MMBI RSM US MIDDLE MARKET BUSINESS INDEX

A REAL ECONOMY PUBLICATION

U.S. Chamber of Commerce

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RSM US LLP and The Harris Poll have collected data on middle market firms from a quarterly survey that began in the first quarter of 2015. The survey is conducted four times a year in the first month of each quarter: January, April, July and October. The survey panel, the Middle Market Leadership Council, consists of approximately 1500 middle market executives, and is designed to accurately reflect conditions in the middle market. The data is weighted to ensure that it corresponds to the U.S. Census Bureau data on the basis of industry representation.

A reading above 100 for the MMBI indicates that the middle market is generally expanding; below 100 indicates that it is generally contracting. The distance from 100 is indicative of the strength of the expansion or contraction.

This report was fielded Jan. 10 to Jan. 31, 2022, and based on the responses of 402 participants.

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RSM US LLP and the U.S. Chamber of Commerce have joined forces to present the RSM US Middle Market Business Index (MMBI)—a first-of-its-kind middle market economic index developed by RSM in collaboration with Moody's Analytics, the financial intelligence provider. We publish the MMBI quarterly to give voice to the middle market and raise awareness of this crucial, yet underrepresented, segment of the economy.

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DESPITE THE DECLINE IN OVERALL SENTIMENT, THE CURRENT READING REFLECTS STRONG BUSINESS CONDITIONS ACROSS THE REAL ECONOMY. MEANWHILE, RUSSIA'S INVASION OF UKRAINE, WHICH OCCURRED FOLLOWING THE CONCLUSION OF THE SAMPLING PERIOD FOR THE FIRST QUARTER, SHEDS UNCERTAINTY ON MIDDLE MARKET BUSINESS SENTIMENT IN THE SECOND QUARTER.

JOSEPH BRUSUELAS, CHIEF ECONOMIST, RSM US LLP

Joseph Brusuelas is the chief economist for RSM US LLP. Brusuelas has 20 years of experience analyzing U.S. monetary policy, labor markets, fiscal policy, economic indicators and the condition of the U.S. consumer. As co-founder of the award-winning *Bloomberg Economics Brief*, Brusuelas was named one of the 26 economists to follow by the *Huffington Post*. In addition, he was named 2020 Middle Market Thought Leader of the Year by The Alliance of Merger & Acquisition Advisors. A member of the *Wall Street Journal*'s forecasting panel, Brusuelas regularly briefs members of Congress and other senior officials regarding the impacts of federal policy on the middle market and the factors by which middle market executives make business decisions.

"This quarter's Middle Market Business Index continues to demonstrate that businesses and job creators remain heavily burdened by inflation, labor shortages, snarled supply chains and continued COVID-19 disruptions. For our economy to reach its potential, expanding the labor force and limiting inflation must be a top priority for policymakers throughout 2022."

Neil Bradley, Executive Vice President and Chief Policy Officer of the U.S. Chamber of Commerce

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Top-line middle market business sentiment eased to 125.1 in the first quarter of the year from 130 in the final quarter of last year.

Source: RSM US LLP

*seasonally adjusted

INFLATION AND OMICRON DAMPEN BUSINESS CONFIDENCE

BY JOSEPH BRUSUELAS

THE OMICRON VARIANT and rising prices have taken a toll on both overall economic activity and consumer and business confidence over the past three months, according to the latest proprietary RSM US Middle Market Business Index.

Top-line middle market business sentiment eased to 125.1 in the first quarter of the year from 130 in the final quarter of last year. Both of those figures were below the all-time high of 143.8 posted in the third quarter of last year.

Despite the decline in overall sentiment, the current reading reflects strong business conditions across the real economy and is perhaps the first sign of relief inside the index on the risk to the outlook posed by inflation.

However, Russia's invasion of Ukraine, which occurred following the conclusion of the sampling period for the first quarter of the year, will likely roil global supply chains and cause the price of energy to rise in the near term. Thus, it is probable that this development and all that follows may damp middle market business sentiment during the second quarter of the year.

Two key components in the current quarter underscore expectations around gross revenues and net earnings—prices received and compensation. Both eased during the first three months of the year, providing some relief to firms scrambling to address a shortage of goods and labor.

While it is too early to call a top to the current surge in inflation, any relief from pricing pressures and the scarcity of labor is welcomed by middle market firms.

Why the focus on this here? In the labor-intensive service industries that constitute the bulk of the real economy, wages play an outsize role in business costs. While bolstering the condition of the American household in the near term, last year's acceleration in pay, if it continues, would cause an increase in operating costs and thinner margins and would result in an acceleration in inflation.

However good that wage acceleration has been over the past year, more than 70% of firms have reported paying higher prices for goods and 71% of those did so in the current quarter; 67% of those expect to do so over the next six months.

Roughly 53% reported passing along those higher prices in the first quarter and 69% said that they would attempt to do so over the next 180 days. Pricing power in the middle market remains quite difficult given the hypercompetitive landscape across the real economy; the average percentage of firms reporting passing those prices along over the past year was 54.5%.

Still, firms are experiencing strong profit margins, accelerated hiring and rising productivity, and as a result are able to absorb higher operating costs. This cannot last indefinitely, though. It is why the Federal Reserve is moving quickly to accelerate its policy normalization through higher interest rates at the short end of the curve and drawing down of the balance sheet starting in the middle of the year, which will place upward pressure on longer-term interest rates.

Impact of omicron and inflation

Survey respondents' views of the economy soured in the quarter, which is almost surely linked to the spread of the omicron variant and to inflation. Roughly 29% of respondents said the economy improved, 41% said it deteriorated and 33% noted it remained unchanged. Looking forward, 43% noted they expect the economy to improve and 29% said they expected it to worsen over the next six months.

