Tips for Running a Business During Tough Times

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June 2009
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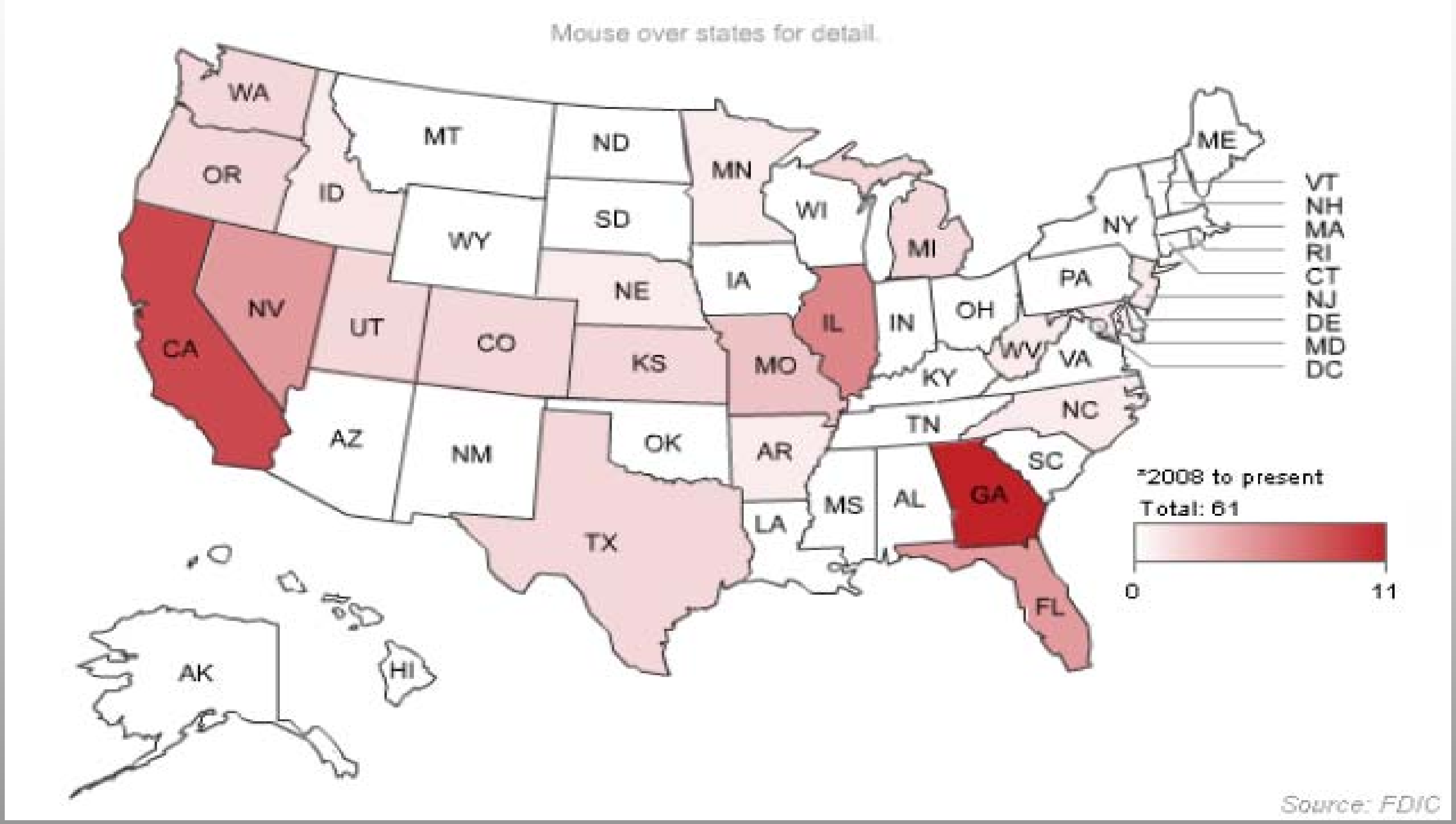
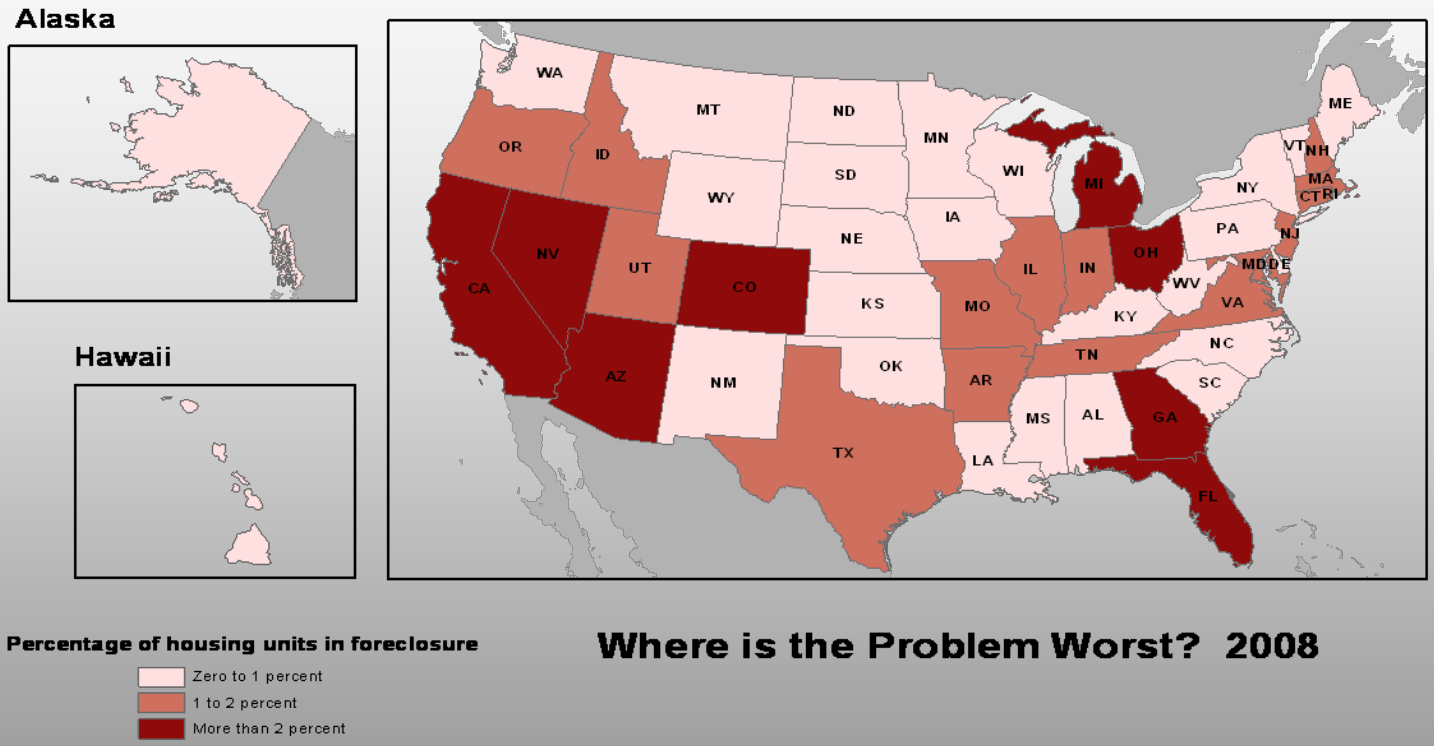
Bank Failures by State 2008-2009



