CHAPTER - 3

BUSINESS ENVIRONMENTAL FACTORS -
A CONCEPTUAL FRAME WORK

This chapter consists of the meaning of entrepreneurial environment and the different business environmental factors identified in literature as likely to influence the growth of enterprises, as well as how the lack of them can constrain the development of enterprises in our country. The focus of this literature review, then, is to outline the logic used for the selection of variables for the research interview schedule. To determine the different business environmental factors to be included in the study a number of text books were reviewed.


The conditions or situations that affect business activities may be regarded as the environment of business. In other words, business environment refers to the surroundings and circumstances, which influence business operations. This environment consists of forces and factors, internal or external to a business firm. The skill and ability of employees, their attitude to work, relations between managers and subordinates etc may be regarded as internal environment of business. These are important factors, which may affect business operations. But these are within the control of the businessman. By taking suitable steps the conditions can be improved. On the other hand, external environment refers to all those aspects of the surrounding of business, which are not within the control of the managers and may affect business activities to a great extent.
The external environment has, broadly, two components, viz, business opportunities and threats to business. Similarly, the organizational environment (i.e., the internal environment) has two components: Strengths and weaknesses of the organization. The business decisions are conditioned by two broad sets of factors, viz, the internal environment and the external environment.

Factors Influencing Business

3.1.1. Definitions of Business Environment

The word business environment is defined by various authors as follows.

“Business Environment encompasses the ‘climate’ or set of conditions, economic, social, political or institutional in which business operations are conducted” Arthur M. Weimer.

“Environment contains the external factors that create opportunities and threats to the business. This includes socio-economic conditions, technology and political conditions” William Gluck and Jauch.
“Business Environment is the aggregate of all conditions, events and influences that surround and affect it”. Keith Davis.

“The environment of business consists of all those external things to which it is exposed and by which it may be influenced directly or indirectly”. Reinecke and Schoell.

“The total of all things external to firms and industries that affect the function of the organization is called business environment” Wheeler³.

On the basis of the above definitions, it is very clear that the business environment is a mixture of complex, dynamic and uncontrollable external factors within which a business/industry is to be operated. But internal factors also have a bearing on the strategy and other decisions of an enterprise.

3.1.2. Importance of the Study of Business Environment.

Before analyzing the various external environmental factors, let us consider the importance of the study of business environment.

1. The study of business environment helps an organization to develop its broad strategies and long term policies.

2. It enables an organization to analyze its competitors’ strategies and thereby formulate effective counter strategies.

3. Knowledge about the changing environment will keep the organization dynamic in its approach.

4. Such a study enables the organization to foresee the impact of the socio-economic changes at the national and international level on its stability.
5. Finally, as a result of the study, the executives are able to adjust to the prevailing conditions and thus influence the environment in order to make it congenial to business.  

3.2. **Types of Business Environment**  

The environment of business is always changing and it is uncertain. The business environment can be under two levels:-  

A. Internal or Organization Environment  
B. External Environment:-It consists of-  
   1. Micro Environment  
   2. Macro Environment  

3.2.1. **Internal Environmental Factors**  

Important internal factors which affect the enterprises are:-  

3.2.1.1. **Value system**  

The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and objectives of the organization, business policies and practices.  

3.2.1.2. **Management structure and nature**  

The organization structure, composition of board of directors, extent of professionalization of management etc are important factors influencing business decisions.
3.2.1.3. Internal power relations

Factor like the amount of support the top management enjoys from different levels of employees, shareholders and board of directors have important influence on decisions and their implementation.

3.2.1.4. Human resources

The characteristics of the human resources like skill, quality morale, commitment, attitude etc; could contribute to the strength and weakness of an organization. Some organizations find it difficult to carry out restructuring or modernization because of resistance by employees where as they are smoothly done in some others.

3.2.1.5. Company image and brand equity

The image of the company helps while raising finance, forming joint ventures or other alliances, soliciting marketing intermediaries, entering purchase or sale contracts, launching new products etc.

3.2.1.6. Miscellaneous Factors

There are a number of other internal factors which contribute to the success/failure of a business or influence decision- making in business. They include the following.

- Physical assets and facility like the production capacity, technology and efficiency of the productive apparatus, distribution logistics etc are among the factors which influence the competitiveness of a firm.
• *Research and development and Technological capabilities*, among other things, determine a company’s ability to innovate and compete.

• *Marketing resources* like the organization for marketing, quality of marketing men, brand equality and distribution network have direct bearing on marketing efficiency.

• *Financial factors* like financial policies, financial position and capital structure are also important internal environment affecting business performance, strategies and decisions.

