CHAPTER - 1 BUSINESS ENVIRONMENT

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Man is a social animal. Every human being needs society for their survival and growth. From society it gains almost everything it requires. These requirements can be fulfilled from natural resources created by God as air, water, sun, etc. or it can be a form of man-made resources school, hospital, temples, etc.

These man-made resources are created by the people from different sectors of the society either for their own use or is meant to exchange the same with certain other resources available with other person. This exchange of resources to satisfy mutual requirements is technically called as Business.

Business can never grow in complete isolation and need takers of its product or services and these takers are its' environment. It even gets resources to convert and bring a final product or services from the society itself and these all factors influence and get influence and called as Business Environment.

Business environment is the combination of two words- **Business and Environment**.

Business means conducting some activities to achieve some specific objective(s). It is a state of being busy. In normal sense, any sort of engagement with commercial aspect related to it is business.

Business is used as a noun also to represent a functional entity, e.g. Company, firm, etc.

Environment is anything in and around a person, place or thing. A human being is surrounded by his relatives, friends, peers and seniors. Our living environment comprises of air, water, light, etc. All these are an example of environment. Environment of Business system or business is employee, vendor, customers, competitor, etc.

Business Environment is the interaction and influence of business and the environmental factors. The combined effect transforms a given input into resultant output.

OBJECTIVES OF BUSINESS

A business always has some purpose and no doubt the most important purpose of business is achieving profitability and growth yet some other purpose also subsists:

S **Survival:** Initially, the business has the biggest challenge to enter and stay long in the market. It should have the capability to survive markets pressure. A business should be there with a vision of long term perspectives. This objective is the basic and implicit objective for almost every organisation at the day when it has started the business.

S **Stability:** Stability means continuity of business even in adverse condition. An enterprise or business should achieve stability in terms of customer satisfaction, employee satisfaction etc. This is the least resistance objective and quiet common when the environment is not favourable.

P **Profitability:** This is one of the most important and but natural objectives of business. But, to earn profit and continue the same an organisation should not work by hook or crook but should earn profit working under rules and regulations, considering and not compromising long-term effect.

G **Growth:** The growth should be in terms of profit, revenue, employee prosperity, etc. which is next most sought objectives of a business. Growth might take the form of expansion, diversification, integration, acquisition, etc.

E **Efficiency:** A long term object is successful when it is working efficiently in its' entire field. A business should always try to achieve the best in its field. Efficiency is considered in terms of productivity, energy consumption and waste reduction, balanced accounting and financial ratios, etc. Due to repeated and continuous movement in the same direction the people feel comfortable and at the same time tries to find the newer and improved means to achieve the same target quicker and thus reduces time and also find ways and means to avoid any wastes. It is an economic version of the technical objective of productivity.

ENVIRONMENTAL INFLUENCES OF BUSINESS

Business Environment

Surrounding of any living creature be it natural or man-made is known as environment e.g. friends, family, neighbors, hospitals and schools, etc. Business is also surrounded by an environment as technology, competition, supply and demand, etc. It doesn't exist in isolation. Similar to environment living creature business environment too is surrounded by many a things which are not within it's control. Like living creature business also interact with it's environment to gain certain advantage and for the same influences environment and get influenced by it. The success or failure of a business depends on how it handles the environmental factors and how better it can harness it. The environment is a vital source of not only the provider of all input but after processing and conversion for getting return the business gets potential customer and that is again an environment.

Characteristics of Business Environment

Some of the important characteristics of business environment are as follows:

C
- **Environment is <u>complex</u>**: An environment consists of many interrelated factors and understanding these factors in group are difficult tasks and hence complex. It can be easily understood in parts and taking every factors independently.

D
- **Environment is <u>dynamic</u>**: Business environment changes continuously due to changing needs of customers and effect of competitions.

E
- **Environment is multi-faceted**: Environmental developments are taken differently by different people. What is Strength or opportunity from one point of view is weakness or threat from other.

