

CHAPTER 2	BUSINESS ENVIROMENT
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MEANING OF BUSINESS ENVIRONMENT

Definition of Business Environment	Environmental Influences on Business
General Definition:- Business environment represents all the forces (whether Internal or External), factors or conditions that exert some degree of impact on the business decisions, strategies and actions taken by the firm. Gluek and Jauch:- "Business Environment includes factors outside the Firm which can lead to opportunities for, or threats to the Firm. Although, there are many factors, the most important of the factors are socio-economic, Technological, Suppliers, Competitors, and Government".	- Each business organization operates in its unique environment. Environment influence businesses and also gets influenced by it. - To be successful, a business has to identify, appraise, and respond to the various opportunities and threats in its environment. - To survive, grow and prosper, the business must continuously monitor and adapt to the environment.

CHARACTERISTICS OF BUSINESS ENVIRONMENT

1. The Environment is Complex - An environment consists of many interrelated factors, events and understanding these factors are difficult tasks. - It is somewhat easier to understand environment in parts but difficult to understand in totality.	2 . The Environment is Dynamic - Business environment changes continuously due to changing needs of customers and competitions - E.g. The film industry generates revenue from ring tones / caller tunes rather than sale of music CD
3. The Environment is Multi-faceted in nature - Environment developments are taken differently by different people the same development is welcomed as an opportunity by one company while other company perceives it as a threat.	4. The Environment has a far-reaching impact - The growth and profitability of a Firm depends critically on the environment - Any environmental change has an impact on the organization in several different ways.

IMPORTANCE OF BUSINESS ENVIRONMENT

1. Determining Opportunities and Threats	Environment brings out opportunities for and threats to the business.
2. Giving Direction for Growth	It enables the business to identify the areas for growth and expansion of their activities.
3. Continuous Learning	It motivates the managers to continuously update their knowledge, understanding and skills to meet the predicted changes in the area of business.
4. Image Building	Environmental understanding helps the business organizations in improving their image by showing their sensitivity to the environment in which they operate. <i>For example, in view of the shortage of power, many companies have set up Captive Power Plants (CPPs) in their factories to meet their own requirement of power.</i>
5. Meeting Competition	It helps the firms to analyze the competitors' strategies and formulate their own strategies accordingly.

EXCHANGES BETWEEN THE ORGANISATION AND ITS ENVIRONMENT

1. Exchange of Information;

Inflow	- The organization analyses variables in the external environment and generates important information, for planning, decision-making and control purposes. - Information may relate to economic activity, market conditions, technological developments, social and demographic factors, political-governmental policies, the activities of other organizations, etc.
Outflow	The organization itself transmits information to several external agencies either voluntarily, inadvertently or legally

2. Exchange of Resources:

Inflow	The organization receives inputs like men, money, materials, methods, machinery from the external environment.
Outflow	The organization supplies necessary the goods and services to the external environment by satisfying the expectations and demands of the Stakeholders.

3. Exchange of Influence and Power:

Inflow	Environment (Government, Competitor, Consumers, Suppliers, investors etc.) holds considerable power over the planning and decision-making process of the organization by virtue of its command over resources, information and other inputs.
Outflow	In some aspects, business can influence the environment in their favour. e.g. the resources which are consumed by an organization should be utilized gainfully.

ORGANISATION'S RESPONSE TO ITS ENVIRONMENT

1. Administrative Responses - Most Common - Formation or Clarification of Org's mission, policies, budgets, creation of scanning units - Proactive or reactive	2 . Competitive Response - Responses associated with for profit Firms + NPO - For Competitive Advantage, Entities must perform internally in ways that are unique, valuable, and difficult to imitate.	3 . Collective Response - Coordination with other Entities - Include methods like bargaining, contracting, co-opting, and creating Partnerships, LLPs, Joint Ventures, Federations, Strategic Alliances, and Consortia.
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FRAMEWORK TO UNDERSTAND THE ENVIRONMENTAL INFLUENCES

