Business Environment

UNIT 1

MEANING OF BUSINESS ENVIRONMENT

Business is an organisation or enterprise engaged in producing goods and services for profit motive. It is a collective effort where a firm is engaged in commercial, industrial or professional activities. The main aim of business is to satisfy the needs of customers. The success of every business depends on adapting itself to the environment within which it functions. For example, with changes in the government policies, the business needs to adapt itself with the new policies. Similarly, any technological advancement may render the existing products obsolete, such as the introduction of smartphones has replaced the telephone to a greater extent. Therefore, it is very important to have a clear understanding of the basic concept of business environment and the nature of its various components.

Business environment includes those external factors and institutions over which it does not have any direct control. These factors affect the functioning of an organisation directly or indirectly. These include customers, competitors, suppliers, government, and the social, political, legal and technological factors, etc.

The set of external factors, such as economic factors, social factors, political and legal factors, demographic factors, and technical factors, etc., which are uncontrollable in nature and affect the business decisions of a firm, is called business environment.

The relationship between business and its environment can be explained by following points:

- Business is affected by its environment and, in turn, to some extent, it will also influence the external factors. Similarly, economic environment influences socio- cultural environment and vice versa. Other environmental factors also have same relationship with each other.
- The environmental factors are constantly changing. Similarly, business is also dynamic.
- One business firm, by itself, may not be able to change its environment. But together with other businesses, it will be in a position to mould the environment in its favour.

In this chapter, you will study the concept of business environment, its components and how it is important for organisations. You will also study about relationship between business environment and strategic management.

Business Environment

In general sense, all businesses aim to achieve multiple objectives. A business manager identifies and sets some important objectives like survival, stability, growth, profitability and efficiency. Enterprise needs to balance these objectives. Profit is the biggest stimulus for the survival of the business and its future development. There is always a risk involved in business and profit is the reward for taking the risk. Business can be established, but it is difficult to survive in this competitive world where whole world is one market. So, it is important for business to scan the environment.

Environment refers to all external forces which affect the functioning of business. Environment factors are largely, if not totally, external and beyond the control of individual industrial enterprises and their managements. The surrounding in which business operates is called business environment.

The word ‘Business Environment’ has been defined by various authors as follows:

According to Keith Davis, Business environment is the aggregate of all conditions, events and influences that surround and affect it.

According to Reinecke and Schoell, the environment of business consists of all those external things to which it is exposed and by which it may be influenced directly or indirectly.

These definitions give a clear understanding of the business environment. We can say that business environment is a combination or mixture of complex, dynamic and uncontrollable external factors within which a business is to be operated.

The change in tastes and preferences of customers, introduction of new technologies, innovations, government policies, etc., all are parts of the business environment. Business needs to accept and adapt these changes promptly to survive in the market. So, it is necessary for the business to analyse the business environment.

The business environment of an organisation usually poses threats as well as opportunities. To grasp the opportunities and reduce the threat, it is important to know the nature of business environment. Following are some points which describe nature of business environment:

◎ Internal and external environment: Every business is surrounded by internal and external environment. Internal environment can be controlled by an organisation, like men, money, material, machine and method, whereas external environment is uncontrollable like political conditions, technologies, legal regulations, etc.

◎ Dynamic and ever-changing: Business environment keeps on changing frequently in terms of technologies, government rules and regulations, socio-economic 3 conditions, etc., which make business dynamic.

◎ Complexity of the environment: Business environment cannot be easily analysed because of too much complexity involved. Environment consists of a number of factors, events, conditions and influences, generating from different sources which impact business, thus, making the business complex.

◎ Inter-relatedness: Factors of business environment are related to each other. For example, change in political parties will result in changing the government rules, fiscal policies, market conditions, technology, etc. So, all the factors need to be scanned properly because these factors are inter-related to each other.

◎ Uncertainty: It is difficult to predict the changes going to take place in future because environment keeps on changing. These changes are uncontrollable. So, business can only try to combat from these challenges. For example, in case of fashion industries, changes take place so frequently, economy could collapse any time.

◎ Impact: Impact means the effect of environment on business. Business environment has both long-term and short-term impacts on business. For example, different firms may get influenced differently from change in monetary policy.

◎ Inter-dependence: A business firm and its environment are mutually interdependent. The economic status of a country affects the development of technology or it may change the lifestyle of people.

The aspects which fall under business environment are as follows:

◎ Internal and external environment: Internal environment includes all those factors that are within an organisation and impart strength or cause weakness in business. For example, inefficient human resource, superior raw material, etc.

External environment includes those factors which are beyond the control of business and are outside the organisation. They provide opportunities and pose threat to business. For example, change in political conditions, technological change, etc.

◎ Specific and general environment: Specific environment includes external forces that directly impact or influence organisations' decisions and actions and are directly relevant to the achievement of organisations' goals. The main forces that make up the specific environment are customers, suppliers, competitors and pressure groups.

General environment includes the economic, political/legal, socio-cultural, demographic, technological and global conditions that affect organisations. External forces do not affect organisations to a great extent, but organisations must plan, organise, lead and control their activities taking into account these factors.

◎ Micro environment and macro environment: Micro environment impacts the working of a particular business. It has direct impact on business activities. It includes customers, suppliers, market intermediaries, competitors, etc. These

4 factors are controllable to some extent.

Macro environment is general environment that impacts the working of all businesses. It is uncontrollable and influences indirectly. Political conditions, economy, technology, etc., come under macro environment.

◎ Controllable and uncontrollable environment: All those factors which are governed by business come under controllable environment. Internal factors are treated as controllable factors, like men, material, machine, money, etc.

Uncontrollable factors are external and are beyond the control of business like technological change and law related change.

<u>Case Study 1: McDonald's - Adapting to Local Business Environments</u>

Scenario: McDonald's, the global fast-food chain, faced challenges while entering India due to cultural, religious, and dietary preferences.

Business Environment

Microenvironment Factors

Suppliers: Sourced local ingredients like wheat, vegetables, and spices to meet Indian tastes.

Customers: Adapted its menu to align with Indian preferences, introducing items like the McAloo Tikki burger and Paneer wraps to cater to vegetarian customers.

Competitors: Faced competition from Indian fast-food chains like Haldiram's and street vendors offering cost-effective meals.

Macroenvironment Factors

Social Factors: India's population has a significant vegetarian demographic due to religious and cultural reasons.

Economic Factors: Targeted the growing middle-class population with affordable meal options.

Political and Legal Factors: Complied with food safety standards and regulations imposed by the Indian government.

Environmental Scanning Techniques

1. SWOT Analysis:

Strength: Strong global brand recognition.

Weakness: Lack of understanding of local food habits initially.

Opportunity: Rising demand for Western-style fast food among youth.

Threat: Competition from local eateries and price sensitivity.