F
- **Environment has a <u>far reaching impact</u>**: The effect of environment and environmental factor is long lasting and effects several issues related to business. Because of its' impact on future for long it is required to handle these factors carefully.

Why Environment Analysis is important?

When a company does not react to environmental changes it cannot achieve its objectives in the long-run. Organization should, therefore, continuously analyze its environment and changes in it to achieve its objectives and accordingly should form a strategy to overcome any negative impact of the environment.

Environmental analysis serves the following purpose:

1. Provide the understanding of **current and potential changes in the environment;**
2. Provide **needed inputs for strategic decision making** such as data on possible demand, changes in functionality, pricing, tastes and preferences etc.;

3. **Facilitate strategic thinking** in the organization which helps to provide rich source of ideas for growth of organization.

Understanding the environmental influences:

'To move in dark is not better than walk with dim light'

Organization cannot move without planning howsoever the extent of dynamism and changeability exists and to understand it they need to create a framework to deal with such environment in the following form and ways:

1. **Understanding Environment:** Organization should take initial view on environment in terms of uncertainty, complexity, etc. This will help to analyse factors that are within control of entity and those that are not.

2. **Impact of environment on organisation**: Impact in terms of continuity, growth, profit, etc. and accordingly organisation should handle those factors in the most careful ways.

3. **Handling competition:** Competitors are also a part of environment. Competitors are that man/entity providing same or similar goods or services and compete for the same customer (group). Final step is to focus on competition factor of environment because this is the factor for which organization should have a special strategy and focus to deal with.

Problems in understanding Environmental Influences of Business:

Understanding influences of environment on business is important for strategy formulation in future and react in present and future but it is quiet critical because:

1. **Multifaceted impact:** The environment comprises many different influences; it becomes a tough job to comprehend the impact in statistic format. The manager should list down all alternative impact. But, it will not give a very clear picture as environment is most dynamic in nature.
2. **Uncertainty**: The second difficulty is uncertainty. It is an open threat to managers to counter change of technology and change of broader social aspect. The rate of global communication is faster than ever resulting prediction quiet difficult.
3. **Personal opinions:** Managers are just human beings. In reality, managers are not different from other individuals in the way they cope with complexity. They make an attempt to simplify the situation. One of the tasks· of the strategic manager is to find ways and means to break out of oversimplification or bias in the understanding of environment, while still achieving a useful and useable level of analysis.

RELATIONSHIP BETWEEN ORGANIZATION AND ENVIRONMENT

Business cannot exist without interacting with their environment. It is only environment which provide opportunities to business to grow and also provide an indication about their strength and weaknesses and at the same time if organisation doesn't respond or react and prepare well handle the situation threatens the organisation.

Organisation interacts with environment for different things which could take any of the following form:

1. **Exchange of Information**: Organization continuously, exchange information with environment which helps them in better planning and functioning of business. It takes information as product requirement (demand), pricing structure (based on competition), and at the same time passes certain information to the environment in the form of product availability, advertisement, etc.

2. **Exchange of Resources**: Organization gets the resources from environment for their functioning. It consumes material, labour, capital, etc. all belongs to society and the society gets product or services from it as organisational output.

3. **Exchange of Power and Influences**: This exists in the form of Government controls, regulations, etc. that enforce business to work in a controlled manner. Organisation gets power of monopoly that is possible only when the society puts reliance on product or services delivered by an organisation and on the same time the quality product or services society gets from those organisations.

COMPONENTS OF BUSINESS ENVIRONMENT

The environment of organization can be divided into two parts:

A. Internal Environment known as Micro Environment

B. External Environment known as Macro Environment

An external environment provides the opportunities and threats, and the internal environment need the understanding of the strengths and weaknesses for the existence, growth and profitability of any organization.

Business firms undertake SWOT (Strength, Weakness, Opportunity and Threat) analysis to understand the external and internal environment and can be effectively utilized for strategy formulation.

