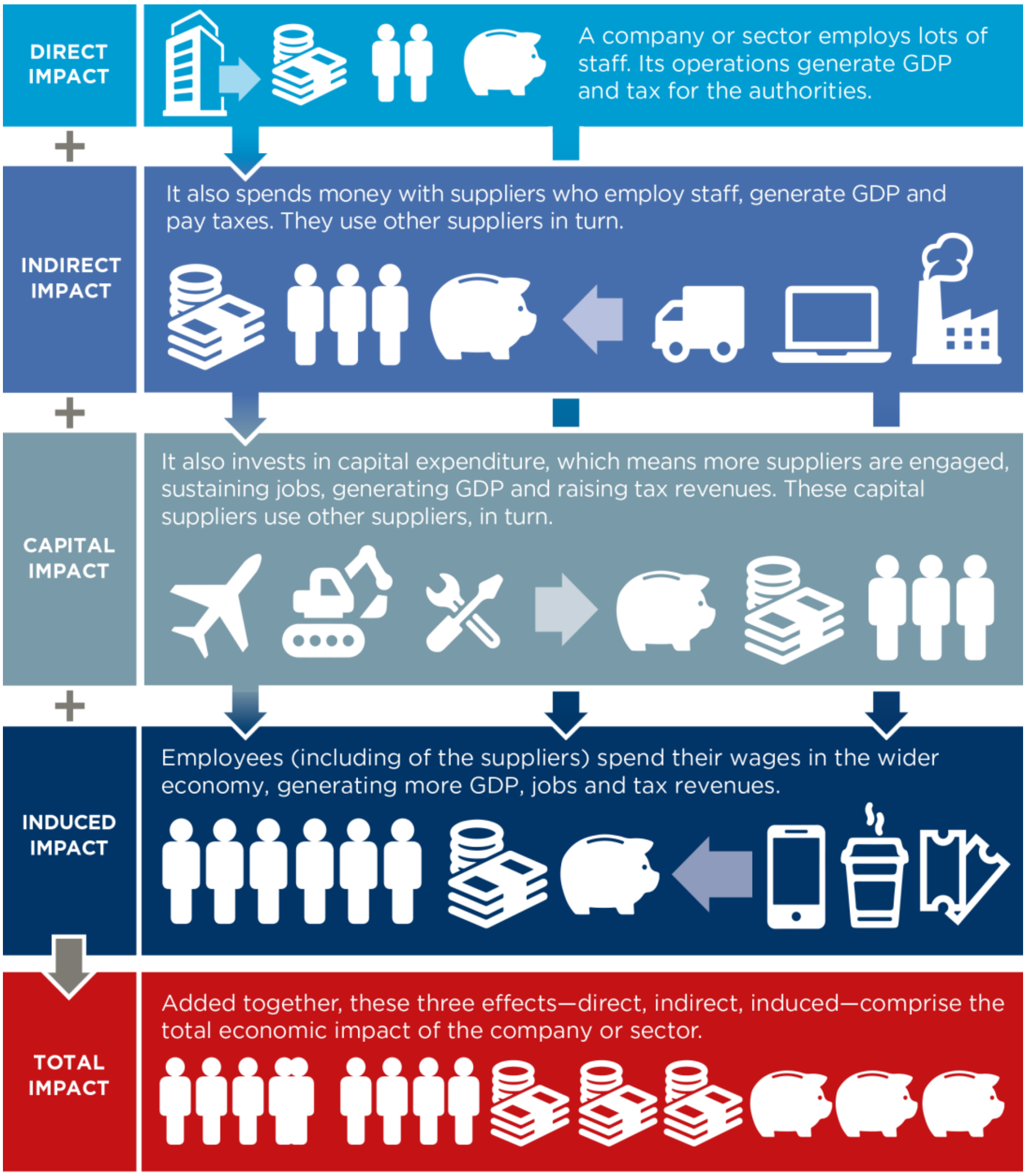
How do we measure the economic impact of a business or organisation on a national economy?

When we assess how a business or other organisation contributes to a national economy we look beyond the company itself and we explore how it interacts with the rest of the economy.

