

# Chapter 18

# Business cycles and the entrepreneur

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## Learning outcomes

- Explain what business cycles are
- Describe the four distinguishable phases of the business cycle
- Provide a historical perspective on business cycles in South Africa
- Provide a sectoral perspective on business cycles in South Africa using financial data from different business sectors and industries
- Indicate the relevance of business cycles to entrepreneurs and prospective entrepreneurs

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## Learning outcomes (cont.)

- Describe how entrepreneurs can ensure profitability during the different phases of the business cycles
- Show how entrepreneurs can incorporate business cycle forecasts in their business plans
- Describe how entrepreneurs can make use of sectoral business cycles to optimise their business success in the sector they are operating in
- Identify business opportunities using business cycle information



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## Introduction

- No economy in the world is static
- To ensure business success entrepreneurs should scan economic trends continuously and should respond to changes in the economy
- Entrepreneurs should use their knowledge regarding economic trends in their business plans, in identifying business opportunities, in identifying markets and products for their services, in conducting market planning, in deciding upon expanding their business, in making decisions about new outlets and in calculating business risks

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## Nature and phases of business cycles

**Business Cycle:** the cyclical but irregular up-and-down movements in economic activity, which are measured by fluctuations in GDP.

### Phases:

- **Contraction:** this occurs when an economy is experiencing negative real growth in its gross domestic product (GDP)
- **Recovery:** This occurs when an economy starts to show positive real GDP growth again after a recession

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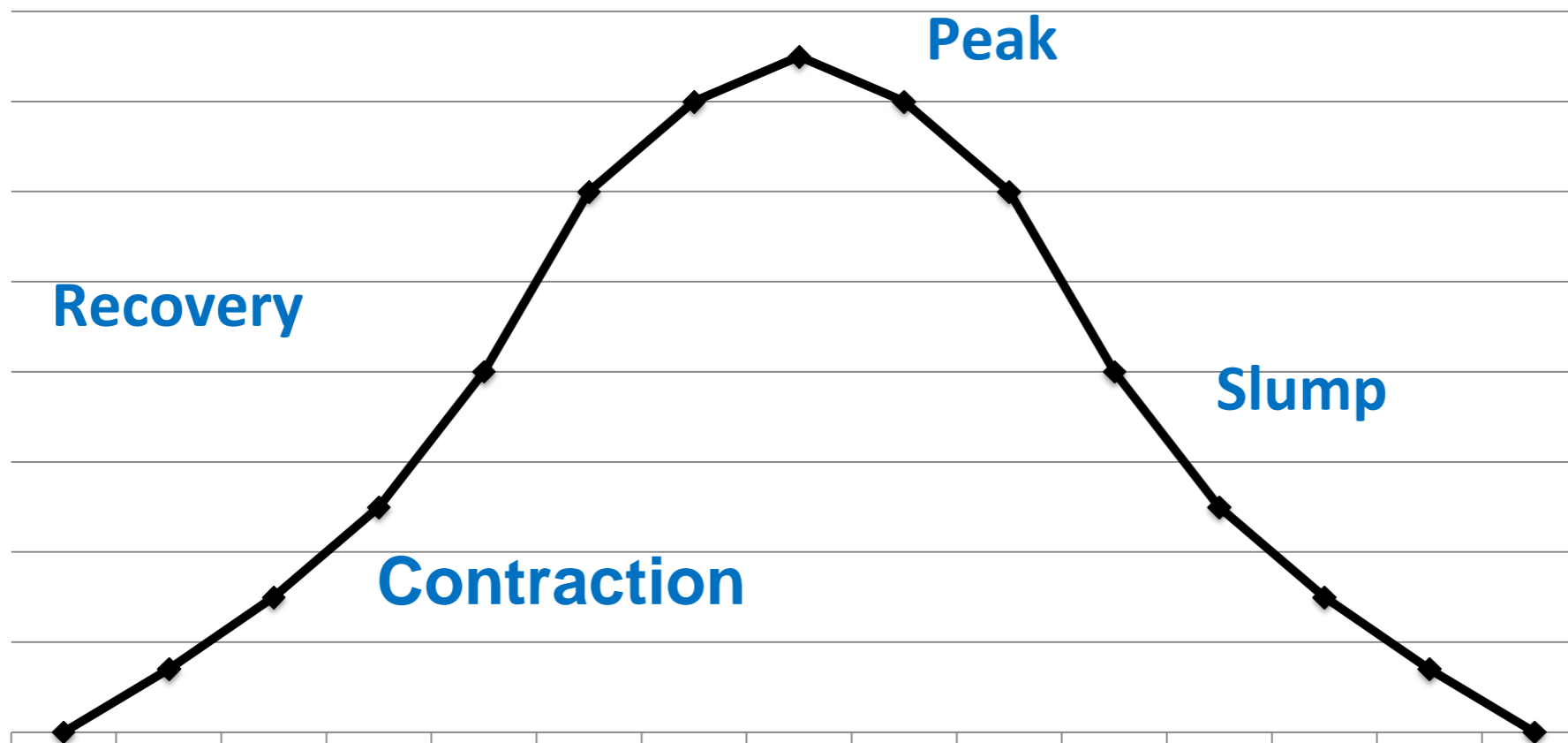
## Nature and phases of business cycles (cont.)

- **Peak:** This is the ‘happy days’ part of the business cycle during which fairly high real GDP growth rates, sustained positive employment growth rates and fairly high levels of consumer and business confidence are experienced
- **Slump:** This phase of the business cycle follows the boom phase when real GDP and employment growth rates start to decline

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## The business cycle





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## Average GDP growth rates in SA

