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CONCEPTUAL REVIEW OF FIRMS BUSINESS STRATEGY FINANCIAL FIEXIBILITY AND PROFITABILITY OF STYLE INVESTING IN THE ECONOMIC ENVIRONMENT

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ABSTRACT

In this study, we're looking at this as a concept somewhat familiar with the economic environment we start edges and investment styles. Therefore, we first attempt a comprehensive definition of business strategies and are flexible. While the precise definition of the relationship they have with each of our investments and the profitability of existing styles. This study examines how firms' financial flexibility affects the profitability of three of the most commonly used style investing strategies. They are the value-growth trading strategy (going long on stocks with high Book-to-Market ratio and short on stocks with low Book-to-Market ratio), the momentum trading strategy (going long on stocks that have performed well and short on stocks that have performed poorly recently), and the accruals based trading strategy. The results suggest that the understanding of corporate investment decisions can help improve the understanding of securities markets and portfolio investment strategies. There are a few lessons that investors can learn from the findings of this thesis. Value-growth investors should focus on value and growth firms with high investment irreversibility gap. Momentum investors should pursue the trading strategy among firms with high financial constraints and during economic upturns. They could also benefit from forming their portfolio from past winners and past losers with high investment gaps. Accruals based investors would benefit from pursuing the strategy among firms with high investment and financing flexibility and during economic upturns.

Keywords: Investment, strategy, flexibility, profitability, economic environment

INTRODUCTION

Investment styles have been playing important roles to industry practitioners. The fund management industry has developed a preference for "specialty" managers who focus on an asset class to a single balanced manager (Bailey and Arnot, 1986). According to Bogle (2005, p.16), the "middle-of-the-road" funds in diversified blue chips companies that resembled the volatility of the whole stock market once dominated the equity mutual funds in 1945. They have now been taken over by funds specialised in different styles. Finally, Kumar (2006) and Froot and Teo (2008) document that styles drive individual and institutional investors' trades. The popularity of style investing can be traced back to the importance of the portfolio allocation decision. Brinson et al. (1986) suggest that 93.6% of the actual variation in returns of a typical institutional investor can be attributed to the asset mix. The remaining variation of less than 7% is due to other factors such as the skills of investment managers and market timing. Investment styles are useful as they help simplify the portfolio allocation process. Managers that do not adhere to their designated styles will expose a portfolio to unnecessary risks (Gallo and Lockwood, 1997)3. In addition, being specialised in a particular style helps

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fund managers save the cost of gathering information about individual securities (Sharpe, 1987). A fund manager can save cost by utilising its financial analysts' comparative advantages and enjoy the economies of scale. (Bailey, J.V. and Arnot, R.D, 1986)

The decision process that investors undertake before entrusting their assets to a professional money manager can be extremely complex. At the heart of this judgment is the inherent belief that they will be better off with professional management than if they had allocated their assets themselves. Whether due to better, less costly information or superior investment skill, it is axiomatic that investors will ultimately benefit from external management if the incremental returns produced exceed the costs of acquiring the manager's services. An interesting aspect of the contracting relationship between investors and managers is that the latter are seldom left completely unconstrained to pursue the superior risk-adjusted returns necessary to justify their existence. In fact, these contracts usually involve myriad investment restrictions, which can take at least two forms. First, as Almazan, Brown, Carlson, and Chapman (2004) note, investors often impose direct investment restrictions (e.g., short sale or margin trading prohibitions) on the manager's actions. Second, money managers might also find the scope of their strategic alternatives limited to a narrow range of investment styles within a specific asset class. One consequence of such style restrictions is that performance evaluation becomes a relative endeavor; it may not be valid to compare two portfolios based on different styles if the respective managers were not free to adopt each other's strategy.(, M., Fisher, A. and Giammarino, R,2004)

Flexibility plays important role in enabling the managers to make investment in the future. Problems of capital market necessitated keeping flexibility for the companies to use profitable opportunities. Myers showed in 1977 how threats resulting from debt of the companies may prevent them from using profitable opportunities even when managers and shareholders are willing to use these opportunities. Optimal acquisition of resources leads to success of the companies in market and companies can follow market opportunities successfully and take advantage of activity in market. Although the profitability of the value-growth, momentum, and accruals based trading strategies is well researched and numerous studies have attempted to explain possible sources of the gains from these trading strategies but their success has been limited. This section provides a snapshot on the existing literature, highlights the gaps, and the potential contributions of the thesis towards examining and testing the success of the aforementioned trading strategies.

