MIDDLE MARKET SURVEY

TRENDS REPORT 2023

UHY

Navigating Complex Challenges While Looking Ahead to Maintain a Competitive Advantage

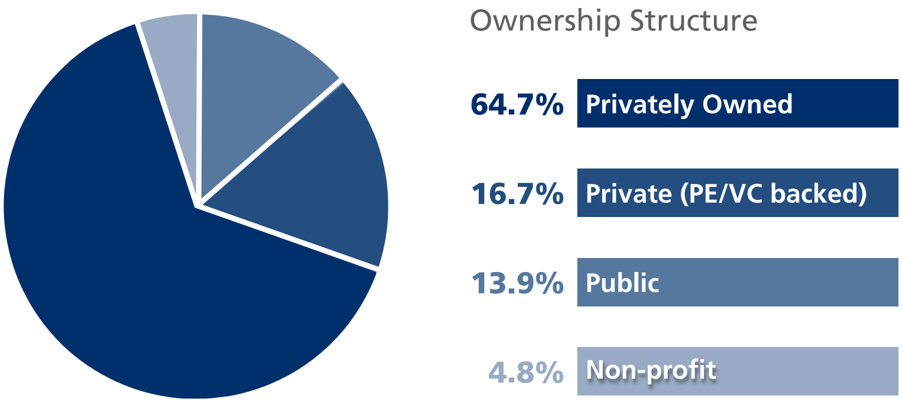
March 2022 marked the beginning of the third year of post-pandemic life. While some degree of normalcy returned, 2022 was anything but "business as usual" as companies continued to face unprecedented levels of adversity.

As 2023 begins, the world economy is teetering on the brink of a recession exacerbated by geopolitical issues. At the same time, companies are facing no shortage of obstacles and disruptions, including retaining qualified staff, finding new team members, navigating digital transformation, evaluating green technologies, and more.

Executive Summary

UHY's Middle Market Survey is intended to identify and understand widespread challenges and trends for businesses in the dynamic middle market and beyond. UHY sampled a diverse group of professionals from various industries, company sizes, and revenue ranges to provide relevant data. Most of our respondents were from private or private-equity-backed companies.

252 PARTICIPANTS SURVEYED



Identifiable Middle Market Trends

Companies are experiencing more post-pandemic growth than expected, with most returning to pre-pandemic growth trajectories and higher in some cases.

While it is a positive sign to see that companies have rebounded from the shock of the pandemic, business owners will not have much time to rest on their laurels as new challenges are rapidly approaching and existing threats continue to impact operations.

Heavy focus on growth, process improvement, and becoming more efficient.

The advent of automated business processes supplemented by artificial intelligence is not fully realized, but companies are recognizing the importance of embracing technology and considering its role in helping business owners improve efficiency.

The importance of environmental, social, and governance (ESG) strategy implementation should not be understated.

Strategic deployment of ESG initiatives is still in its infancy. The adoption of ESG criteria is not currently a major component of overall business strategy. As we move forward, companies may find themselves scrambling to put a strategy in place as uniform reporting standards are established or required.

Companies must improve their recruiting strategies to remain competitive for top job candidates. Existing employees should not be overlooked and are key players when looking to improve retention.

The Great Resignation has completely reshaped the way potential employees approach the process of finding a job. More value has been placed on diverse workplaces, flexibility, feeling valued, expanded benefits, and more, beyond better compensation. Businesses will have to adjust to stay relevant.

Significant barriers to digital transformation still exist, but companies are more interested in exploring it as a part of their strategy.

There are countless benefits to adopting digital transformation, but companies are having trouble assessing their own needs and, in turn, having trouble selecting a partner for implementation. Companies must look deep within their processes and current technology capabilities to confidently identify those needs so they can select the right partner. Resisting change may only leave them further behind.

Most companies turn to a combination of internal IT resources and third-party vendors to manage cyber risk.

With increased connectivity comes vulnerability. Having a cyber assessment conducted by a third-party vendor can expose vulnerabilities never imagined and can also help you manage other cybersecurity components beyond the scope of your internal IT function. Tightening up cyber policies will be a key component of risk management. Cyber breaches could be lethal for any company, and the attacks are only becoming more sophisticated.

More resources should be allocated toward implementing a sound environmental, social, and governance strategy and understanding how it will impact business and operations.

While most respondents have begun to implement some sort of ESG policy, others have cited barriers to adoption. The demand for sustainability disclosures and ESG reporting is growing, and it will have a major impact on the viability of businesses going forward.

COVID-19 and hyperinflation cause the most angst for business owners, but there are countless other concerns on their radars.

COVID-19 and hyperinflation were at the top of the list, but there are important lessons to be learned from both of these issues. In addition, the risk of recession, rising interest rates, climate change, the Russia-Ukraine conflict, and increased hawkishness by the Fed are also areas of major concern.

By-products of COVID-19 are the most limiting factors for business growth.

Supply chain issues, staffing shortages, and economic volatility are among the main factors limiting business growth. Taking steps to prepare for a recession and addressing major hiring needs should be near the top of the list for businesses throughout 2023.

Businesses are plagued by a multitude of supply chain issues.

