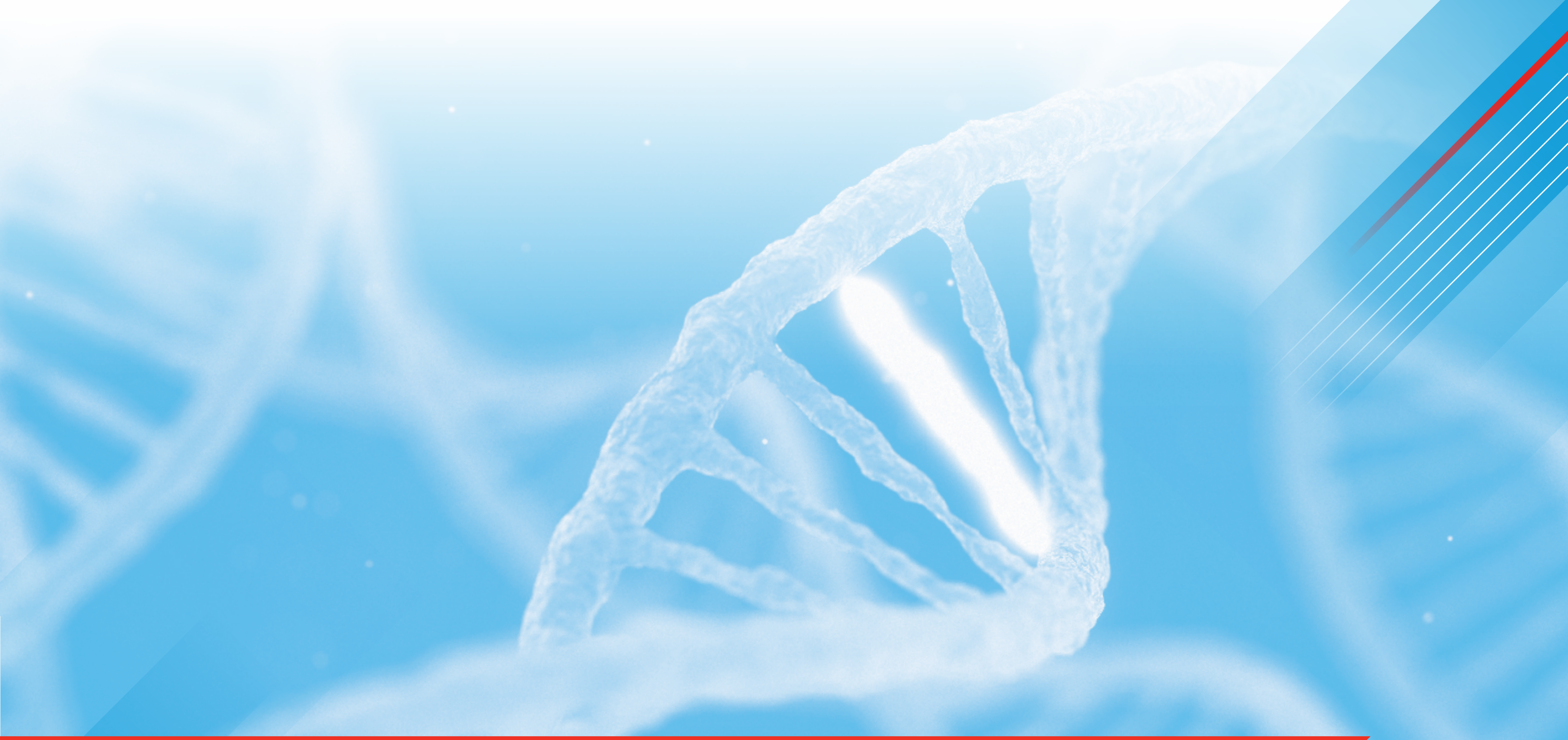
NATIONAL CENTER FOR
THE MIDDLE MARKET



A REPORT BY THE NATIONAL CENTER FOR THE MIDDLE MARKET

THE DNA OF MIDDLE MARKET GROWTH

The Three Types of Growth Champions and the Factors that Drive Their Success

IN COLLABORATION WITH

THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS

SUNTRUST

Grant Thornton

CISCO

About This Report

THE U.S. MIDDLE MARKET

The U.S. middle market comprises nearly 200,000 companies that employ 44.5 million people and generate more than $10 trillion in combined revenue annually. The middle market is defined by companies with annual revenues between $10 million and $1 billion. In addition to their geographic and industry diversity, these companies are both publicly and privately held and include family-owned businesses, sole proprietorships, and private equity-owned companies. While the middle market represents approximately 3% of all U.S. companies, it accounts for a third of U.S. private-sector GDP and jobs. The U.S. middle market is the segment that drives U.S. growth and competitiveness.

GROWTH IN THE MIDDLE MARKET

The middle market consistently outperforms other segments of the economy. As recorded by the National Center for the Middle Market's *Middle Market Indicator*, quarter after quarter, middle market businesses post higher rates of revenue and employment growth than the S&P 500. Of course, as with any segment, a group of top tier middle market companies is responsible for a disproportionate share of this growth. By understanding what underlies the growth of these champions and what they do differently to consistently outperform their peers, the Center and its partners set out to identify pillars of growth and categorize the different types of growth leaders that propel the middle market's success. The purpose of the analysis is to create a framework that companies can use to understand what influences growth the most and to adopt strategies that can help them achieve their growth goals.

HOW THE RESEARCH WAS CONDUCTED

Leveraging 20,000 records of data from five years of *Middle Market Indicator* surveys (Q1 2012 – Q4 2016), the Center and its partners at RTi Research, in consultation with Jay Anand (William H. Davis Chair and Dean's Distinguished Professor of Strategy at the Fisher College of Business), completed a full Bayesian network analysis to identify growth factors and understand the relationships between them. A Bayesian network analysis is a statistical technique that builds a data structure using probability-based learning. It helps researchers understand the strength of relationships between various measures and a "target" metric, in our case, growth. The analysis revealed key elements in the growth model and allowed us to assign weights to each factor, or to determine how much a particular external factor (such as economic confidence or industry performance) or internal management practice (such as opening new markets or innovation) influences the growth paradigm. This helps reveal where a company should focus improvement initiatives in order to drive growth. The analysis also revealed three clusters of activities and behaviors—groups of high-growth companies that act in similar ways. Companies that display one of these "growth typologies" tend to outperform their peers.

Executive Summary

From its beginning, the National Center for the Middle Market has recognized and promoted the critical role that middle market companies play in the growth of the U.S. economy. While the middle market represents just 3% of all U.S. businesses, it is responsible for one-third of private sector GDP and employment. It produces a higher share of economic growth than small and big businesses do. Annual revenue growth in the middle market averaged 6.5% during the 2012 to 2016 period. Middle market employment growth, which averaged 3.4% annually during this time, accounted for approximately 60% of private-sector job creation.

While the U.S. middle market as a whole consistently outperforms the S&P 500 in terms of revenue growth rates, there are, of course, some middle market companies that do better than others. These growth champions drive a disproportionate share of the middle market's exemplary performance. Specifically, over the past five years, the top fifth of middle market businesses grew revenue at an average rate of 24.5% annually (compared to 9.7% for the second quintile and 6.5% for the middle market as a whole).

Understanding what middle-market growth champions do differently to produce that impressive performance can provide valuable insights to companies of all sizes looking to improve. It can—and should—shape the work of scholars and consultants who wish to help companies. It can also inform policymakers looking to create more business-friendly environments. Historically the middle market has been uncharted territory for the academic, business, and policy-making communities. The data that do exist are spotty at best and primarily based on the performance of large, public organizations.

To shed light on the topic and illuminate the real drivers behind middle market growth—the bedrock of the U.S. economy—the Center and its partners conducted extensive analysis on five years of *Middle Market Indicator* data. Every quarter since 2012, the Center has surveyed C-suite leaders from 1,000 American middle market companies in a cross section of industries. The *Middle Market Indicator* surveys ask companies to describe changes and forecasts for

- Revenue and employment growth
- Investment activities, including capital spending and acquisitions
- Innovation and innovation spending
- Market expansion
- Workforce development
- Borrowing and other activities to raise capital
- Internal and external challenges
- Economic confidence.

It is important, of course, to distinguish between revenue growth and overall performance. Growth is not healthy if it is unsustainable or disguises seriously deteriorating profitability. The *Middle Market Indicator* does not track profitability, because private companies (the vast majority of middle market firms) rarely disclose profits; but the *MMI* does track companies' self-reported "overall performance." Since different companies are interviewed each quarter, the data do not provide a view of any individual company's performance over the long term. However, the data do show that overall performance and growth are closely correlated for our sample as a whole, meaning that revenue growth is a perfectly fine proxy for the subjective measure of overall performance. In other words, growing middle market firms typically produce "good" growth.

Collectively, the quarterly surveys capture the performance of 20,000 middle market businesses and provide one of the largest such data sets ever collected for the middle market. Through Bayesian network analysis, the Center and its partners set out to

- Understand the factors that contribute to that growth, each factor's weight in the growth paradigm, and the interaction of the factors with each other
- Use cluster analysis to create profiles of growth champion typologies, or groups of companies that assemble the growth drivers in similar ways to realize superior annual revenue growth
- Reveal whether and how the fastest-growing companies act differently from their peers
- Produce a framework or model of growth that can be used by middle market companies.

Some critical growth drivers are outside of a company's control, such as macroeconomic conditions and the overall health of an industry. We attempted to factor out those drivers so that we could focus on the facets of growth over which companies have a substantial amount of control—decisions about expansion, investments to make, resources to devote to innovation, hiring and developing talent, sourcing and deploying capital, and managing operations, to name a few. Some of these factors are more important than others, and they interact with each other in various ways.

The results of our analysis establish a framework for growth that companies can use to understand their growth DNA, more effectively channel and focus their resources, and make better decisions about how to grow.

Key Findings

GROWTH IN THE MIDDLE MARKET IS HEAVILY INFLUENCED BY A VARIETY OF FACTORS, INCLUDING SOME OVER WHICH COMPANIES HAVE NO OR VERY LITTLE CONTROL.

Macroeconomic conditions, the industry in which a company operates, and megatrends such as digitization each weigh into the growth paradigm. For the most part, companies can do little to influence these factors. They must play the hand they are dealt, so to speak.

SEVEN KEY FACTORS HAVE POWERFUL IMPACTS ON GROWTH AND ARE WITHIN COMPANY CONTROL.

Leaders can take their organizations' fates into their own hands by managing these seven key weapons in the arsenal of growth: entering new markets, investing and innovating, developing a formal growth strategy, attracting and retaining talent, developing talent, managing capital, and obtaining cost efficiencies.

ENTERING NEW MARKETS AND PURSUING NEW CUSTOMERS HAVE THE GREATEST INFLUENCE ON GROWTH.

Among growth drivers companies can control, company expansion into new markets has the greatest weight in the growth paradigm. Decisions on how and where to gain new customers are nearly twice as important as the six other factors.

THE GROWTH FACTORS ARE MUTUALLY REINFORCING.

