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Business cycle fluctuations and consumption behaviour

by Bram Van den Bergh

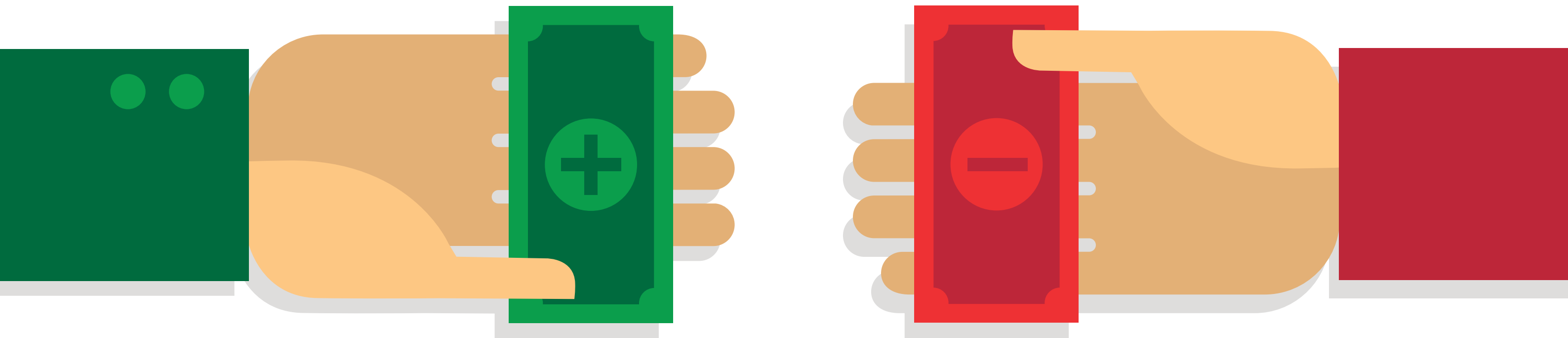
New studies of business cycles and consumption tendencies reveal interesting and sometimes unexpected insights into consumption patterns. It appears that, while purchasing behaviour is obviously influenced by the overall economic environment, it is not merely a matter of more consumption in times of expansion, and less when the economy is contracting.

Research shows that consumption patterns are not the same for all product categories. A new multi-method approach assessed individuals' economic sentiment in varying macro economic environments, and the impact of this on their decision-making processes. The results could influence marketing and communications decisions. With insight into the principles underlying individuals' decision-making where risk is involved, there could be wiser alternatives when it comes to product management and messaging strategies.

Changing patterns

In times of economic downturn, it is true that consumption in general decreases; because they have less money available, people spend less overall. Moreover, it is well known that unemployment and hardship have negative effects on health and lifestyle. People make different decisions, turning to cheaper, private label brands rather than "A" brands, for example. They postpone the purchase of durables like cars, white goods, expensive home electronics, and holidays abroad. When the economy is in a state of expansion, the opposite could be said to be true. However, the increase or decrease in consumption is actually not the same for all product categories.

People are motivated to approach pleasure and avoid pain. True: consumers – and indeed businesses – tend to be oriented towards



"…while contractions generally affects purchasing negatively, products that avoid negative outcomes actually flourish in harsh times."

Business cycle fluctuations
and consumption behaviour (continued)

by Bram Van den Bergh

acquisition and the achievement of gain. Nevertheless, it appears that they are more likely to approach gain in a time of expansion, and not really focus on avoiding losses. The positive environment influences their decision-making, encouraging their orientation towards a positive outcome.

For instance, during times of expansion, people describe themselves as "wealthy", rather than "not poor". Conversely, in times of economic contraction, people show an increased tendency to take decisions towards avoiding loss, even when offered an option that could have a positive outcome. Their orientation is geared more towards avoiding negative outcomes, and people's self-assessment is that they are "poor", rather than "not wealthy".

