

Elements of Business Environment

*Business enterprise operates in an **open system** and has a continuous interaction with environmental forces like customers, suppliers, competitors, government policy, etc. They should adjust themselves with the changing needs of the business environment.*

Business Environment

Business environment is a combination of the words business-environment. Business includes all activities connected with production, trade, banking, insurance, finance, energy, advertising, packaging and numerous other related activities.

Environment refers to all external forces, which have a bearing on the functioning of business. The 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 these factors are socio-economic, technological, supplier, competitors and government.

Business is a very complex process. It does not operate in a vacuum. Environment is the macro setup within which the business firm operates. The term 'business environment' denotes the total surrounding, having various opportunities and constraints for business and have direct or indirect bearing on its functioning or in other words it can be stated that it refers to the aggregate of all forces and institutions which are external to business and beyond the control of management.

Definitions of Business Environment

According to **Bayard O Wheeler**, business environment refers to "The total of all things external to firms and industries, which affect their organisation and operation".

Keith Davis, defines business environment in his famous book "**The challenges of Business**" as "Business environment is the aggregate of all conditions, events and influences that surround and affect it."

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

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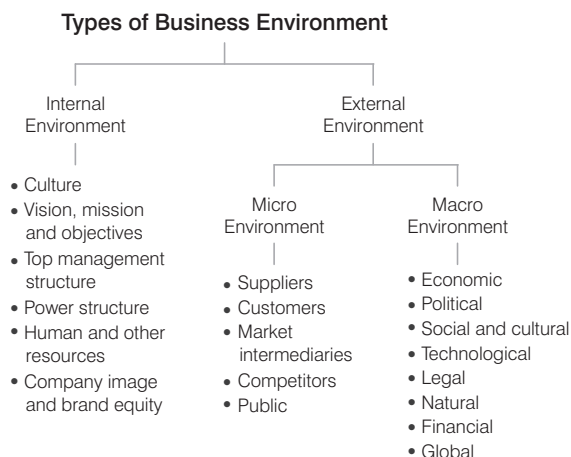
Thus, business environment encompasses all those factors (internal and external) that affect a company's operations and include strengths, weaknesses, internal power relationships, orientations of the organisation, nature of economy and economic conditions, social cultural factors, demographic trends, natural factors, global trends and cross-border development, clients and suppliers, technological developments, laws and government activities.

Types of Business Environment

Business environment is broadly categorised into two categories

Internal Environment

Internal environment refers to the factors internal to the firm *i.e.*, factors existing within a business firm. These factors are generally controllable because the company has control over them and determine the potential of a company to meet the environment challenges.



Important Internal Factors

The important internal factors are as follows

Culture It is widely acknowledged fact that any business organisation is normally undertaken for profit maximisation. Nonetheless, persons holding top positions in certain modern corporate enterprises have some values which influence their policies, norms, working language, systems, symbols practices and overall internal environment. This may be refer as culture of the organisation which is the collective behaviour of humans that are part of an organisation. The extent to which the culture of the organisation is shared by all, leads to an important factor contributing to success.

Vision, Mission and Objectives Vision, mission and objectives of the company guide its priorities, philosophy, policies etc. *e.g.*, Ranbaxy's mission 'to become a research based international pharmaceutical company' led it to enter foreign markets.

Top Management Structure The composition of the **board of directors** is very critical factor for the development and performance of company as they are highest decision-maker authorities, extend of professionalism of management as it may be professionally managed or family controlled, nominee of financial institutions having large holdings in companies, the shareholding pattern could have important managerial implications. All these factors are of great importance from the point of view of the company's internal environment.

Power Structure The internal power relationship between the board of directors and senior executive officers highly effect the decision making process of the organisation.

Human and other Resources The quality of human resources of a company depends largely on competence, commitment, attitude and motivation, plays an important role in the success of the organisation.

Physical Resources and the Technology The production capacity, technology, R & D work, distribution logistics etc are the factors that influence functioning and competitiveness of the firm.

Company Image and Brand Equity The image and brand equity of the company matters a lot in raising finance, forming joint ventures and other alliance, choosing dealers and suppliers etc.

External Environment

External environment refers to external aspects of the surroundings of business enterprise, which have influence on the functioning of business.

Micro Environment

The micro environment or task environment comprises those forces in the immediate vicinity of an organisation that influence it's functioning. The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm.

Important Performers in the Micro Environment

The most important performers in the micro environment are as under

Suppliers Business enterprises requires a number of suppliers, who supply raw materials and components to the company. It is an important force of the micro environment of a company.

