EXTERNAL INFLUENCES ON BUSINESS ACTIVITY (1.6)

(Chapter 8 - A level 1.6)

In most countries – for both political and social reasons – governments introduce laws that constrain business decisions and activities. These laws fall into 4 main categories - **consumer laws**, **employment laws**, **competition laws** and **planning / environmental laws**.

- **Consumer laws** - such as laws regarding **product safety**, the right to have faulty products **replaced or refunded**, **non-misleading advertising** etc. Following these laws will add to business costs, due to costs of replacing/refunding, having to spend more on production and materials as well as being unable to lie in advertisements. However, the benefits of following consumers laws are avoiding fines and customers will view the business as reliable and trustworthy

- **Employment laws** - laws such as **minimum wage**, **health and safety**, **right to holiday + pensions**, **anti-discrimination** and **trade union rights** (depending on the country.) Following these laws will again add to costs, like having to pay no lower than the minimum wage, paying for improved safety equipment and having to monitor employment/recruitment to ensure against discrimination. However, the benefits to the business of following these laws are staff will be more motivated and loyal, make less mistakes and the business can advertise itself as ethical while avoiding bad publicity

- **Competition laws** - laws that will prevent businesses from engaging in **monopolistic behaviour** (complete ownership or control of the entire supply of goods or a service in a certain market, which gives them too much power - i.e they can charge a very high price and consumers will have no other options.) Businesses won't be able to 'fix' prices or engage in uncompetitive actions, certain mergers and takeovers may be stopped to prevent monopoly. Customers may prefer to deal with businesses that compete fairly.

- **Planning and environmental laws** - restrictions on where businesses can set up **location** (like in areas of natural beauty) or **pollution permits** - which put a limit on how much a firm is allowed to pollute the environment. This will add to certain costs, like businesses may not be able to set up in cheaper more convenient areas because of planning restrictions, or they will have to pay more to be able to pollute more. Following these laws will reduce the risk of businesses being accused of damaging the environment, and they can even promote themselves as being environmentally ethical.

Additional info :

Social audit : a report on the impact a business has on society – this can cover pollution levels, health and safety record, sources of supplies, customer satisfaction and contribution to the community

Government

Here, we'll look at the **macro-economic** objectives a government might have and how their absence/negligence will affect the economy as well as businesses. Economic objectives like :

- **Maintain economic growth**: economic growth occurs when a country's Gross Domestic Product (GDP) increases i.e. more goods and services are produced than in the previous year. This will increase the country's incomes and achieve greater living standards.

Effects of reducing GDP (recession):

- ❖ As output falls, fewer workers will be needed by firms, so unemployment will rise
- ❖ As goods and services that can be consumed by the people falls, the standard of living in the economy will also fall

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- **Achieve price stability**: inflation is the increase in average prices of goods and services over time. (Note that inflation, in the real world, always exists. It is natural for prices to increase as the years go by. In the case there is a fall in the price level, it is called a deflation) Maintaining a low inflation will help the economy to develop and grow better.

Effects of high inflation:

- ❖ As cost of living will have risen and peoples' real incomes (the value of income) will have fallen (when prices increase and incomes haven't, the income will buy lesser goods and services- the purchasing power will fall).
- ❖ Prices of domestic goods will rise as opposed to foreign goods in the market. The country's exports will become less competitive in the international market. Domestic workers may lose their jobs if their products and firms don't do well.
- ❖ When prices rise, demand will fall and all costs will rise (as wages, material costs, overheads will all rise)- causing profits to fall. Thus, they will be unwilling to expand and produce more in the future.
- ❖ The living standards (quality of life) in the country may fall when costs of living rise.

- **Reduce unemployment**: unemployment exists when people who are willing and able to work cannot find a job. A low unemployment means high output, incomes, living standards etc.

Effects of high unemployment:

- ❖ Unemployed people do not produce anything and so, the total output/GDP in the country will fall. This will in turn, lead to a fall in economic growth.
- ❖ Unemployed people receive no incomes, thus income inequality can rise in the economy and living standards will fall. It also means that businesses will face low demand due
- ❖ The government pays out unemployment benefits to the unemployed and this will rise during high unemployment and the government will not have enough money left over to spend on other services like education and health.

- **Maintain balance of payments stability**: this records the difference between a country's exports (goods and services sold from the country to another) and imports (goods and services bought in by the country from another country). The exports and imports need to equal each other, thus balanced.

Effect of a disequilibrium in the balance of payments:

- If the imports of a country exceed its exports, it will cause **depreciation** in the exchange rate– the value of the country's currency will fall against other foreign currencies
- If the exports exceed the imports it indicates that the country is selling more goods than it is consuming- the country itself doesn't benefit from any high output consumption.

- **Reduce income equality** : the difference/gap between the incomes of rich and poor people should narrow down for income equality to improve. Improved income equality will ensure better living standards and help the economy to grow faster and become more developed.

Effects of poor income equality:

- Unequal distribution of goods and services- the poor cannot buy as many goods as the rich- poor living standards will arise

Policies used to achieve these macroeconomic objectives :

■ **Fiscal policy** - the use of government spending and taxation to influence the economy. Governments typically use fiscal policy to promote strong and sustainable growth and reduce poverty.

The two major examples of fiscal policy are **tax cuts** and **increased government spending**, which will encourage more production and increase employment, driving up GDP growth.

- This is because government spending creates employment and **increases economic activity** in the economy and lower taxes means people have more money to consume and firms have to pay lesser tax on their profits

■ **Monetary policy** - a government policy that adjusts the interest rate and foreign exchange rates to influence the demand and supply of money in the economy, and thus demand and supply.

It is usually conducted by the country's central bank and usually used to maintain price stability, low unemployment and economic growth.

