LEVEL 4
DYNAMIC BUSINESS ENVIRONMENTS

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1.1	2017	Document created
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Contents

Using your study guide

Welcome to the study guide for **Level 4 Dynamic Business Environments**, designed to support those completing their ABE Level 4 Diploma.

Below is an overview of the elements of learning and related key capabilities (taken from the published syllabus).

Element of learning	Key Capabilities
Element 1: Understanding the role of economics	• Ability to evaluate the role of business economics in understanding markets and the potential impact of current economic issues *Business economics, the potential impacts of governments and levels of competition.*
Element 2: Analysing external environments	• Awareness of external environmental trends • Ability to analyse different types of business organisations and external technological advancements *Understanding the external business environment, use of tools for external analysis*
Element 3: Analysing internal environments	• Awareness of internal environmental trends • Ability to analyse different types of business organisations' internal environment *Understanding the internal business environment, use of tools for internal analysis*
Element 4: Analysing competitive environments	• Ability to use relevant frameworks to identify trends in the competitive environment • Ability to identify methods for gaining competitive advantage based on competitor analysis *Competitive environments, SWOT analysis, spotting opportunities for growth*

This study guide follows the order of the syllabus, which is the basis for your studies. Each chapter starts by listing the syllabus learning outcomes covered and the assessment criteria.

Level 4 descriptor

Element of learning	Key Capabilities
• Has practical, theoretical or technical knowledge and understanding of a subject or field of work to address problems that are well defined but complex and non- routine. • Can analyse, interpret and evaluate relevant information and ideas. • Is aware of the nature of approximate scope of the area of study or work. • Has an informed awareness of different perspectives or approaches within the area of study or work.	• Identify, adapt and use appropriate cognitive and practical skills to inform actions and address problems that are complex and non-routine while normally fairly well-defined. • Review the effectiveness and appropriateness of methods, actions and results.

This study guide includes a number of features to enhance your studies:

Chapter 1

Understanding the Role of Economics

Introduction

In this chapter, we will be looking at: the economic views of businesses; comparing different economic systems; the impact of governments on the economy and on businesses and competition in the marketplace.

Learning outcomes

On completing the chapter, you will be able to:

1 Explain the role of business economics in understanding markets and the potential impact of current economic issues

Assessment Criteria

1 Explain the role of business economics in understanding markets and the potential impact of current economic issues

1.1 Discuss the economic view of businesses

1.2 Compare different economic systems

1.3 Explain the potential impact of governments on business and business environments

1.4 Discuss the varying level of competition in markets and the impact on price volatility

1.1. The economics view of business

The business organisation as a transformation process

NEED TO KNOW

A transformation process is any activity or group of activities that takes one or more inputs, alters, and adds value to them, and deliver outputs for clients or customers.

There are three types of input: materials, information, and customers. An example of transformation of materials is shown below.

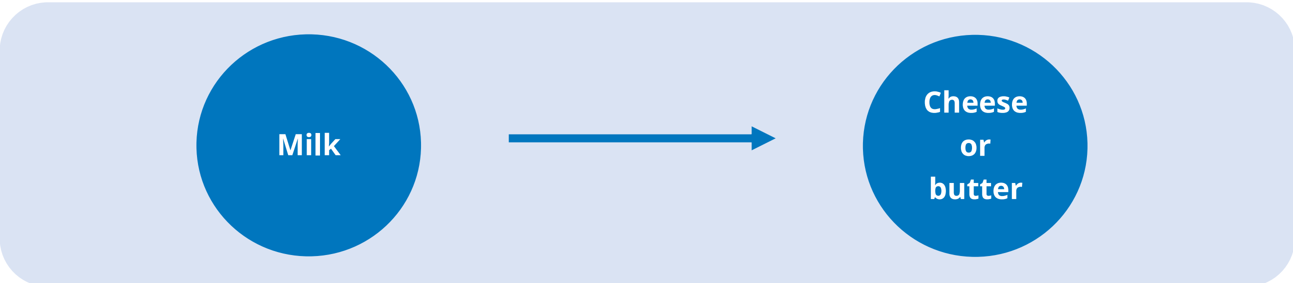


Figure 1: An example of the transformation of materials

Economics in Business

What is business?

A simple definition of business is when a person or group of people trade goods and services in exchange for something of value. Commonly we see it as a business, enterprise or individuals selling goods and/or services in exchange for money.

Goods are physical products (such as a motor car or notepads); services are intangible and include trades such as dentistry and accountancy. As simple as this seems, the world of business has changed significantly over the past 15 years and the roles and activities involved in producing and selling goods and services have similarly changed

Today there are roles within an organisation that would not have been understood 10 years ago, such as bloggers, social media coordinators or content strategists. It is not just the roles that have changed; working methods and the ways organisations are structured have changed also.

It is important that modern employees understand the world they are employed in, and they can use their knowledge to achieve success. When an employee joins a business, there are expectations within the business of what they should already know, and how they should behave and communicate.

The purpose of a business

Simply put, the purpose of a business it to make a profit. Profit is difference between income earned and the amount spent operating the business (which includes taxes and staff costs

For some businesses, the aim is to make income for the owners; for other businesses it is to help others in the form of charity (i.e., of a not for-profit organisation).

Economics is the understanding of goods and services – how and where they are produced, how they are processed and ultimately consumed and where applicable disposed.

Economics is typically split into 2 forms – macro and micro. However, when running a business, no matter what size, its important to understand all the factors of an economy, both direct and indirect.

This study guide supports you qualification with ABE and provides a practical understanding of how economics impacts and is affected by business.

Macroeconomics and microeconomics

In this section, we will look at microeconomics and macroeconomics, what they are and the differences between them.

Microeconomics is the study of economic behaviour of individual aspects of an economy. These include people, firms, and households. By looking at the interrelationships it is possible to determine patterns of production followed by the distribution of goods and services.to customers. Therefore, microeconomics involves how resources in an economy are allocated and how choices affected this. The business organisation as a transformation process.

Therefore, from a microeconomic perspective, the primary aim is to achieve the best return from the factors of production which are shown below.

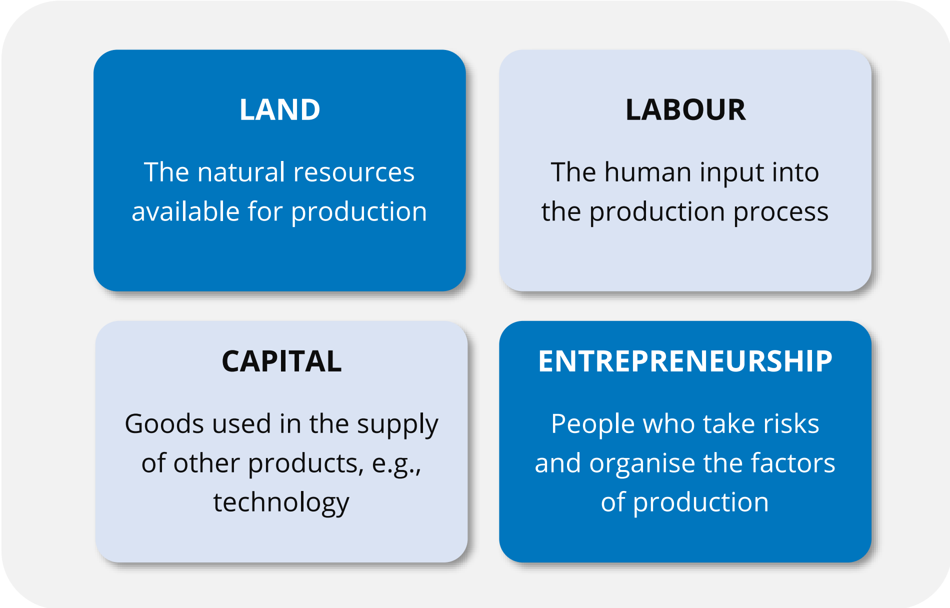


Figure 2: Production factors

Macroeconomics is the study of elements of the national economy, economic aggregates (grand totals). An example of this would be the overall level of output, prices, and employment in the economy. It shows us what stimulates economic growth.

Examples of macroeconomic factors include:

- Inflation
- Unemployment rates
- Taxation
- Consumption
- Imports and exports
- National income

Whilst the micro and macroeconomics have a different focus, the two areas do overlap and are interdependent in several ways. For example, increased inflation, which refers to a general rise in prices throughout the economy (macroeconomics), can cause the price of raw materials to increase, meaning the price the public pays for the product increases.

! NEED TO KNOW

Microeconomics takes a "bottom up" approach, looking at areas such as individual consumer choices and how they filter upwards, whilst macroeconomics is a "top down" approach, which looks at the overall economy, how it is managed and how it filters downwards to the consumer.

OVER TO YOU

Activity: Production factors

Land, labour, capital and resources are all factors of production.

Think about how these different factors apply in two different businesses, such as farming and an electrical parts business.

Economic Measures

In this section, we will look at different economic measures. There are several different methods that can be used to measure economic success, and these are given below.

Gross National Product

Gross national product (GNP) is the value of all goods and services that are made by a country's businesses and residents irrespective of the product location. GNP counts the value of all commodities made by a domestic regardless of whether they are located locally or oversees.

Gross domestic Product

Gross domestic product (GDP) is the value of income produced within a country. So, this is the monetary value of all finished goods and services produced within a country's borders in a specific time. It is usually calculated on an annual basis but can also be calculated on a quarterly basis.

Balance of payments

The balance of payments (BOP) is a record of a country's financial transactions with the rest of the world. It shows a country's receipts from other countries (a credit where a country has received money) and a country's payments or deposits in other countries (a debit where a country has paid or given money).

When these transactions are recorded, we arrive at a balance of payments statement, which is recorded every quarter and every calendar year. The BOP is different to the Balance of Trade (BOT). This is simply the difference between the value of exports and the value spent on imports.

In theory, a balance of payments should stand at zero, meaning credits and debits balance. However, in practice this is not the case. Therefore, the balance of payments can show if a country has a deficit or a surplus and from which part(s) of the economy that comes.

Unemployment

Unemployment is the number of people who are currently without a job, but who are actively looking for employment. The unemployment rate is the number of unemployed expressed as a percentage of the labour force. However, there are differing opinions on who should be officially counted as unemployed. For example, some authorities believe that students shouldn't be counted in the unemployment figures.

Inflation

Inflation is a general rise in prices throughout the economy. Governments aim to keep inflation low and stable. One of the main reasons for this is because it aids the economic decision-making process. For example, businesses will be able to set wage rates and prices and make investment decisions with more confidence about the longer term if inflation is stable

OVER TO YOU

Activity: Economic Measures

By researching your own country and another country of your choice, compare the trends of each of the five economic measures above. If the information is available, look back over a period of five years. Consider the implications of your findings for both countries.

Trading internationally

Both small and large businesses may trade internationally. Examples include the import of raw materials, such as spices for a restaurant, or the export of finished goods, such as garments made in Bangladesh to the UK market.

At some point in the supply chain, it is likely that an element involved in production will have crossed a national border – even if it's not the end product.

For example, a mango stall holder in India may sell fruit from the local region locally, so no international trade occurs in this situation; however, the motor vehicle used to collect the mangos from the distributor may be imported or use parts from other countries, and the fuel may have been imported from Saudi Arabia (India's main suppler)

Therefore, even a locally based business will be affected by factors influencing global trade. International trade affects a business in two main ways: exchange rates and tariffs, but note that political and transnational influences are also important

Exchange rates

The exchange rate is the price for which one nation's currency can be exchanged for another's. For example, it takes 4GHS to buy 1USD (where GHS is Ghanaian cedi and USD is United States dollars).

www.worldstopexports.com/crude-oil-imports-by-country

Tariffs

These are the taxes imposed on imports or exports. These can also be called excise, levy and duty. Importance of trade

Trade is vital to an economy as it increases the market for sales and supplies and can provide new opportunities for markets and foreign investment which increases jobs and funding. International trade improves the quality of living because of the greater quantity and variety of goods on offer at lowered prices (due to competition).

Additionally, free trade areas such as The Association of Southeast Asian Nations (ASEAN) have agreements which stimulate trade between member countries, making it tariff-free and using simpler import and export processes.

While there are many issues for employees concerning the increase in global trade such as the livelihoods of those threatened by foreign competition, all businesses are affected by international trade.

Classifications of business

In this section, we will look at the classifications of business. There are three main types of industry in which firms operate; these form a production chain which results in finished goods or services for customers. They are outlined in Table 1 below.

INDUSTRY	DESCRIPTION
Primary Industry	**Primary industry** production involves acquiring raw materials. For example, oil drilled from the ground, coal mining, fish trawling and foodstuff farming.
Secondary Industry	**Secondary industry** production involves the manufacturing and assembly process. This involves converting raw materials into components, for example, turning oil into plastic. It also involves assembling products, for example, building roads, bridges and houses.
Tertiary Industry	**Tertiary industry** production relates to the commercial services that support the production and distribution process. For example, warehousing, insurance, transport and services such as health care and teaching.

Table: Classification of Business

Private Sector

The private sector is the part of the national economy which is made up of private businesses. It is responsible for allocating most of the resources within an economy. An example is a small motor garage (though there are some very large private limited companies too.

Public sector

The public sector is the part of the economy that provides goods or services that are not, or cannot be, provided by the private sector. It consists of local and national government, their various agencies, and chartered bodies. In the UK, examples of public sector services would be the Driver and Vehicle Licensing Agency (DVLA) and the National Health Service (NHS). Other examples of public sector organisations in the world are the State Services Commission (New Zealand) and the Australian Public Service (Australia).

Sectors and legal structures of organisations

It is important not to confuse the concept of legal structures such as a private limited company, with the sector in which it operates. The limited company is its status not that it works only in the private sector. A private ltd company can work in the public sector such as providing protective equipment to a hospital.

Business Size

Business size can be categorised in several different ways, but the most common is number of people employed. However, actual definitions of businesses of different sizes vary around the world.

INDUSTRY	INDUSTRY
SME (Small and medium-sized enterprise)	Less than 250
Large enterprise	More than 250

Table: Business size classification

BUSINESS TYPE	NUMBER OF EMPLOYEES
Micro enterprise	Less than 10
Small enterprise	Between 10 and 49
Medium enterprise	Between 50 and 249

Table: The classification of small and medium-sized businesses

Domestic business	A company that conducts its affairs in its home country.
International business	A multinational corporation or international business that engages in business among multiple countries, for example coco-cola.

Table: Business classification in terms of global reach

OVER TO YOU

Activity: Business size

What is the percentage breakdown of the 3 categories of business size in your region or country?

The Economic environment

Choice within an economy

Across the world, there is a finite number of resources. Therefore, each action is a choice. Choices can be at an individual level such as buying a car or going on holiday but also at a national level such as investing in road building projects or subsides faring. As there is a finite amount of money, there has to be a choice.

Scarcity can be defined as the excess of human wants over what can be produced. Because of this, various choices have to be made between the available alternatives.

Supply and demand

Within the economy, choices create a supply and demand for goods.

Demand is related to wants. Price is one area that will affect demand. Other areas that affect demand are taste, the number and price of complementary goods, (for example, vehicles and petrol; footwear and polish), the number and price of substitute goods (for example, Pepsi and Coca-Cola; margarine and butter), income, distribution of income and expectations of future price rises.

Supply is related to volume of resources available in an economy and is always and is limited. The amount that firms can supply depends on technology and resources available.

As with demand, supply is not determined by just price. The other areas that affect supply are production costs, profitability of alternative products (for example, of lower price alternatives/substitutes), profitability of goods in joint supply (for example, cows and milk), nature (for example, weather extremes), the number of suppliers, the aims of producers and expectations of future price rises.

