Strategies to prevent economic recessions from causing business failure

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Abstract An average of more than 500,000 businesses failed in the United States during each of the 10 recessions that have occurred since the end of World War II. Yet, scholar and practitioner understanding of how to prepare for and respond to the challenges of an economic downturn remains extremely limited. This article analyzes and synthesizes the information from academic theory and business experience on managing through an economic recession. To assist firms in successfully navigating economic recessions, we suggest a program that involves positioning by investing in multiple markets and geographies, planning by developing a turnaround plan for facing sharply declining sales, promoting by maintaining marketing initiatives, and preparing by acting in anticipation of economic recovery. © 2005 Kelley School of Business, Indiana University. All rights reserved.

1. The danger of recessions

Different economic environments typically reward different business strategies. In high-growth economic periods, there is strong consumer demand for many products and services. Companies' revenues increase and managerial focus is on acquiring and allocating resources to meet growing demand. During such expansionary periods, firms add employees, invest in equipment, and increase production. Strategic success requires the skillful management of growth. In sharp contrast, during periods of contraction or recession, customers are less willing to spend, unemployment rises, credit becomes less available, and competitors engage in price cutting and other desperate moves to produce sales.

No threat from the business environment plagues profitable businesses as does an economic recession. Most importantly for our purposes, business failures are disproportionately concentrated during recessions. For example, the Great Depression of the 1930s eliminated over 50% of the retailing businesses in the U.S. More recently, data on industrial performance shows that over 500,000 companies have failed in each of the recessions that have occurred in the U.S. since 1990. The most recent of these recessions provides statistical evidence of the
phenomenon. With the economy mired in recession from March to November 2001, debt-burdened United States businesses filed for bankruptcy in record numbers, up 14% for the year (see Table 1).

Despite the damage done during each recessionary period, little in the way of diagnosis, prescription, or prophylaxis has been systematically identified to guide managerial action. Our goal is to address this deficiency. Based on reviews of business performance and academic research, we suggest a program of action that is linked to theory and supported by business experience as a successful approach to managing through recession.

Specifically, based on our study of company strategies implemented with recessions in mind, we advocate that a firm position, plan, promote, and prepare. In anticipation of recession, managers should position their firm in multiple markets and geographies, and plan for the contingency of sharply declining sales. During the course of the recession, a firm should promote its business despite the difficult times and prepare to exploit the anticipated recovery through judicious investments. We will detail these recommendations after briefly discussing the recessional dynamics that prompt the need for specific managerial action.

2. The nature of recessions

The term business cycle refers to the familiar ups and downs of economic activity. Recessions occur during the “down” or contraction phase of the business cycle. Since World War II, the United States has experienced 10 recessions, most recently between September 1990 and March 1991, and from January to November 2001. Formally defined as two or more consecutive quarters of falling Gross National Product, recessions during this period lasted 11 months and reduced real GNP by 2.6%. During these times, consumer spending and business investment followed similar patterns of decline.

Recessions cause significant declines in resources available to the firm because customers spend less, lenders lend less, and competitive rivalry increases. Initially, the behavior of consumers changes during recessions. They have less money to spend and cut back personal spending in response to the overall decline in economic activity. Typically, they are more deliberate in their purchases, more sensitive to price, and, because of increased anxiety over personal finances, more likely to abstain from or delay purchases. Similarly, businesses cut back on spending to conserve cash, particularly on investment spending that can be deferred or delayed. Industrial and business customers may become disloyal, demand renegotiated contract terms, and alter purchase patterns.

Margins then fall as a consequence of recession. On the cost side, productivity declines (Perry, Schultze, Tobin, & Friedman, 1993). Regarding price, competitors jockey for position with customers and suppliers to increase their own cash flows at the expense of others. Prices are cut. As a result, heightened competition, downward pressure on revenues, and declining productivity lower margins during recessionary periods (Domowitz, Hubbard, & Petersen, 1987). This is aggravated by international competitors when the recession has a global impact.

