Your road to success

LEVEL 4
DYNAMIC BUSINESS ENVIRONMENTS

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**Using your study guide**

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**Glossary**

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# 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).

<table>
<thead>
<tr>
<th>Element of learning</th>
<th>Key capabilities</th>
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</table>
| Element 1: Understanding the role of economics (Weighting 30%) | • 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 (Weighting 30%) | • 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 (Weighting 30%) | • 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 (Weighting 10%) | • 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.
L4 descriptor

<table>
<thead>
<tr>
<th>Knowledge descriptor (the holder...)</th>
<th>Skills descriptor (the holder can...)</th>
</tr>
</thead>
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<tr>
<td>• 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.</td>
<td>• 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.</td>
</tr>
<tr>
<td>• Can analyse, interpret and evaluate relevant information and ideas.</td>
<td>• Review the effectiveness and appropriateness of methods, actions and results.</td>
</tr>
<tr>
<td>• Is aware of the nature of approximate scope of the area of study or work.</td>
<td></td>
</tr>
<tr>
<td>• Has an informed awareness of different perspectives or approaches within the area of study or work.</td>
<td></td>
</tr>
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</table>

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

- **‘Over to you’**: activities for you to complete, using the space provided.
- **Case studies**: realistic business scenarios to reinforce and test your understanding of what you have read.
- **‘Revision on the go’**: use your phone camera to capture these key pieces of learning, then save them on your phone to use as revision notes.
- **‘Need to know’**: key pieces of information that are highlighted in the text.
- **Examples**: illustrating points made in the text to show how it works in practice.
- **Tables, graphs and charts**: to bring data to life.
- **Reading list**: identifying resources for further study, including Emerald articles (which will be available in your online student resources).
- **Source/quotation** information to cast further light on the subject from industry sources.
- **Highlighted words** throughout denoting **glossary terms** located at the end of the study guide.

**Note**
Website addresses current as at August 2017.
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 market place.

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 economic view of businesses

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 delivers outputs for clients or customers.

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

Macroecnomics and microeconomics

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

Microeconomics is the study of economic behaviour of individual aspects of an economy, e.g. people, firms or households. It studies the interrelationships between these aspects in determining patterns of production and distribution of goods and services.
The primary aim is to achieve the best return from the factors of production which are shown below.

![Figure 2: Production factors](image)

Macroeconomics is the study of economic aggregates (grand totals). An example of this would be the overall level of output, prices and employment in the economy.

Whilst the two areas may seem to be different, they do overlap and are interdependent in some 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 end 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.

Microeconomics tries to understand resource allocation and human choices, whilst macroeconomics looks at “what stimulates economic growth?” and “what should the rate of inflation be?”

Both are very important in terms of looking at how an economy is managed and how companies earn revenue.
Activity 1: 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. Make your notes here.

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 business regardless of where they are made, for example, cars and health provision. GNP excludes products manufactured in the country by overseas businesses and any income earned by foreign residents and businesses.

Gross domestic product

Gross domestic product (GDP) is the value of output 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 is a record of a country’s transactions with the rest of the world. It shows a country’s receipts of deposits 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.

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.

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**OVER TO YOU**

**Activity 2: 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.

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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.
Understanding the Role of Economics

Chapter 1

Industry Description

<table>
<thead>
<tr>
<th>Industry</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary industry</td>
<td>Primary industry production involves acquiring raw materials. For example, oil drilled from the ground, coal mining, fish trawling and foodstuff farming.</td>
</tr>
<tr>
<td>Secondary industry</td>
<td>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.</td>
</tr>
<tr>
<td>Tertiary industry</td>
<td>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.</td>
</tr>
</tbody>
</table>

Table 1: Classifications 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.

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).

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.

<table>
<thead>
<tr>
<th>Business type</th>
<th>Number of employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>SME (Small and medium-sized enterprises)</td>
<td>Less than 250</td>
</tr>
<tr>
<td>Large enterprise</td>
<td>More than 250</td>
</tr>
</tbody>
</table>

Table 2: Business size classifications
SMEs can be further subdivided.

<table>
<thead>
<tr>
<th>Business type</th>
<th>Number of employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro enterprise</td>
<td>Less than 10</td>
</tr>
<tr>
<td>Small enterprise</td>
<td>Between 10 and 49</td>
</tr>
<tr>
<td>Medium enterprise</td>
<td>Between 50 and 249</td>
</tr>
</tbody>
</table>

Table 3: The classification of small and medium-sized businesses

Business can also be defined in terms of the geographical areas they serve.

<table>
<thead>
<tr>
<th>Business classification</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic business</td>
<td>A company that conducts its affairs in its home country.</td>
</tr>
<tr>
<td>International business</td>
<td>A multinational corporation or international business that engages in business among multiple countries, for example, Coca-Cola™.</td>
</tr>
<tr>
<td>Global business</td>
<td>A company that conducts business across the world, for example, Microsoft.</td>
</tr>
</tbody>
</table>

Table 4: Business classification in terms of global reach

Economic environment

Scarcity and choice

NEED TO KNOW

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.

Virtually every time we do something, we are making a choice between alternatives. For example, if you choose to stay in, you are choosing not to go out. Likewise, if a country decides to use more of its resources to manufacture goods, there will be less to use on the provision of agricultural goods.

