

1

Business Environment

Basic Concepts

The chapter on Business Environment aims to familiarize the student with the contemporary business environment. The environment is complex, dynamic, multi-faceted and has a far reaching impact on an organization. It can be divided into external and internal parts.

1. Introduction

Each business organization operates in its unique environment. Environment influence businesses and also gets influenced by it. No business can function free of interacting and influencing forces that are outside its periphery.

2. Meaning of Business

Business is society's organ of economic expansion, growth and change. A business for our purposes can be any activity consisting of purchase, sale, manufacture, processing, and/or marketing of products and/or services.

3. Objectives of a Business

The various objectives of business relate to profitability, productive efficiency, growth, technological dynamism, stability, self-reliance, survival, competitive strength, customer service, financial solvency, product quality, diversification, employee satisfaction, welfare, and so on. However, a critical purpose of business is to create customers. It is the customer who determines what a business is.

4. Environmental influences on Business

Business functions as a part of broader environment. The inputs in the form of human, physical, financial and other related resources are drawn from the environment. The business converts these resources through various processes into outputs of products and/or services.

4.1 Problems in understanding the environmental influences

Environmental forces are difficult to analyse and understand on account of complexity, diversity, uncertainty and limitations of managers.

4.2 Framework to understand the environmental influences

- Take an initial view on uncertainty.
- Audit of environmental influences to identify significant factors which are likely to affect the organization's development or performance.
- Focus towards an explicit consideration of the immediate environment of the organization.

5. Why Environmental Analysis?

In general, environmental analysis has three basic goals as follows:

- First, the analysis should provide an understanding of current and potential changes taking place in the environment.
- Second, environmental analysis should provide inputs for strategic decision making.
- Third, environment analysis should facilitate and foster strategic thinking in organizations.

6. Characteristics of Business Environment

Business environment exhibits many characteristics such as complexity, dynamism, multi-faceted and far reaching impact.

7. Components of Business Environment

The environment in which an organization exists could be broadly divided into two parts the external and the internal environment.

The *external environment* includes all the factors outside the organization which provide opportunity or pose threats to the organization.

The *internal environment* refers to all the factors within an organization which impart strengths or cause weaknesses of a strategic nature.

8. Relationship between Organization and its Environment

The relationship between the organization and its environment may be discussed in terms of interactions between them in several major areas like exchange of information, exchange of resources, exchange of influence and power etc.

9. The Micro and Macro Environment

Micro-environment is related to small area or immediate periphery of an organization. It influences an organization regularly and directly. It consist suppliers, consumers, marketing intermediaries, competitors, organization, market etc. Macro-environment has broader dimensions. It consist demographic, economic, Government, legal, political, cultural, technological, global environment, etc.

10. Environmental Scanning

Environmental scanning can be defined as the process by which organizations monitor their relevant environment to identify opportunities and threats affecting their business for the purpose of taking strategic decisions. It is the process of gathering information regarding company's environment, analysing it and forecasting the impact of all predictable environmental changes. It helps the managers to decide the future path of the organization.

11. Elements of Micro Environment

11.1 Consumers: Customers are the people who pay money to acquire an organization's products. A consumer occupies the central position in the marketing environment. The marketer has to closely monitor and analyse changes in consumer tastes and preferences and their buying habits.

11.2 Competitors: Competitors are the other business entities that compete for resources as well as markets. A study of the competitive scenario is essential for the marketer, particularly threats from competition.

11.3 Organization: An organization has several non-specific elements that may affect its activities. This consists of specific organizations or groups that are likely to influence an organization.

11.4 Market: The market is to be studied in terms of its actual and potential size, its growth prospect and also its attractiveness. The marketer should study the trends and development and the key success factors of the market.

11.5 Suppliers: Suppliers form an important component of the micro environment. The suppliers provide raw materials, equipment, services and so on. Suppliers with their own bargaining power affect the cost structure of the industry. They constitute a major force, which shapes competition in the industry.

11.6 Market Intermediaries: Intermediaries exert a considerable influence on the business organizations.

12. Elements of Macro Environment

12.1 Demographic Environment: The term demographics denote characteristics of population in an area, district, country or in world. Some of the demographic factors have great impact on the business. Factors such as general age profile, sex ratio, income, education, growth rate affect the business with different magnitude.

12.2 Economic Environment: The economic environment refers to the nature and direction of the economy in which a company competes or may compete. The economic environment includes general economic situation in the region and the nation, conditions in resource markets (money, manpower, raw material and so on) which influence the supply of inputs to the enterprise, their costs, quality, availability and reliability of supplies.

1.4 Strategic Management

12.3 Political-Legal Environment: There are three important elements in political-legal environment:

(a) **Government:** Business is highly guided and controlled by government policies. Hence the type of government running a country is a powerful influence on business:

(b) **Legal:** Business organizations prefer to operate within a sound legal system. Legal environment consists of laws governing business.

(c) **Political:** Political pressure groups influence and limit organizations. Apart from internal politics special interest groups put pressure on organizations for consumer's rights or other social issues.

12.4 Socio-Cultural Environment: Socio-cultural environment consist of factors related to human relationships and the impact of social attitudes and cultural values which has bearing on the business of the organization. The beliefs, values and norms of a society determine how individuals and organizations should be interrelated.

12.5 Technological Environment: Technology can act as both opportunity and threat to a business. It can act as opportunity as business can take advantage of adopting technological innovations to their strategic advantage. However, at the same time technology can act as threat if organisations are not able to adopt it to their advantage.

12.6 Global Environment: In simple economic terms, globalization refers to the process of integration of the world into one huge market. At the company level, globalization means two things: (a) the company commits itself heavily with several manufacturing locations around the world and offers products in several diversified industries, and (b) it also means ability to compete in domestic markets with foreign competitors.

