Private company issues and opportunities: What to consider in 2015

A mid-market perspectives report
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Executive summary

As the US economy continues to build positive momentum, it’s no surprise that private companies are adjusting their growth strategies to capitalize on a strengthening market for their goods and services. In fact, our most recent survey of mid-market executives last fall showed noticeable upticks across a broad sweep of indicators, from hiring plans to merger activity to global expansion.

The following report captures some of the most pressing issues privately held companies are facing in the current operating environment. However, we wanted to go beyond problem identification to underscore the opportunities companies can seize by addressing these issues in proactive and systematic ways.

In the pages that follow, Deloitte professionals share their thoughts about key decisions business leaders may be considering — or should consider — in the coming year. The 12 issues they cover address three core aspects of running a successful private company in today’s operating environment: growth, technology, and risk.

The articles on growth capture the various ways closely held companies are investing to win business and boost topline performance. Our piece on talent explores strategies private companies can adopt to acquire skilled workers. Mergers and acquisitions are another means for deploying capital, and we outline steps companies can take to position themselves to evaluate potential targets. For those companies considering global expansion, we address how companies can balance slowing growth overseas with loosening trade restrictions and pro-growth incentives in select markets. Separately, we examine why mid-market companies may find this to be a good time to obtain financing, and we provide tips on how they can bring discipline and accountability to their capital spending decisions.

Of course, private companies aren’t merely looking to grow — they are striving to grow profitably. Many mid-market leaders report exploring new technologies to make their workforces more productive, acquire new customers more efficiently, and pinpoint cost-cutting opportunities.

Our 2014 technology survey of middle market executives found that senior company leaders generally remain confident in their knowledge of their organization’s IT situation and needs, but they also reported a range of challenges in implementing technologies. In separate articles, we highlight the issues private companies are facing in using cloud-based services, tapping social media communities, mining data with analytics, and testing new additive manufacturing technologies (3D printing). Our consultants share their thoughts on how to obviate the challenges and apply these innovations to address some of the hurdles related to talent, M&A, and other areas supporting growth.

In our third and final section, the report tackles the potential risks that can accompany growth and technology initiatives. In the first article, we stress the importance of private companies moving from “mom-and-pop” style governance to more structured processes designed to manage risk holistically. We demystify succession planning by highlighting how this multi-disciplinary process bridges many aspects of running a business. We end this section with a discussion of strategies for defending against and dealing with increasingly sophisticated cyber threats.

Throughout, our Deloitte professionals place particular emphasis on identifying opportunities that overlap these critical dimensions, and ask questions that can help set the middle market agenda for the coming year. By covering a wide stretch of the operating landscape, we hope this report gives privately held companies fresh ideas about how to turn some of 2015’s biggest issues into new opportunities.

Roger Nanney
National Managing Partner
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Private company issues and opportunities
Overview
It’s open season in the hunt for talent. A US economy that continues to distance itself from the recession is churning out more than 200,000 new jobs each month,\(^1\) putting upward pressure on wages and making it tougher to keep other companies from poaching workers. The tightening of the talent supply and increase in demand is exacerbating challenges many private companies were already facing: how to find people with the right skills to help keep growth on track.

These challenges are coming to a head as middle market companies ramp up their hiring efforts. More than half of the mid-market executives we surveyed in the fall of 2014 expect to add more full-time employees in the coming year, and 13 percent project increases of 10 percent or more.\(^2\) In an age when many employees complain of crazy hours and little access to senior leaders, family-run and other privately held companies stand to distinguish themselves from larger corporations where workers may feel more like numbers than contributors. The year ahead presents a range of opportunities for smaller, private employers to seize on such trends and land the talent they need to fuel their future growth and innovation.

Issues
One of the more pressing talent challenges closely held companies could face is making connections between candidates and openings in tough-to-fill jobs. Almost two-thirds of the respondents in our fall mid-market survey agreed that “it is difficult for us to find new employees with the skills and education to meet the needs of our business.” One in five reported that skills shortages are suppressing their company’s growth.\(^3\)

Privately held companies may face a number of disadvantages in trying to lure such talent. For one, their pockets typically aren’t as deep as publicly run corporations. In addition, because of their smaller HR staffs, they sometimes tend to lack the capabilities and organizational infrastructure needed to be both generalists and talent experts. With fewer resources at their disposal, HR leaders at privately held companies can feel like their “want list” is a mile long, making it tough to pick a starting point.

Almost two-thirds of the respondents in our fall mid-market survey agreed that “it is difficult for us to find new employees with the skills and education to meet the needs of our business.”

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\(^2\) America’s economic engine: Opening the throttle, Deloitte, 2014.
\(^3\) Ibid.
For some sought-after talent, small or mid-market companies may not appear on the surface as appealing as working for a high-profile corporation. A lack of clarity around the value proposition of working for a mid-sized business can make it more challenging to land skilled workers who are in hot demand.

Training is another area where, despite recent inroads, privately held companies sometimes tend to underinvest. I’ve seen scores of owners at small and medium-sized businesses hamstring their HR departments by their belief that leaders are born and not made, only to see promising young leaders leave for greener pastures where their development prospects are clear and supported.

Companies without sufficient strategies around hiring, retaining and training future leaders could potentially risk leadership voids in the future. Part of this is merely a function of demographics: the younger employees who comprise the Millennial generation may make up only 34 percent of the global workforce now, but that figure will swell to 75 percent by 2025.¹ That raises the stakes for not only accelerating the development of younger workers inside organizations, but understanding what drives and motivates them.

Opportunities
In dealing with these challenges, privately run companies potentially have a leg-up on the competition because they have inherent traits that job-seekers look for: access to leaders, an entrepreneurial culture, and opportunities for advancement. But they should also be more proactive on a number of fronts to attain and retain the talent they need in today’s competitive marketplace.

Decide what you’re going to be good at from a talent perspective and own it.
To attract the right talent in this environment, you need something that differentiates you as an employer. This need could elevate talent management out of the realm of tactics and into strategy-setting. Think about the markets you’re competing in and what your company is doing to differentiate itself in those markets to help shape them. Once you know that, the next logical step is to identify the kinds of people that are going to help you develop and exploit that advantage.

For example, one mid-market company I’m working with is looking to make a mark on its industry through financial analysis and strong client relationships. Recognizing this has helped them focus their hiring efforts and associated budgets on finding people who can connect with customers and manage opportunities and risks.

Companies without sufficient strategies around hiring, retaining and training future leaders could potentially risk leadership voids.

What to consider in 2015

Spot potential and grow it fast.
Too many privately run companies I’ve worked with believe that leadership development is about identifying and grooming successors in the C-suite. In reality, successful companies have driven leaders at all levels of the organization, and when one of these critical people walks out the door, it can force the company to lose its focus as it deals with the disruption.

Treat your workforce as the growth engine of your business. Identify future leaders throughout the company and spend the time and effort to develop them. In-house training is one way companies can make reasonably certain that promising employees feel valued. In fact, in our fall mid-market survey, nearly two-thirds of the executives cited traditional internal training and development as the best way to cultivate future leaders, and covering the cost — in whole or in part — of external skills training and development was the second most-popular approach.5

Here’s another thing: if one of these future leaders comes to you announcing a job offer from another employer, engage them in a conversation about their career ambitions. Many family-run businesses, in particular, tend to fall into a “loyalty trap,” where they may feel like any employee actively looking for a job elsewhere is being disloyal to the company. You should create an open working environment where your workers feel like they can come to you and start a career conversation. In that sense, “I’m leaving” should be a career pathway as opposed to a closed door. Once you have that kind of talk with one worker, others will likely be more forthcoming about their own feelings and may be a lot easier to retain than those who remain silent.

...including 13% who plan increases of 10% or more.

63% of surveyed mid-market companies plan to increase their workforce in the next 12 months...

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5 Deloitte, America’s economic engine: Opening the throttle.

What to consider in 2015
Compete on issues other than compensation

I’m not a big believer of being the top payer in your field. I think that if you’re performing really well, you should be somewhere at the bottom of the top third or the top of the second third. You want to be competitive without going overboard.

Instead, make your workplace, as my colleague Josh Bersin says, “simply irresistible.” The companies that do the best job at engaging employees — and keeping them around — tend to do five things really well. For one, they provide meaningful work, along with the autonomy employees need to be creative and perform well. Second, they are run by effective management teams that value coaching and feedback, and help their employees slow down and appreciate how they are contributing to the big picture. Third, successful employers offer growth opportunities, enabling people to move from job to job without fear of failure. Fourth is an inclusive, flexible, and fun environment; not every company needs to offer ping pong and free food, but there are plenty of things companies can do to treat their people well. Finally, employees want to work for leaders they can trust and who have a mission and a set of values that they can appreciate and look to emulate.

Questions to consider for 2015

A strengthening job market doesn’t necessarily mean companies have to pull out their checkbooks to compete for talent. Privately owned companies can be attractive to would-be employees for a host of reasons, not the least of which is the ability to rise through the organization quickly and gain new skills along the way.

As mid-market leaders ponder their talent strategy for 2015, they should be thinking of taking advantage of these inherent advantages by asking themselves the following questions:

• Is our talent strategy aligned with our business strategy?
• Are we doing enough to cultivate the next generation of leaders and keep them engaged?
• Are our managers equipped to manage and develop world-class talent for the long term?
• Are we offering the right kinds of work/life incentives to land the right talent without offering them the biggest paycheck?
• Is our HR leadership thinking strategically about our business needs, in addition to running the day-to-day operations of HR (so the business doesn’t have to)?

It’s also important for companies in expansion mode to keep their work processes simple. Growing companies can have a tendency to add layers of oversight and complexity, whether it’s in the form of additional meetings, manager check-offs, or some other layer of bureaucracy. Resist this. Avoid over-complicating your processes, and your employees will thank you for it.

If you’re going to increase someone’s salary, consider your HR leader.

Companies can save money over the long term by making smarter talent investments and freeing up other leaders to focus on growing the business. Instead of an operator or order taker, you should consider hiring a talent strategist who is going to help you grow the business with the right talent behind it. That takes special skills, including the ability to make the company’s value proposition “sing” in the market, to forecast the kinds of capabilities the organization is likely going need to add in the future, and to develop new ways to reach prospective employees.