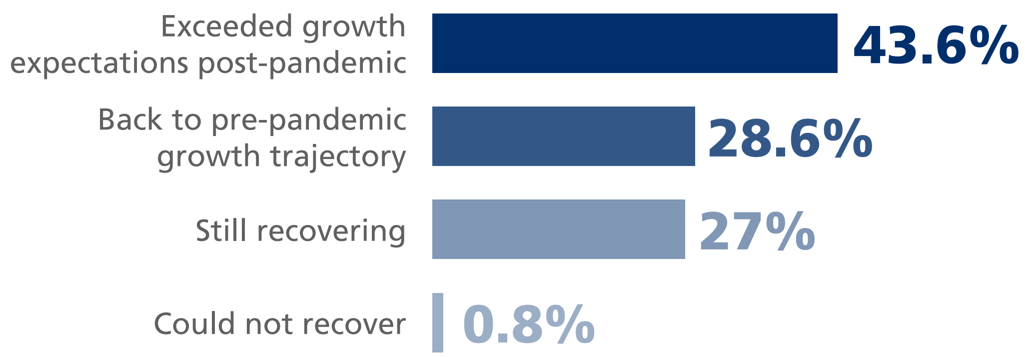
Looking beyond the first tier to the second or third may reveal some weak points in a business's supply chain. A comprehensive evaluation of the supply chain may allow a business to identify those weaknesses and make improvements to prepare for future issues.

Prospects For Growth:
Post-Pandemic And Beyond

The road has been long, tiring, and complicated over the last three years for society as a whole, but especially for business owners. Entire business sectors were upended, and businesses were forced to reinvent ways of doing business.

After adapting and weathering the storm, business owners are now looking toward the future and have reported that they are seeing significant growth or at least reaching pre-pandemic levels.

POST-PANDEMIC GROWTH STAGES OF RESPONDENTS



Businesses Exceeded Expectations or Returned to Pre-Pandemic Growth Trajectories

Despite the challenges of the last three years, business owners have persevered. Our survey bares some positive sentiment, with 44% of respondents stating they exceeded post-pandemic growth expectations and another 29% indicating they have returned to pre-pandemic growth trajectories.

As businesses try to navigate an unpredictable market and the challenging trends of the modern workplace, it is promising to see that most respondents were able to reach or exceed pre-pandemic growth.

Less Bullish Growth Approach for Companies In 2023

Whether or not businesses will be able to maintain growth levels remains to be seen. Some questions remain about the current state of our economy; between hyperinflation and rising interest rates intended to slow it, the outlook for the next 12 months, as told by our respondents, is a bit less optimistic.

40%

Nearly 40% of respondents indicated that they would label their growth approach as "cautious."

29%

Twenty-nine percent described their growth approach as "aggressive," still looking to grow through acquisition or significant investments.

31%

Thirty-one percent are expecting to either maintain their current growth rates or use a conservative approach.

Key Focus Areas For Businesses In 2023

As we move through 2023, will the U.S. fall into a recession? Are we already in one? Examining the macroeconomic picture results in conflicting information, creating an unusual market. Currently, the U.S. has seen a slowdown in growth, but business owners are continuing to deal with an extremely tight labor market, still looking to fill open positions, albeit at a lower rate than a year or even six months ago.

Keeping this unusual market in mind, the following are the key focus areas for middle market businesses over the next 12 months.

39.5% of respondents labeled **ORGANIC GROWTH/NEW BUSINESS MODELS** as their top focus for 2023

36% of respondents labeled **PROFITABILITY/EFFICIENCY IMPROVEMENT/CORPORATE RESTRUCTURING** as their top focus for 2023

9% of respondents labeled **DIGITAL TRANSFORMATION/TECHNOLOGY INTEGRATION** as their top focus for 2023

8% of respondents labeled **PRODUCT/GEOGRAPHICAL EXPANSION** as their top focus for 2023

4.5% of respondents labeled **SUSTAINABILITY/ESG** as their top focus for 2023

4% of respondents labeled **PARTNERSHIPS/MERGERS & ACQUISITIONS (M&A)** as their top focus for 2023

Organic Growth and New Business Models

The highest priority among respondents was placed on organic growth and new business models. Growth is always a key concern for businesses, even in stable economic times. As such, it is not surprising to see this as the number one area of focus for heading into 2023.

Profitability, Efficiency Improvement, Restructuring

The next highest priority for respondents was profitability, efficiency improvement, and restructuring. As costs continue to rise, focusing on direct costs and efficiencies is an integral step to maximize returns on investment and increase profits. Strategies such as alternative inputs, diversifying suppliers, and re-engineering or reformulating products have become worthwhile endeavors to mitigate rising costs while customers are anticipating price increases.

Restructuring offers flexibility regarding improvements, from a complete entity restructuring to create a more favorable tax landscape or simply updating org charts, processes, or internal controls. With ever-changing technological and legislative environments, this trend is expected to continue as companies look to increase efficiency and maximize profitability while battling external market conditions.

Digital Transformation

Growth and profitability are followed by digital transformation as a key priority for respondents. The advent of work-from-home and hybrid positions is likely the most notable outcome of the post-pandemic world. The integration of technology into all aspects of operations as a result continues to be a learning experience for many. When done correctly, digital transformation can be a positive force for companies in ways never thought possible.