Gross revenues and net earnings moved along a similar path, with 43% of respondents reporting an improvement in the former and 40% in the latter. Despite those figures, the view going forward remains decidedly optimistic, with 61% expecting gross revenues to improve and 59% implying growth in net earnings.

During times of rising prices, productivity can be the difference between stable and thinning margins. Middle market firms have consistently increased investment in productivity-enhancing equipment, software and intellectual property, which is a primary reason middle market firms have thrived during the pandemic and are well positioned to prosper.

Capital expenditures

Like the views on the economy, revenues and margins sentiment soured on capital expenditures in the current quarter, with only 27% of respondents indicating an increase in outlays on capital expenditures. However, 51% expect an increase going forward.

Not surprisingly, only 38% of firms reported increasing hiring and 48% of firms indicated they increased compensation. Given that more than half of firms expect to increase outlays on productivity-enhancing equipment, 56% of firms reported they will increase hiring and 62% will increase pay to attract labor to increase output.

Lastly, firms continued to manage inventory levels carefully given the latest round of shocks to the economy from supply chain challenges and worker absenteeism that have characterized the past two months. More than a third of firms, or 36%, reported an increase in inventories and 51% stated they expect an increase over the next two quarters.

Of course, much is dependent on the future of a volatile geopolitical landscape. Factors such as rising energy prices and fractured supply chains lend significant uncertainty to economic growth in the near term.

CYBER BREACHES REMAIN TOP CONCERN OF MIDDLE MARKET EXECUTIVES

CYBERSECURITY ATTACKS and potential vulnerabilities remain a chief concern among middle market business executives. Threats are constantly evolving, and hackers have continued their focus on the middle market as the pandemic has persisted, MMBI data shows.

Responses to special questions in the latest MMBI survey show slightly fewer middle market executives reporting their company experienced a data breach in the last 12 months—22% compared to 28% last year. However, more organizations than ever (72%) believe unauthorized users will deliberately and illegally attempt to access their data or systems this year.

Ransomware attacks and demands remain prevalent in the middle market, although executives who reported an attack over the last year decreased to 23% this year from 34% in 2021. However, again the number of respondents worried their businesses are at risk of a ransomware attack in the coming year grew, to 62% from 57% last year.

Given the level of concern about potential cyberattacks among middle market leadership, cyber insurance policies have grown in importance. But as the environment becomes more volatile, policies have become more stringent, and many premiums have increased to account for new risks. Sixty-one percent of survey respondents reported they carry a cyber insurance policy, and two-thirds of those (67%) are either familiar or very familiar with what their policy covers. Unfortunately, 44% said premiums had increased somewhat, while another 23% indicated they increased significantly.

Ongoing pandemic-induced supply chain challenges are also reflected in many middle market executives' cybersecurity fears. Over half of companies (55%) with increased, decreased or consistent cyber insurance premiums are either concerned or very concerned about an interruption or delay in receiving products, raw materials or services due to cyberattacks on upstream suppliers.

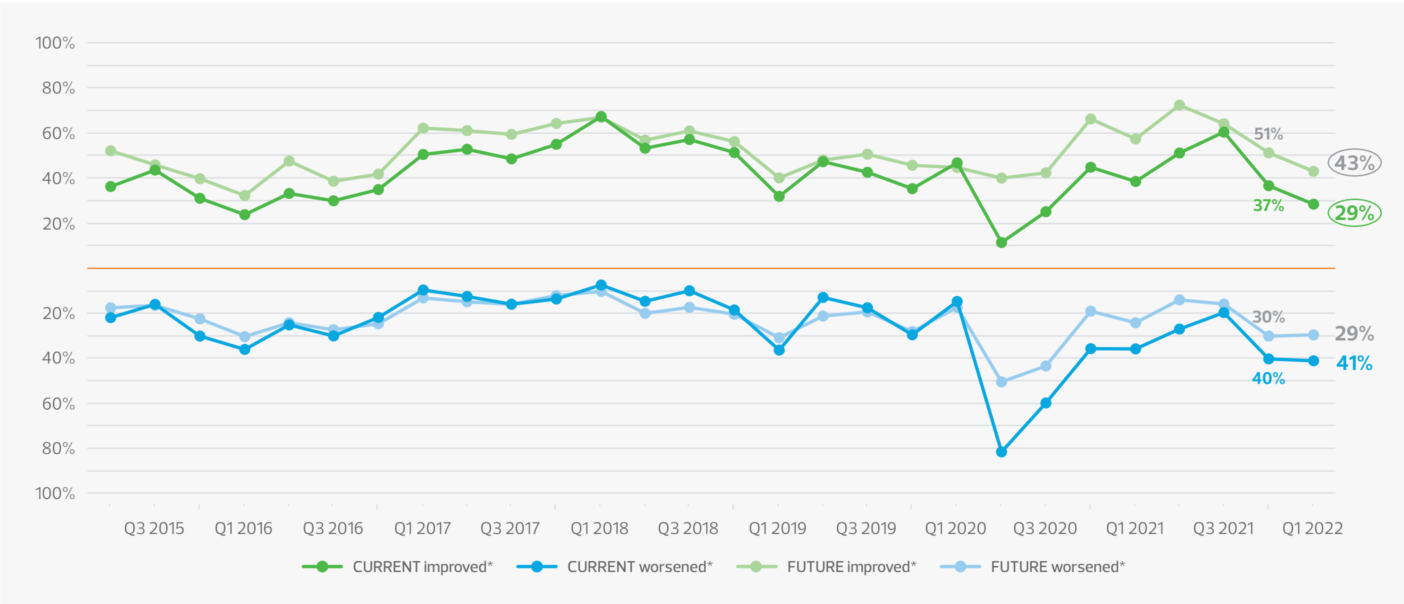
In this quarter's MMBI research, one finance and insurance executive summed up the sentiments of many respondents: "Data security is the biggest headache for our business."

