



In 2022, middle market businesses are cautiously optimistic

As middle market businesses settled into the first quarter of 2022, COVID-19 seemed to be loosening its grip across the country. But shortly after KeyBank surveyed 400 owners and executives of middle market businesses (in the \$10 million to \$2 billion range¹) about their outlook for the coming months, Russia invaded Ukraine – setting off a geopolitical conflict that introduces new layers of economic uncertainty for businesses of all shapes and sizes.

Even before the conflict, middle market business owners expressed a dual economic view: positivity about their own companies' success potential, contrasted with uncertainty about the U.S. economy at large. They focused on their eagerness to resume normal business operations and plans to invest in growth – all while keeping a careful eye on supply chains, rising inflation, and a highly competitive labor market.



“Despite the level of uncertainty, businesses are looking to capitalize on near term opportunities. With the amount of stimulus money, and interest rates that are still historically low, there’s so much cash in the system right now. They’re expanding in a targeted way.”

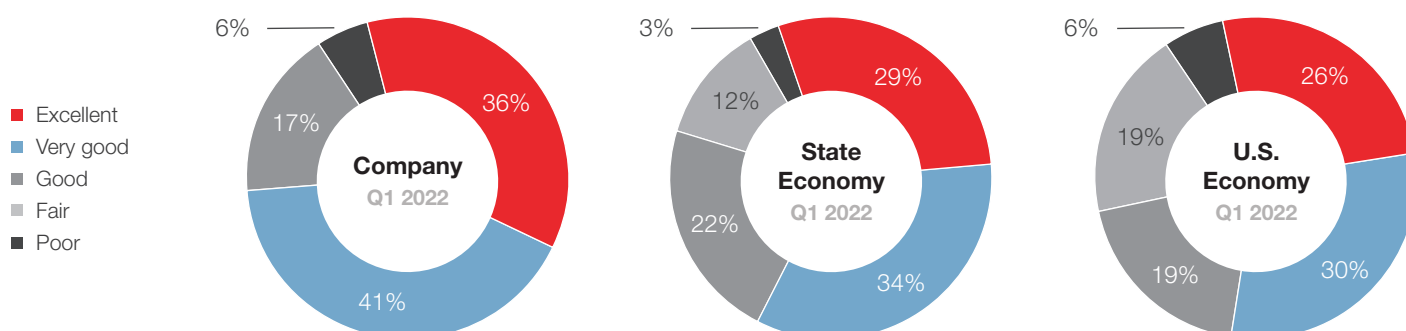
– Kelly Lamirand, market president for Northeast Ohio, KeyBank

¹Business Owners/Executives – This sample group represents the opinions of respondents who are specifically business owners, C-suite professionals, or have the title of SVP, VP, controller or treasurer (\$10M to under \$2B revenues).

Middle market businesses are bullish despite persistent uncertainties in 2022

Compared to the fourth quarter of 2021, slightly more middle market business leaders (77%) reported having an excellent or very good outlook for their company's financial performance over the next 12 months. Larger companies (\$500 million to \$2 billion in revenue) and those in the construction industry were particularly optimistic about their prospects for 2022, with more than 80% of survey respondents in both categories reporting an excellent or very good outlook. However, as was the case in late 2021, significantly fewer business owners and executives (55%) expressed the same levels of optimism about the broader U.S. economy – especially among those who rated their own company's outlook as fair or poor.

