

RSM US MIDDLE MARKET
**BUSINESS
INDEX**

IN PARTNERSHIP WITH THE
U.S. CHAMBER OF COMMERCE

Q3 2021



U.S. CHAMBER OF COMMERCE



RSM US MIDDLE MARKET **BUSINESS INDEX** IN PARTNERSHIP WITH THE U.S. CHAMBER OF COMMERCE

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 700 middle market executives, and is designed to accurately reflect conditions in the middle market. The data is weighted to ensure that they correspond 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.

In March 2020, RSM began conducting the economic portion of the MMBI survey on a monthly basis to capture the effects of the COVID-19 crisis on the middle market. This report was fielded between July 8 to July 26, 2021, and based on the responses of 413 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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AMERICAN MIDDLE MARKET BUSINESS CONDITIONS POINT TO CONTINUED ROBUST ECONOMIC GROWTH, RISING REVENUES AND NET EARNINGS....

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.

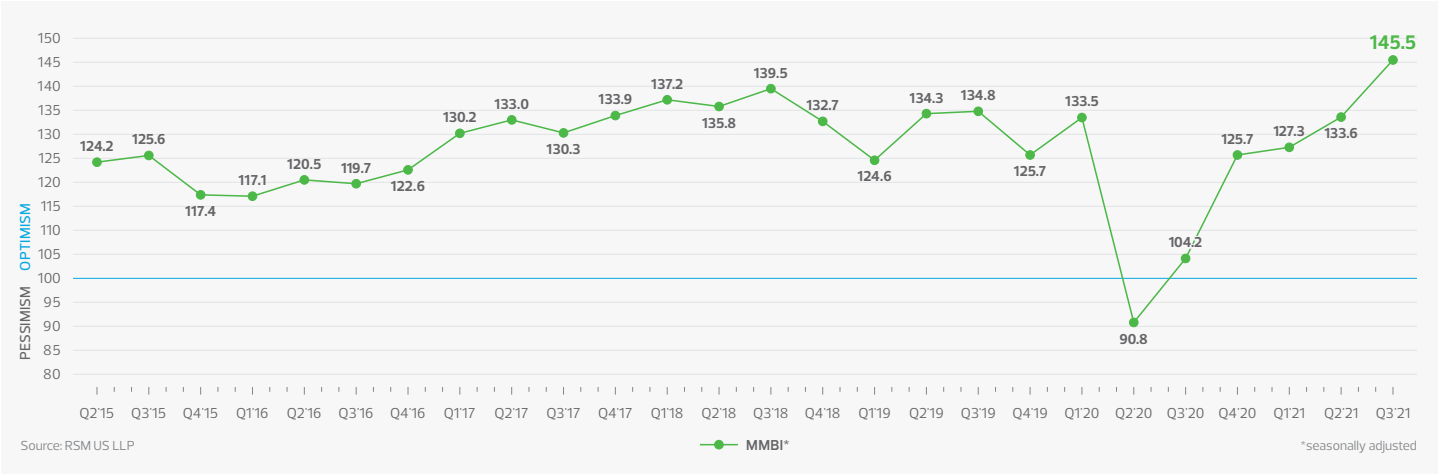
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“The economy has taken off this quarter with middle market business leaders seeing rising revenues, increased consumer demand, and better business conditions with loosened COVID-19 restrictions. But the surge comes with remaining supply chain issues and difficulty finding workers,” said U.S. Chamber Executive Vice President and Chief Policy Officer Neil Bradley. “To sustain our economic recovery, one of the U.S. Chamber’s top priorities right now is working to remove barriers to the workforce. That includes addressing childcare needs, rightsizing unemployment programs, skills training, and increasing legal immigration.”

The topline business conditions index increased from 133.6 in the second quarter to 145.5 in the third quarter of 2021, an all-time high in the MMBI survey’s history.

RSM US MIDDLE MARKET BUSINESS INDEX



RSM MMBI POSTS ALL-TIME HIGH AMID ROBUST GROWTH, HIGHER PRICES

The third-quarter Middle Market Business Index rises to 145.5

BY JOSEPH BRUSUELAS

AMERICAN MIDDLE MARKET business conditions point to continued robust economic growth, rising revenues and net earnings during the third quarter and going forward over the next six months, according to the third-quarter RSM US Middle Market Business Index survey.

Responses from senior executives at middle market businesses to the proprietary survey indicate a willingness to increase compensation to attract labor to meet that growing demand, which bodes well for future growth. The topline business conditions index increased from 133.6 in the second quarter to 145.5 in the third quarter of 2021, an all-time high in the survey's history. The previous all-time high was 139.5 posted in the third quarter of 2018.

Both third-quarter MMBI data and responses to the forward-looking survey questions have captured the economic boom underway in the middle market and the American economy despite higher prices and the fact that companies are passing those costs along to consumers downstream. As such, a strong majority of survey respondents indicated healthy revenue and net earnings in the current quarter and through the end of 2021, which we expect will be the best year of middle market growth over the past four decades.

That said, the latest wave of U.S. COVID-19 cases, largely driven by the rise of the coronavirus delta variant, does denote a measure of risk in the otherwise encouraging outlook. This is also the first time in the survey's history that a majority of respondents are passing price increases to downstream clients.

Sixty-four percent of survey respondents said the broader U.S. economy improved in the current quarter and 65% expect it to do so over the next six months. This is in line with the 59% of respondents that indicated an improvement in gross revenues and the 74% that expect revenues to increase through the remainder of 2021. Not surprisingly, 56% of survey respondents noted a third-quarter improvement in net earnings, and 65% expect a better earnings environment six months ahead.

The U.S. economy grew at an average of 6.4% in the first half of the year, the strongest pace of expansion since the 1980s. This underscores the encouraging improvement across RSM's MMBI data and the optimistic forward look embedded in the survey.

As one might expect, middle market firms have started to restock ahead of the traditional holiday shopping season; 48% of survey respondents indicated that they have started to rebuild inventories in contrast with the 34% that





reported doing so last quarter, while 54% implied they expect to do so going forward through the end of the year. Given that one of the factors that damped gross domestic product during the first half of the year was an inventory correction, we think that this will present a tail wind to the overall economy and middle market in the current quarter and second half of the year.