Overview
By many measures, the environment for corporate mergers and acquisitions couldn’t be more accommodating as 2015 kicks off. Interest rates remain low and balance sheets are strong, providing companies with easier access to capital. Picking up the meaningful acceleration in growth witnessed in 2014, many companies are now looking to expand into new markets or product lines to fuel future expansion. In addition, there’s ever-increasing competition, an outgrowth of low inflation and supply chain efficiencies engendered by customers and larger rivals.

An increasing number of privately held companies are recognizing that M&A can help them navigate through a rapidly changing operating environment and help their businesses to get better-positioned for the road ahead. In our fall 2014 survey of mid-market executives, we saw a significant increase — from 31 percent to 46 percent — in those who said their company is likely, or very likely, to purchase another company in the coming year. In addition, 28 percent believe their company will be targeted in a merger, more than double the previous tally six months prior.1

Some companies see corporate combinations as a way to move overseas by tapping into emerging consumer classes in Asia, South America, and other regions. Some see it as a vehicle to expand product offerings, expand their customer base, increase manufacturing capacity, or even acquire needed talent in their existing markets. And, there are yet other companies that see mergers and acquisitions as a way to consolidate their supply chain and take better control of the delivery and handling of supplies and products, thus fortifying their strategic position.

Issues
Many closely held companies are ramping up their M&A capabilities and are collecting additional, valuable experience in acquiring companies. In fact, our fall 2014 middle market survey found that a majority of the companies that engaged in M&A activity had engineered at least two transactions over the prior 12 months.2

And yet, a sizable contingent of privately run companies rely in the main on organic growth and have yet to build the internal infrastructure and skills needed to make M&A a go-to strategy in their menu of growth options. The leaders of these companies tend to focus more on their customers and their suppliers than on the competition; pound for pound, they rely on knowing their businesses better than anyone else. Acquisitions require a different kind of knowledge — a 360-degree view of the competitive landscape and a deep understanding of valuation and financing methods.

When it comes to considering, initiating, completing, and then integrating a merger or acquisition, larger public companies have the benefit of in-house expertise. These large corporations might have a manager or several managers embedded within the organization who have deep experience in identifying corporate targets, performing due diligence and preparing for Day 1 readiness. They also might have experience in integrating another company and therefore capturing the manufacturing or operational synergies that likely attracted the company as an acquisition target in the first place.

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1 America’s economic engine: Opening the throttle, Deloitte, 2014.
2 Ibid.
Another challenge for closely held companies considering a corporate combination is that their businesses have been built with a specific personality and a certain emphasis on culture. This might make it more difficult to acquire another company and assimilate them so that the two personalities are melded together without compromising their original identities and resulting success in their respective markets.

**Opportunities**

There are some common steps that family-run and other privately held companies can take to help them get positioned to evaluate potential targets, and acquire and integrate companies to achieve their desired ends.

For starters, such companies should evaluate if they are positioned to take advantage of potential M&A opportunities. This capability begins with building market awareness. Most public companies make it an annual — if not more frequent — commitment to assess the landscape for potential merger and acquisition targets, and privately held companies would be wise to follow suit in the current environment. Even if they go through this exercise every two years, they will begin to build greater knowledge of potential opportunities.

Because many closely held companies are more inwardly focused on their customers and suppliers, trusted relationships with investment bankers, private equity firms or other outsiders who monitor the industry and provide a broader view of activity and strategic imperatives across the industry landscape than most companies can develop independently are important. This insight is critical in moving quickly when an opportunity arises — again, an important factor in the currently active M&A market where candidates are likely to field multiple offers.

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**In our latest survey of mid-market executives...**

- **46%** said it’s likely they will purchase another company in the coming year
- Only **31%** said the same thing six months ago
Questions to consider for 2015

Mergers and acquisitions can be a critical way to grow a business — large or small. They can open up new markets or products or tap new capabilities or talent. But they do require commitment and discipline to unlock their underlying value. Privately held companies that are fully apprised of the M&A opportunities that might exist in the market will more often rightfully say “no” to pursuing a transaction. However, when companies do find value in going forward, being well prepared for the spectrum of issues that might arise — from valuation and culture to integration and existing customer support — can help ensure each transaction supports the strategic rationale behind it — and set the stage for many successful deals to come.

Such discipline depends on company leaders being able to answer some basic questions about their readiness to entertain a transaction. For 2015, some of the most pertinent and pressing questions for a company’s leadership to answer are:

- Have we undertaken a recent analysis of the competitive landscape, with an eye toward identifying attractive merger or acquisition candidates?
- Do we have a sufficient understanding of all of the valuation and financing methods available to us in the event we find an attractive opportunity?
- Do we have the outside relationships we would need to move quickly in the event of a transaction?
- Have we identified the right internal leaders or teams to oversee and take responsibility for mergers and acquisitions?

Another proactive step would be to designate an individual or a small team to oversee and take responsibility for mergers and acquisitions, even if only on a limited time basis. Executive leadership is critical, although often difficult to deploy in the absence of a large organizational structure, particularly in times like these when growth is accelerating and other activities compete for their time. A small team or individual could ensure that there are continual touch points with the market to identify and plan for opportunities to enhance revenues or reduce costs. Once an acquisition is made, this individual or group could also oversee workforce stabilization and communications — to new and existing employees and to customers and suppliers — as well as to help put systems and processes in place for a smooth transition.

Of course, no two deals are alike. But there are tried and true evaluation processes that have been tested through hundreds of transactions that can help a company sidestep mistakes that can erode value. In the course of working with scores of businesses that have executed M&A transactions, we have identified several best practices that have enabled privately held companies with their transactions.

A good mergers and acquisitions strategy begins with a clear understanding of the synergies each transaction hopes to capture. Cost reductions are often a factor, but many successful mergers are motivated by more — such as a vision to boost revenue or market share beyond what either company could do on its own.

As cited above, speed often is critical. It’s important to integrate correctly — and swiftly. This means that companies should create early and detailed planning, have senior management involvement, and choose between the best aspects of the combining organizations.

One of the biggest risks of a merger is letting the integration aspects distract the company from its current customer base and businesses. Rather than solely focusing on integrating business processes, companies should maintain their focus on customer support, keeping or stepping-up sales and support professionals in the field.

Finally, the need for ongoing communications is critical. Companies should communicate early and often to customers, employees, partners, investors, and, if appropriate, the media.
By Christy Wissemeier, senior manager, Expansion Services Leader, Deloitte Tax LLP

Overview
Weakness in the global economy outside the United States and a strengthening US dollar haven’t dimmed the interest or motivation for mid-sized and privately held companies in their efforts to enter foreign markets. Far from it. In our latest survey of mid-market executives in the fall of 2014, less than one-third said their companies don’t ring up any sales outside the United States, while one in five counted on international markets for more than 40 percent of their revenues.1 For companies finding it difficult to maintain consistent growth in the US domestic market, a global strategy is almost a given. Depending on their industry, companies can use foreign markets to diversify operations, reach new customers, or tap into new resources, whether material or labor.

Even if some of those markets are currently experiencing a slowdown, the potential for growth is still there. Mid-sized companies have opportunities to sell into developing countries that are loosening trade restrictions and introducing pro-growth incentives and other policies aimed at accelerating economic expansion. Overseas markets, especially those experiencing significant economic challenges, are eager to attract new employers for their talent pool. If a company is willing to put effort into understanding the potential opportunities and challenges in operating in a foreign country — such as local regulations, tax issues, and cultural differences — it may reap significant benefits.

In the end, the arguments for a global strategy still hold true, even in a macroeconomic cycle that favors US-led growth. Privately held companies have the advantage of being able to be patient, riding out periods of relative weakness, picking up investments at a slight discount, and building their overseas operations carefully. The logic behind those decisions doesn’t change just because the macroeconomic conditions have shifted.

Issues
To be sure, the global economic backdrop has been challenging. Outside of very few pockets of growth — which notably includes the United States — most favored markets for middle-market companies slowed in 2014 with little evidence of relief heading in 2015. This ongoing weakness has to factor into the strategic thinking of any globally oriented company.

For companies finding it difficult to maintain consistent growth in the US domestic market, a global strategy is almost a given.

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1 America’s economic engine: Opening the throttle, Deloitte, 2014.
What to consider in 2015

Proportionately, larger companies may have more flexibility regarding the amount of cash tied up in an international expansion, while investments by mid-market firms can represent sizable commitments that raise the stakes for achieving a return in the near term. That means that everything associated with macroeconomic conditions — especially consumer demand — has to be carefully scrutinized by company leadership. For 2015, there are a few issues in particular that deserve extra attention.

Currency volatility
A critical byproduct of this macroeconomic instability has been currency volatility and even weakness in many critical markets. The rising dollar has made US-based companies a bit more competitive as an investor, lowering the cost of plants, equipment and other infrastructure overseas. Yet that currency strength has weakened the value of sales deriving from those same markets. So far this year, weak currencies abroad have translated into lackluster sales for major US consumer products companies, and mid-market companies we work with haven’t been spared. What we are seeing is that the volatility in currency markets is being viewed as yet another source of risk — an added burden and complexity for many mid-sized companies that would otherwise be making a play in new markets.

Taxation and reputational risk
One of the biggest issues in the past year has been a greater focus on tax compliance and related regulatory demands for transparency. This has been particularly true in the EU, where high-profile examples of corporate tax planning have caused regulators and commentators to be far more sensitive about reporting and paying “fair share of taxes.” Other requirements — such as rules requiring certain transfer pricing methodologies, mandatory rotation of auditors, and proposed sharing of company results between tax authorities — have highlighted the rising sensitivity to corporate tax behavior.

In certain markets, the stakes could not be higher: Regulation can impact a company’s reputation and ability to operate. Transfer pricing and related tax structuring, for example, is one area where previously accepted tax reduction approaches are now being thoroughly scrutinized by tax authorities around the world. Our view is that mid-sized companies best operate in this new environment by proactively seeking professional advice on all aspects of the business model, not just tax reporting.

