

Subject: Business Economics

Course: B.A., 6th Semester, Undergraduate.

Paper No: 602

Paper Title: Business Strategy & Ethics

Unit No.: 2 (Two)

Title: Environmental Analysis

Lecture No: 2 (Two)

Title: External Environment: An Introduction

Academic Script

INTRODUCTION:

This session explains that external environment consist of factors existing outside the organization. Firms have to be aware of the conditions in its external environment and firms have to identify and understand the most major threats and opportunities in its external environment that influences the company.

This session explains the importance of analyzing and understanding the firm's external environment. This session presents the concepts and analytical tools for assessing a single-business company's external environment. Attention centers on the competitive arena in which a company operates, together with the technological, societal, regulatory, or demographic influences in the macro-environment that are acting to reshape the company's future market arena.

This session explains need and characteristics of environment factors in context of Remote environment, industry environment and operating environment.

In this session students, will get knowledge of business, business environment, its features and its types.

Business:

A business is always owned by someone. This can just be one person, or thousands. So a business can have a number of different types of ownership depending on the aims and objectives of the owners. Most businesses aim to make profit for their owners. Profits may not be the major objective, but in order to survive a business will need make a profit in the long term. Some organizations however will be 'not-for-profit', such as charities or government-run corporations.

Business Environment:

The word 'Business Environment' has been defined by various authors as follows,

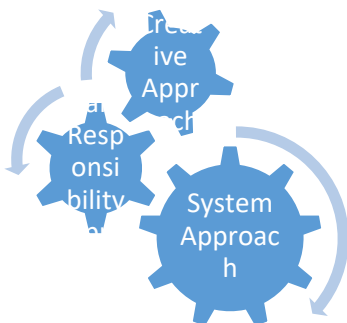
"Business Environment encompasses the - climate or set of conditions, economic, social, political or institutional in which business operations are conducted."—**Arthur M. Weimer**

"Environment contains the external factors that create opportunities and threats to the business. This includes socio-economic conditions, technology and political conditions." – **William Gluck and Jauch**

"Business environment is the aggregate of all conditions, events and influences that surround and affect it."—**Keith Davis**

Nature of Business Environment:

The nature of Business Environment is simply and better explained by the following approaches:



- **System Approach:** In original, business is a system by which it produces goods and services for the satisfaction of wants, by using several inputs, such as, raw material, capital, labor etc. from the environment.
- **Social Responsibility Approach:** In this approach business should fulfill its responsibility towards several categories of the society such as consumers, stockholders, employees, government etc.
- **Creative Approach:** As per this approach, business gives shape to the environment by facing the challenges and availing the opportunities in time. The business brings about changes in the society by giving attention to the needs of the people.

FEATURES OF BUSINESS ENVIRONMENT

On the basis of the above discussion the features of business environment can be summarized as follows.

(a) Business environment is the sum total of all factors external to the business firm and that greatly influences their functioning.

(b) It covers factors and forces like customers, competitors, suppliers, government, and the social, cultural, political, technological and legal conditions.

(c) The business environment is dynamic in nature, that means, it keeps on changing.

(d) The changes in business environment are unpredictable. It is very difficult to predict the exact nature of future happenings and the changes in economic and social environment. .

(e) Business Environment differs from place to place, region to region and country to country. Political conditions in India differ from those in Pakistan.

Significance of Business Environment

There is a close and continuous interaction between the business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively.

As stated above, the business environment is multifaceted, complex, and dynamic in nature and has a far-reaching impact on the survival and growth of the business. To be more specific, proper understanding of the social, political, legal and economic environment helps the business in the following ways

- a) **Determining Opportunities and Threats:** The interaction between the business and its environment would identify opportunities for and threats to the business. It helps the business enterprises for meeting the challenges successfully.
- b) **Giving Direction for Growth:** The interaction with the environment leads to opening up new frontiers of growth for the business firms. It enables the business to identify the areas for growth and expansion of their activities.
- c) **Continuous Learning:** Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in realm of business.
- d) **Image Building:** Environmental understanding helps the business organizations in improving their image by showing their sensitivity to the environment within which they are working. For example, in view of the shortage of power many companies have set up Captive Power Plants (CPP) in their factories to meet their own requirement of power.
- e) **Meeting Competition:** It helps the firms to analyze the competitors' strategies and formulate their own strategies accordingly.
- f) **Identifying Firm's Strengths and Weaknesses:** Business environment helps to identify the individual strengths and weaknesses in view of the technological and global developments.

