ADP Research Institute

Midsized Businesses: Poised to Lose Balance in a Time of Uncertainty

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Introduction

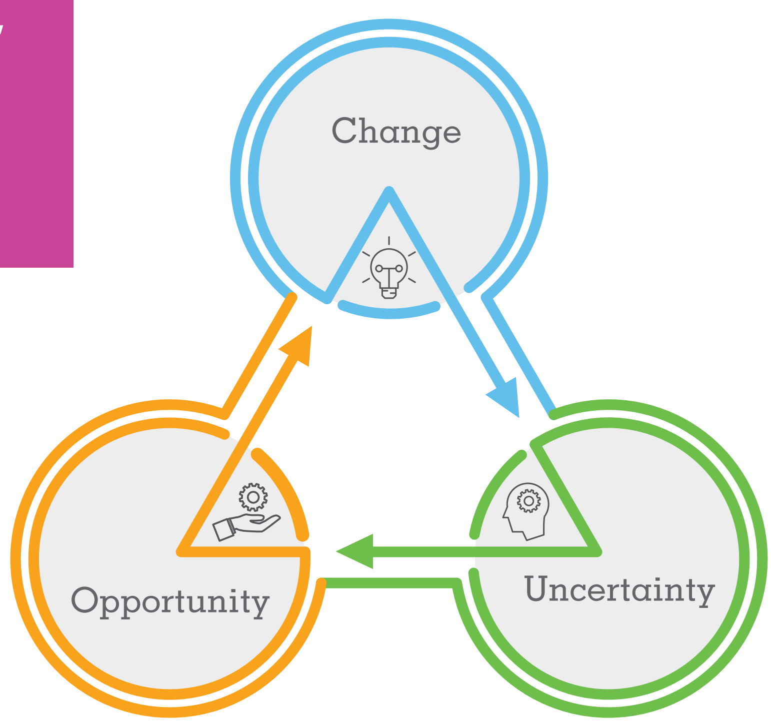
Consider Change. An inevitable constant, change plays an important role in business: the process of change is synonymous with opportunity.

When opportunity is recognized, change becomes a catalyst for advancement. If viewed as a deer views headlights however, fear of change can result in stalled growth at the very least – and loss of marketplace position in a worse case. So, in the midst of a shrinking talent pool, ever-evolving government regulations and recent political upheavals, how are businesses reacting to exceptional change in the air today?

> "Uncertainty at the macroeconomic and government-policy levels is not merely a reaction to sluggish growth, but can also act as an inhibiting influence on growth itself."
>
> Kellogg Insight, Kellogg School of Management, January 2015

This new study by the ADP Research Institute® (ADP RI) assesses the current attitudes of U.S. business owners that staff between 50-999 workers. The study's results point to a wait-and-see approach – even in critical aspects of running a successful business. This seemingly "safe" approach is, on the surface, hard to fault. Waiting can be rationalized overall but once competitive ground is lost it is sometimes too far gone to regain. Focusing on the issues that matter most to midsized business owners, the ADP RI study submits trends that, if continued, could lead to weaknesses in otherwise strong or strengthening companies.

The Cycle of Change



Why the Midsized Focus?

At first glance, approximately 220,000 U.S. companies – less than four percent – in a pool of more than six million may seem less than significant. But good reasons exist for taking a more considered look:

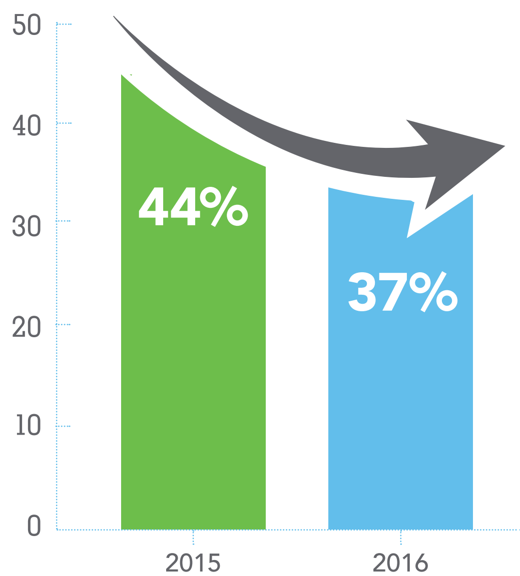
The Center for Middle Market Research asserts that "if the U.S. middle market were a country, its GDP (gross domestic product) would rank it as the fifth largest economy in the world, just behind Japan but ahead of Germany."[1]

Indeed, by that organization's measures, midsized businesses play a key role in the economy in terms of both volume of jobs and of revenue. And their expectation is that influence will strengthen. Third quarter 2016 input showed that 50% had expectations of increased revenues in 2017 and 37% had expectations for increased hiring.[2]

Of the 16.3 million net jobs added during the last seven years, midsized businesses created 7.1 million or 44% of those jobs. A 5.3% increase over the past 10 years.[3]

Job Growth Decline

% of Midsized Business Owners who increased their employee headcount



State of the Middle Market

Evidence of Uncertainty.

