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Environment & PEST Analysis: An Approach to External Business Environment

Abhishek Gupta

Administrative-cum-Accounts Officer & Head of Office, Sardar Swaran Singh National Institute of Renewable Energy (Ministry of New & Renewable Energy, Govt. of India), Wadala Kalan, Kapurthala-144601 (Punjab)

E-Mail: iloveindia1909@gmail.com; Ph. No. 01822-255090, Mo. 09592010278

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Abstract: Environmental management, a term encompassing environmental planning, protection, monitoring, assessment, research, education, conservation and sustainable use of resources, is now accepted as a major guiding factor for sustainable development at the regional and national level. It is now being increasingly recognized that environmental factors and ecological imperatives must be in built to the total planning process if the long-term goal of making industrial development sustainable is to be achieved. Here we will try to define and discuss the role of Environmental Analysis in the strategic management process of organization. The present complex world require as far as is feasible, it consider impact of important factors related to organizations in strategic planning. The strategic planning of business includes all functional subdivisions and forwards them in a united direction. One of these subsystems is human resource management. Strategic human resource management comes after the strategic planning, and followed by strategic human resource planning as a major activity in all the industries. In strategic planning, it can use different analytical methods and techniques that one of them is PEST analysis. This paper introduces how to apply it in a new manner.

Keywords: Environmental Management, Environmental Planning, Business Environment, PEST Analysis.

1. The PEST Analysis: An Introduction

The PEST analysis is the most common approach for considering the external business environment. PEST analysis stands for Political, Economic, Social, and Technological analysis and describes a framework of macro-environmental factors used in the environmental scanning component of strategic management but the word PEST is no more than a convenient mnemonic. The underlying thinking of the PEST analysis is that the enterprise has to react to changes in its external environment. This reflects the idea that strategy requires a fit between capabilities and the external environment and so it is necessary for an enterprise to react to changes. Political changes might be expected to include, for instance, general changes in the domestic political climate, the effects of European integration and the after-effects of the break-up of the Soviet Union, government change, world power shifts, as well as specific legislation and regulation. Economic changes is likely to include the effects of economic cycles, patterns of world trade, currency conversion rate changes, commodity prices, changes in capital markets, labour markets and rates, and economic effects on suppliers and particular groups of customers. Social change includes the effects of demographic patterns, tastes and habits, and concerns about the environment and sustainable development. Technological change covers the effects of technological change on products, processes, and distribution channels. The PEST analysis is very general in nature and this makes it difficult to give clear rules on how best to apply it in varying circumstances. Global or geographically dispersed enterprises will have to conduct separate PEST analysis for different regions as trends occur at different rates in different places. The value of the PEST is likely to relate directly to the quality of the effort put into it. This time spent thinking about how external change will affect the enterprise and its industry is likely to be well spent.

2. Industry Analysis: A Market Assessment Tool

An industry is a collection of firms offering goods or services that are close substitutes of each other. Alternatively, an industry consists of firms that directly compete with each other. In other words an industry is a group of firms producing a similar product or service, such as soft drinks or financial services. An examination of the important stakeholder groups, such as suppliers and customers, in a particular corporation's task environment is a part of industry analysis. An authority on competitive strategy contends that a corporation is most concerned with the intensity of competition within its industry. There are five forces, which work together to determine the type and direction of pressures on profitability that will be found in a given industry. When these forces of competition are favorable, there will be less downward pressure on profitability, and the industry should have a higher average level of profitability. When the structural factors are unfavorable, there will be more downward

pressure on profitability and a correspondingly lower average level of profitability. A company, which is competing in an industry with an unfavorable structure, must find a, ways to gain an advantage over its competitors, which will allow it to earn above average level of profitability. If no competitive advantage can be developed, it may be possible to change the structure of the industry. If changing the structure is not a viable alternative, the company should consider exiting the industry. A company, which is operating in an industry with a favorable structure, should work to maintain the structure.

3. Industrial Rivalry

The force of competition reflects the interactions among competitors who produce products or services that are close substitutes for each other. These competitors are collectively known as the industry. An industry, which is characterized by firms trying to edge out each other for market share is said to be experiencing rivalry. Rivalry is more intense than ordinary competition. Firms take actions, which may damage their own profitability in the short run with the idea that it will hurt competitors more, and in the long run, the initiating firm will gain some advantage over the others. Rivalry is usually exhibited in price wars, advertising barrages and product proliferation. Rivalry is damaging to industry profitability because it is costly. Businesses generally try to minimize rivalry within the bounds of law; however, many factors can create or escalate rivalry in an industry and they should be carefully monitored as part of the environmental analysis process. As rivalry increases, average profitability is pushed down, all other things being equal. Rivalry is greater when there are many small firms in an industry or when there is no clearly dominant firm to set and enforce standards for competition.