2. Porter's Five Forces:

Threat of New Entrants: Local players like KFC and Burger King.

Bargaining Power of Suppliers: Secured local partnerships to reduce dependency on imports.

Bargaining Power of Buyers: Price-sensitive customers demanded value-for-money meals.

Industry Rivalry: Intense due to local and global competitors.

Threat of Substitutes: Traditional Indian meals provided cheaper alternatives.

Case Study 2: Nike - Competitive Strategies Using Environmental Analysis

Scenario: Nike entered the global market with a strong focus on innovation and branding but had to address ethical and environmental concerns in manufacturing.

Microenvironment Factors

Suppliers: Relied on third-party manufacturers in developing countries like Vietnam and Indonesia.

Competitors: Faced stiff competition from Adidas, Puma, and emerging brands.

Customers: Targeted athletes, fitness enthusiasts, and the youth market through effective marketing campaigns.

Macroenvironment Factors

Technological Factors: Invested heavily in R&D for sustainable materials and advanced athletic gear.

Social Factors: Focused on promoting fitness and empowering women through campaigns like "Dream Crazier."

Environmental Factors: Criticized for its carbon footprint and labor practices, prompting initiatives for eco-friendly manufacturing.

Environmental Scanning Techniques

1. ETOP Analysis:

Opportunities: Growing demand for athleisure and sustainable products.

Threats: Negative publicity around labor conditions and counterfeit goods.

2. Porter's Five Forces:

Threat of New Entrants: Barriers like brand loyalty and economies of scale reduced risks.

Bargaining Power of Suppliers: Managed costs by diversifying suppliers across multiple countries.

Bargaining Power of Buyers: Maintained loyalty through innovation and premium products.

Threat of Substitutes: Competition from cheaper, unbranded athletic wear.

Industry Rivalry: High due to major global competitors.

NOTES

Following points describe the importance of business environment:

◎ Identification of business opportunities: Many opportunities are provided by business environment to the organisation. Scanning business environment would help business get the first mover advantage. If changes are analysed carefully, then they can be the reason for business success.

◎ Optimum utilisation of resources: Resources like raw material, machine, money, labour, etc., are input for business. All these inputs are provided by environment to the business firms for carrying out their activities and also expect something in return.

◎ Identification of threat and early warning signal: Business can recognise the threat by analysing the change taking place in the environment. For example, if any new multinational company is entering the Indian market, the manager of an Indian firm dealing with same product as that of the multinational company should take it as a warning signal. Before the MNC launches its product, the manager should implement measures, such as improving the quality of his product and heavy advertisement.

◎ Coping with the rapid changes: To efficiently cope with these changes, managers must understand the environment and should adopt appropriate courses of action at the right time. It helps management become more sensitive to ever-changing needs of customers. As a result, they are able to respond to such changes effectively.

◎ Meeting competition: This helps firms analyse competitors' strategies and formulate their strategies accordingly.

◎ Identifying firm's strength and weakness: Business environment helps identify the individual strength and weakness in view of the technological and global developments.

◎ Assisting in planning and policy formulation: Business environment brings both threats and opportunities to a business. Having a good understanding of the business environment can immensely help an organisation's management in their future planning and decision-making endeavours. For example, competition increases with the entry of new firms in the market.
The management has to draft new plans and policies to deal with new competitors.
Environmental awareness provides intellectual stimulation to planners in their 5
decision making. They can make changes in their plans efficiently and effectively.

Significance of Business Environment:
Business Environment refers to the "Sum total of conditions which surround man at a given point in space and time. In the past, the environment of man consisted of only the physical aspects of the planet Earth (air, water and land) and the biotic communities. But in due course of time and advancement of society, man extended his environment through his social, economic and political function." In a globalised economy, the business environment plays an important

role in almost all business enterprises.

The significance of business environment is explained with the help of the following points:

(i) Help to understand internal Environment: It is very much important for business enterprise to understand its internal environment, such as business policy, organisation structure etc. In such case an effective management information system will help to predict the business environmental changes.
(ii) Help to Understand Economic System: The different kinds of economic systems influence the business in different ways. It is essential for a businessman and business firm to know about the role of capitalists, socialist and mixed economy.

(iii) Help to Understand Economic Policy: Economic policy has its own importance in business environment and it has an important place in business. The business environment helps to understand government policies such as, export-import policy, price policy; monetary policy, foreign exchange policy, industrial policy etc. have much effect on business.

(iv) Help to Understand Market Conditions: It is necessary for an enterprise to have the knowledge of market structure and changes taking place in it.

(v) The knowledge about increase and decrease in demand, supply, monopolistic practices, government participation in business etc., is necessary for an enterprise.

ENVIRONMENTAL MATRIX

A matrix organization is a work structure where team members report to multiple leaders. In a matrix organization, team members (whether remote or in-house) report to a project manager as well as their department head.

A matrix for environmental impact assessment (EIA) is a tool that is used to organize and present information about the potential environmental impacts of a proposed project or development. The matrix identifies the environmental factors that the project may impact and the potential effects of those factors.

An "environmental matrix" in a business context refers to a strategic tool used to analyze and categorize external factors (like economic, political, social, technological, legal, and environmental) that can impact a company, allowing them to identify potential opportunities and threats to develop appropriate strategies; essentially, it's a structured way to assess the external business environment by mapping out key factors across different categories, often presented in a matrix format on a PDF document.

Key points about an environmental matrix:

Components:

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The matrix typically includes rows representing different environmental categories (like political, economic, social, technological, legal, and environmental) and columns detailing specific factors within each category.

Analysis process:

Identify relevant factors: Businesses list key external factors within each category that could significantly impact their operations.

Assess impact: Evaluate the potential positive or negative impact of each factor on the business, considering both opportunities and threats.

Prioritize factors: Analyze the severity and likelihood of each factor occurring to prioritize which ones require the most attention in strategic planning.
Benefits of using an environmental matrix:

Comprehensive overview:

Provides a structured way to systematically examine a wide range of external factors.

Strategic decision-making:

Helps businesses identify potential opportunities and threats to develop proactive strategies.

Improved awareness:

Enhances understanding of the complex dynamics within the business environment.

Business Environment

In a business environment, the most commonly used "environmental matrix" refers to the PESTLE analysis, which considers six key environmental factors: Political, Economic, Social, Technological, Legal, and Environmental, meaning there are six environmental matrices within this framework.
Explanation:

- **Political:** Government policies, regulations, and political stability.
- **Economic:** Interest rates, inflation, unemployment, disposable income.
- **Social:** Demographics, cultural trends, lifestyle changes.
- **Technological:** Technological advancements, innovation, automation.
- **Legal:** Laws, regulations, compliance issues.
- **Environmental:** Ecological concerns, sustainability issues, resource availability.

Forces Affecting Business Environment

Examining the internal and external types of business environments to develop appropriate methods for dealing with any anticipated situation.