As business owners look to the future, their expectations regarding growth in this ADP RI study are similar to their expectations in 2016. Since 2016 was an election year, expectations for 2017 should be stronger.

In election years, many industries anticipate and experience a slowdown in business and, as a result, put their plans for growth on hold.[4] All things being equal, the year following an election – the inauguration year – typically sees the opposite experience. Once the political direction has been defined on the campaign trail and the country has made its choice, businesses feel they can determine how best to operate in that environment and, usually, move forward accordingly.

In this study, fewer business owners indicate plans to reduce their workforces. Less reduction is good – that signals some stabilization – but midsized business owners aren't planning to increase their workforces either. Even though, in an inauguration year, stronger confidence would be expected. Instead, this study finds a sign of hesitation in the segment of the market that has led the country's growth in jobs and revenue.

Looking at election year 2016, seven percent smaller midsized business[5] owners were in growth mode jobs-wise heading into the next year compared with those in 2015 (37% vs. 44%).

Seven percent more larger midsized business[6] owners respondents (20%) decreased their workforce in 2016 versus the respondents in the 2015 study (13%).

In both these measures, the expectations of slowed growth and increased workforce reductions are the same for 2017.

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[1] http://www.middlemarketcenter.org/events/importance-of-us-middle-market-city-club-cleveland
[2] http://www.middlemarketcenter.org/infographics/3q-2016-middle-market-indicator-infographic
[3] January 2010 – March 2017, non-farm private jobs. ADP National Employment Report http://www.adpemploymentreport.com/2017/March/NER/NER-March-2017.aspx
[4] https://www.researchgate.net/publication/227670481_Political_Uncertainty_and_Corporate_Investment_Cycles
[5] Smaller midsized business (50-150 employees)
[6] Larger midsized business (151-999 employees)

Why This Study Now?

This study is more than a snapshot of what is happening today – it is part of a larger series of studies begun in 2012. This year, ADP RI asked 756 business owners, C-suite executives and senior level executives about their experience and their plans. Adding these most recent responses to the previous years' data helps reveal consistencies and inconsistencies that indicate trends and signal change that a single measure in time will not perceive.

ADP RI continues to explore business activities and mine for understanding. Because midsized companies occupy all industries and regions of the country while leading in job and revenue growth, analyzing this stratum of the business world can illuminate trends useful to formulating strategies and investments for businesses of all sizes.

Businesses find themselves in a world of increased change. Political upheavals. Social conflict. Technological tumult. All impact how businesses operate and how they perceive opportunities. Where goes the middle market is likely where the rest of the business world is going.

Midsized Business Owners' Top Concerns

This study explored multiple areas of potential concern for midsized business owners. The business owners were surveyed in the post-election time period of late November and early December of 2016. Despite an identified political direction, uncertainty appears to remain. In the study conducted in 2015, the key themes continue to revolve around compliance and employee engagement.

Not surprising to anyone attentive to the news, the Affordable Care Act (ACA) remains a top concern for midsized business owners. There has been a 13% shift from "moving forward with business as usual" to "not sure." The effect of its implementation on businesses combined with the uncertainty about the long-term future of the U.S. healthcare system has kept the ACA both a high cost and a high impact financial and administrative variable. And a source of uncertainty.

"Healthcare costs and legislation have remained top concerns for midsized business owners, although they also believe healthcare benefits play less of a critical role in talent acquisition and retention than last year. Perhaps due to the volatility with the Affordable Care Act (ACA).

The ability to be compliant is more of a concern and, in an uncertain environment, that makes sense. Presidential election years often have that impact and, with a particular focus on the ACA, this one was no exception."

Dr. Ahu Yildirmaz, Co-Head of the ADP Research Institute.

A Top Concern: Compliance

What is the value of compliance? Cost reduction. Increased revenue. Increased operational efficiency.[7] The cost of non-compliance, however, is where part of the answer may lie.