Partnerships and M&A

One focus area that may have been overlooked by our respondents was capitalizing on market participants seeking opportunities for inorganic growth, meaning either A) considering a liquidity event or an exit strategy, or B) looking to acquire other companies to maintain or expand growth. Comparing these responses to the level of activity over the past few years raises some questions as to what M&A activity might look like in 2023. Disciplined capital allocation strategies will be key in identifying and capturing opportunities. Business owners should seek counsel from advisory and investment banking specialists as an M&A transaction or liquidity event might make more sense in 2023 than it has in over a decade.

Environmental, Social, Governance (ESG) Ranks at The Bottom, but Should It Be Overlooked?

With all of the other issues business owners deal with day-to-day, it is not a surprise that the relatively new concept of ESG is at the bottom of the list. The lack of information and a clear reporting standard, along with high costs associated with ESG strategy implementation, likely causes deterrence to widespread adoption. Despite those factors, there is still a major opportunity to be an "early adopter," and at the very least, ESG should move up on the priority list. Soon enough, ESG will not just be reserved for massive companies like Amazon, Ford, Google, and Coca-Cola.

Addressing The Fallout From The Great Resignation

One of the prominent effects of COVID-19 and the stay-at-home mandates was a mass movement of people leaving long-established careers as they took time to reassess their lives. A few years later and we have moved from the Great Resignation, a time when workers held most of the leverage against employers that were desperate to fill critical roles, to a more level playing field. However, the emergence of new trends, including "quiet quitting," "acting your wage," and "loud layoffs" have both employers and employees on edge.

Despite these trends and perceived entitlement that have come along with them, the labor market still remains relatively tight, with open positions and a lack of ideal candidates to fill them.

UHY's Middle Market Survey asked business owners to identify the areas they plan to maximize investment in regarding employee development to gain an understanding of how they plan to address issues brought upon by the Great Resignation.

Increased Recruiting Efforts Over the Next 12 Months

When looking for the best place to deploy investment dollars to bolster the workforce, 38% of respondents indicated that they plan to place an emphasis on recruiting and attracting better talent.

This has been a recurring theme for the better part of the last two years, with employees and prospective employees placing a higher value on the work-life balance, a truly meaningful career, and an employer whose goals align with their own. There has been a mass exodus of workers opting for remote work or a more empathetic employer. In some cases, this meant trading higher compensation for freedom or seeking both higher compensation and freedom.

This trend has left employers allocating significant resources to recruit and retain top talent to fill critical positions. The most recent Bureau of Labor Statistics Report showed an unemployment rate of 3.5% indicating that there are still more jobs than there are candidates to fill them.[1] However, some believe that the Fed's quantitative tightening policy will lead us into a recession, potentially causing unemployment to rise.

Better Compensation and Upskilling the Workforce

Two key areas of investment in employee development identified by those surveyed were better compensation and upskilling the workforce.

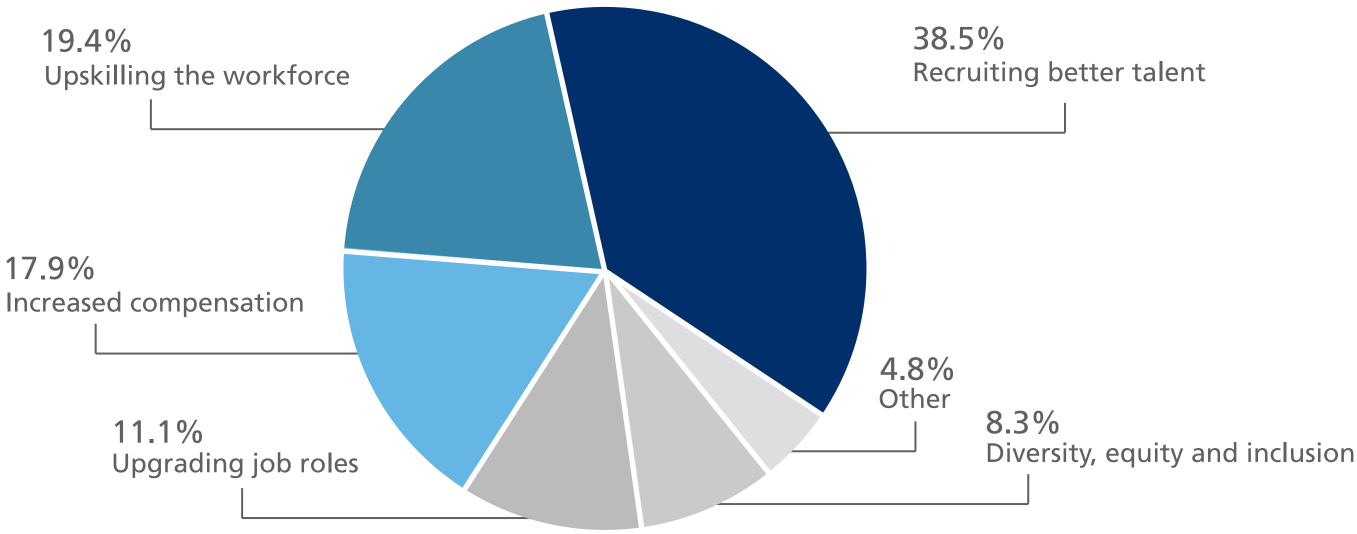
Better compensation likely needs no explanation, but perhaps a simple reframing. Instead of thinking about dollar amounts, business owners should consider other perks that could create a more meaningful career experience for prospective candidates. This can include covering quality-of-life expenses for employees, including cellphone reimbursement, gym memberships, or meal delivery services. As people become accustomed to having such necessities covered and able to spend their money on other items, they may not be willing to give away these perks for a larger salary alone.