Economies of scale exist for current competitors in the industry. New entrants must incur the capita' costs of large production facilities to keep their unit costs down and maintain competitive prices, or they may forego the large employees to, management must consider other staffing alternatives. Absolute cost advantages exist when current competitors have lower costs. This may be due to patents, favorable long-term supply contracts, or experience in operations. Brand loyalty and product differentiation are present in the industry. Users view the product/service as unique and are fewer prices sensitive. This makes it difficult for new competitors to establish a market position. Government regulations limit new competitors. Start-up costs are high. Current competitors move to make it difficult for new entrants to establish themselves. This may be done by cutting prices in markets where new products are being tested as long as such pricing is not predatory.

It should be rioted that entry barriers are most effective against start-ups. The only entry barrier, which seems to be consistently effective against entry by acquisition, is the reaction of existing competitors. Substitute products: Industry sales and profitability are limited by what the customer will

pay for a given level of quality or service when alternatives are available. Commercial banking companies often switch from high-fructose corn sweeteners to sugar when the price of sugar decreases and switch back when the price of sugar increases. As a result profits in the high-fructose corn syrup industry are limited by the price of sugar. When there is a strong threat of substitution, average profitability can suffer. The threat of substitution holds down industry profits by allowing buyers options. The threat of substitution is greater when switching costs are not significant. Substitutes provide about the same value for cost. Buyers are in the habit of substituting.

4. Industries: Global Competition

Over time most industries evolve through a series of stages from growth through maturity to eventual decline. The strength of each of six forces mentioned earlier varies according to the stage of the industry evolution. The industry life cycle is useful for explaining and predicting trends among the six forces driving industry competition. For example, when an industry is new, people often buy the product regardless of price because it fulfills a unique need. This is probably a fragmented industry no firm has large market share and each firm serves only a small piece of the total market in competition with others. As new competitors enter the industry, prices drop as a result of competition. Companies use the experience curve and economies of scale to reduce costs faster than the competition. Companies integrate to reduce costs even further by acquiring their suppliers and distributors. Competitors try to differentiate their products from one another in order to avoid the fierce price competition common to a maturing industry. By the time an industry enters maturity, products tend to become more like commodities. This is now a consolidated industry dominated by a few large firms, each of which struggles to differentiate its products from the competition. As buyers become more sophisticated over time, purchasing decisions are based on better information. Price becomes a dominant concern, given a minimum level of quality and features. As an industry moves through maturity toward possible decline, its products growth rate of sales slows and may even begin to decrease. To the extent that exit barriers are low, firms will begin converting their facilities to alternate uses or will sell them to another firm. The industry tends to consolidate around fewer but larger competitors.

Global industries, in contrast, operate worldwide, with MNCs making only small adjustments for country specific circumstances. A global industry is one in which all MNC's activities in one country are significantly affected by its activities in other countries. MNC's produce products or services in various locations throughout the world and sell them, making only minor adjustments for specific country requirements. Examples of global industries are commercial aircraft, television sets, semiconductors, copiers; automobiles, watches and tires, the largest industrial corporations in the

worked in terms of dollar sales are, for the most part, multinational corporations operating in global industries. The factors that tend to determine whether an industry will be primarily multi-domestic or primarily global are pressure for coordination within the multinational corporations operating in that industry, pressure for local responsiveness on the part of individual country markets.

5. Environment Analysis: Threats & Opportunities

Environment analysis is the study of the organizational environment to pinpoint environmental factors that can significantly influence organizational operations. Environmental analysis is a critical component of strategic management because it produces much of the information, which is, requires to assess the outlook for the future. The environment is a significant source of change. Some organizations become victims of change, while others use change to their advantage. Organizations are more likely to be able to turn change to their advantage if they are forewarned. This is a major purpose of the environmental analysis process.

