26% ranked growing by acquisition as one of their top 3 strategic priorities for the upcoming year.[16]

e. Marketing investments

The survey shows a mix of new and traditional methods. Internet media and advertising ranked first in priority. Social media is gaining importance among mid-market companies, especially consumer-oriented industries. However, business and professional services firms (55% reported they are executing plans, but only 15% have well-developed plans), and consumer products firms (57% engaged, only 10% reported a well-developed strategy).[17]

f. Technology investments

Technology investments remain a high priority for mid-market capital investment in 2013, with 46% of executives ranking technology as one of their top three investment priorities. Smaller firms place a higher priority on this area than larger firms. Cloud computing and business automation were the most popular anticipated investments, with 34% of respondents choosing cloud

[14] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 6-7.
[15] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 18-19.
[16] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 6-7.
[17] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 15.

computing as one of their top three investment choices in 2013. Fewer companies reported investing in data analytics, 29% in 2013 compared to 41% in 2013.[18]

[18] Mid-market perspectives: 201 report on America's economic engine, Deloitte, 20.