Need, Characteristics, and Categorization of Environmental Factors

Meaning

Environmental analysis is a strategic tool. It is a process to identify all the external and internal elements, which can affect the organization's performance. The analysis entails assessing the level of threat or opportunity the factors might present. These evaluations are later translated into the decision-making process. The analysis helps align strategies with the firm's environment.

Our market is facing changes every day. Many new things develop over time and the whole scenario can alter in only a few seconds. There are some factors that are beyond your control. But, you can control a lot of these things.

Businesses are greatly influenced by their environment. All the situational factors which determine day to day circumstances impact firms. So, businesses must constantly analyze the trade environment and the market.

To perform environmental analysis, a constant stream of relevant information is required to find out the best course of action. Strategic Planners use the information gathered from the environmental analysis for forecasting trends for future in advance. The information can also be used to assess operating environment and set up organizational goals.

It ascertains whether the goals defined by the organization are achievable or not, with the present strategies. If is not possible to reach those goals with the existing strategies, then new strategies are devised or old ones are modified accordingly.

Need of External Environmental Analysis

1. Success of Entrepreneurship

For the success of an enterprise, advance evaluation of the far-reaching favorable effects and ill effects of the external environment and its factors is necessary.

If such advance evaluation provides some specific knowledge, the entrepreneur gets alert about them and tries to adjust his decisions, accordingly.

2. Formulation of Viable Plans

We have studied that the business environment is dynamic, and not static.

Hence, the entrepreneurs should effectively assess and analyze it to give practical and functional shape to his plans.

3. To Create Measures for Competitive Environment

The competitive environment is also an essential part of the total environment, which cannot be left unseen.

Hence, it is essential for the entrepreneur that he should study and analyze the external environmental factors, so as to work out measures against the strategies of their competitors and to adopt counter Strategies.

Thus, external environmental analysis is necessary for working out strong measures against the competitors.

4. Formulation of Successful Plans

Components of planning include objectives and goals, policies, Budget, Time, standards and strategies.

The forecast is the base of planning.

Hence, for the preparation of successful business plans of the entrepreneurs, determination of various components, basis and their effects is necessary.

Not only that, but the study of factors of the external environment is totality is also essential.

5. Helpful in Selection of the Best Alternative

External environmental analysis and investigation not only help the strategic decision makers in restricting the volume of available alternatives but also in removing the is irrelevant alternatives, by taking future opportunities and challenges and threats into consideration.

The best strategy cannot be easily identified, but unwanted alternatives may be removed to a large extent and the best available alternative and may be selected through external environmental analysis and investigation.

6. Use of Profit Opportunities in Business

The external environmental analysis provides information on various opportunities of gaining profit in business.

For that**,** it is essential that the entrepreneur may remain alert towards, that environment and factors.

Similarly, the entrepreneur should have knowledge about economic events, social changes, government policies, and foreign Corporation, etc. so that various available opportunities may be availed for earning optimum profits.

Such knowledge maybe also make him alert towards future challenges and threats.

Thus, the entrepreneur may use several opportunities for Profit in his business through external environmental analysis.

7. To Provide Permanency to Possibilities for Sale of Products

In the external environment and its factors, the products, production procedure, and methods, cost structure, marketing strategies, distribution chain, technical and sale methods of the competitors are also studied.

By analyzing these, the possibilities of the sale of products may be provided permanency, because by such analysis the entrepreneur becomes capable to easily take strategic decisions.

8. Leadership of Market

External environmental analysis is also required because through it is the entrepreneur get knowledge about new products and new services available in the market, fashion, likings of the consumers, new techniques of production and methods, etc.

With the use of such knowledge, the entrepreneur may increase his sales by efficiently leading the market, which will surely result in good profits to him.

9. Vigilance Towards Future Threats and Challenges

The external environment analysis also provides advanced Information about various future threats and challenges to the entrepreneur and make him alert.

High management of the corporation (entrepreneur) and his planning department continuously keep watch on happenings in the markets, and which threats and opportunities are waiting for him.

Advantages of Environmental Analysis

Formulation of business policies and strategies should be based on a careful business environmental analysis. The following as the merits of a proper environmental analysis.

1. Helps in Achieving 0bjectives

When a company neglects to adjust its strategy to the business environment, or does not react to the demands of the environment by changing its strategy, the company cannot achieve success in attaining its objectives. However, environmental analysis enables the business enterprises to study the environment and formulate the strategies accordingly, which will result in successful attainment of objectives.

