BUSINESS ENVIRONMENT

– Introduction –

A business may be defined as any activity directed towards procuring or acquiring wealth. Business activities comprise of all economic activities related to production and exchange of goods and services for earning economic returns.

Characteristics of a Business

- It involves production and sale of goods and services
- It requires a certain investment
- It aims at earning profits
- It is subjected to risk and uncertainty factors operating in the environment

Business Environment – It refers to the aggregate of all the conditions, events and influences that surround and affect a business.

Business Environment consists of all the external and internal factors which have an impact on the functioning, performance and decision making of a business.

Types of Business Environment /Factors affecting Business Environment –

There are various sources operating in the business environment, those forces which are external to the business and beyond their control are known external factors which operate in the external environment of the business. Forces which are internal to a business and controllable in nature are known as internal factors which operate in the internal environment of the business.

External Factors/ Uncontrollable Factors –

The external factors affecting a business may be divided into two –

Macro Factors – Factors which operate in the external environment of the business and have an indirect impact on its performance.	**Micro Factors –** Factors which are present in the immediate environment of the business and have a direct impact on its performance.
Demographic Factors	Public and Media
Political & Legal Factors	Customer
Economic Factors	Market Intermediaries
Technological Factors	Investors and Shareholders
Socio-cultural Factors	Competitors
Environmental or Natural Factors	Employees

Internal Factors/Controllable factors –

The internal environment of a business categorised in terms of 6 M`s i.e.

Man, Money, Machinery, Management, Marketing and Miscellaneous Factors.

They Include –

- Vision and Mission of the company
- Dynamic nature of Top Management
- Research and Development
- Organizational Structure
- Organizational Culture and Value system

- Company Image
- Competitive advantage
- Capital Assets and Financial Position of the company
- Human and Industrial Relation

Importance of Business Environment –

- **First Movers Advantage –** Knowledge of the business environment enables a business to exploit opportunities present in the industry and helps a business to gain a first movers advantage and capture virgin markets.
- **Identification of Threats –** It helps a business to identify threats present in the industry and it to overcome drastic cyclic and seasonal fluctuations in the business environment.
- **Coping up with changes –** Constant analysis of the business environment helps a business to be pro-active and cope up with the dynamic business environment.
- **Improve Performance –** Analysis of the business environment helps a business to identify key performance indicators that affect a business and aids in controlling devations in performance.
- **Facing Competition –** It helps a business to face competition by analysing the market share, market growth, market demand of the industry and strategic actions of the competitors.
- **Build company Image –** It helps a business to create a good image in the minds of the public and consumers through constant evaluation, feedback and control of its products, brand, strategy etc.

Components of environment & Environmental analysis / Environmental Matrix.

Environmental Analysis is described as the process which examines all the components, internal or external, that has an influence on the performance of the organization. The internal components indicate the strengths and weakness of the business entity whereas the external components represent the opportunities and threats outside the organization.

To perform environmental analysis, a constant stream of relevant information is required to find out the best course of action. Strategic Planners use the information gathered from the environmental analysis for forecasting trends for future in advance. The information can also be used to assess operating environment and set up organizational goals.

It ascertains whether the goals defined by the organization are achievable or not, with the present strategies. If is not possible to reach those goals with the existing strategies, then new strategies are devised or old ones are modified accordingly.

Some of the features or characteristics of Environmental Analysis are:

- **Holistic View:** Environmental Analysis is a holistic exercise in the sense that it must comprise a total view of the environment rather than viewing a trend piecemeal. The corporate must scan the circumference of its environment in order to minimize the chances of surprises and to maximize its utility.

- **Continuous Process:** The analysis of environment must be a continuous process rather than being an intermittent scanning system. It must operate continuously in order to keep track of the rapid pace of development. So, Environmental analysis becomes essential due to the dynamic nature of the environment.
- **Exploratory Process:** While the Monitoring aspect of the environment is concerned with the present development, a large part of the process seeks to explore the unknown dimensions of possible future. The analysis emphasizes on **"What could happen" and not necessarily "What will happen."**

The Importance of Environmental Analysis are:

- **First Mover Advantage:** Awareness of environment helps an enterprise to take advantage of early opportunities instead of losing them to competitors. **For instance,** Maruti Udyog became the leader in the small car market because it was the first to recognize the need for small cars on account of rising Middle class.
- **Early Warning Signal:** Environmental awareness serves as an early warning signal. It makes a firm aware of the impending threat or crisis, so that the firm can take timely action to minimize the adverse effects if any. **For instance,** A MNC entering in to the Indian market would act as a early warning signal for Indian Firms.
- **Focus On Customer:** Environmental Understanding makes the management or Business organization sensitive towards the changing needs and expectations of customer. **For instance,** Several FMCG companies have launched small sachets of shampoo and other products realizing the wishes of customers.
- **Strategy Formulation:** Environmental Monitoring provides relevant information about the business environment. such information serves as the basis for strategy formulation. **For Instance,** ITC realized that there is a vast scope for growth in the travel and tourism industry in India and therefore ITC planned New hotels in India.
- **Change Agent:** Business leaders acts as the agents of change. They create a drive for change at the grassroot 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 Environmental Scanning.
- **Public Image:** A business firm can improve its image by showing that it is sensitive to its environment and responsive to the aspirations of public.

Environmental understanding enables the business to be responsive to their environment.

- **Continuous Learning:** Environmental analysis keeps the organization in touch with the changing scenario so that thet are never caught unaware. With the help of Environmental learning, managers can react in an appropriate manner and thereby increase the success of their organization.

The Process of Environmental Analysis/Scanning consists of the following steps:

- **Environmental Scanning:** It means the process of analyzing the environment for identifying the factors which may influence the business. Environmental Scanning alerts an organization to potentially significant forces in the external environment, so that suitable strategic initiatives may be taken before the organization reaches to a critical situation.
- **Environmental Monitoring:** At this stage, the information from the relevant environment is collected. Once this information is collected, adequate data is gathered so as to find out the patterns and trends of the environment. Further Monitoring is a follow up and deeper analysis of environmental forces. Several techniques such as company records, spying, publication and verbal talks with the customers, employees, dealers and suppliers are the main sources of collecting data.
- **Environmental Forecasting:** Environmental Forecasting is the process of estimating the events of future based on the analysis of past records and present behavior. Further it is necessary to analyze or anticipate the future events before any strategic plans are formulated. Forecasts are made for economic, social and political factors. Several techniques such as Time series, Graph method, Delphi method etc. are used for this purpose.
- **Assessment Or Diagnosis:** At this stage, Environmental factors are assessed in terms of their impact on the organization. Some factors in the environment may entail an opportunity while others may pose a threat yo the organization. For this purpose, SWOT analysis and ETOP analysis are used.