Here framework means the steps required to understand the environmental

1. First organization should take initial view on environment in terms of; how uncertain it is? how complex it is?	2. Second audit the impact of these environment factors such as demand and supply etc on organization, in terms of continuity, growth and profit, etc and accordingly should deal with factors first which may impact maximum the organization	3. 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.
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ENVIRONMENTAL ANALYSIS

1. Why Environmental Analysis? - When the company does not react to environment	2. Utility of Environmental Analysis Environmental analysis help strategists get time -	3. Three Basic Goal of Environmental Analysis 1. To provide an understanding of current and potential changes
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changes, the result is declining performance of the company in the market	- to anticipate opportunities and - to plan to take optimum responses to these opportunities. - to develop an early warning system to prevent threats - to develop strategies which can turn a threat to the firm's advantage.	taking place in the environment. 2. To provide inputs for strategic decision making. 3. To Facilitate strategic thinking, i.e. a rich source of ideas and understanding of the context within which a Firm operates for growth of firm.
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ENVIRONMENTAL SCANNING OR MONITORING

1. Meaning of Environmental Scanning - It is the process of gathering information regarding company's environment, analyzing it and forecasting the impact of all predictable environmental changes.	2. Need / Importance of Environmental Scanning - to determine development and forecasts of factors that will influence organizational success. - helps the Firm to decide its future path, by identifying the threats and opportunities existing in the environment	3. Factors to be considered: -Events are specific occurrences taking place in different environmental sectors. (e.g. amendment in taxation law, opening of FDI in specified sectors) -Trends are grouping of similar or related events that usually suggest a pattern of change (increasing or decreasing) in a particular area. (For example, changes in the consumer behavior, technology, etc.) -Issues are the current concerns or problems that arise in response to events and trends. -Expectations are the demands made by interested groups in the light of their concern for issues.
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COMPONENTS OF BUSINESS ENVIRONMENT

Internal Environment	External Environment
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Internal Environment is the environment that has a direct impact on the business and is within the control of the Entity / Management / Entrepreneurs. These are internal management, machinery, methods of production, behaviour of employees etc.	External Environmental Factors are largely beyond the control of individual Enterprise, and are dynamic, i.e. they keep on changing. These may be further sub-classified into – (i) Micro Environment (ii) Macro Environment
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SWOT ANALYSIS

The relationship between SWOT and Environment is as under -

- (a) **External Environment** provides the Opportunities and Threats for a Firm, and
- (b) **Internal Environment** contains the Strengths and Weaknesses to handle the External Environment.

Item	Description	Example
1. Strength	Strength is an inherent capacity which a Firm can use to gain strategic advantage over its competitors. '	Superior R&D skills which can be used for new product development so that the Company gains competitive advantage, Huge production infrastructure leading to mass production & economies of scale.
2. Weakness	Weakness is an inherent limitation or constraint which creates a strategic disadvantage.	Over dependence on a single product line or single Customer or Supplier which is potentially risky for a Firm in times of crisis.
3. Opportunity	Opportunity is a favourable condition in the Firm's environment which enables it to consolidate and strengthen its position.	Increase in consumer income, and growing demand for the products or services that a Company provides.
4. Threat	Threat is an unfavourable condition in the Firm's environment which creates a risk for, or causes damage to, the Firm.	Emergence of strong new competitors who are likely to offer stiff competition to the existing Companies.

Note: Business Firms strive to manage as under -

	Strengths	Weaknesses
Opportunities	Capitalise on the Opportunities using	Minimise the effect of opportunities lost

	the Strengths available.	due to weaknesses.
Threats	Neutralise the Threats, using the Strengths and Capabilities.	Take adequate protective action to avoid the extreme of effects of threats and weaknesses.

MICRO AND MACRO ENVIRONMENT

Micro Environment	Macro Environment
Micro Environment is related to small area or immediate periphery of an organization and include the factors which regularly and directly affect the day to day functioning of the organisation.	Macro Environment is that part of external environment which is largely external to the enterprise and thus beyond the direct influence and control of the organisation, but which exerts powerful influence over its functioning.