Finally, troubled clients make for troubled banks. During recession, banks become stingy with their business loans because they seek to improve the quality of their loan portfolios. This results in less lending. The unintended consequence is that financially strained businesses are deprived of attractive loan opportunities precisely when they are most needed, resulting in further business decline and failures. In short, recessions cause lowered sales, decreased margins, and reduced credit, yielding significant shocks to the resources available to the firm, thus threatening its survival.

3. Lessons from theory and practice

In the preceding section, we discussed the challenges of economic recessions and explained their consequences for businesses that are under-pre-
pared. In the remainder of this article, we present a program of action based on four prescriptions that developed from our distillation of prior business successes and academic research in managing through a recession, and bolstered by specific examples of businesses that followed these prescriptions.

The experience of recession thrivers suggests that managers should position their firms among less vulnerable customers and industries, and plan for the possibility of a recession. These two prescriptions might be regarded as “recession-proofing” the business. Further, a firm should promote itself and its products aggressively during recession to retain margins and cash flow, and prepare by making careful investments for the future. This second set of prescriptions might be regarded as “recession fighting.” The components of the suggested program are not mutually exclusive; each can be implemented independently, although a firm would be well advised to employ all four.

3.1. Position the company in multiple markets and geographies

A common classification of industries can be useful in positioning a company’s activities to defend against recession. Industries are classified based on a recession’s effect on their sales. The performance of a cyclical industry coincides with the phases of the business cycle. Therefore, in a recession, a cyclical industry is characterized by stable or falling prices, decreases in company spending, declines in real earnings, excess production capabilities, and high unemployment. Examples of cyclical industries include durable goods manufacturers such as auto makers, producers of apparel and other textile products, producers of paper and paperboard mills, computer manufacturers, home builders, and industries such as real estate sales, travel, media, and electronics.

There are also counter-cyclical and non-cyclical industries. Counter-cyclical industries experience increased sales during recessions. While rare, such industries include insurance, food, home remodeling and maintenance, and alcoholic beverages. The performance of non-cyclical industries is unrelated to the state of the economy. During periods of recession, consumers must continue their expenditures on necessity products such as food and health care. Health care products are less affected by recessions because consumers are relatively insensitive to the costs of their care, and because they are becoming more health conscious. Other non-cyclical industries that perform well during recession include accounting, auditing and bookkeeping services, soap, cleansers, and toiletries. Consumers are also willing to continue spending on services while cutting back on purchases of products. GDP for services increased during every quarter of a typical recession. The industry typology helps in understanding that a recession affects different kinds of businesses differently.

Differences among industries are understandable. Cyclical industries typically provide durable goods. Durable goods depreciate over time, and older goods can be repaired while new purchases can be delayed. Hence, the sensitivity of these purchases to business cycles is typically high. In contrast, the demand for services is generally stable because services cannot be stored. In short, the attempt to delay purchases during a recession by households and business customers gives rise to the cyclicality of some industries, but not others.

In addition, recessions do not affect all places equally or simultaneously. The U.S. recession of 1980–1981 had a great influence on the Midwest, the recession of 1990–1991 hurt the states along the Eastern Seaboard in the New England, Middle Atlantic, and South Atlantic regions, and the 2001 recession had a particularly strong impact on California.

Additionally, recessions usually affect one region of the world more than another (McClenahen, 2003). When the economy contracts in one part of the world, it usually expands, or at least is stable, in other parts. Why? As regions differ in their mixes of industries, the business cycle imparts a differential effect on regions based on their industrial bases. A second reason focuses on the geographic concentration of industries. Industrial concentration makes a region susceptible to both unique and cyclical industry pressures. For example, the harsh effect of the 2001 recession on California was due, in part, to the concentration of communications and computer equipment suppliers in the Silicon Valley. When, in the late 1990s, the forecasted demand for Internet services proved overly optimistic, producers of communications equipment were hurt by their buildup of telecommunications service capacity.

