



**Middle market business leaders focus on factors they can control**

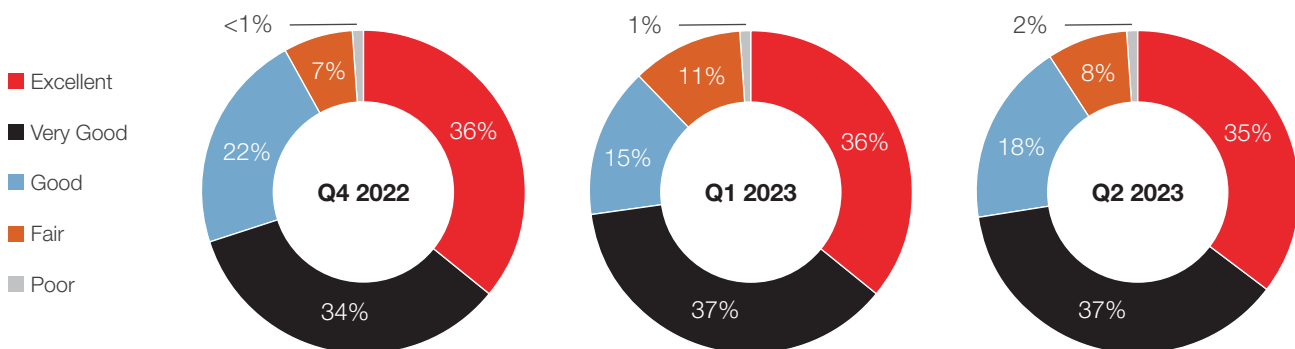
For the past 12 months, middle market business owners have braced for an economic downturn. As of June, 21% believed that the downturn had already arrived, and more than half expected it to hit before the middle of 2024. In KeyBank’s survey of 400 owners and executives of businesses with \$10 million to \$2 billion in revenues, respondents’ confidence in their own business prospects is holding steady, but their outlook on the overall U.S. economy is on the downswing. Their concerns about inflation have started to ease, yet they are once again reporting difficulty attracting and retaining talent and citing challenges with supply chain disruption — painting a now familiar picture of ongoing uncertainty for the middle market.

**Optimism holds steady at the company level while outlook on U.S. economy drops**

Owners and executives of middle market businesses remain optimistic about their companies’ prospects. Nearly three-quarters (73%) characterized the outlook for their company’s financial performance over the next 12 months as excellent or very good.

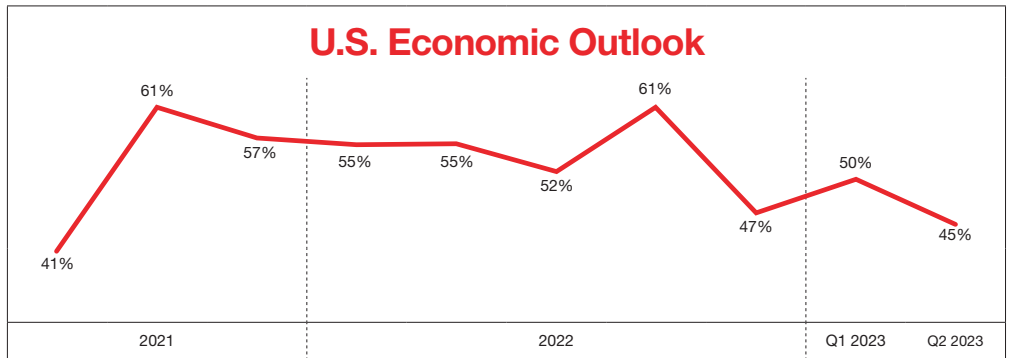
**Overall company outlook for the next 12 months**

*Base: Total business owners/executives*



Positive sentiment increased significantly among business leaders in the manufacturing industry: from 68% of survey respondents reporting an excellent or very good company outlook in March to 74% in June. More companies in the \$250 million–\$500 million revenue range also reported a positive outlook, spiking 12 points to 79% in the latest survey. Across industries, construction recorded the highest percentage (84%) of business leaders with a positive outlook. On the other hand, positive sentiment is lowest in the healthcare industry, where less than two-thirds of middle market business executives (62%) reported an excellent or very good company outlook.

When it comes to the outlook for the overall economy, the middle market is less optimistic. Only 45% of those surveyed said the outlook for the U.S. economy is excellent or very good, a dip of five percentage points since March and 16 points since a peak of 61% in September of 2022.



