



SENTIMENT REPORT 2024 SECOND HALF

Optimistic middle market
leaders are setting
their sights on growth

Executive Summary

Despite market performance, optimism has increased for middle market business leaders looking to the second half of 2024. According to KeyBank’s latest Middle Market Sentiment survey of 700 owners and executives of businesses with \$10 million to \$1 billion in annual revenue, respondents are displaying a renewed confidence in their companies’ financial performance — with optimism jumping to its highest level in years. In the survey, 78% of middle market leaders characterized the outlook for their companies over the next 12 months as excellent or very good.

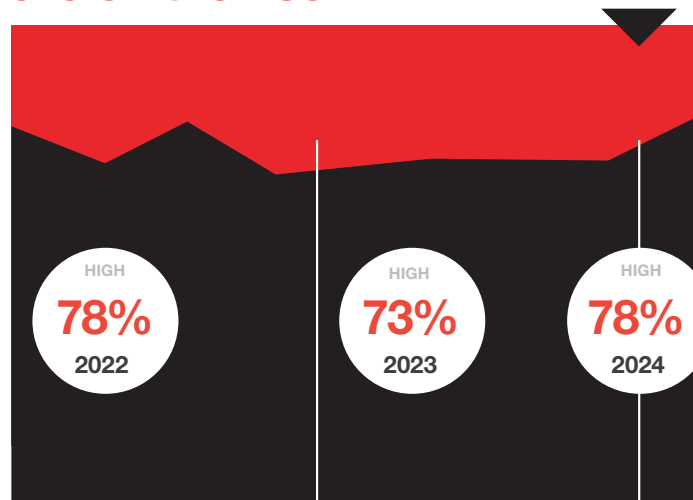
As middle market companies continue to remain resilient, they also have their sights set on growth: 52% of survey respondents with a positive economic outlook expect to be involved in M&A activity on the buy side in 2024, while 87% of leaders with concerns about accessing capital and credit plan to use alternative sources (like private equity and private debt lending, for example) within the next three years to support a transaction. The number of leaders planning to use artificial intelligence (AI) to expand the scope of their operations is also on the rise since late last year. Before the end of 2024, more than half of the business owners and executives surveyed plan to expand company operations by implementing AI, while 46% plan to add employees, and 44% plan to introduce new products.

Despite the overall positive sentiment among business leaders, there are still concerns around inflation, interest rates, and the cost of labor, energy, and materials. In response, they are looking for ways to ramp up operational and energy efficiencies, increase their sales and marketing efforts to boost revenue, and deploy automation to drive productivity.

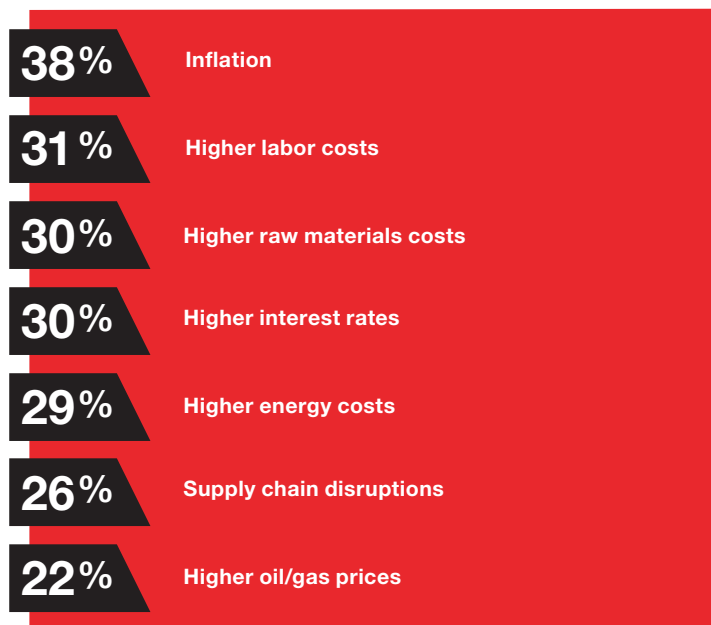
Cybersecurity continues to be front and center for business leaders, with one-third of businesses experiencing a cybersecurity or financial fraud issue in the past 12 months. This might point to why 60% of companies plan to implement AI for cybersecurity and fraud management purposes.

Read on for fresh perspectives on opportunities, challenges, growth strategies, and more from this dynamic, essential segment of the U.S. economy.