While entering new markets is most important to growth, companies cannot afford to ignore the other drivers. Each factor is critical in its own right, and also influences a company's ability to expand—some directly, others indirectly, and each to varying degrees. Innovation, for example, is strongly influenced by talent acquisition, presumably because middle market companies reach outside to find people with ideas and skills needed to develop new products, services, and processes.

THE FASTEST-GROWING COMPANIES—GROWTH CHAMPIONS—ARE PARTICULARLY STRONG IN A FEW KEY CAPABILITIES.

Middle market growth champions build their businesses using all pillars of growth. However, the fastest growers truly set themselves apart from their peers in a number of critical areas, including geographic expansion, marketing and communications, consistent innovation, and building a top team.

GROWTH CHAMPIONS CLUSTER INTO THREE TYPOLOGIES: INVESTORS, INNOVATORS, AND EFFICIENCY EXPERTS.

Among the fastest-growing middle market firms, three distinct typologies—or growth DNAs—emerge. While the categories are not mutually exclusive, rapid growers tend to concentrate heavily in one of three areas: expanding revenue from new markets, customers, and territories (Investors); working to bring new products and services to market (Innovators); and creating and exploiting efficiencies primarily through highly effective management (Efficiency Experts).

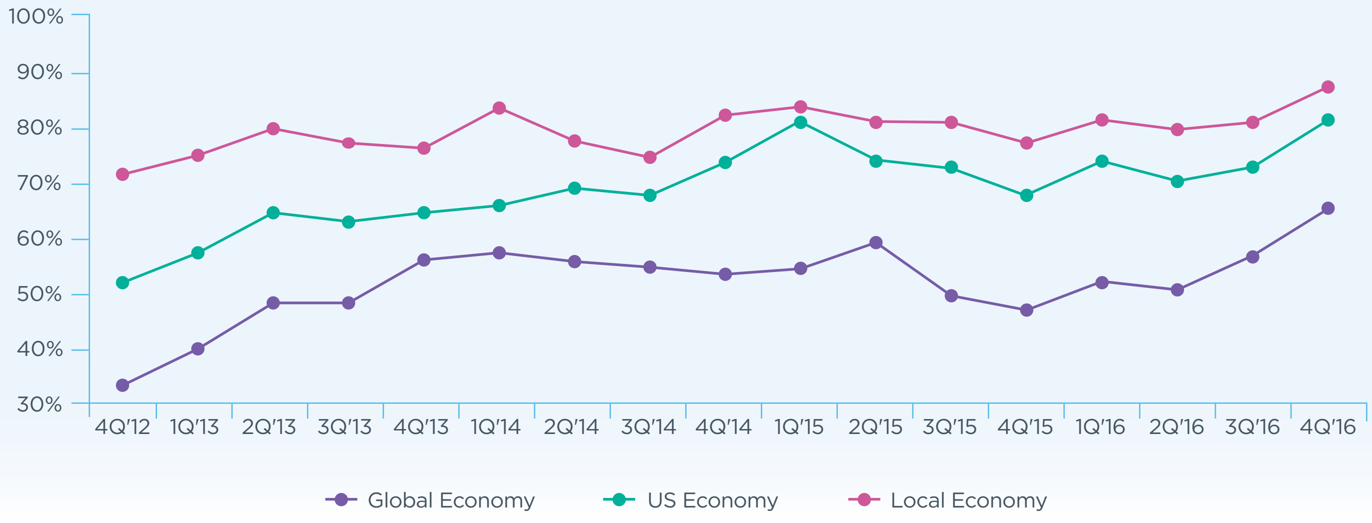
Drivers of Growth

Compared to other segments of the U.S. economy, growth in the middle market is impressive. During the period from 2012 to 2016, the average rate of year-over-year revenue growth among middle market companies was 6.5%. During this period, the companies in the S&P 500 grew an average annual rate of 3.6%. To understand the factors behind the numbers, the Center and its partners completed a Bayesian network analysis of data collected from 20,000 middle market companies over the five-year period. The analysis revealed several critical drivers of growth and their importance in the overall growth paradigm or model. These factors can be divided into drivers that a company cannot directly influence and those that it can.

External Factors: Outside of Company Control

All companies operate in economies and ecosystems governed by factors over which they have little if any direct control, such as interest rates, overall economic growth, or the rise and fall of particular industries. Indeed, the state of the economy is the biggest influence on growth, as determined by our analysis and growth model—and the rain falls on the just and the unjust alike. Beyond macroeconomics, industry and megatrends have a direct impact on growth as well; one should never confuse a bull market with management genius.

CONFIDENCE IN ECONOMY



ECONOMIC CONFIDENCE

Confidence in the economy, which can be taken as a proxy for macroeconomic conditions, is closely linked with growth in the middle market, accounting for 31.5% of corporations' revenue growth per our initial analysis. Since 2012, middle market leaders' confidence in the U.S. and global economies has soared. Local economic confidence, which was relatively strong throughout this period, has escalated as well. These perceptions reflect the steady, if unspectacular, performance of the economy, which grew at an average rate of 2.2% over this time period. Leaders' perceptions of their companies' overall performance have improved, too. Clearly, a tailwind helps all companies. While the performance of the economy has an objective effect on corporate growth, confidence—i.e., the perception of performance—has an impact too. Executives who have high confidence in the economy are more likely to expand their workforces, enter new markets, and invest in new facilities.

INDUSTRY EFFECTS

Some industries grow faster than others. Even within the middle market (which overall grew faster than the economy) the data reveal vast differences in growth by industry: Business services companies, for example, grew by 8.5% between 2012 and 2016, whereas the retail trade and wholesale trade industries grew 5.9% and 5.1%, respectively. "Industry effects," as they are called, strongly influence a company's ability to grow.

Indeed, the analysis reveals that leaders' perceptions of what the future holds for a specific industry are highly correlated to company growth. We can take those expectations as a proxy for industry effects, since, presumably, executives know the industries they work in. In our initial analysis, when we considered both the factors within and outside of a company's control, expectations for industry expansion or contraction had a greater influence on growth than any specific action a company can take, such as expanding into a new market or making an acquisition. To some extent, these predictions may be self-fulfilling. Leaders who anticipate a down year for their industries may be less willing to invest in growth, and thus realize a lower level of performance, whereas leaders who expect the best and act accordingly may be more likely to realize positive results.

A company in a stagnant industry is not doomed to mediocre performance. On the contrary, many companies can and do thrive in a low-growth environment. The key to their success is primarily innovation: They offer something the competition doesn't or develop process efficiencies that drive costs down and profits up. Others succeed by venturing beyond the borders of their markets or industries. (See Succeeding in a Low Growth Environment, p. 7.)

MEGATRENDS

Megatrends have powerful impacts on economies, industries, and companies. Changes in demography (such as urbanization and the aging of the U.S. population), technology (such as digitization), global wealth (such as the rise of Asia), and the environment (climate change) affect companies of all sizes and in all industries. Again, effects vary: An aging population increases demand for healthcare while holding back sales of new clothes.

While none of these trends are escapable, some companies manage them better than others—some ride them, some swim against them. As a result, our past research shows there are dramatic differences in performance between companies that embrace, endure, and try to escape these trends: Middle market companies that take advantage of digitization significantly outperform those that do not, for example.[1]

[1] *How Digital Are You? Middle Market Digitization Trends and How Your Firm Measures Up.* Columbus: National Center for the Middle Market, 2016

Succeeding in a Low-Growth Environment

When the growth factors outside of a company's control conspire against it, so to speak, it becomes even more important for companies to invest in what they can control. Companies in slower-growing industries or that are negatively affected by megatrends, such as digitization or consolidation can still succeed despite the odds. But they may have to work harder to do so.

We looked at companies that continue to grow despite challenging conditions. Companies that express low confidence in local economic conditions, but that, nevertheless, experience annual revenue growth of 10% or more, have several traits in common, including:

AN EXPANSIONARY MINDSET

They report being better than their peers at attracting new customers, and they work hard to find fast-growing markets upon which they can capitalize.

A GLOBAL PERSPECTIVE

They source a greater share of revenue from outside the United States, doing business and selling to customers in places such as Mexico, Canada, Europe, and Asia.

A FORWARD-THINKING FOCUS

They are more likely to have a long-term growth strategy in place covering the next three to five years, which aids in identifying new opportunities and funneling resources to seize them.

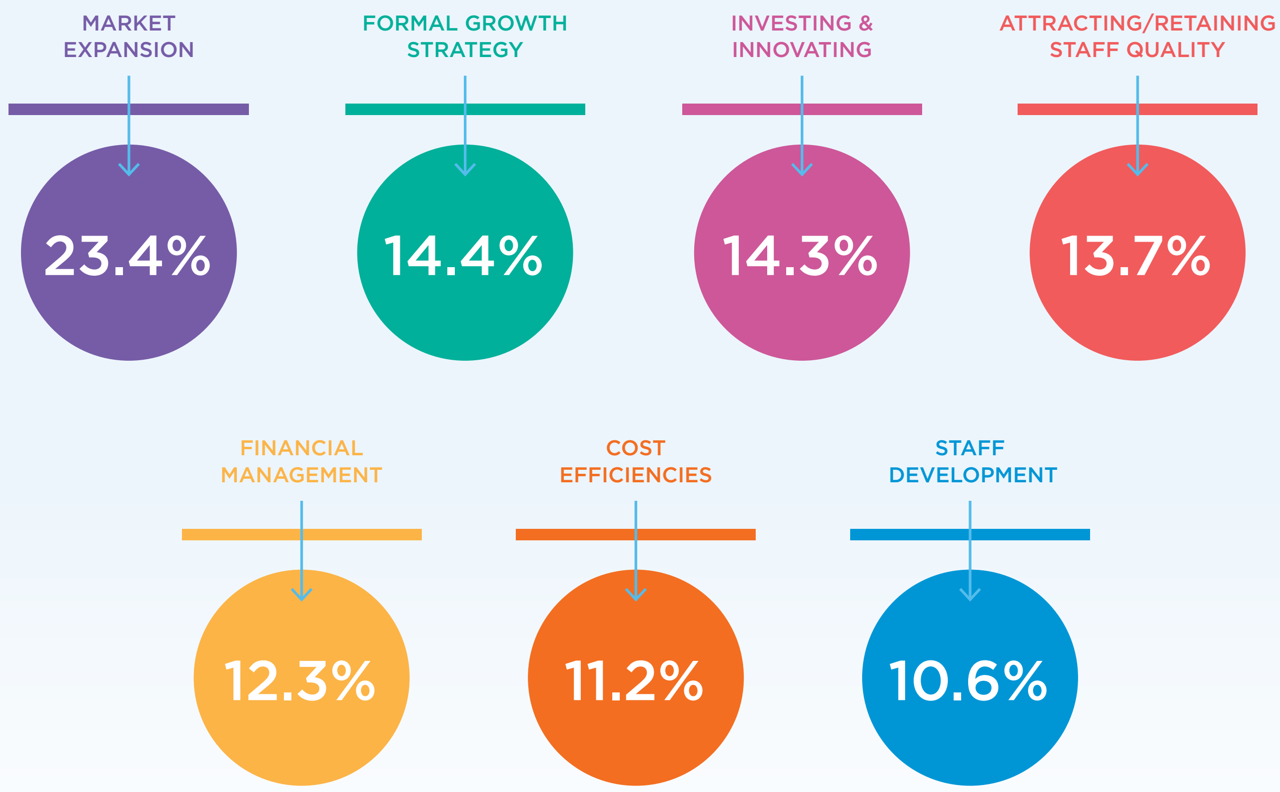
Sutphen, America's second biggest maker of firetrucks, provides an example. After the financial crisis that began in 2008, the Dublin, Ohio-based company faced a crisis of its own, as its most important customer base—U.S. cities and towns—cut spending. With those markets weak, Sutphen's leaders looked to other industries and geographies. They began targeting energy companies, which need firetrucks at oil wells, as well as government buyers in countries like Canada, Malaysia, China, and Peru.