Customers They are highly influential as they are the central point of every business. Success of business largely depends on identifying the need, desire, tastes liking etc of a customers.

Market Intermediaries Every business enterprise is assisted market intermediaries, which include agents, brokers, who help the company to find customers. These acts as a link between company and final consumer.

Competitors Activities of a business adjust according to the actions and reactions of a competitors. This factor should be known to a company as the upcoming profit or revenue will only be driven when this factor is in control.

Public Any group that has actual or potential interest in the business, has its impact on the business. *e.g.*, growth of consumer groups may effect the working of a newly developed business.

Macro Environment

Macro environment has major external and uncontrollable factors that influence an organisation's decision-making and affect its performance and strategies. When the macro environment is uncontrollable, the success of a company depends on its adaptability to the environment.

These factors include

Economic Environment Business enterprises conduct its activities in the market system with the objective of profit maximisation, since business enterprise is essentially an economic institution. Therefore, surrounded by an economic environment which consists of economic factors that influence the business in a country. These factors include gross national product, corporate profits, inflation rate, employment, Balance of Payments, interest rates consumer income etc.

Political Environment The economic and political systems of a country are mutually dependent, the one reflecting the ideologies of the other. It comprises political stability and the policies of the government. Ideological inclination of political parties, personal interest of politicians, influence of party forums etc create political environment.

Social and Cultural Environment Socio-cultural environment means the value attitudes, beliefs and customs of people in a given group or society. Socio-cultural dimensions complicate the environment in which entrepreneurs have to manage their ventures, which literacy rate, customs, values, beliefs, lifestyle, demographic features and mobility of population are part of the social environment.

It is important for managers to notice the direction in which the society is moving and formulate progressive policies according to the changing social scenario.

Technological Environment The progress of business depends on the level of technology available in a country which gives a massive impetus to the economic revival. It also indicates the pace of research and development and progress made in introducing modern technology in production. Technology provides capital intensive, but cost effective alternative to traditional labour intensive methods. In a competitive business environment technology is the key to development.

Legal Environment It has a great impact on the functioning of the organisation as it establishes codes and procedures for various types and aspects of business and deals with deviations or infringement law like bribery, product counterfeiting, gray markets, black markets, consumer deception and tax evasions.

The coverage, efficiency and efficacy of the legal system determine adequacy, cost and speed of economic justice and these factors are of great importance for the growth of business. In every country there exist specific pieces of business legislation which together guide control and regulate business activity, such as in India Trade Mark Act 1969, Essential Commodities Act 1955, Standards of Weights and Measures Act 1969 and Consumer Protection Act 1986.

Natural Environment No business can survive in climatically inhospitable conditions. Business has broadly two relationships with natural environment. First, the environment is the source of resource as raw material and secondly, it has causes damage in the process of production.

Financial Environment Business finance is concerned with making decisions about the investments in the business. It includes bond markets, forex markets, stock markets, commodity markets, OTC markets, Real estate markets and cash or spot markets. All these markets play an important role in raising finances for the companies and at the same time give profits to the investors.

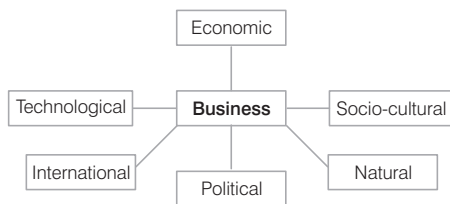
Global Environment It includes rules and regulations of WTO, IMF, WB, SAARC, G20 and other international bodies which duly effect the business organisation operating their business in any particular country. Business has to exist in world market and then it should understand their effect and take action according to these rules and regulations.

➡ **Note** The factors of macro environment are also considered as the elements of business environment.

Business Environment Inter-relationship

Any meaningful organisations have their own vision, mission, objectives and goals and a strategy to achieve them. To realise them it is very important for business firms to understand their environment and changes occurring in it. Hence, it is sometime even said that formulation of appropriate strategy is establishing a proper firm environment.

Business and environment are closely related to each other. Environment may act either as a stimulant or a constant for business. A business enterprise can expand itself as and when favourable changes take place in the environment, on the other hand when the prevailing environment is unfavourable, the business may face challenges and problems.



From the above depicted diagram it is clear that business and its environment are mutually dependent on each other. It is a never ending process of interaction.