To position for recession, firms can seek to be active in multiple geographies, industries, and markets. Banking offers several examples of successful geographic dispersion. Prior to the 1970s, anything that affected the Hong Kong economy also affected the Hong Kong and Shanghai Bank. Consequently, the bank spread its operations to the U.S., Europe, and the Middle East, successfully diffusing its geographic risk (Mooney, 1991). Sim-
ilarly, KeyCorp, headquartered in New York, pursued a nationwide acquisition program that took its holdings as far afield as Alaska. Even when the recession of 1991–1992 advanced regionally, KeyCorp’s widely dispersed branches helped it maintain corporate profitability at levels above those of its competitors (Pare, 1993).

Holding positions in multiple industries has proven valuable to many companies in reducing the variation in cash flows caused by the cyclicality of one industry. However, such a positioning strategy must be implemented cautiously, as multiple industries can overtax managerial time and energy (Lubatkin & Lane, 1996). Therefore, related industries are most likely to offer a desirable tradeoff of additional managerial complexity versus financial rewards.

An alternative approach is to use the distinction between cyclical and counter-cyclical industries to identify markets and customers that are less likely to be affected by recession. Market diversity protects a company by mixing the recession vulnerability of its revenues. When a company can develop geographic dispersion in its customer base, it can increase the likelihood that there will be a smoothing out of sales fluctuations for the firm as a whole. Even within a troubled region, companies in non-cyclical or counter-cyclical industries may be ready and able to spend in a way that companies in cyclical industries cannot. For example, governments are rarely affected by recessions, and services industry spending typically stays high during recession. Internationally, when one market is weak, there should be other markets in the world where products can be sold. As such, identifying, attracting, and retaining recession-proof customers should all become priorities.

3.2. Plan to confront declining sales

To be prompted to act, managers must believe that a recession has begun. Managers should collect and consider as much macroeconomic and market information as can be obtained in a cost-effective manner. However, this information must be used in the recognition that economists are notoriously poor at identifying and predicting recessions. For example, six months after the commencement of the last U.S. recession, which began in March 2001, a full 90% of economists did not believe the United States was in one (Kliesen, 2003).

No definitive test in real time exists to ascertain recession. Therefore, managers should supplement professional prognostications with low-hanging fruit: company sales that can be monitored early and often. When observing declining sales, executives are often unsure whether the cause is a general economic decline in demand or a firm-specific failure of the product or service. To determine whether the decline is caused by a recession, managers can exploit the geographic and sector nature of recessions. For example, are sales holding strong among our customers in services (a non-cyclical industry)? Are sales weak among providers of consumer durables (a highly cyclical industry)? Are prominent customers in notably cyclical sectors such as automobiles cutting orders back? Managers can also use a geographic comparison. If orders from an American-based producer are weak while a European producer increases orders, it is possible that the U.S. is experiencing recession and Europe is not. All of these examples are signs that sales weakness is generated by recession rather than a problem with the product.

A mismatch of forecasted sales with projected spending is a major factor in precipitating business failure during recession (Garter, 1991). If sales do not occur because of recessionary declines and spending plans are not adjusted, profit margins can quickly turn negative. Therefore, to prepare for a recession, a top management priority is to develop a contingency plan in case of declining sales and limited borrowing capacity. A contingency plan can be used if the company is faced with a severe cash flow constraint or if competition is so intense that it cannot keep up. The plan is activated when trigger points on forecasted losses, sales, or cash flow requirements are reached.

Part of such a plan should include turnaround. Company turnaround became a topic of strategy research three decades ago, when investigators studied previously successful firms that had experienced severely declining performance for a protracted period of time (Krell, 2002). Firms that overcame their troubles and returned to match or exceed their most prosperous periods of pre-downturn performance became known as turnaround firms.

Turnaround requires both retrenchment and recovery. In retrenchment, the firm reduces costs and assets to conserve cash flow. Following retrenchment, successful turnaround firms initiate recovery strategies designed to redirect their remaining resources toward more promising product–market combinations (Grinyer & McKiernan, 1990; Pearce & Robbins, 1994a,b; Robbins & Pearce, 1992; Barker, Patterson, & Mueller, 2001).