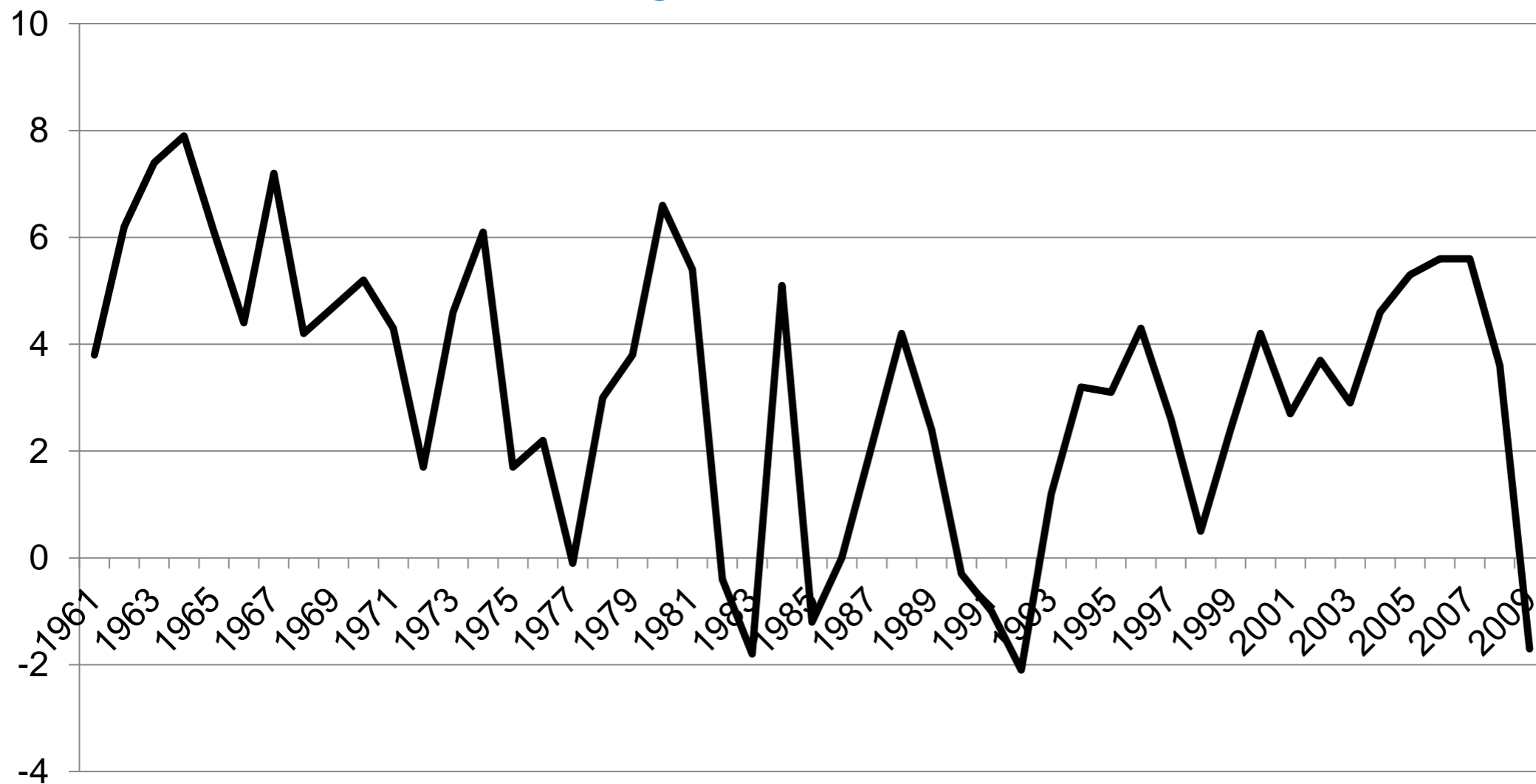
- 5.8% during 1961 to 1969
- 3.3% during 1970 to 1979
- 2.2% during 1980 to 1989
- 1.5% during 1990 to 1999
- 3.7% during 2000 to 2009
- 2.8% during 2010 to 2013
- It is evident from the growth rates above that there are also longer term business cycles present in the economy



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## GDP growth rates in SA

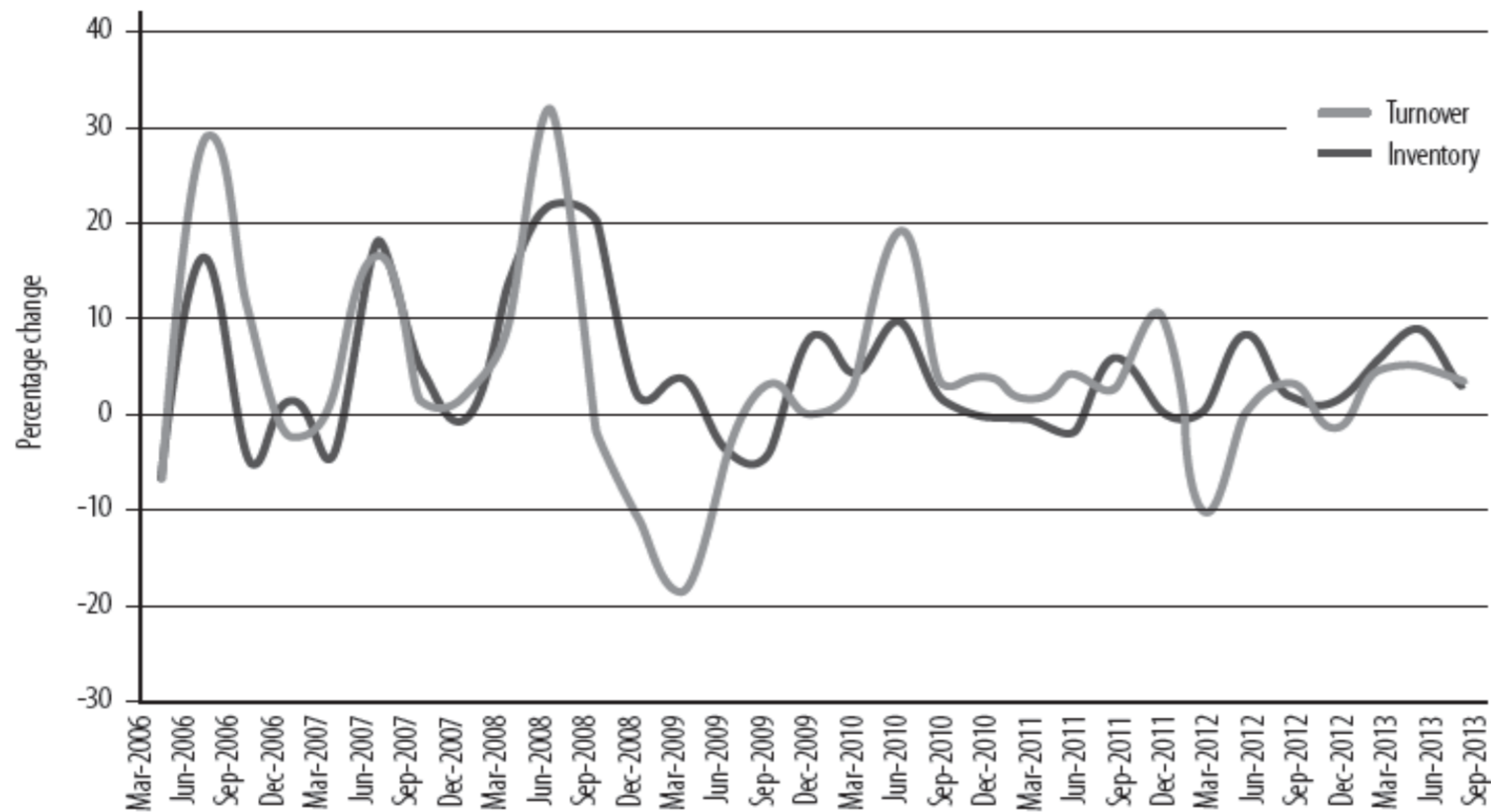


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## Mining sector business cycle

