

# THE REAL ECONOMY

VOLUME 95

## THE GLOBAL ECONOMIC FORCES RESHAPING THE MIDDLE MARKET

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- SURGING U.S. DOLLAR RAISES THE POTENTIAL FOR A CURRENCY CRISIS

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TO THRIVE, THE MIDDLE MARKET NEEDS MORE WOMEN IN LEADERSHIP ROLES

TREND WATCH: MIDDLE MARKET FIRMS REFOCUS THEIR ESG EFFORTS



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# END OF AN ERA? BOND MARKET SELL-OFF PROMPTS POSSIBILITY OF A NEW REGIME

BY JOSEPH BRUSUELAS

**THE DRAMATIC FISCAL** and monetary response to the pandemic has elicited a structural break in globalization, growth and liquidity regimes that have driven the world's economies over the past 25 years.

Gone is the hyper-globalization that was the primary driver of low inflation and low interest rates, and the liquidity that followed.

The higher inflation that has ensued requires higher interest rates and tighter financial conditions to bring it back down, and will lead to what we think will be a recession next year.

As global investors grapple with that structural change, they are driving interest rates higher along the maturity spectrum, causing interest rates to rise.

The U.S. bond market is in the midst of a massive sell-off, with 10-year Treasury yields increasing by 220 basis points between March and the second week of October.

This move is the market's reaction to the prospect of persistent inflation and a rapid shift in monetary policy.



## Sell-offs of five-year and 10-year U.S. Treasury bonds\*



Yet that 220 basis-point increase is on top of the 120-point increase between July 2020 and this past March.

We can characterize the earlier increase in interest rates as resulting from the resumption of economic activity and the normalization of rates away from the zero bound.

No matter where you place the starting point, anytime you have such a sustained increase in bond yields over such a short period of time, something is bound to break.

The result is the end of a period characterized by accommodative financial conditions, extremely low costs for day-to-day business financing and excessive speculative investment.

For middle market companies, the surging cost of capital will most likely restrain the long-term investments in technological advances that became so apparent over the past two years.

## MIDDLE MARKET INSIGHT

The post-pandemic demand shock and the latest in a long line of oil crises have shaken the climate of price stability to its core.

Even though real interest rates, or those adjusted for inflation, will remain negative as long as inflation exceeds 4%, middle market businesses will have a hard time justifying taking on more debt.

This may undermine hard-earned changes in behavior during the pandemic. A majority of middle market firms had indicated over the past seven quarters that they intended to increase investment in capital expenditures, according to the [RSM US Middle Market Business Index](#). But that is now at risk.

This shift is occurring with the backdrop of the worldwide dependence on fossil fuels and the efficiencies of a supply chain that has for decades provided cheap goods and labor to the G-7 economies.

Embedded in that dependence is the inadvertent funding of geopolitical violence and authoritarian rule that runs counter to free market economic systems.

In addition, the lingering effects of a global health crisis continue to disturb the flow of goods and, perhaps more important, distort the labor market.

All these distortions will continue to affect the cost of production and the price of goods and services.

GONE IS THE HYPER-GLOBALIZATION THAT WAS THE PRIMARY DRIVER OF LOW INFLATION AND LOW INTEREST RATES, AND THE LIQUIDITY THAT FOLLOWED.

In contrast to other episodes of rapidly increasing interest rates, the recent bond market sell-off appears to be ushering in an economy characterized by insufficient aggregate supply, negative supply shocks, geopolitical tensions and competition between firms and the state for scarce capital.

The jury is still out on whether the bond market sell-off can be attributed to losses in the more speculative equity and cryptocurrency markets and a tightening of financial conditions.

We nevertheless suspect that this sell-off will become what economists call a "shift in structure," or a substantial increase in interest rates in reaction to the end of disinflation and cheap labor.

### A shift in structure

This isn't the first bond market sell-off, of course. Yet the size of it suggests it has the potential to be something more than the typical sell-off of previous decades.

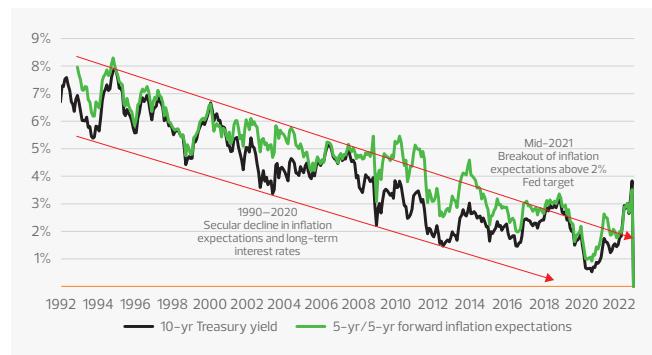
Before the pandemic, the bond market was best characterized as being in "secular decline." Inflation was being squeezed out of the global economy, a result of the efficiencies of the just-in-time supply chain and the wide availability of cheap labor.

Interest rates were moving lower in economies no longer capable of producing high levels of output that would otherwise support traditional levels of domestic investment or the interest rates to finance that investment.

Because long-term interest rates are determined by expectations of monetary policy and the risk of holding those securities over long periods of time, and because both of those factors are subject to the growth of the economy, 10-year Treasury yields closely followed the ups and downs of inflation expectations.

As a result, the long-term decline in 10-year yields would be interrupted by relatively short-lived uptrends as the bond market reacted to perceived changes in monetary and fiscal policies.

### 10-year yields and market-based inflation expectations



Our analysis shows the current bond market sell-off breaking the pattern established over the past 30 years. The post-pandemic demand shock and the latest in a long line of oil crises have shaken the climate of price stability to its core.

