Economic Cycle and Firm Managerial Strategies

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Abstract

Over time many economists have focused on the problems of economic cycles and crises. Economic cycles are generally the result of global demand displacement, its decrease bringing about reduction of production as well whereas its increase leads to production growth.

Starting from the fact that the variations of global demand are the basis of the comprehension of economic cycles, in the literature two categories of theories have been approached(known under the name of external theories and internal theories) which might explain the cyclic evolution of economy. For external theories, the cause of economic cycle is given by the exterior fluctuations of the economic system such as: wars, rates of rise of population and emigration, scientific discoveries and technological innovations. Internal theories refer to mechanisms within the economic system which generates economic cycles and which determines the cyclic movement. According to these theories the whole expansion leads to recession and shrinkage, and the whole shrinkage leads at its turn to expansion similar to a process which recommences regularly.

Key words: economic cycle, cyclicity, fluctuations, strategies, expansion
J.E.L. classification: M10, M21

1. Introduction

The characterization of cyclicity as a form of movement of economic activity has in view the succession and repeatability in time of some similar stages of economy from one cycle to another. The phases of cyclic movement are reciprocally conditioned and they lay their finger on economic activity providing continuity, qualitative changes and progress. Therefore, economic theory has drawn the conclusion that cyclicity represents the normal form of evolution of economic activity (Camelia Constantinescu-Băeșu, 2005, p.55)

The economic literature shows numerous points of view referring *to genesis of cyclic activity*. The analysis of these approaches lead to the conclusion that for long time economic thinking has been dominated by the theory (law) of markets according to which each merchandise creates automatically its own market, providing at any moment the full use of available resources, the automatic mechanisms of market having the role to correct the possible negative phenomena that might occur in any activity sector. (Niță, 1993, p.453)

The capitalist development has not lost its cyclic character, the determining role in the emphasis of world contradictions being held by the cyclic development of production process and economic crises which have led to the occurrence of economic imbalances.

The evolution of main economic activities in an enterprise, national sector and economy determines increases in some periods and in others depressions or even reductions, the overall economic activity or branch going periodically through crisis stages. This fact emphasizes that economic activity may have in time a fluctuating evolution. Therefore it is important to make the distinction between more categories of economic fluctuations: (Negucioiu, 1996, p.208)

Seasonal fluctuations of economic activity occur all along the same year and have a high degree of predictability. They can be generated by natural or social causes such as the seasonal character of some activities carried on in the field of agriculture, industry of constructions, tourism. These fluctuations can also be determined by a series of social circumstances (religious traditions, customs, and holidays);

Accidental fluctuations of economic activity are usually determined by a series of causes and events that cannot be foreseen such as: natural cataclysms, different political and social events;
Economic (aggregated) cyclic fluctuations are generated by economic internal causes of running of national economies and they manifest themselves with certain regularity. Such fluctuations of cyclic type occurred at the beginning of the 19th century. The research of these fluctuations has led to the conclusion that the alternation of expansion and contraction periods of businesses, of economic activity in general takes place with a certain regularity in time. On the whole, the evolution of main economic phenomena has an undulating form of cyclical character.

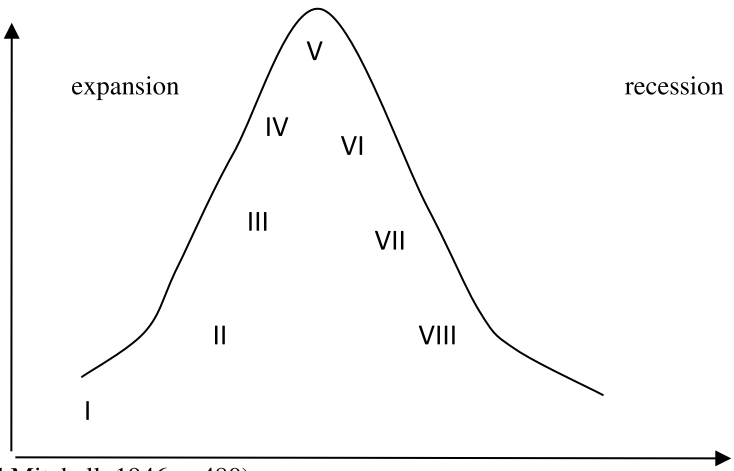
2. Theoretical background - Short Analysis Regarding the Role and Importance of Economic Cycles