The supply and demand diagram below shows the relationship between quantity and price. If demand increases, price will increase; if demand decreases, price will decrease. In some scenarios, if supply increases, price increases, and if it decreases, price decreases. The intersection of the supply and demand curves is known as the equilibrium (price).

For example, if the demand for a style of trainer increases, so will the price to a point where demand falls as the price is too expensive for the market.

If how the supply for the trainer is high, there will be lots available in the market, so the price is likely to fall.

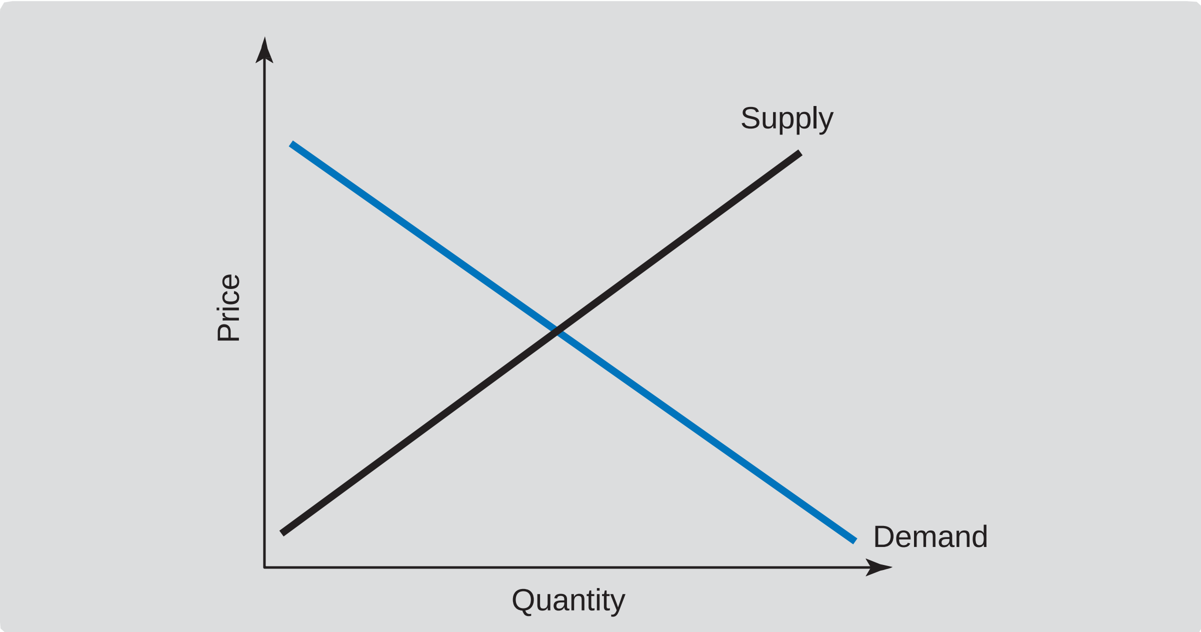


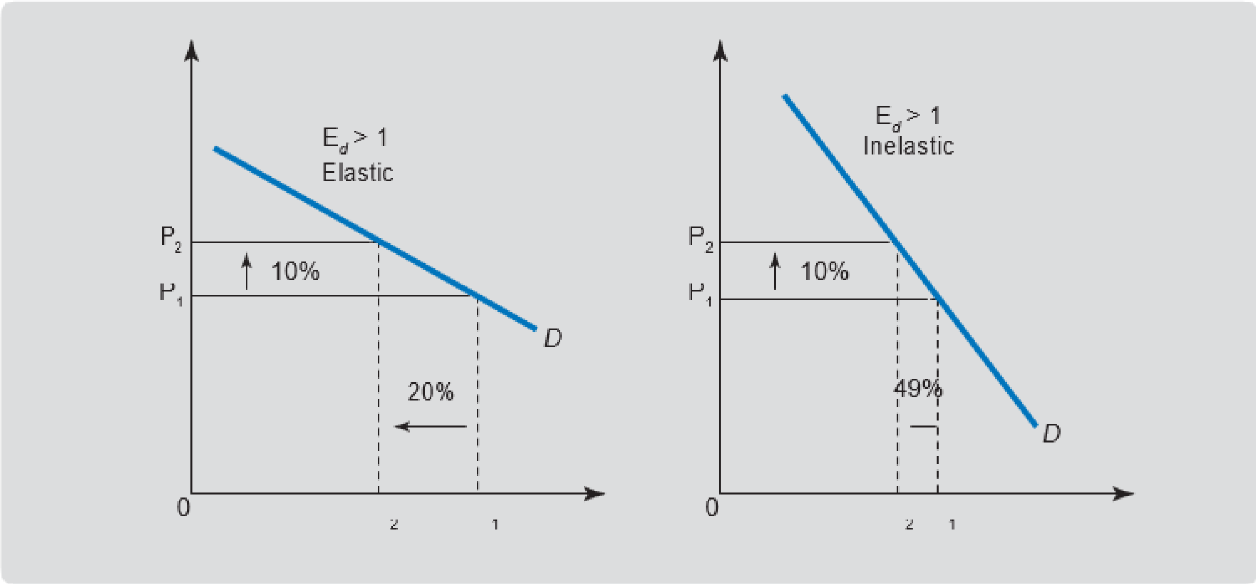
Figure: Supply and Demand

Elasticity of demand

Elastic demand is where quantity demanded changes by a larger percentage than price. So, as price rises, quantity demanded falls, and as price falls, quantity demanded rises. When demand is elastic, quantity demanded changes proportionately more than price. When demand is inelastic it is the other way around: price changes proportionately more than quantity demanded.

Figure 4 shows elastic demand on the left and inelastic demand on the right. On the left, with elastic demand, it shows that quantity demanded (20%) has increased more than price (10%). On the right, with inelastic demand, it shows the opposite, where price (10%) has increased more than quantity demanded (4%).

1.1 Elasticity of demand is an important factor. Firms need to understand elasticity of demand for their products so they can set a rigorous pricing strategy. They need to be aware of changes in consumer incomes, tastes and behaviours.



Price elasticity of supply

When price changes, there will be a change in quantity demanded and quantity supplied. The amount that cost rises as output rises and the time period (short-run, long-run and immediate time) are determinants of elasticity of supply.

Immediate time period	Firms are unlikely to be able to immediately increase supply by very much. Supply here is virtually fixed and can only vary due to available stock. Supply is highly inelastic.
Short run	Overtime, some inputs can be increased, whilst some will remain fixed. Supply can increase somewhat.
Long run	In this time period there will be enough time for all inputs to increase and new firms to enter the industry. Therefore, supply is likely to be highly elastic in many cases.

Table: Price elasticity of supply

Figure 5 illustrates inelastic supply on the left. This is where price increase is greater than quantity supplied. On the right is elastic supply, where the increase in quantity supplied is greater than price increase.

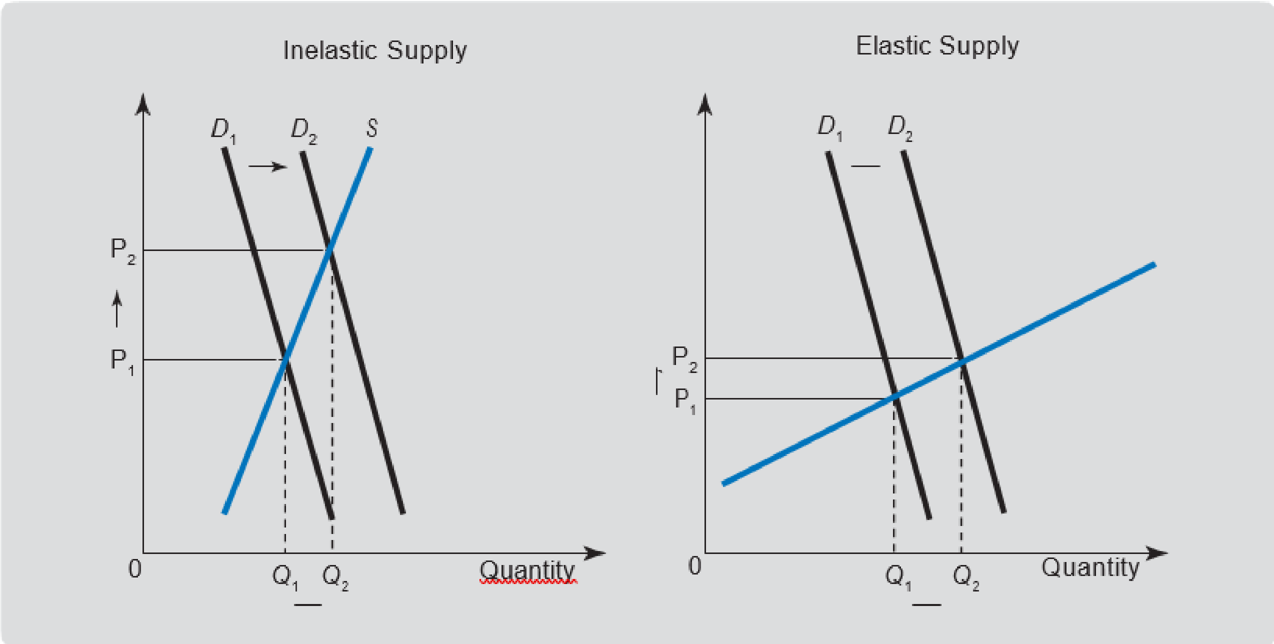


Figure: Elasticity and Supply

OVER TO YOU

Activity: Supply and demand

Research the changes in the price of fuel over recent months and consider the effect on demand. Explain any differences in levels of demand from the consumer and business sectors. Outline the main reasons why demand for fuel is likely to remain inelastic for the short term.

Equilibrium

Equilibrium price will remain the same if the supply and demand curves stay the same. Equilibrium is represented by the intersection of the demand and supply curves.

If either of the curves moves, then a new equilibrium will be formed.

The diagram shows the equilibrium where supply and demand intersect.

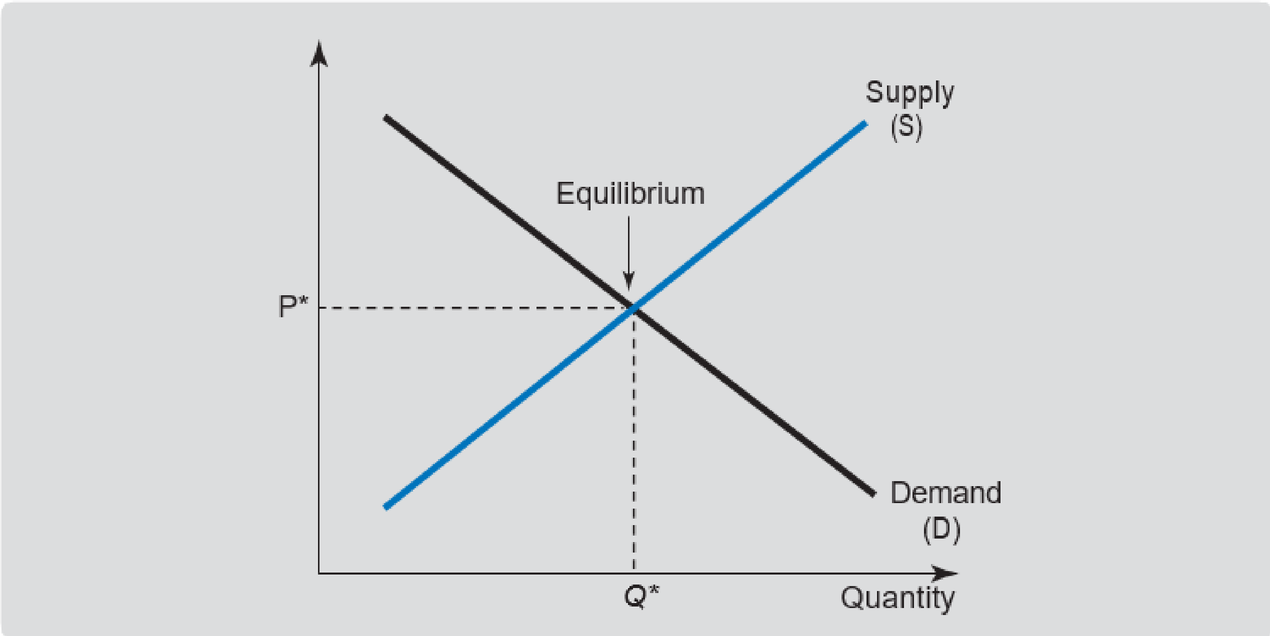


Figure: Equilibrium

OVER TO YOU

Activity: Influences on supply and demand

Using fast food giant McDonald's as an example, explain the key factors that influence the level of demand for and supply of the products or services they offer in over 120 countries.

Changes in supply and demand conditions

Causes and impact of changing demand

Think of a product that you buy regularly. If the price of that product increased to more than you pay now, would you still be willing to pay for it at an increased price?

NEED TO KNOW

A change in price causes a change in demand. If price rises, demand falls, and if price falls, demand rises. However, a shift in demand can also be affected by other factors, such as: income, quality of goods, advertising, substitutes, complements, weather, and expectations.

Causes and impact of changing supply

NEED TO KNOW

A change in supply is also affected by price. As price increases, firms have an incentive to supply more to get extra revenue from selling the goods. If price changes, there is movement on the supply curve, e.g., if price increases, supply increases. This could occur for the following reasons: lower taxes, increase in government subsidies, improvements in technology, increase in supply of related goods, expansion in capacity of existing firms, increase in number of producers and decrease in costs of production.

OVER TO YOU

Activity: Consumer decision-making

As a consumer, what are the key factors that influence your levels of demand for a product or service? Use specific examples and clearly explain why each factor you mention is critical in your decision-making process.

CASE STUDY: ELASTICITY OF DEMAND AND SUPPLY

Competition in the car industry

The car industry is truly global and extremely competitive. Let's look at the USA as an example. The competition between American-made and Japanese cars is particularly fierce.

Let's assume the USA decides to place a 15% tax on foreign-made cars and explore the implications of such a decision.

Initially, this would mean a potential 15% increase in the price of Japanese cars being sold in the USA.

How far the Japanese car manufacturers can pass on this price increase to consumers is dependent on the price elasticity of demand for Japanese cars.

- So, if the demand is relatively inelastic, then demand will fall minimally because of a price rise of 15%. The implication is that consumers don't see American and Japanese cars as close substitutes.

- Conversely, if the demand for Japanese cars is relatively elastic (i.e., price sensitive) then the quantity demanded will fall, possibly considerably because of the 15% increase in prices. The implication here is that consumers see American and Japanese cars as close substitutes.

OVER TO YOU

Activity: Elasticity of demand and supply

1 Assume that American and Japanese cars are sold at a similar price of $30,000 and there is 15% tax ($4,500) placed on imported Japanese cars. Draw diagrams to show the demand and supply curves assuming:

- **American and Japanese cars are close substitutes.**

- **American and Japanese cars are not close substitutes.**

2 Explore the car industry in your country.

- **Write down how far cars from different countries are close substitutes.**

- **Draw a diagram to show the implications for the elasticities of supply and demand.**

1.2. Different economic systems

Economic systems

In this section, we will look at different economic systems. An economic system can be defined as a way in which a nation or state apportions goods and services in its society or geographic area.

There are three main classifications of economic systems:

- Centrally planned economy
- Market economy
- Mixed economy

Centrally planned economies

A **centrally planned economy**, also known as a command economy, is an economy where all economic decisions are taken by central authorities.

With central planning, an overall view of the economy can be taken by the government, and this drives how a nation's resources are used. Therefore, the nation's resources can be directed specifically towards a nation's goals.

This can mean:

- high growth rates could be achieved if the government directed large resources into investment.
- unemployment could be avoided if allocation of labour was planned in accordance with requirements.
- national income could also be distributed more evenly or in accordance with needs.