Supply and demand

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 resources 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).

**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.

<table>
<thead>
<tr>
<th>Immediate time period</th>
<th>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.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-run</td>
<td>As this is a slightly longer period of time, some inputs can be increased, whilst some will remain fixed. Supply can increase somewhat.</td>
</tr>
<tr>
<td>Long-run</td>
<td>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.</td>
</tr>
</tbody>
</table>

Table 5: 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.
Activity 3: 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.

![Equilibrium Diagram](image)

**Figure 6: Equilibrium**

**OVER TO YOU**

**Activity 4: 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. So, an increase in supply occurs when more is supplied at each price. 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 5: 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.
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.
Activity 6: 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.
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.

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. A 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.
- It is 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 liberty.
• Consumers would have no 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.

Most of these problems were experienced by the former Eastern bloc countries (for example Poland, Belarus, the Czech Republic, Hungary, Romania and Bulgaria) and were part of the reason for the overthrow of their regimes.

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.
• 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.
Activity 7: 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.

Because of the problems with centrally planned economies and free market economies, all real-world economies are a mixture of the two systems.

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.

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 disposable 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.

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. 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

**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.
Merit goods are “good” for you. But unlike public goods, they can also be provided privately. However, if these services are provided by just the private sector, they tend to be under-consumed, so the government must intervene and correct the market failure.

Two good examples of this are education and health care. Both services can be provided privately. However, if the government did not step in and provide health care and state schools, then numerous families would not be able to afford, or would choose not to afford either. We need to be aware that these policies vary significantly in different parts of the world.

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 impose heavy duties and taxes. This means that the price rises significantly, in the hope that it will deter consumption. Some demerit goods are so negative that the government bans them altogether – illegal drugs being an obvious example. The additional cost of demerit goods is an increased burden on health provisions, increased crime and decreased labour productivity, which affects the whole economy.

**Activity 8: 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?
**CASE STUDY: PROTECTING THE ENVIRONMENT**

**Merit and demerit goods**

Pollution is a global problem that 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 9: 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, health and pensions.

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 governments 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 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 most developed countries, governments have a target for the rate of inflation. In the UK, the inflation target is 2% and the Bank of England uses interest rate levels to help meet that target.

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.
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 high rates of stable economic growth over the long term, thereby avoiding excessive 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

Balance of payments between the debits and credits is shown under various sub-headings. Keeping this stable over the longer term shows that a country can “pay its way” in the world.

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.
Activity 11: 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 are usually 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 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. Economic policies will inevitably be prioritised by the political beliefs of the government of the day.

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.
Chapter 1

Understanding the Role of Economics

Activity 12: 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.

The advantages and disadvantages of free trade

In this section, we will look at the advantages and disadvantages of free trade. A free trade area is a group of countries that 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 allows 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.

The advantages and disadvantages of barriers to free trade

Import tariffs

Import tariffs are taxes on imports. These are usually “ad valorem” tariffs (a percentage of the price of the import).

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. Tariffs can also affect the quality of goods. Companies may look to cut production costs to account for tariffs. However, tariffs, once agreed, can be easier to administer and should be more transparent. This makes it easier for them to be negotiated with trading partners because the terms of trade have been clarified and agreed.

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 keep market entry costs low for domestic producers and to protect infant industries.
When one country introduces quotas, their trading partners tend to do the same, giving the same reasons. This results in less 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 (e.g. enemies 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.

An example of a non-tariff barrier is exchange controls, which include limits on how much exchange can be made available to importers for investment or to citizens travelling abroad. Other non-tariff barriers are: import licensing, administrative barriers and procurement policies, where the governments favour purchasing equipment from domestic producers.

OVER TO YOU

Activity 13: 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 21st century?

2. What are the domestic and external factors that will influence this level of economic growth?
Over recent years, China has continued to gain political and economic influence on the global stage.

China’s population exceeds 1.3 billion (representing 20% of the world’s population), many of whom until recently lived in conditions of poverty.

However, during the past two to three years, the Chinese economy has entered a slower period of growth. This relative economic slowdown is in the context of an average growth rate of more than 9% since 1978. The mid 1970s also saw the beginnings of the Chinese economic evolution toward a more market-based approach.

The relative economic slowdown has led to the Chinese authorities projecting a lower annual growth target of 7%.

China now needs to rebalance its economy, as historically its period of growth was underpinned by investment (regularly more than 46% of GDP) and exports (for many years exports exceeded 40% of GDP).

China will look to rebalance its economy by:
- increasing exports of greater value with an emphasis on technology and knowledge;
- looking to increase levels of household expenditure;
- confronting the challenges of domestic income and wealth inequality.

Furthermore, whilst China is a communist state, it is becoming a more open economy, increasing trade with the rest of the world. This economic transition, some would say transformation, is scheduled for completion by the end of 2030.

In context, in 2016 China had 17.65% of global GDP.
Activity 14: Our global transformation, embracing the developed, emerging and frontier economies

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.

3. Consider the current and longer-term implications of China’s economic policies.
Key features and the importance of trade agreements

In this section, we will look at the features of the main world 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.

