Deloitte.

Mid-market perspectives
2014 report on America's economic engine

Contents

Executive summary

During the four years Deloitte has been surveying U.S. mid-market executives about their business prospects and plans, the country has been mired in one of the most sluggish and anemic economic recoveries in its history. Growth has remained lackluster and subject to fits and starts, the labor market has added jobs but at a modest clip, and increased demand from businesses and consumers has proven inconsistent.

Yet, the executives who lead these companies and help drive America's economic engine haven't let the uncertainty stop them from investing in their businesses. Building on momentum established over the last year, responses to the current survey continue to depict a middle market that is adding jobs, moving ahead with capital projects and investing in technology – albeit at a measured pace.

In our last two annual surveys (2012 and 2013), the results portrayed a middle market that was cautiously optimistic and measured in its investments for growth. The current survey, which captured the views of more than 500 mid-market executives, suggests they are now stepping up these efforts. By and large, the respondents see the economy emerging stronger from a temporary winter slowdown on its march toward improvement since emerging from the recession.

The executives' persistent optimism in spite of lingering uncertainty underscores what an important and resilient contributor the middle market is to the U.S. economy. The uptick in sentiment and investment detailed in the pages that follow suggests that mid-market executives recognize what commercial pilots have known along: If you only flew when conditions were perfect, you wouldn't go very far. The reality is that businesses often have to act on imperfect or incomplete information, lest they miss out on market opportunities and cede the ground to their competitors. Our latest survey carries home this point on a number of levels.

Making needed investments

During the survey period, a number of economic reports indicated slow growth across much of the country, though the weakness was largely blamed on the impact of severe winter weather. Mid-market companies were not immune to the slowdown, as they reported moderating performance across many of their business metrics. Compared to a survey we conducted last fall, fewer executives reported increases in the pace of sales, profits, and productivity and the size of cash balances.

Still, positive signs remain. The vast majority believe the economy will continue to grow over the coming year, with expectations for increased GDP growth higher than those in our 2013 survey. Over the past year, the numbers of those worried that the uncertain economic outlook will curb their company's growth have decreased significantly. And while most believe the level of uncertainty will remain high, executives in these companies aren't letting that stop them from investing for growth. Only 23 percent said their company is deferring major investments due to uncertainty in the business environment, down from 31 percent six months ago and 43 percent a year ago.

Midsized companies cite increasing investments in human capital and technology in particular as a way to support sales growth in the coming year:

- Over the past 12 months, 37 percent said their company increased its full-time headcount; 43 percent expect their company to boost employment over the next 12 months.
- Hiring and training ran second only to the development of new products and services when the executives were asked to list their company's top investment priority over the coming 12 months.
- More than a third of the respondents said one of their company's investment priorities over the coming year will be to upgrade existing IT systems or implement new systems.

Respondents see the economy emerging stronger from a temporary winter slowdown.

In addition, midsized companies report exploring acquisitions as a way to expand and diversify their customer base. Fifteen percent called it "very likely" that their company would make an acquisition in the coming year, and another 17 percent said it was "quite likely."

Focus on the United States, but growing selectively abroad

The United States continues to be the focal point for the vast majority of midsized companies, as the domestic market was the biggest contributor to growth for 91 percent of the companies surveyed. That will likely to be the case again in the year ahead; growing existing markets remained the top choice when executives were asked to identify their company's main growth strategy for the next 12 months.

At the same time, nearly two-thirds of the companies surveyed generate some revenue from international markets, and they see markets such as China, India, South America and Latin America contributing more in the coming year. The increase in globalization is swelling the ranks of the middle class in emerging markets, and many companies are considering how to tap that growth potential.

But operating overseas is not without its challenges. Nearly a quarter of the respondents said their company is considering bringing certain global operations back to the United States, prompted by rising labor and manufacturing costs in other countries. How these firms address these concerns, as well as those around competitive pricing, local regulatory restrictions and economic instability, will likely dictate how successful their international forays ultimately will be.

In the four years Deloitte has been asking mid-market executives about their expectations and future plans, we have witnessed a gradual reawakening. Throughout this summary and ensuing report, you will find insights about how other mid-market leaders are thinking about their businesses. As always, we stand ready to help you evaluate your alternatives and prepare for what is shaping up to be an exciting year to come.

Tom McGee
Deputy Chief Executive Officer, Deloitte LLP

Roger Nanney
National Managing Partner
Deloitte Growth Enterprise Services
Deloitte LLP

About the survey

From March 17 to April 3, 2014, a Deloitte survey conducted by OnResearch, a market research firm, polled 509 executives at U.S. mid-sized companies about their expectations, experiences, and plans for becoming more competitive in the current economic environment. Respondents were limited to executives at companies with annual revenues between $50 million and $1 billion.

Eighty percent of the companies represented were privately held; only 20 percent were public. Of the private companies, 34 percent were family-owned and 32 percent were closely (non-family) held; 34 percent were private-equity backed, VC-backed, employee-owned, or had other ownership structures.

Nearly half of the respondents were owners, board members, or C-suite executives; the remainder included vice-presidents, department or business line heads, or managers. Industries were diverse: those with the largest representation were business/professional services, retail and distribution, consumer products, technology, construction/engineering, and banking and securities.

The full survey results are included in the appendix; some percentages in the charts throughout this report may not add to 100 percent due to rounding, or for questions where survey participants had the option to choose multiple responses.

Finding balance, taking action

Since our last survey was conducted in the fall, sentiment about the economic recovery appears to have picked up steam, even in the face of a winter season that slowed economic activity across much of the country. During our survey period, consumer confidence rose to the highest level since 2008, and officials at the Federal Reserve began planting the seeds for an eventual increase in interest rates. While our respondents believe that a high level of uncertainty remains — and may even be increasing — they report that their companies are moving ahead with needed investments.

Level-setting in the outlook

Ongoing uncertainty about the economy's prospects seems to have become a constant in the minds of most-mid market executives. Thirty-three percent of the executives said the level of uncertainty today is higher than a year ago, up from 30 percent who were asked the same question last spring, and 48 percent said that level is about the same (up from 45 percent).

Importantly only 41 percent said the uncertain economic outlook was an obstacle to their company's growth, down significantly from 59 percent a year ago. This suggests that companies are either adjusting to the persistent, high level of uncertainty that has characterized the operating environment in recent years, or they are simply more accustomed to managing through it while they wait for growth to accelerate.

In fact, they do expect the economy to improve in the near term. The vast majority of respondents are confident the economy will grow again this year, and many believe that the pace of growth will be better than last year. What is more, they expect the faster rate of growth will help more Americans find work (see facing page).

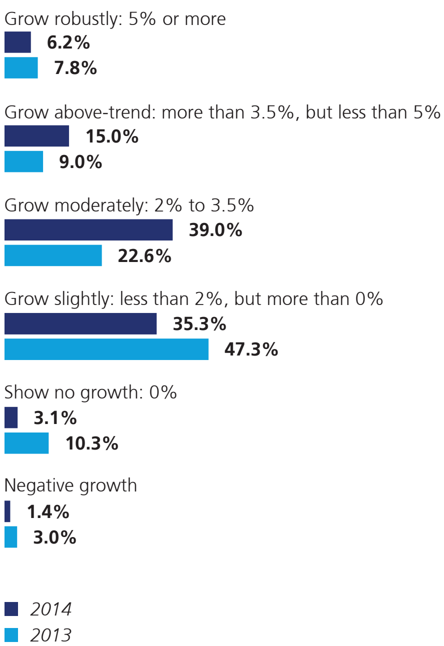
And yet the economic recovery clearly isn't robust, which is contributing to ongoing uncertainty about the future. The National Bureau of Economic Research recently reported that the current economic expansion that began in June 2009 is poised to surpass the average for post-World War II recoveries, but gross domestic product has grown just 1.8 percent over that span, or half the pace of the previous three expansions.[1]

> "It is clear that mid-market companies are adjusting to what has become the new normal over the past several years."

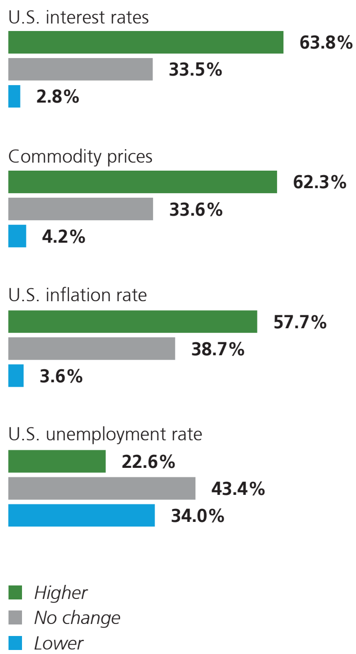
Jeff Provost — Kansas City managing partner, Deloitte LLP

[1] Josh Zumbrun, "Sluggish Economic Recovery Proves Resilient," *Wall Street Journal,* April 20, 2014.

At what pace do you expect the U.S. economy to grow over the next 12 months?



What do you believe is the most likely outlook for the following over the next 12 months?



In fact, the economic data streaming in during our survey period was decidedly lackluster. At the time, severe winter weather was blamed for a host of weaker-than-expected economic reports. The rough patch for the economy appeared to hit many of the companies' top and bottom lines, as fewer respondents than in the fall survey reported increases in revenues, profits, cash balances, and gross profit margins (see facing page).

In most cases, though, the executives reported that these key measures of business success have held firm, and most believe they will improve in the coming 12 months, along with revenues (see facing page). What is more, the vast majority of respondents are at least somewhat confident in both the outlook for the U.S. economy and the success of their business.

"There's an awareness out there that the dip we saw in the economy between December and March was a short-term, weather-related phenomenon," said Deloitte Global Chief Economist Ira Kalish. "The longer-term trend is one of a gradually improving economy with good prospects for moderate growth in 2014."

Budget, health care challenges

When the respondents were asked about challenges they perceived to be the biggest obstacles to continued economic expansion, government budget issues took a noticeable tumble. The issue was cited by 55 percent, down from 69 percent a year ago.

Rising health care costs remain a chief concern among mid-market companies, and took over the top spot on their worry list this time around. The issue was cited by nearly two-thirds of the respondents.

Another challenge increasingly on mid-market executives' radar screens is U.S. infrastructure needs. Lack of consumer confidence and rising inflation and/or energy prices also ranked relatively high.

Asked what measures the government could take to alleviate these concerns, the respondents said rolling back health care reform would be the most beneficial to growth. Reducing corporate tax rates and keeping interest rates low came in second and third, respectively. Stimulating private consumption and supporting increased infrastructure investment ranked fourth and fifth, respectively.

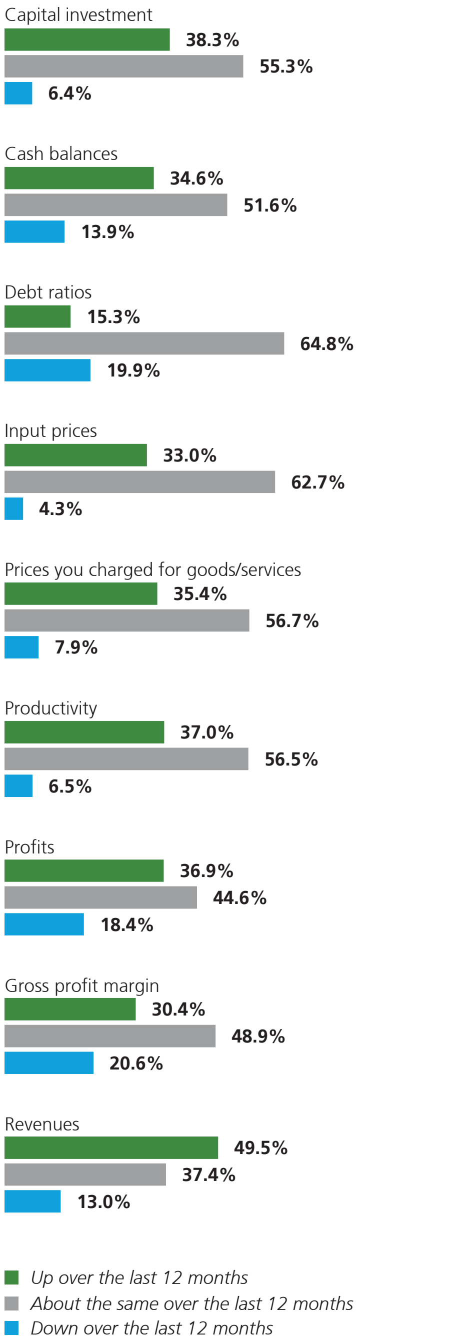
We saw some interesting divergence when the executives were asked to assess the top challenges impeding their company's growth. Fewer executives indicated concern about the impact of health care costs on their company's growth; only 30 percent cited such costs in the current survey, down from 38 percent a year ago.

In a separate question related to the costs of regulatory compliance, fewer respondents appear to believe that the Affordable Care Act will drive their costs up, as only 35 percent now believe costs related to complying with the law will rise sharply in the coming year, compared to 41 percent in the 2013 survey.

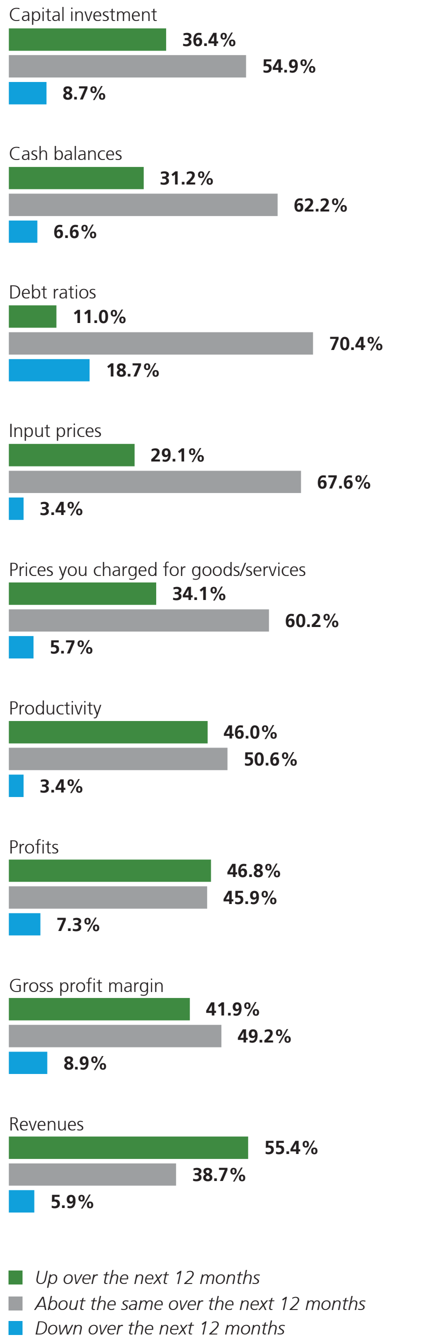
"The longer-term trend is one of a gradually improving economy with good prospects for moderate growth in 2014."