13. PESTLE Analysis

The term PESTLE is used to describe a framework for analysis of macro environmental factors. PESTLE analysis involves identifying the political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy.

14. Strategic Responses to the Environment

It is difficult to determine exactly what business should do in response to a particular situation in the environment. Strategically, the businesses should make efforts to exploit the opportunity and nullify or reduce the impact of threats.

Organizations may follow different approaches as follows:

(i) **Least resistance:** Some businesses just manage to survive by way of coping with their changing external environments. They are simple goal-maintaining units.

(ii) **Proceed with caution:** At the next level, are the businesses that take an intelligent interest to adapt with the changing external environment. They seek to monitor the changes in the environment, analyse their impact on their own goals and activities and translate their assessment in terms of specific strategies for survival, stability and strength.

(iii) Dynamic response: At a still higher sophisticated level, are those businesses that regard the external environmental forces as partially manageable and controllable by their actions. Their feedback systems are highly dynamic and powerful.

15. Competitive Environment

The nature and extent of competition that a business is facing in the market is one of the major factors affecting the rate of growth, income distribution and consumer welfare. Businesses have to consider competitors' strategies, profits levels, costs, products and services when preparing and implementing their own business plans. While formulating strategies, organizations have to separately identify and concentrate on the competitors who are significantly affecting the business.

Cooperation in a Competitive Environment: Some organizations within the same industry may form cartels. Organizations instead of competing may join together to decide explicit or tacit arrangements not known to general public. Cooperation may also be witnessed in highly competitive business environment. The benefits of cooperation also seen in Japan, where large cooperative networks of businesses are known as *kieretsu*. These are formed in order to enhance the abilities of individual member businesses to compete in their respective industries. A *kieretsu* is a loosely-coupled group of companies, usually in related industries.

Cooperation on account of family ownership: Theoretically, cooperation generates automatically in businesses owned by a same family. However, several times internal strife and feuds creates problems for the business.

16. Porter's Five Forces Model - Competitive Analysis

This model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:

- Competitive pressures associated with the market maneuvering and jockeying for buyer patronage that goes on among **rival sellers** in the industry.
- Competitive pressures associated with the **threat of new entrants** into the market.
- Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own **substitute products**. Competitive pressures **stemming from supplier** bargaining power and supplier-seller collaboration.
- Competitive pressures **stemming from buyer** bargaining power and seller-buyer Collaboration.

Very Short Answer Type Questions

Question 1

Explain the meaning of Demographic Environment.

Answer

Demographic Environment: The term demographics denote characteristics of population in an area, district, country or in world. Some of the demographic factors have great impact on the business. Factors such as general age profile, sex ratio, income, education, growth rate affect the business with different magnitude.

Short Answer Type Questions

Question 2

State with reasons which of the following statements is correct / incorrect:

- (a) *Businesses function in isolation.*
- (b) *Environmental constituents exist in isolation and do not interact with each other.*
- (c) *The basic objective of a business enterprise is to monitor the environment.*
- (d) *"Profit may not be a universal objective but business efficiency is definitely an objective common to all business".*
- (e) *Managers must list and analyse all environmental influences for proper strategic understanding.*
- (f) *There is both opportunity and challenge in changes happening in environment*
- (g) *Changes in strategy may lead to changes in organizational structure.*
- (h) *A business, even if it continually remains passive to the relevant changes in the environment, would still grow and flourish.*
- (i) *"Changes of any type are always disquieting, sometimes they may be threatening."*
- (j) *The rate and magnitude of changes that can affect organisations are decreasing dramatically*
- (k) *Strategic actions are always in reaction to the changes in environment.*
- (l) *Successful businesses have to recognize different elements of environment.*
- (m) *Socio-cultural environment consists of factors related to government and politics.*
- (n) *The benefit of competition is also enjoyed by the customers.*
- (o) *Competition is bad for the organizations.*
- (p) *Porter's five forces model considers new entrants as a significant source of competition.*
- (q) *Globalization means different things to different people.*
- (r) *The term PESTLE analysis is used to describe a framework for analyzing the micro-environmental factors.*

- (s) *The process of strategy avoids matching potential of the organization with the environment opportunities.*
- (t) *The PESTLE framework is used for analyzing both macro and micro environment.*

Answer

- (a) **Incorrect:** Businesses do not function in an isolated manner. They function within a whole gambit of relevant environment and have to negotiate their way through it. The extent to which the business thrives depends on the manner in which it interacts with its environment. A business which continually remains passive to the relevant changes in the environment is destined to gradually decline.
- (b) **Incorrect:** Environmental constituents such as economic, legal, society, technology and other macro and micro elements are interwoven through complex and haphazard linkages. These constituents comprise of multitude of forces that are inter-related and inter-dependent. They are termed as environment as they are outside the main periphery of business but may affect its functioning directly or indirectly.
- (c) **Incorrect:** Monitoring environment is ancillary to basic objectives of a business enterprise. It is imperative for organisations to create and retain customers. Organisational objectives may include survival, stability, growth, profitability and like. Organisations monitor the changes in the environment, analyse their impact on their own goals and activities and translate their assessment in terms of specific strategies for survival, stability and strength.
- (d) **Correct:** It is generally asserted that business enterprises are primarily motivated by the objective of profit. Organizations pursue multiple objectives rather than a single objective in which business efficiency is a very useful operational objective. Many organizations, particularly charitable and non-government do not aim for making profits. But in general, all organizations aim for optimum utilization of resources and economy in operational costs.
- (e) **Incorrect:** The environment encapsulates many different influences. The difficulty is in making sense of this diversity in a way which can contribute to strategic decision-making. Listing all conceivable environmental influences may be possible, but it may not be of much use.
- (f) **Correct:** It is said that change is inevitable, especially in the context of business environment. Changes in the business environment from time to time throw up new issues before businesses. A right perspective of such new issues is to view them both as challenges and opportunities - challenge because appropriate action is called for and, opportunity because it opens up new potentials for the future plans that would lead to prosperous business.
- (g) **Correct:** Changes in strategy may require changes in structure as the structure dictates how resources will be allocated. Structure should be designed to facilitate the strategic

1.8 Strategic Management

pursuit of a firm and, therefore, should follow strategy. Without a strategy or reasons for being, companies find it difficult to design an effective structure.

