

BUSINESS ENVIRONMENT

Business enterprises do not function in isolation. They operate within changing environment. Various elements of this environment and changes in them exercise a significant influence on the working and performance of business firms

2.1 MEANING OF BUSINESS ENVIRONMENT

The term business environment means “the aggregate of all the forces, factors and institutions which are external to and beyond the control of an individual business enterprise but which exercise a significant influence on the functioning and growth of individual enterprises.” Keith Davis defines business environment as “the aggregate of all conditions, events and influences that surround and affect business.”

According to Bayard O. Wheeler, business environment refers to “the total of all things external to firms and industries which affect their organisation and operation”.

In the words of Arthur M. Weimer, “business environment encompasses the climate or set of conditions, economic, social, political, or institutional in which business operations are conducted”.

Thus, business environment means all those internal and external factors that have an impact on business.

2.2 NATURE (CHARACTERISTICS) OF BUSINESS ENVIRONMENT

Business environment is characterised by the following features:

1. Aggregative - Business environment is the totality of all the internal and external forces which influence the working and decision-making of an enterprise.

2. Inter-related - Different elements of business environment are closely inter-related and interdependent. A change in one element affects the other elements. Economic environment influences the non-economic environment which in turn affects the economic conditions. For example, economic liberalisation in India since 1991 has opened up new opportunities for private sector and foreign entrepreneurs. Similarly, social pressures against pollution led to the enactment of anti-pollution laws. Therefore, managers should not consider environmental factors in isolation from one another. A holistic approach is necessary for proper understanding of business environment.

3. Dynamic - Business environment is dynamic in nature as it keeps on changing from time to time.

4. General and Specific Forces - Business environment consists of both general and specific forces. General forces such as economic, social, political, legal, natural and technological conditions influence all business enterprises. Specific forces such as investors, customers, competitors, suppliers, etc. affect individual enterprises directly.

5. Relative - Business environment is a relative concept. It differs from country to country and even region to region. Capitalist economies like those of USA and UK have a different kind of environment than communist economies. The nature of economic system in a country affects the environment of business.

6. Inter-temporal - Business environment is also an inter-temporal concept as it changes over time. For example, business environment in India today is much different from that prevailing before 1991. In the short run business environment may remain static. But in the long run, it does change.

7. Uncertain - Business environment is largely uncertain because it is very difficult to forecast the future environment. When the environment is volatile, *i.e.* changes very fast, uncertainty increases.

8. Contextual - Business environment provides the macro framework within which the business firm (a micro unit) operates. The environmental forces are largely those given within which an individual enterprise and its management must function.

Business environment exercises tremendous influence on the working and success of business firms. Different elements of business environment have different types and degrees of influence on business. A factor that has a favourable impact on one firm may adversely effect another firm. Therefore, management of a business enterprise must have a deep understanding and appreciation of the environment. The changes taking place in environment must be continuously monitored to judge their impact on business. Appropriate and timely steps must be taken to face the environmental changes.

2.3 SIGNIFICANCE OF BUSINESS ENVIRONMENT

The survival and success of any enterprise depends upon its inherent capabilities (physical, financial, human and other resources) and its ability to adapt to the changing environment.

It is very important for business firms to understand their environment and changes occurring in it. Business enterprises which know their environment and are ready to adapt to environmental changes would be successful. On the other hand, firms which fail to adapt to their environment are unlikely to survive in the long run. For example, some Indian firms suffered considerably because they failed to appreciate the tightening regulations against environmental pollution. Knowledge of environmental changes is very helpful in the formulation and implementation of business plans. A business can obtain this knowledge through environmental scanning. Environmental scanning is the process by which organisations monitor their relevant environment to identify opportunities and threats affecting their business. With the help of environmental scanning, an enterprise can consider the impact of different events, trends, issues and expectations on its business operations. Firms which systematically analyse and diagnose the environment are more effective than those which do not.

Some of the direct benefits of understanding the environment are given below:

- (i) **First Mover Advantage** - Awareness of environment helps an enterprise to take advantage of early opportunities instead of losing them to competitors. For example, Maruti Suzuki became the leader in small car market because it was the first to recognise the need for small car on account of rising petroleum prices and a large middle class.
- (ii) **Early Warning Signal** - Environmental awareness serves as an early warning signal. It makes a firm aware of the impending threat or crisis so that the firm can take timely action to minimise the adverse effects, if any. For example, 'when new firms entered in the mid segment

cars (threat), Maruti Suzuki increased the production of its Esteem threefold. Increase in production enabled the company to make faster delivery. As a result the company captured a substantial share of the market and became a leader in this segment.