Ira Kalish — Deloitte Global Chief Economist

Are the following key metrics of your business up, about the same, or down over the last 12 months?



Do you expect these same key metrics of your business to go up, stay the same or go down over the next 12 months?



Different temptations, same rules

Following the path to superior profitability means resisting the pull of higher volume in favor of the challenge of higher price

Last fall, a Deloitte Growth Enterprise Services survey was expanded to include a subset of questions that focused on mid-market companies' strategies and the drivers of their profitability. In particular, we wanted to explore if and how mid-market companies adhered to the "three rules" for superior profitability discovered by Deloitte researcher Michael Raynor and Deloitte's Chief Strategy Officer Mumtaz Ahmed, and reported in their book, *The Three Rules: How exceptional companies think* (www.thethreerules.com):

Rule 1. Better before cheaper: Don't compete on price, compete on value.

Rule 2. Revenue before cost: Drive profitability first through higher prices, then through higher volume, and only rarely through lower cost.

Rule 3. There are no other rules: View every decision through the lens of the first two rules.

The results of the fall survey showed that mid-market companies typically drive profitability by adhering to the three rules, in much the same way larger, public companies do. However, we also found that mid-market companies face very different temptations when it comes to following the rules.

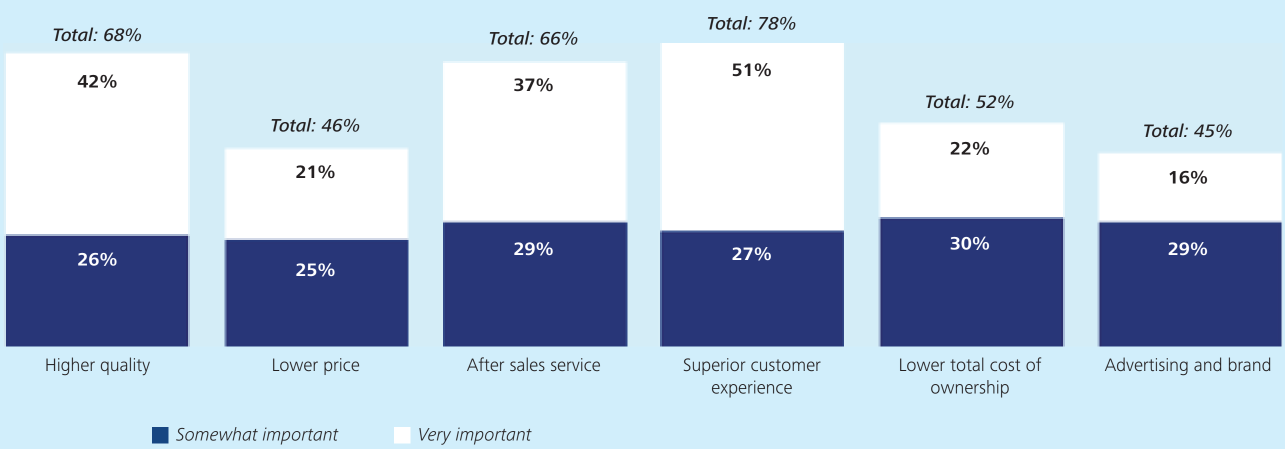
First, when faced with competitive pressure, larger, public companies that abandon the rules tend to more dramatically remake themselves around price-based competitive positions. In contrast, mid-market companies tend to try and maintain volume through price cuts. The resulting drop in profitability can make it difficult to sustain the investments necessary to maintain differentiation, resulting in a slow erosion of a painstakingly built strategic position.

Second, when profitability comes under pressure, larger, public companies tend to focus on cost-cutting. Mid-market companies tend to focus on volume — by improving quality if they can (although this is likely challenging in a period of falling profitability) and, failing that, by cutting price. This reaction runs counter to our findings that focusing on increasing price is typically a more successful reaction.

In our spring 2014 survey, we asked a number of the same questions to verify our initial results, and responses revealed a comforting consistency: companies that report following the rules also report having systematically higher profitability.

We also asked a number of new questions in an attempt to learn more about the tradeoffs and choices mid-market companies make. Responses similarly revealed a general consistency with the rules. For example, 42 percent of respondents report that having higher quality products or services is very important to their competitive position, while only 20 percent report that having lower prices is very important. Similarly, 37 percent and 51 percent, respectively, report that superior customer service and a superior customer experience are very important to their competitive position; only 21 percent report that lower total cost of ownership for customers is very important.

Figure 1: Drivers of profitability



Mid-market companies, consistent with the rules, tend to stay focused on differentiation when faced with profitability challenges: less than 20 percent report frequently lowering price to keep business in response to customer pressure, while 37 percent report frequently finding new customers with greater willingness to pay. Similarly, only 26 percent report cutting price to maintain volume, while 50 percent say they invest in quality in order to increase volume.

At the same time, we see compelling confirmation of the tendency of mid-market companies to focus on driving volume over price to an extent that might, in the long-run, undermine their ability to make good on this commitment to the rules.

For example, 39 percent of respondents reported that having lower price as a key element of their competitive position depended on circumstances. Other dimensions of position — e.g., after-sales, service, or customer experience — were far less contingent.

In addition, only 12 percent of respondents said higher price was very important to their profitability and 41 percent said it depends on the circumstances, while 20 percent said higher volume was very important and only 35 percent said it depends on the circumstances.

The implied willingness to cut price and the dedication to volume signals to us that mid-market companies face their own set of distractions in their quest to follow the rules and drive superior performance. Resisting these temptations demands a willingness to treat the rules like rules, and follow them even when, especially when, the going gets tough.

Figure 2a: Responding to price pressure

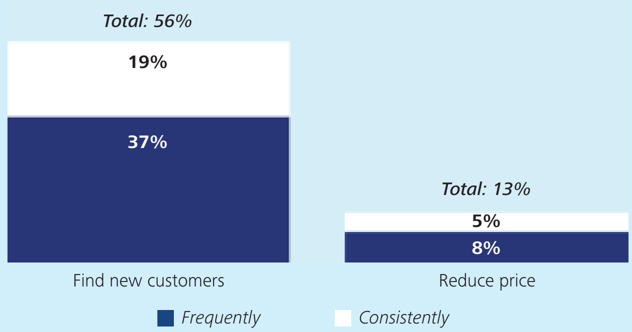


Figure 2b: Responding to volume pressure

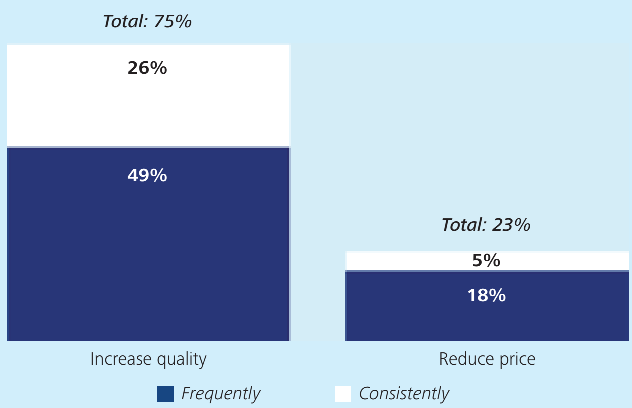
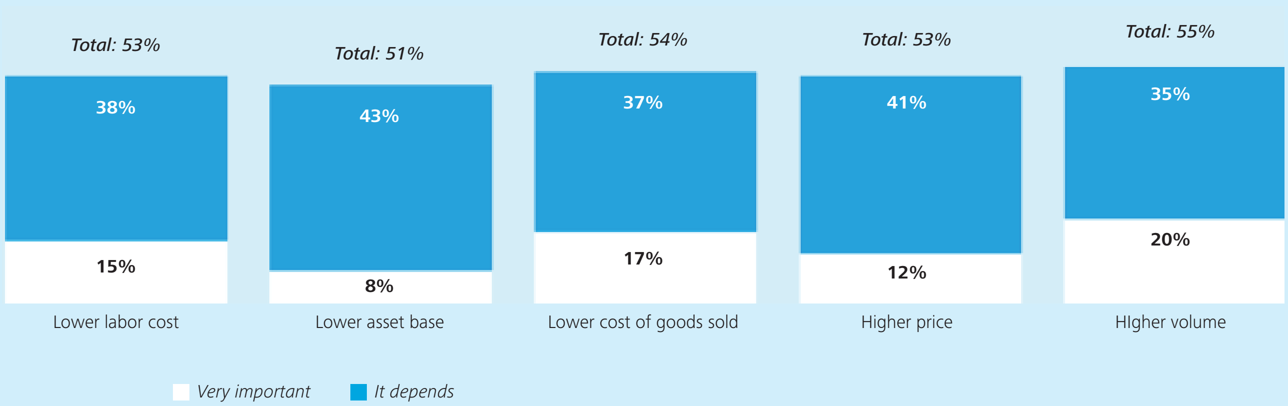


Figure 3: Drivers of profitability



Checkbooks out

Despite these potential obstacles and persistent uncertainty, evidence is emerging that mid-market companies are investing in their businesses. During the depths of the financial crisis, many companies held the line or cut back on capital expenditures while waiting for definitive signs that demand had returned. In the last few years, capital spending has begun to pick back up, though it remains below its pre-crisis high.[2] Today, there is still plenty of equipment that needs replacing. The average age of capital equipment is 7.4 years, the oldest in 20 years.[3]

Uncertainty may still reign today, but more companies aren't letting that stop them from making investments needed to reinvigorate sales and boost productivity. Our survey found that only 23 percent of mid-market executives said their company is deferring major investments due to uncertainty in the business environment, down from 31 percent in the fall and 43 percent a year ago (see facing page). More than a third of the companies said they increased their capital spending over the past 12 months.

"It is clear that mid-market companies are adjusting to what has become the new normal over the past several years — including an uncertain regulatory environment, low interest rates with uncertain timing around future increases, and an ever-changing technological evolution," says Jeff Provost, Kansas City managing partner, Deloitte LLP. Provost, who also is the Central Region co-leader for Deloitte Growth Enterprise Services, adds, "While cognizant of current risks, mid-market companies understand they must deploy capital to meet their growth and profitability goals."

In the main, those investments are taking two primary forms meant to spur productivity and help them grow: hiring and technology spending. Technology and talent were the clear winners — garnering 55 percent and 52 percent of the responses, respectively — when the executives were asked to pick the investments that offer the greatest potential for increasing productivity at their company. Other responses included plant and equipment (27 percent), and research and development (24 percent).

Employment

Job gains may not be dramatic at this point in the recovery, but they are coming all the same, and on what appears to be a consistent basis. Continued hiring pushed the U.S. job market past an important milestone in March as private employment surpassed the pre-recession peak for the first time.[4]

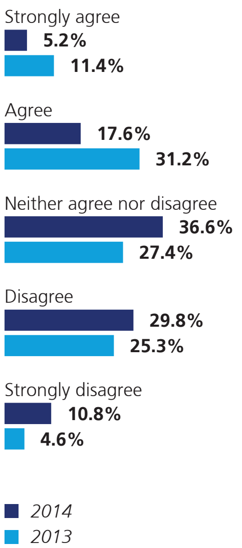
Looking ahead, 43 percent of executives expected their company to boost full-time employment in the next 12 months. While 27 percent of the respondents said they expected their company's employment to grow in the year ahead, but by less than 5 percent, another16 percent forecast job growth of 5 percent or greater.

Hiring and training ran second only to the development of new products and services when the executives were asked to list their company's top investment priority over the next 12 months (see facing page). The 41 percent of respondents who listed hiring and training as a priority was a significant increase over 31 percent who cited it in the fall survey.

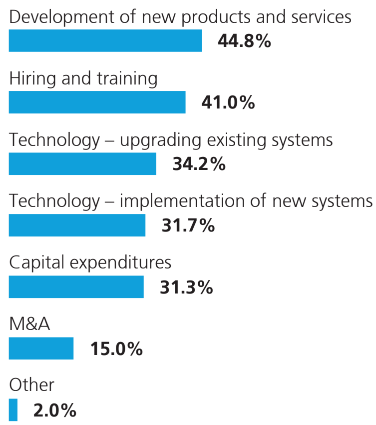
Interestingly, fewer respondents said they were having difficulty finding new employees with the skills and education to meet the needs of their business. Sixty-one percent said changes in U.S. immigration law were not impacting their ability to issue work visas to skilled immigrants, and another 24 percent said the changes were having only a marginal impact and were not affecting their decision to add staff.

[2] Liz Ann Sonders, "A New Machine: Is a Capital Spending Cycle Imminent?" Schwab.com, March 31, 2014.
[3] Victoria Stilwell, "Capital Spending in U.S. Seen From Macy's to Berkshire," Bloomberg.com, April 7, 2014.
[4] Lorraine Woellert, "Payrolls in U.S. Rose 192,000 in March, Unemployment 6.7%", Bloomberg, April 4, 2014.

Please indicate your level of agreement with this statement: "We are deferring major investments due to the uncertainty in the current business environment."



What are your company's top two investment priorities in the next 12 months? Please select two.



Talent acquisition revisited

Increasingly, companies looking to recruit and acquire talent recognize they are now competing on a new battlefield shaped by global talent networks and social media and defined by employment brands and changing views of careers. Sixty percent of respondents to Deloitte's annual global human capital survey said they have updated or are currently updating and revamping their talent sourcing strategy, while another 27 percent are considering changes.

Leading companies are replacing their traditional "staffing" team with a strategic "talent acquisition" function that is focused on building an employment brand, sourcing people in new places using social media tools, creating opportunities for internal candidates, and leveraging referral relationships within their companies. Others are looking for new ways to access and engage people, including through joint ventures, contracting, freelancers, and open source talent.

These approaches are pushing the boundaries of talent acquisition to include new models and new types of relationships for accessing skills and ideas. One innovative tactic is the use of social networks to build talent "communities" supported by full-time employees, retired workers, independent contractors, and everyone in between.

Sixty-two percent of respondents in the global human capital survey said they rely on social tools for sourcing and advertising positions. Organizations also report that they are beginning to utilize analytics for recruitment and staffing.

