

THE PSYCHOLOGY BEHIND THE ECONOMIC CRISIS

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***Abstract:** This paper is an extensive analysis of bought international business press and academic literature in the field about crisis management and related fields. The paper is grounded on the premise that the psychology of the crisis is an important component of the present international context and psychological factors play an important part in the alteration of consumer's behavior. The question that generated our research approach in such conditions was at what extent peoples' behavior is determined by individual rational choices. The central message of this paper is that in the present economic crisis conditions the factors that are playing an important role in shaping people's behaviour are: risk perception and risk attitude. We consider that at present managers should understand how their clients react in crisis conditions and how their behavior changes in order to handle successfully the present situation.*

***Keywords:** economic crisis, behavior alteration, psychological segmentation.*

***JEL Classification:** G01, J64*

1. INTRODUCTION

Since September 2008, we began to carefully supervise the national and international business press in order to see the effects of the financial crisis that began in the USA on various national economies. It is amazing how fast the financial crisis extended and transformed into an economic crisis worldwide, all national economies being affected at a certain extent. Likewise, it is unbelievable how a crisis generated another crisis. For example, at the end of 2008, business analysts launched pessimistic forecasts regarding the evolution of national economies in 2009, but they considered scarcely the issue of social crisis generated by the economic crisis.

Within the conference: "Crisis of Confidence. The Recession and the Economy of Fear" sponsored by the University of Pennsylvania's Department of Psychiatry and the Psychoanalytic Center, there was emphasized the following aspect: "The emotion not only led America into the present economic crisis but it could also keep it there." David M. Sachs, training and supervising analyst at Psychoanalytic Center of Philadelphia stated that "the economic crisis is not one of concern but one of confidence". The emotional response of consumers to the effects of the financial crisis determined the decrease of their confidence in trademarks, organizations, governments. In other words, the negative emotional response determined the appearance of confidence crisis. The negative economic evolutions and the decrease of consumers' confidence implied the restriction of consumption, people considering savings as a reaction to the uncertainty of their present existence. This had as a consequence markets' contractions and alterations, sometimes important in their structure, as they generated overproduction.

Thus, emotion conducted to economic crisis, and confidence crisis conducted to a sharpening of economic crisis, some specialists appreciating the fact that the decrease of consumer confidence in trademarks, companies, fields of activity, governments and anti-crisis

measures taken by them, could prolong the actual economic crisis. This is proved, for example, by the decrease of Consumer Confidence Index (CCI) which according to Nielsen Global Consumer Confidence Index Report (October, 2008), consumers' confidence diminished at the end of 2008 worldwide and on some national markets it attained an absolute decrease record. This emphasizes the economic and social concerns of consumers all over the world.

Consumer's voice:

"There will be no spending for a long time; we have cut up all our credit cards".

"The economic crisis has made me curtail my spending habits. In the future, I will continue to hold off on my spending until the economy gets better".

"The economy is scary".

The Nielsen Company – Consumer Reaction to the Banking Crisis, USA, October, 30, 2008

"The evolution of the Romanian economy is dramatically"

"The present economic situation is very bad"

The effects of the economic crisis over life quality in Romania – own research, April 2010

The one hand, the number of those who profess today that they do not afford almost anything is increasing on all national markets. For example, in a survey made by GFK with the purpose to identify consumers' reactions in different countries in the context of negative economic environment, there is pointed out that in comparison with 2007, in 2008 in Austria the number of those who claim they cannot afford almost anything, increased from 16% to 21%, while in Germany the increase was from 26% to 27%. In 2009 we expect these percentages still go up. At the same time, the number of people living in poverty increased significantly. For example, in Romania, according to a UNICEF and World Bank Report, in 2009 the number of Romanians living in poverty will increase to 7,4% compared to 5,7% in 2008.

On the other hand, the effects of economic crisis, as, for example, the unemployment led to what Ron Anderson (2009) calls "the loss of social capital". Social capital represents the capacity of an individual of being employed and involved in the community he lives. According to the results of some empirical researches, between unemployment, depression and anxiety there is a direct relation of causality. Therefore, the person affected by unemployment not only loses his/her position within the community but also the capacity of interacting with the members of the community. The loss of the social capital affects both the individuals and the community and the entire society (Jennie Brand, 2008).

