

Effect of recession on consumer buying behavior economics essay



**ASSIGN
BUSTER**

The economic cataclysm of the 1930s was an international phenomenon experienced by countries in all parts of the globe. Countries as diverse as the United States, Germany, Chile, and Japan all experienced significant depressions in the 1930s. Thus, the title of Charles Kindle Berger's classic book *The World in Depression 1973* captures an important feature of the Great Depression. These international aspects, especially the importance of the gold standard in causing the downturn and transmitting depression from one country to another, have been emphasized in recent years. Recession started in most countries at around the same time (Burns, 1958).

Looking back at three decades of research on consumer behavior, the proponents of behavioral studies of economic affairs have good reason for satisfaction. Thirty years ago economists generally viewed the consumers as somewhat unimportant source of income. Consumer expenditures were assumed to be dependent on the income received from the business and government sectors whose activities were thought to be responsible for changes in the economy (Eva Mueller, 1959).

Today it is recognized that consumer purchases of durable goods and many other flexible expenditures vary to a much greater extent than income and it is broadly accepted that they are dependent not only on ability to buy but also on willingness to buy (Douglas and Michael, 1986).

Economist's studies are still limited to an analysis of interrelations among summative data that reflect past activities such as consumer expenditures, business investments, incomes, and profits. relationship among data on results of behavior are deemed preferable to a consideration of the

supposedly indefinable psycho logical factors which behavioral economics suggests between stimuli, such as changes in the environment or information transmitted, and spending or saving (George Katona, 1974).

The basic assumptions of economic theorists about the origin of inflation may be expressed simply. First and foremost, when money or incomes grow faster than the quantity of goods supplied, purchasing power exceeds available supplies and the general price level is likely to rise.

Second, when rational people expect prices to go up, those in possession of some liquid funds, or able to borrow, stocks up or hoard at the prevailing lower prices. The conclusion derived from these assumptions is that inflation, a general and sustained increase in the price level, either stimulates or accompanies an increase in consumer demand. In inflationary periods, it is assumed, consumers substitute goods for money and tend to spend more and save less (MacKinnon, James, Haug, and Michelis, 1999).

The dependent variable was the consumer buying behavior; i. e. behavior towards shopping goods, convenience goods, specialty goods, and other items. This thesis presents a picture of change in buying behavior of consumer when they are going through a recessionary period. Their attitude towards the spending six months back and after were measured and their behavior was also evaluated with other factors like average household income, household members, area they live in. In this thesis, the main objective was to find out the effect of recession on consumer buying behavior.

The purpose of this study describe in this research was to examine the effect of recession on buying attitude of consumers, taking into consideration differences in spending in their goods consumption on daily basis, goods bought on monthly account, luxurious items and entertainment. The hypotheses that were checked were does recession affects the buying behavior or not. Therefore, an attempt was put to find out the outcomes of the research that, which factors get affected, given below, in recession by a consumer.

Statement of the Problem

Effects of recession on consumer buying behavior

The main purpose of the research was to find out the effects of recession on buying behavior of consumers.

1. 3 Objective

The purposes of this study are as follows:

To examine which factors bring change in consumer buying behavior.

To identify the categories which gets effected during recessionary period from consumer perspective

1. 4 Research Hypothesis:

H1 Recession has significant effect on consumer buying behavior for shopping

goods

<https://assignbuster.com/effect-of-recession-on-consumer-buying-behavior-economics-essay/>

H2 Recession has significant effect on consumer buying behavior for convenience

goods

H3 Recession has significant effect on consumer buying behavior for specialty

goods

H4 Recession has significant effect on consumer buying behavior for other items

H5 Income has a significant effect on the consumer buying behavior

H6 Number of household members effects the consumer buying behavior

1. 5 Possible Research Findings

The research also provides the following significances.

Help the organizations to better understand the customer expectations that, at what price does customers want to buy the products from the market.

Able to investigate the major customer attitudes associated with their buying behavior.

The study indicates the link between recession and the consumer buying behavior.