Environment Scanning and Strategic Management

A business manager operates in an environment and study the variables to attain good result. These termed as environment scanning or analysis. At the same time, environment scanning points towards interaction among environment factors.

According to **Stephen Robbins**, “Environment scanning entails scrutinising the environment to identify action by competitors, government, union and the like that might impinge on the organisation’s operations.” Environment scanning is a step towards corporate planning which fall in the domain of strategic management.

Chandler describes strategic management as “The determination of the basic long-term goals and objectives of an enterprise and the adoption of courses of action and allocation of resources necessary to carry out these goals.” Strategic management or business policy is, thus, the means to achieve the organisational purpose.

The process of strategic management involves determining the mission and objectives, analysis of the environment opportunities and threats and evaluating the strength and weaknesses of the firm to tap the opportunities or to combat the threat, formulating strategies to achieve the objectives of the organisation. Thus, environment scanning leads to a formulation of sound and effective organisational and managerial strategies by coping with the probable demands of the environment and to a great extent it helps to reduce uncertainty.

Techniques of Environment Scanning/Analysis

William F Glueck has mentioned the following techniques of environment scanning

1. **Verbal and Written Information** Environmental information can easily be obtained by industrial journals, bussiness magazines, published and unpublished materials, talk shows, consultants, seminars and customers etc. The information available from such source provides an authentic information about the environment around the organisation. Government publications are a good source of environment information.
2. **Search and Scanning** If particular type of information is required regarding the business environment, a proper research is conduc to come up with any conclusion.
3. **Spying** Spying is considered as unethical in business, even though organisation often use spying as a source to collect information.
4. **Forecasting and Formal Studies** The information gathered by above three methods is used to predict business environment. Such forecast is basically done by corporate planners of consultants.

Some of the popular techniques of environment analysis are described below

SWOT Analysis

It is a systematic identification or analysis of Strengths (S) Weaknesses (W) Opportunities (O) and Threats (T) in the environment that exist internal or external to the organisation and the strategy that reflects the best match between them. It bases on the assumption that an effective strategy maximises a business’s strengths and opportunities but at the same time, minimises its weaknesses and threats. SWOT is the cornerstone of business policy formulation; which determine the course of action to ensure the survival and growth of the firm.

Uses of SWOT Analysis

- Corporate planning
- Competitor evaluation
- Business and product development
- Set objectives—defining what the organisation is intending to do.
- Environmental scanning.
- Internal appraisals of the organisations SWOT, this needs to include an assessment of the present situation as well as a portfolio of products/services and an analysis of the product/service life cycle.
- Analysis of existing strategies, this should determine relevance from the results of an internal/external appraisal.
- Develop new/revised strategies – revised analysis of strategic issues may mean the objectives need to change.
- Preparation of operational, resource, projects plans for strategy implementation.
- Monitoring results – mapping against plans, taking corrective action which may mean amending objectives/strategies.

PETELS / PESTLE / PEST Analysis

PESTEL stands for Political, Economic, Social, Technological, Environmental and Legal. Traditionally PESTEL analysis was known as the PEST (sometime rearranged as STEP) analysis. In modern time PESTLE came into being by splitting the social part of the PEST into environmental and economic factor into legal factor as these factors have a significant role in the strategic management these days.

It is a strategic planning technique that provides a useful framework for analysing the environmental pressures on an organisation. To have upper hand on the competitors every company should do the PESTEL analysis frequently to make necessary changes in the goals and take appropriate decisions to be alive in the market.

Industry Analysis

An industry analysis is a business function completed by business owners and other individuals to assess the current business

environment. This analysis helps businesses to understand various economic pieces of the market place and how these pieces may be used to gain a competitive advantage. Although, business owners may conduct an industry analysis according to their specific needs, a few basic standards exist for conducting this important business function.

QUEST Analysis

It is a quick environmental scanning technique which is proposed by B Nanus.

It is a four step process

1. Observe the major events and trends in the industry.
2. Speculate on a wide range of important issue.
3. Prepare a report summarising the major issues and their implications.
4. Identify feasible strategic options to deal with the evolving environment.