Since the pandemic took the world by storm, employers have stressed the importance of upskilling and, according to a 2021 Gallup Amazon survey, 65% of their participants said employer provided upskilling is a very important factor when evaluating a potential new job.[2]

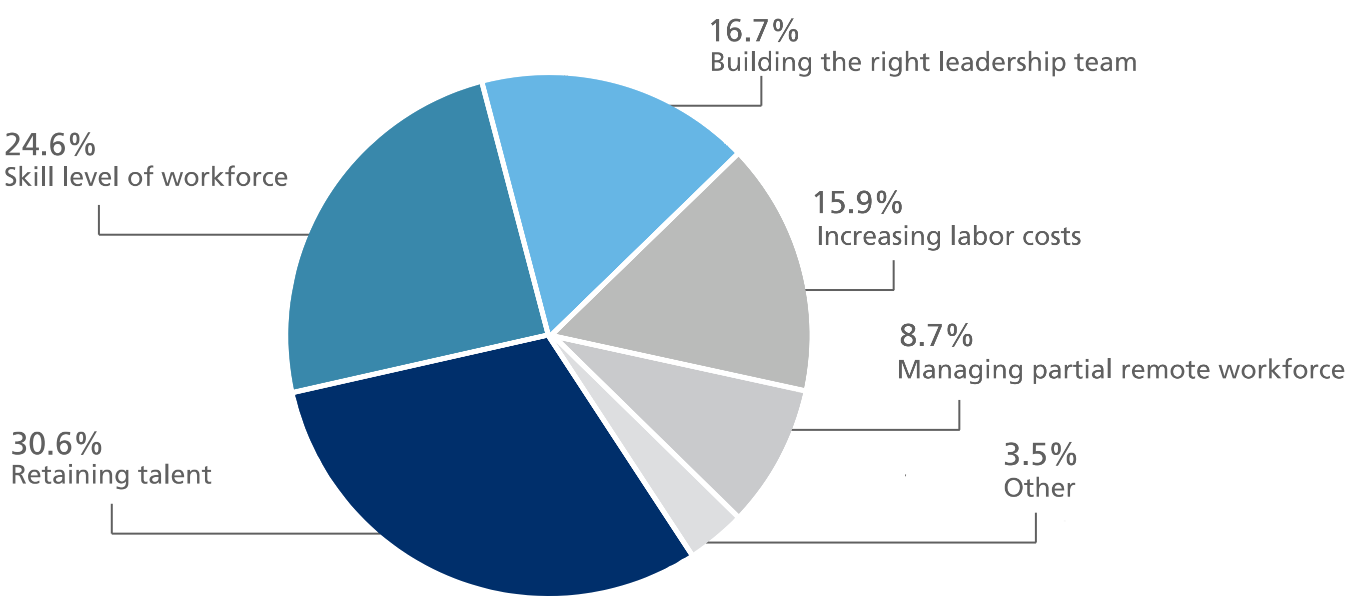
There are numerous benefits to upskilling. When a company makes an investment in current employees, it is an instant morale boost. The employee feels more valued and is less likely to leave the company.

Many see upskilling as a win-win as it is less costly than other recruiting and retention efforts and can unlock hidden benefits and potential within current employees. The majority of business owners feel that upskilling is one of the best ways to address the current skills gap they are experiencing.

