



UNIT-1

Internal and External Environment Analysis

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Discuss what Business Environment is
- ✓ Explore the social responsibility of businesses and business ethics

Unit 1

Internal and External Environment Analysis

There are certain conditions that need to be understood and fulfilled in order for a business to flourish in any environment. Be it for production or for the purchase or sales of goods and services, one has to keep in mind the kind of environment they are working with and adapt its working to the environment.

Just as the growth of a plant depends upon its environment, so does the growth of a successful business. Business Environment in simple terms are the factors that need to be looked into and followed in order to run a successful business which aims to earn profits.

One can define Business Environment as – all those external and internal factors that are highly important for its survival and affect its course and function. The Business Environment for any region or country can be split into two aspects: **Internal and External**.



Fig: 1.1

- **Internal Aspects**

- Internal aspects are factors that are responsible for the smooth functioning of the enterprise, i.e. the workers responsible for the production, the machinery, the money and the material and, finally, the management. These are the factors within one's control and can be altered as per the requirement.

- **External Aspects**

- These are factors or conditions that cannot be controlled or sometimes might even act as a threat to the survival of the enterprise. The external environment, again, is divided into two parts: **Micro and Macro**.
- **Micro Environment** is closer to the operation of a business. **It is important to build a fine working relationship with these factors.** The quality, the cost of production, and the success of the business depends on the relationship that has been developed with these factors.



Fig: 1.2

The factors that come into Micro environment are:

- a. **The suppliers;** who deliver the materials required for the production. Depending solely on one supplier could create a threat to the smooth operation of a business.
 - b. **The customers;** who include all the various kinds of buyers from the wholesalers and retailers to the government, etc. The success of any business falls mainly on the satisfaction of the customers.
 - c. **The middlemen;** who work as a link between the consumers and the business.
 - d. **Competitors;** It is essential to study the competitors of any business in any market and to keep introducing new ways to win over the loyalty of new and existing customers.
 - e. **The public;** which includes the local media as well as the citizens or the target of the business who may or may not be the users of the product.
- **Macro Environment** is usually more uncontrollable than the micro environment. When a business can successfully adapt itself to the factors in the Macro environment, it can survive in that environment. **They are the social, political, legal, technological, institutional and, of course, economical aspects of any society or culture.**

One needs to have a clear understanding of these factors to navigate the business through any sudden changes that might occur in any one of these factors. Macro environment can pose threats to the business and also create opportunities for it to successfully move forward.

The conditions in the macro environment could be anything from, a new government rule or law that requires a certain material's immediate discontinuation, a change in the standard of requirements, a change in the taste and hence the demand of the customer's needs, or the introduction of a similar product by a competitor.

These factors are beyond the control of an individual and are completely external. These factors are:

Economical	Social
Political	Cultural
Legal	Technological
National	International

The economic Factors are concerned with the economic conditions and laws of a certain country, and **non-economic** factors have to do with recent developments in technology, changes in nature, or natural calamities.

Import and export laws of different countries and their foreign policies, the ideals of the current ruling political party, and the beliefs and customs of the people in the nation are also considered the economic factors.

They need to be carefully studied and an eye must be kept on the development to avoid the risk of shocks. Needless to say, these factors are unpredictable and highly important.

While the conditions are basic and true for any environment, **the social aspects** also come into play. For example, the tastes of the people in one country will obviously differ from that of another. Their requirements and expectations will be different too.

Before even thinking of opening a business in any market, one must carefully study the needs and the running of the people of that particular society, and the current competition and the work practices of suppliers, middlemen, and the agencies that are essential for the business.

A successful assessment of the working of the society or the environment will then enable the business to learn about the various opportunities and areas where the business can expand and grow.

By understanding the culture, the business can shape up its image in a way that would win over its prospective customers.

Thorough research and analysis will help the business present itself in a way that would please and attract the market and win them over from existing competitors. Without research, it is impossible to improve and remain one step ahead of the competition.

It would also help the firm understand its own positives and negatives or what could help its image and sales and harm its growth in the market. It could then work on bringing up a more customer friendly front.

Types of Businesses and Their Ownership

A business is an organization run by an individual or a group of individuals with a common interest to trade goods, ideas or services to customers to earn profit. A business can be of different types depending on what it is trading or dealing with, or who runs the business.

