

Thinking big

Midsized companies and the challenges of growth



A report from the Economist Intelligence Unit
sponsored by SAP



Foreword

In business, the big and the small typically grab the glory—the glamour tends to belong to the pesky upstarts or the market leaders. But we believe that midsize matters too: in many countries, midsize companies account for a surprisingly large share of jobs and profits, not to mention corporate ambition. Too often, these companies' specific circumstances and the special challenges that they face are at best little understood, at worst simply ignored. This report aims to fill that gap. It is the result of an extensive research programme, including a global survey of over 3,700 midsize firms and in-depth interviews with executives around the world. The research, conducted by the Economist Intelligence Unit and sponsored by SAP, addresses the principal question facing midsize companies today: how to grow bigger without losing the flexibility and speed that are their prime advantages.

Globalisation is a double-edged sword for midsize firms. It creates stiffer competition and pressure on prices; at the same time, it also provides new opportunities for growth. How can midsize companies successfully go global? How can they compete with

their bigger rivals? What strategies and technologies can help them as they scale up? This white paper describes the main research findings. Other reports in this series will address the specific challenges for midsize companies in particular regions, countries and industries. Together, these studies will help midsize companies make sense of the choices they face as they pursue their ambitions.

Our thanks go to all those executives who freely shared their insights with us in the survey and interviews. Acknowledgments are also due to this white paper's author, David Jacoby, to its editor, Denis McCauley, and also to Mike Kenny, who was responsible for its design and layout. Our friends at SAP, in particular Frances Bell, were instrumental in bringing the project to fruition. Lastly, it goes without saying that the Economist Intelligence Unit bears sole responsibility for the content of this paper: the findings and views found here are ours and ours alone.

Daniel Franklin
Editorial Director
February 2006



Thinking big

Midsized companies and the challenges of growth

Executive summary

Midsized companies matter. In many countries they are an important engine of economic growth. Firms earning between US\$30m and US\$500m represent 1% of all US companies, for example, while generating nearly 30% of corporate revenue. Midsized businesses are only 2% of UK firms but employ 14% of the work force and generate 16% of turnover*.

Midsized companies also have an enormous appetite for growth, but they currently find themselves squeezed by the effects of an increasingly tough global competitive environment, namely downward pressure on prices, rising input costs and consolidation. To cope with these pressures while continuing to pursue growth, they will take great pains over the next three years to improve their operating efficiency. This is the key finding of a major programme of research, conducted by the Economist Intelligence Unit and sponsored by SAP, into the growth challenges of midsized companies.

Based on a global survey of 3,722 executives of midsized companies, as well as a series of in-depth interviews with executives around the globe, the research finds that midsized firms will focus on the following growth priorities:

- **Expand aggressively, but profitably.** Midsized firms aim to boost revenue mainly through expansion of their customer base in existing and new markets. At the same time, a majority of survey respondents (62%) profess their firms' intention to grow at an "optimal rate", indicating a recognition that overly rapid growth can strain their financial, human and physical assets. For the majority, cost reduction and efforts to enhance operating efficiency will go hand-in-hand with new customer acquisition. "Cost reduction will be

a huge part of our business", affirms Doug Ramsdale, CEO of Home Products International, a US-based producer of household articles.

- **Grow organically.** Larger midsized firms appear to be opportunistic about acquisitions, but few midsized companies will pursue M&A (mergers and acquisitions) as a central plank of growth strategy. Rather, they will pull themselves up by their own bootstraps in order to grow, preferring the path of organic growth to other vehicles. A substantial portion, though, also plan to tap into alliances and networks of third parties to achieve their growth objectives.

- **Look abroad.** Globalisation isn't just for the big players. Midsized firms are already venturing into new geographic markets to reap the same benefits that multinationals do, and they plan to continue. Some will do so to service key customers in new markets; some will seek new sources of demand. Others will discover the benefits of global sourcing. But global growth also requires the acquisition of new competencies, as many midsized firms are only beginning to learn how to manage business across borders.

- **Stay nimble and responsive.** Consolidation is producing larger and more powerful customers and larger, more powerful competitors. Midsized firms lack the clout of their large rivals to, among other things, attract and retain talented staff, obtain financing, dictate pricing and delivery terms, and use acquisitions to enter global markets. They are not without advantages, chief among them being faster speed of execution, greater pricing flexibility and deeper customer relationships. But these, midsized company leaders say, are the very attributes that are

* Midsized firms are defined by the Department of Trade and Industry as having between 50 and 249 employees.



Toward a midsize company agenda?

Midsize businesses may not need large-scale assistance programmes to help them grow, but they can use some help—from within and without—in addressing their toughest growth challenges. Nothing beats strong leadership, but their technology partners and governments, among others, can also lend a hand.

Owners and management. The whole of this report explores the growth priorities and challenges that midsize company leaders will set themselves over the next three years. Several prescriptions for them emerge, but three are particularly salient. First, be mindful that breakneck expansion can be hazardous to your health, and that improving operating efficiency and calibrating capacity to meet potential expansion are the hallmarks of sustainable growth. Second, despite the disappointments of the dot.com years, have

faith in the potential of IT to make a difference to the speed and efficiency of operations. Last but not least, rely on good people, not IT alone, to deliver this difference.

Technology vendors. Despite lip service paid to addressing “middle market” needs, suppliers of IT software and hardware until recently have tended to sell big company solutions into midsize customers, complete with big price tags and big requirements for advice, installation and training. Even where software vendors, for example, have scaled back applications packages to fit midsize budgets, customers have often found the application functionality still suited to large-scale operations. Midsize firms also complain of being last on the priority list of consultancies when it comes, for example, to obtaining help with urgent compliance initiatives.

This has begun to change, but vendors can do much more to address the needs of midsize firms. Acknowledging that the latter have unique needs is a start. Dedicating marketing and product development teams to studying their requirements is a next step. Designing new

products from scratch to fit midsize firms’ scale and budgets (as many have done for small firms) is a desirable end result.

Governments. Few economics ministers or development agendas fail to sing the praises of small and medium-sized enterprises (SMEs) or stress the need to develop them. Governments the world over have created departments, agencies and even ministries to deliver assistance to them. More often than not, however, their programmes are tailored exclusively to small or micro enterprises. Says Peter Jenkins, chief executive of the Boston Warehouse Trading Company in the US: “Government doesn’t care about companies our size”.

The best thing governments can do to help midsize companies grow, say 62% of surveyed executives, is to offer them more favourable tax incentives to invest. Over half of respondents also believe cutting red tape should be a government priority. Both worthy objectives, but governments can make a start by dedicating teams to discovering and studying the needs of the ‘M’ within their SME remit. Good policy will hopefully follow.

most likely to erode with growth.

● **Good IT, good people.** Speed, flexibility and responsiveness need not be sacrificed at the altar of scale. Midsize firms today have access to sophisticated information technology (IT) tools that earlier generations lacked. Their executives say emphatically that IT is critical not only to their ability to grow, but to retain flexibility while they do so. And they plan to use IT to help improve customer service, interaction with suppliers and partners, operational management, and product and service innovation—all in the effort to enhance their scalability and maintain some of the attributes that have served them so well.

However, technology is only as good as the people who use it. Midsize firms in all regions, but perhaps more so in Asia-Pacific, grapple with a lack of IT skills among both employees and managers, as well as employee resistance to change. Greater investment by midsize companies in IT training—of managers and employees—is in order. But this challenge extends beyond IT, as executives in the survey expect that a lack of talented staff in general will be among the key impediments to their firms’ growth over the next three years. In this, midsize companies find themselves in the same boat as the big players: finding, training and keeping good people is mission-critical.



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Midsize companies and the challenges of growth

Introduction

Midsize companies may be forgiven a sense of feeling unnoticed and unloved. For the purposes of categorisation and study, governments have traditionally lumped them together with a far larger legion of small and micro-sized firms under the SME umbrella. Yet they are often too large to benefit from government grants and other financial assistance. They also lack the visibility and clout of large firms. Until this decade, organisations having a department or line of business dedicated to addressing the needs of midsize firms were a rarity.

This is starting to change, mainly because of the recognition that, in many countries, midsize companies are an important engine of economic growth. Businesses and governments in many parts of

the world are also beginning to notice that midsize companies face challenges and have needs that are often distinct from companies of different size. Still, there remains little understanding of what makes them tick.

In this white paper, sponsored by SAP, we consider the distinct strategic, operating and competitive issues faced by midsize companies around the globe and their strategies for addressing them. Based on survey results and insights from qualitative interviews, we form a picture of how midsize firms plan to compete in increasingly globalised markets, and the extent to which they will be able to grow without losing their unique advantages vis-à-vis their larger and smaller rivals.



The *Midsize companies* survey

The analysis presented in this report is based on an extensive research programme conducted by the Economist Intelligence Unit from October 2005 to January 2006. At its core was the Midsize companies survey, in which a total of 3,722 executives from around the world participated. The survey covered 18 countries in three regions; 39% of respondents were based in Europe, 37% in the Asia-Pacific region and 24% in the Americas.

Our survey sample was very senior. 50% of respondents were C-level executives such as CEOs, CFOs and CIOs, as well as owners; the other 50% consisted of senior managers such as SVPs and heads of business units. A range of industries was represented, with the largest number of respondents coming from financial and professional services firms, retailers, consumer goods manufacturers and discrete manufacturers (the latter denoting firms engaged in the

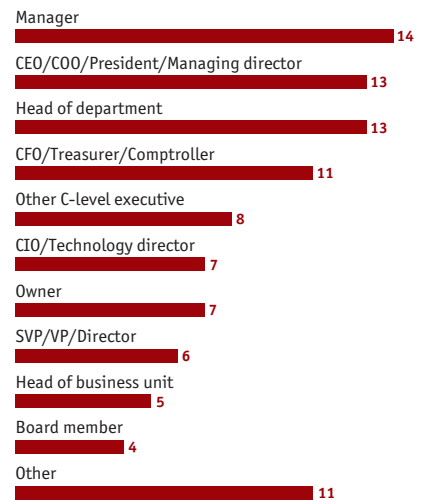
production of distinct units, such as durable goods, electronics and engineering machinery).

