



## Middle market enters expansion mode after one year of pandemic impacts

In its second quarter 2021 survey, Key asked 400 owners and executives of middle market businesses – defined as those in the \$10 million to \$2 billion range<sup>1</sup> – how macroeconomic conditions and government policies have impacted their businesses.

### Middle market executives reinvigorate targeted M&A strategies

The middle market is back to growth mode one year after a COVID-challenged 2020. Having made necessary adjustments to their businesses amid the market turmoil, middle market business owners are happy to be once again identifying expansion opportunities. As they embrace growth mode, they're being met with a competitive employment environment and a flourishing mergers and acquisitions (M&A) marketplace.

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“Middle market executives have bullish optimism around their own businesses and the economy, buoyed by strong Q2 2021 performance, rising vaccination rates and a more stabilized political climate. Today these executives are reinvigorating targeted M&A strategies to accelerate growth, enhance capabilities and penetrate new markets.”

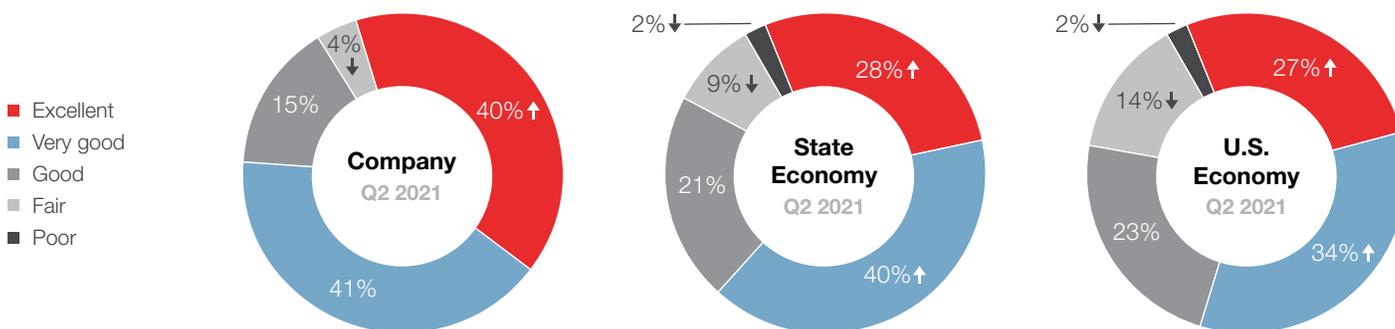
– Mike McMahon, Managing Director & Group Head,  
Industrials for KeyBanc Capital Markets

<sup>1</sup>Business 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).

# Business, state, and national outlook going up, up, up

Continuing a positive trend identified in the first quarter 2021 survey, outlooks at the company, state, and national levels have all become even more optimistic. At the company level, 40% of respondents identified an “excellent” outlook – compared to 31% in Q1, and another 41% had a “very good” company outlook. At the state and national levels, both “excellent” and “very good” outlooks have increased, climbing to 68% total for the state economy and 61% total for the U.S. economy, up from 51% and 41% respectively.

## Overall outlook for the next 12 months



Since late January, middle market business leaders have become increasingly optimistic about the overall health of their businesses than they were amid COVID-19 concerns during 2020. In our second quarter survey, 71% say they felt very or somewhat positive compared to 48% in Q1. More than 80% of middle market business executives now feel the development of the COVID-19 vaccine somewhat or very positively affects the outlook for the overall health of their businesses. This represents a significant jump in optimism since early 2021, and a nod to how efficient vaccine rollout and the U.S. economic recovery are intertwined.<sup>2</sup>

Buoyant business sentiment is mirrored by a continued rise in consumer confidence in the U.S, which denotes a “more upbeat view on both current conditions and expectations amid a better health situation and an improved job market.”<sup>3</sup> The Consumer Confidence Index edged up to 127.3, nearing the pre-pandemic level of 132.6 in February 2020 and beating economists’ predictions.