WE SUSPECT THAT THE BOND MARKET SELL-OFF WILL BECOME WHAT ECONOMISTS CALL A "SHIFT IN STRUCTURE," OR A SUBSTANTIAL INCREASE IN INTEREST RATES IN REACTION TO THE END OF DISINFLATION AND CHEAP LABOR.

### MIDDLE MARKET INSIGHT

For middle market companies, the surging cost of capital will most likely restrain the long-term investments in technological advances that became so apparent over the past two years.

Inflation expectations broke above the Fed's 2% target in the spring, and the forward market is now looking for a 3.7% inflation rate in 10 years.

With the conversation even before the inflation shock centered on the Fed having to accept a 3% to 4% inflation target in the medium term, 10-year bond yields have twice exceeded 4% in the past two weeks.

### Behind the shift

There are fundamental reasons for what could turn out to be a shift in structure regarding inflation and interest rates.

**First and foremost is the schism between the democracies of the G-7**—whose prices are determined by market forces—and authoritarian control of fossil fuels.

**Second is the structural change within a labor force** that no longer accepts the constraints of previous working conditions or wages.

**Third is the recognition of the need to diversify the locations of production**, which entails the acceptance of industrial policy among Western governments. The latest example is the support for the semiconductor and renewable energy industries. It is highly likely that governments and not firms will drive infrastructure and energy investment, placing upward pressure on interest rates as firms compete with taxpayer-funded entities for scarce capital.

**Fourth is the uncertainty over national security threats** in Europe and Asia. Increased uncertainty leads investors to demand a higher compensation for holding longer-term securities.

None of these changes will happen overnight. It will take years to fully transition away from fossil fuels and move production back into the developed economies. And the jump in wages is likely to remain a factor in maintaining an adequate supply of labor. All of that is likely to keep upward pressure on the cost of what we buy.

And because of the uncertainty regarding the ability of the monetary and fiscal authorities to minimize the damage to the economy as they fight inflation, we can expect the markets to form new trading patterns at higher levels of risk implied by higher interest rates in the medium term.

### State of play

The consequences of the U.S. bond market sell-off are arguably not yet as dramatic as the situation in the United Kingdom, where there is the risk of failure in one sector cascading into others.

Global investors have placed a risk premium on the issuance of government and private debt in the U.K. because of the mismatch between fiscal and monetary policy that resulted in the resignation of Prime Minister Liz Truss.

Even with the end of the Truss government, the upheaval in the bond and equity markets has been concerning.

At the corporate level, the increased level of risk is seen in the interest rate spread between high-yield (less than investment-grade) corporate bonds and risk-free Treasury bonds.



As in any market, a sell-off in the bond markets suggests a degree of illiquidity, with an excess of supply meeting reduced demand.

Think of it in terms of the housing market. If a neighborhood becomes less desirable, then the number of willing buyers shrinks along with the price.

Let's look at the signals within the U.S. bond market regarding the demand for Treasury securities and the liquidity of the market.

#### U.S. high-yield bond spread\*



#### Bond market testing limits

There is still a substantial level of demand evident at Treasury auctions. That can be attributed to obligations by investment funds and the safe-haven demand by long-term investors seeking refuge from the losses and volatility of the equity market.

Despite the inevitable rhetoric about the value of the dollar or the government simply printing money, there is little evidence to suggest a loss of confidence in the ability of the economy to support investment in its infrastructure or in the well-being of its population.

#### MIDDLE MARKET INSIGHT

The rapid increase in long-term bond yields indicates a higher cost of capital that will affect the willingness of businesses and financial institutions to borrow or lend.

For the past six years, the bid-to-cover ratio for 5-year and 10-year Treasury bonds has mean-reverted to around 2.5 bids received per bond sold at monthly auctions.

Since May, the ratio has moved slightly below 2.5, which suggests a modest deceleration in a still-robust level of demand for Treasury bonds.

This slight drop in demand is small compared to the severe volatility in the bid-to-cover ratio in the run-up to the 2000 dot-com bust and then to the 9/11 attack and the subsequent economic uncertainty.

We can say the same in reference to the decrease in demand during the 2008-09 financial crisis.

Nevertheless, we are left to monitor whether this slight drop in the bid-to-cover ratio of long-term bonds is pointing to an increased preference for cash and a disruption to the bond market.

#### Bid-to-cover ratio of 5- and 10-year U.S. Treasury bonds\*





## MIDDLE MARKET INSIGHT

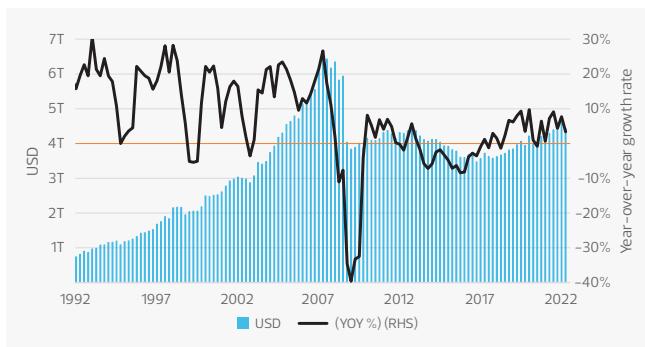
As in any market, a sell-off in the bond markets suggests a degree of illiquidity, with an excess of supply meeting reduced demand.

### Bond market liquidity

The Bank of England has recently provided liquidity for pension funds under attack. And during the pandemic, there was a concerted action by central banks to become the lenders of last resort in the money markets, averting a crisis and a collapse of commercial financing.

In terms of liquidity for longer-term securities, the G-7 central banks embarked on bond purchase programs in the wake of the 2008-09 financial crisis, which lowered the cost of capital and increased economic growth. But that's at odds with the need to increase interest rates to slow spending and stabilize prices.