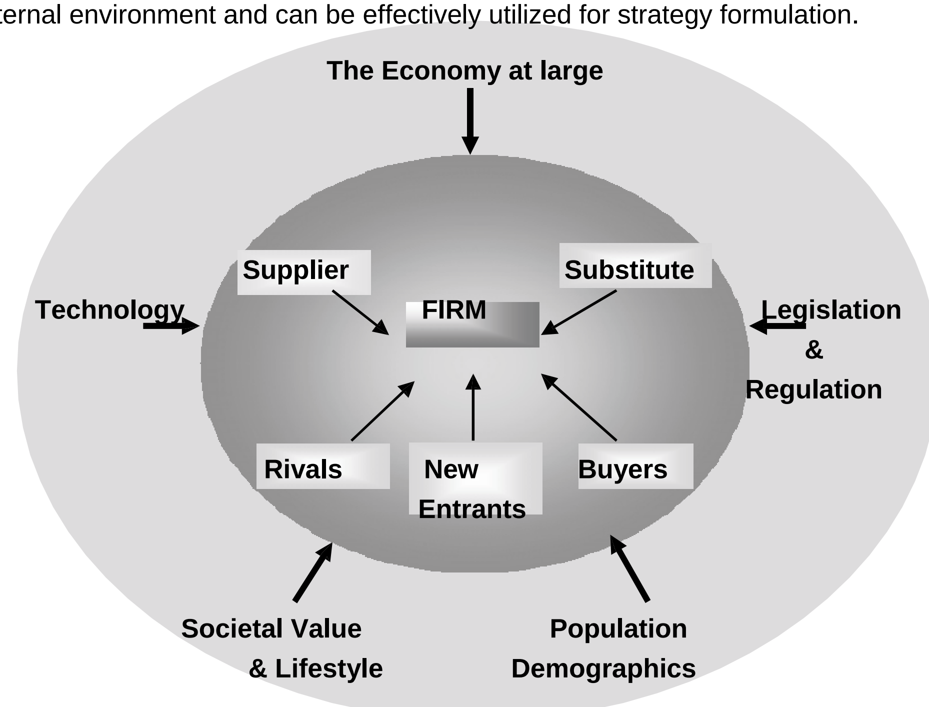

Figure: A Company's Business Environment

The Micro and Macro Environment

A. MICRO/INTERNAL ENVIRONMENT:

The immediate environment with which organization interacts for its day to day operations is known as Micro Environment. The Micro Environment components results in strengths and weaknesses of organization.

The Micro Environment being internal environment is in little control of organisation.

Elements of Micro Environment:

The elements/components of Micro Environment are:

1. **Customers/Consumers:** Customers are the most important components for organization without which no organization can survive. Customers are buyers while consumers of users. Customers buy the product of organization and pay money which help organization to achieve growth and profitability. Consumers are actual users of goods of organization and these may be different from customers. Organization should continuously monitor the use and acceptance of goods and consider feedback by consumers to sustain competition.
2. **Suppliers:** Suppliers provide the raw material for production of goods. Suppliers also form an important part of competition. Nowadays even the manpower supplier is in light and most sought avenue and services as Human resources are the most sought, sensitive and rare resources among all.
3. **Organization:** The organizations are formed with many individuals and these individual influences the workings of organization in direction with the long term goals and objectives of organizations. Organization's individuals are normally divided into Governing Body (Board of Directors), Working group (Employees) and Controlling/Owning group (Owners/Entrepreneurs).
4. **Competitors:** Competitors are other business entities who compete for same resources and market. Competition forces and provides the correct shape to business. Competition can be direct or indirect. Competition between two Accounts and Tax teachers is **direct competition** and competition between Accounts and Audit or Strategic Management is **indirect competition**.
5. **Market:** Market is an extended form of customers and consumers. Market provides a structure to organization and an opportunity to their growth. The important elements of market are: Cost structure, Price sensitivity, Distribution system, Technological structure, Market stability.
6. **Intermediaries:** The intermediaries such as distributors, dealers and retailers play an important role in establishing distribution system of goods and services to end users or consumers of goods.

