Introduction

Disruption is now an ever-present dynamic in the middle market. These forces, much like those of Nature, have the power to benefit or cripple markets, unseat incumbents and undercut business models.

Advances across a range of technologies—including payments, artificial intelligence, machine learning, virtual reality and cloud computing—are making it possible to streamline, automate and add functionality and flexibility to practically any business process.

Because middle-market companies play such an outsized role in the U.S. economy, the impact of disruption on their future is extraordinarily significant. Companies with revenues between $100 million and $3 billion employ more than 30 million people and produce approximately one-third of the $30 trillion annual gross receipts generated nationwide.

Do middle-market companies feel vulnerable to disruption? Or do they see disruption as an opportunity, hoping to benefit by adopting new technologies or by becoming disruptors? How will they seek different directions? To answer these questions, Capital One surveyed 300 senior executives from middle-market companies nationwide.
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Continued innovation is the best way to beat the competition.

Thomas A. Edison
Key Findings

Middle-market executives are increasingly comfortable navigating a disruptive, sometimes chaotic business environment, focusing on opportunities to invest in new ideas and emerging technologies that increase their competitiveness. Their ability to do so, however, depends critically on having strong relationships with banks capable of funding innovation and delivering financial technologies that offer new, more effective ways to manage their finances.
The Middle Market Has Learned to Live with Disruption

The survey findings seem to validate the idea that disruption—though still a cause for concern—has become an accepted part of the business environment. When asked how vulnerable their companies were to disruption, responders showed a significant shift compared with previous years. In the 2017 survey, 38% said that they were “not at all” or “slightly” vulnerable to disruption. In 2018, that number grew to 51%. Results show a similar trend at the other end of the scale. In 2017, 18% reported that they were “quite” vulnerable. In 2018, only 10% felt that way.

The fact that middle-market executives have not increased their preparation for disruption—just 16% did so in both 2017 and 2018—suggests that, for the majority, combating disruption is not a priority.

Designated in-house person/team for identifying threats and opportunities 53%
Created a contingency plan 47%
Collected additional data for analysis 35%
Developed proactive countermeasures 27%
Implemented regular firewall testing 25%
Hired external consultant to identify threats and opportunities 19%
Purchased interruption insurance 19%
None of the above 3%

Specific preparations for disruption

Those who believe innovation is important to maintaining a competitive edge are most likely to have collected additional data for analysis, developed proactive countermeasures and implemented regular firewall testing.
How vulnerable is your company to being disrupted?

Financial services and technology, telecom, IT companies, companies with $2–$3 billion revenues, those who are quite/extremely prepared for a disruptive event and those devoting 6%–25% of their R&D budgets to new technology are significantly more likely to feel their industry is quite/extremely vulnerable to being disrupted.

Vulnerability to disruption

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Disruptions causing a material impact on finances

Within the next year, companies with revenues of $100 million to $499 million are most likely to expect a disruption that has a material impact on finances within the next year.

1% No
4% Yes, it has already happened
25% Yes, within the next year
54% Yes, between 1 and 3 years from now
13% Yes, between 3 and 5 years from now
3% Yes, more than 5 years from now

Other results from the survey support this conclusion. Middle-market executives were no more proactive this year than last in taking specific defensive measures, such as creating contingency plans and appointing staff to identify threats and opportunities. Those who pursued defensive measures were more likely to keep activities in-house rather than hire outside consultants.

In addition, middle-market executives seem to view potential disruption as a distant event. Asked when they expected disruption to have a material effect on their finances, 73% of respondents in 2017 asserted that it would occur in the next one to three years. This year, 79% of respondents made the same prediction.
Companies Need Additional Capital to Defend Against Disruption

If disruption occurs, respondents expect it will come from competitors and new entrants deploying data analytics and mobile capabilities. Disruptors will use big data to discover success factors that have gone unnoticed—much as sports teams have done in the post-Moneyball era—and use mobile apps to dramatically improve internal and customer-facing processes.

That sentiment explains why these executives believe that successfully weathering disruption will require an infusion of capital. **About three-quarters of the respondents declared that they would need additional funds to stay competitive if they were confronted by a major industry disruption.** Significantly, companies across the middle-market spectrum made similar assessments.

**Additional capital to stay competitive**

About three-quarters feel they would require additional capital to stay competitive if they were confronted by a major industry disruption.
79% expect disruption to have a material effect on their finances this year.
Echoed in millions of tweets, articles, white papers and reports over the last decade, the constant reporting on disruption has made an impression on middle-market executives. They realize that any defense against—or creation of—disruption will almost certainly require some measure of technological innovation. More than half of respondents polled reported that innovation is “somewhat” or “extremely important” to maintaining their competitive edge.