(Excerpted from the Global Human Capital Trends 2014 report, published by Deloitte University Press, March 2014.)

Daniele: investing in a rapidly changing marketplace

Daniele, Inc. knows something about getting ahead of changing consumer tastes. The maker of gourmet meats was founded in Pascoag, Rhode Island in 1976 after Vlado Dukcevich moved his family from Italy to see if his family's specialty meats business could succeed in the United States. At the time, American tastes veered toward bologna and cooked ham, but Dukcevich accurately predicted that ethnic and gourmet foods would grow in popularity among a multicultural U.S. public. Once confined to neighborhood pork stores, Daniele, Inc. now sells a variety of gourmet meats under the Daniele and DELDUCA brands in delis and supermarkets across the country, in addition to major international markets such as Canada, Japan, Mexico and China.

The company's desire to stay on top of changes in consumer demand led it to invest $60 million in a new production plant in Pascoag in 2012 that is set to open later this year. At the time, the economy was growing at a modest 2.2 percent rate, and Rhode Island's jobless rate was still hovering above 10 percent.

> "You can learn a lot from talking to your customers."
>
> Davide Dukcevich — Co-owner, Daniele, Inc.

"Most people didn't even know how to pronounce 'prosciutto' when my father arrived here," says Davide Dukcevich, Vlado's son and co-owner of the company. "In a business like ours, it's much more important to understand your customer than worry about what's going on in the overall economy."

The new plant — financed with low-rate construction and equipment loans — is a bet that recent shifts in consumer tastes toward ready-to-eat packaged gourmet meats will only accelerate in the future as food becomes available in a greater variety of outlets, from big box retailers to gas stations to airport terminals. Today, Daniele, Inc.'s best-selling product is a packaged mix of three pre-sliced meats that was only introduced three years ago.

"Things are evolving very quickly in this market, and we don't even know if some sales categories will even exist three years from now," Dukcevich says. In addition to quadrupling the capacity of the adjacent facility, "the new plant will enable us to meet this kind of demand much more quickly," he says.

More recently, Daniele, Inc. responded to consumer preferences for locally-grown food products by contacting New England farmers to see if they raised hogs or would be willing to. The company now has a local line of charcuterie for sale at Trader Joe's and other outlets. Dukcevich credits hours he spent at local farmers markets and reading customers' emails and social media comments.

"You can learn a lot from talking to your customers," he says.

Technology

Survey responses indicate that technology will play a key part in mid-market companies' strategic growth plans in the coming years, with cloud offerings likely to play a prominent role. In fact, technology was second only to sales in terms of management priorities for capital invested.

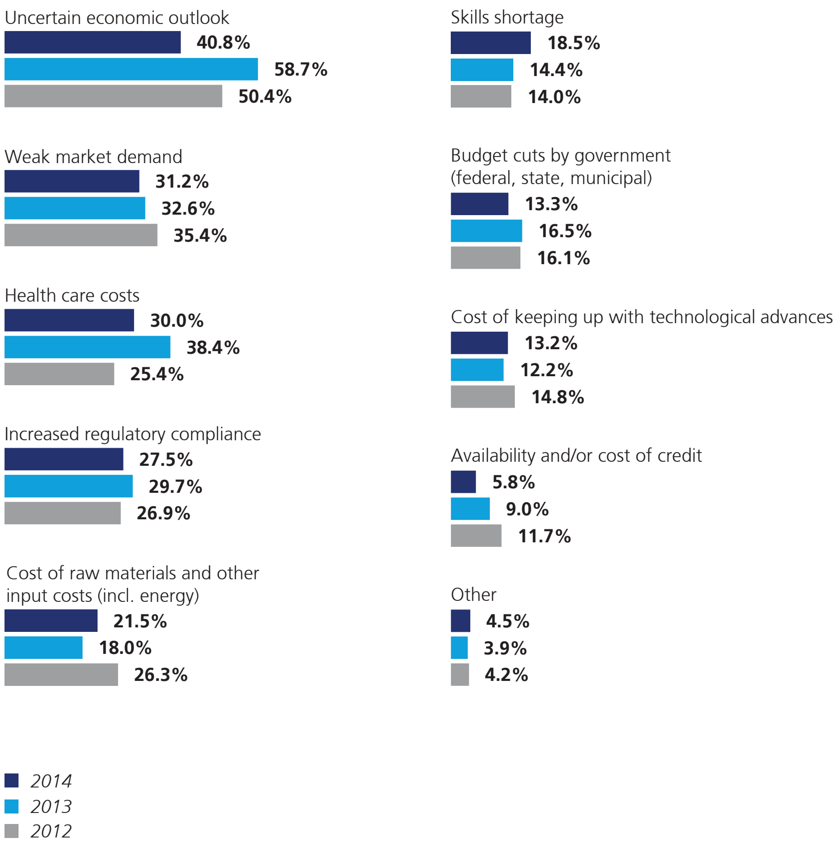
More than a third of the respondents said one of their company's investment priorities over the coming 12 months would be to upgrade existing systems or implement new systems. The most popular technology investment is cloud computing/software as a service (SaaS), which was the top choice, ahead of automating business processes, data analytics/business intelligence, enterprise application suites, and customer relationship management (CRM).

"The main emphasis in the middle market is the democratization of technology with new cloud offerings," said Harvey Michaels, principal, Deloitte Consulting LLP and National Consulting Leader for Deloitte Growth Enterprise Services. "They bring big technology benefits to companies who don't have the budgets to buy hardware, software and IT professionals to run the systems. With further growth of the cloud, we expect to see more software companies either develop or move to the cloud. That means that mid-market companies will have options in the future that have only been available to the largest enterprises."

Greater use of the cloud may be one reason why fewer executives identified the costs of keeping up with technological change as an obstacle to their company's growth; the issue was cited by 13 percent of respondents, down from 17 percent last fall.[5]

[5] Deloitte's *Mid-market perspectives: Moving ahead,* Fall 2013.

What are your company's main obstacles to growth? (Please choose up to three.)



"[The cloud]... means that mid-market companies will have options in the future that have only been available to the largest enterprises."

Harvey Michaels — Principal, Deloitte Consulting LLP,
and National Consulting Leader for Deloitte Growth Enterprise Services

Eye on expansion

With the U.S. recovery fueling increased optimism about the near-term outlook, it is perhaps little surprise that midsized companies see the domestic market playing a dominant role for their business in the coming 12 months. Indeed, growing existing markets remained the top vote-getter (39 percent) when executives were asked to identify their company's main growth strategy over the coming 12 months (see facing page), and it was also their biggest management priority in terms of business strategies.

Deal activity

One way mid-market companies may look to grow in existing markets in the months ahead is to gain access to new customers through an acquisition. Fifteen percent of the respondents called it "very likely" that their company would make an acquisition in the coming year, and another 17 percent said it was "quite likely." Nearly a quarter said their company isn't currently in the market but would consider a deal under the right circumstances. Asked to identify the main drivers of merger activity, half the respondents pointed to the need to expand or diversify their customer base (see facing page).

"Many business leaders were not prepared for the impact of the Great Recession and there is a strong feeling out there that they don't want to go through that again," said Kevin McFarlane, Managing Director of Deloitte Corporate Finance LLC in Los Angeles. "One way they seek to reduce their susceptibility to macroeconomic fluctuations is by diversifying their customer base as well as the end markets those customers serve."

McFarlane said merger activity in the mid-market may be primed to rise in the months ahead, spurred on by a confluence of factors: general consensus around the stability in the global macroeconomic environment, record-low borrowing rates that can have very little room to fall further, and increasing numbers of strategic acquirers looking to put capital to work.

While many would-be sellers currently feel more secure about their prospects, as evidenced by the 42 percent of executives who said in the survey that it was "highly unlikely" their company would be involved in a transaction as a seller in the coming year, the reality is that confluence of factors mentioned above will likely inspire potential acquirers to become even more aggressive in proposing offers that are very difficult to turn down.

"Business owners might be thinking now about holding for a couple more years, but it's a great time to investigate their options," McFarlane said. "The amount of capital available to strategic buyers is as high as I've seen it in my 24-plus years in this business and every large strategic buyer I speak to says they are on the hunt for acquisitions."

"Business owners might be thinking now about holding for a couple more years, but it's a great time to investigate their options."

Kevin McFarlane — Managing Director of Deloitte Corporate Finance LLC

What is your company's main growth strategy over the next 12 months? (Please select only one.)

What will be the main drivers of merger activity in your company's industry over the next 12 months? (Please choose up to two.)

Global aspirations

While mid-market leaders are mainly focused on the U.S. market, evidence is also emerging that they are trying to sort out how to take advantage of rising wealth overseas, particularly in rapidly growing emerging markets where middle-class populations are expanding. The survey findings suggest international markets could play a bigger role for such companies as soon as the coming year.

At present, nearly half of the respondents said their company sells its products or services abroad, and a quarter of them have operations in other countries. More than a third of the executives said their company counts on international markets for up to 25 percent of their annual revenues, and nearly a quarter said they count on them for more than that (see facing page). For most of the companies with international sales, their experience in these markets extends more than a decade, and a almost one quarter said they have operated globally for more than 30 years.

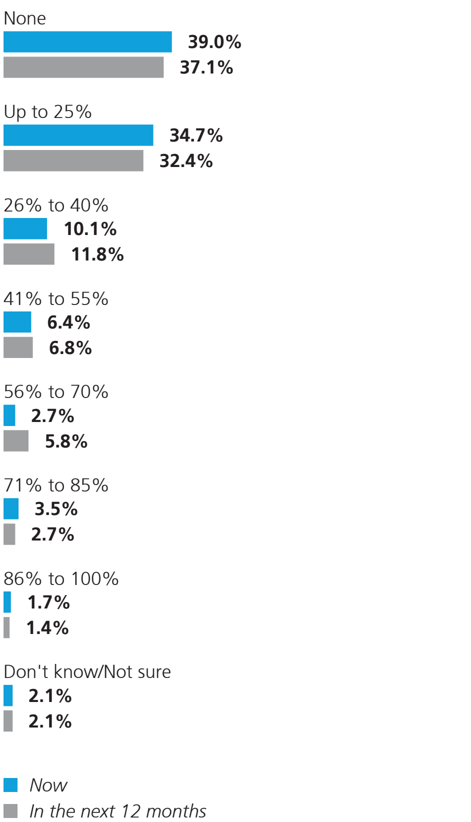
There was a fairly even distribution of operating models among companies doing business abroad. Nearly two-thirds of these companies generate revenue from company-operated locations or other facilities outside the United States, while one-third tap joint ventures with non-U.S. business partners and nearly as many rely on business agents or online sales.

This means that what happens in overseas markets — from the standpoint of demand, costs, partnerships, regulations and manpower — is impactful to many U.S. mid-market companies, even those that are merely dipping their toe in international markets at this juncture.

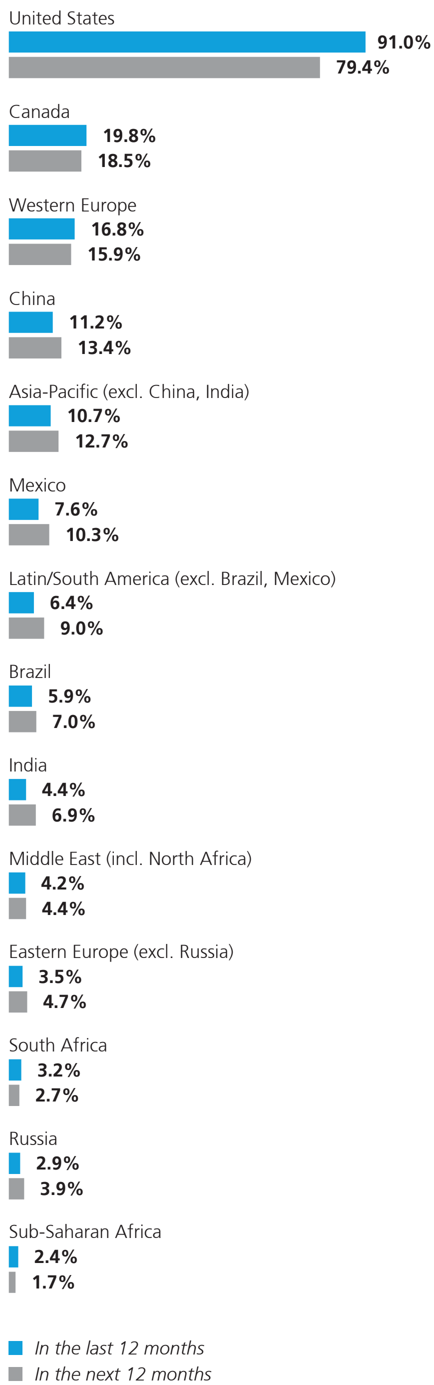
That contribution may be set to grow in the year to come, at least where some select markets are concerned. While 91 percent of the respondents said the U.S. was the biggest contributor to growth over the last 12 months, fewer respondents — 79 percent — predicted the same for the year ahead. Regions that are expected to contribute more in the coming 12 months included China, Asia-Pacific (excluding China and India), Brazil, India, Latin America, and South America (outside of Brazil and Mexico) (see facing page).

What happens in overseas markets... is impactful to many U.S. mid-market companies, even those that are merely dipping their toe in international markets.

What proportion of your revenues comes from outside the United States, now and in the next 12 months?



Which geographic markets have contributed the most to your company's growth over the last 12 months? Over the next 12 months?



That said, mid-market companies likely won't see their international workforces grow, and may even bring some jobs back home in the coming year. Fourteen percent of the companies in the survey have more than 30 percent of their workforce located outside the U.S., and more than a third said their international workforces account for between 1 percent and 30 percent of their employees overall. These figures didn't change materially when respondents were asked to predict their non-U.S. employee base in the coming year. However, nearly a quarter — 24 percent — of the respondents said they are considering bringing certain global operations back to the United States. These decisions likely will be influenced by their ability to price their products or services competitively in international markets, the degree to which labor and manufacturing costs continue to rise in those countries, and quality concerns (see below).

Global challenges

The issue of competitive pricing was the top concern cited by executives when asked to list the main challenges to the overall success of their global operations. The issue was cited by 49 percent of the respondents, edging out regulatory restrictions, lack of brand awareness and economic instability in the target market. Other challenges noted included an inability to attract and retain skilled labor, quality concerns, logistical problems, and lengthening of the supply chain.