Advantages of Environmental Analysis

The internal insights provided by the environmental analysis are used to assess employee’s performance, customer satisfaction, maintenance cost, etc. to take corrective action wherever required. Further, the external metrics help in responding to the environment in a positive manner and also aligning the strategies according to the objectives of the organization.

Environmental analysis helps in the detection of threats at an early stage, that assist the organization in developing strategies for its survival. Add to that, it identifies opportunities, such as prospective customers, new product, segment and technology, to occupy a maximum share of the market than its competitors.

Steps Involved in Environmental Analysis

1. **Identifying**: First of all, the factors which influence the business entity are to be identified, to improve its position in the market. The identification is performed at various levels, i.e. company level, market level, national level and global level.
2. **Scanning**: Scanning implies the process of critically examining the factors that highly influence the business, as all the factors identified in the previous step effects the entity with the same intensity. Once the important factors are identified, strategies can be made for its improvement.
3. **Analysing**: In this step, a careful analysis of all the environmental factors is made to determine their effect on different business levels and on the business as a whole. Different tools available for the analysis include benchmarking, Delphi technique and scenario building.
4. **Forecasting**: After identification, examination and analysis, lastly the impact of the variables is to be forecasted.

Environmental analysis is an ongoing process and follows a holistic approach, that continuously scans the forces effecting the business environment and covers 360 degrees of the horizon, rather than a specific segment.

FACTORS AFFECTING BUSINESS ENVIRONMENT

Analysis of business environment

Environmental analysis is a strategic tool. It is a process to identify all the external and internal elements, which can affect the organization’s performance. The analysis entails assessing the level of threat or opportunity the factors might present. These evaluations are later translated into the decision-making process. The analysis helps align strategies with the firm’s environment.

Our market is facing changes every day. Many new things develop over time and the whole scenario can alter in only a few seconds. There are some factors that are beyond your control. But, you can control a lot of these things.

Businesses are greatly influenced by their environment. All the situational factors which determine day to day circumstances impact firms. So, businesses must constantly analyze the trade environment and the market.

There are many strategic analysis tools that a firm can use, but some are more common. The most used detailed analysis of the environment is the PESTLE analysis. This is a bird's eye view of the business conduct. Managers and strategy builders use this analysis to find where their market currently. It also helps foresee where the organization will be in the future.

PESTLE analysis consists of various factors that affect the business environment. Each letter in the acronym signifies a set of factors. These factors can affect every industry directly or indirectly.

The letters in PESTLE, also called PESTEL, denote the following things:

- **P**olitical factors
- **E**conomic factors
- **S**ocial factors
- **T**echnological factors
- **L**egal factors
- **E**nvironmental factor

Often, managers choose to learn about political, economic, social and technological factors only. In that case, they conduct the PEST analysis. PEST is also an environmental analysis. It is a shorter version of PESTLE analysis. STEP, STEEP, STEEPLE, STEEPLED, STEPJE and LEPEST: All of these are acronyms for the same set of factors. Some of them gauge additional factors like ethical and demographical factors.

P for Political factors

The political factors take the country's current political situation. It also reads the global political condition's effect on the country and business. When conducting this step, ask questions like "What kind of government leadership is impacting decisions of the firm?"

Some political factors that you can study are:

- Government policies
- Taxes laws and tariff
- Stability of government
- Entry mode regulations

E for Economic factors

Economic factors involve all the determinants of the economy and its state. These are factors that can conclude the direction in which the economy might move. So, businesses analyze this factor based on the environment. It helps to set up strategies in line with changes.

- The inflation rates
- The interest rate
- Disposable income of buyers
- Credit accessibility
- Unemployment rates
- The monetary or fiscal policies
- The foreign exchange rate

S for Social factors

Countries vary from each other. Every country has a distinctive mindset. These attitudes have an impact on the businesses. The social factors might ultimately affect the sales of products and services.

Some of the social factors you should study are:

- The cultural implications
- The gender and connected demographics
- The social lifestyles
- The domestic structures
- Educational levels
- Distribution of Wealth

T for Technological factors

Technology is advancing continuously. The advancement is greatly influencing businesses. Performing environmental analysis on these factors will help you stay up to date with the changes. Technology alters every minute. This is why companies must stay connected all the time. Firms should integrate when needed. Technological factors will help you know how the consumers react to various trends.

Firms can use these factors for their benefit:

- New discoveries
- Rate of technological obsolescence
- Rate of technological advances
- Innovative technological platforms

L for Legal factors

Legislative changes take place from time to time. Many of these changes affect the business environment. If a regulatory body sets up a regulation for industries, for example, that law would impact industries and business in that economy. So, businesses should also analyze the legal developments in respective environments.

- Product regulations
- Employment regulations
- Competitive regulations
- Patent infringements
- Health and safety regulations

E for Environmental factors

The location influences business trades. Changes in climatic changes can affect the trade. The consumer reactions to particular offering can also be an issue. This most often affects agri-businesses.

Some environmental factors you can study are:

- Geographical location
- The climate and weather
- Waste disposal laws
- Energy consumption regulation
- People's attitude towards the environment

There are many external factors other than the ones mentioned above. None of these factors are independent. They rely on each other.

If you are wondering how you can conduct environmental analysis, here are 5 simple steps you could follow:

- Understand all the environmental factors before moving to the next step.
- Collect all the relevant information.
- Identify the opportunities for your organization.
- Recognize the threats your company faces.
- The final step is to take action.

It is true that industry factors have an impact on the company performance. Environmental analysis is essential to determine what role certain factors play in your business. PEST or PESTLE analysis allows businesses to take a look at the external factors. Many organizations use these tools to project the growth of their company effectively.

Objectives of Business Environmental analysis

Business Environmental analysis has three basic objectives, which are as follows:

1. **Help understanding Existing Environment**

It is important that one must be aware of the existing environment. Business Environment analysis should provide an understanding of current and potential changes taking place in the micro environment. Micro environment specifies the type of products to be offered, the technology to be adopted and the productive strategies to be used to face the global competition.

2. **Provision of Data for Strategic Decision-making**

Business Environment analysis should provide necessary data for strategic decision-making. Mere collection of data is not adequate. The data so collected must be used for strategic decision-making.