Opportunities
The current macroeconomic environment has driven many companies to take a more aggressive view towards attracting foreign investors. In our view, many mid-sized US companies can find worthy opportunities, given various incentives, policy shifts, and other economic outreach efforts. For example, Norway — which has seen the value of its energy exports drop significantly — has aggressively pursued life sciences companies in the United States (particularly in Boston). India, once wary of foreign investment, has elected a new leader who has promised a far more pro-business, pro-investment set of policies, combined with greater investment in infrastructure, more streamlining of permitting processes, and efforts to bring greater consistency to regulatory and tax requirements.

Another example is the EU Small and Medium Enterprise (SME) Initiative, which supports investments from SMEs with a number of different grants. These grants are designed to promote the goal of “investment for growth and jobs,” which is one of the Community objectives for the implementation of the European Regional Development Fund 2014-2020.
While certain countries are known for treating foreign and domestic investors on equal footing, blended approaches may be more effective to give mid-sized outsiders a strong local presence from the beginning. For example, in Turkey, we have seen mid-sized companies move in through a merger, acquisition or joint venture rather than expanding on their own, which has helped them become accustomed to doing business there while gaining immediate access to customers. Meanwhile, Mexico has opened up its energy markets for foreign investment, and the move promises to give a number of mid-sized players an opportunity that had eluded companies for decades. With the value of the peso declining steadily against the US dollar, companies will need to assess the net impact on their business before making a move.

There are also European Commission direct funding grants for SMEs available within the EU. Although there is an emphasis on EU-based businesses, mergers or even foreign investors can benefit from these grants, provided they “further the interests of the European Union” (e.g., creation of jobs within the EU). These grants may be more relevant to SMEs that are looking for foreign investment opportunities, but may not have the ability to tie up large amounts of cash over longer periods of time before investments start to become profitable. To be considered for an EC direct funding grant, SME business investments cannot already be funded 100 percent, or be funded past the breakeven point.

Currency volatility was rated as the top challenge facing treasury groups – tied with cash repatriation – in Deloitte’s latest biannual Global Corporate Treasury Survey.
Questions to consider for 2015

The strategic impetus for going global or expanding your company’s footprint has to be disciplined by careful study. The leading approach keeps in mind the ultimate goal — where you and your organization want to be in three to five years in a given market. Certain markets are ideal for a manufacturing-driven strategy, while others are more labor-focused, demanding a different level of scrutiny. Any investment meant to spur sales growth outside the United States is going to require a certain level of insight into macroeconomic conditions, tax policy, and transfer pricing rules, as well as an awareness of currency conditions.

In the year ahead, privately owned companies considering international expansion should be able to answer a number of key questions before deploying capital and making any significant moves:

- Has your company reached the point where growth in the domestic market is becoming more difficult to achieve and global expansion may be an option?
- What strategies do you employ to educate yourself on new markets, quickly develop relationships with key regulators and policymakers, and ease the transfer of knowledge from development teams to the production floor?
- Will cost-driven global strategies — especially around resources — be materially affected by changes in certain target markets when their economies rebound?
- Is your tax reporting structure able to endure enhanced scrutiny from outside regulators?

If they aren’t already doing it, closely held companies should explore currency hedging strategies to see if they make sense in their specific industry or business orientation. Currency volatility was rated as the top challenge facing treasury groups — tied with cash repatriation — in Deloitte’s latest biannual Global Corporate Treasury Survey. There may be specific issues tied to the business worth analyzing. Family-owned businesses, for instance, need to consider the impact hedges might have on their cash flow and/or their ability to pay dividends. Finance leaders also need to take a hard look at the mix of their revenues and expenses attached to overseas business. Those who are producing in the United States and exporting to slowing markets overseas may consider moving some production to take advantage of the strong dollar, which shows no signs of significant weakening in the near term.

Before spending capital to expand capacity outside the United States, companies need to assess the risks and challenges tied to moving operations elsewhere. All too often, businesses underestimate the challenges associated with transferring know-how from domestic production facilities to those overseas. They may have identified a potential opportunity to take advantage of low-cost labor in a rapidly developing economy, but fail to plan how their production process will transfer to the factory floor. Companies mulling an overseas move need to plan ahead for the interdependencies between development and production, and how geographic separation between the two will impact their learning methods for transferring production knowledge.

There are also steps privately held companies can take to address the increasingly complex regulatory environment in key overseas markets. That process includes sizing up the full suite of registration requirements, meeting with local officials so they understand your business and value proposition, and understanding how local and national regulators operate and enforce their rules. The goal is to see regulatory behavior as an essential part of your brand in these markets.

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Growth

Financing

By John Deering, managing director, Deloitte Corporate Finance LLC

Overview
Heading into 2015, it is difficult to recall a more attractive financing environment for privately owned companies. The strengthening economic recovery has improved their balance sheets with increased collateral values and growing cash flows, which such companies typically use to secure expansion capital. At the same time, competition is heating up among creditors who lend to the middle market — both traditional and nontraditional — as they feverishly look to put uninvested capital to work.

While these trends can make privately owned companies less vulnerable to interest rate fluctuations, such firms can’t exactly borrow to their hearts’ content. Even with the flood of funds available, banks and other creditors who traditionally lend to privately held firms have restrictions in place for how much leverage they can extend to any one borrower, and they also tend to limit the use of debt proceeds. Fortunately, an emerging class of creditors is stepping into the current financing landscape to give closely held companies greater borrowing bandwidth and flexibility with what they do with the cash proceeds.

Issues
The asset-based lending (ABL) market is a very active area right now in the middle market. In our fall 2014 survey of middle market companies, asset-based financing claimed the top spot as the most likely mode of financing midmarket companies will pursue this year.1

While such financing carries some of the lowest costs available, it is not without limitations. For one, it is a somewhat restrictive form of debt; Most ABL lenders will lend in excess of the borrower’s collateral — a so-called “airball” — but will rarely go beyond 25 percent or 30 percent of the total loan amount to a business. In addition, this tranche of debt typically carries strict amortization requirements of less than three years. In today’s strengthening business environment, many privately owned businesses need more capital than their assets will support, and these kinds of lending restrictions can act as governors on their growth potential.

In addition, many business service companies are “asset light” and are not considered as candidates for the low-cost ABL structures.

Finally, privately held companies will be challenged in the year ahead to prove to lenders that they have addressed risks that have traditionally kept some creditors away. Many smaller businesses don’t have the financial staff and internal controls that lenders like to see. Key person risk — or the risk of a CEO or owner leaving the business — is another concern lenders typically have about closely held companies, particularly family-owned enterprises.

1 America’s economic engine: Opening the throttle, Deloitte, 2014.
Opportunities
Fortunately, there are several market dynamics working in favor of privately held companies as they seek additional financing.

The most significant of these is the emergence of a new crop of creditors. The past several years have seen the rise of business development companies — or BDCs — in the middle market space. A BDC is a publicly registered company that provides financing to small and mid-sized businesses, with the loan and investment objectives of income generation and capital appreciation. BDCs will typically provide debt structures but, on occasion, will take an equity stake as part of their overall financing solutions. The universe of publicly traded BDCs has multiplied over the past five years or so, growing from just a handful to more than 20. The proliferation of BDCs is creating additional competition for borrowers, generating better terms for middle market clients.

Increasingly, that competition is also coming from private equity firms. Worldwide, private equity shops are sitting on more than $300 billion in uninvested capital commitments and the middle market is one place they are looking to put this “dry powder” to work. In Deloitte’s fall survey of mid-market executives, we saw a significant increase — from 12 percent to 20 percent — of those who see a private equity firm as the most likely counterparty in a merger or acquisition.

In the case of BDCs and PE firms, the cost of capital is typically higher than with “go-to” funding sources — those institutions that provide asset-based loans or cash-flow financing, but these lenders also offer much greater flexibility in what borrowers can do with the proceeds. In addition, their time horizons for expected returns tend to be longer, enabling business leaders to invest the money in a broader range of opportunities or return capital to shareholders by way of dividends. Recently, we helped secure BDC financing for a client who needed to fund the buyout of a minority shareholder, an option that likely would have been off the table just a few years ago because fewer financing options and limited competitive pressures gave creditors more leverage to push borrowers to use debt proceeds for growth-related investments.

Privately owned companies can do a few things to make themselves more attractive to such creditors. Because these new entrants tend to base their capital decisions on multiples of earnings rather than collateral, they are keenly focused on the strength of the management team and the sustainability of cash flow. Would-be borrowers should ensure that their top leaders have established a track record of solid growth over the past few years, and that their historical financials exhibit positive trends. What’s more, projections for future growth should be disciplined and well-supported.

Finally, privately owned companies should be proactive when addressing lender concerns about internal controls and key person risk.

Most lenders to the middle market are very dependent on third-party accounting work. In the past, they relied on the companies themselves to generate financial reports only to see their financial personnel take months to produce them — a huge red flag for the state of their internal controls. Today, leading mid-market companies are anticipating such demands and outsourcing such due diligence ahead of time. That way, they are able to unearth any surprises early in the process, keeping the transaction on track.

Privately owned companies should be proactive when addressing lender concerns about internal controls and key person risk.
In our fall 2014 mid-market survey, **asset-based financing** claimed the top spot as the most likely mode of financing mid-market companies will pursue this year.

### Asset-based financing

- Cash flow financing
- Private sources
- Internal sources
- Secured loans

In the same vein, many privately owned companies are making themselves more attractive to lenders by delegating more authority to their senior managers, helping financing parties view the company as more of a team rather than one person at the controls.

#### Questions to consider for 2015

Privately owned companies are looking at one of the best periods ever for accessing debt, with traditional funding mechanisms plentiful and new financing partners competing for borrowers. While there are still constraints on how much such companies can borrow and what they can do with the proceeds, finance chiefs can improve their positions and gain greater flexibility if they plan ahead and address creditors’ likely concerns.

In the year ahead, that planning process should begin with an assessment of how their company is able to answer the following questions:

- Have we established a solid track record of performance over the past few years?
- Are we able to access the level of funding we need to grow our business to its full potential?
- Have we considered extending our financing search to alternative sources such as BDCs or private equity partners?
- Are our projections for future earnings and cash flow robust enough to secure additional financing?
- Do we have the proper internal controls needed to win fresh financing?
- Do we have key person risk at our company, or have we minimized it by delegating authority and building a robust succession plan?
Overview
In the uncertain economy of the past few years, an atmosphere of caution pervaded the capital spending habits of privately held companies. In 2014, that hesitancy began to subside, bolstered by a growing economy and dissipating uncertainty. Companies that for the past several years focused on controlling their cost structures and reducing expenses now see opportunities to extend their geographic reach, broaden their product offerings, and acquire competitors.

