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How to Beat the Recession

Make Sure Your Business Prospers While Others Struggle

By Alistair Gibb

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About the Author

Alistair Gibb studied economics and business at Durham University and the University of Strathclyde and then joined the 3i Group, where he held senior positions in both the investment and merchant banking sides of the business.

His subsequent career has included being group finance director of a construction business, co-founding a chain of fast food and bakery shops and working in economic development in both England and Scotland.

Alistair also helped to develop Scotland's first undergraduate degree in Entrepreneurship and Business Development and is the author of the *Bibliography of Banking Histories*.

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Chapter 1

What Exactly is a Recession?

We are all talking about the recession. You can hardly avoid the word. But though we use the 'R' word a lot, I wonder how many of us could explain what a recession really is, what it does to an economy and why it affects different firms in different ways.

So it makes sense to start with a little gentle economics, because that will help you to understand the new environment your business is facing.

If you are in a hurry, or if you are allergic to economics, you can skip this first part of the book and go straight to the business impact analysis in Chapter 6. But after you have read that bit you might want to come back to understand more about the new world in which we are all operating.

In Britain, we define a recession as occurring when two consecutive quarters show reductions in GDP. In America they do things differently, of course, and the National Bureau of Economic Research defines a recession as three consecutive quarters of falling GDP.

GDP stands for gross domestic product and is a measure of the output of the country as a whole. Here it is measured every three months by the Office for National Statistics (www.ons.gov.uk) and the figure for the previous quarter is usually published towards the end of the first month of the next quarter.

Thus the data for the fourth quarter of 2008, covering the period from 1st October 2008 to 31st December 2008, was published on 23rd January 2009.

Now you might wonder how on earth the clever folk at the ONS manage to accomplish this in such a short space of time and that is a very pertinent question.

There are three ways of measuring the activity in an economy: you can add up all the output achieved during the quarter, and you might do this by taking a periodic census of output from businesses, you can add up all the expenditure that takes place in an economy during the quarter and adjust for changes in stocks or, finally, you could add up everyone's income.

In an ideal world all three measures should be equal. But this is not an ideal world and the three measures are never equal. Drug dealers will not declare their income, lots of cash payments never get recorded and some big numbers are just estimated.

Calculating Statistics

For instance, the statistics include an estimate of the benefit we obtain from occupying the houses we own. The argument is that, if the house were rented, the rent would be part of national income and expenditure. So just because the same person is both owner and occupier does not eliminate the benefit. Hence a figure is imputed for owner occupation – and it is a very large one.

In fact, the more you delve into the national statistics, the more you realise that trying to measure changes of 0.1 of a percentage point every quarter with any degree of accuracy is well-nigh impossible.

The authorities acknowledge this by going back to the initial figure and revising it when more data becomes available. Thus in quarter two of 2008 the economy was initially thought to have grown by 0.3%. Then they had another look at the data and announced that a more accurate figure was 0.2%. Then, when they had even more data, they decided that the economy had not grown at all and announced officially that their best estimate was 0.0%!

So quarter two came within a whisker of being the start of the recession. When it starts matters because, as we will see, recessions may follow a similar time pattern.

We now know that the current downturn officially started on July 1st 2008. That was the start of the first quarter in which GDP declined.

The downturn was confirmed as a recession when the final quarter of 2008 also showed shrinking GDP. At that point we had the two consecutive quarters of decline that are the defining characteristic of a recession.

After such a long period of sustained economic growth, the recession has come as a shock to many.

There are people today who have years of experience running a business but have never experienced a recession. All they have known is expansion.

That is why many of the country's leading businesses are changing their chief executives. The boards probably feel that the outgoing CEOs are too associated with growth and they may not be able to change their attitudes quickly enough to cope in a recession when very different skills and styles are needed.

In fact, it is about 17 years since the last recession ended so people could well be into middle age without having managed a business in a recession.

Many people are going to have to learn fast and this guide is particularly relevant for them.

The book grew out of a series of workshops held around the country with companies, their advisers and economic development agency staff to develop strategies for coping with the downturn.

The workshops were so well received that there has been a call for the material to be made available to a wider audience and Taxcafe is proud to have been selected as the publisher.

Chapter 2

Could It Turn Into a Depression?

As the recession has deepened, the question has naturally arisen: “Could it turn into a depression?”

There is a general awareness that a depression is much worse than a recession but if you ask most people, usually the only one they know about is the Great Depression of the 1930s.