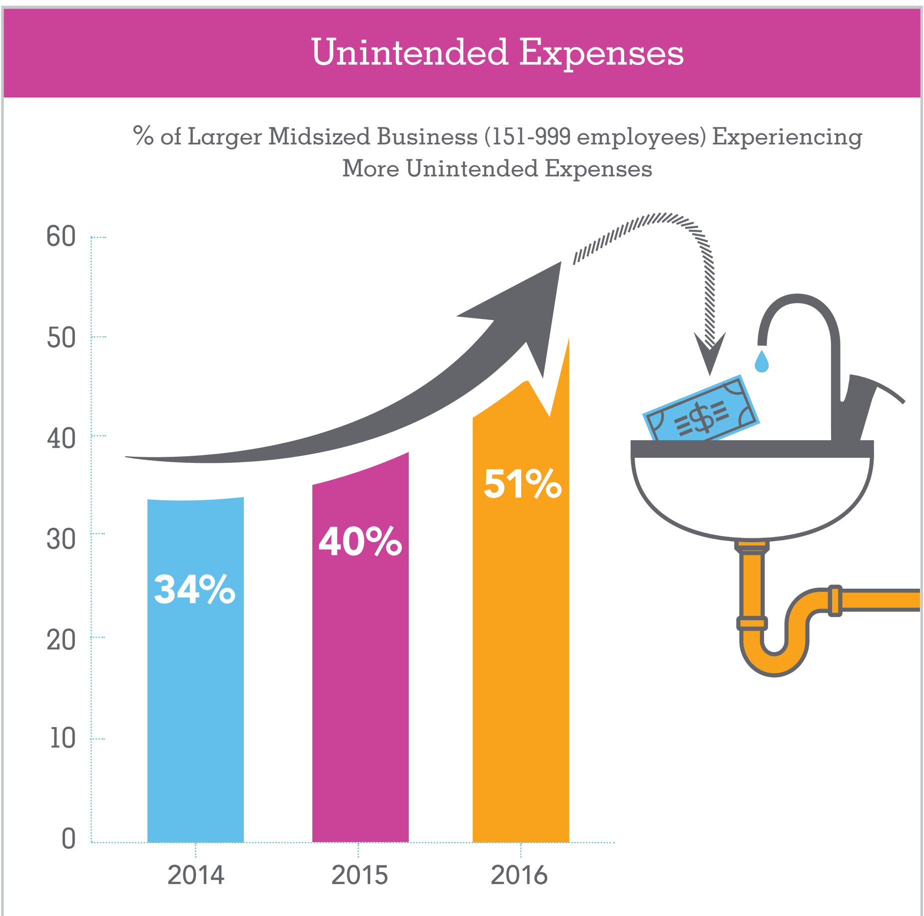
When asked about their biggest challenges to expanding globally, midsized business owners cited two particular issues:

- The complexity of government regulation
- The ability to comply with employee data laws

These challenges align with other findings from this study to tell us that compliance is a primary and consistent concern.

Here's how…

Of all the midsized business owners surveyed, 40% indicate they have experienced unintended expenses as a result of non-compliance with government regulations.[8] The uptick for smaller midsized companies from last year's study is slight (35%) but looking closer at larger midsized companies, the increase is more pronounced. The number of companies with 151-999 employees that were hit with these costs jumped from 40% in 2015 to 51% in 2016.



Midsized Businesses Caught off Guard:

More than ½ had costs neither anticipated nor prepared for.