**Importance of innovation**

More than half of respondents feel innovation is “somewhat” or “extremely” important to maintaining a competitive edge. A third are neutral.
Executives See Innovation as a Prerequisite for Success

All the executives surveyed said that their companies are taking one or more steps to encourage innovation. Most of these leaders are fostering a culture of innovation by brainstorming new ideas and streamlining approvals for new initiatives. Others, especially larger companies with revenues from $2 to $3 billion, have implemented new collaborative technologies. Larger companies also stood out for using acquisitions to gain innovative capabilities, as distinct from traditional drivers of mergers and acquisitions (M&A) such as entering new markets or leveraging pricing power.

Smaller companies are also looking elsewhere for breakthroughs. Companies in the middle range—with revenues from $500 to $999 million—are turning to outside help for guidance on innovation by hiring either external implementation vendors (36%) or external strategy consultants (25%).

65% of middle-market executives were most enthusiastic about online and mobile payment technologies.
There Is No Single Route to Innovation

These trends are consistent with the survey’s findings about investment in research and development. Although the vast majority (87%) of surveyed companies increased their R&D budgets, the changes were not as significant as those of last year, when almost one-third of middle-market executives said that their company’s R&D expenditures rose between 11% and 25%, compared with 15% this year.

Not surprisingly, these changes were particularly dramatic among larger companies, given their emphasis on M&A. Overall, middle-market executives are tending to combine homegrown innovation with externally sourced technologies.
A New Role for Banks: From Funding Innovation to Delivering It

An increased emphasis on financial preparation clearly indicates how serious middle-market companies are about pursuing innovation. **A full 45% believe that they have the necessary financial resources in place to support their innovation goals; 59% have banking relationships they can turn to, while 18% choose to rely on both.** Just 13% are totally financially unprepared.
Applying Innovation to Their Financial Operations

Middle-market companies are expecting innovation from their banks in addition to receiving lending and other financial services. Of the financial products that offer the greatest potential to their companies, 65% of middle-market executives were most enthusiastic about online and mobile payment technologies, which can streamline how they pay suppliers and vendors.

Their enthusiasm for online and mobile payment technologies reflects their experience. Nearly 70% of middle-market companies are already using new digital technologies for billing, transfers and accounting. However, these companies don’t feel compelled to implement these technologies on their own. Executives were virtually unanimous (88%) in declaring that they were “moderately,” “slightly”, or “not at all interested” in introducing new financial products themselves.

More than ever, these firms want a financial partner that can deliver advanced tools to put timely, relevant information at leaders’ fingertips so they can make decisions quickly.

Banks in this space should have the human-centered design capability required to understand customers’ needs and the sophistication to address them with solutions including artificial intelligence, application programming interfaces, blockchain and more.

Larger companies also stood out for using acquisitions to gain innovative capabilities, as distinct from traditional drivers of mergers and acquisitions such as entering new markets or leveraging pricing power.
Conclusion

The survey clearly shows that, in an economy characterized by disruption, innovation is no longer a nice-to-have option for middle-market companies. Their collective future depends on the ability to deliver a continuous stream of new products and services to their markets.

This heightened awareness of the benefits of innovation extends to their own processes and systems. More than two-thirds of the middle-market companies polled have already invested in digital technologies to streamline and automate their billing, transfers and accounting systems. They are especially interested in new technologies that add convenience, control and insight to their payment systems. Banks that combine the ability to fund middle-market innovation and use technology to unlock the power of information are logical partners.

More than two-thirds of the middle-market companies polled have already invested in digital technologies to streamline and automate their billing, transfers and accounting systems.
About the Research

Capital One engaged Beresford Research, a market research firm, to conduct a phone survey of senior middle-market executives consisting of 26 questions covering such issues as disruption, innovation, financial technology, and recruitment and retention. For purposes of the study, middle-market companies were defined as firms with operations in the United States with annual revenues between $100 million and $3 billion. The 300 responses represent the U.S. middle-market population with a margin of error of 5.65 points (at 95% confidence).
About Us

Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries, which include Capital One, N.A. and Capital One Bank (USA), N.A., had $248.2 billion in deposits and $364.0 billion in total assets as of June 30, 2018. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients through a variety of channels. Capital One, N.A. has branches located primarily in New York, Louisiana, Texas, Maryland, Virginia, New Jersey and the District of Columbia. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol “COF” and is included in the S&P 100 index.
Take the next steps

Whether you’re insulating your company from a disruptive event, facilitating an R&D expansion or acquiring new online and mobile payment solutions, a strong banking relationship is key. As a top-10 U.S. bank housing a digital innovation lab, we’re committed to providing you the resources, tools and expertise needed to promote disruptive innovation across your business.

Let’s discuss the possibilities.
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