CHAPTER 2:

LITERATURE REVIEW

Consumer behavior is the study of when, why, how, what and where consumers do or do not buy the products. It has elements of sociology, social, anthropology, psychology and economics. Consumer behavior study is about consumer purchasing behavior, with the purchaser playing the three roles of buyer, user, and payer. It also tries to evaluate influence on the consumer from groups such as family, friends, reference groups, and society. A greater importance is also given on consumer retention, consumer relationship management, personalization, customization, and one-to-one marketing. Social functions can be classified into social choice and welfare roles (Wright and Peter, 1975).

2. 1 Business Definition for Consumer Behavior:

Consumer behavior in marketing is about understanding how and why people behave in different situations with same or different circumstances. Actions undertaken by people through which consumer gets satisfaction of wants and needs. These actions sometimes, and not always, involve the acquisition of goods and services from markets. From a selling perspective, the measures or steps in the procedure of decision making by a shopper (Johnson and Michael, 1986).

The decision making procedure is subjected to various attitudes, and social influence on the purchaser. Buyer be likely to behave in certain manner including loyalty, habits, brand, and post purchase behavior (McSweeney, Frances, and Bierley, 1984).

<https://assignbuster.com/effect-of-recession-on-consumer-buying-behavior-economics-essay/>

The theory of consumer purchasing behavior is considered in its early years. Cognitive theory proposes that the consumer starts a search process to limit the set of product choice from which to make purchase decisions. This search process contains external search in public or social sources and internal search from memory. (Mackenzie, Scott, and Lutz, 1989).

Purchase and consumption decisions typically are separated, and tastes often change over time. So, consumers may not know at the purchase occasion which alternatives they prefer at future consumption occasions (Klein and Lansing, 1955).

The decision making process and it's the physical activity which involves acquiring, evaluating, using and disposing of goods and services. The definition clearly tells about that it is not the buying goods and services but it's the process which starts much before the goods have been bought. A process of buying generally comes into consumer mind which leads to finding of alternatives between products that can be at their possible use (Daubman, and Nowicki, 1987).

Then it goes through the process of decision-making for purchase of that good and using it. The smart marketers always try to understand the need of different consumers with their different behaviors which is affected by their internal and external environment. The consumer role in any industry's growth is hypothesized differently from practice. The responsibility of home production requires some degree of knowledge and effort in combining purchased inputs (Klein and Lansing, 1955).

The consumers enter the market to replenish or extend the assortment of goods needed to support expected patterns of future consumption behavior. He emphasizes that the appropriate method for a consumer to evaluate alternatives depends on whether the item is to be consumed at the time of purchase or in the future. If the product is for immediate consumption, the alternative with the greatest benefit- to-cost ratio at the time of purchase is selected. If the product is for future consumption, the consumer should be concerned about the fit of the alternative with the assortment of items he currently owns, or in the case of zero inventories, the fit of the alternative with the other products bought at the same time and the purchases are made primarily for future consumption (Fry and Joseph, 1967).

With growing affluence, the complication of production increases, and the household provides more experience, education, and effort to labor market. At the same time, consumption activities become relatively less complex. Purchased inputs became more diverse (Kahhn, Barbara and Isen, 1993).

The theory of autonomous tastes that related to an economy with limited product choices is unsuitable for the dynamic markets of the second industrial revolution. The surplus of product variations, advertising methods, and distribution alternatives eventually leave the consumer with a confusing set of choices. Choice behavior retreats to habits and impulses with increasing alternatives and decreasing effort allocated to shopping (Khan, Mohsin and Abdelhak, 2001).

Growing recognition of limitations in the ability of individual consumer characteristics to explain variation in buyer behavior has prompted a number

of appeals to examine situational influences on behavior. Ward and Robertson argued that “ situational variables may account for considerably more variance than actor- related variables.

Clark, and Mark (1976), cautioned that many buyer behaviors may be enacted only under specific conditions and necessitate situational investigations of intra-individual variability. It was also stated that jointly situational and individual factors must be carefully measured in order to explain buyer preferences.