## COVID concerns diminish, but higher taxes and prices cause worry

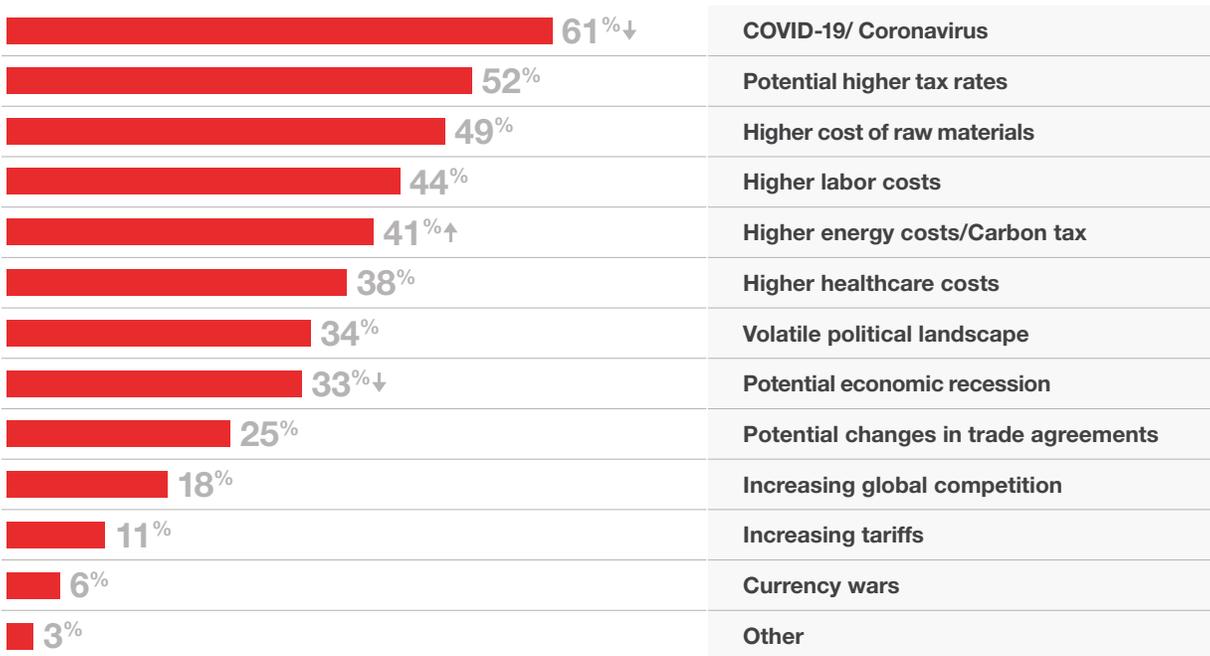
For the minority of middle market executives who expressed a low outlook on the U.S. economy, all is not rosy. For 61% of respondents who have a good, fair, or poor outlook on the U.S. economy, COVID-19 continues to be the primary reason for concern, but the prominence has been decreasing since September 2020, and especially so recently. Additional factors for pessimism include potential higher tax rates (51%) and most recently, the higher cost of raw materials (49%).

<sup>2</sup>Wharton Business Daily, “How Economic Recovery Hinges on the Vaccine Rollout,” March 9, 2021 <https://knowledge.wharton.upenn.edu/article/how-economic-recovery-hinges-on-the-vaccine-rollout/>

<sup>3</sup>MarketWatch, “U.S. Consumer Confidence Rises Sharply in June,” June 29, 2021. <https://www.marketwatch.com/story/u-s-consumer-confidence-rises-sharply-in-june-the-conference-board-271624976883>

## Factors causing low outlook for the U.S. economy

Q2 2021

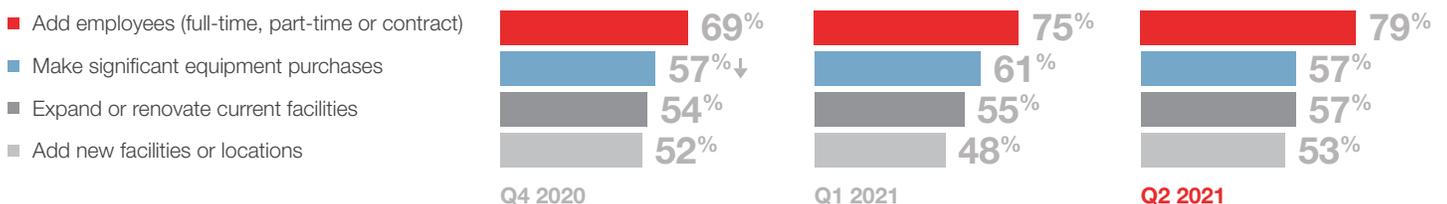


Supply chain challenges due to the pandemic, severe weather events globally, and the Suez Canal blockage have caused price volatility with not only raw materials, such as steel, but also consumer goods prices, which hit a peak in June.<sup>4</sup> However, economists and the Federal Reserve Chair Jerome Powell expressed belief that the supply chain would normalize and inflation would be “transitory.”

## Help wanted: middle market leaders must compete in a tight labor market

Despite some continued uncertainty, middle market executives are overwhelmingly ready to act on their optimism and hire more people. Since late January, plans for expansion have significantly increased to 77% from 63% in Q1. And the primary method for expansion is adding employees, at 79% of those who plan to expand.

### Method for expanding



Middle market businesses are seeking primarily to add skilled workers (30%) or professional workers (22%) versus unskilled workers (17%) and are running into difficulty filling these positions as the U.S. labor market recovery accelerates.<sup>5</sup> More than 60% of executives surveyed said when it comes to hiring skilled workers, limited availability of qualified workers is their most common challenge.