3. **Facilitating Strategic Linking in Organizations**

Business Environment analysis should facilitate and foster strategic linking in organizations.

Process of Business Environment Analysis

The process of Business environment analysis involves many steps, which are as follows:

- Collection of necessary information.
- Scanning and searching of information.
- Getting information by spying.
- Forecasting the conditions.
- Observing the environment.

1. **Collection of necessary Information**

Collection of necessary information is the first stage in the process of business environment analysis. It involves the observation of various factors prevailing in a particular area also. If an environment is to be analyzed, written as well as the verbal information from various sources with regard to the elements of environment for that particular business is to be collected first.

2. **Scanning and Searching of Information**

Scanning and searching is an important technique of business environment analysis. Once the necessary information has been collected, it should be put to scanning. Besides, the search for other relevant information also continues. This technique gives results as to the hypothesis already established. This helps the analyst to know as to what are the conditions prevailing for a particular business at a time.

3. **Getting Information by Spying**

Spying is also one of the techniques of business environment analysis. When the activities of a particular business are to be analyzed and such information cannot be collected by traditional methods, the technique of spying is resorted to. This happens especially when business rivalry exists. Mostly, this technique is used to collect competitive information.

4. **Forecasting the Conditions**

Scanning provides a picture about the past and the present. However, strategic decision-making requires a future orientation. Forecasting is the scientific guesswork based upon some serious study. So it helps to know how a business in particular and conditions in society in general are going to take shape.

5. **Observing the Environment**

One can analyze a business environment by merely observing it. The observation reveals various conditions prevailing at a particular point of time. This is helpful in understanding the existing environment in its entirety so that suitable decisions can be taken.

6. **Assessing**

Assessment is made to determine implications for the organization's current and potential strategies. Assessment involves identifying and evaluating how and why current and projected environmental changes affect or will affect strategic management of the organization.

MACRO AND MICRO FACTORS THAT AFFECT THE ENVIRONMENT

Micro-Environment

The micro-environment is basically the environment that has a direct impact on your business. It is related to the particular area where your company operates and can directly affect all of your business processes. In other words, it consists of all the factors that affect particularly your business. They have the ability to influence your daily proceedings and general performance of the company. Still, the effect that they have is not a long-lasting one.

The micro-environment includes customers, suppliers, resellers, competitors, and the general public.

Macro-Environment

The macro-environment is more general – it is the environment in the economy itself. It has an effect on how all business groups operate, perform, make decisions, and form strategies simultaneously. It is quite dynamic, which means that a business has to constantly track its changes. It consists of external factors that the company itself doesn't control but is certainly affected by.

The factors that make up the macro-environment are economic factors, demographic forces, technological factors, natural and physical forces, political and legal forces, and social and cultural forces.

Constituents of business environment

Micro Environment of Business:

The micro environment consists of the factors of the firm's immediate environment.

These include:

(a) Suppliers

Suppliers or vendors are those persons or firms who supply inputs like new materials, certain parts, cutting tools etc., to the company. The vendor quality and reliability is a must for the smooth functioning of the business.

They should supply all imputes of right quality and stated quantity in time. In order to be on safe side, adequate stock of input elements should be preserved in the company and services should be taken of more than one vendor to supply the goods.

(b) Customers

Today with the advancement of technology and because of foreign collaborations, it has become easy to manufacture any product, but it is still very difficult to sell i.e., to create, increase and sustain the customers.

Every day we watch a new advertisement e.g., buy one tooth paste tube and take another free along with it or take two shampoo bottles at the price of one etc., to allure the customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success. How many different categories of customers shall be there to buy a product, depends upon the product itself.

For example, an automobile tyre manufacturing concern, can sell their tyres to:

- Individual scooter or car owners
- Scooter, car, truck manufacturing industries
- Governments and other user institutions
- Public sector or private sector transport undertakings etc.

(c) Competitors

Take an example of a firm 'A' making Televisions. Its competitors are not only the firms making and marketing T.V., but are all those firms who compete for the discretionary income of the customers. There are so many firms making T.V., scooters, refrigerators, cooking ranges, stereo sets etc.

The first is the desire competition amongst them. In other words, the primary task of firm 'A' here is to influence the basic desire of the customer to buy only T.V. and no other product. This desire can be created in the customer by giving festival discount or by introducing some installment scheme etc.

The second is the product form competition if once the customer decides to by a T.V. Product form competition implies, whether the customer should go for a black and white T.V. or a colour T.V., should he buy a T.V. with or without remote control.

Should he buy a 14″ TV or 21″ TV or still of bigger size. The firm ‘A’ may or may not be making all these models. So it has to attract, by its advertisement, the attention of the customers to go for a model being manufactured by them.

The third is the brand competition i.e., the competition between the different brands of the same product form. For example, there are a number of T.V. makes in the market, such as, Onida, BPL, Sony, Beltek, Videocon, Crown, Texla, etc. Now, the firm ‘A’ should work to create primary and selective demand for his T.V. sets, by alluring the customers by enchanting advertisements, and attractive schemes.

(d) Public

Public means a group of people. Public opinion can be a threat to a business firm whereas it can be an opportunity for another business firm. Public normally forms an opinion about different brands of the same product after using the same.

Opinion travels from friend-to-friend, neighbour-to-neighbour etc.,— Use this brand of washing powder or buy that brand of T.V. or refrigerator. They are using it for the last five years and it is working trouble-free etc. This is consumer publics which has an important effect on any companies business, can make or mar it.

The second is the Media publics where some newspaper tries to tarnish the image of a business firm by giving his own reasons or logic, and this adversely affects the business of the firm. Its share price may also come down. The third is Local publics.

The issue of environmental pollution caused from chimneys or waste liquid streams from the factories has often been taken up by local public and, at times, it has resulted in the suspension of production operations and/or take pollution abatement measures by the factories.

(e) Marketing Intermediaries

Marketing Intermediaries are those firms/individuals who help the company in promoting, selling and distributing its goods to final buyers.

Examples of marketing intermediaries are:

- Middlemen (agents/merchants) who help the company find customers.
- Physical distribution firms who assist the company in stocking and moving goods from their origin to their destination, such as warehouses and transportation firms.
- Marketing service agencies such as advertising agencies, market research firms etc., which assist the company in targeting and promoting its products to the right markets.

Macro Environment of Business

The macro environment consists of larger societal forces that affect all the factors in the company's micro environment.