Some select major emerging markets have proved tumultuous in recent months, led by China's moves to devalue its currency and transition its economy away government-driven investment. These latest developments may be reflected in the fact that so few companies who don't currently do business overseas are mulling such a move. Only 6 percent of the 191 companies who are solely U.S.-focused said they are considering going global.

Please rate each of the following issues or factors in terms of its importance to your decision to bring certain operations back to the United States.

Issues *Rated on a scale ranging from 7 (extremely important) to 1 (not at all important)*	**Weighted average**
Quality (real or perceived)	5.2
Increasing foreign labor costs	5.1
Being able to price products/services competitively internationally	5.0
Regulatory restrictions abroad	5.0
Lengthening of the supply chain	5.0
Inability to attract and retain skilled labor	4.9
Overall manufacturing costs	4.9
Logistical problems	4.9
Currency issues (e.g., fluctuating exchange rates)	4.8
Intellectual property exposure risk	4.8
Economic instability in the target market	4.7
Corruption	4.6
Language/cultural differences	4.5
Inability to establish foreign networks or contacts	4.5
Lack of brand awareness internationally	4.4
Supplier management inexperience	4.4

The 318 executives whose companies are active internationally said the success of their global ventures depends mainly on the growth potential of new markets. Lower costs and favorable regulations or business climate were cited as the second and third most important factors, while other benefits cited included favorable tax considerations, the availability of local resources with specific skills, greater physical proximity to growth markets, and supply chain optimization.

Attracting and retaining local employees was seen as the top talent issue in terms of its importance to a company's global operations. Creating competitive compensation, benefit and incentive plans was also cited by a majority of the executives. Other top talent issues included understanding of local labor laws, cultural differences, and immigration policies and procedures.

Payoneer: Following the money

Some companies might be put off by the regulatory requirements that greet companies when they enter new international markets, but not Payoneer. The New York-based company processes payments for business customers from 215 countries. As such, it has to be intimately familiar with the regulations that govern financial transactions around the world. It is both a challenge as well as a point of competitive differentiation, according to Payoneer Chief Financial Officer Michael Levine.

"The regulatory environment is very challenging with regulators placing additional scrutiny on banks and financial services firms," Levine said. "It's a giant moat that many would-be competitors don't think is worth the trouble to cross. We continue to put money into our compliance effort because it's a point of differentiation."

Compliance approvals are another aspect that other companies might find too demanding. The company receives roughly 100,000 applications each month from global entrepreneurs and business owners looking to join its network and become an approved sender or receiver of funds. Payoneer vets applicants from all over the world, performing background checks, assessing risk, and evaluating businesses' prospects.

Payoneer is counting on technology to continue evolving and granting entrepreneurs from Kenya to Cambodia instant access to customers around the globe. If not for the company's payments solutions, those business owners would mainly rely on international bank wires, which can be expensive and subject to volatile currency rates. Payoneer's revenues have grown by a compounded 65 percent annually over the past four years, and will likely grow by at least 40 percent a year going forward, Levine said.

"Global payments will never stop, no matter how bad the economy gets," he said. "Part of the benefit of being able to service customers from 215 countries is you're going to find the growth because that's where the money is always headed."

"We continue to put money into our compliance effort because it's a point of differentiation."

Michael Levine —
Payoneer Chief Financial Officer

Financing growth

Access to capital is a key consideration for many mid-market firms with growth aspirations. With Federal Reserve officials beginning to pave the way for future interest rate hikes, financing at current levels may be an increasingly attractive alternative for expanding companies looking to get ahead of higher borrowing costs sometime down the road.

Financing costs and options

During the survey period, new Federal Reserve Chair Janet Yellen indicated during a press conference that the Fed could raise rates "around six months" after its bond purchases come to a close, while underscoring the point that it will remain flexible and responsive to economic conditions between then and now.

Based on the survey findings and despite signals from the Fed, mid-market executives appear to be less concerned about rising rates than they were just six months ago. While keeping interest rates low rated as the third most helpful measure the government could take, the executives didn't appear overly concerned that borrowing rates would rise anytime soon. Sixty-four percent expected U.S. interest rates to be higher 12 months from now, down from 69 percent in the fall, and rising interest rates were only cited by 29 percent as an obstacle to U.S. growth.

At the same time, access to credit remains fairly robust in the mid-market segment. While survey results showed a decline in the number of executives who said it was "much easier" to secure credit such as asset-based or cash-flow financing or secured loans, slightly less than half of respondents noted no difference in their access to credit across most financing vehicles.

Asset-based financing remains the most preferred financing vehicle among survey respondents, but more companies plan to use internal sources over the coming 12 months. Other top financing options continue to be cash-flow financing, secured loans, and private sources such as private equity.

Even when companies don't see an immediate need, they are choosing to set aside funds for added flexibility. Payoneer's Michael Levine said his company recently completed a $25 million equity round to set aside funds to seize potential market opportunities.

"We're in a business where you can never have too strong a balance sheet," Levine said. "We don't have any immediate uses for the cash, but it gives us more flexibility to accelerate growth, it puts us in a position to do an acquisition if the opportunity presents itself, and it's a really nice insurance policy."

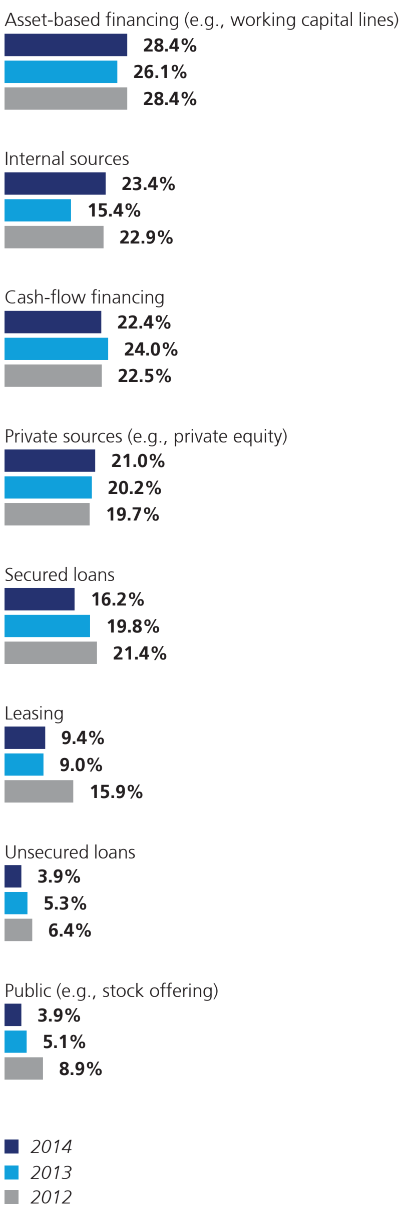
Going public

A solid majority of the mid-market executives surveyed say their companies have no intention of accessing public markets in their quest to grow further. More than two-thirds said their company is privately held and likely to stay that way in the next 12 months; 8 percent said they were likely to go public within the next 12 months, an increase over the 4 percent figure recorded in the fall, and 6 percent said they would likely go public sometime after the next 12 months.

Those who were considering a public offering cited broader exposure for their brand and products (36 percent), the cost-effectiveness of equity capital (35 percent), the desire to provide liquidity for owners (34 percent), and the need of capital to fuel growth (33 percent) as the biggest incentives.

Far and away the biggest reason private companies would elect to stay closely held is the desire for control and/or flexibility in decision making, which was cited by nearly three-quarters of the executives (see facing page). Other factors include the desire to keep financial information private, the size of the organization (too small to consider going public), and the burden of regulatory requirements.

What types of financing do you expect your company to pursue in the next year?



What factors influence your company's decision to remain private for now? Please select all that apply.

"We don't have any immediate uses for the cash, but it gives us more flexibility to accelerate growth, it puts us in a position to do an acquisition if the opportunity presents itself, and it's a really nice insurance policy."

Michael Levine — Payoneer Chief Financial Officer

Conclusion

A lot has happened in the four years since we began conducting mid-market surveys. Just ask the executives who have helped their companies navigate significant business challenges in that span of time — including uncertainty about the economy, regulatory changes, and shifts in market demand.

Our surveys have asked mid-market executives about their expectations, priorities and plans. Over the years, those results have shown an evolution, however slow, from cautious optimism to recognition of the need to move ahead. Perhaps the greatest evidence of this evolution is the substantial reduction in the number of mid-market executives who tell us their companies are deferring investments due to uncertainty — now down to just 23 percent.

The findings in this report offer greater support for the notion that conditions and expectations are improving. Additionally, by examining the concept of "The Three Rules" and how they apply to mid-market companies, we provide a roadmap for creating exceptional performance. Finally, while the numbers present a certain story, it's the conversations with mid-market executives that help paint the true picture of challenges and opportunities. The case studies in this report demonstrate the value of addressing global challenges to capitalize on opportunities throughout the world, and also show how an unrelenting focus on meeting the needs of the customer can be an important filter for making business decisions. Taken together, the trends, insights and perspectives included in this report can be instructive for mid-market companies as they plot their path to growth.

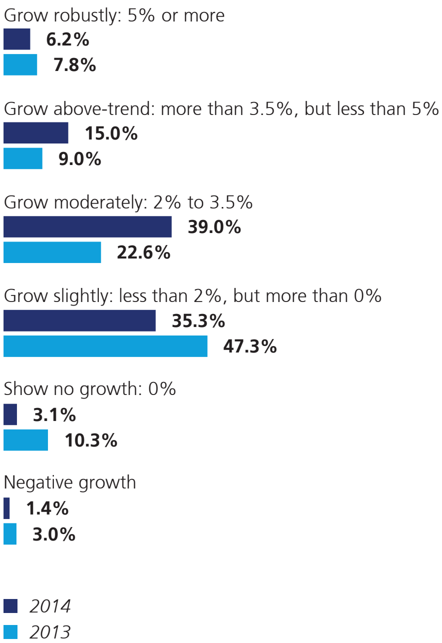
Appendix: full survey results

Note: some percentages in the charts throughout this report may not add to 100% due to rounding, or for questions where survey participants had the option to choose multiple responses.

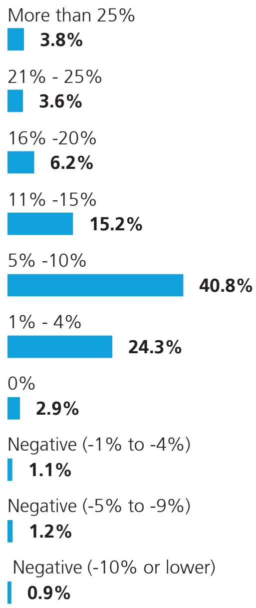
Acknowledgment
We would like to thank all survey respondents and interviewees for their time and the insights they shared for this report, *Mid-market perspectives: 2014 report on America's economic engine*

Performance and growth

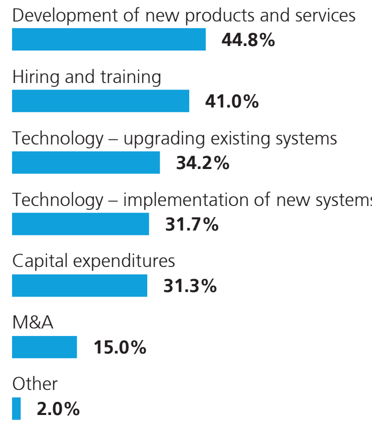
At what pace do you expect the U.S. economy to grow over the next 12 months?



What is your company's projected percentage revenue growth over the next 12 months?



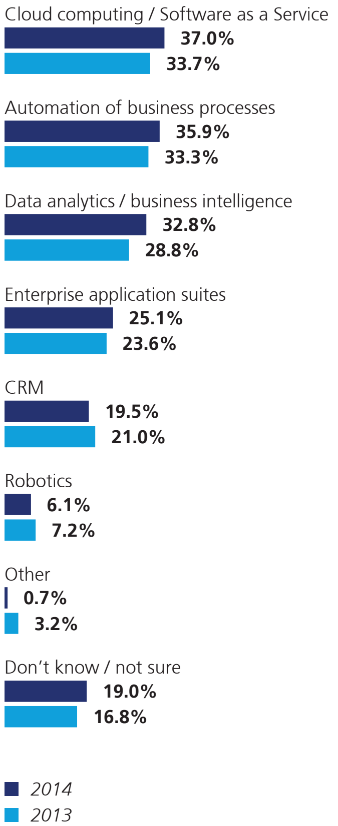
What are your company's top two investment priorities in the next 12 months? Please select two.



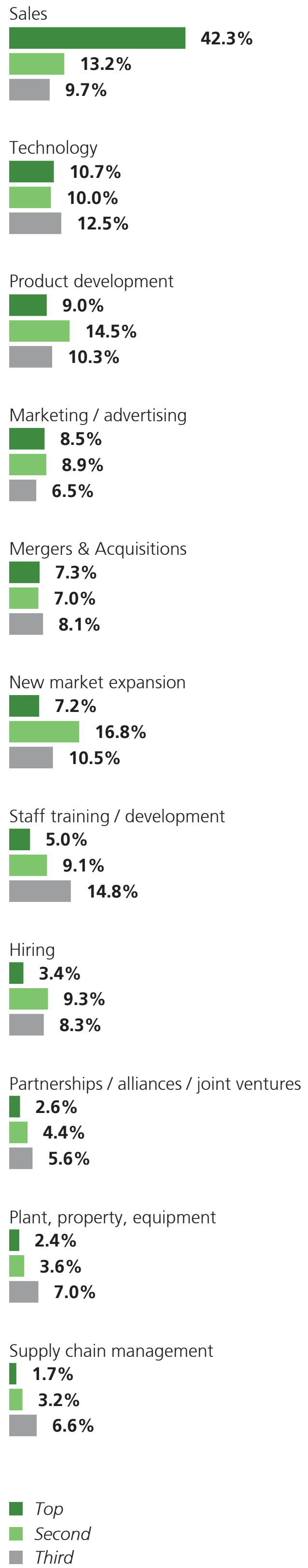
Please rate the frequency with which your organization makes the following choices.

