



# Smack Dab in the Middle Market

New economic index measures middle-market confidence

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**W**ant to know how the U.S. economy is doing? Check the GDP report; it comes out every quarter. Interested in the

domestic labor market? The Bureau of Labor Statistics releases a monthly jobs report detailing employment figures. Large publicly traded companies can be

tracked daily through stock indexes like the Dow Jones Industrial Average and the Standard & Poor's 500, and small business confidence is captured in a monthly survey by the National Federation of Independent Business.

But what about companies in the middle? Firms with yearly revenues between \$10 million and \$1 billion, which number around 200,000 businesses, employ 40 million people and total one-third of private sector gross receipts. Until recently, there were little economic data tracking this group of businesses as a class.

But a new index developed by Chicago-based audit, tax and consulting firm RSM (formerly known as McGladrey) aims to measure business conditions within the middle market. Developed in partnership with Moody's Analytics, the index comprises survey data collected from a representative sample of 700 middle market executives.

The report's topline metric, the RSM Middle Market Business Index, is a measure of sentiment, intentions and overall business conditions determined by questions about economic expectations, gross revenues, quarterly earnings, wages, hiring and capital expenditures. The inaugural survey, released in late March, reported the number to be 116.6—which is good, according to RSM chief economist Joseph Brusuelas. “One hundred is what we consider to be neutral. If it's above 100, the economy is growing. Below 100, the economy would be contracting,” Brusuelas says.

RSM's index lines up with another measure of the middle market: the Middle Market Indicator released by the National Center for the Middle Market at The Ohio State University. That survey reported in its latest version that, “At the end of 2015 ... expectations have materialized, indicating that the middle market has moved from a period of accelerated growth to a steadier, more sustained rate of expansion.”

New editions of the RSM Middle Market Business Index will be released every quarter. Though the current iteration is the first time RSM has published its results, Brusuelas's team has been collecting data for the past five quarters. There are 20

questions total in the survey. Half of the questions are designed to be static; they will be asked in every iteration of the report. The other 10 questions will change every quarter in order to capture middle market reaction to specific events. For instance, Brusuelas plans to include questions about the U.S. presidential election in a later survey this year. “That one will have questions about policy uncertainty and expectations about the upcoming change in administrations,” he says.

While the high-level economic data in the GDP and stock market reports is relevant to middle market firms, it can incorporate variables that do not apply to the middle market, resulting in an inaccurate reflection of how the middle market is performing relative to the overall economy. This can be seen in a previous version of this survey, when RSN asked questions about the appreciation of the U.S. dollar.

“Many middle market firms simply don’t have the exposure to the global economy, or the external economy, that the largest 530 firms that populate the S&P 500 and the Dow Jones industrial averages have. Because the global economy has slowed noticeably, and due to competitiveness issues, many of those firms’ earnings are having problems,” Brusuelas says. “Our firms, which are largely only participating in the U.S. or North American economy, they’re just not seeing those problems. They’re actually outperforming, in some cases, much larger firms.”

Middle markets firms’ reliance on the domestic economy makes them an ideal bellwether for changes in the business cycle. The top-level takeaway ballyhooed by the inaugural index suggests the economy is unlikely to head into a recession this year. This assertion is based on survey data that indicates three in five respondents expect gross revenues to increase over the next six months, and the appetite for capital expenditures is projected to remain constant.

“One of the leading indicators [of recession] is a sharp drop in Capex. The fact that we didn’t see that, and [that] there are plans for expansion, put to rest any fears of a premature end to the business cycle,”

Brusuelas says. “The U.S. economy is not a great, big aircraft carrier that turns very slowly. When the economy goes into a recession, it tends to fall off a cliff.”

Brusuelas is particularly encouraged by the current data because it was collected when high volatility in the stock market fueled fears of an imminent financial downturn. “When we were asking those questions in January and February, that was the most intense portion of global asset volatility, and we thought it would be a real acid test,” he says.

Looking ahead, Brusuelas says he expects the next survey to show improvement in hiring and other economic indicators, most notably a rebound in manufacturing activity.

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Drawing on five quarters of survey data, he’s comfortable reaching some conclusions about where the economy seems to be headed for middle marketers in the short term.

“Our survey participants tend to expect to see improved revenues, improved earnings and modest economic growth. They expect to increase hiring but they’re trying to keep a lid on compensation, which may be a function of overall regulatory pressures and concerns about hiring and retaining technically skilled individuals. This is a function of a tightening labor market,” he says.

Brusuelas sees the survey as a useful tool to influence the decisions of other middle market executives, as well as investors and policymakers. “If you see things getting very

hot and [the RSM Middle Market Business Index] number accelerates well above 120 or 130, ... and let’s say you’re a central banker, that’s probably a good forward look that one should expect inflation to heat up.”

Not everybody is convinced of the index’s value, however. Jack Sweeney, founder of middle market industry news site Middle Market Executive questions whether the data is substantive enough to base decisions around.

“When you consider [that] middle market businesses are the primary customer for [RSM’s] audit services, it makes us all wonder whether this is just marketing window dressing,” Sweeney says. “I’m pretty biased when it comes to the accounting houses. I’m of the opinion they

often have ‘Grade A’ accountants and ‘Grade C’ marketers.”

Sweeney adds, “The question that needs to be asked is whether a middle market business owner would find these numbers useful, or would they more likely desire data specific to their industry rather than their weight class of company. It varies.”

One policymaker who does find the index helpful is Ohio Congressman Steve Stivers, cochair of the Congressional Caucus for Middle Market Growth. In an e-mailed statement, Rep. Stivers said, “RSM’s index further demonstrates the significance of the middle market to our overall economy and future job growth. Our caucus will keep working to tell the story of the middle market and to support policies and legislation that strengthen it.” **m**