Pandemic pricing

The primary challenge for businesses, however, continues to be the pricing environment as the global and domestic economies continue to grapple with supply chain constraints and shortages of goods used at earlier and intermediate stages of production. Seventy-four percent of survey respondents indicated that they paid higher prices for inputs and 76% noted that they expect to do so over the next six months. Notably that 76% figure marks a decline from 85% in our previous quarterly report and is aligned with indications from the [July U.S. consumer price index](#) that the recent five-month burst of inflation is starting to moderate and likely posted a cyclical peak in pricing pressures.

In the third quarter, 62% of respondents reported an increase in prices received and 69% indicated they expect to continue charging higher prices through the end of 2021.

In our estimation, the window to pass price increases downstream may turn out to be brief. Inside wholesale pricing and broader inflation aggregates, we can already observe moderation in price increases and, in some cases, outright declines as supply chains slowly normalize. Many of the categories that have been the primary catalysts behind the surge in pricing are highly idiosyncratic and as a result, the increases are likely not to persist.

We expect that by the end of 2022, the pre-pandemic inflation trend of around 2% will likely reassert itself and the risks of oversupply in some cases will present other challenges that will damp the willingness of downstream clients to accept higher prices.

Labor and investment

Middle market firms continue to signal increased demand for labor and the ability to increase compensation to attract workers. In the current quarter, 58% of respondents indicated they increased hiring and 67% noted they expect to do so through the end of the year. A first in this survey was the fact that zero respondents in the third quarter stated that they expect to decrease hiring over the next six months, which underscores the strength of American middle market business conditions.



As one would anticipate, firms are going to have to increase compensation to attract labor following the significant disruptions that have characterized work throughout the pandemic. Thus, 58% of respondents indicated they increased compensation to attract labor in the current quarter and 70% expect to do so going forward.

Looking ahead as schools reopen, child care becomes more readily available and unemployment insurance is phased out in September, it will be interesting to see if that willingness to increase compensation to attract labor remains at current levels.

Finally, 47% of survey respondents indicated that they increased capital expenditures and 59% said they intend to do so looking ahead.

For some time we have indicated that the ability of midmarket firms to thrive in the post-pandemic economy will depend upon increasing their investment in productivity-enhancing technologies and strategies. Given the recent increase in prices and the tight labor market faced by many midmarket firms, increasing efficiencies via productivity-enhancing capital expenditures needs to remain at the core of firm strategy. This will help position businesses to address the unique confluence of challenges and opportunities that lie ahead for the companies that populate the American real economy. ■

ESG gains prominence in middle market

As gender equity, climate, racial equality, income disparity and other social issues gain national prominence, the role of corporations around social imperatives has come to the fore. It's not surprising that middle market businesses have now elevated environment, social and governance (ESG) measures as a priority for their businesses.

Forty-one percent of respondents indicate that their organizations have devised a formal plan around ESG issues, led by larger middle market businesses, or those with annual revenue of \$50 million to \$1 billion. Nearly all of the midsize companies with a formal ESG plan indicated they had committed to a corporate structure and reporting that incorporates social responsibility or environmental initiatives. Sixty-six percent have a senior executive primarily focused on ESG issues.

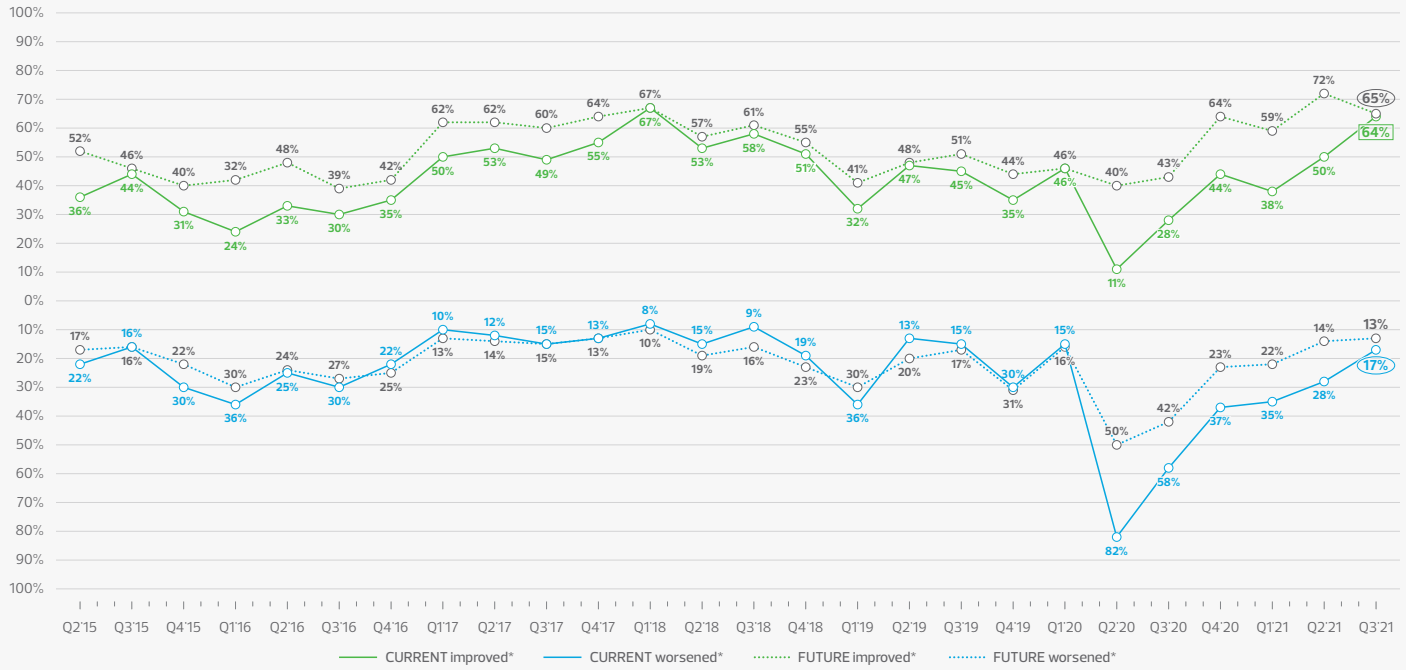
Environmental issues, fair trade, community health and wellness, support for underrepresented businesses and support for minority-led startups were among the top issues that middle market executives cited in their companies' ESG plans. Of these, 84% of respondents said that ESG measures would be used to evaluate their companies' performance. Executives cited a range of reporting standards from Sustainable Development Goals to Global Reporting Initiative Standards, among others.