DEFINITION OF FINANCIALLY FLEXIBLE FIRMS

Financial Flexibility

In order to specify the companies with financial flexibility, the companies with less leverage ratio than medium of statistical sample have been classified as companies with financial flexibility. (CAO, VIET, NGA (2011)

To classify FF firms, we adopt the following criterion: the dummy takes the value of when we observe at least three consecutive periods in which the firm is classified as LL prior to the investment decision. (CAO, VIET, NGA (2011)

Identification Of Financially-Flexible Firms

Recent survey studies of capital structure choices provide strong evidence that the single most important determinant of leverage decisions by firms is the desire to maintain financial flexibility (Bancel and Mittoo, 2004; Graham and Harvey, 2001). However, as we argued above, since there is no well defined measure of flexibility in the literature, this is an unobservable factor that depends largely on managers' assessment of future growth options.

Consequently, this factor will end up in the residual of the model, where it will generate systematic deviations between observed and estimated leverage. For this reason, we propose to indirectly capture the effect of financial flexibility using deviations from predicted target leverage. (CAO, VIET, NGA (2011)

Financial Flexibility and Investment Ability

In their seminal paper, Modigliani and Miller (1963) noted that despite the existence of some tax advantages for debt financing, firms tend not "to use the maximum possible amount of debt in their capital structure" due to limitations by lenders leading to "the need for preserving flexibility." In the modified version of the pecking order theory (Myers, 1984), firms have two main reasons to restrain themselves from issuing debt: 1) to avoid the costs of financial distress, and 2) to maintain financial slack. CAO, VIET,NGA (2011)

Profitability

Union wage gains lower firm profitability unless offset by productivity enhancements in the workplace or higher prices in the product market. The evidence on productivity reviewed above indicates that unionization does not typically offset compensation increases. A rise in the price of the product sufficient to prevent a loss in profitability is possible only in a regulated industry where firms are "guaranteed" a competitive rate of return. In more competitive settings, where unionized firms compete with nonunion domestic companies and traded goods, there is little if any possibility of passing along increased cost via a rise in prices. Lower profitability will be reflected in decreased current earnings and measured rates of return on capital, and in a lower market valuation of the firm's assets. (Barry T. Hirsch1997)

Profit-maximizing responses by firms to cost differentials should limit the magnitude of differences in profitability between union and nonunion companies in the very long run. Differences in profits will be mitigated through the movement of resources out of union into nonunion sectors – that is, investment in and by union operations will decrease until post-tax (i.e., post-union) rates of return are equivalent to nonunion rates of return or, stated alternatively, union coverage will be restricted to economic sectors realizing above-normal, pre-union rates of returns. Because the quasi-rents accruing to long-lived capital may provide a principal source for union gains and complete long-run adjustments occur slowly, however, we are likely to observe differences in profitability as these adjustments take place. (Barry T. Hirsch1997)

The poor profit performance of unionized companies during the 1970s may provide an important explanation for the marked decline in union membership during the 1980s. As noted by Linneman, Wachter, and Carter (1990) and others, employment declines have been concentrated in the unionized sectors of the economy; nonunion employment has expanded even in highly unionized industries.

Although important, shifts in industry demand are an insufficient explanation for the marked decline in private sector unionism. The evidence presented here supports the thesis that declines in union membership and coverage in no small part has been a response to the continuing poor profit performance of unionized companies throughout this period. The conclusion here that large profitability differences between unionized and nonunionized firms help to explain declining unionization is complementary to the conclusion reached by Freeman (1988), Linneman, Wachter, and Carter (1990), and others that high union wage premiums have accelerated unionism's decline. (Barry T. Hirsch1997)

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Profitability in Economic Environments

Economists are understandably skeptical that large profit differentials could survive in a competitive economy, notwithstanding the sizable profit differences between unionized firms and nonunionized firms found in the empirical literature. Yet there are two potentially important econometric biases causing effects of unionization to be understated. First, profit functions are estimated only for surviving firms, since those for which the effects of unionization are most deleterious may be less likely to remain in the sample. Second, unions are more likely to be organized where potential profits are higher; hence, the negative effect of unions on profits may be underestimated in empirical work where union density is treated as exogenous. In fact, those studies that attempt to account for the simultaneous determination of union status and profitability obtain larger estimates of unions' effects upon profits. (Barry T. Hirsch1997)

