Economic factors and consumer durable goods

INTRODUCTION TO CONSUMER DURABLE GOODS

In economics, a durable good or a hard good is a good that does not quickly wear out, or more specifically, one that yields utility over time rather than being completely consumed in one use. Items like bricks could be considered perfectly durable goods, because they should theoretically never wear out. Highly durable goods such as refrigerators, cars, or mobile phones usually continue to be useful for three or more years of use,[1] so durable goods are typically characterized by long periods between successive purchases. This industry includes all those goods which are durable i. e. products whose life expectancy is at least 3 years

The consumer durables industry can be broadly classified into two segments: Consumer Electronics and Consumer Appliances. Consumer Appliances can be further categorized into Brown Goods and White Goods. The key product lines under each segment are as follows.

White Goods

- Kitchen Appliances
- Refrigerators
- Washing Machines
- Air-conditioners
- Speakers and Audio Equipme
- Sewing Machine
- Watches And Clocks

Kitchen Appliances / Brown Goods Consumer Electronics

- Mixers

- Grinders
- Microwave Ovens
- Iron
- Electric Fans
- Cooking Range
- Chimneys
- Electronic Fans

Consumer Electronics

- Mobile Phones
- Televisions
- MP3 Players
- DVD Players
- iPad
- Personal computers
- Audio and video system
- Camcorders

Common example of customer durables in the possession of most households is appliances. These items may include ovens, refrigerators, toasters, and gas or electric water heaters. Consumer durables of this type are intended for use on a continuing basis, and often are sold with some type of warranty or service contract that helps to ensure the appliance will continue working for an appreciable period of time. The family car is also understood to be among the various consumer durables owned by many households. Considered a major investment by many consumers, the expectation is that the vehicle will remain operational for at least the amount of time it takes for the consumer to pay off any loans associated with the acquisition. Further, consumers anticipate that the vehicle can be utilized on a regular basis without fear of being destroyed by the frequent usage.

ECONOMY ANALYSIS

Economic analysis deals with the analysis of forces operating in the overall economy. In the security analysis, the expected course of the economy must be enquired into because overall economic conditions and economic activities affect corporate profits and investors' expectations and thereby affect the security prices in the capital market. Economic analysis has an important role in the investment decisions. If the economic analysis shows strong and vibrant economic conditions, investors will buy the shares in expectation of earning capital profits at a later stage. An expectation of sagging economic conditions can lead to lower corporate profits and the security price will fall resulting from the selling pressure.

The economic analysis helps to identify whether the economic climate is conducive or not for the growth of the business in general. It is imperative to note that when economy grows, all industries are expected to benefit. In case of weak economies, industries struggle to survive.

PORTERS FIVE FORCE MODEL

ECONOMIC FORECASTING:

An investor is interested in forecasting the expected performance of the economy in general and its effect on the performance of a particular industry or on a particular company. Thus, economic forecasting gains a place of prime relevance in the economy analysis.

The outlook for the industries and companies depends on the outlook for the economy. A security analyst may start with the forecast of Gross Domestic Product (GDP) which is a measure of national income and is defined as the value of total goods and services produced in the economy in one year. An analysis of the components of GDP and how these components are related to the performance of industries and companies is also required.

Economic Factors to be Considered before Investing in Consumer Durable Goods

GDP (GROSS DOMESTIC PRODUCT)

Gross domestic product (GDP) is the market value of all officially recognized final goods and services produced within a country in a given period.

GDP per capita is often considered an indicator of a country's standard of living

The Gross Domestic Product (GDP) in India was worth 1847. 98 billion US dollars in 2011, according to a report published by the World Bank. The GDP value of India is roughly equivalent to 2. 98 percent of the world economy. Historically, from 1960 until 2011, India GDP averaged 368. 84 billion USD reaching an all time high of 1847. 98 billion USD in December of 2011 and a record low of 36. 61 billion USD in December of 1960. The gross domestic product (GDP) measures of national income and output for a given country's economy. The gross domestic product (GDP) is equal to the total expenditures for all final goods and services produced within the country in a stipulated period of time.

Change in GDP results on account of:

- Change in availability of resources.
- Change in usage of these resources, and
- Change in efficiency with which factors of production are used.

GDP indicates the performance of the economy during the period. An increasing trend in GDP tells about an expanding economy which provides a lot of opportunities to the firms to increase the level of activities and to increase the earnings. There are two other measures, Gross National Product and Net National Product which are also indicators of economic activity.