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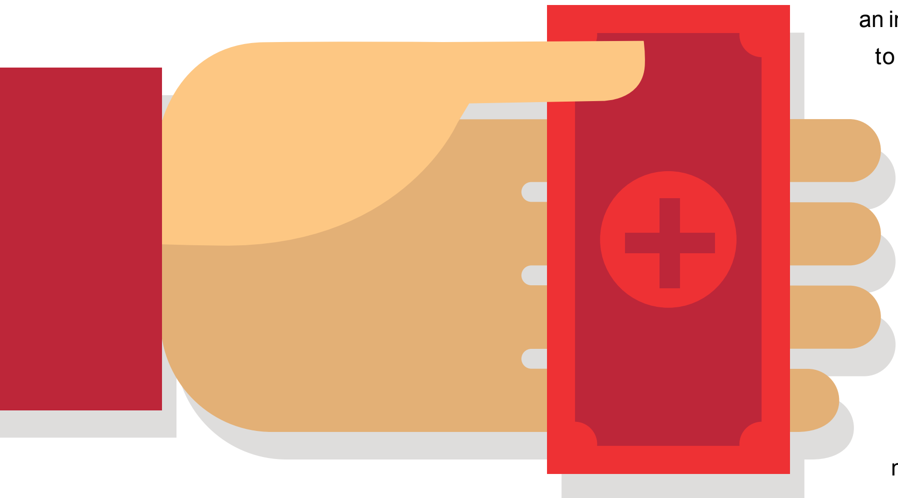

Good times, bad times

Illustrating the issue of "approach" and "avoidance" behaviours is the discussion of spending on gambling – in casinos, lotteries, and horseracing – compared to the purchase of insurance policies. In research tests, for example, we offered participants in three separate groups a series of choices. The first group was asked to imagine an expanding environment; the second, a contracting environment, and the third was given a neutral, control scenario.

All groups were offered the same two options in two different sets of circumstances. Option A: receive €20 for sure. Option B: flip a coin and receive €100 if heads, or nothing if tails. In the second situation, participants were offered the same two options, but faced losses rather than gains. Option A: pay €20 for sure. Option B: flip a coin and pay €100 if heads, or nothing if tails.

The results showed that people were more inclined to take risks after reading about an expanding economy when they stood to gain, but not when they stood to lose. In contrast, those who read about a contracting economy were less likely to take risks, but only when they could limit their loss, not when they stood to gain.

Looking at consumption patterns, these results are corroborated by the statistics. Spending on gambling is motivated by the attraction of potential gain, whereas purchasing insurance is motivated by the wish to avoid a negative outcome. Nobody would ever gamble if they assumed they were going to lose; the general stance is one of optimism.

On the other hand, when people purchase insurance, it is from a negative standpoint; they want to protect against loss, or against the possibility that things will get worse than they already are. People would not buy insurance if they thought that nothing bad was going to happen to them.

When it comes to the macro influence of the overall economic environment, our studies show that spending on gambling – such as visits to a casino, purchasing lottery tickets, betting at horse-races – actually increases during times of expansion, whereas insurance purchases remain stable. In times of economic contraction, however, spending on insurance increases, but there is no significant change in gambling patterns.

In sum, while it is generally true that expansions positively affect purchasing, products that yield positive outcomes benefit from a positive economic climate, while products that minimise losses benefit less. And, while contractions generally affects purchasing negatively, products that avoid negative outcomes actually flourish in harsh times.

Balanced action

Most studies of economic fluctuations tend to focus on specific crisis periods, looking at business cycles and economies within a relatively short-term timeframe. Our research takes a different perspective, combining experimental studies with individuals' actual purchasing behaviour over a period of 80 years. It is this long-term analysis, together with experimental studies, that have led to the above conclusions. The most important insight is that the macro economic environment directly and causally motivates individuals to achieve positive or avoid negative outcomes.

Of particular interest, considering the events of recent years surrounding subprime mortgage rates and credit card debt, is the suggestion emerging from this research of a need to disentangle attitudes towards gains and losses. Generally speaking, people tend to consider these two movements to be one process, i.e., that the motivation to move towards achieving gain is the same as acting to avoid loss.

However, our research indicates that they are actually two different processes, more independent from each other than normally believed. Behaviour is seen to be significantly influenced by the prevailing environment, and in an unexpected way. This is seen to be true in many situations, not only with regard to financial products.

For instance, we speculate that a toothpaste advertisement promising "protection against cavities" (i.e., avoiding negative outcomes) would be more effective during contractions than an advert promising "shining white teeth" (i.e., approaching positive outcomes). With this understanding, businesses should and could choose strategies to cope with business cycles in an efficient way. ■

This article is based on the paper *Avoiding negative vs. achieving positive outcomes in hard and prosperous economic times*, which was written by Kobe Millet, Lien Lamey and Bram Van den Bergh. It was published in the journal *Organizational behaviour and Human Decision processes* 117 (2012) 275–284.

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