- (h) **Incorrect:** Businesses function within a whole gamut of relevant environment and have to negotiate their way through it. A successful business has to identify appraise and respond to various opportunities and threats in its environment. The extent to which the business thrives depends upon the manner in which it interacts with environmental situations or constraints. A business remaining passive to changes in its environment is destined to gradually fade away into oblivion.
- (i) **Incorrect:** Favourable changes either in the external environment or internal environment are not threatening and/or disquieting. Changes that are initiated by the management to bring improvements in its working are not always disquieting. However, sometimes changes can be threatening especially for old and weak organizations with risk averse and stodgy managers.
- (j) **Incorrect:** No, the reality is just the other way round. Business environment especially after globalisation and liberalisation is witnessing changes that are fast paced and have far-reaching implications for businesses. This is true for economic, political, technological, legal, and socio-cultural factors. This has created strong pressures on organization for proactive adaptation to environmental changes for survival growth and competitive edge.
- (k) **Incorrect:** Strategic actions are typically a blend of (1) proactive actions on the part of managers to improve the company's market position and financial performance and (2) as needed reactions to unanticipated developments and fresh market conditions and developments.
- (l) **Correct:** To be successful businesses have to recognise different elements of the environment. They have to also respect, adapt to or have to manage and influence them. Businesses must continuously monitor and adapt to the environment to survive and prosper.
- (m) **Incorrect:** Socio-cultural environment consist of factors related to human relationships and the impact of social attitudes and cultural values which has bearing on the business of the organization. The beliefs, values and norms and general fabric of society determine how individuals and organizations should be interrelated.
- (n) **Correct:** The benefit of competition are enjoyed by the society and the markets in which organisations operate. The customers are able to get products at lower costs and of better quality. They are able to get better value of their money because of competition.
- (o) **Incorrect:** All organizations have competition that makes their working challenging. However, competition is neither a coincidence nor bad luck. The nature and extent of competition that a business is facing in the market is one of the major factors affecting the rate of growth, income distribution and consumer welfare. Competition makes them

work harder, brings innovation and cost economies. The benefit of competition is also enjoyed by the society and the markets in which organisations operate.

- (p) **Correct:** Porter's five forces model considers new entrants as major source of competition. The new capacity and product range that the new entrants bring in throw up new competitive pressure. The bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players.
- (q) **Correct:** Globalization refers to the process of integration of the world into one huge market. Such unification calls for removal of all trade barriers among countries. Globalization is an opportunity for organizations to expand their markets and reach out to different customers. Globalization can also have other meanings. For some it is a new paradigm - a set of fresh beliefs, working methods, and economic, political and socio-cultural realities in which the previous assumptions are no longer valid. For developing countries, it means integration with the world economy.
- (r) **Incorrect:** The term PESTLE Analysis is used to describe a framework for analysis of macro environmental factors. It involves identification of political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy. The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.
- (s) **Incorrect:** In the process of strategic management an organisation continuously scan its relevant environment to identify various opportunities and threats. Organisations keen to grow and expand often look for promising opportunities that match their potential. Such opportunities become a good stepping stone for achieving the goals of the organisation.
- (t) **Incorrect:** PESTLE Analysis is used in analysis of macro environmental factors and not micro environment. It involves identification of political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy. The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.

Question 3

Briefly answer the following questions:

- (a) *Discuss profit as business objective as per Peter F Drucker.*
- (b) *What do you understand by ethnic mix?*
- (c) *Can a change in the elected government affect the business environment? Explain.*
- (d) *What is Kieretsus?*
- (e) *Elaborate the characteristics of Business Environment with reference to Decision Making.*

1.10 Strategic Management

- (f) *Industry is a composite of competitive pressures in five areas of the overall market. Briefly explain the competitive pressures.*
- (g) *Distinguish between Micro Environment and Macro Environment.*
- (h) *"Environment is the sum of several External and Internal forces that affect the functioning of business." Explain.*
- (i) *Write short notes on Role of Global Industries.*
- (j) *Describe two environmental changes that you expect to have a major impact on the industry:*
 - (i) *Retail Industry*
 - (ii) *Automobile Industry*
 - (iii) *Education Industry*
- (k) *Explain the factors that affect the strength of competitive pressures from substitute products.*
- (l) *How would you analyse the meaning and importance of Efficiency and Profitability as objectives of business?*
- (m) *Write short notes on Characteristics of a Global Company.*
- (n) *"A business enterprise is a sub-system of the larger environmental system." Discuss the relationship between the organization and its business environment.*
- (o) *"Business environment exhibits many characteristics." Explain.*
- (p) *A global company has three characteristics. Explain.*
- (q) *Assume that you are an entrepreneur who has an intense desire to get into the business. What types of information relating to macro environment would you need to determine external opportunities and threats?*
- (r) *You have been hired as a consultant by a company to advise it on factors it need to consider for environmental scanning. Explain briefly these factors.*
- (s) *In your view what are the Key Success Factors for operating in a competitive market place?*
- (t) *How would you argue that modern enterprises pursue multiple objectives and not a single objective?*
- (u) *Analyse the following cases in the context of Michael Porter's Five Forces Model:*
 - (i) *A supplier has a large base of customers.*
 - (ii) *A manufacturer of sports goods has the advantage of economies of large scale production.*

