

Risk Insights

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How Small Businesses Can Prepare for a Recession

A recession is a prolonged and pervasive reduction in economic activity. Generally speaking, multiple successive quarters of negative growth in gross domestic product—a monetary calculation of the market value of goods and services generated and sold during a set time period within a given country—constitute a recession.

A recession can last for several months or years. Furthermore, recovering from this state to the nation's previous economic peak can take years, even after a recession ends. Because a recession typically results in diminished economic output, lowered consumer demand and a drop in employment, such a downturn can present various challenges for organizations across industry lines—especially small businesses.

Although organizations can't prevent a recession from happening, they can take steps to limit its ramifications and maintain financial stability. This article provides more information regarding how a recession impacts small businesses and what these businesses can do to adequately prepare for an economic downturn.

How a Recession Impacts Small Businesses

Amid a recession, organizations of all sizes and sectors usually experience decreased sales and profits stemming from changing consumer behaviors. An economic downturn may also limit organizations' credit capabilities and reduce their overall cash flow as customers take more time to pay for products and services.

While these behaviors can threaten the financial stability of any organization, large businesses are

often better positioned to weather a recession because of their substantial revenues, excess reserves and privileged access to a wider range of credit markets. Small businesses, on the other hand, may be particularly vulnerable during an economic downturn, as they generally lack the additional capital necessary to offset extended periods of loss. As a result, when a recession occurs, small businesses are more likely to have to make difficult financial decisions to avoid issues such as insolvency or bankruptcy. Primarily, these businesses may need to cut operational costs and consider staff reductions to stay afloat.

Financial media website Investopedia reported that nearly 1.8 million small businesses closed their doors amid the last major U.S. economic downturn, known as the Great Recession, which took place between 2007 and 2009. Looking ahead, a recent survey conducted by investment banking company Goldman Sachs found that the vast majority (93%) of small businesses fear the nation will enter another recession in the coming months. With this in mind, now is the time for such businesses to prepare for an economic downturn.

Tips to Prepare for a Recession

To promote financial stability during an economic downturn, small businesses should consider the following recession-proofing tips:

- **Establish a financial plan.** It's critical to closely monitor current economic conditions and form a plan for remaining profitable amid a recession, whether this entails adjusting specific business practices or scaling back certain operations. Having such a plan in place will help eliminate unnecessary spending and highlight investment priorities.

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- **Prioritize savings and cash flow.** In addition to having a solid financial plan, building up reserves and maintaining a steady cash flow are key steps in successfully navigating an economic downturn. This may include limiting excess inventory, finding ways to reduce overhead expenses, implementing shorter payment terms for customers and even encouraging early or advance payment options.
- **Ensure proper debt management.** While it may be tempting to pay off any debts in the face of a recession, doing so can rapidly deplete reserves and threaten long-term financial stability. Instead, it's best to reassess interest rates on current debts and consider paying down debts with the highest rates first. If reserves are already low, utilizing additional financing options and establishing a line of credit may be useful. Yet, it's always vital to carefully review potential costs before taking on new debt.
- **Be innovative.** Frequently researching the economic climate and seeking ways to adapt business strategies in response to recession-related trends can promote innovation and operational success during challenging circumstances. For example, diversifying income streams by creating an online shopping platform to boost product sales or offering a new service to attract additional customers could prove valuable.
- **Stay transparent.** An economic downturn impacts multiple parties. That's why employees, customers and other stakeholders should be informed of shifting business strategies and associated decisions amid a recession. Open communication will help these parties understand the reasoning behind any changes, make them feel valued and provide them with a chance to share ideas they may have to increase financial stability.
- **Build strong relationships.** Fostering connections with customers can help bolster company loyalty when an economic downturn strikes. Dedicated customers may also serve as effective ambassadors by sharing their satisfaction and bringing in new business. Additionally, building reliable connections with business partners and suppliers can ensure all parties will work together to safeguard operations and stay afloat during a recession.
- **Leverage effective marketing strategies.** Even when an economic downturn is on the horizon, utilizing solid marketing practices should always be a top business priority. Specifically, crafting a unique brand and messaging techniques can make all the difference in attracting new customers and keeping profits up.
- **Maintain sufficient coverage.** To ensure ample financial protection against potential losses, it's crucial to have proper insurance. After all, business risks tend to rise amid a recession, making coverage increasingly important. Policies should be customized to address specific exposures. It's best to consult qualified insurance professionals to determine particular coverage needs.

Conclusion

A recession can have serious impacts on small businesses. Fortunately, by adequately preparing for an economic downturn, these businesses will be better positioned to minimize financial hardships.

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