3. Common reactions to a recession

Companies typically react to a recession in at least one of the following ways: they attempt to carry on as normal (inertia); they lower prices; or they cut costs. Each of these reactions is discussed in turn below.

Inertia

Samli (1993, p1) argues that if firms behave in a reactive or inactive fashion in response to a recession, they are not seeking to counteract market adversities and ultimately take a fatalistic point of view of doing nothing. Such a passive approach to recessionary pressures is dangerous, for it displays indifference to volatile markets comprising customers that are more likely to switch to competitors with more attractive offerings.

The contraction in demand is significant and sustained in a recession, meaning that for many companies it is simply not possible to wait out the storm. Consequently most companies are forced to react in some way. Competitive pressures increase substantially in a downturn as revenues plummet and everyone fights to maintain or grow their customer base. The companies that ultimately cannot fight hard enough fail.

Lowering prices

A collapse in demand can lead to price wars as markets are more price conscious and "price driven" in a recession. Lowering prices is thus a common reaction to recessionary pressures as too many suppliers chase too little demand, meaning that prices are competed down.

Lowering prices is the easiest short-term means of winning sales. This need for an immediate boost in sales is stressed by Charan (2009). Building sales is crucial during a recession (as it is at any other time), but what is not clear, however, is what Charan's views

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are on marketing expenditure as he appears to favour investment in sales over marketing.

Lowering prices may be more of a tactic than a strategy because it is often very much a short-term course of action with price rises following as soon as possible. And it is dangerous as many companies that slash their prices have a preconceived notion of the price elasticity of their market, i.e. how sensitive the market is to price. For example, it was estimated that in the chemical industry of 1991, for the average European company a 1% fall in prices would cut profits by as much as a 5% decline in volume (Hart, 2008 p49).

Cutting prices is no panacea, especially if it is a knee-jerk reaction as opposed to a long-term strategic response. In doing so, companies are making the assumption that their market segments are price buyers, which is a dangerous trap to fall into. Indeed, customers do not buy exclusively on price but on perceived value, i.e. the trade-off between the benefits a product or service offers and the price tag attached.

Lowering prices is often a desperate attempt of companies to generate sales and to keep up with the competition. Without a commercially sound pricing strategy, however, lowering prices can cut profit margins to fatally low levels.

Cutting costs

In general, companies suffer a recession with a reduction in profits of about a third peak-to-trough (idem p6). Many companies suffer even worse than this, such as in the 1991 recession when the profits of both Whirlpool and Renault were down by 65% respectively and the profits of NatWest bank fell 71% (idem). Faced with squeezing profit margins, many companies are forced to cut costs in an attempt to conserve cash.

Financial pressures force firms to cut costs on a wide range of investments, not only in plant closures, but also in intangibles such as marketing, training and R&D. When the economy is in a downturn, many business expenditures such as promotional, sales and market research outlays are cut first because they do not show tangible and immediate results. What is more, in a recessionary economy companies are prone to curtailing areas that are easy to cut in the short-term, cashing in investments regardless of their medium-term prospects.

Moreover, retrenchment can be dangerously obvious to the market, such as by a deterioration in customer service, an absence in sales reps, delayed delivery times or a lower quality product or service. In spite of tumultuous change, the customer's experience with the product must continue to live up to the promise of the brand, and management must not sacrifice its image and identity by cheapening its product (Charan, 2009 p56).

Geroski and Gregg (1997 p14) argue that the challenge companies face in cutting costs is the difficultly in distinguishing between which overheads are 'fat' and which are 'muscle', especially as intangibles have subtle and potentially very long-run effects on corporate performance. Indeed as the business cycle progresses and marketing activity declines, the company's position deteriorates with decreasing sales and shrinking profits. Samli (1993 p7) posits that this conventional wisdom of non-marketing management in turbulent times contributes substantially to the turbulence itself.

Thus as with lowering prices, cutting costs can be a fatal move, especially if the costs that are cut reduce the company 'muscle', as opposed to the company 'fat'. Such knee-jerk reactions with a view to obtaining a quick fix are, in the main, flawed given that the economy (and markets) will take some time to recover from the recession. There is a clear need for proactive marketing strategies that can be sustained throughout the economic woes and which result in profitable rather than break-even or loss-making outcomes. This leads on to the following chapter on effective marketing strategies for a recession.