WHAT COMPANIES CAN CONTROL

The Seven Growth Drivers

With external factors such as economic conditions and industry, companies need to play the hand they've been dealt. To do that successfully, they must focus on the growth drivers within their direct control—and this is where we most sharply focused our analysis. When we took all external factors out of the equation and reran the analysis focusing exclusively on management practices, we identified seven areas of leadership and managerial action that drive growth for companies, regardless of the industry in which they operate. The factors have various levels of influence in the growth paradigm, which again, are very consistent across industries.

THE MOST 7 MOST IMPORTANT GROWTH DRIVERS & THEIR WEIGHT IN THE GROWTH MODEL



1. MARKET EXPANSION

Middle market companies that experience the fastest growth actively pursue expanding the markets where they sell, by seeking new customers or moving into new territory or both. In fact, market expansion is the most important pillar of growth within a company's control, accounting for nearly a quarter (23.4%) of the overall growth equation.

Looking at the sub-elements that factor into market expansion, overall salesforce effectiveness is the most important. And the faster a company is growing, the more likely it is to say its salesforce is exceptional. The Center's report[2] on building an effective sales organization illustrates the critical role of sales in successful middle market organizations. The report shows that sales teams at fast-growing firms are more effective in almost every dimension, including retaining customers and prospecting for new ones. But they especially excel at developing customers, that is, turning smaller customers into big ones.

Obviously, salesforce effectiveness ties directly to attracting new customers, as do marketing and communications capabilities. The fastest-growing companies foster strong teams in both areas in order to increase their chances of bringing new customers to the business and selling more to them.

Rapid growers don't just look for more business where they currently operate, however. They actively expand into new geographic markets, including foreign markets. The fastest growers self-report much better performance in these areas than their peers: Among businesses growing at 30% or more annually, nearly 75% say they are quite good at geographic expansion compared to about 50% of other growing firms. And about two-thirds rate themselves highly for exploiting opportunities in fast-growing foreign markets, compared to around two-fifths of business that are growing more slowly.

Both areas—sales and marketing—are critical to geographic expansion, with marketing capabilities following after sales. According to Clay Spitz, managing partner of Chief Outsiders, which provides fractional CMOs for middle market companies, "Often I see B2B companies grow geographically using the same approach they did before: boots on the ground salespeople. Management teams start to look for a different solution, perhaps a CMO, when they realize that adding salespeople and upping the tactical marketing budget isn't adding to growth like it used to."

2. FORMAL GROWTH STRATEGY

Growers are much more likely to formalize a long-term growth strategy (and a plan to execute it) than non-growers and companies that are losing ground. The growth-strategy process includes setting multiyear and annual growth targets, tracking progress toward those targets, and communicating targets to all levels of the business. This is true even among the smallest middle market companies. Companies experiencing the most dramatic revenue gains increase the sophistication of their strategic processes by making a point of staying up to date with the latest management thinking. (It is interesting that effective management of healthcare costs shows up as a subfactor of formal growth strategy—that is simply the way the data landed during a statistical factor analysis. A likely explanation: Companies that are best at long-term, strategic thinking get good results when they apply the same mindset to the nettlesome issue of health benefits.)

3. INVESTING AND INNOVATING

It's one thing to expand your customer base by opening new markets; it's another to increase demand by developing and introducing new products and services and investing in scaling the business to support that growth. The fastest growers innovate and invest both in what they have to offer (products and services) and in the business systems, processes, equipment, and facilities necessary to delivering those offerings. The faster a company is growing, the better it says it performs across a mix of these factors.

Rapidly growing firms are thinking not just about what to do to meet demand right now; they are also actively investing for the future. This type of investment is highly correlated with resilience: Those with the ability to plan and prepare for the years ahead typically have the human and financial capital it takes to deal with unforeseen circumstances outside of their control, such as a downturn in the industry.

[2] *The Force Is with You: Building a Highly Effective Sales Organization.* Columbus: National Center for the Middle Market, 2016.

4. ATTRACTING AND RETAINING TALENT

Since 2012, the rate of employment growth in the middle market has accelerated considerably. Quarter after quarter, the Center's *Middle Market Indicator* shows mid-sized businesses create more jobs than small or big companies do. Between January 2012 and December 2016, U.S. unemployment dropped from 8.3% to 4.7%. It is no wonder, then, that middle market executives struggle to find and keep the talent they need to grow, a challenge that has intensified as the labor market tightened.

The fastest-growing firms rate themselves higher than their peers for recruiting power, retention capabilities, and ability to get access to an affordable workforce. They consider themselves particularly adept at attracting top management talent: Seven out of 10 executives at companies that grew 30% or more in the previous year boast of their company's ability to attract top managers. This is a virtuous circle, of course: Better talent produces faster growth, and faster growth attracts better talent. In this respect, the "ability to access a workforce that is affordable to our company" has less impact on growth than the ability to attract and keep employees with the right skills.

5. FINANCIAL MANAGEMENT

Rapid growth depends not only on how much a company brings in—i.e., the ability to attract and keep profitable customers—but also on how well capital and revenue are obtained and managed. Strong growers appear to have strong finance functions, led by a CFO who effectively manages cash flow and working capital, oversees financial processes and controls, and maintains strong relationships to sources of capital (principally banks) while keeping a sharp eye on the competition.

6. COST EFFICIENCIES

Like athletes, companies that are fit and lean usually outrun those that are out of shape. To grow rapidly, companies need the ability to identify and capitalize on operating efficiencies, making a good COO (11.2% of the growth model) about equally as important as a talented CFO (12.3% of the model). While operating efficiencies are most important for controlling cost, efficient policies and procedures and the ability to maintain margins weigh in as well. Efficient operations can turbocharge a strong growth strategy, because an efficient company spends less for each dollar of additional revenue. Companies often struggle to find the right balance between the expansion of their revenue and the growth of their administrative functions—too little and they lose control, too much and they become bureaucratic.

7. STAFF DEVELOPMENT

Human capital shows up two times in the growth model: first in companies' ability to attract and keep good people; second in their ability to provide an environment in which talent can flourish. The latter is only partly a matter of offering tools to grow (training and development). Even more important is offering employees opportunities to grow through career paths, mentoring, and a culture that encourages and rewards ambition—all strategies that are documented in the Center's *Mastering Talent Planning* report[3].

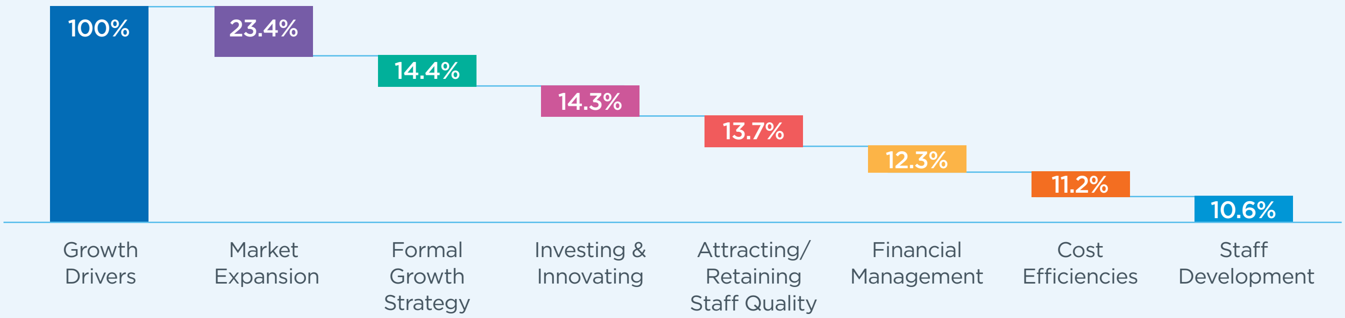
Among companies experiencing growth of 30% or more per year, more than two-thirds believe they are doing well in providing staff with both tools and opportunities. However, fewer than half of all other middle market companies say their capabilities in these areas are up to snuff.

[3] *Mastering Talent Planning: A Framework for Success. Rep.* Columbus: National Center for the Middle Market, 2016.

INDUSTRY VARIATIONS

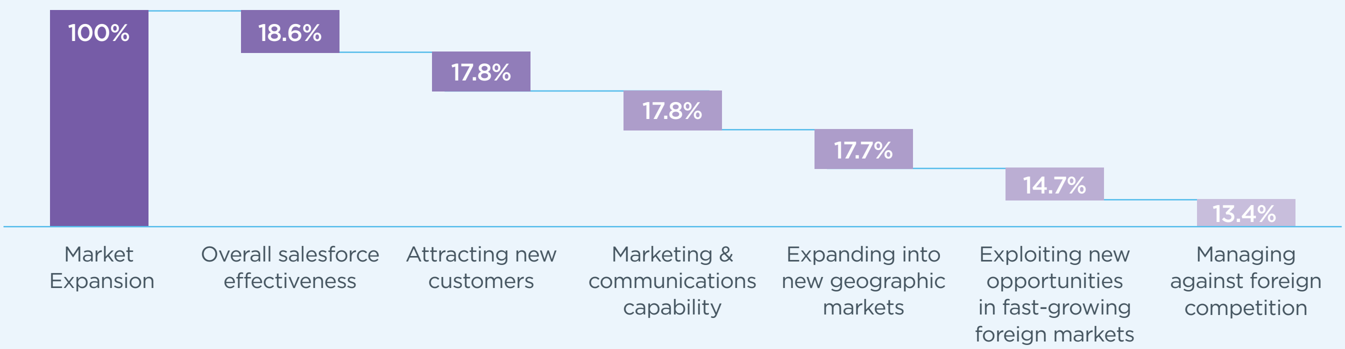
	Total Middle Market	Construction	Financial Services	Healthcare	Manufac-turing	Retail Trade	Business Services	Wholesale Trade
Market Expansion	23.4%	23%	25%	24%	23%	22%	23%	23%
Formal Growth Strategy	14.4%	15%	14%	14%	14%	15%	14%	15%
Investing & Innovating	14.3%	15%	14%	15%	14%	14%	14%	14%
Attracting/ Retaining Staff Quality	13.7%	14%	13%	13%	14%	14%	14%	15%
Financial Management	12.3%	11%	12%	12%	12%	13%	13%	12%
Cost Efficiencies	11.2%	12%	11%	12%	11%	12%	11%	10%
Staff Development	10.6%	10%	10%	11%	11%	10%	11%	11%