**The Trans-Pacific Partnership (TTP)**

Originally, 12 countries that border the Pacific Ocean signed up to the TPP in February 2016. This represented approximately 40% of the world’s economic output. The USA were part of the TPP, but President Trump pulled them out of the deal when he came to power. The other member states are: Japan — the only nation to have already approved the pact — Singapore, Malaysia, New Zealand, Mexico, Vietnam, Brunei, Australia, Canada, Peru and Chile. For the pact to come into effect, all countries must approve it.

The aim of the pact is to deepen economic ties between these nations, fostering trade and significantly reducing tariffs to boost growth. Members had also hoped to foster a closer relationship on economic policies and regulations.

The agreement was intended to develop into a new single market, on a similar basis to the EU.

**The Transatlantic Trade and Investment Partnership (TTIP)**

Commonly known as TTIP (pronounced T-tip), the Transatlantic Trade and Investment Partnership is a deal being negotiated between the US and the EU, and in many ways, is a straightforward trade agreement. Negotiations are expected to be finalised by 2019 or 2020.

The aim of the TTIP is to bring about lower trade tariffs, and reduce regulatory barriers that make trade between the US and the EU costlier than it would otherwise be. If eventually approved by both the EU and US politicians, TTIP would be the biggest agreement of its kind.

Many economists see considerable benefits for both sides. Some projections see the benefits for the US economy at US$101 billion and for the EU at US$135 billion. In theory, decreased trade barriers mean that more activity should take place. The increased competition should then result in cheaper and higher quality goods.

Key features and the importance of trading blocs

In this section, we will look at features of the main global 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.

**The European Union (EU)**

The EU was founded in 1993 and is a political and economic union currently made up of 28 member states located primarily in Europe.

In principle, this economic union is the last step of an economic (both monetary and fiscal) integration process. The previous steps are the formulation of a free trade area, customs union and common market. It also facilitates the free movement of goods, services and production. A common currency is used by most members and could involve a fixed exchange rate system. Government spending and taxation are also synchronised under an economic union.
The formation of an economic union will lead to the surrender of a large part of a county’s national sovereignty to an overarching body.

**The North American Free Trade Agreement (NAFTA)**

The North American Free Trade Agreement is a treaty entered into by the United States, Mexico and Canada. The agreement came into effect on 1 January 1994, broadening the free trade arrangements that had already existed between the US and Canada since 1989.

NAFTA was created to remove investment restrictions, protect intellectual property rights and remove tariff barriers to manufacturing, services and agriculture. Labour and environmental concerns were also addressed. Small businesses would expect to benefit from NAFTA, as lowering trade barriers would make doing business in Canada and Mexico less expensive and would simplify processes needed to export and import goods.

When NAFTA came into effect, the three countries became the largest free market in the world. This directly affected more than 365 million people and the combined economies of the three nations at the time measured six trillion dollars.

**The Asia-Pacific Economic Cooperation (APEC)**

The primary objective of APEC is to support sustainable economic growth and prosperity in the Asia-Pacific region. APEC has 21 members: Australia, Brunei Darussalam, Canada, Chile, Hong Kong, China, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Chinese Taipei, Thailand, the United States and Vietnam.

The combined economies accounted for approximately 59% of world GDP and 49% of world trade in 2015. APEC’s role in expediting regional integration whilst reducing trade barriers has been vital to promoting economic growth and trade. More consistent regulations and standards with streamlined customs procedures have encouraged cross-border deals.

**The Central America Free Trade Area (CAFTA)**

CAFTA is a free trade agreement between the United States and six countries in the greater Central American Region. It was the first multilateral free trade agreement between smaller developing economies and the US. The other members are Costa Rica, El Salvador, Nicaragua, Honduras, the Dominican Republic and Guatemala.

The agreement promotes stronger investment, trade alliances, stability and prosperity throughout the region. The agreement reduces barriers to trade with the US, promotes economic growth of member countries and expands US opportunities in important regional markets. CAFTA is also strengthening workers’ rights and conditions throughout the region through enforcement of labour protection legislation.

In addition, CAFTA requires fair and transparent processes in government action and rule of law, thereby creating an enhanced climate for business and investment.

**Mercosur**

Mercosur is South America’s leading trading bloc. The aim is to bring about free movement of people, capital, goods and services among its members. The area covered by Mercosur is four times larger than the European Union. Mercosur was set up in 1991 and has four full members: Brazil, Argentina, Uruguay and Paraguay.
Mercosur’s tariff policies regulate imports and exports and the bloc can mediate between any member country’s trade disputes.

However, Mercosur has had issues with disputes among its members. The bloc’s smaller members, Paraguay and Uruguay, complain of restricted access to markets in Brazil and Argentina. Both Brazil and Argentina have also have clashed. Critics have accused Mercosur of becoming more politicised and less focused on free trade.

**OVER TO YOU**

**Activity 15: Trading blocs**

Which main trading blocs has your country joined? Write them down and identify the main benefits for businesses in your country that are involved in imports and exports.

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**CASE STUDY: TRADING BLOCS – AFRICA**

**Sustainable free trade for Africa**

In recent years, there have been significant moves across the African continent to establish sustainable free trade areas to eventually evolve into a single customs union. The idea was first proposed in the Treaty of Abuja in 1991.

