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Economic recessions, strategy, and performance: a synthesis

Scott Latham
College of Management, Falmouth, University of Massachusetts-Lowell, Lowell, Massachusetts, USA, and

Michael Braun
Department of Management & Marketing, University of Montana-Missoula, Missoula, Montana, USA

Abstract

Purpose – Despite the episodic pervasiveness of recessions and their destructive impact on firms, a void exists in the management literature examining the intersection between recessions, strategy, and performance. This paper seeks directly to address this research void by reviewing relevant literature spanning the past 20 years and building an integrative framework for future research efforts.

Design/methodology/approach – The paper systematically reviews and compartmentalizes articles on the intersection between firm strategy and economic recession published between 1991 and 2010 in widely recognized management and entrepreneurship journals. Concurrently, a theoretical framework is proposed which identifies distinct constructs and linkages related to economic recessions, strategy, and performance.

Findings – The findings are twofold. First, the review distils disparate scholarly works on firm behavior and recessions to provide a systematic appraisal and review of what people know and do not know about managing firms through economic downturn. Second, the conceptual framework points to numerous opportunities to scholars interested in conducting research on this timely and important topic.

Practical implications – The paper answers a call by scholars for research that fills a void on systematic diagnosis, prescription, or prophylaxis that can guide managers through recessions.

Originality/value – This paper represents the only research initiative to systematically bring a comprehensive overview of firm strategy in the context of recessionary environments. In effect, it addresses the larger research question: "What do we know about the interplay between firm strategy and recession?"

Keywords Business cycles, Recession, Performance management, Corporate strategy

Paper type Research paper

1. Economic recessions, strategy, and performance: a synthesis

A compelling and strong argument exists maintaining that economic recessions represent the most transformative event faced by organizations. Extant research has demonstrated that recessions dramatically transform industry landscapes and "cleanse" industries (Caballero and Hammour, 1994; Schumpeter, 1939; Tvede, 1997). These scholars, among others, maintain that in recession, not all firms within an industry have the capabilities to survive the economic slowdown or to adapt to the new economic reality. However, while the disruptive nature of economic recessions on firm viability and competitiveness is roundly acknowledged by practitioners and academics alike, comparatively little research has addressed how managers can successfully navigate these treacherous events. To provide an impetus for management scholars to redirect their attention to this timely but understudied topic, we set out to develop a

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review of what we know, as well as what we have yet to learn, about how firms behave during economic recession.

In conducting our review, we offer a theoretical framework that compartmentalizes firm-level studies in the context of recessionary environments. Our approach in building this framework borrows from past efforts (see Ramanujam and Varadarajan, 1989) to develop comprehensive overviews of disparate streams of literature. Within the framework, we conduct a literature review of published scholarly efforts in widely recognized management journals during the 1991-2009 time-period and summarize their contributions to leading themes on the topic. In doing so, we discuss our broader observations of the literature in the context of our synthesized framework, in efforts to build a roadmap for future research.

Apart from attempting to highlight a need for scholarly studies on firm strategies during recessions, we believe our manuscript offers a strong managerial contribution. Since the Second World War, economic recessions occur on average every five years. Accordingly most managers are bound to face economic downturns several times during the course of their careers, making coping with recession a critical part of the suite of managerial skills. However, while their cyclical nature suggests that they transpire with foreseeable regularity, several dynamics unique to economic recessions greatly complicate management's initial reaction and subsequent decision-making. First, different "triggers" set off recessions (e.g. overheated leveraged buyout/junk bond markets, overconfidence in dot com technologies, inflated housing market). In this regard, no two recessions are alike, thus presenting unique challenges for managers. Second, recessions emerge without warning (Geroski and Gregg, 1997; Tvede, 1997), therefore making it difficult for managers to prepare for recessions as they might for other changes in the environment (e.g. deregulation, technological disruptions, etc.), which, more often than not, have well-identified precursors or warnings. Third, because recessions have no set time frame as to when they conclude, managerial discretion around strategic decisions and investments take on a higher level of uncertainty. That is, while flawed strategic investments without adequate returns on investment may be withstood more easily during economic prosperity, those same investments made during a recessionary period can seriously hinder the firm's performance and endanger its survivability. In putting forth a framework to compartmentalize the various firm-level dynamics particular to the context of economic recession, and to subsequently evaluate contributions and shortcomings in the broader management literature on strategy and recessions, we attempt to highlight issues that may prove important to managers facing these economic disruptions. We now move to a theoretical review of the literature on firm strategy in the context of recessionary environments.

