Decision factors: H2 2018

Economic considerations for SMB executives

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Economic considerations for SMB executives

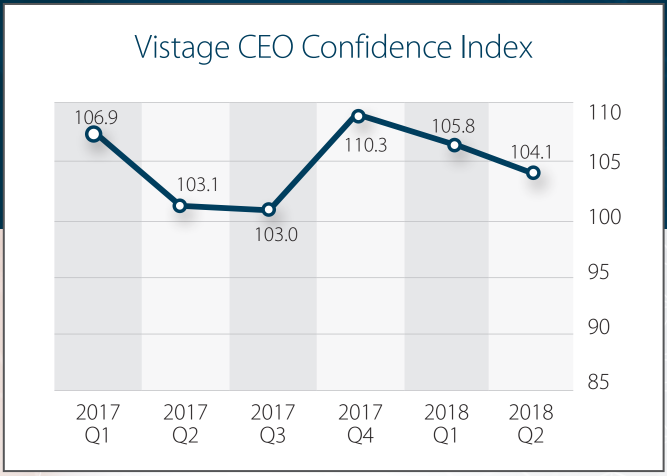
The majority of CEOs from small and midsize businesses (SMBs) continue to be optimistic about their growth prospects, according to the Q2 2018 Vistage CEO Confidence Index. The index is based on the sentiments of 1,467 SMB CEOs. "It reflects the opinions and projections of CEOs about the economy, hiring and investment plans, and prospects for revenue and profit growth in the next 12 months," explains **Dr. Richard Curtin**, a researcher from the University of Michigan who analyzes the Vistage data each quarter. While slightly off the 10-year high from last December, the current index remains at favorable levels.

Despite these results, it's unclear what the future will hold. On the one hand, many signs point to continued growth. For example, more than three-quarters (78%) of CEOs in the Q2 survey said they expect higher revenues in the year ahead, while 62% said they expect greater profits. Nearly half (48%) said they plan to increase their investments and 61% said they will increase their employee count. Recent low interest rates, ready access to capital and healthy consumer spending have added to this favorable environment.

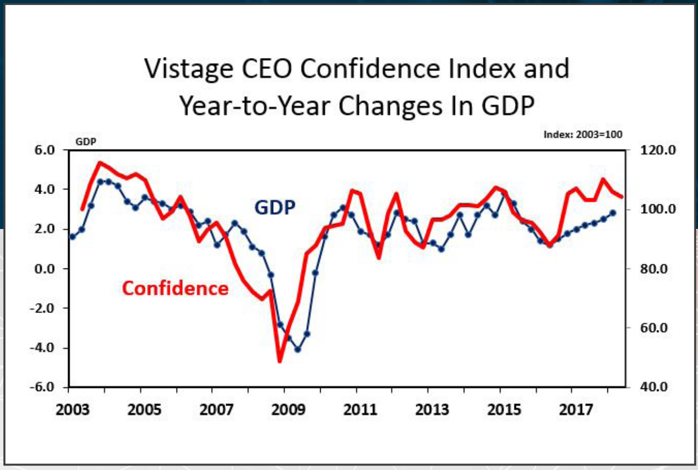
On the other hand, there are signs that the best days may be behind us. Some market observers are concerned that the nine-year economic expansion — now the second-longest period of economic recovery in U.S. history — is starting to lose steam. Meanwhile, interest rates are starting to rise while wage pressure and material costs are growing. Trade conflicts are also stoking fears of a recession.

To make smart decisions, mitigate risk and capitalize on opportunities, it's critical that CEOs stay on top of key economic trends and considerations. This report, based on data from the Q2 Vistage CEO Confidence Index report and insights from economic experts in the Vistage community, **aims to both identify the five top economic decision factors for the remainder of 2018 and recommended actions**.

- Cost pressures are broadening and growing stronger
- Talent shortage goes critical
- Taxes, trade and tariffs translate to trouble
- Cyberattacks are the silent killer of SMBs
- A recession is inevitable



In Q2 2018, the Vistage CEO Confidence Index was 104.1, between the prior quarter's 105.8 and last year's 103.1.



Trends in the Vistage CEO Confidence Index show a close correspondence with year-to-year changes in real GDP published by the U. S. Bureau of Economic Analysis.