If a firm wants to be successful in the marketplace, it needs to first understand the many factors that influence its growth. Being aware of the good and negative influences within and outside the firm will help the organisation devise appropriate plans to deal with even unforeseen events. So, the most crucial responsibility for an organisation before launching any strategic marketing plan

is to examine the types of business environments. The external factors of a business environment impact business success, scale, vision, and development plans.
The firm may develop appropriate plans to tackle any foreseen or unpredicted scenario by understanding both positive and negative forces affecting the business environment within and beyond the firm.
Let’s take a look at these types of business environment factors here.

Economic Factors

Every facet of daily life, from employee well-being to a company’s growth, is influenced by the state of the economy. Businesses may have to work harder to keep their employees and adapt their operations to continue earning money if the economy declines and unemployment grows. For instance, if the company makes products for retail sales, it can consider lowering the price to boost sales and improve revenue.

Political Factors

Developments in politics and legislation may have an impact on a company’s ability to operate freely. Government policies, such as changes in trade tariffs and tax policy, have a significant impact on the operations of corporations.
For instance, a country with a stable government and uniform trade legislation typically attracts more foreign business since this helps increase investor confidence. Companies working within this framework may be less willing to conduct business in countries without favourable policies.

Sociocultural Factors

Social demographics and socio-cultural settings, or a blend of social and cultural elements, are other external factors of a business environment. Population size and cultural trends, as well as demographics such as age, gender, and ethnicity, are sociocultural influences. Businesses consider their target demographics when advertising to consumers to determine the most effective ways to reach and engage with them.
The rise in health consciousness in the general public is one example of a socio-cultural aspect that impacts businesses, causing corporations to promote certain items differently. As a result of this increased consumer knowledge, several soda producers are now offering more diet soda options and natural fruit flavours to appeal to health-conscious customers.

Demographic Factors

Successful businesses assess the demographics of their target market to ensure that their products and services best suit the demand of the audience. This is one of the biggest types of business environment factors that should be considered as it may significantly affect the growth of any organisation. Consumer surveys are an excellent way to understand consumer needs and predict trends in the market. This enables them to determine whether their target market has changed and how they may improve their services to existing clients while also attracting new ones.

Technological Factors

Business Environment

Automation: Many low-skilled operations can be automated, allowing corporations to replace human-operated manufacturing lines altogether with machine-operated ones. Manufacturers, wholesalers, supermarkets, and a variety of other industries can all benefit from this. This is especially useful to increase the efficiency of repetitive manual tasks and reduce human error. On the flip side, technological unemployment is a fast emerging threat to those employed to do menial tasks.

Internet connectivity: Worldwide internet connectivity has increased manifold in the recent past. With almost all businesses now having a digital footprint, the world is an open market. On the other hand, a global increase in internet connectivity may lead to a drop in interest in traditional communication methods, which could be a hindrance for some. Telephone service providers will have to change their offerings to stay relevant, and brick and mortar stores too are now adopting a hybrid model to sustain in the market.

Competitive Factors

By keeping track of their competition, businesses may expand their market share and remain relevant to their customers. They can recognise and assess the strengths and weaknesses of competitors, allowing them to learn what to include in their processes and how to avoid income loss. They can also use the data they collect to develop new product ideas, such as product revisions, relaunches, and new product development.

Legal Factors

The law that protects intellectual property rights is an example of a legal aspect that has an impact on enterprises. This law prevents piracy, which may result in a movie studio losing money if their latest film were to be sold illegally on rival streaming sites.

Impact on business

A company’s ability to procure resources and export items can be shaped by general environmental pressures. They can also influence essential areas of their business, such as the willingness of their customers to buy their product. For instance, the sociocultural force of people migrating to streaming movies has reduced the popularity of movie theatres and movie rental services.

These types of business environments shape an organisation’s strategy and determine its overall success. When deciding what to offer and how to promote their products, it is beneficial for a company to analyse all the factors that influence their success, so they can be proactive in spotting opportunities and mitigating risks.

The performance of an organisation is affected by the business environment. It has a far-reaching impact on its survival, profit and growth. There are certain forces inside and outside the organisation. These forces affect the business both in positive and negative ways.

Business Environment

<u>Various components of business environment are as follows:</u>

- **Internal environment:** These are those factors or conditions that exist within an organisation and affect its performance. These factors are controllable in nature and organisation can try to change or modify these factors. Organisation's resources like men, material, money, method and machine come under internal environment. Various internal factors are as follows:
- **Value system:** The values are the ethical beliefs that guide the organisation in achieving its mission and objectives. It is framed by top-level managers like board of directors. The extent to which the value system is shared by all in the organisation is an important factor contributing to its success.
- **Mission and objectives:** The objective is the end towards which business activities are directed. All businesses focus on maximisation of profit. Mission is defined as the overall purpose or reason for its existence. A mission guides and influences an organisation's decisions and economic activities. An organisation can change or modify its mission and objective accordingly.
- **Organisation structure:** The organisational structure is the hierarchy in business that define roles, responsibilities and supervision. The composition of the board of directors, the professionalism of management, etc., come under organisation structure and are important factors influencing business decisions. For efficient working of a business organisation and to facilitate prompt decision making, the organisation structure should be conducive.
- **Corporate culture:** Shared values and belief in an organisation which determine its internal environment are called corporate culture. Organisation where there is strict supervision and control results in lack of flexibility and unsatisfied employees. The sets of values that help members understand what organisation stands for how it does work, what it considers, cultural values of business forces of business, and so on. It helps in direction of activities.
- **Human resources:** Human quality of a firm is an important factor of internal environment. Skills, qualities, capabilities, attitude, competencies and commitment of its employees, etc., could contribute to the strengths and weaknesses of an organisation. Organisations may find it difficult to carry out modernisation and redesigning because of resistance by its employees.
- **Physical resources and financial capabilities:** Physical resources, such as plant and equipment, facilities and financial capabilities of a firm determine its competitive strength which is an important factor for determining its efficiency and unit cost of production. Also research and development capabilities of a company determine its ability to introduce innovations which enhance the productivity of workers. Financial capabilities are company's source of fund generation.
- **External environment:** These are those factors and the conditions which are outside the organisation and affect the performance of business. External factors are further divided into micro environment and macro environment which are as follows:

Business Environment

- **Micro environment:** Those factors which have direct impact on business. The various constituents under micro environment are as follows:
- **Suppliers of inputs:** The suppliers of inputs are important factors in the external micro environment of a firm. Suppliers provide raw material and resources to the firm. A firm should have more than one supplier for proper inflow of inputs.
- **Customers:** They are the buyers of firm's products and services. Customers are an important part of external micro environment because sales of a product or service are critical for a firm's survival and growth, so it is necessary to keep the customers satisfied.