Recession experience has shown that retrenchment, through cost and limited asset reduction, can enable firms to rebound from a recession. Examples
of cost reduction in the retail industry include leasing rather than purchasing retail space, laying off employees, and dropping expensive products from shelves. Examples of asset reduction include selling non-essential warehousing, duplicate equipment, and company cars. The main goal of retrenchment is to stabilize companies financially so they can recover from the recession through entrepreneurial activities that increase revenues or through efficiency to streamline operating expenses and increase profit margins.

When choosing candidates for retrenchment, theory can help. Academic research has concluded that the firm is best viewed as a bundle of factors of production that management must deploy systematically to add value (Barney, 1991). Factors can yield sustained competitive advantage when they are relatively scarce, hard to imitate, and hard to replace. In short, these factors are not easily traded on markets. Applying this logic, factors that are easily traded do not contribute to sustained competitive advantage and can be easily obtained or restored. For example, among human assets, foremen probably have more firm-specific skills and related knowledge; hence, they are more valuable than hourly workers. The specific categorization is not as important as the principle: let the market hold inventory. Cutbacks should be targeted for assets (whether machinery, property, or people) that can be replaced with little cost of deploying, adapting, or training into the firm’s production system.

Strategic managers used these ideas to guide ADC Telecommunications during the most recent recession. ADC saw its sales nosedive as a consequence of the 2000 recession, which pulled down the global industries of fiber optics and broadband network equipment. In 2001, ADC’s revenues dropped $900 million, or 27%. After a thorough review of its cost structure, ADC undertook retrenchment. To save costs, the company centralized many of its administrative and operational functions and closed or divested several businesses that were outside of its core activities (McCarthy & Sutcliff, 2002). This retrenchment and reformulation strategy was coupled with a unification of its brand. The strategy paid off, as ADC improved its market share against Cisco Systems, Lucent Technologies, and Nortel Networks Technologies, its principal competitors.

3.3. Promote the firm’s products and services

It is tempting to abandon initiatives and reduce expenditures on promotion and marketing during a recession; after all, reductions convert directly to profitability. While this may be alluring, it is wrong, for two reasons. First, recessions create opportunities (Pearce & Michael, 1997). During a downturn of the business cycle, customers are often willing to rethink their existing contracts and relationships and, as a result, are more willing to switch to other suppliers. Second, recessions are likely to increase the returns on marketing activities. For example, advertising usually becomes cheaper during recessions, as newspapers and TV networks and stations seek to fill their timeslots, despite a decrease in demand. Therefore, firms are likely to earn a higher return from marketing activities during downturns.

While the marketing activities a firm undertakes will be specific to its situation, any increase in activity is likely to pay off. For example, at Dixieline Lumber, a 10-unit San Diego chain, two marketing initiatives helped increase company sales by 9% during the recession of 2001. The first was directed to the building trade and involved training the in-store sales force to assemble hardware packages for custom-home builders. The second initiative was directed at homeowners and involved increasing marketing on millwork as homeowners switched from spending on traveling and entertainment to fixing up their homes.

3.3.1. Maintain advertising

Research by Ogilvy and Mather Direct provides evidence that advertising during recession pays off, particularly as the economy begins to recover (Mooney, 1991). A study by a British industry group found that smaller grocery brands that maintained higher ad levels than their larger competitors increased share during the recent recession, with some gaining as much as a 15% increase in market share (Buck, 2002). Similarly, a study by the Strategic Planning Institute revealed that the companies that fared best in the two years following a recession had either held steady in advertising expenditures during the downturn, or had made only moderate cuts.

Furthermore, aggressive marketing campaigns may be more effective during recessions, as competitors feeling the pinch might attempt to forestall losses by reducing their advertising. In addition, hungry ad agencies could well be motivated to turn out a more creative product at a more competitive price. If a firm can just maintain a constant level, it can increase its exposure due to the attrition of competing ads. For example, Carpet Mills of America increased its sales by 24.4% during the recession of 2001. Executives credited the company’s success to sustained mar-

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marketing: “We advertise no matter how bad the market is. When nobody else is advertising, we capture more customers” (Canlen, 2002). In short, steady advertising maintains a brand or product in the mind of consumers during recession.

