International Journal of scientific research and management (IJSRM)
||Volume||3||Issue||1||Pages|| 2004-2009 ||2015||
Website: www.ijsrm.in ISSN (e): 2321-3418

Economic Policies to Control Downturn

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Abstract

Possibly, we all as an individual or as a company by one way or another in the country or around the world certainly experienced the recent global downturn. Downturn is frustrating time for businesses where revenues drop, costs seem to be unmanageable and the bottom line becomes bottomless. Normally business leaders tend to focus on revenue growth during normal and boom times while during slowdown and downturn they focus on cost management to cut or control the cost. Actual recession now appears to be over or is at least coming to an end, according to most fiscal authorities. Having survived the economic meltdown it might not yet be the moment to celebrate, it should be a time to look ahead and plan for a future in a stable economic climate. This paper put emphasize on analyzing different approaches to counter downturn.

Key words: Recession, Cost Management, Counter

Introduction

Downturn and depression are not same. It is a shorter period and less severe than depression during which there is a decline in trade and prosperity. During depression there is severe fall in economy for a longer duration; almost collapse of economy. It is very striking fall in real GDP. As generally understood, depression is said to have taken place when output falls for more than a year or by more than say 5%. During the great depression of 1929-33, output fell by 18%. Normally economy grows over a period of time say 6 to 10 years and tends to slow down the growth as a part of the normal economic cycle for about six months to two years. Downturn normally takes place when consumers lose confidence in the growth of the economy and are not able to spend or want to spend less. The consumer is not ready to spend as there is an anxiety concerning security. Therefore, with lower volumes of sales and lower profitability, growth of business slows down or stops.

Recent Downturn of the early 21st century started in 2007 and gradually spread around the world. Numerous economic analysts attributed the cause of the economic downturn to be the crash in the U.S. real estate market, which in turn impacted the value of monetary products tied into real estate resources. The growth of the property market until that stage had encouraged homeowners to refinance their first homes in order to obtain second or third houses with a view to a long-term gain. The subsequent financial fallout saw many people lose their jobs as well as lose their properties, while many large, global organizations were forced out of business. Downturn may occur because of several reasons; some are controllable, uncontrollable, tangible and intangible. This paper put emphasize on finding different ways to counter downturn.

Impact of Downturn:

It is doubtless fair to state that the Downturn had an impact on just about every enterprise around the world. Many small and medium sized companies have been pressured out of business because of the recent Downturn. Working capital of the producing organizations starts declining and they cannot run their organizations effectively. Many times the organizations cannot provide monthly salary and lay off their employees which increase unemployment. Companies not doing well, their stock prices start falling and so, the investors stop investing in stocks, this hits companies further. These days' businesses being inter-reliant locally as well as globally, all events result in local as well as global impact. The manifestations of Downturn would be unemployment rises, personal savings likely to rise, consumer confidence lowers down, consumption falls, demand falls, profitability of businesses falls, share prices falls, investment falls, inflation lowers down, government tax revenue lowers down, government borrowings rises, government spending rises etc,.

Fundamentals to Avert Global Downturn:

If all organizations and people in general, follow the fundamental given below, all the times Downturn can be eliminated. Such as no one should try to exploit the general public and customers in any way, prices of lands, buildings, goods and services as well as share stock should not be artificially inflated, Buyers should not take loans to buy the things needed by them, they should try to buy what they can afford without taking loans, prices of goods should be an outcome of free economy based on sound principles of supply and demand and healthy competition and should not be an outcome of lobbying and cartels, the organizations should be run at the highest effectiveness and efficiency levels all the time, all kinds of non value adding expenses should be controlled, cost management should be at its peak all the time etc. Downturn has multidimensional impact on businesses and many ways exists to come out of it, of which in this paper author has tried to make humble attempt to tackle or to come out of Downturn through cost management strategies.

Strategies to Respond Downturn:

Companies or organizations have many ways to deal with Downturn of which cost management is one of the ways of handling Downturn. In times of uncertainty and harsh economic conditions, the immediate reaction of most companies is to cut costs. For a viable future, companies must think strategy, not just bottom line. Orthodox cost management usually follows the formula that when the economy deteriorates, companies should reduce costs to become profitable again. This cost cutting approach to cost management can lead to a loss of customers and market share, unsound turnover of qualified personnel, and inefficiencies in the long term. In comparison, strategic cost management argues that cost should not be reduced at the expense of business strategy and that costs must be managed for economic value. For example, a supermarket looking to reduce costs might be considering buying a fleet of new trolleys. Under traditional cost management, this may mean reducing the number of trolleys ordered from say 5,000 to 2,000 and ordering from a cheaper supplier for a lower price. Strategic cost management takes into account the fact that customers may become dissatisfied with the lack of trolleys available and the poor quality of a trolley's deviating wheel. These customers may then decide to shop elsewhere. So, every area of the business must be challenged to participate in improved profitability through cost reduction activities.