### 3.2.2. External Environment of Enterprises:

It consists of

1. The Micro Environment of Enterprises
2. The Macro Environment of Enterprises

### 3.2.2.1. The Micro Environment of Enterprises

The micro environment consists of the factors, having direct bearing on the performance of an enterprise. These factors are more closely linked with the business than the macro factors. The micro environment factors are discussed below:

**a. Suppliers**

These are the firms and individuals who supply the input like raw materials and components to the company. It is very important to have a reliable source of supply. Uncertainty regarding the supply or other supply problem will compel the
companies to maintain high costs. It is very risky to depend on a single supplier. Hence the company should have multiple source of supply.\(^6\)

b. Customers

According to Peter F. Drucker, “There is only one valid definition of business purpose, that is to create a customer”. A business exists only because of its customer. A company may have different categories of customers like individual, household, industries and other commercial establishments, and government and institutions.

Depending on a single customer is often too risky because it may place the company in a poor bargaining position. With the growing Globalization, the customer environment is increasingly becoming global. Not only that the markets of other countries are becoming more open, the Indian market is becoming more exposed to the global competition and the Indian customer is becoming more “global” in his shopping.\(^7\)

c. Competitors

The success of an enterprise depends upon its ability to satisfy the needs and wants of consumers better than those of its competitors. The most common competition which a company’s product now faces is from differentiated products of other companies. eg. Philips TV faces competition from other companies like Videocon, BPL etc. (ie, brand competition). Philip Kotler is of the opinion that the best way for a company to grasp the full range of its competition is to take the viewpoint of buyers.\(^8\)
Due to the liberalization, the competitive environment in India has been undergoing a sea change. Many companies restructured their portfolio and strategies. In many industries where a seller’s market existed a buyer’s market has emerged.

d. Marketing Intermediaries

These are the firms that help the company to promote, sell and distribute its goods and services to the final buyers. They include middlemen, physical distribution firms, marketing services agencies and financial intermediaries. Middlemen such as wholesalers and retailers buy merchandise and resell. Physical distribution firms such as warehouses and transportation firms help the company to stock and move goods from their point of origin to destination. Marketing service agencies such as marketing research firms, advertising agencies and marketing consulting firms help the company in targeting and promoting its products to the right markets. Financial intermediaries such as banks, credit companies and insurance companies help in financial transactions or insure against the risks associated with the buying and selling of goods. The company has to develop strong relationship with all these for the successful operation of its business.

e. Financiers

Another important micro environmental factor is the financiers of the company. Besides the financing capabilities, their polices and strategies, attitudes (Including attitude towards risk) ability to provide non-financial assistance etc. are very important.
f. Public

A company has to protect the interest of certain public in its environment. The environmentalists, consumer protection groups, media persons and local people are some of the well known examples of public. In our country some companies are seriously affected by media public. Some companies are affected by local publics. Environmental pollution is an issue often taken up by a number of local publics. Non-government organizations (NGOs) have been raising protests against child labour, cruelty to animals, environmental problems, deindustrialization resulting from imports and so on\textsuperscript{11}.

g. Labour

The companies, where hundreds of workers are employed, the labour force is organized in the form of trade unions. The trade unions interact with the management for higher wages and bonus, better working conditions etc. They pressurize the management for the fulfillment of their demand and even resort to go slow tactics such as strikes, gherao etc..

h. Regulatory Agencies:

The regulators include government department and other organizations which monitor the activities of business. The example is income tax department, other revenue departments, quality control departments etc. Besides these professional bodies such as Institute of Chartered Accountant of India may also prescribe certain standards and practices for the business in their respective areas\textsuperscript{12}.
3.2.2.2. The Macro Environment of Enterprises

Macro environment is also known as general environment. The macro forces are generally, more uncontrollable than the micro forces. When the macro environment is uncontrollable, the success of an enterprise depends on its adaptability to the environment. Important macro environment factors include: economic environment, technological environment, natural environment, political and governmental environment, Socio-cultural environment, demographic environment and Global environment.\(^{13}\)

a. Economic Environment

Economic environment of a business has reference to the broad characteristics of the economic system in which the business operates. The survival and success of a business enterprise is finally decided by the economic environment and various market conditions. The economic environment comprises a wide spectrum of items, namely land, availability of raw material, skilled labour, infrastructure, machinery and capital. In addition to these the other important external factors that affect the economic environment of a business are as follows.

a.1. Economic Condition

The general economic conditions prevailing in the country viz national income, per capital income, economic resources, distribution of income and assets, economic development etc are important determinants of the business strategies. Business cycles and economic growth of the economy are important factors defining the economic environment. The stage of economic development decides the size of
the local or domestic market. In economies where the income of the people is rising, the business prospects will be brighter and investment will get automatics attraction. Recently growing income of middle class in India has encouraged foreign investors to invest in India\textsuperscript{14}. Other important economic conditions are Human resources, Foreign exchange reserve position, Demand and supply trends, inflation/ Deflation etc.