2. Identification of Threats

Business Environment analysis and diagnosis give businessmen time to anticipate opportunities and to plan to take optional response to these opportunities. It also helps strategies to develop an early warning system to prevent threats or to develop strategies, which can turn a threat to the firm's advantage.

3. Happenings in the Market Place

Every firm should be in constant touch with the market place and should be aware of what is happening in the marketplace. If the company fails to adjust or react to the demands of the environment, by changing their strategies, it can't achieve corporate objectives.

4. Threats Inherent in any Opportunity

Business Environmental diagnosis helps the businessmen in two ways. 1. He can ascertain the possible threats to the business. This will enable him to take proper preventive measures. 2. He can identify the opportunities and avenues in which the businessman can operate successfully and achieve the object.

5. Forecasting the Future

Changes in the environment are often frequent and all of a sudden. Moreover, such changes cannot be predicted precisely well in advance. Again the entrepreneur can anticipate only a few of such changes and not all. If the anticipations and expectations are precise and accurate, the decisions are likely to be better. Hence business environment analysis helps to forecast the future prospects of the business concern.

6. Threats and Opportunities

Some factors of the environment present threats to the company's present strategy and the accomplishment of the objectives. While some factors, on the other hand, present greater opportunities for a great accomplishment of the objectives. A thorough analysis of the environmental factors shall enable the analyst to recognize the inherent risk involved and also enable him to take advantage of the opportunities.

In every threat there is an opportunity and in every opportunity there is a threat. By properly analyzing the environment and anticipating the changes likely to occur in the environment, the business manager can estimate the future and adjust his plans accordingly. Of course, not all the future events can be anticipated but some can and are, the extent to which the expectations are accurate, managerial decisions are likely to be better. Moreover, the process of environmental analysis reduces the time pressures on a few which are not anticipated.

Characteristics of Business Environment

1. Totality of External Forces:

Business Environment is the sum total of all the external factors that influence the functioning of the business.

Hence, it can be called as the comprehensive mega force consisting of all external inputs.

2. Specific and General Forces:

Business Environment is made up of both specific and general forces. Specific forces refer to the customers, competitors, investors etc. which have a direct effect on the day to day working of the business while the general forces refers to social, political, legal, technological and other forces which indirectly affect the operations of a business.

3. Inter-Relatedness:

Various elements of business environment are very closely related to each other. For example, at present there has been an increase in demand for products like diet colas, fat free cooking oil, sugar free products etc. due to increase in awareness for good health among the consumers.

4. Dynamic Nature:

Business environment is dynamic in nature i.e. it keeps on changing. For example, change in government policies, change in taste and choice of the consumer, change in technology etc. Such changes could be triggered by internal or external factors.

5. Uncertainty:

Business environment is very uncertain as one cannot predict as to what will happen in future especially in case of fashion industry, film industry and information technology. Its dynamic nature makes it all more challenging to handle uncertainty.

6. Complexity:

Many forces constitute the business environment. Thus, it becomes very difficult to know exactly the relative influence of a particular force (social, economic, technological etc.) on the functioning of a business enterprise as all these factors are related to one another.

Managers constantly need to simplify this complexity as much as possible all the time. For example, if there is change in demand of a product, it becomes very difficult to determine the separate influence of social, political, technological, economic or legal forces etc. on such a change.

7. Relativity:

Different countries and different regions have different business environment. Thus, business environment is a relative concept. For example, technology in Japan differs from that in India or say Pakistan, China etc. Hence, a multinational enterprise has to keep this aspect in mind while formulating its policies for different countries.

Classification of Environmental Factors

On the basis of the extent of intimacy with the firm, the environmental factors may be classified into different types namely internal and external.

1) Internal environmental factors

The internal environment is the environment that has a direct impact on the business. The internal factors are generally controllable because the company has control over these factors. It can alter or modify these factors. The internal environmental factors are resources, capabilities and culture.

i) Resources:

A good starting point to identify company resources is to look at tangible, intangible and human resources.

Tangible resources are the easiest to identify and evaluate: financial resources and physical assets are identifies and valued in the firm's financial statements.

Intangible resources are largely invisible, but over time become more important to the firm than tangible assets because they can be a main source for a competitive advantage. Such intangible recourses include reputational assets (brands, image, etc.) and technological assets (proprietary technology and know-how).

