

# Understanding the business environment

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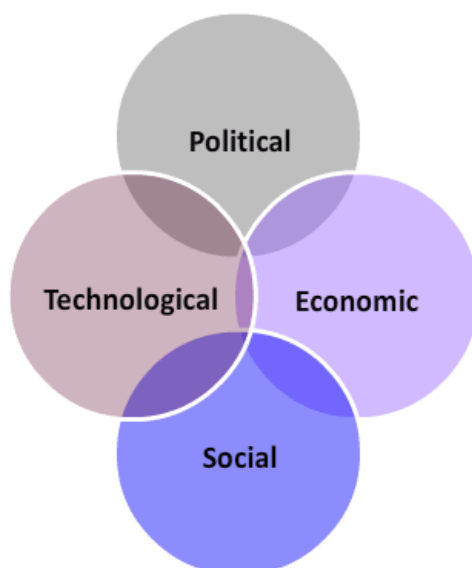
## Introduction

At the end of this topic you will be able to:

- describe what PEST is, and be able to carry out a PEST analysis for a business;
- explain what SWOT means and be able to carry out a SWOT analysis for a business.

## External environment

First of all we are going to look at the external environment in which an organisation operates. Read on to find out how events that occur anywhere in the world can effect what happens to an organisation.



### A strategy for examining the external environment - PEST

The four areas we are looking at: Political, Economic, Social and Technological have the acronym PEST. The audio transcript below will explain the four circles.

“The PEST analysis is a useful tool for understanding market growth or decline, and as such the position, potential and direction for a business. A PEST analysis is a business measurement tool. PEST is an acronym for Political, Economic, Social and Technological factors, which are used to assess the overall environment in which a business or organisational unit functions.

The PEST model is sometimes known as STEP – but obviously the same headings. Other variations are PESTLE, STEEPLE. These include Environmental, Legal and Ethical factors. However the PEST model covers these within the four headings. For example, legal issues are covered under Political, as legislative changes are largely

politically driven. Ethical issues can come under Social and or/political; and the environment can come under all of them really.

Basically using PEST allows you to get an understanding of the various factors which have an influence on the way in which you are able to do business. Your company does not exist in a vacuum...it is constantly being pushed and pulled in all sorts of directions by political, economic, social and technological changes. Knowing what these changes might be and how they might affect you, goes a long way to being ready for them when they happen or at least being able to mitigate or reduce the effect they can cause”.

Let's start by getting you to think about how certain external factors could affect an organisation. We will be looking at **PEST** - an acronym for evaluating **P**olitical, **E**conomic, **S**ocial and **T**echnological factors.

## Political

Historically the UK Conservatives have always been more in favour of individualism, and protecting the owners of industry; whereas the Labour Party is more concerned with the collective and the employees within industries. However, the governments in other countries also impact upon the UK - in terms of the relationship they have and whether we are co-operating with them or not. Political areas which can have an impact include:

### Social and Employment Legislation

Linked to the government in power, as their fundamental policies will affect what laws come into being, legislation can actually come and go. For example, in the USA, Barack Obama got through his Health Bill - Obamacare - which provides supported healthcare to millions of citizens in America; however since Donald Trump has been elected he is working very hard to get this legislation revoked.

### European/International Legislation

The EU has a huge impact upon us in this country. Many of the laws we have in place now are as a result of EU legislation - particularly with relation to working hours and holiday provision - and this can have a huge impact on businesses. The BREXIT implications will involve huge changes again.

### Wars and conflict

Wars and conflicts in the world - all have an impact upon us. Whether we become involved in a war - and then if we do, how we service that war and provide the equipment necessary, and the cost to the economy etc.

## Economic

How is the home economy at the moment? Are there risks of higher unemployment, rising inflation, and increased costs. This can mean your products are worth less abroad or that the cost of resourcing your products is more.

### Overseas economies and trends

Who has power and influence on the global stage? Which countries have strong economies?

According to Dominic Wilson & Roopa Purushothaman, first coining the phrase 'BRICs' to describe what they foresaw as four key economies to emerge within the global market place in a Goldman Sachs report (2003, 8):

*"Over the next 50 years, Brazil, Russia, India and China-the BRICs economies-could become a much larger force in the world economy. Using the latest demographic projections and a model of capital accumulation and productivity growth, we map out GDP growth, income per capita and currency movements in the BRICs economies until 2050.*

*The results are startling. If things go right, in less than 40 years, the BRIC's economies together could be larger than the G6 in US dollar terms. By 2025 they could account for over half the size of the G6. Currently they are worth less than 15%. Of the current G6, only US and Japan may be among the six largest economies in US dollar terms in 2050."*

Goldman Sachs report (2003, 8)

The Goldman Sachs report 'Dreaming with BRICS: The Path to 2050' indicates:

- India's growth rate will be the highest -- not China's -- and it will overtake Japan (today the world's second largest economy) by 2032.
- BRICs' currencies could appreciate by 300% over the next 50 years, providing a big tailwind for investors in BRIC assets.
- Taken together, the BRICs could be larger than the U.S. and the developed economies of Europe within 40 years.
- Over the next two decades, BRICs will bring another 200 million people with incomes above \$15,000 into the world's economy. That's equal to the combined populations of Germany, France and the U.K.