**a.2. Economic System:**

The economic system operating in the country also affects the business enterprise to a very great extent. The economic system of a country may be capitalist, socialist, communist or mixed.

**a.3. Economic Policies: -**

There are several economic policies which can have a very great impact on business. Important economic policies are industrial policy, trade policy, foreign exchange policy, monetary policy, fiscal policy and foreign investment and technology policy, business laws etc.

**a.3.1. Industrial Policy:-**

Industrial policy can even define the scope and role of different sectors like private, public, joint and cooperation, or large medium, small and tiny. It may influence the location of industrial undertaking, choice of technology, scale of operation, product mix and so on.

In India, until the liberalization ushered in 1991, the scope of private sector, particularly of large enterprises, was very limited. In pre-liberalization era, the
government policy was a severe constraint on the portfolio and growth strategies of companies. The liberalization has enormously expanded the business opportunities. It has at the same time tremendously increased the competition tending to make survival of the fittest the order.

a.3.2. Trade Policy

Trade policy can significantly affect the fortunes of the firms. For example, a restrictive import policy or a policy of protecting the home industries, may greatly help the import competing industries, while a liberalization of the import policy may create difficulties for such industries. As part of economic liberalization and WTO compliance, India has very substantially liberalized imports. Domestic firms now face increasing competition from imports. Many Indian firms which do not come up to the international standards-in quality, cost marketing, after sales service etc. will not be able to survive.

a.3.3. Foreign Exchange Policy

Exchange rate policy and the policy in respect of cross border movement of capital are important for business. The abolition /liberalization of exchange controls all-round the world since the late 1970’s has encouraged cross-border movement of capital.

a.3.4. Foreign Investment and Technology Policy

After 1991, foreign capital and technology policies have been substantially liberalized. It will increase the domestic competition. At the same time it would
benefit many domestic firms - by permitting global sourcing of capital and technology.

a.3.5. Fiscal Policy

Government’s strategy in respect of public expenditure and revenue can have significant impact on the business. Public expenditure improves the infrastructure facilities within the country. Different taxation policy like Income Tax, VAT, excise duty etc. of the Government will affect the business/industries.

a.3.6. Monetary Policy

Monetary policy of the central bank like increase/decrease in Cash Reserve Ratio (CRR) or Statutory Liquidity Ratio (SLR), Repo rate etc will significantly affect the volume of loanable fund with the commercial banks.

b. Technological Environment

Technological environment consist of those factors related to knowledge applied and the materials and machines used in the production of goods and services that have an impact on the business of an organization. Technological changes may enable a firm to achieve its objectives or threaten the existence of the firm. A firm which is not able to cope with changing technology may not survive. Fast changes in technological factors can create problems as they render plants and products obsolete very quickly. Technological development may increase the demand for some existing products. For example, voltage stabilizer helps to increase the sale of electrical appliances.
The information technology has vastly transformed the marketing and financial marketing scenario. Technology often provides a competitive advantage success in many industries. Success in many industries has a lot to do with R&D and innovation. There are many factors which stimulate the innovative drive of a firm. These include the company’s own strategy, demanding customers, competition, certain social forces, government policies etc. An important strategic issue confronting many firms is whether to be a technology leader or follower—there are a number of advantages and disadvantages associated with both.

A Company may also source a technology externally, like from R&D Organizations, other firms (including foreign firms). While sourcing foreign technology the firms should ensure that the technology it chooses is the appropriate one and should be able to properly absorb the technology. Restrictions on foreign technology, scale of the operation, type of technology etc very adversely affected the Indian business in the past. The liberalization has significantly improved the situation. 18

c. Natural Environment

As Watrick and Wood observe, “the natural environment ultimately is the source and support of everything used by business (and almost any other human activity)—every raw material, every energy source, every life-sustaining factor, even every waste disposal site”. The geographical and ecological factors, such as natural resource endowments, weather and climate conditions, topographical factors, locational aspects in the global context, port facilities etc. are all relevant to business. Ecological factors have recently assumed great importance. The depletion
of natural resources; environmental pollution and the disturbance of ecological balance have caused great concern\textsuperscript{19}.

\textbf{d. Political and Government Environment}

Political and government environment has close relationship with the economic system and economic policy. In the present world, government intervention in business activity is a hard fact. Under a democratic set up, the ideology of the ruling party influences ownership, management and size of a business. Political stability of the country is another factor which affects business activities. Business thrives where there is political stability. All business firms are affected greater or lesser level by the changes in government programs at the central, State or local bodies. Such programs are usually the result of shifts in the political weather arising from changes in the attitudes, preferences and objectives of voters and political leaders. Businessmen try to anticipate changes in government policies or in the political forces at the back of them so that they may be able to operate successfully\textsuperscript{20}.