As they switch from a cost-containment to growth strategy, private companies confront an increasingly complex set of tradeoffs. A Deloitte survey of financial executives at more than 2,000 closely held companies identified deploying capital as their greatest challenge, surpassing other related issues such as raising capital and deploying it to shareholders.1 Faced with financial political and regulatory uncertainties, these executives are struggling to adjust to the new capital spending environment.

Issues
One of the biggest challenges faced by privately held companies as they begin exploring avenues for deploying capital is the lack of an adequate planning process. Most of the executives we surveyed said they were not confident that they were effective in planning their capital decisions. They worried they were leaving value on the table. To help improve the effectiveness of their capital spending processes, executives should balance the interests of their key stakeholders, which often involves making difficult trade-offs. As they embrace more robust capital spending, companies should also adopt new objectives and risk profiles that affect the business. At the same time, businesses need to be careful not to be overly confident and underestimate risks.

Even if they get the risks and assumptions right, companies must focus on delivering the intended value of a spending project. In other words, they need to demonstrate that their capital spending is worthwhile. Implementing accountability for capital decisions, however, can also pose a challenge for private companies.

Without the right planning process, deployment decisions become more difficult. For many closely held companies, the focus of their capital planning comes down to whether to expand their business organically or through acquisitions. In the current economic environment, mergers and acquisitions are making a comeback, as companies become more willing to finance rapid growth. However, the decision-making process behind acquisitions is often one with which many private companies have less experience. It tends to be more fast-paced than a conventional growth strategy, and the pressure of an acquisition can lead to mistakes if executives don’t evaluate options and make decisions properly.

Faced with financial political and regulatory uncertainties, executives are struggling to adjust to the new capital spending environment.

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While mergers and acquisitions often dominate discussions of how companies should deploy capital, other decisions can be more tactical. For example, companies may consider whether to take on debt or return more cash to their investors. As basic as these decisions may be, many private company executives said they struggle with how to address them in the context of their larger capital allocation planning.

Opportunities
A step companies can take to improve their capital deployment process is to examine the decision-making process itself. It may sound simple, but how companies make decisions can have more to do with the success of that decision than the execution. Too often, capital spending decisions are made in response to vague directions from top executives. Good decisions often start with specific guidance from the top — think of it as the company’s “value architecture” — and they are supported with data that demonstrates why the decision is appropriate — think of this data as the key performance indicators that flow from the value architecture. Decisions should be supported by an understanding of how an investment will impact the company’s value.

Without good analytics, a capital investment can quickly become a mess. As the capital team begins to explore the decision, they should analyze the data upon which it is based. Often, executives promote the first idea they come up with. A defined process that evaluates risks and assumptions will help determine if that first idea is a good one.

The decision-making, though, can’t be limited to an executive’s own ideas. Companies that effectively plan for capital spending incorporate a broad range of input from all stakeholders to evaluate risks from all perspectives. One key question that should be asked by every stakeholder is: “How could this go wrong?” That will typically lead to a discussion of alternatives.
And while most companies want to pick the best idea, they also should consider whether they need a gold-plated solution to every problem. In some cases, a lower cost solution may be equally effective in achieving the goal, and it may reduce the risk as well.

As the spending decision moves through the review process, there should be milestones and benchmarks included that will be monitored over the life of the project to ensure it stays on track. This infuses a greater sense of accountability into the process and can help generate metrics that may be useful in the next capital deployment decision.

Once companies have the proper decision making in place, they will find it easier to implement spending plans. In weighing potential acquisitions, for example, executives need to conduct an honest assessment not just of the deal itself, but of their ability to complete it. It’s important that executives don’t allow themselves or their subordinates to “fall in love” with a deal that they don’t have the organizational capability to complete.

Privately held companies should recognize the complexity of acquisitions, in terms of both finances and numbers of people required. The potential warnings that can be raised by an effective decision-making process can help companies determine if they can achieve their goals for growth without buying another company.

Similarly, an effective decision framework can help private companies address the capital structure of their organizations. Effective decision making, for example, can help a company evaluate whether it should issue debt, explore the importance of paying a dividend, or if investing in the future of the business should be given greater priority. While this doesn’t apply to all private companies, the overall principle of setting priorities for capital is the same. In assessing the best uses for capital, executives may want to determine where they see the company in five years, then determine the key drivers for getting there. Will they need capital to grow the business? If so, what’s the range of capital that might be needed? Will acquisitions be necessary? And how will growth affect the cash that’s needed to run the company in the ordinary business cycle? Answering these questions can help private companies determine the appropriate level of debt, dividends and other capital deployment needs.

Questions to consider for 2015
With interest rates remaining low, the pace of transactions increasing and the economy accelerating, privately held companies are facing a range of opportunities for deploying capital. As they shift from the cash conservation strategies implemented after the recession, the proper decision-making framework can help them make more effective capital deployment decisions.

To ensure that they’re making the proper decisions, private companies can ask themselves some key questions:

- Are we gathering the proper value-based data we need to build metrics for our decision-making process going forward?
- Once we adopt a strategy, are we effectively considering ways the strategy could go wrong?
- Is there a cheaper alternative to each decision that may achieve our goal with equal effectiveness?
- Do we have adequate milestones to monitor our spending projects and ensure they stay on track?
- Do we have the skills we need to complete the projects we plan to take on?
Technology

Cloud computing

By David Evan Moore, principal, NetSuite Practice Leader, Deloitte Consulting LLP

Overview

Advances in cloud computing are creating broad new opportunities for privately held companies constrained by IT budgets. Web-based tools and applications that manage sales, planning and other labor-heavy responsibilities are already complementing traditional, on-premise computing services or replacing them outright. With adornments such as automatic updates and plug-and-play ease, cloud-supported tools are becoming must haves for IT managers in the middle market.

Clearly, confidence in the capabilities of cloud computing continues to grow. In Deloitte’s most recent survey of technology trends among middle market firms, seven in 10 respondents said their companies had embarked on some degree of cloud computing, from pilot projects all the way to mature, successful off-premise cloud operations.1 By 2018, Gartner predicts about a third of service-focused firms will shift the majority of their enterprise resource planning (ERP) applications to the cloud. Within a decade, some organizations will see all of their ERP migrate to the cloud, according to the same projections.2

Just like any new purchase, users need to familiarize themselves with the instruction manual. As enthusiasm for cloud computing spreads from applications for sales, customer relations and talent sourcing technologies to full ERP applications, so have complications in managing cloud adoption across business systems. IT leaders should approach investments in the cloud as they would any other business decision — with a formal strategy for acquiring the technology, adapting it to evolving business needs and evaluating its success on a continuing basis.

Issues

Certain challenges in adopting cloud technologies are better not left to troubleshooting, but managed in advance of any major cloud implementation. If these issues are carefully and sufficiently addressed, cloud solutions stand to significantly reduce costs, add flexibility, better manage employees and protect privacy and sensitive information.

All too often, technology purchases are made in isolation, with some IT leaders making decisions without assessing the needs of individual business units or teams or vice versa, where the business unit makes a purchase without including IT in the decision. In other cases, some IT departments are restrictive, applying a one-size-fits-all model to IT investments and curbing department-level autonomy to select technology vendors. These IT pitfalls may be exacerbated when companies move to the cloud, however. In the hybrid IT environment, cloud applications are matched with other cloud solutions and technology managers are seeing their roles change from service provider to service assembler; however, problems surface when these changes occur at organizations with no central strategy to manage the technology.

Even at startup technology firms, organizations that are frequently among the best suited for cloud-based solutions, cloud adoption can get derailed by poor communication. The harmful effects are clear: the most innovation-friendly organization can spoil well-intentioned efforts to embrace cloud computing if no formal strategy exists.

A related concern for middle market firms is appropriate procurement procedures for cloud-based applications. When establishing a relationship with a new vendor for off-premise services, auditors should be called in to support the process and ensure that data, roles and responsibilities are managed properly.

While cloud providers have succeeded in convincing customers their solutions are out-of-the-box ready, service-level agreements shouldn’t be taken lightly. Performance issues for cloud solutions need to be monitored. There have to be contractual consequences when providers don’t meet pre-negotiated standards. And there should also be a role for legal departments to ensure expectations meet the needs of parties.

1 Technology in the mid-market: Perspectives and priorities, Deloitte, 2014.
What to consider in 2015

Some of the most fertile ground for cloud-based solutions for middle market companies can be found in ERP applications. These solutions bundle capabilities such as finance, manufacturing, and supply chain management, handling otherwise dissimilar business functions in common, secure environments in the cloud. Three out of four respondents in our most recent survey of middle market firms said they were considering shifting ERP functions to the cloud or had already made the move. Among industries, Gartner projects that segments such as professional services and digital media will be among the businesses that adopt integrated ERP suites at increasing rates within the next five years.³

Cloud computing is on the rise.

- **34%** in deployment phase (vs. 26% in 2013)
- **24%** have pilot projects started or planned (vs. 21% in 2013)
- **14%** report mature, successful deployments (vs. 9% in 2013)

Perhaps one of the biggest expectations placed on cloud vendors is data integrity. As growing numbers of middle market firms place financial, employee, and operations information in the cloud, data integrity remains a source of unease — but confidence is building. In our recent technology survey of middle market firms, 38 percent of respondents said they believed they might not be able to ensure integrity and reliability of data in the cloud.²

Building a cloud-ready environment to handle needs across business functions isn’t all challenges, however. Opportunities for success abound as the middle market enterprises utilize, deploy, and investigate cloud-based services.