### Financial assets of broker-dealers



The tightening of monetary policy has the ripple effect of increasing uncertainty regarding short-term rates.

That increases the risk of holding a long-term security, with investors requiring additional compensation in the form of higher interest rates. The reduction in the willingness to borrow or lend reduces liquidity in the bond market.

The monetary authorities are well aware of the damages to the market and to the health of the economy inherent in the tightening of monetary policy. As reported by Bloomberg, Secretary of the Treasury Janet Yellen [said after a recent speech](#), "We are worried about a loss of adequate liquidity in the market."

She noted that the balance-sheet capacity of broker-dealers to engage in market-making in Treasury bonds had not expanded much, while the overall supply of Treasury bills has climbed.

The quarterly flow-of-funds data collected by the Federal Reserve shows that the financial assets of broker-dealers has yet to regain anything near pre-financial crisis levels, with a drop in the second quarter along with a moderation of yearly growth.

Yellen also noted the presence of the repo facility as providing liquidity in the Treasury markets. Created after the financial crisis, the facility has seen increased usage since last year, and now pays out an award rate of 3% for securities parked there.

THE FED IS LIKELY TO CONSIDER A NEW RANGE OF INFLATION ABOVE ITS 2% TARGET AS INCREASES IN THE COSTS OF ENERGY, FOOD AND HOUSING, AS WELL AS LONG-TERM INVESTMENT, MAY PROVE TO BE TOO STUBBORN.

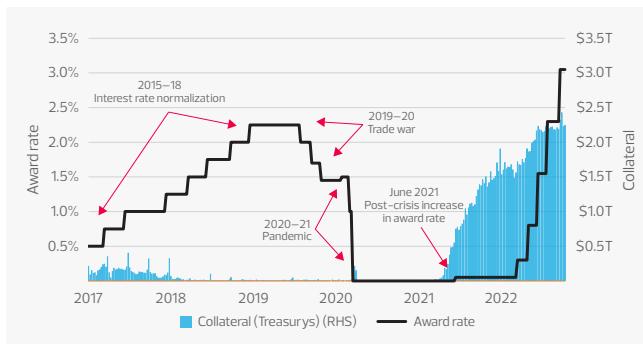
### MIDDLE MARKET INSIGHT

There is little evidence to suggest a loss of confidence in the ability of the economy to support investment in its infrastructure or in the well-being of its population.

We attribute at least some of the success of the facility as a vehicle for parking collateral necessary to short the bond market to the Fed signaling it would begin hiking its policy rate.

In the event of a collapse of liquidity in the Treasury market, we would expect a severe drop in economic activity and another shift in structure that would require a restart of the quantitative easing program and federal funds rate cuts.

### Federal Reserve repo and reverse repo operations



Source: Bloomberg; RSM US LLP

### The takeaway

The rapid increase in long-term bond yields indicates a higher cost of capital that will affect the willingness of businesses and financial institutions to borrow or lend.

Along with the sell-off in the equity markets, the tightening of financial conditions is part of an intentional program to limit spending and reduce inflation.

We think this marks a break from the era of disinflation and extremely low interest rates. The Fed is likely to consider a new range of inflation above its 2% target as increases in the costs of energy, food and housing, as well as long-term investment, may prove to be too stubborn.

There are also advantages to consider if interest rates stay above 4%. Higher interest rates offer a significant slice of the population a safe place to park their nest eggs. They also imply normal levels of return on investment within the real economy.

In the end, the changes are prompting a regime shift that was hard to imagine even two years ago. ■



# AS THE U.S. DOLLAR SURGES, THE POTENTIAL FOR A CURRENCY CRISIS GROWS

BY JOSEPH BRUSUELAS

**THE LIQUIDITY CRUNCH** driving the withdrawal of bond purchases by global central banks is creating the conditions of a classic policy quandary that is stoking international financial instability.

The challenge in balancing growth, inflation and financial stability is now being exacerbated by interest rate differentials that are causing the American dollar to soar against major trading currencies.

As central bankers and fiscal authorities seek to balance those three policy objectives, there is a growing possibility that we are walking into another financial crisis.

The problems in the United Kingdom, which are linked to inconsistency between fiscal and monetary policy along with financial instability, are the most trenchant signs of growing problems in global financial markets.

But given the fact that dollar appreciation is driven by differentials in interest rates, growth, energy and the safe-haven move into dollar-denominated assets, we think

that the more probable site of global financial instability will be in emerging markets, especially Asia.

With the dollar rising to new heights, the United States is exporting inflation through international oil markets—oil is priced in American dollars—by making dollar-denominated debt that much more expensive.

These factors all prompt a question: Will the soaring dollar result in a replay of the Asian currency crisis of 1997?

We would argue that the answer is probably no. Still, the broad depreciation of the major Asian currencies against the dollar will create collateral damage in the region, most likely resulting in demand for financial assistance from the International Monetary Fund.

In our estimation, the G-7 fiscal and monetary authorities will have to cooperate if they are to avoid even a modest replay of the Asian currency crisis. Absent such cooperation, fissures within the global financial system could spill over into the global real economy.

With the dollar rising to new heights, and oil priced in American dollars, the United States is exporting inflation through international oil markets.

Already, financial markets are sending signals that the policy quandary needs to be solved quickly.

Consider what has already happened:

- **The Japanese yen** lost more than 25% of its value versus the dollar through the middle of October, with much of that because of long-term sluggish growth in Japan and its near-zero interest rate policy. The Bank of Japan's recent intervention to prop up the yen has failed and the yen is now trading above 146 to the dollar, which is where the Bank of Japan has traditionally threatened further intervention into currency markets.
- **The euro and British pound** each lost nearly 20% of their value through October as the Russia-Ukraine war threatens to turn an energy and inflation crisis into a full-blown recession.
- **Other Asian currencies have plunged as well.** The Korean won lost 20% of its value versus the dollar through the middle of October, the Philippine peso 15%, the Thai baht 14% and the Indian rupee 11%.