In the study *Measuring Business Cycles*, published in the year 1964, Arthur Burns and Wesley Mitchell define business cycle as being fluctuations of economic aggregated activity of a nation that runs its economic activity by means of commercial companies. (Burns, et Mitchell, 1946, p.480). The previously mentioned authors summarize a few characteristics of economic cycles: (Burns et Mitchell, 1946, p.480)

- such a cycle is being formed by an expansion which takes place at the same time in many economic activities, followed by general similar recession, contractions and booms which get united in the expansion phase of the next cycle;
- this sequence of changes is repetitive but not periodical;
- duration of a business cycle varies from more than a year to 10-12 years;
- they are not dividable to smaller cycles of similar characteristics and proportional amplitudes.

Burns and Claire consider that an economic cycle consists of more phases, such as: ascending phase, descending phase, crisis phase (named also recession) and phase of economic activity reprise.

Figure no. 1. Stages of economic cycle



Source: (Burns and Mitchell, 1946, p.480)

The stage I is the lowest point from where the cycle starts;
The stages II, III, IV are the expansion phase;
The stage V is the highest point of cycle;
The stages VI, VII and VIII show the contraction phase (decrease or shrinkage);
The stage IX is the lowest point which ends the cycle.

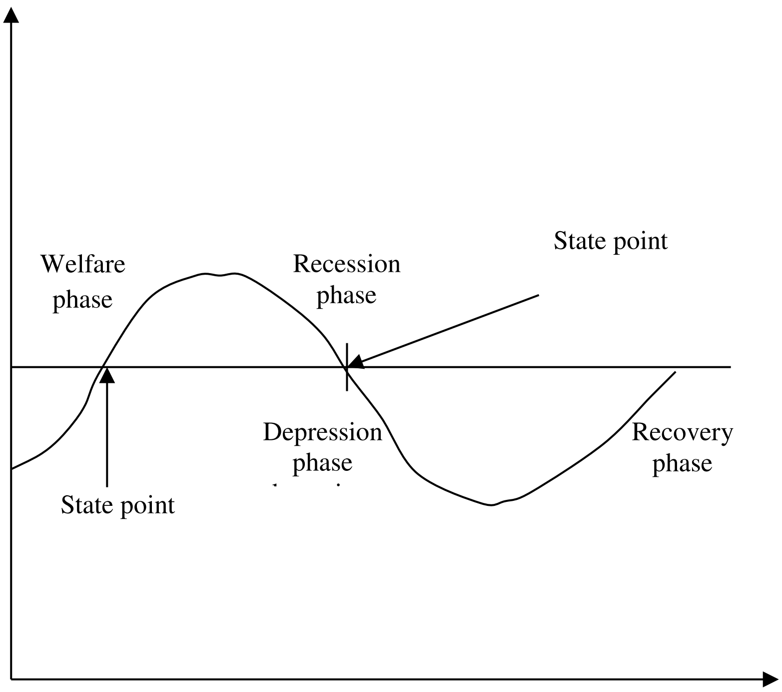
Economic cycles take place continuously and they change their total duration, duration of phases and intensity with which these phases manifest themselves.

In the paper *Economics*, in the chapter *Business Cycles and Unemployment*, Paul Samuelson thinks that a business cycle lasts between two and ten years. The author considers that a business cycle is like an oscillation in the total, national production, income and labor force marked by a large expansion or contraction in different sectors of economy.(Samuelson, 1992, p.242)

Keynes considers that investments are the main element in achieving a business cycle. Consequently, he explains the way how a cycle is getting formed, starting from the investments' growth which determines changes in the aggregated demand, cyclical fluctuations being determined by the oscillations of investments in stocks. Thus, if in the expansion phase the increase of aggregated demand determines the increase in production and decrease in stocks, in the recession phase because of decreased demand, companies will significantly reduce their production showing a tendency of increasing the stocks. (Reynes, 1970)

An important role in the study of economic cycles is held by Joseph Schumpeter by his studies Die Theorie der Wirtschaftlichen Entwicklung (Theory of economic dynamics, 1911); Business Cycles. According to Schumpeter's opinion an economic cycle comprises the prosperity phase, recession phase, depression phase and recovery phase.