In this global agitated context, the companies have to learn the survival lesson and find their own way out of the crisis. Having as starting point what Darwin said that "species surviving during time are not the strongest or the most intelligent ones but those having a higher capacity to adapt themselves in changing conditions" we think that companies overcoming the economic crisis and having a successful comeback, are those with a higher adapting capacity through change. This means they have the capacity of responding quickly and effectively to a new context. At the same time, we think that the companies should build their response considering the outside-toward-inside prospect. What we would like to suggest is that in present, disregarding the market, sets in danger not only the recovery of the company from the crisis but also its survival.

If in conditions of economic raise, the companies concentrated their marketing efforts on gathering information about consumers' needs and desires, information used to build the value proposition (Kholi and Jaworski, 1993); in present this approach represents an unjustified marketing effort. What companies should understand is how their clients react in crisis conditions and how their behavior changes. Such an understanding represents a good starting

point in planning the response of the organization. Thus, the companies have to “penetrate” into their clients’ minds.

Diagram No. 1. The context of the economic crisis



Source: Authors' point of view

2. INSIDE CONSUMERS' MINDS IN ECONOMIC CRISIS CONDITIONS

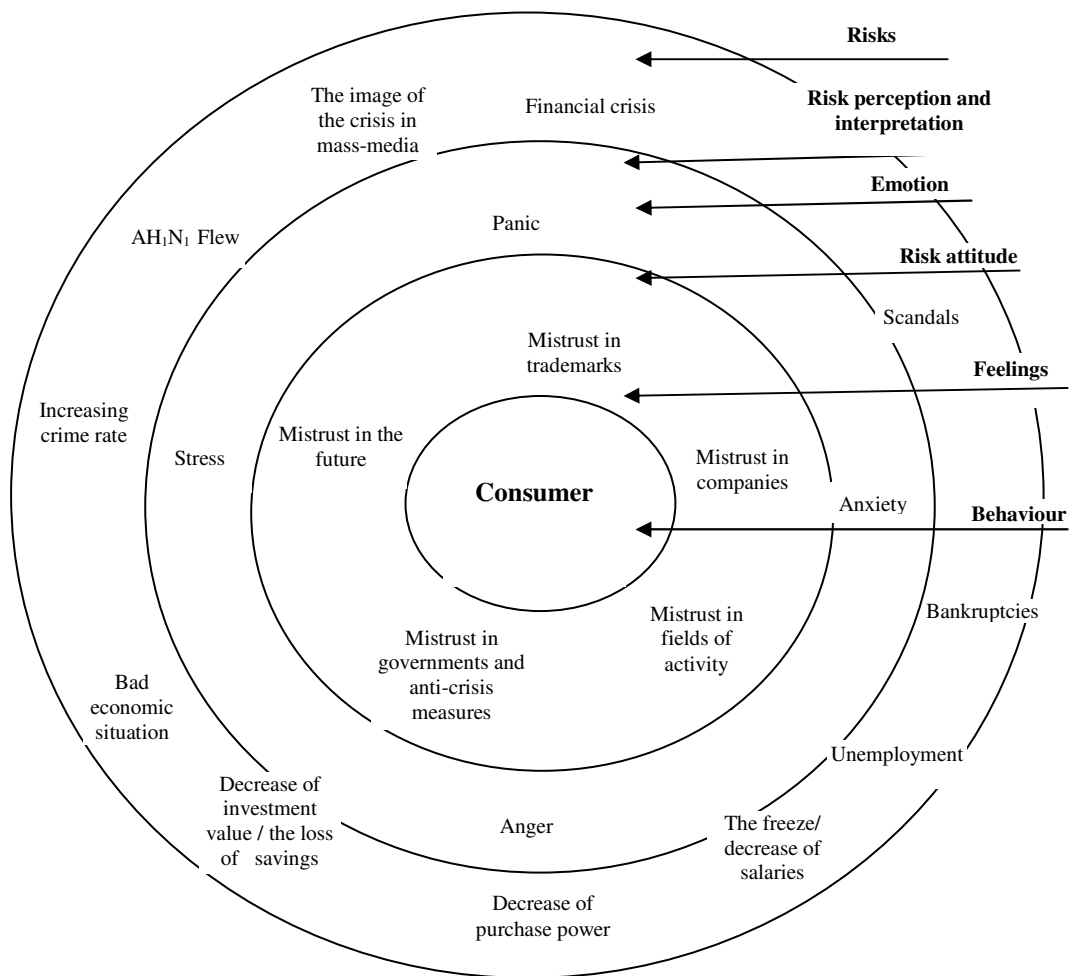
Unemployment, the increase of inflation, the freeze or decreasing of salaries, the decrease of purchasing power, the decrease of investment values, the increase of criminal rate, a new flu pandemic (AH1N1) represent only some of the realities that the consumers face at present on almost all national markets. These generated stress and panic among people. The picture wouldn't be complete if we didn't speak about the role that media plays in strengthening panic. In some situations, media has the tendency to exaggerate when they present the effects of the economic crisis, delivering scenarios that make people agitated. Even when press reflects correctly the actual problems, it is empirically proved that the more people read about the crisis and the more the press focuses on its reflection, the more people have to face a negative psychological impact upon them (Miller and Reilly, 1994).