<sup>4</sup>Reuters, “U.S. consumer prices post largest gain in 13 years,” July 12, 2021. <https://www.reuters.com/article/usa-economy/wrapup-1-u-s-consumer-prices-post-largest-gain-in-13-years-idUSL1N2OP138>

<sup>5</sup>Wall Street Journal, “U.S. Added 850,000 Jobs in June Labor Rebound,” July 2, 2021. <https://www.wsj.com/articles/june-jobs-report-unemployment-rate-2021-11625176511>



“We have clients in the middle market who are dealing with labor issues from multiple standpoints. Some believe they are still competing with increased unemployment benefits, and others have seen employees in the Baby Boomer generation choose to retire earlier than planned after the challenges of the pandemic.”

**– Matt Nipper, Senior Vice President,  
Commercial Market Leader for KeyBank**

Nipper also adds that the rise of remote work means companies are now in competition for employees with companies across the nation, not solely in their region. And, desirable candidates are taking advantage of the demand for skilled workers to relocate, change job tracks and demand new incentives, a trend Business Insider has dubbed “The Great Reshuffle.”<sup>6</sup> The publication cites research from economists at Arizona State and Virginia Commonwealth that shows one in four Americans works for a different employer than before the pandemic.

Middle market businesses are employing offensive strategies in the frenzied job market, including competitive wages/salaries and health and wellness benefits for all employee categories. Stock options are being used more among those looking to attract professional employees, while when it comes to unskilled workers, safe physical working environments are used to attract qualified workers.

## Measures companies are considering using to attract workers

**Q2 2021**

Professional	Skilled	Unskilled	
53%	48%	57%	Competitive wages/salaries
45%	43%	45%	Health and wellness benefits
37%	31%	30%	Paid time off (PTO)
37%	32%	43%	Creating a safe working environment at company offices and physical locations
36%	36%	44%	New employee signing bonuses
33%	37%	44%	Bonus programs
33%	43%	32%	Flexible hours/schedule
31%	23%	N/A	Options to work remotely
25%	28%	43%	Job training and educational benefits (such as tuition reimbursement)
22%	21%	25%	Company match on retirement plans
21%	12%	N/A	Stock options
17%	12%	22%	Social impact/volunteer initiatives
15%	10%	N/A	Profit sharing
14%	16%	N/A	Offering child care reimbursement
5%	8%	4%	Nothing

<sup>6</sup>Business Insider, “There’s a bidding war for jobseekers, and it’s getting crazier by the day,” July 10, 2021. <https://www.businessinsider.com/the-great-reshuffle-upward-mobility-quitting-jobs>

# A second-half M&A boom is brewing

Beyond expanding by adding employees and physical space, many middle market executives are exploring growth through acquisition. Since late January, acquisitions are becoming more likely: 71% of respondents have completed or strongly considered an acquisition in the past six months, and 64% say they are extremely or very likely to complete an acquisition in the next six months.

This trend bears out in the M&A marketplace, say KeyBank experts. “The second half of year is going to be an incredibly hot M&A market for a number of reasons,” said Nipper. He points to the liquidity in the system between private equity (PE) and corporate buyers who did not complete transactions in 2020, as well as Baby Boomer owners of middle market businesses who are looking to monetize their businesses and exit. The potential to avoid future capital gains tax increases is also a consideration.

McMahon adds that having a full twelve months of financial reporting since Q2 2020 better positions business owners to go to market. “The reality is many businesses were able to emerge even during the pandemic to recovery periods earlier than anticipated, so rather than having nine months of COVID-impacted numbers, they may have only had 2nd and partial 3rd quarter impacts,” said McMahon.



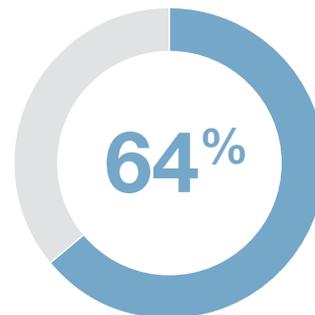
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Both Nipper and McMahon expect a “tremendous” amount of assets to come onto the market in the second half, which – along with the interest among middle market owners in completing an acquisition – should make for an M&A surge to end the year.

## Exploring growth through acquisition

- Completed or strongly considered acquisition in past 6 months
- Likely or extremely likely to complete acquisition in next 6 months



## Conclusion: Seizing opportunities as economic conditions improve

One year after the most impacted quarters of a tumultuous 2020, middle market business leaders have emerged with confidence in how their companies persevered and optimism about the future. However, while concerns about the pandemic recede, concerns about tax hikes and supply prices emerge.

As your company considers expanding workforce, facility or major equipment upgrades, M&A or other capital-intensive priorities, having a trusted advisor attuned to your goals is invaluable. KeyBank middle market experts can provide exclusive insights and real-time support from a nationwide, integrated team.

For more information on KeyBank's middle market capabilities, contact a KeyBank Relationship Manager.



"KeyBank Middle Market Business Sentiment Survey" June 2 - July 17, 2021.

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