Human resources or human capital are the productive services human beings offer the firm in terms of their skills, knowledge, reasoning, and decision-making abilities.

ii) Capabilities:

Resources are not productive on their own. The most productive tasks require that resources collaborate closely together within teams. The term organizational capabilities are used to refer to a firm's capacity for undertaking a particular productive activity. Our interest is not in capabilities per se, but in capabilities relative to other firms. To identify the firm's capabilities we will use the functional classification approach. A functional classification identifies organizational capabilities in relation to each of the principal functional areas.

iii) Culture:

It is the specific collection of values and norms that are shared by people and groups in an organization and that helps in achieving the organizational goals.

2) External environment factors

It refers to the environment that has an indirect influence on the business. The factors are uncontrollable by the business. The two types of external environment are micro environment and macro environment.

a) MICRO ENVIRONMENTAL FACTORS

These are external factors close to the company that have a direct impact on the organizations process. These factors include:

i) Shareholders

Any person or company that owns at least one share (a percentage of ownership) in a company is known as shareholder. A shareholder may also be referred to as a "stockholder". As organization requires greater inward investment for growth they face increasing pressure to move from private ownership to public. However this movement unleashes the forces of shareholder pressure on the strategy of organizations.

ii) Suppliers

An individual or an organization involved in the process of making a product or service available for use or consumption by a consumer or business user is known as supplier. Increase in raw material prices will have a knock on affect on the marketing mix strategy of an organization. Prices may be forced up as a result. A closer supplier relationship is one way of ensuring competitive and quality products for an organization.

iii) Distributors

Entity that buys non-competing products or product-lines, warehouses them, and resells them to retailers or direct to the end users or customers is known as distributor. Most distributors provide strong manpower and cash support to the supplier or manufacturer's promotional efforts. They usually also provide a range of services (such as product information, estimates, technical support, after-sales services, credit) to their customers. Often getting products to the end customers can be a major issue for firms. The distributors used will determine the final price of the product and how it is presented to the end customer. When selling via retailers, for example, the retailer has control over where the products are displayed, how they are priced and how much they are promoted in-store. You can also gain a competitive advantage by using changing distribution channels.

iv) Customers

A person, company, or other entity which buys goods and services produced by another person, company, or other entity is known as customer. Organizations survive on the basis of meeting the needs, wants and providing benefits for their customers. Failure to do so will result in a failed business strategy.

v) Competitors

A company in the same industry or a similar industry which offers a similar product or service is known as competitor. The presence of one or more competitors can reduce the prices of goods and services as the companies attempt to gain a larger market share. Competition also requires companies to become more efficient in order to reduce costs. Fast-food restaurants McDonald's and Burger King are competitors, as are Coca-Cola and Pepsi, and Wal-Mart and Target.

vi) Media

Positive or adverse media attention on an organizations product or service can in some cases make or break an organization.. Consumer programmes with a wider and more direct audience can also have a very powerful and positive impact, forcing organizations to change their tactics.

b) MACRO ENVIRONMENTAL FACTORS

An organization's macro environment consists of nonspecific aspects in the organization's surroundings that have the potential to affect the organization's strategies. When compared to a firm's task environment, the impact of macro environmental variables is less direct and the organization has a more limited impact on these elements of the environment.

The macro environment consists of forces that originate outside of an organization and generally cannot be altered by actions of the organization. In other words, a firm may be influenced by changes within this element of its environment, but cannot itself influence the environment. The curved lines in Figure 1 indicate the indirect influence of the environment on the organization.

Macro environment includes political, economic, social and technological factors. A firm considers these as part of its environmental scanning to better understand the threats and opportunities created by the variables and how strategic plans need to be adjusted so the firm can obtain and retain competitive advantage.

i) Political Factors

Political factors include government regulations and legal issues and define both formal and informal rules under which the firm must operate. Some examples include:

- tax policy
- employment laws
- environmental regulations
- trade restrictions and tariffs
- political stability

ii) Economic Factors

Economic factors affect the purchasing power of potential customers and the firm's cost of capital. The following are examples of factors in the macro economy:

- economic growth
- interest rates
- exchange rates
- inflation rate

iii) Social Factors

Social factors include the demographic and cultural aspects of the external macro environment. These factors affect customer needs and the size of potential markets. Some social factors include:

- health consciousness
- population growth rate
- age distribution
- career attitudes
- emphasis on safety

iv) Technological Factors

Technological factors can lower barriers to entry, reduce minimum efficient production levels, and influence outsourcing decisions. Some technological factors include:

- R&D activity
- automation
- technology incentives
- rate of technological change