In theory, a centrally planned economy can achieve those goals. However, in practice, achieving these goals would come at considerable economic and social cost. There are several reasons for this.

- The larger and more complex the economy, the larger the task is to build a plan. The more complicated the plan, the more likely it is to be inefficient and costly.
- If there is no pricing system, planning is likely to be inefficient, the economy does not flex in line with supply and demand.
- It can be difficult to set "reward and recognition" incentives to encourage workers to be productive and deliver quality. To reduce the risk of lower productivity, people may have to be employed for quality audits.
- Complete state control can have a negative effect on individual choice.
- Consumers would have limited choice where to buy and workers would have no choice where to work.
- The government could put plans in place even if they were unpopular.

An example of an economy that is near to being centrally planned in today's world is China.

Market economies

NEED TO KNOW

A market economy, also known as a free market economy, is an economy where the economic decisions and pricing of goods and services are guided solely by the interactions of a country's businesses and citizens. There is very little central planning or government intervention.

The fact that a free-market economy functions automatically is one of its main advantages.

The main implications may be:

- There is no need for costly and complex bureaucracy to make or co-ordinate economic decisions and the market can respond quickly to changes in supply and demand.
- When markets are highly competitive, no single firm has market dominance. Competition keeps prices down and incentivises firms to be more efficient. The more firms that are competing, the more responsive they will be to customer needs.
- The more efficiently firms can combine factors of production, the more profit they could make.
- So, people pursuing their own self-interest through a competitive environment helps to minimise scarcity by efficient use of resources in line with consumer wishes.
- Defenders of the free market would say the pursuit of private gain results in both social and national good.

However, in practice, free markets may not achieve maximum efficiency without some government intervention.

Some of the issues with free markets are:

- Competition can be limited between firms. A few larger firms may dominate an industry.
- Lack of competition and high prices may make being efficient less of an incentive.
- Power and property may be unequally distributed across the population.
- Some firms may use undesirable practices.
- A free-market economy could lead to instability, such as periods of recession, periods of rising prices, falling output and high unemployment.
- There can also be an ethical objection, i.e., a free market economy by rewarding self-interest may lead to greed, materialism and acquisition of power.

OVER TO YOU

Activity: Human Capital

Many organisations around the world see people as their most important asset. The term "human capital" is more readily used to describe this asset. Using an organisation of your choice, how far is the people resource seen as human capital?

Mixed Economies

A **mixed economy** is an economy where economic decisions are made partly by the government and partly through the market.

NEED TO KNOW

In mixed economies, the government influences:

- relative prices of goods, by taxation or subsidies.
- relative income, by use of taxation, welfare payments or direct control over wages, profits, etc.
- macroeconomic problems of unemployment, inflation, lack of growth, balance of trade deficits, exchange rate fluctuations, level of interest rates and bank lending, and the foreign exchange rate

Government Intervention and business economics

So, government intervention can be used to influence some market failings. However, it is worth noting that governments are not perfect, and their actions and interventions can cause both beneficial and adverse reactions.

For example, if a government increases levels of personal taxation, levels of income will fall and consequently levels of consumer spending and saving may also decline. If a government increases the levels of taxation for a business, this will lead to lower levels of business confidence, and their ability to invest and create employment opportunities. If a government increases its levels of spending on infrastructure projects, this could lead to creation of employment and better communication between different regions.

Government control of goods within the economy

While the supply and demand of goods in any economy, there are 3 classification which need a greater focus as the influence of government significantly affects their availability and or price.

Merit and demerit goods

Merit goods are goods and services which the government feels that people will under-consume and therefore should be subsidised or provided for free, so the government must intervene and correct the market failure This assumes that consumption is not dependent on the ability to pay. Examples of merit goods are education, public libraries, citizen's advice and health services.

Demerit goods are goods and services which can have a negative effect on the consumer. These effects can sometimes be ignored or unknown to the consumer. The consumption of demerit goods can sometimes have negative effects on third parties and can be over-consumed if left to market forces. Examples of demerit goods are gambling, junk foods, alcohol and cigarettes.

So, you could say merit goods are "good" for you, whilst demerit goods are thought to be "bad" for you. It is also worth noting that just as merit goods provide positive consequences that the government wants to encourage, demerit goods cause negative consequences that the government is keen to avoid.

Government intervention in the provision of public goods, merit goods and demerit goods

! NEED TO KNOW

Public goods are goods or services that have features of non-excludability and non-rivalry and therefore would not be provided by the free market. Examples of public goods include pavements, lighthouses, public drainage, and public services, for example, the police and armed forces. So, we assume that public goods are good things, which must be provided by the government due to non-excludability and non-rivalry.

In the cases of the armed forces and street lighting, a private company could provide both services. With the armed forces, a company could create a national army and raise funds, possibly by asking everyone for a fee. There will be some people who don't want to pay and some people who do want to be defended but won't pay and will assume that they will be defended anyway. This concept is known as a "free rider problem". If the private company couldn't raise funds, they may decide to give up. The government can provide these goods because they can raise funds through taxation. In the case of street lighting, no one can stop another person benefitting from it. Equally, the benefit one person receives does not limit the benefit of others. If a private company tried to finance street lighting, again, the issue of relying on getting enough people to pay to raise sufficient funds would arise. So, governments must be responsible for street lighting.

The reason public goods come under market failure is because the free market would fail to provide services such as the armed forces and street lighting if left to themselves. So, the government must intervene to correct this failure.

Government intervention with demerit goods is slightly different. In this case, the market fails due to overconsumption if these goods are left to the free market. The government must step in to stop this market failure.

In countries where alcohol and cigarettes are legal, governments may impose heavy duties and taxes. This means that the price rises significantly, in the hope that it will deter consumption. Some demerit goods are considered to be so negative that the government bans them altogether. The additional cost of demerit goods is an increased burden on health provisions, increased crime and decreased labour productivity, which affects the whole economy.

OVER TO YOU

Activity: Government intervention

You have learnt about different types of economic systems and levels of central government intervention. Consider the role of the government in your country.

1 Explore your government's current and likely future interventions in the economy.
2 To what extent have these interventions been effective?

REVISION ON THE GO

Merit and demerit goods

Pollution is as global problem which affects us all. Governments around the world are becoming more aware of the current and longer-term risks of excessive pollution and are acting, often by:

- taxing or fining polluters.
- introducing legislation to require organisations to control their levels of pollution.

Examples would include car manufacturing, the heavy industries (e.g., steel) and cosmetics.

Public and private sector

Merit goods are seen as being good for all of us and in many countries, are provided by both the public and the private sectors. In most instances, however, if merit goods were to be provided exclusively by the private sector, there would be a market failure, i.e., underconsumption. This means that government intervention becomes unavoidable.

Good examples of merit goods are education and health. In many parts of the world, both education and health are offered by the private sector. However, without government intervention, many families would not be able to afford or enjoy either. The implications for society would be lower levels of education and poorer health.

So, if the government provides education and health facilities that are free at the point of access, the consequence is that they will be paid for via taxation.

OVER TO YOU

Activity: Protecting the environment

1 Research examples of organisations in your own country that are seen as polluters.

2 Note down what actions, if any, the government is taking.

3 If the government fines polluters and/or introduces appropriate legislation, write down what the likely effects on consumer demand for these organisations' products would be.

4 Which merit goods does your government provide? For example, education,

5 Write down the implications for the public in terms of:

- **The overall levels of education and health**
- **Levels of taxation to fund these merit goods**

1.3. The potential impacts of government on business and business environments

Four main government macroenvironmental objectives

In this section, we will look at the four main government macroenvironmental objectives. We have seen in the previous section (Chapter 1.2) that governments can intervene to achieve optimum economic performance.

In doing this, governments usually have four main economic aims.

1 Low inflation

The rate of inflation is the percentage increase in prices over a 12-month period. Government policy typically here would be to keep inflation low and stable. The main reason for this is that it gives price stability and aids economic decision-making. This means organisations can set wages, prices and make investment decisions with much more confidence. In some developed countries, governments have a target for the rate of inflation.

Inflation and interest rates are linked. In general, if interest rates are lowered, people are able to borrow more money. The result is that people have more money to spend, causing the economy to grow and inflation to increase. The opposite is true for rising interest rates. People tend to save as interest rates are higher, which means less disposable income to spend, and, as the economy slows as a result, inflation decreases.

OVER TO YOU

Activity: Inflation

Find out the recent, current and predicted rates of inflation in your area Consider the main implications of your findings for consumer spending and business confidence.

2 Economic growth

The rate of economic growth is the percentage increase in national output, normally expressed over both annual and quarterly periods.

Governments try to achieve stable economic growth over the long term, so avoiding excessive periods of non-sustainable short-term growth and the extremes of a recession. (A recession is where national output falls for six months or more, i.e., growth becomes negative.)

3 Low unemployment

Reducing unemployment is an objective not only for the sake of the unemployed, but also because it represents a misuse of human resources. The provision of unemployment benefits can be a considerable drain on government resources and cause a significant opportunity cost as these resources cannot be used elsewhere.

4 Balance of payments stability

Businesses may trade locally but in a national economy, it's important to see the impact of global factors, such as the importing of goods and services. The result is a movement of currency in and out of the country reacting the balance of trave

In addition to these four main areas, there are other objectives that are becoming increasingly important to governments. For example, increasing productivity, care for the environment and equal distribution of wealth and income.

All the above objectives are important; however, different governments will vary in how they prioritise them.

OVER TO YOU

Activity: Wealth creation

All governments have a responsibility to make the best use of resources available and to create and sustain wealth. Governments have consistently looked to measure their progress under the following headings.

1. **Inflation**
2. **Unemployment**
3. **Economic growth**
4. **Stable balance of payments**

Using specific examples, make some notes on how far these policies have been successful in terms of wealth creation in your country.

The advantages and disadvantages of monetary and fiscal policy

In this section, we will look at the main advantages and disadvantages of monetary and **fiscal policy**. Both are "demand side" policies. A demand side policy is a government policy designed to alter aggregate demand and, in turn, the level of output, employment and prices.

Monetary policy

Monetary policy involves influencing the interest rate (cost of money) and/or altering the supply of money in the economy.

! NEED TO KNOW

Advantages:

- can be implemented quickly and easily.
- central banks can be independent and politically neutral.
- predictable exchange rates with other currencies can be maintained. This means businesses that either export and/or import can plan ahead with greater confidence.

Disadvantages:

- there may be a time lag (delay) in the effect of these policies on the economy.
- monetary policy is general and affects an entire population. Higher or lower levels of interest will affect different parts of a population in different ways. For example, low levels of interest may encourage spending but discourage saving.

Fiscal policy

Fiscal policy involves changing the level of government expenditure and/or the levels of taxation.

! NEED TO KNOW

Advantages:

- increased levels of government spending can be used to stimulate economic activity.
- tax can be used to discourage negative externalities (e.g., taxing polluters).
- short time lag (delay) on effects to an economy.

Disadvantages:

- can create fiscal deficits if increased levels of spending are not matched by increased levels of taxation.
- government spending or tax incentives may be spent on imports, which could be a disadvantage to the national economy and to those businesses that export.
- could be politically motivated

In summary, both monetary and fiscal policy have the primary objective to create economic stability. However, there is no generic strategy as both have their own advantages and disadvantages.

OVER TO YOU

Activity: Your government's economic policies

Using your own country as an example, consider how far your central government's economic policies have been:

- **fiscal**
- **monetarist**
- **a combination of both.**

Evaluate how successful these policies are/have been.

Trade

The advantages and disadvantaged of free trade

In this section, we will look at the advantages and disadvantages of free trade. Free trade is when a group of countries agree to have no trade barriers between each other. Free trade is a "supply side" policy. A supply side policy is a government policy that attempts to directly alter the level of aggregate supply (rather than through changes to aggregate demand).

Free trade should allow lower prices for consumers, increased imports, benefits from economies of scale and increased choice.

NEED TO KNOW

Advantages:

- The law of comparative advantage. (A country has comparative advantage over another if it can produce a good at a lower cost, forgoing less goods in order to produce it.) This means that trade can benefit all countries if they specialise in the goods in which they have a comparative advantage.
- Reducing tariff barriers leads to creation of trade between countries.
- Increased exports.
- Economies of scale. When increasing scales of production leads to lower long-run cost per unit of output.
- Increased competition. This may stimulate greater efficiency and may prevent the emergence of domestic monopolies, oligopolies and cartels.
- Trade as an "engine of growth". In a growing world economy, demand for a country's exports is likely to grow, providing stimulus to growth in the exporting country.

Most countries have not implemented a policy of completely free trade. Governments know that trade involves costs as well as benefits.

Some of the disadvantages are listed below.

- The infant industry argument. (An industry that has potential comparative advantage but is too underdeveloped yet to realise it.) Without protection, infant industries will not survive competition from abroad.
- The senile industry argument. (Industries that are declining and inefficient.) Like infant industry, senile industry cannot survive without protection.
- Over-reliance on goods with limited dynamic potential, which may stifle innovation.
- The importation of harmful goods.
- Dumping and other unfair trade practices. A country may engage in dumping by subsidising exports, resulting in prices no longer reflecting comparative costs. Therefore, there is benefit to tariffs being introduced to counteract this.

OVER TO YOU

Activity: Trade

Give an example of free trade in an area known to you.

What impact has it had on products and services.

Barriers to free trade

Import tariffs

Import tariffs are taxes on imports. These are usually a percentage of the price of the import and can be known as "ad valorem" tariffs

Tariffs used to restrict imports are more effective when demand is elastic.

Tariffs can also be used to raise revenue, but they are more effective if demand is inelastic. They can also be used to raise the price of imported goods to prevent unfair competition for domestic companies.

However, when introducing tariffs, trading partners can also retaliate and introduce their own tariffs, raising the cost for exporters. Companies may look to cut production costs to account for tariffs and then can affect the quality of the goods.

However, tariffs, once agreed, can be easier to administer and should be more transparent

Import quotas

Quotas are limits imposed on the quantities of goods that can be imported. Quotas can be imposed by governments or negotiated with other countries, which agree to import quotas "voluntarily".

Import quotas are usually used to protect domestic markets and encourage local industries and to support the introduction of infant industries.

As with import tariffs, when one country introduces quotas, their trading partners tend to do the same, giving the same reasons. This results in fewer exporting opportunities for all producers and higher prices for consumers. Quotas can require a high level of administration, which makes them cumbersome for each country using them.

Embargoes

An **embargo** is a complete government ban on certain imports (e.g., drugs) or exports to certain countries (during times of war).

Embargoes can raise awareness of a political issue and force the embargoed country to change their approaches. Embargoes also tend to be very quick to take effect.

However, embargoes can cause restraint of trade, limit communication and can have unfortunate implications for the general population of the embargoed country.

Non-tariff barriers

There are also various non-tariff barriers that can be used. They are used because they can

help protect a country's natural resource and people, whilst also serving as a possible source of government revenue. Similarly, with any tariffs, the downside is that they limit the flow of goods into a country, even if the goods are safe and of high quality.

OVER TO YOU

Activity: Imports and exports

You have been learning about aspects of free trade and ways in which governments can influence the levels of imports and exports. Use your own country as an example.

1 How can you see your own economy growing in the next 10 years?

2 What are the domestic and external factors that will influence this level of economic growth.

OVER TO YOU

Activity: Our global transformation, embracing the developed, emerging and frontier economies

Think about the country where you live or a country with which you are familiar.

1 Research the recent trends in economic activity (for example GDP or inflation) and explain the trends in growth or slowdown.

2 Investigate the levels of imports and exports and the implications for achieving a balanced economy.

Trade agreements

A trade agreement can be defined as a treaty between two or more countries to establish a free trade area where trade can take place across borders without tariffs.