(a) Economic Environment

Economic environment refers to all those economic factors which have a bearing on the functioning of a business unit. Some such factors have been discussed below:

- **Growth Strategy:** The economic environment in our country is the result of the economic growth strategy pursued during the past five decades by the Government of India. The growth strategy followed was based on the Soviet Planning Model which believed that the saving rate in the economy and growth rate could be increased by investing heavily in the capital goods and heavy industry sectors at the expense of the consumer goods sector.
- **Economic System:** The economic system is a very important determinant of the scope of (private) business. The economic system and policy are a very important external constraint on business.
- **Economic Planning:** The Government prepares and implements a comprehensive economic plan integrating the private sector with the public sector. India has been doing economic planning since 1951, when First Five Year Plan was launched.

- **Industry:** Around mid-1960s, India had a better industrial base and possessed more pre-requisites for industrial growth than South Korea, Malaysia, Taiwan etc. But the country subjected all outputs and other factors to rigid price and quantity controls, investment was strictly rationed, there were multiple barriers to entry, and the objective of the financial system was to supply subsidised development funds irrespective of returns. As a result all the countries mentioned above are far ahead of India in industrial growth. In 1970's, Indian Government started believing that mini-plants constituted appropriate technology, notwithstanding strong evidence to the contrary. Such plants were encouraged through fiscal concessions and subsidised development finance. Mini-cement, mini-paper, mini-steel, mini-sugar plants were set up. None of these were technically viable, so they fell short of economies of scales, and could only exist under a regime of subsidies, high tariffs, severe quotas and purchase preferences. In 1980's as the financial situation worsened, all these mini-plants became sick units. According to the Industrial Policy of the Government of India until July 1991, the development of 17 of the most important industries were reserved for the state. In the development of another 12 major industries, the state was to play a dominant role. In the remaining industries, cooperative enterprises, joint sector enterprises and small-scale units were to get preferential treatment over large entrepreneurs in the public sector. The government policy, thus limited the scope of private business. However, the new policy ushered in, since July 1991 has wide opened many of the industries for the private sector.
- **Human Resource:** Human Resources play a crucial role (of people) in an economy. People work to produce goods and services. People provide markets for goods produced. Degree of economic prosperity depends on the quality and skill of the people. People need economic growth just as prosperity demands services of people. Unluckily, our country has more number of people than the economy could afford. However it goes to the credit of the country that it was the first in the world to adopt family planning as a state policy.
- **National Income and Per Capita Income:** The aggregate flow of goods and services represents the total income earned by factors of production (such as) land and other natural resources, labour, capital and enterprise) employed during the year and this is popularly called national income. The rate of growth of the national income in an economy is an indication of the pace at which the economy has been growing. A high growth rate indicates that the economy is a developed one. Low growth rate implies that the economy is a developing or a

poor one. A high national income indicates that the economy is developed and the overall environment is favourable for business growth.

(b) Technological Environment

Science is a systematised body of knowledge and when this knowledge is put into practice (or to practical tasks) it becomes technology. Technology changes very fast and a firm which is unable to cope with the technological changes may not survive.

(c) Political Environment

Political environment is another important constituent of the business environment which can bring any business enterprise to the ground. A Political (and Government) Environment or system prevailing in a country decides, promotes, fosters, encourages, shelters, directs and controls the business activities of that country.

A political environment/system that is stable, honest, efficient and dynamic and which ensures political participation of the people, and assures personal security to the citizens, is a primary factor for economic development. Two basic political philosophies exist all over the world.

The first, known as Democracy refers to a political arrangement in which the supreme power is vested in the hands of people. They have got the right to rule and vote on every matter. But this form of pure democracy is not workable in a complex society. Hence the Republican form of government comes into the picture in which the people/public, in a democratic manner, elects their representatives who do the ruling.

The second system known as totalitarianism also called Authoritarianism is one in which individual (person's) freedom is completely subordinated to the power of authority of the state and concentrated in the hands of one person (i.e., a Dictator) or in a small group which is not constitutionally accountable to the, people. Societies ruled by military or by a dictator, plus most oligarchies and monarchies belong to this category.

(d) Social Environment

The social environment is made up of the attitudes, desires, expectations, degrees of intelligence and education, beliefs, and customs of people in a given group or society. Social desires, expectations and pressures give rise to laws and laws, in turn, influence the business.

Social factors include:

(i) Attitude of people to work

(ii) Attitude to wealth.

(iii) Desires and expectations.

(iv) Family and customs.

(v) Religion and Marriage.

(vi) Values and beliefs.

(vii) Intelligence and education.

(viii) Ethics-personal conduct.

(ix) Tastes and preferences.

(x) Social responsibility of business.

For any business, the cost of ignoring the customs, traditions, taboos, tastes and preferences, etc., of individuals or of society can be very high. The buying and consumption factors, habits of people, their language, beliefs and values, customs and traditions, tastes and preferences, education, all these factors affect the business. In Thailand, Helene Curtis switched to black shampoo because Thai women felt that it made their hair look glossier.

(e) Legal Environment

Judiciary settles legal disputes between the employer and the employees, employer and public or employer and government and hence affects the business. Legal authority also sees to it that the exercise of government conforms to the general rules laid down by the legislature, it may declare that the particular order issued is, in fact, ultra vires.

The courts of justice protect the citizens from unlawful acts passed by the legislature and arbitrary acts done by the government. Many times, judiciary has ordered the closure of fume-emitting and other factories spreading pollution which became dangerous for society. Judiciary has also restrained and censored human rights violations etc. The legal environment has far-reacting consequences on business.

Difference

	Macro Environment	**Micro Environment**
Meaning	Macro environment refers to the general environment, that can affect the working of all business enterprises.	Micro environment is defined as the nearby environment, under which the firm operates.
Elements	PESTLE, i.e. Political, Economic, Socio-cultural, Technological, Legal and Environmental.	COSMIC, i.e. Competitors, Organization itself, Suppliers, Market, Intermediaries and Customers.
Nature of elements	General	Specific
Are these factors controllable?	No	Yes, but to some extent only
Influence	Indirectly and Distantly	Directly and Regularly

ENVIRONMENTAL SCANNING

Environmental scanning is the process of gathering information about events and their relationships within an organization's internal and external environments. The basic purpose of environmental scanning is to help management determine the future direction of the organization.

Every organization has an internal and external environment. In order for the organization to be successful, it is important that it scans its environment regularly to assess its developments and understand factors that can contribute to its success. Environmental scanning is a process used by organizations to monitor their external and internal environments.