INVESTMENT IN AREAS OF EMPLOYEE DEVELOPMENT



TOP WORKFORCE CHALLENGES FOR ORGANIZATIONS

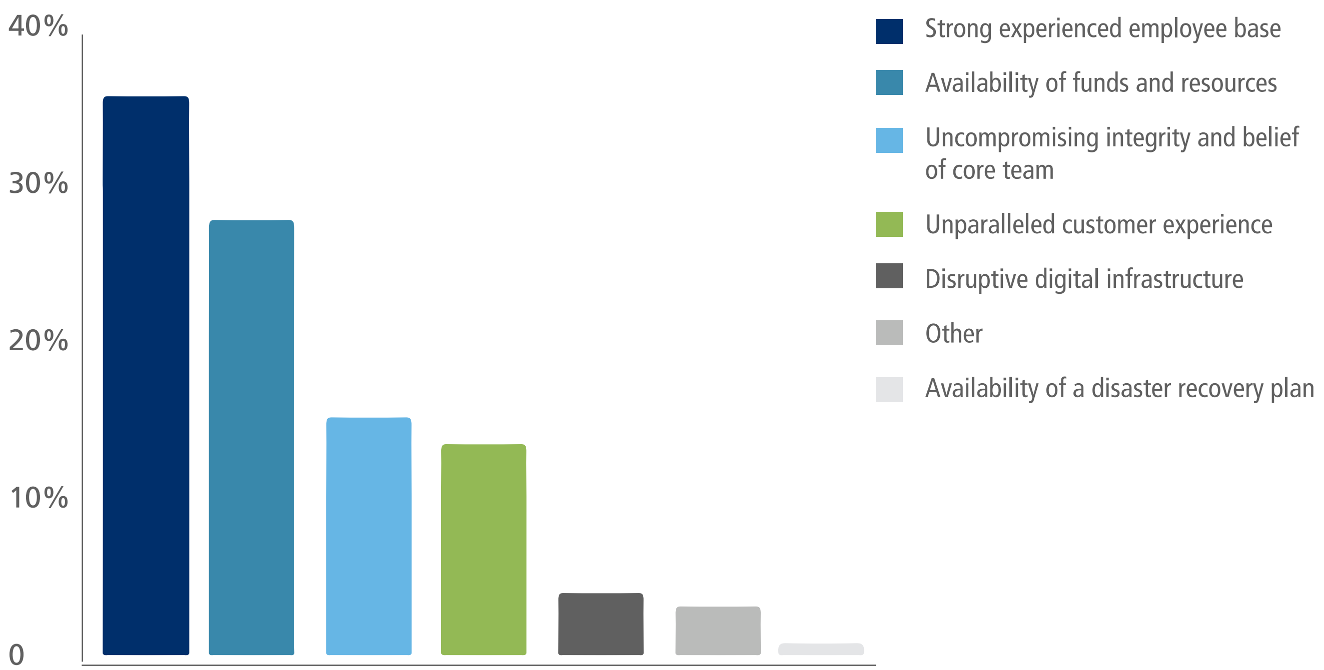


Talent retention was marked as both the most important area for investment in employee development as well as one of the top workforce challenges.

Planning For Difficult Economic Situations

Difficult economic situations tend to cast a negative light and cause business owners and their employees much stress. We wanted to know specifically which areas executives would consider their strengths as they prepare for difficult economic situations.

RESPONDENTS' BIGGEST STRENGTHS



Strong, Experienced Employee Base

Most respondents believe that their strong experienced employee base is their biggest strength when planning for difficult economic situations. Strong, experienced employee base may refer to "core people" who have been with the company for an extended period with a thorough understanding of the business. These tenured employees can be helpful in evaluating current state, making tough decisions, revisiting practices, and restructuring, which are all critical functions in difficult economic situations.

Availability of Funds and Resources

Availability of funds and resources was listed as the biggest strength in difficult economic situations for 30% of our respondents. The top concerns when preparing for recession are usually related to cash flows, debt management, and revenue protection. Recession or no recession, middle market businesses with the availability of funds and resources should find themselves in an advantageous position.

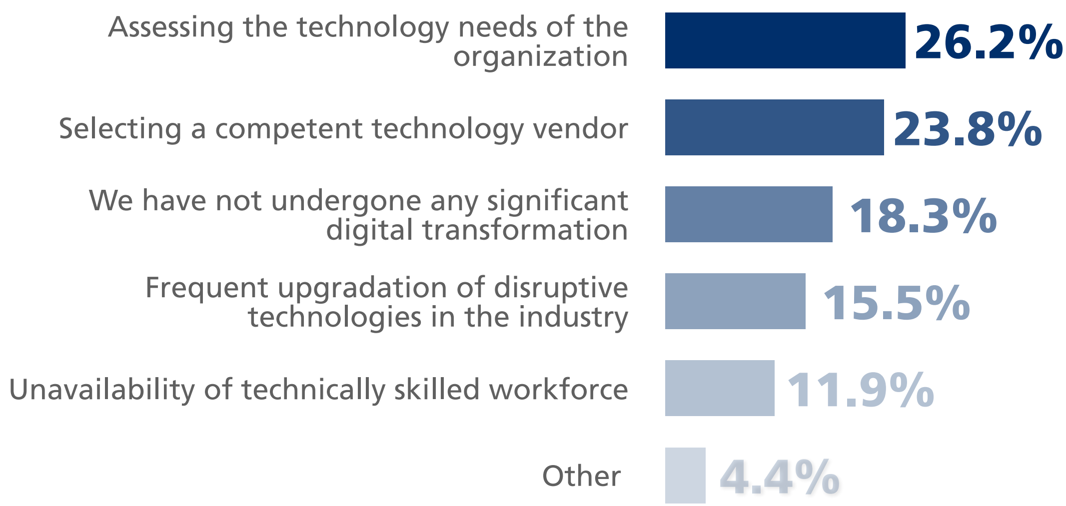
Other Strengths for Difficult Economic Situations

A smaller faction of respondents felt that their strengths lie in other areas, including a strong belief in the core team, uncompromising integrity, and unparalleled customer experience.

Confronting Technology Issues

Digital transformation will continue to gain momentum and become integrated into the way of doing business, though many report that they are still experiencing challenges when trying to incorporate digital transformation.

CHALLENGES WHILE ADOPTING DIGITAL TRANSFORMATION



Difficulty Assessing the Needs of Their Organization

More than 50% of respondents indicated that they were either having trouble assessing the technology needs of their organization or selecting a competent vendor. The two are very closely related because without being able to assess your needs properly, it would be difficult to select a competent vendor and ensure they are a proper fit for your business.

Eighteen Percent Have Not Undergone Any Significant Digital Transformation

During the Gartner IT Symposium/Xpo in 2022, analysts predicted a 4% increase in worldwide IT spending for 2023, which equates to roughly $4.6 trillion.[3] That spending includes data center systems, software, devices, IT services, and communication services. With proof that companies are investing in technology and executing major implementations, companies that have not considered digital transformation are at risk of falling behind.

