WHY DOES MACRO AND MICROECONOMICS MATTER TO SMALL BUSINESSES?

August 4, 2020

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Macroeconomics is about the government policies and decisions that impact the entire economy. Decisions about regulations, tax rates, fixed or floating exchange rates, size of the government budget, whether the government will run a surplus (an excess) or deficit (falling short of what is needed) and how the government spending will be financed.

Microeconomics is about individual and industry business decisions that affect supply, demand and the pricing of products and services. This affects resource allocation (assigning your resources to various uses) and investing decisions. If tourism is growing worldwide and consumers show an increasing interest in having beach holidays, investors will seek to build more hotels on Jamaican beaches which will increase the supply to meet the demand.

Microeconomics lies at the equilibrium between capital, labour, production and pricing. In order for a lamp manufacturing industry to exist over the long term, there must be consumers seeking to buy lamps (the demand). Also, the overall cost of making the lamps, including the cost of inputs in terms of the raw materials and labour plus the cost of producing the lamps (for example, electricity for running lamp making machines etc.) must be less than the price the consumers are willing to pay for these lamps. Only then can lamp manufacturing be a profitable investment. It is largely the microeconomic conditions that determine which businesses and industries will exist in a country.

While Macroeconomics and Microeconomics are two distinct areas of Economics, they are intimately related and therefore affect each other. If the tax rate on lamp sales are too high (macroeconomic decision), then far fewer lamps will be sold (microeconomic impact) and there will be less lamp manufacturers than there would have been if there was no sales tax on lamps at all.

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Key Macroeconomic indicators include:

- **Gross Domestic Product (GDP)** which is the output of the entire country. When GDP is growing there is likely to be higher individual incomes overall and therefore maximum business opportunity for small and medium businesses. Growing GDP often also means greater access to finance as Banks and other Financial Institutions tend to be more willing to lend and provide other funding;
- **Per Capita Income** is the income of the average Jamaican. When this is high then consumers tend to spend more on non-essentials; industries such as travel, automotive, and real estate will be attractive in these times. In slow downs people will tend to hold on to the old car for longer and not take as many holidays;
- **Inflation** is an increase in the cost of living. Very often your inputs might be increasing as a business if there is inflation and you might have to adjust your own prices upwards if you can;
- **Foreign Exchange Rate** is particularly crucial if your business is cross border and the US dollar price is significant. If the value of the Jamaican dollar is declining and your inputs are bought in US dollars this can significantly affect your profit margins. On the other hand if you are selling into the US market, there may be more business opportunity as the landed price of your goods in the US will be lower than the competition. The dollar matters if you import or export raw materials or finished goods;
- **Low Unemployment Rates** suggest a strong and healthy economy which directly reflects an increase in retail sales;
- **Consumer Sentiment** is how Jamaicans feel about the economy which is often driven by the unemployment rate, per capita income and GDP. “Happy” is the sentiment when the economy is growing, unemployment rate is low and per capita income is growing;
- **Fiscal Balance** is when the government’s budget/spending matches the anticipated revenue (taxes). Where the spending is higher than collected tax revenue (fiscal deficit) the government has to either increase taxes (on everyone including small businesses) and/or borrow to cover the shortfall. Government borrowing tends to increase the cost of borrowing for small businesses.

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The Government of Jamaica has broadly three sets of policy tools which set the direction of the Jamaican Economy:

1) **Fiscal Policy**
2) **Monetary Policy**
3) **Industrial Policy**

The overall **Fiscal Policy** and economic framework is managed largely out of the Ministry of Finance. The overall government budget is set in conjunction with the various government ministers and members of parliament. The Ministry of Finance will think through how best to fund the budget through taxes or loans (domestic or foreign). Much of the data gathering and analysis for the Ministry of Finance is done by the Planning Institute of Jamaica and the Statistical Institute of Jamaica which both report into the Ministry of Finance.

Monetary Policy is set by the central Bank of Jamaica (BOJ). The BOJ's role is to ensure monetary and financial stability. For instance, the question of how much money or liquidity should be in the system? How should the exchange rate be set? How large should our foreign exchange reserves be to cushion any unexpected shocks to the system? The BOJ has the power to influence interest rates and the level of credit in the banking system. It is these combined decisions that will determine the national level of inflation and the currency exchange rates. The BOJ is the banker of record to the Government and the Commercial Banks. BOJ is also responsible for regulating our deposit taking institutions to ensure that your money is safe and sound.

Industrial Policy is set by the Ministries that deal with the various industries. The government may undertake various policies and/or projects to build, protect or even discourage an industry. There may be for e.g. special tax rates to encourage investment and regulations to enhance competition and fairness to consumers.

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The Private Sector operates within the overall environment shaped by the fiscal, monetary and industrial policy decisions of the government.

Private sector decision making is driven by the intersection of:

- Expectations of the Macro/Micro environment;
- Appetite for risk; compared to other opportunities available;
- Belief in the capability to deliver on strategic plans given the environment.

A situation such as the COVID-19 pandemic can result in the need to take bold actions to ensure that we build our way sustainably out of the crisis. Accordingly,:

- Banks may consider preserving their current loan portfolios rather than expanding it with new loans to businesses in the current environment;
- The Government may be particularly cautious about state expenditures as there might be increasing concerns about tax revenues;
- Small businesses may use expensive credit card financing for business operations if there are no alternative funding mechanisms available.
- Consumers will be wary of spending as they are feeling insecure about their own job prospects.

Each of these decisions may be prudent in isolation, but together they could lead to a recession that takes years to recover from, even after COVID-19 is over. The Macro and Microeconomic policies feed into the consumer and business decisions that will impact the overall economy.