In recent years the consumer has started to get a reputation with business cycle analysts and economists for being volatile or unpredictable in his spending behavior. The industry has witnessed a number of ups and downs in consumer spending-some of significant importance which could not be explained by the level of, or changes in, consumer incomes (Sujan and Mita, 1985).

One of the most prominent instances was the recession in discretionary consumer spending in 1951, at a time when personal incomes were rising. Another was the quick increase in the level of consumer spending in the winter of 1954-55 which exceeded the increase in personal income occurring at that same time (Khan et al., 2001).

Consumer knowledge can be measured accurately by studying the actual performance of consumers in purchasing goods for consumption. If an individual spends his income in a manner that it gives him close to expected obtainable value for his outlays, the consumer should be credited with profound knowledge. Although it is not necessary of all products and product <https://assignbuster.com/effect-of-recession-on-consumer-buying-behavior-economics-essay/>

quality is not at all the same for all consumers, various brands of the same product often offer different values (Eva Mueller, 1959).

2. 2 Recession

A period of general economic decline; defined as a decline in GDP for the period of two or more quarters, it is an international or national event. The roots of a recession and its opening point actually rest in the quite a few quarters of positive but slowing growth before the recession really begins. Sometimes in a mild recession the initial quarter of negative growth is followed by the minor positive growth, then negative growth is back and the recession trend continues. It comes with a drop in the stock market, a rise in unemployment, and a turn down in house market (Grauwe and Polan, 2005).

A recession is considered less harmful than depression and once it gets continued for a longer term it is than classified under depression. Many professionals and experts around the globe believe that a genuine economic recession can only be confirmed upon the negative growth of GDP for more than two following quarters. The bases of a recession and its starting point actually rest on the period of several quarters of slow positive growth before the recession cycle truly begins. In a mild recession the initial quarter of negative growth is followed by a minor positive growth, then negative growth returns and the recession continues (Balke, Nathan, and Emery, 1994).

Whereas the “ two quarter” definition is accepted worldwide, many economists have problem in supporting this entire concept totally as it does not reflects on other key economic variables which might be bringing <https://assignbuster.com/effect-of-recession-on-consumer-buying-behavior-economics-essay/>

changes in economic system of a country. For instance, current national or international unemployment percentage or consumer self-confidence and expenditure levels are also an element of the economic system and must to be taken into account when explaining a recession and its attributes (Burns, 1958).

An economic recession is principally credited to the measures taken to organize the money supply in an economy. The Federal Reserve is the bureau in charge for sustaining the fragile balance between interest rates, inflation, and money supply when this slight balance is tipped; the economy is enforced to correct itself.

Inflation is the increase in the prices of commodities over a span of time. So, if there is rise in inflation, it means that commodities are getting expensive than before. The advanced the level of inflation, the lesser the percentage of commodities can be bought with a precise amount of money (Grauwe and Polan, 2005).

There can be many causal factors for price increases, which incorporate but are not restricted to increased overheads of production, high costs of power, and/or the national debt. In a situation where inflation is widespread, people tend to cut out things like leisure spending. They also save more, spend less on things they use to buy for their free time, and budget more carefully than they did. As businesses and people begin to limit their budgets and drop avoidable expenditures, the GDP begins to reduce or decrease. Then, unemployment percentage rises because companies start terminating contracts of workers to cut down more costs, because customers spending

are not the same as they were. It is all these combined factors that directs the economy into a state of recession (Khan, Ashfaque, and Qasim, 1996).

2. 2. 1 Causes of Recession

One thing that every economist firmly believes in is that recessions are somewhat that cannot be avoided. The reason for this is that in a strong economy you have stages of high growth, slow growth and no growth. In fact even fifty years after the great Depression, a really bad recession, and the answers to what causes an economic downturn or a recession is still a huge mystery (Sunkel and Osvaldo, 1958).

Actually in order for the economy to be strong there needs to be some contracting and expanding. But the most generally asked question that nobody can seem to answer very well is what is going to cause the next recession (Mubarik and Yasir, 2005).

Despite of which theory you believe there is no specific answer to what causes a recession. But mainly cases there are ample proof that a recession is caused by several factors, meaning that various actions took place and the conclusion was a recession. In fact an example of the numerous factor theories is the recession that took place after the artificial increase in oil prices in the 1970's (Wyer, Robert, and Srull 1986).