3.3.2. Introduce new products
New product introductions may be especially effective during a recession. At such a time, competitors are relatively “quiet,” and the availability of advertising and distribution may help a fledgling product capture customer loyalty early. Additional encouragement can be derived from the common customer complaint that, during recessions, a lack of innovations in companies’ product lines keeps consumers from buying (Drickhamer, 2003).

A successful new product introduction occurred during the 1990–1991 recession. Paychex, a nationwide provider of payroll processing services to small- and medium-sized companies, responded to its initial recession-driven downturn by undertaking the development of an expensive new product called Taxpay (McCarthy & Sutcliffe, 2002). The highly successful introduction of Taxpay in 1990 infused Paychex with a burst of new revenues, which helped the company weather the recession. As a second example, Black and Decker concentrates on new product development during recessionary periods. The company launched a product line of 33 new power tools during the 2001 recession, in anticipation and expectation of the recovery.

3.3.3. Find alternatives to price cuts
The temptation to cut prices to increase sales during a recession should be resisted. A company that reduces price may unintentionally send the message that they have reduced quality, especially if product or service changes are involved.

One alternative to price cuts is private labeling. To remain price competitive and attract newly price- and value-conscious customers during a recession, many retailers opt to increase their stock of less expensive private label products. Part of JCPenney’s rebound from the 1990–1991 recession was driven by increased sales of Penney’s own labels of Stafford menswear, Worthington women’s wear, and Arizona casual wear. Similarly, Loblaw, a Canadian grocery chain, relied heavily on its 1300 President’s Choice private label products to maintain sales. The company estimated that the private label program increased their gross margins by three percentage points during the recession.

A second tactic to add value without an explicit price cut is bundling. Bundling allows vendors to subtly decrease prices without apparent price cuts. For example, Microsoft sells individual software programs such as Word, Excel, and PowerPoint at premium prices when purchased separately. However, a bundled package, Microsoft Office, includes all three programs and is priced at a lower total than the three individual programs. Whether accomplished through pairing existing products or through an alliance to offer complementary products, bundling can create value for customers without the poor signal of a price cut.

3.3.4. Attract new customers
In order to offset the loss of existing customers during recessionary periods, attracting new customers should be a priority. First, firms should qualify their prospects based on product fit, dollar and profit potential, buying patterns, credibility, and growth potential. It may also be desirable, as part of positioning, to consider the cyclicality of the customer’s business and industry. Second, companies should concentrate on selling solutions, not products. After analyzing customers’ needs, firms should focus on selling the company’s value-added selling systems that meet those needs. This will result in satisfied customers who recognize the value of working with these companies during and after the recession. Third, maintaining or even increasing presence at industry trade shows and exhibitions, and other indirect marketing methods can convince customers that the firm stands ready to serve, despite the economic difficulties (Friedmann, 2003).

Firms should also be prepared to enter new channels of distribution. Recession often creates shelf space in otherwise inaccessible retailers, and distributors are willing to rethink traditional suppliers as their own margins shrink. Aggressively seeking new accounts, some found through the Internet, is likely to pay dividends during recession.

3.4. Prepare for economic recovery

Sometimes businesses find themselves in trouble just as the economy is turning toward recovery because they took drastic measures during the downturn to reduce expenses. Unaltered, such actions have a degenerating effect on a company’s success potential when the economy is in recovery (Cooper & Madigan, 1992). It is management’s responsibility to ensure that the company not only outlasts the recession, but emerges stronger and more competitive than before. The typical recession lasts between six months and two years, so managers need to prepare for the growth that
inevitably follows a recession. When an economic recovery begins, exports rise and consumer demand increases, requiring that businesses have the necessary cash flow to finance growth in investments.

The message for managers is that during a recession, firms need to invest to protect their position in the marketplace. Not investing often leaves companies unable to meet the demand generated by economic recovery, and new competitors emerge to fill the void. In short, firms must trade off the financial risk of investing prior to full economic recovery versus the competitive risk of not investing.

Recovery will come, sooner or later. The preparations managers make in a recession will determine their company’s participation in that recovery. The willingness to implement aggressive strategic decisions allows companies to move ahead as a recession reaches its end. Dell Computer shares this view. Dell’s invested capital increased by more than 60% a year during the 1990–1991 recession, increasing its market share in 1992 by an impressive 4%, which it subsequently retained and grew (Dobbs, Jesudason, & Malige, 2002).