1. Cost pressures are broadening and growing stronger.

SMBs are feeling cost pressures from every angle. Fierce competition for talent is causing wages to rise. Interest rates are increasing and expected to grow further. Energy costs are surging, while new tariffs and trade policies are stressing supply chains and spiking raw material costs.

Expect this trend to continue, says Curtin. "Wages, commodities and interest rates will continue to edge upward during the year ahead, putting the emphasis on lowering costs as well as increasing prices," he says.

Recommendations

- **Raise your prices.** Research shows that about half (56%) of CEOs plan to increase their prices in the next 12 months. That's the right move says **Joseph Quinlan**, Managing director and head of market strategy for U.S. Trust, Bank of America Private Wealth Management. "This is going to be very important for midsize companies," he says. "How much can they pass on these intermediate price costs? How much can they pass on to the consumer? That will determine their profitability."
- **Talk with customers about their long-term plans.** "Price conversations can be an opportunity to reframe your long-term relationship with a customer. It is a time that you can create transparency on the problems you can solve for them and how to improve the outcomes of your solution," says **Marc Emmer**, a business strategist and president of Optimize, Inc.
- **Use technology to lower costs.** Invest in cloud-enabled software that will boost your productivity and reduce costs, recommends Emmer. "There is a sea change that has been driven by cloud computing," he says. "Small businesses have access to systems with capabilities similar to ERP (enterprise resource planning) that are easy to implement quickly and inexpensively." For example, some CRM (customer relationship management) vendors are bundling in marketing automation, email marketing, web conferencing, surveys and project management with their capabilities. "If you are not operating with a CRM, your team is operating at a disadvantage," Emmer says.
- **Restructure your debt.** If you haven't yet restructured your debt, this is probably your last chance to do so at a decent price, says Quinlan. "The good price is behind us," he notes.

> "Companies are going to be hard-pressed to maintain their level of output and increase their productivity in the second half of this year."
>
> **Joseph Quinlan**
>
> Managing Director and Head of Market Strategy for U.S. Trust, Bank of America Private Wealth Management

2. Talent shortage goes critical.

The recent hiring shortage has turned into a hiring crisis, says **Joe Galvin**, chief research officer for Vistage. According to the Bureau of Labor Statistics, there are currently 6.7 million jobs open in the United States and only 6.4 million available workers to fill them. "Everyone wants to hire the best people, so the competition for talent is fierce," Galvin says.

That's a problem for a lot of CEOs, as 61% of those surveyed in Q2 said they planned to increase their workforce in the next 12 months. Research from the National Center for the Middle Market (NCMM) also indicates that only 22% of middle-market firms have a formalized process for talent planning.

Without the right talent in place, "we see companies with delayed delivery times," Galvin says. "We also see companies turning away new customers because they can't fulfill the work." **Fabiola Brumley**, Southeast regional executive at Bank of America Merrill Lynch, adds that many of her clients "have the opportunity to grow, but are restricted by their ability to get talent."

Recommendations

- **Change how you retain talent.** To hold on to your best people, Brumley suggests supplementing employee benefits with non-traditional benefits, such as financial counseling or a reward system that recognizes high performers. Quinlan stresses that companies should be "much more flexible — not just for millennials, but for the aging cohort as well. There are a lot of folks who are 'retiring' who really want to keep one foot in the door, and companies should think about how they utilize that talent."
- **Build a workforce within your community.** If you can't find people with the right skills, train people to develop those skills. Quinlan encourages companies to reach out to community colleges and mayor's offices to develop vocational training programs and attract local talent. "You've got to be creative about creating a workforce that's local to your environment or operation," he says.
- **Rethink how you recruit.** Traditional methods of recruiting have quickly become outdated, says Emmer. "Instead, there are some small and midsize businesses using technology and self-serve recruiting models that are proving to be effective in some environments. It's about rethinking human capital from 20,000 feet, deploying more resources to the HR function and making sure the entire management team is invested in the process," he says. In a recent survey, about 20% of CEOs said they leveraged artificial intelligence for talent management and hiring. Another consideration, Emmer notes, is how you attract millennials. "You will need to have both a strong brand and strong offerings as an employer if you are going to attract millennials."
- **Substitute labor with technology.** Explore whether technology can help you deal with a labor shortage by automating tasks or improving efficiency, for example. Brumley offers the example of a landscaping company that might invest in equipment to reduce lawn mowing time from three hours to 45 minutes. "You don't need as much human capital because you're transferring it to equipment," she explains.
- **Develop a systematic framework for talent planning.** Data from NCMM confirms that talent planning has a strong correlation with the growth and performance of a company. To that end, CEOs should use a talent-planning framework that meets four criteria:
  1. Align talent strategy with strategy.
  2. Build sufficient processes to ensure systematic talent-planning efforts.
  3. Lead by example and involve leadership in the process.
  4. Engage employees in talent planning and ensure that they recognize the value of the process.