ELEMENT OF MICRO ENVIRONMENT (Note: Memory Rule = COSMIC)

1. Competitors:

- (a) Competitors refer to the other business *entities that compete for resources as well as markets*.
- (b) Competition may be direct or indirect.
 - Direct Competition is between Firms, which are in same business activity.
 - Indirect Competition is between Firms in different areas of activity, For example, a Big restaurant, faces indirect competition from small Dhabas and Dominos, KFC who sale ready food.
- (c) The major aspects to be considered for analysing competitions are –

• Number of Competitors. • Nature of products/ product versions.	• Long-term objectives of competition. • Present strategies adopted.
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2. Organization Itself:

(a) The objectives, goals, strengths and resource availabilities of a Firm occupy a critical position in the microenvironment. So, internal analysis or self-analysis is an important aspect of micro environment analysis.

(b) The following organisations or groups affect the organisation's environment -

- **Owners:** Individuals, Shareholders, Groups, or Organizations, who have a major stake in the organization, have a vested interest in the well-being of the Company.
- **Governing Body:** Board of Directors or Governing Body is charged with overseeing the general management of the organization, to ensure that it is being run in a way that best serves the Shareholders' interests.
- **Employees:** Employees are a major force who actually execute and perform work in the Firm. There should be synchronization between the values and goals of the employees with that of the Firm, irrespective of the difference in beliefs, education, attitudes, and capabilities.

3. Suppliers:

(a) Suppliers provide inputs like Raw Materials, Components, Equipments, Services, etc.

(b) Firms have to take decisions on "make or buy", i.e. own production vs. outsourcing, depending on the Supplier Environment.

(c) Aspects of Supplier Environment that have an impact on the business are –

• Availability of Materials & Services. • Extent of competition/ availability of more Suppliers, • Cost structure of materials & services	• Quality. • Bargaining Power. • Timeliness of Supply.
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4. **Market:** Market is a wider term than customers. The Manager should study the trends and development and the key success factors of the market in which the business is operating. Important issues relating to the market are –

(a) Actual and Potential Size, (b) Growth prospects and attractiveness, (c) Cost Structure of the market, (d) Price Sensitivity of the market,	(e) Technological Structure of the market, (f) Existing distribution system of the market, (g) Maturity Level of the market, (h) Possibility of Market Segmentation & Differentiation.
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5. Intermediaries:

(a) Intermediaries in the marketing channel, i.e. Wholesalers, Retailers and Dealers, establish an important link between the organisation and its customers.

(b) Aspects of this environment that have an impact on the business are -

- Availability of intermediaries,
- Cost-push effect of intermediaries,
- Effect of direct dealings with customers on the business operations.

E.g. Countrywide retail distribution network has contributed significantly to the success of companies like Hindustan Unilever and Dabur India.

6. Consumers/Customers:

(a) Consumer is the one who ultimately consumes or uses the product or service produced by an enterprise. A Consumer occupies the central position in the marketing environment.

(b) Aspects to be considered in respect of Consumers are -

- Potential Consumers/ Customer Groups, (For example, the customers of a paper company may include students, teachers, educational institutions, business firms and other users of stationery.)
- Benefits & Utilities that Consumers/ Customers expect,
- Buying patterns of Consumers,
- Changes in consumer tastes, preferences and expectations.

ELEMENTS OF MACRO ENVIRONMENT (Note: Memory Rule= SPELT-G)

1. Socio-Cultural Environment

Social environment refers to the characteristics of the society in which a business firm exists. Social and cultural environment consists of the following:

- (i) Social institutions and groups on **social concern**.
- (ii) Caste structure and **family organisation**.
- (iii) **Educational system** and literacy rates.
- (iv) Customs, **attitudes**, beliefs, **values** and life styles.
- (v) Tastes, preferences of people, and their buying behaviour.
- (vi) Religions, etc.
- (vii) Role of women in society, position of children and adolescents (teenagers) in family and society,

Family, marriage, education, religion, attitudes to work and wealth and ethics are some examples of socio-cultural factors.