The purpose of the scan is the identification of opportunities and threats affecting the business for making strategic business decisions. As a part of the environmental scanning process, the organization collects information regarding its environment and analyzes it to forecast the impact of changes in the environment. This eventually helps the management team to make informed decisions.

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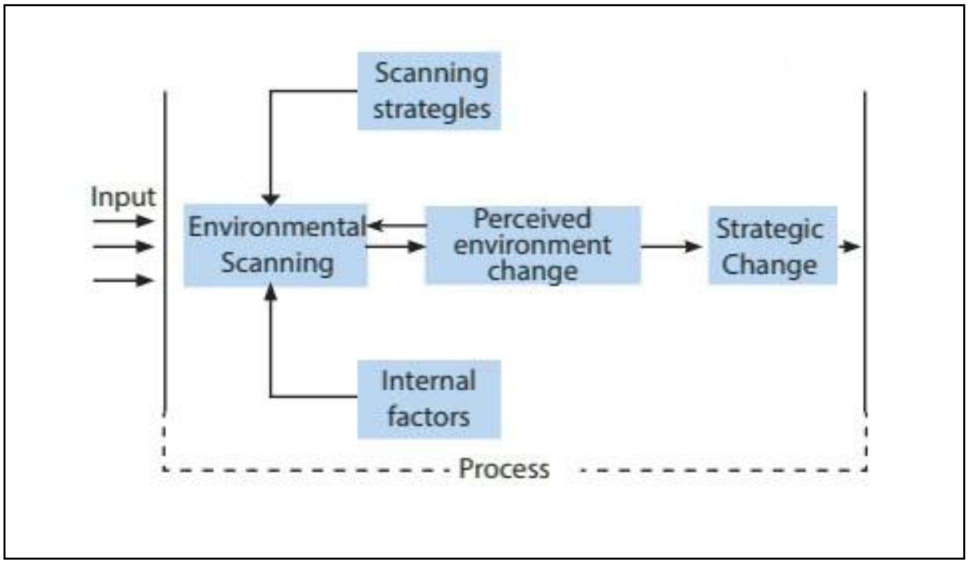

As seen from the figure above, environmental scanning should primarily identify opportunities and threats in the organization's environment. Once these are identified, the organization can create a strategy which helps in maximizing the opportunities and minimizing the threats. Before looking at the important factors for environmental scanning, let's take a quick peek at the components of an organization's environment.

Importance of Environmental Scanning

1. **SWOT Analysis**

As we saw previously in the environmental scanning meaning, it is a complex process. The close study of the internal and external environment of an organization will reveal some very valuable information, i.e. the strengths, weaknesses, opportunities, and threats of a company. Let us take a brief look.

- Strength: After analysis of the internal environment of a company, we will be able to identify the strengths that give the company a competitive advantage. The entrepreneur can use this information to maximise these strengths and earn more profits.
- Weakness: Study of the internal environment also point out the weaknesses of the company. For the growth and stability of the company, these identified weaknesses must be corrected without delay.
- Opportunity: Analysis of the external environment helps with the identification of possible opportunities. The entrepreneur can prepare to capitalize on these.
- Threats: Analysis of the external environment will also help in the identification of any business threats from competitors or any other factors. The company can come up with a strategy to diffuse such threats or minimize its impact.

2. **Best Use of Resources**

Environmental scanning helps us conduct a thorough analysis and hence leads to the optimum utilization of resources for the business.

Whether it is capital resources, human resources or other factors of production, their best use and utilization is very important for any business.

Environmental scanning will help us avoid any wastages and allow for the most effective and economical use of these resources.

3. **Survival and Growth of the Business**

It is a very competitive world and for any business to survive and thrive it is a difficult task. But if the business employs all the techniques of environmental scanning it can gain a significant advantage.

It will allow the firm to prepare for future threats and opportunities while at the same time eliminating their weaknesses and improving on their strengths.

4. **Planning for Long Term**

A business must have a plan for both short term and long term. The planning of long-term objectives can only occur after proper analysis and environmental scanning meaning. This will help the entrepreneur plan the necessary business strategy.

5. **Helps in Decision Making**

Decision making is the choice of the best alternative done by management. Environmental scanning allows the firm to make the best decision keeping in mind the success and growth of the business. They point out all the threats and weaknesses. And they also identify the strengths of the firm.

Important Factors for Environmental Scanning

Before scanning the environment, an organization must take the following actors into consideration:

(i) Events

These are specific occurrences which take place in different environmental sectors of a business. These are important for the functioning and/or success of the business. Events can occur either in the internal or the external environment. Organizations can observe and track them.

(ii) Trends

As the name suggests, trends are general courses of action or tendencies along which the events occur. They are groups of similar or related events which tend to move in a specific direction. Further, trends can be positive or negative. By observing trends, an organization can identify any change in the strength or frequency of the events suggesting a change in the respective area.

(iii) Issues

In wake of the events and trends, some concerns can arise. These are Issues. Organizations try to identify emerging issues so that they can take corrective measures to nip them in the bud. However, identifying emerging issues is a difficult task. Usually, emerging issues start with a shift in values or change in which the concern is viewed.

(iv) Expectations

Some interested groups have demands based on their concern for issues. These demands are Expectations.

Strengths, Weakness, Opportunities, Threats (SWOT Analysis)

A successful business is founded on a series of sound decisions, so the way you analyze situations and choose to react is essential. When trying to assess the lay of the land, few tools are more useful than the SWOT analysis. It stands for strengths, weaknesses, opportunities, and threats; the SWOT analysis is a planning process that allows your company to overcome challenges and determine what new leads to pursue.

The primary objective of a **SWOT** analysis is to help organizations develop a full awareness of all the factors involved in a decision.

“It is impossible to accurately map out a small business’s future without first evaluating it from all angles, which includes an exhaustive look at all internal and external resources and threats,” said Bonnie Taylor, chief marketing strategist at CCS Innovations. “A SWOT accomplishes this in four straightforward steps that even rookie business owners can understand and embrace.”

You could employ SWOT before you commit to any sort of company action, whether you’re exploring new initiatives, revamping internal policies, considering opportunities to pivot, or altering a plan midway through its execution. Sometimes it’s wise to perform a general SWOT analysis just to check on the current landscape in which your business finds itself. Performing a SWOT analysis is also a great way to improve business operations, said Andrew Schrage, partner and editor-in-chief of Money Crashers.

