

# Chapter 2

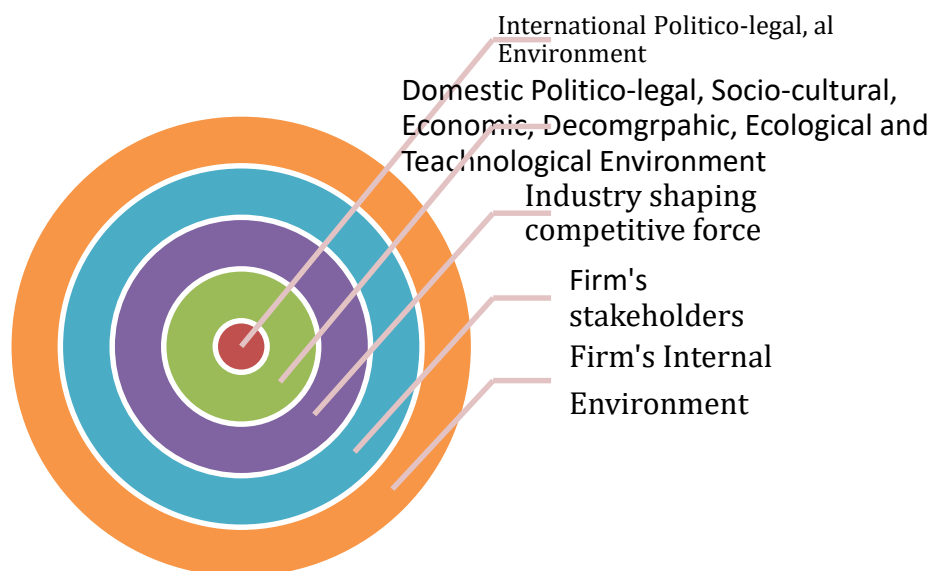
## STRATEGIC ANALYSIS: EXTERNAL ENVIRONMENT

### INTRODUCTION

There are different kinds of business activities that take place in an organisational setting, and a cursory look into their world reflects a wide variety of organisations ranging from small local businesses to international or multinational corporations' level. Generally, organisations are distinguished based on their size, type of products, markets, geographical coverage, legal status, and like because of vast organisational diversity.

Whatever their size or other distinguishing feature they do not operate in a vacuum. They continuously act and react to what happens outside their periphery. **The factors that are outside the business operations are typically referred to as organisational / business environment.**

In other words, and in the specific context of business, environment may be defined as a set of all external factors that weigh in the minds of the manager.

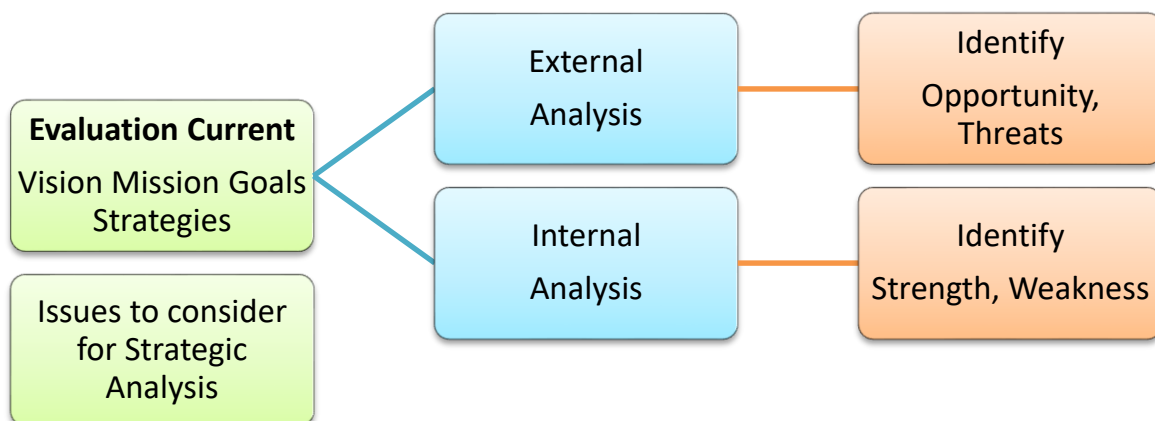


The objective is to compile information about internal and external environments in order to assess possibilities while formulating strategic objectives and contemplating strategic activities

