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The Great Recession and its Effect on Small Businesses and Unemployment Rates

Alyssa Sharples
Coastal Carolina University

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ALYSSA SHARPLES

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Philip Whalen

Director, Honors Program

Cristina Reiser

Thesis Advisor

Keira Williams

Honors 499 Professor

ABSTRACT

The 2007 financial crisis, otherwise known as the "Great Recession," has impacted the economy tremendously in the past three years. Businesses have been drastically impacted, as have the lives of workers in the United States. Many articles have been published about different aspects of the recession. One question that has not been completely addressed is how the Great Recession has affected small businesses and unemployment rates. The reason for addressing these two topics is because they are closely related to one another. Small business owners are reporting that there has been a decline in sales. Consumers are not willing to buy products if they do not have jobs. If small businesses are struggling, they will not hire employees, which results in the unemployment rate remaining high. Unemployment is directly affecting the way small businesses are operating, and the struggles of small businesses are directly affecting unemployment rates. Major themes that are presented in this question are defining a recession, factors that led to the financial crisis, history of past recessions, restraints for the emergence of new small businesses, the impact on small businesses, responses to the recession, and unemployment rates.

INTRODUCTION

Imagine a small town where everyone knows each other, and where everyone works together. Most of the community relies on their jobs at the local factory. But what happens when that factory shuts down, and nearly everyone in town loses their jobs? This occurred in Newton, Iowa. The Maytag factory, which produces kitchen and laundry appliances, began to go out of business due to the recent financial crisis and abruptly shut down several of their locations. Now Newton is left with an unemployment rate of 8.8%, being the third highest unemployment rate in a town. The closing of the factory put 1,800 people of their jobs. Many people lost their homes and were forced to move or move in with one another. This is all due to the recent recession that the United States experienced.

The recent financial crisis is known as the "Great Recession" of 2007. Its downturn was sparked by the collapse of the U.S housing market. In 2006 the prices of homes began to rise, and the banks began to encourage potential homebuyers to take out larger loans. There were lower interest rates at the time, and this seemed like a good idea for most individuals who were searching for a new home. Then, in mid-2007, the interest rates began to rise. The values ofthe homes decreased and the amount of money a house was worth declined significantly. Many homeowners were stuck with large loans, increasingly high interest rates, and a decreased price of their home. Many homeowners went into foreclosure or were evicted. This eventually led large financial institutions and banks to become bankrupt, which lead to an overall fall in the U.S economy. Stocks dropped, consumer spending declined significantly, and companies began to go out of business (Athanasiu, 43)

The “Great Recession” is still occurring today; the economy is having a difficult time recovering. In past recessions, the growth of small businesses sparked the economy. The past can be instructive here: when small businesses grow, jobs are created, unemployment rates drops, and the overall economy improves. There is a clear connection between the struggles of small businesses and unemployment rates in the United States due to the “Great Recession” in 2007.

METHODS

Methods used to answer the question at task were by doing expansive reviews of existing literature. The type of literature that was implemented throughout this research were scholarly articles that were retrieved from Coastal Carolina University’s library database. The most common database that was utilized was Business Source Premiere from EBSCO host. A large majority of the authors were in the business field. The types of degrees and areas of expertise ranged from management to economics to finance and accounting. Authors wrote information that pertained to their specific area of knowledge.

WHAT IS A RECESSION?

In order to answer how the recession has affected small businesses and unemployment rates, other questions need to be addressed as well. The first thing that needs to be established is: what exactly is a recession? According to John E. Gnuschke, a recession is “a period of falling economic activity spread across the economy, lasting more than a few months, normally visible in real GDP [gross domestic product], real income, employment, industrial production, the housing market and wholesale-retail sales” (Gnuschke 3). Another author from the *AAII Journal* similarly agrees that it is defined as “negative gross domestic product (GDP) growth over the period of two quarters [six months] (Tips 2).” GDP can be defined as “the value of total production of goods and services in a country over a specified period” (TD Waterhouse). It is a key indicator of a country's standard of living and its overall health. Factors that contribute to GDP are consumer spending (C), investments from businesses (I), government spending (G), and the amount of net exports in the country (NE). The basic calculation to compute it is: GDP= C+I+G+NE. When there is a negative gross domestic product for six or more months and there is an overall decline in the economy, then the country is considered to be in a recession.