### Seasonality/weather issues

Yes the weather can have a huge impact upon the economy. Just look at what happens when the UK gets a bit of snow and the country grinds to a halt! This costs the economy millions of pounds. Also can you get your goods and services where they need to be on time?

**Market and trade cycles**

Also there are peaks and troughs in the consumer market - obviously the build-up to Christmas is good, but January and February is very poor. The housing market also dips in the winter and comes back up again at Easter time.

**Interest and exchange rates**

Interest rates are low in this country currently to try and encourage investment and growth. However, the full interest rate is not passed to the consumer when borrowing, but, ironically, it is passed to us when trying to save. Related to this are:

- Unemployment and labour supply
- Labour costs
- Levels of disposable income and income distribution

**Socio-cultural**

Social factors have a massive impact upon organisations. The population, gender, age, fashions, leisure pursuits etc - all impact on the way in which organisations look, feel and behave. Some key areas in particular are:

**Population growth rate and age profile**

Heard of a population pyramid? A healthy population in a country should have a population mass which looks a bit like a pyramid - lots of young people at the bottom and as you go up the pyramid then there are less people as they get older. However, many western societies have an inverted pyramid - it's up-side down. Not enough young people at the bottom and too many old people at the top. This means that there are not enough young people working and paying taxes to support the old people who are no longer working and require pensions and medical care. Whilst having an aging population opens up certain business opportunities: care homes, Saga holidays, walk-in showers, and stair lifts (to name but a few); it also puts a great strain on the economy.

Related to the issue of population growth and structure is the number of generations that are currently in employment. We now have a society where 4 generations can be working in one organisation. This clip explains who they are:

- mccrindlerresearch - [Understanding the Global Generations](#). Youtube (5m, 16s)

**Population health, education and social mobility, and attitudes to these**

The health of a population is also a big factor. One of the key problems facing many western populations currently is obesity. We are slowly killing ourselves by eating unhealthy foods and not doing enough exercise. This has an impact on economies as obesity causes many chronic illnesses which put a strain on health care and also mean that these people cannot work. Western countries also tend to have large populations concentrated in conurbations - cities...and this brings with it certain positives and negatives: increased pollution and congestion; and also less economic strength to fund more remote and rural areas.

**Population employment patterns, job market freedom and attitudes to work**

In Japan there has been traditionally a far stronger work ethic than in the UK - where people generally work to live rather than live to work. This has meant that UK productivity levels have remained lower than in quite a few countries and this impacts on overall competitive advantage.

**Lifestyle choices and attitudes to these**

Until the current recession there was an attitude of 'spending' and often spending beyond our means - through loans and credit. We have a society that tends to view itself in terms of what it owns...in 'things', and that buying more will make us happy. Oliver James refers to this as 'Affluenza' - a 21st century disease which has made us unhappy - it is a spiral whereby we want to consume more because we are unhappy, and then that means we need more money either through work or loans, which makes us more unhappy and we need to consume more again!

## Technology

These have a huge impact upon our working and daily lives. Technologies are advancing constantly and not keeping pace with them, particularly in industry, can have a huge detrimental effect. These days if you do not have a website, or at least an internet presence then your business will struggle to survive. Making sure you have the latest software in your area of expertise is important because your competitor might have it which will make them more efficient and cost-effective.

**Impact of internet, reduction in communications costs and increased remote working**

The world has shrunk as a result of technology...not literally, but certainly figuratively. Thomas Friedman has written a book entitled 'The World is Flat 3.0' and he describes how information communication technology has effectively 'flattened' the world - making it so much easier to communicate, do business, work, live our lives...

**Future technologies**

Here are some examples of where technology is going in the not too distant future:

- [Top 10 Upcoming Technologies 2017](#). Youtube (1m, 54s)

## SWOT

Developed in the 1960's as a planning tool for large businesses, SWOT analysis allows managers to consider key areas of the business and evaluate what is known against what might happen in the future. But it is equally valid and useful in a small business.

Strengths and Weaknesses represent what is known about the business; whilst

Opportunities and Threats represent what might happen in the future based on the Strengths and Weaknesses of the organisation.

### Strengths

- Positive business tangible and intangible attributes.
- What are the main strengths of your business?
- For example - its location, its unique product, great customer service, good staff etc.

### Weaknesses

- Positive business tangible and intangible attributes.
- These are the weaknesses your business may have.
- These can be the same as possible strengths as what are strengths to some are weaknesses to another.

### Opportunities

- External attractive factors that give the business an opportunity to meet its objectives progress. What can you tap into? New products? New markets? Expansion? Merging? Change in economy etc?

### Threats

- External factors, often beyond the businesses control, which could represent a risk to its progress. What competitors do you have? What can you afford to do? Changes in politics, society, economy etc.

