



A Firm's External Macro Environment: PESTEL

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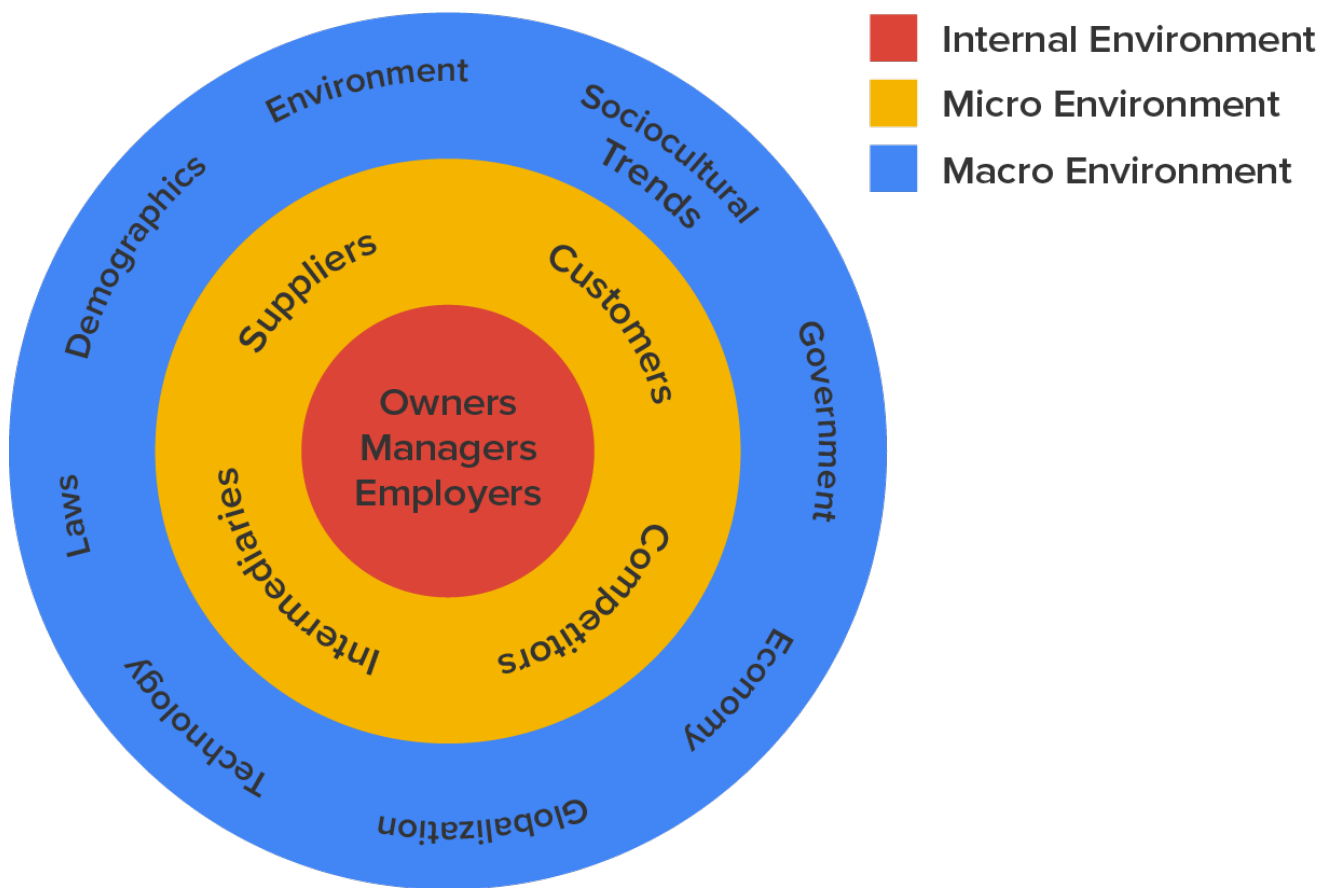


WHAT'S COVERED

In this lesson, you will learn how to articulate a firm's external macro environment and the tools strategists use to understand it. Specifically, this lesson will cover:

1. External Macro Environment

The world at large forms the **external environment** for businesses. A firm must confront, adapt to, take advantage of, and defend itself against what is happening in the world around it to succeed. To make gathering and interpreting information about the external environment easier, strategic analysts have defined several general categories of activities and groups that managers should examine and understand. The diagram below illustrates layers and categories found in a firm's environment.