COMPANY PERFORMANCE ON GROWTH DRIVERS



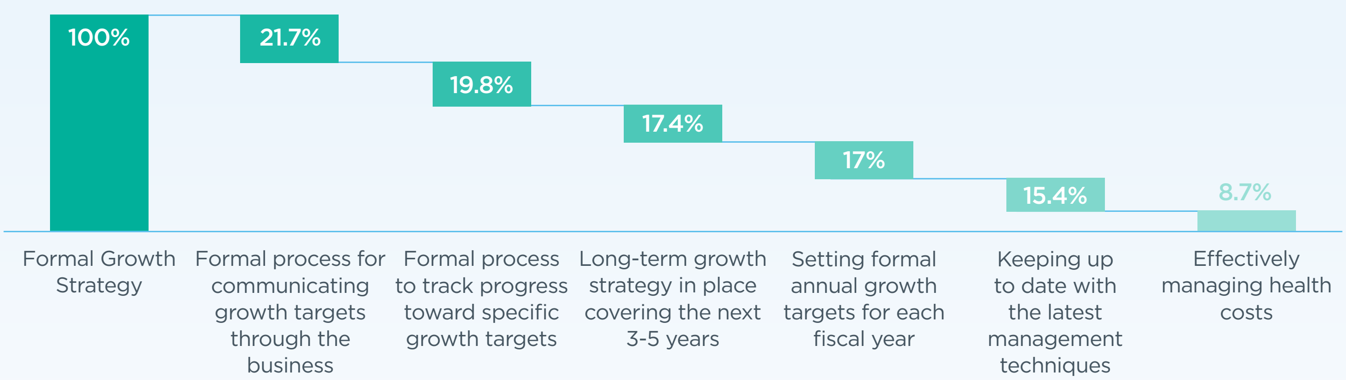
MARKET EXPANSION

(23.4% OF TOTAL GROWTH)



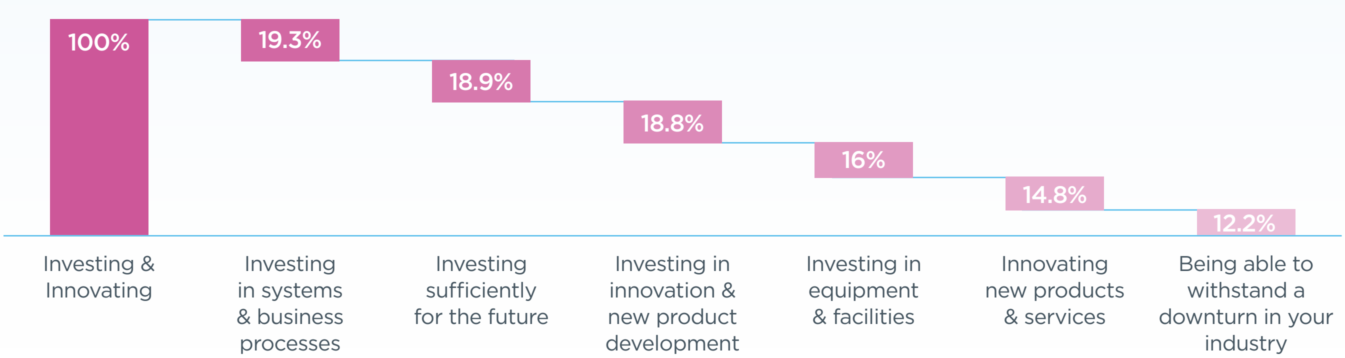
FORMAL GROWTH STRATEGY

(14.4% OF TOTAL GROWTH)

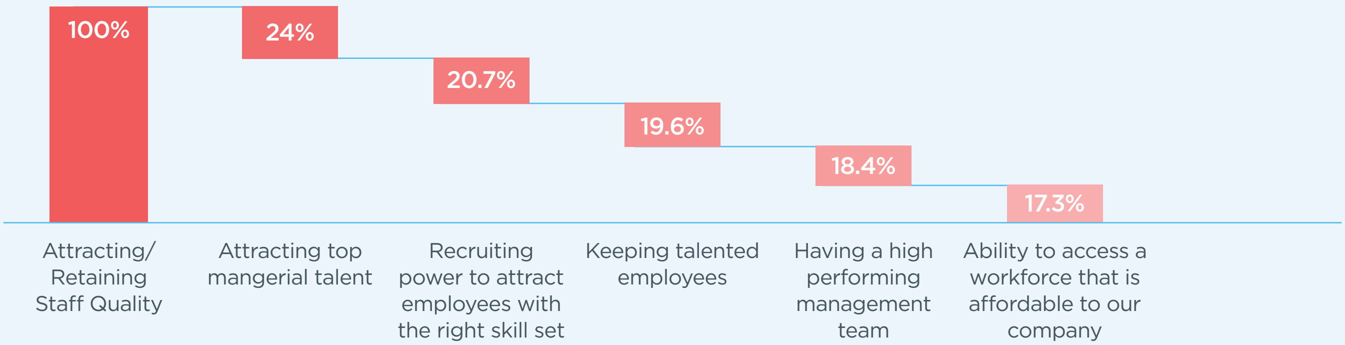


INVESTING & INNOVATING

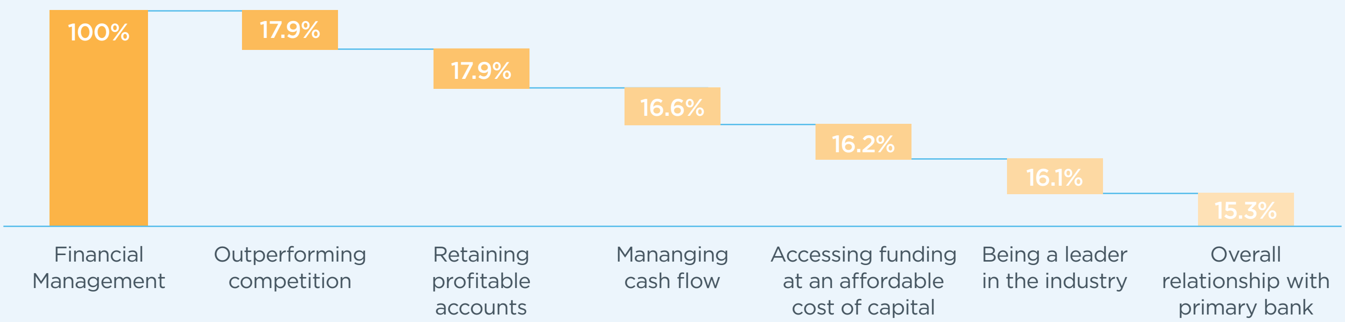
(14.3% OF TOTAL GROWTH)



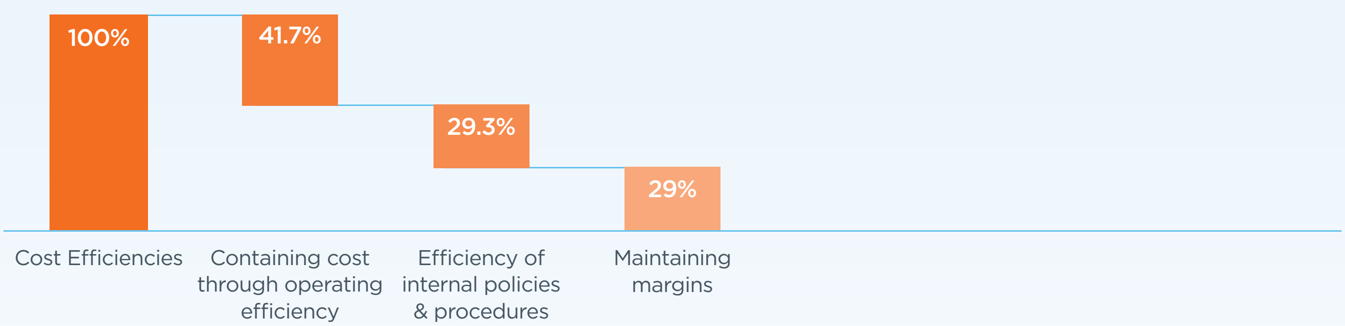
ATTRACTING/RETAINING STAFF QUALITY
(13.7% OF TOTAL GROWTH)



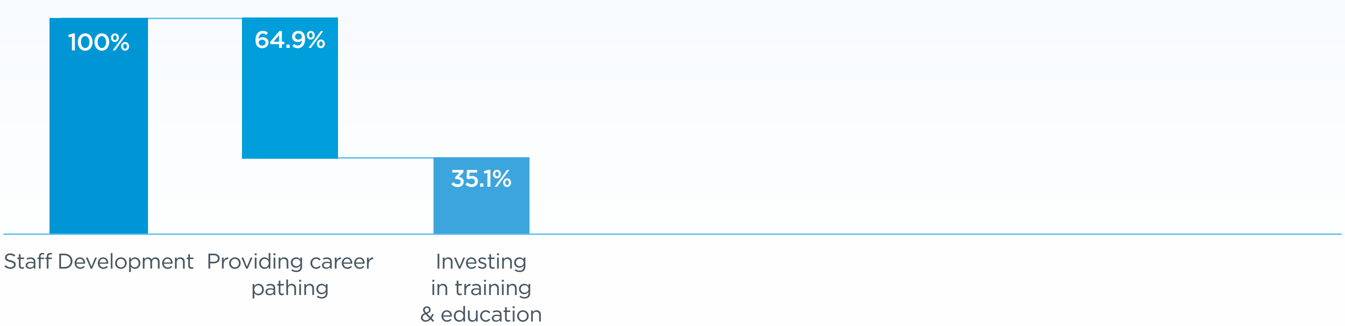
FINANCIAL MANAGEMENT
(12.3% OF TOTAL GROWTH)



COST EFFICIENCIES
(11.2% OF TOTAL GROWTH)