STRATEGIES OR INVESTMENT STYLES

The Value-Growth Trading Strategy

Value and growth are known to the investing public as early as the beginning of the 20th century. According to Graham and Dodd (1940, reprinted in2009, p.61), during the period after the World War I up to the market peak during1927 – 1929, investors pursued the "new era" investment theory that favours stocks with high growth, or growth stocks. Graham and Dodd's classic work "Security Analysis" is often referred to as the first comprehensive support for investment in value stocks (Klarman, 2009). Value style has since become one of the most important investment styles.

Subsequent academic studies tend to simplify the definition of value (growth) stocks down to stocks of firms with high (low) ratios of fundamentals to price. They study the profitability of the value-growth trading strategy, i.e. the strategy that goes long in value stocks and short in growth stocks. The information needed to pursue this strategy is historical and public. In the language of the efficient market hypothesis, the success of the value-growth trading strategy violates the semi-strong form market efficiency, hence the value anomaly. (CAO, VIET, NGA, 2011)

The Momentum Trading Strategy

The next strategy to be examined is based on the stock price momentum, a popular technical analysis tool. In the academic literature, the first evidence on the profitability of the momentum trading strategy, i.e. the strategy to buy past winners and sell past losers, was documented in Levy (1967).

However, Jensen and Benington (1970) report that the strategy is not better than a simple buy-and-hold one. Over 20 years later, Jegadeesh and Titman (1993) revisit the stock price momentum phenomenon. They report that winner (loser) stocks, i.e. those performing well (badly) in the last six to twelve months, will continue to perform well (badly) in the following six to twelve months.

The return to the momentum trading strategy (here after the momentum profit) cannot be explained by the CAPM related risk (Jegadeesh and Titman, 1993), or the Fama and French three factor model (Fama and French, 1993, 1996). In the language of the efficient market hypothesis, the success of such a simple trading strategy based purely on past stock returns violates the weak form market efficiency, hence the momentum anomaly. The success of the momentum trading strategy has been considered as a challenge in the literature given that it does not appear to be riskier and is robust innumerous international markets outside the US.

Jegadeesh and Titman (1993) do not find evidence that the momentum profit is due to a positive market beta of the hedge portfolio or a positive serial correlation of the factor mimicking portfolio. Fama and French (1996) report that their three factor model cannot explain the momentum profit. (CAO, VIET, NGA, 2011)

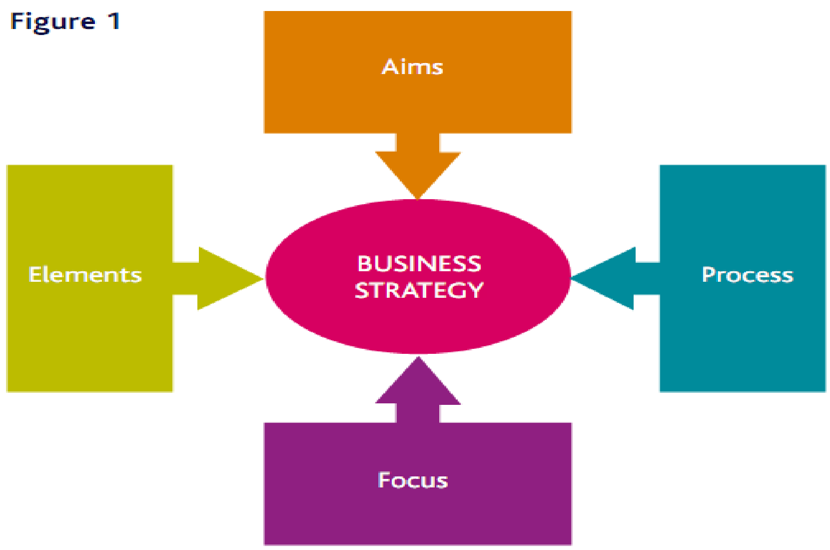
The Accruals Based Trading Strategy

Finally, this thesis examines the success of the accruals based trading strategy, (the strategy of buying stocks that have low accruals and selling stocks that have high accruals) in generating excess returns. First documented in Sloan (1996), this strategy is reported to generate positive and significant returns that cannot be explained by the CAPM related risk. Similar to the value trading strategy, the accruals based trading strategy uses the historical and public information. In the language of the efficient market hypothesis, the success of the accruals based trading strategy violates the semi-strong form market efficiency, hence the accruals anomaly. (CAO, VIET, NGA, 2011)

