

Gillespie: Foundations of Economics - Additional chapter on Business Strategy



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Table of Contents

- A. Business and strategy
- B. Business as a transformation process
- C. Forms of business
- D. Why buy shares?
- E. Mission statements
- F. Objectives
- G. Strategy
- H. The functions of business
- I. Business and the environment
- J. Analysing the micro-environment
- K. Porter's Five Forces analysis of market structure
- L. **PESTEL analysis of the macro-environment**
- M. Opportunities and Threats
- N. Using PESTEL analysis
- O. Influencing the PESTEL environment
- P. Developing a strategy: SWOT analysis

PESTEL analysis of the macro-environment

There are many factors in the macro-environment that will effect the decisions of the managers of any organisation. Tax changes, new laws, trade barriers, demographic change and government policy changes are all examples of macro change. To help analyse these factors managers can categorise them using the PESTEL model. This classification distinguishes between:

- *Political factors.* These refer to government policy such as the degree of intervention in the economy. What goods and services does a government want to provide? To what extent does it believe in subsidising firms? What are its priorities in terms of business support? Political decisions can impact on many vital areas for business such as the education of the workforce, the health of the nation and the quality of the infrastructure of the economy such as the road and rail system.
- *Economic factors.* These include interest rates, taxation changes, economic growth, inflation and exchange rates. As you will see throughout the "Foundations of Economics" book economic change can have a major impact on a firm's behaviour. For example:
 - higher interest rates may deter investment because it costs more to borrow
 - a strong currency may make exporting more difficult because it may raise the price in terms of foreign currency
 - inflation may provoke higher wage demands from employees and raise costs
 - higher national income growth may boost demand for a firm's products
- *Social factors.* Changes in social trends can impact on the demand for a firm's products and the availability and willingness of individuals to work. In the UK, for example, the population has been ageing. This has increased the costs for firms who are committed to pension payments for their employees because their staff are living longer. It also means some firms such as Asda have started to recruit older employees to tap into this growing labour pool. The ageing population also has impact on demand: for example, demand for sheltered accommodation and medicines has increased whereas demand for toys is falling.
- *Technological factors:* new technologies create new products and new processes. MP3 players, computer

games, online gambling and high definition TVs are all new markets created by technological advances. Online shopping, bar coding and computer aided design are all improvements to the way we do business as a result of better technology. Technology can reduce costs, improve quality and lead to innovation. These developments can benefit consumers as well as the organisations providing the products.

- *Environmental factors:* environmental factors include the weather and climate change. Changes in temperature can impact on many industries including farming, tourism and insurance. With major climate changes occurring due to global warming and with greater environmental awareness this external factor is becoming a significant issue for firms to consider. The growing desire to protect the environment is having an impact on many industries such as the travel and transportation industries (for example, more taxes being placed on air travel and the success of hybrid cars) and the general move towards more environmentally friendly products and processes is affecting demand patterns and creating business opportunities.
- *Legal factors:* these are related to the legal environment in which firms operate. In recent years in the UK there have been many significant legal changes that have affected firms' behaviour. The introduction of age discrimination and disability discrimination legislation, an increase in the minimum wage and greater requirements for firms to recycle are examples of relatively recent laws that affect an organisation's actions. Legal changes can affect a firm's costs (e.g. if new systems and procedures have to be developed) and demand (e.g. if the law affects the likelihood of customers buying the good or using the service).

Different categories of law include:

- consumer laws; these are designed to protect customers against unfair practices such as misleading descriptions of the product
- competition laws; these are aimed at protecting small firms against bullying by larger firms and ensuring customers are not exploited by firms with monopoly power
- employment laws; these cover areas such as redundancy, dismissal, working hours and minimum wages. They aim to protect employees against the abuse of power by managers
- health and safety legislation; these laws are aimed at ensuring the workplace is as safe as is reasonably practical. They cover issues such as training, reporting accidents and the appropriate provision of safety equipment

Typical PESTEL factors to consider include:

Factor	Could include:
Political	e.g. EU enlargement, the euro, international trade, taxation policy
Economic	e.g. interest rates, exchange rates, national income, inflation, unemployment, Stock Market
Social	e.g. ageing population, attitudes to work, income distribution
Technological	e.g. innovation, new product development, rate of technological obsolescence
Environmental	e.g. global warming, environmental issues
Legal	e.g. competition law, health and safety, employment law

By using the PESTEL framework we can analyse the many different factors in a firm's macro environment. In some cases particular issues may fit in several categories. For example, the creation of the Monetary Policy Committee by the Labour government in 1997 as a body that was independent of government but had the ability to set interest rates was a political decision but has economic consequences; meanwhile government economic policy can influence investment in technology via taxes and tax credits. If a factor can appear in several categories managers simply make a decision of where they think it best belongs.