Download the **Guide to Talent Planning for the Middle Market CEO**

3. Taxes, trade and tariffs translate to trouble.

The new tax law has created as much uncertainty as opportunity for SMBs. Certain changes — such as the revised Section 179 deduction and 20% pass-through income deduction — are expected to benefit many companies. However, other revisions to the tax law — such as limitations to net business loss deductions — may create new costs.

At the same time, new trade policies and tariffs (e.g., steel and aluminum tariffs) are driving up material costs and heightening financial risks for businesses. "Global supply chains are becoming more fractured, and that filters down to midsize companies," says Quinlan. "A lot of midsize companies are part of a larger ecosystem, and if that ecosystem is shaken by trade policies that inhibit cross-border movements of goods and services, that's a huge risk."

Recommendations

- **Hire a CPA you can trust.** Your accountant should be willing to sit down with you and explain how they're planning to calculate your income as a result of the tax law. For example, a great CPA will show you what your taxable income looks like under the old rules compared to the new rules and walk you through multiple options for filing. Your accountant should also ensure that your business is taking full advantage of the new tax rules while mitigating new risks.
- **Take a critical eye to your supply chain.** Emmer sees the new tariffs as "wake-up call" for many businesses. "Companies need to carefully consider what concentration risk they have in their supply chain," says Emmer, "and perhaps think about alternatives or contingencies with suppliers in other regions."
- **Educate yourself.** Brumley encourages CEOs to stay on top of policy changes and ask experts for advice whenever possible. "We have provided webinars and brought in experts to talk about what policy changes might lead to," she says. "It's important for our clients to think through the implications and have the ability to ask questions."
- **Consider trade risks when making decisions.** "If you're in manufacturing or do anything that involves any international partners, you have to understand what the risks are and factor them into your decisions — knowing that this could swing 100 points in either direction," says Galvin. "It is a factor to consider for the first time in decades."

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Marc Emmer

President, Optimize Inc.

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Top 8 things small and midsize businesses need to know about tax reform

While some details of the tax code passed last year are still becoming clearer, what we do know is that the changes present both serious implications and potential opportunities for small and midsize businesses. As a business leader, you should not feel you have to become a tax expert. However, you should develop an understanding of how tax changes could impact both yourself and your business, as well as how you can best work with your tax professional to take advantage of some changes or mitigate risk.

Planning for next year needs to happen far in advance to both capitalize on changes that have a positive impact, such as new rules about bonus depreciation, and adjust for potential negative consequences, such as reduced deductions for meals, entertainment and transportation costs. You may decide to restructure your business, or find that you want to make investments that take advantage of new deductions. The income of your spouse has more impact than ever, so you may need to adjust how you keep financial records.

To gain clarity on these issues, we invited tax experts from the Vistage community to identify and answer the top eight questions they hear from CEOs regarding the new tax code. While every CEO should consult with a tax expert to review their own company's circumstances, this research note serves as a starting point for that exploration.

Click the links below to find answers to the most frequently asked questions, which are followed by key recommendations at the end of this document:

1. How do you know if your accounting firm or CPA can handle the complexity of the new tax legislation?
2. What businesses qualify to take advantage of the 20% pass-through income deduction, and how does it work?
3. What legal entity would you recommend for a new business? Should a business owner consider changing to another entity type to take advantage of new tax laws?
4. What does a business owner need to understand about changes to the meals and entertainment deduction under the new tax law?
5. How will the new interest expense deduction apply to small and midsize businesses?
6. What other loss limitation has been created or changed by the new tax act?
7. How does the expansion of Section 179 impact businesses for 2018 and beyond?
8. One of the stated goals of the new tax act was to stimulate capital spending by businesses. What fixed asset additions will qualify for the new 100% bonus depreciation?

