Doron F. Eghbali Business Planning

[Economics 101 for Businesses]

Monday, January 11, 2010 by [Doron F. Eghbali]

Business owners usually worry about paying their bills on time and putting bread on the table for their family. However, knowing the truck that delivers the bread runs on gas and the gas price could affect the price of the bread make us think of the bigger economic picture.

In fact, knowing roughly what business environment will look like in the next month or quarter helps business owners plan ahead. Business owners, based on financial forecast, might want to cut inventories, slash prices or expect a modest growth. In such circumstances, business owners should have enough capital to weather the storm or invest more to take advantage of improving economic environment.

So, knowing and keeping track of some basic economic indicators might be very helpful.

CONSUMPTION

Consumption or Real Personal Consumption Expenditures tracks the inflation-adjusted price changes in consumer goods or services. In essence, this economic indicator tells us whether consumers are spending and by how much.

The reality is if consumers are not spending small businesses feel the pain more acutely than big businesses. As we all know, about 70% of our gross domestic products-i.e.the total market value of all goods and services produced in the US- comes from consumer spending.

PRODUCER PRICE INDEX

Businesses that make products should track this economic indicator very closely. Consumer price index tracks the changes in producer prices before they get passed onto consumers. This is very important because businesses should follow this indicator to raise their prices if producers raise their prices. However, businesses should be wary of price increases in a downturn as consumers look for bargains. So, in a downturn, businesses often reduce their prices despite some rise in producer prices and lower their profit margins.

Therefore, this is of paramount of importance for businesses in the business of making products to know how the economic conditions are changing and they adjust themselves accordingly.

CONSUMER CONFIDENCE/CONSUMER SENTIMENT

Consumer confidence and consumer sentiment figures tell us how consumers think of the economy. Undoubtedly, the more confident consumers are about the economy, the more likely they are to spend. Businesses are highly advised to track these figures to ascertain what they should expect in consumer behavior.

There are two indexes businesses should track:

- University of Michigan's Institute for Social Research: Index of Consumer Sentiment
- Conference Board, a Research Firm in New York: Consumer Confidence Index

US DOLLAR

The dollar's value tells us about whether we have inflationary pressures. In other words, the stronger the dollar is the less it costs to purchase materials and as such producer prices are lower and inflation is lower because the finished product is cheaper. However, a strong dollar might harm exports as dollar looks more expensive to some foreign buyers.

On the other hand, a weak dollar makes producer prices more expensive and consequently finished products sold to consumers are relatively more expensive.So, it takes more US dollars to purchase the same materials in the US and inflation goes up.

Inflation weakens the purchasing power of consumers. Therefore, it is integral to track inflationary pressures. (Deflation is really dangerous, too.)

To track inflation, we could monitor the Dollar Index Futures and the price of gold. Usually, as the dollar weakens commodity prices including gold prices increase.You could check the price of gold futures on the Comex Division of New York Mercantile Exchange.

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