B. MACRO/EXTERNAL ENVIRONMENT

The Macro Environment covers the broader areas or issues with which organization deals for its long terms working and plays an important role in strategic planning of organization growth. It provides opportunities and threats which may results in either growth or decay of organization.

Elements of Macro Environment:

Macro Environment components are treated as broad components and these components are environments in themselves.

Followings are some important components of Macro Environment:

1. Economic Environment:

Economic environment in itself is a very broad component. It covers the region and nation in which firm operates. It broadly describes the conditions of money market, manpower markets, buying power of consumers, supply and demand for goods, etc. It represents the size of market, income distributions, taste and preferences of consumers etc. There are many economic indicators or factors to be considered for strategic planning such as;

(a) GDP size and growth rate

(b) Unemployment, Interest, Taxation and Inflation Rates

(c) Liquidity position and Monetary and Fiscal policies (SLR, CRR, etc)

(d) Income Distribution

(e) Consumption pattern and regional disparity

(f) Foreign exchange reserve, rates and policies

(g) Stock market conditions, etc.

2. Demographic Environment:

Demography means characteristics of population. It includes factors such as race, age, income, education level, employment status and location. Businesses often analyze the demographic data and trend to understand what factors determines Opportunities and Threats and what determines/creates Market Size of industry, e.g. most of the software companies like to open their centers in Bangalore, Pune and other metropolitan cities because the demographic environment of these cities best suits their skilled manpower requirements. These cities provide opportunities as manpower at appropriate cost but also present threats in the form high turnover of manpower.

Different types of companies have different types of demographic interest. Normally companies look for following important factors in demographic environment:

a) Population Size

b) Income Distribution

c) Education level

d) Ethnic Mix

e) Geographic profile in terms of urban and rural distribution

3. Global Environment

Globalization refers to integration of world into one huge market as organization can't think to be performing at regional or national level. The globalization is also a part of organization planning and growth. The global organizations are known as MNC (Multi National Corporation) or TNC (Trans National Corporation), e.g. Unilever, Nestle, Nokia and Microsoft, etc. These organization setup manufacturing facilities at one place, R&D centers at other place and raise the capital and other resources at third place wherever from these can be raised in cheapest mode.

At organization level 'Globalization' means three things:

- It is an organization of multiple units linked with common ownership.
- Multiple units draw on common pool of resources (money, information, patents, brand name and credit, etc.).
- Units respond to common strategy.

Reasons of globalisation/Why do companies go global?

There are many reasons for companies to go global, such as;

- The shrinking time, distance and low cost communication.
- Domestic markets are no longer adequate.
- Companies dependent upon some or other natural resources e.g. mines and mineral resources, petroleum, etc. look for to new resources overseas.
- International demand for the product forces companies to setup the facilities in the other part of world.
- Cheap labour and Government incentives.
- Consolidation of business and resources to achieve economy of scale
- Environmental restrictions also forces organizations to go global.

Benefits of Globalisation: There are many effects of globalization such as

- **Global Location of Different Operations:** Companies can locate their operation anywhere in the world depending upon the economy of operation, availability of raw material and low cost labour, etc.
- **Infrastructure Development:** Globalization has helped in providing better infrastructure in the form of better roads, ports, airport and telecom network, etc
- **Improvised Entrepreneurship:** Globalization has given great opportunities to professionals by way of entrepreneurship to setup their own enterprise by way of providing cheap capital.

4. Technological Environment:

Technology and business are inter-related and inter-dependent. Technological innovations or advancement pave the way for business innovations and advancement. Use of technologies influences style of business operations which leads to many opportunities for business and also makes many existing operation obsolete. Therefore, it is very important for business to analyze the impact of technology environment carefully on business functioning for both short term and long term planning.