However, it is important not to just list PESTEL factors because this does not in itself tell managers very much. What managers need to do is to think about which factors are most likely to change and which ones will have the greatest impact on them i.e. each firm must identify the key factors in their own environment. For some such as pharmaceutical companies government regulation may be critical; for others, perhaps firms that have borrowed heavily, interest rate changes may be a huge issue. Managers must decide on the relative importance of various factors and one way of doing this is to rank or score the likelihood of a change occurring and also rate the impact if it did. The higher the likelihood of a change occurring and the greater the impact of any change the more significant this factor will be to the firm's planning.

It is also important when using PESTEL analysis to consider the level at which it is applied. When analysing companies such as Sony, Chrysler, Coca Cola, BP and Disney it is important to remember that they have many different parts to their overall business - they include many different divisions and in some cases many different brands. Whilst it may be useful to consider the whole business when using PESTEL in that it may highlight some important factors, managers may want to narrow it down to a particular part of the business (e.g. a specific division of Sony); this may be more useful because it will focus on the factors relevant to that part of the business. They may also want

to differentiate between factors which are very local, other which are national and those which are global.

For example, a retailer undertaking PESTEL analysis may consider:

- *Local factors* such as planning permission and local economic growth rates
- *National factors* such as UK laws on retailer opening hours and trade descriptions legislation and UK interest rates
- *Global factors* such as the opening up of new markets making trade easier. The entry of Bulgaria and Rumania into the European Union might make it easier to enter that market in terms of meeting the various regulations and provide new expansion opportunities. It might also change the labour force within the UK and recruitment opportunities.

This version of PESTEL analysis is called LoNGPESTEL. This is illustrated below:

	LOCAL	NATIONAL	GLOBAL
POLITICAL	Provision of services by local council	UK government policy on subsidies	World trade agreements e.g. further expansion of the EU
ECONOMIC	Local income	UK interest rates	Overseas economic growth
SOCIAL	Local population growth	Demographic change (e.g. ageing population)	Migration flows
TECHNOLOGICAL	Improvements in local technologies e.g. availability of Digital TV	UK wide technology e.g. UK online services	International technological breakthroughs e.g. internet
ENVIRONMENTAL	Local waste issues	UK weather	Global climate change
LEGAL	Local licences/planning permission	UK law	International agreements on human rights or environmental policy

In "Foundations of Economics" we focus on the economic environment. We examine issues such as the effect of interest rate changes, changes in exchange rates, changes in trade policy, government intervention in an economy via spending and taxation and economic growth rates. These can be incredibly important factors in a firm's macro-environment. The growth of China and India, for example, have had massive effects on many

organisations. Firms can relocate production there to benefit from lower costs; these emerging markets are also providing enormous markets for firms to aim their products at. With a population of over 1 billion, for example, the Chinese market is not one you would want to ignore; at the same time Chinese producers should not be ignored either. However, the relative importance of economic factors compared to other factors will depend on the particular position of a business. Exchange rate fluctuations may be critically important to a multinational but less significant to a local window cleaner. Rapid economic growth or economic decline may be very significant to a construction business that depends heavily on the level of income in the economy but may be slightly less significant to a milk producer whose product is less sensitive to income. So whilst the economy is important to all firms on both the supply side (e.g. unemployment levels affect the ease of recruitment) and demand side (e.g. income tax affects spending power) the relative importance of specific economic factors and the relative importance of the economy compared to, say, regulation or social trends will vary. Whilst we hope this book provides a good insight into the economy and the possible effects of economic change on a business these must be considered in the light of other macro and micro factors that influence a firms' decisions and success.