APPROACHES TO CONTROL DOWNTURN

Value Management:

Value Management can be defined as a planned, systematic and analytical process which seeks to achieve value for money by providing all the necessary functions at the lowest total cost maintaining required levels of quality and performance. Ideally, value management should be carried out as early as possible in the project life in order to maximize the saving potential.

Figure 1: The Value Management process

It is essential to achieve value for money from the whole system because system thinking is based on the view that when each part of the system is performing well, the system as a whole will perform at its best. This means requiring good interface not only between all the team members but also input from other stakeholders such as Sales, Marketing etc. as shown in Figure 1.

Cost of Sales:

It seems to be the most difficult area to address for two reasons. First, dealing with the strong individuals required being good at sales and systematic analysis of the risks and rewards of reducing costs in this area is essential. Due to our unwillingness to address excessive sales expenditures, this area is full with opportunity to reduce cost and improve profitability. The sales staff is the last team we want to offend. We need their loyalty and dedicated effort, so a separate meeting with this team is required. Susan Greco, In "How to Recue Your Cost of Sales," opens with, "Why would you bite the hand that feeds you? That's a standard argument against a cost-cutting eye on company's sales department." When revenue is down, it is difficult decision to ask our sales staff to be more careful in spending.

But a few relatively non disturbing initiatives can significantly reduce costs, such as fewer client lunches, limiting the number of sales staff attending certain functions and implementing a rigid expense review process. These cost reduction practices, however painful but are far better than the alternatives salary cuts and 100% commission plan.

Supply Chain Cost Management:

In “Four Ways to Trim Your Supply Chain Costs,” According to Fawn Fitter; there are many ways to improve inefficiencies in the short term to reduce supply chain costs. Short-term gains must be compared with long-term strategic plans to avoid additional cost consequences in the future. For supply chain cost reduction, the short-term emphasis is on improving efficiency rather than “reengineering your whole supply chain.” To control supply cost enter purchase collectively with other companies to improve ability to demand better volume discounts, designate specific suppliers as preferred vendors to assist in acquiring better pricing, streamline shipping etc. Short-term efficiencies must be part of long term strategy to protect supply chain partnerships and provide measurable results by which to refine cost reduction activities.

Operating Expenses and Administrative Overhead:

This category includes areas of the business that reach to every other facet of the business such as rent, warehouse, legal fees, wages, advertising, equipment and much more. As the sales category is likely the most sensitive area to address, this category is the most complex. A qualified consultant can assist with putting together a unified strategy covering all the categories in this segment; however, this category will require the largest part of efforts. Any attempt at a summarized treatment of this category is beyond the scope of this paper.

Inventory Management:

Excess inventory always block company money. Optimum inventory helps companies to use the working capital elsewhere. Online schedules to suppliers, use of correct kanban size, communicate suppliers instantly etc. will be the right steps towards reducing inventory cost. Two approaches have had a major impact on inventory management; Material Requirements Planning (MRP) or Enterprise Resource Planning (ERP) and Just-In-Time (JIT and Kanban). Companies using these techniques are much benefited.

Investment Approach:

All costs should be viewed as investments and not as expenses. Therefore every cost item is required to evaluate based on returns generated on its spending. Returns generated from payouts on rent, utilities, travel, marketing spends etc. will be evaluated. Surely, it will be difficult to evaluate returns on several types of spends. The alternative criterion in such cases will be the opportunity cost of that item; that is, the additional costs likely to incurred, if we do not spend on that particular item.

Variable Cost approach:

In this approach the objective is to convert some part of the fixed costs into variable costs. When sales volumes are down, variable costs will go down and when volumes are growing these costs will increase. A popular example of this approach is the variable pay component in the salary package. It is not a piece rate system, but a performance based incentive system where at low volumes amount payable is small, but with higher volumes the amount payable goes up. It pumps the salesman to put his best efforts to increase sales volume.

Capacity Reduction:

Sometimes fixed costs are called capacity costs, because they are of fixed nature for a given level of capacity of production or sales. When capacity to do work or to produce or sell by a business organization increases, fixed costs also increase but in steps. During Downturn when sales volumes drop substantially, management might consider reducing capacity. Capacity reduction will mean giving up people, space, plant etc. If that is neither possible nor desirable then the excess items or space can be isolated as idle capacity, so that expenditure on related maintenance and utilities will not incur.

Conclusion:

Whether the Downturn is absolutely over yet or not, it has provided as a timely reminder that no business can afford to become unworried with its own position of success. Company owners should constantly seek to consolidate their own position and improve their operations wherever possible. The companies which manage to survive the economic downturn will have learned valuable lessons. Reducing costs throughout an organization directly improves or protects profitability, especially when sales are flat or declining. Every rupees saved through cost reduction directly benefits profitability. Each area of the business should be open for thorough cost analysis. Every business is unique and no single strategy or formula exists to ensure success in this critical area; however, with diligent effort expended to manage costs, profitability and a stable staff structure are possible.

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