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- ✓ **Marketing intermediaries:** Intermediaries play an essential role of

  selling and distributing its products to the final customers. Marketing intermediaries are an important link between a business firm and its ultimate customers. Retailers and wholesalers buy in bulk and sell business products and services to the ultimate consumer.
- ✓ **Competitors:** Competitors are the rivalry in business. Competition can based on pricing of products or based on competitive advertising. For example, organisations may sponsor some events to promote the sale of different varieties and models of their products. Business formulates strategies after analysing their competitor.
- ✓ **Public:** Public or groups, such as environmentalists, media groups, women's associations, consumer protection groups, are important factors in external micro environment. Public, according to Philip Kotler, is any group that has an actual or potential interest in or impact on the company's ability to achieve its objective.

- **Macro Environment:** These are the factors or conditions which are general to all businesses and are uncontrollable. Because of the uncontrollable nature of macro forces, a firm needs to adjust or adapt it to these external forces. These factors are as follows:

- ✓ **Economic environment:** All those forces which have an economic impact on businesses are called economic environment. It includes agriculture, industrial production, infrastructure, and planning, basic economic philosophy, stages of economic development, trade cycles, national income, per capita income, savings, money, etc., For example, low per capital income will negatively impact business because people have less money to spend.
- ✓ **Political-legal environment:** The activities of legislature, executive and judiciary play a vital role in shaping, directing, developing and controlling business activities. Rules and regulations, framed by the government, like licensing policy, polythene ban, etc., affect the business. Business growth can be achieved by using a stable and dynamic political-legal environment.
- ✓ **Technological environment:** Systematic application of scientific or other organised knowledge to practical tasks or activities is called technology. As it is changing fast, businessmen should keep a close look on those technological changes for its adaptation in their business activities.

Business Environment

- ✓ **Global or international environment:** The global environment is also important for shaping business activity. In the era of globalisation, whole world is a market. Business analyses international environment to cope up with the changes.
- ✓ **Socio-cultural environment:** People's attitude towards work and wealth, lifestyle, ethical issues, role of family, marriage, religion and education and also social responsiveness of business affect the business.
- ✓ **Demographic environment:** Population size and growth, life expectancy of the people, rural-urban distribution of population, the technological skills and educational levels of labour force come under demographic environment. These features also affect the functioning of organisations.
- ✓ **Natural environment:** The natural environment plays an important role as it provides raw materials and energy for production in a firm. Natural environment consists of geographical and ecological factors a such as minerals and oil reserves, water and forest resources, weather and climatic conditions and port facilities. These are very important for many business activities. For example, in places where temperatures are high, the demand for coolers and air conditioners is high. Also, demand for clothes and building materials depends on weather and climatic conditions. Natural calamities like floods, droughts, earthquakes, etc., immensely affect business activities.

<u>Micro and macro environments</u>

Micro and macro environments are terms used to describe the factors that affect a business or a system. The micro environment is specific to a business, while the macro environment is broader and can affect many businesses.

Micro environment

- **Definition:** The factors that directly impact a business's operations and customers
- **Examples:** Customers, suppliers, competitors, and employees
- **Importance:** Understanding the micro environment helps businesses adapt to customer needs and stay competitive
- **Management:** Businesses can manage or influence the micro environment by monitoring customer preferences, competitor strategies, and supplier performance Macro environment

Definition

The broader factors that can affect a business, such as the economy, society, and technology

Examples: Economic, technological, social, political, and environmental influences

Importance: Businesses can use the macro environment to identify potential opportunities or risks

Management: Businesses must adapt and respond to the macro environment, which they cannot easily manipulate

The terms micro and macro can also be used to describe the physical conditions of a system, such as a barn or pasture the Micro Environment and Macro Environment

Business Environment

The business environment is a significant component of any business as it is to be considered for making the right decision at the right time. It also enables a business to be competitive in the industry and grow, prosper and thrive. This environment is the set of external influences over which the company has little or no direct control. The business environment can be classified into two broad categories, i.e., the Micro Environment and Macro Environment. Both Micro and Macro environments are essential for any business to operate efficiently within its industries and consumer markets. Therefore, the company needs to understand each of these environments to take the necessary steps to ensure its viability, growth, and success within the markets.

What is a Micro-Environment?

The micro-environment or the working environment of a business is a set of factors directly linked to the functioning of that particular business. It encompasses all factors, like people, organization structure, technology, administration, etc. These factors act as an input to the decision-making process by the managers for them to carry out their tasks well.

What is a Macro-Environment?

The macro-environment is a term used to describe the overall economic condition of any country. It is also referred to as the general business environment. The elements comprise overall market trends, exchange rates, inflation rates, and stock indexes. The macro-environment is the sum of all these factors. It is important to note that while the micro-environment directly affects the functioning of a business, the macro-environment influences it indirectly.

What are some Micro-Environment Factors?

The main factors that influence the macro-environment are the overall global economy, exchange rates, economy of goods and services, unemployment rates, inflation rates, stock indexes, etc.

What are some Macro-Environment Factors?

The essential elements of the Macro-environment are overall consumer demand trends and consumer disposable income trends. Other factors like general economic growth and consumer prices also play a vital role in the macro-environment.

What is the difference between Micro and Macro environments?

To understand the difference between micro and macro environment, it is essential to know what they are. As discussed above, the micro environment pertains to various factors that influence particular business activity and are considered inputs for decision making. On the contrary, the macro-environment includes factors that influence all businesses (like interest rates), considered outputs for decision-making. It is important to note that all businesses do not consider the macro environment despite its importance. Some businesses consider direct micro factors to be more important than the macro environment.

What is the Importance of Micro and Macro Environment?

Understanding and adequately analyzing the micro and macro environment is critical for any business. It enables a business to decide its future course of action within its markets, further determining its success or failure. In addition, the microenvironment of a business is directly linked to the organization's performance within its industry. Therefore, any decision taken must be so that it helps improve the performance of the overall business process while also considering various other factors within the organization. Similarly, the macro-environment impacts a company's financial policies, such as fixed costs or variable costs (direct & indirect), which directly affect the profit margin and liquidity of a company.

ENVIRONMENT SCANNING TECHNIQUES

SWOT Analysis:

SWOT analysis is a technique used to evaluate the strengths and weaknesses of any organization or product. This analysis also helps identify the opportunities and threats it faces to design appropriate strategies, considering the competition. The strength of a company refers to its ability to offer services or products that customers demand. For example, Apple has been known for the advanced technology behind its iPhones. This is one of the main strengths of Apple, which enables it to operate within its markets successfully. On the other hand, weakness is where a business lacks an edge over others compared to its competitors.

How does SWOT Analysis help Businesses?