2. Theoretical review

In an effort to succinctly and methodically assess the organizational implications of economic recession, we rely on a framework that details firm-level constructs and linkages related to the particular context of recessionary environments. Figure 1 highlights the underlying dynamics associated with our proposed framework. In developing the framework, we referenced seminal papers in the management field by diligently reviewing relevant literature on the intersection between strategic management and economic recessions. At a general level, Figure 1 comprises five

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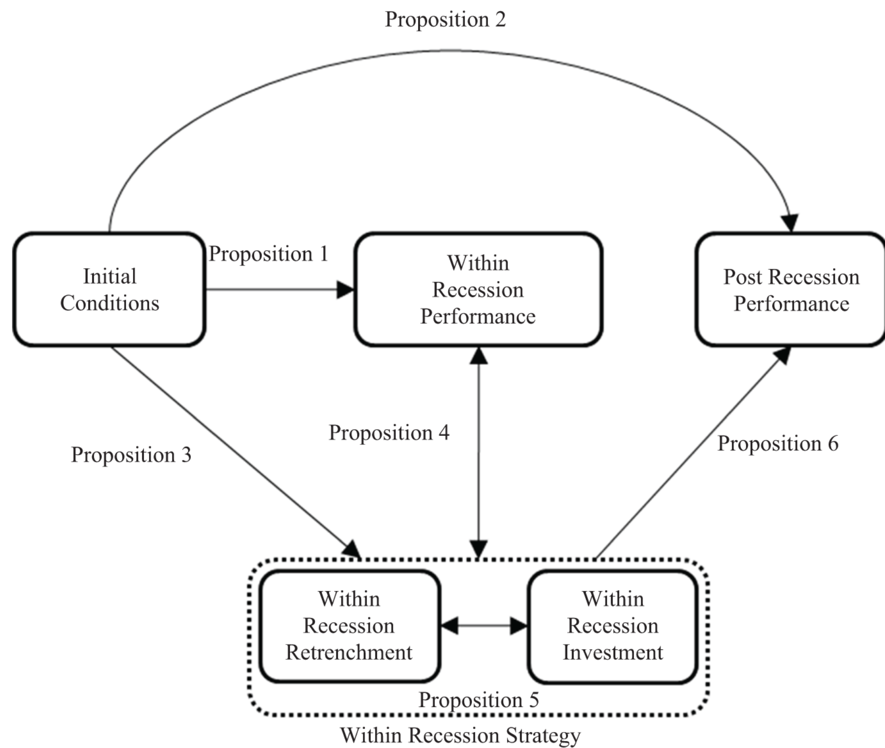

Figure 1.
An integrated framework for understanding firm level dynamics during recession

distinct constructs present in the literature on recessions. Additionally, we include seven distinct linkages within the model representing the dynamics between constructs – and the bases for our propositions – which we detail in the following pages. In building this framework and its relevant propositions, we integrate, where appropriate, theoretical concepts and tenets from across the strategy field that help explain and predict the dynamics we anticipate to unfold during recession.

As indicated by Figure 1, our first contention is, that an organization's initial conditions in terms of its current stocks of resources and capabilities (see Dierickx and Cool, 1989), at the onset of the economic recession, will mitigate or accentuate recessionary pressures and subsequently influence firms' short-term response and performance (i.e. intra-recessionary) performance (Proposition 1). Furthermore, we expect initial conditions to partially determine the firm's long-term performance, including survivability and competitive advantage, once the recession ends (Proposition 2). Given the detrimental nature of recessions on firms' short and long-term viability, and in keeping with the majority of extant literature on firm strategies during economic downturns (Ghemawat, 2009; Latham and Braun, 2008; Bohman and Lindfors, 1998), we attend to the performance construct in terms of accounting-based performance metrics (e.g. sales, ROA, ROS, etc.). Our third proposition holds that organizations' initial conditions, which more often than not are a by-product of past decisions, will dictate firms' strategic decision-making in response to recessions (Proposition 3). The next phase of the model deals with the unique

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interplay between within-recession performance and within-recession strategy (Proposition 4 and 5). As we discuss, such an interaction has significant repercussions for firms' post-recessionary performance (Proposition 6). Our final proposition demonstrates the effect of the recurring nature of recessions on firms' competitiveness and subsequent performance over multiple business cycles (i.e. economic growth and retraction) (Proposition 7).

In supporting our framework, we include the specific articles that pertain to the various constructs and linkages. To this end, we systematically read and summarized articles published between 1991 and 2010 in acknowledged management and entrepreneurship journals examining recessions and firm strategy. These dates were selected because they encompass the last three recessions, thus potentially providing impetus for current academics to engage in this type of research. We excluded any literature reviews, book reviews, editorials, opinion pieces, and/or introductions to special issues. For each paper returned, the entire content was carefully reviewed to reveal if recession was central to the theoretical foundation of the paper, or was a passing, non-essential reference. Only in those papers where recession and firm strategy were central to the work was the paper included in our review. The majority of papers make only a superficial passing of recession and strategy with little or no theoretical explanation. The resulting analysis produced 34 articles with substantive examination focused centrally on the intersection between economic recession and firm strategy. Table I serves to indicate the scale and scope of the managerial literature on recessions and strategy; we include a brief summary of each article, along with its empirical or theoretical methodology. We now shift to a discussion of the framework, its theoretical bases, and supporting scholarly investigations.