RSM will release the full findings around special questions on ESG and climate issues in a larger report in October.



GENERAL ECONOMY PERFORMANCE

Sixty-four percent of respondents said the economy improved in July, up from 50% last quarter. Nearly two-thirds see improvement continuing over the next six months.

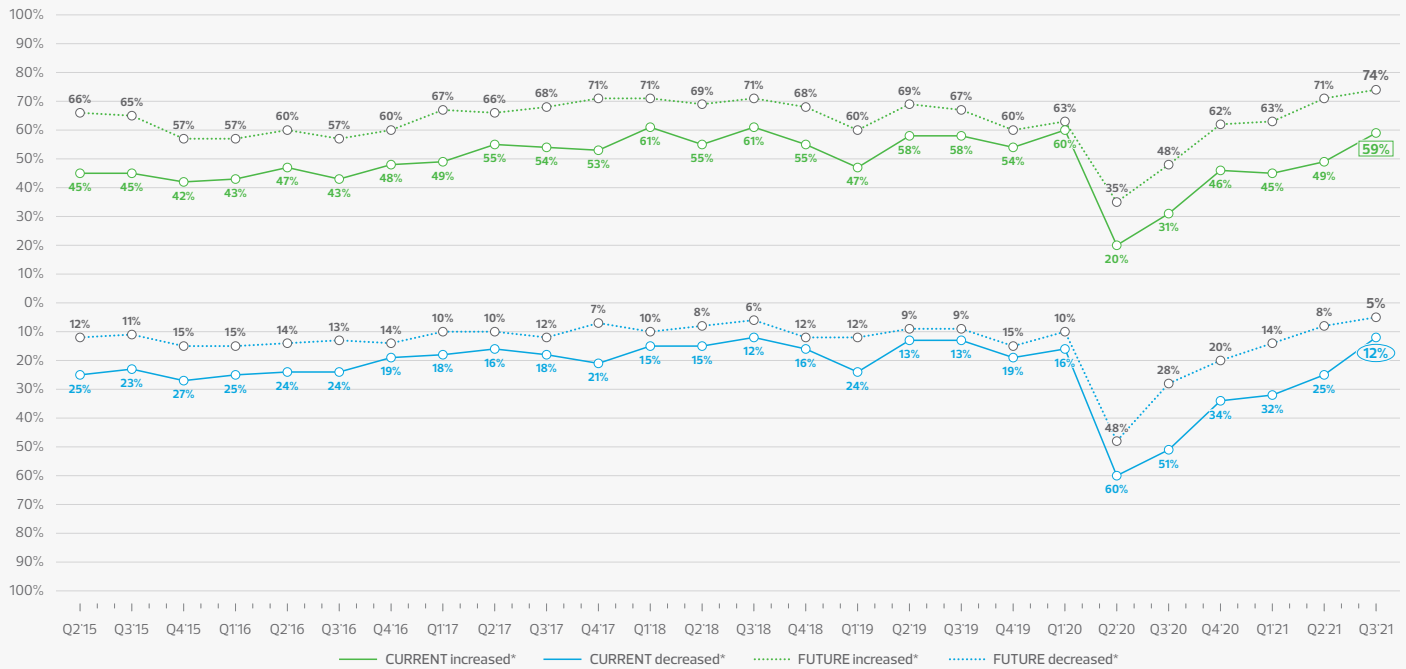


- First, thinking about the general economy this quarter versus last quarter, how would you describe the current general economy? Would you say the general economy has...?
 - What are your expectations regarding the general economy over the next six months? Do you expect the general economy will...?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

*seasonally adjusted

GROSS REVENUE PERFORMANCE

Fifty-nine percent of executives surveyed said gross revenues improved in the third quarter, a 10 percentage point improvement from last quarter.