SWOT-analysis helps businesses assess various aspects of the organization or product effectively. A business can focus on its strengths and weaknesses to improve upon them by developing strategies. For example, suppose a company is lacking behind in terms of technology. In that case, it can adopt a strategy to attract more customers towards its products by providing discounts and other schemes. The additional revenue acquired from this strategy will help the company overcome its weaknesses. Similarly, SWOT analysis helps businesses identify their opportunities and threats within their markets to prepare for them accordingly.
SWOT analysis refers to the analysis of both the internal and external environments of an organisation. In this term, S stands for Strengths and W stands for Weaknesses. Both these terms are internal components of an organisation. O stands for available Opportunities in the market and T stands for the possible Threats in the market. Both of these are the external components of the organisation.

Let us discuss these above-mentioned terms in detail:

Strengths: The term 'strengths' basically means the things you are good at or your capabilities. In the organisational context, it means the core competencies or capabilities of an organisation for which it can gain strategic advantages from its competitors. Even if it does not gain any advantages over competitors, it refers to an organisation's capacities in which the organisation is having affirmative aspects.
Strength is necessary for every organisation to gain competitive advantages. For example, some organisations have their employees as their strength and some organisations may have low cost of production as their strength.

Weaknesses: Weaknesses are exact opposites of Strengths. While strengths are competitive advantages, weaknesses are competitive disadvantages of an organisation. Weaknesses are responsible for downfall of an organisation. The term 'weakness' also refers to the things in which the organisation is not good. For example, an organisation might not have better marketing strategies in comparison to its competitors. Then, in such a case, marketing would be its weakness.

Opportunities: The term 'opportunity' means a chance to grab on in a positive sense. This is actually a favourable condition or circumstances present in the external environment, which should be grabbed by the organisation, in order to increase its strengths and gaining competitive advantages. A company's strategist must be aware of the coming opportunity in the market, so that it could grab them on time and could raise revenues and profits; for example, sudden rise in demand of customers, new government policies in the favour of the organisation, emerging technologies, etc.

Threats: The term 'threat' means exposing vulnerability of something which might create an adverse impact. In an external environment, if suddenly or even gradually some changes occur

and those are not in favour of the organisation, then these are called threats to the organisation. For example, a changes in preferences of customers, and changes in government policies, which are not in favour of the organisation, are considered as threats to the organisation.
It is not necessary that an organisation has only its one single strength. An organisation might have one or more strengths at one time. More number of strengths would give an organisation more competitive advantages. An organisation might have one or more weaknesses which would degrade its competitive position in the market. The weakness of an organisation would factually hamper the growth of an organisation. The strengths and weaknesses of an organisation could be collectively determined and this combination would create a collective impact on the organisation and it is called a circumstance of synergistic effect. The concept of synergy says that if two things are merged together, then the resulting effect could be greater or lesser. This means when strengths and weaknesses of a company are understood together, then they could create a resulting strength or resulting weakness. This could be better understood as ‘two plus two could be either five or three’.

The SWOT analysis is a tool to evaluate the strengths, weaknesses, opportunities and threats of an organisation. Every organisation must do this analysis very effectively, as all these areas are necessary to be understood in detail. A strategy would be formed on the basis of these elements only. Through SWOT analysis, a detailed study could be done about both internal and external factors of an organisation.
The SWOT analysis as a whole matches the organisation’s strengths and weaknesses with the market’s opportunities and threats. It is in the organisation’s self-interest to use its strengths to exploit the available opportunities in the market. Further, an organisation must neutralise its weaknesses and avoid the possible threats in the external environment of the organisation. A four-cell matrix is being used to perform the SWOT analysis. In this matrix, the cells are referred to as strengths,

WEAKNESSES, OPPORTUNITIES AND THREATS.

SWOT ANALYSIS OF APPLE INC.

SWOT analysis is basically an analysis of company or organisation’s strengths, weaknesses, opportunities and threats. Here is a case study of Apple Inc. on SWOT analysis.
Apple had launched its new phone iPhone 7 in an event. It has also expanded its business boundary by launching Apple watch, and Bluetooth headphones, also
known as AirPod.

Apple’s Strengths

iPhones have created a unique brand identity for themselves. People are willingly ready to spend lakhs in the name of iPhone. The logo of Apple is a symbol of status these days. Moreover, Apple’s product design is artistic, yet simple, rich and royal and creative too. Apple has customer faith and its brand value has worldwide recognition. Its brand value is so high that most of the Apple’s products are often pre-ordered worldwide. Moreover, Apple utilises its image to sell a way of life of imagination, extravagance and smoothness. This is how it advertises its items: Not as a straightforward contraption, yet as a route into its designed and planned world. This is why, its revenues and, subsequently, its profit margin are too high in products like Mac Laptop, iPhone, iPad, etc.

Apple's Weaknesses

One of the greatest weaknesses of Apple is its high prices of products. Although its prices are high, but it restricts its buyers from upper middle class to high class. Usually, a PC can be bought for $200. On the contrary, Apple's Mac laptop costs around $1100-$1200+. If offered at a sale price, the sales reduce the price of the product by only $50-$100. Only the students are able to get the laptops at discounted prices. If we take globally, then there are a number of lower-class people who couldn't afford to buy Apple products. Apple ignores this class of customers. We can say that this is a great weakness of Apple Inc.

Apple's Opportunities

Apple has witnesses a potential advantage in teaming up with various solid and existing brands identified with its commercial centre. With its new AirPods, it has collaborated with Beats earphones to present the new remote Beats X close by its iPhone 7. Moreover, Nintendo is bringing another amusement, Mario Run, to iPhone
— consolidating the Apple name with the notable diversion face of Nintendo. This is another incredible brand which could get gigantic numbers from its numerous fans all over the world. Apple's present advancement can be derided, criticised or cheered. In any case, the business openings from working together with other expansive brands over the world will profit the Apple brand monstrously, insofar as it keeps on building up these business connections.

Apple's Threats

Ever since Apple Inc has entered in the market, its biggest threat is innovation. It keeps on producing the same kind of products. The regular customer might lose interest after some time. While Apple's structure is smooth and short-sighted, that is actually what makes it simple to imitate. Worldwide stores sell counterfeit renditions of iPhones and iPod contacts which, outwardly, look about indistinguishable. Furthermore, numerous individuals fall for the tricks of 'overly cheap Apple items' sold on the web. Another threat to Apple products is competition. Companies like Samsung have captured the market with the launch of the concept of androids in the market. Apple has heightened its competition by not providing earphones in its new model, iPhone 7. Moreover, android companies are providing the same facilities at much cheaper rates.

ETOP: It analyses the external components of the business environment. It is basically the study of
factors that are responsible externally to affect the business functioning. It is essential to study the impact
of external components which might create an impact on an organisation. Components can be both
positive and negative or even neutral in nature. Thus, it becomes necessary to determine which aspects
will create a positive impact and which will create a negative impact.