In order to perform an environmental analysis efficiently and effectively, a manager must thoroughly understand how organizational environments are structured. The environmental analysis phase of the strategic management process seeks to uncover relevant information rather than extensive information; it rewards the pursuit of quality rather than quantity. Furthermore, the process must be future-oriented to provide for adequate response time, whether the desired response is to capitalize on a trend or to influence its direction. Finally, the information must be translated into a form that facilitates its use in strategic planning. From these requirements, environmental analysis can be divided into three major steps determining the bounds and relevant sectors of the environment; Scanning and forecasting and ensuring that information is available concerning the defined environment, interpreting packaging information into forms that are useful for Planning. Every organization is subject to general trends which are felt in many industries and which are not usually amenable to influence by a single organization. These trends can be classified as technological, economic, social, and political according to the sector of the environment from which they come. The force of trends varies with the geographical scope of competition, so it is helpful to identify the scope of the sector, which requires scanning.

6. The General Environment

The components normally considered part of the general environment are Economic, Technological, Social and Political. The fluctuations of local, national, and world economies are related in many ways, but it is still important to make separate assessments based on organizational scope. Local conditions can moderate or deepen the effects of national economic trends. The

underdeveloped nations are characterized by rising populations, low standards of education, and lack of a transportation and commercial base. In the developing nations, gross national product is rapidly increasing, but wages are low and consumer goods scarce. Most critical is the unevenness of income and wealth, the rapidity of change, and the political instability, which can threaten organizations operating in such areas. Technology refers to the means chosen to do useful work. Technological trends include not only the glamorous invention that revolutionizes our lives, but also the gradual painstaking improvements in methods, materials, in design, in application, in diffusion into new industries and in efficiency. It includes hardware, software and live ware. For centuries, the simple process of handling business correspondence has involved dictation, transcription, and final review and signature. Technological improvements, which made the process more efficient, include the creation of a standardized shorthand writing system, the invention of the typewriter, the use of voice recording machines for dictation, and the use of the microcomputer for transcription and editing. All four represent technological change even though only the typing, recording, and word processing activities involve machines.

The behavior patterns of individuals and groups reflect their attitudes, beliefs and values. The social environment includes the attitudes and values of society as well as the behavior, which is motivated, by those values. A community's attitudes toward legalized gambling, the composition of families and households, and the preference for fast food over home cooking are all manifestations of the social environment. The impact of the social sector is felt in changing needs, tastes and preferences of consumers, in relations with employees, and in the expectations of society about how the organization should fulfill its citizenship role. The political sector of the environment presents actual and potential restrictions on the way an organization operates. These restrictions can take the form of laws which require or prohibit certain actions, regulations which interpret and detail laws, or avenues for reporting relationships and oversight functions. The differences among local, national, and international subsectors of the political environment are often quite dramatic.

7. Worldwide/Global Environment: An International Perspective to Global Industry

Although industries can be characterized by the global multi-domestic distinction, few pure cases of either exist. Thus, a multinational competing in a global industry must, to some degree, also be responsive to local market condition. Similarly, the multinational firm, competing in a multi-domestic industry cannot totally ignore opportunities to utilize intra-corporate resources in competitive positioning. The question then becomes one of deciding, which corporate functional activities should be performed where and what degree of coordination should exist between them.

A multinational corporation has a wide range of possible location options for each of these activities and must decide which set of activities will be performed in how many and which locations.

The basic international strategies derive from considering the location and coordination dimensions. If the firm is operating in a multi-domestic industry, choosing a country-centered strategy implies low coordination of functional activities and geographical dispersion of organization activities. This allows each subsidiary to closely monitor the local market condition it faces and the freedom to respond competitively. A high coordination and geographical concentration of the multinational's activities results from choosing a pure global strategy. Although some activities, such as after-sales service, may need to be located in each market, the activities need to be tightly controlled so that standardized performance occurs worldwide.

Domestically, the public image is often shaped from a marketing viewpoint. The firm's public image is considered a marketing tool that is managed with the objective of customer acceptance of the firm's product in the market. Although this dimension remains a critical consideration in the multinational environment, it must be properly balanced with concern for organizational claimants other than the customer. The multinational firm is a major user of national resources and a major force in the socialization processes of many countries. Thus, the MNC must manage its image with respect to this larger context by clearly conveying its intentions to recognize the additional internal and external claimants resulting from multi-nationalization.