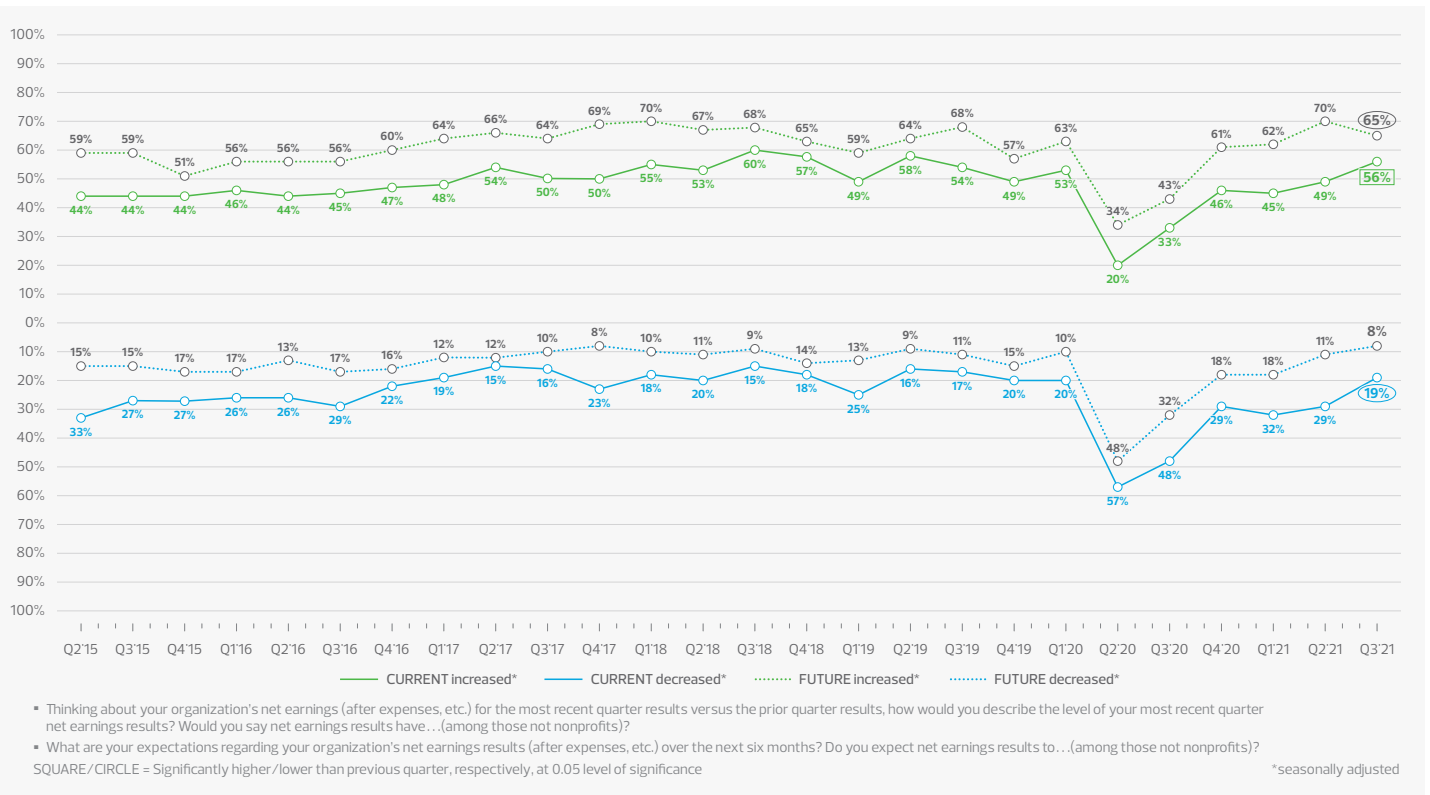


- Thinking about your organization's gross revenues/all incoming funds this quarter versus last quarter, how would you describe current gross revenues/all incoming funds? Would you say gross revenues/all incoming funds have...?
 - What are your expectations regarding your organization's gross revenues/all incoming funds over the next six months? Do you expect gross revenues/all incoming funds to...?
- SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at 0.05 level of significance

*seasonally adjusted

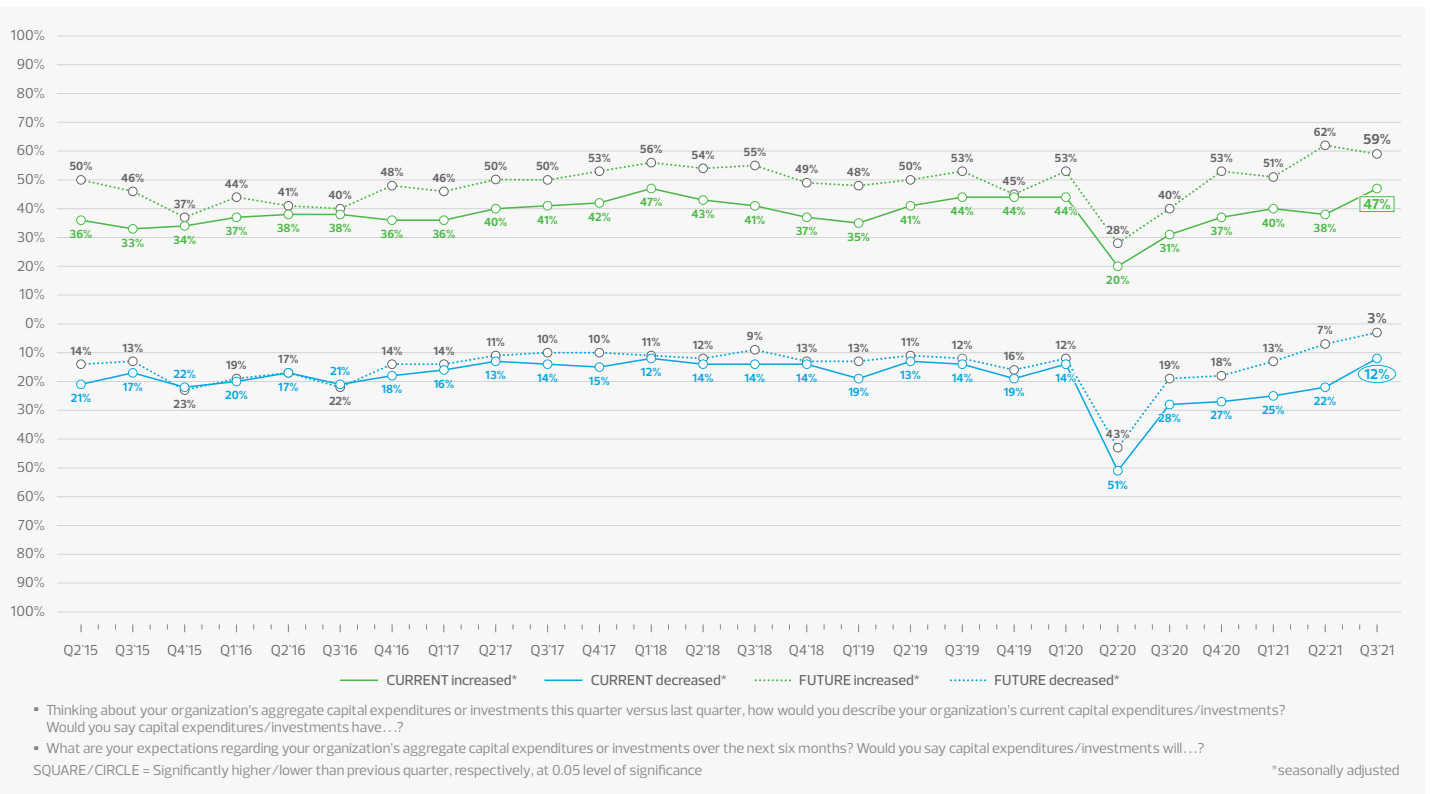
NET EARNINGS PERFORMANCE

Fifty-six percent of respondents noted an increase in net earnings in the third quarter, a significant jump from last year's third-quarter reading of 33%.