This trading area would embrace a population of over 527 million and generate a combined GDP of over US$624 billion.

Representatives of the East African state community (EAC), the South African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA) are involved in these ongoing discussions.

This free trade area will lead to a merger of these regional economic communities.
• Many of the countries involved already belong to more than one of the trading blocs mentioned above.
• On average, every African nation belongs to three or more of the continent’s 30 current regional trading agreements.
• There is a vision that there will be enormous potential for economies of scale, which will give Africa greater leverage on the global scale.

OVER TO YOU

Activity 16: Trading blocs – Africa

Research the current level of progress towards this free trade area.

1. How far has economic growth been accelerated?

2. What are the impacts for regional stability and peace?

3. Have the levels of cooperation between the member states of this free trade area been affected? If so, in what way?

4. How far has Africa been able to increase its profile at a global level?
Free trade in Europe

The EEC (European Economic Community) was launched in 1957 with the signing of the Treaty of Rome. The aim of the EEC was to offer a common market where there was free movement of labour and capital, together with a customs union.

Since then the EEC has continued to evolve and has additional common policy areas and increased membership. For example, Greece joined in 1981 and Spain and Portugal in 1986. In 1986, an agreement was signed to establish a single market in 1992 and at the same time a common external tariff was imposed.

The European Union was formally established in 1993 when the Maastricht Treaty came into effect. This meant, for example, that euro currency replaced the national currencies of 12 of the member states.

Currently, the EU is the second largest trading bloc economy. It has over 500 million citizens who generate approximately 21% of the world’s economic output. Although there is currently some instability, the EU is likely to grow further in the next few years with countries like Albania, Iceland, Serbia and Turkey looking to join.

OVER TO YOU

Activity 17: Trading blocs – the EEC and EU

Imagine you were a representative of a country looking to join a trading bloc like the EU.

1. What would you consider to be the major benefits of membership?

2. What would be your main concerns about membership?
1.4 The varying level of competition in markets and the impact on price volatility

Conditions for perfect competition

In this section, we will look at the conditions for perfect competition. The model of perfect competition is formed on four assumptions.

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.

CASE STUDY: PERFECT COMPETITION

Does perfect competition exist?

Perfect competition means:

- all firms offer identical products;
- all firms have a small market share;
- there is freedom of entry and exit to and from the market;
- buyers have complete knowledge of the product or service on offer and of the price being charged.

Examples of true perfect competition are difficult, perhaps impossible, to find. There are often, for example:

- barriers to entry, like high start-up costs;
• less than complete levels of consumer awareness of the availability of products and services;
• government laws and regulations that restrict perfect competition.

Raw agricultural products are often used as an example of near-to-perfect competition. However, there are considerable ranges in quality of agricultural products. The rapidly growing bottled water industry is another example, although there are differences in methods of branding, sourcing production and product size.

A stock market is a location where shares are bought and sold. A share (stock) may only be bought or sold (i.e. traded) if it is listed at the stock exchange.

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**OVER TO YOU**

**Activity 18: 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?

2. If you discover considerable variances from a perfectly competitive scenario, explain what type of market you think exists.

---

**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). Similarly, although in a different sector, SA Breweries is seen by some observers as very near to being a monopoly. However, again, there are the potential substitutes of wine, spirits and soft drinks.

OVER TO YOU

Activity 19: 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 20: 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?
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 firm's decision-making processes 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.
Advantages and disadvantages

<table>
<thead>
<tr>
<th>Perfect competition</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advantages</strong></td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td>There is no guarantee that goods produced will be fairly distributed to every member of society.</td>
</tr>
<tr>
<td>Production costs being low and firms making normal profit keeps prices at a minimum.</td>
<td>The production of certain goods may lead to undesirable side effects like pollution. Perfect competition cannot guard against this.</td>
</tr>
<tr>
<td>If consumers want change, the resulting price change will lead firms to respond, purely out of self-interest.</td>
<td>Industries produce undifferentiated products under perfect competition. Lack of variety could be seen as a consumer disadvantage.</td>
</tr>
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</table>

**Table 6: Perfect competition**

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

**Table 7: Monopolies**
### Monopolistic competition

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

**Table 8: Monopolistic competition**

### Oligopoly

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adopt a highly competitive strategy, where firms can make similar benefits to other competitive structures, such as lower prices.</td>
<td>Reduction in consumer choice caused by high concentration of firms in a given industry.</td>
</tr>
<tr>
<td>Firms may be dynamically efficient in terms of new process and product development.</td>
<td>Cartel behaviour reduces competition and can lead to higher prices and decreased output.</td>
</tr>
<tr>
<td>Price stability helps consumers to plan.</td>
<td>New firms can be prevented entry into the market due to deliberate barriers to entry.</td>
</tr>
<tr>
<td>Price stability may also reduce the extremes (i.e. boom and bust) of the trade cycle in the macroeconomy.</td>
<td>Oligopolies can be inefficient in terms of resource allocation and productivity.</td>
</tr>
<tr>
<td></td>
<td>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.</td>
</tr>
</tbody>
</table>

**Table 9: Oligopoly**
Potential impact on 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.

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**Activity 21: 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 1

**Understanding the Role of Economics**

#### READING LIST

- “The Telegraph – What is TTIP and how is it supposed to make us better off”, Retrieved from: [http://www.telegraph.co.uk/business/2016/05/05/what-is-ttip-and-how-is-it-supposed-to-make-us-better-off/](http://www.telegraph.co.uk/business/2016/05/05/what-is-ttip-and-how-is-it-supposed-to-make-us-better-off/) [Accessed on: 24 August 2017]


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 this 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 strategies

2.1 Discuss relevant frameworks to analyse external environmental trends

2.2 Apply relevant frameworks to analyse external environmental trends
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 policy-making 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.