2.1 Selection pressures, firm initial conditions, and performance (Propositions 1 & 2)

As previously noted, recessions emerge in an unexpected fashion with no set time frame for their duration. Indeed, the advent of the two most recent recessions illustrate this preceding point – the.com-related recession of the early 2000s and the housing-related recession of 2007 surfaced with little or no warning. As such, the sudden, unexpected, and overwhelmingly detrimental nature of economic recessions precludes managers from adequately preparing, partially explaining the detrimental nature of recessions. In doing so, these economic downturns, to a large degree, exert significant selection pressures on organizations as environmental munificence is reduced. Our first proposition deals directly with firms' positioning at the onset of recession. That is, to a large degree, an organization's intra- and post-recessionary performance will be partially determined by the organization's cache of resources and capabilities as the economic downturn begins, i.e. their initial conditions.

In building this proposition, we draw from the population ecology school of thought attending to the notion of initial conditions and selection pressures (Hannan and Freeman, 1977). According to this theoretical perspective, initial conditions refer to a firm's core characteristics under circumstances of environmental shifts such as a recession, regulatory change, technological disruption, or other external changes in the environment. Depending on the nature of the external change and the firm's unique initial conditions, selection pressures emerge, although they do not impact a population of firms equally. Rather, they affect firms depending on the firm's unique initial conditions relative to the exogenous shock and the new economic reality (Levinthal,

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Table I. Managerial literature on recessions, strategy and performance

Author(s)	Empirical (E) or Theoretical (T)	Selection pressures, firm initial conditions, and performance (*P1* & *P2*)	Initial conditions and strategic response (*P3*)	Performance, perception, and response (*P4*)	Within-recession strategy, short-termism, and risk (*P5*)	Within-recession strategy and post-recession performance (*P6*)	Economic recession as stochastic performance cycles (*P7*)
Navarro *et al.* (2010)							×
Braun and Latham (2009)	E	×	×				
Deans *et al.* (2009)	T			×	×	×	
Ghemawat (2009)	T			×	×	×	
Latham (2009)	E	×		×		×	
Wang (2009)	T				×		
Latham and Braun (2008)	E	×	×				
Tubbs (2007)	E				×	×	
Lee (2006)	E	×			×		
Pearce and Michael (2006)	T	×			×		
Srinivasan *et al.* (2005)	E	×		×	×		
Navarro (2005)	E	×	×	×	×	×	×
Rafferty and Funk (2004)	E			×	×		
Alessandri and Bettis (2003)	E	×					×

(*continued*)

Author(s)	Empirical (E) or Theoretical (T)	Selection pressures, firm initial conditions, and performance (*P1* & *P2*)	Initial conditions and strategic response (*P3*)	Performance, perception, and response (*P4*)	Within-recession strategy, short-termism, and risk (*P5*)	Within-recession strategy and post-recession performance (*P6*)	Economic recession as stochastic performance cycles (*P7*)
Rafferty (2003)	E			×	×		
Roberts (2003)	E				×	×	
Kamber (2002)	E				×	×	
Lamming (2000)	E				×		
Beaver and Ross (1999)	E	×	×	×			
Bohman and Lindfors (1998)	E				×		
Brockhoff and Pearson (1998)	E				×		
DeDee and Vorhies (1998)	E				×	×	
Michael and Robbins (1998)	E				×		
Geroski and Gregg (1997)	E	×	×	×	×	×	×
Pearce and Michael (1997)	E			×	×	×	

(*continued*)

Table I.

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Table I.

Author(s)	Empirical (E) or Theoretical (T)	Selection pressures, firm initial conditions, and performance (*P1* & *P2*)	Initial conditions and strategic response (*P3*)	Performance, perception, and response (*P4*)	Within-recession strategy, short-termism, and risk (*P5*)	Within-recession strategy and post-recession performance (*P6*)	Economic recession as stochastic performance cycles (*P7*)
Dugal and Morbey (1995)	E				×		
Shama (1993)	E	×					
Bacot *et al.* (1992)	E				×		
Bigelow and Chan (1992)	T				×	×	
de Chernatony and Knox (1992)	E				×	×	
Goodell and Martin (1992)	T	×			×	×	
Morbey and Dugal (1992)	E				×	×	
Whittington (1991)	E				×	×	

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1991). As such, organizations can be adversely selected, resulting in discounts to the value of an organization's resources that eventually lead to performance decline. Alternatively, selection pressures can also be deemed to favorably leverage organizations' initial conditions, thereby resulting in immediate as well as long-term performance benefits.

Under circumstances of recession, selection pressures are bound to be unique in comparison to the selection pressures associated with other environment changes. While McKelvey and Aldrich (1983, p. 115) make the case that "sometimes, resources are so abundant that no selection takes place . . . ." under circumstances of recessions, selection pressures are heightened as firms lose access to critical resources (e.g. customers, funding, etc.) in the marketplace. As firms struggle under conditions of reduced environmental munificence, we expect a strong interplay between recessionary selection pressures and firm initial conditions to have significant bearing on a firm's short-term performance. That is, firm performance will be dictated not only by its response, but also by the nature of the firm's existing resource base at the onset of recession.