Overall outlook for the next 12 months

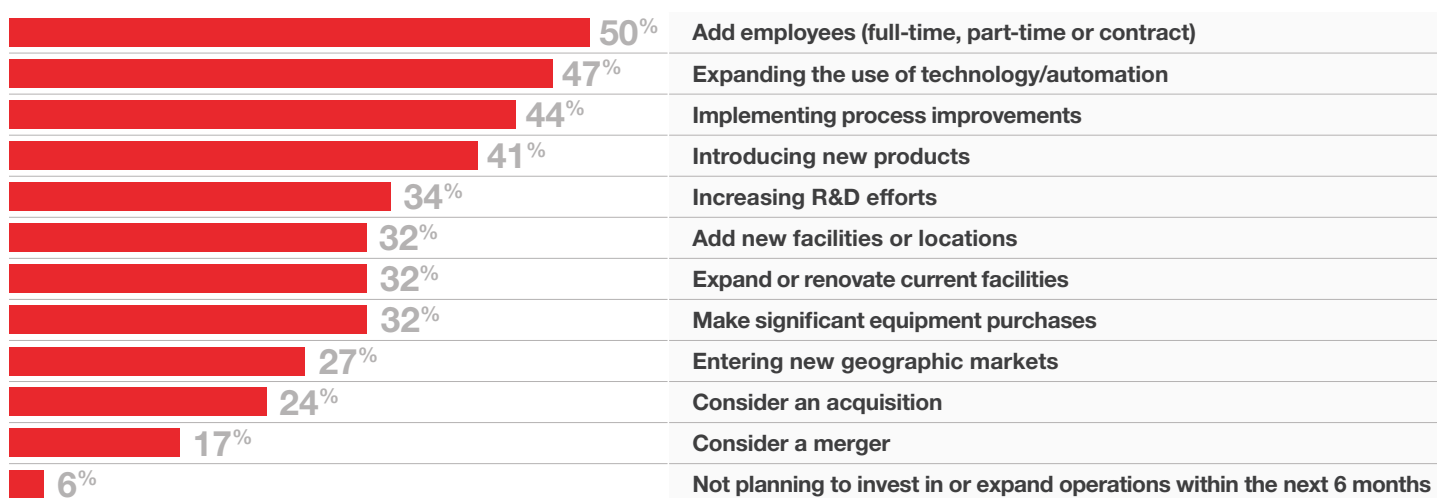


While two-thirds of respondents reported being somewhat or fully back to normal business operations since the onset of the pandemic, other factors contributed to uncertainty in the middle market. Thirty-nine percent of middle market executives said that supply chain disruptions are currently having a negative impact on their business, and 32% expected these issues to continue over the next 12 months. About the same number (38%) said they were already feeling the negative effects of rising inflation, with about 43% expecting inflation to impact their businesses in 2022.

Despite these uncertainties, middle market businesses started the year off with plans to expand the scope of their operations. Half of those surveyed anticipated bringing on new employees within the next six months, and nearly as many (47%) plan to further invest in technology/automation. A quarter (24%) said they were considering an acquisition; among companies in the \$500 million to \$2 billion revenue range, that number climbed to 31 percent.

Method for expanding scope of operations

Q1 2022



“M&A activity is robust right now,” observed Lamirand. “Multiples are super high, even in the lower end of the market. It reminds me of the hot housing market – before you even get to see a place in person, it’s gone.”

As the pandemic fades, consumer restrictions lift, and economic activity picks up, middle market businesses are eager to use available cash to seize opportunities for growth. But uncertainty persists, especially when it comes to supply chains, inflation, and the labor market.

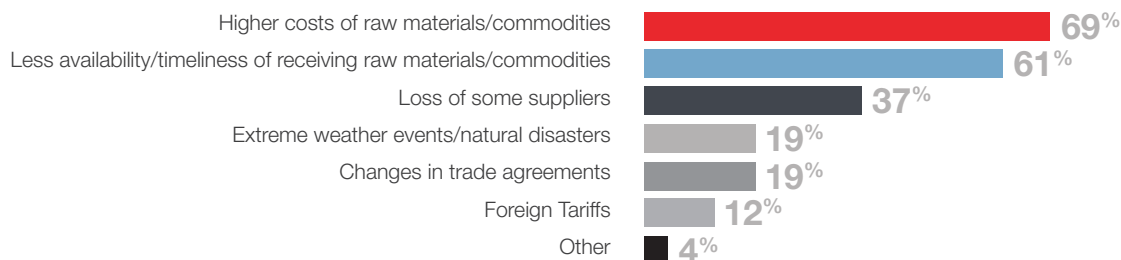
Supply chain disruptions continue to impact the middle market

The havoc wreaked on global supply chains during the pandemic continues to ripple through the economy. Of the executives Key surveyed, nearly half (44%) reported that supply chain issues had negatively impacted their business within the past 12 months. Among those reporting a neutral or negative outlook on the overall U.S. economy, that number increased to two-thirds, suggesting that supply chain woes have significantly contributed to economic pessimism in the middle market.

Digging deeper into the supply chain dilemma, the cost and availability of raw materials as well as the loss of key suppliers continued to rank as survey respondents’ top three concerns. Of those who reported that supply chains had negatively impacted their businesses, 55% have experienced a decrease in the efficiency/productivity of their business operations. Nearly half (47%) reported both lower revenues and thinner profit margins because of supply chain difficulties.

Supply chain difficulties

Q1 2022



In response to supply chain disruptions, the middle market businesses impacted are working to identify alternative suppliers (44%), passing increased costs onto their customers (42%), and carrying excess inventory as a buffer (42%). In addition, 43% expect to update their supply chain information/management systems – compared to only 23% who planned to take that approach last quarter.

Fortunately, lack of availability and long wait times for raw materials seem to be abating: 61% of respondents said they were experiencing these problems in Q1 of 2022, compared to 76% the previous quarter.



“The general sentiment among our clients is that the supply chain issues will work out over the next eighteen (18) months – however the Ukraine-Russia crisis has complicated that view in the short term. While optimistic that things will get better, smart businesses are taking steps to prepare in case they get worse in the short term.”