**Figure 18.3** Time series of percentage change in turnover and inventory between consecutive quarters for the mining and quarrying industry

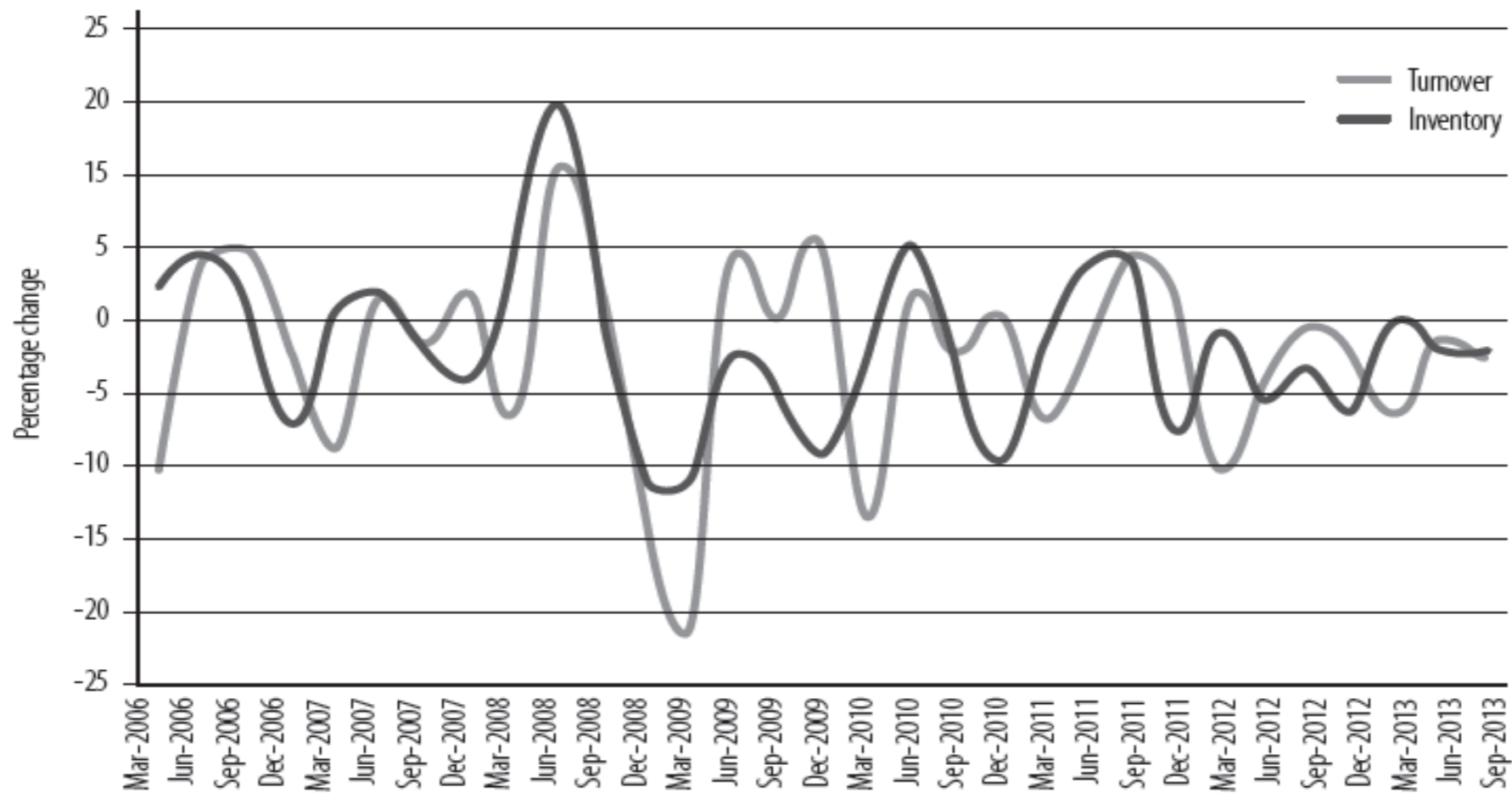


Source: Statistics South Africa (2014).

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## Manufacturing sector business cycle