## STRATEGIC ANALYSIS

The majority of the rapidly expanding organisations use strategic planning throughout various stages of their operations. The strategic analysis is a component of business planning that has a methodical approach, makes the right resource investments, and may assist business in achieving its objective. It forces to think about the rivals and aids in the evaluation of business plans to stay ahead of the competition. The two important situational considerations are:

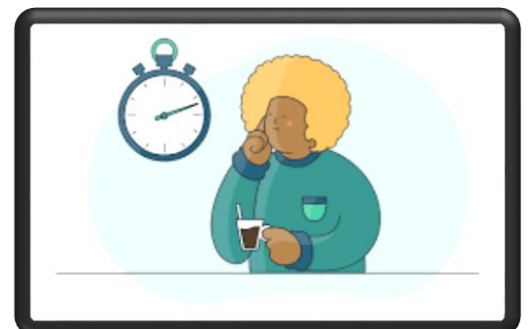
- (1) industry and competitive conditions, and
- (2) an organisation's own capabilities, resources, internal strengths, weaknesses, and market position.



### Issues to consider for Strategic Analysis

#### Strategy evolves over a period of time:

Each strategic decision must balance the different factors that impact and constrain strategy. A key element of strategic analysis is the probable outcomes of everyday decisions. A current strategy is the result of several little



choices taken over a protracted period of time. A management radically changes strategy when they try to speed up the organisational growth. Strategy is influenced by experience, but it has to be updated when the results become clear. It therefore evolves with time.

**Balance of external and internal factors:**

In practise, strategic analysis necessitates creating a reasonable balance between many and conflicting challenges, because a perfect fit between them is unlikely. Management must consider opportunities, influences, and



constraints while taking a strategic decision. There are factors driving a decision, such as entering a new market. Concurrently, there exist constraints that limit the option, such as the presence of a large opponent.

**Risk:** In strategic analysis, the nprinciple of maintaining balance is important. However, the complexity and intermingling of variables in the environment reduces the strategic balance in the organization



Competitive markets, liberalization, globalization, booms, recessions, technological advancements, inter-country relationships all affect businesses and pose risk at varying degrees

External Risk

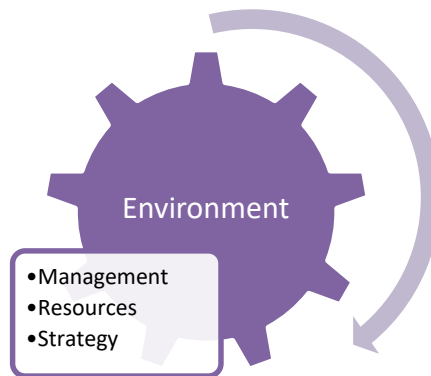
Short Time	Long Time
Errors in interpreting the environment cause strategic failure	Changes in the environment lead to obsolescence of strategy.

Internal Risk

Organizational capacity is unable to cope up with strategic demands.	Inconsistencies with the strategy are developed on account of changes in internal capacities and preferences
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## STRATEGY AND BUSINESS ENVIRONMENT

To accomplish the goals and objectives of a business, business strategist creates strategies and formulate policies considering both internal and external factors.



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The term "business environment" refers to all external factors, influences, or situations that in some way affect business decisions, plans, and operations. Organisational success is determined by its business environment, and even more from its relationship with it.

Strategic management is **involved with choosing a long-term direction in relation to these resources and opportunities**. There is a close and continuous interaction between a business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively. It helps the business in the following ways:

### **Determine opportunities and threats:**

The interaction between the business and its environment would explain opportunities and threats to the business. It helps to find new needs and wants of the consumers, changes in laws, changes in social behaviours, and tells what new products the competitors are bringing in the market to attract consumers.



### **Give direction for growth:**

The interaction with the environment enables the business to identify the areas for growth and expansion of their activities. Once the business is aware and understands the changes happening around, it can plan and strategise to have successful business.



**Continuous Learning:** The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in the realm of business.



**Image Building:** Environmental understanding helps the business organizations to improve their image by showing their sensitivity to the environment in which they operate.