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

Table 1: Advantages and disadvantages of government information

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 1: Government information**

Explore what sources of information are available from your central and local government. How does this information help you in your day-to-day life?
News sources

A news source is an individual publication, document or record that seeks to provide timely information. Examples may include broadcasts, information from governments, official records and witness statements.

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

Firstly, the use of confidential information, which is often eagerly-sought, and the terms of use need to be considered. Some of this information may be “off the record” and needs to be verified. Organisations may avoid an “off the record” approach as they believe it obstructs their aim to report truthfully and there may be an unintended outcome of misleading the public.

Secondly, there are some instances where there is a reliance on anonymous sources. Often, legal advice is sought as to whether it is advisable to release certain information (for example, about court hearings). Also, prior to publishing information from this type of source, checks need to be taken to ensure that the source exists, then sometimes offering a second opinion to confirm authenticity. The use of anonymous sources will always be controversial and is prohibited by some organisations.

Thirdly, some news sources are unrecorded. This can occur where the source requests that all or part of the encounter should not be captured and recorded. Providing the encounter is not confidential, the information used can still be reported. This approach can be useful if a source is uncomfortable being recorded and may even question the motives of the journalist. Sometimes a source will prefer a journalist to repeat their words, rather than being on air themselves to blunt their impact. For example, if they have bad or disappointing news to share.

Fourthly, we need to mention attribution. This is the identification of the source of reported information and is a key aspect because some sources may wish to remain anonymous. Some news sources are dependent upon these anonymous sources.

Finally, we need to consider ethics. In many democracies, sharing the identity of a confidential source meets with disapproval. In many countries, journalists are protected under the law and, in some circumstances (for example, a criminal investigation), may be required to divulge their sources. The use of anonymous news sources is defended when, for example, there was no guarantee of anonymity, the news wouldn’t be shared or there may be fear of punishment or reprisal. Conversely, the use of such sources is criticised by some as they may be unreliable, be used as opportunities to present opinion rather than fact, and can encourage the disclosure of illegal information (for example, of a legal settlement).

Examples of news sources

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: users need to be cautious about which websites are accessed and how much they can be trusted. However, many websites are the only 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 2: 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 are likely 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**

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.

**Activity 3: 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.

By making political donations, there will also be an attempt to influence public opinion to become more favourable to the association’s members. These donations may be towards the campaign of a political party or candidate, or possibly in support of a piece of legislation. In some instances, there may be an attempt to influence the actions of regulatory bodies.

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.

OVER TO YOU

Activity 4: 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:

- P: Political
- E: Economic
- S: Social
- T: Technological
- L: Legal
- E: Environmental

**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.
- All six categories apply, always, with no exceptions.
- 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. right- or left-wing policies);
- 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;
- in some parts of the world, politicians are seen as corrupt, possibly out of touch and bureaucratic operations.

Economic factors

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

Possible examples are:

- 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;
- prevailing 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
• discrimination law
• equal opportunities
• 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
• sustainability
Activity 5: PESTLE

In your country, what do you see as being the two most important factors under each of the six PESTLE categories? (Remember when using this framework, all six categories always apply.) Consider how these external factors then impact on the performance of your organisation or an organisation of your choice.

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.

**Activity 6: 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.

Political

PepsiCo is the world’s second largest beverage seller and it needs to adhere to government policies in the markets where it operates. For example, in the USA, one of PepsiCo’s largest markets, it is regulated by the policies of the Food and Drug Administration (FDA).

In some markets there are competitive pricing policies in place, which means PepsiCo needs to adjust its own pricing strategies to remain competitive and maintain levels of sales.

As we have seen, some areas of the world are beset by instability and unrest, possibly accompanied with inflationary pressure which could threaten PepsiCo with falling sales.

Coffee company Starbucks aims to operate in the same environment as PepsiCo, as it looks to influence the buying power of consumers all over the world. One political challenge Starbucks faced was over its supply chains and the sourcing of its raw materials. Starbucks therefore looks to increase key stakeholder visibility of its “Fair Trade” practices. Starbucks must also adhere to the government policies in the countries where it sources its raw materials.

Both PepsiCo and Starbucks, as multinational operations with global profiles, are subject to ever greater scrutiny about their behaviour and practices. For example, ensuring that they are seen to pay the appropriate amount of taxes.

Economic

Since 2007 to 2008 there has been a severe global recession, from which many regions are yet to emerge. For many organisations, this has meant being more cost- and efficiency-focused. All budget and resource allocations are more closely scrutinised than ever before, including marketing and sales expenditure. Curiously for PepsiCo, during the economic downturn, it saw levels of sales increase with people, spending more time consuming its products at home or with family and friends – perhaps being laid off or working reduced hours.