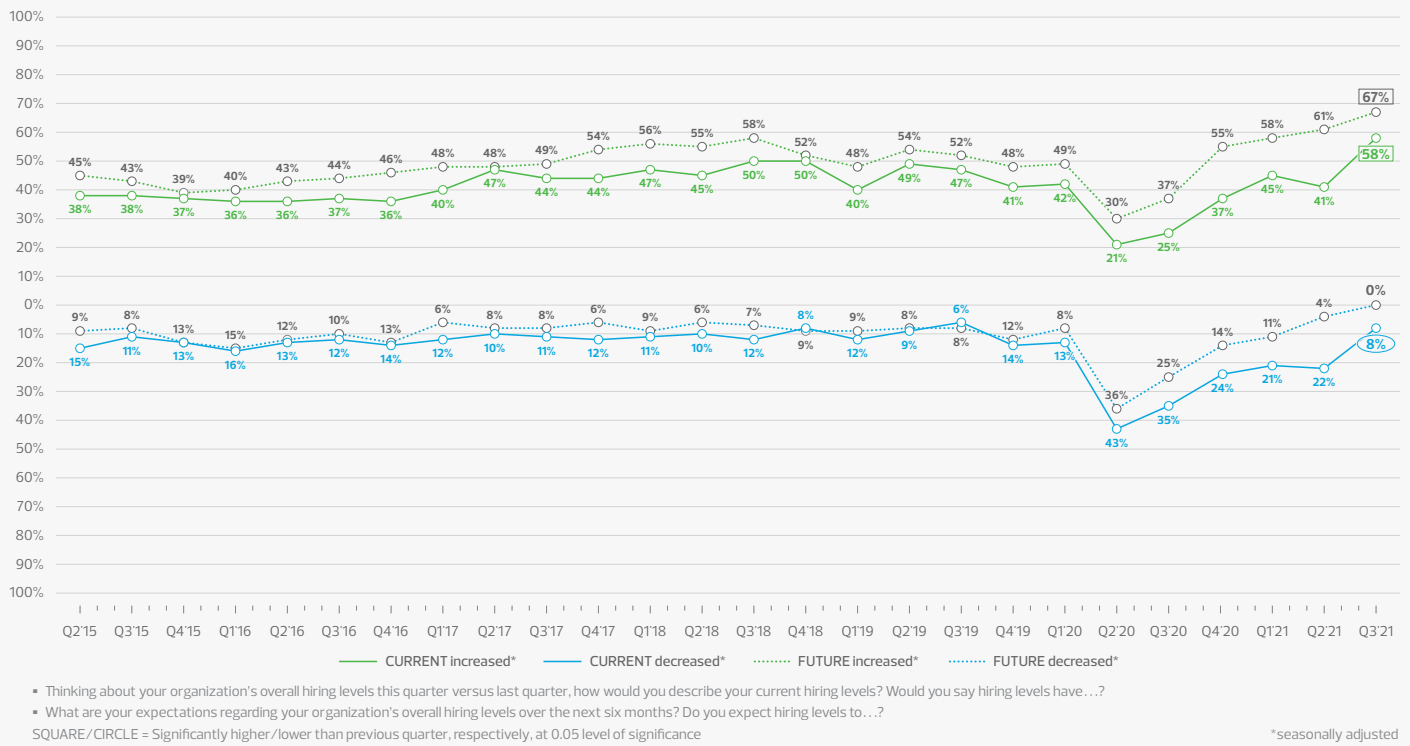
AGGREGATE CAPITAL EXPENDITURES/INVESTMENTS PERFORMANCE

Forty-seven percent of executives said their business made capital investments in the third quarter, up sharply from 38% the previous quarter.



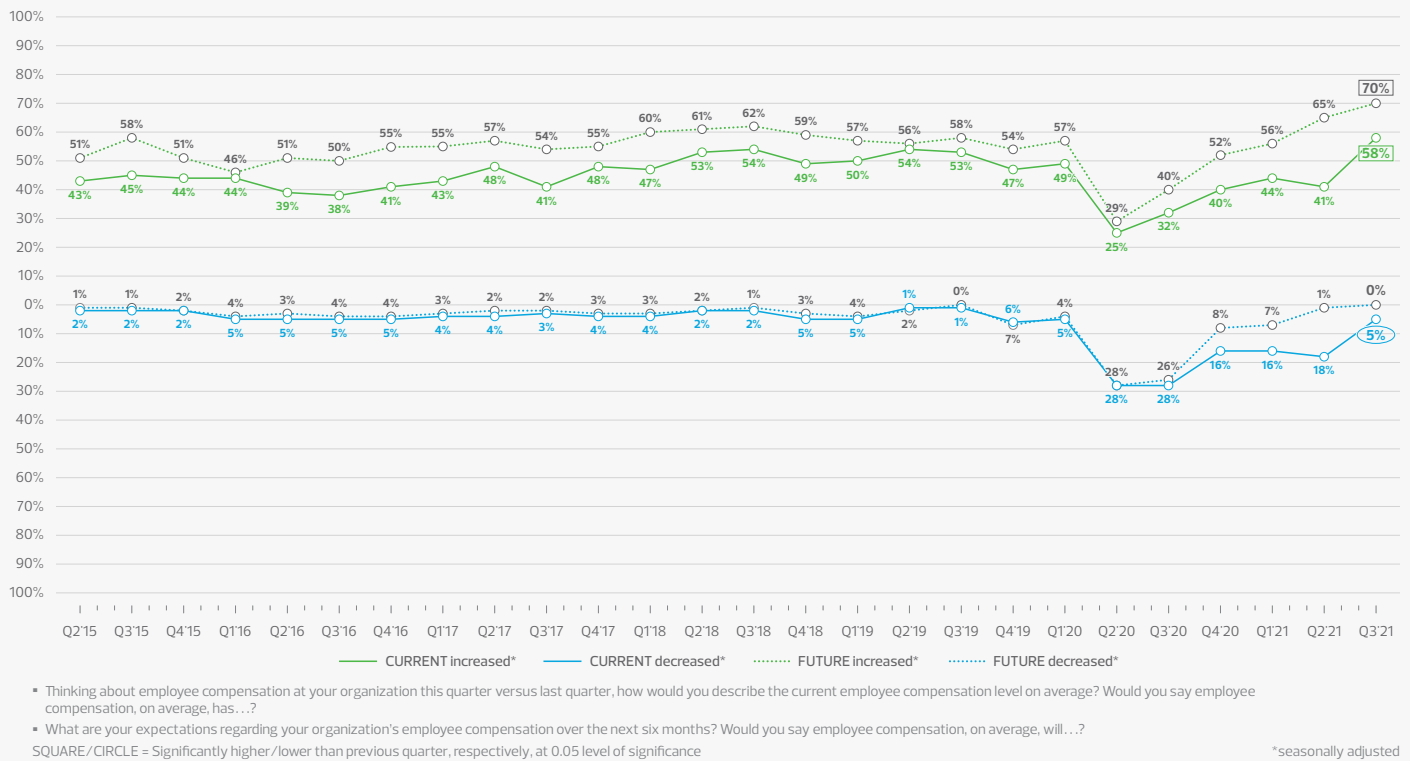
OVERALL HIRING LEVELS

Hiring jumped sharply in the third quarter, with 58% of executives indicating they added staff, compared to 41% last quarter.