The cause that lay off a recession was that the prices set off an economy-wide decline in the demand for oil because of the fact that real income was reduced because of the higher costs of oil imports. Tighter monetary policy dampened the inflationary pressures which followed the price increases. It

was all of these factors that slowed the overall demand, which in turn resulted in a recession (Eva Mueller, 1959).

2. 2. 2 Theories Causing Recession

George Katona, (1974), revisits there are many theories that have been put forward as to what causes an economic recession. But most likely the most common thought on what causes a recession is that they are caused by events that have an economy-wide impact, such as, an increase in interest rates or a decline in consumers confidence. In fact the general consent is that a recession is mainly caused by the actions taken to control the money supply in the economy.

Another theory about what causes an economic recession is that they are caused by events that damage particular firms or industries rather than events causing damage to entire economy. The basis that some economists believe in this theory is because of how a recession seems to influence some industries badly, while other industries seem to flourish during these hard times. The economists believe that this happens because either a major innovation or a change in the price of a key item can adversely affect some firms (Hussain, 2005).

Loayza and Ranciere (2005) suggest that this series of events lead to another factor and the industries are badly affected they tend to set off workers and cut down on their production, which slows down that industry. Next what happens is that the people who were laid off can't find work right away because sometimes it takes time to find new employment so while

they are waiting for that new job to come in there is a period of unemployment, is another factor causing a recession.

Riazuddin and Khan (2005) believe that every recession has a unique reason, while others think that recession usually only have a single reason, bad investments by businesses, stock market crashes. Factors that slow down short term growth in the economy; e. g.: a sharp increase in oil prices or even going to war.

The following negative items that could cause an economic recession

value of local currency going down

rise in Oil prices

Inflation

Unemployment

Housing Bubble

Global Economy

2. 3 Consumer Reaction to Inflation

The consumers' reaction towards inflation is imperative. Consumers are the biggest source of demand for the goods and services produced by the economic system of any country. Consumers in past has shown their attitude of spending disposable income, every time when there has been recession or has been a drastic change in an external environment. They allocate their

budget for consumable goods in such a way that even if they have to go without some products in their daily life because of the rising prices, they either switches to a lower range product or simply try to save that money for future.

Change in consumer spending certainly effects the investment rate, specially a speedy effect on investment or disinvestment in inventories. Contrary to consumer responses towards inflation are quite acceptable. There is always a possibility that due to inflation, there could be a definite change in consumer behavior as the consumer either go into bulk buying or shops in advance for future needs (Gardner and Meryl, 1985).

This behavior shown from consumer side never does good to him as there is a very rare chance that inflation may raise the average propensity to consume because, in spite of high prices, people with firm house hold incomes may try to maintain their living standards, and those with getting raise in their incomes may attempt to pick up their standard of living. In both cases consumer behavior can not be the same and it is frightening for the country's economy (Gerrards, Astrid, Kordelia, and Hesse, 1994).

Where, there is a chance that consumers may feel that their incomes are being reduced by inflation and they surely cut down their spending and it leads to an act of involuntary saving. This saving is generated by this whole inflationary process, and to that part consumer behavior is some what can be called is at still. Consumers may be upset by price advances and hold unnecessary spending to as minimum as they can and live with it. In this case consumer behavior may turn into a very strong stabilize power. It is

also a possibility that some consumers can response in one way and some in another at one time in same situations, as their perceived value of that particular situation may be at varying degree (Neuhauser, Colin, and Taylor, 1972).

To understand the consumer preference one first should understand the relationship between consumer preference and processes, functions, and structural characteristics of the economy. The magnitude of the study of consumer preference is matched by its complexity. This whole idea has its biological, sociological, physical, political, psychological, economic, legal, and other dimensions (Thomas, Clark, and Lynn, 1978).

Currently, the role of consumer preferences in the economic system is a matter of several often contradictory interpretations. These controversies are mostly due to the differences in scale and in the choice of strategic variables and their relationships. One position claims that consumer is “king.” The other comment is that the concept of consumer control is dead (Zeithaml and Valarie, 1988).