There are a few globally recognized business entities or systems. They are legally recognized by all countries. In addition, different countries also have different laws for certain businesses. However, the following are the main types of globally recognized business.

Corporations	Co-operatives
Partnerships	Sole Traders
Limited Liability Companies	

Corporations

A corporation is created under the laws of the state, but it has detached accountability, i.e. the leader and the corporation are treated as different entities, and the corporation is held accountable for its liabilities and achievements.

This means that the corporation is treated as an individual or a separate legal entity. A business that is recognized as a separate legal entity has some of the same rights as a person in a court of law.

It can enter contracts, it can be held accountable for any loss or profit, and it can also be sued (like a person) by other companies or individuals and held accountable for any damages to be paid.

In this case, it would use the name of the company and not the members of its board or its shareholders. A corporation can also use its name to sue another corporation, management, state, or individual against any misdemeanour done towards it.

In most countries, a corporation can be created through registration. It has many types, but they are mainly used to conduct business. If a corporation fails for whatever reason, its shareholders or employees are not liable to pay any debt created by it.

There is a special area of law created for corporations called corporate law, with lawyers who specialize in this area and run cases for it.

Co-Operatives

A co-operative is an association of people that are self-governed and work for the benefit of their economic, social or cultural benefit. These can be non-profitable organisations that are run by various communities for the benefit of their community (or for a cause) and also by a group of people who use its services.

These are owned and managed by the people involved in the co-operation. The name comes from the word which means to co-operate for a certain cause or a similar purpose.

It can be on a small scale, like a building or housing co-operation, where the various owners of the houses or apartments of a certain area come together to work for the mutual benefit and betterment of their society, manage its funds, and take care of any repairs or problems that arises.

Or it can be on a larger scale like workers co-operatives, where the workers of a factory, or an enterprise or a group of enterprises with similar dealings come together to work for the benefit of its members, or cooperative banks that are mostly non-profit in nature.

Partnerships

A partnership is a type of business that is run by two or more individuals who have the same goals and aims for the business. A partnership is a common thing among people around the world, but when it is done for economic purposes, it becomes a business partnership.

These can be temporary in nature between two or more organisations and even nations, who come together to work on one goal, or they can be a permanent partnership. Some partnerships (like in law firms) add new partners to the agreement between fixed times.

- **Sole Traders**

Sole traders or sole proprietorship, is a business run by one individual who is completely responsible for its liabilities and achievements. He owns every aspect of the business and is responsible for all the debts and has the sole right to the profits.

The business is owned by one individual alone, even though she may have men working under her. She may use an assumed or business name during trade. However, it must be in accordance with the law of that nation.

Some laws require the name of the owner to be printed on the various products, cards, and buildings owned or distributed by the business.

- a) **Limited Liability Companies**

A limited liability company is a mix of a corporation and a partnership. **In such a company, one partner or member of the business is not responsible for the mess or trouble created by another.** The partners of this business type have the right to administer and manage the many dealings of the business directly.

However, limited liability companies have different rules and laws in different countries. Some countries require the companies to elect one general partner with unlimited liability. Every partner, as the term suggests, has limited liability towards the losses and gains of the company.

Importance of Business Environment

There is a close and continuous interaction between the business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively. As stated above, the business environment is multifaceted, complex, and dynamic in nature, and has a far-reaching impact on the survival and growth of the business. To be more specific, proper understanding of the social, political, legal, and economic environment helps the business in the following ways:

- a) **Determining Opportunities and Threats:** The relations between the business and its environment would identify opportunities for and threats to the business. It prepares the business enterprises for meeting the challenges successfully.

- b) **Giving Direction for Growth:** It enables the business to identify the areas for growth and expansion of their activities.
- c) **Continuous Learning:** Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding, and skills to meet the predicted changes in realm of business.
- d) **Image Building:** Environmental understanding helps the business organisations in improving their image by showing their sensitivity to the environment within which they are working.
- e) **Meeting Competition:** It helps the firms to analyse the competitors' strategies and formulate their own strategies accordingly.
- f) **Identifying Firm's Strength and Weakness:** Business environment helps to identify the individual strengths and weaknesses in view of the technological and global developments.

