

CHAPTER 2

Business activity is a fundamental and universal feature of human existence and yet the concept of 'business' is difficult to define with any degree of precision. Dictionary definitions tend to describe it as being concerned with buying and selling or with trade and commerce, or the concern of profit-making organizations, and clearly all of these would come within the accepted view of business. Such a restricted view, however, would exclude large parts of the work of government and its agencies and the activities of non-profit-making organizations – a perspective it would be hard to sustain in a climate in which business methods, skills, attitudes and objectives are being increasingly adopted by these organizations. It is this broader view of business and its activities which is adopted below and which forms the focus of an investigation into the business environment.

While such distinctions are both legitimate and informative, they can conceal the fact that all business organizations are ultimately involved in the same basic activity, namely, the transformation of inputs (resources) into outputs (goods or services). In essence, all organizations acquire resources – including labor, premises, technology, finance, materials – and transform these resources into the goods or services required by their customers. While the type, amount and combination of resources will vary according to the needs of each organization and may also vary over time, the simple process described above is common to all types of business organization and provides a useful starting-point for investigating business activity and the environment in which it takes place. The need, here, is simply to appreciate the idea of the firm as a transformation system and to recognize that in producing and selling output most organizations hope to earn sufficient revenue to allow them to maintain and replenish their resources, thus permitting them to produce further output which in turn produces further inputs. In short, inputs help to create output and output creates inputs. Moreover, the output of one organization may represent an input for another, as in the case of the firm producing capital equipment or basic materials or information or ideas. This interrelationship between business organizations is just one example of the complex and integrated nature of business activity and it helps to highlight the fact that the fortunes of any single business organization are invariably linked with those of another or others.

The firm in its environment

The simple model of business activity described above is based on the systems approach to management. One of the benefits of this approach is that it stresses that organizations are entities made up of interrelated parts which are intertwined with the outside world – the 'external environment' in systems language. This environment comprises a wide range of influences – economic, demographic, social, political, legal, technological, etc. – which affect business activity in a variety of ways and which can impinge not only on the transformation process itself, but also on the process of resource acquisition and on the creation and consumption of output.

In examining the business environment, a useful distinction can be made between those external factors which tend to have a more immediate effect on the day-to-day operations of a firm and those which tend to have a more general influence. The immediate or operational environment for most firms includes suppliers, competitors, labor markets, financial institutions and customers, and may also include trading

organizations, trade unions and possibly a parent company. In contrast the general or contextual environment comprises those macroenvironmental factors such as economic, political, socio-cultural, technological and legal influences on business which affect a wide variety of businesses and which can emanate not only from local and national sources but also from international and supranational developments. This type of analysis can also be extended to the different functional areas of an organization's activities such as marketing or personnel or production or finance. Such an analysis can be seen to be useful in at least two ways. First, it emphasizes the influence of external factors on specific activities within the firm and in doing so underlines the importance of the interface between the internal and external environments. Second, by drawing attention to this interface, it highlights the fact that, while business organizations are often able to exercise some degree of control over their internal activities and processes, it is often very difficult, if not impossible, to control the external environment in which they operate.

The general or contextual environment

A 'PESTLE' (or 'PEST') analysis can be used to analyze a firm's current and future environment as part of the strategic management process.

The political environment

A number of aspects of the political environment clearly impinge on business activity. These range from general questions concerning the nature of the political system and its institutions and processes, to the more specific questions relating to government involvement in the working of the economy and its attempts to influence market structure and behavior. Government activities, both directly and indirectly, influence business activity and government can be seen as the biggest business enterprise at national or local level. Given the trend towards the globalization of markets and the existence of international trading organizations and blocs, international politico economic influences on business activity represent one key feature of the business environment. Another is the influence of public, as well as political, opinion in areas such as environmental policy and corporate responsibility.

The economic environment

The distinction made between the political and economic environment – and, for that matter, the legal environment – is somewhat arbitrary. Government, as indicated above, plays a major role in the economy at both national and local level and its activities help to influence both the demand and supply side. Nevertheless, there are a number of other economic aspects related to business activity which are worthy of consideration. These include various structural aspects of both firms and markets and a comparison of economic theory and practice.

The social, cultural and demographic environment

Both demand and supply are influenced by social, cultural and demographic factors. Cultural factors, for example, may affect the type of products being produced or sold, the markets they are sold in, the price at which they are sold and a range of other variables. People are a key organizational resource and a fundamental part of the market for goods and services. Accordingly, socio-cultural influences and developments have an important effect on business operations, as do demographic changes.

The technological environment

Technology is both an input and an output of business organizations as well as being an environmental influence on them. Investment in technology and innovation is frequently seen as a key to the success of an enterprise and has been used to explain differences in the relative competitiveness of different countries. It has also been responsible for significant developments in the internal organization of businesses in the markets for economic resources.

The legal environment

Businesses operate within a framework of law which has a significant impact on various aspects of their existence. Laws usually govern, among other things, the status of the organization, its relationship with its customers and suppliers and certain internal procedures and activities. They may also influence market structures and behavior. Since laws emanate from government (including supranational governments) and from the judgments of the courts, some understanding of the relevant institutions and processes is desirable.

The ethical environment

Ethical considerations have become an increasingly important influence on business behavior, particularly among the larger, more high-profile companies. One area where this has been manifest is in the demand for firms to act in a more socially responsible way and to consider the impact they might have on people, their communities and the natural environment.