Indeed, empirical research supports this view. In Geroski and Gregg's (1997) examination of the role initial conditions and selection pressures within the context of recession, their research points to the role of firm size, profitability, and diversification on short- and long-term organizational performance. Specifically, they find that, in general, smaller, less profitable, and less diversified firms performed worse during the recession than their comparably larger, more profitable, and more diversified peers. In similar step, research by Shama (1993) shows that recessionary effects vary dramatically depending on the size of the organization although, surprisingly, smaller organizations are least affected by recessionary pressures.

Aside from firm attributes, other research has examined the linkage between initial conditions and performance. Braun and Latham (2009), for one, focus explicitly on the unique organizational attributes of publicly-traded family firms. Their analysis of 75 family firms indicates that firms with a dual governance structure (e.g. combined CEO and chair positions) and ample slack resources exhibit the necessary decision-making speed and resources to favorably respond to demand shocks. Non-dual, low slack family firms, in contrast, demonstrate lower performance both during and after the recession. Similarly, Lee (2006) finds in a longitudinal study of 403 firms that family firms demonstrate a higher rate of employee retention, supporting the notion of a stewardship orientation inherent in family firms. In similar vein, Nunez-Nickel and Moyano-Fuentes (2004) focus their empirical research on the particular organizational form of cooperatives, determining that, as an ownership structure, the cooperative also provides for a buffer during recessionary disruptions. While these are limited in their scope, by drawing from the extensive literature on the function of governance in turnaround, management scholars can bring a clearer understanding of pre-recessionary firm attributes and their subsequent impact on intra-recessionary firm performance. In drawing from the above-mentioned literature, we offer our first proposition:

P1. To a significant extent, firms' within-recession performance will be dictated by their initial conditions at the onset of the recession.

Extant literature also suggests that initial conditions, accentuated by selection pressures, also affect post-recessionary performance, specifically with respect to firms'

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long-term viability. In other words, a firm's "fitness" prior to recession will influence, to an extent, its financial health once the recession comes to an end. Debatably, Schumpeter (1950) puts forth the most compelling argument for the transformative nature of recessions. Specifically, his theoretical notion of creative destruction is inextricably tied to the business cycle – whether in a single industry or across all sectors of an economy. According to Schumpeter, while creative destruction is triggered by innovation, it is the subsequent recession that reorders the economic system. From Schumpeter's perspective, the destructive aspect of the business cycle, which culminates in recession, purges inefficient firms and industries, making way for more efficient and innovative modes of competing. Simply put, less efficient and less innovative firms tend to fail during recessionary periods, while more innovative, entrepreneurial firms prosper, or, as Schumpeter (1936, p. 216) maintains "new combinations mean the competitive elimination of the old" and "the appearance of new enterprises *en masse* on the old firms." It is recession that brings the drama of creative destruction to close, with much "dead wood" disappearing in the process. Indeed, while firms experience performance deterioration during economic recessions, research demonstrates that bankruptcies are higher after recessions come to a conclusion.

Geroski and Gregg (1997) argue that, generally, while many firms may survive the immediate jolts of economic downturns, longer-term survival and competitive advantage are dictated by the extent to which a firm can leverage its existing resource base. The Geroski and Gregg (1997, p. 67) make a strong case that "firms which make operating losses at the start of the recession have a ticking clock counting down to failure". Accordingly, Latham and Braun (2008) find support for this view in studying the role of financial slack on the performance outcome of software firms over the 2001 recession. Their results indicate that companies with higher initial levels of slack resources fared better in terms of post-recession performance. While slack slowed management's initial reaction to the demand shock, thereby accentuating their performance decline at the onset of the recession, the availability of slack resources enabled firms to better withstand economic scarcity by insulating them not just throughout the recession, but allowing for strategic investments for long-term performance benefits once the recession comes to a close.

Other scholars have found similar linkages between firm attributes and firm survivability. Beaver and Ross (1999) interviewed executives at 87 small businesses in the Midlands, UK, in an effort to determine which factors determined whether or not the business would survive the recession. They found that small businesses were at a higher risk of failure than larger businesses, but that smaller firms maintaining strategic consistency were likely to prevail. In line with these studies, our second proposition is as follows:

P2. To a significant extent, firms' post-recession performance will be dictated by their initial conditions at the onset of the recession.

2.2 Initial conditions and strategic response (Proposition 3)

Our third proposition extends our previous suggestions in terms of the nature of management's response to the onset of recession. More specifically, we foresee a firm's resource base prior to recession to determine the types of strategic choices available at management's discretion. For example, firms financially vulnerable at the onset of recession may opt to focus on fiscal conservatism, cost reductions, and operational

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streamlining in efforts to stabilize the firm and curtail resource losses (Robbins and Pearce, 1992). However, while these efficiency measures may be necessary to accomplish immediate performance improvements, they may not be sufficient to position the firm for long-term (i.e. post-recessionary) competitive advantage. On this particular point, Ghemawat (2009, p. 32), among others, makes a strong case that firms in recession, seeking to gain a long-term competitive advantage, need to strike a balance between "the error of pursuing too many unprofitable investment opportunities as opposed to the error of passing up too many potentially profitable ones." Given this delicate balance between managerial saving and spending during recession, a firm's resource base will influence not merely management's strategic decision-making choices, but ultimately the performance outcome of those particular choices once the recession ends.

