

CHAPTER 1: What is the Business Environment?

Key Revision Points

Defining the Business Environment

An environment can be defined as everything which surrounds a system.

Business organisations exist to turn inputs from their environment (e.g. materials, labour and capital) into goods and services which customers in the environment seek to purchase. This transformation process adds value to the inputs. This is the basis of a simple model of the organisation in its environment.

There are three important elements of the business environment:

- The micro-environment
- The macro-environment
- The internal environment

Why Study the Business Environment?

There is evidence that successful organisations are not so much those that deliver value to customers today, but those that understand how definitions of value are likely to change in the future.

Of course, it is much more difficult to predict the future than to describe the past.

Successful companies have often been those who understand their business environment and have invested in growth areas, while cutting back in areas which are most likely to go into decline.

The Macro-Environment

The macro-environment comprises general trends and forces that may not immediately affect the relationships that a company has with its customers, suppliers and intermediaries, but, sooner or later, macro-environmental change will alter the nature of these relationships.

Most analyses of the macro-environment divide the environment into a number of areas. The principle headings, which form the basis for chapters of the text, are described below. It must, however, be remembered that the division of the macro-environment into subject areas does not result in watertight compartments.

- The political environment
- The social and cultural environment
- The demographic environment
- The technological environment
- The economic environment

The Micro-Environment

The micro-environment of an organisation comprises all those other organisations and individuals who directly or indirectly affect the activities of the organisation. The following key groups can be identified:

1. *Customers*
2. *Suppliers*
3. *Intermediaries*
4. *Competitors*
5. *Government*
6. *Pressure Groups*
7. *The financial community*
8. *Local communities*

The Internal environment

Internally, the structure and politics of an organisation affect the manner in which the organisation responds to environmental change.

Within many organisations, it has proved difficult to change cultural attitudes when the nature of an organisation's business environment has significantly changed, leaving the established culture a liability in terms of managing change.

Contextual issues in a dynamic environment

The business environment was broken down into a number of component parts in this book. The key to analysing the business environment is to see the links between these component parts by taking a snapshot of their interdependency. Another important consideration is to analyse their dynamic interaction. Successful business organisations have spotted trends, especially the interaction between trends in the different environments.

We cannot introduce the main levels of the business environment without explaining the interrelatedness of the elements of an organisation's environment. These elements run through all levels of the environment and are explained as follows:

- **The interdependency of organisations in the business environment**

A crucial aspect of understanding the business environment lies in understanding the networks of formal and informal relationships that exist between a firm and its various stakeholders.

The people and organisations within a particular company's business environment that are of particular relevance to it are sometimes referred to as its environmental set.

The relationship between set members is likely to be complex and constantly changing. Change can take a number of forms, including:

- A tendency for firms to seek long-term relationships with key members of their environmental set
- Shifts in the balance of power between members of the environmental set
- Emergence of new groups of potential customers or suppliers

- Fringe pressure groups may come to represent mainstream opinions, in response to changes in social attitudes

- **Value chains**

The purpose of organisations is to transform inputs bought from suppliers into outputs sold to customers. In carrying out such a transformation, organisations add value to resources.

Backward vertical integration occurs where a manufacturer buys back into its suppliers. Forward vertical integration occurs where it buys into its outlets. Many firms expand in both directions.

It is important that an organisation looks not only outwardly at the value chain, but also inwardly at its own service profit chain.

- **The information environment**

Information represents a bridge between the organisation and its environment and is the means by which a picture of the changing environment is built up within the organisation.

Information about the current state of the environment is used as a starting point for planning future strategy, based on assumptions about how the environment will change. It is also vital to monitor the implementation of an organisation's corporate plans and to note the cause of any deviation from plan, and to identify whether these are caused by internal or external environmental factors.

- **The communication environment**

Communications bring together elements within a firm's environmental set. With no communication, there is no possibility for trading to take place. Today, the internet has emerged as a versatile tool in an organisation's relationship with its business environment, combining a communication function with a distribution function. The ability of companies to rapidly exchange information with their suppliers and intermediaries has allowed for the development of increasingly efficient supply chains. The internet has allowed companies to communicate with their final consumers using email and to target promotional messages which are directly relevant to the user.

- **The ethical environment**

Ethics is essentially about the definition of what is right and wrong. In Western societies there is increasing concern that relationships between members of the environmental set should be conducted in an ethical manner. With expanding media availability and an increasingly intelligent audience, it is becoming easier to expose examples of unethical business practice. However, it can be difficult to agree just what is right and wrong - no two people have precisely the same opinion.

- **The ecological environment**

Only a few years ago, most business organisations in Western developed economies could have dismissed ecological concerns as something with which

only fanatical, minority groups were concerned. Today, the situation is very different, and just about all business organisations need to take the ecological environment seriously. There are many good reasons why the ecological environment is rising up the agenda of business organisations, including the need to preserve a good public image, threats of government regulation, and potential shortages of raw materials as finite resources are used up.

- **Systems theory, complexity and chaos**

Systems theory is the interdisciplinary study of the abstract organisation of phenomena, and investigates both the principles common to all complex entities and the models which can be used to describe them. Although a number of attempts have been made to apply the principles of systems theory to the business environment, there are major differences between scientific models and the business environment. Natural sciences deal more often with closed systems in which all parameters are known, monitored and controlled. By contrast, the business environment is essentially an open system in which it is very difficult to place a boundary round the environment and to identify the complete set of components within the system since it varies all the time and a researcher generally has no control over these elements in the way a laboratory-based scientist can do.

Two developments of systems theory are complexity theory and chaos theory. Complexity theory is concerned with the behaviour over time of certain kinds of complex system. Chaos theory describes the dynamics of sensitive systems which are mathematically deterministic but nearly impossible to predict, due to their sensitivity to initial conditions.

- **Business cycles**

The business environment is rarely in a stable state, and many phenomena follow a cyclical pattern. Companies are particularly interested in understanding business cycles and in predicting the cycle as it affects their sector.

- **Risk and uncertainty**

Because the business environment for most organisations is rarely in a stable state, there is no certainty that the future will follow the pattern of the recent past. Therefore organisations must assess the risk associated with their chosen strategies, and whether the macro- and micro- environments, on which they based their planning, turns out to be a reality.