A Definition of Business Strategy

The definition of business strategy is a long term plan of action designed to achieve a particular goal or set of goals or objectives. Strategy is management's game plan for strengthening the performance of the enterprise. It states how business should be conduct to achieve the desired goals. Without a strategy management has no roadmap to guide them. Most business organisations of any size will probably have some form of business strategy (even if it is not articulated in such terms). However the term ‘business strategy’ is sometimes a nebulous term and there are many different definitions and aspects of business strategy. Some of these are shown in figure 1 and subsequently discussed briefly. All of these themes were considered during the course of the research. (Glynn Lowth, Malcolm Prowle, Michael Zhang, 2010).

Figure 1



Aims of Business Strategy

In broad terms a business strategy should aim to define: The external, environmental factors affecting the businesses’ ability to compete. The position the business is trying to get to in the long-term. The markets a business should compete in and the activities are involved in such markets. The values and expectations of those who have power in and around the business. The resources required in order to be able to compete. The means by which the business can

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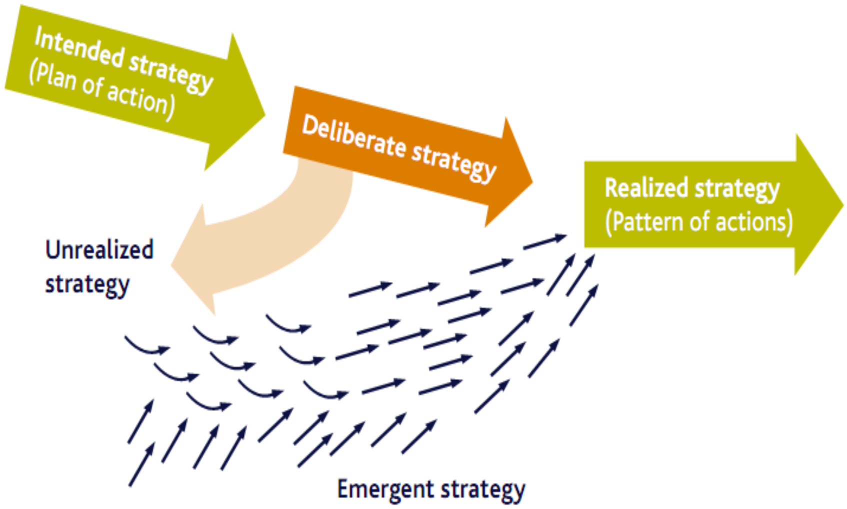
perform better than the competition in those markets.(Glynn Lowth, Malcolm Prowle, Michael Zhang ,2010)



The Process of Strategy Development

There is strong debate about exactly how business strategies are or should be developed and these are shown in figure 2 overleaf.(Glynn Lowth, Malcolm Prowle, Michael Zhang ,2010).

Elements of Business Strategy

There are various elements which make up the strategy of the business and these are illustrated in figure 3. Arenas - where will we be active? (E.g. product categories market segments, geographic areas, core technologies) Vehicles - how will we get there? (E.g. internal development, joint ventures, franchising) Differentiators - how do we differentiate ourselves? (e.g reliability, price, custom is at ion etc) Staging - what will be our speed and sequence of moves? (e.g. Speed of expansion, sequence of initiatives, need for quick wins) Economic logic – how will we obtain our returns (profitscash, ROI etc) All these elements are relevant in considering business strategy in recessionary times.(Glynn Lowth, Malcolm Prowle, Michael Zhang, 2010)

Figure 3

The Scope of Business Strategy

Each separate 'business' should have its own business strategy so that a multiple business enterprise will have a number of separate business strategies. This raises the practical question of how to define the scope for each such business. Mathur and Kenyon (1997) have examined this question rigorously. They suggest that there should be a separate competitive strategy for each 'offering' defined as the unit of customer choice. The unit of customer choice depends on what the customers comparing when he or she makes the buying decision. Their many examples of offerings suggest, for instance, that a 100g jar of Nescafe might be a separate offering from a 200g jar of Nescafe if the closest substitute for the customer is the same size jar of another make of instant coffee. They see the two different sizes of jar as being different offerings and therefore requiring different business strategies. This is certainly theoretically elegant but may present a few problems in practice. To divide businesses so finely is likely to be too much work and it is unlikely that it would be possible ever to implement such fine-grained strategies. There is often a conflict between theoretical rig our and practical constraints. (Glynn Lowth, Malcolm Prowle, Michael Zhang, 2010).