Choices ***Rated on a scale ranging from 4 (consistently) to 1 (almost never)***	**Weighted average**
Our company seeks to increase total unit volume through higher product or service quality	3.0
When an increase in product or service quality imposes higher cost, my company maintains profitability through higher price	2.7
Faced with a decline in demand, my company increases quality in order to maintain volume	2.6
When an increase in product or service quality imposes higher cost, my company maintains profitability through higher volume	2.6
When existing customers are unwilling to pay for superior quality, my company seeks out new customers that are willing to pay rather than cut price	2.5
When we reduce prices, we maintain profitability by increasing volume	2.5
Faced with a decline in demand, my company is willing to cut price to maintain volume	2.5
When we reduce prices, we maintain profitability by cutting cost	2.5
Our company seeks to increase total unit volume by lowering unit price	2.3
When existing customers seek quality levels my company is unable to provide, we lower our price rather than lose the business	2.1

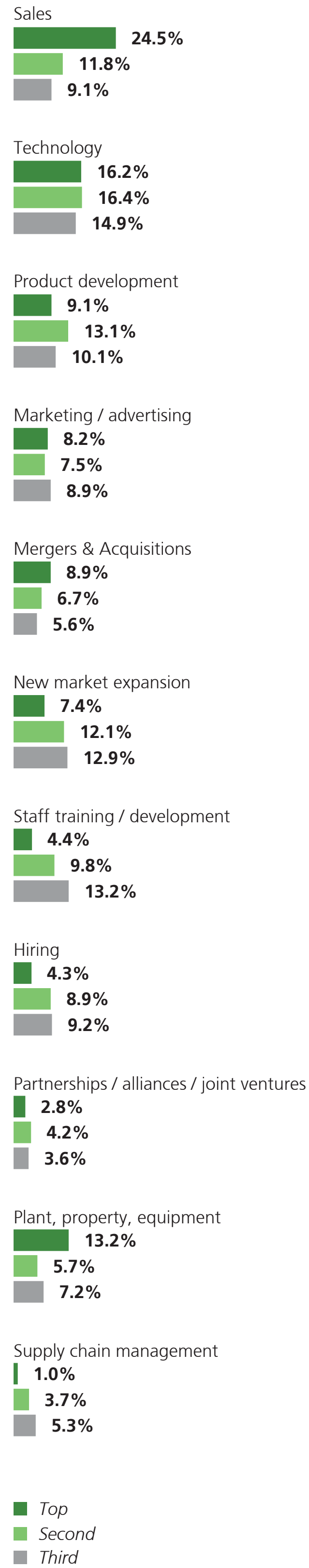
Which investment(s) in technology is your company most likely to make in the next 12 months? (Please select up to three.)



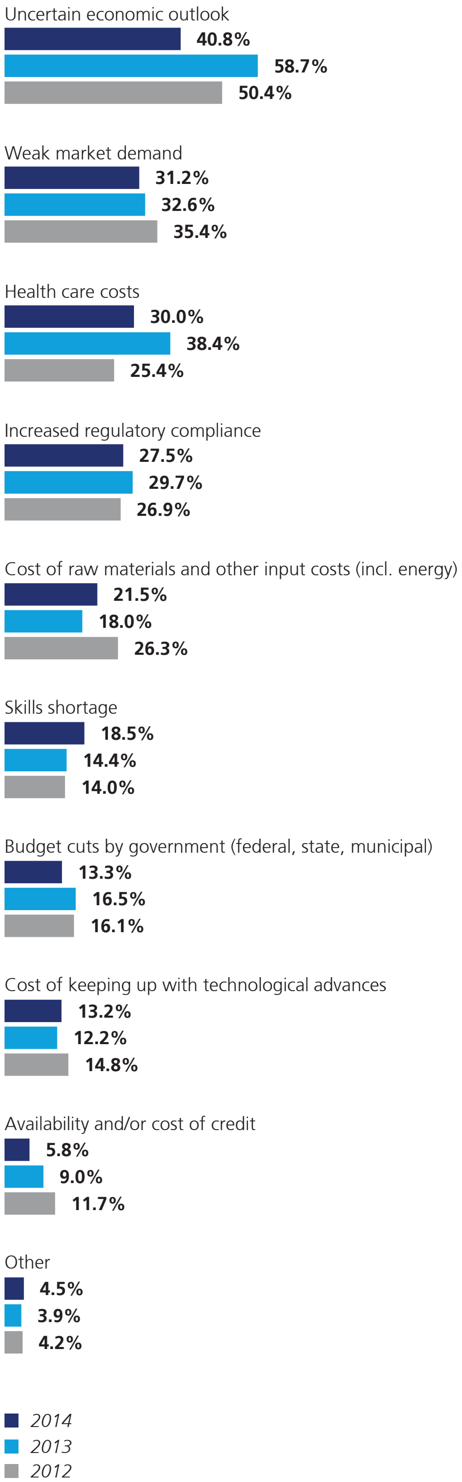
Please rank (in order of importance) your management's top three priorities for the next 12 months in terms of time invested.



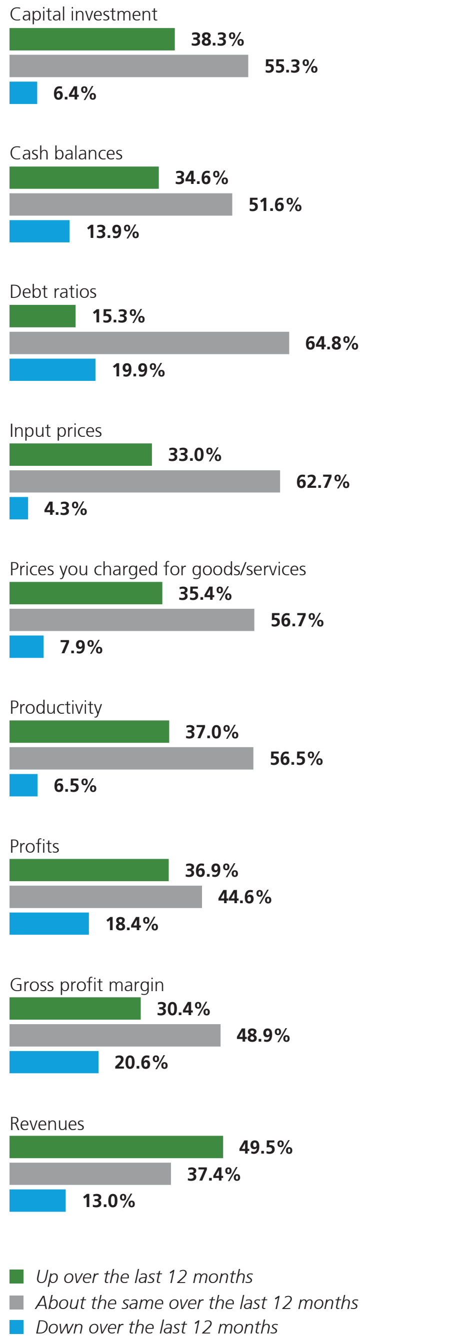
Please rank (in order of importance) your management's top three priorities for the next 12 months in terms of capital investment.



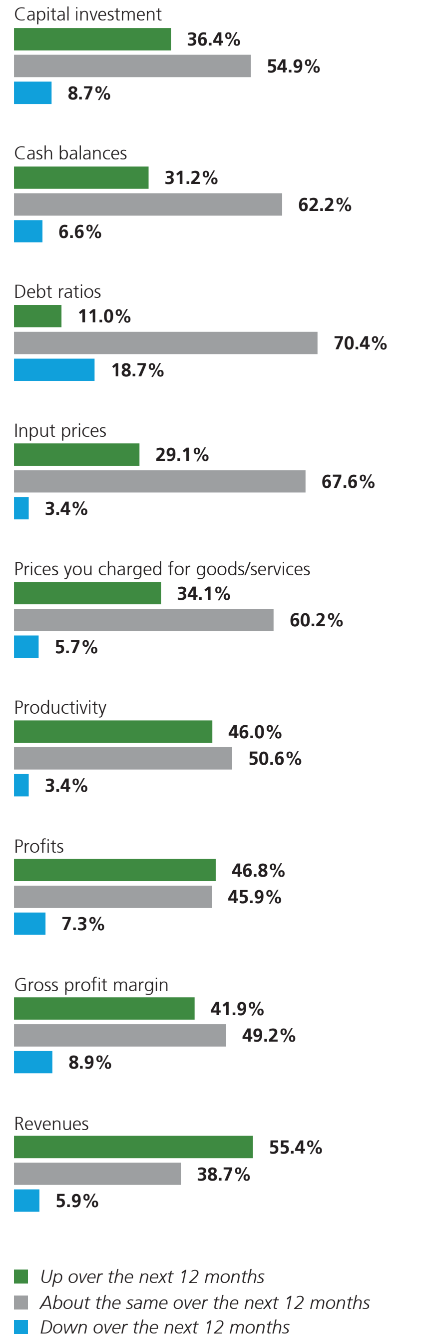
What are your company's main obstacles to growth? (Please choose up to three.)



Are the following key metrics of your business up, about the same, or down over the last 12 months?

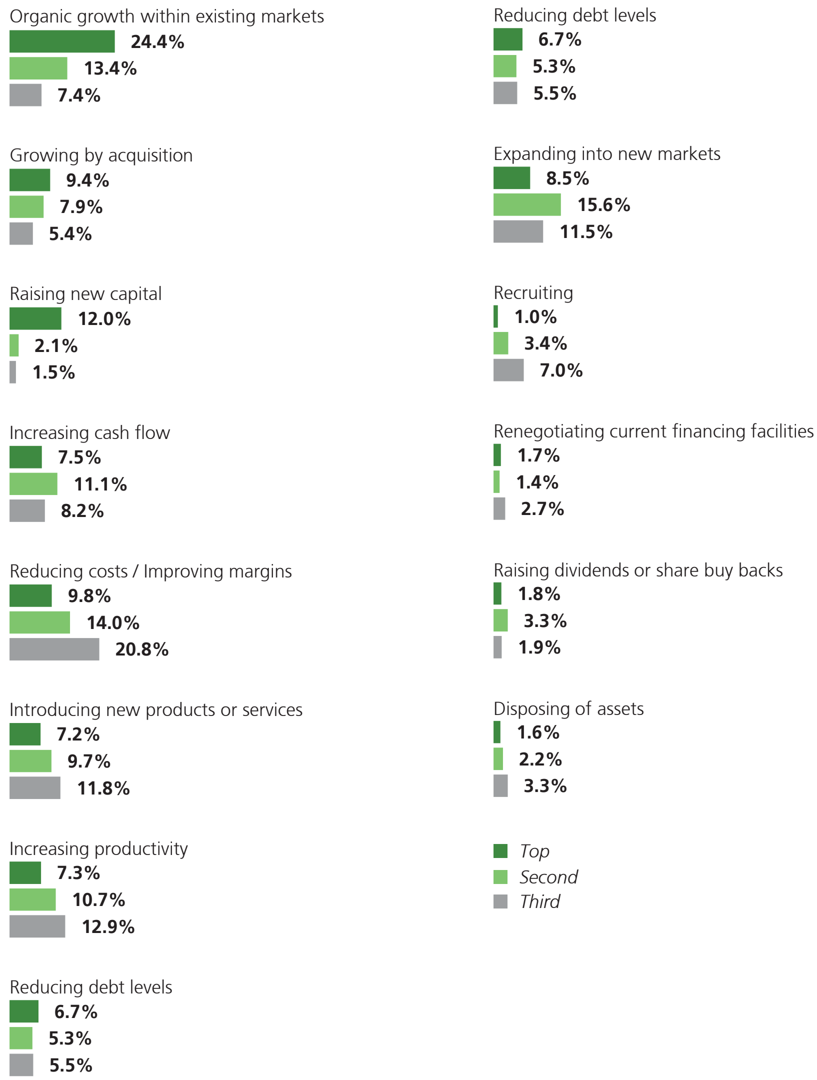


Do you expect these same key metrics of your business to go up, stay the same or go down over the next 12 months?

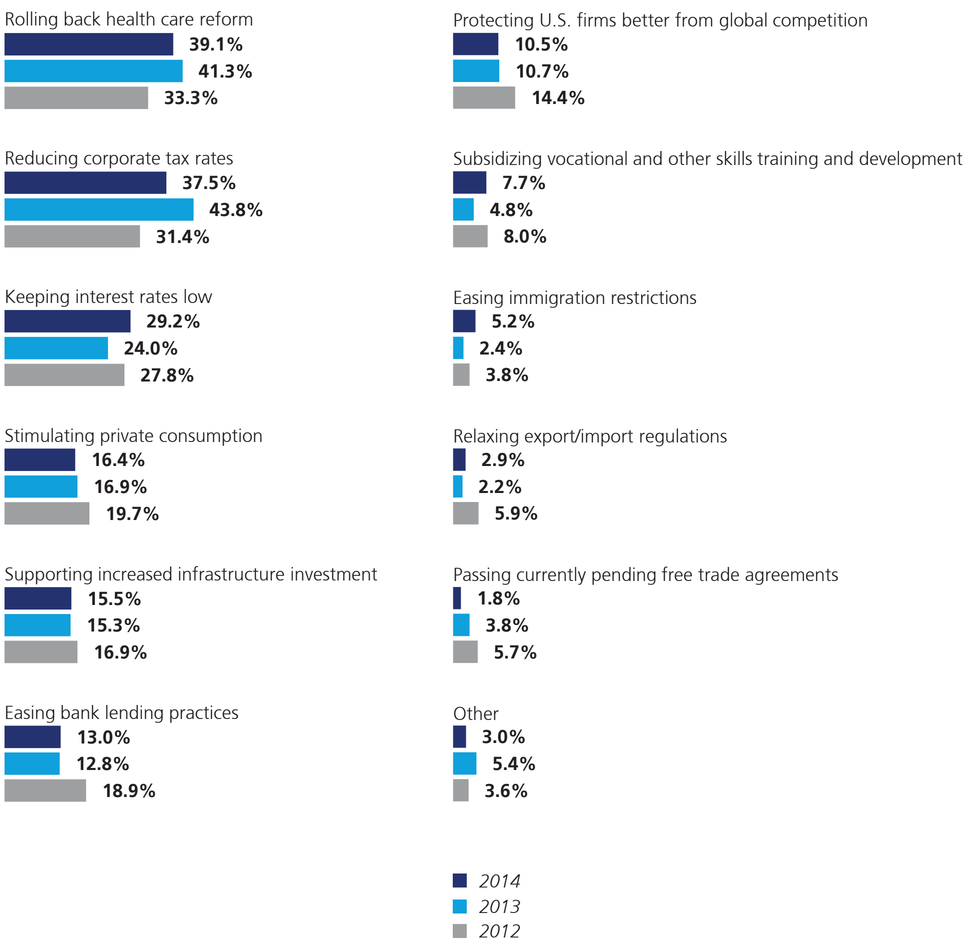


What is your company's main growth strategy over the next 12 months? (Please select only one.)