Defining the size parameters of a midsize company is anything but straightforward, as the definitions employed by governments, multilateral institutions and companies vary widely. We have chosen to employ a definition based on revenue, and observe that US\$20m and US\$500m are the most widely accepted lower and upper limits of a midsize firm's size in revenue terms. At the same time, since our survey covered numerous countries, we tried to conform as closely as possible to the accepted local definitions. As a result, 82% of the firms in our survey have annual global revenue of between US\$20m and US\$500m. The other 18% represent an allowance for those countries in which the accepted range extends higher or lower. (For more detail on the sample and the results of the survey, please see the Appendix to this report.)

In addition to our survey, we conducted a series of in-depth interviews with senior

executives of midsize companies in a range of industries, obtaining their insights into the nature of the growth challenges facing them over the next three years and how they plan to overcome them.

Which of the following titles best describes your job? (% respondents)



Source: Economist Intelligence Unit



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Midsized perspectives on growth

Midsized companies are nothing if not growth-oriented. While some are spin-offs from big organisations, many more started life as small firms that have grown organically or through merger into larger entities. Some will continue along the path to become truly large enterprises, although by no means all aspire to this.

It may appear self-evident that companies aim to grow, but leaders of most midsized firms also appear to appreciate the limits of expansion. Over 60% of the executives in our survey say that senior management has set an optimal rate of growth for their company, and nearly the same number (59%) say that they have also identified an optimal size. (Midsized firms in Asia-Pacific and the US are considerably more likely than those in Europe to set optimal dimensions of size and growth.)

“Optimal”, though, does not mean unambitious. For example, Nijkerk Group, a privately owned industrial IT group based in the Netherlands, is a long way from reaching optimal size. It’s managing

director, Richard Nijkerk, says that the US\$70m company hasn’t reached a threshold yet. We can still grow for 10-15 years to three or four times our current size without making an acquisition”.

For Thoresen, a US\$250m Thailand-based shipping firm, it depends on which part of the business is under discussion. CEO Ike Chandratat describes its underwater construction and cabling business as niche, with the market limited to South-East Asia. However, it also operates a maritime shipping line requiring global reach and shipping frequency to meet customer needs, and Mr Chandratat aims for his firm to achieve the necessary scale to provide this.

Instead, “optimal” suggests that owners and management are aware of the strains that overly rapid growth can place on the firm’s financial, human and other resources (of which more later). Management of some fast-growing midsized firms consciously try to calibrate growth to the resources at hand in order to avoid breakdowns and customer dissatisfaction.

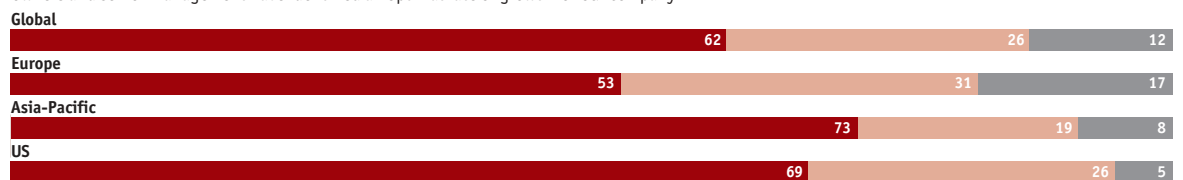
A clue to how midsized firms view growth of their

Please indicate whether you agree with the following statements about your company’s size and growth.

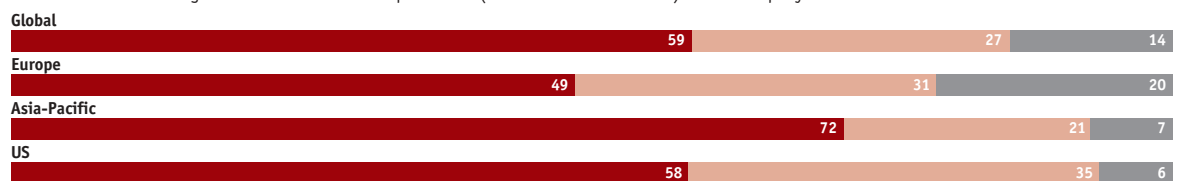
(% respondents)

Owners and senior management have identified an optimal rate of growth for our company

■ Agree ■ Disagree ■ Don’t know



Owners and senior management have identified an optimal size (in revenue or other terms) for our company

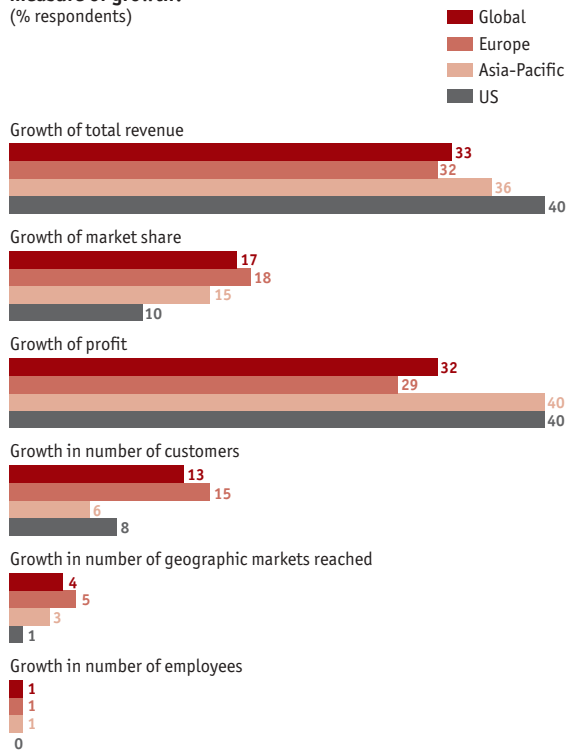


Source: Economist Intelligence Unit



In your company, what is viewed as the single most important measure of growth?

(% respondents)



Source: Economist Intelligence Unit

business is provided by the way that they measure it. One-third of surveyed executives say that their firms look at the increase in total revenue as their main measure of growth. Yet nearly as many, 32% (and 40% in Asia-Pacific), assert that their eye is primarily on profit growth. Other survey findings underscore a sharp management focus in all regions and industries on reducing costs and improving operational efficiency. All of which combines to draw a picture of midsize companies that aim to expand, many of them aggressively, but with a keen eye on the bottom line.

Marshaling internal resources for growth

Lacking the assets—and thus options—available to large multinationals, midsize companies plan to pull themselves up by the bootstraps in order to grow.

Nearly half (46%) of survey respondents report that, in the main, their firms aim to pursue a strategy of organic growth over the next three years.

The preference for organic growth is stronger—and the interest in M&A weaker—among the smaller midsize companies, particularly those earning less than US\$100m. Firms at the larger end of the midsize range, though, appear to have a more opportunistic view. One-third of executives at firms in the US\$500-700m range look to M&A as a main plank of their growth strategy, compared with only 13% of the total sample. Anthony Cardinale, operations engineering manager of c-Cor, a US\$250m US producer of telecommunications gear, says organic growth is preferable, but notes that the company has made six acquisitions in the last three years.

Of course, an M&A strategy can involve a decision to sell as well as buy. Owners and managers of some midsize firms will decide that being acquired makes more sense to ensure continued growth of the business, even if they lose control over it.

MacGregor, a Boston, Massachusetts-based provider of trade order management technology to the financial services industry, has grown organically since its establishment in 1991. Steven Levy, CEO, has always rejected the notion of acquisitions for the sake of building scale. Nonetheless, MacGregor recently reached the point where it appeared to offer greater potential for value generation in combination with one of its partners. Mr Levy and his co-founding partner were approached by numerous suitors who wanted to buy the company, and accepted bids. MacGregor was eventually sold to Investment Technology Group (ITG), a long-time channel partner, which has complementary products and a worldwide distribution network. The combined entity has both “breadth” of client presence and “depth” of product offering.

A predilection for organic growth does not mean that midsize firms will go it entirely alone. Nearly one-fifth of surveyed executives say that their primary

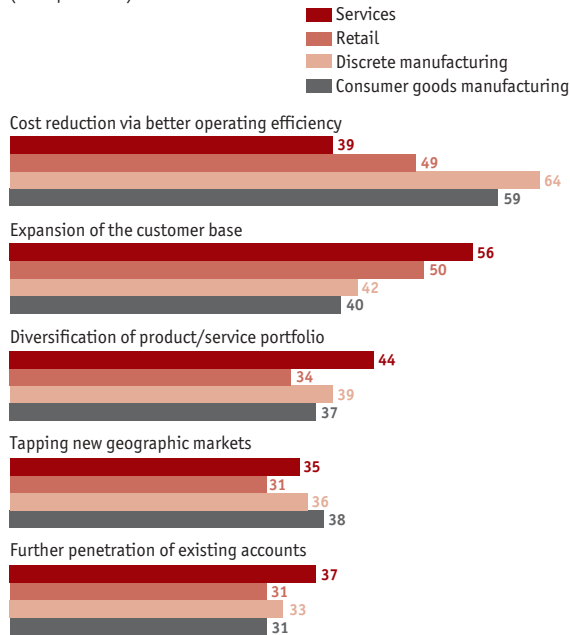


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What are the most important ways in which your company will implement its growth strategy over the next three years? Choose up to three responses.