Webinar on demand: Tax Reform: Key Considerations for SMBs

Download **Top 8 things small and midsize businesses need to know about tax reform**

4. Cyberattacks are the silent killer of SMBs.

If you have employees, customers or financial data, you are a target for a cyberattack. Cyber criminals are aggressively targeting SMBs, and cyberattacks are increasing in complexity, frequency and severity. For many SMBs, those attacks are leading to loss of data, cash, customer records, employee information, leadership credibility, and employee and customer trust.

Yet many SMBs still haven't taken the proper precautions to protect themselves. Nearly two-thirds (62%) of CEOs surveyed by Vistage do not currently have an active cybersecurity strategy in place, and 27% have no plan at all.

Part of the problem is companies don't fully realize what's at risk, says Quinlan. "There is a lot of brand and reputational risk around cybersecurity breaches, and a lot of small and medium-size companies haven't factored that in," he explains. "It just takes one hack, and you have a lot of issues right in front of you."

"Cybersecurity is a silent killer," Galvin adds. "It can shut you down like nothing else."

Recommendations

- **Assess the strength of your cybersecurity.** To gauge the strength of your cybersecurity, use a reputable tool — such as the Cybersecurity Framework offered by the National Institute of Standards and Technology — to perform an assessment.
- **Create a layered defense.** A comprehensive cybersecurity plan has three core components: people, process and technology. Review your strategy to ensure these are addressed; if you don't have a strategy in place, use this framework as a starting point.
- **Call on a cybersecurity expert.** "Just as you may have an outside legal counsel or CPA, consider engaging a cybersecurity professional for additional support," says Galvin.

"Cybersecurity is a silent killer. It can shut you down like nothing else."

Joe Galvin

Chief Research Officer, Vistage Worldwide

Download Cyberthreats and solutions for small and midsize businesses

5. A recession is inevitable.

Is a recession on the horizon? Many economists think so. In May, half of the economists surveyed by the National Association for Businesses Economists said they predict a recession by late 2019 or early 2020. Two-thirds said they predict a recession by the end of 2020.

A few factors are contributing to this outlook. For one, the nation is in its ninth year of economic growth, which is the second-longest period of expansion in U.S. history. In addition, the gap between short-term and long-term interest rates, known as the yield curve, is shrinking. If this trend continues and leads to an inverted yield curve, it sends a strong signal that a recession is coming. In fact, every recession of the past 60 years has been preceded by an inverted yield curve.

CEOs may be starting to perceive this downward trend or at least sense the end of growth. In the Q2 survey, just 32% of CEOs said they expected economic conditions to improve in the next 12 months, while half (50%) thought they would stay the same. About 17% thought economic conditions would worsen.

"Of some concern is that CEOs anticipate slowing growth in the national economy during the year ahead," says Curtin. "In contrast, many observers now anticipate a stronger pace of economic growth in 2018 with a modest slowdown in 2019."

Recommendations

- **Keep costs variable.** Instead of making investments in long-term assets, keep your costs as variable as possible so you can maneuver in a down cycle," says Brumley. "We think this is an important part of risk management." For example, it might make sense to buy equipment that has a three- to five-year shelf life, as opposed to making long-term real estate investments.
- **Build flexibility into your labor force.** During the Great Recession, Quinlan notes, U.S. companies fired their employees while European companies moved them to part-time roles — which meant that when the economy improved, the European companies could deploy their workers quickly. Choose the latter model, he says.
- **Plan for the long term.** Instead of worrying about how you'll weather the next downturn, plan for how you can be most competitive five to 10 years from now. "Any company that's got a good five-year horizon will find that the next recession is more of a blip than anything," says Quinlan.

Decision Factors: H2 2018

There's a lot to be optimistic about in 2018: The U.S. economy is strong, many small and midsize businesses have a positive outlook for the future, and the Vistage CEO Confidence is close to its 10-year high (104.1).

However, it's possible that the tide may soon turn. New economic risks are increasing the probability that the economy will slow or even fall into a recession in the next several years. Uncertainty is, arguably, at its highest level since the Great Recession.