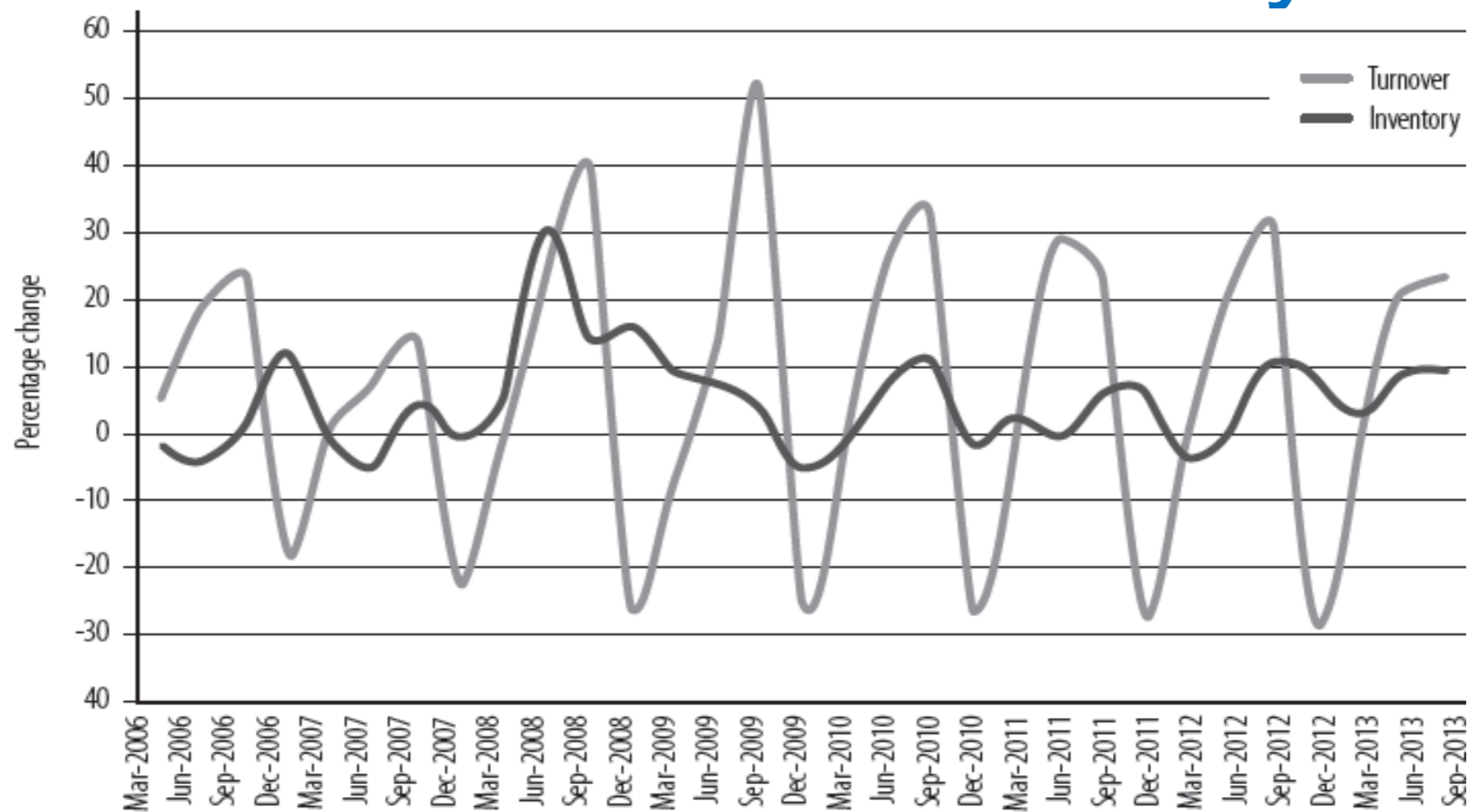


Source: Statistics South Africa (2014).

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## Utilities sector business cycle



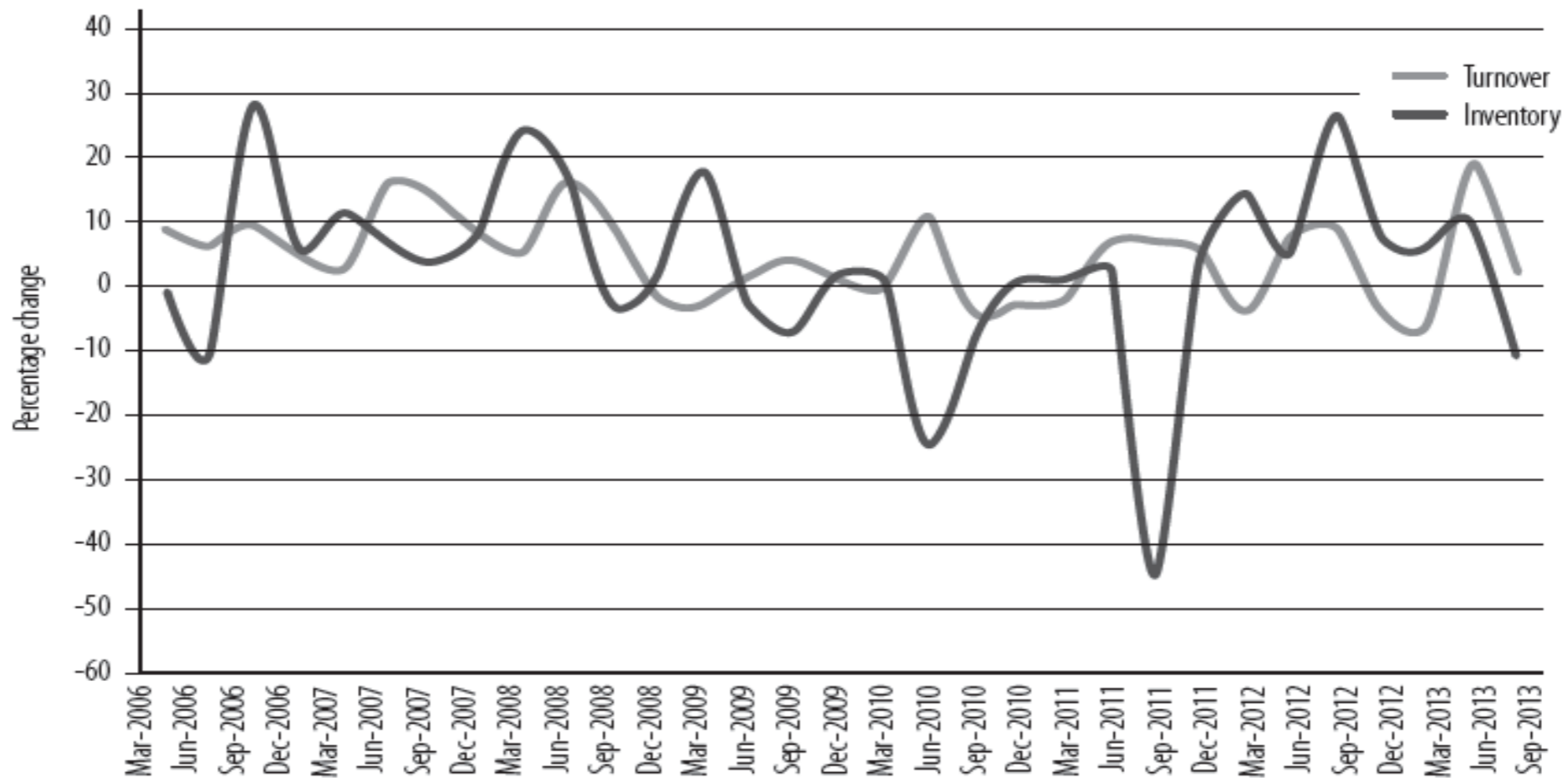
Source: Statistics South Africa (2014).



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## Construction sector business cycle