“It allowed me to identify the key areas where my organization was performing at a high level, as well as areas that needed work,” said Schrage, who expanded on his thoughts about business decision making in a blog post. “Some small business owners make the mistake of thinking about these sorts of things informally, but by taking the time to put together a formalized SWOT analysis, you can come up with ways to better capitalize on your company’s strengths and improve or eliminate weaknesses.”

While the business owner should certainly be involved in creating a SWOT analysis, it could be much more helpful to include other team members in the process. Shawn

Walsh, founder and CEO of Paradigm Computer Consulting, said his management team conducts a quarterly SWOT analysis together.

“The collective knowledge removes blind spots that, if left undiscovered, could be detrimental to our business or our relationship with our clients,” Walsh said.

The elements of a SWOT analysis

A SWOT analysis focuses on the four elements comprising the acronym, allowing companies to identify the forces influencing a strategy, action or initiative. Knowing these positive and negative elements can help companies more effectively communicate what parts of a plan need to be recognized.

When drafting a SWOT analysis, individuals typically create a table split into four columns to list each impacting element side-by-side for comparison. Strengths and weaknesses won't typically match listed opportunities and threats, though they should correlate somewhat since they're tied together in some way. Billy Bauer, managing director of Royce Leather, noted that pairing external threats with internal weaknesses can highlight the most serious issues faced by a company.

"Once you've identified your risks, you can then decide whether it is most appropriate to eliminate the internal weakness by assigning company resources to fix the problems, or reduce the external threat by abandoning the threatened area of business and meeting it after strengthening your business," Bauer said.

Internal factors

The first two letters in the acronym, S (strengths) and W (weaknesses), refer to internal factors, which means the resources and experience readily available to you. Examples of areas typically considered include:

- Financial resources (funding, sources of income, investment opportunities)
- Physical resources (location, facilities, equipment)
- Human resources (employees, volunteers, target audiences)
- Access to natural resources, trademarks, patents and copyrights
- Current processes (employee programs, department hierarchies, software systems)

External factors

External forces influence and affect every company, organization and individual. Whether these factors are connected directly or indirectly to an opportunity or threat, it is important to take note of and document each one. External factors typically reference things you or your company do not control, such as:

- Market trends (new products and technology, shifts in audience needs)
- Economic trends (local, national and international financial trends)
- Funding (donations, legislature and other sources)

- Demographics
- Relationships with suppliers and partners
- Political, environmental and economic regulations

The SWOT analysis is a simple, albeit comprehensive strategy for identifying not only the weaknesses and threats of a plan but also the strengths and opportunities it makes possible. However, a SWOT analysis is just one tool in the strategy toolbox. Additional analytic tools to consider include PEST (political, economic, social and technological), MOST (mission, objective, strategies and tactics) and SCRS (strategy, current state, requirements and solution) analyses.

SWOT can also prompt businesses to examine and execute strategies in a more balanced, in-depth way.

Environmental Threat and Opportunity Profile (ETOP)

The Environmental factors are quite complex and it may be difficult for strategy managers to classify them into neat categories to interpret them as opportunities and threats. A matrix of comparison is drawn where one item or factor is compared with other items after which the scores arrived at are added and ranked for each factor and total weight age score calculated for prioritizing each of the factors.

This is achieved by brainstorming. And finally the strategy manger uses his judgment to place various environmental issues in clear perspective to create the environmental threat and opportunity profile.

Although the technique of dividing various environmental factors into specific sectors and evaluating them as opportunities and threats is suggested by some authors, it must be carefully noted that each sector is not exclusive of the other.

Each of the major factors pertaining to a particular sector of environment may be divided into sub-sectors and their effects studied. The field force analysis goes hand in glove with ETOP, as here also the contribution with regard to opportunities and threats posed by the environment is also a necessary part of study.

ETOP Preparation

The preparation of ETOP involves dividing the environment into different sectors and then analyzing the impact of each sector on the organization. A comprehensive ETOP requires subdividing each environmental sector into sub factors and then the impact of each sub factor on the organization is described in the form of a statement.

A summary ETOP may only show the major factors for the sake of simplicity. The table 1 provides an example of an ETOP prepared for an established company, which is in the Two Wheeler industry.

The main business of the company is in Motor Bike manufacturing for the domestic and exports markets. This example relates to a hypothetical company but the illustration is realistic based n the current Indian business environment.

Table 1: Environmental Threat and Opportunity Profile (ETOP) for a Motor Bike company:

Environmental Sectors	Impact of each sector
Social (↑)	Customer preference for motorbike, which are fashionable, easy to ride and durable.
Political (→)	No significant factor.
Economic (↑)	Growing affluence among urban consumers; Exports potential high.
Regulatory (↑)	Two Wheeler industry a thrust area for exports.
Market (↑)	Industry growth rate is 10 to 12 percent per year, For motorbike growth rate is 40 percent, largely Unsaturated demand.
Supplier (↑)	Mostly ancillaries and associated companies supply parts and components, REP licenses for imported raw materials available.

Technological (↑)	Technological up gradation of industry in progress. Import of machinery under OGL list possible.

As shown in the table motorbike manufacturing is an attractive proposition due to the many opportunities operating in the environment. The company-can capitalize on the burgeoning demand by taking advantage of the various government policies and concessions. It can also take advantage of the high exports potential that already exists.

Since the company is an established manufacturer of motorbike, it has a favorable supplier as well as technological environment. But contrast the implications of this ETOP for a new manufacturer who is planning to enter this industry.

Though the market environment would still be favorable, much would depend on the extent to which the company is able to ensure the supply of raw materials and components, and have access to the latest technology and have the facilities to use it. The preparation of an ETOP provides a clear picture for organization to formulate strategies to take advantage of the opportunities and counter the threats in its environment.

The strategic managers should keep focus on the following dimensions:

1. **Issue Selection**

Focus on issues, which have been selected, should not be missed since there is a likelihood of arriving at incorrect priorities. Some of the impotent issues may be those related to market share, competitive pricing, customer preferences, technological changes, economic policies, competitive trends, etc.

2. **Accuracy of Data**

Data should be collected from good sources otherwise the entire process of environmental scanning may go waste. The relevance, importance, manageability, variability and low cost of data are some of the important factors, Which must be kept in focus.

3. **Impact Studies**

Impact studies should be conducted focusing on the various opportunities and threats and the critical issues selected. It may include study of probable effects on the company’s strengths and weaknesses, operating and remote environment, competitive position, accomplishment of mission and vision etc. Efforts should be taken to make assessments more objective wherever possible.