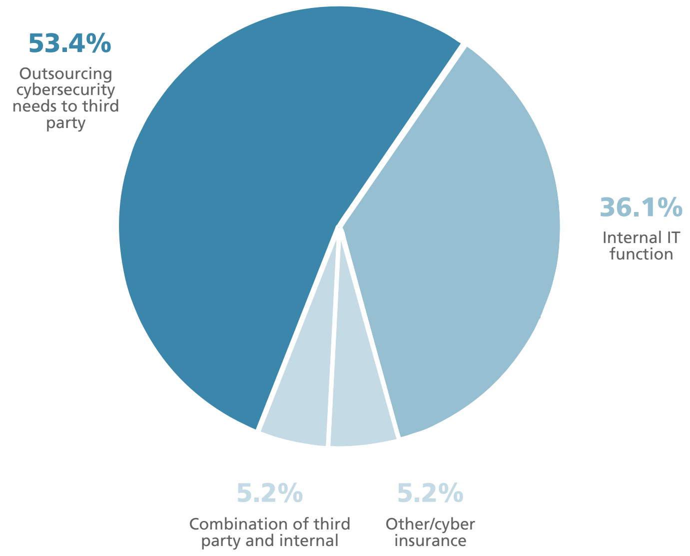
Limiting Vulnerability To Cyber Attacks

The internet has helped expand the amount of information exchanged and stored in the cloud rather than on hard drives, leading to increased opportunities for those databases to be hacked. According to respondents, middle market business owners are addressing their cybersecurity needs in a variety of ways.

Turning to Third-Party Vendors for Cybersecurity Needs

Businesses are dealing with balancing operations, staffing shortages, supply chain issues, economic uncertainty, and a litany of other external factors that make keeping up with the evolving cyber attacks increasingly difficult. With that context, 54% of respondents stated that they are hiring out their cybersecurity needs to third-party vendors.

With increased connectivity and more devices in circulation than ever, seeking a third-party provider that specializes in cybersecurity offers businesses an additional level of protection.



Thirty six percent shared that they have an internal IT function. Another 5% stated that they either had a combination of third-party resources and internal, some sort of cyber insurance, or stated that they rely on a third party to store important data and information making cyber protection a lower priority.

Environmental, Social, And Governance Awareness Among Middle Market Companies

"ESG" is an acronym created for environmental, social, and governance issues, which are the pillars of "socially responsible investing" and the criteria those investors use to measure a company's overall impact on society.

ESG issues are one of the more popular topics on the radar for businesses today. While it is more widely recognized than in previous years, quite a bit of confusion and a lack of familiarity still remains relative to this topic, making it challenging for middle market business owners to include it in their broader business strategy and make it a high priority.

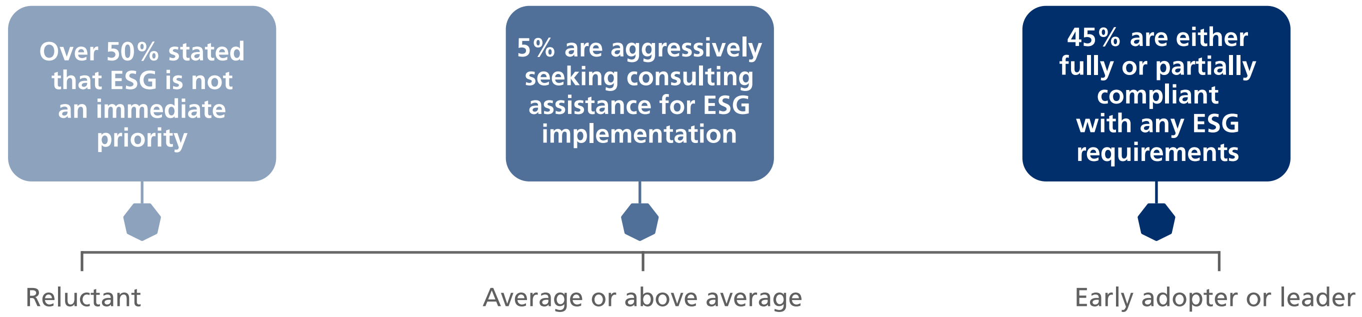
Assessing the Current State of ESG Strategies Impacting Middle Market Companies

Responses from a previous section of the survey ranked ESG as the least important focus area for companies going into the next 12 months, and that sentiment is further echoed in the more than 50% of participants who indicated that ESG implementation is not an immediate priority for them. Another 45% are either fully or partially compliant with ESG requirements, even with a lack of clear reporting standards. The smallest percentage of responses, at 5%, stated that they were aggressively seeking a consulting firm to assist in ESG implementation.

Evaluating the responses in terms of the understanding of the ESG landscape, the 45% that are either fully or partially compliant with any existing ESG requirements may be considered more toward the "early adopter or leader" category. These respondents have indicated that they not only understand ESG, but they recognize the opportunity that it brings and are dedicating significant resources toward creating an ESG strategy.