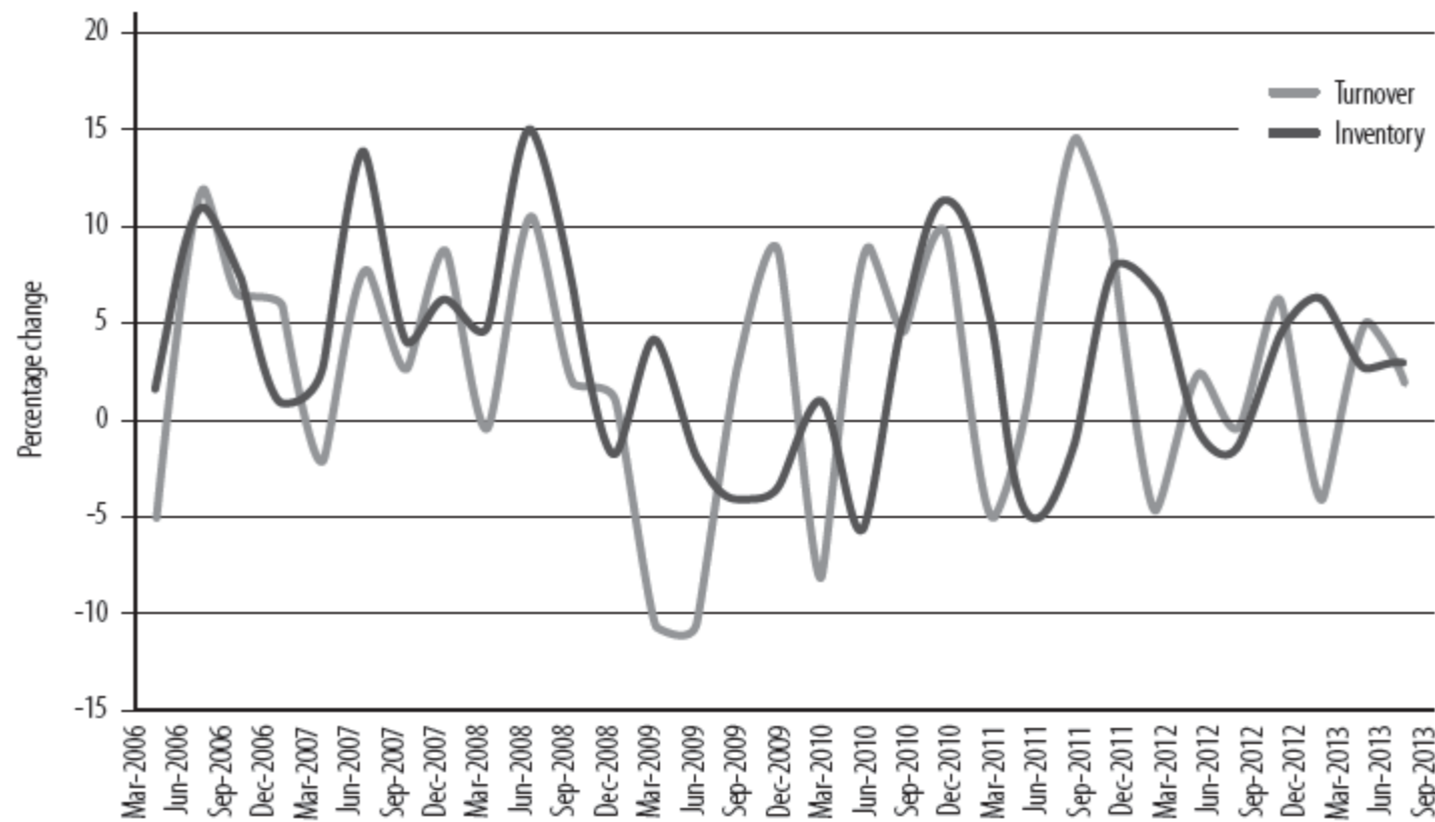


Source: Statistics South Africa (2014).

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## Trade sector business cycle



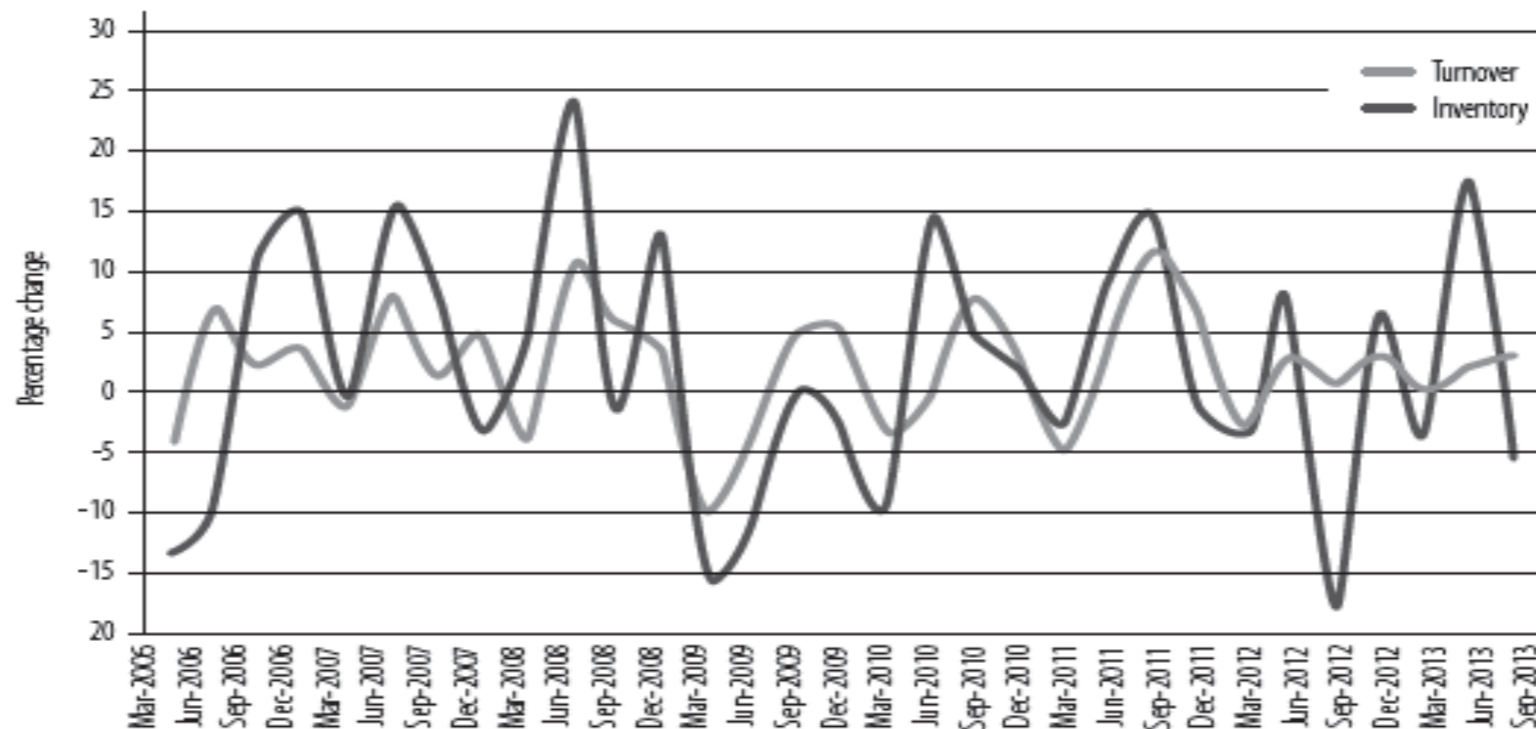
Source: Statistics South Africa (2014).