While companies may never be able to eliminate cybersecurity threats, understanding current challenges and using available information to develop a proactive strategy is the first step to alleviating those concerns.

For deeper insights on these topics, look for the RSM US Middle Market Business Index Cybersecurity Special Report due out in June. Given escalating cyberthreats following Russia's invasion of Ukraine, data security continues to be a concern. The report will detail various cybersecurity trends that have emerged through seven years of data.

GENERAL ECONOMY PERFORMANCE

Twenty-nine percent of respondents said the economy improved in January, down from 37% in the previous quarter, and down significantly from the third quarter's 61%.

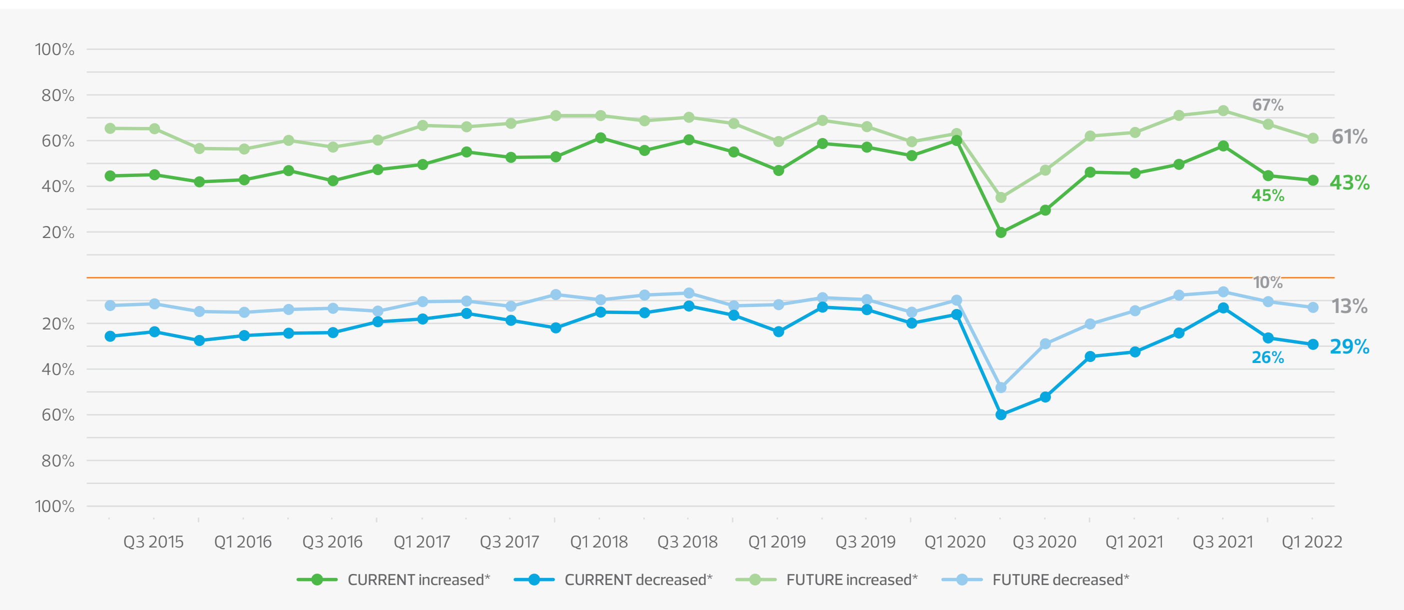


First, thinking about the general economy this quarter versus last quarter, how would you describe the current general economy? Would you say the general economy has…?
What are your expectations regarding the general economy over the next six months? Do you expect the general economy will…?
SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*seasonally adjusted

GROSS REVENUES PERFORMANCE

Sixty-one percent of executives expect future gross revenues to improve, down from last quarter's 67%.

