Making the Right Decisions in a Recession

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Companies turn to ideology and imitation to make big decisions in hard times.

The **latest Jobs Report from the US confused many** because it showed fewer hires by firms than one would expect given all the positive news from the economy lately. Lately there has been expansion in manufacturing, growth in economic activity overall, and increased exports from the US, showing clear signs that the US economy is doing better than before. One would think that firms would hire under such conditions, especially to increase production, but the jobs report contradicts that idea. What is going on here?

First, to be technical, manufacturing has become a pretty small part of the economy, and General Motors (GM) producing more trucks doesn't mean that Starbucks will hire more people. In fact, it may not even mean that GM hires more people, because manufacturing firms can choose between investments and hiring as ways of increasing production.

But the technical question is not the interesting part; what should interest us is what firms will actually decide to do. How are managers thinking about the economy, and their own response to it? There is a fair amount of research on this, and a recent paper in [***American Journal of Sociology*** **by Todd Schifeling**] adds more knowledge. Two clear answers emerge. First, what managers are thinking about the economy and their own response is partly driven by what others do. Firms imitate each other in their choices of how many to hire during recessions, something they don't do when the economy is doing well. The usual explanation for imitation is uncertainty, and it makes sense that a troubled economy is more uncertain than a healthy one. On the other hand, those who think that managers apply creativity to solve the problems presented by a recession are probably disappointed to see this. Recessions are anti-creativity events.

But another effect was equally interesting. During the 1950s and 1960s recessions that he studied, business leaders were affiliated with two organisations with opposing views on what firms should do during recessions. The Committee for Economic Development (CED) saw hiring by firms as a way to fight against recessions, but The National Association of Manufacturers (NAM) favoured adapting to the recession through reduced hiring. These responses were connected to political ideology, with the CED view seeing firms as important economic problem-solvers while the NAM view saw firms as needing to wait for someone else to fix things. And as it turned out, one could tell what a firm would do by which of these organisations their leadership was affiliated with, with CED-affiliated firms hiring more than NAM-affiliated firms. Then as now, the response to recessions was a political issue, but the discussion was not just what the state should do, but also what firms should do.

What does this mean for firms and the economy now? Well, we know that the economy can recover from a recession by actions from the state, from firms, or from consumers. Or maybe through some sort of sheer luck. Many think that the state should do nothing, but these days firms also do nothing and consumers have learnt not to spend more when the economy is doing poorly. That leaves luck. The CED style of adapting to recessions is rare now, but to scholars who are interested in strategy rather than economics it actually looks pretty interesting. If a firm can afford to maintain and even strengthen its employment during a recession, will it or the contracting firms be stronger when the economy starts recovering again? It depends on whether you think money saved from not hiring is the key source of strength, or whether innovation and production is more important. It would be interesting to see whether the expanding CED firms or the contracting NAM firms did better when the economy recovered.

Henrich's blog

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