**Meeting Competition:** It helps the businesses to analyse the competitors' strategies and formulate their own strategies accordingly. The idea is to flourish and beat competition for its products and services.



The external environment can be categorised in two major types as follows:

- ◆ **Micro environment**
- ◆ **Macro environment**

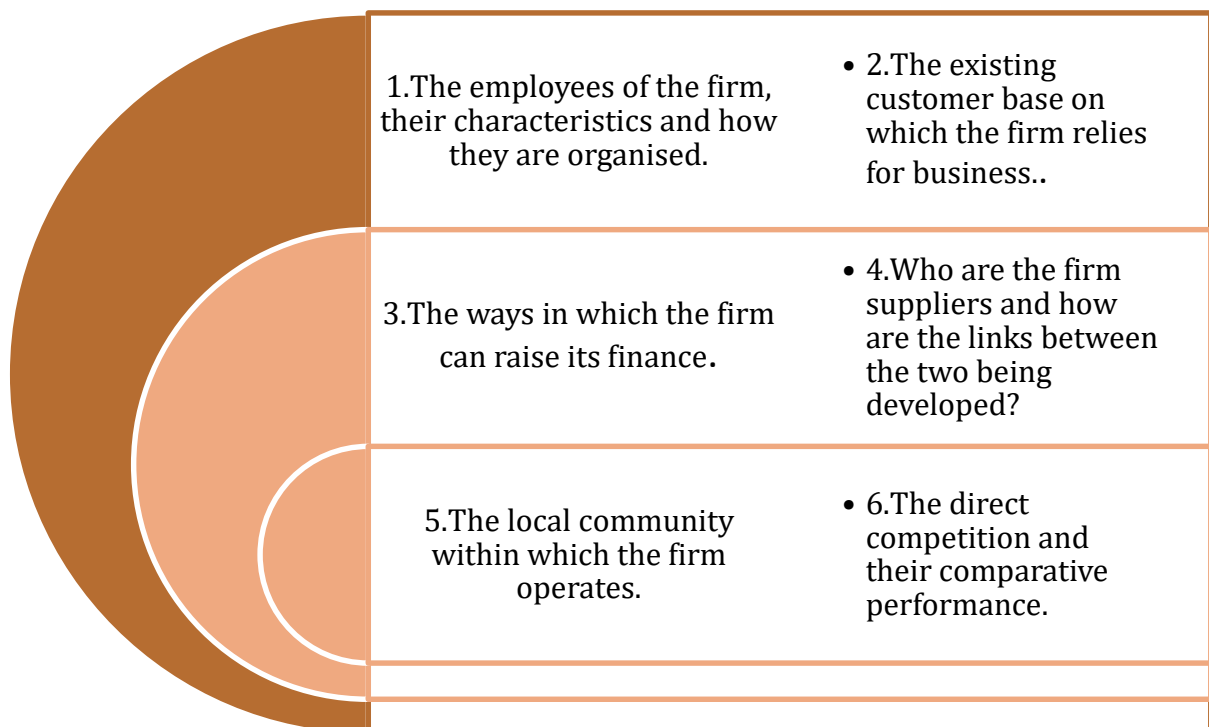
**Micro-environment is related to small area or immediate periphery of an organization.**

**It influences an organization regularly and directly.** Micro environment consists

of suppliers, consumers, marketing intermediaries, competitors, etc.



Within the micro or the immediate environment in which a firm operates we need to address the following issues:



The **macro environment** is the portion of the **outside world that significantly affects how an organisation operates** but is typically much beyond its direct control and influence.



## Elements of Macro Environment

Macro environment has broader dimensions as it consists of economic, socio-cultural, technological, political and legal factors. The classification of the relevant environment into components or sectors helps an organization to cope with its complexity, comprehend the different influences operating, and relating the environmental changes to its strategic management process

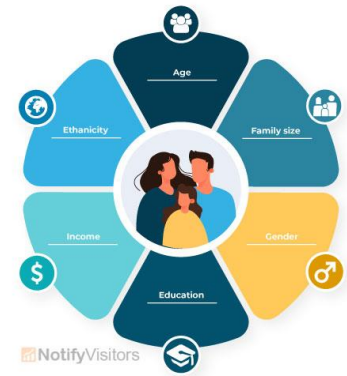
“The environment includes factors outside the firm which can lead to opportunities for, or threats to the firm. Although, there are many factors, the most important of the factors are socio-economic, technological, supplier, competitors, and government.”