Figure no.2.Four-phase Cycle adapted from *Schumpeter*



Source: (Schumpeter, 1998)

One can notice that the periods of expansion and recession shown in figure 2 alternate with peaks and inferior limits of activity after crisis which interpose. Recession ends with an inferior limit of activity after crisis which implies the turning point when the economic activity is the lowest. This is followed by expansion stage, period in which productivity increases and available jobs as well, salaries, enterprises' profit. (Schumpeter, A.J., 1998). But not every period of expansion reaches a high share of prosperity with a low rate of unemployment. It is difficult to determine the moment when a change is strong enough to be considered depression. At present there is no definition of depression unanimously accepted, this term being used to describe the economic situation of the year 1930 (the depression in 1930 was profound and of long duration). (Wannacott, et. al, 1986, p.138)

On the basis of available data analysis, economic theory emphasizes also three categories of economic cycles which overlap and intertwine (Modelski, 1987, p.49).

Long, secular or Kondratieff, called after the name of the economist who studied them for the first time, have a period of evolution from 20-30 years and up to 500 years;

Juglar cycles, called after the name of the French economist concerned with the evolution of medium term fluctuations;

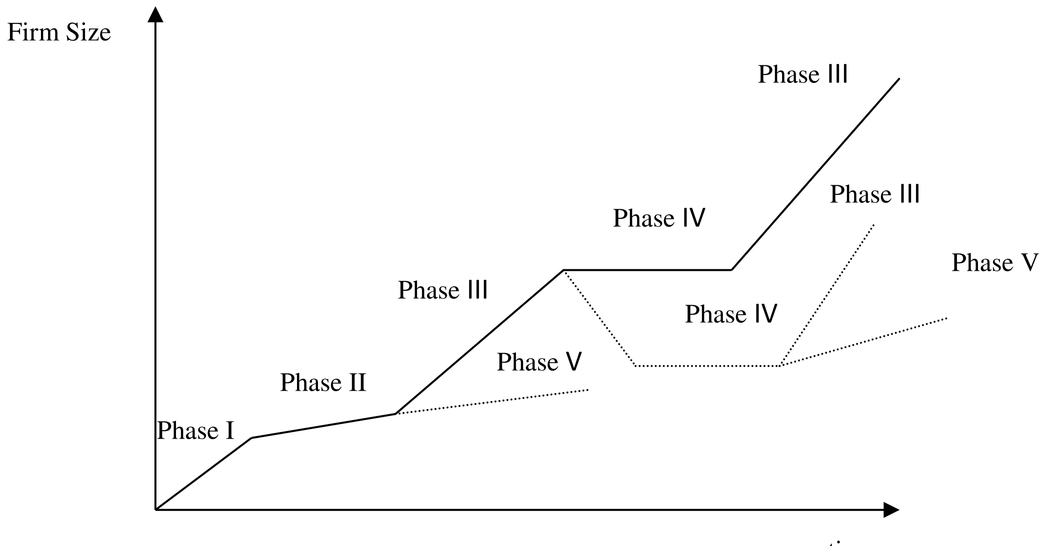
Short or Kitchin cycles, called after the name of the American economist who analyzed them in 1923.

At present business cycle was defined as being the model of succession of recession stages of economic activity around the trend (tendency) of economic growth. Later on other types of cycles have also been defined such as: cycle of political businesses, cycle of inflation, cycle of assets, cycle of unemployment, as well as constant economic growth, economic growth from the point of view of demand, extensive economic growth, intensive economic growth, potential economic growth, stable economic growth and economic crisis.

3. Elaboration of Firm's Strategies Depending on Phases of Economic Cycle

Elaboration of economic strategies is a complex process which requires good knowledge of internal and external factors influencing the firm's activity, the study of demands on different markets, good documentation regarding the evolution of products, technologies, economic, political and social life. The evolution in business of a firm in a competitive environment can differ from one period to another and it depends on the life cycle in which the firm is. The six phases of a firm's life cycle are shown in figure no 3: launching phase of the firm on the market (phase I), development phase of firm (phase II), growth and expansion phase (phase III), stagnation or decline phase (phase IV), comfort phase (phase V), the owner's and/or firm's juridical form changing phase (phase VI) ; this phase is not illustrated in the fig. n. 4.3. as it may occur at any moment in the firm's evolution. (Nicolescu, 1996, p.65)

Figure no. 3. Stages or phases of firm's life cycle



Source: (Nicolescu, 1996, p.65)

To solve the problems specific to each stage of firm's life stage in practice the decision maker can apply different strategies sometimes even opposite ones. Thus, in the boom phase, enterprises apply successfully a series of strategies such as: the sale of discounted products, domination on market provides the company with high position on the market and competitive advantages. If the firm is in the stagnation or decline phase, then the strategies applied will be more prudent, being focused on the protecting of market share where the firm carries on its activity.