FACTORS THAT LED TO THE CRISIS

The financial crisis began in December 2007 and technically ended in June 2009 (Recession 1). This recession has lasted eighteen months, which is the longest in history since World War II. Prior to this, the "longest postwar recessions were of 1973-5 and 1981-2; each lasting approximately sixteen months" (Recession 1). Gregory W. Brown and Christian Lundblad, in the article "The U.S. Economic Crisis: Root Causes and the Road to Recovery," state that "the root cause of the economic crisis is excessive consumption accompanied by record low savings rates and huge budget and current account deficits" (Brown 21). Anthony H. Catanach Jr. and Julie Anne Ragatz, the article "2008 Market Crisis: Black Swan, Perfect Storm, or Tipping Point?," argue that there were several factors such as economic policy, the banking system, and oversight. The authors state "the Federal Reserve provided low-interest-rate environments which promoted home borrowing loans and an increase in real estate values" (Catanach 22). Both authors agree in the sense that low-savings/interest rates fueled the financial crisis.

RECOVERIES IN PREVIOUS RECESSIONS

The United States has dealt with several different financial crises in the past, from the Great Depression in the 1930s to the early 1990s recession. After every recession, a speedy recovery is ideal. An important area to examine is how the economy has recovered from these previous recessions. Economist and author Scott Brown and the author of the article "Policy Responses to the Economic Crisis – Investing in Innovation for Long Term Economic Growth" (author unknown) agree that in previous financial downturns, small businesses have led the economy out of recession. Brown supports this by stating "small firms play an important role in recoveries, accounting for roughly a third of net job growth" (Brown 10). The creation of small businesses enables new job opportunities. Authors Ma Yigui and Lin Shuman agree that "small businesses are main contributors to the growth of the economy" (Yigui 293). The second article also supports the idea that small businesses help recover the economy: "new business models and new technologies, particularly those allowing a deduction in cost, often arise in recessions; as dominant players weaken, they open space for new players and innovators" ("Policy," 217). When small firms emerge, they create a significant amount of jobs. Economist Michael Mckee states "small companies have led the past four recessions to a healthy recovery as entrepreneurs sense opportunity and open businesses (McKee 16). There is enough evidence from the authors to support that small businesses are key players in helping the economy recover.

Historically, there has been proof from previous recessions that "new small businesses helped usher in an era of tremendous prosperity by creating 3.8 million jobs, a figure that surpassed big business expansion by nearly 500,000 after the 1990s recession" (Lee 25). An economist, David Birch, explored the idea that small businesses create employment opportunities from recessions: "70% of all new jobs were created by these small firms. They created more jobs than large corporations such as Wal-Mart" (Zumbrun 124). Ultimately, recessions recover by the creation of small businesses. One problem exists: if small businesses cannot expand due to bank restrictions and other external factors, then the economy will recover at a noticeably slower rate.