4. **Flexibility in Operations**

There are number of uncertainties exist in a business situation and so a company can be greatly benefited buy devising proactive and flexible strategies in their plans, structures, strategy etc. The optimum level of flexibility should be maintained.

Some of the key elements for increasing the flexibility are as follows:

(a) The strategy for flexibility must be stated to enable managers adopt it during unique situations.

(b) Strategies must be reviewed and changed if required.

(c) Exceptions to decided strategies must be handled beforehand. This would enable managers to violate strategies when it is necessary.

(d) Flexibility may be quite costly for an organization in terms of changes and compressed plans; however, it is equally important for companies to meet urgent challenges.

PORTER FIVE FORCES MODEL

The main purpose of industry analysis, in the context of strategic choice is to determine the industry attractiveness, and to understand the structure and dynamics of the industry with a view to find out the continued relevance to strategic alternatives that are there before a firm.

It follows that, for instance, if the industry is not, or no longer, sufficiently attractive (i.e. it does not offer long-term growth opportunities), then the strategic alternatives that lie within the industry should not be considered. It also means that alternative may have to be sought outside the industry calling for diversification moves.

Porter's Five Forces is a business analysis model that helps to explain why different industries are able to sustain different levels of profitability. The model was originally published in Michael Porter's book, "Competitive Strategy: Techniques for Analyzing Industries and Competitors" in 1980.

The model is widely used to analyze the industry structure of a company as well as its corporate strategy. Porter identified five undeniable forces that play a part in shaping every market and industry in the world. The forces are frequently used to measure competition intensity, attractiveness and profitability of an industry or market.

These forces are:

1. **Threat of new entrants**

This force determines how easy (or not) it is to enter a particular industry. If an industry is profitable and there are few barriers to enter, rivalry soon intensifies. When more organizations compete for the same market share, profits start to fall. It is essential for existing organizations to create high barriers to enter to deter new entrants. Threat of new entrants is high when:

- Low amount of capital is required to enter a market;
- Existing companies can do little to retaliate;
- Existing firms do not possess patents, trademarks or do not have established brand reputation;
- There is no government regulation;
- Customer switching costs are low (it doesn’t cost a lot of money for a firm to switch to other industries);
- There is low customer loyalty;
- Products are nearly identical;
- Economies of scale can be easily achieved.

New entrants raise the level of competition in an industry and reduce its attractiveness. Threat of new entrants depends on barriers to entry. More barriers to entry reduce the threat of new entrants. Some of the key entry barriers are:

(i) Economies of scale

Industries where the fixed investment is high (such as automobiles), yield higher profits with larger scale of operations. In such industries, established players may have economies of scale of production which new entrants will not have, thus acting as a barrier.

(ii) Capital requirements

Industries that require large seed capital for establishing the business (such as steel) discourage new entrants that cannot invest this amount.

(iii) Switching costs

Customers may face some switching cost like having to buy new spare parts or train employees to run the new machine, in moving from one company to the other, thus discouraging movement of customers from existing players to new entrants.

(iv) Access to distribution

Established players may have access to the most efficient distribution channels. Distribution channel members may not tie up with new entrants who pose competition to their existing partners.

(v) Expected retaliation

If existing players have large stakes in continuing their business (large investment, substantial revenues, strategic importance), or if they are dominant players, they would retaliate strongly to any new entrant.

(vi) Brand equity

Existing players have established product reputation and built a strong brand image over the years. New players would find it hard to convince customers to switch over to their offering. To incumbent competitors, industry attractiveness can be increased by raising entry barriers. In fact, one of the main objectives of existing players in the industry is to erect strong entry barriers to prevent new competitors from entering the industry.

2. **Bargaining power of suppliers**

Strong bargaining power allows suppliers to sell higher priced or low quality raw materials to their buyers. This directly affects the buying firms' profits because it has to pay more for materials. Suppliers have strong bargaining power when:

- There are few suppliers but many buyers
- Suppliers are large and threaten to forward integrate
- Few substitute raw materials exist
- Suppliers hold scarce resources
- Cost of switching raw materials is especially high

Bargaining power of suppliers will be high when:

(i) Many buyers and few sellers

There are many buyers and few dominant suppliers. Suppliers would be in a position to charge higher prices or cause instability in supply of essential products. The buyers should develop more suppliers by agreeing to invest in them and helping them with technologies.

(ii) Differentiated supplies

When suppliers offer differentiated and highly valued components, their bargaining power is higher, since the buyer cannot switch suppliers easily. When many suppliers offer a standardized product, their bargaining power reduces. The buyer should bring the processes that enable the supplier to make differentiated products in-house and buy only standard components from the supplier.

(iii) Crucial supplies

If the product sold by the supplier is a key component for the buyer, or it is crucial for its smooth operations, then the bargaining power of suppliers is higher. The buyer should always keep the production of key components with itself.

(iv) Forward integration

When there is a threat of forward integration into the industry by the suppliers, their bargaining power is higher. There is a strong threat of forward integration when the supplier supplies a very crucial part of the final product. The supplier of engines to an automobile maker is in a very strong position to contemplate making automobiles because it already has expertise over a key component of the final product.

(v) Backward integration

When there is threat of backward integration by buyers, the bargaining power of suppliers becomes weaker, as the supplier may become redundant if the buyer starts making the same product. The buyer should always have an idea of the technologies that are being employed in making crucial and differentiated products and should be capable of putting together the resources to make these components. Suppliers should always understand that if the buyer is cornered, he will start making the components himself.

(vi) Level of dependence

When the industry is not a key customer group for suppliers, their bargaining power increases. Buyers are dependent on suppliers, though suppliers do not focus on the customer group. The suppliers can survive even when they stop supplying to the buyers as the major part of their business is coming from some other industry. The buyers should be careful in selecting their suppliers. They should select suppliers who have strong stake in the buyers’ industry and not those who only have peripheral interests in the buyers’ industry.

3. **Bargaining power of buyers**

Buyers have the power to demand lower price or higher product quality from industry producers when their bargaining power is strong. Lower price means lower revenues for the producer, while higher quality products usually raise production costs. Both scenarios result in lower profits for producers. Buyers exert strong bargaining power when:

- Buying in large quantities or control many access points to the final customer
- Only few buyers exist
- Switching costs to other supplier are low
- They threaten to backward integrate
- There are many substitutes
- Buyers are price sensitive

Higher bargaining power of customers implies that they can seek greater compliance from the companies of the industry.