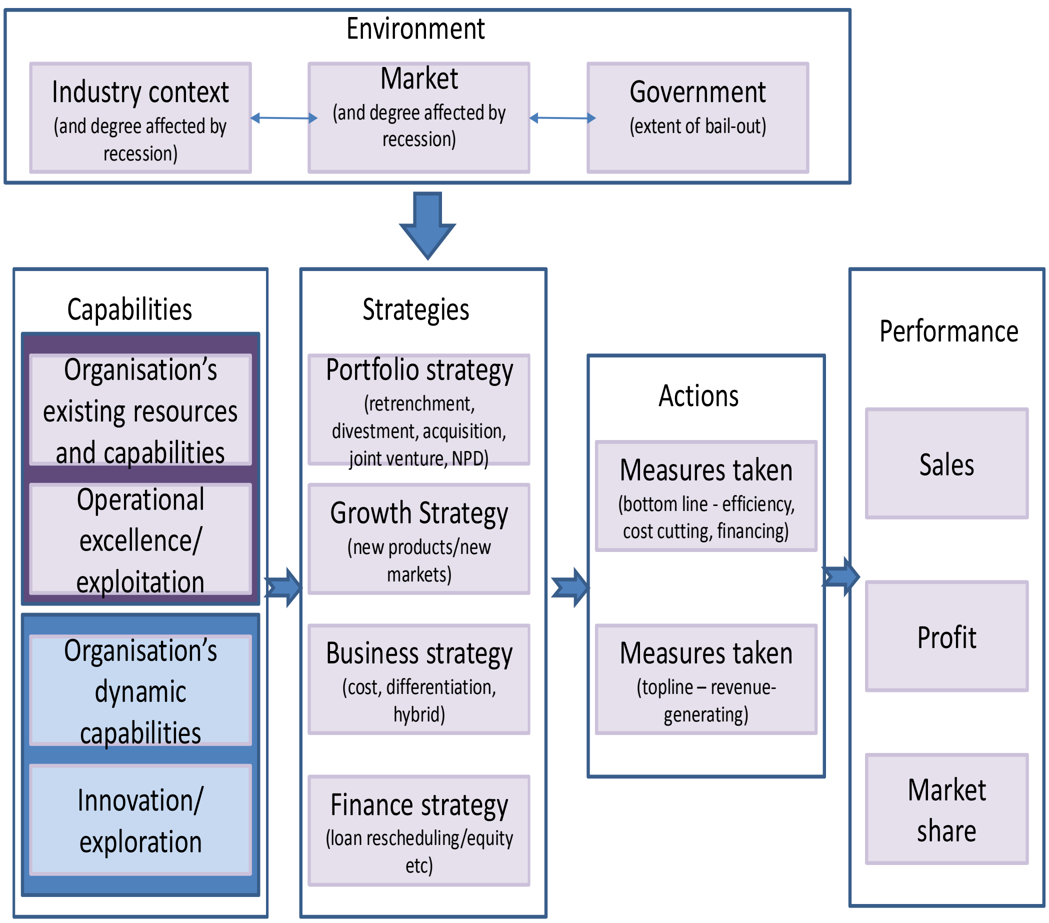


Figure 4. Business Size as an Influence on Strategic Adaptation to Difficult Economic Conditions

A firm's size can affect the nature of external environmental impacts and the mechanisms through which they are transmitted, as well as the firm's ability to respond (Curran, 1996). The more limited resource base of SMEs compared with larger firms, particularly in terms of finance and management, can affect their ability to scan, analyse and respond to major environmental change (Smallbone et al, 1999b).

Business size shapes perceptions of external pressures, threats and opportunities, the business strategies adopted, and the levels of performance achieved (Curran, 1996).

