



## Middle market business leaders maintain confidence despite ongoing uncertainty

As the end of 2023 approaches, middle market business leaders are maintaining a steadfast sense of confidence in their own companies, despite geopolitical conflicts around the world, political turmoil at home, and a generally lackluster outlook on the overall U.S. economy. In September, KeyBank surveyed 400 owners and executives of businesses with \$10 million to \$2 billion in annual revenue to better understand their perspectives, predictions, and plans heading into 2024. While many still believe an economic downturn is looming, these leaders have become accustomed to navigating uncertainty and adapting accordingly.

### Confidence at the company level, skepticism about the U.S. economy

About half of the middle market business leaders KeyBank surveyed in September (47%) characterized their outlook on the overall U.S. economy as very good or excellent. Those with distinctly more favorable perspectives on the overall economy include businesses with revenue of \$250 million to \$500 million (63%) and those in the retail sector (57%). At the other end of the spectrum, those with \$10 million to \$25 million in annual revenue (34%) and in the healthcare industry (35%) were among the least likely to express optimism about the U.S. economy. Meanwhile, just over half (53%) of middle market leaders surveyed are expecting an economic downturn sometime in 2024.

When it comes to their own businesses, however, the response is much more upbeat. For the past four consecutive quarters, at least 70% of middle market business owners and executives have characterized the overall outlook for their companies' financial performance as excellent or very good.



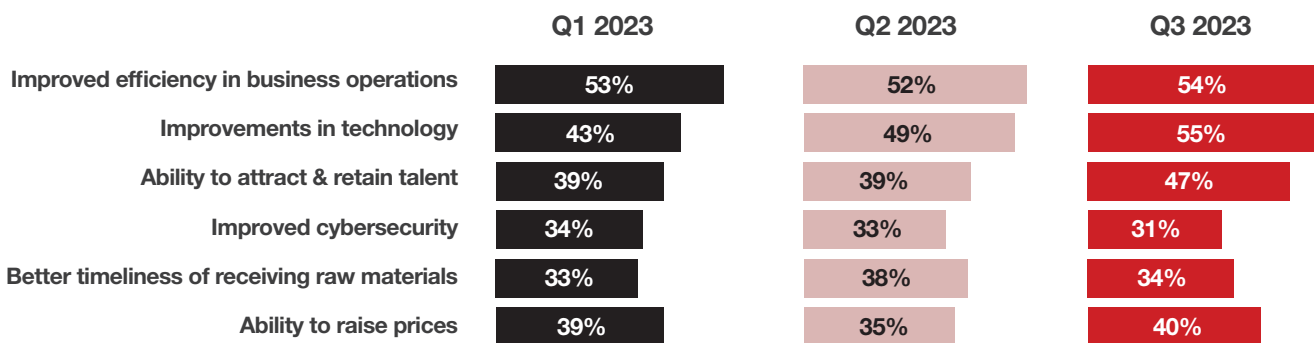
“Strong management teams have a finger on the pulse of their own industries, and they’re confident in their ability to deliver on their budgets. But they also recognize that there are a lot of broader market forces and economic factors outside of their control.”

– Sean S. Moskal, Buffalo Commercial Banking Leader, KeyBank

Since the beginning of 2023, sentiment trended upward most significantly in manufacturing (from 68% in March to 76% in September) and transportation (from 58% in March to 76% in September). More business leaders in the South (83%) and West (77%) regions also reported a strong company outlook, whereas in the Midwest, sentiment is trending downward — from 78% positive in March to 63% positive in September.

Technology plays a big part. Among those who expressed optimism about their business prospects this quarter, the top contributing factor to their positive outlook was improvements in technology, cited by 55% of respondents. Improved efficiency in business operations, the ability to attract and retain talent, and the ability to raise prices also factored into middle market leaders' confidence in their own businesses.

## Top factors contributing to positive company outlook



## Investing in growth and exploring AI

It should come as no surprise that many middle market business leaders are focused on expansion, given their positive outlook. Over the past six months, 66% of those with a positive company outlook have increased funding plans to invest in or expand their businesses. Nearly half of those surveyed (47%) plan to add employees, 46% will make process improvements, and 40% will introduce new products. Moreover, the number of middle market businesses planning to expand or renovate their current facilities increased significantly throughout 2023, from 25% in March to 36% in September.

Technology will play a major role in 2024 growth plans. Half of business owners and executives surveyed will expand their use of technology or automation over the next six months — and among companies at the larger end of the middle-market spectrum (revenue between \$500 million and \$2 billion), that figure increases to nearly two-thirds (63%). Middle market business leaders are also exploring opportunities around artificial intelligence (AI): 42% overall and 63% of those in the higher revenue category plan to implement AI for combating fraud, analyzing data, and automating simple tasks. These leaders identify a wide variety of benefits emerging from AI adoption, including faster and more accurate customer service, improved productivity, and better decision-making.