Types of Business Environment

1. Economic Environment

Various economic factors or conditions come into play and affect the working and plans of a business. These factors or conditions are known as the **economic environment**. They come under the external factors of a business environment and are out of one's control.

They are highly unpredictable and often change from time to time. The economic environment depends on factors like the economic conditions, economic systems, and the government's economic policies at the time.

a) Economic Conditions

The economic conditions of a nation largely affect the sales and in turn the success of a business. For example, if a country is struggling with recession, it is less likely that the people of that country would spend on goods and services that they can do without or are not essential for their comfort like cars and vacations, etc.

On the other hand, if the country is doing very well economically, then it is more likely that the people of that nation would splurge on items of comfort and luxury. While opening a business in any country, it is important to first keep in mind the conditions of the economy, and then to assess if the products that the business would promise to sell would be worth the people's money.

This would also affect the cost of production, depending on the prices of various materials in the market and the inflation level at the time, and the production quantity and quality. If the economy of the country is in prosperity or is booming, there are high chances of the business being successful.

b) Economic System

The economic system that a country follow (i.e. mixed, capitalist, or socialist) is also an important factor as its rules and regulations will affect the working and the market of the business in that country.

For example, in a capitalist country where the aim is profit earning, companies have the freedom to make their own decisions and the government will not interfere with its decisions. While in a socialist country, there is heavy involvement from the government, even down to the occupation of its citizens.

c) Economic Policies

The government of every nation passes certain economic policies which depend on its ideology or philosophy. These policies are very important for every business.

They have no choice but to abide by the policy and it may or may not be in their favour. Out of the economic policies the industrial, fiscal, monetary, foreign investment, and export import policies are very important.

The policies change as per the economic conditions, the developments in the market scene, and the party's goals. Every country expects the businesses of their nation to abide by these policies strictly. These are important to keep a check on the business. However, they can work in one's favour too.

Industrial policies are those policies which the government frames to control the industrialization of the country. Even though every country would naturally support industrialization, there are certain guidelines that it would wish for businesses to follow.

Fiscal policies are also known as budget policies. Every country works within the confines of a budget plan, and it wishes the businesses in its nation to follow certain rules and to keep to a certain limit when it comes to borrowing and spending. This policy also deals with the taxes every business must pay.

Monetary policies are framed by the central banks of every country to control the rates of interest.

Foreign Investment policies are made to control the level of investment of foreign countries in that nation. Aside from these, the technological developments around the world are also important for the economic environment. The world is striving to come up with inventions that would help cut the cost of production and increase its speed.

It is essential for any business to work using the latest developments in production. If not they might be at a risk of higher cost of production and sales and lose in the market amongst their competitors.

It is also important to keep in mind the latest trend among the society of a particular environment. A product that is out of date will not do well in the market. It would be wise to stay ahead of the trend and times rather than to lag behind.

2. Non-Economic Environment

a) Political Environment

The political environment of a market depends upon the ruling political party or the government of the time. The changes in this field are completely dependent on the policies, ideologies and philosophies of the ruling party, its attitude towards the business or the firm, and also on the longevity and guarantee of its term or rule.

Political environment is one of the external macro environmental factors affecting business. One must always keep an eye on the change in the governments and its policies.

Foreign investors can flourish in a country where the ruling political party works in its favour and suffer greatly if it does not support its business and imposes high tariffs and taxes on the import quotas, etc. The political beliefs of a country and a party, and its strength and power in that nation will affect the progress of a business.

The stability of the ruling party would also influence investor's decisions to invest in a country or not. A ruling party that does not have the faith of the people, or appears too domineering, would fail to earn the faith of interest groups and foreign investors as they would not want to be a part of any volatile situations that might arise in the future.



Fig: 1.3

Also, if the party is liberal and open to expanding and globalising its country, it would create a favourable environment for foreign business entities, on the other hand a political party that is wary of these would serve to do the opposite. In countries where most businesses have a tie in with political parties, would suffer economically with strikes and protests by workers and unions. Poor management and carelessness would create troubles for the business.

And as stated earlier, the type of government also affects the progress of a business. In a democracy where people have a choice to trade and create a business as they wish, within the confines of the law, it would be easier to run a business and to carry out trade.

But in dictatorial nations, or totalitarian countries, where there would definitely be a definite interference by the rulers, businesses would find it difficult to flourish and to create a stable market for them.