Opportunities

Some of the most fertile ground for cloud-based solutions for middle market companies can be found in ERP applications. These solutions bundle capabilities such as finance, manufacturing and supply chain management, handling otherwise dissimilar business functions in common, secure environments in the cloud. Three out of four respondents in our most recent survey of middle market firms said they were considering shifting ERP functions to the cloud or had already made the move. Among industries, Gartner projects that segments such as professional services and digital media will be among the businesses that adopt integrated ERP suites at increasing rates within the next five years.⁴

² Deloitte, Technology in the mid-market, 2014.
Respondents to our mid-market technology survey indicated they prefer the benefits of the cloud for ERP needs: automatic updates, uninterrupted service, and hosting capabilities which free up IT budget normally used to maintain systems.5

Merger and acquisition activity in the middle market will likely continue to offer instructive business cases for cloud computing. Many scenarios play out like this: technology firms pick up new acquisitions at home and abroad and eventually spin the companies out as new entities. The new businesses may then take advantage of applications such as NetSuite, Workday or Kenandy, cloud-based solutions that allow companies to integrate multiple business functions into a single system.

Talent management is yet another promising, developing area of opportunity in the cloud ecosystem. In the recent mid-market technology survey, around one in five respondents said they had already moved human resources functions to the cloud. Just over half said they were in the process of moving talent tasks to the cloud or considering it.6

Questions to consider for 2015

Cloud computing is affording new possibilities to mid-sized firms to transform function-level gains into enterprise-wide achievements. Companies in this segment are clearly receptive to the shift towards the cloud. Privately held firms that are considering moving their operations from the ground to the cloud should consider these questions:

• Do we have a formal strategy for procurement that allows us to manage, evaluate and pivot to new technology as business needs emerge?
• How can cloud computing help us integrate disparate functions across our business in order to maximize competitive advantage?
• What safeguards exist to ensure data integrity and reliability once our company moves sensitive, proprietary information to the cloud?

5 Deloitte, Technology in the mid-market, 2014.
6 Ibid.
By Eric Piepho, director, Deloitte Digital, Pioneer Square Studio Leader, Deloitte Consulting LLP

Overview
How valuable is business data if companies can’t make use of the massive amounts of information in the digital environment? Welcome to the dominant driver behind analytics: finding patterns in statistics, meaning in databases, and insight in figures that are otherwise missed by the untrained eye.

In a few short years, the concept of analytics has matured from unwieldy database mining requiring complex decoding to scenarios where vast amounts of unstructured information can be translated simply and cost effectively. Increasingly, analytics solutions permit privately held companies to punch above their weight class with rapid, detailed reporting that had been otherwise unattainable without costly investments of manpower and resources.

Two-thirds of company leaders in our most recent survey of technology trends affecting mid-sized firms said they’re employing analytics as part of their computing mix.¹ The predictive capabilities of analytics and advances that allows targeting of customers by taste, location and behavior are arming companies with better information than ever before.

Still, some companies are not ready to commit to the technology. Nearly a third of firms in the survey who had yet to embrace analytics said they think their companies don’t possess the scale or maturity level to benefit from analytics. And one-quarter of firms in this group reported that they weren’t sure how to begin to capture value from analytics.²

Issues
Analytics is by far one of the most dominant forces in information technology today, ranking prominently on the agenda among CIOs and IT managers.³ Tax obligations, consumer engagement, and manufacturing are among the myriad areas in which firms can make better decisions through analytics. But far too many companies begin the journey without asking the right questions. In the case of analytics, that should be: What specific business issue are you trying to solve?

A persistent challenge we’re seeing among closely held companies is the lack of leadership awareness about the value of analytics. About one in five executives in our mid-market technology survey said they didn’t see the business value of analytics and therefore hadn’t implemented it at their companies.⁴ Think about the missed opportunity: a customer analytics solution can convert buyer behavior information into insights that lead to sales. The information is already there, but without action the data amount to little more than numbers and figures.

Two-thirds of company leaders in our most recent survey of technology trends affecting mid-sized firms said they’re employing analytics as part of their computing mix.

¹ Technology in the mid-market: Perspectives and priorities, Deloitte, 2014.
² Ibid.
⁴ Deloitte, Technology in the mid-market, 2014.
Two-thirds of company leaders in our most recent survey of technology trends affecting mid-sized firms said they’re employing analytics as part of their computing mix.

As firms expand their footprints, they also report having difficulty folding analytics into their operations. This is especially true among larger firms that are products of acquisitions and mergers, experience in our practice has revealed. On top of the complexities of orchestrating a deal, a newly blended entity is making forecasts based on distinct historical patterns of the constituent parts.

Signaling yet another challenge within the universe of big data, one-fifth of firms exceeding $1 billion in sales said the topic of analytics is too complex to digest at their current stage of growth, according to our mid-market technology survey.\(^5\)

The human resources function should become more sophisticated about analytics, both in information produced within the HR ecosystem as well as other areas of the business. Just under one in five mid-market executives in our survey said their companies were using or leveraging analytics in the human resources function.\(^6\) The benefits of investing in a strong analytics program within human resources are manifold: anticipation of employee departures; identification of high-potential talent; and improved integration during a merger, to name a few.

The benefits of investing in a strong analytics program within human resources are manifold.

\(^5\) Deloitte, Technology in the mid-market, 2014.
\(^6\) Ibid.
Opportunities
A common goal of analytics is to create predictive models intended to improve key business processes by helping workers make more effective decisions.\(^7\) Predictive analytics techniques can offer opportunities for privately held firms across the value chain, in business functions ranging from sales to maintenance. A well-designed analytics program can help predict equipment breakdowns and detect patterns of customer behavior, among other forecasts serving the business. In our survey, a third of respondents said the ability to predictively manage aspects of the business was the greatest value of analytics.

Customer acquisition in the health care industry offers a strong example of the opportunities for precision targeting with analytics. A client may seek to grow specific segments for the health care services they provide. Past customer profiles, for instance, only provide data for a population that the company already knows. But if you are trying to raise revenue, target a specific geography or address a certain customer segment, targeting within analytics can help a health care business design a marketing campaign to address specific segments instead of investing broadly.

Privately run and mid-market companies traditionally have had problems dealing with the complexities of data. But advances in sorting and interpreting unstructured data are far more advanced today. These tasks can be done as a service, in an automated way, providing access and offering insights through platforms that were prohibitively expensive even five years ago. The democratization of these tools is helping to bring about more cost-effective data interpretation capabilities for the middle market.

So what does modern-day analytics look like in practice? Our work at Seattle-based Banyan Branch, a digital agency recently acquired by Deloitte, sheds some light. In this case we use information from three disparate data sources: social sentiment on a topic, supply chain data from the client, and point of sale data from a major retailer. When we line up the data and see the effect of their marketing against this sentiment and geographies and their availability and supply chain, it provides some very interesting insights that you would only gather from lining up the data from three data sources. The prototype demonstrates that those who can adopt analytics will benefit, and those who don’t will fall behind.

Questions to consider for 2015
The traditional notion of big data warehousing is fading. It’s being replaced and improved by analytics capabilities that are allowing privately held firms to achieve greater understand of data that allows insight into their businesses. These privately held firms should be considering broad strategies and asking key questions as they enter this domain:

- Focusing on objectives: What is the business issue you’re trying to solve?
- Making an information inventory: What data is required to solve your business needs?
- Starting small: What business need can you begin to tackle now using analytics?
- Applying intelligence: How will you use the data once you’ve collected it?
- Considering resources: What capabilities does your company have in-house to better understand your data?

\(^7\) James Guszcza and John Lucker, “Beyond the numbers: Analytics as a strategic capability,” Deloitte University Press, 2011.
By Eric Piepho, director, Deloitte Digital, Pioneer Square Studio Leader, Deloitte Consulting LLP

Overview
Social media communities help companies promote their wares and services, manage complaints and keep their leaders tuned to reality through the virtual world. Mid-sized, privately held firms — largely unburdened by the scale and scope of bigger enterprises — can put the benefits of smaller size to work to become leaders in social business.

Among companies whose stance towards social business is maturing, a recent Deloitte-sponsored study by MIT Sloan Management Review showed more than 90 percent of leaders believe the technology can fundamentally change their firms.¹ Business pages and blogs corroborate the trend: companies are having successes with social commerce, video campaigns on Facebook, and viral sensations that become worldwide trends on YouTube and Twitter.

But don’t believe everyone is convinced about social, at least just yet. One in four leaders view social media as having “no significant impact” on the business, according to Deloitte’s most recent technology survey of mid-sized company executives.² Within our digital practice, we find that many companies see social media as more of a risk than an opportunity, not to mention a drain on productivity.³

But as companies’ grasp of social media matures in sophistication, privately held firms have true opportunity to create more meaningful experiences for customers and employees, and to improve the bottom line.

Issues
Social media may be a staple for many firms in their business to consumer (B2C) operations, but it’s by no means a must-have feature for all companies. Only 8 percent of executives in our survey of mid-sized firms said social media was among the top three trends with most potential.³ Some key factors help explain why.

Many of the privately held firms we approach in our practice still view social media from a risk perspective — a threat as opposed to an opportunity. What does that mean when we’re delivering services to these clients? Social media is habitually considered a public relations function with little thought about broader applications for other areas of the business. To advance beyond this thinking, companies should view social media in the broader business context, as a means to drive top-line growth through high-level strategy, sales and marketing actions.

Another reason social media may have problems gaining ground among privately held companies is that many of these businesses see it as a business-to-consumer (B2C) concept. By and large, these firms have yet to explore opportunities to use social media in business-to-business capacities. For instance, social media can be used to connect global collaborators in a highly-matrixed organization, or even help experts across departments or different organizations share tips.

Our study of social business trends with MIT pointed to a few, recurring obstacles to B2B social success:

- There are too many competing priorities.
- No one has articulated a strong business case.
- The business lacks an overall social business strategy.⁴

² Technology in the mid-market: Perspectives and priorities, Deloitte, 2014.
³ Ibid.
Opportunities
Companies with established and maturing social media programs demonstrate the possibilities online communities can offer to the privately managed firm. A number of opportunities will characterize the growth of social business in 2015 and beyond.

First, marketers, do not fear: the old-fashioned, in-person focus group and the feedback it provides are not likely going away. But at a lower cost, privately held firms can get good measurement data on customer sentiment through social media. Customers are willing to express their opinion in ways that they wouldn’t in a focus group or a third-party survey, and often are far more direct than they would be in person. To pare back the noise and obtain meaningful data in an environment of anonymous posting, technology is improving and permitting better analysis of social data to find true customer sentiment.