The Singapore dollar is the exception, losing less than 7% versus the dollar as it strengthens against the currencies of other trading partners. But that's because of its position in the global supply chain and its dependence on imports. In addition, the Monetary Authority of Singapore's [policy tool of choice](#) is management of its exchange rate.

So the strength of the dollar is testing the limits of global financial and economic stability. Yet we need to recognize that there are mitigating circumstances.

Since the Asian currency crisis of the 1990s, the emerging-market economies have not stood still. And the monetary authorities among the developed economies have gained experience with each crisis, developing new tools to stabilize the markets and the economy.

Let's take a closer look at the risk of another Asian debt crisis.

### Local currency bond markets

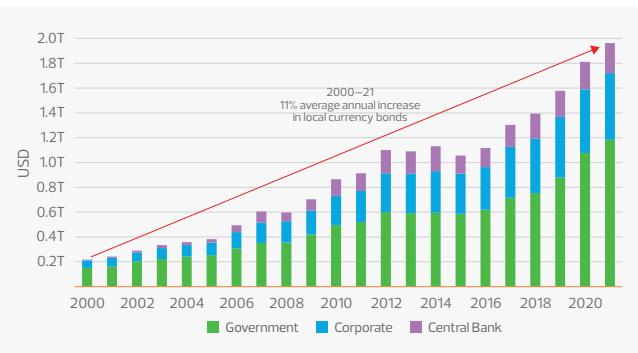
After the Asian currency crisis, there was a concerted effort to reduce Asia's reliance on cheap dollar funding, which puts local government finances at risk during episodes of dollar strength.

If funding is in U.S. dollars, then the cost of paying down that debt would increase when the dollar strengthens. Minimizing this currency risk entailed the development of local currency bond markets in Asia and the increased ability to fund in local-currency terms.

As of last year, local currency bond markets of ASEAN-5—the five major countries in the Association of Southeast Asian Nations—had grown tenfold, from \$200 billion to nearly \$2 trillion, according to an analysis by AsianBondsOnline.

While bond market growth of 11% per year is certainly not a panacea for all the world's troubles, the likelihood of a catalyst for a global recession developing out of insufficiencies in the Asian debt markets has been reduced.

### Size and growth of the ASEAN local currency bond markets



Source: Asian Bonds Online; RSM US LLP

About 60% of international and foreign currency liabilities (primarily deposits) and claims (primarily loans) are denominated in U.S. dollars.

### MIDDLE MARKET INSIGHT

The problems in the United Kingdom, which are linked to inconsistency between fiscal and monetary policy, are the most trenchant signs of growing problems in global financial markets.

### Foreign exchange holdings

At the core of the global supply chain has been the stability and financing of the U.S. dollar. The dollar dominates worldwide commercial activity, and in particular the pricing of energy and food. If a country is buying oil or wheat, then it will need to convert its local currency into dollars. If the dollar is soaring, then the cost of the oil and wheat will also soar, hurting the local economy.

Each of the central banks has holdings of currencies of other countries, with those reserves acting as an insurance policy should the value of their domestic currency collapse.

As we saw with the Asian debt crisis, this is particularly important if government debt is payable in dollars and the dollar's soaring value strains the ability to cover those liabilities.

A [study by the Federal Reserve](#) discusses the dominant role of the dollar as a medium of exchange.

About 60% of international and foreign currency liabilities (primarily deposits) and claims (primarily loans) are denominated in U.S. dollars. This share has remained relatively stable since 2000 and is well above that of the euro (about 20%).

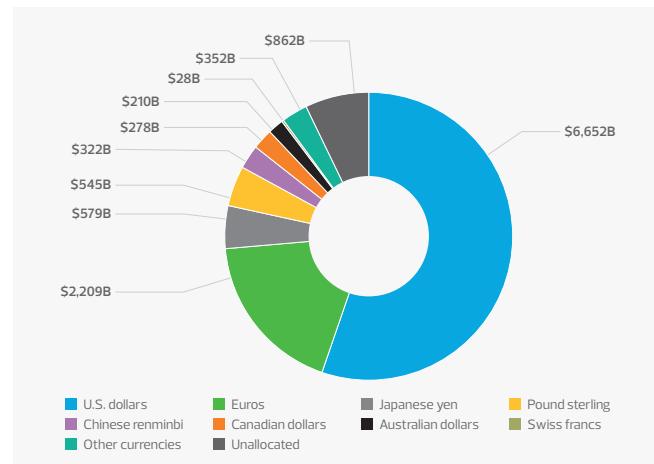
It seems obvious, then, that the majority of worldwide reserve holdings would be in U.S. dollars.

As of June, those dollar reserves totaled nearly \$6.7 trillion, comprising nearly 60% of all allocated reserves, according to data from the International Monetary Fund.

Reserve holdings of euros were \$2.2 trillion in dollar terms, which is 20% of all allocated reserves.

Among the two remaining major currencies, reserve holdings of Japanese yen were \$579 billion and British pound holdings were \$545 billion in U.S. dollar terms, with each accounting for 5% of total reserves.

### Currency composition of foreign exchange reserves\*



Source: IMF; Bloomberg; RSM US LLP

\*As of June 2022

### The growth and diversification of reserves

What is encouraging is the growth of currency reserves since 2000. Total allocated reserves have grown at an average pace of 10% per year, with dollar reserves growing at 9.7% per year and euro reserves at 10.2% per year.