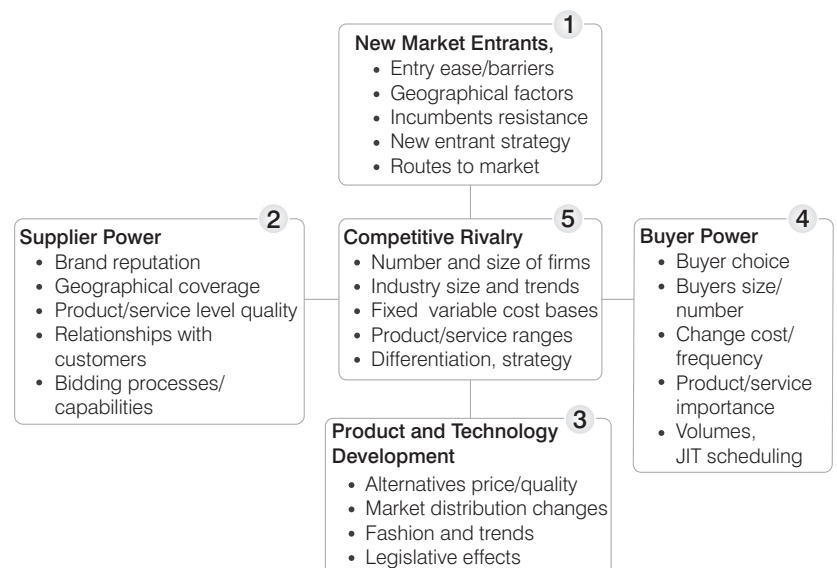
Competitor's Analysis

The competitive structure of industries is a very important business environment. Identification of forces affecting the competitive dynamics of an industry will be very useful in formulating business strategies.

According to **Michael Porter's**, "The state of competition in an industry depends on five basic competitive forces which provides a simple perspective for assessing and analysing the competitive strength and position of a business organisation," which are as

1. Existing competitive rivalry between suppliers
2. Threat of new market entrants
3. Bargaining power of buyers
4. Power of suppliers
5. Threat of substitute products (including technology change)

Typically, this **five forces model** is shown as a series of five boxes in a cross formation, item 1 being central.



Porter's Five Forces of Competitive Position

Change with Environments Changes

An organisation may use several techniques to change with its environments.

Buffering This technique is used to soften the impact of environment on the organisation. Stocking materials, preventive maintenance, employee training, building inventory are some of the examples of buffering.

Rationing It involves allocating organisational resources according to a system of priorities.

Levelling On the one hand, buffering absorbs environment fluctuations and on the other levelling is an attempts to reduce fluctuations in the environment. *e.g.*, retail firms faced with seasonal fluctuations offer price cuts in order to spread sales more evenly throughout the year.

Dominating Under this method organisation tries to control events in the environment and reduce its dependence on them.

Anticipation It mean acquiring information about probable changes in the environment.

Changing An organisation may change itself, its operations and output.

Benefits of Understanding the Environment

First Mover Advantage Early identification of opportunities helps an enterprise to be the first to exploit them instead of loosing them to competitors.

Customer Focus Environmental understanding provide enough information regarding the need and expectation of the customer and helps business organisation to focus towards their customers.

Strategy Formulation Keeping an eye on environment provide relevant information to the organisation in formulation of strategy.

Early Warning Signal It makes a firm aware of the impending threat or crises, so that the firm can take timely action to minimise the adverse effects.

Public Image A business firm can improve its image by showing that it is sensitive to its environment and responsive to the aspiration of public.

Continuous Learning Enterprises that continuously monitoring their environment and adopt suitable business practices not only improve their present performance, but also succeed in the market for a longer period.

Change Agent Business leaders act as agents of change. They create a drive for change at the gross root level. In order to decide the direction and nature of change, the leaders need to understand the aspirations of people and other environmental forces through environment scanning.

Technological Change Environmental study helps us in getting updates regarding technological changes and helps in making action plans to cope with such changes.

Summary

- Business is an economic activity with the objective of earning and income.
- Environment refers to the sum total of all factors which are external to and beyond the control of individual business enterprises.
- There are broadly two types of business environment viz **internal environment** and **external environment**.
- Internal environment refers to the factors internal to the firm. These factors are generally controllable because the company has control over them and determine the potential of a company to meet the environment challenges.
- External business environment consists of a micro environment and a macro environment.
- The micro environment or task environment comprises those forces in the immediate vicinity of an organisation that influence it's functioning.
- Macro environment has major external and uncontrollable factors that influence an organisation's decision-making and affect its performance and strategies.
- The study of environment variables are termed as **environment scanning** or **analysis**.
- Techniques of environment scanning or analysis are SWOT analysis, PESTEL analysis, QUEST analysis, Industry analysis and Competitor's analysis.
- SWOT analysis is a systematic identification or analysis undertaken by a business firm to understand the impact of internal and external environment.