Example:- The sale pattern in different parts of our country is different. For example, Diwali has a big impact in north, west and central India whereas in eastern India, major sales time is Durga pooja and in south the regional festivals dominate the maximum sales.

2. Demographic Environment

- Demographic environment means various dimensions of country's population. The demographic environment is important to business because people constitute the market for a business.
- Business firms often use demographic factors (e.g., age, sex, family size, occupation, family life cycle, education, social class, income distribution) in order to ascertain - (a) Possible effect on market size, and (b) Effect of demographic trends, e.g. young vs. ageing population, educational levels, etc.
- **The demographic factors which have very significant implications for business are as follows:**
 - (a) **Population Size:** A company has to detect the following changes in a population's size which are-
 - Changes in a nation's **birth rate** or **family size**.
 - Increases or declines in the total population.
 - Effects of rapid population growth on natural resources or food supplies.
 - (b) **Geographic Distribution:** Population shifts from one region of a nation to another or from non-metropolitan to metropolitan areas may have an impact on a Company's strategic competitiveness. Issues to be analysed include -
 - Government support or tax benefits leading to attractiveness of a **Company's location**.
 - Need for **relocation**, if population shifts have a significant impact on the availability of a qualified workforce.
 - Concepts of working-at-home and commuting electronically on the **information technology or internet** have also started in India in a very small level. These may imply changes in recruiting and managing the workforce.
 - (c) **Ethnic Mix:** It refers to the **cultural composition** of population. Issues to be analysed include -
 - Need for changes in service design and delivery.
 - Need for new products and services and modification of existing products/ services.
 - Managers' preparedness to manage a more culturally diverse workforce.
 - Taking advantage of increased workforce heterogeneity.

Example:- Shampoo companies sell their product in bottles in residential area/ malls while the same product is sold in sachets in hostel/ rural areas. This is done because in hostels or rural areas the pocket money/disposable income is less as compared to residential areas where people prefer buying in large quantity.

- (d) **Income Distribution:** Changes in income distribution affects the individual's or group's purchasing power & influences consumption and savings patterns. Its analysis may help in identifying new opportunities for companies.

3 Economic Environment

- Economic factors have a major impact on how businesses operate and make decisions. For example, interest rates affect a firm's cost of capital and hence the extent a business can grow. Exchange rates affect the cost of exporting goods and the price of importing goods.
- An analysis of the nature and direction of the economy in which a company competes is crucial.

Factors that have an impact the External Environment include the following -

Aspect	Description
Economic Systems	(a) Capitalism: A Capitalist Economy is an economy where the laws of demand and supply operate freely. This economy is characterized by private ownership of the means of production, individual decision-making, and the use of market mechanisms to carry out the decision of individual participants and facilitate the flow of goods and services in market. (b) Socialism: Socialism is generally understood as an economic system where the means of production are either owned or controlled by the state and where the resources allocation, investment pattern, consumption, income distribution, etc. are directed and regulated by the state. (c) Mixed economy: Mixed economy is the outcome of compromise between two diametrically opposing schools of thought. In a mixed economy, private, public and joint sectors and the like all have some say in the major decisions that influence the functioning of the economy. These are followed by the four important economic roles played by the government in a mixed economy viz. regularity role, promotional role, entrepreneurial role and planning role.
Economic Policies	All business activities and operations are directly influenced by the Economic Policies framed by the Government from time to time. These economic policies include - (a) Industrial Policy: This covers all Principles, Policies, Rules, Regulations and Procedures, which direct and control the Industrial Enterprises and shape the pattern of industrial development. (b) Fiscal Policy: This covers Government Policy in respect of Public Expenditure, Taxation (both Direct and Indirect) and Public Debt. (c) Monetary Policy: This includes all those activities and interventions that aim at smooth supply of credit to the business and a boost to trade and industry.