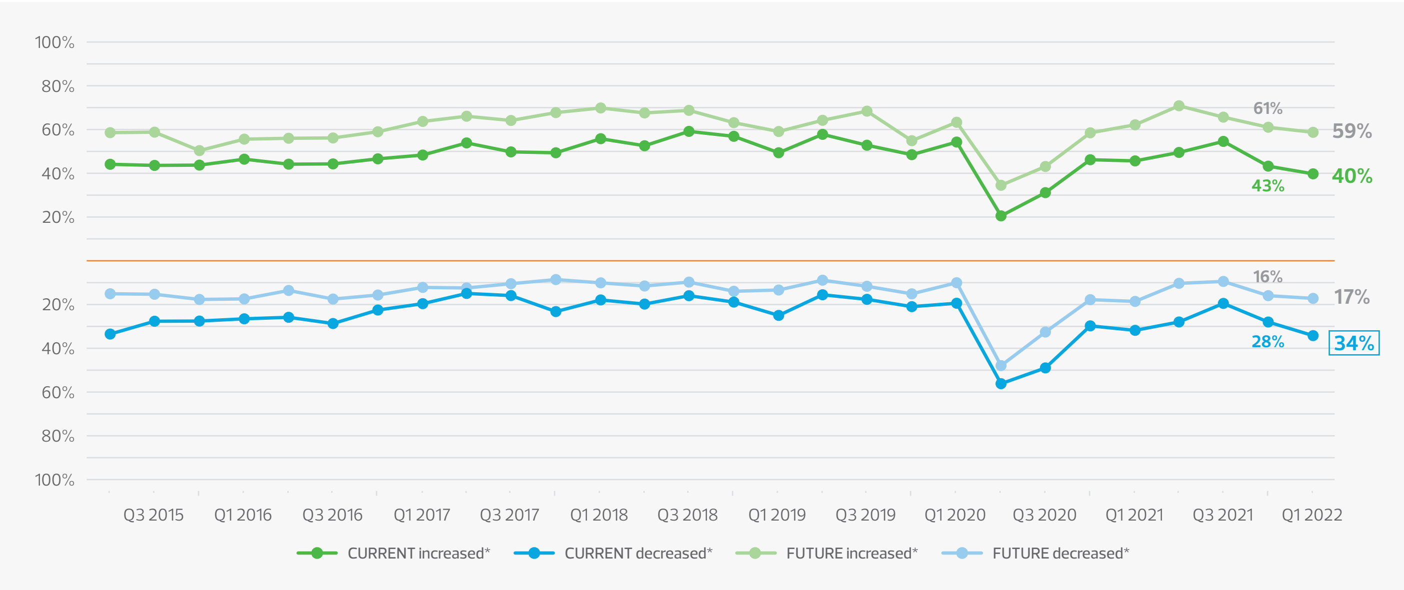


Thinking about your organization's gross revenues/all incoming funds this quarter versus last quarter, how would you describe current gross revenues/all incoming funds? Would you say gross revenues/all incoming funds have…?
What are your expectations regarding your organization's gross revenues/all incoming funds over the next six months? Do you expect gross revenues/all incoming funds to…?

*seasonally adjusted

NET EARNINGS PERFORMANCE

Forty percent of respondents noted an increase in net earnings in the first quarter, down from 43% in the prior quarter.



Thinking about your organization's net earnings (after expenses, etc.) for the most recent quarter results versus the prior quarter results, how would you describe the level of your most recent quarter net earnings results? Would you say net earnings results have…(among those not nonprofits)?

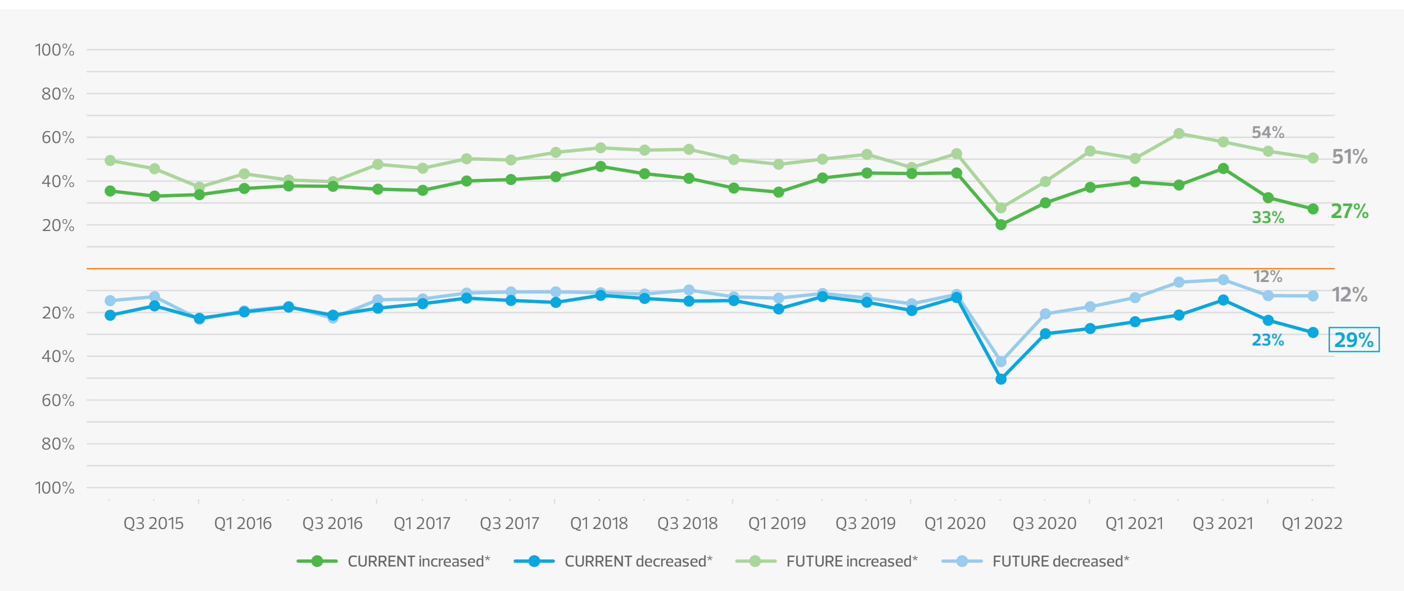
What are your expectations regarding your organization's net earnings results (after expenses, etc.) over the next six months? Do you expect net earnings results to…(among those not nonprofits)?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*seasonally adjusted

AGGREGATE CAPITAL EXPENDITURES/INVESTMENTS PERFORMANCE

Capital spending fell in the first quarter; 27% executives said their business made investments, down from 33% in the previous quarter.



Thinking about your organization's aggregate capital expenditures or investments this quarter versus last quarter, how would you describe your organization's current capital expenditures/investments? Would you say capital expenditures/investments have…?