Mid-sized, privately held firms will likely usher in the next generation of customer interaction with predictive social media, offering another area of opportunity. It’s akin to forecasting the future, or at least the next mouse click: companies will be able to anticipate interactions, purchases and browsing patterns as opposed to waiting for consumers to act. A company with access to the social stream can detect the propensity to buy certain products or services. By applying a predictive algorithm, the sales force can reach out and create leads. The technology is permitting companies to have dialogue with customers through selective ad placements on their social media channels.

The potential gains are clear: the ability to get into someone’s stream is even more attractive to the privately held firm because of the cost. You don’t have to build up the infrastructure. You already have the data. You just quite literally have to have the idea, and then go buy the media with your message ready to deliver.

Guidance from the top will also characterize many of the opportunities privately held firms can explore in social media. Our MIT Sloan study revealed that the most mature organizations had leaders who believed social could fundamentally change their business. Companies showing success in this area are typically taking some steps to make incremental progress. They’re identifying the key influencers within their communities. And through a team effort, they’re planning and distributing high-quality social content through the branded channels.

Mid-sized, privately held firms will likely usher in the next generation of customer interaction with predictive social media, offering another area of opportunity.

In 2014, a survey found that 69% of respondents see opportunities for social business and mobile applications to disrupt or transform the status quo and generate a competitive advantage.

Indeed, good social content from leadership doesn’t just happen. There’s an evolving science and economy around actually managing the profiles of such individuals. The campaigns are orchestrated with clear messaging, serving as an authentic extension of the brand that they represent.

**Questions to consider for 2015**

The privately held firm should view social media as building a community. Companies that understand the context will be able to convert interactions into business opportunities that are difficult or impossible to achieve through traditional communication with customers. Elaborate social strategies can get lost on customers. Rather, keep it simple and keep it authentic.

In the year to come, privately held firms should draw up a list of questions as they consider how to create their strategy:

- How can you start to build a social culture at your company?
- How can you make your leaders comfortable with social media?
- What business value can your company drive (or create) through social media?
- Does your company have a social strategy?
- Who will manage your company’s social media efforts, and how will you measure success?
- How can you use social media to anticipate your customers’ needs?
Additive manufacturing (3D printing)

By Jim Joyce, specialist leader, Deloitte Consulting LLP, and Mark Cotteleer, research director, Deloitte Services LP

Overview
Additive manufacturing (AM) is getting a boost these days as key industry patents expire, throwing open the market to new players in 3D printing, which allows products to be formed by machines that print materials in successive layers. After decades of research undertaken to place 3D objects into the hands of consumers, experimentation is yielding growing numbers of AM-produced goods that are reshaping businesses across the spectrum.

Today and for the foreseeable future, the biggest opportunity for companies is in the market for 3D-produced aftermarket parts. Original equipment manufacturers (OEMs) that take advantage of 3D printing options will likely play an increasingly important role in the product supply chain, helping their customers address supply pain points through solutions that range from metal engine components for passenger cars to everyday household goods.

Privately held companies will have to confront a number of challenges if they wish to succeed as innovators in the 3D printing world. If they fail to address them and stick to traditional manufacturing methods instead, they risk losing their competitive advantage while those that understand the economics and the mechanics of AM edge ahead.

Issues
Despite a raft of news headlines that have accompanied the wave of consumer-oriented 3D printers in recent years, privately held manufacturers haven’t exactly scrambled to become AM suppliers. In our most recent, comprehensive appraisal of technology trends in the mid-market segment, fewer than 50 respondents in a survey of 500 executives said they were executing plans based on AM technology.1

When it comes to understanding the stakes involved, though, far more executives see the writing on the wall. Forty-four percent of respondents in the same survey said they agree or strongly agree that 3D printing will have an impact on their companies. A few factors help explain the disharmony between recognition of the business opportunity in AM and the relative inaction among closely held companies.

Today and for the foreseeable future, the biggest opportunity for companies is in the market for 3D-produced aftermarket parts.

1 Technology in the mid-market: Perspectives and priorities, Deloitte, 2014.
Smaller, privately run companies by nature seek competitive advantages against their larger public rivals by identifying openings in the market where they can secure an edge. Speed to market is one area where smaller competitors have historically had an inherent advantage. Presumably, a private manufacturer with such a timing advantage could stand to expand on their lead by adding a 3D printing capability.

The reality is quite different, however. Across a number of industries, economics and talent are among the challenges keeping middle market firms from widespread adoption of AM.

In some industries, advances in 3D printing technologies have not been sufficient to be seamlessly integrated into the supply chain. In the automotive parts industry, a market that amounts to a huge opportunity for AM applications, lower-tier suppliers play a key role in satisfying maintenance requirements for car manufacturers. But, to date, they have been unable to successfully deploy high-speed AM capable of keeping up with global production that reached 86 million automobiles in 2013 alone. Instead, 3D printing has been more successful in niche applications, particularly among hobbyists looking for replacement parts that are no longer available. Entertainer Jay Leno, known for his comedy as well as his collection of more than 200 cars and motorcycles, relies on an industrial-strength 3D printer to generate parts to keep the vehicles in his collection running.2

Gaps in talent amount to another significant hurdle, as educational institutions aren’t churning out enough graduates with knowledge of AM technologies and capabilities. Universities across the country are striving to fix this by offering AM development programs with laboratory 3D printing research in disciplines as diverse as engineering and art. Students in these programs are getting exposed to coursework meant to replicate the manufacturing site, participating in assignments ranging from CAD preparation to the fabrication and testing of 3D-printed objects. While these programs are gaining traction, they haven’t been around long enough to fill skills gaps across the manufacturing sector.3

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Finally, those privately held companies that haven’t cracked the business case for employing 3D printing will likely have to double their efforts to catch up. A parts manufacturer that hasn’t begun to use 3D printing in design and prototyping — two foundational AM skills — is probably a decade behind peers that have already started cultivating such capabilities.

Opportunities
Nearly every big manufacturer of industrial products we encounter in our practice is trying to figure out how to deploy 3D printing within the supply chain. While smaller, privately run manufacturers don’t enjoy the same scale and scope, many of them recognize that AM may enable them to level the competitive playing field with larger, better capitalized players — or wind up supplying them. In our recent survey of technology trends affecting the middle market, respondents said the primary impact AM would have on their organization would be through accelerating product development.4

The $200 billion aftermarket automotive parts industry is a key area to watch in 2015 as a host of smaller suppliers are working to deploy 3D printing in their businesses. They are being lured by the automakers themselves, who see much promise in a technology that enables them to be both flexible and efficient.5 Ford Motor Co., for example, has laid out the cost savings it can derive from point-of-use, 3D manufacturing in select applications. Through traditional manufacturing, an engineer would create a computer model of an engine manifold and wait about four months for a $500,000 prototype. With 3D printing, multiple iterations of the same component takes four days and cost $3,000. The manifold and brake rotors for the Explorer SUV are among the AM innovations Ford is perfecting as 3D printing is starting to make inroads into auto manufacturing.6

The opportunities aren’t confined to the auto industry. Privately run companies that can harness AM to provide replacement parts for housewares, appliances and other domestic products may find success as 3D manufacturers if they can adjust their business models accordingly. We’ve all lost a knob, enclosure or button on a household product that a manufacturer will replace at a premium, if the part is available at all. The privately held company that can position itself as a designer and provider of such components — making them available on demand — will be in a better position differentiate themselves in the marketplace and build consumer loyalty around their products.

While cost savings make for good headlines, the real opportunity for middle market manufacturers is finding ways to scale high-value objects by getting 3D printers and know-how into more households.

Questions to consider for 2015
Despite the business possibilities in 3D printing, many companies still lack a comprehensive awareness and strategy for dealing with the major changes that are coming as a result of AM. The trip has commenced, and middle market firms need to identify ways to join a significant movement that’s already in progress. Like preparation for any journey, there are a couple of questions that privately run businesses should be asking:

• Does our industry stand to benefit from 3D printing or be disrupted by it?
• Do we have an AM strategy? If so, how does it compare with our key competitors’ plans? If not, do we have a roadmap in place to catch up?
• Do we fully understand the diversity, capability, advantages and disadvantages of the various technologies that fall under AM?

4 Technology in the mid-market, Deloitte, 2014.
5 On the road: U.S. automotive parts industry annual assessment, Department of Commerce International Trade Administration, 2011.
Overview
In today’s business environment, closely held companies can no longer afford to accept the informal governance practices that have long separated public and private concerns. Increasingly, private company executives are embracing public company style governance practices. This increased sense of formality, even among family-owned businesses, is giving privately held companies more structured processes for addressing everything from strategy to cyber security. In a recent Deloitte survey of board practices, conducted in collaboration with the Society of Corporate Secretaries and Governance Professionals, 250 corporate secretaries from publicly traded companies identified key areas that their boards will focus on in 2015. What we found was that many of the same issues they raised — especially strategy, risk, and board composition — are also confronting privately held companies as they adopt more public company governance practices.

Issues
The challenge for closely held companies is how to strengthen their governance without compromising the flexibility that many see as their primary advantage in the marketplace. While most public companies have clear rules and strict procedures to help ensure everything from regulatory compliance to risk assessment, private companies may be wary of becoming too bureaucratic or beholden to process. Many private companies, however, are finding ways to strengthen their board structures and enhance their long-term growth prospects without sacrificing their nimbleness in their existing market.

Overall, closely held companies tend to have smaller boards, with directors often selected from the company’s executive team or, in the case of family-owned businesses, relatives of the founders. Populating the board with insiders may give companies a strong sense of mission, but it could leave them unable to objectively assess risks, develop effective strategy, or adapt quickly to unexpected changes in the marketplace or customer base.

On the other hand, private companies have fewer worries about meeting the demands of the investing public and analysts and, as a result, they can focus more on the long-term growth of the company.

Further, the governance challenge of attaining the ideal board composition and size may enhance board structure at smaller boards and allow for an extension of separate board committees, where much of the “board work” takes place.

Opportunities
By adopting common elements of the governance practices at publicly traded companies, private businesses can enhance board oversight to help their operations run more effectively.

Board composition and structure
One of the first steps is to decide the composition and size of board a company should have. Board structure should align with the company’s strategy; the composition should include the skills and experience needed to ultimately advise on the development of the strategy and overseeing its execution.