How tough are times really?

Foreclosures by State

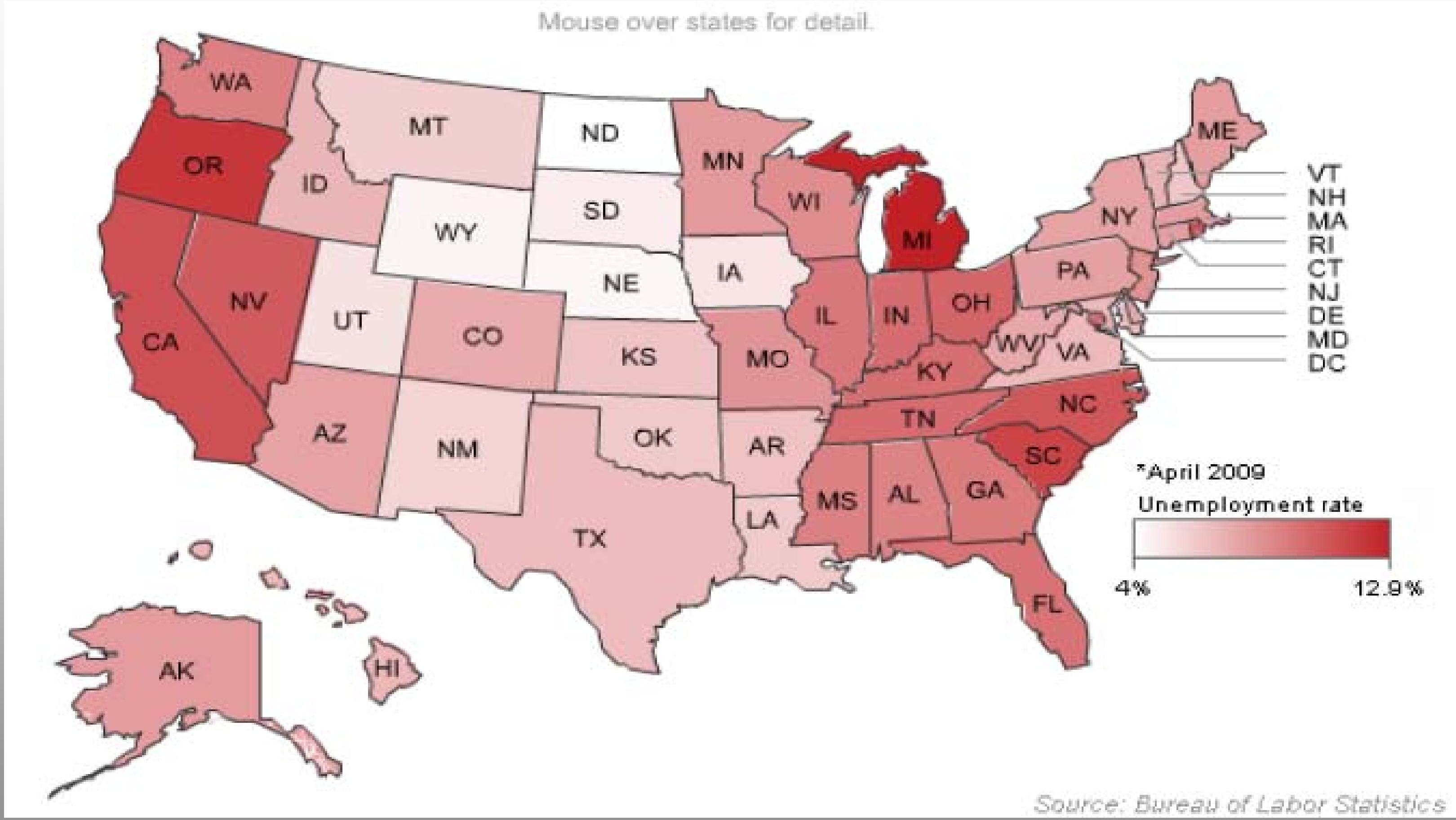


Where is the Problem Worst? 2008

Source: Realty Trac