Corrupt governments would make it impossible for businesses to carry on their dealings without paying bribes in various areas. They might create trouble for the business if they refuse. It would be wise for a business to keep a check of who would support or oppose their business.

If they face opposition from opposition parties, they might find trouble for themselves in the event that party comes into rule. It is not uncommon for big businesses to come under problems with politics, even if they are not the main culprit or have done nothing wrong.

It is important to have favourable political relationships as it would open doors for that business in national as well as the international markets that the country deals with. There would be lesser risks to the business and more opportunities would find its way to them and create a more stable business environment.

If a country is undergoing war, there could be far worse troubles for a business, especially for foreign entities looking to start their branch in another country.

b) Legal Environment

Legal environment comes under the external macro environmental factors that affect the growth of a business. The legal environments depend on the legal systems of the countries which differ from country to country. Every business must obey these laws without a choice. The domestic laws of the country and of the foreign markets and also the laws of business followed globally are the factors that come into play in the legal environment. The laws that were passed globally are:

<ul style="list-style-type: none"> • Companies Act, 1956 • Foreign Exchange Management Act, 1999 • The Factories Act, 1948 • Industrial Disputes Act, 1972 • Payment of Gratuity Act, 1972 • Industries (Development and Regulation) 	<ul style="list-style-type: none"> • The Standards of Weights and Measures Act, 1956 • Monopolies and Restrictive Trade Practices Act, 1969 • Trade Marks Act, 1999 • Bureau of Indian Standards Act, 1986
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<p>Act, 1951</p> <ul style="list-style-type: none"> • Prevention of Food Adulteration Act, 1954 • Essential Commodities Act, 2002 	<ul style="list-style-type: none"> • Consumer Protection Act, 1986 • Environment Protection Act • Competition Act, 2002
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Aside from these, new and flourishing businesses must also follow other laws that the government of certain nations (or global unions) pass from time to time. This can affect everything from the packaging to the contents of a product and its advertising.

In most cases, business enters into contracts that have the written terms of the agreements conducted with the nation. Legal laws and regulations also form the way businesses are created in a nation. How they would work, how they would progress, and who they would be liable to.

Some countries do not have strict laws when it comes to copyrighting and legal ownership and distribution of goods and services. While in some, the laws are really strict.

A country whose legal system is effective and works smoothly attracts foreign investors and groups, whereas one with glitches in the legal system, and one that is faced with corruption can turn away many investors.

Starting up businesses could also be trouble, or easy for hopeful entrepreneurs, as per the registration laws of the country. And if a business offends the sentiments of the people of the nation, it might have to face charges or penalty.

The terms of the contracts that a business signs are to be followed to the letter and the same can be enforced by courts. The contracts must, of course, be ethical and fair to all the parties involved and in terms of business contracts it must be in writing.

It is essential to keep in mind the above laws of business in every country, and also the laws that the country passes. A business that wishes to work on legal terms must account for every action it takes and every contract it enters. It is also important to keep an eye on the activities of the competition.

If they enter into a contract with the state or another company, they must research on the benefits and the terms of the contract. Legal environment is one of the essential areas to concentrate on while starting or working on any business.

c) Social Environment

The social environment accounts for the behaviour of the society. A proper analysis of the way the society of a particular region or country works would help a business bloom in that part.

The knowledge and understanding of everything that makes a society, its people, the caste, religion, attitude of the people towards various aspects of the world, their values, their beliefs, and the life expectancy of the people of that region, would then help the business to create an image amongst the people that would seem favourable.

In turn the locals would invest in the business, buy the products, and support the business. For example, in a country that mainly consists of vegetarians, it would be difficult for restaurant chains to open business and find profit with a completely non vegetarian menu. They would have to add some vegetarian items in their menu in order to compete with the market.

Every society is a part of a culture that celebrates various festivals. Even if the business is of a foreign land, it would be wise to create certain activities that would show their support for the festival, by either giving discounts during the festival or creating products that would be beneficial during the occasion.

This would bring them closer to the customers in the market. A business cannot carelessly operate without keeping in mind what could potentially hurt the sentiments of a society.

Even if certain aspects are not written in the law of a nation, and even considered legal, it would be wise to delve deeper into the thinking of the people and introduce ways to work around the restrictions of certain practices.