	(d) Foreign Investment Policy: This policy aims at regulating the inflow of Foreign Investment in various sectors for speeding up industrial development, and related objectives. (e) Export-Import Policy (Exim Policy): This policy aims at increasing exports and bridge the gap between Exports and Imports. Government announces various duties/levies, and also procedural aspects relating to removing trade barriers and controls, lowering duties to facilitate trade, etc.																		
Key Economic Indicators	There are many economic indicators or factors to be considered such as; <table border="1"> <tr> <td>GDP size and growth rate</td><td>The Higher the better</td></tr> <tr> <td>Exchange Rate</td><td>The stronger the better</td></tr> <tr> <td>Stock Market</td><td>The More Stable is better</td></tr> <tr> <td>Employment</td><td>Fuller the better</td></tr> <tr> <td>Disposable Income</td><td>Higher the better</td></tr> <tr> <td>Consumption & Demand Trends</td><td>Higher the better</td></tr> <tr> <td>Inflation Rates</td><td>Lower the better</td></tr> <tr> <td>Interest Rates</td><td>Lower the better</td></tr> <tr> <td>Budget deficit</td><td>Lower the better</td></tr> </table>	GDP size and growth rate	The Higher the better	Exchange Rate	The stronger the better	Stock Market	The More Stable is better	Employment	Fuller the better	Disposable Income	Higher the better	Consumption & Demand Trends	Higher the better	Inflation Rates	Lower the better	Interest Rates	Lower the better	Budget deficit	Lower the better
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4. Legal - Political Environment

The important **elements** of Legal - Political environment are -

Government	Business Enterprises are guided and controlled by Government policies. For Example: The Indian government is promoting manufacturing sector through campaigns like Make in India. (a) Every Firm has to consider the changes in the regulatory and legal framework and their impact on the business. (b) Taxes and duties that may be levied have an impact on business, For Example: New GST law will influence most of the businesses.
Legal	(a) Business Firms must understand the principles & procedures in the laws relating to Companies, Competition, Intellectual Property, Foreign Exchange, Labour, etc. (b) Businesses must comply with the various procedures and regulations specified under various laws.
Political	(a) Political pressure groups influence and limit organizations. (b) Political influences can be seen in - (i) movements and agitations against certain

	products, service and organizations, (ii) Employee unions, etc. (c) Special interest groups and political action committees put pressure on business Firms, to pay more attention to consumer's rights, minority rights, and women rights. <i>Example: - Recent closure of Nano car plant by TATA MOTORS is an example of this political pressure.</i>
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Factors: Legal - Political environment includes factors like -

1. General state of political development,
2. Degree of politicalization of business and economic issues, Nano car plant of TATA MOTORS in West Bengal is an example of this category
3. Political stability,
4. Political ideology and practices of the ruling party,
5. Law and Order situation,
6. Public attitude towards business,
7. Specific legal enactments and framework in which the enterprise has to function,
8. Degree of effectiveness with which laws are implemented,
9. Government policies (fiscal, monetary, industrial, labour and export-import policies),
10. Extent and nature of governmental intervention in the economy and the industry,

5. Technological Environment

- Technology and business are highly inter-related and inter-dependent, technological inventions 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 any existing operation obsolete. **For Example there are some business which 'we completely dependent on latest technology, such as telecom, banks, etc.**
- Factors to be considered in the Technological Environment are -
 - (a) Pull effect of technological change,
 - (b) Opportunities arising out of technological inventions,
 - (c) Risk and uncertainty of technological development,
 - (d) Role of R&D in a country and Government's R&D budget,
 - (e) Technologies used by the Company (Manufacturing and Information Technologies),
 - (f) Role of technology i.e. its Criticality,

- (g) Sources of Technology (Internal or External),
- (h) Investment in Technology,
- (i) Areas of utilization of Technology and Requirement of additional technology.