– Christopher Doyle, KeyBank commercial banking sales leader in Cleveland, Ohio

A recent report from Moody's Analytics stated that the greatest risk to global supply chains is no longer the pandemic, but the war in Ukraine and its resulting geopolitical and economic uncertainties. Companies that rely on energy resources will be especially affected, according to the report.²

²CNN Business. “Russia-Ukraine crisis replaces Covid as top risk to global supply chains,” Moody's says.” March 4, 2022. <https://www.cnn.com/2022/03/04/business/russia-ukraine-supply-chain-oil/index.html>

Rising inflation and interest rate hikes loom large for the middle market

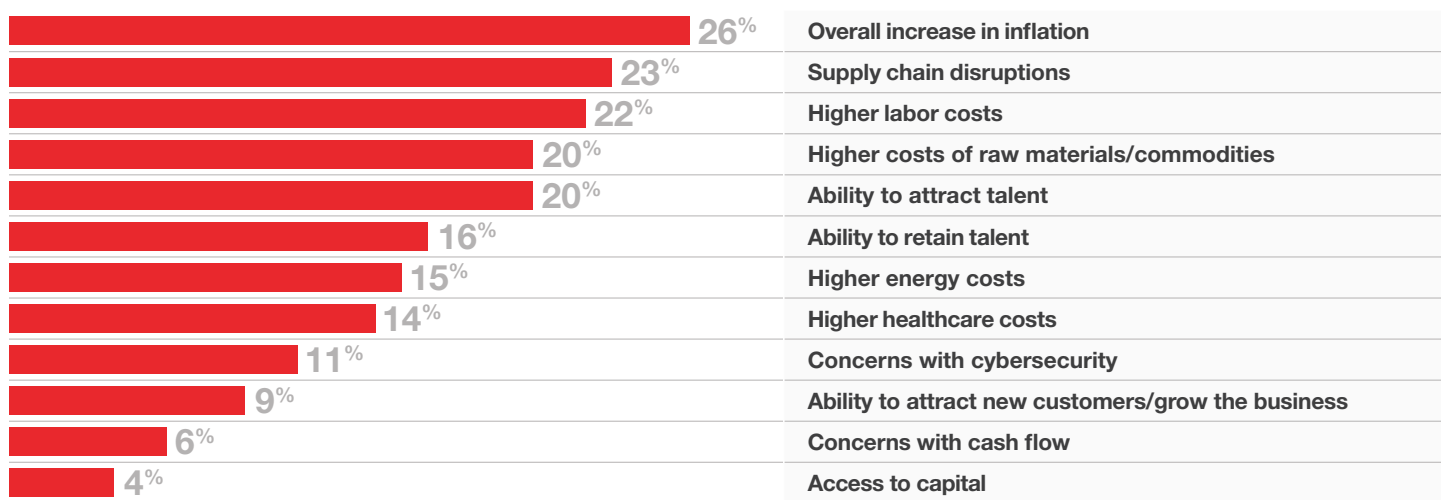
In the first quarter of 2022, inflation emerged as a broad concern among middle market businesses – and especially among the 45% of survey respondents with a less optimistic economic outlook. Sixty percent of these skeptical middle market business leaders cited higher rates of overall inflation as a contributing factor to their concerns about the economy, along with higher costs for labor and raw materials. However, as Lamirand observed, businesses in sectors where demand remains high can pass those price increases along to customers:

“With demand remaining strong, companies can increase prices and maintain their margins. Businesses that are sitting on excess inventory are seeing even greater profits when they can pass along those price increases to customers.” That said, Lamirand is also cautioning clients that strong demand won’t last forever, especially if prices stay high. “The correction hasn’t happened yet, but at some point, it will. It always does.”

Regardless of their economic outlook, 43% of business owners and executives surveyed anticipated that an overall increase in inflation will have a negative impact on their businesses within the next 12 months – more than any other factor listed. More than a third (38%) reported that they are already feeling the effects of inflation.

Factors currently having or anticipated to have negative impact on business in next 12 months

Q1 2022



Middle market businesses are certainly not alone when it comes to apprehensions around rising inflation. Driven primarily by rising food and energy costs, the U.S. inflation rate climbed to 7.9% in February, a level not seen in decades. Economists anticipate that Russia’s war in Ukraine could push prices even higher, exerting additional upward pressure on the rate of inflation in the U.S. and around the world.³ In an effort to slow inflation, the Federal Reserve announced its first interest rate hike since 2018, to be followed by additional increases throughout the year. However, NPR reports that the Federal Reserve is “walking a tightrope” in trying to bring inflation under control without dealing too large a blow to the country’s economic growth.⁴

³Wall Street Journal: “Inflation Reached 7.9% in February; Consumer Prices Are the Highest in 40 Years.” March 10, 2022.
<https://www.wsj.com/articles/us-inflation-consumer-price-index-february-2022-11646857681?page=1>