RESTRAINTS ON THE CREATION OF SMALL BUSINESSES

Small businesses are obvious factors to a healthy recovery for a recession. But what happens when small companies are not being created? This could be a huge reason as to why the economy has taken such a long time to recover from this recession. For most people, a vital component in opening a small business during a recession is receiving a loan from a bank or another external source. Since the recession has occurred, banks are limiting the amount of loans they are giving out. It is clear that "banks, markets, and investors have become more risk adverse resulting in potential firms to face difficulties in tapping into sources to fund their investments" (Policy 216). Small businesses depend on bank loans, "which has tailed off 17% since last year [2008]" (Foroohar 53). Banks are supporting "short-term, low risk innovations while long-term, high risk innovations [such as a small business start-ups] are being denied first" (Policy 216). It was when the financial downturn hit the economy hardest in fall of 2008 that small businesses had their lines of credit cut from the banks. (Brown 42). Lack of access to credit substantially affects the creation of small businesses. On February 1, 2009, the Federal Reserve reported that, "banks were continuing to tighten standards for loans to small businesses, while standards for large companies were unchanged (McKee 16). Another obstacle to small business expansion is that a majority of the time businesses want to invest in a "intangible item, such as a patent or idea which can be difficult for banks to value, making it hard to borrow" (Policy 215). From the financial institutions' perspective, they are having difficulty trusting and finding good quality borrowers that will pay back their loans. The banks do not want to finance an investment that is not going to be successful. In the past, "financial institutions have been criticized for previous lending patterns and are more likely to be conservative in their lending patterns in the future, exhibiting more risk-averse behavior (Yigui 296). In order for small businesses to develop, banks and other financial institutions need to extend lines of credit and give out more loans to these prospective owners. Although it is important for small businesses to develop in the economy, it is also vital that current small businesses stay afloat.

THE IMPACT ON SMALL BUSINESSES

In order to be considered a small business, a company must be a "privately owned [business] with less than five hundred employees and less than ten million dollars in sales each year" (Sweeny 45). The recent recession has impacted current small businesses greatly; they have been faced with many struggles. Typically, small businesses help the economy recover, but this financial crisis has put several small firms in a deficit. Several articles support the idea that small businesses have been faced with the most hardships during this economic downturn. Paul Sweeney in, "SMEs Tough Out The ECONOMY," describes how small businesses owners are struggling financially. A small business owner, Mike Smith, owns a trucking company in Texas that has been in his family for years. He states that his "biggest problem is getting paid" (Sweeney 46). Smith reports that clients are falling behind on their payments; "clients who used to pay their bills in thirty days are now taking sixty days, while those who used to pay in sixty days are delaying payments for ninety days" (Sweeney 47).When this occurs, it is difficult for Smith to pay his bill if he is not getting paid. If there is no cash circulating into his accounts receivable, he is suffering financially.

Smith also says that he is getting a lot of phone calls from people wanting their money, but because he is not getting paid, he cannot pay them. This has also affected Smith as a small business owner because the bank has cut his line of credit. The bank has "based this year's line of credit on performance numbers from recessionary 2009, when revenues fell to less than one million dollars from a robust one million eight hundred thousand dollars in sales in 2008" (Sweeney 47). This is the case for most small business owners; similar situations such as Smith's are making it difficult for them to stay afloat during a recession. Economist Bill Dunkleberg agrees with Paul Sweeney, stating that "according to the latest survey by his organization, 42 percent of small businesses reported that they were being paid more slowly; a scant 1 percent reported getting paid more quickly. At the same time, 22 percent reported that they themselves were taking longer to pay their bills" (Dunkleberg 45).

Other authors, such as Ma Yigui and Lin Shumin in "'Credit Crunch' and Small- and Medium-sized Enterprises: Aspects Affecting Survival," believe that the banks are making small businesses struggle by cutting their lines of credit and denying loans. They explain "that the lack of credit availability and the extra cost of credit during the credit crunch has impaired small-and-medium sized enterprises" (Yigui 290).

The author of "Policy Responses to the Economic Crisis – Investing in Innovation for Long Term Economic Growth," agrees that small businesses are struggling as well. The author states that, "Small, innovative firms are particularly hit hard because in many cases their primary asset is intangible in nature (e.g. an idea or patent) and difficult to value, making it hard to borrow against, or sell, to stay afloat" (Policy 217). If the banks are not providing loans, it is difficult for small companies to be inventive and expand. In "Inflexible Wages and Prices? Evidence in the Current Recession," the authors William Dunkelberg, Jonathan Scott, and Michael Chow provide evidence that small businesses have been impacted significantly. According to the authors, the recession "has provided evidence that small businesses are experiencing the most rapid adjustments in wages, prices, and inventories in the past 35 years"

(Dunkelberg 94). Small businesses owners have had to decrease the wages of their employees or let them go. They also have been forced to raise the prices of their products. Now the businesses inventories remain high because the demand for goods has decreased and the prices are higher. Both of these authors agree that small businesses are affected by the decrease in revenues. Without money, they cannot be innovative or keep up with wages, prices, and their inventories.