(% respondents)



Source: Economist Intelligence Unit

growth strategy will involve building networks of third parties to assist in the production or distribution of their goods and services. For some firms this may mean entering into large-scale production outsourcing arrangements or distribution alliances. Those intending to grow mainly through their own resources will not eschew opportunistic partnerships to extend their reach or capabilities. The use of third parties will come in particularly useful as midsized firms attempt to extend their business into global markets.

First things first—boost operating efficiency

The respondents to the *Midsized companies* survey make it clear that profitable growth will be their priority—yet another indication that it won't be “growth at all costs”. According to Ronald Black, CEO of Wavecom, a French manufacturer of mobile phone components, “profitable growth is the optimal size for a firm; that's the right way to look at it”.

Downward pressure on prices combined with the rising cost of inputs (particularly energy and raw materials) are combining to squeeze the margins of companies of all sizes. Executives in all the industries represented in our survey—but particularly manufacturers—are extremely keen to reduce costs and improve operating efficiency as their companies grow. Achieving these objectives will, they believe, enable the business to expand further.

Beyond this, companies can achieve organic revenue growth in a number of ways: for example, through a focus on new customer acquisition or efforts to increase the spend of existing customers. For midsized firms in the survey, expanding the customer base will be the priority. US companies will pursue this path particularly aggressively: 62% of American respondents cite new customer acquisition as their top growth objective. Their European and Asia-Pacific peers place the improvement of cost-efficiency at the top of their respective lists, but nonetheless they agree that new customer acquisition will be the primary way in which they achieve revenue growth.

Much of this growth will occur outside their home markets. 36% of midsized company leaders maintain that entry into new geographic markets will be a growth priority, and international expansion figures prominently among the cited growth strategies in every region and industry represented in the survey.

Clearly, globalisation is not just for the big players. Midsized companies are tapping into global markets to reap the same benefits that multinationals are, including both revenue growth and cost reduction. Mr Black of Wavecom says that, in his industry, “you have to be global. There is no option to focus on a small part of the world. If your customers are global, you go where they are”.

Global strategies for medium-sized players

Having limited resources, midsized companies will enter foreign markets selectively. Mr Levy describes



MacGregor's approach to international growth: "Each market is different. For example, in Tokyo you need to be seen as a local company. We often find a local entrepreneur and fund him as part of a deal in which we buy him out after five years".

Distribution and licensing arrangements are preferred by other firms as a faster method of new market entry. Others will use channel partners and strategic customers to achieve virtual global scale, offsetting a relative lack of equity to invest in foreign infrastructure. Expansion into new geographic markets is central to the mission of many midsize companies, yet investment in overseas operations is expensive and risky.

VT Sampath Kumaran, corporate adviser at India-based MTR Foods, describes his company's "springboard" approach, in which it has used strategic supply relationships with large multinational customers such as Carrefour Japan in order to reach new geographies it would not otherwise have been able to do.

Others will source globally to reduce costs. Once the

exclusive purview of large companies, technology advances and better transportation have made the global sourcing of products and services available to midsize firms. "The key is to be able to procure and manufacture product at a sufficient scale with limited quality control issues", says Tom Kim, COO of The FaceShop, a South Korean retailer of cosmetic products.

Global sales or sourcing strategies are not necessarily for everyone. Smaller midsize firms with strong niche positions in local or regional markets often find that a local approach makes most sense. This is particularly true among smaller service providers. Mr Nijkerk, for example, says that his IT services firm "does not compete with companies that are outsourcing". Still, the company's customers are spread across Belgium, the Netherlands and France, and they require local support with immediate responsiveness. Even at this level, midsize companies in many countries need to be able to do business—to sell, hire, communicate and source—across borders to sustain growth. This is no easy task.



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A multitude of challenges

Globalisation, of course, is a two-sided coin. More open markets and greater ease of doing business across borders means unprecedented revenue growth opportunities. At the same time, it adds a new dimension and intensity to competition—at home and abroad—that few firms are immune to. For executives of midsized companies, the result is a sense of mounting competitive pressure to go along with their hopeful outlook on growth prospects.

The big squeeze

For executives of midsized firms in all regions and all industries, downward pressure on prices is the most troublesome manifestation of this tougher competitive environment. Technology advances and market liberalisation are combining to lower entry barriers to new competitors. Customers enjoy greater choice, and suppliers are finding it increasingly difficult to differentiate their products sufficiently in order to charge premiums. In many markets, price competition and margin squeeze is the result.

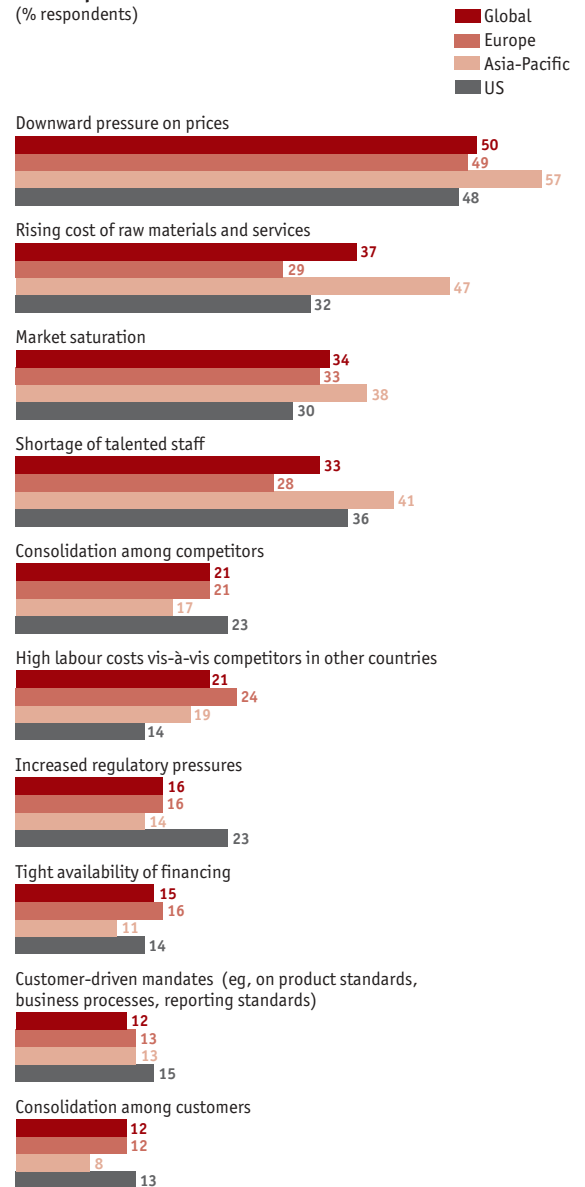
Dexxon, based in France, is a wholesale supplier of IT products to European electronics retailers. Albert Bechet, its CFO, confirms that the firm has aggressive rivals in France and other European countries. “They’re not yet able to deliver high levels of service”, observes Mr Bechet, “but, being low-cost organisations, they can offer some good prices. This price pressure hurts, because margins are very low already”.

Peter Jenkins, CEO of Boston Warehouse Trading Company, a US\$40m US consumer goods wholesaler, observes that competition from low-cost producers and larger, international competitors is squeezing the company’s margins and market share.

This is even the case in more capital-intensive industries. Mr Chandratat, of Thoresen, observes that

What do you believe will be the most serious impediments to growth in your key markets over the next three years? Select up to three.

(% respondents)



Source: Economist Intelligence Unit



ship supply is increasing and freight rates are coming down, and says that “supply and demand fundamentals in his industry may not hold up”.

Half of midsize company executives in the survey, by far the largest portion, view downward pressure on prices as the most serious impediment to their companies’ growth over the next three years. 37% (and 50% of manufacturers) also view the rising cost of raw material inputs and services as a barrier, and 34% say that saturation of markets will negatively impact on growth. (The rising cost of inputs is felt strongly among respondents in Asia, and particularly China, which is soaking up ever larger volumes of energy and other raw materials to sustain its rapid growth.) No wonder, then, that the majority consider reducing costs and improving operating efficiency as a critical component of growth strategy.

Growing pains

Constraints on the growth of midsize companies exist not only on the demand side—they come from within as well. Expansion, particularly of the rapid variety, inevitably exerts strains on a company’s human resources. Labour markets, however, are tightening the world over, and companies find themselves competing not only for customers but also for skilled employees and managers. It will only get tougher: 33% of survey respondents cite a shortage of talented staff as one of the key impediments to growth.

It will be a tough challenge everywhere, but midsize company leaders in the fast-growth markets of Asia-Pacific express serious concern that it will curtail their growth, 41% citing it as a key barrier. Antony Tin, general manager of M&C China, a Tianjin-based subsidiary of a 60-year old US producer of die-cut adhesive tape components, confirms that difficulties in finding skilled staff is a constraint on the firm’s growth in China.

Services firms will feel the labour crunch more than those in other industries: among executives from this

sector, a shortage of skilled staff surpasses price pressure, rising costs and other factors as a barrier to growth.

Hiring and retaining talent may be difficult at home, but the difficulties are magnified as midsize firms look to expand in international markets. Resources Global Professionals is a US-based professional services firm specialising in providing qualified staff to clients on a project basis. It has expanded rapidly out from its US base since its inception in 1996, having established offices through Europe and Asia-Pacific. For it, finding good staff is not only an operational challenge, but also a supply issue impacting directly on revenue-generation. According to Steve Giusto, the firm’s CFO, “finding the talent to support international operations is our key growth issue, although it’s a double-edged sword because if there were unlimited talent, we’d have no reason to be in business”.

Growth can also strain a midsize firm’s IT infrastructure. Many companies outgrow their existing systems: nearly one-third of executives in the survey complain that their current IT systems do not meet the requirements of scalability, and 39% say they will be spending to replace obsolescent equipment and software over the next three years. As discussed in more detail later, IT infrastructure need not hold back growth, even for midsize firms without the wherewithal to purchase regular upgrades. On the contrary, the effective use of IT by skilled managers and employees can help create extra speed and flexibility to counteract the internal strains that growth produces.