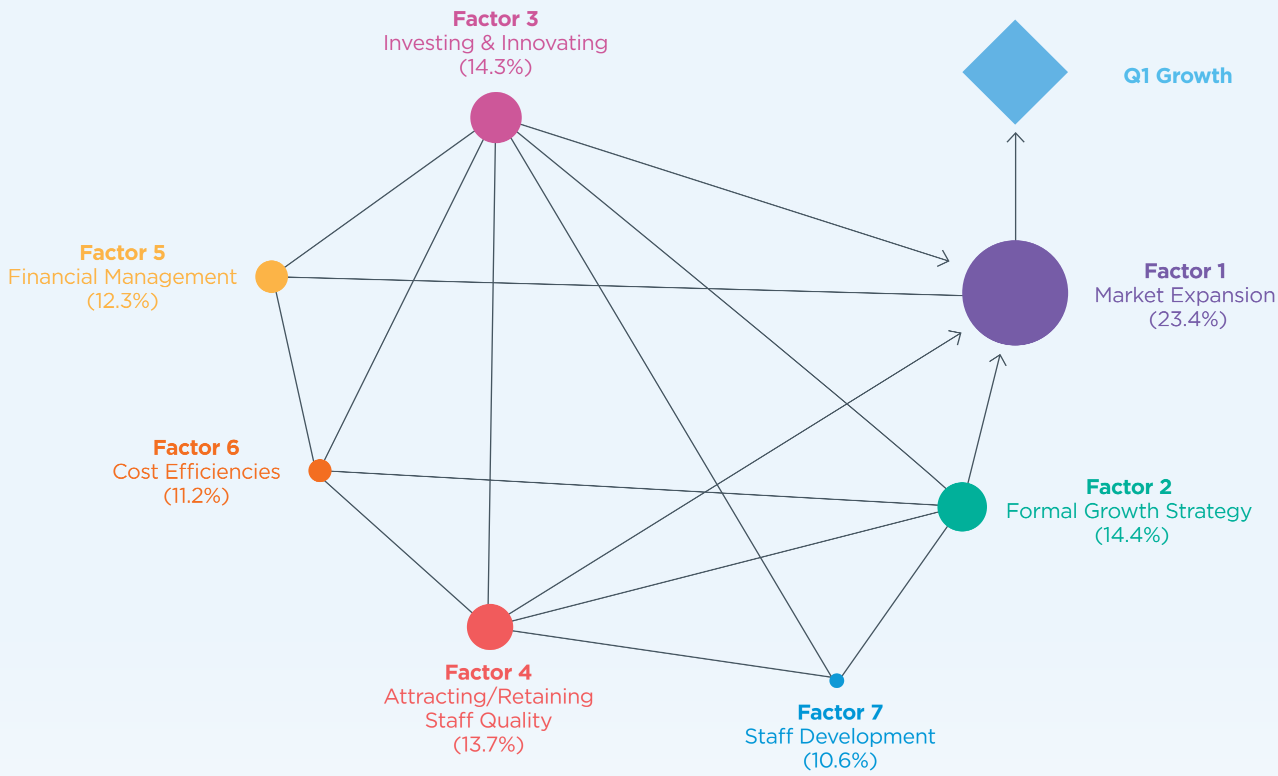
STAFF DEVELOPMENT
(10.6% OF TOTAL GROWTH)



How the Growth Factors Interact

The better a company performs across all seven growth pillars, the faster it grows. That is to say, middle market companies that achieve breakthrough gains tend to be adept in all seven areas, just as the members of a high-performing team inspire one another. The data allow us to see how the factors are connected, how performance in one area influences performance in others, and whether the impact is direct or indirect.

BAYESIAN NETWORK ANALYSIS OF MIDDLE MARKET GROWTH FACTORS



» Lines depict a connection between two growth factors. For example, financial management and cost efficiency are linked. In some cases, it is possible to infer causality, which is indicated in the exhibit by arrows. Market expansion is a cause of growth, for example. Innovation and investment, a formal growth strategy, and attracting and retaining quality staff directly contribute to or cause expansion. Additionally, relationships are in play among and between all of the factors, but no direct connection exists, for example, between cost efficiencies and market expansion or staff development and market expansion.

Examining the interactions among the drivers of growth, we can make several observations.

Growth *is* expansion.

All the other activities—innovation, investment, planning, managing resources, finding and developing talent—become growth only when they are deployed to reach new customers or sell more to existing customers. That may seem obvious; but it is possible to spend money in any of these areas that does not result in growth, such as training people in skills that are not relevant to your value proposition, or making facilities fancier but not more productive. If growth is the goal, then it should be the lens through which decisions are examined.

Investment and innovation connect all the growth drivers.

Investing and innovation fuel and move the growth system of successful companies. All other activities—even growth itself—get their impetus from the decisions leaders make about where to invest and how to innovate. For example, decisions about how to acquire and develop talent depend on investment plans, but the reverse is also true: The human capital a company has shapes its decisions about where and how to invest. Commitments to innovation and investment in growth succeed when they are part of a solid growth strategy in a well-managed company with good people. When companies are firing on all cylinders, so to speak, they can turn their attention to developing and improving their offerings, the assets that produce them, and the channels that deliver them.

Investment and innovation fuel acquisition of new customers and expansion into new markets.

A clear and strong relationship exists between investing and innovating and market expansion. That, too, may seem obvious, but it is worth underscoring: Growth isn't free. Companies that wish to expand get there through strategic investment in their business. Solid financial management, the right talent, and a formal growth strategy are additional prerequisites for successful expansion into new markets and reaching new customers.

The effect of cost efficiencies on growth is often indirect.

Keeping a sharp eye on costs benefits companies in many ways, but does not have a direct impact on a company's growth. Money saved though efficiency does not flow directly to support investment and innovation, for example. Indeed, efficiency taken to extremes becomes tight-fistedness and can result in underinvestment in innovation. Interestingly, however, investment and innovation drive down cost—presumably due to economies of scale. Efficient cost management affects expansion indirectly as well. Specifically, cost management factors into a company's growth strategy, which in turn drives growth. The indirect relationship can be powerful. There is no cheaper source of funds than releasing the cash tied up in working capital—inventories, receivables, and bills paid before they need be—as we saw in our *Working Capital Management*[4] report. Efficient operations tie up less capital and can reduce a company's dependence on outside sources of funds, such as loans or equity offerings.

Talent and strategic planning go hand-in-hand.

Staff development is linked to market expansion through formal growth strategy. While attracting and retaining talent has a direct link to expansion, it is also closely tied to growth strategy. This implies that companies that want to formalize their growth plans must consider the role talent will play—and, vice versa, they should base their strategy on their capabilities. Specifically, companies require the ability not only to attract top managerial talent and recruit people with the right set of skills, but also to provide career paths that will empower people to lead future growth.

When it comes to growth, financial management and human capital management are only indirectly related.

Growing companies need both financial and intellectual capital, but there appears to be some truth in the cliché that the CFO and the head of human resources see the world differently. The two talent factors (attracting and retaining talent; developing talent) do not directly connect to financial management. Talent and finance are linked through the search for efficiency, which includes labor productivity. By contrast, both talent factors tie directly to innovation and investing and to growth strategy, and attracting talent has a direct impact on growth. One implication: HR leaders who feel they do not have a "seat at the table" will find it easier to get influence through the folks in charge of those activities. Another: Finance executives with corner-office ambitions should spend time learning about talent planning and management.

[4] *Working Capital Management: How Much Cash Is Your Business Tying Up?* Columbus: National Center for the Middle Market, 2016.

Growth Champion Best Practices

Middle market companies experiencing annual revenue growth of 30% or more outperform their peers across all the pillars of growth. However, the gap between the leaders and the others is much wider in certain areas. Specifically, growth champions are ahead when it comes to:

GEOGRAPHIC EXPANSION INCLUDING GLOBAL INITIATIVES.
Nearly three-quarters (73%) of companies growing at 30%+ per year consider themselves very adept at entering new geographies. Just 55% of firms in the next closest tier of growth (20-29% per year) and 32% of non-growers say they do this well. Similar differences show up with respect to global expansion.

MARKETING AND COMMUNICATIONS.
Nearly seven out of 10 (67%) of the growth leaders say their marketing is first class. That number drops to 50% for other growing firms.

STICKING TO IT.
Growth champions don't just invest and innovate some of the time. Well over two-thirds of the fastest growers have an innovation and investment strategy that is sustained, programmatic, and consistent. This allows managers to plan more than a few months ahead.

WORKING ON THE BUSINESS AS WELL AS IN THE BUSINESS.
Growth champions make the time and have the intellectual curiosity to lift their noses from the grindstone. Nearly three-quarters (73%) of the fastest-growing businesses have a long-term growth strategy, not just an annual budget. By a substantial margin, they are more likely to keep up with the latest management techniques (66% compared to 40% of all other middle market companies).

BUILDING THE TOP TEAM.
The 30%+ growers are notable for superior recruiting power and ability to attract top managerial talent. Their attractiveness may be related to their commitment to leveraging the latest management techniques. And, of course, fast growth is a beacon to top talent.

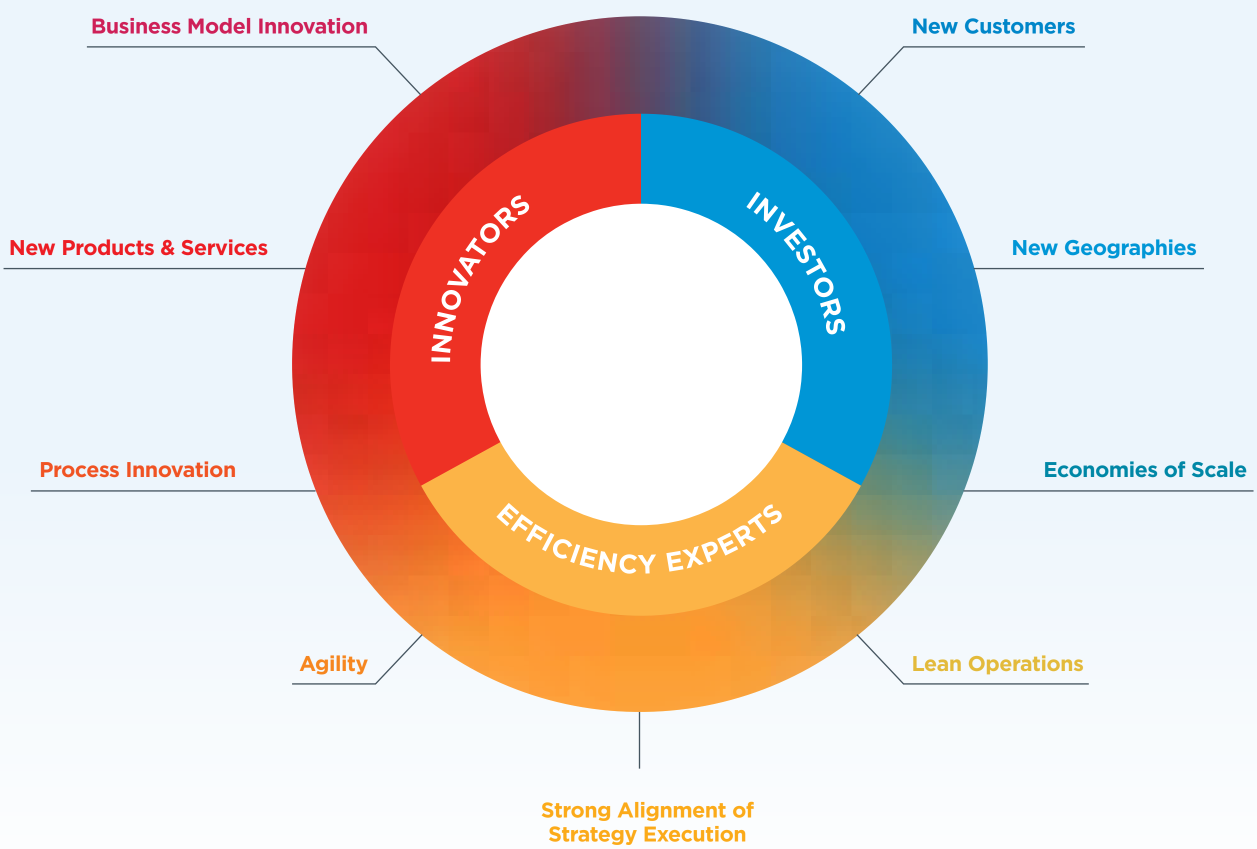
MAINTAINING EFFICIENT POLICIES AND PROCEDURES.
Growth champions are much more likely to boast of efficient and effective internal controls, even at stunning 30% growth rates.