In many countries, there are a large number of laws that regulate the conduct of the business. These laws cover matters as standard of product, packing, promotion, ethics, ecological factors etc. For most countries, protecting the interest of consumers, governments have introduced so many regulations. There are so many statutory controls on business in India. Although the controls have been substantially brought down as a result of liberalization, a number of controls still prevail\textsuperscript{21}.

Governments pass legislation on such matters as wages and prices, employment opportunities, safety and health at work, location, what the plant can
emit into the air, how much noise the product can make and other similar matters. The actions of the Government affect the strategic choices of business. They may increase or curtail business opportunities. The following are some of the examples of opportunities that are created by the actions of Governments. - Governments are large purchasers of goods and services. - Central as well as State Governments in our country provide subsidies and incentives to small-scale industries which help them to withstand competition from large industries. - Governments protect home industries against “unfair” foreign competition.

e. Demographic Environment

Demography refers to the study of the human population especially with reference to age structure, gender, income distribution, family size, family life cycle (for eg:- young, single, married, no children, young married with children…..), occupation, education, social class, religion, race, nationality etc. All these factors have very significant implications for business. All these informations relating to population help in selecting the items to produce, the channel of distribution, advertising media, choice of marketing methods and other business decisions. The choice of manufacturing or trading site would be influenced by the size of the population. Governments always look to the demographic considerations in terms of their licensing policy. Manufacturing units, particularly those which cause air or noise pollution are not permitted to operate in thickly populated area that is the reason why every State Government has established industrial estates away from residential areas.
If there is a change in population, there will be a change in the demand for products or services. If there are fewer people to buy a product or services, the primary demand for that product or service will be affected. In developed countries like U.S.A and Canada the population growth rate is declining. In the case of underdeveloped countries like India, population growth rate is increasing. This can affect a firm’s location strategy.  

f. Socio-Cultural Environment

The type of products to be manufactured and marketed, the marketing strategies to be employed, the way the business should be organized and governed, the values and norms it should adhere to, are all influenced by the social structure and culture of a society.

The buying behavior of consumers, their preference, attitudes, beliefs, lifestyles and social values change over a period of time. These social and cultural changes affect the business strategies of an organization.

Culture, broadly determines the type of goods and services a business should produce. The type of food people eat, the cloth they wear and building material they use to construct houses, vary from culture to culture. The values and beliefs associated with colour also vary from culture to culture. Green is favourite colour in Arab countries, where as in Malaysia it is associated with illness. Red is a favourite colour in communist countries, where in many African countries, it is an unpopular colour. Therefore, while designing a product, the business must take into account the values and beliefs associated with colours.
Social changes also influence the business policies of an organization. Some examples are:- Once it was thought that three children are sufficient for a family. Now people prefer to have a small family with one child. This change has a big impact on baby food, toys and other such items. At one time, retired people lived with their children. Now the trend is to live alone. This has a big impact on builders.

Newer attitude on the part of the workers and employees about how many hours they wish to work, what kind of supervisory style they expect etc, affect the strategy formulation of a business. The emergence of strong consumer movement is having its own impact on business strategy. The growth of strong consumerism in India has led to the passing of consumer protection Act, 1986\(^\text{25}\).

\textbf{g. International(Global) Environment}

The international environment mainly consists of those factors which have an impact on foreign trade of a country due to globalization and privatization. Those factors may be foreign policy, international treaties and foreign investment policy and various acts which are concerned with the dealings with other countries in trade matters. With the introduction of economic reforms and the policy of liberalization in our country, our exports have increased considerably and many foreign companies started to trade with our country\(^\text{26}\).

Globalization has both beneficial and harmful effects. Indian business suffers from a number of disadvantages in respect of globalization of business. The government policy and procedures in India are among the most complex, confusing and cumbersome in the world. Another problem is that the high cost / inadequacy of
many vital inputs and other factors like raw materials and intermediates, power, finance, infrastructure facilities like port etc. tend to reduce the international competitiveness of the Indian business. There are also problems related to technology, small size and lack of experience of firms, poor quality, lack of R&D efforts etc.

Although India has several handicaps, there are also a number of favourable factors for globalization of Indian business. These include the human resources, growing entrepreneurship, growing domestic market, growing foreign market for Indian products etc.²⁷

The new economic policy of India is expected to encourage the internationalization of Indian business with removing all international environmental obstacles. The increasing domestic competition is compelling many companies to pursue international trade. The foreign collaboration is enabling Indian companies to upgrade their production methods.²⁸

From the above discussions, it is clear that the business environment is dynamic. Many environmental factors change either frequently or periodically. Hence, business policy and strategy should be dynamic enough to meet the changing environment. The success or failure of an enterprise whether it is small or large, depends upon the support of favorable business environment where it operates.
References

11. Cherunilam, Francis, *op. cit.*., p. 3.
27. Cherunilam, Francis, *op. cit.*.,p. 656.