http://www.realtytrac.com/ContentManagement/pressrelease/aspx?ChannelID=9&ItemID=3988&accnt=64847

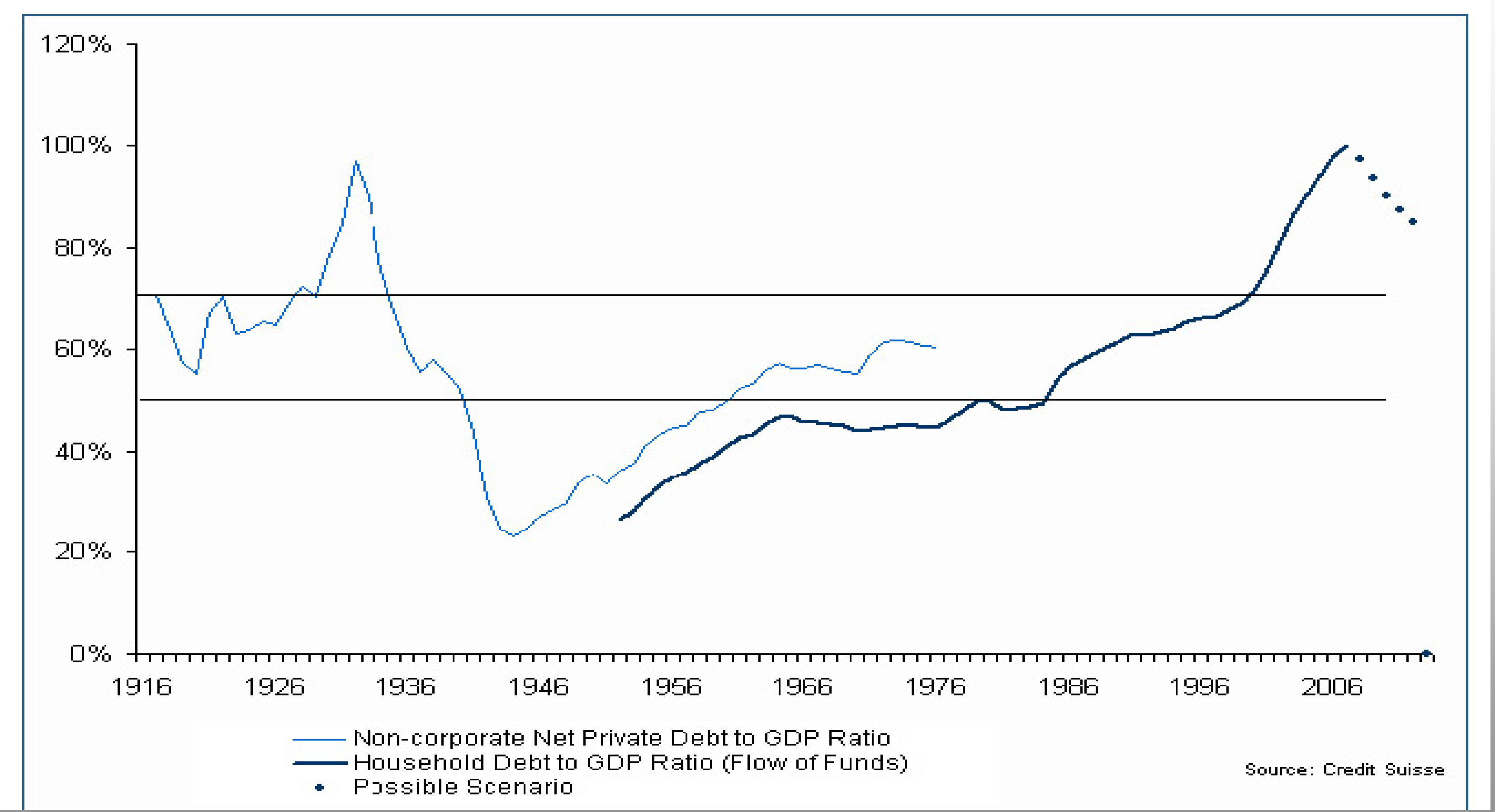
How tough are times really?