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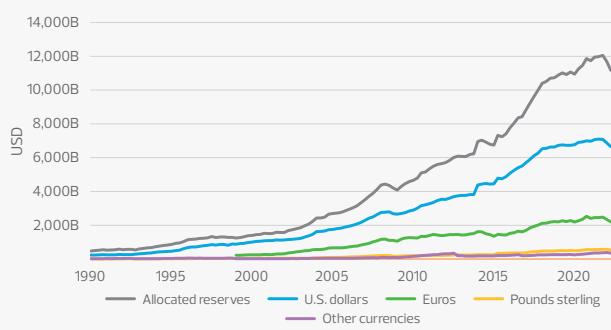
### MIDDLE MARKET INSIGHT

The likelihood of a catalyst for a global recession developing out of insufficiencies in the Asian debt markets has been reduced.

And there has been a diversification of holdings. [An analysis by the IMF](#) in 2020 noted the decline in reserve holdings of dollars since the euro's advent in 2000, with the euro becoming the dominant currency vehicle for African economies as well as within Europe.

And we note the increased growth of "other currency" holdings, some of which are approaching holdings of the yen and pound. That may represent what will be a maturation of other economies and further diversification of financial centers.

#### Foreign exchange reserves by major currency



Source: IMF; Bloomberg; RSM US LLP

#### The takeaway

As in past crises, there is the danger of a financial upheaval in one country spilling over into another.

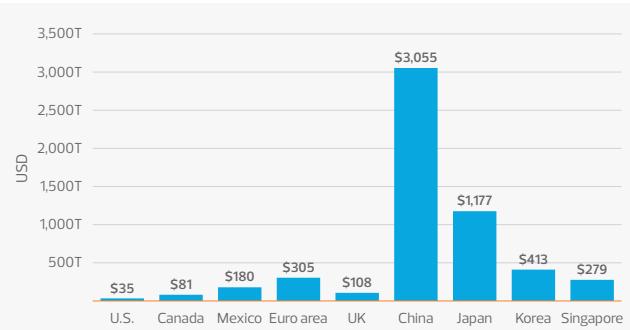
Just as public health authorities must act swiftly to curb the spread of infection during a health crisis, monetary authorities need to react quickly to the risks of contagion, which can result in lack of liquidity in the financial markets and an economic collapse.

If the currency markets were to come under attack, as they were during the Asian currency crisis, then the monetary authorities would need sufficient foreign currency holdings to cover their liabilities. China is far and away the largest holder of foreign exchange reserves, followed by Japan, Korea and Singapore.

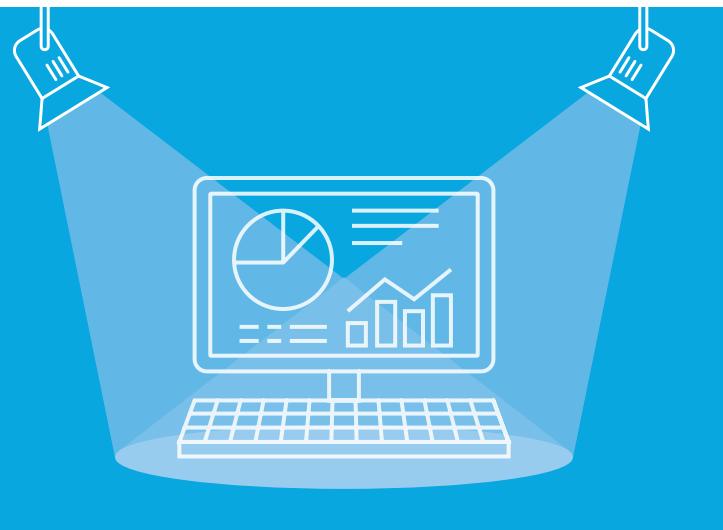
Among the Western economies and those most affected by the cutoff of Russian energy supplies, the euro area has amassed the most reserves, but only a fraction of those held by Asian governments.

If the governments in the West were to conduct currency intervention programs, it would require the cooperation of all the authorities. ■

#### Reserve foreign exchange holdings of selected economies



Source: IMF; Bloomberg; RSM US LLP



## FINANCIAL SERVICES

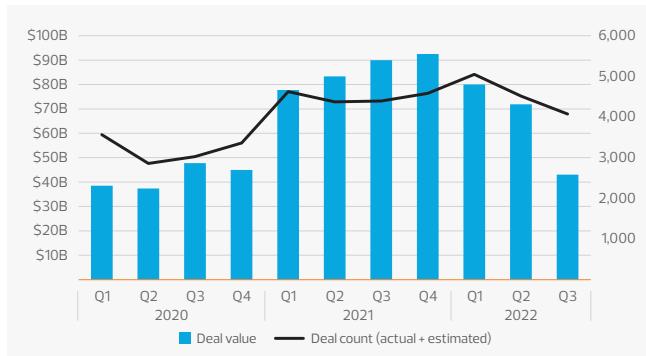
# VENTURE CAPITAL ACTIVITY SLOWS EVEN AS DEAL COUNTS AND FUNDRAISING HIT RECORDS

BY KENNEDY CHINYAMUTANGIRA

**VENTURE CAPITAL** deal and exit activity for the first nine months of the year was well below the explosive pace set last year as various headwinds set in during the third quarter.

Deal activity through September totaled \$194.9 billion, down 22% compared to \$251.1 billion over the same period in 2021, according to data from PitchBook.