For example, scholars have posited that slack permits managers increased flexibility during a period of environmental uncertainty. Cheng and Kesner (1997, p. 3) reaffirm this perspective by stating that "firms with slack are more likely to respond aggressively to shifting environmental demands than those without slack". More recently, Tan and Peng (2003, p. 1250 bluntly state that slack resources enable firms to "hang in there". Lastly, slack facilitates innovation in the form of new product experimentation or new market entry by providing a safety net for failure (Nohria and Gulati, 1996; Bourgeois, 1981). Hence, as environmental disruptions, such as recession, jeopardize existing products or markets, firms with slack can survive and succeed by seeking out alternative sources of revenue that might be critical during the emergence of a new environment.

Gittell *et al.* (2006) demonstrate that reduced resource munificence combined with a firm's existing financial resources had significant implications for the manner in which Southwest Airlines responded to contraction in the airline business arising from the 9/11 terrorist attacks. In contrast to other cash-strapped airlines, Southwest Airlines possessed substantial financial resources not only to buffer the firm in the short-term, but also determined the types of strategic responses it could engage to position it for long-term competitive advantage. In stark contrast, executives at other airlines voiced a desire to avoid layoffs, with their lack of freed financial resources forcing them to engage in downsizing strategies. While these layoffs may have secured these airlines' short-term viability, they came at the expense of long-term competitiveness. Though the preceding case study does not relate directly to recessions, it speaks to the "handcuffing" influence that firm's initial conditions can have when environmental conditions shift.

With regard to the relationship of initial conditions and their subsequent effect on strategic response, three studies warrant attention. Whereas Latham (2009) finds that smaller organizations tend to be more resistant to recessionary pressures, a significant difference exists also in terms of the nature of the strategic response; Latham's results demonstrate that start-up organizations respond by finding market niches, while larger organizations rely on cost cutting and layoffs. Another study by Srinivasan *et al.* (2005) indicates that proactive marketing (i.e. marketing intended to build new products and markets) is a function of management's strong emphasis on marketing, entrepreneurial culture, and slack. The authors find that proactive marketing is causally related to improved within-recession performance, thereby establishing a strong linkage between a firm's initial conditions and its strategic response. Beaver

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and Ross (1999) offer commentary on the effect of firm size on the strategic planning process. In interviewing executives at 87 small businesses in the Midlands, UK, in an effort to determine which factors determined whether or not the business would survive the recession, they find that small businesses are much more at risk than larger ones, but that smaller firms maintaining strategic consistency are likely to prevail. Drawing from these studies, we anticipate that managers engage different strategies responses over the course of the recession dependent on the resources and capabilities available to them prior to recession. Thus, our third proposition reads:

P3. A firm's initial conditions in terms of its resources and capabilities at recession onset will determine the nature of its response.

2.3 Performance, perception, and response (Proposition 4)

We anticipate that a firm's strategic response will be partially dictated by the extent to which managers perceive the recession to be a threat or an opportunity. In the context of recessionary environments, our expectation is that a firm's immediate performance outcomes at the onset of the economic disruption will influence the underlying risk attitudes of management's strategic decisions. This particular view borrows from literature making the case that managers respond to environmental disruptions in two distinct fashions (Latham and Braun, 2008). One school of thought maintains that environmental uncertainty and risk inhibits managerial risk-taking, among other things, and thus reduces organizational change and adaptation (Staw *et al.*, 1981). Making their case for the rigidity perspective, Staw *et al.* posit that external threats can dramatically influence the behavior of groups and organizations. More specifically, they maintain that when faced with an external threat, managers shift their attention towards efficiency concerns by focusing their efforts on budget tightening, cost cutting, and increased accountability, or what Braun and Latham (2009, p. 138) call a managerial "battening down the hatches". Similarly, Heifetz *et al.* (2009, p. 3) call such a prospect "hunkering down".

A competing view holds that managers, when faced with environmental uncertainty, will adopt more risk-seeking behavior. Such a perspective draws heavily from prospect theory (Kahneman and Tversky, 1979) to suggest that risk-taking depends on whether decision-makers reside in a domain of gains or losses. That is, decision-makers evaluate outcomes against some referent point, becoming risk-averse when outcomes are in a domain of gains but risk-seeking when faced with a domain of losses. In line with prospect theory, therefore, the expectation is that managers facing declining performance may undertake increased levels of risk within their strategic decisions. Conversely, when in the domain of gains as reflected in positive short-term performance, prospect theory puts forth that managers will engage in risk-averse behavior by opting for more risk-averse strategies.