Unemployment Rates by State



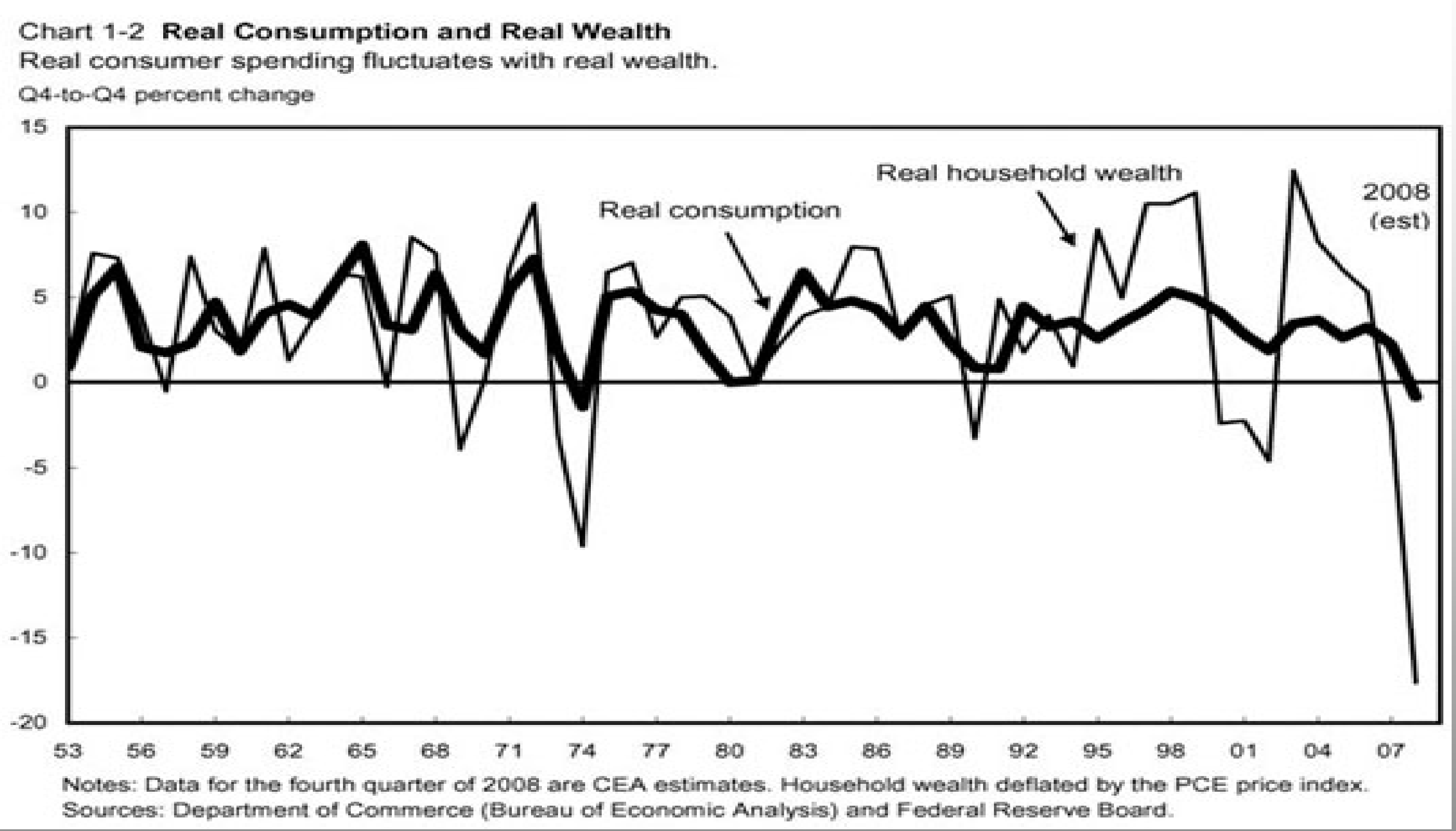
How tough are times really?