Interestingly, some studies suggest that small businesses are *less* likely to perceive negative impacts on performance during recession periods (Shama 1993; Latham 2009).

Large companies tend to have greater scope for strategic choice because of their superior resources to scan the environment for potential market opportunities, to develop a wider range of capabilities and also facilitate greater resilience to withstand difficult times. This particularly applies in the case of multinational firms, with operations spread across countries. Small businesses are perhaps more vulnerable to market shifts as they lack resources and usually operate with narrower product portfolios, rendering them at greater risk from industry-related downturns; yet some studies find that small businesses report more limited impacts than larger enterprises (e.g. Shama 1993).

Small businesses are, therefore, more likely to react to environmental shifts than be in a position to direct them. But, conversely, small firms often possess the flexibility to adjust resource inputs, processes, prices and products quickly in response to environmental shocks, a crucial capability to facilitate business survival (e.g. Reid 2007).

Small firms might also be more willing to engage in risky investment/innovation behaviour to improve performance because they realise that the current successful situation cannot continue indefinitely. Latham (2009), in a study of US software firms during the 2001-3 downturn, found that start-up firms were much more likely than larger businesses to pursue revenue-generating strategies as means of coping than strategies entailing cost reductions. Such a view is consistent with the wider literature that start-ups often seek to position themselves in particular market niches.

Content Of A Business Strategy Document

There is a tendency for strategy documents to be too long. It should be possible to read the whole document at a sitting and find it easy to understand. However, the document should give clear answers to the questions posed above, concisely and persuasively. Key facts and summarized analysis should support the answers. It may be appropriate to refer to more detailed documents or to include telling details.

Principal Findings of Strategic Assessment

Typically, the strategic assessment will have involved detailed analyses of both the external business environment and the capabilities of the enterprise. Only the most important or most surprising results need to be recorded. However, this section should provide a reasoned assessment of current status and future prospects of the business if present strategies were to be continued. This then makes the case for change in business terms. (G. Johnson, 2008).

Strategic Choices Which Have Been Made and Supporting Rationale

This section has to summarize the options that have been identified and the choices made. The reasons for preferring one direction to another have to be spelt out and must be persuasive. The rationale for strategic choice should be based on a rigorous analysis of the basis of competitive advantage and how that will relate to the demon- stable capabilities of the enterprise. It is also desirable to show how the choice matches the strategic intent of the enterprise as a whole. (G. Johnson, 2008).

Statement of Goals and Objectives

The overall goal is to realize the strategic intent of the business. More measurable supporting goals are also very valuable. Objectives should not all be financial. It is important that some objectives set measures that relate to the fundamental nature of the business and to meeting customer and stakeholder needs. (Kay, J., 1999).

Variety of Strategies in the Economic Environment

Business Strategies

Recessions present businesses with a dilemma: whether to cut costs to conserve resources, or to invest in new products and processes to exploit competitor weakness. In general terms, the literature identifies three broad categories of strategy in recession conditions: retrenchment, investment, and 'ambidextrous' strategies. (G. Johnson, 2008)

Retrenchment Strategies

Involve cutting operating costs and divestment of non-core assets. These appear to be the most common approaches adopted by businesses to deal with recession conditions, especially in the short-term. Analysts report divestment of businesses, closure of establishments, reductions in employment, expenditure cuts on a wide range of activities including R&D, marketing and employee training.(G. Johnson,2008).

Investment Strategies

Involve expenditure on innovation and market diversification. Recession is regarded as an opportunity to implement strategic change that would otherwise not have occurred. Many of today's household names launched successful businesses during recessions. The evidence on businesses adopting investment strategies to manage through recession, however, is patchy. Such strategies are risky and many firms are likely to be too preoccupied with short-term survival to think about innovation and growth, or lack the resources to implement such strategies effectively. (G. Johnson, 2008).

'Ambidextrous' strategies combine retrenchment and investment. It is likely that most firms adapt under recession conditions through judicious cost/asset-cutting behavior *and* through investment in product innovation and market development. Choosing the appropriate investments to make and costs to cut takes on additional importance during recession when market selection pressures are at their most severe. (G. Johnson, 2008).

