**Why study business environment in MBA?**

Businesses are part of the society they operate in. In addition, they also have their own system within. They are affected by both internal and external environment. Businesses need to thrive within the dynamics that these environments create. Many environmental dynamics are outside their control. It is, therefore, necessary for businesses to either adapt to them or try and make the environment favorable to them. In doing either of these, businesses need to know the causes of the environmental dynamics. It is for this reason knowledge of business environment analysis becomes essential in a business administration studies.

Business environment analysis is not just a set of techniques or combination of tools. The tools and techniques certainly help collect facts, but ultimately it is the quality of the intuitive judgment that really matters. Business environment analysis in effect, therefore, is a skill. The first and foremost necessity of this skill is being informed. Information is the key to analysis and an open mind is necessary to see the opportunity that the information indicates.

Therefore, we will not just discuss the concepts, facts and the techniques, we shall equally and— perhaps more—discuss about the real-life examples of Nepal and of any other countries in the similar situation.

**Concept of business environment**

“Business environment is the aggregate of all conditions, events and influences that surround and affect a business.” – Keith Davis.

People often consider events or actions of people or rumors as irrelevant for their businesses because they do not even remotely concern them. Take example of an event of theft in a neighborhood residential area. It would appear obvious that an isolated instance of a theft in a residential area is not really a matter of concern for a large business having headquarters in a most secured place in the capital city. Some people might simply ignore it. But the fact of the matter is that it indicates a tendency, perhaps a threat to businesses as well in the longer term no matter how protected they are. This is where the skill is required. This is effectively an art of making right judgment and making right moves before the threat becomes a reality.

**Business system and environment**

A business system naturally means converting inputs into outputs. No matter what kind of business one talks about—a merchandising or manufacturing or service, the essence is that a set of given inputs are needed to bring about another set of outputs. The business environment is all about the dynamics surrounding inputs, processes and outputs.

In technical classification, the input and output may belong to external environment whereas process would, in many cases, belong to internal environment.

***Classification of business environment***

The study of classification is necessary for making proper business environment analysis. Classification can be done in a number of ways and it is necessary to choose right classification to make meaningful analysis of any environmental issue.

**Why classification?**

Events and conditions can be classified in different ways because our reaction to those events and conditions change when classification changes. For example, when COVID-19 pandemic emerged, this pandemic could be classified in different ways. One approach is to classify this as a threat, another approach is to classify as an opportunity. The behavior of businesses will be one when it is treated as a threat and another when it is thought as an opportunity.

Proper classification leads to right behavior/reaction and possibly right solution.

Business environment can be classified from different perspectives. A brief outline of in how ways business environment can be classified has been presented below.

1. **From the standpoint of ability to exercise control**:

This classification is based on how far a company can exercise control over environmental developments. On this basis, business environment can be classified into:

* Operating environment and
* Remote environment

Operating environment includes issues and agencies upon which a business entity can have some, if not all, control. Trade unions, suppliers, customers and the likes are part of the operating environment. Companies have some degrees of control or some leverage in relation to the issues related to these parties.

Remote environment includes issues and agencies totally independent of the business entity and, therefore, a business can at best adapt to the given environment as given. There can be indirect influences, but there is hardly any scope of direct influence on the remote environment. For instance, global financial crisis that affected foreign investment flow to Nepal or Nepal’s tourism industry, there’s hardly anything a large hydropower developer or a deluxe hotel in Nepal can do to avert the negative consequences of such a development. In such a situation, the best one can do is to try to adapt and survive.

1. **From the standpoint of territorial jurisdiction**:

* Domestic and
* International environment

Domestic laws, institutions and government are something that a business located and operating in a country can have some influence over.

International environment is the result of a combination of a number of factors and often very complex. Even a business having all operations within a country can be affected by international environment. Economic or financial issues mostly affect through different transmission channels. Other influences come because of bilateral government to government treaties or multilateral treaties or conventions.

1. **From the standpoint of effect on a particular business**:

* General environment, and
* Task environment

General environment is something within which all kinds of businesses need to operate. For example, political environment of a country affects all industries and businesses, the intensity of effect between businesses may be different.

The task environment relates particularly to a business and task environment of one category of business may be different from that of another. For example, for a cement industry how government allocates mining resources affects supply of their critical raw material. But a decision on mining resource allocation does not in any way affect and ICT business or perhaps banking business.

