Unit 3: Business Environment

Name: ____________________

Date: __/__/__

Meaning

The term 'business environment' means the sum total of all individuals, institutions and other forces that are outside the control of a business enterprise but that may affect its performance. As one writer has put it– "Just take the universe, subtract from it the subset that represents the organization, and the remainder is environment".

Thus, the economic, social, political, technological and other forces which operate outside a business enterprise are part of its environment. So also, the individual consumers or competing enterprises as well as the governments, consumer groups, competitors, courts, media and other institutions working outside an enterprise constitute its environment

Features

(i) Totality of external forces: Business environment is the sum of all things external to business firms and, as such, is aggregative in nature.

(ii) Specific and general forces: Business environment includes both specific and general forces. Specific forces (such as investors, customers, competitors and suppliers) affect individual enterprises directly and immediately in their day-to-day working

(iii) Inter-relatedness: Different elements or parts of business environment are closely interrelated. For example, increased life expectancy of people and increased awareness for healthcare have increased the demand for many health products and services like diet Coke, fat-free cooking oil, and health resorts

(iv) Dynamic nature: Business environment is dynamic in that it keeps on changing whether in terms of technological improvement, shifts in consumer preferences or entry of new competition in the market.

(v) Uncertainty: Business environment is largely uncertain as it is very difficult to predict future happenings, especially when environment changes are taking place too frequently as in the case of information technology or fashion industries.

(vi) Complexity: Since business environment consists of numerous interrelated and dynamic conditions or forces which arise from different sources, it becomes difficult to comprehend at once what exactly constitutes a given environment. In other words, environment is a complex phenomenon that is relatively easier to understand in parts but difficult to grasp in its totality.

(vii) Relativity: Business environment is a relative concept since it differs from country to country and even region to region. Political conditions in the USA, for instance, differ from those in China or Pakistan. Similarly, demand for sarees may be fairly high in India whereas it may be almost non-existent in France.

Importance of Business Environment

The importance of business environment and its understanding by managers can be appreciated if we consider the following facts:

(i) It enables the firm to identify opportunities and getting the first mover advantage: Opportunities refer to the positive external trends or changes that will help a firm to improve its performance. Environment provides numerous opportunities for business success. Early identification of opportunities helps an enterprise to be the first to exploit them instead of losing them to competitors. For example, Maruti Udyog became the leader in the small car market because it was the first to recognize the need for small cars in an environment of rising petroleum prices and a large middle-class population in India

(ii) It helps the firm to identify threats and early warning signals: Threats refer to the external environment trends and changes that will hinder a firm's performance. Besides opportunities, environment happens to be the source of many threats. Environmental awareness can help managers to identify various threats on time and serve as an early warning signal. For example, if an Indian firm finds that a foreign multinational is entering the Indian market with new substitutes, it should act as a warning signal. Based on this information, the Indian firms can prepare themselves to meet the threat by adopting such measures as improving the quality of the product, reducing cost of the production, engaging in aggressive advertising, and so on

(iii) It helps in tapping useful resources: Environment is a source of various resources for running a business. To engage in any type of activity, a business enterprise assembles various resources called inputs like finance, machines, raw materials, power and water, labor, etc., from its environment including financiers, government and suppliers. They decide to provide these resources with their own expectations to get something in return from the enterprise.

(iv) It helps in coping with rapid changes: Today's business environment is getting increasingly dynamic where changes are taking place at a fast pace. It is not the fact of change itself that is so important as the pace of change. Turbulent market conditions, less brand loyalty, divisions and sub-divisions (fragmentation) of markets, more demanding customers, rapid changes in technology and intense global competition are just a few of the images used to describe today's business environment

(v) It helps in assisting in planning and policy formulation: Since environment is a source of both opportunities and threats for a business enterprise, its understanding and analysis can be the basis for deciding the future course of action (planning) or training guidelines for decision making (policy). For instance, entry of new players in the market, which means more competition may make an enterprise think afresh about how to deal with the situation

(vi) It helps in improving performance: The final reason for understanding business environment relates to whether it really makes a difference in the performance of an enterprise. The answer is that it does appear to make a difference. Many studies reveal that the future of an enterprise is closely bound up with what is happening in the environment.

Dimensions of Business Environment

Dimensions of, or the factors constituting the business environment include economic, social, technological, political and legal conditions which are considered relevant for decision-making and improving the performance of an enterprise. In contrast to the specific environment, these factors explain the general environment which mostly influences many enterprises at the same time

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Economic Environment: Interest rates, inflation rates, changes in disposable income of people, stock market indices and the value of rupee are some of the economic factors that can affect management practices in a business enterprise. Short and long-term interest rates significantly affect the demand for product and services. For example, in case of construction companies and automobile manufacturers, low longer-term rates are beneficial because they result in increased spending by consumers for buying homes and cars on borrowed money. Similarly, a rise in the disposable income of people due to increase in the gross domestic product of a country creates increasing demand for products. High inflation rates generally result in constraints on business enterprises as they increase the various costs of business such as the purchase of raw materials or machinery and payment of wages and salaries to employees.

Social Environment: The social environment of business include the social forces like customs and traditions, values, social trends, society's expectations from business, etc. Traditions define social practices that have lasted for decades or even centuries. For example, the celebration of festivals in India provides significant financial opportunities for greetings card companies, sweets or confectionery manufacturers, tailoring outlets and many other related business

Technological Environment: Technological environment includes forces relating to scientific improvements and innovations which provide new ways of producing goods and services and new methods and techniques of operating a business. For example, recent technological, advances in computers and electronics have modified the ways in which companies advertise their products. Retailers have direct links with suppliers who replenish stocks when needed. Manufacturers have flexible manufacturing systems. Airline companies have websites where customers can look for flight times, destinations and fares and book their tickets online.