The burden of regulation

In many countries, dealing with regulation often represents a greater burden for midsize firms than for their larger and smaller brethren. Big corporations typically dedicate teams of professionals across departments (accountants, lawyers and others) to

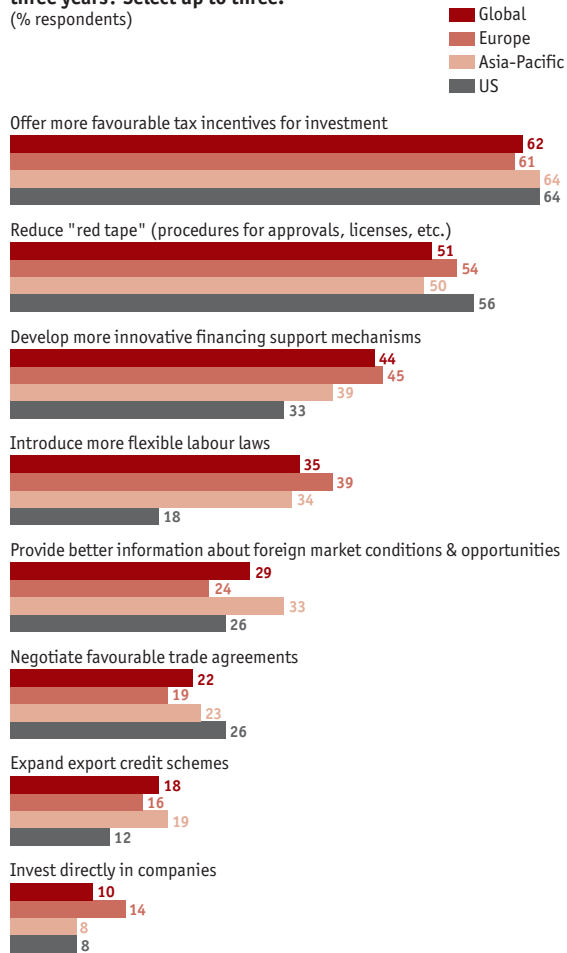


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In your view, what will be the most effective ways that government can help mid-size companies grow over the next three years? Select up to three.

(% respondents)



Source: Economist Intelligence Unit

ensure compliance with regulatory requirements and resolve bureaucratic wrangles surrounding import/export regulations, registration, taxation and other issues. Small firms frequently escape compliance requirements thanks to their unlisted status and to government incentive programmes. Midsized companies are large enough to face all the requirements, but often have scarce human resources to devote to the task.

The US Sarbanes-Oxley legislation (SOX), for example, is a torment for IT firm MacGregor. The company has been forced to review myriad details about its operation, according to CEO Levy, including where it places its servers. Moreover, he says, "the Big Four accounting firms can't handle the work. They're so overwhelmed that they've tripled their rates, and the service is poor".

For other midsized firms, tax is the greatest public burden. Some executives bemoan the UK's triple taxation regime, referring to the double taxation on dividends plus the stamp tax required to buy a new building. In the US, firms must deal with different levels of sales tax in each state. Firms the size of MacGregor, according to Mr Levy, have to work very hard, sometimes adding staff and consulting expenses, in order to operate on a nationwide basis.

Asked the most effective measures governments can take to assist midsized companies over the next three years, a majority of 62% cite more favourable tax incentives for investment. A smaller majority (56%) say that reducing red tape should be the priority. Many executives, however, aren't hopeful. In the opinion of Mr Jenkins of Boston Warehouse, "government doesn't care about companies our size".



Consolidation, competitors and customers

Another major manifestation of intensified global competition is the consolidation of players within industries. For midsize firms, this portends not only more powerful rivals to contend with, but more powerful customers as well.

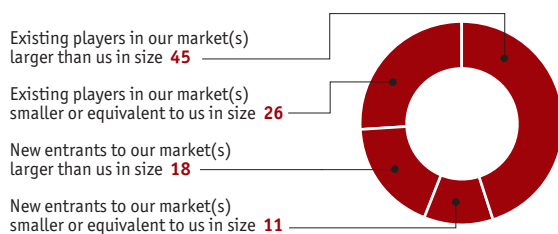
Rivals new and old

For midsize and small companies, an unwelcome byproduct of globalisation is the emergence of new, offshore competitors in their existing markets. Midsize companies tend to see the principal foreign challenges arising from relatively close to home: in Asia-Pacific, from Chinese firms; in Latin America, from Brazilian firms; and in Europe, from German firms. At the same time, respondents in all regions also expect entrants from China and the US to pose strong challenges in their markets.

But executives of midsize firms in all regions and industries make clear that the chief competitive threats to their position over the next three years will emanate from existing players in their markets that are larger than them. Mr Cardinale of telecoms equipment producer c-Cor, for example, relates that his firm is number two in its niche market, but is dwarfed by a market leader that is 20 times c-Cor's size.

What types of firms are likely to pose the main competitive threat to your company over the next three years? Select one only.

(% respondents)



Source: Economist Intelligence Unit

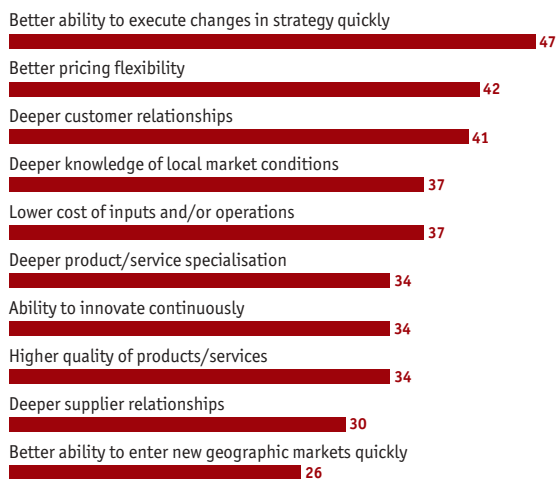
Punching above their weight

Competing with rivals several times your size is no easy task, but midsize companies enjoy a number of advantages that many use to good effect. Chief among these is speed. Smaller firms with flatter management structures are often (although not always) able to make strategy decisions more rapidly and frequently than larger rivals and—crucially—to implement them faster.

Jun Takeuchi, for example, director of Japanese financial software developer, Gaitame.com, is sanguine about his firm's ability to compete with much larger rivals, Matsui Securities and Monex Securities: "Because we're a smaller company we can move much more quickly. We can reflect the demands of customers with greater speed". Mr Black of France's Wavecom agrees: "Smaller companies are much more agile and nimble, and the rate of information flow is much,

Which of the following types of competitive advantage does your company enjoy vis-à-vis larger firms? Select up to three.

(% respondents)



Source: Economist Intelligence Unit



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Acting big

Thoresen, a US\$250m Thailand-based shipping firm, is a midsize company by our definition, but one that looks and acts like a large one. It has 2,300 employees and is the seventh-largest ship-owning company in the world for ships in its class (under 50 deadweight tons).

Thoresen leverages the traditional strengths of midsize companies, operating with a niche focus. It primarily serves the liner business on the Far East–Mediterranean trade route. Because of its limited size, it has the flexibility to

deploy new services and change its strategy with relatively little investor review. In fact, it made a major investment in vessels two years ago, doubling the size of the fleet when the market was in a trough, and is now reaping the rewards of a hot market with high rates and high asset valuations. Mr Chandratat, Thoresen's CEO, credits "superb timing" by the previous management team.

At the same time, however, Thoresen employs strategies that are common to larger companies. Its capital-intensive ship acquisition plans resemble those of much larger, more capitalised firms. It has built a portfolio of services ranging from

underwater maintenance and repair to ship-brokering, stevedoring and port services. In addition, it has the ability to enter new markets quickly and aggressively because of the unique characteristics of a shipping line: it can re-route vessels easily.

Thoresen is something of an anomaly: a midsize firm with stature in a capital-intensive industry. Mr Chandratat puts its success down to its niche focus in each of its businesses, to shrewd management decisions and to the greater operational flexibility it enjoys compared with its larger competitors. Anomalous perhaps, but proof that midsize companies can punch above their weight.

much higher".

The speed advantage that midsize firms enjoy over large rivals is also reflected in greater pricing flexibility—the ability to react swiftly, for example, to changes in demand and supply. It also helps to generate another critical attribute—deeper customer relationships. Most midsize firms enjoy greater flexibility to tailor solutions to their clients, and are also able to offer personalised customer service. At many companies, it is not unusual for customer service representatives to know customers by their first names.

For many midsize firms, superior customer service and personalisation is their chief differentiator vis-à-vis larger rivals, and also their best way of compensating for a lack of brand equity. "Our goal", says Doug Ramsdale, CEO of Home Products International, "is to over-serve, over-satisfy and never disappoint".

When it comes to competing against smaller firms, midsize companies generally cede the advantages of speed, flexibility and customer intimacy. In turn, however, they bring to bear the relative advantages of their own greater resources, which above all else enable them to pursue global opportunities more

effectively. 42% of survey respondents feel that a key advantage for midsize firms in battling against smaller, nimbler competitors is the ability to marshal resources to enter new geographic markets. Another 37% say it's the depth of their supplier relationships (and their ability to translate that into lower costs and faster, more reliable delivery).

The downside of growth

But here's the rub: as midsize firms grow into larger entities, the advantages of speed, flexibility and customer intimacy that they hold over larger firms will tend to erode. 44% of global respondents—and 50% in the US and Asia-Pacific—say that the ability to execute strategy quickly is the attribute most likely to weaken as they grow. Another 36% say the same of their ability to maintain deep customer relationships.