Household Debt to GDP Ratio

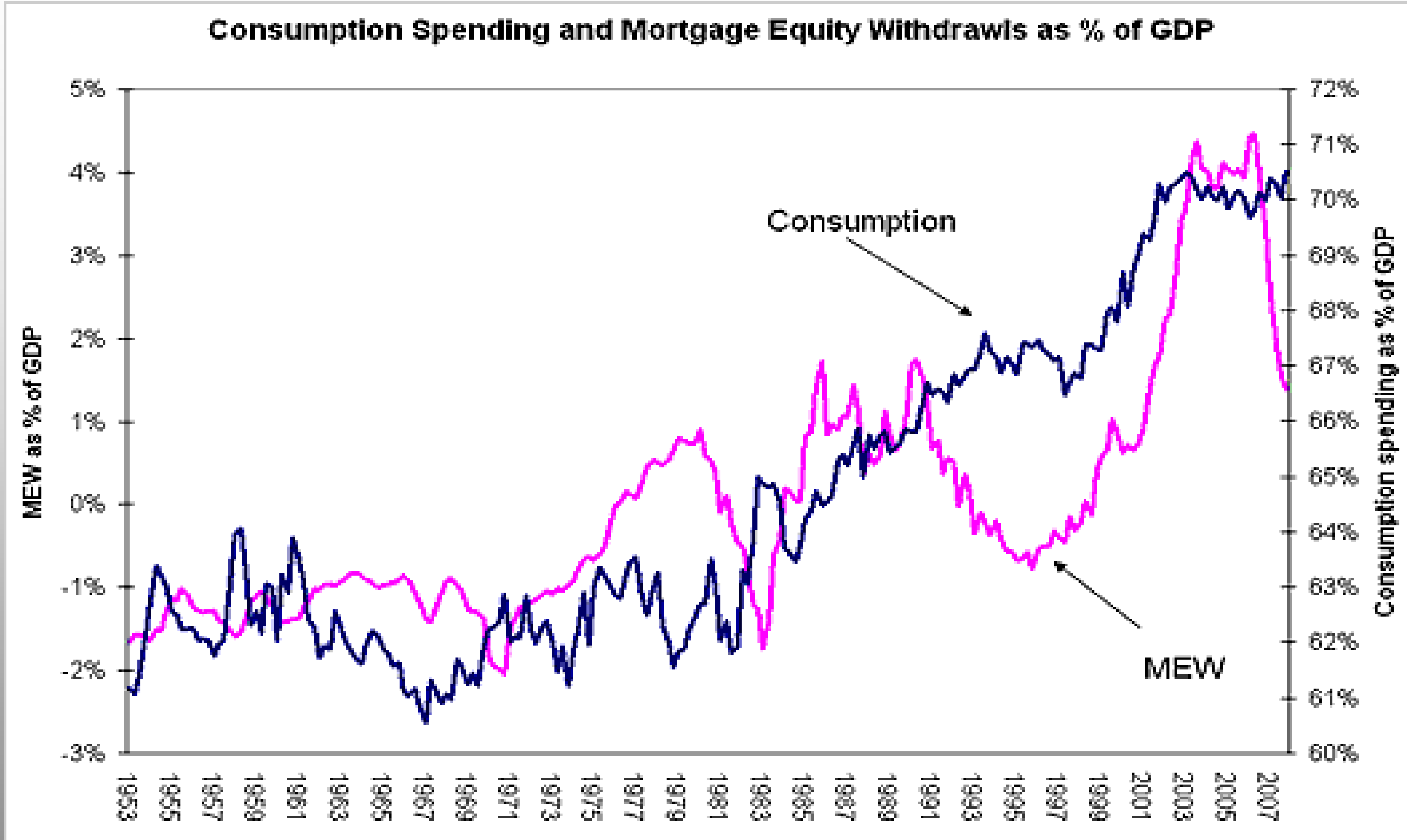


How tough are times really?

Household Wealth and Real Consumption



How tough are times really?



How tough are times really?

How tough are times really?

Pretty Tough...

But things could always be worse

What does this all mean?

- Correction in markets is necessary! Record consumer spending expansion ripples through economy.
- Paradox of Thrift is not necessarily a bad thing!
- Many businesses will not survive the downturn.
- Distribution of Winners and Losers will be lumpy.
- Innovation and Adaptation will make some businesses more successful in long run.

What does this all mean?

- **Successful Businesses will view recession as an opportunity rather than a nail in the coffin.**

- **Examples of businesses born or expanding in downturns:**

  - **Burger King**
  - **CNN**
  - **Microsoft**
  - **Fed Ex**
  - **Yours?**

Management and Planning

"The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelop our future."

J.M. Keynes

Management and Planning

Why do businesses need planning and management to be successful?

Problem:

Dispersed knowledge and uncertainty

Solutions:

Man made conventions and tools
Adaptation
Learning
Experience
Start with basics

Management and Planning

Six Interrelated Steps to Management Process:

Step 1:

Define and develop the firm’s mission

Answer the Who, What, Why, Where and How of the firm.

Management and Planning

Step 2:

Formulate Objectives

Link the mission statement of the firm to specific targets and goals.

Management and Planning

Step 3:

Assess the firm and evaluate the environment

Strength, weaknesses, opportunities and threats analysis.