8. Environmental Forecasting

Environmental scanning, monitoring, and competitive intelligence are important inputs for analyzing the external environment. However, they are of little use unless they provide raw material that is reliable enough to help managers make accurate forecasts. Environmental forecasting involves the development of plausible projections about the direction, scope, speed, and intensity of environmental change, its purpose is to predict change. No one can deny that economic, technological, political, and social change is a part of organizational life. To say the least, forecasting is a most difficult process. At this point it may be consoling to recall some humorous forecasting rules. Several studies have examined the impact of environmental analysis and forecasting on organizational performance. One study found that increased knowledge, through environmental analysis and forecasting was positively correlated to profitability.

Brainstorming is a technique that is primarily used to produce creative ideas for solving problems, but it can also-be-used in forecasting. Basically, brainstorming involves presenting a particular subject to a group of people and allowing them to present their forecasts on the subject. Brainstorming generally consists of three phases. In phase one, members of the group are asked to

present spontaneously their ideas on the future of the subject under study. The group is told that producing a large quantity of their ideas is desired, and that they should not be concerned about the quality of their ideas. Basic rules are observed in the first phase. No criticism of forecasts is allowed. No praise of forecasts is allowed. No questions or discussion of forecasts is allowed. Combination and improvements of forecasts that have been presented are encouraged. During the second phase, the merits of each forecast are reviewed, which often leads to additional alternatives. Alternatives with little merit are eliminated in this phase. In the third phase, one of the alternatives is selected, normally through group consensus.

Trend-impact analysis is also used in environmental forecasting and is conducted along the following general steps. Past history of a particular phenomenon is extrapolated with the help of a computer. Panel of experts specifies a set of unique future events, which could have a bearing on the phenomenon under study. Panel of experts indicates how the trend extrapolation would be affected by the occurrence of each of these events. Computer then modifies the trend extrapolation using these judgments. Panel of experts then reviews, the adjusted extrapolation, and modifies the inputs.

9. Environmental Uncertainty: A Threat to Strategic Manager

Environmental uncertainty is the degree of complexity plus the degree of change existing in an organization's external environment. Environmental uncertainty is a threat to strategic managers because it hampers their ability to develop long-range plans and to make strategic decisions to keep the corporation in equilibrium with its external environment. Most industries today are facing an ever increasing level of environmental uncertainty. They are becoming more complex and more dynamic. Industries that used to be multi-domestic are becoming global. New flexible, aggressive, innovative, competitors are moving into established markets to rapidly erode the advantages of large previously dominant firms. Distribution channels vary from country to country and are being altered daily through the use of sophisticated information systems. Closer relationships with suppliers are being forged to reduce costs, increase quality, and gain access to new technology. Companies learn to quickly imitate the successful strategies of market leaders, and it becomes harder to sustain any competitive advantage for very long. Consequently, the level of competitive intensity is increasing in most industries. In hypercompetitive industries such as computer, competitive advantage comes from an up-to-date knowledge of environmental trends and competitive activity coupled with a willingness to risk a current advantage for a possible new advantage.

It is sometimes argued that it is so difficult to forecast the future that it is better not to attempt forecasting at all. Scenario planning offers a fundamentally different approach that does not depend on forecasting the future. Rather it postulates possible future scenarios without making any assessment of

the likelihood that any one scenario will occur. Scenario planning was pioneered in Shell. Scenario planning involves the creation of a number typically two to four complete scenarios of the future, each of which is self-consistent but significantly different from the others. Under scenario planning, the purpose of the strategy process is to help managers to develop better mental models so that they can deal with change as it occurs. It turns planning into learning exercises and places the emphasis on the process of planning rather than the resulting plans. It is therefore reason of the Learning and Cognitive schools. Scenario planning is being used to an increasing extent, but it does require considerable time and effort to achieve the best results.

10. Conclusion

The PEST analysis is a useful tool for understanding market growth or decline, and as such the position, potential and direction for a business. A PEST analysis is a business measurement tool. This research dealt about the important PEST analysis which is very essential for strategic management. Apart from this analysis the industry analysis, types of industries, the different kinds of strategies to be adopted in the industries and the strategy alternatives are also discussed. After going through this lesson we may understand the Environmental analysis, global environmental dimensions, environmental forecasting, risk and uncertainty in business strategic management.

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About Author:

Dr. Abhishek Gupta (B.Com, MBA, Ph.D) is the Administrative-cum-Accounts Officer & Head of Office, Sardar Swaran Singh National Institute of Renewable Energy (Ministry of New & Renewable Energy, Govt. of India), Kapurthala (Punjab), India. Dr. Gupta is working in Finance & Administrative Department at management level since over twelve years.