Five percent of respondents understand and recognize the importance of complying with ESG standards and are aggressively seeking a consulting firm to assist in ESG implementation. These companies might fall into the "average or above average" category. Lastly, 50% do not recognize the importance of ESG and would be considered reluctant, indicating that they have not begun to include ESG into their overall business strategy.

UNDERSTANDING OF THE ESG LANDSCAPE

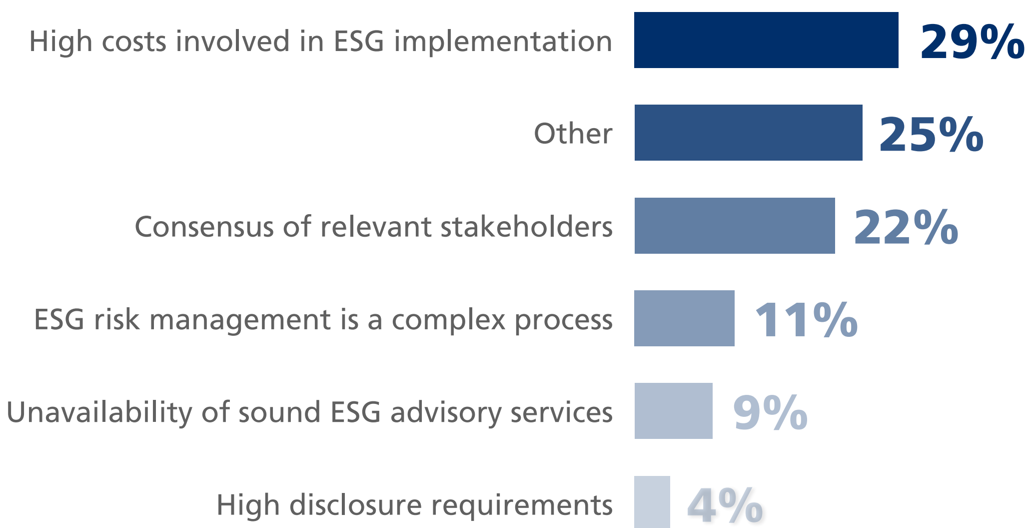


Factors Preventing Middle Market Companies From Implementing An ESG Strategy

Building off of the data from the previous section we sought to get a clearer understanding of what was preventing middle market business owners from building an ESG strategy.

As a relatively new concept, a great deal of confusion surrounds the implementation, monitoring and regulation of ESG standards creating a host of barriers to adoption.

BARRIERS TO ESG IMPLEMENTATION



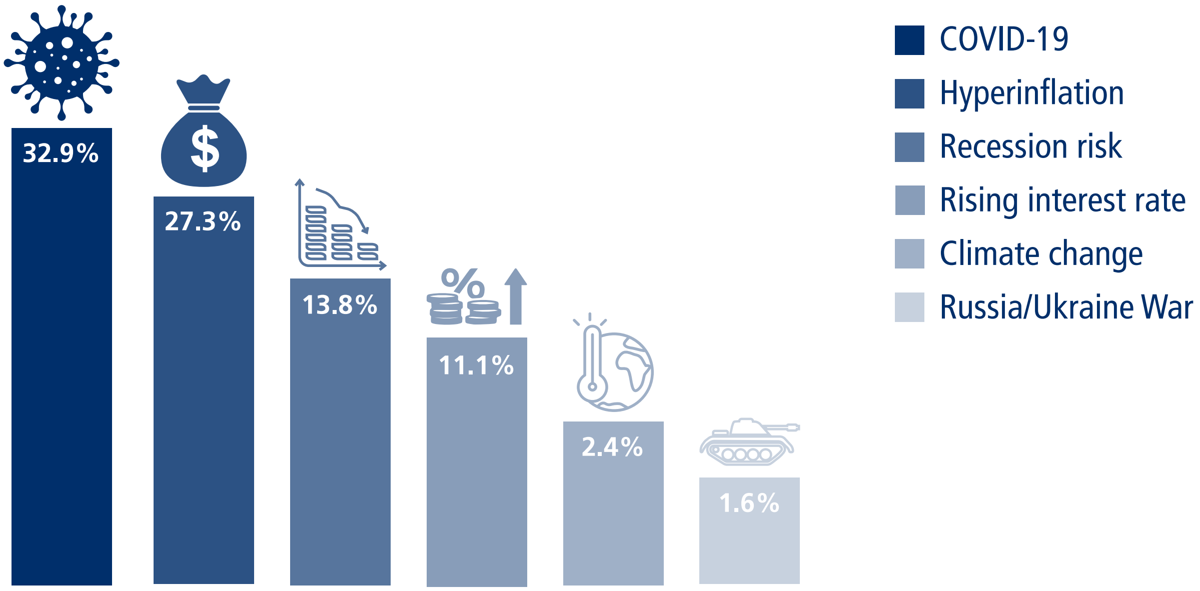
Impact Of External Events On Middle Market Companies

There has been no shortage of disruptive external events for business owners in recent years, but it is debatable which of them had the greatest impact on middle market businesses. Making sense of which events had the largest impact is an important step in preparing for future disruptions.

COVID-19 and Inflation Ranked as Most Impactful External Events

COVID-19 still ranks as the most impactful global event for 33% of respondents. It goes without saying that COVID-19 and the measures put in place to limit its spread impacted all businesses and individuals in a significant way. With many acclimating to "post-pandemic" life, we would have expected to see COVID-19 give way to more recent events.