- Reducing interest rates will boost investment, consumption, employment, and thus GDP.

Government policy change	Possible business decision	Problems with this decision
Increase income tax – this reduces the amount consumers have to spend	Lower prices on existing products to increase demand Produce 'cheaper' products to allow for lower prices	Less profit will be made on each item sold (reduces gross profit margin) The brand image of a product might be damaged by using cheaper versions of it
Increase tariffs on imports	Focus more on the domestic market as locally produced goods now seem cheaper Switch from buying imported materials and components to locally produced ones	It might still be more profitable to export Foreign materials and components might be of higher quality
Increase interest rates	Reduce investment so future growth will be less Develop cheaper products that consumers will be better able to afford Sell assets for cash to reduce existing loans	Other companies might still grow so market share will be lost Depends on the product but could consumers start to think that the quality and brand image are lower? The assets might be needed for future expansion

How do governments support businesses?

Businesses (both small and large) contribute to the growth of the economy, provide jobs and pay taxes to the government. Therefore the state will in some situations choose to help them :

- **Organise advice**: provide business advice to potential entrepreneurs, giving them information useful in starting a venture, including legal and bureaucratic ones
- **Provide low cost premises**: provide land at low cost or low rent for new firms
- **Provide loans at low interest rates**
- **Give grants for capital** : provide financial aid to new firms for investment
- **Give grants for training** : provide financial aid for workforce training
- **Give tax breaks/ holidays** : high taxes are a disincentive for new firms to set up. Governments can thus withdraw or lower taxation for a certain period of time

How demographic changes affect business activity

In almost all countries there are significant changes to demographics. Below are the ways that these demographic changes may positively and negatively affect businesses.

- **Rapidly increasing population** - means increased potential market (more people to sell to) and increased potential workforce (more people looking for jobs) it also however means increased demand of land for expansion
- **Ageing population** - there is an increased demand for 'old-age' related products, older customers tend to be more resistant to change

- **More women in the workforce** - greater potential workforce, but there will be increased levels of maternity leave/pay
- **Increased immigration** - more cultural diversity in the workforce, more demand for culturally specific products, but existing products/policies may have to be changed

Corporate social responsibility

Refers to the concept that states businesses should consider society's interests in its activities and decisions, rather than only focusing on what shareholders want.

CSR issues could include :

- **Business decisions that affect the environment** - should businesses protect the environment for future generations even if this adds to costs and reduces profits?
- **Social and environmental auditing** - should businesses truthfully report on their social and environmental impacts even if it paints them in a negative light?
- **Accurate financial accounting** - should businesses 'window dress' their financial statements and accounts? Making them look better than they are?
- **Not paying or accepting incentives (bribes)** - should businesses compete fairly?

Environmental audits are a part of a business's CSR report (its social audit). It is a report assessing the impact of a business's activities on the environment.

Benefits of environmental audits :

★ Showcases the efforts made by the business to reduce its negative environmental impact - such as using less energy, producing less waste, reducing carbon footprint etc.

★ Informs stakeholders (the public) of these efforts, which will reduce bad publicity and **pressure group** activity

Limitations of environmental audits :

➢ Not legally required in all countries - if you don't have to spend time and money producing it then why would you?

➢ Can result in bad publicity and increase pressure group activity if the results are negative… The report must be truthful otherwise it'll be even worse for the business. It's one thing to be bad but it's another thing entirely to try and cover up how awful you are

Pressure groups are organisations created by individuals who aim to hold businesses and governments accountable for their negative actions and to apply pressure on them in order to bring about positive change.

- If a pressure group has many members it can organise a consumer ‘boycott’ of a certain business - where no one will purchase their products/services until they do XYZ
- If the company that is being pressured is short on resources, like cash, they will want to comply with demands in order to maintain profits
- They also have influence over the government through ‘lobbying’ - any attempt to influence government decision-making. If the objectives are popular enough and there is money to finance campaigns you can effectively convince gov. officials to do stuff

Technology in business

New technology has a range of advantages and disadvantages for businesses and business stakeholders. It is important for businesses to assess the risk and make informed decisions about whether to use the latest technology.

Advantages of new technology include:

- **Easier**, **faster** and more **effective communication** (through the internet, phones etc.)
- Better, **more efficient manufacturing and stock management techniques**
- **Less wastage** - machines make less mistakes
- More effective **marketing and promotion** - marketing ads on the internet can help reach a vast audience of potential customers

Disadvantages of new technology include:

- **Increased dependency** on technology - which is not always reliable
- Often **large initial costs** involved with using the latest technology
- increased risk of **job cuts** - certain positions being made redundant
- **Closure** of high street stores in favour of online business
- **Security risk** in relation to data and fraud - hacking, viruses etc.
- Can go down or have faults, which can stop all business operations instantly

Exchange Rates

The **exchange rate** is the price of one currency in terms of another currency.

For example, €1= $1.2. To buy one euro, you'll need 1.2 dollars. The demand and supply of the currencies determine their exchange rate. In the above example, if the €'s demand was greater than the $'s, or if the supply of € reduced more than the $, then the €'s price in terms of $ will increase. It could now be €1= $1.5. Each € now buys more $.

A currency **appreciates** when its value rises. The example above is an appreciation of the Euro. A European exporting firm will find an appreciation disadvantageous as their American consumers will now have to pay more $ to buy a €1 good (exports become expensive).

A currency **depreciates** when its value falls. In the example above, the Dollar depreciated. An American exporting firm will find a depreciation advantageous as their European consumers will now have to pay less € to buy a $1 good (exports become cheaper).

In summary, an **appreciations is good for importers**, bad for exporters; a **depreciation is good for exporters**, bad for importers; given that the goods are price elastic (if the price didn't matter much to consumers, sales and revenue would not be affected by price- so no worries for producers.