Types of Business Environment:



(a) Economic environment

- Economic Conditions
- Economic Policies

- Economic systems

(b) Non-Economic Environment

- Social Environment
- Political Environment
- Legal Environment
- Technological Environment
- Demographic Environment
- Natural Environment

ECONOMIC ENVIRONMENT:

The survival and success of each and every business enterprise depend fully on its economic environment. The main factors that affect the economic environment are:

A) Economic Conditions:

The economic conditions of a nation refer to a set of economic factors that have great influence on business organizations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market etc. All these helps in improving the pace of economic growth.

b) Economic Policies:

The world economy is All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are:

- industrial policy
- Fiscal policy
- Monetary policy
- Foreign investment policy
- Export –Import policy

The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business firm has to function strictly within the policy framework and respond to the changes therein

Important Economic Policies

(i) Industrial policy: The Industrial policy of the government covers all those principles, policies, rules, regulations and procedures, which direct and control the industrial enterprises of the country and shape the pattern of industrial development.

(ii) Fiscal policy: It includes government policy in respect of public expenditure, taxation and public debt.

(iii) Monetary policy: It includes all those activities and interventions that aim at smooth supply of credit to the business and a boost to trade and industry.

(iv) Foreign investment policy: This policy aims at regulating the inflow of foreign investment in various sectors for speeding up industrial development and take advantage of the modern technology

(v) Export–Import policy (Exim policy): It aims at increasing exports and bridge the gap between export and import. Through this policy, the government announces various duties/levies. The focus now-a-days lies on removing barriers and controls and lowering the custom duties.

c) Economic Systems:

primarily governed by three types of economic systems, viz.,

- (i) Capitalist economy;
- (ii) Socialist economy; and
- (iii) Mixed economy

India has adopted the mixed economy system which implies co-existence of public sector and private sector.

Non-economic environment

Non-economic environment is as important as economic environment for influencing the business activity of the country. All non-economic issues related to business are included in non-economic environment of a country. The non-economic environment of business can be classified broadly as — legal, demographic, socio-cultural, technological and natural.

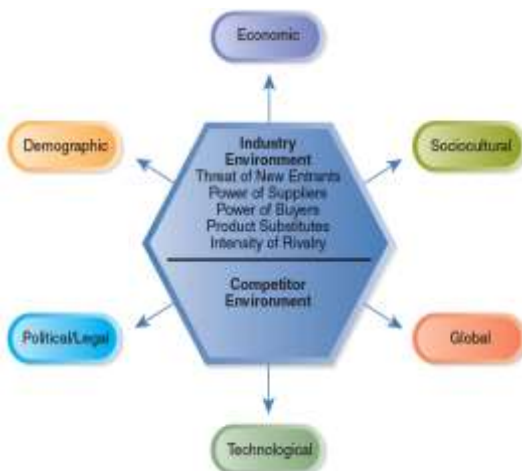
1. The External Environment:

1. Managers are not prepared to act wisely in steering a company in a different direction or altering its strategy until they have a deep understanding of the company's situation.

2. This understanding requires thinking strategically about two facets of the company's situation:

- a. The industry and the competitive environment in which the company operates and the forces acting to reshape that environment and the forces acting to reshape this environment.
 - b. The company's own market position and competitiveness - its resources and capabilities, its strengths and weaknesses vis-a-vis rivals, and its windows of opportunities.
3. Managers must be able to perceptively diagnose a company's external and internal environments to succeed in crafting a strategy that is an excellent fit with the company's situation, is capable of building competitive advantage, and promises to boost company performance – the three criteria of a winning strategy.
 4. Developing company strategy begins with a strategic appraisal of the company's external and internal situations to form a strategic vision of where the company needs to head, then moves toward an evaluation of the most promising alternative strategies and business models, and finally culminates in a choice of strategy.

The Components of a Company's Macro-environment



The Strategically Relevant Components of a Company's External Environment:

1. All companies operate in a macro-environment shaped by influences originating from the economy at large, population demographics, societal values and lifestyles, governmental legislation and regulation, technological factors, and the industry and competitive arena in which the company operates.
2. The Components of a Company's Macro-environment, identifies the arenas within an organization's macro-environment.
3. A company's macro-environment includes all relevant factors and influences outside a company's boundaries.
4. The factors and forces in a company's macro-environment having the biggest strategy-shaping impact almost always pertain to the company's immediate competitive environment.

Thinking Strategically about a Company's Macro- environment

- ◆ A company's macro-environment includes all *relevant factors and influences* outside its boundaries.
- ◆ It is diagnosing a company's external situation involves assessing *strategically important factors* that have a bearing on the decisions a company makes about its
 - ➔ Direction
 - ➔ Objectives
 - ➔ Strategy
 - ➔ Business model
- ◆ Requires that company managers *scan the external environment* to
 - ➔ Identify potentially important external developments
 - ➔ Assess their impact and influence
 - ➔ Adapt a company's direction and strategy as needed

Components of the External Environmental Analysis

- | | |
|--------------------|--|
| Scanning | • Identifying early signals of environmental changes and trends |
| Monitoring | • Detecting meaning through ongoing observations of environmental changes and trends |
| Forecasting | • Developing projections of anticipated outcomes based on monitored changes and trends |
| Assessing | • Determining the timing and importance of environmental changes and trends for firms' strategies and their management |

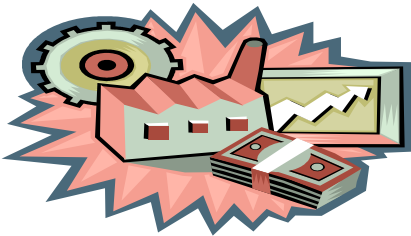
2. Need and characteristics of environment factors in context of Remote environment, industry environment and operating environment.