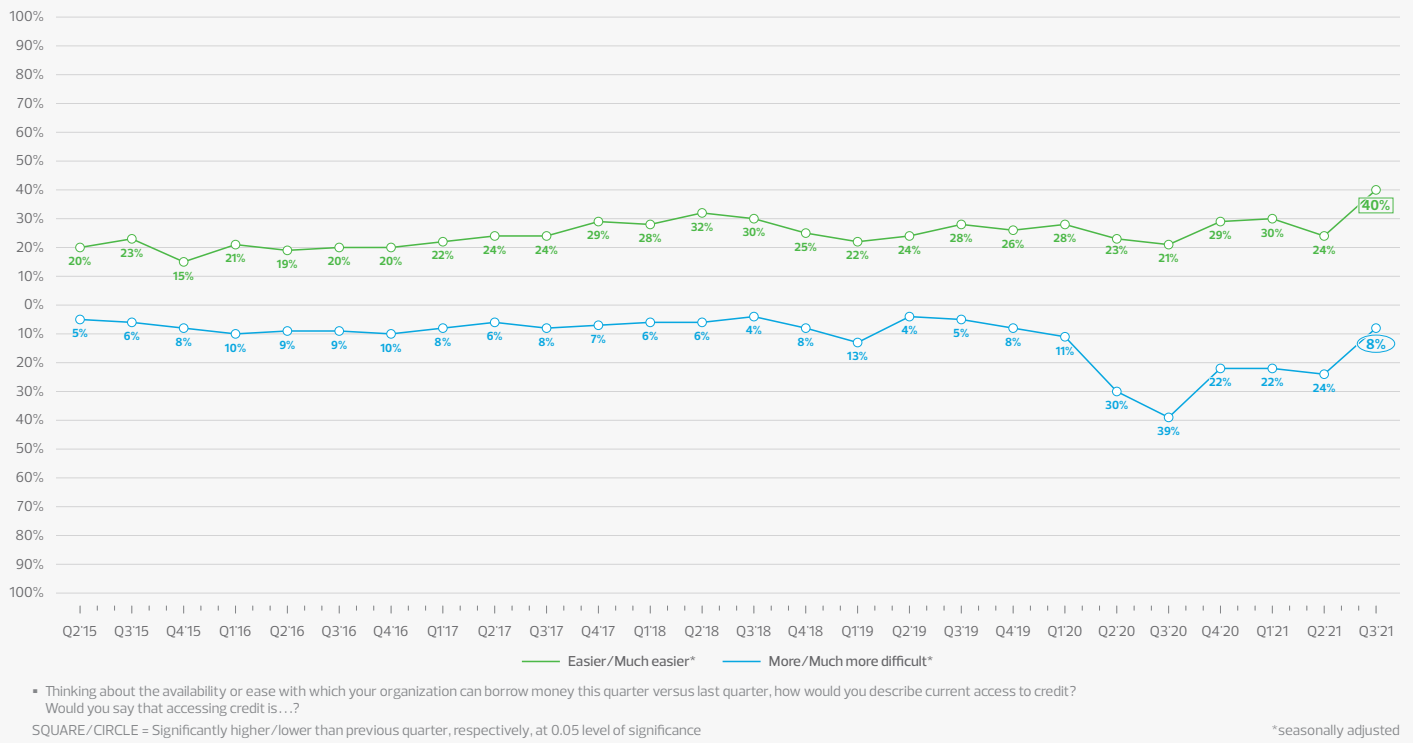
EMPLOYEE COMPENSATION

Worker compensation increased significantly in the third quarter, with 58% of respondents indicating they boosted wages, up from 41% in the second quarter. Seventy-percent expect to boost compensation over the next six months.