## PEST versus SWOT

It is important to see that the two forms of business analysis are different but complimentary, and are very useful in assessing your company's present and future position.



## Activity – PEST or SWOT

**Test your understanding of PEST and SWOT by trying this exercise. Which statements are PEST and SWOT:**

1. This is most useful when looking at product or service feasibility. PEST/SWOT
2. Often used when entering a new market, but increasingly now for improving penetration of existing ones too. PEST/SWOT
3. Strengths and weaknesses address the internal factors; and opportunities and threats address the external ones. PEST/SWOT
4. Focuses on internal and external factors which directly relate to the company. PEST/SWOT
5. Focuses on all external factors which may indirectly impact upon the company. PEST/SWOT
6. The external factors need to be looked at a company, country and global level. PEST/SWOT
7. It is a flexible approach that can be used across all business functions. PEST/SWOT
8. When looking at market or business expansion then this is the best model to use. PEST/SWOT

Answers are provided at the end of this document.

### Audio: PEST versus SWOT

"PEST is useful before SWOT - not generally vice-versa - PEST definitely helps to identify SWOT factors. There is overlap between PEST and SWOT, in that similar factors would appear in each, but they are different perspectives:

PEST assesses a market, including competitors, from a business perspective. SWOT is an assessment of a business, whether your own or a competitor's. While PEST has more use for larger, more complex business structures, it is still very much of value for small businesses. The four factors in PEST will have different priorities and vary in terms of significance according to the sort of business you are in. Things like social factors will be more prevalent within a customer-facing business, for example. All businesses can benefit from a SWOT analysis, both of themselves and of their competitors.

This sort of strategic planning is essential within contemporary businesses who need to understand their global competitors and exploit new global markets in order to survive".

Therefore, in conclusion, the next page contains some examples of the sort of manager you will need to be in this new global economy in order to help your organisation survive.

## Inter-dependent business environment

In this new inter-dependent business environment:

<b>You need to be able to:</b>	<b>What does this mean to you:</b>
Understand interdependencies – complexity of decision making on global stage	You need to know that what happens in one company or country will have an impact on others. Keep up with current affairs and know what is happening in the global economy. Watch the news and find out how things happening abroad will affect you at home.
Know your competitors' strengths and weaknesses	That way you will know exactly what you are up against and how you can compete with them for market share.
Know your own company's strengths and weaknesses	Make sure you carry out a SWOT analysis and where you have strengths, then exploit them; and where you have weaknesses, then address them.
Analyse where new opportunities may come from	Look globally for new business opportunities, but also make sure you regularly carry out a PEST analysis as this may highlight changes which you can exploit in your internal market too.
Respond to different cultures simultaneously – not sequential like an expatriate	You will need to be able to interact with people from a number of different cultures at the same time and you need to know how to do this effectively. Cultures have different approaches to meetings, formal negotiations and protocols. You need to make sure you don't offend people.
Have a willingness to share power – learn from foreign businesses	Be receptive to new ideas and new ways of working. Keep an open mind and be inquisitive to learn new ways of doing things.
Recognise cultural differences at home – do not overlook foreigners in home organisation	Cultural awareness at home is also very important. You need to make sure you get the best out of your workforce and adapt to meet the needs of cultural groups.

Think about local responsiveness to global requirements (Wills & Barham, 1994)	Related to understanding the global market place you need to think about how you can respond to it at a local level – from your company’s perspective. So the financial crisis in Greece currently – what are the implications for your business – what are the opportunities? The threats?
Awareness of national, corporate & financial differences	Again – keep up to speed with current news events, and also understand how to do business with other countries and the ways in which they do things. Who you might need to go through and what specific requirements they might have.
Develop cross-cultural competence: <ul style="list-style-type: none"> <li>• Learning about thinking &amp; feeling (EI)</li> <li>• Active participation by learners</li> <li>• Learning specific to own jobs</li> <li>• Balance of specific &amp; general knowledge</li> <li>• Awareness of own culture</li> <li>• Allow for experimentation &amp; taking risks</li> </ul>	Basically this means being flexible and open-minded to new ideas and new ways of doing things. Be adaptable and not ‘stuck in your ways’. Do not think that your way is best...always look for the ‘new’.
Adopt a ‘culture-general’ response	Rather than just knowing about one culture other than your own and one language, try to learn about lots of different cultures but not in-depth. Just an overall awareness of how different cultures do different things. Learn just a few key phrases in a language and this will ‘oil the wheels’.

## Summary

During this business environment topic you have been introduced to:

- Introduction to the topic
- Explanation of the PEST analysis
- Understanding the political environment
- Understanding the economic environment
- Understanding the social environment
- Understanding the technological environment
- SWOT analysis
- What organisations need to be able to do in order to remain competitive

## References

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## Activity answers

### Activity – PEST or SWOT

1. SWOT
2. PEST
3. SWOT
4. SWOT
5. PEST
6. PEST
7. SWOT
8. PEST