However, if you look back in history, there have been many others. In the UK’s economic history, the period from 1873 to 1896 is sometimes labelled ‘The Long Depression’ as that is what it was, especially for industries connected with agriculture.

But in the 19th century what we would call depressions were more often called crashes or panics and there were several of note.

If you want to read about them I would recommend Charles Kindleberger’s *Manias, Panics and Crashes: A History of Financial Crises*. The manias were the booms and the panics and crashes were the busts.

World economic history is punctuated by these cyclical peaks and troughs. And, of course, the UK is not unique in this respect.

However, the depression of the 1930s is the one we all think of because it lies just on the far perimeter of living memory and we have all seen grainy black and white film of out-of-work men queuing at the doors of the soup kitchens in the United States.

As far as many people are concerned, 1930s America defines a depression. So what exactly happened?

During the Great Depression, GDP in the United States fell over a prolonged period. Here are the figures:

- 1930 – GDP fell by 8.6%
- 1931 – GDP fell by 6.4%
- 1932 – GDP fell by 13.0%
- 1933 – GDP fell by 1.3%

Over the whole period of the depression, American GDP fell from $103 billion to $55 billion. Unemployment reached 25% of the working population and wages fell by 42%.

These are truly jaw-dropping figures and the suffering that took place behind the numbers is almost unimaginable.

Could it happen again? If you flick forward to Chapter 3, you will see how far GDP fell in the UK during the previous three recessions. The figures are tame compared with those from the Great Depression.

Recession or Depression?

Although there is no official definition of a depression, there does seem to be something of a consensus that a depression lasts longer than a recession and results in a drop in GDP of at least 10%.

The forecasts for the current recession hover around a 4% reduction in UK GDP so, by a fair margin, the official view is that it is unlikely to turn into a depression.

Economic historians rarely see eye to eye on anything but there is a measure of agreement that what made the 1930s depression so bad was the shrinking of the money supply that accompanied the fall in GDP.

In a depression, banks see loans turning sour and become less eager to take risks (in other words, make new loans). In the UK this sort of behaviour has been noticeable in the mortgage market for many months. Property finance was easy to obtain three years ago. Now it is much, much harder.

In times like these property developers also find it harder to obtain funding and banks call for more security for their loans, thereby forcing developers to sell assets which causes prices to fall further.

Banks rein in all forms of lending and increase their holdings of cash. Even normal business activity become harder to finance. Share prices collapse. Economic paralysis starts to set in. Pension funds run out of cash. Fraudsters, who relied on the good times and people not asking too many questions to keep afloat, get caught. People start to withdraw savings from anything they think is risky.

Against a background such as this, the only way for companies to stay in business is to cut prices. They also cut wages to pay for price reductions. When the general level of prices begins to fall we have deflation.

With wages, prices and the value of assets all falling together and confidence at a low level, investment grinds to a halt and the economy enters a downward spiral.

You may well say, “But all of this is happening in Britain at the moment.” And you would be correct.

Government Action

But the difference is that here the Government has taken decisive action to flood the system with very cheap money. Bank base rate at 0.5%? That must be really tempting if you have a project in mind. And it will encourage you to hold on to an asset and wait for the good times rather than sell now for anything you can get.

And borrowers will have more money to spend because they are paying less interest. All of these consequences will tend to stimulate the economy again and prevent the recession becoming a depression.

And then there is ‘quantitative easing’. You won’t find that in the textbooks because it has never been done quite like this before.

The Government is spending up to £125,000,000,000 (I thought I should write the number out in full just to emphasise how large it is!) to purchase Government and corporate bonds.

The idea is that that sellers of these bonds, such as banks, will then have cash on their balance sheets and will be encouraged to look for something to do with it – like investing it or lending it out to companies.

Whether this is what will happen is unknown. Interfering with markets is extremely dangerous and the history of governmental action in commodity markets is not encouraging.

When the Government steps in to buy its own bonds to force the price up I am reminded of Robert Maxwell buying up shares of the Mirror Group. Eventually he ran out of money, even the money he stole.

So the UK and other governments are flooding the economies of the world with liquidity to prevent this recession from turning into a depression. Will it work? No one knows. But the odds are that it will work.

This is a recession, not a depression, and there are ways to avoid its impact, to prosper during it and to emerge stronger than you were when it started. That is what this book is about.