ETOP (Environmental Threat and Opportunity Profile

Business Environment

) Analysis

The identification of environmental issues is helpful in structuring the environmental appraisal so that the strategists have a good idea of where the environmental opportunities and threats lie.

Structuring the environmental appraisal is a difficult process as environmental issues do not lend themselves to a straightforward classification into neat categories. An issue may arise simultaneously from more than one sector of the environment. Strategists have to use their experience and judgement to place the different environmental issues where they mainly belong, so that clarity emerges.
There are many techniques available to structure the environmental appraisal. One such technique, suggested by Glueck, is that of preparing an environmental threat and opportunity profile (ETOP) for an organisation.
ETOP (environmental threat and opportunity profile) is a technique to structure environmental issues.

ETOP involves:

- Dividing the environment into different sectors. each sectors can be subdivided into sectors.
- analyzing the impact of each sector and subsector on the organization
- Describe the impact in the form of statement.

A summary ETOP may only show the major factors for the sake of simplicity.
Advantage of ETOP

- it provides a clear of which sectors and sub sectors have favorable impact on the organization. it helps interpret the result of environmental analysis
- the organization can assess it competitive position
- appropriate strategies can be formulated to take advantage of opportunities and counter the threat

ETOP further analyzes the impact of each sector and sub-sector on the organization.
For example, GE Oil & Gas as an existing organization in this sector requires to scan the environment from an industry perspective: O&NG industry is divided into three major sectors – upstream, midstream and downstream.

Example of ETOPAnalysis Lets take the example of the environment analysis of Hindustan Aeronautics Limited (HAL) Variable Opportunity Threat Economic Infrastructural development is enhanced. This development includes power supply, transport and internal consumption Resource constraints.

Technological Organization’s production increases and technology upgrades that helps the organization to grow Supplier Scarcity of resources due to implementation often new technology. Government Liberalization of technology import policy. Applying new rules and policies for the organization Competitor To hold the market, organization needs to take the risks based on new ideas to raise the market demand.

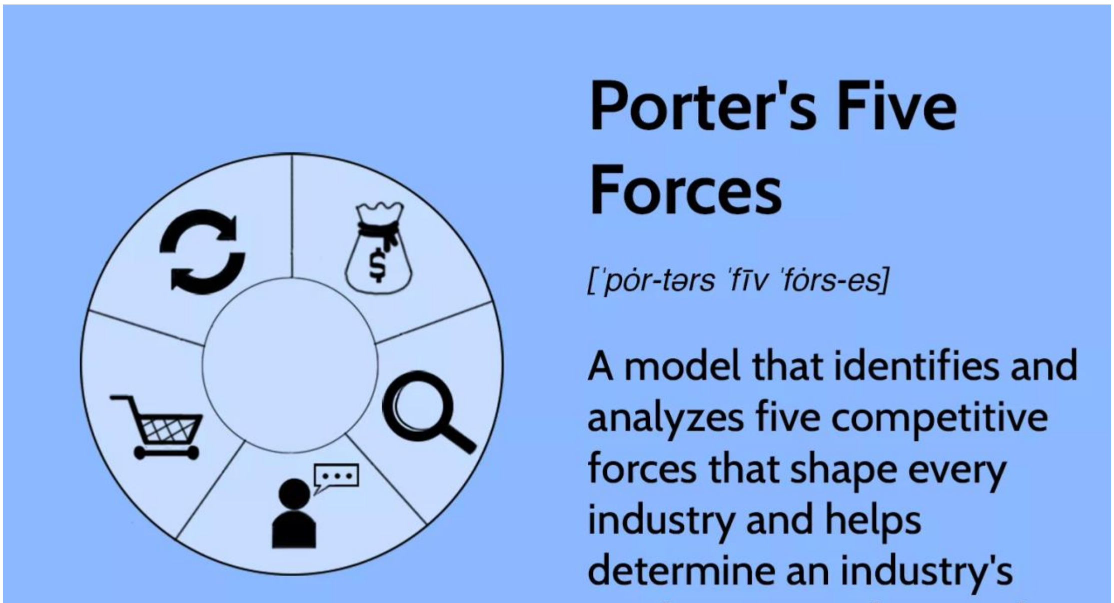
Business Environment

EXAMPLE : MILLIPORE COMPANY LTD, India ABOUT MILLIPORE Millipore is a multinational company, high technology, Bioscience Company that provides technologies, tools and services for the development and production of new therapeutic drugs. The company, headquartered in Bedford, England.
It serves the worldwide life science research, biotechnology and pharmaceutical industries. In India its subsidiary company was located in Bangalore. MILLIPORE PRODUCT LINE Life science, Drug discovery, Sample preparations, Lab water, Process development, Bio production, & Process monitoring.

Porter's Five Forces MODEL

What Are Porter's Five Forces?
Michael Porter's five-force strategic analysis model, introduced in a 1979 article published in the Harvard Business Review, remains a fundamental tool for strategic analysts plotting the competitive landscape of an industry.
In a bid to mirror the complexity real strategists would face while keeping their strategic analysis manageable, Porter set out five forces at play in a given industry: internal competition, the potential for new entrants, the negotiating power of suppliers, the negotiating power of customers, and the ability of customers to find substitutes. Below, we take you through each of Porter's five forces, detail the significant critiques of his approach, and show how to apply the model to specific markets.
KEY TAKEAWAYS

- Porter's five forces are used to identify and analyze an industry's competitive forces.
- The five forces are competition, the threat of new entrants to the industry, supplier bargaining power, customer bargaining power, and the ability of customers to find substitutes for the sector's products.
- The model guides businesses in determining the intensity of competition and potential profitability within their market, helping them better understand where power lies in their sector.
- Porter's model was meant to critique "perfectly competitive" business models, unlike real-world markets where competitors aren't just rivals and firms in specific industries tend to rise and fall together.
- Criticisms mounted against the model include that it's too static, doesn't speak to the advantages or problems of specific companies, doesn't account enough for collaborative business models, and doesn't apply as well to quick-changing markets.