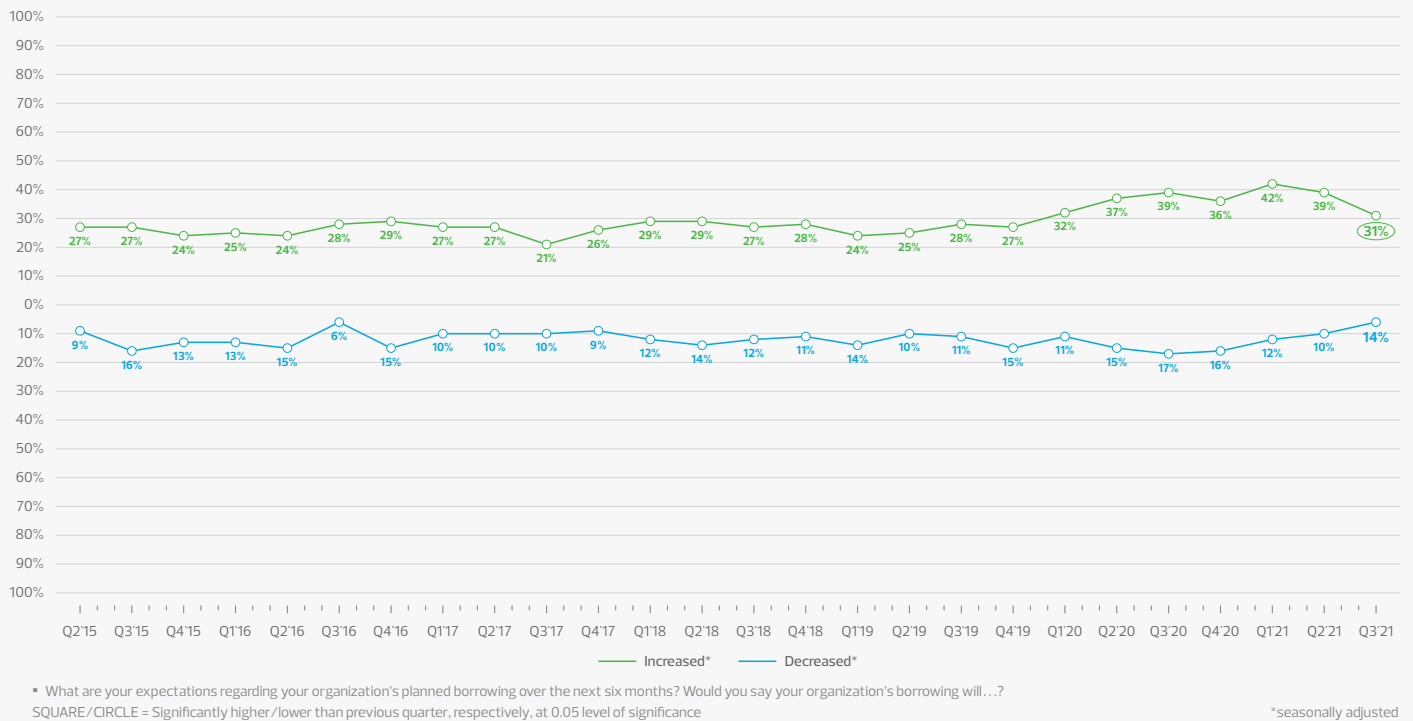
ACCESS TO CREDIT

Forty percent of survey respondents indicated that loans were easier to get in the third quarter, up sharply from 24% in the prior period.



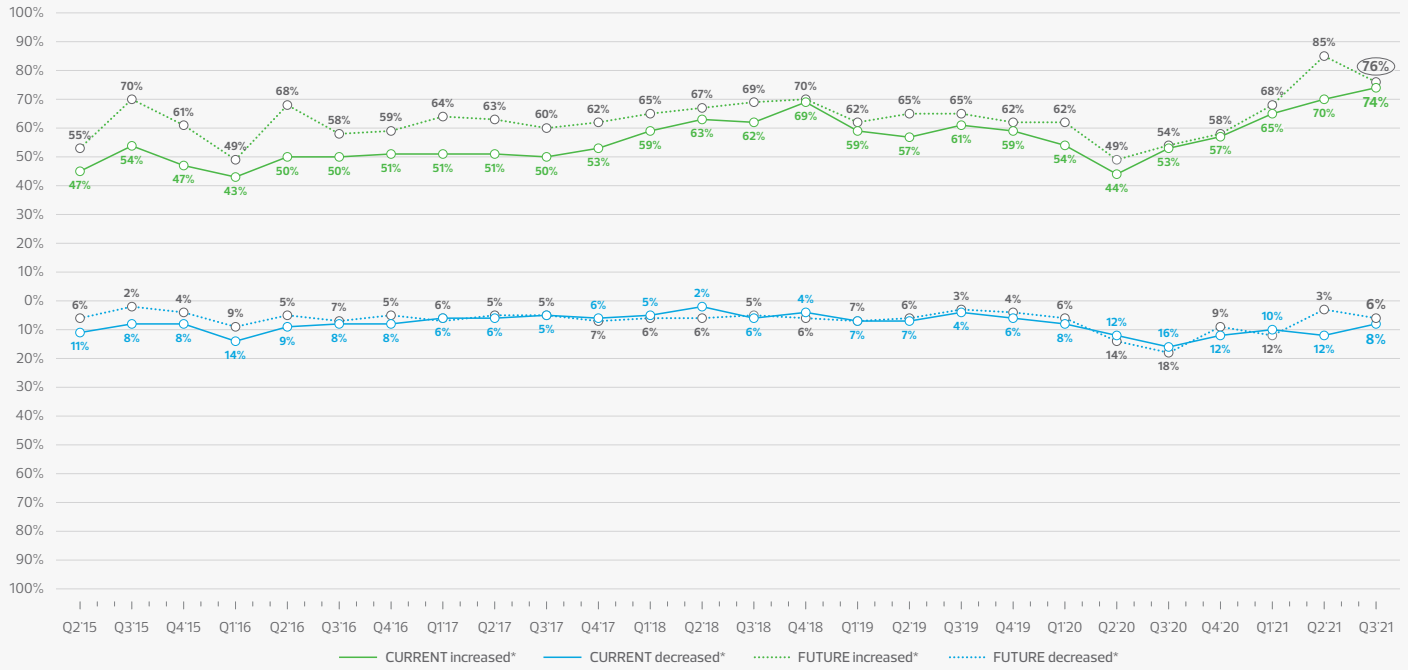
PLANNED BORROWING

Middle market companies plan to take on less debt over the next six months than they did in the second quarter; 31% of respondents indicated they would boost future borrowing, down from 39%.



AMOUNT PAID FOR GOODS AND SERVICES

The cost of goods and services to middle market businesses was higher in the third quarter, continuing an upward trend that began a year ago. Seventy-four percent of executives polled said their companies paid more, and a majority indicated they expect pricing pressure in the future.



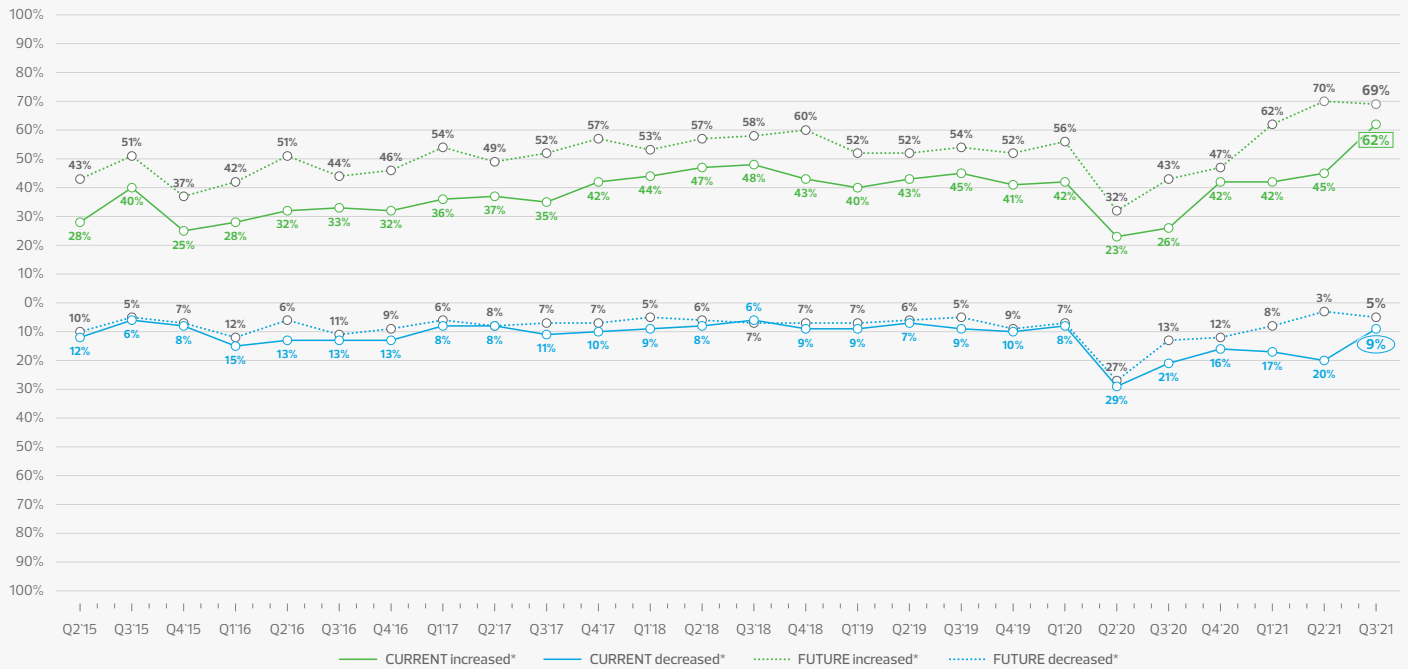
- Thinking about the prices that your organization pays for all goods and services, except labor, this quarter versus last quarter, how would you describe the current general level of prices paid? Would you say prices paid, on average, have...?
- What are your expectations regarding the general level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