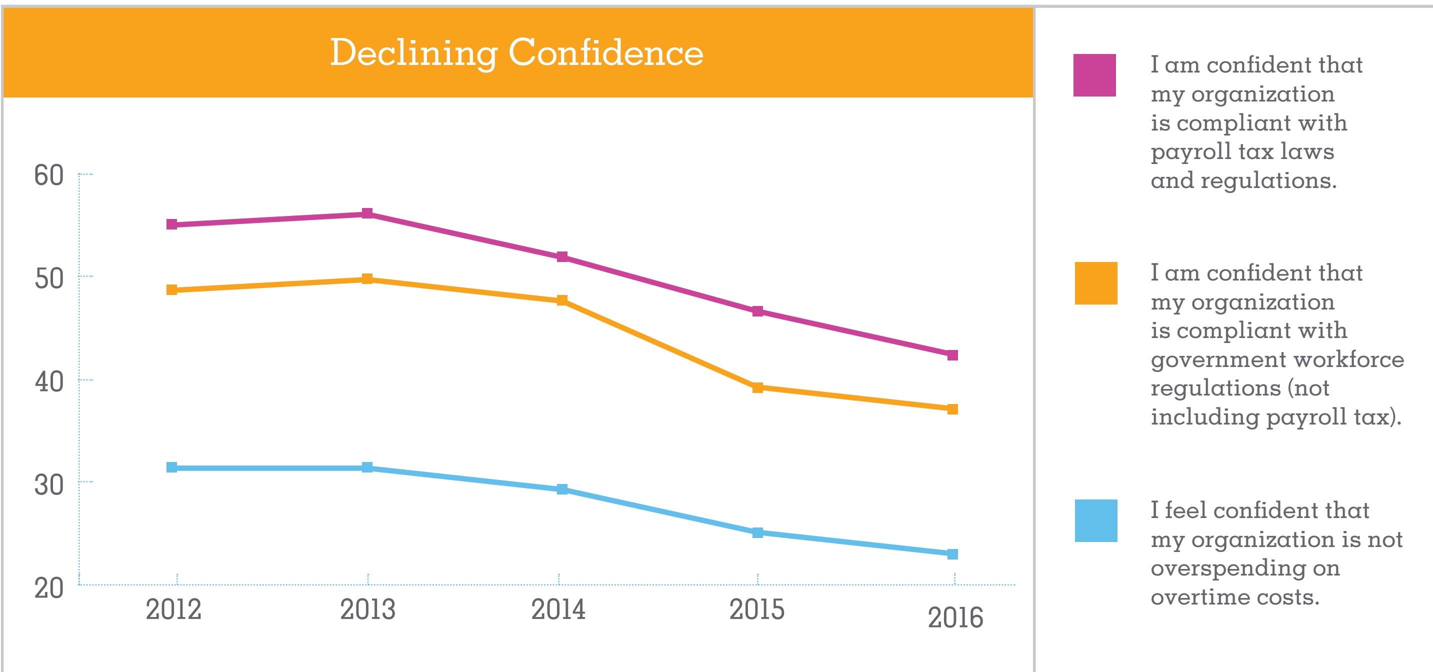
[7] http://www.pwc.com/us/en/financial-services/publications/viewpoints/risk-regulatory-compliance-data.html

[8] In this study, unintended expenses are identified as fines, penalties or lawsuits as a result of non-compliance with government regulations (federal, state or local) in the past 12 months.

A Top Concern: Compliance

Although respondents cited many types of unexpected expenses, the biggest increases over the prior year are related to terminations[9] (3% to 6%; 7% to 11% in the larger companies) and the ACA which, among the larger midsized companies, is now the largest source of unexpected expenses at 17%.

Business owners also indicate their confidence regarding compliance is sliding – and has been for some time. On every marker, from visibility into labor costs to workforce regulations to overspending on overtime, the percentage of respondents indicating confidence in these areas has dropped steadily.



Going forward, the current political environment promises almost certain changes in regulations that impact the way companies conduct business. So, staying alongside of these changes and therefore remaining compliant will get harder. At the same time, each company will have to ask: Will these changes be beneficial? Will some industries have a harder time while others get a reprieve? The extent and exact nature of the changes will be unclear for the near future. Because of this, businesses might decide to cut back resources in anticipation of a possibly worse environment. Or, unsure of a move in either direction, they may rationalize a wait-and-see approach.

PRO TIP – Ask the Right Questions

Can your HR department:

- Quickly determine shifts in regulations?
- Rapidly inform you of outside changes that may impact your business?
- Swiftly adapt your processes to those changes?