- (iii) *Products offered by competitors are almost similar.*
- (v) *The environment has many different influences, but it is very difficult for the managers to make sense of these influences. Why?*
- (w) *Can a business succeed in the long run by focusing only on profit as its primary objective? What are other objectives of a business?*

Answer

- (a) Peter F Drucker was of the view that businesses cannot be explained in terms of profit. The economic criterion of maximising profits for a firm has little relevance in the present times. Profit maximization, in simple terms is selling at a higher price than the cost. Profit maximization is subject to the long-term perspective and includes development of wealth and several non-financial factors such as goodwill, societal factors, relations and so on.
- (b) Ethnic mix reflects the changes in the ethnic make-up of a population and has implications both for a company's potential customers and for the workforce. Issues that should be addressed include:
- What do changes in the ethnic mix of the population imply for product and service design and delivery?
 - Will new products and services be demanded or can existing ones be modified?
 - Managers prepared to manage a more culturally diverse workforce?
- How can the company position itself to take advantage of increased workforce heterogeneity?
- (c) The type of government running a country is a powerful influence on business. Businesses are highly guided and influenced by government actions. Change in the elected government relates to the change in political environment. To an extent, even legal environment may change with the changes in the Government. It has a strong bearing on the conduct of business as it leads to significant changes in the economic policies and the regulatory framework. It generally reflects the political ideology of the political party or alliances. The government's policy of promoting select sectors further impacts the functioning of business organizations.
- Businesses are affected by the factors such as political stability, the political ideology and practices of the ruling party, the purposefulness and efficiency of governmental agencies, the extent and nature of governmental intervention in the economy and the industry, Government policies (fiscal, monetary, industrial, labour and export-import policies), specific legal enactments and framework and so on.
- (d) *Kieretsus* is a loosely-coupled group of companies, usually in related industries. It is a Japanese term which is used for large cooperative networks of businesses. *Kieretsus* members are peers and may own significant amounts of each other's stock and have many board members in common.

1.12 Strategic Management

- (e) Decision making is a managerial process and function which is greatly influenced by the broad characteristics of business environment. These characteristics are:
- Environment is complex: The environment consists of a number of factors, events, conditions and influences arising from different sources. All these do not exist in isolation but interact with each other to create entirely new sets of influences. It is difficult to comprehend at once the factors constituting a given environment. All in all, environment is a complex that is somewhat easier to understand in parts but difficult to grasp in totality.
 - Environment is dynamic: The environment is constantly changing in nature. Due to the several varied influences operating; there is dynamism in the environment causing it to continuously change its shape and character.
 - Environment is multi-faceted: What shape and character an environment assumes depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers. This is frequently seen when the same development is welcomed as an opportunity by one company while another company perceives it as a threat.
 - Environment has a far reaching impact: The environment has a far reaching impact on organizations. The growth and profitability of an organization depends critically on the environment in which it exists. Any environment change has an impact on the organization in several different ways.
- (f) A popular tool for systematically diagnosing the significant competitive pressures in a market is Porter's five-forces model of competition. The model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:
- Threat of new entrants: New entrants with their extra capacity and new product range bring new competitive pressures.
 - Bargaining power of customers: The bargaining power of the buyers influences not only the prices that the producer can charge but also influences costs and investments.
 - Bargaining power of suppliers: The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry.
 - Rivalry among current players: Rivalry or competition leads to actions taken by different players to get an edge over other players.
 - Threats from substitutes: Substitute products are a latent source of competition in an industry. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry.
- (g) The business environment consists of both the macro environment and the micro environment. Following are the differences between the two:

- The micro environment refers to the forces that are very close to the company and affect its ability to do routine functions. Macro environment refers to all forces that are part of the larger periphery and distantly affect organization and micro environment.
 - Micro environment includes the company itself, its suppliers, marketing intermediaries, customer markets and competitors. Whereas macro environment includes demography, economy, natural forces, technology, politics, legal and socio-cultural.
 - The elements of micro environment are specific to the said business and affects its working on short term basis. The elements of macro environment are general environment and affect the working of all the firms in an industry.
- (h) Business environment in which an organization exists can be broadly divided into two parts: the external and the internal. Since the environment is complex and has multiple elements of it helps to understand it better. External environmental factors are largely beyond the control of individual enterprise and are dynamic in the sense that they keep on changing. These are technological, physical, political and socio-cultural. Internal environment is the environment that has a direct impact on the business and is within the control of the entrepreneurs. These are internal management, machinery, methods of production, etc.
- (i) The term global industry specifically means an industry where a firm's competitive position in one country is affected by its position in other countries. A global industry is one that by operating in more than one country gains R&D, production, marketing and financial advantages in its costs and reputation that are not available to purely domestic competitors. The global business organisation views the world as one market, minimises the importance of national boundaries, sources material, raises capital and markets wherever it can do the job best. The industries reveals global pattern in today's world include automobiles, television sets, commercial aircrafts and boats, sporting equipment, watches, clothing, semiconductors, copiers and also the transfer of funds.
- (j) All the environmental forces impact industries in varying degree. Over a period of time these may change and oscillate between dominant factors and insignificant factors.
- (a) Retail Industry**
- Macro environmental factors such as Technological, Economic, Demographic, Social, Legal and political.
 - Rapid change in production process and product innovation.
 - Foreign Direct Investment and policies thereon.
 - Changes in Direct and indirect taxes
 - Inflation, interest rates.
 - Changes in employment / labour laws.

1.14 Strategic Management

- Change in attitude towards health.
- Developments in IT can help in support supply chain management, logistics and transportation.