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

*seasonally adjusted

AMOUNT RECEIVED FOR GOODS AND SERVICES

Midsize organizations received significantly higher prices for their own goods and services in the third quarter, according to 62% of respondents, up from 45% in the second quarter. More than two-thirds expect this trend to continue over the next six months.



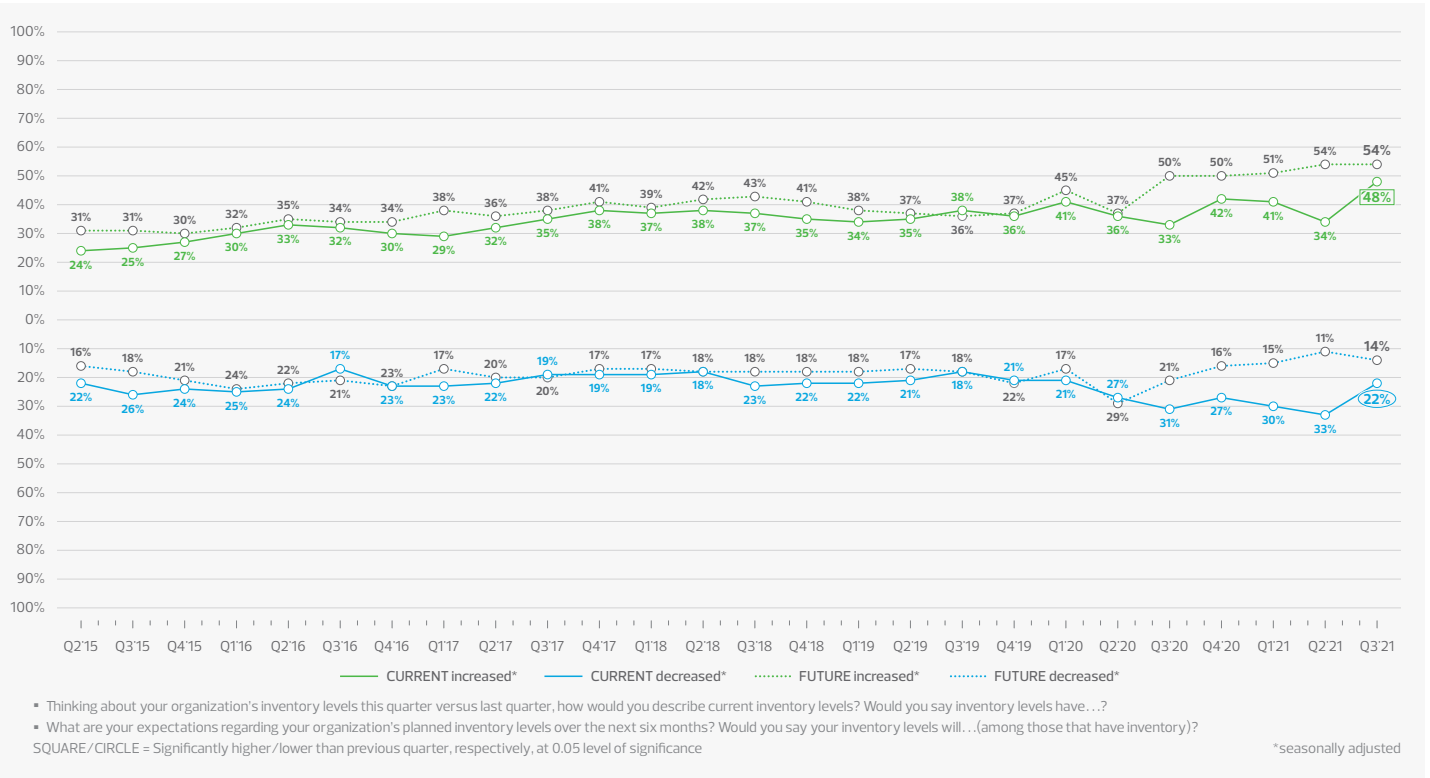
- Thinking about the prices that your organization received for all of its goods and services this quarter versus last quarter, how would you describe the current general level of prices received? Would you say prices received by your organization, on average, have (among those not nonprofits)...
- What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

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

*seasonally adjusted

INVENTORY LEVELS

Inventories at middle market companies rose in the third quarter, according to nearly half of executives polled. Thirty-four percent had indicated increasing inventories in the second quarter.



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

How the MMBI is constructed

The MMBI is borne 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?

REAL BUSINESS INSIGHTS FOR MIDDLE MARKET COMPANIES

Check out *The Real Economy: Industry Outlook* and get data-driven, sector-specific insights from RSM's senior industry analysts, a select group of professionals dedicated to studying economic and industry data, market trends and the emerging issues faced by middle market businesses like yours.

Each outlook provides unique perspectives and planning opportunities affecting businesses in the following industries:

- Business and professional services
- Consumer products
- Financial services
- Health care
- Manufacturing and energy
- Life sciences
- Real estate and construction
- Technology, media and telecom

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