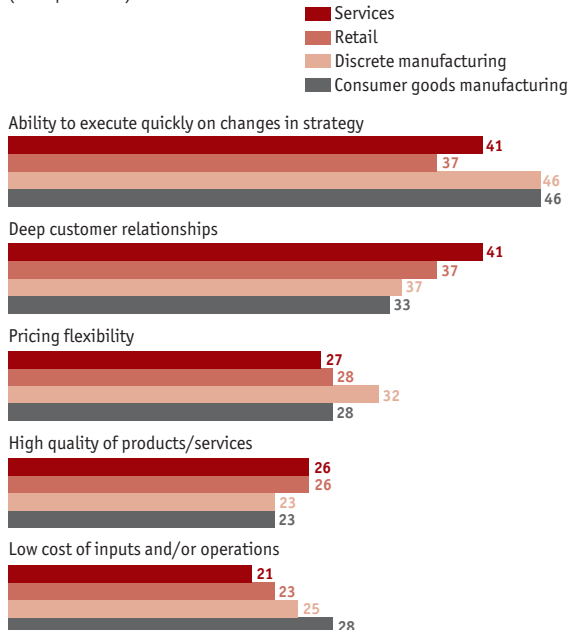
Not all leaders of midsize firms believe that erosion of these attributes is inevitable. Take depth of customer relationships. Mr Jenkins of Boston Warehouse says that it's all in the quality of customer service, which, he claims, has continued to improve as the firm has grown. "Size does not affect customer service".

Mr Nijkerk of Nijkerk Group agrees: "It is not



In your view, which of the following attributes is most likely to erode as your company expands in size? Select up to three.

(% respondents)



Source: Economist Intelligence Unit

difficult to maintain the relationship with customers as you grow. For one thing, customer service should be part of the quality management standard and

organisational model. Respect it as important”.

Mr Jenkins concedes that the odds are against being able to retain the same level of management flexibility and speed of execution. But it’s not impossible, and the key is the quality of the management team: “You have to have great leaders and a great management team in order to grow. This is not more difficult [for us] now”.

As our survey respondents suggest in citing a shortage of talent as a major impediment to growth, a midsize firm’s ability to attract, nurture and hold onto high-quality staff—particularly senior and middle managers—will be critical to its success. The organisational structure may not remain flat as the firm grows, but talented managers tend to seek and find ways to streamline decision-making and simplify implementation.

Bigger customers, too

As if facing off against ever-larger competitors isn’t tough enough, midsize companies must also deal with larger and more powerful customers, another effect of consolidation. Nearly 60% of executives in our survey say there is at least a medium risk that they will

Investing in people

Phones4u, a UK-based reseller of mobile phones and services, has been one of the country’s fastest growing retailers over the past few years, even after entering the market later than many of its rivals. Operating in a fast-moving business with constant pressure on prices and margins, the company attempts to differentiate itself from its High Street rivals with superior customer service. Group managing director Tim Whiting says his organisation is set up to provide an entirely different experience for customers. “This is a complicated

market and there’s a lot of anxiety with consumers about what handset and tariff to get, so we pride ourselves on giving a service to our customers and the best advice”.

To get this right, the company has invested more than £10m over the past year in a major staff training campaign. Mr Whiting firmly believes that the best way to grow is to train people well. “We have a bespoke national training academy, and every person in does one week of training at this facility before setting foot in our stores”, he says. Retail locations are also configured differently from rivals, with more attention paid to how customers are

handled. “We’re very different from our rivals; you’ll see that most of our floor space is taken up not by display shelves, but by desks”. According to Mr Whiting, staff spend an average of an hour with every client helping them complete a contract.

The result for customers is something more of an appointment-based concept, where they are led carefully through the mass of available options to find one that precisely suits their needs, rather than simple self-service. “When we get it right, we take a very high level of market share”, says Mr Whiting. “So for us it’s not about the generation of footfall, but its conversion.”



Thinking big

Midsize companies and the challenges of growth

become overly dependent for revenue on a few large customers, and 20% characterise the risk as high. In Asia-Pacific, 11% of respondents say their firms already find themselves in this situation.

Large customers will exert their power, among other ways, by controlling access to channels of distribution. Three accounts now represent 70% of sales for Home Products International, and Mr Ramsdale sees little chance for the firm to diversify its customer base. The company will grow by “taking market share”, he says, as well as by diversifying into new channels.

Big companies also flex their strong buying power, leading to lower prices. 85% of survey respondents feel that large customers will come to dictate the pricing of their products or services to some extent over the next three years, and 44% believe that they will do so “substantially”.

Large customers also require global scale and coverage. Nearly 80% of surveyed executives feel that big customers will come to dictate terms of delivery to at least some extent. At one level, it is not unknown for

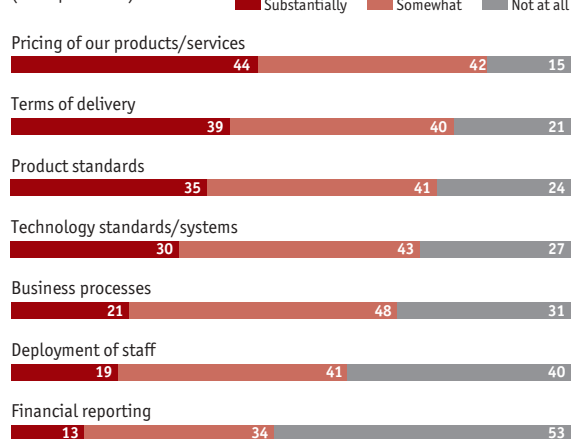
large retailers to tell suppliers when and where to deliver the product, and to fine them, for example, if labels are not properly affixed to boxes. At another level, it is becoming commonplace for multinational customers to initiate smaller suppliers into their international expansion plans and ask them to establish a local presence to ensure continuity of delivery.

“Big box” retailers have already acquired a reputation for domineering sourcing practices, and many are now extending that to influence their suppliers’ IT investment decisions. 73% of executives say that large customers will come to dictate technology standards and systems to some extent, and 30% believe such control will be “substantial”. The US retailers Wal-Mart, Target and Albertsons, for example, have already mandated that suppliers absorb the cost of expensive radio frequency identification (RFID) tagging.

The dictates of influential customers (and also big suppliers) promises to have a substantial impact on the IT platforms of midsize firms. The good news is that over 60% of executives feel that their firms’ IT systems conform to the business process requirements set by customers or suppliers. But for a large minority—27%—bringing their systems up to customers’ and suppliers’ standards will cause strains.

To what extent will large customers come to dictate the following aspects of your company's operations over the next three years?

(% respondents)



Source: Economist Intelligence Unit

Against all odds?

Coping with globalisation, with competition from nimble new entrants and larger players, and with the demands of ever-more powerful customers will require all the speed, adaptability, innovation and responsiveness that midsize firms can muster. Retaining some measure of these attributes as they grow is a tall order, but not impossible. One tool at their disposal in trying to pull this off is a team of managers skilled in adapting business processes. Another is IT.



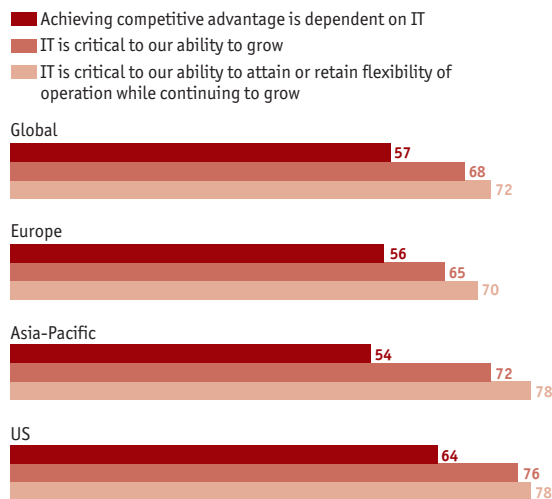
The promise of IT

If the bursting of the dot.com bubble showed nothing else, it is that IT is no substitute for good management. Midsize businesses in many countries remain avid buyers of IT equipment and software, and many look to IT to help them grow. If they've learned their lessons from earlier years, they will realise that IT is no panacea. Yet, if managed and used skillfully, it can help mitigate the erosion of speed, flexibility, customer intimacy and other attributes that they used to their advantage as smaller, leaner firms.

Business objectives come first

Executives of midsize companies certainly assign IT a central role in their planning for the future. That it is critical to the firm's ability to grow is a view shared by 68% of survey respondents. Another 57% say that achieving competitive advantage hinges on their use

Share of respondents agreeing with the following statements about the role of IT in their company.
(% respondents)



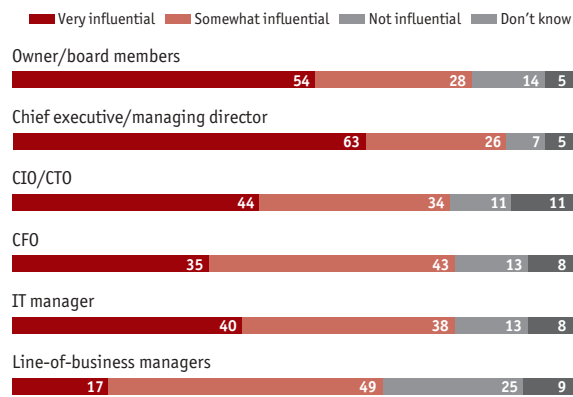
Source: Economist Intelligence Unit

of IT. And 72% believe that it is critical to their ability to retain operational flexibility as they grow. This sense of importance attached to IT is palpable right across regions and industries, although European executives and those in the retail industry are slightly less emphatic than their peers.

A board member of one US retailer currently in the midst of a turnaround neatly articulates the importance of IT for its future growth: "We need technology to better analyse our customers, and to improve our logistics and merchandising. If we don't automate everything, then we're going to be deflating our growth. We need the systems that a US\$5bn company would rely on".