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## Transport, storage and communication business cycle

**Figure 18.8** Time series of percentage change in turnover and inventory between consecutive quarters for the transport, storage, and communication sector

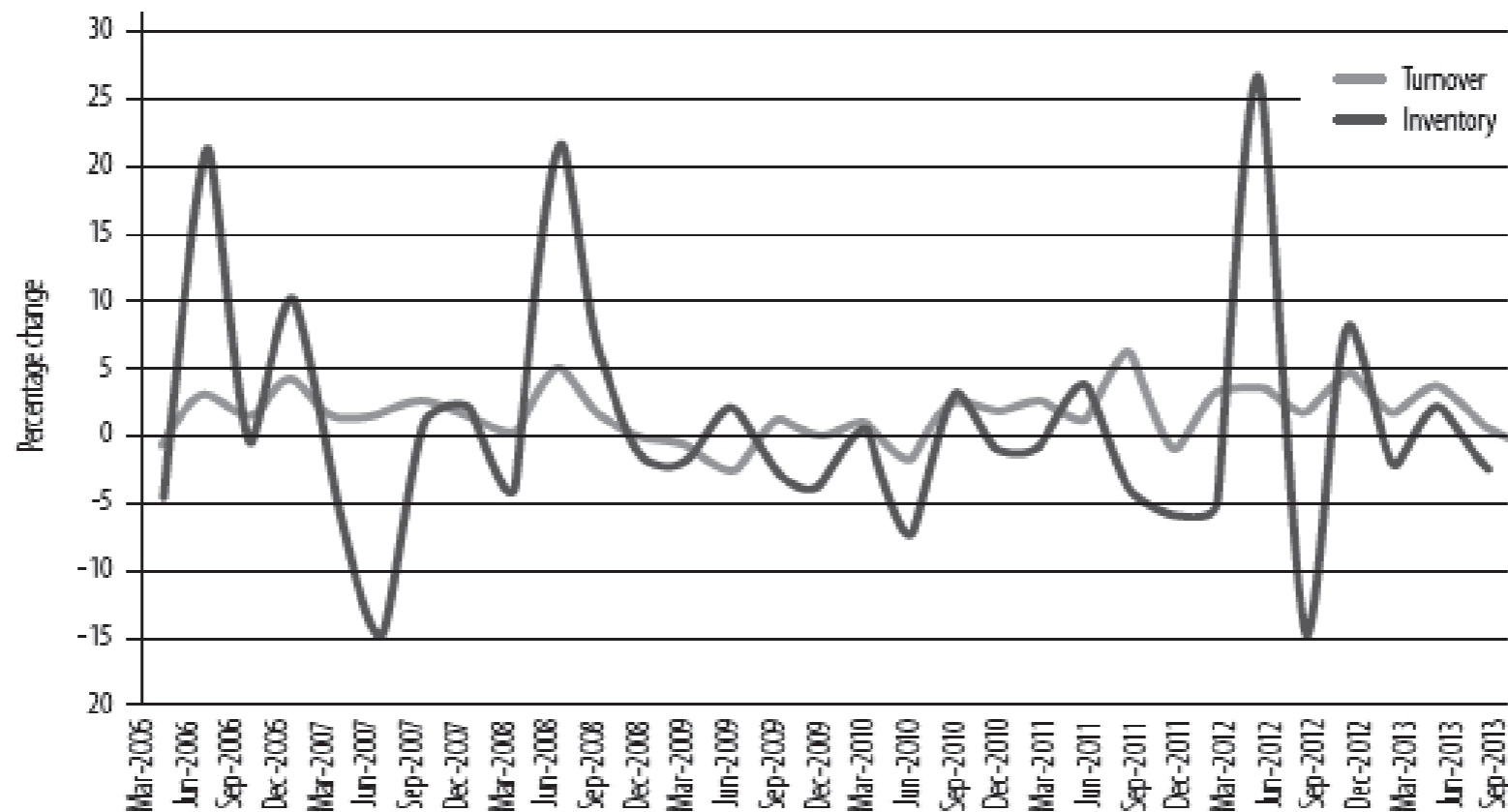


Source: Statistics South Africa (2014).

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## Real estate and business services business cycle



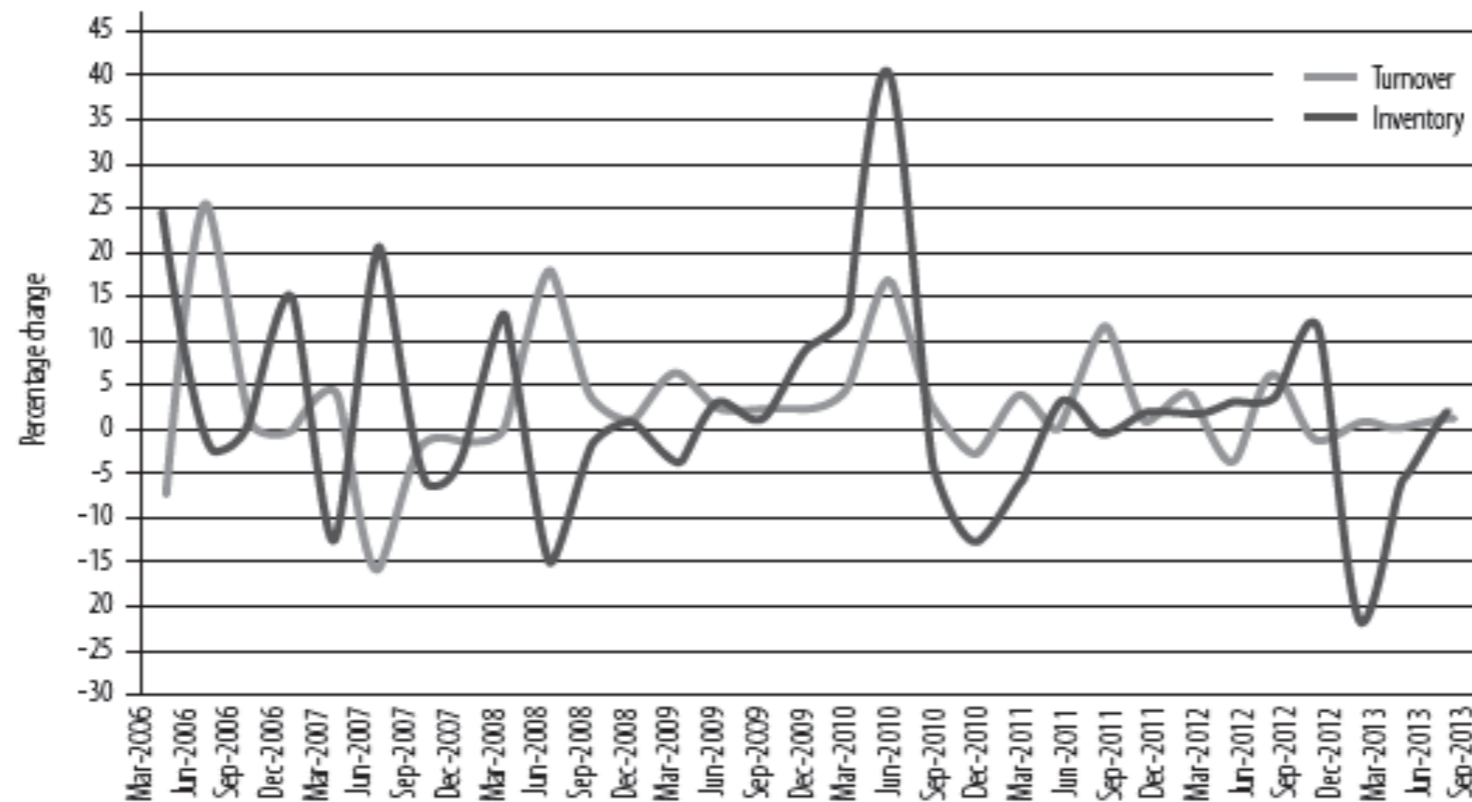
Source: Statistics South Africa (2014).