Sentiment is more positive among middle market business leaders in the construction industry, with 57% feeling excellent or very good about the outlook for the broader economy over the next 12 months. At the other end of the spectrum, those in transportation and logistics are much less optimistic, with only 35% expressing the same positive outlook. In the manufacturing sector, the number of respondents with a positive U.S. economic outlook fell 12 percentage points since March to 39%, despite respondents in this industry reporting a surge of confidence in their own companies. This reflects a persistent trend among middle market business owners and executives: they feel more confident in their own businesses than in the U.S. economy at large.

## Finding success despite uncertainty

Nearly three out of four (73%) survey respondents reported a positive outlook for their companies' prospects, pointing to several underlying factors for their optimism. More than half (52%) attributed their positive outlook to improved efficiency in business operations, and almost as many (49%) cited improvements in technology as a reason for their success. And despite an overall increase in labor market concerns, 39% of companies with a positive outlook characterize their ability to attract and retain talent as an advantage. Companies with a positive outlook also benefited from improved timeliness in receiving raw materials (38%) and the ability to raise their prices (35%). On that note, middle market business leaders with a positive company outlook are expecting moderate (58%) to significant (35%) revenue increases over the next 12 months.



"Certain industries are definitely struggling more than others from a top-line standpoint and in managing expenses. Other industries believe the worst is behind them, and they're positioning themselves for growth."

**– Tim Burke, Central and East region sales executive,  
KeyBank commercial banking**

While these success factors are generally common across industries, each sector cited its own mix of key elements: for example, optimistic retail business leaders named improvements to efficiency in business operations, technology, and cybersecurity as keys to their success. In healthcare, technology, talent, and efficiency topped the list. For transportation and construction businesses, the magic formula was efficiency, technology, and timeliness of raw materials; and in manufacturing, the top two game-changers were improvements to efficiency and technology, with talent and price increases tied for third.

## Company outlook by industry

	Manufacturing	Construction	Healthcare	Retail	Transportation & Logistics
<b>U.S. outlook</b>	39%	57%	28%	43%	35%
<b>Company outlook</b>	74%	84%	62%	69%	64%

## Factors contributing to high company outlooks

(Among businesses with “Excellent/Very Good” outlook)

	Manufacturing	Construction	Healthcare	Retail	Transportation & Logistics
<b>Improved efficiency in business operations</b>	52%	56%	47%	53%	61%
<b>Improvements in technology</b>	48%	47%	67%	50%	48%
<b>Ability to attract and/or retain talent</b>	38%	36%	62%	35%	33%
<b>Improved cybersecurity</b>	25%	34%	28%	39%	28%
<b>Better timeliness of receiving raw materials/commodities</b>	33%	43%	43%	32%	40%
<b>Ability to raise prices</b>	38%	36%	30%	26%	37%
<b>Anticipated decrease in overall inflation</b>	26%	28%	23%	27%	32%

Highest across industries
Lowest across industries

In addition, optimistic middle market business leaders reported plans to expand the scope of their operations. More than 50% of companies with a positive company outlook have made plans to invest and expand their businesses in the next six months; among those with a less optimistic outlook, 29% plan to expand during the same period.

Middle market businesses that plan to expand the scope of their operations are focusing on expanding the use of technology/automation (48%); adding full-time, part-time or contract employees (48%, a significant increase from 41% in March); or implementing process improvements (47%). A significantly higher number indicated plans to add new facilities or locations than during last quarter’s survey (30% in June vs. 22% in March) — and the number of respondents planning to renovate or expand their existing facilities also increased from 25% to 30%.

While many middle market business leaders are looking forward to a bright future, a number of challenges persist, including some that recently seemed to be in the rearview mirror.

## Inflation still tops list of middle market business challenges

In June of 2022, inflation surged to 9.1% — the highest level in decades. A year later, it has cooled to 3.2%.<sup>1</sup> As inflation subsides, the number of middle market business executives reporting that it is currently having a negative impact on their businesses has started to decrease, from 43% in March to 39% in June. That said, inflation is still the top concern, followed by high costs of labor and raw materials/commodities. Among business leaders who reported that inflation is negatively affecting their organizations, the steps they are taking to address it vary: for example, those with a positive company outlook (excellent or very good) are most likely to increase sales and marketing efforts to attract new customers and boost revenue. Those with a more negative company outlook are more likely to report focusing on improving processes and efficiencies.