While managerial perception of environmental change is likely to influence strategic response, this aspect remains underdeveloped in the recession-related literature. One unique studies to attend to this particular theme (Bacot *et al.*, 1992) involves in-depth interviews of 30 senior executives immediately after the late 1980s recession to determine their strategic responses to the economic downturn, in turn identifying five strategic clusters: cluster one is characterized by firms seeking to reduce costs in order to expand their core business through horizontal integration. Cluster Two involves firms solely seeking to cut costs without any attempt at

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expansion. Cluster Three comprises firms seeking to differentiate their product offerings. Cluster Four is characterized by firms seeking to diversify their core business into related operations, while firms in Cluster Five pursue a course of unrelated diversification. Similarly, Bohman and Lindfors' (1998) examination of ten organizations' change management strategies in response to economic recession find dramatic shifts in structure, myths, and processes. In drawing from these two studies, and by extrapolating from the larger literature on managerial risk-taking under conditions of uncertainty (e.g. Bromiley *et al.*, 2001; Chattopadhyay *et al.*, 2001; McKinley *et al.*, 1986) we offer the following proposition:

P4. Managerial perception of the threat or opportunity presented by recession, inevitably shaped by short term performance, will moderate the nature of the strategic response.

2.4 Within recession strategy, short-termism, and risk (Proposition 5)

While strategic responses to recession may be largely determined by the nature of the organization's initial conditions (*P3*), as well as the managerial perception of the recessionary effect on the organization (*P4*), we deem any strategic response to recession to be complicated by trade-offs between managerial short-termism and long-term prospects (Laverty, 2004). Short-termism, specifically, emerges when managers are driven to invest current resources in risky endeavors, such as advertising and capital expenditures, which may or may not yield expected outcomes in a near or distant future. Nevertheless, tensions arise since they must conserve current resources in their efforts to deliver short-term financial performance goals for stakeholders who measure the value of the firm (and managerial abilities) in the immediate future. That is, the underlying conflicts in decision-making imply that the need to make investments necessary for building long-term competitive advantage often conflicts with managers' short-term orientation to meet performance benchmarks for key external constituencies (Marginson and McAulay, 2008).

In the particular context of recessionary environments, Ghemawat (2009) makes a strong case that this tension is heightened as managers weigh the financial risk of investing against the competitive risk of not investing. Indeed, both risks are tangible and significant; managers may favor retrenchment initiatives that emphasize efficiency measures such as cost cutting, asset sales, and employee lay-offs at the expense of repositioning – including product and market expansions, innovation and acquisitions – intended to strategically transform the firm for competitive advantage. Alternatively, investing in activities with uncertain outcomes (i.e. innovation) may expend critical resources to maintain the firm's viability over the course of the recession. We anticipate the choice of strategy to influence the firm's immediate performance. In similar vein, others have theorized as to the delicate balancing act inherent in crafting strategy during a recession. Deans *et al.* (2009) cast the within-recession strategy decision as "offensive" (i.e. revenue generating) or "defensive" (i.e. cost or asset reducing). Lastly, Pearce and Michael (2006) put forth "recession proofing" and "recession fighting" prescriptive for planning for and coping with recession.

Indeed, research has focused on firms' decision to err on the side of financial risk, thus undertaking retrenchment strategies. With regards to research focusing on the nature of retrenchment, specifically cost and asset reductions, the driving research

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question has been the nature of these reductions. DeDee and Vorhies' (1998) study of 110 executives at smaller high-technology firms finds a significant and positive relationship between retrenchment and subsequent performance, with specific attention given to cost controls, lower priced product alternatives, and centralized decision-making. Similarly, in a study of 164 small manufacturing firms, Michael and Robbins (1998) observe that managers opt to retrench by reducing costs and assets deemed "replaceable" – that is, resources lacking asset specificity. Other studies have offered similar commentary on the effectiveness of retrenchment (Bigelow and Chan, 1992; Whittington, 1991).These findings serve as the basis for our fifth proposition.

P5. A firm's choice of retrenchment versus repositioning strategies will be related to its short-term (intra-recessionary) performance.

2.5 Within-recession strategy and post-recession performance (Proposition 6)

As detailed previously, firms pursuing retrenchment strategies may witness tangible, short-term performance gains during the recession, albeit with the possibility of compromising their long-term competitive advantage. Conversely, a long-term orientation without necessary attention given to immediate needs can further destabilize firms roiling from the onset of recession. However, extant turnaround literature (e.g. Pearce and Robbins, 2008; Lohrke *et al.*, 2004; Chowdhury and Lang, 1996; Robbins and Pearce, 1992) proffers that managers experiencing deteriorating performance will engage with both retrenchment and repositioning in response to decline. That is, managers reacting to performance deterioration will, initially, seek to stabilize their firm's financial state via efficiency measures, such as cost cutting, asset sales, and employee lay-offs. Following retrenchment, they shift their attention towards entrepreneurial initiatives – including product and market expansions and acquisitions – intended to strategically transform the firm for competitive advantage. In short, these turnaround responses to decline indicate management's short-term objective to get "lean and mean" before engaging in longer-term actions aimed at growing the business (see Dobbs *et al.*, 2002).