A firm's **macro environment** contains elements that can impact the firm but are generally beyond its direct control. These elements are characteristics of the world at large and are factors that all businesses must contend with, regardless of the industry they are in or type of business they are. In the diagram above, the macro environment is indicated in blue. Note that the terms contained in the blue ring are all “big-picture” items that exist independently of business activities. That is not to say that they do not affect firms or that firm activities cannot affect macro environmental elements; both can and do happen, but firms are largely unable to directly change things in the macro environment.

☆ BIG IDEA

Strategists study the macro environment to learn about facts and trends that may present opportunities or threats to their firms. However, they do not usually just think in terms of SWOT. Strategists have developed more discerning tools to examine the external environment.

📄 TERMS TO KNOW

External Environment

The world at large forms the external environment for businesses.

Macro Environment

A firm's macro environment contains elements that can impact the firm but are generally beyond its direct control. These elements are characteristics of the world at large and are factors that all businesses must contend with, regardless of the industry they are in or type of business they are.

2. PESTEL and Factor Categories

PESTEL is a tool that reminds managers to look at several distinct categories in the macro environment. Like SWOT, PESTEL is an acronym. In this case, the letters represent the categories to examine: **p**olitical factors, **e**conomic factors, **s**ociocultural factors, **t**echnological factors, **e**nvironmental factors, and **l**egal factors. When using PESTEL to analyze a specific firm's situation, the overlap between different categories of PESTEL factors can sometimes happen just as it can with SWOT.

Remember our earlier example: When urban millennials decide that car ownership is no longer attractive, car manufacturers' sales are threatened. However, those same manufacturers might be able to adapt their sales methods to offer millennials car-sharing services, taking advantage of the opportunity to earn revenue from millennials who want access to cars for vacations or big shopping trips. PESTEL can also reveal multiple impacts from a single element in the external environment.

➔ **EXAMPLE** Decreasing interest in car ownership among urban millennials would be a sociocultural trend. However, the technological connectedness of those same urban millennials is exactly what makes it possible for ride-sharing services such as Uber and Lyft to thrive—their services are app-based and provide convenience both by connecting drivers and passengers quickly and by making transactions cashless.

The table below describes the components of PESTEL, which will be discussed individually below.

| Component of PESTEL | Description |
|-----------------------|--|
| Political Factors | Tax rates, tariffs, trade agreements, labor, and environmental regulations |
| Economic Factors | Employment levels, interest rates, exchange rates |
| Sociocultural Factors | Demographic trends, consumer preferences, market diversity |
| Technological Factors | The internet, smartphones, connectivity, automation |
| Environmental Factors | Resources scarcity, recycling, alternative energy sources |
| Legal Factors | Contracts, laws, intellectual property rights |



TERM TO KNOW

PESTEL

A tool that reminds managers to look at several distinct categories in the macro environment. PESTEL is an acronym with each letter representing categories to examine: political factors, economic factors, sociocultural factors, technological factors, environmental factors, and legal factors.

2a. Political Factors

Political factors in the macro environment include taxation, tariffs, trade agreements, labor regulations, and environmental regulations. Note that in the PESTEL framework, factors are not characterized as opportunities or threats. They are simply things that a firm can take advantage of or treat as problems, depending on its own interpretation or abilities.



DID YOU KNOW

American Electric Power, a large company that generates and distributes electricity, may be negatively impacted by environmental regulations that restrict its ability to use coal to generate electricity because of pollution caused by burning coal. However, another energy firm has taken advantage of the government's interest in reducing coal emissions by developing a way to capture the emissions while producing power. The Petra Nova plant, near Houston, was developed by NRG and JX Nippon, who received Energy

Department grants to help fund the project (Mooney, 2017).