How do we cross this chasm? How do we bridge from the period inside the pandemic until we move to the new normal where economic demand has recovered?

To that end the PSOJ has organized an online conference on August 14th, Crossing the Chasm: The Road to Economic Recovery where many of our most capable thinkers in the private and public sector will convene to talk about the way forward. If you wish to attend, please email SME@psoj.org. Come to listen, come to learn and come to share your ideas. Preference will be given to PSOJ members.

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Responding to the economic impact of the COVID pandemic requires an integrated system view and a multi-sectoral response.

Journalist Keith Collister wrote an article in the Jamaica Observer on July 31, 2020 entitled 'The Way Forward for Jamaica's Tourism Industry'. In it, he outlines the current state of play in the industry due to COVID and the various steps and players required to ensure sector sustainability.

Only 15% of properties have opened. A hotel needs about 60% occupancy to breakeven. Most have opened with between 10-35% occupancy. Even closed a hotel still has ongoing fixed costs ranging from $30-$50K per month for a small hotel and $500K-$850K for a large hotel. This means that most hotels will have negative cash flows for the near term. This industry employs over 150,000 people directly and impacts another 200,000 indirectly. Directly impacted means for example someone working at a hotel. Indirectly impacted means for example the taxi a hotel worker takes to work.

To create tourism sector sustainability during COVID-19 requires:

- A temporary change in the worker redundancy regulations as many of the hotels post COVID-19 do not have the funds to pay for widespread redundancies especially if the hotel is not open or open with very low occupancy;
- A CARE like government program to temporarily help those workers laid off by low demand in the tourism industry;
- In order to protect the industry and country, we need to aggressively create a Private Sector industry for COVID-19 testing in order for the guests, workers and the country to be safe. The state health system alone cannot manage the millions of visitors we need to bring into the island; we must build out private testing capacity;
- There is a significant need for bridge funding which will require that banks or other financiers support many of the hotels in the interim period as they build themselves back up to profitability. This may require low interest loans or new, innovatively structured financial products;
- In order to support the hotels, the banks will require regulatory relief or additional liquidity from the BOJ.

This is what is meant by an integrated and multisectoral private and public sector response to the COVID crisis.

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Small businesses need to be most acutely concerned about macro and microeconomic issues when making a big move.

- Are you opening a business?
- Expanding your product?
- Closing a division?
- Entering a new geographic market?
- Changing your supply chain?
- Any of these business changes require that you understand the key macro and micro indicators because they will govern what you do next.

Imagine I am thinking about starting a retail clothing business in the middle of a credit bubble where because of the policies of the central bank it is inexpensive for me to borrow and start my business. Moreover, lots of women will have credit card facilities to buy my dresses. This would suggest going ahead. However, as I read my macroeconomic news I hear increasing stories of bad loans and the discussions that the central bank will be raising interest rates to protect the viability of the economic system. If my business margins are high and can take a 30% reduction in anticipated sales (less women will have access to cheap credit cards) and an increase in the cost of my borrowing then I can still proceed with my business plan. However, if it was a thin margin business that cannot take the dual shock of less overall sales as well as increased borrowing rates then I might not go ahead. The Macro/Microeconomics will greatly affect my decisions.

And Macro/Microeconomic conditions can distort Private Sector behaviours for a long time. Our decades of high interest rates meant that we were able to be just save and be traders to survive never fully undertaking production and industry building as a nation. The heavy financial restructurings that we have had to do in the past has made many of our banks risk averse around lending to small businesses.

DO NOT be blind-sided by crucial macroeconomic or microeconomic factors. Assess the economic environment around you before making big business decisions. Be aware, investigate and act with the full benefit of economic insight.

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REFERENCES

Blog Post (IDB) - **Extreme Outlier: The Pandemic's Unprecedented Shock to Tourism in Latin America and the Caribbean by Henry Mooney**

- https://blogs.iadb.org/caribbean-dev-trends/en/extreme-outlier-the-pandemics-unprecedented-shock-to-tourism-in-latin-america-and-the-caribbean/

Bulletin (IDB) – **Caribbean economies in the time of the coronavirus by Henry Mooney**

- https://publications.iadb.org/publications/english/document/Caribbean_Quarterly_Bulletin_Volume_9_Issue_1_April_2020.pdf

Using Microeconomics to Maximize Revenue

- https://www.stevebizblog.com/using-microeconomics-maximize-revenue/

5 Macroeconomic Research Factors That Affect Business

- https://homebusinessmag.com/growing-a-business/how-to-guides-growing-a-business/5-macroeconomic-research-factors-affect-business/

Small Business and Macroeconomics

- https://www.caseyresearch.com/daily-dispatch/small-business-and-macroeconomics/

Helpful Videos

Revenue, Profits, and Price: Crash Course Economics #24 - How do companies make money? What are profits? Revenues? How are prices set?

- https://www.youtube.com/watch?v=UWImfFax8Ew

How Important Are Small Businesses?

- https://www.youtube.com/watch?v=7MTaI216nQA

The Importance of Small Business

- https://www.youtube.com/watch?v=WqWxHHaRt40

Why small businesses are an important part of economic recovery

- https://www.youtube.com/watch?v=hZZTCrJVccI

Goldman Sachs CEO: Small businesses are very important to growing this economy

- https://www.youtube.com/watch?v=rYA-cBGnz10

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sme@psoj.org

CROSSING THE CHASM: *THE ROAD TO RECOVERY*

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FRIDAY
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PSOJ Members & Invited Guests

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