Management and Planning

Step 4:

Build Strategy

Managerial tasks involving procedures requisite to achieve expenditures. Analyze data, policy and institutional framework, and relevant external factors.

Management and Planning

Step 5:

Implement Strategy

Personnel, expenditures, operating procedures.

Involves administering plan throughout business.

Management and Planning

Step 6:

Evaluate Performance

May involve corrective actions. Adaptability.

Who exemplifies this in our current environment?

Management and Planning

Fundamental Goals of the Firm

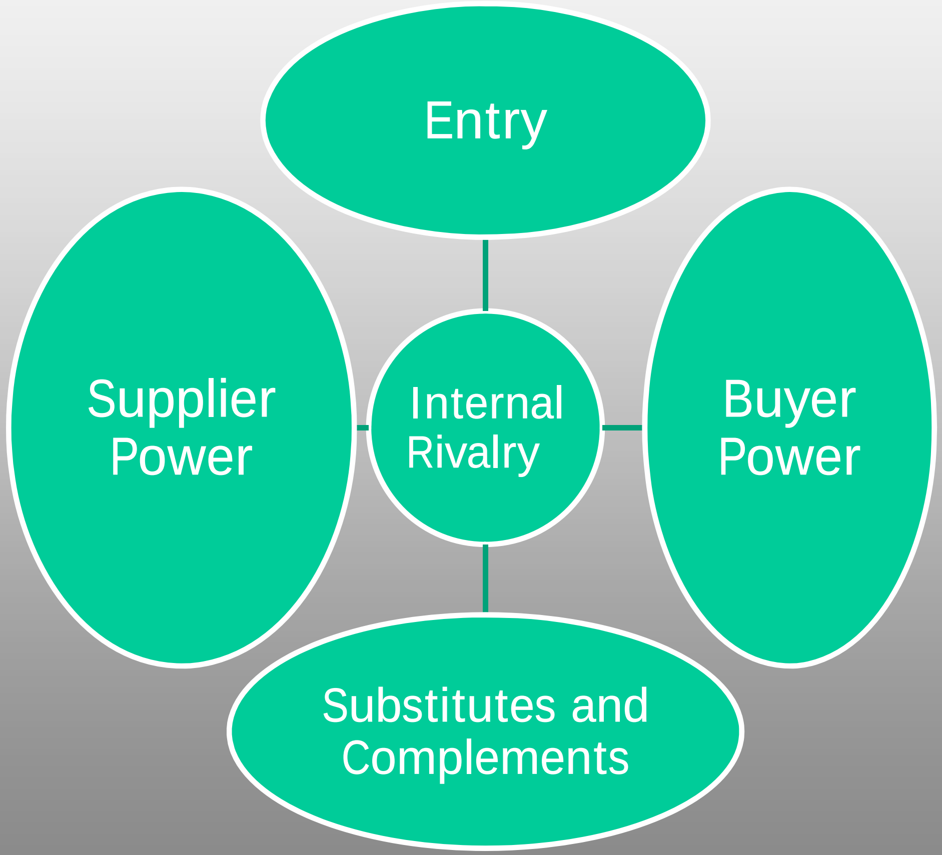
Profitability

Reduction of Risk

Liquidity

Strategies

Five Forces Analysis



Strategies

Why do we care about Industry Analysis?

- Tool available to facilitate effective management in world of dispersed knowledge
- Can directly impact profits
- Self preservation

Strategies

Industry Analysis Facilitates these tasks:

- Assessment of industry and firm performance
- Identification of key factors in vertical trading relationships and horizontal competitive relationships
- Determination of how changes in the business environment affect performance
- Identifying opportunities and threats (SWOT analysis, step 3 in six interrelated steps)
- Assess business strategies

Strategies

I. Internal Rivalry

Reflects degree of competition for market share

1. Define market: all firms that constrain each other's strategic decision making; elements may be spatial, categorical, etc.

2. Price Competition: drives down price/cost margins

3. Non-Price competition: drives up fixed costs (R& D, Image, Advertising, Branding)

Strategies

Price Competition: Exacerbating factors

Can be more dangerous to profits by definition, cannot pass on to consumers

1. Many sellers in market
2. Stagnant or declining industry (zero sum game)
3. Firms have different costs (different incentives)
4. Excess Capacity
5. Undifferentiated products/Perfect Substitutes (no transaction cost for consumer to switch)
6. Low Transparency (when rivals cannot immediately see change in prices or sales terms, slower response time)
7. Infrequent sales orders/large size (may cut prices knowing it will be one time phenomenon to get business)
8. No history of cooperative pricing: true competition
9. Strong exit barriers (can prolong price wars)

Strategies

II. Entry: Limits to

Divides up market demand, increases internal rivalry

1. Economies of scale; must have significant market share to reach efficient scale
2. Government protection of incumbents
3. Consumers are brand loyal/excessively value reputation
4. Access to inputs, R&D, raw materials, location, distribution (patents, unique locations are barriers)
5. Steep experience curve
6. Network externalities: advantage to incumbents with strong base
7. Expectations and history of incumbent behavior after entry