### U.S. venture capital quarterly deal activity



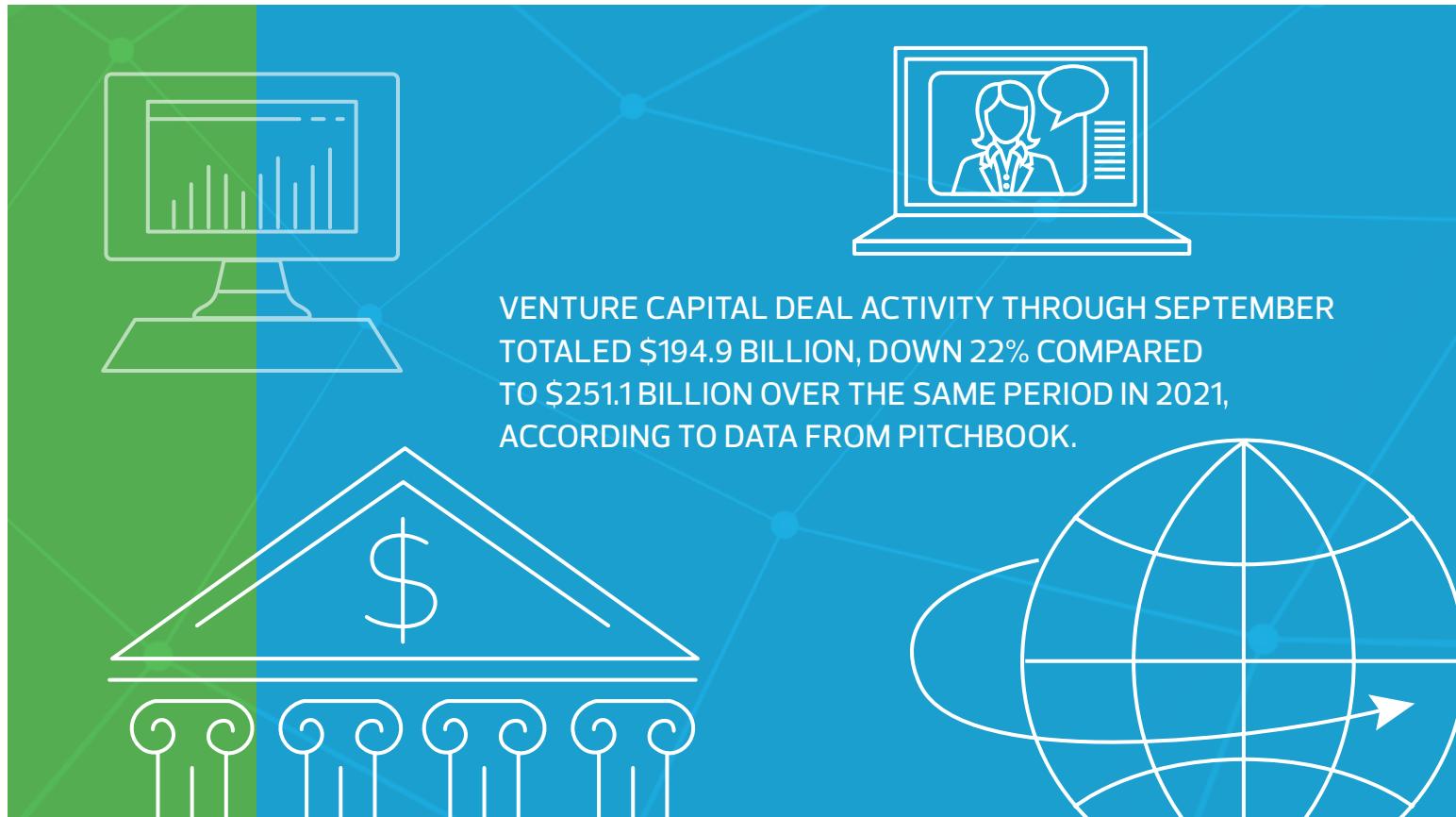
Source: PitchBook

The third-quarter deal activity total of \$43 billion was the lowest recorded since the second quarter of 2020. Activity in the third quarter fell by 40% from \$71.9 billion in the second quarter, showing that sentiment has finally caved amid growing uncertainties.

Markets are fretting about the Federal Reserve's ability to bring inflation to heel without tipping the economy into recession because of the Federal Open Market Committee's sustained interest rate hikes. Investors have also had to contend with geopolitical tensions and significantly weakened financial conditions.

Despite the notable drop-off in deal values, deal volume has endured, though cracks are forming.

PitchBook estimates this year's total deal count through September at 13,636, ahead of the 13,391 deals closed in the first nine months of last year. This sets a record for the first three quarters of the year. However, this year is unlikely to take over the full-year deal count record, as the third quarter showed signs of a slowdown, with only 4,074 deals closed compared to 5,049 and 4,513 in the first and second quarters, respectively.



### MIDDLE MARKET INSIGHT

Despite the notable drop-off in deal values, deal volume has endured, though cracks are forming.

The relatively modest 10% decline in deal count compared to the 40% collapse in total deal value means that average and median deal sizes have fallen.

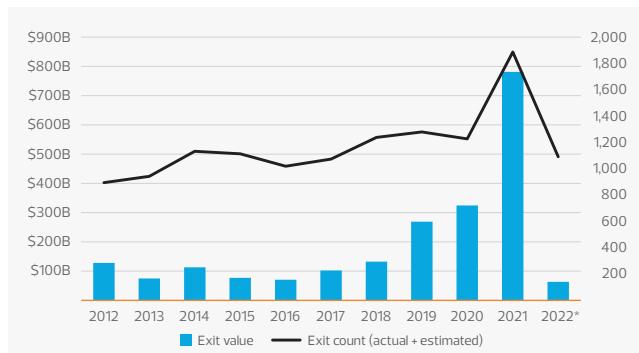
This decrease is pronounced in the late-stage category, where medians and averages have dropped from \$14.55 million to \$11.53 million and \$52.15 million to \$39.65 million, respectively.