In the context of recessions, we anticipate that managers will need to strike a delicate balance between retrenchment and repositioning strategies in efforts to make it through the short-term disruption and to favorably position the firm for post-recessionary performance. To that end, studies have offered commentary on repositioning strategies involving, for example, R&D and marketing investments: Tubbs' (2007) study examined R&D investment effects on firm performance across 16 industries, demonstrating that firms which increase R&D during the early stage of recession tended to demonstrate higher performance in the recovery cycle of the economy. Other research has supported such findings (Dugal and Morbey, 1995; Morbey and Dugal, 1992).

Scholars have also examined the change in the nature of R&D spending during recession. For instance, Rafferty and Funk (2004) contrast two conflicting explanations for an increase or decrease in R&D expenditures associated with economic recessions. The cash flow perspective argues that firms with fewer pools of funds available to the firm will reduce R&D during recession. In contrast, the opportunity cost perspective maintains that recessions offer cheaper strategic factor markets. As such, we may therefore expect firms to increase their innovation activities. Rafferty's (2003) study of R&D behavior during recession highlights two interesting points. First, total R&D

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expenditures drop during recessionary periods and rise during recovery and, second, innovative R&D activities tend to increase during recession whereas development activities decrease. Brockhoff and Pearson (1998) also establish that the scale of R&D drops during recession, with the nature of the investment shifting as well. In a survey and interview study of British and German organizations, the authors demonstrate that recessionary pressures alter the scale and scope of R&D investments, with reduced budgets shifting toward higher probability projects and cooperative endeavors.

Other studies have focused on customer-oriented activities, such as sales and marketing. Roberts (2003) examines the linkage between within-recession strategy and post-recession profit and market share. By relying on the PIMS database, he demonstrates that firms willing to make "good" investments, including marketing, quality and product development, typically warrant higher profits and experience sharper market share increases during the recovery. Kamber (2002), in a study of 822 organizations' advertising spending during the 1991 recession, uncovers a positive relationship between advertising expenditures and sales growth in the post-recessionary phase. Pearce and Michael's (1997) examination of 114 start-up manufacturers' marketing-related strategic investments indicates that firms investing heavily in marketing-related activities (e.g. advertising) before and during recession relates to higher returns on equity. Also, they find that companies relying solely on cost cutting demonstrate weaker returns on equity. Finally, the study by de Chernatony and Knox (1992) of the bottled water and fruit juice market segment suggests that brand image has a reduced effect during a recessionary pressure, but additional pricing reductions have a two-pronged negative effect – they diminish brand equity and affect long-term positioning. In general, we take these studies to denote that a firm's intra-recessionary response strategies will have a significant impact on firm performance once the recession comes to a conclusion. Our next proposition thus follows:

P6. A firm's response strategies, specifically its repositioning efforts, will determine its long-term (post-recessionary) performance.

2.6 Economic recession as stochastic performance cycles (Proposition 7)

The final aspect of our framework addresses the unique, recurring aspect of economic recessions, as well as their iterative, long-term impact on a firm's competitiveness. More specifically, we contend that recessions partially explain firm variance within industries because their repetitive nature represents a stochastic model for performance variance. In putting forth our assertion, we borrow from Richard Mancke (1974) who suggests that firm performance variance cannot solely be explained by industry or firm factors; rather, there exist cyclical, repetitive processes that aggregate the successes and failures of firms' strategic decisions. Reflected in this notion is that firms which realize a higher rate of return are likely to have more funds to invest in subsequent strategic investments, with the benefits of these investments carrying through subsequent rounds of business cycles within the industry.

With recessions occurring in a similar cyclical fashion, thereby potentially offering similar stochastic dynamics, we maintain that organizations which emerge from recession in stronger form will accrue benefits of their strategic decisions in the recovery period to strengthen their resources and capabilities, and thus hold an

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enhanced position entering into any subsequent recession. Similarly, organizations which emerge from a downturn in a weakened state may be either unwilling or unable to make necessary investments that improve their resource position. As another recession arises, they are likely to enter the downturn at a disadvantage. In general, we may argue that once one recession concludes, some firms may continue with retrenchment strategies, in this manner engaging in a type of "organizational anorexia" that ultimately compromises the organization, especially in light of follow-on recessions. In that recessions occur every four to five years on average, such a dynamic has potentially significant implications for explaining why some firms fail while others succeed when faced with economic recession. Figure 2 reflects this dynamics by offering an interlocking perspective on the nature of economic recessions: the nature of a firm's performance in the wake of recession inevitably serves to create the initial conditions that will dictate their ability to cope with the cycle of consecutive recessions.

Limited empirical examination supports the notion that recessions are subject to a carry-over effect. For one, Mascarenhas and Aaker's (1989) examination of the strategies of 33 oil well drilling firms over the 1973-1983 time period details any variance in business strategy across the business cycle. Interestingly, they find that performance across the business cycle follows a random walk; that is, higher performance-ranking firms during good times do not necessarily perform better during recession and vice versa. Additionally, their results indicate that firms greatly overcompensate, depending on the stage of the cycle, by cutting costs dramatically in times of recession and, alternatively, investing more, if not "too much", during prosperous times.

