RSM US and The Harris Poll have collected data on middle market firms from a quarterly survey that began in the first quarter of 2015. The survey is conducted four times a year, in the first month of each quarter: January, April, July and October. The survey panel, the Middle Market Leadership Council, consists of 700 middle market executives, and is designed to accurately reflect conditions in the middle market. The data is weighted to ensure that they correspond to the U.S. Census Bureau data on the basis of industry representation.

A reading above 100 for the MMBI indicates that the middle market is generally expanding; below 100 indicates that it is generally contracting. The distance from 100 is indicative of the strength of the expansion or contraction.
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RSM US LLP and the U.S. Chamber of Commerce have joined forces to present the RSM US Middle Market Business Index (MMBI)—a first-of-its-kind middle market economic index developed by RSM in collaboration with Moody’s Analytics, the financial intelligence provider. We publish the MMBI quarterly to give voice to the middle market and raise awareness of this crucial, yet underrepresented, segment of the economy.
THE MMBI REMAINS WELL BELOW THE CYCLICAL PEAK OF 136.2 POSTED IN THE FIRST QUARTER OF 2018, BUT OVERALL BUSINESS SENTIMENT REMAINS SOLID

JOSEPH BRUSUELAS, CHIEF ECONOMIST, RSM US LLP

Joseph Brusuelas is the chief economist for RSM US LLP. Brusuelas has 20 years of experience analyzing U.S. monetary policy, labor markets, fiscal policy, economic indicators and the condition of the U.S. consumer. As co-founder of the award-winning Bloomberg Economics Brief, Brusuelas was named one of the 26 economists to follow by the Huffington Post.

This publication represents the views of the author(s), and does not necessarily represent the views of RSM. This publication does not constitute professional advice.
“Midsize businesses are a powerhouse of the U.S. economy, employing approximately 30 million Americans. The segment’s overall business sentiment remains robust, however we continue to see an economic drag due to U.S. trade policy,” said Neil Bradley, U.S. Chamber of Commerce executive vice president and chief policy officer. “We must continue to deescalate trade tensions with China, and Congress must complete enactment of USMCA in order to ensure growth conditions remain solid in the coming year.”

— Neil Bradley, Executive Vice President and Chief Policy Officer, U.S. Chamber of Commerce

Middle market business sentiment declined to a seasonally adjusted 127.2 from 131.0 in the prior quarter; however, conditions for growth in 2020 remain.

RSM US Middle Market Business Index (seasonally adjusted)
MIDDLE MARKET BUSINESS sentiment remained stout in the fourth quarter, according to the RSM US Middle Market Business Index survey, as expectations about the direction of the economy, capital expenditures and hiring softened. Solid domestic demand continues to bolster current conditions and expectations for increasing revenues and net earnings in the real economy. This will provide a sound foundation for growth and economic activity in 2020, though at a more modest pace. As long as middle market expectations remain in sync with economic activity next year, the U.S. economy is unlikely to experience a premature end to the business cycle.

The decline in the proprietary RSM US Middle Market Business Index (MMBI) to a seasonally adjusted 127.2 from 131.0 in the prior quarter reflects overall slowing of economic growth, which has decelerated to 2% over the past 18 months from a prior 3%. While the MMBI remains well below the cyclical peak of 136.2 posted in the first quarter of 2018, overall business sentiment remains solid. The recent moderation in part reflects the fading impact of the 2017 Tax Cuts and Jobs Act. In addition, it is due to the adverse effect of slowing global demand, declining auto sales, challenges in aerospace associated with Boeing 737 Max aircraft, slowdowns in mining and agriculture and the drag on activity associated with U.S. trade policy.

If the economic status quo around the trade conflict holds (i.e., the trade war doesn’t reaccelerate) the peak negative effects on economic activity from trade policy will likely occur in the first 90 days of 2020. Even so, conditions for growth next year will remain solid, if unspectacular, and certainly not consistent with an economic downturn. If an economic downturn does occur in 2020, it will almost surely be caused by further intensification or extension of the trade conflict, or a large exogenous shock that emerges from the energy sector.