DEVELOPING TALENT INTERNALLY.
The fastest-growing businesses are streets ahead of the others in career pathing, training, and development for their people.

Growth Champion Typologies

While each of the elements of growth identified is critical to company performance, rapidly-growing middle market businesses tend to use them in different ways. Our cluster analysis revealed three distinct pathways along which companies can drive to exceptional growth. While a subset of middle market companies demonstrates high performance across the full range of variables, most can be associated with three categories, which we have named Innovators, Investors, and Efficiency Experts. While these are distinct types, they are not rigid categories. Most companies display some characteristics of each type. The boundaries can be fuzzy and all growing companies need to innovate, expand, and control. The typologies are a matter of emphasis, intention, style, and perhaps culture.

GROWTH CHAMPION DNA: THREE PATHWAYS TO GROWTH



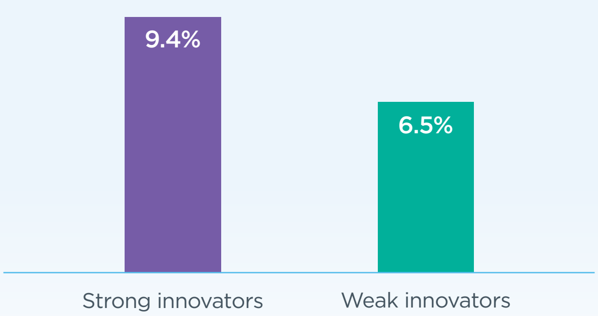
Innovators

Collectively, the Innovators grow their revenue at a rate of 9.4% per year, compared to non-innovators, which experience year-over-year revenue growth of 6.5%.

The defining characteristic for these companies is that they receive more than 20% of revenue from newly introduced products or services. These businesses are continually bringing new or improved products, services, and solutions to market to drive increased sales to both new and existing customers.

These new offerings are their primary means of business expansion, with the majority of Innovators introducing at least one new product or service every year. Innovators have long-term growth strategies, which likely reflect their commitment to adding these new offerings. They are also proud of their accomplishments, and most say they outperform their competitors. Innovators believe they manage well against foreign competition.

REVENUE GROWTH (PAST 12 MONTHS)



AGE, INDUSTRY, AND OWNERSHIP STRUCTURE

In the public eye, innovation is often associated with start-up companies, but Innovators are only slightly younger than other types of middle market growers. They are 39 years old on average—compared to 45 years for the sample as a whole. Only a third of the companies in the Innovator cluster have been in business 20 years or less.

They are, however, smaller. A majority (55%) fall into the lower end of the middle market revenue spectrum, with between $10–$50 million in annual revenues. They are also smaller in terms of workforce size; a third have fewer than 100 employees. Size may work to their advantage by fostering closer-knit, more collaborative internal relationships that drive innovation.

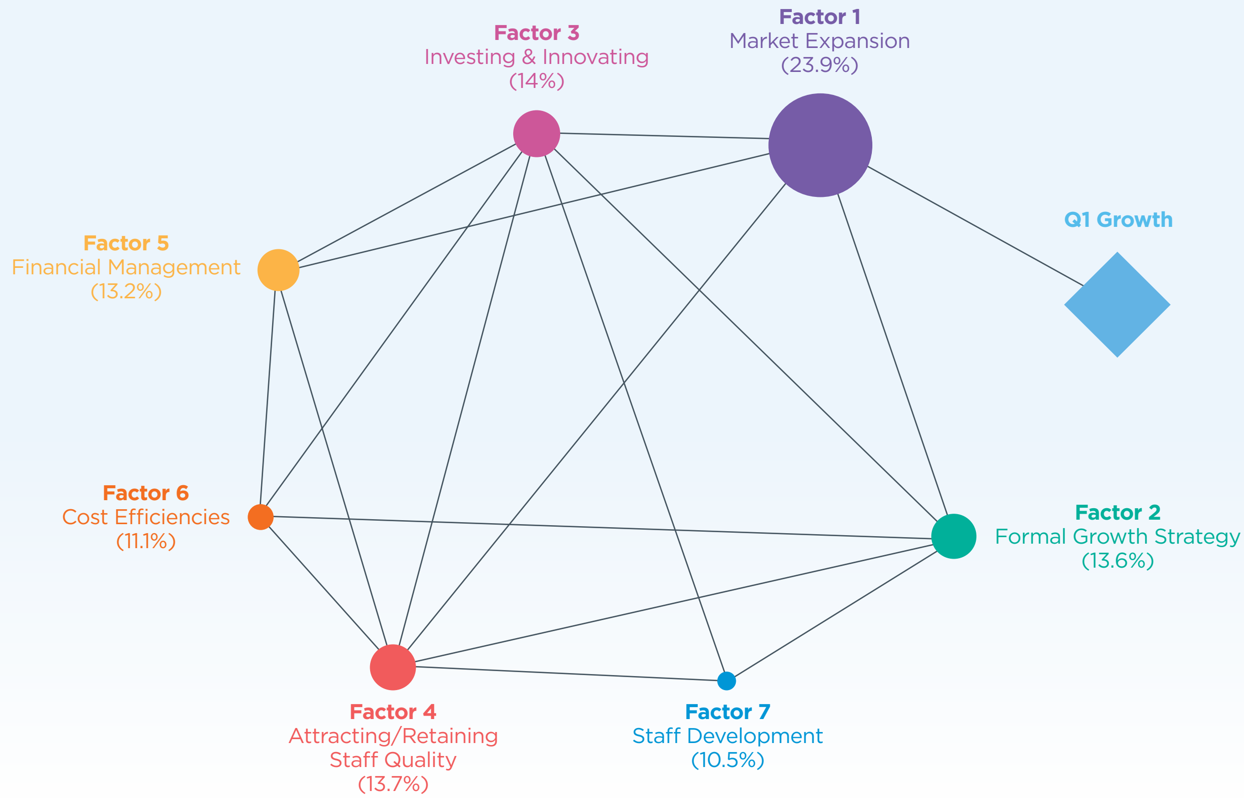
Innovators are more likely than other types of growers to deal in retail trade and to be privately held or family owned. A little more than a third (35%) of Innovators have some private equity ownership.

BEHAVIORS

The Bayesian network analysis for Innovators is similar to the analysis for the middle market overall, with market expansion accounting for 23.9%, compared to 23.4% for the market as a whole. Strong financial management, however, weighs more heavily for Innovators than for the middle market as a whole—13.2% compared to 12.3%.

For Innovators, a clear growth strategy emerges when looking at how they choose to allocate capital. Compared to Investors (see below), Innovators appear to be more capital-constrained. This could be partly a function of their size. Like all types of growers, most Innovators would invest an extra dollar as opposed to save it. But Innovators are more inclined than their peers to invest in people and technology; they are somewhat less likely than other growers to put funds toward capital expenditures such as plant, equipment, and facilities; and they are considerably less likely to acquire or plan to acquire another company. In short, Innovators produce organic growth by means of new products and services; they invest heavily in human capital—the source of innovation—and relatively less in physical assets; and they fund growth from retained earnings as much as possible.

BAYESIAN NETWORK ANALYSIS OF MIDDLE MARKET GROWTH FACTORS—INNOVATORS



INNOVATOR SPOTLIGHT

VARIDESK®: Thinking on Their Feet

When VARIDESK CEO and co-founder Jason McCann's business partner couldn't find an affordable, effective sit-stand desk to help relieve his back pain, the pair decided to create their own. That very first VARIDESK, manufactured in 2012, worked so well that other businesses soon wanted one. Today, VARIDESK's extensive line—which includes around 100 active office products designed to create healthier, more productive workplaces—can be found in 130 different countries and more than 98% of Fortune 500 businesses. And the company is just getting started.

"We have more than 200 products and prototypes in the pipeline that we plan to launch over the next 24 months," McCann says. Each is designed to deliver the highest quality at the best price and to be simple and fast to put together so companies can easily reimagine their work environments. Much of the inspiration for these new products come from feedback the company receives from its fan base.

"We live in a transparent world where feedback is immediate," McCann explains. VARIDESK staff not only pays attention to online reviews, the company actively solicits input from customers face-to-face. "We get to tour some awesome corporate offices, and we walk around and ask people what they like and don't like." All of that feedback gets channeled back to the design team and is used to tweak and enhance existing products and generate new solutions. The company's best-selling product has been modified 22 times.

But it's not just office furniture that VARIDESK works to improve. The company also solicits ideas and input from customers and business partners on everything from product packaging, to installation and assembly, to how pallets are built and products are shipped. Like many manufacturers, VARIDESK is innovating its way into value-added service offerings, such as installation, service, and consultation on workspace design.

"Everything we do is about making people more productive and efficient." This way of thinking, along with investing back in the business, has allowed VARIDESK to grow by 30% annually over the last three years. "We want to be one of the great ones," says McCann, who's a fan of businesses like Zappos and Southwest Airlines. By designing continuous innovation into its business model, the company is well on its way.

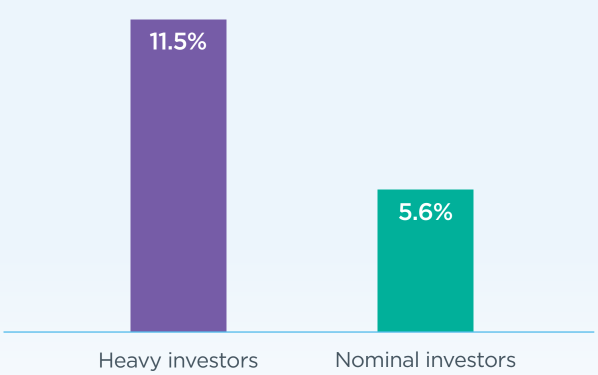
Investors

Investors are scalers, putting capital to work across the entire spectrum of growth-producing activities. They are the most likely to expand into new markets, both domestic and foreign; the most likely to add a new plant or facility; the most likely to make an acquisition—or to be acquired; and the most likely to increase R&D and launch a new product or service. (Innovators get a higher proportion of revenue from new offerings, however.)

These investments pay off. Companies in the Investor cluster are larger than the others, with 47% of these businesses making between $100 million and $1 billion in annual revenues (compared to 32% of Innovators and 33% of Efficiency Experts). Innovators' average annual revenue is also the highest of the three groups at $196 million. And the Investors, as a group, boast the highest rate of year-over-year revenue growth.

Willingness to invest is likely driven by this cluster's high economic confidence levels and expectations for a more favorable business climate and increasing demand. Perhaps as a result of such investments, growers in this group self-report being particularly adept at exploiting new opportunities in fast-growing foreign markets and managing against foreign competition. They also appear to have a solid handle on costs, including healthcare costs.