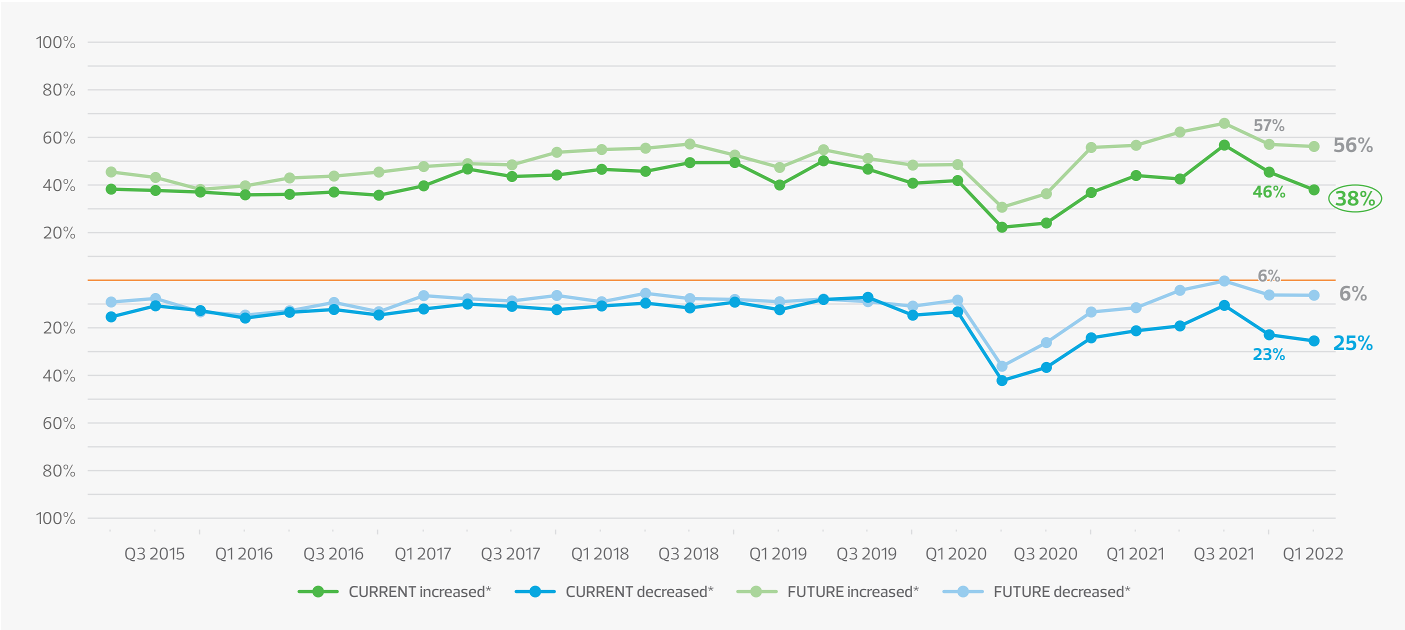
What are your expectations regarding your organization's aggregate capital expenditures or investments over the next six months? Would you say capital expenditures/investments will…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*seasonally adjusted

OVERALL HIRING LEVELS

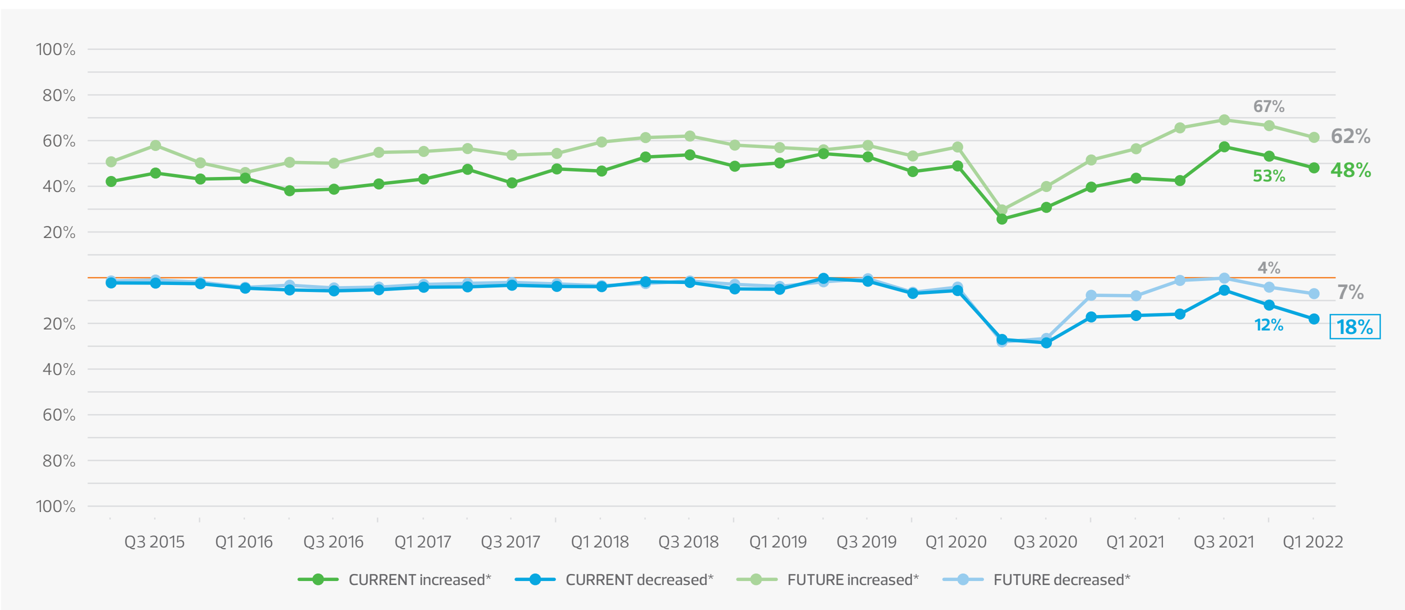
Hiring slid in the first quarter, with 38% of executives indicating they added staff, compared to 46% last quarter.