Forty-one percent of executives polled in the MMBI survey indicated that the economy improved during the fourth quarter, while 46% expect it to improve over the next six months; both measures were somewhat softer than those implied in the previous quarter.

NEW: Seasonally adjusted numbers
The fourth quarter MMBI data reflects seasonally adjusted numbers for the main index and all subindices. We have transitioned to seasonally adjusted numbers in an effort to remove the influences of seasonal patterns.
Sentiment surrounding the broader economy did not significantly diminish the outlook for revenues and net earnings, which remain at or near levels one would identify as robust. The MMBI survey saw 54% of companies report improved revenues in the current quarter, and 62% said they expect improvement to continue over the next six months. Similarly, 50% said net earnings increased over the past 90 days; 59% foresee profit increasing over the next 180 days. Both indicators were down modestly from third quarter 2019 MMBI readings.

A plurality of middle market executives said their firms plan to increase outlays on capital expenditures or critical productivity-enhancing equipment, software and intellectual property. Only 46%, however, said they boosted capital expenditures in the current quarter and plan to do so during the next six months. Given the acceleration of the integration of technology into the production of goods and the provision of services in the broader economy, this reticence toward capital improvements will likely continue to remain a challenge throughout this business cycle and well into the next. Midsize firms remain wary about making significant investments that would bring them in alignment or ahead of the technological curve; in our estimation, this remains one of the major risks to the middle market economy outlook going forward.

Since the MMBI was introduced in March 2015, the ability to find willing and available workers has remained one of the major challenges for businesses. The final quarter of 2019 was no different. In our estimation, softening in plans to hire and increase compensation right now do not reflect any major economic weakness. Rather, it corresponds to a tight labor market across industrial ecosystems that populate the broader economy. Roughly 42% of executives polled stated their businesses intend to increase hiring and 48% indicated they plan to do so in the first half of 2020. Similarly, 48% increased compensation, while 54% indicated a willingness to do so early next year.

Prices paid by middle market firms in the current quarter, and those expected over the next six months point to a modest increase in overall inflation. However, a majority of businesses are clearly not passing those increases along. From our vantage point, this implies confidence in the direction of revenues and net earnings, and an ability to absorb the mild inflation implied by the data, most of which is attributable to the trade war.

Stability in middle market borrowing conditions and inventories defined the quarter as those subindices remained essentially unchanged.
GENERAL ECONOMY PERFORMANCE

Forty-one percent of middle market executives believe the general economy improved in the current quarter. Twenty-eight percent expect the economy to worsen in the next six months, significantly higher than Q3’19.

What are your expectations regarding your organization’s gross revenues/all incoming funds over the next six months? Do you expect gross revenues/all incoming funds to...

/Thinking about your organization’s gross revenues/all incoming funds this quarter versus last quarter, how would you describe current gross revenues/all incoming funds?

Would you say gross revenues/all incoming funds have...

NOTE: Due to seasonal adjustment, % top–two box, % bottom–two box, and % remained unchanged may not add to 100%

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

GROSS REVENUE PERFORMANCE

Fifty-four percent of executives reported gross revenues increased in the current quarter. Sixty-two percent expect revenues to increase in the next six months.

Thinking about your organization’s gross revenues/all incoming funds this quarter versus last quarter, how would you describe current gross revenues/all incoming funds?

Would you say gross revenues/all incoming funds have...

NOTE: Due to seasonal adjustment, % top–two box, % bottom–two box, and % remained unchanged may not add to 100%

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance
NET EARNINGS PERFORMANCE

Half of middle market executives reported net earnings increased in the current quarter. Fifty-nine percent expect earnings to increase in the next six months.

Aggregate Capital Expenditures/Investments Performance

Forty-six percent of middle market executives indicated capital expenditures increased during the current period and expect them to increase over the next six months.
OVERALL HIRING LEVELS

Forty-two percent of middle market executives reported hiring levels increased in the current quarter.