Starbucks has seen a similar scenario, with the economic recession clearly impacting actual and potential levels of profitability.

Both organisations continue relentlessly to review the efficiency and effectiveness of all their internal processes and operations.
Social

Social factors are also crucial for PepsiCo as it operates in a very wide range of markets where there can be extreme differences in culture. PepsiCo, as a global brand, needs to be able to communicate to its worldwide customer base, whilst at the same time accommodating local cultural differences. It places great emphasis on being a global brand that unites and connects the world. PepsiCo needs to be aware of and sensitive to any religious festivals that take place in different countries.

Starbucks continues to expand its global presence in a very competitive sector. With increased consumer awareness comes greater interest in the ethical stance of companies like Starbucks, along with a desire to know more about its social and environmental policies. Also, with its continued growth, Starbucks enters markets where potential consumers are from the middle and lower income categories. This means Starbucks is continually reviewing its pricing strategies in these markets, whilst trying to offer cheaper alternatives without compromising on quality.

Technological

The rate of technological development is relentless. The emergence, over recent years, of the importance of social media, is an opportunity that organisations like PepsiCo has looked to embrace. Social media has meant that organisations can now look to interact more readily with their current and potential consumers. Key social media users, for example the youth, are accessed so that they can be influenced by PepsiCo to increase their level of brand recall and engagement.

Starbucks has similar opportunities and has, for example, introduced Wi-Fi access in all of its outlets as a method of enhancing the consumer experience whilst adding value to its brand. Furthermore, Starbucks has allied with Apple Inc. and regularly introduces app-based discount vouchers. Starbucks is therefore being very proactive in response to developments in the mobile market and has its own app, enabling consumers to pre-order and make payments with their mobile device.

Legal

Organisations look to adhere to the laws and regulations of all the countries in which they operate. This includes, for organisations like Starbucks, being compliant in the countries where they source their raw materials and facilitate their supply chains, and in the global range of markets where they offer its products.

Any example of non-compliance or non-adoption of local laws and regulations can have severe, sometimes long-term implications for an organisation. Recently, for example, PepsiCo was accused of using contaminated water in its processes in India, one of its major and rapidly emerging markets. This led to a massive product recall for PepsiCo, with products being removed from many outlets and extensive product testing. As well as the considerable financial implications, there was very visible and longer-term damage to its brand.

Environmental

All organisations are subject to greater scrutiny in terms of how they operate in the external environment whilst responding to the expectations of key stakeholders - for example, environmental pressure groups like Greenpeace.

Organisations like PepsiCo and Starbucks must take note of these issues to develop a relationship of trust with their consumers, current and future.
Activity 7: Conducting a PESTLE review

Choose one 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 organisation needs to accommodate over the short and medium term.

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.
Analysing External Environments

Chapter 2

Each of the letters is defined as follows:

- **S** → Strengths
- **W** → Weaknesses
- **O** → Opportunities
- **T** → Threats

**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 reputation
- 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?

Activity 8: 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.
Chapter 2

Analysing External Environments

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.

CASE STUDY: 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.
READING LIST


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 important for an organisation to understand its internal key perspectives and dynamics.

Learning outcomes

On completing this chapter, you will be able to:

3 Discuss how analysing internal environments enables the development of successful business strategies

Assessment criteria

3 Discuss how analysing internal environments enables the development of successful business strategies

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 given organisation
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:

• a home page;
• a navigation bar which facilitates access to other sections;
• 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?
Chapter 3

Analysing Internal Environments

OVER TO YOU

Activity 1: 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 to improve 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 magazines.
Activity 2: Sources of information

Research what sources of information are available in your organisation (or in an organisation 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 mission statement and values

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.
Activity 3: The mission statement

What are your organisation’s mission statement and values (or those of an organisation with which you are familiar)? How well are these recognised and adopted across the organisation?

Here are some examples of some organisations’ mission statements:

AT&T: “To connect people with their world, everywhere they live and work, and do it better than anyone else.”

BMW: “The world's leading provider of premium products and premium service for individual mobility.”

Coca-Cola:
- “To refresh the world
- To inspire moments of optimism and happiness through our brands and actions
- To create value and make a difference.”

Nike: “To bring inspiration and innovation to every athlete in the world.”

Here are some examples of some organisations’ value statements:

Twitter: “To give everyone the power to create and share ideas and information instantly, without barriers.”

L.L.Bean: “Sell good merchandise at a reasonable profit, treat your customers like human beings, and they will always come back for more.”

Bright Horizons Family Solutions: “the HEART principles:
- Honesty,
- Excellence,
- Accountability,
- Respect,
- Teamwork.”
Making it clear

An organisation needs to have a mission statement which is very clear and easy to understand for all its key stakeholders, including the consumers, employees and owners.

A mission statement should:
- describe what the organisation does;
- describe how an organisation carries out its activities;
- state why it does these activities.

Google’s mission statement is:
“To organise the world’s information and make it universally acceptable and useful.”

OVER TO YOU

Activity 4: Mission statements

1. Research two other 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?

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 a set of activities that an organisation carries out to create value for its key stakeholders, for example, customers. 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 affects profits, so Porter’s value chain can help you understand the sources of value in an organisation.