While management and directors will likely overlap more in private companies than in public ones, boards should be structured to include independent, outside directors, and meetings should be conducted in a manner that encourages fresh perspectives. By having more outsiders on the board, discussions on agenda topics such as risk, strategy, and succession may become more robust.

To determine the type of outside director a company needs, the existing board should consider assessing long-term goals and determine if there are gaps in the skills, expertise, and experience of the current directors. For example, does a company need more financial experience on the board? Should it hire a director who has a background in international expansion? Utilizing board skills matrix can help to identify current board skills and where gaps may exist. Further, independent directors should be considered for inclusion on the audit committee and other formal committees of the board, including a compensation committee that deals with management compensation.

As they expand their boards, middle market companies should consider evaluating the diversity of directors as well. Family-owned businesses may have multiple generations represented, but age isn’t the only consideration. Is there also ethnic and gender diversity? In addressing these issues, companies may want to consider their customer base and whether the makeup of the board reflects that base.

While private companies should have a separate audit committee to oversee the integrity of the financial statements, financial reporting process, and the independent audit, they have the flexibility to determine the need for other separate board committees. Consideration should be given to formalizing the oversight of compensation and governance practices with committees that include independent directors. Other committees might focus on specific areas such as risk, investment, finance, or strategy.

Finally, board structures vary among private companies. For example, many leading family companies have a board of directors with independent members, as well as a separate family council that is responsible for the family matters, which are handled outside of the board of directors. Further, some private companies also consider the need for advisory boards to provide objective, specific knowledge on certain topics or business development needs.

By having more outsiders on the board, discussions on agenda topics such as risk, strategy, and succession may become more robust.
Strategy
In our survey, corporate secretaries listed strategy concerns as the most important topic on the public company board agenda. Privately held businesses, however, often can focus more closely on strategy issues because they don’t have as many regulatory and compliance issues to deal with as their publicly traded counterparts. Not only should strategy be a focus of frequent discussion, it should also be monitored by the board to ensure it is being implemented properly. The board may even propose metrics for monitoring the continued execution of strategic objectives.

While it may not be practical in every case, middle market companies may want to consider conducting strategic retreats, which are considered a leading practice for private company boards. Such retreats typically include both senior leadership and the board, allow for a day focused on the business strategy, both short- and long-term, and include a deep dive into the risks associated with the outlined strategic objectives. The retreat can set the foundation for future board meeting agendas and for monitoring the execution of strategic objectives.

Risk oversight
Boards should consider addressing risk management issues regularly, either through an audit committee, or if a company is in the financial services sector, a separate risk committee — or at the full board level. Regardless of whether risk oversight is delegated or not, the full board is ultimately accountable. Directors should decide on the governance structure that will work at their company to oversee the risk management process. The full board should be discussing the most significant strategic risks to the enterprise, while understanding that the full list of enterprise risks (whether operational, compliance, or financial) are being continually monitored, mitigated, and assessed. The board structure and committee composition will provide the basis for an effective risk governance structure to oversee risk processes and specific, significant risks.

This applies to cyber-security risk issues as well. Cyber threats against businesses increasingly are becoming a concern for companies of all sizes. Directors may want to consider whether their company needs a chief technology officer or if the company has the necessary in-house expertise and experience to manage cyber risks. There may be a need to bring in outside expertise to brief the board on cyber security, the board’s role in overseeing such risks, and being prepared with an incident plan.

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Overall, closely held companies tend to have smaller boards, with directors often selected from the company’s executive team or, in the case of family-owned businesses, relatives of the founders.

Once the proper board is in place, the committee structure is determined and planning issues such as risk and strategy are evaluated, companies should examine the frequency of their board meetings and whether the board is allowing appropriate time to oversee company issues. Boards may want to consider how their practices — meetings, composition, and structure — measure up against other private company leading practices and make adjustments if needed.

Questions to consider for 2015
As the challenges facing privately held companies grow more complex, many are finding that the board structures adopted by public companies can help position them for long-term growth. While the board needs of private companies vary widely based on their size and type of business, a stronger governance structure can help companies move beyond the more insular boards that are common among family-run businesses and invite fresh ideas for building the business.

For companies of all sizes, more formalized board structures, with greater diversity of directors, are becoming the standard. To implement these strategies, some of the key questions companies need to answer are:

- Do we have the most effective board structure in place – including independent directors and the committee structures?
- How do we ensure we’re finding the most qualified outside directors and meet our commitment to diversity?
- Do we place enough emphasis on strategy and long-term planning in our board discussions or do we need to implement stronger metrics?
- Are we adequately planning for risk, and how might we improve our risk oversight and assessment, including emerging risks such as cyber threats?
- Do our directors meet frequently enough to adequately address the concerns facing the company?
Succession planning

By Thomas Plaut, partner, Deloitte Tax LLP

Overview
When most mid-market leaders think of business succession their thoughts fly to replacing an exiting CEO, transferring the business from one owner to another, or any number of other acute pressures. When I speak to CEO groups and ask what succession planning means to each executive, I tend to get many different answers.

In fact, business succession planning is a multi-disciplinary process that bridges many aspects of running a business in facilitating an orderly transition of management and ownership. For private, owner-managed businesses, as many middle market companies are, a solid succession plan can determine the survival and growth of the business, reduce taxes and set the stage for retirement. Family-run businesses benefit further by focusing on preserving harmony within the family.

Oftentimes, it only takes a couple of questions to help a business owner begin to focus on succession issues. Do you have enough liquidity to avoid the forced sale of your business? Can your business provide the cash flow you need for retirement? Are you using techniques to mitigate or eliminate estate taxes? A business leader might not link these kinds of questions to succession planning but being able to answer them in the affirmative may be critical to the future success of the business.

Issues
With the economy kicking into a higher gear and the labor market recovery well underway, certain issues may be more pressing than they were just a few years ago.

Little sense of worth
Many leaders of privately held companies think they have a sense of what their business is worth, but reality can paint a far different picture. I was recently talking with the CEO and the CFO of one such company, when I asked them what they thought the value of the business was. Their estimates differed by more than $20 million (25 percent of actual value). The problem is that many aspects of business succession and strategy hinge on having a realistic understanding of business value.

When these off-the-cuff estimates are so disparate, it can lead to poor decision-making and less-than-optimal outcomes. For instance, an inaccurate estimate of value can underestimate the amount of estate taxes that will come due when one owner succeeds another. Mistakes like these often trickle down through the planning process. In the previous example, the current owner might not have enough liquidity to foot the tax bill, and allow for the business to transition to the next generation of leaders.

Business succession planning is a multi-disciplinary process that bridges many aspects of running a business in facilitating an orderly transition of management and ownership.
Sometimes, this leads to a forced sale of the business. Perhaps with a better understanding of real value, business owners can address these liquidity needs with life insurance. Having a good sense of a business’ value could also allow owners to consummate a sale that would help preserve wealth more so than turning over the reins to the next generation. Sometimes, selling the business is the right thing to do.

**Leadership voids**
The dramatic improvement the labor market has experienced in recent months has set the stage for more workers to leave their current jobs in search of higher-paying or higher-quality positions. In Deloitte’s most recent governance survey of family-owned businesses, close to half — 49 percent — said they only review succession plans when a change in management requires it, and 41 percent said they do not have any leadership contingency plans. Without such plans in place, executives or family members deemed to be the best candidates might be unavailable or unprepared when their time comes, leaving a massive leadership void that risks upending the business.

**Inability to disengage**
Even when everyone agrees that succession planning is important and necessary, reasons to delay the process often sidetrack the discussion. Running a business takes maximum effort, and long-term planning can take a backseat to short-term issues. Carving out the time necessary to engage in business succession planning is likely even tougher these days, with economic activity picking up and spurring increased demand.

For any business, working without a succession plan can invite problems such as disruption, uncertainty and conflict. For family-owned businesses, the stakes are even higher; the issue of succession often introduces deeply emotional personal issues and may incorporate non-employee family members. An owner-manager may have a vision to retire and sell the business at some point down the line, but he or she may not have adequately shared that vision with those who will be affected, or considered what it will take to make that vision a reality.

**Opportunities**
Kicking the can down the road on something as important as succession planning is a sure-fire way to invite unwanted surprises into the business. While there are many ways to approach succession issues, the current business environment lends itself to addressing certain opportunities, with some yielding potentially significant near-term benefits.

**Business valuation**
A pre-requisite to successful succession planning is to understand the value of the business, so that it can be preserved and passed on. The value of a business affects many succession planning issues, including retirement plans, gift and estate taxes, compensation levels, insurance, shareholder agreements and corporate finance strategies.

Over the course of a year, a business’ prospects can change dramatically, and there is a pretty reasonable likelihood that valuations have changed for the better over the past 12 months with the improvement we have seen in the economy. Merger and acquisition activity has accelerated in kind, and private equity firms need to put record amounts of uninvested capital to work. A current sense of value that takes account of factors such as the company’s earnings history and its capacity to earn in future periods, its financial condition, the value of non-operating assets, and industry and general economic conditions may prevent a privately run business from selling itself short in the event that suitors come calling.

On a broader level, there are risks associated with simply relying on last year’s business appraisal or, worse, a back-of-the-envelope guess. A company I recently worked with had a formula baked into its shareholder agreement that dictated how much the company would pay when buying the shares from a shareholder in the event of death or disability. The formula had not been updated in years, so it was no longer aligned with the company’s current state or its growth potential. If the valuation formula were updated, it would significantly increase the value paid for those shares.

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Grooming future leaders at all levels
Many family-owned sole proprietorships or organizations in the early stages of growth may informally approach management development, with the founder-owner relying on personal interactions to both identify and train their eventual successors. This form of planning might work to fill the company’s top spot, but it ignores all the other vital roles that have significant impact on the business’ performance and therefore present additional difficulty when recruiting. In addition, the company’s needs and circumstances likely will change over time, elevating the importance of a dynamic and flexible succession plan.

Conducting an analysis of the talent pipeline, with a keen emphasis on identifying critical roles, is one of the best practices leading employers use to groom leaders at every rung of the organizational ladder. This process entails developing a common template for future leadership qualities and then evaluating each person in the talent pool against them to see who has the highest potential. This is important at lower levels of the organization as well, an area where leadership development has typically been lacking and may expose companies to retention issues. It’s also especially relevant in family-run businesses in which the leading candidates for promotion aren’t necessarily family members; in those cases, special arrangements — such as phantom stock incentives — might be needed to reward talent without sharing equity.