General environment can be either “market environment” or “non-market environment”. Increasingly, nonmarket environment, such as, issues concerning human rights, climate change, environmental concerns, inclusion, etc. have become very important for all businesses. It can sometimes be fatal if nonmarket issues are ignored.

**Components of business environment**

For the purpose of the systematic analysis of business environment, we can classify the environment into:

* Internal environment, and
* External environment

**Internal environment**

Internal environment consists of the issues and agencies within which the business entity operates. Business entity deals with them almost on a daily basis. If a business cannot properly handle the dynamics of internal environment, then it faces problems in smooth operation. Internal environment comprises the following:

* Employees: Every individual employee is distinct from the department or unit he/she is working. He/she is also distinct from the union he/she is associated with. Employees have aspirations from the company. They are part of the society; therefore, they are influenced by the developments happening in the broader society. Their behavior, attitude to work and their productivity are influenced by a host of factors outside of company.
* Structure: The structure of the company or how the company is organized influences the dynamics of the management, because the units or departments or branches are all manned by people. A wrongly designed structure may make organization less efficient. It is for this reason, whenever management notices inefficiencies or lack of co-ordination, they reorganize.
* Corporate culture: Corporate culture is an invisible force that binds all together, which evolves either through formal training provided by the organization or through the traditions built by staff groups. There are also social influences on the corporate culture.
* Shareholders: Shareholders are the owners, but they do not run the day to day operations, therefore, they remain a strong oversight force.
* Unions: Individual employees and their formal organization in the form of Union are to distinct forces influencing the environment businesses operate in. Individual employees mostly operate under the set of rules while Unions often can challenge the rules.

**External environment**

External environment can further be classified into General Environment and Task Environment. In many ways, task environment is just like operating environment. General environment affects all businesses, but the intensity of effect may be different. Task environment is different between different businesses.

* General environment
  + Economic
  + Socio-cultural
  + Political
  + Legal
  + Technological
  + Global
* Task environment
  + Customers
  + Suppliers
  + Distributors
  + Government
  + Special interest groups
  + Financial institutions
  + Media
  + Competitors

**Why study business environment**: Business environment analysis is basically done for the following five reasons.

* **Strategy formulation**: Every business needs to formulate strategy for its operations. This includes sourcing of materials and services, expanding market, setting prices, choosing the technology, etc. Businesses need to prepare strategy to deal with each of such issues. No strategy can be permanent, it needs to be revised whenever there’s change in the environment.
* **Competitive analysis**: Competition comes in different forms even for businesses that may apparently have monopoly. Rise of alternative technologies have posed challenge to even absolute monopolies in the past. It is for this reason business environment analysis is necessary.
* **Adaptability**: In many cases, businesses may not any leverage in the emerging business environment. The best approach would be to devise ways to adapt to the changes. A proper strategy for adapting can be developed only after thorough analysis of the business environment.
* **Stability**: Future is never certain because several unforeseen events can happen leading to different consequences. A timely analysis of the environment can help businesses cope up with the emerging developments and bring some kind of stability in operations.
* **Dynamism**: A rigorously done environment analysis can always be helpful in developing right strategy so that business can be proactive in taking right steps.

**Environment analysis:**

Business environment analysis exercise isn’t same for all types of companies. Different businesses are subject to different environmental influences. A garment or apparel factory may not have much legal issues, while for a highly regulated sector, such as, banking business face legal issues all the time. Most businesses may not have any ecological or environmental issues, but a cement factory or a thermal power plant or a chemical factory certainly needs to accord high priority to environmental or ecological issues. Which of the environmental issues is prominent depends also upon the location of the business.

It is for this reason, based on the need, business environmental analysis takes into consideration only those elements that are necessary in order of priority. For example, in PEST, political issues carry highest importance followed by economic, social and technological. Such combinations can be listed as follows:

**PEST**: political, economic, social, and technological analysis

**PESTLE**: Political, economic, social, technological, legal and environmental analysis

**STEEPLE**: social, technological, economic, environmental, political, legal, and ecological analysis

**SLEPT**: Social, legal, economic, political and technological analysis

**STEPE**: Social, technological, economic, political and environmental analysis

**ETPS**: economic, technological, political and social analysis

**Environmental scanning**

Business environment consists of both external and internal factors. Environment must be scanned to determine development and forecasts of factors that will influence success of the entity. Environmental scanning refers to possession and utilization of information about occasions, patterns, trends, and relationships within an entity’s internal and external environment.