Current small businesses are also being affected because consumer spending has decreased dramatically. Customers are not willing to put forth extra money in a recessionary time. Many people are unemployed due this recession so they are saving every dollar they can. Dr. Seen Meng Chew and Dr. Harlow Higinbotham support this idea in "Coping with the Economic Downturn." They argue "that a major consequence of the economic crisis is that supply chain profits have often turned to losses because of steep declines in production volumes" (Chew 46). Small companies are not producing as much because there is not enough of a demand for their inventory. This will ultimately lead to lost profits. Small companies in the country are now "confronted with a clean downturn in demand for goods and service which results in a crimping cash flow" (Policy 218).

Economist Michael Mckee reviewed data from the National Federation of Independent Business which tracks how small businesses are operating and how they respond to changes in the economy. He examined the index of small business optimism; it describes how hopeful and confident managers are in their company. The most recent index revealed that "for the past sixteen consecutive months the index has hit all time lows. The index has not dropped this low even during the four prior recessions" (McKee 16). This recession proves that managers are not as confident as they used to be, managers do not see a pickup for their company anytime soon. All of the authors agree that small businesses are being affected the most by the financial crisis.

Although they all have different reasoning for why they are struggling, they all provide significant evidence to prove their ideas.

SMALL BUSINESSES' RESPONSE TO THE RECESSION

The next question is: how are small businesses responding to the crisis? Small businesses have been forced to adjust the way they operate due to the recent recession. They are doing everything they can to survive the negative consequences of the economy. Managers have had to make extremely difficult decisions such as whether to downsize, move to a smaller facility, or shutdown. Managers of small businesses have had to get creative in promoting their company so they can stand out in their industry. In “Mixed-Use Shake-Up: IREM Members Get Creative During Economic Downturn,” Kristen Gunderson Hunt interviews different property managers and how they are responding to the recession. She argues: “real estate managers are doing everything from offering rent deferrals and extending leases to current clients, to offering move-in specials and tenant improvement allowances for potential clients” (Hunt 50). She also states that “in a good economy, these deals and promotions are things you probably would not do, but now we are doing everything we can to win over customers and to keep our current ones” (Hunt 50). Caryl Athanasiu, in the article “After the Crisis,” discusses that companies are in the business of trust and they need to regain that trust back. She argues “after the meltdown, it has become painfully apparent that we are in the business of trust. The trust of our customers, our counterparties, and our regulators is important. Lack of trust is contributing to our current challenges” (Athanasiu 42). One author argues that managers need to get creative with promotions while one believes they need to regain trust first before they do anything.

Some scholars debate the merits of saving as a response to recessions. Shelley A. Lee discusses this in her article “Guiding Your Small-Business Clients Through the Downturn Maze.” She interviewed a small businesses owner, Matthew Davis, a dentist. He is responding to the recession by promoting discounts to fill empty chairs. He is also “refinancing or restructuring debt, freezing salaries, and suspending owner savings to maintain sufficient cash in the business are also part of [his] strategy, as is taking the red pen to little "extras"—employee parties or buying the latest piece of technology when it's not essential” (Lee 4). He argues that his strategy is trying to promote business while saving as much money as possible. Another small business owner states that he is surviving by cutting costs: “I included a 30% pay-cut to myself, along with trimming my fulltime staff by a third. I had to eliminate bonus opportunities which decreased worker’s motivation (Sweeney 45). But John J. Jablonski agrees that saving money is that best way to respond to the fallen economy in the article, “Focusing on the Big Picture.” Jablonski states “an organization will be better prepared to respond to economic hardship by downsizing. Proactively working to reduce the volume of information stored at an organization can reap obvious cost savings, such as by reducing fees for offsite paper storage, archiving, and server space” (Jablonski 3). Moving from a large facility to a smaller one will decrease fixed expenses such as water and electric bills (Lee 6). But downsizing to a small facility means downsizing in the number of employees. According to the National Employment Report, “companies with fewer than 50 workers cut 75,000 jobs in October 2009 from 290,000 in March (Yigui 298). All of the authors agree that saving money is the best way to respond to the financial crisis.