Positive company outlooks are on the rise



Q2 2024
Top challenges facing middle market businesses
 Base: Total business owners/executives



Company outlook rises while overall economic outlook holds steady

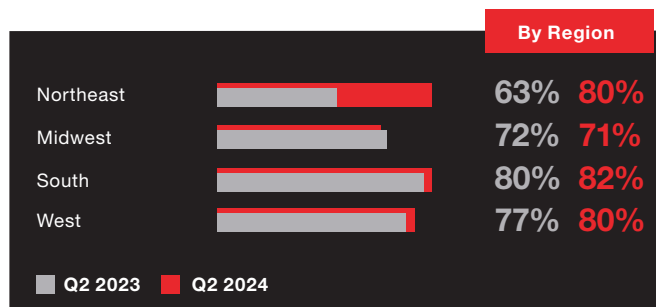
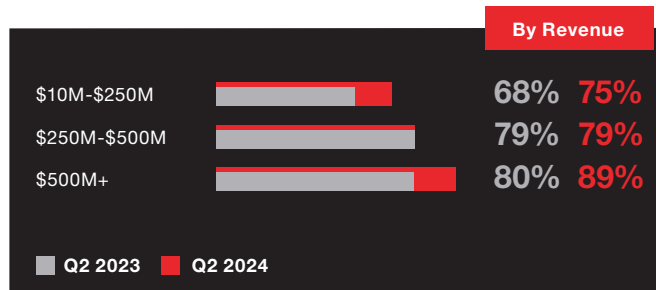
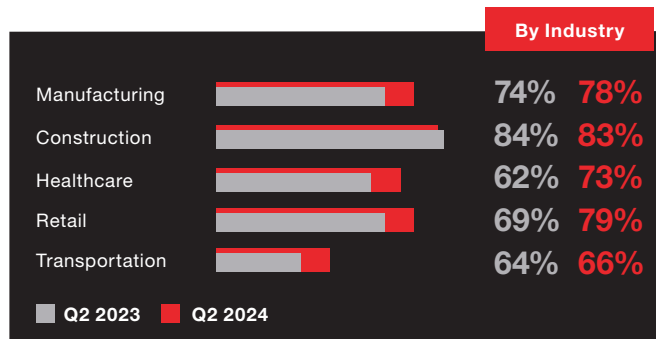
Middle market business leaders feel more optimistic about their companies' outlooks than they did a year ago. Nearly 80% of middle market business leaders surveyed characterized the outlook for their companies' financial performance over the next 12 months as excellent or very good — an increase of 5 percentage points from a year ago. The uptick in positive sentiment was steeper among leaders of companies in the healthcare and retail industries, those in the highest revenue groups, and businesses based in the Northeast.

Leaders attribute these upticks primarily to continued efficiencies in their business operations and technology advancements. Improved efficiency in business operations remained the top factor contributing to a positive company outlook, cited by 64% of respondents compared to 56% at the end of 2023 and 52% in Q2 2023. Improvements to technology was cited by 60% as a top factor, climbing from 54% at the end of 2023 and 49% in Q2 2023. The ability to attract and/or retain talent was also crucial, with 44% reporting that it was a contributing factor to their positive company outlook.

Meanwhile, middle market business leaders' overall outlook on the economy held steady. The number of respondents who described their outlook on the U.S. economy over the next 12 months as excellent or very good increased 1 percentage point to 50%. Many leaders who were especially optimistic about their corporate outlooks also shared optimism about the economy, including companies in the retail industry, those in the highest and lowest revenue groups, and businesses based in the Northeast.

Uptick in company outlook by industry, revenue, and region

Base: Total business owners/executives with excellent/very good company outlook



Q2 2024 Top factors contributing to a positive company outlook

Base: Total business owners/executives



Optimistic business leaders express appetite for M&A activity

M&A is on the minds of middle market leaders. More than half (52%) of survey respondents with a positive economic outlook expect to be involved in M&A activity on the buy side by the end of 2024.

When looking a few years into the future, optimistic leaders are even more interested in M&A, as 56% of leaders expect buy-side activity in 2025, and 60% in 2026. Optimistic leaders also anticipate sell-side M&A activity to increase from 31% by the end of 2024 to 36% in 2025 and 37% in 2026.

Leaders at public companies appear more likely to be involved in buy-side activity than leaders at smaller firms. Middle market companies between \$250 million and \$500 million in revenue are more likely to seek sell-side opportunities.

Identifying the right targets was the top challenge identified on the buy side. On both the buy and sell sides of potential transactions, middle market leaders cited developing relationships with owners and executives of target firms and cultural considerations (including alignment of values, beliefs, behaviors, and organizational norms) as top-of-mind challenges.



Middle market businesses are rapidly expanding, with many turning to M&A to accelerate growth in a dynamic environment. Achieving an optimal outcome requires a deep knowledge of industry and market subtleties and a planned approach to optimize target identification, transaction execution, business integration, and synergy capture.