(i) Few dominant customers

When there are few dominant customers and many sellers, customers can exercise greater choice. They also dictate terms and conditions to the supplier. This is true in industrial markets where many suppliers make standard components for a few Original Equipment Manufacturers. The OEMs are able to extract big concessions on price and coerce the suppliers to provide expensive services like just-in-time supplies. The suppliers have to agree to debilitating terms of the buyers if they have to continue to supply to them.

(ii) Non-differentiated products

If products sold by the players in the industry are standardized, or there are little differences among them, buyers can easily switch over to competitors, increasing their bargaining power. This is increasingly happening in consumer markets. Customers are not able to tell one manufacturer's product from that of another. The result is that the customers are buying mostly on price and the manufacturers are reducing prices to lure customers.

The problem with such an approach is that with reduced profits, a company's ability to differentiate its product further goes down. The manufacturer is caught in the spiral of low differentiation-low price-low profits- further low differentiation-further low prices-further low profits. The manufacturer has to break this chain and collect resources to differentiate its product so that it can fetch a higher price and profit.

(iii) Small proportion of customer's total purchase

If the product offered by the firm is not important or critical for the customer, the bargaining power of customers is higher. The product may be of a relatively smaller value in the overall disposable income of the customer. This may work out to be to the advantage of the seller.

The customer will not be overly worried if the supplier raises its price by small amount as the slightly increased expenditure will not be a big dent in the income of the customer. As level of economic prosperity rises, manufacturers of packaged foods and other fast moving consumer goods can increase the quality and price of their products. Customers would not mind paying slightly higher prices for better products.

(iv) Backward integration

Customers may threaten to integrate backward into the industry, and compete with suppliers. This may be a reality in industrial markets but it is very rare in consumer markets. Most customers do not have the resources to start making what they buy.

(v) Forward integation

Suppliers can threaten to integrate forward into customers' industry. The customers have to understand and contain the imminent threat of competition from their suppliers. This threat is meaningless in consumer markets but the threat is real in industrial markets, particularly when the supplier is supplying a key component.

(vi) Key supplies

The industry is not a key supplying group for buyers. In consumer markets, one manufacturer supplies only a small fraction of his total purchases.

4. **Threat of substitutes**

This force is especially threatening when buyers can easily find substitute products with attractive prices or better quality and when buyers can switch from one product or service to another with little cost. For example, to switch from coffee to tea doesn't cost anything, unlike switching from car to bicycle.

The threat of substitute products depends on:

(i) Buyer's willingness to substitute

Buyers will substitute when the industry's product is not strongly differentiated, so the buyers will not have developed strong preference for the product. In industrial markets, the product should be either enhancing value of the final product it becomes a part of, or is enhancing the operation of the buyer.

(ii) Relative prices and performance of substitutes

If the substitute enhances the operation of the customer without incurring additional costs, substitute product would be preferred.

(iii) Costs of switching over to substitutes

In industrial markets, if a company has to buy another manufacturer's product, the company will have to buy new spare parts and will have to train its operations and maintenance staff on the new machine.

The substitute products satisfy the same general need of the customer. The customer evaluates various aspects of the substitute products such as prices, quality, availability, ease of use etc. Relative substitutability of products varies among customers. The threat of substitute products depends on how sophisticated the needs of the buyers are, and how strongly entrenched their habits are. Some people will continue to drink coffee, and will never ever switch to drinking tea, no matter how costly coffee may become.

A company can lower threat of substitute products by building up switching costs, which may be monetary or psychological-by creating strong distinctive brand personalities and maintaining a price differential commensurate with perceived consumer value.

5. **Rivalry among existing competitors**

This force is the major determinant on how competitive and profitable an industry is. In competitive industry, firms have to compete aggressively for a market share, which results in low profits. Rivalry among competitors is intense when:

- There are many competitors
- Exit barriers are high
- Industry of growth is slow or negative
- Products are not differentiated and can be easily substituted
- Competitors are of equal size
- Low customer loyalty

The intensity of rivalry between competitors depends on:

(i) Structure of competition

An industry witnesses intense rivalry amongst its players, when it has large number of small companies or a few equally entrenched companies. An industry witnesses less rivalry when it has a clear market leader. The market leader is significantly larger than the industry's second largest player, and it also has a low cost structure.

(ii) Structure of costs

In an industry which has high fixed costs, a player will cut price to attract competitors' customers to fill capacity. A player may be willing to price just above its marginal cost, and since the industry's marginal cost is low, it is not unusual to see price cuts of 50-70 per cent Such price cuts are almost always matched by competitors, because all of them are trying to fill capacity. The inevitable result is a price war.

(iii) Degree of differentiation

Players of an industry whose products are commoditized will essentially compete on price, and hence price cuts of a player will be swiftly matched by competitors, resulting in intense rivalry. But when players of an industry can differentiate their products, they understand that customers do not associate the industry's products with a single price, and that the price of a product is dependent on its features, benefits and brand strength. Players of such an industry compete on features, benefits and brand strength, and hence rivalry is less intense. When a player cuts price, its competitor can react by adding more features, providing more benefits, or hiring a celebrity in its advertisements, instead of cutting price.

(iv) Switching costs

Switching cost is high when product is highly specialized, and when the customer has expended lot of resources and efforts to learn how to use it. Switching cost is also high when the customer has made investments that will become worthless if he uses any other product. Since a customer of a company is not likely to be lured by competitors' price cuts and other manoeuvres, competitive rivalry is less in such an industry.

(v) Strategic objectives

When competitors are pursuing build strategies, they will match the price cuts of a player because they do not want to lose market share to the player who has cut price. Therefore, rivalry will be intense. But when competitors are pursuing hold or harvest strategies, they will not be too keen to match the price cuts of a player, because they are more interested in profits than market share. Therefore, rivalry will be less intense.

(vi) Exit barriers

When players cannot leave an industry due to factors such as lack of opportunities elsewhere, high vertical integration, emotional barriers or high cost of closing down a plant, rivalry will be more intense. In such an industry, players will compete bitterly as they do not have the option to quit. But, when exit barriers are low, players who are not good enough, or who have found more attractive industries to enter, can exit. With fewer numbers of players in the industry now, rivalry will be less intense.

Although, Porter originally introduced five forces affecting an industry, scholars have suggested including the sixth force: complements. Complements increase the demand of the primary product with which they are used, thus, increasing firm's and industry's profit potential. For example, iTunes was created to complement iPod and added value for both products. As a result, both iTunes and iPod sales increased, increasing Apple's profits.

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