Followings are some of the factors that business should consider for technologies impact on business:

- **Impact of technology on business operation**, e.g. telecom, banks, software, etc. technology dependent organisations. These organizations should make use of latest technology as an integral part of their business operation.

- **Opportunities arising out of technological innovations or advancement**
- **Risks and uncertainties from technological changes**

Issues for consideration in selection of technology

- Type of technologies used by business
- Technologies are developed in-house or procured externally.
- If procured externally will these be always available or there is a risks of discontinuity
- Technologies used are latest and ahead of used by competitors
- Technologies which are must and which require to be curtailed, etc

5. Legal- Political Environment:

There are three important elements organization should analyze to understand the legal political impact:
The Government, **The Laws and Regulations, and** **The Political environment**.

The government has great influences on businesses. It guides the business environment in country. No business can isolate itself from legal-political system of country.

Business should analyze the followings for impact of legal-political system;

- General state of political development
- Degree of political impact on business and economic activity.
- Political stability
- Law and order situation
- Legal framework of country and implications of various laws under which business need to functions
- Effectiveness of implemented laws
- Government policies such as labour, fiscal, EXIM, FDI (foreign investment) and industrial development

6. Social- Cultural Environment:

Organizations are an entity only still it responses to environment similar to human entity and this response can be in three forms:

(a) **Conservative/Slow-moving:** Such enterprises are passive in their operation and these enterprise react only when external environment force them to do so e.g. Nationalised banks, PSU, etc. These entity moves slowly to change themselves in response to environment.

(b) **Cautious/Adaptive:** These organizations take intelligent approach to response to environment. These organizations adapt themselves to changing environment quickly but take a cautious approach before taking actions, e.g. TATA.

(c) **Confident/Aggressive:** These organizations work aggressively and some time converts threats into opportunities. These are highly dynamics organizations and known as **trend setter** or **mover and shaker** of market. Their feedback system is highly dynamic, e.g. Reliance.

ENVIRONMENTAL SCANNING/ MONITORING

The process of **Gathering information** regarding company's environment, **Analyzing** it and **Forecasting** the **impact** of all predictable environmental changes is called Environmental Scanning.

COMPETITIVE ENVIRONMENT:

Competition is the major threat of losing market and thus become obsolete and accordingly dealing it is the most vital for strategic management. While preparing strategic plans, organizations should seriously consider the competitors strategies, products, cost and profits level, etc.

Organization should consider followings major points to deal with competitions:

1. Who are the competitors?
2. What are their products and services?
3. What are their market shares?
4. What are their major strength: financial positions, regional dominance, resource advantage, market advantage?
5. What are their potential strategies?

Effect of Competitions:

Competition is good for both consumers and organizations and also for economy. It helps to bring the true economic value of any product and service to consumer and forces organization to invent cost effective and high quality products. Sometimes too much competition is bad for organization and economy as whole.

Cooperation in Competitive Environment: Businesses cooperate with each other to maximize the profit out of their products or cutting the cost to minimum.

There are three types of cooperation in competition:

1) Cartelization:

Enterprises sometimes form a group or cartel to create the market conditions to suits their interest. This type of cooperation provides a situation of oligopoly but indirectly it is a monopoly kind of situation, e.g. OPEC try to create the price and supply scenario of oil to protect their interest. Cartel in reference to the stock market implies set of brokers grouping together to manipulate the price of any particular stock.

Cartelization is not good for development of industry, consumers and country as whole because it does not provide true economic value of products.

2) Kieretsus:

Cooperative network of business is known as Kieretsus (a Japanese term). This is cooperation in business to extract the maximum benefits of already existing setup. The cooperation between two entity in completely diverse operation is one such example as Black Berry and Airtel, Mother Dairy and BSNL even cooperation of similar business enterprise also take the form e.g. Tata Motors selling Fiat cars through its dealer and distributors network.