(b) *Automobile Industry*

- Macro environmental factors such as Technological, Economic, Demographic, Social, Legal and political.
- New research and development.
- Anti- pollution pressures. Use of eco-friendly cars.
- Use of alternative fuels.
- Population growth and age mix
- Rural urban ratio.
- Changes in family structure.
- Changes in income levels.
- Changes in Import & Excise Duties.
- Foreign Direct Investment.
- Financing facilities at low interest rates.

(c) *Education Industry*

- Macro environmental factors such as Technological, Economic, Demographic, Social, Legal and political.
- Changes in government policies. Proposed Higher Education and Research outlays.
- Privatization of Higher Education.
- Availability of soft loans for higher / professional education.
- Attitude towards education.
- Mobility of students.
- Income.
- Job opportunities.

- (k) Substitute products are a latent source of competition in an industry. In many cases they become a major constituent of competition. With regards to substitute products, factors such as prices, easy availability, and how best they are able to satisfy the needs of customers, determine the amount of competition through them. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. And they can bring it about all of a sudden. Wherever substantial investment in R&D is taking place, threats from

substitute products can be expected. Substitutes, too, usually limit the prices and profits in an industry.

- (l) Enterprises pursue multiple objectives rather than a single objective. In general, we may identify a set of different business objectives pursued by a large cross-section of enterprises. Efficiency and profitability are two of the important objectives of any business. Efficiency is the relationship between input and output whereas profitability is the relationship between profits and investments.
- ◆ *Efficiency:* Business enterprise seek efficiency in rationally choosing appropriate means to achieve their goals, doing things in the best possible manner and utilising resources in a most suitable combination. In a sense, efficiency is an economic version of the technical objective of productivity – designing and achieving suitable input output ratios of funds, resources, facilities and efforts. Efficiency is a very useful operational objective.
 - ◆ *Profitability:* It is generally asserted that private enterprises are primarily motivated by the objective of profit. Some may go even further and emphasise that profit is the sole motive of business enterprises. All other objectives are facilitative objectives and are meant to be serve the profit motive. It is pointed out that private business enterprises are operated on behalf of and for the benefit of the owners who have assumed the business risk of investing their funds.
- (m) In simple economic terms, globalization refers to the process of integration of world into one huge market. At the company level, globalization means two things: (a) the company commits itself heavily with several manufacturing locations around the world and offers products in several diversified industries and (b) it also means ability to compete in domestic markets with foreign competitors.

The global company views the world as one market minimizing the importance of national boundaries. A global company has three attributes:

- (i) It is a conglomerate of multiple units located in different parts of the globe but all linked with common ownership.
 - (ii) Multiple units draw a common pool of resources such as money, credit, patents, trade name, etc.
 - (iii) The units respond to common strategy.
- (n) A business does not function in isolation, rather, it acts as a sub-system of its environment consisting of society, economy, laws, competitors and so on. Business draws certain inputs from environment in form of resources and information and transforms them into outputs. The relationship between the organization and its environment may be discussed in terms of interactions between them that can be broadly outlined as below:

1.16 Strategic Management

Exchange of information: The organization scans the external environmental variables, their behaviour and changes, generates important information and uses it for its planning, decision-making and control purposes.

On the other hand, the organization itself transmits information to several external agencies either voluntarily, inadvertently or legally.

Exchange of resources: The organization receives inputs — finance, materials, manpower, equipment etc., from the external environment. It sustains itself by employing the above inputs for involving or producing output of products and services.

The organization is also dependent on the external environment for disposal of its output of products and services to a wide range of clientele.

Exchange of influence and power: The external environment holds considerable power over the organization both by virtue of its being more inclusive as also by virtue of its command over resources, information and other inputs. The external environment is also in a position to impose its will over the organization. Governmental control, competitors, customers, suppliers, investors etc., exercise considerable power and influence over the organization.

In turn, the organization itself is sometimes in a position to wield power and influence over the external environment by virtue of its command over resources and information.

(o) Business environment exhibits many characteristics as follows:

- **Environment is complex:** The environment consists of a number of factors, events, conditions and influences arising from different sources and is complex because it is somewhat easier to understand in parts but difficult to grasp in totality.
- **Environment is dynamic:** The environment is constantly changing in nature. Due to the many and varied influences operating; there is dynamism in the environment causing it to continuously change its shape and character.
- **Environment is multi-faceted:** What shape and character an environment assumes depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers, i.e. as an opportunity for one company and a threat for another.
- **Environment has a far reaching impact:** The growth and profitability of an organization depends critically on the environment in which it exists. And thus any environmental change has an impact on the organization in several different ways.

(p) The global company views the world as one market minimizing the importance of national boundaries. It has three attributes:

- (i) It is a conglomerate of multiple units located in different parts of the globe but all linked with common ownership.

- (ii) Multiple units draw a common pool of resources such as money, credit, patents, trade name, etc.
 - (iii) The units respond to common strategy.
- (q) Macro environment mainly consists of economic, technological, political, legal and socio-cultural elements. For an entrepreneur it is important to identify those factors that are likely to affect the new business. Each of the elements can have a bearing on the opportunities and the threats.

Particularly, he should scan the relevant changes that have happened in recent past that can provide competitive edge. For example, a technological innovation in the production process can be opportunity. Incentives such as cheaper land, tax free periods can be other form of opportunities. Entrepreneur has to identify such opportunities that can be capitalized to enter markets or provide an edge over the competitors. Entrepreneur has to also take care as these opportunities can also act as threats when competitors are able to exploit them.

- (r) Organizational environment consists of both external and internal factors. Environment must be scanned so as to determine development and forecasts of factors that will influence organizational success. The factors that need to be considered are explained below:

Events: Events are important and specific happenings in the internal or external organisational environment which can be observed and tracked.