OVER TO YOU

Activity: Trade agreements

There are several key trade agreements throughout the world

Research the largest training agreements include detail on the members, the purpose and date of its creation.

Trading blocs

A trading bloc can be defined as a set of countries that engage in international trade together and are usually related through a free trade agreement or similar association.

OVER TO YOU

Activity: Trading blocs

There are several key trading blocs with multiple countries that give tremendous competitive advantages to its members.

Research the largest trading bloc which include the countries below –research detail on the members, the purpose and date of its creation.

- **North America**
- **Central America**
- **South America**
- **Asia**
- **African continent**
- **Pacific countries**
- **Europe**

1.4. The varying level of competition in markets and the impact on price volatility

Perfect competition

Firms are "price takers"

This is when there are so many firms in an industry that each one produces a very small portion of the total industry supply. Therefore, one company has no power to affect the product price in any way, i.e., no single company can have market dominance.

Complete freedom of entry

This is where there is complete freedom of entry for new firms into an industry. Existing firms are unable to prevent new firms from setting up a business in their industry. However, setting up a business takes time, so freedom of entry applies in the long run.

Identical products

All firms produce identical products, meaning that there is no advertising or branding.

Perfect market knowledge

Consumers and producers have a perfect knowledge of the market. So, producers are fully aware of market opportunities, costs and prices, and consumers are fully aware of the product availability, quality and price.

Few, if any, industries meet these criteria in the real world. There are some agricultural markets that are maybe closest to perfect competition. For example, the fresh vegetable market

OVER TO YOU

Activity: Perfect competition

Use the four criteria for perfect competition given in the case study above and refer to your earlier reading to answer the following questions.

1 How far would you see a stock market as being perfectly competitive?

Sources of monopoly

A pure monopoly is a market structure where there is only one firm in an industry. This means that there is no competition from within the industry.

Law

In some cases, the government can grant a firm monopoly status. For example, until recent years in the UK, the key utilities of gas, water and electricity held monopolies in their respective areas.

Possession of a unique feature

This is where a company owns something unique or scarce. For example, a telecommunications company may own the telephone cabling running to businesses and homes.

Controlling the market

This is where firms have copyright or patents to give them exclusivity in a market. This gives firms the right to sell and protect their intellectual property. For example, Microsoft and the Windows brand name and software are protected from unauthorised use.

CASE STUDY: MONOPOLIES

True monopolies

In its purest form, a monopoly is where there is a single supplier of a good or service in a specific market.

In reality it is very rare, unusual even, to see a pure monopoly, as in practice they exhibit some rather than all of the monopolistic characteristics. We see, for example, many instances where there is only one seller of a good or service in a particular market. However, there are (close) substitutes. Also, as we continue to evolve into a more global economy, domestic monopolies or near monopolies can be prone to international competition.

An example is Indian Railways, the state-owned railway company of India. Indian Railways had, until very recently, a monopoly on the country's rail transport. It is one of the largest and busiest rail networks in the world. Indian Railways is probably the world's largest commercial or utility employer, with more than 1.6 million employees, and annually transports over 6 billion passengers.

A similar example is in South Africa, where there is a single railway system. However, that railway system, as is increasingly the case in India, must compete with close substitutes (i.e., transport via road, sea and air)

OVER TO YOU

Activity: Perfect competition

By using either the examples in the case study above, or another example you are familiar with, consider the main advantages of a monopoly scenario for:

- **the economy**
- **the consumer**
- **the employer (i.e., the monopolistic organisation)**

Sources of Oligopoly

An oligopoly is a market structure where there are several firms which put up barriers to restrict and prevent new firms entering the market.

Oligopoly and anti-competitive behaviour

Because there are only a few firms under an oligopoly, they are mutually dependent. This makes them interdependent. Therefore, each firm is affected by its rival's behaviour, so no firm can afford to ignore the actions and reactions of other firms in the industry. Firms recognise this interdependence, and this will affect their decision-making.

Collusion and cartels

The interdependence of firms may make them want to collude. If they collude and act together, as if they were a monopoly, they could jointly maximise industry profits. A formal collusive agreement is called a cartel. A cartel looks to maximise profits and acts like a monopoly, if all members behave like they are a single firm. Some commentators would say the global oil sector is an example.

Non-collusive oligopoly

This is where oligopolies have no agreement between them, be it formal or informal. In some oligopolies, there may be few reasons for favouring a collusion. Even if there is collusion, the temptation is still there for individual firms in the oligopoly to "cheat" by cutting prices or selling more than allotted quota allows.

OVER TO YOU

Activity: Monopoly or oligopoly

Use your own country as an example and/or a country with which you are familiar.

1. **How far do sectors of the economy adopt monopolistic tendencies?**
2. **Identify sectors in the economy that appear to be operating as an oligopoly.**
3. **What are the implications for the consumer with the examples you have discovered?**

Characteristics of monopolistic competition

In this section, we will look at the characteristics of **monopolistic competition**. This is a market structure, where similarly to perfect competition, there are many firms and freedom of entry into the industry. However, in monopolistic competition each firm produces a different product and therefore has some control over price.

So, as there are many firms, each has a small share of the market, and its actions are unlikely to affect rival companies to any great extent. This means that a firms decision-making process need not be influenced by any concern about the possible reaction of its rivals or competitors. This is known as the assumption of independence. There is also freedom of entry into the industry. If any firm wants to set up a business in this market, it is free to do so. In these two areas, monopolistic competition is therefore like perfect competition.

However, there are also some key differences. Each firm provides a service or product in some way that is different from its rivals. As a result, it can increase prices without losing customers. This assumption is known as product differentiation.

Builders, hairdressers and restaurants are all examples of monopolistic competition. Another typical feature of monopolistic competition is that, although there are many firms in an industry, the theory assumes there is only one firm in each location. This theory applies particularly to retail. For example, there may be many hairdressers in a town, but not on one street. This means customers may be happy to pay higher prices for a haircut to save having to go elsewhere.

Perfect Competition

Advantages	Disadvantages
Perfect competition means inefficient firms will be driven out of business as they will not be able to make profits. This encourages firms to be as efficient as possible and, where possible, invest in new technology.	There is no guarantee that goods produced will be fairly distributed to every member of society.
Production costs being low and firms making normal profit keeps prices at a minimum.	The production of certain goods may lead to undesirable side effects like pollution. Perfect competition cannot guard against this.
If consumers want change, the resulting price change will lead firms to respond, purely out of self-interest.	Industries produce undifferentiated products under perfect competition. Lack of variety could be seen as a consumer disadvantage.

Monopoly

Advantages	Disadvantages
They can benefit from economies of scale, so may benefit from staying as monopolies to avoid wasteful duplication.	Restricted choice for consumers.
Domestic monopolies can become dominant at home and then abroad, earning their home country valuable export revenue. A good example is Microsoft.	Reducing consumer sovereignty.
Some economists argue that monopolies are needed to create dynamic efficiency; that is technological progressiveness.	Restricting output into the market.
	Charging a higher price than in a competitive market.
	Can be inefficient as there is no competition.

Monopolistic competition

Advantages	Disadvantages
There are no major barriers to entry. This makes the markets relatively contestable.	Can generate unnecessary waste, for example, excess packaging and advertising.
Differentiation creates choice and diversity for consumers.	Inefficiency for firms assuming profit maximisation, i.e., less focus given to firms striving to reach optimum efficiency.
The market is more efficient than a monopoly, but less efficient than perfect competition.	

Oligopoly

Advantages	Disadvantages
Adopt a highly competitive strategy, where firms can make similar benefits to other competitive structures, such as lower prices.	Reduction in consumer choice caused by high concentration of firms in a given industry.
Firms may be dynamically efficient in terms of new process and product development.	Cartel behaviour reduces competition and can lead to higher prices and decreased output.
Price stability helps consumers to plan.	New firms can be prevented entry into the market due to deliberate barriers to entry.
Price stability may also reduce the extremes (i.e., boom and bust) of the trade cycle in the macroeconomy.	Charging a higher price than in a competitive market.
	Lack of competition may lead to oligopolies manipulating consumer decision-making, by making decisions more complicated. In this case, consumers may fall back on "rule of thumb" thinking and may make purchases that they don't need.

Potential impact of prices

Perfect competition – each firm takes its price from the industry. Therefore, they are referred to as “price takers”. The industry is made up of all firms and prices are set where supply meets demand. Each firm must charge this price.

Monopoly – the traditional view of monopolies is that a monopoly commands higher prices. Because of the lack of competition, a firm in a monopoly can charge higher prices than they would in a competitive market.

Monopolistic competition – each firm makes independent decisions about price and output, based on cost of production, its product and its market. Firms are “price makers”, because each firm has a unique product and can charge a lower or higher price than its rivals.

Oligopoly – firms may use predatory pricing to force rivals out of the market. This means keeping prices artificially low, sometimes below the full cost of production. Oligopolies can also collude with rivals and raise prices at the same time.

OVER TO YOU

Activity: How volatile is the global economic situation?

Most economists would see the global economic situation as being the most volatile in history.

Using specific examples, consider how far you agree with this statement.

By completing this activity, you will make a good connection between this chapter and the next, where we explore the complexities and uncertainties of the external environment.

Chapter 2

Analysing External Environments

Introduction

In this chapter, we will be considering a range of approaches which enable an organisation to gain a greater understanding and awareness of the external environment. Clearly this is important, as this information can help an organisation plan, manage risk and have a greater possibility of accommodating (inevitable) change.

An organisation will be unlikely to survive without an awareness and understanding of what is happening in the external environment, together with a realisation of the implications for its own performance and for its key stakeholders. It is also important that an organisation constantly analyses the external environment because it is relentlessly changing and turbulent.

Today, it seems that all organisations need to accept the realities of the external environment in which they operate and navigate through in a constant state of flux.

Learning outcomes

On completing the chapter, you will be able to:

2 Discuss how analysing external environments enables the development of successful business strategies

Assessment Criteria

2 Discuss how analysing external environments enables the development of successful business strategies1.1 Discuss the economic view of businesses

2.1 Discuss relevant frameworks to analyse external environmental trends

2.2 Apply relevant frameworks to analyse external environmental trends

2. Analysing External Environments

2.1. Frameworks to analyse external environmental trends

Advantages and disadvantages of sources of information

Governments

In many countries, central government has the role of collecting and publishing statistics related to the economy, population and society. This wide range of information is used for social and economic policymaking as well as providing a detailed overview of a country's population and how it is likely

to evolve. The availability of this information often means that comparisons can be made with other societies and economies. Much of the data produced by a country can be obtained via population censuses, surveys, samples and the collation and analysis of information provided by organisations.

Principal areas for data collection and analysis often include agriculture, business, crime, children and education, economy, energy, environment, government, health and the labour market.

Government publications are often reported and discussed daily in the media to provide the public with a greater understanding and awareness of the country in which they live.

Advantages	Disadvantages
In many countries government information is readily available and accessible to the public.	Often the government decides on the chosen topics.
Information can cover a wide range of areas.	There is a risk of information being incomplete, not specific enough or unreliable.
Often made available free of charge or at minimal cost for the user.	The definitions of different topics may change over time, making it more difficult to assess trends.
Research has been carried out on a large scale with representative data.	The risk that a quantitative approach to collating information may exclude key aspects.
Information enables the showing of trends and comparisons with other countries.	The information collected may not be in sync with the times and a time lag may not reflect any changes.

In the UK, the Office for National Statistics (ONS) is the largest provider of information that is produced impartially and free from political influence. Central and local government make significant use of the information provided by the ONS, for example, in evolving its social and economic policies.

In the USA, there are established networks of libraries where copies of a range of documents are held. These are known as depository libraries. They usually receive government documents free of charge in exchange for offering assistance to the general public when accessing them. Today, of course, an increasing amount of government information is accessed via the internet.

OVER TO YOU

Activity: Government Information

Explore what sources of information are available from your central and local government. How does this information help local businesses?

News sources

It is important for businesses to understand external events, so when short- and long-term business decisions are being made, information is current. Businesses use news sources to support their evidence and often for smaller businesses this is the only external information that they will use.

Examples of new sources include TV programmes, newspapers, journals and government documents.

There are several factors that we should consider before accepting information from these news sources.

The key area is authenticity. Ensuring that information that you rely in is from a reliable source is vital.

Once the source of the information, it's possible to make an informed choice on whether the information is wholly reliable and therefore how much weight is attached to its credibility such as:

- This can be influence but the source – a blog is not seen as a reliable source, but it may be from an author who has proved consistent over time
- There may be a reliance on anonymous sources,
- Information published maybe within a country where there is limited freedom of the press

- Journalists' articles: these can be a very reliable source of current thinking and opinion. Reliability can be checked by being peer reviewed (reviewed by another journalist) to ensure that all the material in an article has been verified.
- Websites: websites are a source for official documents like company reports and government papers. Care needs to be taken as to which sites are trustworthy and which are not. Information from less reputable sites should be used with caution, especially if intended for subsequent sharing with the public.
- Newspapers: newspapers have a primary objective to inform the public. However, each paper will always have its own political and social agenda. This means the context of the writer's audience and the intended purpose in authoring needs to be considered. There is a risk that facts are used selectively to support a line of argument and so the resulting content may lack balance and could be biased. Newspaper articles can be a good way of evidencing public opinion, although they should usually be supplemented with other sources of information

OVER TO YOU

Activity: News Sources

What news sources are available in your country? How far can you assess the reliability of these sources?

Industry experts and industry bodies

Industry experts

Industry experts typically to have worked or be involved in a specific area of interest. Perhaps they will join the board or volunteer to be involved in some, usually high profile, way. In addition, it is important that an industry expert continually networks so that can establish and develop key stakeholder relationships.

Industry experts are also likely to do the following:

- Write about the industry, perhaps articles and news items, which then appear in the industry publications. They tend to keep a high profile and readily offer advice and expertise. An industry expert will continually self-market and look to build their reputation.
- Get involved whenever that industry has a more national profile. They will offer ideas and articles that will look to raise both their own and the industry's profile. Over time,

an industry expert's reputation may see them become a key source of advice/opinion to be approached for interviews and appearances at industry events.

- Author material, for example, a book containing everything a stakeholder would need to know about an industry. Effectively, this would be seen as an insider's view and offer advice, even expertise.
- Use social media to create an online presence. For example, to build followings via LinkedIn
- and Facebook, and to author regular newsletters, blogs and vlogs. They may also use Twitter to share key headings and useful links.

Industry bodies and trade associations

An industry body is in many ways similar to a trade association (see below) and represents the interests of an industry. Usually an industry body will:

- have membership.
- promote the reputation of an industry.
- look to improve industry standards.
- seek to influence national policy.

OVER TO YOU

Activity: Industry Experts

What roles do industry experts take in your country? How far do these experts influence the strategies and policies of particular organisations? What about industry bodies? Research the role and influence of three such bodies in your home country.

Trade associations

A trade association is an organisation founded and funded by organisations from within a specific sector. Usually, its primary focus is on collaboration between organisations, whilst also being involved in activities like advertising, education, making political donations, publishing and lobbying key stakeholder groups. Trade associations can be either profit or non-profit making.

Most trade associations are involved in publishing activities online and in print. Examples include association websites which explain their aims and objectives whilst outlining their products and services together with the benefits of membership; members' newsletters or magazines, distributed to members and sometimes to lobbyists and regulators; membership directories and yearbooks which can promote the association to key stakeholders.

Trade associations often place advertisements with the aim of showing their industry/organisation in a positive light, so that the public form a positive opinion of them.

The role of trade associations varies considerably from country to country. It is important to consider the political aspect of these as it may influence the research or output.

OVER TO YOU

Activity: Trade Associations

Do trade associations exist in your country? If so, how far do they fulfil the roles you have just read about?