Political Environment: Political environment includes political conditions such as general stability and peace in the country and specific attitudes that elected government representatives hold towards business. The significance of political conditions in business success lies in the predictability of business activities under stable political conditions. On the other hand, there may be uncertainty of business activities due to political unrest and threats to law and order.

Economic Environment of India

The economic environment in India consists of various macro-level factors related to the means of production and distribution of wealth which have an impact on business and industry. These include:

a) Stage of economic development of the country.
b) The economic structure in the form of mixed economy which recognizes the role of both public and private sectors.
c) Economic policies of the Government, including industrial, monetary and fiscal policies.
d) Economic planning, including five-year plans, annual budgets, and so on.
e) Economic indices, like national income, distribution of income, rate and growth of GNP, per capita income, disposal personal income, rate of savings and investments, value of exports and imports, balance of payments, and so on.
f) Infrastructural factors, such as, financial institutions, banks, modes of transportation communication facilities, and so on.

The economic environment of business in India has been steadily changing mainly due to the government policies. At the time of Independence:

a) The Indian economy was mainly agricultural and rural in character;
b) About 70% of the working population was employed in agriculture;
c) About 85% of the population was living in the villages;
d) Production was carried out using irrational, low productivity technology;
e) Communicable diseases were widespread; mortality rates were high. These was no good public health system.

To solve economic problems of our country, the government took several steps including control by the State of certain industries, central planning and reduced importance of the private sector. The main objectives of India's development plans were:

a) Initiate rapid economic growth to raise the standard of living, reduce unemployment and poverty;
b) Become self-reliant and set up a strong industrial base with emphasis on heavy and basic industries;
c) Reduce inequalities of income and wealth;
d) Adopt a socialist pattern of development — based on equality and prevent exploitation of man by man.

As a part of economic reforms, the Government of India announced a new industrial policy in July 1991. The broad features of this policy were as follows:

a) The Government reduced the number of industries under compulsory licensing to six.
b) Many of the industries reserved for the public sector under the earlier policy, were de-reserved. The role of the public sector was limited only to four industries of strategic importance.
c) Disinvestment was carried out in case of many public sector industrial enterprises.
d) Policy towards foreign capital was liberalised. The share of foreign equity participation was increased and in many activities 100 per cent Foreign Direct Investment (FDI) was permitted.
e) Automatic permission was now granted for technology agreements with foreign companies.
f) Foreign Investment Promotion Board (FIPB) was set up to promote and channelise foreign investment in India.

<u>Liberalization:</u> The economic reforms that were introduced were aimed at liberalizing the Indian business and industry from all unnecessary controls and restrictions. They signalled the end of the licence-pemit-quota raj. Liberalisation of the Indian industry has taken place with respect to:

(i) Abolishing licensing requirement in most of the industries except a short list,
(ii) Freedom in deciding the scale of business activities i.e., no restrictions on expansion or contraction of business activities,
(iii) Removal of restrictions on the movement of goods and services
(iv) Freedom in fixing the prices of goods services, (v) reduction in tax rates and lifting of unnecessary controls over the economy,
(v) Simplifying procedures for imports and experts, and
(vi) Making it easier to attract foreign capital and technology to India.

<u>Privatization:</u> The new set of economic reforms aimed at giving greater role to the private sector in the nation building process and a reduced role to the public sector. This was a reversal of the development strategy pursued so far by Indian planners. To achieve this, the government redefined the role of the public sector in the New Industrial Policy of 1991, adopted the policy of planned disinvestments of the public sector and decided to refer the loss making and sick enterprises to the Board of Industrial and Financial Reconstruction. The term disinvestments used here means transfer in the public-sector enterprises to the private sector

<u>Globalization:</u> Globalization means the integration of the various economies of the world leading towards the emergence of a cohesive global economy. Till 1991, the Government of India had followed a policy of strictly regulating imports in value and volume terms. These regulations were with respect to

(a) Licensing of imports,

(b) Tariff restrictions and

(c) Quantitative restrictions

Globalization involves an increased level of interaction and interdependence among the various nations of the global economy. Physical geographical gap or political boundaries no longer remain barriers for a business enterprise to serve a customer in a distant geographical market. This has been made possible by the rapid advancement in technology and liberal trade policies by Governments.

Impact of Government Policy Changes on Business and Industry

(i) Increasing competition: Because of changes in the rules of industrial licensing and entry of foreign firms, competition for Indian firms has increased especially in-service industries like telecommunications, airlines, banking, insurance, etc. which were earlier in the public sector.

(ii) More demanding customers: Customers today have become more demanding because they are well-informed. Increased competition in the market gives the customers wider choice in purchasing better quality goods and services

(iii) Rapidly changing technological environment: Increased competition forces the firms to develop new ways to survive and grow in the market. New technologies make it possible to improve machines, process, products and services. The rapidly changing technological environment creates tough challenges before smaller firms.

(iv) Necessity for change: In a regulated environment of pre1991 era, the firms could have relatively stable policies and practices. After 1991, the market forces have become turbulent because of which the enterprises have to continuously modify their operations.

(v) Need for developing human resource: Indian enterprises have suffered for long with inadequately trained personnel. The new market conditions require people with higher competence and greater commitment. Hence the need for developing human resources

(vi) Market orientation: Earlier firms used to produce first and go to the market for sale later. In other words, they had production-oriented marketing operations. In a fast-changing world, there is a shift to market orientation in as much as the firms must study and analyse the market first and produce goods accordingly.

(vii) Loss of budgetary support to the public sector: The central government's budgetary support for financing the public-sector outlays has declined over the years. The public-sector undertakings have realised that, in order to survive and grow, they will have to be more efficient and generate their own resources for the purpose.