**Elements of Porter’s 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](image)

**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.
Chapter 3
Analysing Internal Environments

OVER TO YOU

Activity 5: 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.

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 structure: this includes management structure (e.g. hierarchical or flat) and unwritten lines of power and influence.
5. Control systems: for example, financial systems, reward and quality systems.
6. Power structures: where the real power lies in the company. For example, with a small number of senior executives, a group of executives or a department.
These six areas are represented as overlapping circles, which influence the overall culture.

![Johnson’s cultural web](image)

**Figure 2:** Johnson’s cultural web

**How to use the cultural web**

The cultural web is used firstly to look at the organisation’s current culture and secondly at how the organisation wants its culture to be. The third step is to identify the differences between the two. The differences that are established are the changes that need to be made to achieve that desired high-performance culture.

We need to remember that identifying a particular culture and looking to change “the way things are done around here” is a very complex scenario that will invariably take time. Some organisations may have a primary culture and sub-cultures (e.g. in different locations or regions) and inevitably any attempt to change an organisation’s culture will be attempted in a context of evolving internal and external environments.

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 6: 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?

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**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 7: 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.

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.

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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

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**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.

![The 5Ms](image)

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.

**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. Currently, for example, IKEA purchases materials from over 1000 suppliers from over 50 countries. Therefore, the management of these supply chains is a key element of their competitive advantage.

McDonald’s, by comparison, has 16 major suppliers with the key performance indicator (KPI) being “no item may be ever out of stock”.

**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.

**Outbound logistics**

IKEA has 34 distribution centres and 13 customer distribution centres spread across 17 countries.

At McDonald’s, great emphasis is given to stock levels at each restaurant, and together with details of inventories, key data is obtained to forecast distribution requirements.
Marketing and sales

For IKEA, this is an organisational function of considerable scale: over 200 million catalogues are produced annually and the IKEA online app was accessed 46 million times in 2014. In addition, IKEA undertakes ongoing sales promotions and media advertising.

Online retailer Amazon is positioned as a truly global operation, with the aim of having an enormous range of products available for delivery throughout the world. Amazon base its marketing strategy on actual consumer behaviour (i.e. purchases) rather than predictive intentions. This has meant that more than 50% of Amazon’s customers are repeat buyers.

Service

All world-class organisations need to offer consistently world-class service for every customer touch point (i.e. via every delivery channel). Examples of world-class customer service providers include Jaguar Land Rover, UK retailer John Lewis, Emirates (Airline), Virgin and Toyota.

CASE STUDY: PORTER’S VALUE CHAIN

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.
Activity 8: Porter’s value chain

1 Select one of the following organisations: IKEA, IROKOTV (Nigeria), MTN (South Africa), Nissan, Safaricom (Kenya) or Unilever.

2 Explore how Porter’s value chain framework can be applied to your chosen organisation in terms of the applications and implications mentioned above.

Activity 9: Key processes and procedures

In your organisation or an organisation of your choice:

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

Applying Johnson’s cultural web in practice

The six categories of this framework are:

• **Stories**: past events and employees who have become part of an organisation’s history and folk law. The type of events and past employees that an organisation recognises and remembers will have a significant impact on current values, attitudes and behaviours.

• **Rituals and routines**: these are the daily activities and behaviours of employees that are considered acceptable (the norm). These norms are usually the same as those valued by the management.

• **Symbols**: this is about the visual representation of an organisation. The brand is an integral part of this, but elements like dress code, premises layout and local surroundings are also important here.

• **Organisational structure**: this is represented by a structure chart or organogram. The organisational structure may be hierarchical (with clearly defined reporting lines and levels of accountability) or flat (with less layers of management). By implication, the type of organisational structure shows sources of power and influence.

• **Control systems**: this framework considers the key parameters of control which probably include financial and quality processes, and reward and recognition schemes.

• **Power structures**: this identifies where the key sources of power are in an organisation. These sources will have a significant influence over organisational strategy and direction.

CASE STUDY: THE APPLICATION OF JOHNSON’S CULTURAL WEB

How does Johnson’s cultural web apply to your organisation?

Having read and reflected around the key elements of Johnson’s cultural web, look to explore how each of the six categories applies in your organisation or an organisation with which you are familiar.
Examples of areas you can explore include:

1. **Stories**
   - What stories are currently being shared around your organisation?
   - What do these stories reveal about your organisation’s core beliefs and values?

2. **Rituals and routines**
   - What are the main expectations of your customers and fellow employees?
   - What attitudes, beliefs and behaviours do these routines promote?

3. **Symbols**
   - What symbols and jargon are used?
   - What type of image is associated with your organisation?
   - What examples of organisational jargon and language can you discover?

4. **Organisational structure**
   - What are the formal and informal lines of authority?
   - Does your organisation adopt a more hierarchical or flat structure?

5. **Control systems**
   - What are the levels of control and checks in your organisation?
   - How are employees rewarded and incentivised?
   - How well are key processes managed and monitored?

6. **Power structures**
   - Where are the key sources of power in your organisation?
   - Who are the key decision makers?
   - What are the key beliefs and values demonstrated by those in positions of power?