Definition of 'Investment Style

The overarching strategy or theory used by either a retail investor or an institutional money manager to set asset allocation and choose individual securities for investment. The investment style of a fund helps set expectations for long-term performance potential and aids in advertising the fund to investors looking for a specific type of market exposure.

LAYERS OF THE BUSINESS ENVIRONMENT:

The Macro-Environment

Is the highest-level layer. This consist of broad environment factors that impact to greater or lesser extent on almost all organizations. Here, the PESTEL framework can be used to identify how future trends in political, economic, social, technological, environment (green) and legal environments might impinge on organizations.

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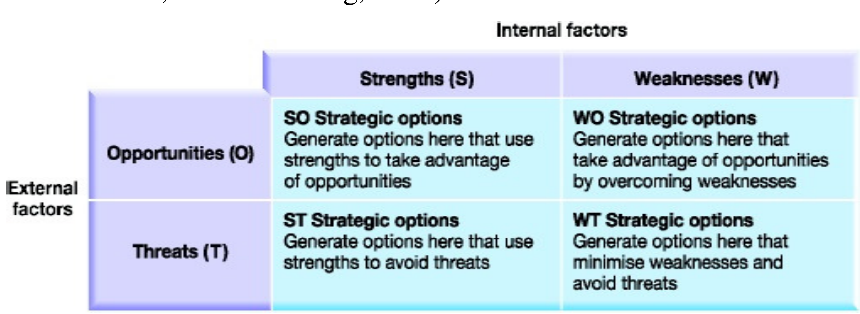
The Industry Environment

Economic theory defines an industry as 'a group of firms producing the same principal product' or, more broadly, 'a group of firms producing products that are close substitutes for each other'. This concept of an Industry can be extended into the public services through the idea of sector .This section looks at Michael Porter's M five forces framework for industry analysis.

Developing and Implementing Strategies

In developing business strategies, management will often begin with a SWOT (strengths, weaknesses, opportunities and threats) analysis that evaluates the strengths and weaknesses of the firm as well as its opportunities and threats. This evaluation is then used to develop strategies to minimize risks and take advantage of major opportunities. This analysis is usually displayed in a SWOT matrix. SWOT analysis summarises the key issues from the business environment and the strategic capability of an organisation that are most likely to impact on strategy development. This can also be useful as a basis against which to judge future courses of action. The aim is to identify the extent to which the current strengths and weaknesses are relevant to, and capable of, dealing with the changes taking place in the business environment. It can also be used to assess whether there are opportunities to exploit further the unique resources or core competences of the organisation. Overall a SWOT analysis should help focus discussion on future choices and the extent to which an organisation is capable of supporting these strategies. (Glynn Lowth, Malcolm Prowle, Michael Zhang, 2010).

The SWOT matrix (TWOS matrix) is used to generate strategic options by building directly on the information about the strategic position that is summarised in a SWOT analysis. In this sense the TOWS matrix not only helps generate strategic options it also addresses their suitability. Each box of the TOWS matrix is used to identify options that address a different combination of the internal factors (strengths and weaknesses) and the external factors (opportunities and threats). For example, the top left-hand box should list options that use the strengths of the organisation to take advantage of opportunities in the business environment. In contrast the bottom right-hand box should list options that minimise weaknesses and also avoid threats. Business strategies are generally classified as being product differentiation or cost leadership.1.Product differentiation. Product differentiation involves modification of a product to make it more attractive to the target market or to differentiate it from competitors' products. Products may be differentiated in the following ways: Physical characteristics (e.g., aesthetics, durability, reliability, performance, serviceability, features, etc.) Perceived differences (e.g., advertising, brand name, etc.)Support service differences (e.g., exchange policies, assistance, after-sale support, etc.)By differentiating its products, the firm may be able to charge higher prices than its competitors or higher prices for the same products sold in different market segments. (Glynn Lowth, Malcolm Prowle, Michael Zhang, 2010).



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Investment strategy:

In finance, an investment strategy is a set of rules, behaviors or procedures, designed to guide an investor's selection of an investment portfolio. Usually the strategy will be designed around the investor's risk-return tradeoff: some investors will prefer to maximize expected returns by investing in risky assets, others will prefer to minimize risk, but most will select a strategy somewhere in between.