Thinking about your organization's overall hiring levels this quarter versus last quarter, how would you describe your current hiring levels? Would you say hiring levels have…? *seasonally adjusted
What are your expectations regarding your organization's overall hiring levels over the next six months? Do you expect hiring levels to…?
SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

EMPLOYEE COMPENSATION

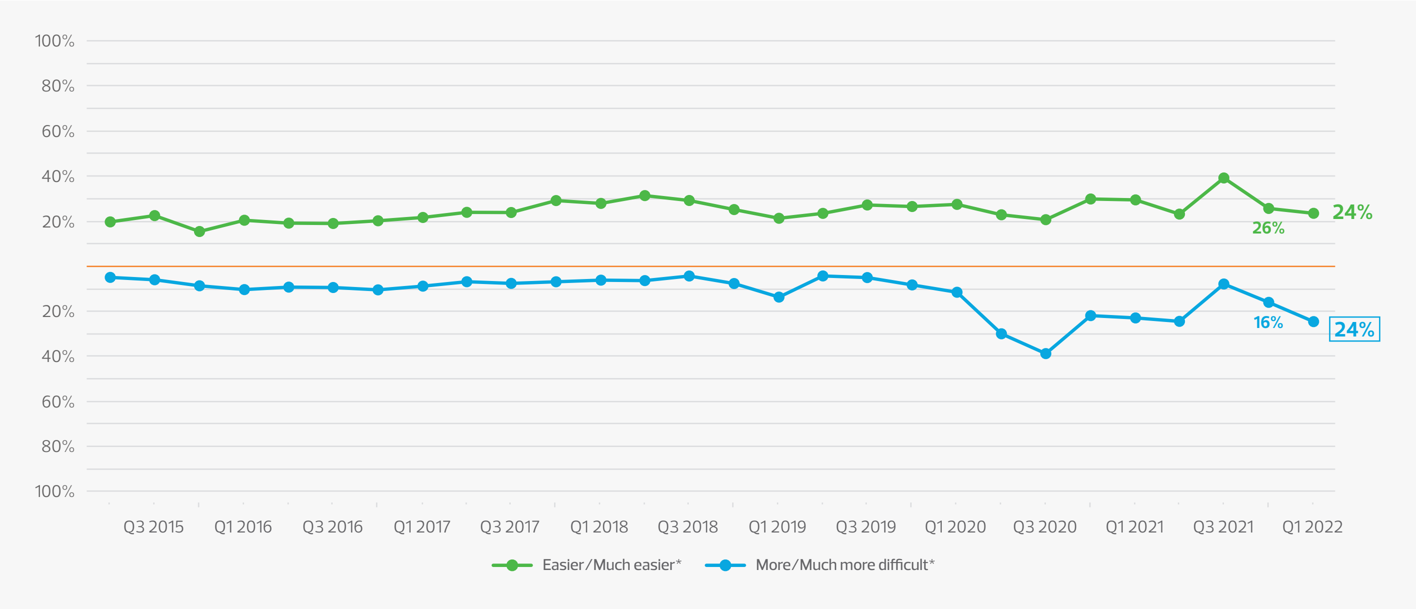
Forty-eight percent of respondents indicated worker compensation increased, down from the previous quarter's 53%.



Thinking about employee compensation at your organization this quarter versus last quarter, how would you describe the current employee compensation level on average? Would you say employee compensation, on average, has…? *seasonally adjusted
What are your expectations regarding your organization's employee compensation over the next six months? Would you say employee compensation, on average, will…?
SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

ACCESS TO CREDIT

Twenty-four percent of survey respondents indicated that loans were easier to get in January, just slightly down from last quarter's 26%, and on par with pre-pandemic sentiment.



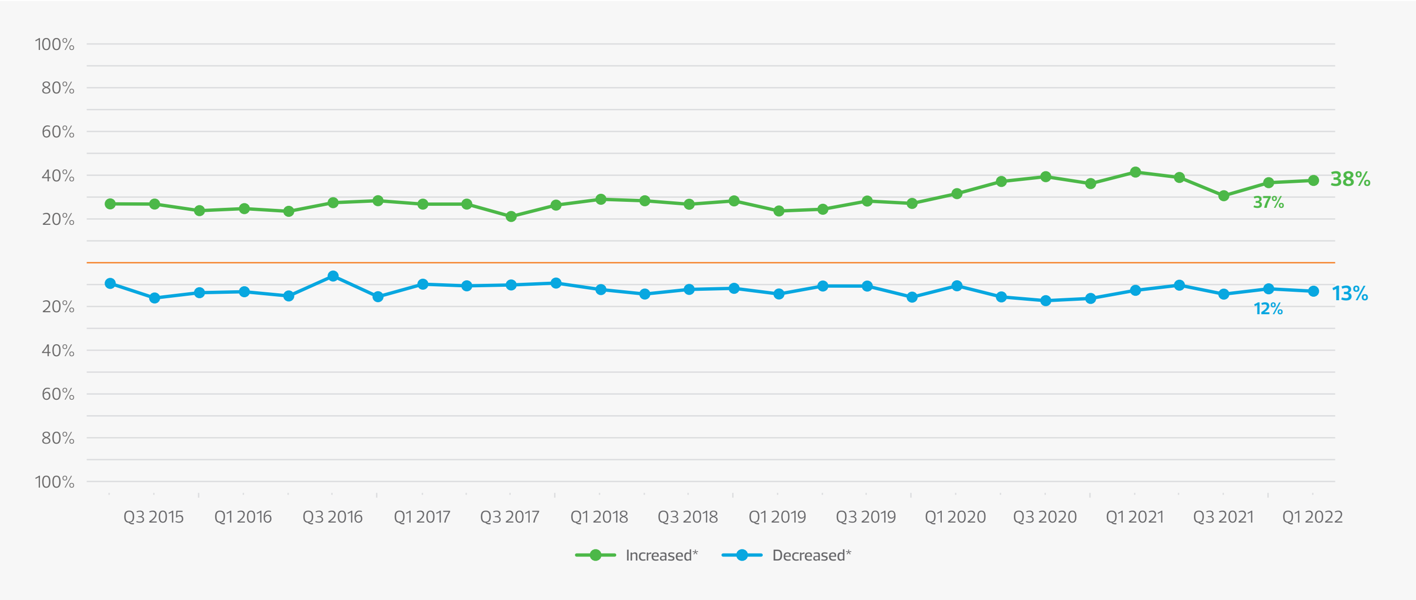
Thinking about the availability or ease with which your organization can borrow money this quarter versus last quarter, how would you describe current access to credit? Would you say that accessing credit is…?