More recently, Navarro *et al.* (2010) argue that managers can prepare for the business cycle with appropriate strategies. Their study of 35 S&P 500 firms supports the notion that firms which develop strategies, such as countercyclical investment decisions, tend to demonstrate a higher rate of performance. Their findings support Navarro's (2005) earlier contention that firms adopt a master cyclist perspective, pursuing strategies that are in line with the backdrop of the business cycle. In their analysis of 54 organizations across seven industries, Alessandri and Bettis (2003) observe that the business cycle plays a significant backdrop for corporate strategy in that organizations that excel during an economic boom often find their strategies untenable during recession. Their conclusions support the notion of Navarro's (2005) "master cycling", or that organizational strategies are best dissected over the course of a full economic cycle. The authors identified four organizations - Dell, Southwest

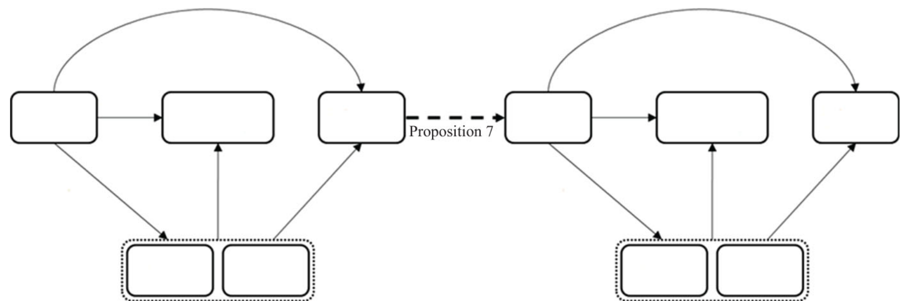

Figure 2.
An interlocked stochastic perspective on firm performance variance during recession

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Airlines, MBNA and Family Dollar Stores – that exemplified strong performance throughout the business cycle relative to their industry and competitors. Furthermore, their study makes the case for firms' initial conditions and performance by indicating that organizations with a strong cost position tend to benefit when recessions unexpectedly emerge. Aside from these studies, however, very little research exists on the stochastic nature of recessions and the extent to which firms navigate the rising and ebbing tides of the economy. We offer our last hypothesis on firm strategies over multiple recessionary periods:

P7. To a significant extent, firms' abilities to withstand recession will influence their ability to navigate subsequent recessions.

3. Discussion

Several observations can be drawn from the review of the recession literature within the management field. First, as detailed, economic recessions represent an enduring environmental force which results in large-scale changes across markets, industries, and firms. Pearce and Michael (2006) finds that, on average, more than 500,000 businesses failed in the USA during each of the ten recessions that have occurred since the end of the Second World War. In the most recent economic downturn, dubbed "The Great Recession", the number of firm bankruptcies ballooned to new heights, including venerable consumers brands such as Eddie Bauer, Blockbuster Video, Six Flags, and, of course, General Motors. Yet, in the past 20 years, only a small number of scholarly articles have been published in which recessions take the central seat in the investigation. Certainly, management scholars can provide a more thorough examination of this unique yet ever-present phenomenon in hopes of providing managers with the necessary prescriptions. Second, there is a dramatic absence of recession-themed investigations in the top journals of the management field. With the lone exception of Mascarenhas and Aaker (1989), most of the articles reviewed fell outside of the disciplines so-called leading journals (e.g. *SMJ*, *AMR*). In efforts to make academic research more relevant to management, we perceive a unique opportunity for the scholarly community to connect with practitioners. Third, studies on the intersection between economic recession and firm strategy are overwhelmingly Western-centric, despite the fact that recessions represent a worldwide phenomenon. Some important research questions arising during our review involve the global nature of recessions: What are the far-reaching implications of global recession on the strategies of multi-national enterprises? To what extent do the strategies of firms in emerging economies mirror those of firms studied in the USA and the UK? The most recent recession offers a singular prospect for management scholars to engage in cross-border research on this topic.

To our knowledge, this article represents the first effort of its kind to take a broad perspective on the managerial literature dealing with firm strategies in the context of recessions. More importantly, it paves the way to offer a theoretical framework that integrates firm-level dynamics unfolding in the context of economic recession. While the studies detailed herein have made significant contributions, we believe that additional theoretical insight can be weaned to bring a more thorough and practical understanding of what happens to organizations as they experience the duress related to recession. Economic recessions lend themselves to scholarly investigation in that they are characterized by tremendous uncertainty, a reduction in environmental

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munificence, and a hypercompetitive environment entailing "do or die" strategies. As such, a strong theoretical basis is needed to understand various facets of the interplay between the external context and the firm-specific strategic behavior. Indeed, if good theory predicts and explains, our scholarly attention then needs to turn to building a deeper understanding of firm strategies during recession, a particular phenomenon that most business managers are bound to grapple with at one point or another in their careers.

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Corresponding author
Scott Latham can be contacted at: scott_latham@uml.edu

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