Please rank (in order of importance) your top three priorities for the next 12 months in terms of business strategies.

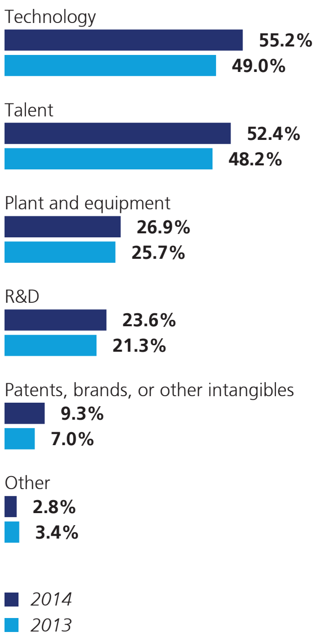


Which of these measures by the U.S. government would most help U.S. mid-sized businesses to grow in the next year? (Please choose up to two.)

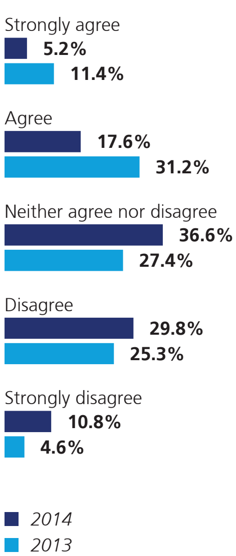


Business environment

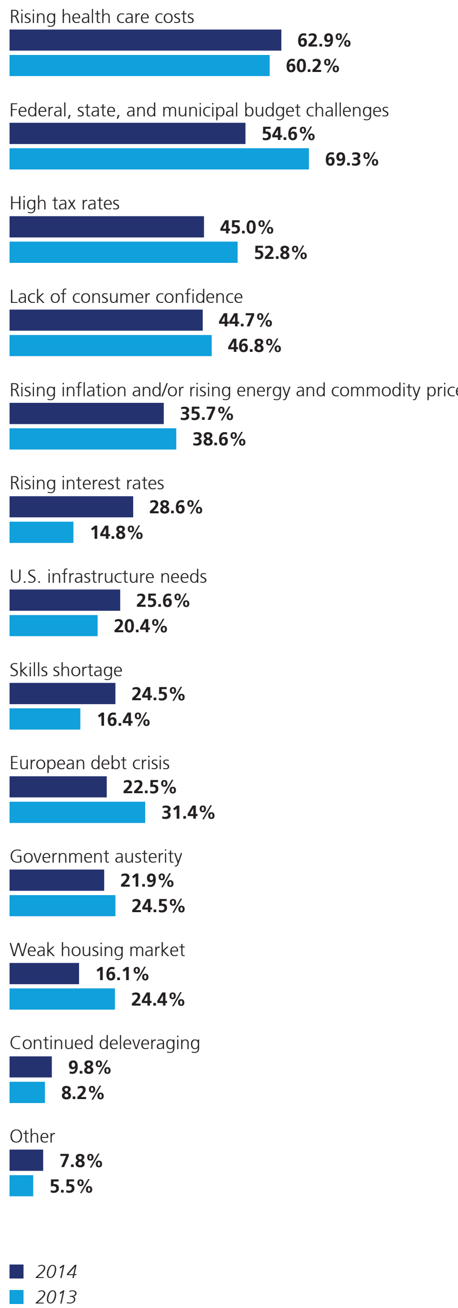
Which investments offer the greatest potential for increasing productivity at your company?



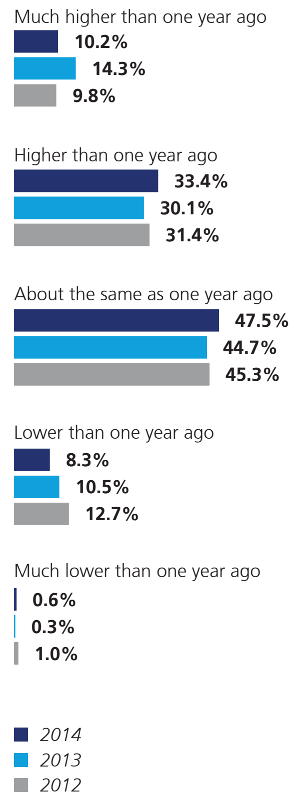
Please indicate your level of agreement with this statement: "We are deferring major investments due to the uncertainty in the current business environment."



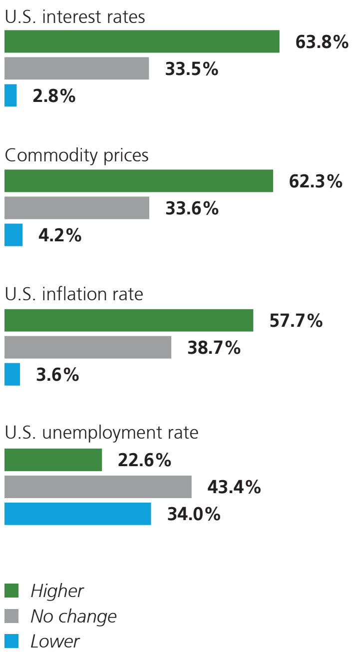
Which of the following issues present the greatest obstacles to U.S. growth over the next 12 months? (Please select all that apply.)



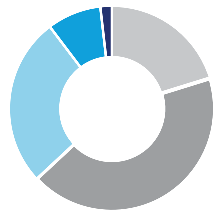
The level of uncertainty in terms of factors that drive future business prospects (e.g., taxes, regulations, credit availability and the economic outlook) is:



What do you believe is the most likely outlook for the following over the next 12 months?



What is your level of confidence that the U.S. economy will continue to improve over the next 24 months?



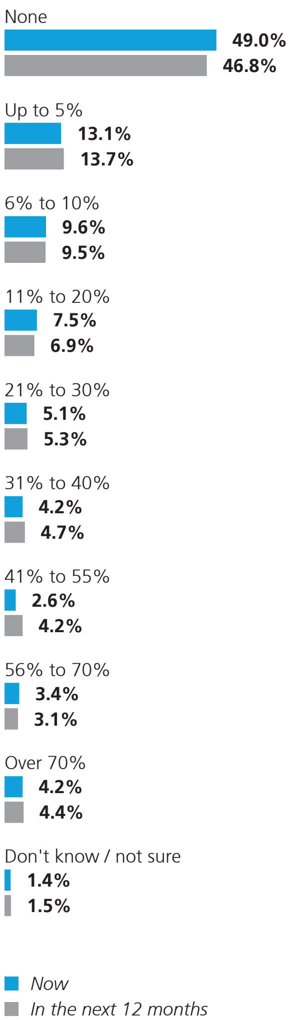
- Not confident: 20.2%
- Somewhat confident: 42.8%
- Confident: 26.6%
- Very confident: 8.5%
- Extremely confident: 1.8%

What is your level of confidence in the success of your company (based on revenue, profitability, and growth) over the next 24 months?

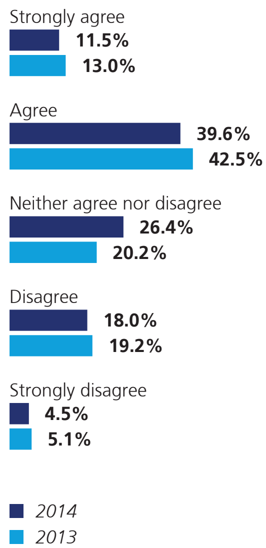
- Not confident: 4.0%
- Somewhat confident: 28.8%
- Confident: 34.5%
- Very confident: 23.2%
- Extremely confident: 9.5%

Workforce/hiring

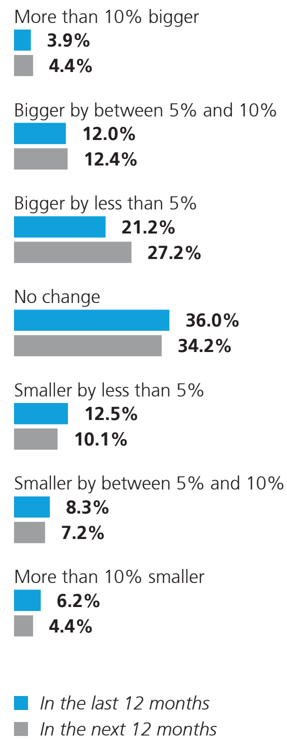
Please specify the percentage of your workforce based outside the United States, now and in the next 12 months.



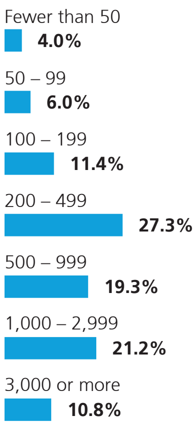
Please indicate your level of agreement with this statement: "It is difficult for us to find new employees with the skills and education to meet the needs of our business."



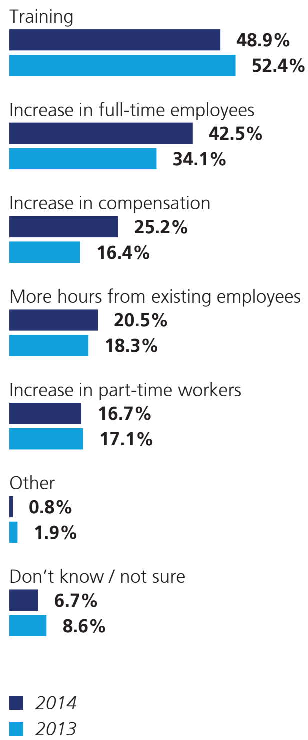
How has the size of your full-time domestic workforce changed over the last 12 months? How do you expect to change in the next 12 months?



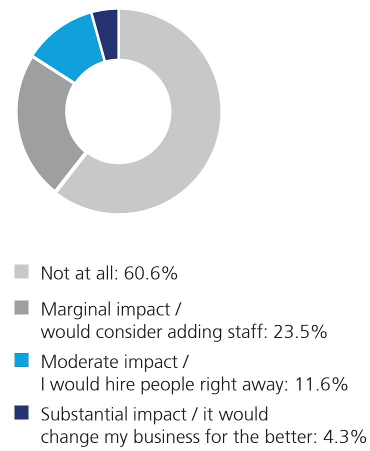
Approximately how many full-time staff are employed by your business?



Which investment(s) in talent is your company most likely to make in the next 12 months? (Please select up to two.)

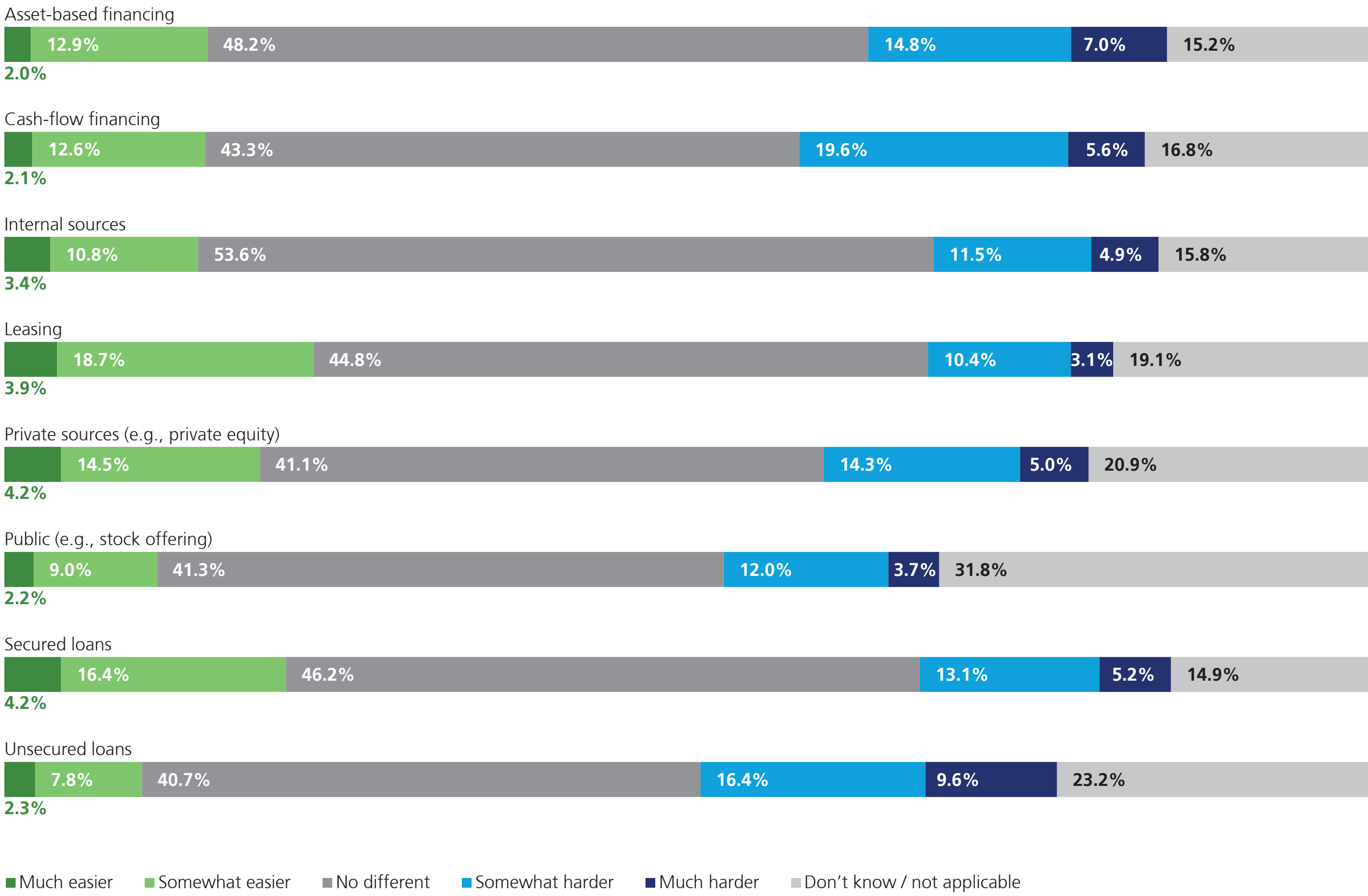


How would a change in U.S. immigration law easing issuance of work visas to skilled immigrants affect your ability and willingness to hire?