Trends: Trends are grouping of similar or related events that tend to move in a given direction, increasing or decreasing in strength or frequency of observation.

Issues are the current concerns that arise in response to events and trends. Identifying an emerging issue is more difficult.

Expectations are the demands made by interested groups in the light of their concern for issues.

- (s) KSFs are the rules that shape whether a company will be financially and competitively successful. Important key success factors for operating in competitive markets are:
- ◆ Cost structure of the market.
 - ◆ The price sensitivity of the market.
 - ◆ Technological structure of the market.
 - ◆ The existing distribution system of the market.
 - ◆ Is the market mature?
- (t) Objectives are organizations performance targets – the results and outcomes it wants to achieve. They function as yardstick for tracking an organizations performance and progress.

Today, organizations are capable of achieving multiple objectives and they focus on different objectives rather than a single objective. In general, we may identify a set of business objectives being pursued by the business. These may relate to profitability, productive efficiency, growth, technological dynamism, stability, self-reliance, survival, competitive strength, customer service, financial solvency, product quality, diversification, employee satisfaction and welfare, and so on. Organizations need to balance these objectives in an appropriate manner.

- (u) (i) *Large base of customers of an organization (supplier) may increase its bargaining power in comparison to the bargaining power of the customer.*
- (ii) *The manufacturer of sports goods would be in better position amongst existing competitors since it has advantage of economies of scale. Even the threat of new entrants gets reduced.*
- (iii) *Similar products will reduce the bargaining power of the rivals, i.e., competitors. In other words the bargaining power of the customer will be more.*
- (v) *The environment consists of several micro and macro factors that influence business enterprises. Some of these factors may directly impact business, while others may have insignificant or far-fetched influence. In spite of best of resources and capabilities it may not be possible for managers to make sense of all these influences due to limitations of human mind at one end and diversity, uncertainty and complexity of the environment on the other hand. These can be explained as follows:*
 - Diversity: On account of diversity listing of all conceivable environmental influences may not be possible.*
 - Uncertainty: It is difficult to predict and understand future external influences on an organization.*
 - Complexity: Managers, like other individuals, may tend to simplify complexity by focusing on aspects of the environment that may confirm their prior views or are historically important.*
- (w) *Business enterprises pursue multiple objectives rather than a single objective, however it is generally asserted that private enterprises are primarily motivated by the objective of profit. All other objectives are facilitative objectives and are meant to be subservient to the profit motive. However, profits cannot remain primary objective in long run. Although some profits are necessary, organizations need to pursue other objectives such as survival, stability, growth and like. These objectives also change with the changes in the environment. Organisations monitor the changes in the environment, analyse their impact on their own goals and activities and translate their assessment in terms of specific strategies. In general, all organizations aim for optimum utilization of resources and economy in*

operational costs. Some of the other important objectives of a business are as follows:

- ◆ **Survival**: *Survival is a basic, implicit objective of most organizations. While survival is an obvious objective, it gains more value and prominence during the initial stage of the establishment of the enterprise and during general economic adversity. The ability to survive is a function of the nature of ownership, nature of business competence of management, general and industry conditions, financial strength of the enterprise and so on.*
- ◆ **Stability**: *Another important objective of business enterprises is stability. It is a cautious, conservative objective that is often employed when things are not very conducive. It is a strategy of least resistance in a hostile external environment.*
- ◆ **Growth**: *This is a promising and popular objective which is equated with dynamism, vigor, promise and success. Enterprise growth may take one or more of the forms like increase in assets, manufacturing facilities, increase in sales volume and so on. Growth may take the enterprise along relatively unknown and risky paths, full of promises and pitfalls.*
- ◆ **Efficiency**: *Business enterprises seek efficiency in rationally choosing appropriate means to achieve their goals. In a sense, efficiency is an economic version of the technical objective of productivity – designing and achieving suitable input output ratios of funds, resources, facilities and efforts. Efficiency is a very useful operational objective.*

Questions with Descriptive Answers

Question 4

What do you mean by micro environment of business? Explain its elements.

Answer

The environment of business can be categorised into two broad categories micro-environment and macro-environment. Micro-environment is related to small area or immediate periphery of an organization. Micro-environment influences an organization regularly and directly. Developments in the micro environment have direct impact on the working of organizations. Micro environment includes the company itself, its suppliers, marketing intermediaries, customer markets and competitors. The elements of micro environment are specific to the said business and affects its working on short term basis.

- **Consumers / Customers**: Customers who may or may not be consumers are the people who pay money to acquire organisational products and services. Consumer is the one who ultimately consumes or uses the product or services. The marketer has to closely monitor and analyse the changes in the consumer tastes and preferences and their buying habits. Consumer occupies the central position in the market.

1.20 Strategic Management

- **Competitors:** Competitors are the other business entities that compete for resources as well as markets. A study of the competitive scenario is essential for the marketer, particularly threats from competition.
- **Organization:** Individuals occupying different positions or working in different capacities in organizations consists of individuals who come from outside. They have different and varied interests. An organization has several non-specific elements in form of individuals and groups that may affect its activities. Owners, board of directors and employees form part of organisation.
- **Market:** The market is larger than customers. The market is to be studied in terms of its actual and potential size, its growth prospect and also its attractiveness. The marketer should study the trends and development and the key success factors of the market.
- **Suppliers:** Suppliers form an important component of the micro environment. The suppliers provide raw materials, equipment, services and so on. Suppliers with their own bargaining power affect the cost structure of the industry. They constitute a major force, which shapes competition in the industry.
- **Market Intermediaries:** Intermediaries bridge the gap between the organisations and customers. They are in form of stockist, wholesalers and retailers. They exert considerable influence on the business organizations. In many cases the consumers are not aware of the manufacturer of the products they buy. They buy product from the local retailers or big departmental stores.