Business Environment

Understanding Porter's Five Forces

Strategic analysis at the time of Porter's article tended not only to love acronyms (SWOT, PEST, PESTEL, BCG Matrix, ETPS, etc.) but also models focused on the internal dynamics of individual companies.
While it would be unfair to suggest they ignored the competitive environment companies face, they were typically vague while doing so; e.g., the "opportunities" and "threats" of SWOT analysis were too "macro" for many dealing with the challenges of specific industries.
Porter's Five Forces
1. Competitive Rivals
Porter's first force is what we usually mean when discussing business competition. We think of Pepsi and Coca-Cola for soft drinks, Apple and Samsung for smartphones, Nike and Adidas for sneakers, and Ford and General Motors for autos.
Indeed, some of these rivalries are so influential that consumers split almost culturally among those who have an iPhone, drive a Ford, or prefer Netflix to Hulu. Thus, it's no accident that we also consider business competition chiefly a war among rivals.
Such rivalries can lead to price wars, high-priced marketing battles, and races for slight advances that could mean a competitive advantage. These tactics can stimulate companies to make ever better products but also erode profits and market stability.3
Several factors contribute to the intensity of competitive rivalry in an industry:

- **The number of competitors:** The more competitors in an industry, the more fierce the rivalry, each fighting for scraps of market share.
- **Industry growth**: In an expanding industry, competition is usually less dramatic because the market is growing so fast that competitors have little need to fight for customers—think of the automobile industry of the early 20th century and the dot-com boom of the late 1990s. However, in a stagnant or declining industry, competition can be ferocious as firms fight for a larger piece of a shrinking pie, such as in the global coal mining or print media industries of today.
- **Similarities in what's offered:** When the products or services in a market are awfully similar (think of the lower page of results in any Amazon product search), competition tends to be intense because customers can easily switch. However, if a company offers a unique product or service or has earned brand loyalty, this can reduce competitive rivalry. Apple, Inc. (AAPL) comes to mind in tech goods, just as Rao's Italian sauces or King Arthur flour do in your supermarket aisles, each charging a higher price given its style, taste, or whatever makes it unique.
- **Exit barriers:** When it's difficult or costly for companies to leave the industry due to specialized assets, contractual obligations, or emotional attachment, they may choose to stay and

compete, even if the market's prospects grow dimmer by the day. The airline industry is a classic example. Airlines have high costs for their assets, contractual obligations (leasing agreements and labor contracts), and regulatory requirements, which means that when airlines face a shrinking market—or even an unprofitable route—they can't retreat from the market quickly.

- **Fixed costs:** Porter notes that if an industry has high fixed costs, companies have a "strong temptation" to cut prices rather than slow production when demand slackens. Paper and aluminum manufacturing are two good examples that Porter gives.1

2. Potential for New Entrants in an Industry

Industries where new firms can enter more easily almost always have lower profit margins, and the firms involved each have less market share.1

The sector for local restaurants has relatively low entry requirements: there aren't significant investments or regulatory hurdles to surmount before opening to the public. Thus, it's also the case that your favorite restaurant may not stay open for long, given the hypercompetitive environment and constant entrance of new restaurants opening.

Here are factors in measuring how much new entrants threaten an industry:

- **Economies of scale:** Industries where large-scale production leads to lower costs face less of a threat from new entrants. New firms would need to achieve a similar size to compete on price, which might be difficult or costly.
- **Product differentiation**: When existing firms have strong brand identities or customer loyalty, it's harder for new entrants to gain market share, reducing the threat of entry.
- **Capital requirements:** High startup costs for equipment, facilities, etc., can deter new entrants. For example, starting a car manufacturing business requires significant investment, so until Tesla Inc.'s (TSLA) growth in the early 2010s, Americans from the 1950s could have named the major U.S. car brands of the early 2000s.
- **Access to distribution channels:** If existing firms control the distribution channels—retail stores, online platforms, cable infrastructure, etc.—then new entrants would need to find a way to replicate that structure while competing with the established firms on price, a tricky proposition.
- **Regulations:** Licenses, safety standards, and other regulatory standards can create barriers, making it too ungainly or costly for new firms to enter the market. Examples would include those looking to build new hotels in downtown areas or supply power to a region.
- **Switching costs:** If it's costly or difficult for customers to switch from existing firms to new entrants, the threat of entry is lower.

3. Supplier Power

Suppliers are powerful when they are the only source of something important that a firm needs, can differentiate their product, or have strong brands.

When the power of suppliers in an industry is high, this raises costs or otherwise limits the resources a firm needs. Here are some factors used to measure the supplier power of an industry:

- **The number of suppliers:** When few firms can give a company something it needs to stay in business, each has greater negotiating power. They can raise prices or reduce quality without fear of losing business.
- **Uniqueness:** If a supplier provides a unique product or it's not easy to find a substitute, it

is more dominant. Businesses can't easily switch to another supplier.
- **Switching costs**: If it's costly or time-consuming to switch suppliers, then they have more power. Businesses are less likely to switch, even if prices increase.
- **Forward integration:** If suppliers can move into the buyer's industry, they have more power. They already have access to the necessary supplies, making it difficult for their former buyers to compete once they decide to enter the market themselves.
- **Industry importance:** Some sectors are tightly intertwined, such as automotive suppliers and the major auto companies or the semiconductor and tech industries, which can balance the power between the suppliers and those in the sector. This is because the supplier needs these buyers to do well so that it can, too. When a supplier can just as easily sell its products elsewhere, that gives it a great deal more power.

4. Customer Power

When customers have more strength, they can exert pressure on businesses to provide better products or services at lower prices. This force intensifies under certain conditions:
- **The number of buyers:** The fewer the buyers, the more they have power. In sectors like aerospace manufacturing, each major airline, the industry's customers, has significant leverage in negotiations and can demand favorable terms because the sellers depend on their business.
- **Purchase size**: Just like you head off to the big box stores to buy in bulk for a cheaper per-unit cost on whatever now fills up your garage, major retail chains like Walmart Inc. (WMT) buy in large volumes and can negotiate better terms and discounts.
- **Switching costs:** In industries like telecommunications, where it's easy for consumers to switch providers, companies such as Verizon Communications, Inc. (VZ) and AT&T Inc. (T) have to offer competitive terms.
- **Price sensitivity:** In the fast-fashion industry, where customers are highly price-sensitive, brands must keep their prices low to attract cost-conscious consumers.
- **Informed buyers:** In many sectors, the customers are savvy, know the competitive terrain well, and thus can negotiate better prices.

Porter chose the metaphor of forces because they aren't static, so business must constantly adjust their strategies as forces in an industry change.

5. Threat of Substitutes

When customers can find substitutes for a sector's services, that's a major threat to the companies in that industry.

Here are some ways that this threat can be magnified:
- **Relative price performance:** If the cost of a substitute is lower and its performance is comparable or better, customers are likely to switch to the substitute. For instance, streaming services like Netflix became a substitute for traditional cable TV, providing a lower price that soon threatened the cable industry.
- **Customer willingness to go elsewhere:** The threat is high if buyers find it easy to switch to a substitute. For example, in the early 2010s, customers found switching from taxis to ride-sharing apps like Uber or Lyft cheaper and easier.
- **The sense that products are similar:** If buyers perceive that there are few differences between your product and a substitute, even if there are, they may be more likely to switch.

- **Availability of close substitutes:** Though this sounds the same as the last bullet point, you have to strategize differently around it. There are times when potential substitutes are very different from a company's products but consumers still treat them as the same. But in other cases, there are genuinely similar products in the market and the threat of substitutes is high, such as between brand-name and generic medications.