EMPLOYEE COMPENSATION

Almost half of middle market executives say compensation for employees has increased.
ACCESS TO CREDIT

Current perceptions regarding access to credit are comparable to the levels observed in the third quarter.

- Thinking about the availability or ease with which your organization can borrow money this quarter versus last quarter, how would you describe current access to credit?
  - Would you say that accessing credit is . . .?

NOTE: Due to seasonal adjustment, % top-two box, % bottom-two box, and % remained unchanged may not add to 100%

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

PLANNED BORROWING

Eighteen percent of middle market executives expect planned borrowing over the next six months to decrease, significantly more than Q3 ’19.

- What are your expectations regarding your organization’s planned borrowing over the next six months? Would you say your organization’s borrowing will . . .?

NOTE: Due to seasonal adjustment, % top-two box, % bottom-two box, and % remained unchanged may not add to 100%

SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance
AMOUNT PAID FOR GOODS AND SERVICES

Sixty-one percent of middle market executives reported the amount paid for goods and services increased in the current quarter.

**Note:** Due to seasonal adjustment, % top-two box, % bottom-two box, and % remained unchanged may not add to 100%.

**SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance**

AMOUNT RECEIVED FOR GOODS AND SERVICES

Forty-two percent of middle market executives reported the amount received for goods and services increased in the current quarter.

**Note:** Due to seasonal adjustment, % top-two box, % bottom-two box, and % remained unchanged may not add to 100%.

**SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance**
INVENTORY LEVELS

Current perceptions and future expectations regarding inventory levels are comparable to the levels stated in the third quarter.

![Chart showing inventory levels from Q2'15 to Q4'19](chart.png)

<table>
<thead>
<tr>
<th>Q2'15</th>
<th>Q3'15</th>
<th>Q4'15</th>
<th>Q1'16</th>
<th>Q2'16</th>
<th>Q3'16</th>
<th>Q4'16</th>
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<th>Q2'17</th>
<th>Q3'17</th>
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<th>Q2'18</th>
<th>Q3'18</th>
<th>Q4'18</th>
<th>Q1'19</th>
<th>Q2'19</th>
<th>Q3'19</th>
<th>Q4'19</th>
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<tbody>
<tr>
<td>38%</td>
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<td>(n=333)</td>
<td>(n=342)</td>
<td></td>
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</tr>
</tbody>
</table>

* Thinking about your organization’s inventory levels this quarter versus last quarter, how would you describe current inventory levels? Would you say inventory levels have . . . ?
* What are your expectations regarding your organization’s planned inventory levels over the next six months? Would you say your inventory levels will (among those that have inventory) . . . ?

NOTE: Due to seasonal adjustment, % top-two box, % bottom-two box, and % remained unchanged may not add to 100%
SQUARE/CIRCLE = Significantly higher/lower than previous quarter, respectively, at .05 level of significance

How the MMBI is constructed

The MMBI is borne out of the subset of questions in the survey that ask middle market executives to report the change in a variety of indicators. Middle market executives are asked a total of 20 questions patterned after those in other qualitative business surveys, such as those from the Institute of Supply Management and the National Federation of Independent Businesses.

The 20 questions relate to changes in various measures of their business; such as revenues, profits, capital expenditures, hiring, employee compensation, prices paid, prices received and inventories. Middle market executives are asked to report the change from the previous quarter and to state the likely direction of these same indicators six months ahead. See a sample of the questions in Table 1.

The MMBI is a composite index computed as an equal weighted sum of the diffusion indexes for 10 survey questions plus 100 to keep the MMBI from becoming negative. The index is designed to capture both current and future conditions, with five questions on middle market executives’ recent experience and five on their expectations for future activity.