Question 5

Explain briefly different strategic approaches for Globalisation by a company.

Answer

Strategic approaches: International economic dynamics accompanied by geographical changes have changed the paradigm of global business. A firm / company which wishes to go global will be guided by the following four types of strategies:

- (i) Multi-domestic strategy:** A multi-domestic strategy focuses on competition within each country in which the firm operates. This Strategy is adopted when a company tries to achieve a high level of local responsiveness by matching their products and services offerings to national conditions prevailing in the countries they operate in. The organization attempts to extensively customize their products and services according to the local conditions of different countries.
- (ii) Global strategy:** A global strategy assumes more standardization of products across country boundaries. Under this strategy, the company tries to focus on a low cost structure by leveraging their expertise in providing certain products and services and concentrating the production of these standard products and services at a few favourable locations around the world. Competitive strategy is centralized and controlled by the home office.

(iii) **Transnational strategy:** Many large multinational firms, particularly those with many diverse products, may use a multi-domestic strategy with some product lines and a global strategy with others. A transnational strategy seeks to combine aspects of both multi-domestic and global strategies. Thus there is emphasis on both local responsiveness and global integration and coordination. Although the transnational strategy is difficult to implement, environmental trends are causing multinational firms to consider the needs for both global efficiencies and local responsiveness.

When a firm adopts one or more of the above strategies, the firm would have to take decisions on the manner in which it would commence international operations. The decision as to how to enter a foreign market can have a significant impact on the results. Expansion into foreign markets can be achieved through following options:

- Exporting.
- Licensing/ Franchising.
- Joint Venture.
- Foreign Direct Investment.

Question 6

Write a short note on the strategic responses to business environment.

Answer

A business organization and its many environments have innumerable interrelationships that at times it becomes difficult to determine exactly where the organization ends and where its environment begins. It is also difficult to determine exactly what the business organisation should do in response to a particular situation in the environment. Strategically, the business organisations should make efforts to exploit the opportunities and avoid the threats.

In this context following are the possible strategic responses of an organisation to its business environment:

- (i) **Least resistance:** Some organisations just manage to survive by way of coping with their changing external environments. They are simple goal-maintaining units. They are very passive in their behaviour and are solely guided by the signals of the external environment. They are not ambitious but are content with taking simple paths of least resistance in their goal-seeking and resource transforming behaviour.
- (ii) **Proceed with caution:** At the next level, are the organisations that take an intelligent interest to adapt with the changing external environment. They seek to monitor the changes in that environment, analyse their impact on their own goals and activities and translate their assessment in terms of specific strategies for survival, stability and strength. This is a sophisticated strategy than to wait for changes to occur and then take corrective-adaptive action.

1.22 Strategic Management

- (iii) **Dynamic response:** At a still higher sophisticated level, are those organisations that regard the external environmental forces as partially manageable and controllable by their actions. Their feedback systems are highly dynamic and powerful. They not merely recognise and ward off threats; they convert threats into opportunities. They are highly conscious and confident of their own strengths and the weaknesses of their external environmental 'adversaries'. They generate a contingent set of alternative courses of action to be picked up in tune with the changing environment.

Question 7

What are the five competitive forces in an industry as identified by Michael Porter?

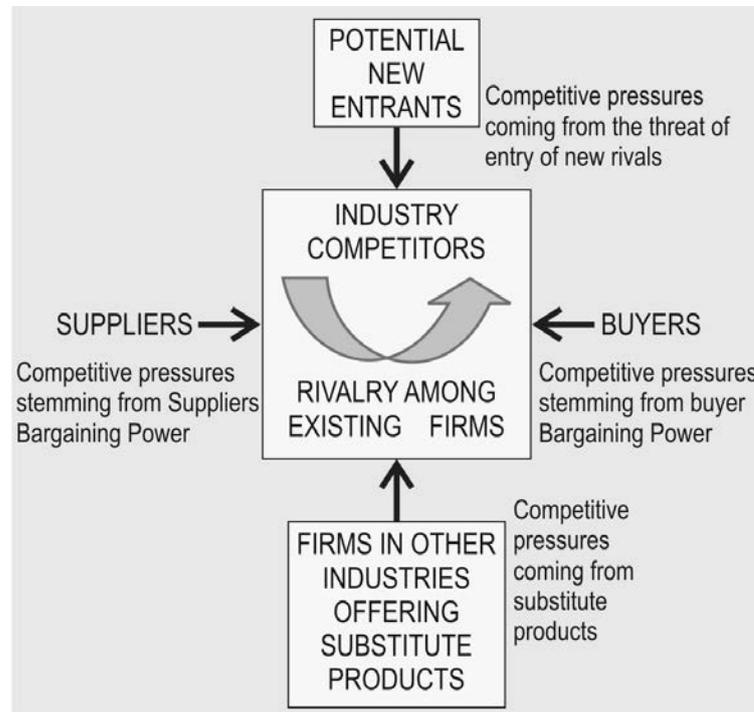
Answer

Five forces model of Michael Porter is a powerful and widely used tool for systematically diagnosing the significant competitive pressures in the market and assessing their strength and importance. The model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the over all market. These five forces are:

1. **Threat of new entrants:** New entrants are always a powerful source of competition. The new capacity and product range they bring in throw up new competitive pressure. And the bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players.
2. **Bargaining power of customers:** This is another force that influences the competitive condition of the industry. This force will become heavier depending on the possibilities of the buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products. Quite often, users of industrial products come together formally or informally and exert pressure on the producer. The bargaining power of the buyers influences not only the prices that the producer can charge but also influences in many cases, costs and investments of the producer because powerful buyers usually bargain for better services which involve costs and investment on the part of the producer.
3. **Bargaining power of suppliers:** Quite often suppliers, too, exercise considerable bargaining power over companies. The more specialised the offering from the supplier, greater is his clout. And, if the suppliers are also limited in number they stand a still better chance to exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, industry attractiveness and profitability.
4. **Rivalry among current players:** The rivalry among existing players is quite obvious. This is what is normally understood as competition. For any player, the competitors influence strategic decisions at different strategic levels. The impact is evident more at functional level in the prices being changed, advertising, and pressures on costs, product and so on.