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## Demographic Environment

Demographics are the **characteristics of a population that have been classified and explained according to certain criteria, such as age, gender, and income, in order to understand the features of a specific group.** Demographical analysis considers factors such as race, age, income, education, possession of assets, house ownership, job position, region, and the degree of education.

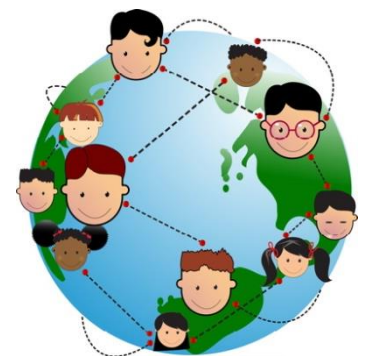


Considering demographics is of immense importance for any business. Business Organizations need to study different demographic factors. Particularly, they need to address following issues:

- ◆ What demographic trends will affect the market size of the industry?
- ◆ What demographic trends represent opportunities or threats?

## Socio-Cultural Environment

It represents a complex group of **factors such as social traditions, values and beliefs, level and standards of literacy, the ethical standards and state of society, the extent of social stratification, conflict, cohesiveness** and so forth. It differs from demographics in the sense that it is not the characteristics of the population, but it is the behaviour and the belief system of that population.



**Socio-cultural environment consists of factors related to human relationships and the impact of social attitudes and cultural values which has bearing on operations of the organization.** The beliefs, values and norms of a society determine how individuals and organizations should be interrelated.

The social environment primarily affects the strategic management process within the organization in the areas of mission and objective setting, and decisions related to products and markets.



## Economic Environment

Economic conditions have a direct bearing over the business strategies. **The economic environment refers to the overall economic situation around the business and include conditions at the regional, national and global levels.**



Economic environment determines the strength and size of the market. The purchasing power in an economy depends on current income, prices, savings, circulation of money, debt and credit availability. Income distribution pattern determine the business possibilities. The important point to consider is to find out the effect of economic prospect, growth and inflation on the operations of the business

**Example - Higher interest rates are detrimental for the businesses with high debt. In the realestate market, they reduce the capability of the prospective buyers to avail loan and pay instalments, thus lower the demand.**

## Political-Legal Environment

Political-legal environment takes into account elements like the general level **of political development**, the degree to which business and **economic issues** have been politicised, the degree **of political morality**, the state of law and order, **political stability**, the political ideology and practises of the ruling party, the effectiveness and purposefulness of governmental agencies, and the scope and type of governmental intervention in the economy and industry.



**Business is highly guided and controlled by government policies. Hence the type of government running a country is a powerful influence on business.** A business has to consider the changes in the regulatory framework and their impact on the business. Taxes and duties are other critical areas that may be levied and affect the business.

**Example - Nationalism supports measures aimed at enhancing the position of a country in International business. Presently, there is immense thrust on nationalism in Indian business through policies like Make in India and Aatmanirbhar Bharat. Production Linked Incentives scheme, another step in the direction, rewards businesses for increased sales of goods produced domestically**

## Technological Environment

A highly important factor in the present times is technology. Technology has changed the way people communicate and do things. Technology has also changed the ways of how businesses operate now.



**Technology and business are linked and are interdependent on one another.**

Technology has impacted on how businesses are conducted.

**With use of technology, many organisations are able to reduce paperwork, schedule payments more efficiently, are able to coordinate inventories efficiently and effectively.**

**Example - Changes in technology have an effect on how a business runs its operations. The technological advancements might require a business to drastically alter its operational, production and marketing strategies.**

## PESTLE- A tool to Analyse Macro Environment

The term PESTLE is often used to describe a framework for analysis of macro environmental factors. **PESTEL analysis is frequently used to assess the business environment in which a firm operates.** Political, economic, social, and technological (PEST) analysis was the name given to the framework.



## The Key Factors