In order to determine the way in which consumers react in crisis conditions and how their behavior moulds, we started from a larger frame. We analyzed a certain number of research papers dealing with various types of crises: economic crises (Recession in Germany, 2002-2003; The Asian Crisis, 1998-2000, The Great Depression, 1928-1938); food security crisis (salmonella contamination, avian flu); terrorist crisis (USA, 2001); public health security (AH1N1 flu, 2009). Our analysis revealed the fact that obviously one type of crisis is not similar to another type, but also that two crises of the same type are not necessarily alike, they may be different as to generating causes, effects, duration, severity, etc. Interesting is the fact that all these situations with a negative impact have a certain common point. The factors playing an important role in shaping people's behaviour in all these circumstances are: risk perception and risk attitude. Thus, the change of behaviour in present conditions is determined, on a great extent, by psychological elements along with other types: economic or political elements, etc.

If we admit that psychology of the crisis is an important component of the present economic crisis and that psychological elements play an important part in the alteration of consumers' behavior, then it becomes an essential condition for companies to know and understand these aspects in order to handle the crisis successfully. Therefore, we would like to have a closer look upon the way that people's behavior is molding in present economic crisis conditions.

Within our pattern, negative economic and social evolutions (the effect of economic crisis) represent stimuli that unleash human reaction; we labeled these stimuli as risks as long as these evolutions represent "uncertainties that matter" (Hillson D. and Murray-Webster R., 2007). Every risk is perceived and represented (interpreted) differently by every individual. Risk perception reflects the interpretation that the individual makes regarding the chances for risk exposure – unemployment, decrease of purchase power, decrease of the value or the loss of investments, etc. Still, it is empirically proved that people make different estimations for this chance. The interpretation of risk content represents the subjective judgment that the individual makes about its characteristics and steadiness. Risk perception and representation consequently stir emotions – panic, stress, anxiety, anger, etc. Emotions are the basis of risk attitude. Risk attitude is a hypothetical construction representing the degree of individual risk content liking or disliking that reflects risk aversion. This is the basis for feelings – mistrust in trademarks, companies, governments and anti-crisis measures adopted by them, mistrust in future, etc. The feelings lead, in the end, to behavior patterns.

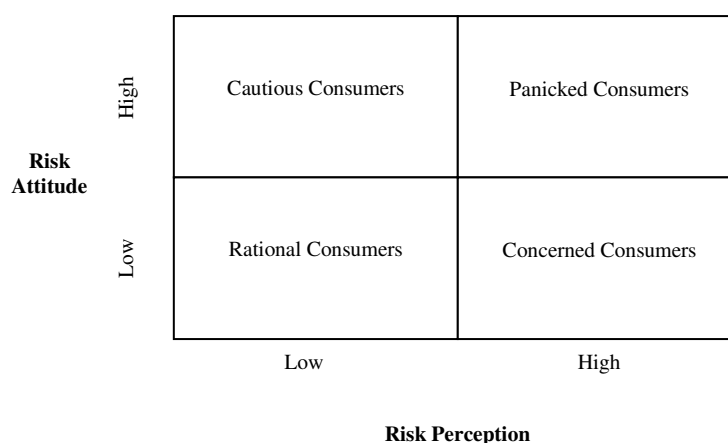
Diagram No. 2 Consumers' behavior in the context of economic crisis



Source: Authors' point of view

But not all people are alike and they do not react identically in a negative impact situation such as an economic crisis that is why we expect that behavior alteration may not have the same intensity and follow the same patterns for all consumers. What we suggest is the fact that in a situation such as the economic crisis, by decomposing consumers' behavior, the companies can get a more comprehensive image of the way their clients react in crisis conditions than if they used criteria such as: income, lifestyle, etc.