The PESTLE framework

A PESTLE is a snapshot of six interrelated categories of external factors which will impact on an organisation's performance.

The mnemonic stands for:

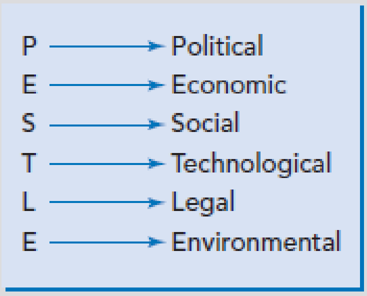


Figure 1: PESTLE framework

This framework is one that organisations can use to gain a greater understanding of the external environment and so increase their capability to strategically plan and react to or accommodate change. By clear inference, this means that external analysis helps an organisation to manage risk.

There are some critical assumptions that we need to recognise here when linking the external environment to an organisation's performance.

Building on Systems Theory (1937), which studies complex systems, we need to consider whether an organisation is an "open looped" or "closed looped" system.

! NEED TO KNOW

An "open looped" system is one that is inevitably dependent on the external environment for its longer-term survival.

A "closed looped" system is one that can survive in the longer term independently of the external environment.

We can readily see, therefore, that an organisation, if it is to survive in the long term, is an "open looped" system. This means it is crucial for an organisation to have a detailed and regularly reviewed understanding of the external environment and how it will affect its levels of performance.

Below we will explore the key aspects which may be included in each of these six factors. Before we do so, we need to recognise the guiding principles of this framework as follows.

- As a snapshot (i.e., at a moment in time) it may quickly become out of date and therefore needs to be regularly reviewed and updated.
- At any one time, one or more of the six categories may have relatively more significance.
- These six categories are inevitably interrelated and therefore a single issue may appear in more than one category, albeit in a different context.
- The range of issues uncovered in each category can be ranked in accord with their known/ expected impacts on an organisation's performance and/or by geography (into local, regional, national, global issues).

Political factors

These are external political factors, brought about by central and local governments which will impact an organisation.

Examples could include:

- political stability.

- the political beliefs of a government (e.g., intervention in market)
- political lobbying.
- political involvement in wars, terrorism and conflicts – often referred to as "geopolitical hotspots".
- the event of elections and political public opinion.
- relationships with other countries.
- perception of politicians and their actions

Economic factors

These are external economic factors, circumstances and policies that will impact an organisation.

Examples could include:

- the level of economic recession or relative prosperity.
- the rate of inflation.
- levels of unemployment.
- the rate of economic growth.
- rates of direct and indirect taxation.
- levels of consumer and business confidence.
- seasonal factors.
- the impact of fluctuating exchange rates.
- the relative levels of imports and exports.

Social factors

This category relates to the external cultural attitudes, beliefs and behaviours that affect the demand for the goods and services an organisation offers.

Possible examples of social factors include:

- demographic trends.
- age distribution.
- the perspectives of the media including social media.
- the external perception of an organisation's brand and values.
- existing lifestyle trends.
- consumer attitudes, tastes and values.
- major events.
- the importance of advertising and brand awareness.
- ethical considerations.

Technological factors

Clearly this category relates to technology and its ever-increasing significance for all of us, especially in terms of the availability of artificial intelligence. We need to be cautious when considering the availability of technology, both in the external and organisational environments, as, for example, significant parts of the world are still without internet connectivity.

Possible key factors here include:

- the rate of change and technological innovation.
- trend towards automation in some sectors.
- the need to respond to competitor strategies when embracing technology.
- the increasing range of technological communication channels.

Legal factors

This category relates to the laws and regulations which place a range of boundaries around specific organisational activities.

Examples of legal factors may include:

- workers' rights
- consumer protection
- employment law
- health and safety
- legislation to encourage/restrict competition
- money laundering legislation
- tax regulations

Environmental factors

Environmental factors relate to the ecological and environmental factors that will impact an organisation. Examples include:

- environmental regulations
- the reduction of an organisation's carbon footprint
- degree of focus on sustainability issues

OVER TO YOU

Activity: PESTLE

In your country, what are the two most important factors under each of the six PESTLE categories?

CASE STUDY: PESTLE

Factors affecting performance

You have seen that a PESTLE is one way in which an organisation can gain a greater understanding, at a specific moment in time, of the external factors that will impact on its performance.

Remember that these implications for organisational performance will be both internal and external.

For example:

- an internal impact on the number of employees required now and in the future.
- an external impact on current and future customers.

It is also very important that the external factors are identified, explored and fully understood, prior to considering their implications for an organisation's performance. Because of the complexities of the external environment and the reality that all six categories of the PESTLE framework interrelate, it is critical for an organisation to:

- rank these external factors in terms of their known/likely significance to an organisational performance.
- and/or categorise these factors, perhaps into local, regional, national and international groups.

OVER TO YOU

Activity: Factors affecting performance

Think about your own employer or an organisation of your choice.

1. **Identify and explain at least five external factors under all six categories of the PESTLE framework.**
2. **Rank these external factors in terms of their relative importance for your chosen organisation's performance levels.**
3. **Consider the specific impacts on the organisation's internal and external performance.**

2.2. Applying relevant frameworks to analyse external environmental trends

The PESTLE framework looks at six categories of external factors which currently, and for the foreseeable future, are at their most volatile for many years. This means that organisations will be looking to navigate through and survive very challenging, ever-changing and turbulent times.

We will now look at examples of organisations and identify the main PESTLE factors that are impacting them.

The following exercise should take some time to complete. It needs research from multiple news sources (all referenced) and should form a detailed and accurate review.

OVER TO YOU

Activity: Conducting a PESTLE review

Choose two of the following organisations and complete a PESTLE review.

1. **Emirates (airline)**
2. **HSBC Bank**
3. **Nike**
4. **Nissan**

Once you have completed your PESTLE:

- **Categorise or rank the factors you have uncovered in each category.**
- **Identify and consider the stakeholder implications of the critical issues that your**

The key principles of SWOT

A SWOT analysis is another framework that organisations can use to gain a greater understanding about their organisation and become more aware of the environments in which they operate.

Each of the letters is defined as follows:

Figure 2: SWOT analysis

We have seen that a PESTLE framework explores the external environment and then considers how its various dimensions impact an organisation's performance.

! NEED TO KNOW

A SWOT analysis identifies both internal and external factors that can impact an organisation's performance, so adopts a slightly different approach. This framework can be defined as a snapshot (i.e., at that moment in time) of the internal (S and W) and external (O and T) factors that will affect an organisation's performance.

When using a SWOT, it is important to recognise the following:

- all four categories interrelate.
- the need to prioritise, probably in terms of likely relative impact, the factors identified in each quadrant.
- all four categories need to be populated and always apply, no exceptions.
- because this framework is a snapshot and all organisations operate in an environment of constant change, there is a need to regularly review and update the key issues placed in each quadrant.

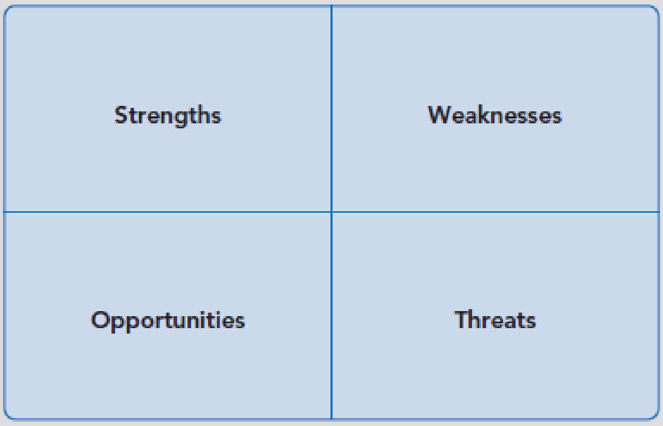


Figure 3: SWOT categories

We will now look at some key factors that may appear in each of the four categories of a SWOT.

Strengths (internal factors)

- quality of employee resource
- very effective leadership team
- quality of processes
- capability of key functions, for example, marketing and sales
- production of high-quality product or service
- location which is suitable for consumers
- having an element of individuality about what the organisation represents
- level of expertise and experience
- positive internal stakeholder relationships
- customer loyalty

Weaknesses (internal factors)

- lack of resources
- need for more space
- reluctance to accommodate changes in technology
- ineffective change management processes
- lack of available funding
- lack of established reputation in the marketplace
- possible over-reliance and dependence on key individuals in an organisation
- excessive and unsustainable overheads
- inefficient processes

Opportunities (external factors)

- potential to access new markets and expand
- looking to work with Government organisations and consumer groups
- to have a very effecting marketing and branding strategy
- to be an environmentally, socially and ethically responsible organisation
- to build a brand that facilitates consumer loyalty, even advocacy
- the potential to establish and build new stakeholder alliances
- the potential for fast growth in markets yet to be accessed
- embracing the potential offered by technology and social media

Threats (external factors)

- competition, both domestically and abroad
- cost fluctuations in supply chains
- availability of resources essential to production
- lack of reputation and consumer awareness in the marketplace
- weather and its implications for the supply chain
- areas of global instability (geopolitical hotspots)
- overdependence on specific suppliers
- scarcity or unavailability of key resources
- levels of government bureaucracy
- the need for greater levels of compliance

As you look through these factors, and of course there are others you will have seen, you will be aware that some factors could, in different circumstances, be placed in a different quadrant, i.e., a weakness could be a strength and vice versa, similarly an opportunity could become a threat.

Organisations need to consider the key findings from a SWOT, whilst always being realistic about taking any action.

For example.

- How can an internal strength become an external opportunity?
- How can an internal weakness become a strength?
- How can a threat, in reality, be overcome or best accommodated?
- How can a potential opportunity be fully exploited?

OVER TO YOU

Activity: SWOT Analysis

Use an organisation of your choice to complete a SWOT analysis.

1. **What are the main internal and external factors that will impact your chosen organisation's performance?**
2. **Ensure you prioritise the factors you identify in each quadrant in accordance with their relative impact/significance.**
3. **Consider the implications for your chosen organisation over the short and medium term.**

CASE STUDY: HOW THE MACROECONOMIC ENVIRONMENT INFLUENCES ORGANISATIONAL STRATEGY

Macro Factors

Inevitably, an organisation should recognise the need to understand the implications of the ever-changing and turbulent external macro environment. Organisations that are looking to survive for the longer term need to be able to accommodate and embrace change and readily adapt to the volatility in the macro environment.

An organisation needs to identify its key stakeholders,
their respective agendas and their expectations. The organisation also needs to be able to recognise the more specific implications of the macro environment on each of these key stakeholders.

Some of the main stakeholders include employees, customers, suppliers and owners. Here are some examples of macro factors.

- Government intervention – via legislation and directives. Clearly the most favourable macro environment for an organisation is where there is political and legal stability. This can mean an organisation will have greater confidence when making short and longer-term decisions.
- Macroeconomic factors – this includes interest rate levels, inflation, currency stability and the prevailing economic policies of the government.
- Technology – this is possibly the current biggest macro environmental influence, because of the rapid rate of change and the resulting impacts for organisations, and the increasing significance of artificial intelligence.
- Competition – an important factor for an organisation to understand. Issues here may include the activities of the competitors, changes in the marketplace, changes in consumer behaviour and the arrival of new entrants to the market.

OVER TO YOU

Activity: How the macroeconomic environment influences organisational strategy

Think about your own organisation or an organisation of your choice.

1. **Identify the main current macroeconomic factors relating to government intervention, the macro economy, technology and competition.**
2. **Consider the specific implications of these factors on:**
   - **your chosen organisation's strategies.**
   - **the key stakeholders.**

Chapter 3

Analysing Internal Environments

Introduction

Earlier we began to explore the significance of the external environment for an organisation's performance. Clearly the external and internal environments are interrelated. This means it is

Learning outcomes

On completing the chapter, you will be able to:

3 Discuss how analysing internal environments enables the development of successful

Assessment Criteria

3 Discuss how analysing internal environments enables the development of successful

3.1 Discuss frameworks to analyse key aspects of the internal environment

3.2 Apply frameworks to analyse key aspects of the internal environment to a

3. Analysing Internal Environments

3.1. Frameworks to analyse key aspects of the internal environment

In this section, we will be looking at sources of information for an organisation's internal environment and exploring how they help to identify internal trends.

Website

An organisation's website provides information to its key stakeholders about the organisation. Today, the majority of organisations have websites which include the following features:

- the organisation's logo and brand images.
- an "about us" section, which usually includes details of the organisation's mission statement and brief history, its key employees, the organisation's products and services, and possibly details of its key clients and achievements.
- pages of specific interest and relevance to that organisation which may include a jobs section, an investors page, the annual report and appropriate details for customers, suppliers, affiliates and other key stakeholders.
- a terms of use document and statement of intellectual property ownership as they apply to site content.
- a privacy policy.

When an organisation builds its website, there are many important issues to consider. Website design is a specialism so many organisations outsource it to an external company.

- What is the primary aim of the website (e.g., to build the brand)?
- How can the website be divided into clear and logical sections?
- How can the website be made easy to navigate?
- How can the website be made attractive to clients?
- Can the website be made so that it is search engine friendly, i.e., a website that search engines can readily visit and index?
- How can the website be made interactive so that key stakeholders can readily communicate with the organisation?
- How can the website be regularly reviewed and updated to accommodate change?

OVER TO YOU

Activity: Websites

Explore your own organisation's website (or that of a brand with which you are familiar) from the perspective of a customer.

What recommendations for change would you suggest improving the customer experience when accessing the website?

Sources of information

All organisations need to know and understand what is happening in the world that could affect their business. An organisation will be constantly changing and so information needs to be gathered from various sources.

Primary sources: this is new information and data gathered for a specific purpose by the organisation itself. This is usually an expensive activity. However, all information is timely and up to date. Methods for organisations to adopt include surveys, interviews, observations and focus groups.

Secondary sources: this is information and data that already exists. This is a less costly option, but the information may not be quite what is needed and may be dated. Sources include: the internet, newspapers and magazines, market research, trade associations, competitor reports/ benchmarking, industry experts and government publications.

Internal information: this is information that is available exclusively to the organisation, i.e., for internal use only, and is effectively confidential. Examples could include internal reports, accounts, sales figures, personnel records, customer records and some financial documents.

External information: this is information which primarily comes from outside the organisation. Examples of sources include: the internet, newspapers and journals.

OVER TO YOU

Activity: Sources of information

Research what sources of information are available in your organisation (or one with which you are familiar). How readily accessible are these sources of information in terms of supporting employees in their day-to-day work?

An organisation's missions statement and values

- It is a Statement of Purpose and Focus
- In 1 or 2 sentences it describes the purpose of a business.
- In these sentences you can sum up everything about your enterprise.
- It says:-
    - What you do
    - How and Why, you do it
    - Who you do it to?

NEED TO KNOW

An organisation's mission statement should demonstrate what the organisation stands for and represents. The mission statement should clarify the organisation's values to its employees and its key stakeholders.

It can be very challenging to make a mission statement concise, whilst retaining meaning and emphasis. However, one of the primary purposes of a mission statement is to achieve a set of commonly held beliefs and values that represent an organisation. These statements therefore become an integral part of an organisation and guide organisational strategy and employee expectations.

Not all organisations adhere to this approach, as for some there is a belief that mission statements can be too restrictive, as they may be unable to accommodate the expectations and priorities of all the main stakeholders, especially current and potential customers. However, overall, the majority of organisations see a mission statement as a reflection of what they are about: their primary beliefs and values.

OVER TO YOU

Activity: Mission Statements

1 Research two examples of mission statements of organisations of your choice.

2 Are these mission statements clear and easy to understand?

3 How far do these mission statements fulfil the three aims outlined above?

Analysing organisations

To add to the analysis of the external environment discussed in chapters 1 and 2, the organisation must also focus on the internal environment too . For this there are several key frameworks to assist.