Leaders of midsize firms share the recognition that heads of large corporations frequently profess, which is that business objectives must dictate how IT is deployed and used. Three-quarters of our survey group maintain that they integrate IT strategy closely with overall business strategy. And in 63% of firms in the

How influential are the following executives in key decisions your company makes on IT?
(% respondents)



Source: Economist Intelligence Unit

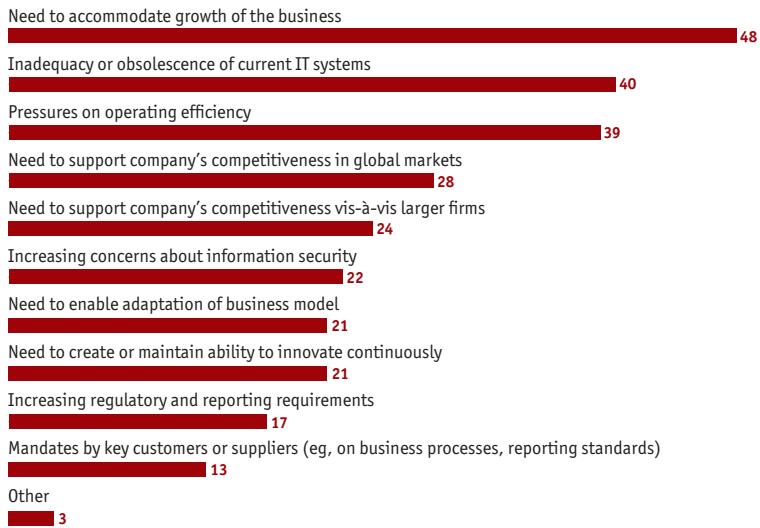


Thinking big

Midsized companies and the challenges of growth

What are likely to be the main drivers of IT investment in your company over the next three years? Choose up to three responses.

(% respondents)



Source: Economist Intelligence Unit

survey, the CEO or managing director takes direct responsibility for major IT decisions, a response rate that holds even among the larger midsized firms. This suggests that, at most midsized companies, the CEO is on hand to ensure that IT strategy is adequately aligned with the business objectives.

Enhancing scalability will be uppermost in the minds of management as they consider how much to invest in IT and what exactly to spend it on. Half of survey respondents cite the need to accommodate the growth of the business as a key driver of IT investment over the next three years. As firms expand, they often outgrow their IT systems, and the latter end up curtailing growth rather than enabling it. Many midsized firms will spend to replace legacy software and equipment; in so doing they will seek to ensure that new systems are scalable to allow business growth. They will also invest (manufacturers more than other types of firms) to ensure improvement of operating efficiency.

Globalisation comes into focus again here: with expansion into foreign markets a priority for many midsized firms, respondents say they will also deploy IT

to help streamline cross-border operations. Mr Bechet of Dexxon says that his firm plans to grow aggressively in Europe—including through acquisition—outside of its home base of France, and that IT, particularly enterprise resource planning systems, will be important to smoothing this process. He notes, though, that “we’re moving too slowly with IT. We’re doing rollouts in new countries, but we’re too slow”.

Where IT will make a difference

Technology is ubiquitous in companies, but in terms of ensuring speed, flexibility and responsiveness, its impact in midsized firms is likely to be felt most heavily in the areas of customer service, supplier and partner interaction, operations management and innovation.

● **Customer relationships.** As the customer base expands with business growth, some loss of intimacy with individual clients is inevitable. But using data analytics to develop better insights into customer preferences and behaviour, and customer relationship management (CRM) systems to improve responsiveness, will help compensate.

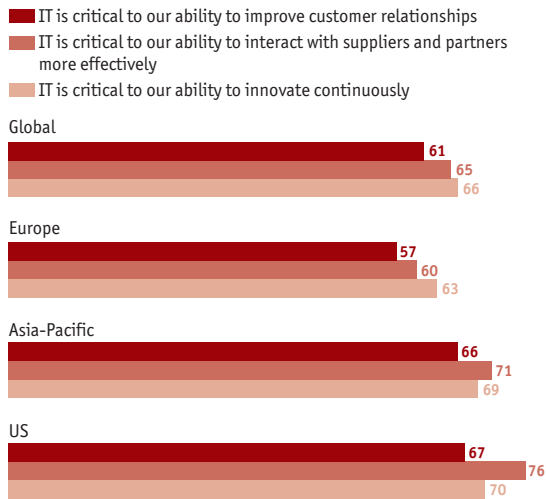
Over 60% of survey respondents say that IT will be critical to their ability to improve customer relationships. Says Tim Whiting, group managing director of UK mobile phone retailer Phones4u: “Access to customer data is key, because it helps us understand user requirements and helps us mould those requirements to individual customers. We need to know what customers have, so there’s a lot of focus on CRM systems”.

● **Supplier and partner interaction.** Another 65% of surveyed executives believe IT will be vital to improving their interaction with suppliers and partners. Mr Whiting agrees: “IT is fundamental in the way we operate with our network partners. Real-time connectivity to pass information to network partners is critical”.



Share of respondents agreeing with the following statements about the role of IT in their company.

(% respondents)



Source: Economist Intelligence Unit

Midsized firms will put tailored systems to work to improve information interchange with suppliers as well as channel partners. This will entail supply chain management (SCM) and supplier relationship management (SRM) solutions tailored to their size and unique needs. Mr Cardinale of telecoms equipment vendor c-Cor spends a lot of time on supplier management. "There's a lot of manual work that needs to be done to partner with suppliers and customers. You need to open up the enterprise resource planning (ERP) system to suppliers and customers".

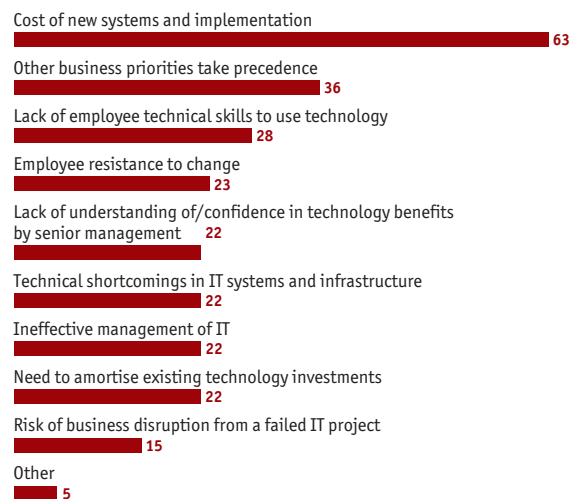
● **Operations management.** Many midsized firms have bought into the potential of enterprise planning systems such as ERP to accelerate information flow throughout the company, thus helping to boost operational speed and improve co-ordination across departments. As their access improves to vendor offerings that are tailored to their scale and needs, midsized manufacturers and retailers in particular should be able to reap greater operational improvements out of such tools.

● **Innovation.** In an Economist Intelligence Unit study, *Business 2010*, published in February 2005 (and sponsored by SAP), a majority from a global sample of over 4,000 respondents stated the belief that ensuring speed of innovation would be a critical management challenge for businesses over the next five years. A large share of midsized company executives (33%) also believe that their ability to innovate continuously gives them a competitive edge over firms of all sizes.

Two-thirds of the respondents make clear that IT will be critical in helping their firms maintain this attribute as they grow. They will use technology, for example, to improve product design and lifecycle management and thus reduce cycle time. But IT has the potential to impact on innovation in indirect ways as well, in particular from better information flow with customers, suppliers and partners as well as other enterprise departments.

What are likely to be the main impediments to IT investment in your company over the next three years? Choose up to three responses.

(% respondents)



Source: Economist Intelligence Unit



Thinking big

Midsized companies and the challenges of growth

No panacea

IT vendors have indeed begun to grasp that midsized firms are a category of business unto themselves, with unique needs. Few are any longer forcing large enterprise packages down their throats, and are making cheaper, more flexible CRM, ERP and other enterprise systems available to them. They'll have to be cheaper, because cost will restrain the IT spend of many midsized customers. Asked to list the top three barriers to their IT investment over the next three years, a substantial majority (63%) cited the cost of new systems and their implementation ahead of all others. The limited IT budgets typical of small and midsized firms, and fierce internal competition for funds, also mean that other business priorities will often take precedence over IT investments.

Technology is only as good as the people who manage and use it. Over one-fifth (22%) of global respondents say that ineffective IT management will impede investment. Even more cite a lack of adequate IT skills among employees, and more generally employee resistance to change. More importantly, the ineffective use of technology will limit the impact of new systems that are deployed.

There are no magic solutions to addressing such problems. As in most other areas of operation, it boils down to good hiring, employee retention and training. Says Mr Kumaran of MTR Foods: "You need good people to implement technology, so you have to either bring in capable people or train the existing people. We chose to adopt technology in a way that the existing people could grow into it".



Conclusion

Pity the typical midsize business. It lacks the visibility, resources and influence of its larger rivals. These disadvantages often make it difficult for it to compete not only for customers, but also for talent, finance and sometimes even the attentions of suppliers—weaknesses that are often magnified in foreign markets. Yet it is too big to attract the attention of policymakers or qualify for financial assistance from government.

Happily, the prospects for growth and recognition are getting brighter. Government assistance may not be forthcoming, but globalisation is providing midsize companies with unparalleled opportunities to grow in ways that had previously been open only to the big

players. Our research confirms that they have every intention of pursuing these.

But can they grow while retaining the distinct operational advantages they enjoy vis-à-vis large firms? Can they become as expert as their big rivals at managing business across borders? The effective use of more sophisticated technologies may help them achieve this, at least in part. For Mr Whiting of Phones4u, though, the most critical task is clear: “It’s to invest in our people. Having the best people and the best skills will differentiate us going forward. This is all supported by IT, good supply chain management systems, strong deals and locations. But investing in people is absolutely key”.

