The Impact Of Recession On Businesses

by Marc Davis (Contact Author | Biography)

Some economists have jokingly defined a recession like this: If your neighbor gets laid off, it's a recession. If you get laid off, it's a depression. Economists officially define a recession as two consecutive quarters of negative growth in gross domestic product (GDP). The National Bureau of Economic Research cites "a significant decline in economic activity spread across the economy, lasting more than a few months" as the hallmark of a recession.

Both definitions are accurate because they indicate the same economic results: a loss of jobs, a decline in real income, a slowdown in industrial production and manufacturing and a slump in consumer spending - spending that drives more than two-thirds of the U.S. economy.

In the article we'll explain how the impact of these broad-spectrum slowdowns on both large and small businesses can be very damaging, and in some instances, catastrophic. Some businesses may be affected only moderately, or not at all, if the recession is mild and brief. If the recession lingers and the downturn is widespread, all big businesses - firms publicly traded on major stock exchanges - may ultimately be hurt. (Read about classic examples of economic downturn in *Stagflation, 1970s Style* and *What Caused The Great Depression?*)

How a Recession Impacts Large Businesses

Let's take an unnamed Fortune 1000 manufacturer as a typical big business suffering the effects of a recession. What happens to this firm will likely happen to other big businesses as the recession runs its course.

As sales revenues and profits decline, the manufacturer will cut back on hiring new employees, or freeze hiring entirely. In an effort to cut costs and improve the bottom line, the manufacturer may stop buying new equipment, curtail research and development and stop new product rollouts (a factor in the growth of revenue and market share). Expenditures for marketing and advertising may also be reduced. These cost-cutting efforts will impact other businesses, both big and small, which provide the goods and services used by the big manufacturer.

Falling Stocks and Slumping Dividends

As declining revenues show up on its quarterly earnings report, the manufacturer's stock price may decline. Dividends may also slump, or disappear entirely. Shareholders may become upset. They and the board of directors (B of D) may call for a new CEO and/or an entirely new senior management team. The manufacturer's advertising agency may be dumped and a new agency hired. The internal advertising and marketing departments may also face a personnel shakeup.

When the manufacturer's stock falls and the dividends decline or stop, institutional investors who hold that stock may sell and reinvest the proceeds into better-performing stocks. This will further depress the company's stock price. (Learn how understanding the business cycle and your own investment style can help you cope with an economic decline in *Recession: What Does It Mean To Investors?* and *Recession-Proof Your Portfolio*.)

The sell-off and business decline will also impact employer contributions to profit-sharing plans or 401(k) plans if the company has such programs in place.

Credit Impairment and Bankruptcy
Also impacted by the recession is the accounts receivable (AR). The customers of the company that owe it money may pay slowly, late, partially or not at all. Then, with reduced revenues, the affected company will pay its own bills more slowly, late, or in smaller increments than the original credit agreement required. Late or delinquent payments will reduce the valuation of the corporation's debt, bonds and ability to obtain financing. The company's ability to service its debt (pay interest on the money it has borrowed) may also be impaired, eventuating in defaults on bonds and other debt, further damaging the firm's credit rating and preventing further borrowing. (*Debt Reckoning* can teach you how a company's debt is an indicator of financial health.)

Debt will have to be restructured and/or refinanced, meaning new terms will have to be agreed upon by creditors. If the company's debts cannot be serviced and cannot be repaid as agreed upon in the lending contract, then bankruptcy may ensue. The company will then be protected from its creditors as it undergoes reorganization, or it may go out of business completely. (For related reading, see *An Overview Of Corporate Bankruptcy*, *Profit From Corporate Bankruptcy Proceedings* and *Taking Advantage Of Corporate Decline*.)

Employee Lay-offs and Benefit Reductions
The business may cut employees, and more work will have to be done by fewer people. Productivity per employee may increase, but morale may suffer as hours become longer, work becomes harder, wage increases are stopped and fear of further layoffs persists. (Read about how employment statistics influence corporate confidence in *Surveying The Employment Report*.)

As the recession increases in severity and length, management and labor may meet and agree to mutual concessions, both to save the company and to save jobs. The concessions may include wage reductions and reduced benefits. If the company is a manufacturer, it may be forced to close plants and discontinue poorly performing brands. Automobile manufacturers, for example, have done this in previous recessions.

Cuts to Quality of Goods and Services
Secondary aspects of the goods and services produced by the recession-impacted manufacturer may also suffer. In an attempt to further cut costs to improve its bottom line, the company may compromise the quality, and thus the desirability, of its products. This may manifest itself in a variety of ways and is a common reaction of many big businesses in a steep recession. (Learn about the importance of production levels in *Understanding Supply-Side Economics*.)

Airlines, for example, may lower maintenance standards. They may install more seats per plane, further cramping the already squeezed-in passenger. Routes to marginally profitable or money-losing destinations may be cut, inconveniencing customers and damaging the economies of the cancelled destinations.

Giant food purveyors may offer less product, for the same price, in the same size package in which the larger amount was previously sold. Quality may also be reduced. Coffee, for example, may be cut with lesser-quality beans, compromising flavor and driving away cost-conscious consumers with little brand loyalty who have noticed the change. (Read about the importance of standing out from the competition in *Competitive Advantage Counts*.)

Reduced Consumer Access
As firms impacted by the recession spend less money on advertising and marketing, big advertising agencies which bill millions of dollars per year will feel the squeeze. In turn, the decline in advertising expenditures will whittle away at the bottom lines of giant media companies in every division, be it print, broadcast or online. (Read about successful marketing strategies in *Advertising, Crocodiles And Moats*.)

As the effects of a recession ripple through the economy, consumer confidence declines, perpetuating the recession as consumer spending drops. (To learn more, read *Economic Indicators: Consumer Confidence Index (CCI)*.)

A Recession's Impact on Small Businesses
The impact of a recession on small businesses that have annual sales substantially less than the Fortune 1000 and that are not public companies is similar to large businesses. Without major cash reserves and large capital assets as collateral, however, and with more difficulty securing additional financing in trying economic times, smaller businesses may have a harder time surviving a recession. Bankruptcies among smaller businesses may therefore occur at a higher rate than among larger firms.

The bankruptcy or dissolution of a small business that serves a community - a franchised convenience store, for example - can create hardships not only for the small business owners, but for residents of the neighborhood. (Learn how businesses can safeguard their assets in *Asset Protection For The Business Owner*.)

In the wake of such bankruptcies or dissolutions, the entrepreneurial spirit which inspired someone to go into such a business may take a hit, discouraging, at least for a while, any risky business ventures. Too many bankruptcies may also discourage banks, venture capitalists and other lenders from making loans for startups until the economy turns around. (Read *Six Steps To A Better Business Budget* to learn about an easy but essential process that helps owners keep their small businesses afloat.)

Recessions Don't Last Forever

Recessions come and go and some are more severe and last longer than others. But history shows that recessions invariably end, and when they do, an economic recovery follows.

For related reading, see *The Federal Reserve's Fight Against Recession*.

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