It is important to note that there is a close relations shop between both internal and external framework. For example, a change in importing tariffs will affect the supply chain, so there may be a need to make changes to the internal operations. All these areas are interdependent and need to be fully addressed.

1 Porter's Value Chain (1985)

Understanding how any company creates value, and looking for ways to increase added stakeholder value, are very important fundamentals in developing a competitive strategy.

Michael Porter discussed this in his influential book Competitive advantage, published in 1985. It was in this book that he first introduced the concept of a **value chain.**

A value chain is the set of actions organisation carries out to produce goods and services. Therefore, by analysing this chain, it is possible to see where each step can add value for the customer.

Porter proposed a general-purpose value chain that companies can use to examine all their activities, and to see how they are inevitably connected. The way in which value chain activities are performed determines costs, facilitates process efficiencies and will ultimately

Elements of Porters Value Chain

Rather than looking at individual departments or functions, Porter's value chain focuses on systems, and how inputs (from the organisation) are changed into the outputs (goods and services) purchased by consumers.

Using this perspective, Porter described a chain of activities that are common to all organisations and divided them into primary and support activities, as shown below.

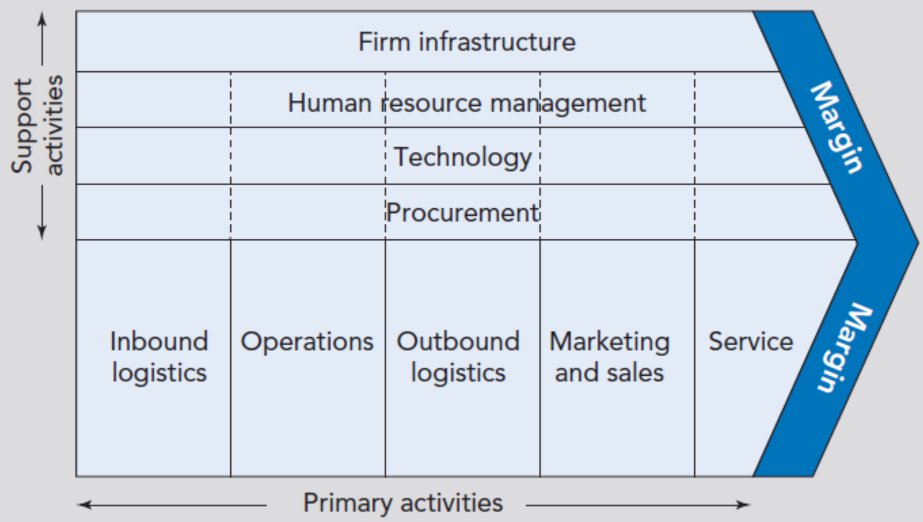


Figure 1: Porter's generic value chain

Primary activities

Primary activities are directly related to the physical creation, sales support and maintenance of a good or service. They are:

- inbound logistics
- operations
- outbound logistics
- marketing and sales
- service.

Support activities

Support activities support the primary activities that are listed above. In the diagram, the dotted lines show where support activities can play a role in primary activities.

Support activities are:

- infrastructure
- human resource management
- technology development
- procurement

For example, human resources can support services with some activities (e.g., recruitment, selection and training) and marketing and sales with other activities (e.g., increasing consumer awareness and gaining new customers).

How to use Porter's value chain

To understand and identify a company's value chain, follow these steps:

1 Identify sub-activities for each primary activity.

In this step, for each primary activity you would look at what sub-activities create value. There are three different types of sub-activity:

- Direct activities: these create value by themselves. For example, a technology company's sales and marketing activity. This would include selling online, advertising and making sales calls.
- Indirect activities: these allow direct activities to run smoothly. For the technology company's sales and marketing activity, this would include keeping accurate customer records and managing the sales teams.
- Quality assurance: this ensures that the direct and indirect activities meet the required standards. An example of this could be proofreading a sales release to a national newspaper.
- Compliance: this is where an organisation needs to formally demonstrate its adherence to and application of legal requirements, directives and codes of practice.

2 Identify sub-activities for each support activity.

For each of the procurement, human resource management, technology development and infrastructure support activities, determine the sub-activities that create the value within each primary activity. For example, consider how procurement adds value to operations, inbound logistics, service, etc. As in step 1, look for direct, indirect, quality assurance and compliance activities. Then, look for and identify the various value-creating sub-activities in the company (firm) infrastructure. As a rule, these will be cross-functional rather than specific to each primary activity. Again, you would look for direct, indirect and quality assurance activities.

3 Identify the links.

In this step, you need to find the connections between all the value activities you have identified. These links may take time to recognise and locate but are key to increasing competitive advantage from the value chain.

4 Look for opportunities to increase value.

In this step, review each of the identified links and sub-activities and look at how you can change or enhance them to maximise value offered to all key stakeholders.

OVER TO YOU

Activity: Applying Porter's Value Chain

Use Porter's value chain framework and apply its principles to an organisation of your choice. Specifically identify the primary and support activities and the links between them.

2 Johnson's cultural web (1987)

The **cultural web**, developed by Gerry Johnson and Kevan Scholes , provides an approach for looking at and changing an organisation's culture. Using this model, you can expose cultural assumptions, cultural practices and work towards aligning organisational elements with one another and with the company strategy.

Elements of the cultural web

The web identifies six interrelated parts, which help make up what Johnson and Scholes call the "paradigm" of the work environment. By looking at the factors of each, you can build a picture of the organisation culture: what is working, what is not working and what needs to be changed.

1 **Stories**: the past events and people who are talked about inside and outside the company.

2 **Rituals and routines**: the actions and behaviours of people that align to acceptable and expected behaviour. This determines what is valued by management and what is expected in given situations.

3 **Symbols and artefacts**: for example, company logo, dress codes and office décor.

4 **Organisational structures**: this includes management structure (e.g., hierarchical or flat) but also includes unwritten lines of power and influence.

5 **Control systems**: for example, financial control, quality control, employee reward

6 **Power structures**: where the real power lies in the company. (The board , a key executive group)

These six areas are represented as overlapping circles, which influence the overall culture.

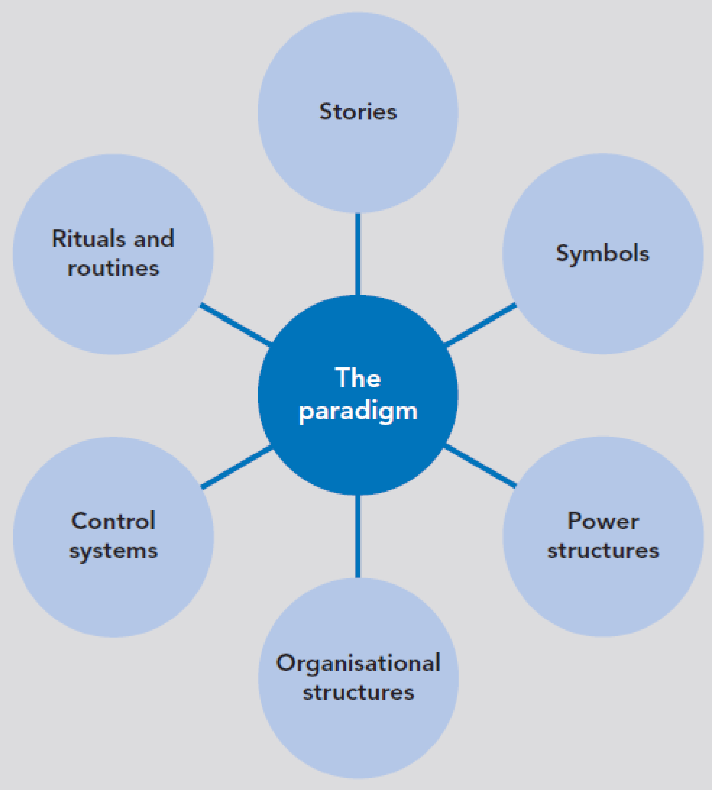


Figure 2: Johnson's cultural web

REVISION on the go

How to use the cultural web

1 Look at the culture as it is now.

Start by looking at each element separately and ask questions that help determine the dominant factors in each. This stage is critical, and all key stakeholders should be involved.

2 Analyse the culture as you want it to be.

Now, repeat the process, thinking about the culture you want to achieve.

For example, beginning with your organisation's strategy, think about how you want the organisation's culture to look. Engage all your key stakeholders in creating a vision of their ideal future organisational culture.

3 Map the differences between the two.

In this step, compare the outcomes from step 1 and step 2 and identify the differences between the two, considering:

- What cultural strengths/weaknesses have been identified in the current culture?
- What factors need to change?
- What factors need to be re-aligned?
- What new attitudes, behaviours and workplace practices need to be promoted?

4 Prioritise changes and develop a plan to address and implement these changes.

At this stage, there needs to be as great a stakeholder consensus as possible about what the key priorities should be. Prioritise changes and develop a plan to address and implement these changes. Also, key roles and responsibilities need to be agreed, as well as identifying the main milestones where progress can be tracked in the months ahead.

OVER TO YOU

Activity: What is your cultural web?

Explore what type of prevailing culture exists in your organisation (or an organisation with which you are familiar). What would be the main cultural changes that you would look to implement? Why?

3 Boston Consulting Group's growth share matrix

The Growth share matrix is a framework which was first developed by the Boston Consulting Group (BGC) to help companies consider the resources and priority they should give to different aspects of their operations.

Therefore, this matrix can be used to analyse the performance of a portfolio of products around two key dynamics:

1 Market share: does the product being sold have a low or high market share?

2 Market growth: are the numbers of potential customers rising or falling?

The guiding principles of this framework are:

- Market share will be gained by investment in marketing.
- Gains in market share will always generate cash surpluses.
- Cash surpluses are most likely to be generated when the product or service is in the maturity stage of the life cycle.
- The best chance to strive for a dominant market position is during the growth phrase.

The matrix places each part of a firm's businesses into four categories.

- **Cash cows**: tend to be businesses or brands that have a high market share but low growth prospects. They therefore generate a lot of cash and have a low need for more resource. They are sometimes seen in industries that are about to fall into decline.

- **Stars**: have a high market share and good prospects for growth.

- **Question marks/Problem children**: have high growth prospects but a low market share. These circumstances can arise when a new product is brought to market.

- **Dogs**: low on both market share and growth prospects. These businesses or brands are likely to be making a loss or at best a low profit.

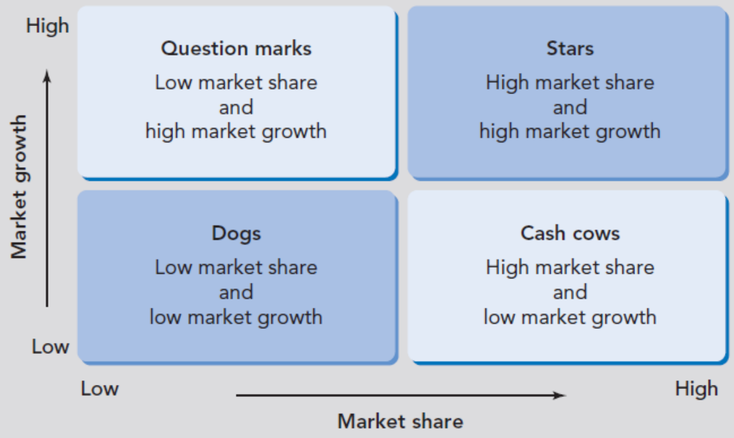


Figure 3: The Boston Consulting Group's growth share matrix

There are four recognised strategies which are used after the BCG analysis.

1. **The build strategy:** create a new target audience and brand by means of a question mark.
2. **The hold strategy**: maintain success and increase growth and market share by means of a star.
3. **The harvest strategy**: make as much money as possible out of the product by means of a cash cow.
4. **The divest strategy**: abandon any investment in the product by means of a dog.

The aim would be to transfer resource from the cash cows to the stars or question marks and close or sell the dogs. The growth share matrix also provides companies with a tool for maximising competitiveness, sustainability and value, by helping to strike a balance between exploitation of successful and mature business and exploration of new business to secure future growth.

However, this matrix has been criticised as it emphasises the need for businesses to overtly focus on market share. In a world where some markets are spread across several regions and, in some areas, are very volatile, this matrix can blind organisations to the "bigger picture".

OVER TO YOU

Activity: BGC growth share matrix

Research an organisation other than your own, for example, Nike, McDonalds, Starbucks, Emirate Airlines, HSBC Bank, Microsoft or Apple and explore which aspects of its operation fall within the four categories in this matrix.

4 The GE/McKinsey matrix

The GE/McKinsey matrix is a strategy tool that helps businesses prioritise their investments amongst their business units.

The GE/McKinsey matrix is a very similar framework to the BCG Matrix, in that it assigns business units to groups on the matrix that show whether they are worth investing in or whether they should be harvested/divested. The main differences between the two matrices are:

1 Visual: the BCG matrix is a four-cell matrix whilst the GE Matrix is a nine-cell matrix. The thinking is that a nine-cell matrix offers a better visual representation of where the business stands. The GE Matrix is more detailed, for example the invest/grow cells are separated, which offers more detail to those making investment decisions.

2 Market attractiveness replaces market growth. Market attractiveness includes a broader range of factors other than growth rate to determine attractiveness of a market.

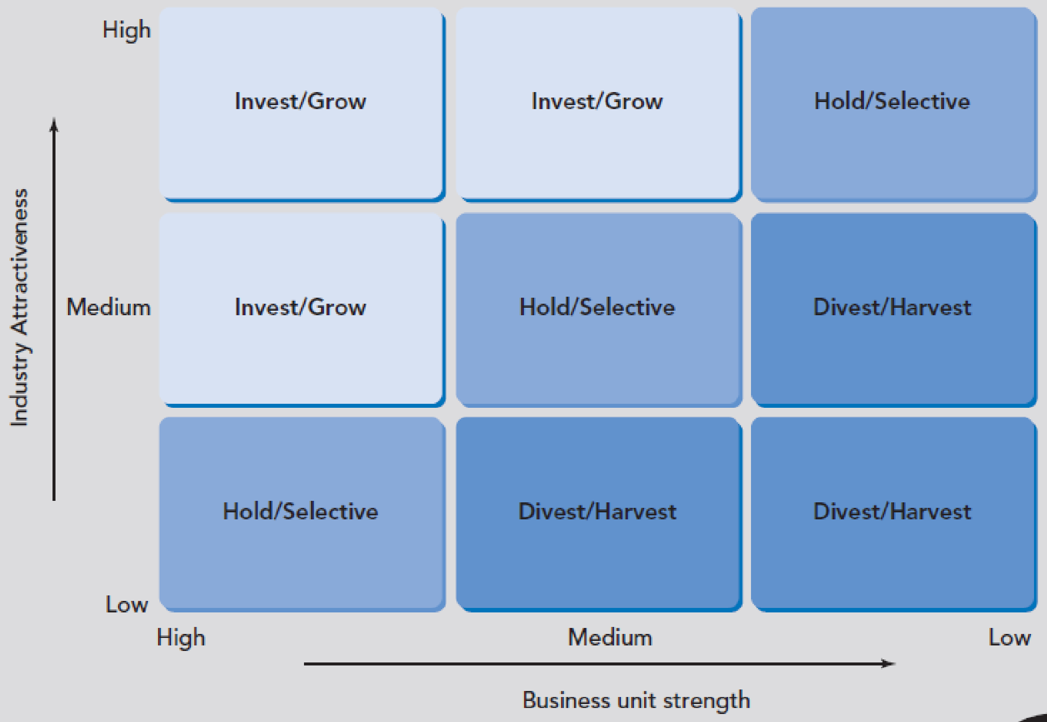


Figure 4: The GE/McKinsey matrix

The vertical axis shows industry attractiveness, which is determined by factors such as:

- market size and growth rate
- industry profitability and rivalry
- demand variability
- global opportunities

The horizontal axis is business unit strength, which is determined by factors such as:

- market share
- growth in market share
- profit margins relative to competitors
- production capacity

5 Internal Audit process

The primary purpose of internal audit is to offer third party, independent assurance on all key aspects of an organisation's risk management, compliance, governance and internal control processes.