As a CEO, factor the following into your decision-making:

- **The rising cost of everything.** Rising costs will force you to raise your prices, which will cause others to raise theirs. Massive government debt and a growing deficit will drive more government borrowing, which will only fuel the inflation furnace.
- **The talent war is reaching new levels.** The talent crisis is already throttling growth. Workers are in high demand at all levels — from factory-floor workers to corporate cube-dwellers to managers, executives. Competition for talent is high, which means that your best people are already being recruited. Retaining your superstars should be a top priority.
- **Taxes, trade and tariffs.** The new tax law, along with radical shifts in trade policy and tariffs, means that the legal and financial landscape is rapidly evolving. The impact and outcome of these shifts is highly unpredictable, so keep a careful eye on them.
- **Cyberattacks.** Cyberthreats are a clear and present danger for every SMB. As sudden as a heart attack, a cyberattack can compromise your computers, highjack your wire transfers, or steal customer, employee and financial data. If you don't defend your digital assets, you will expose your business to a ruthless hacker.

Despite the growth spurt in the 2nd quarter, a recession is inevitable whether it's triggered by one of these risk factors or caused by the natural end of an economic cycle. But until that happens, SMB CEOs should take advantage of low interest rates and access to capital, using this time to make key investments in technology, equipment and people. In other words, enjoy the good old days — while they're still here.

Contributors

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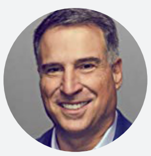
As senior vice president and Southeast regional executive for Bank of America Merrill Lynch, Fabiola Brumley is responsible for a seven-state region in the southeastern U.S. Since beginning her career in 1982, she has served in a variety of roles, including controller, chief financial officer, commercial lender, client manager, market manager and market executive.

Dr. Richard Curtin

Research Professor and Director of the Surveys of Consumers Survey Research Center, University of Michigan

As research professor and the director of the Surveys of Consumers at the University of Michigan since 1976, Dr. Richard Curtin's monthly report on consumer confidence is one of the most closely followed economic indicators, with findings from his research extensively reported in the media. His research is widely used by businesses and financial institutions as well as by federal agencies responsible for monetary and fiscal policies. Data from the Surveys of Consumers is an official component of the Index of Leading Economic Indicators. Professor Curtin has consulted with hundreds of corporations on issues related to future trends in consumer purchases.



Marc Emmer

President, Optimize Inc.

Marc Emmer is president of Optimize Inc., a growth consultancy specializing in strategic planning. Marc speaks, writes and consults throughout North America and is a recognized thought leader on strategy. Marc's second book, "Momentum, How Companies Decide What to Do Next," was covered online by Yahoo Finance, Business Insider, CBS and NBC. Marc has crafted strategic plans for over 130 organizations, including more than 40 Vistage members. Marc is also active on for-profit and nonprofit boards and is a weekly contributor to Inc.com.

Joe Galvin

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As chief research officer for Vistage, Joe Galvin is responsible for providing Vistage members with the most current, compelling and actionable thought leadership on the strategic issues of small and midsize businesses. Joe is an established thought leader and analyst who has researched and presented to business leaders around the world on customer management, world-class sales performance, and CRM and sales force automation technology.

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About Vistage Worldwide

Vistage Worldwide is an organization designed exclusively for high-integrity CEOs and executive leaders who are looking to drive better decisions and better results for their companies. Our members — 22,000 strong in more than 20 countries — gather in trusted, confidential peer advisory groups where they tackle their toughest challenges and biggest opportunities. CEOs who joined Vistage in the past five years grew their companies 2.2 times faster than average small and midsize U.S. companies, according to a 2017 analysis of Dun & Bradstreet data.

Learn more at vistage.com.

About our research

Vistage curates subject matter from our community and collaborates with top thought leaders to create unique content. Vistage executives access actionable, thought-provoking insights from the Wall Street Journal/Vistage Small Business CEO Survey and Vistage CEO Confidence Index results, as well as national and local economic trends. Since it began in 2003, the Vistage CEO Confidence Index has been a proven predictor of GDP, two quarters in advance. Vistage provides the data and expert perspectives to help SMB CEOs make better decisions.

Learn more at vistage.com/confidenceindex and vistageindex.com.

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