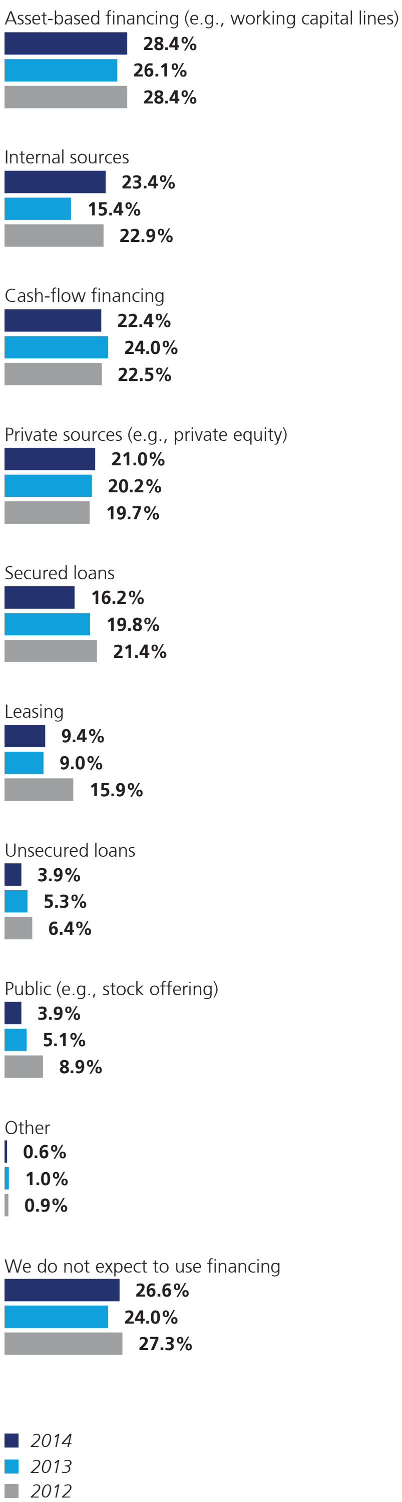


Financing

Do you believe it is easier or more difficult for mid-market companies in your industry to secure credit now than it was a year ago?

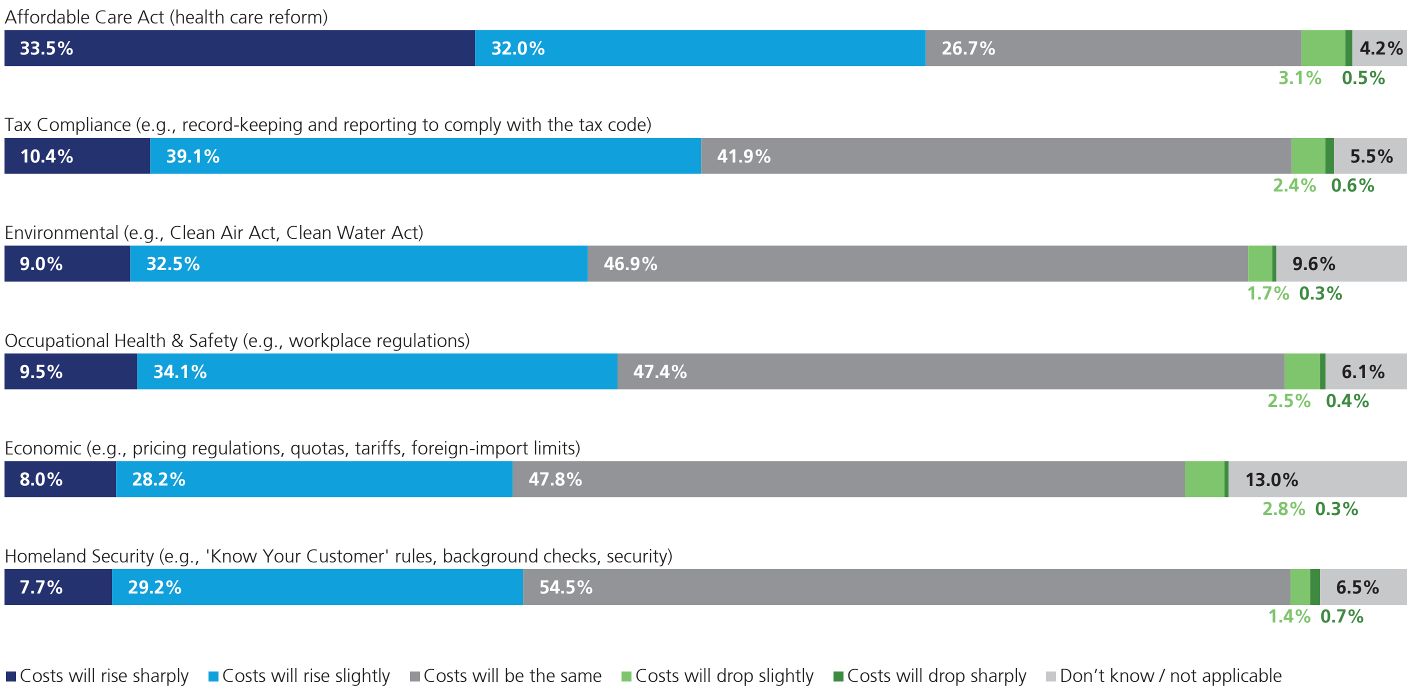


What types of financing do you expect your company to pursue in the next year?



Regulatory compliance

For each of the following, please indicate how the costs of regulatory compliance will change for your company in the next 12 months.



Public vs. private

Is your company public or private?

- Public : 19.6%
- Private: 80.4%

If private, which category best describes your company?

Family-owned
33.7%

Closely-held (non-family)
31.8%

Private equity owned
24.9%

VC-backed
4.4%

Other
5.1%

Which of the following best describes your company's ownership status?

- Privately held, and unlikely to go public within the next 12 months: 68.0%
- Privately held, but likely to go public within the next 12 months: 7.8%
- Privately held, but likely to go public sometime after the next 12 months: 5.7%
- Public, but held by a small number of owners: 7.5%
- Public and broadly held: 11.0%

What factors influence your company's decision to remain private for now? Please select all that apply.

Desire for control and/or flexibility in decision-making
72.3%

Desire to keep financial information private
37.5%

We are too small to consider going public
28.1%

Burden of regulatory requirements (e.g., Sarbanes-Oxley, disclosure rules)
24.4%

Operational requirements of the shift are burdensome (e.g., might need additional staff to deal with analysts and shareholders)
18.7%

We would prefer to tap private funding sources (e.g., private equity, venture capital)
14.3%

Other
5.8%

What factors influence your company's decision to be or go public? Please select all that apply.

Being public can broaden the exposure of our brand and products
35.7%

Cost-effectiveness of equity capital
34.7%

Desire to provide liquidity for owners
34.0%

Need capital to fuel growth
32.8%

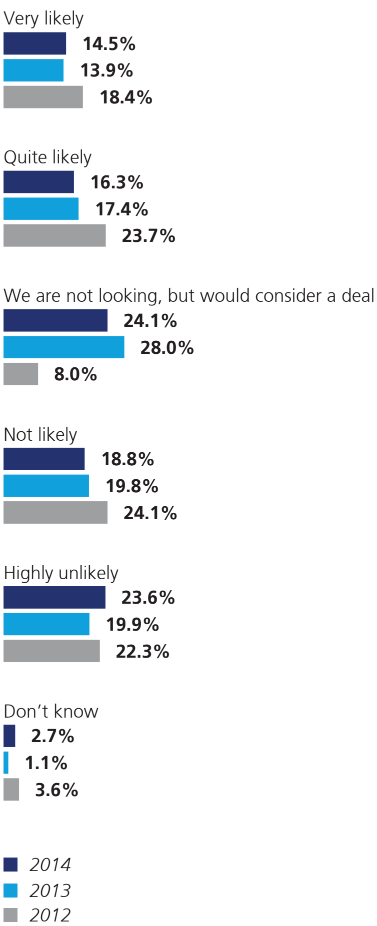
Investment banking relationship
14.4%

Looking to cash out
6.3%

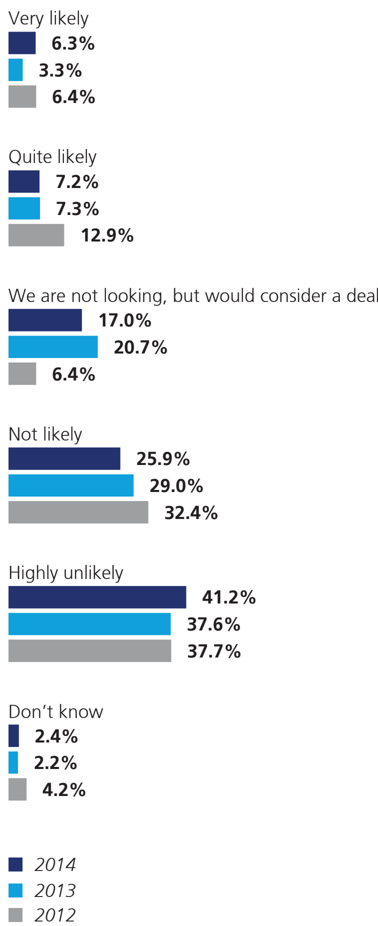
Other
4.8%

Mergers and acquisitions

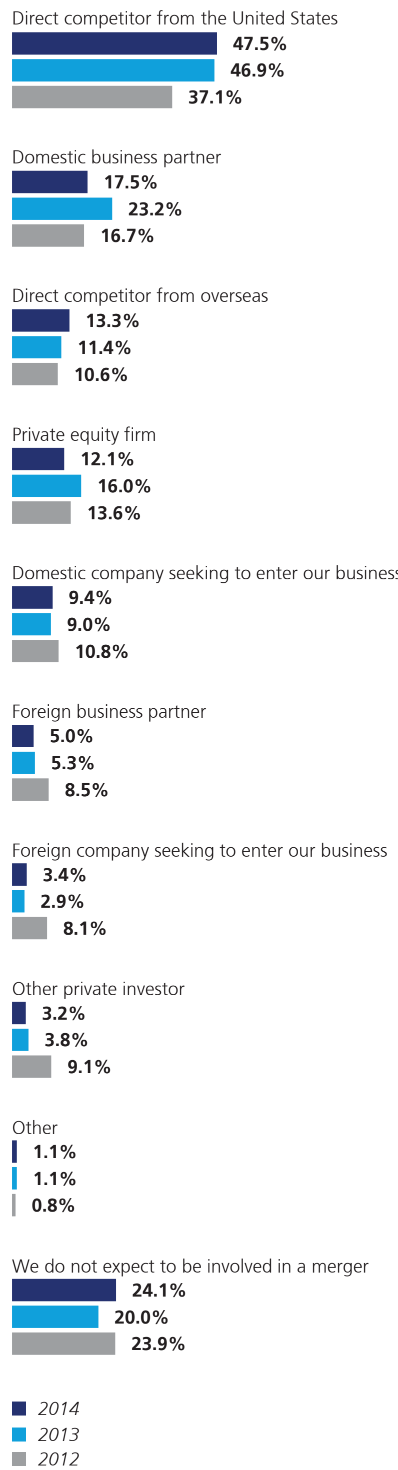
How likely is it that your company will participate in a merger or acquisition in the next 12 months as an acquirer?



How likely is it that your company will participate in a merger or acquisition in the next 12 months as a merger target?



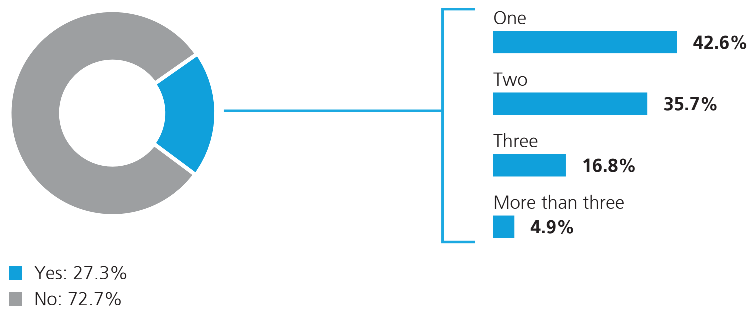
If you participate in a merger or acquisition, which of the following entities is most likely to be the counter-party? (Please choose up to two.)



What will be the main drivers of merger activity in your company's industry over the next 12 months? (Please choose up to two.)

In the past 12 months, have you completed any mergers or acquisitions?

How many?



Global and emerging markets

What proportion of your revenues comes from outside the United States, now and in the next 12 months?

	Now	*In the next 12 months*
None	39.0%	37.1%
Up to 25%	34.7%	32.4%
26% to 40%	10.1%	11.8%
41% to 55%	6.4%	6.8%
56% to 70%	2.7%	5.8%
71% to 85%	3.5%	2.7%
86% to 100%	1.7%	1.4%
Don't know/Not sure	2.1%	2.1%

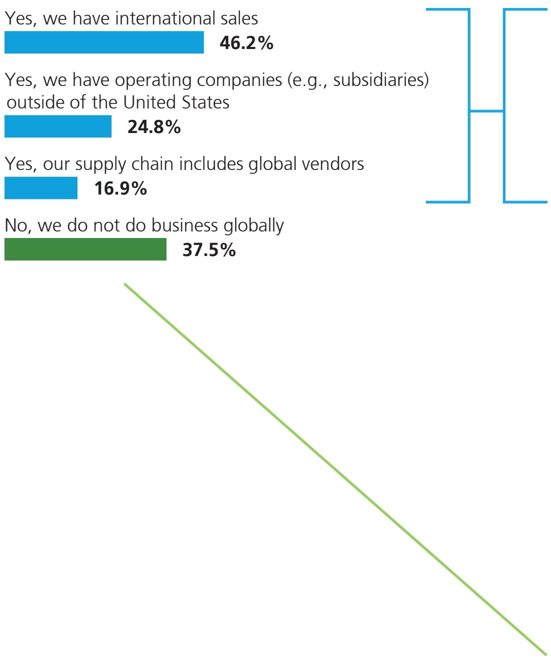
Which geographic markets have contributed the most to your company's growth over the last 12 months? Over the next 12 months?

	In the last 12 months	*In the next 12 months*
United States	91.0%	79.4%
Canada	19.8%	18.5%
Western Europe	16.8%	15.9%
China	11.2%	13.4%
Asia-Pacific (excl. China, India)	10.7%	12.7%
Mexico	7.6%	10.3%
Latin/South America (excl. Brazil, Mexico)	6.4%	9.0%
Brazil	5.9%	7.0%
India	4.4%	6.9%
Middle East (incl. North Africa)	4.2%	4.4%
Eastern Europe (excl. Russia)	3.5%	4.7%
South Africa	3.2%	2.7%
Russia	2.9%	3.9%
Sub-Saharan Africa	2.4%	1.7%

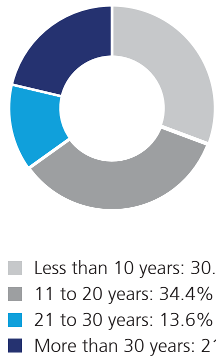
What types of operations generate global revenue for your company? Please select all that apply.