Executives should seek bargains and buy during a recession. The benefits of recessions for customers, businesses, or individuals are derived from the consequences of intensified business competition. Because many firms engage in heightened competition during a recession, customers find they can obtain goods and services at more attractive prices. Perhaps the best example is provided by Southwest Airlines, which exploited the buyers’ market for used jet aircraft during the 1990–1991 recession to become the #1 airline in the industry. The company complemented its purchases of Boeing 737 regional jets with the acquisition of the landing slots of failed competitor Midway Airlines.

Nowhere is aggressiveness more helpful than in company acquisitions. During a recession, acquisition targets are likely to be weakened, and therefore less expensive. Competitors are also less likely to jump into the bidding process. As a result, growth and expansion through acquisition may become less expensive during a recession and, ultimately, more profitable. Banc One used these ideas as the basis for its hugely successful acquisition strategy throughout the 1990–1991 recession. The goal of the Columbus, Ohio-based company was to become a national bank. In 1991 alone, its assets grew 50% through careful selection of target acquisitions (Jacob, 1992). As a second example, during the 2001 recession, Timken Company acquired Torrington Company, combining the two largest U.S. makers to create the world’s third largest supplier of bearings (Aeppell & Ansberry, 2003). Timken executives expressly undertook this move to position their firm to exploit economic recovery.

Further, a specialty chemicals firm, Great Lakes Chemical, used a string of 10 geographically dispersed acquisitions during the 1990–1991 recession to capture the market share leadership in its industry. The M&A activity contributed to a compound annual growth rate of 18% and enabled the company to exploit its underleveraged balance sheet (Dobbs et al., 2002). These acquisitions were made possible because the sellers’ performance during the recession had driven their value down. However, they represented more than cheap assets. These acquired companies provided Great Lakes Chemical with a basis for future recession resistance.

Employee issues are critically important in preparing for recovery. Employees find recessions to be an anxious time; they are often overworked, threatened with job loss, and suffer low morale. It is important to maintain communications with these employees (as well as customers and suppliers) to emphasize the company’s strength as a going concern and the opportunities that a recession creates.

For example, Black and Decker increases communications during times of recession in order to maintain morale and credibility among their employees. The company alerts employees to changes in their respective departments and communicates up front what the managers see as areas for potential reductions in employment or financial support. Black and Decker also continues its investment in organizational development. The company philosophy is to promote employees from within, even during a recession. Although bringing in an outsider may be possible, promoting from within is better for morale. The company also identifies and develops “fast-trackers,” managers who will guide the firm through the recovery.

In addition, corporations that reduced spending in job training, hiring, and staff during a recession have a deleterious tendency to continue their reductions during recovery periods. It is important to remember that a recession does not increase the supply of skilled and experienced labor, although it temporarily lowers demand for their talents. When good times return, so does the demand for educated, talented, and experienced people. Therefore, it is unwise in the extreme to use extensive layoffs as a short-term solution to a cash crunch. By retaining skilled employees, the firm is prepared to meet rising demand when conditions change. Moreover, research has suggested that employees with higher human capital may be better able to help the firm
make necessary changes to adapt to recession and recovery (Michael & Kim, 2005).

4. Implications for practice

Capturing the complexity of the economy is difficult, yet essential for both strategic management theory and managerial practice. Recessions are a major cause of that complexity. The “winds of creative destruction” dramatically affect the resources available to the firm. These winds are not predictable in real time, and do not blow at the same velocity at all times or in all places. What is predictable is that major recession-driven changes will occur.

Traditional advice from the business press on how to manage through recession has been straightforward: reduce expenses in any possible way. But, in a recession, strategies implemented to facilitate a business’s short-term relief are often the precipitators of its long-term pain. Reducing R&D expenses, reducing customer service, and laying off employees may have the desirable effect of improving near-term results, but they increase the likelihood of permanent damage to competitive advantage and market share growth.