<sup>1</sup>Reuters, “US inflation cooling as consumer prices rise moderately again,” August 10, 2023. <https://www.reuters.com/markets/us/us-consumer-prices-rise-moderately-july-weekly-jobless-claims-above-expectations-2023-08-10/>

The number of middle market business leaders reporting concerns about oil/gas prices and energy costs declined to 26% and 30%, respectively. That being said, the June survey data reveals an uptick in other areas of concern. One-third of respondents reported that supply chain issues are currently affecting their businesses in a negative way compared to 29% last quarter, which at the time was the lowest number in over a year. Labor market challenges seem to be intensifying: 28% cited the ability to retain talent as currently having a negative impact on their businesses, compared to 21% last quarter. The number of respondents concerned about their ability to attract new workers also increased, to 27% in June from 19% in March.

When it comes to challenges over the next three months, middle market business leaders have slightly different issues on their radar. Their top concerns all revolve around elevated costs, specifically higher prices for oil and gas, raw materials, and labor.



“Inflation is still an issue, although it is subsiding, and that is a welcome relief. While some companies have been able to pass on increased costs to their customers and maintain their gross margins, others have not been able to for a variety of reasons.”

– Tim Burke, Central and East region sales executive, KeyBank commercial banking

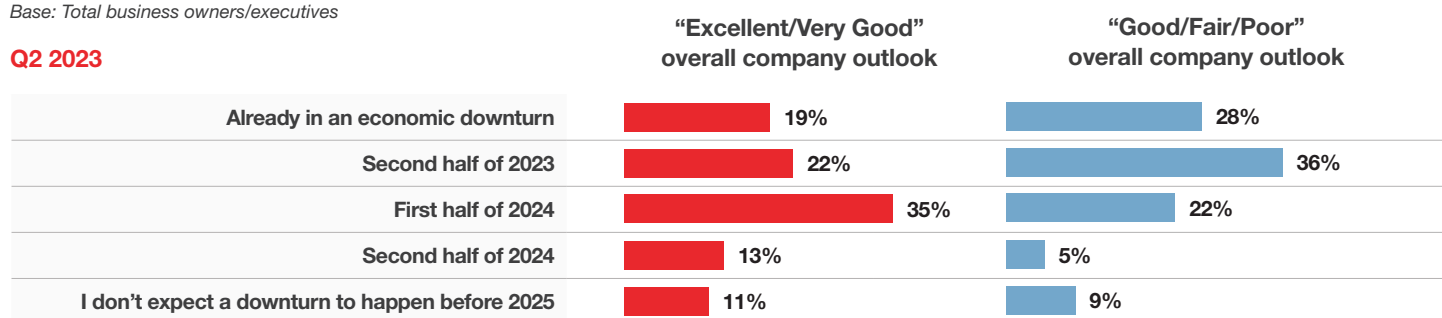
## Is a downturn still looming, or is it already here?

In March, 40% of middle market business leaders expected a downturn to arrive within the first half of 2023. As of June, about one-in-five of those surveyed (21%) believed that prediction had come to pass, and the U.S. was already experiencing a general economic downturn. On the other hand, 57% believe the predicted downturn is still on the horizon: 26% expect it to occur in the second half of 2023, and 31% think it will happen in the first half of 2024. Those with an excellent or very good company outlook are more likely to be in the latter group, while those with a more pessimistic outlook are more inclined to believe a downturn will arrive in 2023. The same pattern holds true for sentiment about the overall economy: middle market business owners with a less rosy view of the U.S. economy expect a downturn will happen sooner than those with a positive outlook.

### Next expected U.S. economic downturn timing by overall company outlook

Base: Total business owners/executives

Q2 2023



Among the 89% of middle market business leaders who anticipate a downturn sometime before 2025, 71% believe it will negatively affect their business. Steps companies are taking to mitigate the impact of a downturn have remained consistent over the past three quarters: improving operational efficiencies/productivity (39%), identifying new markets/products/services to increase revenues (35%), and identifying alternate/lower-cost suppliers of raw materials/component parts (33%) were the top three options selected by survey respondents in June.

## Some businesses anticipate capital and cash flow concerns that could hinder growth

Despite a steady stream of headlines about elevated interest rates and a few high-profile bank failures in the spring, most middle market business leaders are not reporting significant concerns about higher borrowing costs or cash flow. Twenty-one percent of survey respondents reported that higher borrowing costs are currently having a negative impact on their businesses, and 15% expect it to be problem in the next 12 months. Sixteen percent of the middle market business executives said cash flow concerns were currently affecting their companies, and the same percentage anticipate that to be the case over the coming year.