Competitive Measures

When published, Michael Porter's framework marked a departure from the then-dominant models of business strategy, steeped in classic competition theory.4
Those models, still echoed in Economics 101 textbooks, rested on several key, if questionable, assumptions: markets as arenas for many small firms with no significant market power, homogeneous products, perfect information symmetry, and no barriers to market entry or exit. While helpful for learning basic principles, this idealized view could be taken to an extreme when strategizing with neatly constructed supply and demand curves, assuming, for instance, new market entrants would stabilize rising prices by increasing supply.
Business strategists need to deal with sectors where information asymmetry, product differentiation, and significant entry and exit barriers are common. Firms do have some control over prices, contradicting classical assumptions.
In short, where economists assumed most markets acted like the model, for Porter, most firms are in industries with entrenched interests and different supplier and customer relations. They need strategies for dealing with anything but perfect competition.5

Mild-to-Intense Competition

Porter's five forces come together in different ways for any given sector. He labeled industry competition as ranging from "intense" to "mild," with profits harder to achieve as the intensity in a sector rises. In intensely competitive industries, all or most of the five forces have a strong influence.1

Porter, Michael. "How Competitive Forces Shape Strategy." Harvard Business Review. March-April 1979. pp. 137-145.

In this sector, there's a fierce rivalry among established players like McDonald's and Burger King, high bargaining power for suppliers and customers, and a relentless threat of new entrants and substitutes, all of which means profits are constantly getting squeezed for anyone in the sector.

Meanwhile, in "mild" industries, such as commercial aircraft manufacturing, there are weaker forces. Here, low supplier bargaining power, a minimal threat of new entrants, and a lack of direct substitutes (like commercial aircraft for long-distance travel) help form a sector more conducive to higher profits.

Applying the Model

Since his 1979 Harvard Business Review article, Porter has published many books on strategic analysis, including works where he has expanded on his five-force model. He's also become very concise in providing the specific steps in performing an industry analysis:3

. **Define the industry:** The process begins with a clear description of the industry, helping you to focus your analysis.

. **Identify the key players:** Specify and group the major actors in the sector into strategic categories based on relevant criteria.

. **Assess the strategic strengths:** This means evaluating the firm and its industry to determine the better and worse strategies that can be applied.

. **Analyze the industry structure:** This involves examining the overall structure of the industry, particularly the factors that influence how profitable it is.

. **Evaluating the competitive forces:** Only once you've done the above does Porter advise doing a detailed analysis of the five competitive forces, assessing their positive and negative effects, and then looking forward to any changes in these forces ahead.

. **Identify the factors you have some control over:** Here, you want to pinpoint aspects of the industry structure that could be influenced by competitors, new market entrants, or your firm. In sum, what can be changed?

Critiques of the Five Forces

Porter’s model helped reframe the understanding of competition. It wasn’t confined to direct rivals but extended to suppliers and customers—traditionally viewed in a transactional light. Suppliers, especially those with unique resources or enjoying a monopoly, could dictate terms, lower profits, or, in extreme cases, forward-integrate into the buyer’s industry. Customers, too, wield power, especially when buying in bulk or when they can just go elsewhere quickly or choose to bypass companies for in-house products.2

But the model has its pitfalls. For example, many have critiqued the model’s emphasis on sector affiliation. Porter concentrates on industry-wide forces, which can sideline an individual company’s unique strategies and advantages. This industry-centric view may not fully capture how distinct company characteristics can change the game, not just play within an industry’s preset rules.6

The model assumes clear lines among sectors, which may not be tenable given the increasingly blurred lines in today’s business world, where companies are simultaneously in several sectors. Industries are no longer isolated silos; instead, they often intersect and interact, leading to a far more complex environment than the model suggests.4

Porter’s five-force model has also been critiqued for not adequately addressing the role of partnerships and collaboration.6

While Porter certainly entertained a competitive model where rivalry wasn’t just a war to the death, the problem is that he didn’t go far enough. In an interconnected global economy, alliances and cooperative strategies are often as pivotal to success as having a competitive advantage, a factor that the model doesn’t explicitly consider.

Business Environment

Another critique that can be filed under “going in the right direction but not far enough” is that the model is too static and fails to account for industries with rapid changes in technology and consumer preferences. While effective in stable sectors, critics say it doesn’t apply well to industries marked by fast-paced innovation and shifting demand.2
Most strikingly, Porter’s model generalizes competition, implying a seemingly uniform industry structure for every market.2
This might overlook the unique competitive scenarios in different sectors and the increasing importance of the nontraditional strategies involved in digital transformation and platform-based competition.

How Does Porter's Five Forces Differ From SWOT Analysis?

Both are strategic planning tools, but they serve different purposes. The five-force model analyzes the competitive environment of an industry, looking at its intensity and the bargaining power of suppliers and customers. SWOT analysis, meanwhile, is broader and assesses a company's internal strengths and weaknesses as well as its external opportunities and threats.

It can assist in strategic planning by pinpointing areas where the company excels and faces obstacles, helping to align the company's strategy with its internal resources and prospects in the market while mitigating its vulnerabilities and external challenges.

How Can Porter's Five Forces Address the Effects of Globalization on an Industry?

Porter's model has been used to analyze how globalization affects industry competition. For instance, globalization lowers barriers to entry in specific industries, intensifying the threat of new entrants from different regions.2
It can also expand the pool of potential substitutes and alter the power dynamics with suppliers and customers worldwide. While Porter and others were doing this analysis for industries facing global competition decades ago, it's still applicable to sectors undergoing this process in the 2020s.

How Does Porter's Five-Forces Model Apply to the AI Sector?

Using the model, we would begin by looking at the competitive rivalry. The AI sector is marked by high competition with key players ranging from tech giants to small startups. Rapid advances mean companies have to move quickly simply to maintain relevance. We would then need to gauge the power of suppliers of data sets and specialized hardware, which have ample power since AI firms rely heavily on these resources.

Moving to consumers, we would need to review the needs of individual consumers and whether larger companies can force AI firms to negotiate better services and prices for them. The field of AI has been attracting many new entrants, but there are significant barriers to entry, including high initial research and development costs. Lastly, the threat from the last force, the possibility of substitutes, depends on what a firm wants to do with its AI-based technology. The more complicated the tasks the AI is given, the more likely other goods and services can't substitute for it.

The Bottom Line

Porter's five-forces model sets out essential criteria for considering a company's competitive landscape: the power of suppliers and buyers, the threat of new entrants and substitutes, and competitive rivalry.

While the economic terrain has evolved significantly since the 1970s and Porter has updated his work ever since, the principles underlying Porter's model remain current. It's still the case that companies don't rise and fall on their portfolio of products alone but are jockeying with others in industries that have their own logic and structural forces at play.

Today, while the five-forces model may require adapting it to rapid technological change and the importance of collaboration across many industries, it's a reliable way to help guide companies needing to navigate industry-specific challenges in their competitive strategy.