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CHAPTER 2
THE BUSINESS ENVIRONMENT

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1. Analyzing the environment

1.1 Definition

The **environment** is everything that surrounds an organization, physically and socially. Environmental analysis is one of the inputs to the **strategy-making process.**

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1.2 Types

General/task

- The **general or macro environment** covers all those factors influencing all organizations *indirectly*, such as general economic trends, population growth, new technology. These are abbreviated as **PEST** (political-legal, economic, social-cultural, and technological factors).
- The **task or micro environment** includes those areas which have a *direct* impact on the organization, such as its ability to acquire raw materials, its competitors and its customers. (Porter analyses the task environment into **five competitive forces.**)

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Types	Impact	Analysis model
General/macro environment	Indirect	PEST
Task/micro environment	Direct	Five competitive forces

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1.3 Uncertainty

The environment is a source of **uncertainty**. The overall degree of uncertainty may be assessed along **two axes**: simplicity/complexity and stability/dynamism.

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(a) Simplicity/complexity

- The variety of influences faced by an organization. The more open an organization is, the greater the variety of influences. The greater the number of markets the organization operates in, the greater the number of influences to which it is subject.

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(b) Stability/dynamism

- Stable: environment remains the same.

  Firms which can predict demand face a stable environment.

- Unstable/dynamism: environment changes often.

  The environment of many fashion goods is unstable.

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As a rule of thumb, use the following checklist for uncertainty:

- Simple and stable: **low uncertainty**
- Complex and stable: **low to moderate uncertainty**
- Simple and unstable: **moderate to high uncertainty**
- Complex and unstable: **high uncertainty**

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1.4 The changing environment

Changes in the business environment have driven by a number of developments

- Globalization of business – increased competition and global customers as domestic markets become saturated. Companies are able to compete easily anywhere in the world
- Science and technology developments, especially in communications and transport
- Mergers, acquisitions and strategic alliances
- Changing customer values and behavior

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- Increased scrutiny of business decisions by government and the public
- Increased liberalization of trade, and deregulation and co-operation between business and government have eased access to foreign markets
- Changes in business practices – *downsizing, outsourcing and re-engineering*
- Changes in the social and business relationships between companies and their employees, customers and other stakeholders

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2. PEST/PESTEL model

P--Political/legal

E—Economic

S--Social and cultural trends

T—Technology

E—Environmental

L—Legal

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2.1 Political/legal (P)

- All the political and legal influences will have ***a direct influence*** on market and industrial accessibility, and can affect the ***decisions and strategies*** of an organization in its planning and operations.

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- Legal influences can come from many areas of laws, such as general business laws, company laws, criminal laws, employment laws, copyright laws, environment laws, tax laws, health and safety laws, and general legal framework as a whole

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Government intervention and reaction:

Businesses are able to influence government policies in a number of ways

- They can employ ***lobbyists*** to put their case to individual ministers of civil servants
- They can give *MPs* ***non-executive directorships***, in the hope that the MP (Member of Parliament) will take an interest in all legislation that affects them
- They can try to influence ***public opinion***

Government policies have significant influences in a number of ways.

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Political risk and political change

- The ***political risk*** in a decision is the risk that political factors will invalidate the strategy and perhaps severely damage the firm. Examples are wars, political chaos, corruption and nationalization.

- ***Political change*** will complicate the planning activities of many firms. Many economic forecasts ignore the implications of a change in government policy.

International trade

- The European Union operates a single European market, allowing for the free movement of labor, goods and services, and free competition.
- WTO was set up to promote free trade and resolve disputes between trading partners.
- ***Protectionist measures*** to restrict competition from overseas include:
  - ✓ Quotas
  - ✓ Import bans
  - ✓ Restrictions on foreign ownership of certain industries
  - ✓ Tariffs

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SUMMARY

1. **Business environment**

   General & Task

2. **PEST & Five competitive forces**

3. **Political/legal factors**

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