6. Global Environment

- Globalization refers to the process of integration of the world into one huge market. This unification leads to removal of all trade barriers among countries.
- At the organizational level, Globalization has two effects - (a) the Company commits itself heavily with several manufacturing locations around the world and offers products in several diversified industries, and (b) it has the ability to compete in domestic markets with foreign competitors.
- Factors of Global Environmental that should be assessed include -
 - (a) Potential positive and negative impact of significant international events such as sport meet or a terrorist attack.
 - (b) Identification of changing and emerging global markets such as china, south korea even in India also.
 - (c) Differences between cultural and institutional attributes of individual global markets i.e. Cultural factors in different countries.

PESTLE ANALYSIS

1. **Meaning:** Macro Environment analysis is also sometimes described as **PESTLE Analysis**, representing identification of **Political, Economic, Socio-Cultural, Technological, Legal** and **Environmental** influences on an organization.
2. **Scope:** PESTLE Analysis involves the framework for analysis of the above macro-environmental factors, and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy.
3. **Merits:** PESTLE Analysis - (a) is simple to understand, (b) is quick to implement, (c) encourages management into pro-active and structured thinking in its decision making, (d) involves a comprehensive study of the environment.
4. **Key Factors in PESTLE:**

The PESTLE includes analysis of the following key factors for strategic decision making:

Political	Economic
• Political Stability	• Economic situation and trends

• Political Principles and Ideologies • Current and future Taxation Policy • Regulatory Bodies and Processes • Government Policies • Government Term and Change • Thrust areas of Political Leaders.	• Market and Trade Cycles • Specific Industry Factors • Customer/End-User Drivers • Interest and Exchange Rates • Inflation and Unemployment • Strength of Consumer Spending
Social	Technological
• Lifestyle trends • Demographics • Consumer Attitudes and Opinions • Brand, Company, Technology Image • Consumer-buying patterns • Ethnic/Religious Factors • Media Views and Perceptions	• Maturity of Technology • Replacement Solutions • Manufacturing Maturity and Capacity • Innovation Potential • Technology Access, Licensing, Patents • Intellectual Property Rights and Copyrights
Legal	Environment
• Business and Corporate Law • Employment Law • Competition Law • Health & Safety Law • International Treaty and Law • Regional Legislation	• Ecological/Environmental Issues • Environmental Hazards • Environmental Legislation • Energy Consumption • Waste Disposal

if any company wants to start business in a new country then above analysis play very important roles. . For example, in the US/developed nations there are strong legal, environmental and technological laws/rules for the companies to comply strictly else there are huge penalties.

STRATEGIC RESPONSES TO THE ENVIRONMENT

Response to the environment depends on the nature of the business. Some of the strategic responses to the environment are -

1. **Conservative Approach, i.e. Least resistance:**

What's hurry?

- (a) Some simple goal-maintaining units / Firms manage to survive by way of coping with their changing external environments.
- (b) Such enterprise are **passive in their operation** and these enterprise react only when external environment force them to do so. Also known as slow moving organization.

Example:- We all know government banks and organization are normally considered as conservative organizations and moves slowly to change themselves in response to environment

2. Cautious Approach, i.e. Proceed with caution:**Let's Adapt.**

- (a) These organizations **take intelligent approach** to response to environment.
- (b) They seek to **monitor the changes in environment**, analyze their impact on their own goals and activities and translate their assessment in terms of specific strategies for survival, stability and strength.
- (c) These are also known as adaptive organizations and adapt themselves to changing environment **quickly but takes a cautious approach** before taking actions.

Example:- We can say TATA companies may fall under this category

3. Confident Approach, i.e. Dynamic response:**Take it head-on.**

- (a) Some firms treat external environmental forces as partially manageable and controllable by their actions
- (b) Such a response is proactive in nature and aims at **converting threat into opportunities**
- (c) These Firms are **highly conscious and confident of their own strengths and the weaknesses** of their external environmental adversaries.

Example:- Dhirubhai Ambani, the founder of Reliance Industries could successfully mould several external environmental factors in his favour.