BIG IDEA

Although firms do not directly make government policy decisions, many industries and firms invest in lobbying efforts to try to influence government policy development to create opportunities or reduce threats.



TERM TO KNOW

Political Factors

Include taxation, tariffs, trade agreements, labor regulations, and environmental regulations.

2b. Economic Factors

All firms are impacted by the state of the national and global economies. The increased interdependence of individual country economies has made evaluating the **economic factors** in a firm's macro environment more complex. Firms analyze economic indicators to make decisions about entering or exiting geographic markets, investing in expansion, and hiring or laying off employees. As discussed earlier in this tutorial, employment rates impact the quantity, quality, and cost of employees available to firms. Interest rates impact sales of big-ticket items that consumers normally finance, such as appliances, cars, and homes. Interest rates also impact the cost of capital for firms that want to invest in expansion. Exchange rates present risks and opportunities to all firms that operate across national borders, and the price of oil impacts many industries, from airlines and transportation companies to solar panel producers and plastic recycling companies.



BIG IDEA

Many scenarios can be a threat to one firm and an opportunity to another, so economic factors should not be assumed to be intrinsically good or bad.



TERM TO KNOW

Economic Factors

Firms analyze economic indicators to make decisions about entering or exiting geographic markets, investing in expansion, and hiring or laying off employees.

2c. Sociocultural Factors

Quite possibly the largest category of macro environmental factors an analyst might examine are **sociocultural factors**. This broad category encompasses everything from changing national demographics to fashion trends and many things in between. **Demographics**, a subset of this category, includes facts about income, education levels, age groups, and the ethnic and racial composition of a population. All of these facts present market challenges and possibilities. Firms can target products to specific market segments by studying the needs and preferences of demographic groups, such as working women (they might need daycare services but not watch daytime television), college students (who would be interested in affordable textbooks but couldn't afford to buy new cars), or the elderly (who would be willing to pay for lawn-mowing services but might not be interested in adventure tourism).

Changes in people's values and interests are also included in this category.



DID YOU KNOW

Environmental awareness has spurred demand for solar panels and electric and hybrid cars. A general interest in health and fitness has created industries in gyms, home gym equipment, and organic food. The

popularity of social media has created an enormous demand for instant access to information and services, not to mention smartphones.



BIG IDEA

Values and interests are constantly changing and vary from country to country, creating new market opportunities as well as communication challenges for companies trying to enter unfamiliar new markets.



TERMS TO KNOW

Sociocultural Factors

This broad category encompasses everything from changing national demographics to fashion trends and many things in between.

Demographics

A subset of the sociocultural factors category; it includes facts about income, education levels, age groups, and the ethnic and racial composition of a population.

2d. Technological Factors

The rise of the Internet may be the most disruptive technological change of the last century. The globe has become more interconnected and interdependent because of the fast, low-cost communications and information-sharing the Internet provides.



DID YOU KNOW

Customer service agents in India can serve customers in Kansas because technology has advanced to the point that the customer's account information can be instantly accessed by the service provider in India.

How else have **technological factors** impacted business? The Internet is not the only technological advance that has transformed how businesses operate. Automation has increased efficiency for manufacturers. MRP (materials requirement planning) systems have changed how companies and their suppliers work together, and global-positioning technology has helped construction engineers manage large projects more accurately. Consumers and firms have nearly unlimited access to information, and this access has empowered consumers to make more informed buying decisions and challenged firms to develop ways to analyze the large amounts of data their businesses generate. Developing information technologies, which are soon to become more common across industries, include artificial intelligence and machine learning—which may further transform the way we live and work.



TERM TO KNOW

Technological Factors

This category includes the Internet, automation, and consumer's increased access to information to make buying decisions.

2e. Environmental Factors

The physical environment, which provides natural resources for manufacturing and energy production, has always been a key part of human business activity. As resources become scarcer and more expensive, **environmental factors** impact businesses more every day. Firms are developing technology to operate more cleanly and using fewer resources. Political pressure on businesses to reduce their impact on the natural environment has increased globally and dramatically in the 21st century.