Today, the emphasis given to internal audit processes has increased, both in terms of stakeholder reliance and organisational contribution.

Internal audits look to enhance an organisation's governance, risk management, compliance and management controls by continually making recommendations/proposals based on their findings.

Profitable operations and manufacturing are rooted in "the 5Ms" shown in Figure 5 below. This can be used to evaluate each process or problem in manufacturing to determine the root cause of any inefficiency.

Manpower (staffing)	Results are linked to resource hired being fit for purpose, developed and motivated
Material	This includes information and supplies
Machines	Materials are produced by machines
Methods	This includes tasks to create, design, sell and deliver a product or service
Money	This includes profit and loss, budgets, finance and accounting

Figure 5: The 5Ms

Internal auditors are sourced by organisations and are valued because of their integrity and ability to offer objective and independent advice. However, internal auditors are not responsible for the effective implementation of organisational activities.

The main roles of an internal auditor generally include:

- Internal controls: the effectiveness and efficiency of operations, the robustness of management reporting and compliance with legislation.
- Risk management: advice on the ways an organisation identifies, analyses and monitors risk, deterrence of fraud, budgeting, and capital planning.
- Corporate governance: looking to protect the interests of all key stakeholders in a way which is ethically compliant

With more regulation and more organisations operating globally, there is almost inevitable exposure to greater regulatory and compliance risks. Regulators anticipate, through due diligence, background checks to be undertaken on many key stakeholders (e.g., vendors and suppliers).

Fraud has become an increasingly important risk, which can have significant negative financial and reputational risks for an organisation. Effective fraud-risk management processes are critical for organisations, both in terms of controls and personnel.

An internal audit function needs to be adequately supported, funded and resourced. The purpose, size and complexity of an organisation will help to determine the specific requirement of an internal audit function. In all circumstances, it is essential that the independent authority of this function is never compromised.

3.2. Applying frameworks to analyse key aspects of the internal environment to a given organisation

In this section, we will be exploring how some of the frameworks reviewed in Section 3.1 work in reality. The emphasis will be on the internal environment, although as we have seen earlier (Section 2.1), the internal and external environments will always be interrelated.

Porter's value chain in practice

The main emphasis of this framework is to enable an organisation to become more competitive by identifying and prioritising those activities/processes that add most value. Effectively, this means that each stage of any process undertaken in an organisation will directly or indirectly impact the levels of efficiency, quality and, by implication, relative added value.

This exercise will take time and research to fully understand the business. Use a variety of current sources (i.e., not older than 2 years) and this will help you to fully understand the value chain of your chosen organisation

Inbound logistics

If we look at organisations like home interiors giant IKEA and the major car manufacturers, there is a critical dependency on their supply chain logistics which can be globally based.

Operations

Currently, there are 315 IKEA stores located in 27 countries. In the car manufacturing sector, Nissan, for example, is represented in Japan, North and South America and across Europe. In both these organisations, managers are given considerable autonomy to accommodate aspects of local markets, cultures and consumer behaviour.

Service

All world-class organisations need to offer consistently world-class service for every customer touch point (i.e., via every delivery channel).

OVER TO YOU

Activity

Inbound logistics

Research a company using news sources to determine:-

- **The number of suppliers**
- **The number of countries in their supply chain**
- **How they manage their supply?**
- **How do they manage inventory?**

Outbound Logistics

Research a company using news sources to determine:-

- **How are finished goods stored**
- **How are they moved to the customer?**
- **Are there distribution hubs?**
- **Are transport hubs (such as those at airports) used?**

Marketing and Sales

Research a company using news sources to determine:-

- **How are products sold?**
- **How is the website used for sales?**
- **What are they access points for customers?**

Service

How does your organisation provide world class customer service?

CASE STUDY: THE IMPACT ON INBOUND LOGISTICS

The main supposition of Porter's value chain framework is that methodically analysing the key activities of an organisation (i.e., the chain) will add more value to the offering of products and services and their accumulative costs. This framework can therefore be a very valuable influence in an organisation's strategies and decision-making process.

Specific applications of this framework can be on, for example:

- the supply chains.
- the distribution networks.
- each stage of the process that produces the good or service.

The optimum outcome is where value is added at every possible stage.

Specific implications resulting from this organisational analysis could be in the following categories:

- key organisational functions, especially those that are primarily involved in marketing activities.
- support functions, for example, human resources (HR), finance and research and development (R&D).
- quality management and control.
- production.

OVER TO YOU

Activity: Key processes and procedures

In your organisation or an organisation of your choice:

- **What are the key processes and procedures that are both priorities and important?**
- **How effective are these processes and procedures at adding value to organisational performance?**

Applications of the Boston Consulting Groups' growth hare matrix

OVER TO YOU

Activity: BCG Activity continued

Continuing the research activity from earlier choose an organisation on which a BCG Matrix will apply – it may be different to earlier organisations that you have chosen.

Give an outline of this organisation, chose one with several key products or services

Which products or services are

- **Stars: brands with a high market share and high market growth.**
- **Cash cows: brands with high market share and low market growth.**
- **Question marks/Problem children**
- **Dogs: brands with low market share and low market growth**

Chapter 4

Analysing Competitive Environments

Introduction

In this chapter, we will be considering a range of ways in which an organisation can gain a greater understanding of the external environment. This chapter builds on the areas covered earlier in this study guide (primarily Chapter 2).important for an organisation to understand its internal key perspectives and dynamics.

Learning outcomes

On completing the chapter, you will be able to:

4 Discuss how analysing competitive environments enables the development of successful

Assessment Criteria

4 Discuss how analysing competitive environments enables the development of successful business strategies

4.1 Apply relevant frameworks to analyse competitor environmental trends

4.2 Identify methods in which an organisation can gain competitive advantage in response

4. Analysing Competitive Environments

4.1. Relevant frameworks to analyse competitive environmental trends

Different sources of competitor information

Information can come from a very wide range of sources, some of which were mentioned in Chapter 2.1. Surveys, data, media articles, references and search engines can offer information that will facilitate an organisation's ability to plan, manage risk and prepare for change, i.e., information will help an organisation have a better awareness and understanding of the environment in which it operates.

Examples of where these sources of information can be used include:

- being aware of changes in customer requirements.
- gaining an awareness of changing tastes and attitudes.
- understanding the market/sector in which they operate.
- comparison of organisational performance to other similar organisations.

These sources of external information are usually available to the general public and are produced independently, by a third party.

Written documentation

Written documentation covers a wide range of options – books, periodicals, newsletters – many of which will be available in hard copy and online. These could include topics such as:

- advice on employee resourcing (HR).
- options for product development.
- sources of finance when an organisation is looking to grow.
- building a healthy workforce.
- vital information relative to the market in which the organisation operates.

Many organisations also access trade journals, which offer detail aimed at specific and sometimes niche audiences. For example, grocery stores, hair salons, bakeries and builders.

Government and educational departments also offer a wide range of information that can be accessed by organisations. Government sources are well thought-of because they come from official sources and are free of charge. Curiously, the wide variety of information offered by educational institutions (e.g., universities) is less readily accessed.

Online sources

The internet via the worldwide web is the most powerful source of information.

Online sources have information readily available around key organisational issues. Examples include:

- demographic data in specific market sectors.
- details about international trade and markets.
- information for potential investors.
- economic trends;
- updates on government regulations and laws.

All organisations seeking to navigate through the relentless environment of uncertainty and change are clearly dependent upon understanding the external environment in which they operate.

NEED TO KNOW

Organisations that rely mainly on internal sources of information:

- may be completely unaware of significant external changes until it is too late to respond, e.g., to the actions of a competitor.
- could evolve strategies that are developed on an incomplete level of awareness and understanding (i.e., built primarily from internal sources) and therefore may take the organisation in the wrong direction.

OVER TO YOU

Activity: External information sources

Research what sources of external information are used by your organisation (or an organisation with which you are familiar). Find out how these various sources of information help to shape your organisation's strategic direction.

Benchmarking

NEED TO KNOW

One way in which an organisation can use sources of external information to assess its own levels of performance relative to others, is to benchmark. This is where an organisation's key process measures and performance indicators are compared with those of other organisations. Usually, the comparative measures are more quantitative and relate to cost, quality and time. An organisation can therefore assess its level of competitiveness relative to others and can compare its own levels of performance to best practice.

Benchmarking, therefore, can enable an organisation to make appropriate changes to its strategies and operations to enhance its levels of performance. As all organisations need to evolve constantly to align with the changing external environment, benchmarking is best seen as a continuous process.

Sources of competitor information that can be accessed by benchmarking can include:

- Gaining a greater understanding of organisational problem areas that need to be addressed. For example, the need to enhance levels of customer service or to re-engineer a series of processes.
- Comparison with organisations that adopt similar processes, who may well operate in the same market/sector.
- Comparison with best practice via research from customers, trade associations, suppliers and analysts.
- Visiting other organisations first-hand so that the more qualitative elements of an organisation's performance can be added to the more readily available quantitative information.

OVER TO YOU

Activity: Benchmarking

Identify an organisation, from the same or a different sector to your employer (or preferred employer) and consider which would be the most significant area to benchmark. Discover where your findings from your benchmarking exercise would add value to your organisation's performance.

Porter's five forces analysis

The five forces analysis tool is a simple but effective tool for analysing where the power lies in a business situation. This approach enables the organisation to understand the level of competition within an industry, thereby enabling it to plan its future business strategies. This is useful because it helps to understand the current competitive position and therefore what needs to be done to become more competitive.

With a full and clear understanding of this framework, the organisation can take advantage of a position of strength, improve a situation of weakness and avoid taking a wrong step: all vital parts of good planning.

This framework is usually used for deciding whether services, businesses or products have the potential to be profitable.

The five forces analysis assumes there are five forces that determine competitive power.

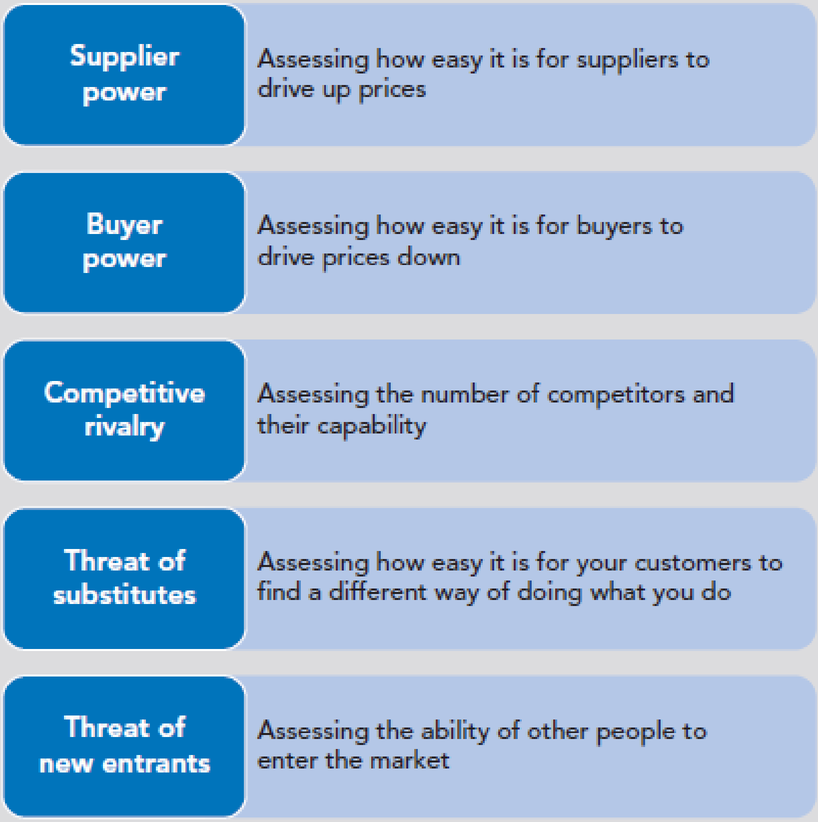


Figure 1: The five forces determining competitive power

Using Porter's framework

Look at each of the five forces, then identify and explore the key factors under each area. For example, if you were looking at competitive rivalry, you would note down the number of competitors, their difference in quality and the loyalty of their customers. If you were looking at threat of new entrants, you would look at areas such as the cost of entry, economies of scale and barriers to entry.

Then look at the situation you find using this analysis and think about how it affects you. Looking at things in this way helps you to think about what you can do to increase your power in each force. If you find yourself in a weak position, this tool can help you work out how strengthen it. These forces can be brought together as shown in Figure 2:

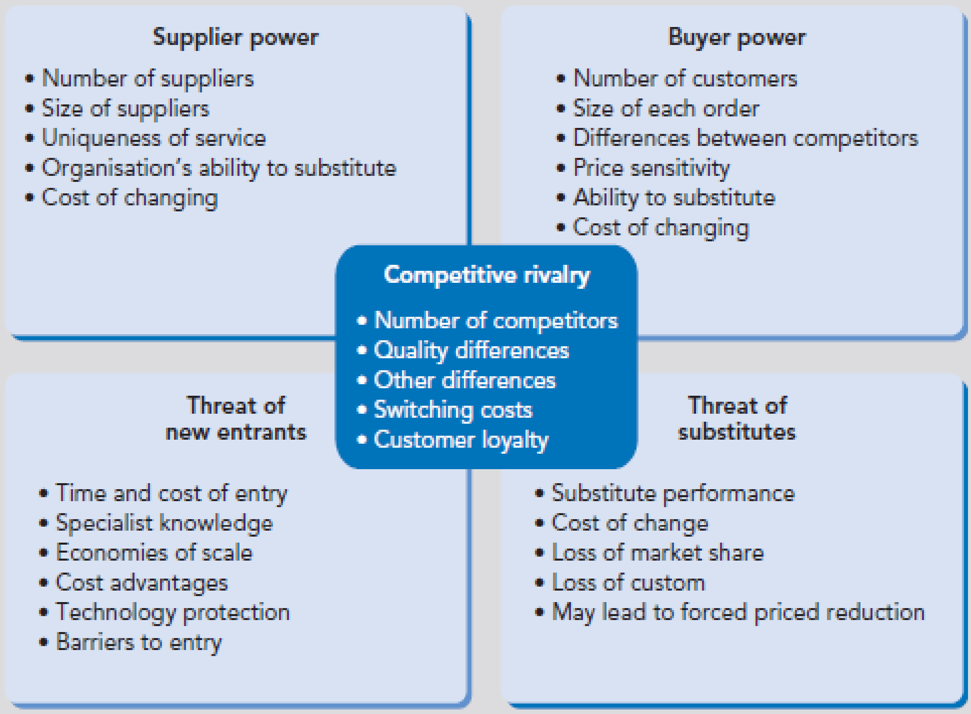


Figure 2: The five forces of competitive power

REVISION on the go

Porter called these five forces the microenvironment, as opposed to the macro environment, i.e., they are forces that are very close to and will directly impact a company, especially in terms of its capacity to satisfy its customers and maximise profits. As was mentioned earlier, a change in any one of the five forces requires a company to realign its strategies.

OVER TO YOU

Activity: Adopting Porter's framework

How far does your organisation (or one with which you are familiar) adopt each of the five elements of Porter's framework in order to gain a greater understanding of its competitors?