In any case, it’s critical that organizations invest in building the capabilities of first-level leaders so they can not only hold onto promising talent, but also enable them to succeed in their initial management roles and set the stage for future responsibilities. In-house training is a primary vehicle among mid-market firms when it comes to developing talent for expanded roles. In a recent survey we conducted of mid-market executives, training was listed as the top priority investment in talent their company was likely to make over the ensuing 12 months. Nearly two-thirds cited traditional internal training and development as the best way to cultivate future leaders, and external training was close behind.2

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Questions to consider for 2015
The operational demands of running a family business or other closely held enterprise can be all-consuming, particularly now that a resumption in growth is well under way for many. But it’s vital that business leaders take the time needed to assess their organization’s business succession planning. The penalty for failing to get ahead of leadership or ownership changes is significant and many-layered. The coming years may bring substantial transfers of wealth as businesses change hands and adopt new ownership structures. The long-term survival of those businesses, and the preservation of the wealth that has been built, will likely depend on getting ahead of those changes through strategic succession planning.

In the year ahead, privately held companies should position themselves to answer the following questions in the affirmative:

- Do we have an accurate, updated measure of what our company is really worth?
- Do we have a leadership succession plan in place in case of a surprise departure at the top?
- Do we have a process in place to identify and groom future leaders at all levels of the organization?
- Do we have enough cash on hand to manage a change in ownership? If not, how would we address the issue?
Cyber risk

By Adnan Amjad, partner, Cyber Risk Services, Deloitte & Touche LLP

Overview
Let there be no doubt about it: Cyber criminals have grown up. Once characterized as members of the dark web and denizens of the underbelly of society, today’s increasingly sophisticated hackers steal financial information, intellectual property and other highly sensitive data that its owners believe are tucked away where outsiders can’t find it.

While this kind of theft is damaging on its own, the ripple effects from a reputational standpoint are just as harmful. Customers are not only aware of cyber crime in its many forms, they fear it. They’ve personally felt the effects of attacks on high-profile, business-to-consumer companies. And as a result, they’re concerned for their financial security, their identity, and ultimately, their privacy.

Companies that are targeted by cyber criminals pay an ongoing toll tied to customer attrition and retention. Customers now place a high premium on the security of their personal information in the public space, and over time may show favoritism toward businesses that demonstrate the same level of concern in the form of strong security protocols.

While most recent high-profile cyber attacks have targeted major organizations, all companies, regardless of size, must operate with the assumption that cyber attacks will happen — to them. If short on resources and advanced cyber security skills, mid-market companies may be more vulnerable than larger ones.

But organizations don’t need to be wracked with fear. Now, a distinct opportunity is emerging for private and middle-market companies that direct their innovation efforts toward cyber security, particularly leveraging a risk-based approach. This doesn’t always mean layering on new security controls, which is often cost-prohibitive. In some parts of the business, it may be more appropriate to emphasize detection capabilities so threats and infiltrations can be identified more readily, and to be more fully prepared for the eventualty of a cyber incident taking place. In some cases, how an organization treats its customers in the wake of an attack can be at least as consequential as the attack itself. At Deloitte, we advise clients to develop a secure, vigilant and resilient cyber model, which can help create a strong point of differentiation in the eyes of customers.

A distinct opportunity is emerging for private and middle-market companies that direct their innovation efforts toward cyber security, particularly leveraging a risk-based approach.
Issues
In building these capabilities, there are several issues privately held businesses should consider being especially attentive to in the coming year.

Innovation and growth are increasing risk
Cyber risk and business growth are inextricably linked. Leveraging digital innovation can help a company achieve its market position objective, but many of the actions companies now take to meet increased demand, drive efficiencies and capture market share — embracing cloud computing, developing mobile apps, engaging in social marketing — can also elevate their risk for assault. For example, the 2014 Deloitte survey, Technology in the Mid-Market, found that 69 percent of respondents see opportunities for social business and mobile applications to disrupt or transform the status quo and generate a competitive advantage.

In the course of innovation efforts, companies need to proactively examine how they might be increasing their cyber risk exposure. If the owners of a mid-sized retailer were to build a cloud-based infrastructure and develop a mobile app toward streamlining its ordering, fulfillment, and delivery processes, their efforts would certainly be welcomed by customers and suppliers as innovative. A well-chosen cloud provider with strong security controls and practices could actually enhance a company’s risk posture, but unless the extended infrastructure comes with proper safeguards in place, those moves potentially could open the door to cyber threats by creating more openings beyond the primary security grid for hackers to penetrate.

Failure to address the growing “extraprise”
As privately owned companies appear on cyber thieves’ radar screens, third-party vendors — both B2C and B2B — and subsidiaries are becoming attractive targets.

Larger companies often neglect to adequately consider the risk of cyber attack to their suppliers from an asset perspective, but as the number of attacks on smaller companies increases, smaller entities may be vulnerable gateways into their holding or partnering companies’ data troves. The typically less sophisticated cyber infrastructure of subsidiaries and third-party vendors allows not only for their data to be compromised, but acts as a backdoor into the larger organization’s security apparatus. Once inside the smaller company, hackers could make themselves comfortable for an extended period of time, undetected, and chip away at the barriers of the larger company’s security structure, paving the way to create real harm in the future.

An increasingly mobile and unsuspecting workforce
Perhaps the greatest threat that company leaders consistently underestimate is that posed by their employees who may be unwittingly facilitating cyber-attacks. The Ponemon Institute identifies workers who use multiple mobile devices and commercial cloud apps while working outside the cyber security structure within an office as the leading threat to companies’ cyber security.

There’s good reason why cyber thieves continue to target individual employees: it’s working. Elaborate email phishing schemes require only one employee to let their guard down to let the hacker in. That’s why inboxes are being inundated by junk mail. Analysis conducted by Cisco of such threats from 2014 confirms that the amount of e-mail spam increased 250 percent between January and November of last year. What’s more, roughly two-thirds of the Cisco report’s respondents disclosed that their internal IT departments do not have the bandwidth needed to govern employees’ personal devices.

With new threats such as “Snowshoe spam” — small amounts of spam sent from often thousands of IP addresses in order to avoid detection — targeting employees’ devices, the threat is growing every day.

Opportunities
A winning approach for privately owned companies to address their vulnerabilities and create a strong cyber security framework starts with acknowledging the potential threats faced and maintaining constant vigilance. Dedicating specific resources, both human and financial, toward this task will strengthen an already strong prospect for differentiation.

More importantly, the biggest opportunity companies face in this realm is avoiding the layers of costs that come when a cyber attack is successful.

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1 Technology in the mid-market: Perspectives and priorities, Deloitte, 2014.
2 Symantec’s 2014 Internet Security Threat Report notes that in 2013, attacks on small and mid-size firms rose by 61 percent over the previous year.
Private company issues and opportunities

Promote awareness
Sixteen percent of respondents to the 2014 Deloitte mid-market technology survey reported that their companies have no formal IT governance in place, and in a few cases, have “little to no formal IT processes, structures or awareness.”

Your employees and your partners need to know what to look for, and who to contact in the event that an attack is successful. You may have top-notch hardware and software in place to protect against cyber criminals, but it only takes one employee clicking on the wrong thing to let them in. This challenge calls for the creation of a corporate-wide cyber mindset that blends awareness, education and training throughout the organization.

No matter how many precautions you take, the odds are your information network will be compromised. Everything can’t be protected equally, so it’s important to know what information or business processes are vital to running the organization and could pose serious threats to your business if exposed or disrupted. By making a hierarchy of data and other assets tailored to your company, you will be able to make better decisions when it comes to prioritizing protective controls, and more effectively allocate your IT spending on an overall cyber risk program.

Elevate to the top
The bedrock of awareness is ownership, instilling at all levels of leadership and employees a sense of responsibility for cyber security. For some companies, this will begin with appointing a member of the C-Suite with oversight responsibilities. For others, it will mean committing a portion of each leadership meeting agenda to cyber risks and threats. Hopefully for many, it will necessitate bringing any outsourced managed services providers and internal IT personnel together consistently with all employees for assessment and review.

The layers of governance may vary, but commitment to the structure should not.

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6 Technology in the mid-market, Deloitte, 2014.
Look outside for help
Almost one-quarter of respondents to the 2014 Deloitte technology mid-market survey report that it is difficult to keep up with the rapid pace of change in the technology landscape. To maintain a strong cyber risk program, it’s critical not to get caught up in the “keep up with technology” hype. Burdening internal IT resources with the impossible task of staying ahead of emerging cyber threats will only distract from the ultimate task at hand: Putting in place defenses that address the most serious cyber threats.

The prevalence of cyber attacks among private companies creates opportunities to leverage managed cyber security service offerings. Companies can seek scaled, enterprise-level help, at decent price points, to fill in the security gaps that their in-house IT teams likely don’t have the capacity to provide.

Questions to consider for 2015
Though privately-held and other middle-market companies now consistently face the threat of cyber crime, it’s truly impossible to know how this particular branch of illegal activity will evolve in the months and years to come. Today’s phishing schemes, targeting of subsidiary and third-party vendors for their illegal benefit, will remain in hackers’ playbooks, but will ultimately give way to new threats.

Protecting your business in an increasingly complex and hyper-connected world is all about having the people, systems and processes in place that adjust as the nature and severity of attacks change. To build those capabilities in the year ahead, business leaders should consider asking themselves a few foundational questions:

- What are the potential risks to our customers from a cyber attack on our business?
- How could our business be most seriously impacted by a cyber attack? Are we doing what we can to prevent those scenarios?
- Do we have the ability to detect attempts to harm the most sensitive parts of the business? Do we have plans in place to bounce back if a cyber attack happens?
- Is our technology spend being used wisely? Are we focused on how to handle the most egregious cyber attacks unique to our business, rather than trying to keep up with every security trend?
- Does our company have a cyber security governance structure in place? When we undertake significant business changes, do we carefully consider how they could impact our risk exposure?
- Are our subsidiaries and/or third-party vendors operating under a similar security structures to ours?

* Technology in the mid-market, Deloitte, 2014.
Private company issues and opportunities
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