Appendix: survey results

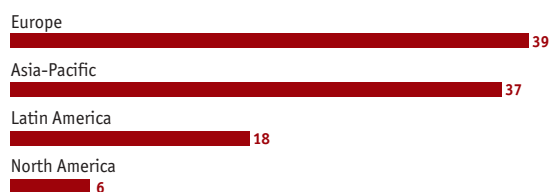
Thinking big
Midsize companies and the challenges of growth

From October 2005 to January 2006, the Economist Intelligence Unit conducted a survey of 3,722 executives of midsize companies from 18 countries in Europe, Asia-Pacific and the Americas. Our sincere

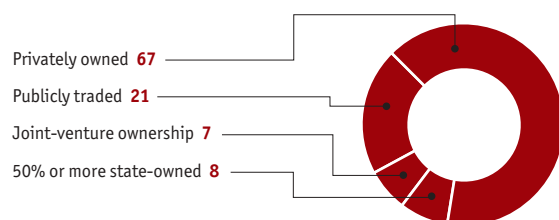
thanks go to all those who took part in the survey.

Please note that not all answers add up to 100%, because of rounding or because respondents were able to provide multiple answers to some questions.

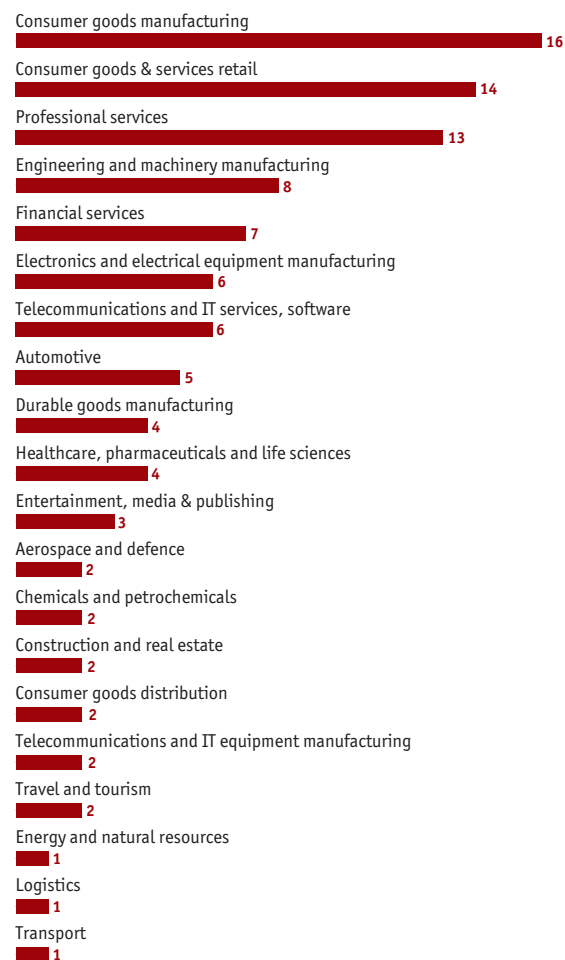
In which region are you personally based? (% respondents)



What is your firm's ownership status? Select all that apply. (% respondents)

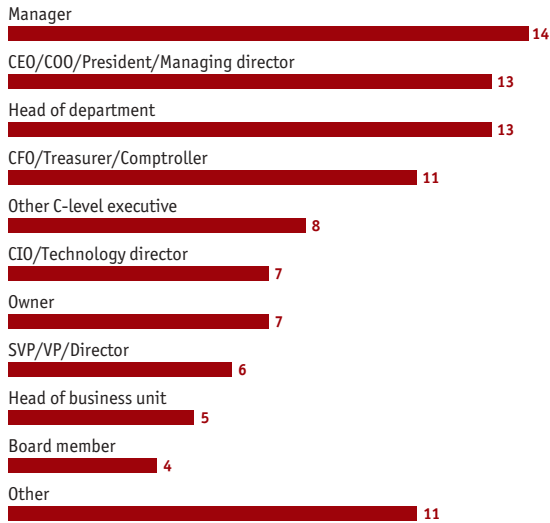


In which sector does your organisation belong? (% respondents)



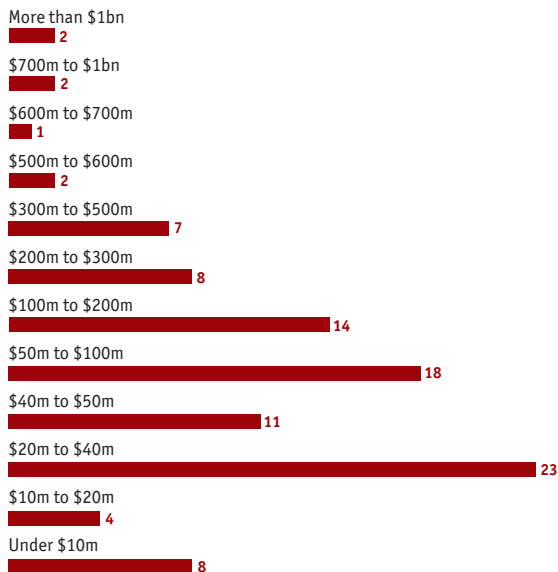
Which of the following titles best describes your job?

(% respondents)



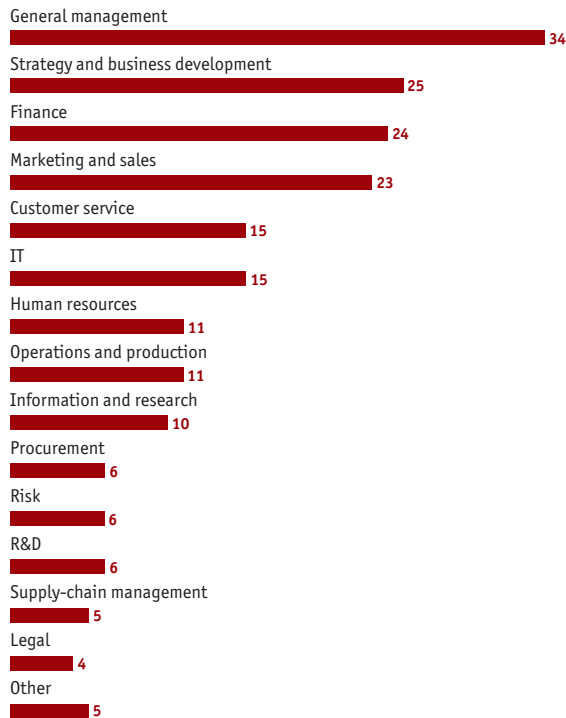
What is your company's annual turnover in US dollars?

(% respondents)



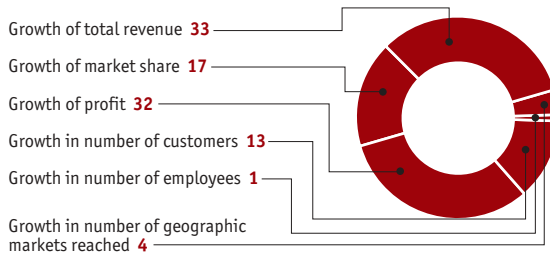
What are your main functional roles? Choose up to three responses.

(% respondents)



In your company, what is viewed as the single most important measure of growth? Select one only.

(% respondents)



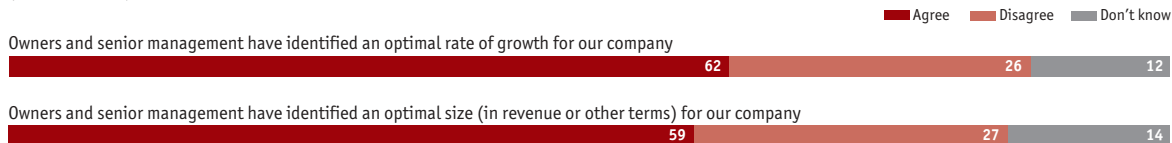
Appendix: survey results

Thinking big

Midsize companies and the challenges of growth

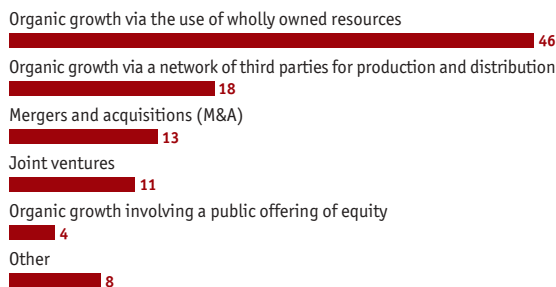
Please indicate whether you agree with the following statements about your company's size and growth.

(% respondents)



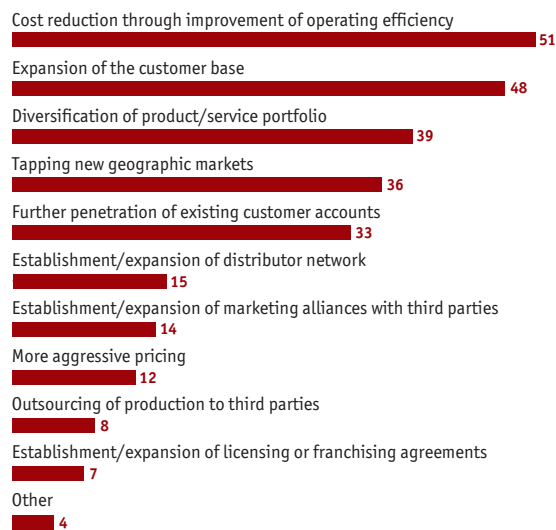
Please characterise the primary type of growth strategy that your company will pursue over the next three years.