Other stages have held up well, showing that appetite for large deals has waned while the record pace of deal counts was sustained by early-stage, angel and seed venture capital activity. This is expected—investors shy away from writing bigger checks and prefer smaller deals in more uncertain times.

### Exit activity

Exit activity has been the biggest stumbling block for venture capital firms this year. Following years of one home run after another in the form of large initial public offerings of venture-backed companies, exit channels this year have dried up. As of the end of September, PitchBook estimates that total exits amounted to \$63.4 billion, down a whopping 89% compared to the \$585.7 billion through the end of September last year.

#### U.S. venture capital exit activity



Source: PitchBook

\* As of Sept. 30



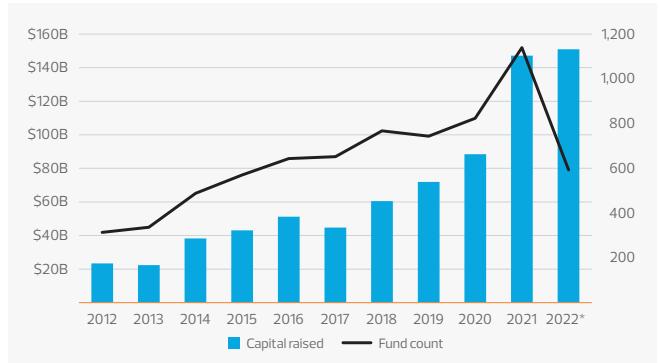
One force that drove venture capital deal activity and fundraising in recent years was a robust exit pipeline that allowed venture capital funds to return some capital to investors, who in turn could recycle that back into new fund launches. This does not bode well for new fund launches in the future, particularly for smaller funds and emerging venture capital fund managers.

## Fundraising activity

Fundraising has been resilient this year, with the impressive returns from recent years still holding sway in investors' memories. Despite the economic headwinds, investors have continued to allocate to venture capital, hoping that venture capital managers will recapture the magic that saw activity double between 2020 and 2021.

With three months remaining in the year, U.S. venture capital fundraising activity reached \$150.9 billion at the end of the third quarter, eclipsing the full-year total of \$147.2 billion from last year. This is remarkable given that last year was a banner year, having recorded a 66% increase over 2020.

### U.S. venture capital fundraising activity



Source: PitchBook

\*As of Sept. 30

## MIDDLE MARKET INSIGHT

Following years of one home run after another in the form of large initial public offerings of venture-backed companies, exit channels this year have dried up.

The record fundraising this year has, however, been dominated by the larger and more established venture capital fund managers. This can be seen in the fact that only 593 new funds made up this year's record fundraising total as of the third quarter, compared to 1,139 for last year's full-year total. This suggests that the average size of new fund launches has increased to \$254.5 million from \$129.2 billion, and that fundraising has been concentrated among big-name fund managers that can pull off bigger launches.

## The takeaway

Deal values have slowed in the most recent quarter even though deal counts remain high, with investors shifting to deals in the earlier stages of the venture capital life cycle to manage risk by underwriting smaller deals that still have a longer runway ahead of them.

A frozen exit market is likely to sustain for the remainder of the year, challenging fund managers' ability to return funds to investors. This will limit the room that investors have in their portfolio allocations to enable them to recycle capital back into new fund launches. We expect this to continue a trend of forcing limited partners to be more selective about the managers they will invest in.

While venture capital fundraising has remained robust, small to midsize managers will have to battle hard to get their share of any new capital, as larger firms dominate in this selective environment. ■

# WOMEN AND LEADERSHIP IN THE MIDDLE MARKET

BY TU NGUYEN AND TUAN NGUYEN

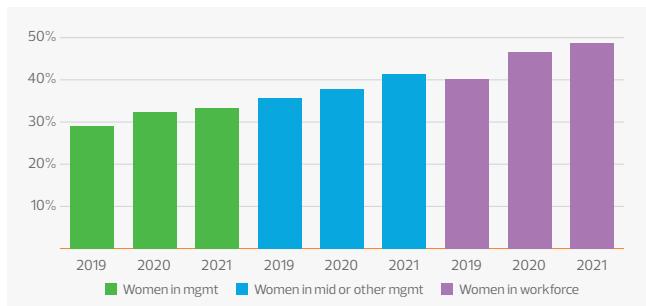
**ONE OF THE FUNDAMENTAL CHANGES** in the workplace over the next decade will be the increasing role of women.

Women not only make up half the workforce in the United States but also are the more educated half. College-educated women outnumber men with similar education in the United States, and [the gap is growing](#), especially among younger adults.

Still, representation of women in senior leadership roles in American businesses remains low.

If businesses are to thrive in an era of chronic labor shortages, they must attract, retain, recognize and reward women.

## Percentage of women in management in middle market firms



Source: Bloomberg; RSM US LLP

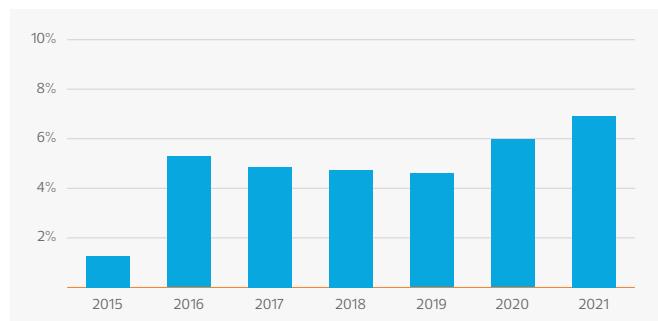
Note: Data based on sample of more than 1,000 public firms with annual revenue between \$10M and \$1B.