UNEMPLOYMENT RATES

During this recession, not only have small businesses been struggling, but unemployment rates have been impacted negatively as well. In any recession, there is bound to be an increase in unemployment rates. But this recession has broken records. The national unemployment rate number has not been this high in the past thirty years. Authors Mark deWolf and Katherine Klemmer argue that “unemployment rates have reached a high of 10.1% in October 2009, increasing five percent in December 2007; approximately eight million jobs were lost” (deWolf 36). That is a huge deficit in the job sector. John E. Gnushcke believes that “the latest economic recession officially ended in June 2009 and the recession in the labor market lasted until February 2010, employment levels may not return to prior levels for years (Gnuschke 3). Small businesses are affecting unemployment rates. Since managers are forced to let go of employees while also being reluctant to hire, they are contributing to the unemployment rate significantly. Michael McKee states that in “January 2009, small companies eliminated three thousand jobs in just one month” (McKee 16). Small businesses account for a “disproportionately large share of new jobs in the U.S- maintaining working capital in the form of earned revenues” (Sweeney 47).

The academic journal, Phi Kappa Phi Forum, views unemployment from a different perspective. It states that the recession has put unemployment rates in such a deficit that it will take approximately 8 years until it is at a steady yet normal rate again. He determined this mathematically by “seeing that there is a 10.3 millions employment shortage, and 2.15 million jobs are needed for annual employment growth, 900,00 will be needed to accommodate the expanding labor force, leaving only 1.25 million jobs to counter the current employment shortage. Dividing 10.3 million by 1.26 million will result in 8.3, which is approximately 8 years and three months until the economy is at a healthy unemployment rate,” (Hughes).

Sahin Ayesgul, Joesph Song, and Bart Hobijn studied the gender gap within unemployment rates. They found that men had a higher unemployment rate at 11% while women only had an 8.3% unemployment rate. The authors claim that “men were much more heavily represented in the industries that suffered the most during the downturn” (Şahin 1). The industries that they are referring to are the blue-collar jobs. These authors agree with Andrew Sum in his article, “The Great Recession of 2008-2009 and the Blue-Collar Depression.” Sum states that there had been a rapid increase in the unemployment and underemployment rate among blue- collar workers. Blue-collar jobs are considered to be: construction and extraction occupations; installations/maintenance and repair crafts; production workers; and transportation operatives. These types of jobs typically fall under the categories of small businesses. Having a significant decrease in these particular areas will affect how certain small businesses are struggling which contributes to unemployment rates. The authors state that “the loss of blue-collar employment explained 81% of the decline in jobs among men from 2007 to 2009” (Sum 19). The unemployment rate has increased because of the recession and the authors provide evidence that the group that has suffered the most has been male blue-collar workers.

In their research, these authors have come to some broad conclusions about the effects of the “Great Recession” on small businesses and unemployment rates. The first is that the financial crisis was caused by the U.S banks over-lending, which led to the collapse of the financial system. Secondly, the authors conclude that in previous recessions, the creation of small businesses has helped the economy get out of the recession by creating new job opportunities. A third conclusion is that small businesses are struggling most because of the recent recession, and if small businesses are under pressure, then the economy will take longer to recover. The authors also state that small businesses are enduring hardships because of the banks, their customers, delay in innovation, the supply-chain cycle, and wage and price adjustments. Another conclusion that the authors have reached is that small businesses are responding to the recession by being creative, offering promotions and discounts. The last conclusion that the authors have reached is that there is a high unemployment rate and there is a gender gap between rates. They also state that blue-collared jobs are the jobs that have been affected most by the Great Recession.