⁴NPR: “The Federal Reserve raises interest rates for the first time since 2018.” March 16, 2022.
<https://www.npr.org/2022/03/16/1086484178/the-federal-reserve-interest-rates-inflation>

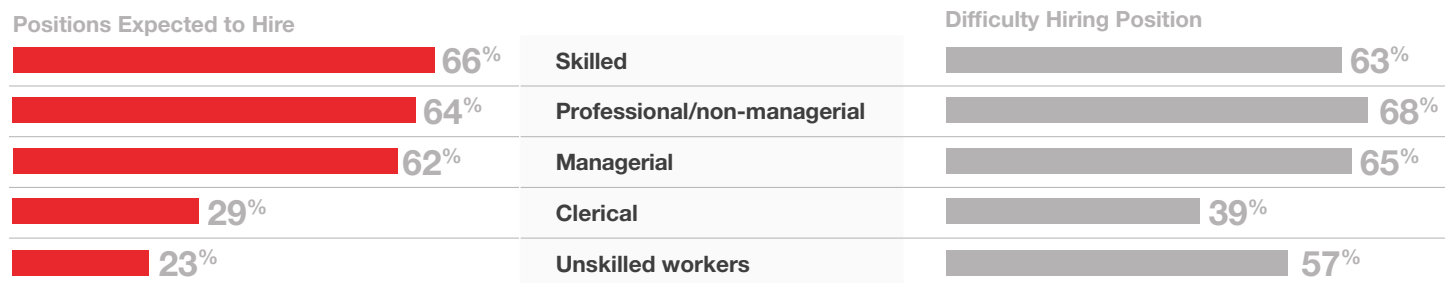
In a tight labor market, flexibility is crucial

Current conditions in the U.S. labor market are complicating the picture for middle market businesses. In February, the unemployment rate fell to 3.8%, edging closer to its pre-pandemic level of 3.5 percent.⁵ As a result, competition for qualified workers remains high.

Middle market business leaders are acutely aware of the tight labor market: among the 50% who plan to hire over the next six months, more than 6 in 10 anticipated some degree of difficulty hiring skilled workers, non-managerial professionals, and managers. When asked to identify the main obstacles to filling their hiring needs, they cited scarcity of qualified workers, high salary requirements, and the length of time required to identify and hire qualified workers.

Types of employees planning to hire and expected difficulty

Q1 2022



To attract and retain talent in this tight labor market, middle market businesses planned to offer competitive wages, flexible working hours, and comprehensive benefits packages.

“You’ve got to have the best people, and businesses are willing to do whatever it takes to get them on board,” said Doyle in Cleveland. “Companies with strong profits can be very competitive when it comes to attracting and retaining talent and may be more aggressive with signing bonuses and profit-sharing. Many have a surplus of cash – giving that back to employees in some way can be a strong tactic in this labor market.”

Measures companies are considering using to attract talent










Q1 2022



⁵Bureau of Labor Statistics: “Employment Situation Summary.” March 4, 2022.
<https://www.bls.gov/news.release/emp/sit.nr0.htm>

Measures companies are considering using to retain talent

Q1 2022

 44%	The competitiveness of wages/salaries
 43%	Flexible hours/schedule
 40%	Health and wellness benefits
 39%	Bonus programs
 37%	Paid time off (PTO)
 36%	Creating a safe working environment at company offices and physical locations
 34%	Options to work remotely
 33%	Company match on retirement plans (e.g., 401K plans)
 29%	New employee signing bonuses
 24%	Job training and educational benefits (such as tuition reimbursement)
 14%	Stock Options
 12%	Profit sharing
 11%	Social impact/volunteer initiatives
 9%	Offering child care reimbursement
 4%	Nothing

Survey results also show that for many businesses, the shift toward remote work is here to stay. About one-third of business owners and executives said they will continue to hire remote employees even after they have fully resumed normal operations, and many anticipated reconfiguring (30%) or reducing the size of (21%) their offices or facilities. “We are confident that pandemic-driven flexibility measures are here to stay,” said Lamirand.

Conclusion: COVID-19 may be subsiding, but uncertainty is not

During the first quarter of 2022, middle market businesses were feeling optimistic as many resumed normal business operations after two years of pandemic restrictions and protocols. However, Russia’s invasion of Ukraine will likely exacerbate existing concerns around supply chain disruptions and inflation. And with the Federal Reserve raising interest rates carefully so as not to disrupt a strong labor market, competition for qualified talent is likely to remain stiff in 2022.

Whether you’re gearing up for an acquisition, or seeking to hedge against looming uncertainty, KeyBank middle market experts can provide customized insights and real-time counsel to guide your decision-making. For more information on KeyBank’s middle market capabilities, contact a KeyBank Relationship Manager.

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"KeyBank Middle Market Business Sentiment Survey" February 1, 2022 - February 15, 2022.

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