Kieretsus is different from **conglomerate** as in Kieretsus every member is an independent company but conglomerates means same owner own the majority of capital in different companies. Members remain independent, the only strategy they have in common is to prefer to do business with other members, both when buying and when selling.

3) Internal Co-operation (Family Owned co-operation):

Cooperation in business owned by same family is normally an automatic process. Decisions are made by family members who manage the enterprise. The interests of the family largely influence the managerial decisions and activities of the enterprise. Quarrels and conflicts among the managing members of the family on family matters tend to distort their behavior in managing the enterprise also and thereby damage its functioning.

PORTER'S FIVE FORCES MODEL: COMPETITIVE ANALYSIS:

To sustain in the market in the long run the competition analysis is very important aspect. To help in focusing on competitive analysis a powerful and widely used tool is known as Porter's Five Forces Model.

Followings are the five areas of forces of competition analysis:

1. **Bargaining power of buyers** by Formation of Cartels or Groups to influences prices, costs
2. **Bargaining Power of Suppliers:** Number of supplier and their bargaining power is inversely related
3. **Rivalry among current players:** Competitor influences product quality, price, costs, etc.
4. **Threats from substitutes:** Limits the prices and profits and is advantageous for customers
5. **Threats of New Entrants:** Threats can be due to new product range, size of entrant and pricings

The above analysis is performed in three steps

Step 1: Identify competitive pressure associated with above forces

Step 2: Determine how strong is the pressure?

Step 3: Determine whether the collective strength of five forces may help to earn attractive profits.

For your practice

Correct/incorrect with stating reasons 2 marks each

(i) The basic objective of a business enterprise is to monitor the environment.
(ii) The first step of strategy formulation in strategic management model is to undertake internal analysis.
(iii) Environmental constituents exist in isolation and do not interact with each other.
(iv) "Profit may not be a universal objective but business efficiency is definitely an objective common to all business."
(v) The rate and magnitude of changes that can affect organisation are decreasing dramatically.
(vi) A business, even if it continually remains passive to the relevant changes in the environment, would still grow and flourish.
(vii) Globalisation means different things to different people.

Short answer Questions

1. What is a kieretsus?
2. What is demographic environment of business?
3. Write a short note on micro environment.

Descriptive Questions

(1) Discuss strategic alternatives with reference to Michael Porter's strategies.
(2) Do you advocate that organizations should concern themselves with the elements of its outside world? Why?
(3) Discuss the relations between organizations and their external environment? How organizations strategically respond to their environment?
(4) What do you mean by micro and macro environment?
(5) Briefly discuss various elements of macro environment.
(6) What is competitive environment? Discuss the five forces driving industry competition as given by Porter.

Case Study

Information technology (IT) exports from the Software Technology Park in Sohanpur in Uttar Pradesh has increased from Rs 1005 crore to Rs 1455 crore in the last five years. To further this growth and discuss the common issues various IT professionals of different companies assembled for a meeting. Their agenda included discussion on the issues relevant for the development of the technology park and available opportunities in IT industry for companies planning to set up IT and processing businesses in Sohanpur.

It was felt by a few persons that the absence of an airport and availability of uninterrupted round the clock power supply were major hurdles towards the development of the park. The nearest airport is 600 km away in New Delhi.

One of the participant highlighted the importance of world-class telecommunication facilities in the area. He felt that the telecommunications technology in the region is primitive and is not able to meet the present needs of the region. He also spoke at length about the problems of frequent job changes by present youth. He highlighted that a major problem is lack of patience in the young generation of IT professionals. He said retention was a major problem in Sohanpur as professional also preferred bigger cities. He suggested that the IT businesses should get together to create a conducive working climate for retention as well as growth.

Read the above case and answer the following questions:

(1) List out different environmental factors for a new entrepreneur who wants to start a new IT project in the Technology park. Segregate them as positive and negative.

(2) What is importance of an Airport in the city? Discuss.

(3) Suggest how manpower issues can be dealt by the businesses in the park.