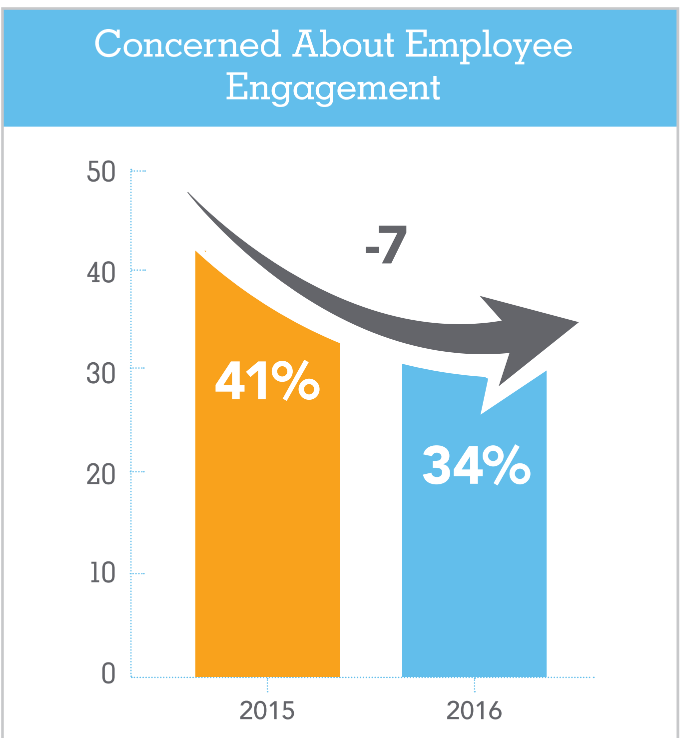
Being alert should be part of human capital management (HCM).

[9] E.g. discrimination, final pay requirements, layoff rules, etc.

Employee Engagement

Despite all the recent economic changes and talent challenges, the emphasis on employee engagement has dropped, not risen. The U.S. unemployment rate is at its lowest point since the recession.[10] The nation's workforce is nearly fully employed,[11] which means the battles for talented individuals are at their peak. Employers can no longer assume that valuable employees can be so easily replaced; therefore retaining and engaging your workforce, especially your top performers, has to be a rising concern. Also, it is significant that companies that are stronger in people management have a correspondingly higher financial performance.[12]

"Talent is the multiplier. The more energy and attention you invest in it, the greater the yield. The time you spend with your best is, quite simply, your most productive time." Marcus Buckingham, Co-Head of the ADP Research Institute, and author of *First, Break All the Rules: What the World's Greatest Managers Do Differently.*



Losing sight of a bigger picture? Employee engagement provides a notable exception to the lack of movement seen elsewhere in the study. Rankings of concern about employee engagement declined significantly over the previous year – from 41% in 2015 down to 34% of business owners who found it an important concern in 2016. This was one of the biggest declines in the study.

A possible explanation could be that an increased focus on compliance in the uncertainty of an election year leaves less time to focus on employee engagement, or their employers feel their workforces are fully and fruitfully engaged.

"A lessened emphasis on employee engagement is not, generally, a step forward. For most organizations, the workforce is its largest asset and often its most expensive one. For most organizations, focusing this resource toward a clear direction is essential to meeting their goals. A workforce is too big of a ship to change course quickly. Steady, ongoing alignment with defined goals is just sound management." Dr. Ahu Yildirmaz, Co-Head of the ADP Research Institute.

[10] *https://www.nytimes.com/2017/04/07/business/economy/job-creation-unemployment-trump.html?ref=business&_r=0*

[11] *A U-3 rate of 5.0-5.2% unemployment is what the Federal Reserve considers "full employment."*
http://www.businessinsider.com/us-full-employment-2015-6

[12] *Boston Consulting Group: Creating People Advantage 2014-2015: How to Set Up Great HR Functions*

Employee Engagement

Could this slide down the scale of concern be a sign of great improvement and therefore less concern? Not if you look closely at the study's results. Here is what we can observe:

- Most midsized companies don't have a formal plan, process or even a means to measure employee engagement.
- Larger midsized companies are now indicating more concern than before over employee turnover.
- Confidence in talent management-specific tools (recruitment, performance management, succession planning, compensation, and learning) has declined.

Given that confidence in more general workforce management tools (payroll, HR administration, benefits administration, time & labor) has grown, this last point can be of interest in this discussion.

Align Perceptions

When it comes to employee engagement and delivering on corporate strategies, perception can be reality:

- Employees rank compensation and benefits less favorably than their employers
- Career opportunities receive significantly lower ratings from employees than from HR.
- Senior leadership is rated less positively by employees than HR.

Source: Fixing the Talent Management Disconnect: Employer Perception vs. Employee Reality in the U.S. Midsized Market, ADP Research Institute, 2017.

Another insight from a recent ADP RI study, *Fixing the Talent Management Disconnect* shows that a significant gap exists between employers and employees when it comes to the importance of training.[13] While only 45% of employees surveyed feel that "the training received helps me perform to the best of my ability," 67% of employers say "my employees are adequately trained to perform their jobs" – a gap of 22 points.

Additionally, only 1/3 of midsized organizations say that they offer professional development training programs. Now, stir in the reduced concern about employee engagement and this disconnect points to further workforce management issues. The indication is that owners are doing less to motivate employees while making it harder for those who are engaged to do their jobs.