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*seasonally adjusted

PLANNED BORROWING

Thirty-eight percent of respondents plan to take on more debt over the next six months, nearly unchanged from last quarter's 37%.

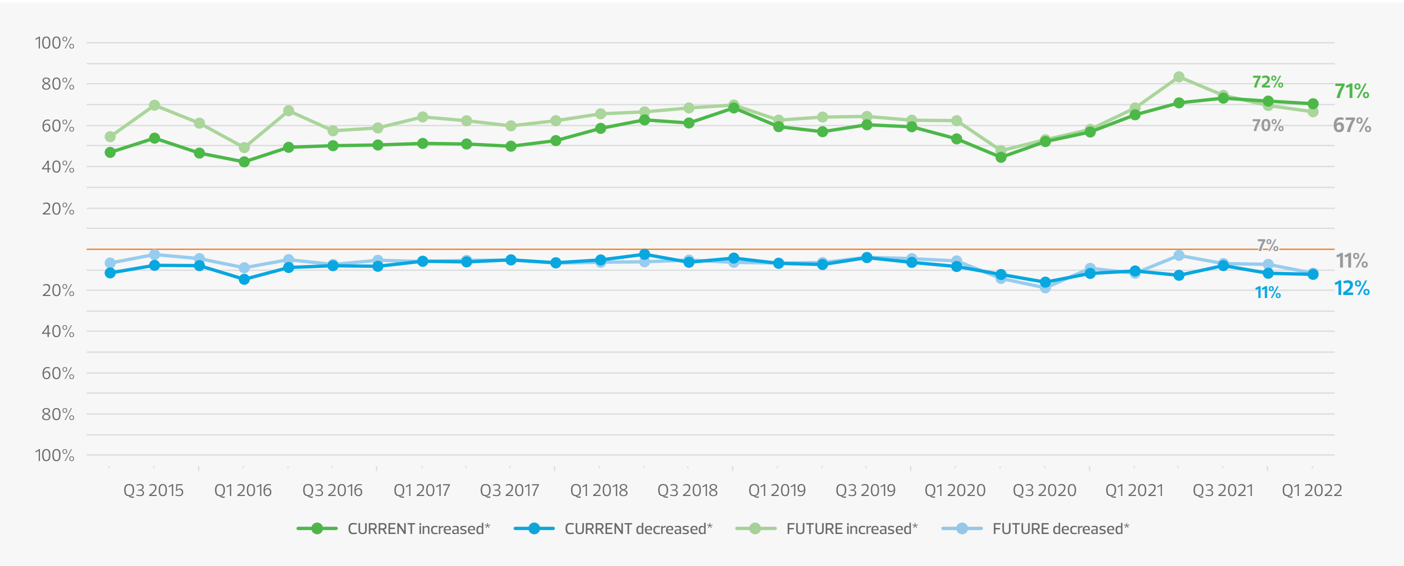


What are your expectations regarding your organization's planned borrowing over the next six months? Would you say your organization's borrowing will…?

*seasonally adjusted

AMOUNT PAID FOR GOODS AND SERVICES

Seventy-one percent of middle market businesses paid more for goods and services this quarter, down slightly from 72% in the prior quarter.



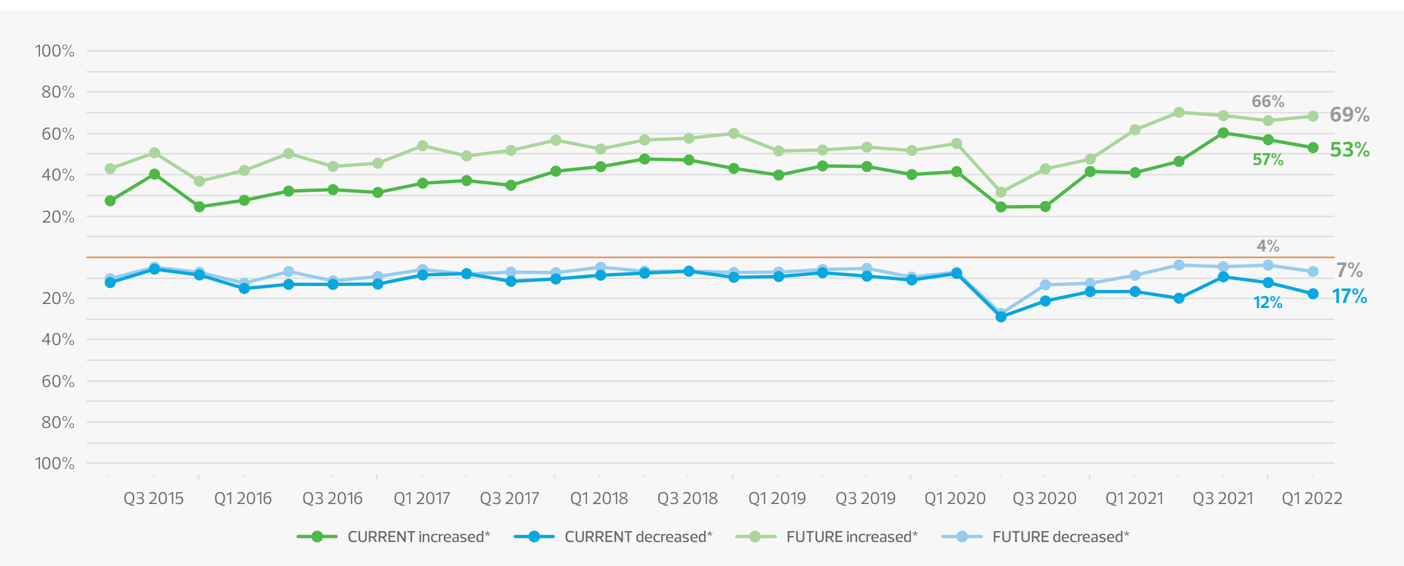
Thinking about the prices that your organization pays for all goods and services, except labor, this quarter versus last quarter, how would you describe the current general level of prices paid? Would you say prices paid, on average, have…?