EMPLOYMENT

Employment is a contract between two parties, one being the employer and the other being the employee. The demand for consumer durables has been rising with the increase in disposable income coupled with more and more consumers falling under the double income families. Also, the growing Indian middle-class plays a major role in increasing the demand. This, along with a fall in the prices of durable goods mainly due to the advancement of

technology, easy import of components has led to an increase in the consumption expenditure on durable goods

INTEREST RATES

Interest rates directly affect the cost of funds to the industry. Higher inters rates increase the cost of funds and thus squeezes the income of companies. On the other hand, a lower interest rate reduces the cost of funds resulting in higher profit. There are several reasons for change in interest rates such as monetary policy, fiscal policy, inflation rate, etc. Irrespective of the reasons for change in interest rates, the investment pattern in the economy is affected by the change in interestrates; the interest rates affect the opportunity cost of the investors also, thus affecting the bond and equity prices. So, the changes in interest rates have repercussion on the profit of the companies as well as on the market prices of securities. There are several indicators of interest rates. These are interest rates in the call money market or the bank rate or the prime lending rate of the lending institutions. Consumer financing has become a major driver in the consumer durables industry. In the case of more expensive consumer goods, such as refrigerators, washing machines, color televisions retailers are marketing their goods more aggressively by providing easy financing options to the consumers by partnering with banks.

INFLATION

Inflation refers to a general rise in prices measured against a standard level of purchasing power. Inflationary pressure in the economy affects (decreases) the purchasing power of the consumers and thus has a considerable impact on the performance and profitability of companies. High inflation rate can be considered as an indication for slower growth rate and low inflation rate can be taken as a positive sign for an expansionary phase. Inflation has a relationship with capital market as well. During inflation, the nominal required rate of return of investors goes up resulting in the decrease in bond and equity prices. Inflation can be measured in terms of wholesale index or consumer price index. An analysis of these indices will indicate the economic conditions expected to prevail.

The most well known measures of Inflation are the CPI which measures consumer prices, and the GDP deflator, which measures inflation in the whole of the domestic economy.

BUSINESS CYCLES

Business cycles refer to cyclical movement in the economic activity in a country as a whole. An economy marching towards prosperity passes through different phases, each known as a component of a business cycle. These phases are generally designated as depression, recovery, boom and recession. Interest rates and inflation rates are high. Individual companies face different degrees of economic crises. There is a heavy pressure on their profitability resulting in lesser and lesser dividend payout and reinvestment activities. Companies even forced to shut down some of the plants. Some industries Show above-average response and tend to outperform the economy. These include capital goods industries such as consumer durables. The demand for these goods is generally deferred during recession period. But during the recovery, the demand pattern outperforms the general demand level. However, during the same period, industries dealing with essential commodities such as food, are less responsive. On the other hand, these industries would tend to outperform the general level during the recession period

MONETARY POLICY, MONEY SUPPLY AND LIQUIDITY

The liquidity in the economy depends upon the money supply which is regulated by monetary policy of the government. Reserve Bank of India has been adopting several measures to regulate the money supply and liquidity in the economy. Business firms require funds for expansion projects. The capacity to raise funds from the market is affected by the liquidity position in the economy. The monetary policy is designed with an objective to maintain a balance in liquidity position. Neither the excess liquidity nor the shortage is desirable. The shortage of liquidity will tend to increase the interest rates while the excess will result in inflation.

Monetary supply and monetary environment affect share prices through affecting the discounting rate. An easy monetary policy is expected to result in decreasing discount rate. Money supply also affects the real economy through

- Change in growth in demand level,
- Change in growth of supply position

OTHER FACTORS

Besides the factors mentioned, there are cartain other factors which should also kept in mind while economic analysis. Some of these factors are:-

- Cheap imports from Asian Countries: The cheap imports of consumer durable products from countries like China, Singapore etc is a major concern.
- Increasing competition: Presence of a large number of players in each segment leads to high rivalry. Also, the unorganized market is yet very strong in the case of many consumer durable goods. The pie of the unorganized sector is relatively large in most of the segments, hence increasing the competition.
- Fluctuating raw material prices: Rising input costs of raw materials viz. copper, steel, aluminum and plastic – the major raw materials required for this industry will severely put pressures on margins.
- Unfavorable Duty Structure: Top players in the consumer durables industry have been demanding a more favorable import duty on

durable components imported by them. Take the case of LCD’s which is the fastest growing segment right now – the industry has beendemanding a reduction in the import duty. Contrary to this is the case of set top boxes, where 80% of the set top boxes are imported. The industry has been recommending that the custom duty on STB should be increased by 5% to 10% in order to boost domestic manufacturing.

- Continuously changing technology; a challenge: The consumer durables sector faces the challenge of a continuous change in technology and the inability to cope with it. High-end consumers prefer changing their goods along with the up-gradation of technology and manufacturers have to make sure they cater to this requirement.

CONCLUSION

The outlook for the industries and companies depends on the outlook for the economy. If the outlook in the economy is bright and upbeat, this may be considered as good indicator of growing profit of the firm. The general optimism is reflected in the security prices. The linkage in economic environment and the security prices is obvious and critical. This analysis helps to decide when to invest and where to invest. The Indian market is fast moving towards high-end products and the importance of media and entertainment is growing among the young market. The consumer durables industry needs to constantly focus on innovation and needs to come out with product variations across categories to meet the different expectations of a varied class of customers. With easy availability of finance, fall in prices due to increased competition, growth of media, growth in consumer base of rural sector, the consumer durables industry is growing at a fast pace. Given these factors, a good growth is projected in the future, too.