- (iii) **Customer Focus** - Environmental understanding makes the management sensitive to the changing needs and expectations of consumers. For example, Hindustan Unilever and several other FMCG companies launched small sachets of shampoo and other products realising the wishes of customers. This move helped the firms to increase sales.
- (iv) **Strategy Formulation** - Environmental monitoring provides relevant information about the business environment. Such information serves as the basis for strategy making. For example, ITC realised that there is a vast scope for growth in the travel and tourism industry in India and the Government is keen to promote this industry because of its employment potential. With the help of this knowledge, ITC planned new hotels both in India and abroad. Study of environment enables an organisation to analyse its competitors' strategies and thereby formulate effective counter strategies. All strategic decisions such as what business to do, whether to expand or reduce a business, and so on require a thorough understanding of the internal and external environment of the organisation.
- (v) **Change Agent** - Business leaders act as agents of change. They create a drive for change at the gross root level. In order to decide the direction and nature of change, the leaders need to understand the aspirations of people and other environmental forces through environmental scanning. For example, contemporary environment requires prompt decision-making and power to people. Therefore, business leaders are increasingly delegating authority to empower their staff and to eliminate procedural delays.
- (vi) **Public Image** - A business firm can improve its image by showing that it is sensitive to its environment and responsive to the aspirations of public. Leading firms like Reliance Industries, ICICI Bank and others have built good image by being sensitive and responsive to environmental forces. Environmental understanding enables business to be responsive to their environment.
- (vii) **Continuous Learning** - Environmental analysis serves as broad based and ongoing education for business executives. It keeps them in touch with the changing scenario so that they are never caught unaware. With the help of environmental learning managers can react in an appropriate manner and thereby increase the success of their organisations. Knowledge of changing environment can keep the organisation dynamic in its approach.

There are two major components of business environment-micro and macro.

2.4 MEANING AND ELEMENTS OF MICRO ENVIRONMENT

Micro environment or *task environment* refers to those individuals, groups and agencies with which the organisations comes into direct and frequent contact in the course of its functioning. In the words of Philip Kotler, "micro environment consists of the actors in company's immediate environment that affect the performance of the company." Micro environmental factors exercise a direct and intimate influence on the operations of the enterprise. Therefore, it is also known as *Direct Action Environment* or *specific forces* or *Stakeholders*. Micro environment consists of the groups in the company's immediate operating environment which have a stake in the company. However, the micro forces may not influence all the firms in a particular industry in the same manner. For example, one firm's supplier environment may be entirely different from that of another firm which has in-house supplies. Even when all the competing firms in an industry have similar micro environment, their relative success depends on how effectively they face the micro forces.

Micro environment consists of the following elements:

1. Customers - The people who buy a firm's products and services are its customers. A business exists to create and satisfy customers. A firm may have different types of customers like individuals,

households, Government departments, commercial establishments, etc. For example, the customers of a paper company may include students, teachers, educational institutions, business firms and other users of stationery.

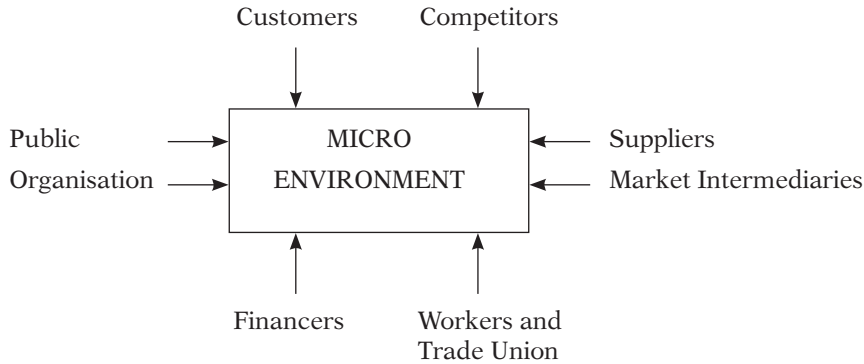


Fig. 2.1: Elements of Micro Environment

In order to be successful a company must understand and meet the needs and expectations of its customers. A firm can select the target customer group or market segment on the basis of factors like profitability, elasticity of demand, dependability, degree of competition and growth prospects. It is generally risky to depend upon a single customer group. The customer environment is becoming global due to increasing globalisation and liberalisation of the economy. With the opening up of Indian market and foreign markets, the customer is becoming more global in the matter of shopping.

2. Competitors - A company may have both direct and indirect competitors. Direct competitors are the other firms which offer the same or similar products and services. For example, Sony TV faces direct competition from other brands like LG, Samsung, Onida, Videocon, BPL, etc. Indirect competition comes from firms vying for discretionary income. For example, a cinema house, faces indirect competition from Casino, and other firms marketing entertainment. Due to economic liberalisation and globalisation, Indian companies are now facing competition from both domestic firms and multinational corporations. In order to understand the full range of its competition, a company must look at from buyers' viewpoint.

3. Suppliers - Suppliers refer to the people and groups who supply raw materials and components to the company. Reliable sources of supply enable the company to carry on uninterrupted operations and to minimise inventory carrying costs. Suppliers also influence quality levels and costs of manufacturing. It is very risky to depend on a single supplier. A strike or any other production problem of the supplier may cause interruptions in manufacturing. Therefore, it is advisable to develop and sustain multiple sources of supply. Some companies like Maruti Suzuki undertake vendor development to ensure timely and regular supply of materials and parts. The relationship between the suppliers and the firm reflects a power equation which is based on the extent to which each of them is dependent on the other.