By contrast, our program contains four prescriptions, grounded in academic research and business practice, which prepare a firm for recession, guide it through the downturn, and lead it out of recession, stronger than before. Table 2 summarizes the program for managing through an economic recession. It lists the four prescriptions down the left-hand column. The first two are based in the desire to conserve resources, and the last two in the desire to attract new resources. These are coupled with explanations for the expected performance advantage and a listing of the effects that may be anticipated.

<table>
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<th>Prescription</th>
<th>Explanation</th>
<th>Effect</th>
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<tr>
<td>To conserve resources</td>
<td>Position the firm in multiple markets and geographies. Sales are imperfectly correlated across regions and industries. Recessions are hard to forecast; sales declines are a leading indicator.</td>
<td>Creates a balancing effect on cash flow. Facilitates a swift response to recession.</td>
</tr>
<tr>
<td>To attract resources</td>
<td>Promote the business in tough times. Customers often rethink supplier relationships during tough times. When competitors are conserving cash, desirable hires, capital assets, and even companies may become available.</td>
<td>Makes new customer inroads. Adds capacity or customers at a discount.</td>
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Given the constraints that recessions impose on resources, it is natural to ask what demands the four prescriptions place upon them. The first prescription, hold positions in multiple products and industries, can be taken in advance of recession, in an attempt to recession-proof the business. The cost can be large if the firm pursues acquisitions in multiple industries; however, it can also be much less: the cost of prospecting for a “recession-proof” customer can be as little as a sales call.

The second prescription, plan judicious cuts and implement them in the face of recession, is designed as a cost saving measure. Although planning can be expensive, the actual cuts are designed to save money. Moreover, instead of slashing budgets, by applying the principle of “let the market hold inventory,” the firm can recover quickly from either a recession or a mistaken interpretation of recession. The resources saved can be applied to meet existing needs, or to either or both of the other prescriptions.

The third prescription, promote the business even in recession, is costly. Marketing expenses, though, come in all shapes and sizes. Improving a website or intensifying cold calling of new customers or channels is relatively inexpensive. Moreover, selling expenses rarely have scale effects: the firm can do as little or as much as it wants. An ad campaign, on the other hand, requires a certain scale to be effective; one ad rarely works. However, the cost of a major ad campaign in surely less during a recession, so, while costly, it may be a good value. An ad campaign purchased when ad space is tough to sell will be less costly, and one unleashed when others are not advertising will be more effective in the absence of clutter.

The fourth prescription, prepare for the return of better times through careful purchasing, is also costly, although how costly is variable. Again, investing in undervalued human resources is always a good risk, but major capital expenditures and
significant acquisitions are a serious drain on cash. However, lower purchase prices due to recession will almost surely result in shortened payback periods.

Although we have suggested the four prescriptions as part of a program, they are not inseparable. Managers may choose among them. The prescriptions are complementary, not contradictory, in terms of managerial time and resources. A firm can do all four, or choose to do fewer. The third and fourth prescriptions, spending on marketing versus spending on acquisition, compete only in that each requires cash, and possibly a significant amount of it. To assist in the tradeoff, managers might ask whether customers are more cost effectively acquired through competition or acquisition, since, ultimately, winning profitable customers is the purpose of the expenditures.

Perhaps the most important implication of our findings for theory is that recession-induced declines in the market value of resources not only create new threats, they provide important new opportunities. Recessions generate both an operating effect and a strategic effect. The operating effect is that the decline in resources affects our firm; the strategic effect is that the decline affects all firms. By being better able to conserve, maintain, and attract resources relative to competitors during recession, and to deploy those resources to capture customers, competitive advantage can be built.

Companies typically build their strategies to take advantage of the growth and expansion of an economy, but it is equally important to prepare for periods of economic stagnation and decline. Preparing for inevitable recession allows managers to act quickly and decisively when economic downturns occur, helping to avoid overproduction and monetary losses. Optimal preparation for dealing with an economic recession includes positioning the firm in multiple markets and geographies, planning for declining sales, maintaining promotional initiatives in the face of sales declines, and preparing through judicious investing for future competitive advantage.

References


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