(% respondents)



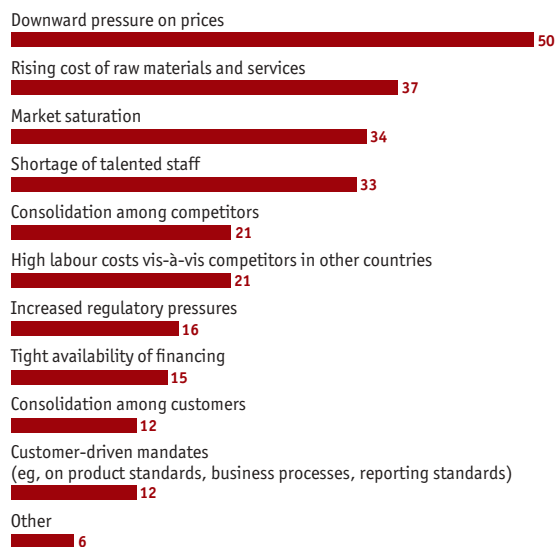
What are the most important ways in which your company will implement its growth strategy over the next three years? Choose up to three responses.

(% respondents)



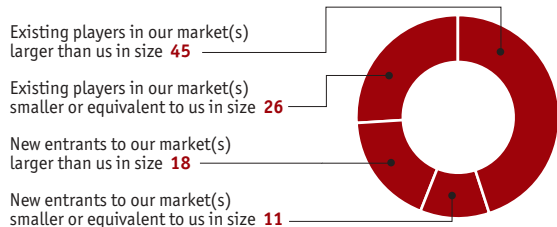
What do you believe will be the most serious impediments to growth in your key markets over the next three years? Choose up to three responses.

(% respondents)



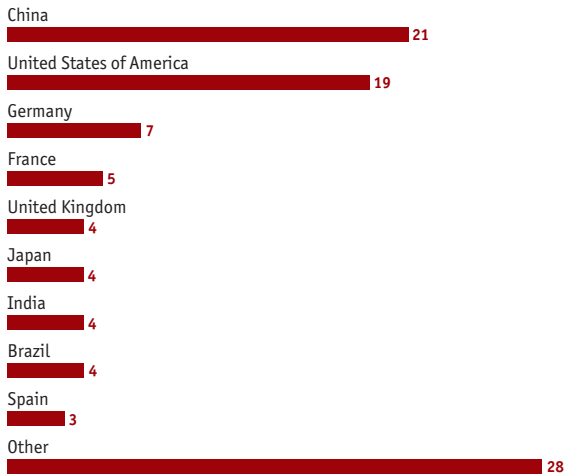
What types of firms are likely to pose the main competitive threat to your company over the next three years? Select one only.

(% respondents)



**Competitors from which country are likely to present the biggest threat to your company in your existing market(s)?
Select one only.**

(% respondents)



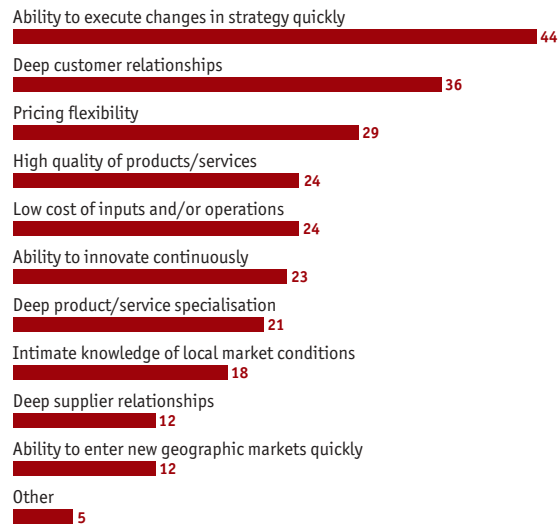
To what extent does your company enjoy the following types of competitive advantage vis-à-vis firms of different sizes?

(% respondents)



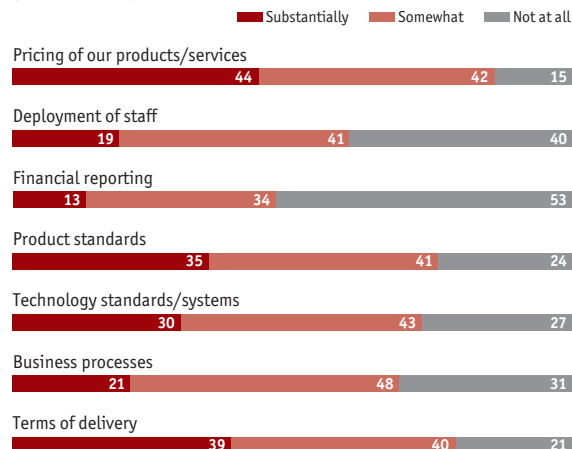
**In your view, which of the following attributes is most likely to erode as your company expands in size?
Choose up to three responses.**

(% respondents)



To what extent will large customers come to dictate the following aspects of your company's operations over the next three years?

(% respondents)



Appendix: survey results

Thinking big

Midsize companies and the challenges of growth

How would you characterise the risk of your company becoming, over the next three years, overly dependent on a few large customers or suppliers?

(% respondents)

■ High risk ■ Medium risk ■ Low risk ■ We're already overly dependent

A few large customers, for revenue



A few large suppliers, for key inputs



Please indicate whether you agree with the following statements about the role of information technology (IT) in your company.

(% respondents)

■ Agree ■ Disagree ■ Don't know

IT strategy is closely integrated with business strategy



Achieving competitive advantage is dependent on IT



IT is critical to our ability to grow



IT is critical to our ability to attain or retain flexibility of operation while continuing to grow



IT is critical to our ability to improve customer relationships



IT is critical to our ability to interact with suppliers and partners more effectively



IT is critical to our ability to innovate continuously



Please indicate whether your company's current IT infrastructure and systems meet business requirements in the following areas.

(% respondents)

■ Meet requirements ■ Do not meet requirements ■ Don't know

Scaling up to accommodate growth of business



Conforming to business process requirements set by customers or suppliers



Conforming to government-mandated reporting and other standards



How influential are the following executives in key decisions your company makes on IT?

(% respondents)

■ Very influential ■ Somewhat influential ■ Not influential ■ Don't know

Owner/board members



Chief executive/managing director



CIO/CTO



CFO



IT manager



Line-of-business managers



What are likely to be the main drivers of IT investment in your company over the next three years? Choose up to three responses.

(% respondents)

Need to accommodate growth of the business



Inadequacy or obsolescence of current IT systems



Pressures on operating efficiency



Need to support company's competitiveness in global markets



Need to support company's competitiveness vis-à-vis larger firms



Increasing concerns about information security



Need to enable adaptation of business model



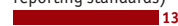
Need to create or maintain ability to innovate continuously



Increasing regulatory and reporting requirements



Mandates by key customers or suppliers (eg, on business processes, reporting standards)

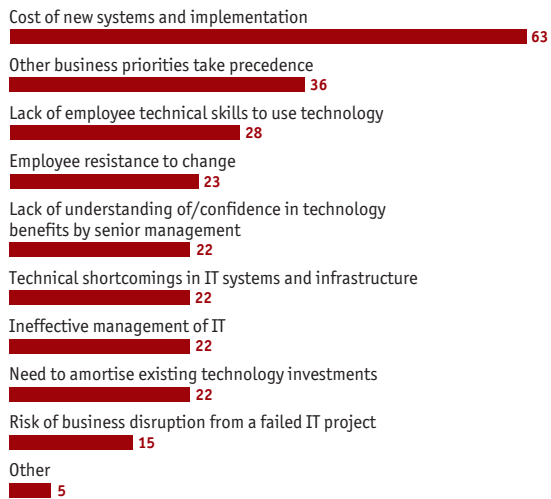


Other



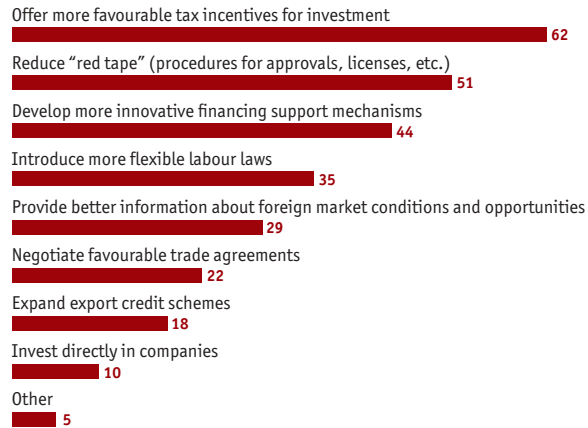
What are likely to be the main impediments to IT investment in your company over the next three years? Choose up to three responses.

(% respondents)



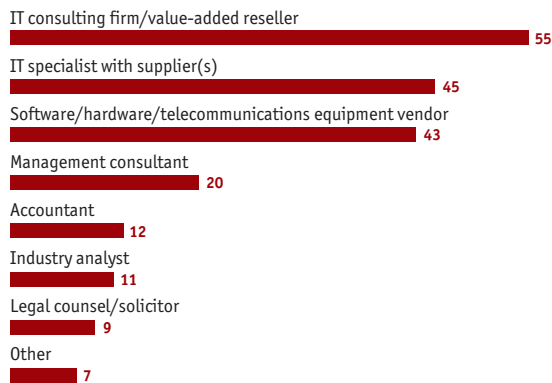
In your view, what will be the most effective ways that government can help midsize companies grow over the next three years? Choose up to three responses.

(% respondents)



To whom does your company typically turn for external assistance on IT matters? Select all that apply.

(% respondents)



Whilst every effort has been taken to verify the accuracy of this information, neither The Economist Intelligence Unit Ltd. nor the sponsor of this report can accept any responsibility or liability for reliance by any person on this white paper or any of the information, opinions or conclusions set out in the white paper.

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