It helps managers to chart out future path of the entity. Scanning must identify the threats and opportunities existing in the environment. While strategy formulation, an organization must take advantage of the opportunities and minimize the threats. A threat for one entity may be an opportunity for another. It is about the examination of internal and external environment.

**The external environment is generally observed through**:

* Personal experience
* Journals
* Reports
* Professional meetings
* Board members
* Employees
* Other sources

**The internal environment is generally observed through**:

* Reports
* Conferences
* Committees
* Employees
* Outsiders
* Memoranda: A paper where issue concerning a decision are written.
* Other sources

**Scanning methods**:

* **Extrapolation method**: In mathematics, extrapolation is a type of estimation beyond the original observation range. Suppose a printing press is trying to examine the business environment and prospect during the year of general election in Nepal planned for year 2023. In this case, the best approach would be to tabulate
* **Historical analogy**: The effect or impact of an event or emerging new condition is analyzed on the basis of what had happened in exactly similar the situation in the past. For instance, if CPN (Maoist)—Biplaw faction announces public strike all over Nepal, then retail businesses and public transport operators, in general, presume that there will be violence and destruction based on the analogy of the past. The analogy is developed using principles of reasoning—either Inductive Logic or Deductive Logic.

When a conclusion is arrived at based on a sample of event or events or a specific case, then there is inductive reasoning. For instance, a person died. The cause diagnosed was a new strain of SARS Cov-2 virus. The conclusion that may be arrived is that everyone who contacts SARS Cov-2 will die. In this case, a larger premise is built on the foundation of a smaller premise.

On the contrary, when you draw conclusions on the basis of a universal premise, such as, every time there’s black cloud over Kathmandu sky, it rains. Today, there’s black cloud, therefore, there will be rain. This reasoning is deductive from a larger premise to a smaller premise.

* **Intuitive reasoning**: This is based on perceptions that are firmly built in our minds. For example, when somebody serves a cup of coffee, even without touching we tend to assume that it is hot. It is known as unconscious cognition, such as, when you pull up the bicycle break you so promptly drop your foot off the paddle. In business environment analysis, the intuitive reasoning people often use relates to what policies will the government take if a particular party wins the election.
* **Scenario building**: Oftentimes this is a diagrammatic presentation of possible sequences of events. This might also be in the form of a matrix identifying consequences of two parallel evens. One example of scenario building is as follows:

**Virus Pandemic breaks**

* **Cross-impact matrix**: This is tool that can help forecasting how different variables may influence the future events. An example is given below with four variables and how they interact.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | A | B | C | D |
| Petroleum price rises (A) | x | 0.5 | 0.75 | 0.25 |
| People will switch to EVs (B) | 0 | x | 0 | 0.5 |
| Petroleum supply will be constrained (C) | 0 | 0 | x |  |
| Load shedding will increase (D) | 0.25 | 0.5 | 0.75 | x |

* **Network methods**: Generally either of the two methods is used, Critical Path Method or PERT Method. In both the cases, sequence of events necessary to complete a work or project is identified along with the duration required. These methods are useful in timely completion of projects by focusing the on the most important element of the project.
* **Model building**: This approach mostly involves “systems thinking approach”, which basically means looking at a problem from its wider perspectives. For example, sales of cold drinks increases when the temperature rises. This represents a two-way relationship. Higher temperature means higher sales of cold drinks and higher sales of cold drinks would indicate that people find weather very hot. However, higher sales of cold drinks could be because of a several different factors. Considering these several different factors, such as, festivities, purchasing power of people, changing attitude, etc. also affect sales of cold drinks. In a model, a relationship is developed between a dependent variable and several different independent variables. Based on the model, forecasting can be done.
* **Delphi technique**: This is a technique of soliciting opinions from interlocutors, professionals, experts, etc., who have knowledge of the environment. A group of people are invited to a brainstorming session to discuss on certain environmental issue. It may be on political or economic or any other environmental issue. Typically in a day or little more the group will discuss the matter, which is then transcribed and sent to the same group for review. After a few weeks, the same group is invited for another brainstorming session where the note prepared after the first session will again be discussed. This way, the analysis will be better. The word Delphi comes from Greek mythology, Oracle of Delphi. This was developed for the purpose of military technology forecasting in the 1950s under the Project RAND.

**Five-forces Model**

This model for environmental analysis developed by Harvard Professor Michael Porter does not talk about adapting to the environment, but about analyzing and acting in ways that can shape and change the firm’s environment. The five forces, namely, barrier to entry, suppliers, substitute products, customers affect the competition in the industry. They are rated from low to moderate to high.