What are your expectations regarding the general level of prices that your organization will pay for all goods and services, except labor, over the next six months? Would you say prices paid, on average, will…?

*seasonally adjusted

AMOUNT RECEIVED FOR GOODS AND SERVICES

Fifty-three percent of midsize organizations received higher prices for their own goods and services in the first quarter, down from 57% in the previous quarter.



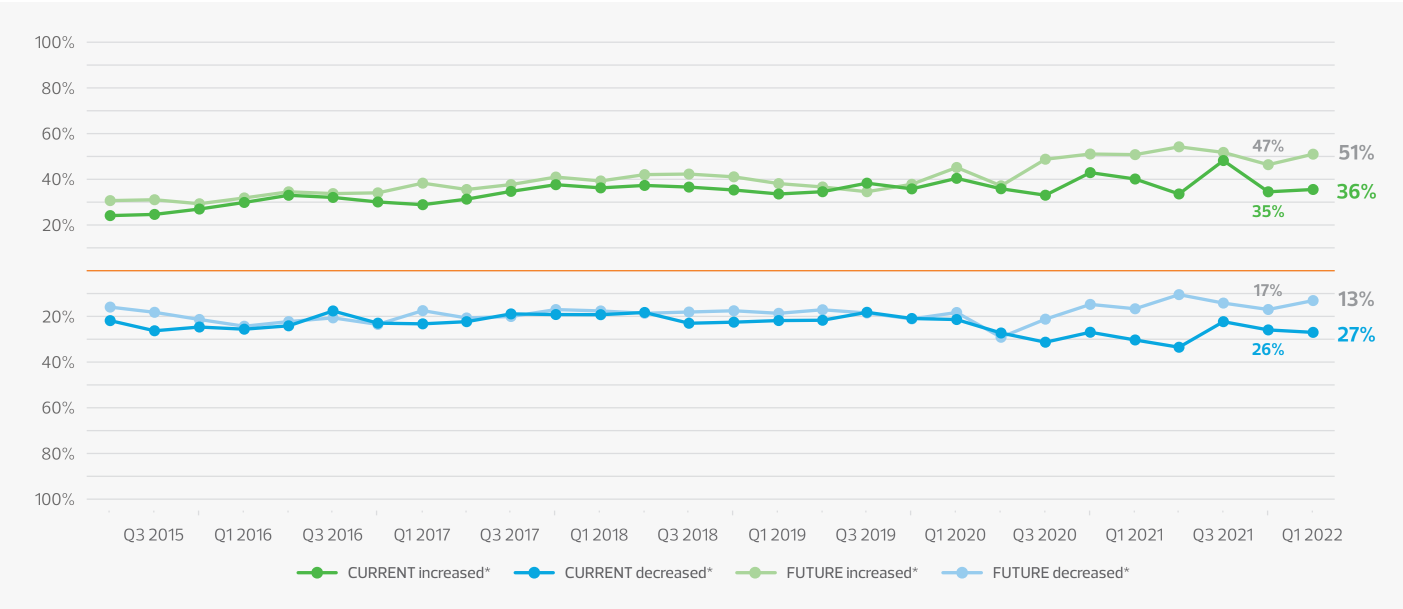
Thinking about the prices that your organization received for all of its goods and services this quarter versus last quarter, how would you describe the current general level of prices received? Would you say prices received by your organization, on average, have (among those not nonprofits)…?

What are your expectations regarding the general level of prices that your organization will receive for all goods and services over the next six months? Would you say the prices received by your organization, on average, will…(among those not nonprofits)?

*seasonally adjusted

INVENTORY LEVELS

Thirty-six percent of executives indicated increased inventories in the first quarter, slightly up from last quarter's 35%.



Thinking about your organization's inventory levels this quarter versus last quarter, how would you describe current inventory levels? Would you say inventory levels have…?
What are your expectations regarding your organization's planned inventory levels over the next six months? Would you say your inventory levels will…(among those that have inventory)?

*seasonally adjusted

How the MMBI is constructed

The MMBI is born out of the subset of questions in the survey that ask middle market executives to report the change in a variety of indicators. Middle market executives are asked a total of 20 questions patterned after those in other qualitative business surveys, such as those from the Institute of Supply Management and the National Federation of Independent Businesses.

The 20 questions relate to changes in various measures of their business, such as revenues, profits, capital expenditures, hiring, employee compensation, prices paid, prices received and inventories. Middle market executives are asked to report the change from the previous quarter and to state the likely direction of these same indicators six months ahead. See a sample of the questions in the table.

The MMBI is a composite index computed as an equal weighted sum of the diffusion indexes for 10 survey questions plus 100 to keep the MMBI from becoming negative. The index is designed to capture both current and future conditions, with five questions on middle market executives' recent experience and five on their expectations for future activity.

RSM US Middle Market Business Index questions

- What are your expectations regarding the general economy?
- What are your expectations regarding your organization's gross revenues?
- How would you describe the level of your organization's most recent quarter net earnings results?
- What are your expectations regarding your organization's aggregate capital expenditures or investments?
- What are your expectations regarding your organization's overall hiring levels?
- How would you describe your organization's current employee compensation level on average?
- How would you describe current access to credit?
- What are your expectations regarding your organization's planned borrowing?
- How would you describe the current general level of prices received?
- What are your expectations regarding your organization's planned inventory levels?

For more information on RSM, please visit **rsmus.com**.

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