REVENUE GROWTH (PAST 12 MONTHS)



AGE, INDUSTRY, AND OWNERSHIP STRUCTURE

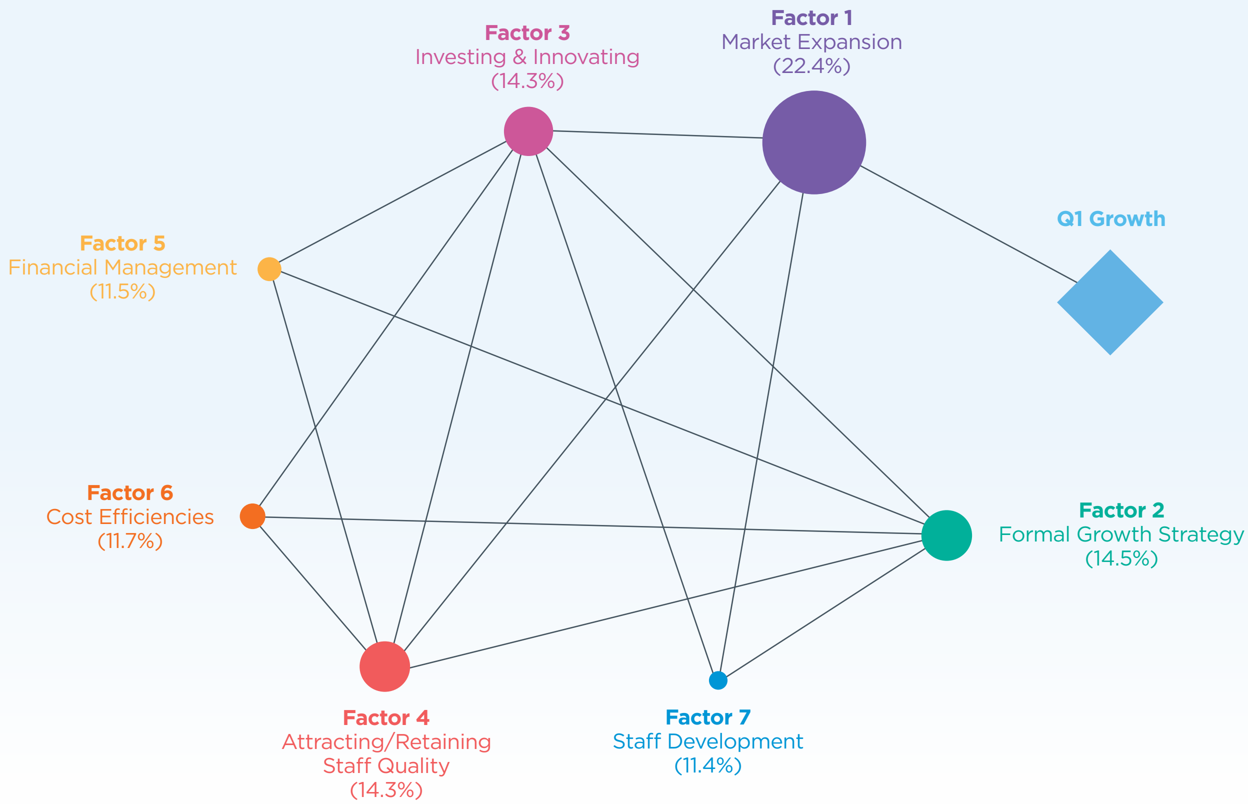
On average, Investors have been in business 43.2 years. They are also most likely to have some private equity ownership, with more than four out of 10 (42%) of companies owned in part by private investors. Rapidly growing businesses in the manufacturing industry are most likely to be this type of a grower.

BEHAVIORS

Like the Innovators, Investors display a Bayesian network analysis that is quite similar to the analysis for the overall middle market, with market expansion remaining the most important factor with the only direct relationship to growth. The talent factors and cost efficiencies have a marginally stronger relationship with growth for the group.

Investors typically have a formal process for communicating their growth targets throughout the business. Not surprisingly, they are the least likely to hold onto an extra dollar and the most likely to invest, primarily in capital expenditures such as plant and equipment. They are also considerably more likely than other types of growers to expect an increase in M&A activity in their industries.

BAYESIAN NETWORK ANALYSIS OF MIDDLE MARKET GROWTH FACTORS—INVESTORS



INVESTOR SPOTLIGHT

Daseke®: Investing in People

Don Daseke bought his first specialty trucking company in 2008 because he believed in the company's CEO. While he knew virtually nothing about trucking at the time, "I knew from my business history that the key difference in making a company successful is the people," he says.

Since then, Daseke has acquired 16 flatbed and specialized trucking businesses, making Daseke—which went public in February 2017—the leading consolidator and largest company of its type in North America. Over the past decade, the business has grown from $30 million to $1.3 billion in annual revenue, all without eliminating a single job.

"This is not the way Wall Street typically thinks about mergers," Daseke concedes. But Daseke's not interested in pursuing companies that are for sale. Instead, he takes a Warren Buffet-style approach, seeking out the best-run businesses and strategically wooing them, a process that can take years.

His efforts are typically met, at first, with a response such as, "We're flattered by your interest. But we're not for sale." Daseke is not deterred. He follows up with his prospects regularly, presenting his case.

Nor is he interested in restructuring. "We don't buy companies that need to be fixed," he says; Daseke insists that existing management teams sign five-year contracts to stay, and only once has it been necessary to change management. Daseke is consolidating the flatbed and specialized trucking industry in a unique way. The company pursues growth by honeycombing the country with autonomous, complementary operating companies, all focused on the same niche.

By becoming part of Daseke's innovative business model—there's no other national or public company focused on the flatbed and specialty trucking category—smaller operations have much to gain. Benefits include a national presence, the ability to share best practices with other operations, better insurance coverage, and price savings on everything from vehicles to tires to fuel. Companies that become part of the Daseke family can also offer unique incentives: Daseke is the first public trucking company to offer stock ownership to all of its employees.

"Anyone can buy trucks, or terminals, or land," Daseke says. "But the people are the unique asset. If you have good people, you create an environment where they want to stay long-term." So far, it's a strategy that's paid dividends for Daseke, and one the business plans to continue to drive for the foreseeable future.

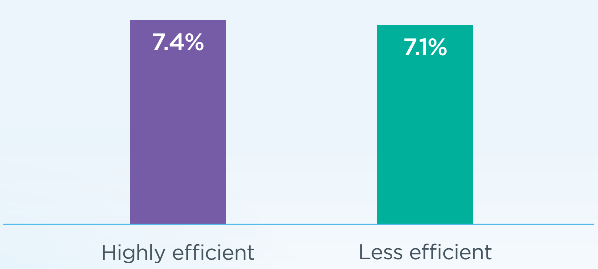
Efficiency Experts

While efficiencies in process and workforce have less weight in the growth model than market expansion, investment, and innovation, efficiency can still be a pathway to rapid growth for companies that master the nuances, especially companies that drive efficiency from the top down via highly-skilled leaders.

Efficiency Experts are particularly adept at attracting top managerial talent and maintaining a high-performance management team. They boast of exceptional workforce productivity and say talent management is less of a challenge than other fast-growing organizations. They stay up to date on the latest management techniques, and they are extremely confident in economic conditions close to home and across the nation.

Of the three types of growth champions, Efficiency Experts have the lowest rate of year-over-year revenue growth (7.4%). The true growth-driving power of efficiency comes when it is overseen by top-performing management—that is to say, management that sees efficiency as a means to an end rather than an end in itself. For Efficiency Experts, there is a very strong Bayesian correlation between the "cost efficiency" and "formal growth strategy" factors. Uniquely in this group, "staff development" outweighs "attracting and retaining staff," suggesting that Efficiency Experts focus on producing ever-more output from existing assets—human as well as financial and physical.

REVENUE GROWTH (PAST 12 MONTHS)



AGE, INDUSTRY, AND OWNERSHIP STRUCTURE

Efficiency Experts are the oldest of the bunch with an average age of 45.1 years. Only a quarter of these companies have been in business for less than two decades. They fall between the innovators and the investors in terms of revenue size and workforce size. Half are privately held corporations. They are the least likely of all the growth types to have private-equity ownership or to be family-owned. Efficiency Experts are common in the wholesale trade and financial services industries.

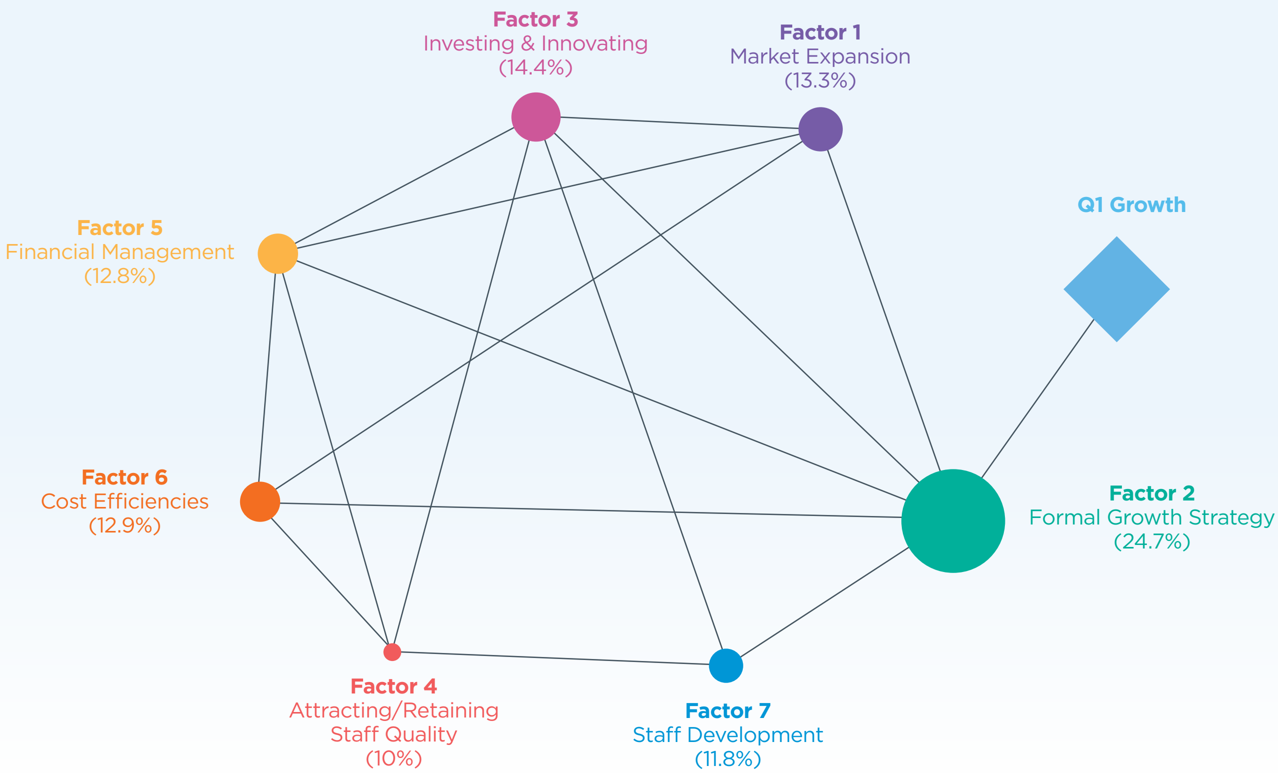
BEHAVIORS

There is no direct connection between market expansion and growth for Efficiency Experts, which sets them apart from the other two groups. Rather, Efficiency Experts rely primarily on a formal growth strategy to drive performance. Indeed, for this group, formal growth strategy accounts for 24.7% of the overall growth equation (compared to 13.6% for Innovators and 14.5% for Investors) and market expansion drives 13.3% of growth (compared to 23.9% for Innovators and 22.4% for Investors).

