

Environmental Analysis

What is it?

Environmental analysis (sometimes referred to as “environmental scanning”) is the analysis of factors in the larger competitive context that are currently affecting, or may in the future influence, the nature of competition within an industry.

When do we use it?

Environmental analysis identifies trends that influence things such as demand, growth, entry and exit of firms, innovation, and regulation. Environmental analysis can lead to better planning and decision making for a firm, but should be used in combination with other analytical tools.

Why do we use it?

While constituting a simple framework for organizing data and observations about the larger societal context, environmental analysis can nevertheless be a useful starting point for thinking about institutional and environmental factors that impact the firm’s strategic actions.

Although the competitive prospects for a firm are directly influenced by the competitive actions and strategic options of its competitors (as addressed in a competitor analysis), a number of broader societal forces can also impact the opportunities a firm has for creating value for its stakeholders. For instance, a typewriter-manufacturing firm in the late 1970s might have occupied a competitive position superior to its competitor firms, but generalized technological advancement ultimately posed a greater threat; the advent of the personal computer and the word processor eliminated much of the demand for typewriters. In this case, it was an environmental factor – technological advancement – and not a competitive factor that most dramatically impacted the firm. Similarly, a travel and tourism company might offer customers a superior value when compared to its direct competitors, but the firm’s prospects might feel a more substantial impact resulting from larger economic trends. After all, a more competitively attractive tourism option for consumers may be insufficient to overcome the effects of an economic recession that eviscerates demand for travel and tourism overall. Once again, an environmental factor – in this case, macroeconomic conditions – exert a significant impact on a firm’s value proposition.

These are just two examples of factors in the broader societal environment that can dramatically impact the strategic outlook for a firm. They illustrate why it is important to consider such factors in assessing a firm's strategic position and competitive options.

Strategists should also pay attention to trends in the political and regulatory environment, as such factors can also impact a firm's prospects in a substantial way. Government regulation and other forms of market intervention can directly affect a firm's operations and strategic options, and therefore should be carefully considered when formulating and implementing a firm's strategy.

In addition to technological, macroeconomic, and regulatory factors, a firm's context also includes many tacit influences that can arise from geographic differences, cultural trends, and social norms. These broad institutional factors constitute the "rules of the game" for doing business⁶ within that societal context, and can influence a firm's actions. A firm is well advised to carefully study and understand the social forces that could influence its operations or the demand for its products or services. What's more, doing so may yield other important benefits; for example, a thorough environmental analysis might allow you to predict the behavior of a firm's competitors. Even further, an environmental analysis might illuminate opportunities to influence certain factors or "rules of the game" through direct engagement with relevant stakeholders.

In conducting a strategic analysis, a business strategist should be careful to not ignore the institutional forces in the broader social environment.

How do we use it?

Step 1. List factors.

The first step in an environmental analysis is to identify a set of factors of interest for the competitive setting. Most consulting firms (and strategy text books) have their own, sometimes proprietary frame-works, yet most contain roughly the same elements. A list of common factors of interest for an environmental analysis might include:

- **Demographic trends:** analysis of the current and changing population distribution of the consumer base within an industry
- **Socio-cultural influences:** analysis of features that influence consumers' choices including values, beliefs, and societal attitudes
- **Technological developments:** analysis of new technologies and their potential impact on consumers' choices and competitive dynamics
- **Macroeconomic impacts:** analysis of large-scale economic trends (inflation, exchange rates) and their impact on the industry
- **Political-legal pressures:** analysis of relevant laws, regulations, and policies
- **Global trade issues:** analysis of impacts of globalization and international governance bodies on industry competition

6. Douglass North, 1990. *Institutions, institutional change and economic performance*. New York: Cambridge University Press.

Step 2. Collect data.

The second step is to collect data and information to help shed light on each of these factors. The diagram below lists some of the specific considerations one may consider under each of these factors. Many, but not all, of these may be quantifiable.

DEMOGRAPHIC TRENDS	SOCIO-CULTURAL INFLUENCES
<ul style="list-style-type: none"> ▪ population growth and death rates ▪ age distribution trends ▪ migration/immigration ▪ population segmentation 	<ul style="list-style-type: none"> ▪ lifestyle and fashion trends ▪ social issues ▪ media views and influence ▪ ethnic/religious differences
MACROECONOMIC IMPACTS	POLITICAL-LEGAL PRESSURES
<ul style="list-style-type: none"> ▪ influence of business cycle ▪ home economy situation and trends ▪ overseas economies and trends ▪ taxation issues ▪ seasonality of demand ▪ market volatility due to wars/conflicts 	<ul style="list-style-type: none"> ▪ current and pending legislation ▪ regulatory bodies and processes ▪ environmental/social pressures ▪ public funding for grants and initiatives ▪ influence of lobbying/advocacy groups
TECHNOLOGICAL DEVELOPMENTS	GLOBAL TRADE ISSUES
<ul style="list-style-type: none"> ▪ maturity of current technology ▪ emergent technology developments ▪ public and private research funding ▪ technology licensing and patents ▪ intellectual property legislation 	<ul style="list-style-type: none"> ▪ interest and exchange rates ▪ international trade/monetary policies ▪ international pressure groups ▪ international legislation ▪ globalization impacts



FURTHER READING

Chapter 3 of R. Grant, *Contemporary Strategic Analysis* (Blackwell Publishers, 2008).