Investment Style Identification

Identifying styles that investors direct funds into and out of is a prerequisite to measuring co movement of stocks with respect to their styles. As Barberis and Shleifer (2003) point out with the aid of numerous examples, some investment styles are born and die while others are permanent. Styles can share common characteristics in law, markets, or cash flows, which sometimes (but not always) results in highly correlated cash flows. Since the Barberis and Shleifer (2003) model is one of relative style chasing, it is critical that any taxonomic scheme satisfy two conditions. First, styles must span the entire market. Technically, this could include all asset classes, including equity, fixed income, real estate etc., but following Barberis and Shleifer (2003) we consider the "market" to be that of domestic equity. Second, styles should be mutually exclusive. This is not a requirement of the model but an important empirical convenience; without it, a security that appears in two styles would have two measures of co movement. Thus, ideally, we want to identify a manageably small number of mutually exclusive styles that are relatively widely followed over our entire sample period. (P. Kotler and K. Keller, 2008).

CONCLUSIONS

The purpose of the review has been to: identify the pressures, threats and opportunities facing businesses operating in difficult economic conditions such as those currently being experienced in the UK and globally; categorise the strategies adopted by businesses that have experienced such conditions; and to assess which strategies proved to be problematic and those that have allowed businesses to respond dynamically, survive and emerge strongly as economic conditions improved. This we have done using three main data sources: academic studies of business responses to recession and 'environmental jolts', including secular industrial decline and business turnaround; an analysis of contemporary commentary on the current crisis; and the output of a 'think-tank' of experts on business strategy and management. Bearing in mind the gaps and weaknesses in the literature, we summarise the key findings of the review and highlight key issues for policy makers to consider. First, the current recession, combined with the global financial crisis, arguably constitute a 'structural break', one likely to produce a new economic order whose precise parameters are only dimly understood today. The specificities of the current crisis mean that any simple extrapolation of previous business experience of, or responses to, recession conditions is ruled out. In today's increasingly global economic environment, UK businesses might have to adapt to recession in quite different ways in comparison with previous downturns. Such a break is likely to require organisations to reconfigure their business *models* as well as their

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organisational structures and operations. Continuing 'business as usual' appears not to be an option for most, if not all, organisations.

Second, firms' experiences of, and responses to, recession are diverse. Businesses adopt a variety of strategic approaches to dealing with recession conditions. Some firms focus on retrenchment activities, entailing cost/asset-reduction, in order to conserve resources; other businesses use recession to exploit opportunities to invest, innovate and diversify; yet others, perhaps most, adopt an 'ambidextrous' approach combining judicious cost/asset-reduction activity with equally carefully chosen investment projects to expand sales, profits and/or market share. Although widely regarded as giving business owners/managers good reasons to engage in retrenchment, recession also creates opportunities for innovation by incumbent firms, to stay in the game, and by new entrants who spot an opportunity. Businesses, it might be contended, are more likely to succeed if they combine strategies of cost efficiency and retrenchment (exploitation) with strategies of innovation and positioning for future growth (exploration). There may be a role for Government to foster a spirit of innovation and entrepreneurship, as the think-tank suggested, by legitimising and promoting such activities. This might include facilitating cross-sector dialogue. Third, business performance is highly variable under recession conditions. Some firms prosper while others struggle and yet others are forced into closure. Within- and post-recession performance does not correlate with pre-recession performance in an obvious way. Recession is likely to generate considerable volatility in business performance. Erstwhile high-performers might struggle in recession conditions, while previous poor-performers may leapfrog competitors. Market selection pressures appear to operate quite differently in times of recession in comparison with more buoyant periods. This market volatility increases pressures on businesses to adapt, as even previously secure and stable enterprises may find the ground shifting beneath their feet. Fourth, business performance under recession conditions does not map on to organisational characteristics such as business size or sector in an undifferentiated way. Small and large firms are among the high and low performers. Even in industries harshly impacted by recession, some businesses perform better than others. Outcomes cannot simply be read off from organisational characteristics; performance, including survival, is contingent, to some degree, on how businesses act. To conclude, the current recession represents both a threat and an opportunity for UK businesses. Grasping the opportunities will be key to securing the competitive advantage of UK companies in the global arena. Policy can play a role in supporting UK businesses either to exploit the opportunities enabled by recession, or to manage the threats posed, but given the knowledge limitations and broader institutional constraints arising from globalising tendencies, it should also be acknowledged that there are strong limits to what is possible.

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