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**OVER TO YOU**

**Activity 10: The application of Johnson’s cultural web**

1. **Describe the prevailing structure in your organisation (or in an organisation with which you are familiar).**
2. **Identify the main contributory factors to this culture from all six elements of Johnson’s cultural web.**
Examples of organisational culture

For any organisation which aims to be world-class, a “learning organisation” or an employer of choice, having a positive and vibrant workplace culture is extremely important.

At Adobe, employees are engaged with challenging projects and tasks and are trusted to deliver them. There is an emphasis on trust and employees are well rewarded, whilst being continually developed.

Organisations like Facebook and Google are well known for their unique workplace cultures. Facebook offers a wide range of facilities for its employees, amid a competitive environment. There is a priority given to personal growth and to developing a flatter organisational structure.

Googlers (Google’s employees) are known as being talented and driven, and among the best in the world. With the inevitable stress that is implied from such a competitive and driven workplace culture, Google strives to promote the importance of work-life balance to its employees.

Zappos, an online shoe retailer based in Las Vegas, USA has a reputation for a very positive workplace culture. Every team member is expected to adopt 10 core values and reward is incentivised by delivery. Budget is allocated for specific expenditure on team development and embedding these 10 core cultural values.

OVER TO YOU

Activity 11: Changing an organisation’s culture

Think about and identify your organisation’s culture (or that of an organisation with which you are familiar).

1. What are the realistic changes you would propose?
Consider how these cultural changes would positively impact levels of organisational performance.

Real-world applications of the Boston Consulting Group’s growth share matrix

This matrix is used to gain an understanding of an organisation’s portfolio management and assumes that all brands/products/services can be categorised.

We will look at Unilever as an example and consider how well this framework applies. Briefly, Unilever is the world’s third largest consumer goods organisation (after Nestlé and Proctor and Gamble). It comprises over 400 brands, although it tends to focus on 14 key brands (those that generate the highest income).

**Stars**: brands with a high market share and high market growth. For Unilever, this is where their brands need continued investment to retain their competitive advantage. An example would be Lipton, the world’s best-selling tea brand.

**Cash cows**: brands with high market share and low market growth. This category covers brands that have peaked in terms of sales and may have reached saturation point. For global organisations like Unilever, these types of brand will need little further investment, which means resource can be diverted/prioritised elsewhere. Examples would be Marmite (food spread) and Hellmann’s mayonnaise.

**Problem children**: brands with low market share and high market growth. These brands often become the stars of tomorrow and require higher levels of investment. This is often sourced by the income generated from the cash cows. For Unilever, this has meant resource being invested in brands like Omo (washing detergent) and T2 (an emerging tea brand).
**Dogs**: brands with low market share and low market growth. These are brands which have fulfilled their purpose and in most cases any further investment will be a waste of resource. For Unilever, an example was its SlimFast brand, which it sold in 2014.

We can conclude that global organisations like Unilever, which offer a diverse portfolio of brands, need an ever-evolving balance in all four quadrants of this matrix. This is because all markets are constantly changing, developing, peaking at maturity and at some stage reaching inevitable decline.

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**Activity 12: Applying the growth share matrix**

We have seen how Unilever’s range of key brands can be applied to the BCG growth share matrix.

Now, choose either Proctor and Gamble or Nestlé and research their background.

1. How well can the BCG growth share matrix be applied?

2. Compare your findings above with those for Unilever.
### READING LIST

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).

Learning outcomes

On completing this chapter, you will be able to:

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

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 to competitor analysis
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 1: 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 2: 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](image)

### 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

Porter called these five forces the micro environment, 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 3: 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 4: Applying the VRIN 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.

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.

![Ansoff's Matrix](image-url)

- **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 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.

### 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](image-url)
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 well-specified, 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.

Again, we will see how this framework applies to the realities of an organisation later in this section.

CASE STUDY: APPLYING PORTER’S FIVE FORCES FRAMEWORK TO COCA-COLA

Analysing the five forces

Earlier in this section, we considered the conceptual perspectives of Porter’s five forces and now we can look to see how this may apply to Coca-Cola.

Threat of new entrants/potential competitors: medium pressure

This is a highly competitive sector. Coca-Cola has long held a significant market share with a high element of brand loyalty. There are regular new entrants to the sector, with similar prices, thereby offering greater consumer choice.

Threat of substitute products: medium/high pressure

As above, there is a wide range of consumer choice in the energy/juice market sector. Over time, a key factor for Coca-Cola will be how far its taste is unique and therefore differentiated from its competitors.

The bargaining power of buyers: low pressure

Some of the larger retailers can exert an element of bargaining power, purely because of the quantity required. However, this is offset because of the retailer’s desire to sell Coca-Cola to a very loyal consumer base.
The bargaining power or suppliers: low pressure

The reality is that for any supplier, Coca-Cola will be its largest and most prestigious customer, whom they will obviously wish to retain. This reality will limit levels of supplier bargaining power.

Rivalry amongst existing firms: high pressure

This is a fiercely competitive market, primarily between Coca-Cola and PepsiCo, the two market leaders. Both of these organisations compete for sector dominance by sponsoring high-profile activities and events.

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.

### READING LIST

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.