From a capital perspective, Efficiency Experts are the most likely to hold onto cash with nearly four out of 10 of these businesses saying they would save an extra dollar as opposed to investing it. They are the least likely to introduce new products and services or to have recently engaged in other types of expansion activity, such as entering a new market or opening a new plant. Instead, Efficiency Experts focus heavily on developing people with the right set of skills, presumably to drive greater efficiencies in their business and hence grow. They focus on honing their recruiting capabilities, and they believe they can access an affordable workforce. Once people are in the door, Efficiency Experts invest in training and education and providing career pathing to keep their experts engaged and as productive as possible.

They are not debt-averse in theory: About a quarter say they expect to take on new debt or open a new line of credit in the year to come. But their history suggests that they are reluctant to put theory into practice: Just three out of 20 went to the credit markets in the year just past. A similar combination of appetite and wariness shows up in deal-making: 30% say they expect to make an acquisition in the year ahead, but 21% say they pulled the trigger on a deal in the prior year.

BAYESIAN NETWORK ANALYSIS OF MIDDLE MARKET GROWTH FACTORS—EFFICIENCY EXPERTS



EFFICIENCY EXPERT SPOTLIGHT

Signature Consultants®: Efficiency Through Culture

Out of 19,000 staffing firms in the U.S., only 140 have exceeded the $100 million revenue mark, according to *Breaking Through*, a new book coauthored by Barry Asin, President at Staffing Industry Analysts. Signature Consulting, headquartered in Fort Lauderdale, is one of the top 10. The 21-year-old IT staffing firm has historically grown at three times the industry rate. They've doubled in size since 2010 and have plans to double again over the next five to 10 years. The growth has been 100% organic.

Signature's secret sauce is efficiency, but not just the typical process efficiencies that help many organizations scale successfully. According to EVP Geoff Gray and COO Mark Nussbaum, Signature succeeds through cultural mechanics. The company has created a culture where every employee from the back office to the front lines is enlisted in the business' profitability.

"We're all in this for the greater good," says Gray. "People in every department understand their contribution to the bottom line." And departmental budgets reflect that: Back office budgets—sales, general, and administrative—are allowed to increase at no more than half the company's growth rate.

"Each department has complete control over its budget and the freedom to decide which processes work and where they need to improve efficiencies," Nussbaum explains. Those efficiencies drive profits, all of which are invested back into the company. This not only allows the company to grow; it "creates opportunities for our people to do more with their careers." A motivator that's clearly working.

Signature has realized additional efficiencies through practices such as developing people internally and maintaining a redeployment rate for consultants that's double the industry average. The company also enlists the help of consultants to manage its aggressive growth and continually stay focused on the right KPIs.

Of course, being in a booming industry doesn't hurt. "It's a great time to be in IT staffing and we're fortunate that American businesses need good help," Gray says. "But running the business profitably has always been our founder's ultimate goal." By continuing to leverage its people and drive process efficiencies from within, Signature has a solid model in place for continued breakthrough performance.

A Framework for Middle Market Growth

GROWTH TYPOLOGIES

The three growth "types"—Innovators, Investors, and Efficiency Experts—embody distinct but complementary approaches to growth.

Innovators grow by seeking, always, for what's new. Whether they are in high-tech industries or not, Innovators pursue the advantages that come from being first to market with a technology or an idea. It is probably not a coincidence that Innovators tend to be smaller than companies of the other two types: They may be quicker on their feet than larger firms.

If Innovators pursue the new, Investors pursue scale. They are always going for more: moving into more markets, opening more offices and plants, adding more new offerings to sell. They are scalers. Investors have the biggest appetite for capital; they are 17% more likely than the middle market as a whole to be planning to take on new debt and 15% more likely to open a new line of credit. Not surprisingly, private equity ownership is more common in this cluster than in the others.

Efficiency Experts win by running tight ships. They are most often found in regulated industries (such as financial services) or where a low-cost, low-price strategy clears the road to growth (certain retailers, for example, but not high-end boutiques). There is no evidence that companies become Efficiency Experts as they mature. They are barely older than those in the other clusters: 45.1 years on average, vs. 43.2 for investors and 39.1 for innovators. Instead, as noted above, these companies combine lean operations with a hungry outlook and formal growth strategy, turning the cash they save in operations into the fuel they use to expand.

It is interesting that these three types—derived purely by clustering *Middle Market Indicator* data points—resonate with other growth frameworks. Michael Treacy and Fried Wiersema, in their classic book *The Disciplines of Market Leaders* (1995), described three ways to move to the forefront of competition: product leadership, customer intimacy, and operational excellence. These roughly correspond to Innovators, Investors—who emphasize marketing and salesforce management more than the others, though companies in the Treacy/Wiersema framework are often niche players—and Efficiency Experts. There is a similar correspondence with the strategies documented in the long-running Innovation 1000 study of the consulting firm Strategy& (formerly Booz & Company): technology drivers (like Innovators, they hone the cutting edge), need seekers (like Investors, they find and fill unserved customer demand), and market readers (like Efficiency Experts, they compete in established markets with a low-cost or fast-follower strategy).

Growth types are not strategies; they are means to a strategic end. Any given group of competitors is likely to include representatives of each type, trying to win the business of the same customers. Companies may straddle the boundaries between types, and it appears possible to "major" in one and "minor" in another. But resources and management attention are not infinite. Leaders should take a hard look at the value proposition they offer customers, the capabilities at which they truly excel, and the resources they command, using those insights to guide them toward an emphasis on innovation, scaling, or efficiency.

Growth types are not immutable; companies, unlike leopards, can change their spots. Because Innovators are younger, on average, than Investors, and Investors are younger than Efficiency Experts, there may be a maturation process for companies akin to the product life cycle, which begins with a flurry of innovation, proceeds to market expansion, and ends with the pursuit of profits.

UNIQUE MIDDLE MARKET GROWTH CHARACTERISTICS

The growth DNA of middle market companies is distinct from that of larger companies.

- The strategic goals of the owners may differ from what public-company shareholders want. More than 90% of companies in this sample are owned by families, individuals, partners, or private equity investors. They might be able to take a longer view of investments than companies subject to quarterly earnings pressure. For some, growth might not be a priority. Family-owned businesses are much more likely than PE-owned companies to sit on the lower end of the growth spectrum. This might be because PE firms select companies with strong growth prospects; but some family firms are "lifestyle companies," whose owners are less concerned with growth than with security and profitability.
- Private companies that don't want to sell equity have fewer sources of capital. This might constrain their strategic options—perhaps in a constructive way by forcing them to select investments with demonstrable cash paybacks. It might also discourage acquisitions that dilute equity. But it might also limit their ability to satisfy an appetite for growth.
- Middle market companies almost by definition have more runway for growth than big multinationals. Though they are not young (the average company age in this sample is about 45), neither are they mature. Of the companies that grew more than 30% in the previous year, nearly half expanded into new domestic markets and more than a third into new international markets. This is a playing field quite different from that of Procter & Gamble, with operations in 80 countries and sales in 100 more[5], or IBM, which operates in 170 countries and has more employees in India than in the U.S.[6]
- With untapped markets and limited means, middle market companies appear to prioritize organic growth over M&A and, when they make acquisitions, may be more likely than large firms to be motivated by the chance to expand markets than to consolidate the competition and squeeze out costs.
- Functions that once grew internally can nowadays often be outsourced or automated, for example via cloud computing, software as a service, electronic payments, and online sales that obviate the need for physical stores. Middle market companies can leverage this new ecosystem of functional services to grow with relatively little capital. Big companies that want to take advantage of it may need to get there via painful restructuring.
- Middle market companies are disadvantaged in the area of talent planning. Being less known than big companies, they attract fewer resumes over the transom; with leaner HR teams, they appear to underinvest in training, succession planning, and other forward-looking activities, and are less likely to take advantage of outside resources such as community colleges.[7]

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[5] https://us.pg.com

[6] https://www.ibm.com

[7] *Help Wanted: How Middle Market Companies Can Address Workforce Challenge to Find and Develop the Talent They Need to Grow.* Rep. Columbus: National Center for the Middle Market, 2017.

A NOTE ON ECONOMIC CONDITIONS

Economic conditions may affect the relative success of the growth types—and the growth factors. These data were collected in a benign economy, where growth was moderate but steady, there were no major economic shocks domestically or internationally, interest rates were low, and there was little cost pressure from energy, labor, or raw materials. The analysis here focuses on growth factors that management can affect, such as investment, innovation, and operations. But 35% of the growth documented by the *Middle Market Indicator* comes from macroeconomic factors over which companies have no control, such as industry performance and the economy as a whole. Other outside factors affect what managers do; interest rates influence investment plans, for example.

Under different economic conditions, the growth types might perform differently. Inflation might benefit efficiency experts; high interest rates would penalize companies that rely on debt to finance growth and reward those that fund growth from retained earnings and working capital. Innovators presumably are better able to take advantage of accelerating technological change. If trade barriers rise, Investors might find that one avenue of growth—international expansion—becomes less attractive than it was.

We can make similar observations about the growth drivers. Developing staff is an example. As unemployment has fallen, middle market companies have increased their spending on training and development, according to *Middle Market Indicator* data, presumably because fewer fully qualified people are looking for work. As one manufacturer told us, "If you can't hire them, you have to grow them."[8] Reverse those conditions and the value of training might fall.

These propositions cannot be tested except by running this analysis in another economic environment; executives should therefore not assume that insights from this study will apply equally well to different times.

Many of these factors are plain good business, however, viable and vital at all times. The Center's 2012 report, *Blueprint for Growth*[9], documented six practices of "growth champions." These are companies that had produced 10% or higher growth in 2010 and 2011 and projected the same for 2012—a time when the U.S. economy was still emerging from the 2008-2010 financial crisis and recession. The practices, all of which appear in this study, are: a strong management culture, exceptional talent management, a formal growth strategy process, sharp customer focus, broad geographic vision, and focus on innovation. This study reveals a broader range of factors, shows how they interact with each other, and how companies assemble them into a mindset—a DNA—that enables them to achieve the growth they seek.

[8] *Middle Market Manufacturing: How to Thrive in a Transforming Environment.* Rep. Columbus: National Center for the Middle Market, 2018.

[9] *Blueprint for Growth: Middle Market Growth Champions Reveal a Framework for Success.* Columbus: National Center for the Middle Market, 2012.

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