### Table 1: RSM US Middle Market Business Index questions

<table>
<thead>
<tr>
<th>Question</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>What are your expectations regarding the general economy?</td>
<td></td>
</tr>
<tr>
<td>What are your expectations regarding your organization’s gross revenues?</td>
<td></td>
</tr>
<tr>
<td>How would you describe the level of your organization’s most recent quarter net earnings results?</td>
<td></td>
</tr>
<tr>
<td>What are your expectations regarding your organization’s aggregate capital expenditures or investments?</td>
<td></td>
</tr>
<tr>
<td>What are your expectations regarding your organization’s overall hiring levels?</td>
<td></td>
</tr>
<tr>
<td>How would you describe your organization’s current employee compensation level on average?</td>
<td></td>
</tr>
<tr>
<td>How would you describe current access to credit?</td>
<td></td>
</tr>
<tr>
<td>What are your expectations regarding your organization’s planned borrowing?</td>
<td></td>
</tr>
<tr>
<td>How would you describe the current general level of prices received?</td>
<td></td>
</tr>
<tr>
<td>What are your expectations regarding your organization’s planned inventory levels?</td>
<td></td>
</tr>
</tbody>
</table>
**AS INVESTORS** increasingly steer their dollars toward businesses that make a priority of social issues like environmental, social and governance concerns, or ESG, businesses are starting to pay attention.

The Business Roundtable, in a striking shift, announced in August that the purpose of a corporation was broader than simply advancing the interests of shareholders. Instead, corporations now have many stakeholders and are expected to be good stewards of the environment, invest in their employees and exercise responsible governance, the Business Roundtable said.

Middle market companies, many with strong community ties, have long engaged in social responsibility efforts; they have been slower, however, to embrace ESG measures. The MMBI survey, which covered a range of industries, compared the third quarter of 2018 with the fourth quarter of 2019.

“Middle market organizations oftentimes lack the financial and people resources to drive actual change,” said Anthony DeCandido, a partner and senior analyst with RSM specializing in private equity and ESG. “Yet, they are challenged by stakeholders to be more conscientious of the world in which they operate in, and drive better financial and nonfinancial outcomes.”

Similar to 2018, more than 90% of middle market executives said that their companies supported social, community or philanthropic causes in the past two years.

**Increasing support**

The survey asked executives what causes they had supported over the past two years, either in direct contributions or in the way the company is managed. At the top of the list were traditional charitable organizations like the United Way, as well as educational institutions. But two other social causes showed significant gains in this year’s survey:

- **Housing quality and affordability.** Middle market businesses’ support of access to affordable housing went from 16% in the third quarter of 2018 to 25% in the fourth quarter of 2019.

- **Creating a product or service that addresses a social challenge.** A generation ago, addressing social change through business—like developing an eating utensil for people with Parkinson’s disease—was seldom mentioned in the nation’s boardrooms. Now, a fifth of the executives surveyed, or 20%, said they had steered resources to initiatives like these, up from the 15% in 2018.

When asked why they steered resources to these social causes, 70% of the executives said it was a way to support their local community. But an increasing number, 27% in 2019 compared to 20% a year earlier, said it was also to appeal to shareholders or investors.
Their responses do not mean that executives have taken their eyes off serving customers or enhancing shareholder value. Of the executives surveyed, 97% said that delivering value for customers was important or somewhat important. And 85% still said that generating value for shareholders, investors or owners was very important or somewhat important.

“Stakeholders are demanding a look under the hood before engaging with your business,” DeCandolo said.

Even so, only 39% of middle market executives report being familiar with ESG measures. Of that group, 79% use ESG to track their own activities, while 74% say they use it to measure the performance of other organizations.

The economist Milton Friedman wrote in 1970 that a corporation’s only responsibility is to its shareholders. And for a generation of business leaders, the Friedman Doctrine, as it came to be known, was their guiding principle.

But as the Business Roundtable shows, that view is changing. And the middle market should be ready to respond.

### Using ESG measures to evaluate your own or other organizations’ performance

Among those familiar with ESG criteria, 79% of middle market organizations indicated they use the ESG criteria to evaluate their own performance and 74% use the ESG criteria to evaluate the performance of others.
The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

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