Diagram No. 3. Psychological segmentation of the market



Source: Authors' point of view

Panicked consumers are those consumers thinking that the effects of the present economic crisis will affect them on a great extent. They dislike a lot the present economic situation. Such consumers have sometimes the tendency to exaggerate about their own and their family situation, and in some circumstances they have an irrational behavior. Those belonging to this segment are first of all consumers with a low income but also actual and would-be unemployed persons. It is expected that this category of consumers reduce drastically their expenses for all categories of products, cut off major purchase and migrate to the low part of demand_curve by changing trademarks, allotting an extra information period and comparing offers in order to find the lowest price.

Cautious consumers are those who dislike a lot the present economic situation but who think that nowadays economic and social evolution will scarcely affect them. This category includes those consumers who have relative job stability and thus, income stability, retired persons with an average pension and people that are unlikely to lose their jobs. It is expected that these consumers be careful and plan carefully their expenses. They either postpone or do some major purchases in this period. Sometimes they move down to the lower part of demand curve, changing trademarks.

Concerned consumers are those having no risk aversion but they think that present economic and social evolution will affect them on a great extent. This category includes those having no secure job, income or investments but they calmly handle this instability tolerating the risk. It is expected that this category of consumers plan carefully their expenses, postponing major purchases. In some situations they move down the demand curve by switching trademarks and buying major products only if they are necessary and they perceived as good investments.

Rational consumers are those thinking that present economic and social evolution will scarcely affect them and take chances having a low risk aversion. Thus, it is expected that this category preserve the "habitual behavior" they had before the crisis. This category includes those

with a high income level but also those with secure average income and those who are not in danger of losing their jobs – retired persons. Thus, these consumers will buy their favorite trademarks and only in some particular situations they will move down on demand curve. Still, even in the case of this category, the expenses will be carefully planned and it is expected a decrease of average consumption.

3. THE DYNAMICS OF SEGMENTS

The dimension of the four segments varies from one national market to another depending on how deeply the national economy was affected by the economic crisis and thus, according to either the intensity of effects generated by the crisis or the previous experiences, that is, if the respective national economy has in its recent history such anomalies.

When people interpret the risk content in order to evaluate how severe is the situation they confront with at present, they use the past experience (the recessions overcome in the past) for this interpretation. In fact, consumers learn from past experiences and use them for these evaluations. In other words, the response of such consumers is built on learning and they are in a better position to evaluate correctly the gravity of the situation. If a previous experience lacks, consumers' response will be an emotional one, as in the absence of a previous experience we project our worst fears in the evaluation of present situation. That is why, on markets that do not have a relatively recent crisis past, the consumers tend to exaggerate the gravity of the present situation as long as there is no past context to include such events. Taking into account these aspects, we expect that on national markets that experienced relatively recent crisis of the kind, the number of panicked people be lower than on national markets that did not have a recent experience of such anomaly.

On the other hand, the four segments change their dimensions according to the evolution of the crisis. Thus, it is expected that migrations appear between the four market segments as the crisis evolves – a worse economic situation, a climax of the crisis, the signs of recovery and the overcome of the crisis. For example, the more severe the crisis becomes and more people become affected by it, the higher the number of panicked people, due to the alteration of risk perception and risk attitude. At the opposite pole, recovery signs of economic situation and the beginning of the overcome leads to migrations between the four segments, but this time in a reverse way, because risk perception and risk attitude decrease. That is why, the number of rational consumers is expected to rise.

In conclusion, the enlargement of the segments varies from a national market to another according to: how severe the effects of the economic crisis are (stimuli) (S), the experience / lack of experience in previous crisis of relatively recent history (E), the moment within the crisis (T).

$$M_s = f(S; E; T)$$

Management decision:

“We need to get right inside customers' heads to understand their feeling and come up with relevant new, value proposition for them“. - HR Director, UK pub chain

“We have to stop focusing on sales targets and now look at the broader picture of the customers and their behavior“. - Group HR director, financial service company.

4. CONCLUSIONS

The present economic crisis is an unprecedented situation for the entire world if we consider its global and severe character. As a consequence of negative economic and social evolutions of all national markets of the world some important alterations appeared in the way that people think and behave as well as in the way they treasure things. The question that generated our research approach in such conditions was at what extent peoples' behavior is determined by individual rational choices. The results of our analysis revealed that in uncertainty and turbulent conditions the psychological factors play an important role in building consumers' behavior. That is why we think that in order to overcome the economic crisis and to have a successful recovery the companies should understand the way their clients react and behave at present and this is a good starting point in planning organization's response.

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