Strategies

III. Substitutes and Complements

Substitutes reduce profits in same fashion as new entrants, complements enhance opportunities (big tubs and water heaters)

1. Availability
2. Price value characteristics
3. Price Elasticity of demand for subject industry

Strategies

IV & V. Supplier and Buyer Power

Substitutes reduce profits like new entrants, complements enhance opportunities

Supplier Power: Takes point of view of downstream industry and asks what power the suppliers have to extract or erode profits through their negotiated prices

Buyer Power: Takes consumer point of view, What power do customers have to negotiate purchase prices that erode sellers profits. Direct power refers to situations where buyers are concentrated and can negotiate, not the indirect power dictated by supply/demand and competition

Strategies

- Studies suggest that industry factors dictate about 10-20% of a company’s profitability
- Firm specific effects represent another 20-40%
- Proper management requires analysis of firm and industry, along with recognition of exogenous factors

Strategies: Pricing

Price Elasticity

Describes the degree to which consumer's adjust the quantity demanded of a good when the price changes. Businesses need to understand the demand for their good or service to make proper decisions

Inelastic Goods (over some horizon): Gasoline, water
Tend to be goods with no close substitutes

Elastic Goods: Dining out, luxury automobiles, sugar
Goods with many substitutes

Strategies: Pricing

Menu Costs

Economic Theory suggests that it is not costless to change prices in response to every economic situation due to transaction costs.

Standard example: Restaurants have to print new menus to change their prices which is a costly endeavor. This coupled with the relevant elasticity can lead to huge consequences for overall revenue.

Strategies: Pricing

Consumer Segments

Pricing strategies can differ amongst your customers to maximize revenue if they are heterogeneous or easily identified in distinct groups.

Can be identified in various ways:

- Demographics (age, sex, etc.)
- Geographic
- Behavioral (readiness to buy, brand loyalty)

Strategies: Pricing

Consumer Segments

Can also be used as a retention tool by asking:

1. **Is this customer at high risk of cancelling service or enlisting competition's goods or services?**

2. **Is this customer worth retaining?**

3. **What retention tactics should be used with this customer? Discounts and lower prices are often strategies here.**

Strategies: Pricing

Anticipating Competitive Response

Knowing your customers is important but so is knowing your competition.

- Pricing wars can be costly for the smaller firm
- How much transparency is there in your market? Are prices readily apparent?
- Consumers choose on a bundle of attributes, not just price. Service, convenience, and loyalty can all lessen the impacts of prices.

Strategies: Pricing

Inventory

Willingness to adjust pricing to manage inventory can maximize revenue and control inventory costs

- **Discount older merchandize not selling, sunk cost theory.**
- **Reduce inventory and operate with a leaner approach, focus on major sellers and must haves. Do not be induced by lower prices to over order.**
- **Offer lower price substitutes within your business to avoid losing business to competition.**

Strategies: Marketing

BE INNOVATIVE

Marketing tends to be one of the first cuts businesses make when times are tough. Is this not counterintuitive?

- **Try lowest cost options 1st: Use customer database as a tool, offer workshops or seminars in house, partner with other businesses.**
- **Don’t eliminate your marketing budget, but stick with the tried and true. Spend money where its been most effective.**
- **Use the WEB and Local business resources for networking.**