Hyperinflation was ranked as the second most impactful, with 28% of responses. The risk of recession, rising interest rates, climate change, the Russia-Ukraine conflict, and increased hawkishness by the Fed made up smaller percentages of responses, indicating that there is a multitude of issues on the radars of middle market business owners at any given time.



Ranking Growth Limiting Factors

As companies have exceeded expectations or returned to pre-pandemic growth, many still report numerous growth limiting factors. While this may vary from business to business, there are several that are weighing more heavily on the minds of middle market business owners.

These percentages indicate respondents who labeled each of the given factors as having the most significant negative impact on the growth of their business.

43% — Supply Chain Disruption

19% — Economic Volatility

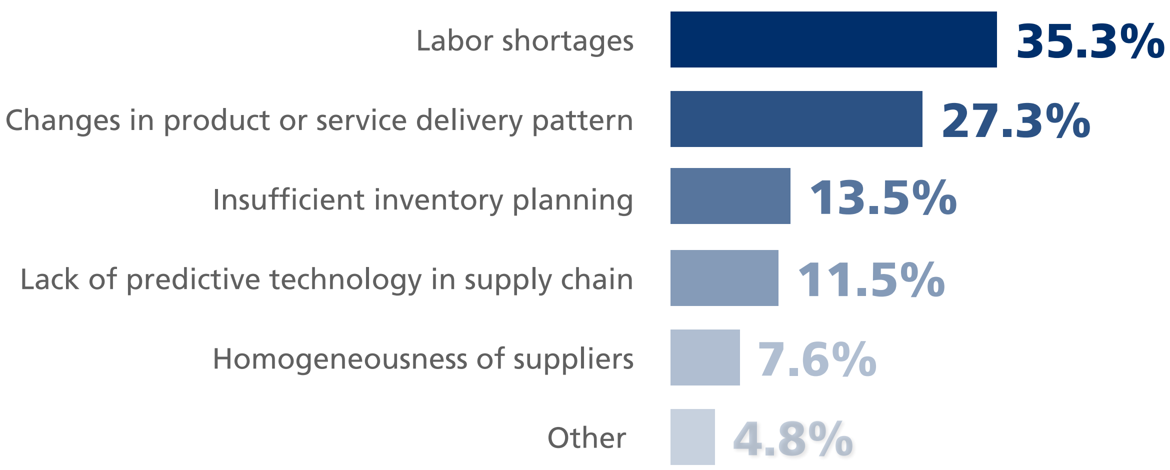
18% — The Great Resignation

8% — Change in Customer Preferences

Weakest Areas Of The Supply Chain

Looking further into the topic of supply chain disruption, we sought to determine specific segments of the supply chain where middle market businesses are experiencing significant challenges. Another potential pitfall for companies emphasized in the recent past, shoring up the supply chain should be a top priority.

WEAKEST AREAS OF SUPPLY CHAIN MANAGEMENT



Labor Shortages

As one of the biggest concerns for our middle market respondents, labor shortages were labeled as the weakest segment of the supply chain for middle market companies, receiving over 36% of the votes. Simply put, there has been too much work for the number of workers with the necessary skill sets available to complete it. Without the workers to produce the necessary materials or even handle the logistics, labor shortages can wreak havoc on the supply chain.

Changes in Product/Service Delivery Pattern

Government intervention, restrictions, and scarcity of resources forced many businesses to adjust their processes to survive, all the way down to how and when their products or services were delivered.

Twenty seven percent of respondents cited changes in product or service delivery patterns as the weakest segment of their supply chain. Companies lacking an effective sales and operations planning process and/or well-organized supply chains have felt the most impact. Changes in delivery patterns could also be due to a lack of resources or ongoing labor

Insufficient Inventory Planning

Just under 13% of participants indicated insufficient inventory planning was the weakest segment of their supply chain. To be effective, proven supply chain strategies require an effective sales and operations planning process, accurate inventory control, and well-organized and integrated value streams. Recent disruptions in the flow of goods have reinforced the importance of these activities. Companies with weaknesses in one or more of these areas have experienced shortages, with many of these companies compensating by adding inventory. This presents an opportunity to reduce cost and working capital by assessing and making corrections where necessary.

UHY is prepared to help business owners minimize risk while capitalizing on opportunities for growth. As one of the nation's largest professional services firms we provide audit, tax, consulting and advisory services to clients primarily in the dynamic middle market.

We are innovators who bring our experience from working within numerous industries to our clients so that we can provide them with a 360-degree view of their businesses. Together with our clients, UHY works collaboratively to develop flexible, innovative solutions that meet our clients' business challenges.

Research Methodology

UHY partnered with Acuity Knowledge Partners on the 2023 Middle Market Survey. Participants received the survey via email, were completely anonymous and were independent of UHY or any of its affiliates.

END NOTES

1. United States Department of Labor Bureau of Labor Statistics, THE EMPLOYMENT SITUATION- DECEMBER 2022, January 6, 2023.

2. Gallup/Amazon, The American Upskilling Study Empowering Workers for the Jobs of Tomorrow, 2021

3. Gartner, Gartner Forecasts Worldwide IT Spending to Grow 5.1% in 2023, October 19, 2022

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