CONCLUSIONS

There has not been one piece of writing that has covered all of the aspects of recessions, particularly the links with small businesses and unemployment rates. The effects on small businesses and unemployment are directly related, yet no author has come to that conclusion yet. Economists have been dismissive of this topic because their focus is most likely on other factors such as possible financial solutions to recover the economy or what the leading and underlying causes of the recession were. Economists have been doing extensive research and publishing literature about the real-estate market and its connection with the recent recession. Perhaps all of their research topics focus around this aspect and that is why they have not expanded research on examining the relationship between small businesses and unemployment rates. Since this is still a fairly recent recession, it is possible in the future they will evaluate and draw conclusions about these two variables.

Small businesses are directly related to unemployment rates during a recession. The cycle begins when there is a decline in the economy; GDP becomes negative because consumer spending has decreased. This leads to a recession. This then leads to banks limiting their loans and cutting lines or credit. If small businesses typically lead recession to a healthy recovery, then they need to emerge. If small businesses are not emerging because of bank issues, then this will not create any job opportunities. If current small businesses are struggling to survive, they will most likely cut the number of employees that they have. If that happens, then no one will have jobs and consumer spending will continue to be extremely low. This results in the economy continuously being in a recession. If small businesses cannot come forward or expand, then unemployment rates will continue to remain high. The creation of small businesses and the importance of maintaining a healthy current economy will decrease the unemployment rate because there is then an opportunity for jobs. If there is an opportunity for jobs, then people will not be unemployed. If people have jobs, they will finally have extra money to spend, which will increase consumer spending. An increase in consumer spending will lead to an overall stronger economy. Small businesses and unemployment rates have a significant relationship when it comes to being a recession.

LIMITATIONS

There were several limitations presented in this research. This study is limited because it is solely a literature review. Information was gathered from other scholars and their researches on the variables are discussed through this essay. There were no surveys completed or tests that were done. There was no number crunching involved. The only information present is the scholar's literature. These conclusions could be accurately measured because the scholars conducted several tests and studies to precisely prove their information. Also, the research was limited because this is still a fairly recent topic. The recession is still occurring now even though it is technically over. In a few years, it is probable that more literature will be published concerning the recession, small businesses, and unemployment rates. Many of the scholars are solely focusing on the effects of the housing market on the recession. Perhaps this is the reason for most scholars missing the question that has been presented in this essay.

Adding surveys or conducting interviews with small businesses owners in the state of South Carolina among other states could improve the study. It would be more precise if the survey or interview were issued to those throughout the nation. Having a more spread out and diverse geographic area may prove the study to be more accurate. A large number of small business owners would need to be interviewed so the result would not be bias. The only issue that would be common is that since the recession has had a negative effect on most small business owners, their responses to the survey or interview would be most likely negative because their emotions are directly involved. Also, conducting interviews and surveys with those who are unemployed would be helpful to. Finding out how many people lost their jobs to small businesses would be very relevant to this study. Also, interviewing the unemployed and asking if they see themselves opening a business to spark the economy is realistic or not.

SOLUTIONS

There are possible solutions to fixing the problem of small businesses struggling and unemployment rates suffering as a result. Unemployed individuals could become innovative and start creating small businesses. If they are collecting unemployment checks, that income could be an investment to creating a business. Also, if President Obama implemented another stimulus package just like he did in February 2008, then perhaps people would take that money to invest in creating a small company. This would decrease unemployment rates and help the economy recover faster.

In order for unemployed people to start businesses, a solution needs to be formed on how to get banks to become less risk adverse and to give out loans. Banks could lend out more loans if they received federal funding from the United States government. If the banks have more money to give away, they will give it to those who are attempting to spark the economy by creating a small business. If more money is funded to the banks, this will make it a lot easier on current small business owners as well because it would not hurt their line of credit as significantly.

This an extremely important topic in the business field and for non-business people to understand because the recession is still occurring and it has affected almost everyone in the United States. If it has not affected you personally, then it has affected someone you know. Individuals should care about this topic because it is our economy and our country.

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