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## Community and personal services business cycle



Source: Statistics South Africa (2014).

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## Relevance of business cycles to the entrepreneur

- An in-depth knowledge of business cycles is important to entrepreneurs. Failing to base business decisions on business cycles often have disastrous consequences for entrepreneurs
- The quantity of goods and services demanded differ during different states of the business cycle
- The nature of goods and services demanded differ during different phases of the business cycle
- The quality of goods and services demanded differ during different phases of the business cycle
- There are always business opportunities but they differ during different phases of the business cycle

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**Table 18.1** Yearly percentage change in turnover per industry from September to December quarter, 2006 to 2012

INDUSTRY	SEPTEMBER 2006 – DECEMBER 2006	SEPTEMBER 2007 – DECEMBER 2007	SEPTEMBER 2008 – DECEMBER 2008	SEPTEMBER 2009 – DECEMBER 2009	SEPTEMBER 2010 – DECEMBER 2010	SEPTEMBER 2011 – DECEMBER 2011	SEPTEMBER 2012 – DECEMBER 2012
Mining and quarrying	-2.7	2.1	-10.8	-0.1	4.1	10.4	-1.3
Manufacturing	2.6	6.7	-7.3	10.0	5.4	6.8	2.6
Electricity, gas, and water supply	-18.6	-22.3	-25.2	-24.9	-26.1	-27.4	-28.3
Construction	3.7	6.5	-4.2	-0.7	-5.0	3.4	-4.9
Trade	5.4	8.3	0.8	8.1	9.1	8.1	5.7
Transport, storage, and communication	3.5	4.6	3.4	5.3	2.4	6.1	3.2
Real estate and other business services, excluding financial intermediation and insurance	5.9	1.2	-2.0	-1.8	2.0	-3.5	7.5
Community, social, and personal services, excluding government institutions	0.0	-1.7	1.0	2.3	-2.6	1.0	-1.5
All industries	3.3	5.5	-3.3	5.5	4.4	5.3	2.5

Source: Statistics South Africa (2013).



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**Table 18.2** Comparison of QFS turnover between the December quarters 2006 to 2012

INDUSTRY	DECEMBER 2006- DECEMBER 2007	DECEMBER 2007 - DECEMBER 2008	DECEMBER 2008 - DECEMBER 2009	DECEMBER 2009 - DECEMBER 2010	DECEMBER 2010 - DECEMBER 2011	DECEMBER 2011 - DECEMBER 2012
Mining and quarrying	23.9	26.7	-19.2	32.5	19.8	-8.3
Manufacturing	13.0	12.4	6.2	5.6	17.5	1.7
Electricity, gas, and water supply	-3.5	26.9	21.4	22.3	15.2	12.2
Construction	37.2	21.0	-3.8	-5.7	9.5	0.8
Trade	16.2	11.6	-12.4	12.7	17.4	1.6
Transport, storage, and communication	13.2	16.7	-3.6	7.0	17.3	4.2
Real estate and other business services, excluding financial intermediation and insurance	7.3	6.0	-11.6	0.0	11.3	20.4
Community, social, and personal services, excluding government institutions	-15.7	23.0	13.5	21.7	16.7	4.6
All industries	14.2	13.5	-5.3	9.4	16.7	2.8

Source: Statistics South Africa (2013).



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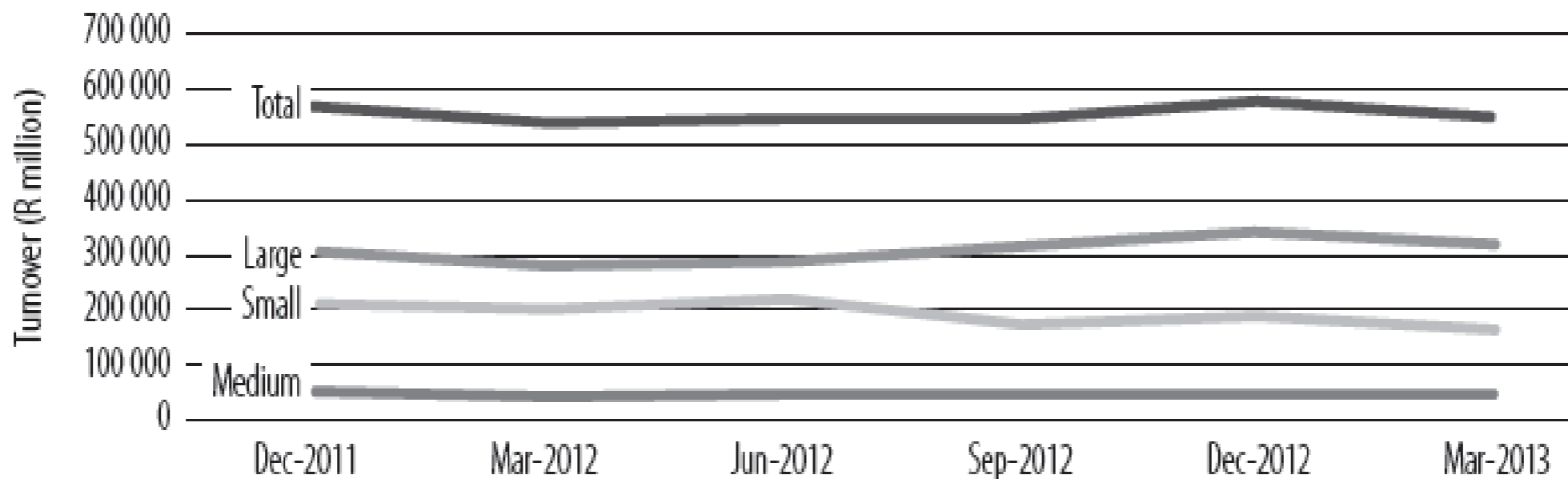
## Quarterly value added by sector (R mil)