In doing this, we employ a standard economic impact assessment framework, which is based on the work of a Nobel Prize-winning economist, Wassily Leontief.

This framework examines the three main economic channels through which an individual business, organisation or sector impacts on – and contributes to – a national economy and its output.



Direct Impact

At the core of any economic impact assessment of an organisation is, clearly, the organisation itself. During their operations firms and other organisations make purchases, employ staff, generate sales and profits, and pay taxes. Each of these could be used to measure how much a company directly contributes to an economy. However, we choose three key metrics:

- Employment – typically measured on headcount basis for easy comparison with national statistics.
- Contribution to GDP (Gross Domestic Product) – also known as 'gross value added', this is the contribution a company makes to a national economy's output. It can be measured as either the difference between its revenues and spending on bought-in goods and services, or by the wages and salaries it pays its staff, and the profits it makes[1] (both approaches should arrive at the same result).

GDP measures the total economic output of the country. It is used to judge the rate of growth of the economy and to define whether it has fallen into recession (often defined as two consecutive quarters of falling GDP).

- Tax payments – incorporating corporate and personal income taxes, and social security contributions.

But that is not the limit of an organisation's interaction with other parts of a nation's economy.

Indirect, or Supply Chain Impact

An organisation will make purchases from other companies during its operations. This spending can take place with firms elsewhere in the economy, or with international firms.

In the latter case, this represents leakage from the domestic economy and supports no further activity domestically. But spending with domestic firms requires those businesses to then produce goods and/or services to satisfy these purchases.

In doing this, the supplying firm will make its own purchases, employ staff, make profits, and pay taxes. Similarly, by making its own purchases the supplying firm is stimulating activity in its own domestic suppliers, who also make purchases, employ staff, make profits, and pay taxes on the back of this demand. And so on down the supply chain.

Using our models of the economy concerned, we trace how the first round of spending a company makes with domestic suppliers leads to further spending in the rest of the supply chain. From this, we can then calculate the total value added that occurs across the entire supply chain, and the resulting employment and tax payments supported by the organisation's overall activities.

Induced, or Consumption Impact

The people employed within the organisation or in its supply chain will be paid wages that can be attributed back to the firm's activities. Individuals will use these wages to save and make household purchases, including entertainment, transport and shopping.

When these purchases are made abroad—such as while on holiday—they leak out of the domestic economy. But domestic purchases cause the establishments where they are made (for example, cinemas or restaurants) to make purchases, employ staff, make profits, and pay taxes.

As in the indirect impact, our models enable us to calculate how the spending made by employees of a business or other organisation then trigger activity throughout the domestic economy, as supply chains are used to supply the goods and services purchased. They also turn this expenditure into a measurable gross value-added contribution to GDP, employment and tax revenues to the government of the country concerned.

Total economic impact

By summing the three channels of economic impact together we can then measure all the economic activity attributable to the company whose business we are considering.

---

[1] *Measured in terms of earnings before interest, taxation, depreciation and amortisation (EBITDA).*

Measuring what a business contributes to an economy vs measuring whole economy GDP

When we look to understand the overall economic impact of a business we use a standard and widely accepted economic toolkit and consider three types of contribution a firm makes to a national economy – its *direct* contribution, and what we call *indirect* and *induced* contributions, as defined above.

The size of an entire economy, known as its national GDP, is measured by aggregating the direct contributions of *every firm* (with some technical adjustments). Here, including *indirect* contributions would mean double-counting. Indirect effects cancel-out as GDP is the *net* total of value-added for all firms.

This 'double counting' problem does not apply, however, when looking at the economic impact of one firm or industry alone. Its indirect spending with suppliers clearly generates further outputs, profits and jobs from their activity. Likewise, everyday spending by a firm's staff from wages creates *induced* contributions.

To illustrate the distinction, consider a firm that decides to outsource its IT department so that its IT tasks and staff are taken on by another local company. In doing so, the firm's measured direct contribution to GDP would fall, while its indirect contribution would rise by an equivalent amount. But clearly its overall economic contribution remains the same and includes the value generated by those who works as part of its (now-expanded) supply chain.