This analysis is good from the standpoint of developing strategy for business.

The first step to understanding competitive environment, a firm must always identify its competitors. Competition pushes profits down because firms always compete by reducing prices.

The potential for making entry into an industry is another factor that determines the nature of competition. If entry is difficult, then there will be less competition.

Suppliers are equally powerful in making or breaking the business. They can increase the price of supplies.

The risk of substitute products emerging or taking over one’s product is just a threat as the competition itself.

Customers, certainly, are the most powerful.

**SWOT Analysis**

This analysis is done normally after the environment scanning results are analyzed.

SWOT Analysis can be approached in two ways: (a) bringing people together to think through strategy formulation informally, or (b) as a more sophisticated and formal tool.

In either case, it is appropriate to gather a team of people from a range of functions and levels in your organization for a brainstorming session. Depending upon the number of people invited and issues at hand, the brainstorming session can take one full day or more. Along the discussion, a list of ideas will come up about where your organization currently stands. Every time you identify a Strength, Weakness, Opportunity, or Threat, write it down in the relevant part of the grid.

To clarify which section an idea belongs to, it may be useful to think of **Strengths and Weaknesses as internal factors** – that is, to do with the organization, its assets, processes, and people.

**Opportunities and Threats normally are external factors, mostly coming from market, and the wider domestic and global economy**.

In the following sections we will discuss what questions you could ask as part of your analysis.

**Strengths**

Strengths are things that your organization does particularly well, or in a way that distinguishes you from your competitors. Think about the advantages your organization has over other organizations. These might be the motivation of your staff, access to certain materials, or a strong set of manufacturing processes.

Your strengths are an integral part of your organization, so think about what makes it "tick." What do you do better than anyone else? What values drive your business? What unique or lowest-cost resources can you draw upon that other can't? Identify and analyze your organization's [Unique Selling Proposition](https://www.mindtools.com/pages/article/newTMC_11.htm)  (USP) and add this to the Strengths section.

Then turn your perspective around and ask yourself what your competitors might see as your strengths. What factors mean that you get the sale ahead of them?

Remember, any aspect of your organization is only a strength if it brings you a clear advantage. For example, if all of your competitors provide high-quality products, then a high-quality production process is not a strength in your market: it's a necessity.

**Weaknesses**

Now it's time to consider your organization's weaknesses. Be honest! A SWOT Analysis will only be valuable if you gather all the information you need. So, it's best to be realistic now, and face any unpleasant truths as soon as possible.

Weaknesses, like strengths, are inherent features of your organization, so focus on your people, resources, systems, and procedures. Think about what you could improve, and the sorts of practices you should avoid.

Once again, imagine (or find out) how other people in your market see you. Do they notice weaknesses that you tend to be blind to? Take time to examine how and why your competitors are doing better than you. What are you lacking?

### Opportunities

Opportunities are openings or chances for something positive to happen, but you'll need to claim them for yourself!

They usually arise from situations outside your organization and require an eye to what might happen in the future. They might arise as developments in the market you serve, or in the technology you use. Being able to spot and exploit opportunities can make a huge difference to your organization's ability to compete and take the lead in your market.

Think about good opportunities you can spot immediately. These don't need to be game changers: even small advantages can increase your organization's competitiveness. What interesting market trends are you aware of, large or small, which could have an impact?

You should also watch out for changes in government policy related to your field. And changes in social patterns, population profiles, and lifestyles can all throw up interesting opportunities.

### Threats

Threats include anything that can negatively affect your business from the outside, such as supply chain problems, shifts in market requirements, or a shortage of recruits. It's vital to anticipate threats and to take action against them before you become a victim of them and your growth stalls.

Think about the obstacles you face in getting your product to market and selling. You may notice that quality standards or specifications for your products are changing, and that you'll need to change those products if you're to stay in the lead. Evolving technology is an ever-present threat, as well as an opportunity!

Always consider what your competitors are doing, and whether you should be changing your organization's emphasis to meet the challenge. But remember that what they're doing might not be the right thing for you to do and avoid copying them without knowing how it will improve your position.

Be sure to explore whether your organization is especially exposed to external challenges. Do you have bad debt or cash-flow problems, for example, that could make you vulnerable to even small changes in your market? This is the kind of threat that can seriously damage your business, so be alert.