### Reasons for implementing AI

Base: Those investing in/expanding scope of ops with AI in next six months

Q3 2023



### Perceived benefits of AI

Base: Those investing in/expanding scope of ops with AI in next six months

Q3 2023



Cybersecurity considerations are critical as businesses ramp up their investment in AI and other digital transformation tools. In this survey, most middle market business leaders (82%) characterized their IT networks as secure. This reflects an increase from 2020 when threats and cyberattacks spiked during the COVID-19 pandemic, and only 70% of those surveyed indicated that their networks were somewhat or very secure.

However, when asked about specific cybersecurity tools, many middle market business leaders revealed that their organizations still have room for improvement in critical areas. Just over half reported having antivirus and anti-malware protection on all business computers, less than one-third have written information on security policies and procedures in place, and only 18% provide social engineering training, which can help prevent hackers and cybercriminals from gaining network access through phishing, synthetic identity fraud, and other schemes. Last, implementing tools to protect against payments-related fraud and cybercrime is a crucial component of managing cash flow.

## Inflation remains a top challenge, but some business leaders report silver linings

The top three challenges currently negatively impacting middle market businesses are the overall increase in inflation (46%), higher labor costs (35%), and higher energy costs (32%).

”

“Even as inflation settles, middle market businesses are dealing with increased costs for energy and utilities, labor, insurance, transportation, interest expenses, and more. These businesses are learning to operate in a higher-price environment, and many are looking to pass on price increases to customers in the first quarter of 2024.”

– Timothy J. Glass, Western Pennsylvania Commercial Banking Leader, KeyBank

While inflation continues to top the list of current concerns, business leaders are divided about its overall impact on their organizations over the past six months. Thirty-two percent report that the positive impacts of inflation outweighed the negative, 30% said the positives were equal to the negatives, and 33% said negative impacts outweighed the positive. Higher numbers of middle market business owners and executives in the retail sector reported positive effects of inflation (44%), as did those with revenues above \$250 million (42%). Among business leaders who reported positive effects of inflation, 51% cited the ability to increase prices, 44% cited increased incentives for the business to spend or invest, and 43% named increased customer spending as a primary benefit.

Looking ahead to 2024, leaders with a positive company outlook plan to respond to ongoing inflation by prioritizing automation (36%) and improving processes to create efficiencies (34%). Those with a less optimistic company outlook are also looking to boost efficiency with process improvements (37%) — but more business leaders in this group (40%) intend to pass increased costs on to customers.

Over the next 12 months, the negative effects of inflation and elevated costs remain the top challenges anticipated by middle market business owners — but concerns about the labor market and the cost of capital are on the rise. About a quarter (24%) of survey respondents expect their ability to attract talent to negatively impact their business in the coming year, compared to 18% in June. And 24% anticipate issues related to higher borrowing costs, compared to only 15% in KeyBank’s survey from last quarter.

## Attracting and retaining talent is harder for some businesses than others

Turning to people issues, nearly half of middle market business owners and executives report that their growth plans include adding more employees to their workforces over the next six months. Forty-one percent of survey respondents expect finding talent over that period to be easy or very easy. Positive sentiment about talent acquisition is more prevalent among those with a positive outlook on the U.S. economy (67%), from firms with \$500 million or more in revenue (55%), and in the construction industry (51%). Conversely, 39% of middle market business leaders anticipate finding talent to fill their open positions will be difficult or very difficult. This is especially true in the Midwest (55%), the healthcare industry (50%), and for companies with revenue in the \$25 million–\$50 million range (50%).



“Labor, especially certain types of skilled labor, is still very hard to come by and especially hard to retain. There’s more talent available now, but businesses have to pay more to attract that talent.”

– Christopher Picardi, Colorado Commercial Banking Leader, KeyBank

This quarter, the top method for attracting talent among business leaders who anticipate hiring challenges is implementing or enhancing health and wellness benefits. More than half (53%) reported taking this approach in September, a significant increase from 41% in June. The number of respondents offering job training and educational benefits as a means to attract new workers is also on the rise, at 34% from 29% previously.

Fewer middle market business owners and executives are concerned about retaining their existing talent than attracting new workers. Among the 20% who anticipate challenges in this area over the next six months, improving the competitiveness of wages and salaries is the most cited method for talent retention (56% versus 45% last quarter). The number of respondents who are enhancing their efforts to create a safe working environment at company offices and physical locations is also on the rise, from 21% in June to 31% in September.