Randy Paine
President

KeyBanc Capital Markets & Key Institutional Bank

Anticipated M&A activity during 2024, 2025, and 2026

	Excellent/ Very Good U.S. Economy Outlook	
Q2 2024	Total	
By the end of 2024		
Buy Side	37%	52%
Sell Side	22%	31%
Neither	49%	31%
During 2025		
Buy Side	44%	56%
Sell Side	25%	36%
Neither	41%	23%
During 2026		
Buy Side	46%	60%
Sell Side	26%	37%
Neither	40%	21%

Q2 2024

Top buy-side and sell-side challenges

Base: Total business owners/executives

Buy Side

- 47%** Identifying the right targets that are currently interested in selling or pursuing a sale process
- 44%** Developing or leveraging existing relationships with the business owners of target firms
- 43%** Cultural considerations (e.g., company culture, alignment of values, beliefs, behaviors, organizational norms)

Sell Side

- 59%** Developing or leveraging existing relationships with the business owners of target firms
- 53%** Cultural considerations (e.g., company culture, alignment of values, beliefs, behaviors, organizational norms)
- 49%** Market disruptions/unpredictable events

Private equity represents alternative capital source, growth engine

The latest survey revealed a strong connection between private equity and middle market corporate growth.

More than half of middle market business leaders with a positive outlook on the U.S. economy reported that their organizations were fully or partially owned by private equity firms. Similarly, 41% of those with positive company outlooks reported having some private equity ownership.

When asked which factors had influenced or would influence their decision to engage with a private equity firm, 50% cited growth opportunities, followed by access to capital (45%) and access to talent (37%).

For leaders concerned with access to capital and credit, a large majority (87%) plan to use alternative sources within the next three years. Of those alternative sources, private equity firms were the top alternate source of capital/credit cited by respondents.



Access to capital and credit is a continuing concern for middle market companies, and as inflation and elevated interest rates continue to pose challenges, it is no surprise that business leaders are looking for alternative sources. Banks are an attractive option for acquisition financing, with plenty of capacity to lend — often at a better price and with more flexible terms than alternative financing methods that lack the relationship approach banks provide.

Doug Ingram
Head of Syndicated & Leveraged Finance
KeyBanc Capital Markets

Q2 2024

Top factors driving private equity engagement

Base: Total business owners/executives

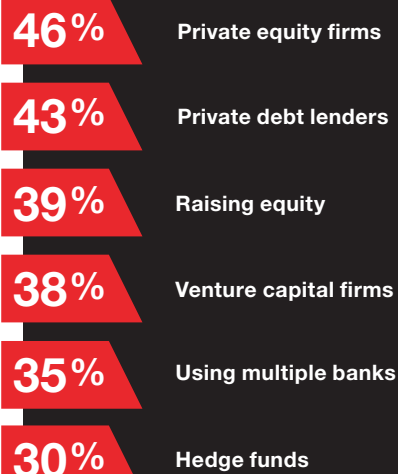


Private equity: The top alternate source of capital/credit

Q2 2024

Alternate source of capital/credit

Base: Total business owners/executives



AI adoption tops list of methods for expanding operations

Many middle market businesses have set their sights on growth in the second half of 2024. These ambitious leaders are looking to expand their use of technology and automation, add employees, introduce new products, and more. Companies with higher annual revenue are more likely to report investing in several methods of expansion.

Once again, AI topped the list of methods companies are using to expand the scope of their operations. In mid-2024, more than half of those surveyed (54%) reported plans to implement artificial intelligence, an increase of 10 percentage points since the fourth quarter of 2023.

The three top reasons for implementing AI were data analysis, cybersecurity/fraud management, and data entry and/or data processing.



Middle market expansion plans reflect a continued resiliency of this sector, demonstrating an ability to adapt to the changing landscape, explore new opportunities, and invest in their future. Whether it's adding new product lines, expanding markets, scaling their operations, or implementing new technology and automation, these businesses are setting the stage for a robust and sustainable future.

Ken Gavriety
President
KeyBank Commercial

The top five methods for expanding operations

54%

Implementing the use of artificial intelligence (AI)

48%

Expanding the use of technology/automation

46%

Add employees (full-time, part-time or contract)

44%

Introducing new products

42%

Implementing process improvements

The top five reasons for implementing AI

65%

Data analysis

60%

Cybersecurity/fraud management

57%

Data entry and/or data processing

52%

Automating simple employee tasks

51%

Inventory management

Inflation remained a concern, but some leaders report silver linings

Not surprisingly, inflation remained a top concern in the middle market at mid-year. More than one-third of survey respondents (38%) reported that overall increases in inflation are negatively impacting business operations. Inflation-induced impacts continue to include increased costs of raw materials/supplies, increased overhead costs, and increased costs of energy/oil/gas, among others.

