The Business Cycle

Business and the economy

All businesses operate within a **competitive environment** – the nature of competition varies from industry to industry, though.

All businesses also operate in the **economic environment**. It is something they can do nothing about but they must understand and respond to changes in the economic conditions.

A key part of the economic environment is the strength of the macro-economy. Macroeconomics is mainly concerned with:

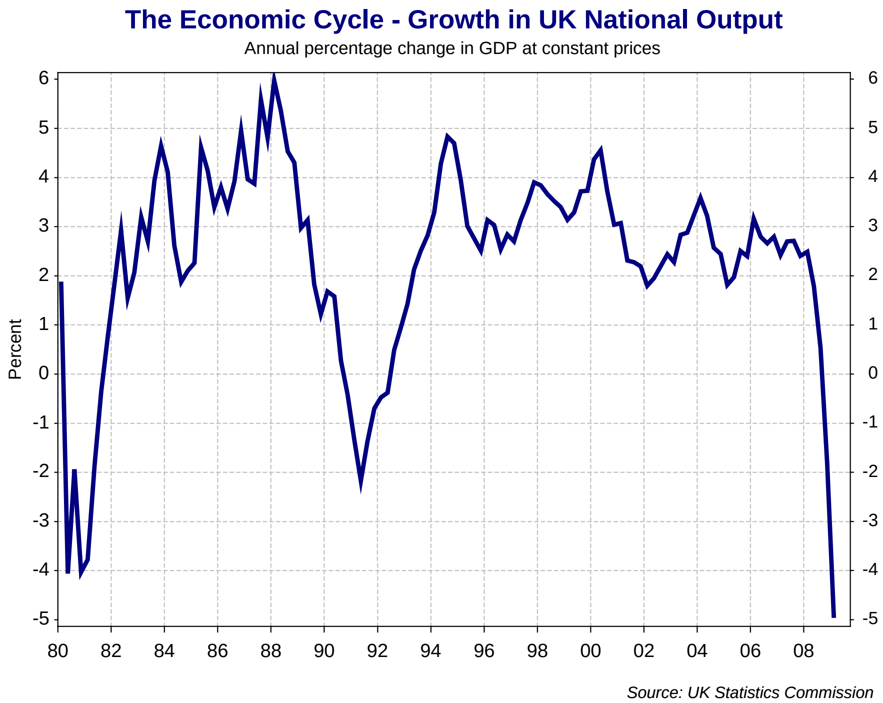
- The total level of spending (or demand) in the economy
- Levels of employment and unemployment
- The general level of prices
- The rate of interest and exchange rates

The strength of the economy is always changing, although broad movements take time to occur. The level of activity in an economy can be measured in several ways, but the most common way is to look at the value of gross domestic product (shortened to "GDP") (the main measure of economic activity) in each period.

Economies go through a regular pattern of ups and downs in the value of GDP. This is known as the **"business cycle"** (sometimes you also see it referred to as the "economic cycle").

The business cycle is characterised by four main phases:

- **Boom:** high levels of consumer spending, business confidence, profits and investment. Prices and costs also tend to rise faster. Unemployment tends to be low
- **Recession:** falling levels of consumer spending and confidence mean lower profits for businesses – which start to cut back on investment. Spare capacity increases + rising unemployment
- **Slump / depression:** very weak consumer spending and business investment; many business failures; rapidly rising unemployment; prices may start falling
- **Recovery:** things start to get better; consumers begin to increase spending; businesses feel a little more confident and start to invest again; but it takes time for unemployment to stop growing



How businesses are affected by the business cycle

Every business is affected by the stage of the business cycle, but some businesses are more vulnerable to changes in the business cycle than others.

For example, a business that relies on consumer spending for its revenues will find that demand is closely related to movements in GDP. During a boom, such businesses should enjoy strong demand for their products, assuming that the products are actually what customers want! But during a slump, the business has to "ride out the storm" – suffering a sharp drop in demand.

You can see lots of examples of this in the UK economy currently.

During the housing-market inspired boom of the early 2000's, many retail and consumer goods businesses took advantage of the boom. Consumers were prepared to take on significant personal debt in order to finance their purchases. However, the sharp economic downturn during 2008 and 2009 has seen many businesses suffer sales falls of between 10-30%. Some have not survived.

Some businesses benefit from an economic downturn. If their products are perceived by customers as representing good value for money, or a cheaper alternative than more expensive products, then consumers are likely to switch.