Remote environment	Industry Environment	Operating Environment
<ul style="list-style-type: none">• Demographic• Economic• Political/legal• Sociocultural• Technological• Global	<ul style="list-style-type: none">• Threat of new entrants• Power of suppliers• Power of buyers• Threat of product substitutes• Intensity of rivalry among competitors	<ul style="list-style-type: none">• Competitors• Creditors• Customers• Labour• Suppliers

A) Remote Environment

- General Environment shows dimensions in the broader society that influence an industry and the firms within it, (we will discuss this point in detail in our 3rd point of this session analysis of remote environment)

Economic Factors:



Economic factors concern the nature and direction of the economy in which a firm operates. On both the national and international level, managers must consider the general availability of credit, level of disposable income, the propensity of people to spend. They should also monitor prime interest rates, inflation rates, and trends in the growth of the gross national product.

Socio -cultural factors:

The social factors that affect a firm involve the beliefs, values, attitudes, opinions, and lifestyles of persons in the firm's external environment, as developed from cultural, ecological, demographic, religious, educational and ethnic conditioning. Like other forces in the remote external environment, social forces are dynamic, with

constant change resulting from the efforts of individuals to satisfy their desires and needs by controlling and adapting to environmental factors.

- One of the most profound social changes in recent years has been the entry of large number of women into the labor market.
- 2nd profound social changes have been the accelerating interest of consumers and employees in quality- of- life issues.
- Third profound social changes has been the shift in the age distribution of population.

Political factors:



Political factors define the legal and regulatory parameters within which firms must operate. Political constraints are placed on firms through

- fair trade decisions
- antitrust laws
- Tax programs
- Minimum wage legislation
- Pricing policies
- Administrative jawboning

And many other actions aimed at protecting employees, customers, the general public, and the environment.

Technological factors:

The fourth set of factors in the remote environment involves technological change. A firm must be aware of technological changes that might influence its industry. Creative technological adaptations can suggest possibilities for new products or for improvements in existing products or in manufacturing and marketing techniques.

Technological forecasting:

It is quasi-science of anticipating environmental and competitive changes and estimating their importance to an organization's operations.

Technological forecasting can help protect and improve the profitability of firms in growing industries. It alerts strategic managers to both impending challenges and promising opportunities.

Demographic factors:

It is a particular sector of populations. And it is related to the structure of the populations.

There is constant change in the make-up of the population some of this changes include an increasing proportion of elderly citizens, increasing number of two- income families, the age at which people marry is increasing, increasing ethnic diversity, These demographic changes can have a significant effect locally.

Legal factors: The legal factor plays a very essential role in determining the success of any businesses. Legal factors relate to new laws and directives governing how businesses act. This can be in relation to other industry, business, customers or the environment.

Global factors:

- Important political events
- Critical global markets
- Newly industrialized countries
- Different cultural and institutional attributes

B) Industry Environment

- Industry environment shows the set of factors which are directly influencing a firm and its competitive actions and competitive responses
 - Threat of new entrants
 - Power of suppliers
 - Power of buyers
 - Threat of product substitutes
 - Intensity of rivalry among competitor.

C) Operating Environment:

- **Competitors:** It is a business which provides similar type of product or service. Competitor may be a person or a firm in the same industry.
- **Creditors:** A creditor is a party, person or institution to whom money is owed. Creditors are the persons from where a company can receive goods on credit. A creditor may be a supplier, bank, or a company.
- **Customers:** A customer is a person or entity who buys products or avails services in the business market. Customer can be an individual or business or entity.
- **Labor:** Labor is a person whose physical and mental efforts used in creation of goods and services.
- **Suppliers:** A supplier is an entity that supplies goods and services to another organization. This entity is part of the supply chain of a business, which may provide the bulk of the value contained within its products. A supplier is usually a manufacturer or a distributor. A distributor buys goods from multiple manufacturers and sells them to its customers.

Summary:

This session presents the concepts and analytical tools for assessing a single-business company's external environment.

Students exposed to environmental scanning which involves capturing information about the firm's external environment in terms of opportunities and threats.

It is a proactive exercise to ensure that changes in the external environment- either remote or operating- do not take the firm by surprise.

The external environment consists of a set of forces that originate beyond a firm's operating situation. This comprises political, economic, social, technological and legal forces which create opportunities, threats and constraints for the firm.

students learnt about the operating environment, which has a direct impact on the operations of a firm, includes all factors which a firm faces while sourcing its inputs and while marketing and selling its outputs. The competitors, customers, suppliers, and the labor market constitute the operating (competitive) environment.