Among those business leaders who did report cash flow concerns, 58% were specifically concerned with their ability to invest in growth, and 49% cited specific concerns about their ability to increase employee compensation — which could exacerbate challenges companies may face in attracting and retaining talent. Nearly half (48%) felt concerned about their ability to offset unexpected expenses or financial emergencies, an increase of 10 percentage points since March.

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“Things have changed dramatically since March, and banks are tightening up lending standards. When cash flow issues arise, banks will be more accommodating to business owners that maintain strong, holistic relationships with their banks.”

– Michael S. Katz, market president, KeyBank Colorado

## Labor challenges intensify as companies encourage return-to-office

More than one-third (38%) of middle market business owners and executives surveyed in June believe that it will be difficult or very difficult to fill their company’s job openings over the next six months. This represents a significant increase from the 27% who felt this way in March. Healthcare companies are having a particularly hard time attracting talent: 50% of respondents in this industry said it was going to be difficult or very difficult to fill open jobs through the end of 2023. Fifty-nine percent of business leaders with a neutral or negative company outlook also reported hiring difficulties. And while 56% of survey respondents at publicly owned companies and 58% of those with \$500 million–\$2 billion in revenue indicated that finding talent was easy or very easy, the overall number of companies confident in their ability to attract and retain talent dropped from 52% in March to 43% in June.

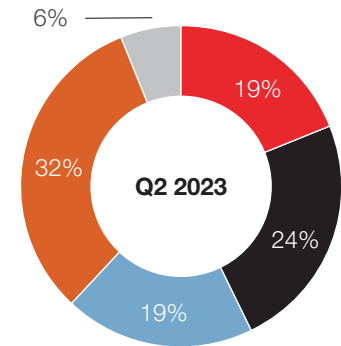
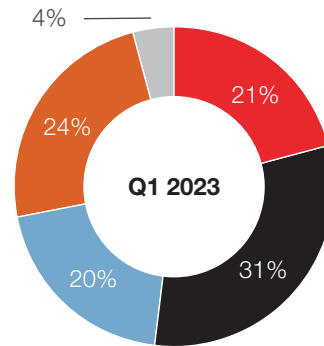
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“Recruiting and retaining top talent should always be a priority. In terms of recruiting, it’s not enough to do a job posting and hope that the most coveted candidates apply. You have to be proactive and aggressive.”

– Michael S. Katz, market president, KeyBank Colorado

# Perceived difficulty in finding talent

Base: Total business owners/executives



Somewhat surprisingly, fewer middle market business leaders who anticipate hiring difficulties said their companies are taking key measures to attract talent. Specifically, the number of respondents who said their businesses are considering implementing or enhancing competitive wages, bonus programs, and flexible hours — the top three measures — all declined slightly this quarter. Similarly, fewer companies are considering implementing or enhancing some of the standard options previously offered as a means for retaining talent, including health and wellness benefits, PTO, and signing bonuses. Yet 20% of middle market business leaders anticipate that it will be difficult or very difficult to retain their employees over the next six months, up from 16% in March.

This quarter's survey also revealed more energy around "return to the office," more than three years after COVID-19 lockdowns necessitated remote work in a variety of industries. Over the past six months, among middle market employers who offer remote work as an option, 54% asked employees to return to or spend more time in their offices — and over the next six months, 60% plan to make this request. Business leaders who plan to take this step hope to increase in-person collaboration and employee productivity, and 42% believe it will have a positive impact on their ability to attract and retain talent. Yet only 26% of the middle market business executives who have already asked employees to return to the office believe it will improve their ability to attract and retain employees moving forward.

## In the face of persistent uncertainty, resilience is crucial

Middle market business leaders' confidence in their enterprises' prospects is holding steady, but their outlook for the broader U.S. economy still skews negative. Many continue to anticipate an economic downturn before the end of 2024 — and they are concerned about high costs for oil and gas, labor, and raw materials, even as inflation subsides. As the fourth quarter looms large, some middle market companies are forging ahead with expansion plans and investing in growth while others anticipate cash flow challenges. Whether they're in healthcare, manufacturing, construction, or retail, middle market leaders have one thing in common: they've navigated an economy plagued by uncertainty for months on end — and in such an environment, resilience remains one of their greatest assets.

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"KeyBank Middle Market Business Sentiment Survey," May 22 – June 9, 2023.

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