To ensure high competitiveness on the market, the firm is orienting firstly its efforts to minimize complete costs (these include production cost, marketing costs, and administrative costs). In this sense, a strategy which under certain conditions can be successfully applied by the enterprise on a market is the strategy of getting market advantages by prices which aims at sale of discounted products. This type of strategy is currently applied on an oligopoly market characterized by the existence of a small number of producers and high number of buyers. To get advantages by applying this strategy, companies apply specific pricing procedures of different products they launch on the market. There are five price strategies which correspond to competitive position of the firm. (Bărbulescu, 1999, p.227)

In practice, there is the possibility that the cycle phases specific to firm businesses (at micro-economic level, respectively) coincide with the phases of economic cycle on the whole of national economy, case in which synchronous phenomena take place, but there is also the possibility for the enterprise knowing the further development of economic cycle phases to adopt divergent strategies, when asynchronous phenomena occur.

The implementation of an adequate economic strategy must take into account mainly the new internal and international conditions in which the enterprise carries on its activity in order to determine viable economic orientation that guides the firm's management to achieve the goals aimed at under conditions of profitability.

4. Conclusions

At microeconomic level, cyclic evolution of business of a firm on the market can be influenced by the type of strategy adopted in practice by the decision maker, but also by the economic conjuncture existing at macroeconomic level which can be favorable or not the firm in question. In this sense the way in which the succession of classical cycle phases takes place at macroeconomic level is significant.

Crisis is defined as a temporary breaking but often violent and profound of an ascending evolution of economy, of the equilibrium between production and consumption which follows after the maximum point of growth of a cycle. The crisis itself is a brusque, perturbing phenomenon which is felt in the enterprise as brusque fall down of prices, by massive dismissal of labour force, stock exchange collapses and even bankruptcy.

Depression is the phase succeeding crisis and is characterized by stagnation of economic activity, production diminution, price cut down, and increase in unemployment, a series of weaker enterprises reducing or slowing down their activity. As a consequence of slowdown or reduction of investment process and of decrease in incomes of a part of population which does not succeed in coping with price raise, the demand tends to decrease more and more. Therefore, once with the diminution of orders, restriction of monetary mass and significant decrease in profit rate, share quotation, a reduction of current production volume takes place. The enterprises which have resisted to crisis and depression are adopting severe measures of cost reducing by renewing active labor means based on technical innovations.

Reprise or revival of economic activity makes companies improve significantly their activity and create new capacities of production. Therefore, refreshment of economic activity has in view the renewal of permanent capital and especially of its active part in order to overcome the most critical point of cycle. On the whole, all these bring their contribution to the increase in labor force and reduction of unemployment. Restarting and refreshing of economic activity turns gradually into an economic advance whose duration may differ depending on the conditions of every country.

Expansion (advance) is characterized by an increase in sales and prices and a general increase in incomes. In such more favorable economic conjuncture businesses become prosperous and the consumer goods demand becomes dynamic with perspectives of getting stronger. In economy a strong investment process takes place, the modernization of existing production capacities and the creation of new ones occur, facts which determine a significant increase in production and take-up of labor force. Enterprises increase sales amount, clients receive the products well and the profit made allows the covering of investment expenses. It is the phase when artificial stimulation of demand takes place in multiple ways, stock increase being obvious in view of high profit selling-off. Aggregated demand in artificially simulated increase and by increase in monetary mass and cash rotation speed determines a slow but long lasting ascending tendency of prices. Against the inflationist phenomena, the monetary authorities adopt measures to slow down global demand, especially by raising the rate of interest which determines investment slowdown. The real rate of profit in new investments often tends to be smaller than the anticipated one, thus generating a slowdown in renewing and modernization of production capacities. Thus economy enters a new phase, a new cycle.

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