5. **Threats from substitutes:** Substitute products are a latent source of competition in an industry. In many cases they become a major constituent of competition. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. And they can bring it about all of a sudden. For example, coir suffered at the hands of synthetic fibre. Wherever substantial investment in R&D is taking place, threats from substitute products can be expected. Substitutes, too, usually limit the prices and profits in an industry.

The five forces together determine industry attractiveness/profitability. This is so because these forces influence the causes that underlie industry attractiveness/ profitability. For example, elements such as cost and investment needed for being a player in the industry decide industry profitability, and all such elements are governed by these forces. The collective strength of these five competitive forces determines the scope to earn attractive profits. The strength of the forces may vary from industry to industry.



Five Forces Model of Competition

Questions with Hints

Question 8

Explain the need for a business organization to scan the environment on a continuous basis. Discuss the contemporary developments in the business environment.

Answer

Environmental analysis helps strategists to develop an early warning system to prevent threats or to develop strategies which can turn a threat to the firm's advantage. Because of the difficulty in assessing the future and its dynamism, all future events can not be anticipated. However, some future events can be and are anticipated. The extent to which a few or more events are anticipated through the process of the analysis and diagnosis, will reflect in the quality of managerial decisions. The managers can also concentrate on a few major events, instead of dealing with all the environmental influences. In general, environmental analysis has three basic goals as follows:

1. The analysis should provide an understanding of current and potential changes taking place in the environment.
2. Environmental analysis should provide inputs for strategic decision making.
3. Environment analysis should facilitate and foster strategic thinking in organizations-typically a rich source of ideas and understanding of the context within which a firm operates.

A lot of changes are occurring within India and across the globe affecting the business. Students should list out different elements of macro environment and discuss the contemporary developments in each of the area. They may develop their answers to cover different elements of environment.

For example in the economic environment, students may briefly list out the impact of the global recession on the Indian Business. They may list different factors such as difficulty in financing through primary market, inflation, low demand in certain sectors such as real estate etc. As far as social environment is concerned a new culture is evolving in the country on account of increased global interaction and impact of mass media. There is also increase in awareness. The developments in the legal environment including introduction of new direct tax code, limited liability partnership, GST, etc. have their own bearing on the business.

Question 9

What is Environment? Briefly explain macro environmental factors that affect an organization's strategy.

Answer

Environment is sum of several external and internal forces that affect the functioning of business. Businesses function as a part of broader environment. The inputs in the form of human, physical, financial and other related resources are drawn from the environment. The business converts these resources through various processes into outputs of products and/or services. The latter are partly exchanged with the external client groups, say customers. The extent to which the business thrives depends on the manner in which it interacts with its environment. Macro environment is explained as one which is largely external to the

enterprise and thus beyond the direct influence and control of the organization, but which exerts powerful influence over its functioning. Important elements of macro environment are:

- Demographic environment.
- Economic environment.
- Political-Legal Environment.
- Socio-Cultural environment.
- Technological environment.
- Global environment.

Students may briefly explain the above.

Question 10

Explain how technological factors present an opportunity as well as threat to a particular business organization.

Answer

Technology is the most dynamic of all the environmental factors. An individual enterprise is concerned with the dynamics of its product and process technology, research and development activities in the industry and elsewhere, innovations in products and processes, technological obsolescence and so on. Changes in technology vitally affect the enterprise's costs, profitability, plant location decisions, product lines, growth and development.

The technology and business are highly interrelated and interdependent also. Technology is patronized by business. Technology also drives business and makes a total change on how it is carried out.

Technology can act as both opportunity and threat to a business. It can act as opportunity as business can take advantage of adopting technological innovations to their strategic advantage. However, at the same time technology can act as threat if organisations are not able to adopt it to their advantage. For example, an innovative and modern production system can act as weakness if the business is not able to change their production system. New entrants or existing competitors can always use availability of technological improvements in products or production methods that can be a threat to a business.

Technological opportunities and threats are not limited to the product or production. Technology permeates whole gambit of business. It can transform how a business acts and functions.

Question 11

Do you think that competition is always bad for organisations? Explain Porter's five forces model as to how businesses can deal with the competition.

1.26 Strategic Management

Answer

Although competition makes organizations work harder, intense competition is neither a coincidence nor bad luck. All organizations have competition. The benefit of competition is also enjoyed by the markets in which organisations operate. The customers are able to get products at lower costs and better quality. They get better value of their money because of competition.

To gain a deep understanding of a company's industry and competitive environment, managers do not need to gather all the information they can find and waste a lot of time digesting it. Rather, the task is much more focused. A powerful and widely used tool for systematically diagnosing the significant competitive pressures in a market and assessing the strength and importance of each is the Porter's five-forces model of competition. This model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:

- Competitive pressures associated with the market manoeuvring and jockeying for buyer patronage that goes on among rival sellers in the industry.
- Competitive pressures associated with the threat of new entrants into the market.
- Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products.
- Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration.
- Competitive pressures stemming from buyer bargaining power and seller-buyer Collaboration.

Questions for Practice

1. What is the concept of environment in strategic management?
2. Up to what extent global environment affects the business environment?
3. Define environmental scanning.
4. How the new entrant affects the competition?

Activity

Take a case of specific industry and evaluate the impact of five forces that drive competition in that industry. Use annual reports, Journals and Internet for sources of information.