Company-operated office locations/other facilities outsid	64.7%
Joint ventures with non-U.S. business partners	31.7%
Business agents in other countries	30.4%
Online sales	29.8%

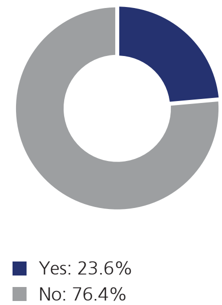
Do you do business globally? Please select all that apply.



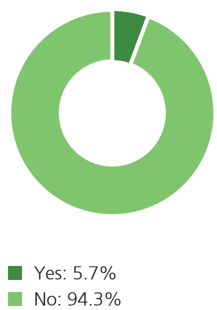
How long has your company operated globally?



Are you considering bringing certain operations back to the United States?



Is your company considering going global?



Please rate each of the following in terms of its importance regarding the motive / incentive for considering going global.

Motive / incentive *Rated on a scale ranging from 7 (extremely important) to 1 (not at all important)*	**Weighted average**
Growth potential in new market(s) for our products / services	5.6
Greater physical proximity to growth markets	5.3
Favorable regulations or business climate	4.9
Lower costs	4.8
Favorable tax considerations	4.6
Availability of local resources with specific skills	4.5
Supply chain optimization	4.1
Local government support or incentives	4.0
Access to local natural resources	3.5

Please rate each of the following talent issues in terms of its importance when thinking about your global operations.

Issue *Rated on a scale ranging from 7 (extremely important) to 1 (not at all important)*	**Weighted average**
Attracting and retaining local employees	4.7
Creating competitive compensation, benefit, and incentive plans	4.5
Understanding of local labor laws	4.4
Cultural differences	4.2
Immigration policies and procedures	3.9

Please rate each of the following issues or factors in terms of its importance to your decision to bring certain operations back to the United States.

Issues *Rated on a scale ranging from 7 (extremely important) to 1 (not at all important)*	**Weighted average**
Quality (real or perceived)	5.2
Increasing foreign labor costs	5.1
Being able to price products/services competitively internationally	5.0
Regulatory restrictions abroad	5.0
Lengthening of the supply chain	5.0
Inability to attract and retain skilled labor	4.9
Overall manufacturing costs	4.9
Logistical problems	4.9
Currency issues (e.g., fluctuating exchange rates)	4.8
Intellectual property exposure risk	4.8
Economic instability in the target market	4.7
Corruption	4.6
Language/cultural differences	4.5
Inability to establish foreign networks or contacts	4.5
Lack of brand awareness internationally	4.4
Supplier management inexperience	4.4

Please rate each of the following in terms of its challenge to the overall success of your global operations.

Challenge *Rated on a scale ranging from 7 (extremely important) to 1 (not at all important)*	**Weighted average**
Being able to price products / services competitively internationally	4.4
Regulatory restrictions abroad	4.3
Inability to attract and retain skilled labor	4.2
Economic instability in the target market	4.1
Lack of brand awareness internationally	4.1
Quality (real or perceived)	4.1
Logistical problems	3.9
Intellectual property exposure risk	3.8
Currency issues (e.g., fluctuating exchange rates)	3.8
Inability to establish foreign networks or contacts	3.8
Increasing foreign labor costs	3.8
Overall manufacturing costs	3.8
Lengthening of the supply chain	3.7
Language / cultural differences	3.7
Supplier management inexperience	3.7
Corruption	3.6

Please rate each of the following in terms of the importance of its benefit to the overall success of your global operations.

Benefit *Rated on a scale ranging from 7 (extremely important) to 1 (not at all important)*	**Weighted average**
Growth potential in new market(s) for our products/ services	5.2
Lower costs	4.8
Favorable regulations or business climate	4.7
Favorable tax considerations	4.4
Availability of local resources with specific skills	4.3
Greater physical proximity to growth markets	4.3
Supply chain optimization	4.2
Local government support or incentives	3.9
Access to local natural resources	3.5

Please rate each of the following talent issues in terms of its importance when thinking about potential global expansion of your operations.

Issue *Rated on a scale ranging from 7 (extremely important) to 1 (not at all important)*	**Weighted average**
Attracting and retaining local employees	5.2
Creating competitive compensation, benefit, and incentive plans	4.9
Cultural differences	4.8
Understanding of local labor laws	4.5
Immigration policies and procedures	4.1

Competition

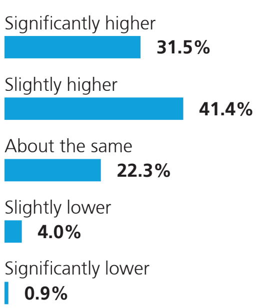
Please rate the importance of each of the following activities with respect to making your company's products or services more attractive to your customers than your most direct competitors' products or services.

Activities *Rated on a scale ranging from 5 (very important) to 1 (very unimportant)*	**Weighted average**
Superior customer experience	4.2
Having higher performance products or services	3.9
Introducing new, higher quality product or services	3.5
Superior after-sales service	3.9
Lower total cost of ownership for the customer	3.6
Have lower-priced products or services	3.5
Advertising, marketing and/or brand	3.4
Introducing new, lower-priced products or services	3.3

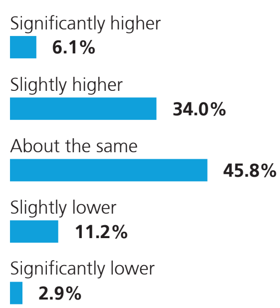
Please rate the contribution of the following drivers of cost and revenue to your company's profitability compared to your most direct competitors.

Drivers *Rated on a scale ranging from 5 (very important) to 1 (very unimportant)*	**Weighted average**
Higher unit volume	3.7
Lower sales, general & administrative (SG&A) cost	3.5
Lower cost of goods sold	3.5
Higher unit prices	3.4
Lower labor cost	3.4
Lower asset base	3.2

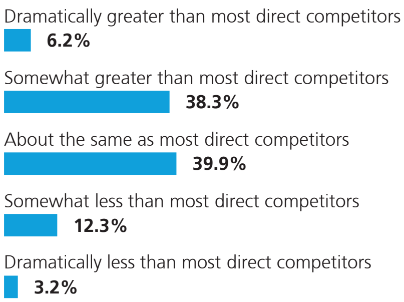
Comparing your company to your most direct competitors, please complete the following statements: The quality of our products and services is:



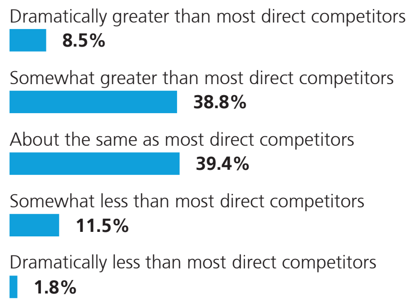
Comparing your company to your most direct competitors, please complete the following statements: The price of our products and services is:



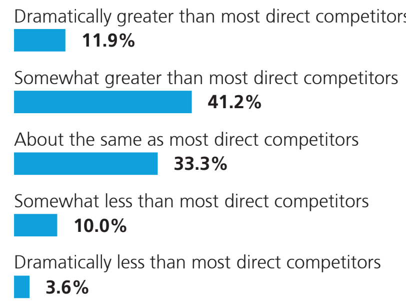
Please rate your company's PAST profitability compared to your most direct competitors: Over the last one year your profitability has been:



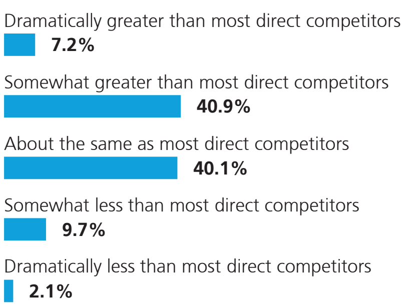
Please rate your company's PAST profitability compared to your most direct competitors: Over the last three years your profitability has been:



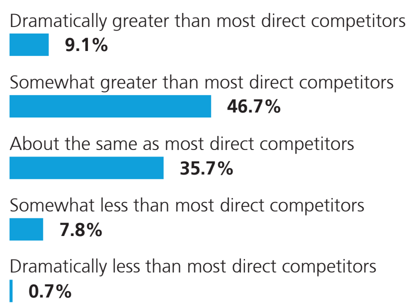
Please rate your company's PAST profitability compared to your most direct competitors: Over the last five years your profitability has been:



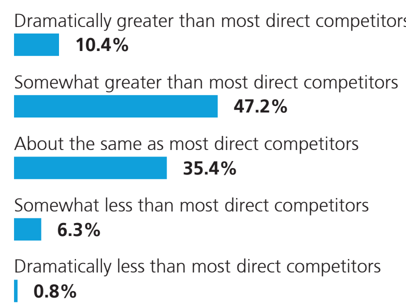
Please rate your company's expected FUTURE profitability compared to your most direct competitors: Over the next one year your profitability will be:



Please rate your company's expected FUTURE profitability compared to your most direct competitors: Over the next three years your profitability will be:



Please rate your company's expected FUTURE profitability compared to your most direct competitors: Over the next five years your profitability will be:



Survey respondent demographics

How long has your company been in existence?

- Less than 10 years: 7.7%
- 11 to 20 years: 25.0%
- 21 to 30 years: 16.1%
- More than 30 years: 51.2%

What was your company's 2013 annual revenue in U.S. dollars?

Between $50 million and $99.99 million
25.9%

Between $100 million and $199.99 million
25.7%

Between $200 million and $499.99 million
25.7%

Between $500 million and $1 billion
22.6%

Which of the following best describes your title?

Owner/Partner
9.6%

Board member
1.0%

CEO
7.7%

President
3.3%

CFO
12.4%

CIO / CTO
8.1%

COO
3.9%

Other C level
2.4%

Senior vice president / vice president
13.4%

Head of business unit
31.0%

Head of department
5.9%

Controller
4.3%

Senior director / director
6.9%

Senior manager / manager
18.1%

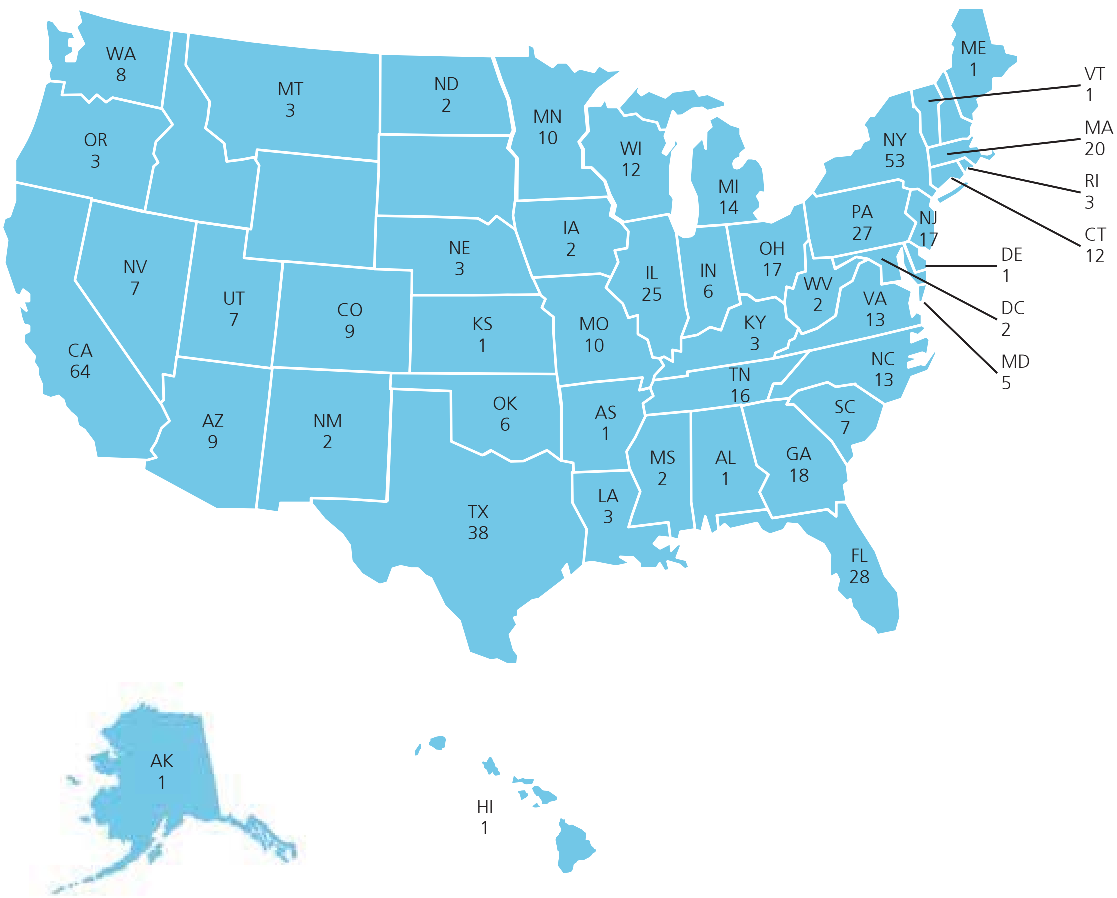
What is your main functional role?

Finance	15.3%
Operations and production	15.3%
Marketing and sales	13.8%
Human resources	10.2%
General management	9.5%
Strategy and business development	6.2%
IT	5.1%
Customer service	4.0%
Procurement	4.0%
R&D	2.9%
Risk	2.5%
Legal	1.8%
Supply-chain management	1.8%
Information and research	0.7%
Other	6.9%

In what sector does your company belong?

Aerospace and defense	2.9%
Automotive	3.5%
Banking and securities	6.9%
Business / professional services	9.4%
Construction / engineering	6.9%
Consumer products	12.6%
Insurance	3.5%
Life sciences and health care	8.1%
Media and entertainment	2.9%
Oil and gas	3.1%
Power and utilities	0.8%
Private equity, hedge funds, mutual funds	1.2%
Process and industrial products	7.3%
Real estate	2.0%
Retail and distribution	7.1%
Technology	6.9%
Telecommunications	1.8%
Other	13.2%

In which state is your company's headquarters located?
(Number of respondents shown.)



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