Resource-based view and VRIN

The resource-based view is a way of assessing a company and its strategy. It looks at a company as a bundle of resources and considers how these resources are combined to make companies different from one another. The starting point of this view is the internal environment of the organisation.

Resources can be anything that facilitates the organisation performing its functions. They can include capabilities, assets, processes, knowledge and information.

The VRIN characteristics

For a resource to be strategically important there are four characteristics to consider which together spell "VRIN":

Valuable: when a resource brings value to an organisation, it can be a source of competitive advantage, i.e., this type of resource needs to be of greater relative benefit than similar resources in competing firms.

Rare: this is where a resource brings competitive advantage to the organisation, as compared to other competing organisations, i.e., this type of resource has an element of scarcity relative to the demand for its use or what it helps to produce.

Inimitable: resources can be a source of competitive advantage if one organisation has them and competing firms cannot obtain or imitate them.

Non-sustainable: resources should not be able to be replaced or substituted by any other strategically equivalent valuable resource.

OVER TO YOU

Activity: Adopting Porter's framework

Research an organisation, other than your employer (if you have one) and try applying the VRIN framework. How useful has this framework been in terms of enabling your chosen organisation to adapt its strategies to become more competitive?

4.2. Identify how an organisation can gain competitive advantage in response to competitor analysis

In this section, we will consider a range of approaches an organisation can adopt to gain a competitive advantage.

1 Ansoff's growth matrix

Business leaders need to think about moving their organisation forward. Clear priorities are to reach new customers and increase profits. No business can afford to stand still or adhere to a "business as usual" mindset. If this approach is adopted in a business environment of continual change, the chances of longer-term survival are significantly reduced.

There are numerous options available. Deciding which one is best is where Ansoff's growth matrix could help.

The Ansoff matrix was developed by H Igor Ansoff and was first published in the Harvard Business Review in 1957. It has given generations of business leaders a quick and simple way to think about the risks of growth. This framework is effectively a strategic marketing analysis that facilitates a business's product and service growth objectives.

Sometimes called the product/market expansion grid, Ansoff's matrix shows four strategies that organisations can use to grow. It also helps you analyse the risks associated with each one. The idea is that each time the organisation moves into a new quadrant (horizontally or vertically), risk increases.

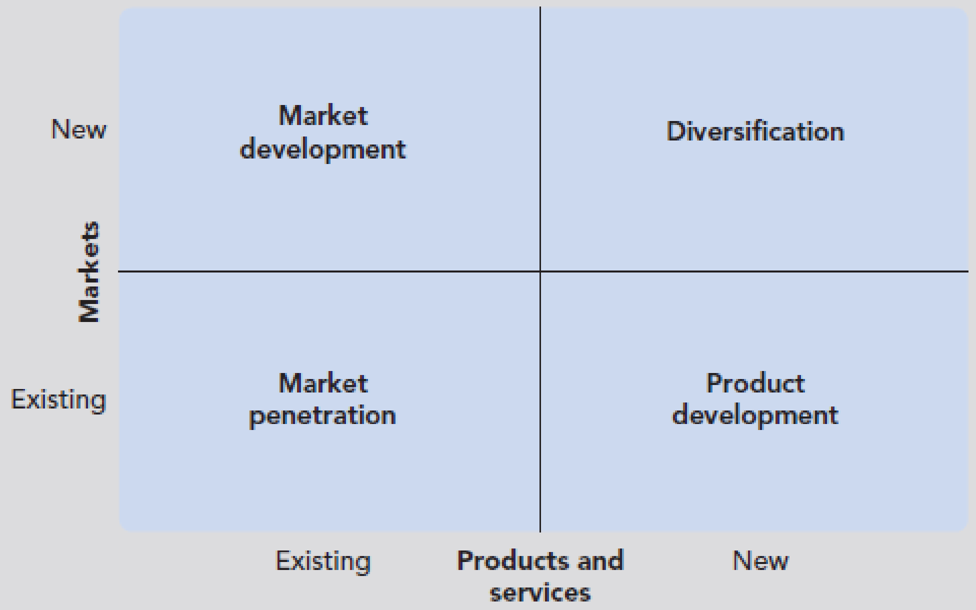


Figure 3: Ansoff's matrix

Market penetration: the safest of the four options. Here, you focus on expanding sales of your existing product in your existing market. You know the product works and the market holds few surprises for you. Priorities here would be to encourage greater numbers of consumers to use your product or service. Possibilities are the lowering of price, introduction of a customer loyalty scheme, increased advertising or to have regular special offers and/or discounts.

- Product development: slightly riskier, because you are introducing a new product into your existing market. This means you are expecting your existing customers to buy more from you, possibly products or services that are related to existing offerings.
- Market development: placing an existing product into an entirely new market. You can do this by finding a new use for the product, or by adding new features or benefits to it. Possible approaches to adopt here include the completion of a PESTLE review and considering adopting new delivery channels (for example an online offering).
- Diversification: without doubt the riskiest of the four options, because this involves the introduction of a new, unproven product into an entirely new market that you may not fully understand. Effectively, this means a business is aiming to sell a brand-new product to a new customer base with the potential benefit of being able to expand into new territory.

To use the matrix, you plot your options into the appropriate quadrant. You look at the risks associated with each option and develop contingency plans to mitigate the risks. This will help make the best decision for your company, although the levels of relative risk need to be regularly reviewed to accommodate inevitable change. We will discover how Ansoff's model can be applied a little later in this section.

2 Porter's generic strategy model

Generic strategies can be applied to products or services in all industries and to organisations of any size. Generic strategy was first set out by Michael Porter in 1985. This model explores different aspects of competitive advantage.

Porter called the generic strategies: cost leadership, differentiation and focus. The focus element is divided into two parts: cost focus and differentiation focus.

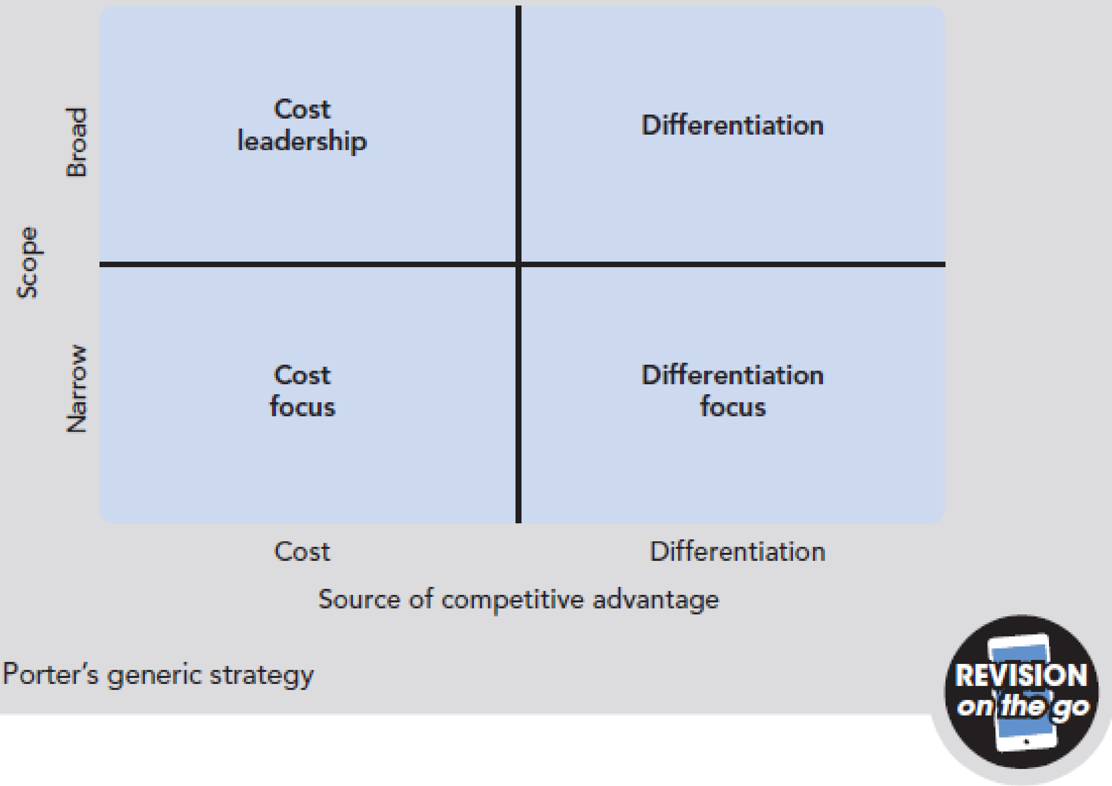


Figure 4: Porter's generic strategy

The cost leadership strategy: this involves being the leader in terms of cost in your chosen market or industry. This means having the lowest pricing strategy, whilst still being profitable; therefore, having very efficient processes is of the utmost importance. The continual focus on process efficiency may create a barrier to entry for potential competitors. In reality this strategy is only sustainable for businesses with a large existing market share, which has already adopted economies of scale.

The differentiation strategy: this involves making products or services that are more attractive or different to those of your competitors. This strategy may work where current and potential customers are less price sensitive and have specific needs that are yet to be fully met. Businesses that are successful with their product differentiation can then charge a premium price, as consumers see a perceived uniqueness in their purchase.

The focus strategy: this involves concentrating on particular niche markets and, by understanding the customer needs and the dynamics of that market, then developing wellspecified, low-cost products for that market. Here we often see businesses prioritise their brand recognition and product innovation as strategies to achieve competitive advantage.

It is worth noting that, according to this framework, you can only pick one strategy to follow, and the decision-making process is very important for a successful outcome to be achieved. Porter warns of the clearly implied risks of trying to follow more than one strategy. One of the main reasons for this is because of the things a business needs to do to make each strategy work and appeal to different market segments.

At the outset, when adopting this approach, it is vital to take your company's strengths and attributes into account when choosing a strategy. For example, cost leadership requires a detailed approach on processes, whereas differentiation requires a highly creative approach.

Examples of Ansoff's matrix in practice

This framework consists of four areas: penetration, product development, market development and diversification.

Penetration is where an organisation continues to try to sell its offerings, products and services to existing customers, i.e., to facilitate customer loyalty. Ways in which this can be achieved include altering prices levels, adding new features to a product or service, changing the packaging (part

of a rebrand) or suggesting alternative uses. Confectioner Cadbury's regularly adopts this strategy. For example, its creme eggs are available all year round rather than just in the spring as you might expect. In some countries, for example, India, Cadbury's suggests that its chocolates are given as gifts for special occasions rather than eaten for everyday consumption.

Product development is a core activity for successful organisations, primarily because there is a need to accommodate the changing expectations of current and potential customers, together with other changes in the external environment. (We have looked at the PESTLE framework in Chapter 2.) A good example of this is when McDonald's began to offer salads and fruit as part of its menu in response to negative media coverage, legislation, and changing customer demands for a healthier diet.

Market development is where an organisation looks to launch its products and services in a new market, possibly in a new geographical area. One example is fast food giant KFC, which entered the Chinese market several years ago and is now one of the most popular fast-food outlets there. In the mobile phone sector, Apple and Samsung compete for market dominance in the emerging markets, for example, in parts of Africa, India and the Middle East.

Diversification is when a completely new product or service is brought to the market. One such example is when Apple successfully introduced the iPod, which gave it access to a far larger audience. Coca-Cola introduced Vitamin water into its range of products to accommodate the ever- increasing demand for healthier drinks.

Areas an organisation can consider when applying Porter's generic strategy

Competitive advantage: here there is a need for an organisation to offer better value, either actual or perceived. This can be done by product or service differentiation. For example, increasing levels of benefits and service or perhaps by reducing the price.

Cost leadership: today's reality is that organisations compete for customers by the prices placed on their goods and services. Therefore, any organisation must look to keep its costs of production to acceptable minimums. Many organisations (e.g., in car manufacturing) constantly seek process enhancements to both increase productivity and reduce unit costs.

Organisations have two main options: to either offer their goods and service at discounted rates (e.g., Aldi, Lidl) to entice custom and increase market share, or offer higher prices, aiming to maximise profitability, whilst possibly seeking to achieve a level of exclusivity.

Differentiation strategy: this is where an organisation offers an element of uniqueness to its current and potential customers. Apple is a good example. This may also lead to the potential for an organisation to offer its products and services at premium prices.

Focus strategy: this is where an organisation makes a strategic decision to focus on a specific customer base/segment and strives to look after them better than any competitor. Here an organisation is looking to stand out as the clear leader in a given sector. This approach could be suited to a smaller organisation, who may not have the capacity to compete in the larger markets.

Integrated cost leadership-differentiation strategy: where an organisation looks to adopt a range of interrelated strategies and thereby offer a range of products and services to several customer segments. Clearly, technology is a key enabler in this scenario, as an organisation may then be more capable of quickly responding to change.

Glossary

Balance of payments A record of a country's transactions with the rest of the world.

Benchmarking The way in which an organisation measures its own levels of performance relative to others using external information.

Centrally planned economy An economy where all economic decisions are taken by central authorities.

Demand Consumer wants.

Demerit goods Goods that can be considered harmful, e.g. alcohol and tobacco products.

Economic growth The percentage increase in national input, normally expressed over both annual and quarterly periods.

Elasticity of demand How demand changes in relation to price.

Elasticity of supply How supply changes in relation to price and time period.

Embargo A complete government ban on certain imports or exports to certain countries.

Equilibrium The state of balance, where the supply and demand curves intersect.

External information Information that primarily comes from outside the organisation, e.g., newspapers and online.

Fiscal policy The levels of government spending and/or taxation.

Free trade A free trade area is a group of countries that have no trade barriers between them.

Gross domestic product The value of output produced within a country.

Gross national product The value of all goods and services made by a country's residents and businesses, regardless of domestic location.

Import quotas Limits imposed on the quantity of goods that can be imported.

Import tariffs Taxes on imports.

Industry body A body that represents the interests of an industry.

Industry experts Experts in a given industry who are likely to have worked or be heavily involved in that area of industry.

Inflation A general rise in prices throughout the economy.

Internal information Information that is available exclusively to an organisation.

Macroeconomics The study of the whole economy.

Market economy An economy where the economic decisions are guided solely by the interactions of a country's businesses and citizens.

Merit goods Goods that benefit the public, but which are likely to be under produced.

Microeconomics The study of the economic behaviour of individual parts of the economy.

Mixed economy An economy where economic decisions are made partly by the government and partly through the market.

Monetary policy Influencing the interest rate and/or altering the supply of money in the economy.

Monopolistic competition A market in which many producers sell goods that are similar, but not perfect substitutes for each other.

Monopoly A market where there is only one firm in the industry.

News source An individual publication, document or record that seeks to provide timely information, e.g. broadcasts and official government statements.

Non-excludability A non-excludable good is where customers who are non-paying cannot be stopped from accessing it.

Non-rivalry Can be used by one consumer but does not stop concurrent use by other consumers (for example broadcast television).

Oligopolies Markets where there are several firms that put up barriers to prevent new firms entering the market.

Online sources Sources available via the internet (worldwide web).

Perfect competition A market in which consumers and suppliers essentially have no control over prices.

Primary industry The acquiring of raw materials.

Primary sources New information and data gathered for a specific purpose by an organisation.

Private sector The sector of the economy not under direct state control.

Public sector The state-controlled sector of the economy.

Secondary industry The manufacturing and assembly process.

Secondary sources Information and data that already exists and has already been collected.

Supply The amount of something that firms can supply, depending on resource and technology.

Tertiary industry Commercial services that support the production and distribution process.

Trade agreements A treaty between two or more countries to establish a free trade area.

Trade association An organisation founded and funded by organisations from within a specific sector.

Trading blocs A set of countries that engage in international trade together.

Unemployment The number of people who are currently without a job, but who are actively looking for employment.

Written documentation Sources such as books and journals.