## The data

Middle market firms are no exception, and they have been making strides. Between 2019 and 2021, the percentage of female workers in middle market businesses increased from 40.1% to 48.8%, according to a sample survey conducted by Bloomberg. This increase came even as the pandemic placed added burdens on women.

The proportion of women in management has also been on the rise, going from 29.2% in 2019 to 33.2% in 2021, according to the Bloomberg sample survey.

## Percentage of middle market firms that have a chairwoman



Source: Bloomberg; RSM US LLP

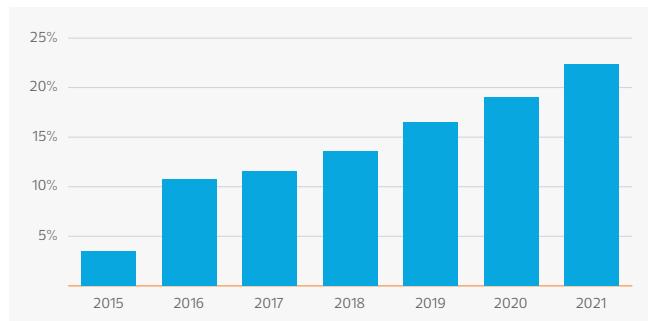
Note: Data based on sample of more than 1,000 public firms with annual revenue between \$10M and \$1B.

If businesses are to thrive in an era of chronic labor shortages, they must attract, retain, recognize and reward women.

But the number of women in senior leadership and top management positions has not kept pace with their overall participation in the workforce.

Even as the share of middle market companies that have women leading a board of directors jumped from 1.2% in 2015 to 6.9% in 2021, and as women's representation on boards overall grew from 3.4% to 22.4%, the disparity remains wide.

#### Average percentage of board members who are women



Source: Bloomberg; RSM US LLP

Note: Data based on sample of more than 1,000 public firms with annual revenue between \$10M and \$1B.

#### ESG performance

With workers still in short supply and gender diversity consistently lagging, it is more critical than ever for organizations to attract and retain talent.

One reason for a company to promote women into leadership roles is that companies are being judged on how well they meet environmental, social and governance criteria.

Our research shows that gender diversity among board members is among the top 10 factors that determine a company's ESG performance. Increasing the percentage of female board members from 0% to 50% can help improve a company's ESG performance by 2.7%. In an evaluation process that factors in hundreds of variables, that increase is substantial.

It also affects the bottom line. [Research](#) published in the Academy of Management Journal has also shown that firms with more women in leadership positions are more profitable.

#### MIDDLE MARKET INSIGHT

Between 2019 and 2021, the percentage of female workers in middle market businesses increased from 40.1% to 48.8%, according to a sample survey conducted by Bloomberg.

Yet in RSM's latest [Middle Market Business Index survey](#), only 14% of senior executives reported they explicitly include gender equity in their ESG plans, and only 44% include the gender pay gap in their external ESG reporting, a notable decline from last year.

When workers, including women, feel unappreciated at work, they leave, and companies lose out on talent as well as years of experience and relationships that are difficult to replace.

Gender diversity, equity and inclusion offer an alternative: better outcomes for organizations, and for female workers who benefit from a workplace that values them.

#### The takeaway

Hiring more women in itself is not enough. Conscious efforts must be made to prepare women for and promote them to senior management and leadership positions.

Make no mistake: The economic downturn will not end the talent shortage, a long-term challenge given the aging workforce and slowing immigration. The pandemic only made the shortage more acute as women opted out of the workforce to care for their children, adding to the challenge for employers.

Companies that provide flexibility and family-friendly benefits and culture will continue to attract talent.

As organizations prepare for the future of work, DEI efforts must stay front and center.

Organizations need to create a workplace that values women and enables them to ascend to top leadership positions. This includes providing coaching, mentorship and sponsorship for higher roles. When employees perceive equity in opportunity and the presence of advocates and are put in a position to succeed, the workers, and their businesses, excel. ■

# MIDDLE MARKET FIRMS REFOCUS THEIR ESG EFFORTS

## SUPPORT FOR ENVIRONMENTAL, SOCIAL AND GOVERNANCE

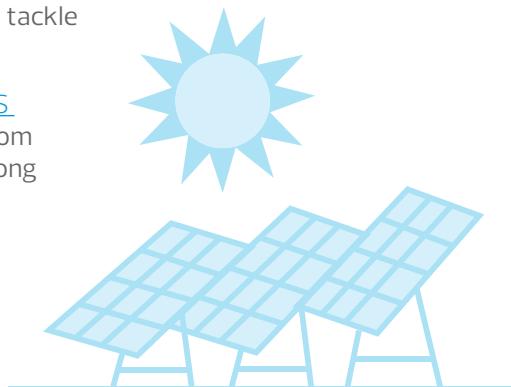
initiatives continues to be high among middle market companies. But the nature of that support is evolving. Middle market companies are reprioritizing their ESG policies to better reflect their industries and organizational goals. Companies are focusing on specific objectives, rather than attempting to tackle a broad range of ESG concepts.

These insights come from the data provided by the third-quarter [RSM US Middle Market Business Index survey](#). The survey compiled responses from 407 middle market executive decision makers from July 5 to July 26. Among the survey's findings:

**More firms are adopting formal ESG plans ...**

**70%**

of middle market companies have formal plans or strategies regarding ESG initiatives, up from 66% for the comparable period a year ago.



**... and are providing some kind of accountability ...**

**88%**

of companies provide external reporting on their ESG performance, a statistically significant increase from 77% the previous year.



**... including appointing a senior executive to oversee ESG plans.**

**69%**

of companies now have a dedicated senior executive whose primary responsibilities include establishing and achieving a vision for ESG. This is on par with 66% the previous year.

For more information on RSM, please visit [rsmus.com](http://rsmus.com).

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