In an era of hybrid work, about half of those surveyed who offer remote work options have asked employees to return to the office in the past six months, and roughly the same number plan to make the request within the next six months. Increasing productivity and collaboration are the main reasons cited, but a growing number of those asking employees to spend more time in the office said that enabling better access to new technologies (48%) and concerns about data security and privacy concerns (43%) are important considerations.

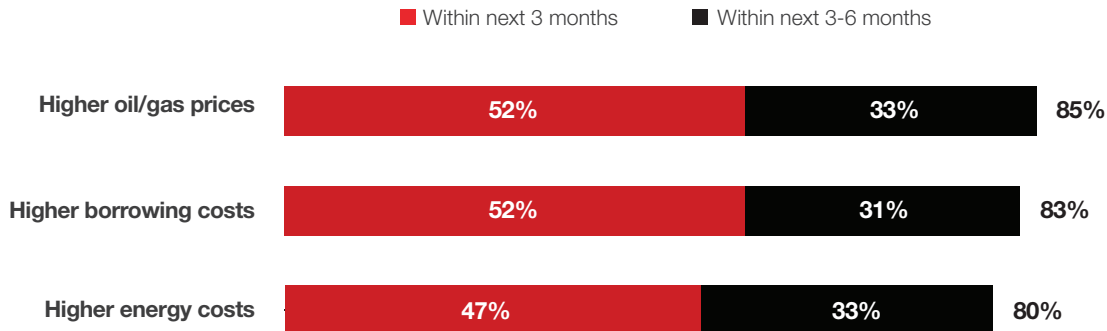
## Concerns mount about access to capital and credit

As interest rates remain elevated, concerns about higher borrowing costs are on the rise — especially in the near term. As of September, higher borrowing costs were tied with higher oil and gas prices as the top issue expected to negatively affect middle market businesses’ bottom lines during the fourth quarter of 2023.

Twenty-four percent of middle market business owners and executives anticipate higher borrowing costs to negatively impact their businesses within the next 12 months, compared to only 15% in Q2. Of those respondents, more than half (52%) expect it to be a problem in the next three months, and 83% anticipate a negative impact on their bottom line within the next six months. In response, middle market business leaders are exploring new sources of capital and credit, including private equity firms (55%), commercial lenders (46%), and the use of multiple banks (43%). In the current rate environment, business leaders may benefit from reviewing and updating their liquidity strategies.

# More businesses expect higher borrowing costs to be an issue in the next 6 months

Base: Total business owners/executives



“Given the current environment of higher interest rates and continued uncertainty, businesses are taking steps to manage liquidity in a way that will maximize earnings without locking up their cash. The credit market is a lot tighter than it was a year ago, so having excess cash on hand can enable middle market businesses to take advantage of opportunities that arise.”

– Jeff Wenham, Senior Leader Pricing & Portfolio Management, KeyBank Payments

For middle market businesses anticipating issues around cash flow, the ability to invest in growth (66%) is the most cited concern, but nearly half (45%) are now also concerned about their ability to pay bills — a significant jump from 27% in June. On the other hand, fewer leaders are worried about their ability to offset unexpected expenses or financial emergencies than in Q2.

## Persevering through ongoing volatility and uncertainty

2023 has imposed a host of challenges on middle market businesses — and between a potential downturn, ongoing geopolitical conflict, and what promises to be a tumultuous election year, it looks like uncertainty and volatility will continue in the year ahead. Yet in the face of these challenges, middle market business leaders are maintaining their resolve, managing for growth, and making plans to expand. This vital segment of the economy has proven its resilience in recent years, and the optimism shown by many middle market business owners and executives seems warranted as they approach 2024.

**KeyBank has the industry expertise, insights, and solutions to help your business manage for growth and identify opportunities in an uncertain economic environment. Our payment capabilities offer integrated solutions and strategic expertise to help your business manage liquidity and cash flow. To learn more about KeyBank’s middle market capabilities, contact a KeyBank Relationship Manager.**



“KeyBank Middle Market Business Sentiment Survey,” August 21 – September 8, 2023.

This article is for general information purposes only and does not consider the specific investment objectives, financial situation, and particular needs of any individual person or entity. Information included was prepared based on survey respondents’ answers, information from business leaders considered to be reliable, and an express disclaimer of warranty, express or implied, as to such information’s accuracy or completeness. KeyBank does not provide legal advice.

Please read our complete KeyBank Capital Markets [disclosure statement](#).

©2023 KeyCorp. All rights reserved.