As Fusfeld’s said, “ the paradigm of a smoothly adjusting system of largely competitive markets that produces what consumers want, provides rewards appropriate to effort, and is assured of stable economic growth through Keynesian macroeconomic policies lost its credibility”. In the same level, Lekachman rejects the view of the economy as “ an engine powered by uncovered inner motivated decisions of legions of ardently competing businessmen and hordes of their customers” and the contention that “

success is ultimately related to individual merit and application" (Swinyard and William, 1993).

A drop in current income typically has indefinite implications for the consumer's estimates of future income flows. Assuming that waiting for new information be likely to resolve the uncertainty created by the initial income fall, even a risk-neutral consumer provokes to defer durable purchases until the uncertainty is resolved (Sunkel and Osvaldo, 1958).

During recessionary periods, the cost to households of durable stocks accumulated under times of more optimistic income expectations may decline by more than fixed life and straight-line depreciation assumptions (Bernanke, 2005). When this occurs, specification of consumption functions in flow of services definitions or with a total wealth variable as usually estimated, leads to problems both for the testing of theories and for forecasting. Arguments for this position are:

It is irrational for consumers to prefer higher durable consumption relative to income when current outlays for new durables are lower;

A large econometric model specified with flow of services definitions exhibits long runs of similar signs in the error terms around cyclical turns; and

The finding that the case for money illusion is dependent on flow of services definitions.

The evidence that there may be substitution of lower quality goods when inflation rates rise and that expected price changes were relatively

unimportant in explaining variations in the saving rate support our finding
<https://assignbuster.com/effect-of-recession-on-consumer-buying-behavior-economics-essay/>

that the typical response of the American consumer was to save more for necessities and pre-several balances when the rate of inflation accelerated (Zeithaml and Valarie, 1988).

Definitions of consumption could be changed to reflect changing consumer utilities and liquidity preferences, but in practice it may be impractical to implement such estimates. In the meantime, given the problems for theory, forecasting, and wealth variables, NIA definitions of income and spending are more satisfactory than flow of services definitions for most purposes (Slichter, 1957).

Several studies have tried to explain the decline in consumer spending. Not unexpectedly, nearly all of these explanations have paid attention on the effects of the stock crash. One link that has been examined is the effect of the Great Crash on consumer expectations. It is possible that the crash depressed consumer spending simply by leading consumers to believe that the Great Depression was coming and hence that permanent income was lower (Klein and Lansing, 1955).

Another link between the Great Crash and the drop in consumer expenditure that has been examined is the wealth effect of the decline in stock prices. It is a possibility that the crash depressed consumption simply by demolishing a great deal of wealth (Bierley, 1985).

But what is important is that real consumer spending on non durables other than food and energy dropped to a large extent. Nondurable expenses is the largest component of personal spending, about twice as large as the expense on durables. Consumers are battling in their daily life, and this <https://assignbuster.com/effect-of-recession-on-consumer-buying-behavior-economics-essay/>

resistance has developed primarily because inflation has eroded the purchasing power not only of their income but also of their wealth. Consumer spending. It is commonly agreed that any business recovery is limited in temperament if consumers fail to step up their spending. About two-thirds of all the goods and services produced in the country, consumer spending has much to do with bringing the economy back into a recovery phase (George Katona, 1974).

With reduction in their real incomes, consumers cut down on spending for nonessentials. Apart from a net decline in real disposable income, consumers are beaten by an additional financial burden that is the high level of debt. Roughly one-quarter of after-tax income is needed to serve debts; that, no doubt, holds down consumer spending. Generally, consumer loses his confidence and becomes hesitant about his buying plans (Khan et al., 2001).

Factors affecting the courses of the economy: Price increases is continued to be large. Conceivably, the course of inflation in the months ahead can be affected by (1) the pace of economic activity, both here and abroad; (2) availability and cost of energy and raw materials; (3) consumer spending; (4) the size of wage adjustments; (5) expectations regarding future price trends; (6) government economic policies; and (7) level of exports. Some elaboration on the effect and probable course of these economic factors follows (Slichter, 1957).