Marcus Buckingham asserts "Although corporate methods, behaviors and values vary, the most powerful human need at work remains the same: 'help me discover my strengths, and help me use them a lot.' Yet, the alarming reality is, by and large, companies continue to obsess about fixing employee weaknesses, rather than leveraging their strengths."[14]

Less emphasis on engagement, fewer metrics in the face of potentially more turnover, and acknowledgment that viable support tools aren't in place – the resulting picture suggests midsized business owners are directing attention elsewhere and backing off from talent management at a less than auspicious time to do so.

[13] *Fixing the Talent Management Disconnect, ADP Research Institute, 2017.*

[14] *Business Wire interview http://www.businesswire.com/news/home/20150625005580/en/Marcus-Buckingham-Company-Announces-Results-First-Ever-Standardized*

Maintain Balance. Eyes on the Horizon. Many great companies thrive because they recognize opportunity in times of uncertainty.

Small companies overtake larger ones. Large companies find new ways to expand. Midsized organizations leap ahead of competitors. Here we observe that in a time of change and opportunity, midsized businesses appear to be holding steady, not prepping their resources for what could lie ahead. What might you consider doing instead?

Think about long-term viability and how not to sacrifice it for short-term fixes. The level of coming opportunity may not yet be visible but how will you be best ready when it is? Are tools and assets, like a strong workforce, primed and well-oiled? Possibilities identified and employees able to respond as needed? Didn't someone say that fortune favors the prepared?

Keep your footing steady. Compliance and regulations have always been shifting sands. They just have the potential to shift a lot more now. When the shifting starts to turn into quicksand, you want to know early enough to adjust and which hop, skip or jump is the right one. Have the right questions been asked? Of your team? Of your support tools? Of yourself? Are they ready and able to stay alongside of changes and capable of helping you react to them speedily?

But don't frustrate your greatest asset. Your workforce wants to succeed. Consider how your people can impact your business – negatively or positively. Are you nurturing their passion and helping them achieve their potential? Put a formal employee engagement plan in place. Survey your employees to really know how they are feeling and then invest in the tools to help them deliver and prosper. Be proactive in times of change, especially when it comes to the critical asset in your business' success.

Strike the right balance. Being compliant helps you stay in business today. Developing resources strategically with an eye on future opportunities helps you succeed in the long run. Although balancing resources across short-term needs and long-term goals can be tricky – in a time of uncertainty, keeping that balance can determine viability.

Is HR keeping up with the latest changes in government regulations? In doing so, is too much time focused on compliance at the expense of other human capital resources? Are they spending enough time fostering your culture and implementing and refining programs to build a better workforce? Might there be other approaches to tackling both?

What gets measured, gets improved. You measure profits. You measure operating costs. You measure revenue drivers. But do you measure the important aspects of your workforce such as their engagement levels? Benchmarking figures for key areas of performance, compensation, recruitment and retention can help. Do that benchmark across divisions in your organization, as well as other companies like yours in your region. And then create the plan you need to improve the weakest areas.

Conclusion

Stay in business today. But stay in business tomorrow as well. Midsized business – the strata of the business world currently leading job and revenue growth is showing indications of slowing down. Or, at least, of hesitation. Concerns about compliance continue to grow, not lessen. Meanwhile, the focus on employee engagement weakens.

Will your actions today leave an open path for more prepared competitors tomorrow? Will you still be able to leverage critical opportunities at that point? Operating a lean workforce may be smart especially if it is engaged, focused and able to move quickly in the right direction.

In good times and bad, a dedicated workforce has shown to be a necessary asset to identifying opportunities and to turning them into successful initiatives.

Striking the right balance is a key to success. As with driving, the rules of the road you are on are the rules you follow. Cross the bridge of something different when you come to it, then make your best decisions.

Be sure you stay compliant by today's laws but have your machine ready when the road ahead opens up.

Research Methodology

The ADP Research Institute conducted an online survey among 756 business owners at midsized companies (defined as those with 50 to 999 employees). The survey was fielded in November and December 2016 (survey was launched post-presidential election). This was the 5th consecutive year conducting this survey. Over 3,700 business owners have participated in the survey over the 5-year period.

About ADP Research Institute

The ADP Research Institute provides insights to leaders in both the private and public sectors regarding issues in human capital management, employment trends and workforce strategy. ADP.com/research.

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