The effects of rising energy, oil, and gas costs continue to take a toll on companies looking to combat inflation. Almost a third (29%) of leaders reported negative effects on business operations due to higher energy costs. The number of those respondents who have experienced shrinking profit margins as a result of higher energy costs increased by 9 percentage points during the first half of 2024.

An increasing number of leaders (42%) are also seeing decreased revenue due to higher energy costs, compared to the end of 2023 (36%) and Q2 2023 (37%). To combat rising energy costs, affected business leaders plan to increase energy efficiency efforts and improve processes/create operational efficiencies.

It is not all bad news: Some middle market business leaders reported positive outcomes from inflation. Among those with a positive economic outlook who reported at least some positive impact from inflation, increased productivity was the top benefit. The number of these companies citing the ability to increase prices as a positive outcome of inflation also increased by 12 percentage points to 41% since Q4 of 2023.

The top five effects reported by companies feeling negative impact of inflation

55%

Increased costs of raw materials/supplies

50%

Increased overhead costs

46%

Increased costs of energy/oil/gas

41%

Increased manufacturing/operating costs

37%

Increased employee salaries/wages/benefits

Silver linings of inflation in the middle market

Q2 2024

Positive inflation effects on business by U.S. economy outlook

Base: Total business owners/executives

60%

Increased productivity due to greater investments in automation/process improvements

56%

Increased value of investments/holdings

55%

Increased incentive for the business to spend or invest

52%

Increased customer spending (e.g., building up inventories, buying ahead)

41%

Ability to increase prices

Phishing, data corruption, and check fraud are pervasive threats

In 2023, the FBI reported a staggering \$12.5 billion in losses due to cybercrimes, representing a 22% increase from 2022. According to our survey, within the past 12 months, an alarming 1 in 3 middle market businesses surveyed had experienced a fraud or cybersecurity issue. The most common issues were phishing/email spoofing and data corruption, but respondents also reported identity theft, ransomware attacks, and financial statement fraud.

Despite the severity of these threats, only about half of those surveyed used multifactor authentication, and only 36% had security measures in place to prevent unauthorized devices from connecting to their networks. When asked how they plan to bolster cybersecurity defenses in the coming year, 21% of middle market business leaders plan on implementing controlled access to servers and key technologies, followed by using anti-malware protection on all business computers (19%), and requiring dual authorization for outgoing payments (19%).

In addition to high-tech security threats, old-fashioned paper check fraud remains a cause of financial losses among middle market businesses. Fraudsters are becoming more organized and sophisticated — and businesses need to protect themselves accordingly.



I've seen fraud losses of hundreds of thousands of dollars on a single check. Fraud is widespread because when it works, unfortunately, it can result in very large losses for the victims. It is so important for businesses to take advantage of products to protect themselves.

Matt Swope
Senior Product Leader
KeyBank Payments

Phishing/email spoofing, data corruption are most common issues

Q2 2024

Cybersecurity or fraud occurrences in the past 12 months
Base: Total business owners/executives



The top tools leaders plan to use to combat cybersecurity threats

Q2 2024

Cybersecurity tools plan on using
Base: Total business owners/executives



Conclusion

At the mid-year mark for 2024, middle market business leaders' optimism about their companies' financial prospects soared to its highest point since mid-2022. This optimism, reflected by nearly 80% of business leaders surveyed, continues to be driven by improvements in operational efficiency and improvements in technology.

Companies anticipating strong performance over the coming year are exploring M&A opportunities and private equity engagement with an eye toward growth. To expand their operations over the next six months, middle market business leaders plan to implement AI, expand their use of technology and automation, and add more employees.

At the same time, inflation backed by high costs remains a stubborn challenge for many middle market companies, with more than one-third reporting that increases in inflation are currently having a negative impact on their business. Cybersecurity and financial fraud also pose threats to business operations, and companies are taking measures to bolster their defenses accordingly.

It has been a tumultuous few years for businesses, and the middle market is no exception. But heading into the second half of 2024, most middle market business owners and executives are looking forward with renewed confidence and a charted path toward future growth.



KeyBank has the industry expertise, insights, and solutions to help your business manage growth and identify opportunities in an uncertain economic environment.

Our banking teams offer integrated solutions and strategic expertise to help your business raise capital and manage payments, liquidity, and cash flow. To learn more about KeyBank's middle market capabilities, [contact a KeyBank Relationship Manager](#).



"KeyBank Middle Market Business Sentiment Survey," May 14 – June 12, 2024. KeyBank's Middle Market Sentiment survey asked more than 700 owners and executives of businesses with \$10 million to \$1 billion in annual revenue about their outlook for the year, the challenges currently affecting their businesses, and their growth plans for 2024.

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](#).