A majority of the Americans in fact, a majority of any subset of them partitioned by income, education, race, region, age, or political affiliation-

now supports imposition of mandatory wage-price controls. An even larger majority of American economists categorically opposes such controls.

Public support for controls is easy to explain. People favor any-thing they think can combat rising prices-including cutbacks in social programs and their own standard of living-except for higher unemployment and interest rates. The opposition of economists is equally easy to interpret. They believe that mandating wages and prices below equilibrium levels causes shortages, illicit markets, and misallocated resources.

In the postwar period, there have been at least four episodes of buy-now-beat-inflation consumer psychology-at the outbreak of the Korean War, in 1968-69, in 1973-74, and recently in 1978-79 (Wyer et al., 1986)

The recent episode is now the longest-lived, keeping consumer spending high and personal savings at a thirty-year low, and defying forecasts of recession.

Trying to forestall inflation by accelerating purchases, like wage profit conflict, is amenable to analysis by game theory. An individual consumer must choose between two moves, buy now or wait (Mubarik and Yasir, 2005).

There is imperfect information, because no buyer knows precisely to what extent others opt to wait or buy now, or what the impact of those decisions could be. The game is non-zero-sum, as buyers stand to gain or lose together from stable or rising prices. The particular payoff matrix reveals the prisoner's dilemma. For each consumer, the dominant individual strategy is

to buy now. If A defers his spending while B advances his, A pays higher prices later and loses out. If both A and B reason this way, both buy now and compel the very price rises they wish to forestall (Joel and Basu, 1987).

The most likely source of the precipitous drop in American consumption following the stock market crash in 1929 is the crash itself. In a previous paper, I showed that the stock market crash in October 1929 and the subsequent gyrations of stock prices through the middle of 1930 generated tremendous uncertainty about future income; the stock price movements did not necessarily make consumers and investors pessimistic about the future, only highly uncertain. This uncertainty is clearly reflected in the forecasts made by contemporary analysts. Not only was there more variation across forecasts of future income immediately following the Great Crash, but the analysts expressed great uncertainty about their forecasts and speculated that consumers and businessmen felt the same way. The effect of this uncertainty was that consumers and producers immediately cut their spending on irreversible durable goods as they waited for additional information about the future (Bierley, 1985).

As much as they may have contributed to real income losses, worldwide recessions, and some disruption to international financial markets, the extraordinary rises in food and fuel prices of 1973 and 1974 have not added much, if anything, to the underlying world wage inflation as of 1974. Partly, the reason is that, in some countries, the wage inflation had been so rapid that the increment from food and fuel was relatively small. Only in Canada and the United States did real wages fall over the 1972-74 intervals. But more important, the absence of substantial cost-of-living effects on wages

<https://assignbuster.com/effect-of-recession-on-consumer-buying-behavior-economics-essay/>

prevented these exogenous price shocks from precipitating an accelerating price-wage-price spiral (Burns, 1958).

Cost-of-living effects on wages should not be ruled out entirely. In the equations for Canada and the United States, they were found to add a minor amount to wages. With good enough data and close enough scrutiny, I expected to find some effects elsewhere as well. But till date, they do not seem to have played a large part, and certainly not a dominant part, in the wage determination of the countries studied (McSweeney et al., 1984).

Although the cost of living has not had significant effects on wages thus far, given strong enough union and political power it could. In 1973, consumer prices accelerated by more than 2% in Canada, Italy, Japan, and the United States only. In Italy and Japan, the increases are fully accounted for by wage accelerations. It was 1974 before consumer prices exploded in most countries. So the feared problem of fuel prices feeding into wages may still lie ahead. Only a change in the structure of wage determination could trigger this problem; but, in view of the wage histories analyzed here, such a change could not be unprecedented, and therefore policy maker should not be complacent (Sujan and Mita 1985).

The ten buyer behavior trends in a recession are:

The Aldi effect - looking for low price retail outlets to buy things, rather than not obtaining at all

The lipstick effect - Buying goods of less value in place of