➔ **EXAMPLE** In 2017, London, Barcelona, and Paris announced their plans to ban cars with internal combustion engines over the next few decades, in order to combat air quality issues (Smith, 2017).

This external environment category often overlaps with others in PESTEL because concern for the environment is also a sociocultural trend, as more consumers look for recycled products and buy electric and hybrid cars. On the political front, firms are facing increased regulation around the world on their carbon emissions and natural resource use. Although SWOT would characterize these factors as either opportunities or threats, PESTEL simply identifies them as aspects of the external environment that firms must consider when planning for their futures.



TERM TO KNOW

Environmental Factors

The physical environment, which provides natural resources for manufacturing and energy production.

2f. Legal Factors

Legal factors in the external environment often coincide with political factors because laws are enacted by government entities. This does not mean that the categories identify the same issues, however. Although labor laws and environmental regulations have deep political connections, other legal factors can impact business success.



DID YOU KNOW

In the streaming video industry, licensing fees are a significant cost for firms. Netflix pays billions of dollars every year to movie and television studios for the right to broadcast their content. In addition to the legal requirement to pay the studios, Netflix must consider that consumers may find illegal ways to view the movies they want to see, making them less willing to pay to subscribe to Netflix.

Intellectual property rights and patents are major issues in the legal realm.

Note that some external factors are difficult to categorize in PESTEL. For instance, tariffs can be viewed as either a political or economic factor while the influence of the Internet could be viewed as either a technological or social factor. While some issues can overlap two or more PESTEL areas, it does not diminish the value of PESTEL as an analytical tool.



HINT

You will perform a Macro Environment Analysis of your chosen organization and apply the PESTEL framework to identify 1-3 relevant factors. Using the PESTEL framework for strategic analysis will help you gain a better understanding of your organization's external environment, and strengthen your overall presentation for the Touchstone assignment.



REFLECT

1. Describe a firm's macro environment.
2. What does PESTEL stand for? How do managers use PESTEL to understand their firm's macro environment?



TERM TO KNOW

Legal Factors

Laws and regulations that can impact business success. These factors commonly have deep political connections.



SUMMARY

In this lesson, you learned to how to articulate a firm's **external macro environment** and the tools strategists use to understand it. The world at large forms the external environment for businesses, while a firm's macro environment contains elements that can impact the firm but are generally beyond its direct control. These elements are “big-picture” items that exist independently of business activities. You learned that strategists study the macro environment to learn about facts and trends that may present opportunities or threats to their firms, utilizing a tool called **PESTEL**, which is an acronym that represents the **factor categories** to examine in the macro environment: **political factors**, **economic factors**, **sociocultural factors** (like demographics), **technological factors**, **environmental factors**, and **legal factors**. Remember, when using this tool, overlap between different categories of PESTEL factors can sometimes happen, similar to SWOT, and in the PESTEL framework, factors are not characterized as opportunities or threats—they are simply things that a firm can take advantage of or treat as problems, depending on its own interpretation or abilities.

Best of luck in your learning!

Source: Access for free at <https://openstax.org/books/principles-management/pages/1-introduction>

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TERMS TO KNOW

Demographics

A subset of the sociocultural factors category; it includes facts about income, education levels, age groups, and the ethnic and racial composition of a population.

Economic Factors

Firms analyze economic indicators to make decisions about entering or exiting geographic markets, investing in expansion, and hiring or laying off employees.

Environmental Factors

The physical environment, which provides natural resources for manufacturing and energy production.

External Environment

The world at large forms the external environment for businesses.

Legal Factors

Laws and regulations that can impact business success. These factors commonly have deep political connections.

Macro Environment

A firm's macro environment contains elements that can impact the firm but are generally beyond its direct control. These elements are characteristics of the world at large and are factors that all businesses must contend with, regardless of the industry they are in or type of business they are.

PESTEL

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Political Factors

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Sociocultural Factors

This broad category encompasses everything from changing national demographics to fashion trends and many things in between.

Technological Factors

This category includes the Internet, automation, and consumer's increased access to information to make buying decisions.