Industry	June 2009	September 2009	December 2009	% Change Jun 09 to Sep 09	% Change Sep 09 to Dec 09
Mining and quarrying	54 186	56 872	54 226	5.0	-4.7
Manufacturing	77 755	84 035	86 588	8.1	3.0
Electricity, gas and water supply	13 576	15 718	12 250	15.8	-22.1
Construction	21 899	22 089	19 933	0.9	-9.8
Trade	69 276	71 792	81 577	3.6	13.6
Transport, storage and communication	51 177	51 971	54 956	1.6	5.7
Real estate and other business services	117 881	119 390	117 576	1.3	-1.5
Community, social and personal services excluding government institutions	33 079	33 399	31 999	1.0	-4.2
<b>Total</b>	<b>438 829</b>	<b>455 266</b>	<b>459 105</b>	<b>3.7</b>	<b>0.8</b>

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**Figure 18.11** Time series of turnover for small, medium, and large enterprises within the trade industry

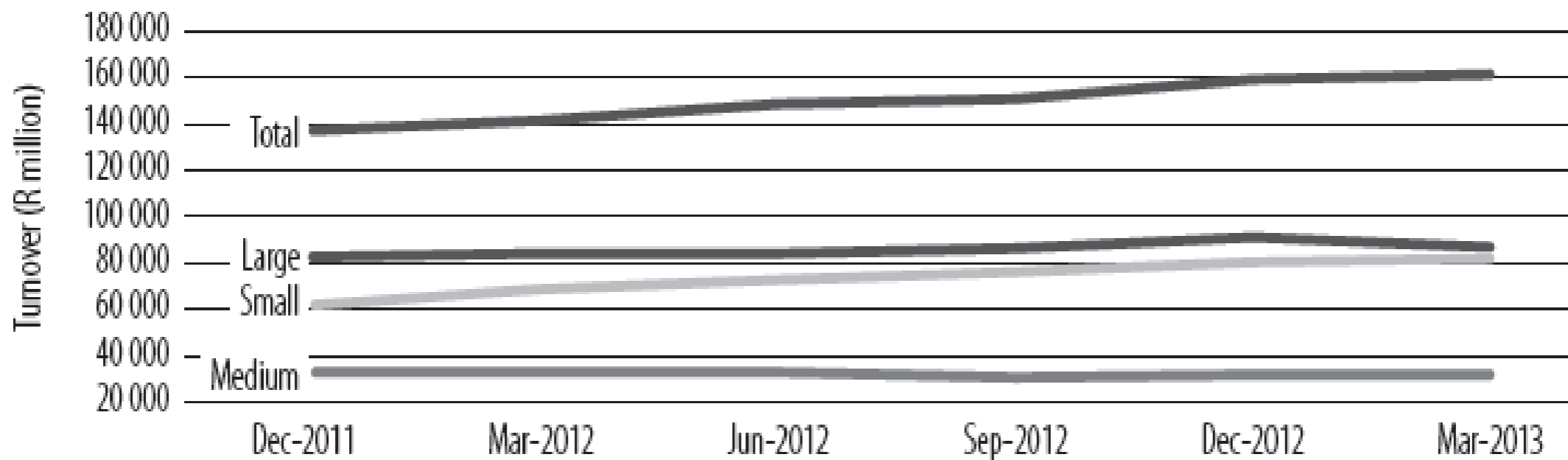


Source: Statistics South Africa (2014).

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**Figure 18.12** Time series of turnover for small, medium, and large enterprises within the real estate and other business-services industry



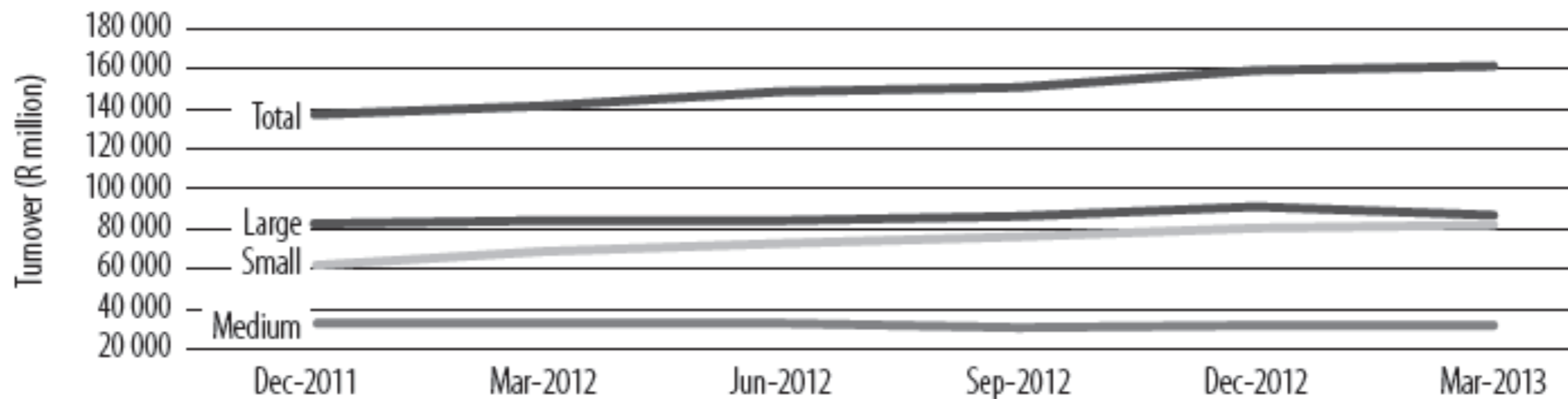
Source: Statistics South Africa (2014).



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**Figure 18.12** Time series of turnover for small, medium, and large enterprises within the real estate and other business-services industry



Source: Statistics South Africa (2014).

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## Reasons to incorporate business cycle forecasts in business plans

- **To anticipate changes in demand and supply of goods and services.** This is required to ensure that the entrepreneur is not caught unprepared for changes in the business cycle
- **To realign capital overheads in such a way that scarcer capital resources could be used in such a way that the business survives while creditors are paid.** During times of economic contraction entrepreneurs need to decide whether they cut back on capital spending or increase it to gain first mover advantage during the upturn that will follow

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## Reasons to incorporate business cycle forecasts in business plans (cont.)

- **To make important inventory decisions.** Entrepreneurs can make use of business cycle forecasts to decide whether they should add to inventory or cut back on it
- **To decide on the welfare of human resources in the face of a looming contraction.** Because skilled human resources is the biggest asset of a business it will not be wise for entrepreneurs to shed a large number of workers to cut costs during a recession. Having a substantial pool of skilled human resources will be vital to ensure business success during the following upswing in economic activity