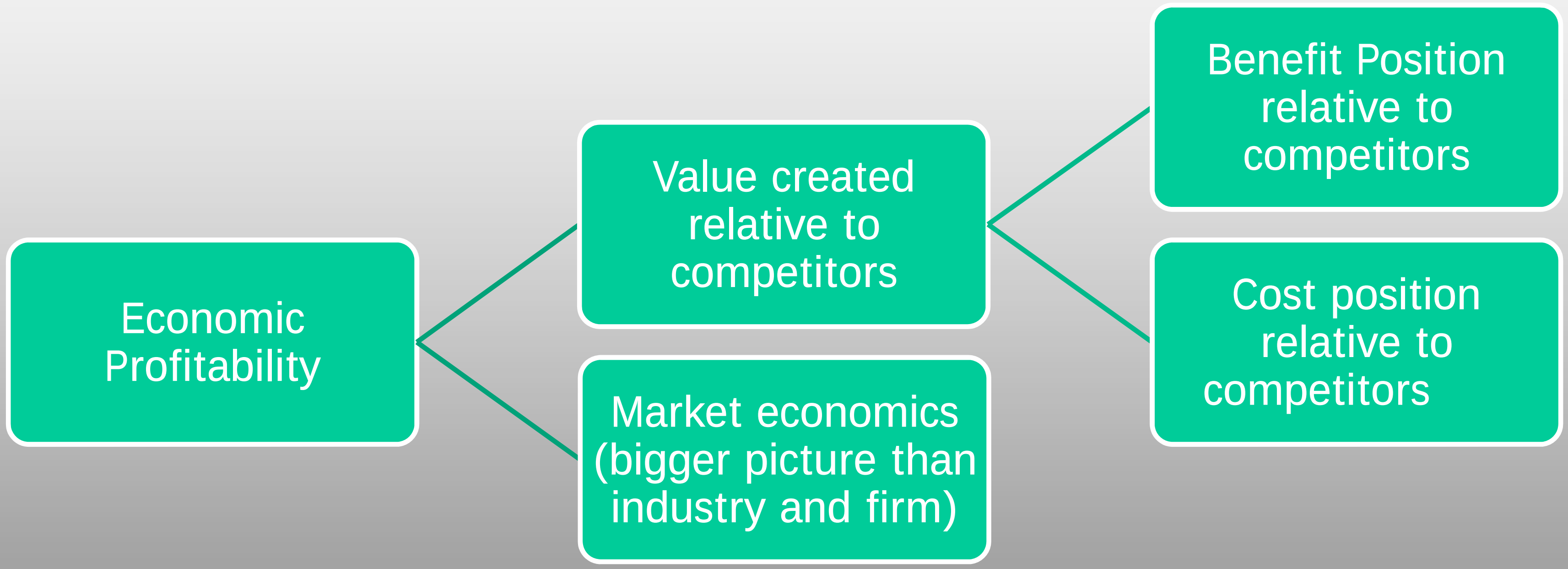
Strategies: Marketing

REINVENT YOURSELF

Upgrade and enhance your image as a marketing tool.

- **Retail businesses can inexpensively update the appearance of the store by changing signage, moving around inventory, updating fixtures.**
- **Service based businesses can enhance logos and branding, update uniforms, change appearance of front of business.**
- **Remember that consumers are looking at a bundle of attributes and some are on soft dimensions.**

Overall Strategy



Overall Strategy

Cost Advantage / Leadership

- **Produce at lower unit cost than your competition.**
- **Minimize overhead, operate leaner.**
- **Sole proprietors may have to work more and lean labor costs.**
- **Offer lower prices than competitors. Cost savings must offset loss in quality.**

Overall Strategy

Benefit Advantage/Leadership

- Try and command a price premium for superior quality and service.
- Offer more upscale mix of inventory or more services.
- Requires strong knowledge of customer base and their demand.

Overall Strategy

Narrowing Focus/Niche Markets

- Offer a narrow set of product varieties or serve narrower set of customers.
- Can include customer, product, or geographic specialization.
- Can insulate a firm from competition.

Overall Strategy

Horizontal Differentiation

Refers to the bundle of attributes consumers choose a product on.

- Weak HD: When product is simple and only a few attributes matter and are uniformly ranked. (Light bulbs, erasers)
- Strong HD: When there are many product attributes consumers weigh and opinions vary widely. (Cereal, beer, etc.)

Horizontal Differentiation and Price Elasticity

	Cost Advantage	Benefit Advantage
High Price Elasticity (weak HD)	**-Modest price cuts gain lots of market share** **Exploit advantage through higher market share, underprice competition**	**-Modest price hikes lose lots of market share** **Exploit advantage through higher market share, maintain price parity**
Low Price Elasticity (strong HD)	-Big price cuts gain little share Exploit advantage through higher profit margins, maintain price parity	-Big price hikes lose little share Exploit advantage through higher profit margins, charge price premium relative to competition

Overall Strategy

Non-Substantive Product Features and Choice: **When consumers are faced with a choice between multiple products with little differentiation *research* suggests they may**

a. **Defer choice: Customers may not purchase until they can conduct search to determine which they should buy.**

b. **Differentiate based on packaging, attractiveness, and peripheral inputs**

c. **Choose randomly**

Overall Strategy

Signaling Effects:

When quality of unobservable and differences between products difficult to discern, quality perceptions may be made by inference.

1. **Advertising Commitment: Idea that large advertising budget and effort leads to idea that quality must be higher.**
2. **Product Warranties/Guarantees.**
3. **Position: First in market or pioneer seen to better quality.**

Overall Strategy

Ways of Differentiating a Product on Soft Dimensions:

1. Through the emotions consumers experience with or attach to consumption of the product.

2. Experiential Aspects of consumption: perception that product is superior in absence of physical differences.

3. Emphasize symbolic aspects of products use, group membership, sensory pleasure.

Overall Strategy

Five Types of Business Strategies

Where are you & where do you want to be?

1. **Growth Strategies (Expand)**
2. **Stability Strategies (Maintain)**
3. **Restructuring Strategies (Refocus)**
4. **Succession Strategies (Transfer)**
5. **Exit Strategies (End)**

Conclusion

What can you do to prosper and survive tough times?

1. Know and listen to your customers, it's the oldest adage for a reason.
2. Make the moat around your business deep and wide.
3. Know your inventory and your competitors.
4. Adjust your pricing if you can.
5. Remain liquid!
6. Conduct SWOT analysis and industry analysis. Consider your overall position, what competitive advantage do you have?

For more information please visit our website:

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