4. Marketing Intermediaries - Several marketing intermediaries help a company in promoting, selling and distributing its products to consumers. Middlemen like agents, wholesalers, and retailers serve as a link between the company and its customers. Transportation firms and warehouses assist in the physical distribution of products. Advertising agencies, marketing research agencies and insurance companies are other types of marketing intermediaries. Countrywide retail distribution network has contributed significantly to the success of companies like Hindustan Unilever and Dabur India.

5. Financers - The shareholders, financial institutions, debenture holders and banks provide finance to a company. Financial capacity, policies and attitudes of financers are important factors for the company. For example, the company cannot raise funds through shares if the financers are not risk taking.

6. Publics - Publics include all those groups who have an actual or potential, interest in the company or who influence the company's ability to achieve its objectives. Media groups, environmentalists, non-government organisations (NGOs), consumer associations and local community are examples of publics. These publics can have both positive and negative impact on a business firm. For example, media groups can be used to disseminate useful information. A company can cooperate with the local people to improve its image as well as to provide some benefit to the people. On the negative side, local community concerned with public health can force a company to suspend operations or to take pollution control measures. Non- government organisations often organise protests against firms suspected of being guilty for child labour, cruelty against animals and damage to nature. For example, one of the leading companies in India was attacked by the media for writing advertisements on rocks near a famous hill station. Such activities of publics can tarnish the image of business.

7. Workers and Trade Union - Workers and their union are an important component of micro environment. A firm's relations with its workers and trade union have a significant impact on its functioning and performance. Company's work environment and industrial relations system must be conducive to efficient functioning.

According to Philip Kotler, "companies must put their primary energy into effectively managing their relationships with their customers, distributors and suppliers. Their overall success will be affected by how other publics in the society view their activity. Companies would be wise to spend time monitoring all their public, understanding their needs and opinions and dealing with them constructively."

2.5 MEANING AND ELEMENTS OF MACRO ENVIRONMENT

Macro environment refers to the general environment or remote environment within which a business firm and forces in its micro environment operate. A company does not directly or regularly interact with the macro environment. Therefore, macro environment is also known as *Indirect Action Environment*. Forces in the macro environment, however, create opportunities for and pose threats to the company. The macro environment forces are less controllable than the micro forces. Therefore, success of an enterprise depends on its ability to adapt to the macro environment. For example, when there is a substantial increase in the cost of imported raw materials due to depreciation of the Rupee, production of such materials within the country may become necessary.

Macro environment consists of the following components:

- (i) Demographic environment
- (ii) Political and legal environment
- (iii) Social and cultural environment
- (iv) Economic environment
- (v) Technological environment
- (vi) Natural environment
- (vii) Global environment.

1. Demographic Environment : Demographic environment means various dimensions of country's population. The demographic environment is important to business because people constitute the market for a business. Moreover, business management involves management of people and the efficiency of business depends largely on the competence and motivation of its people. Business firms often use demographic factors (e.g., age, sex, family size, occupation, family life cycle, education, social class, income distribution) as the basis of market segmentation. The demographic environment differs from country to country and from one place to another within a country. The demographic factors which have very significant implications for business are as follows:

1. Size and growth rate of population,
2. Age and sex composition of population,
3. Life expectancy,
4. Rate of employment,
5. Density of population,
6. Rural urban distribution,
7. Family size,
8. Ethnic composition,
9. Literacy levels, and
10. Income levels.

2. Economic Environment - The economic environment comprises all those economic forces which influence the functioning of business enterprises, e.g., the nature and structure of the economy, the stage of economic development, economic resources, the level of income, economic policies, distribution of income, etc. The main components of economic environment are as follows:

- (i) The nature of economic system-capitalist, socialist or mixed economy.
- (ii) Economic structure-occupational distribution of labour force, structure of national output, capital formation, investment pattern, composition of trade, balance/imbalance between different sectors, five year plans.
- (iii) Economic policies-industrial policy, export-import policy, monetary policy, fiscal policy, foreign investment and technology policy.
- (iv) Organisation and development of the capital market-banking system, securities markets, etc.
- (v) Economic indices-gross national product, per capita income, rate of savings and investment, price level, balance of payments position, interest rates, etc.
- (vi) Economic infrastructure and stage of development of the economy.
- (vii) Product markets and factor markets-degree of competition, market size, etc.

3. Political and Legal Environment - Political environment comprises the elements relating to Government affairs. It serves as the regulatory framework of business. The main constituents of a country's political and legal environment are as follows:

- (i) The constitution of the country.
- (ii) Political organisation-organisation and philosophy of political parties, ideology of the Government, nature and extent of bureaucracy, influence of primary groups, business donations to political parties, political consciousness, etc.
- (iii) Political stability-structure of military and police force, election system, law and order situation, President's Rule, foreign infiltrations, secessionist activities, etc.
- (iv) Image of the country and its leaders.
- (v) Foreign policy-alignment or non-alignment, relations with neighbouring countries.
- (vi) Defence and military policy.
- (vii) Laws governing business, and legal system.
- (viii) Flexibility and adaptability of laws-constitutional amendments and direction of public policies.
- (ix) The judicial system-implementation and effectiveness of laws.