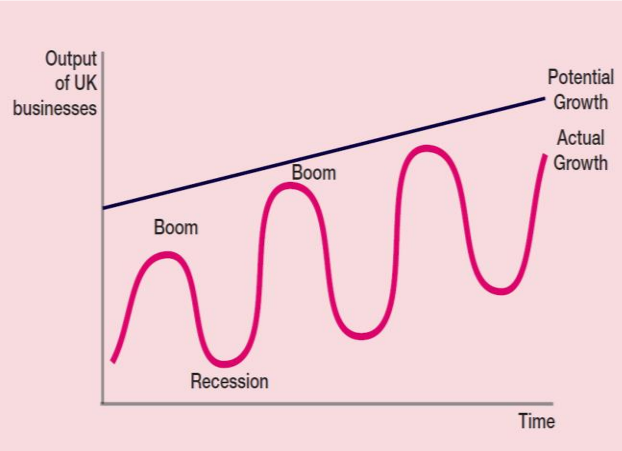
THE TIMES 100

BUSINESS CASE STUDIES

Downturn and recession in the business cycle - CIMA

CIMA, the Chartered Institute for Management Accountants, is the world's leading body for **management accountants**. Management accountants can provide management information and insights as well as financial data to help managers make decisions. Between 2008 and 2009 there was a fall in production and consumer spending. Economic performance has continued to be poor. During these hard times it is essential to have a good understanding of how to make important decisions to get the economy growing.

Gross Domestic Product (GDP) is the value of all the goods and services produced in an economy over a period of time. When GDP rises, economic activity is increasing. This is called economic growth. Periods of high growth are followed by periods of slow growth, or even negative growth. These fluctuations are known as the business cycle:



- *Boom* –the economy is growing quickly. Demand in the economy is high and consumer spending grows.
- *Downturn* – growth starts to slow down. Consumer spending begins to fall and businesses invest less.
- *Recession* – a continued downturn in economic activity can lead to a recession. Demand is low and firms may struggle to survive.
- *Recovery* – GDP starts to rise again as consumer spending rises & businesses increase production.

Downturn - a downturn is a slowdown in economic activity. High levels of inflation in a boom can lead to businesses becoming uncompetitive. Inflation increases uncertainty as rising costs and prices are difficult to predict. In order to try to control demand when inflation is high, the government can increase taxes. In addition to this, the Bank of England can raise **interest rates**. These actions encourage saving and discourage spending. The result is that economic activity begins to decline.

Recession - a downturn can lead to a recession which is defined as two successive quarters of negative economic growth. During a recession, demand in the economy is low and markets shrink. There are pressures for businesses to reduce costs, which can lead to increased unemployment as companies lay off workers. The resulting higher unemployment means people have less money to spend, thus contributing to the downturn in the economy. Some businesses may have to close down. In 2009 a number of well known businesses closed in the UK, for example, Woolworths. Other businesses reduced the number of outlets or stores they operated. During a recession, the Board of Directors of a company needs to consider various options of managing lower revenues and therefore profits. Management accountants can provide analysis to help focus on core profitable activities and identify where costs can be cut. They may provide detailed figures relating to options such as making redundancies, closing offices, shrinking capacity or even selling off assets like machinery and buildings. However, the problem in making cutbacks is that it reduces the ability of a business to respond when the economy takes an upturn. Management accountants may also help identify opportunities for immediate or future growth during a recession. Good deals may be available at this time. Investment in equipment or acquiring another business during a recession is likely to be cheaper than during a boom. This can put a company in a strong position to deal with increasing demand when the economy begins to recover. Management accountants are able to explore every way to reduce the impact of a recession, without resorting to impulsive decisions which may harm recovery.

Questions

1. What is the definition of a recession?

2. Describe the factors that might make the economy move into a downturn in the business cycle.

3. Explain the actions firms may take during a recession.

4. Analyse why management accountants might look for growth opportunities during a recession.

Task

Using the case study to help you, draw a business cycle and annotate it to show the characteristics and possible government intervention at the downturn and recession stages of the business cycle.

What have you learned?

In small groups, play hangman of different terms relating to downturns and recessions in the business cycle. When someone has correctly guessed the term, they have to explain what that term means.