If a society is such where nature is considered God, then a business that works on cutting trees, infecting the air by emitting toxic fumes from their factories, uses certain materials that could harm the environment, produces too much trash or uses animals skin or meat in its products would face opposition from pressure groups and might even have to close down in the future.

It would also create trouble for the society, instead of helping it grow. A business can only flourish if it helps the society flourish too. It is the responsibility of every entrepreneur to manage their business in such a way that it would not harm any aspect of the society.

If not, the government or management of that nation or region could impose taxes, penalties, or laws on such an enterprise. On the other hand, if it benefits the society, they would then create more opportunities for its progress. The individual parts of society must also be researched and the way that they function thoroughly understood.

For example, in societies where parents keep a strict control on their children, and do not allow them to use certain products until a suitable age as per them, or one where families believe in frugally spending and not overindulging themselves with unneeded products, or a family that stays together with their parents and siblings, or follows the nuclear way of family life style, a businessman must analyse the needs of these families which would in turn help him make decisions to boost his sales. The rate of literacy, and the teachings of educational institutions, and that of the parents and grandparents would affect the future as well as the many generations of the people in the society and influence their outlook towards certain products which would increase or decrease the sales.

And religion, too, is a major influence on the people's choices. If religion prohibits or condemns the use of certain materials, products, or the consumption of certain food items or drinks, it would be difficult for a business to sell their products or to increase their sales.

And apart from that the use of materials that is prohibited or considered taboo in a religion would also be banned by the law, or if not that be opposed by the people, and they would refuse to use the goods.

Therefore, even though in some cases most cultures do not have strong laws supporting or condemning the use of certain products, materials, or methods, the practice of these would be negatively received in the market. Since the people of the society are the potential and prospective customers of a business, social environment is essential to research for any company.

d) Technological Environment

Technological environment include the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments of different countries affect the designing of products. For example, in USA and many other countries electrical appliances are designed for 110 volts. But when these are made for some other countries, they have to be of 220 volts. In the modern competitive age, the pace of technological changes is very fast. Hence, in order to survive and grow in the market, a business has to adopt the technological changes from time to time. It may be noted that scientific research for improvement and innovation in products and services is a regular activity in most of the big industrial organisations. Nowadays in fact, no firm can afford to persist with the outdated technologies.

e) Demographic Environment

This refers to the size, density, distribution and growth rate of population. All these factors have a direct bearing on the demand for various goods and services. For example, a country where population rate is high and children constitute a large section of population, then there is more demand for baby products. Similarly the demand of the people of cities and towns are different than the people of rural areas. The high rise of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skill labour in certain areas motivates the firms to set up their units in such area. For example, the business units from America, Canada, Australia, Germany, UK, are coming to some Asian countries due to easy availability of skilled manpower.

f) Natural Environment

The natural environment includes geographical and ecological factors that influence the business operations. These factors include the availability of natural resources, weather and climatic condition, location aspect, topographical factors, etc. Business is greatly influenced by the nature of natural environment. For example, sugar factories are set up only at those places where sugarcane can be grown. It is always considered better to establish a manufacturing unit near the

sources of input. Further, government's policies to maintain ecological balance, conservation of natural resources, etc. put additional responsibility on the business sector.

Social Responsibility of a Business

Every business enterprise is an integral part of the society. It uses the resources of the society for its growth. Hence, it is important that no activity of business is injurious to the interests of the society. However, it is observed that, in practice, there are a few socially undesirable aspects of business such as polluting the environment, non-payment of taxes, manufacturing and selling adulterated products, giving misleading advertisement, and so on.

This has resulted in the development of the concept of social responsibility of business whereby the owners and managers of business are made conscious about the responsibilities of their business towards the community and its customers, workers, etc.

Social responsibility of business refers to the obligation of business enterprises to adopt policies and plans of actions that are desirable in terms of the expectation, values, and interest of the society. It ensures that the interests of different groups of the public are not adversely affected by the decisions and policies of the business.

Social Responsibilities towards Different Groups

The responsibilities of those who manage the business cannot be limited to the owners only. They have to take into account the expectations of other stakeholders like the workers, the consumers, the government, and the community and public at large.

- a. Responsibility towards the shareholders or owners:** The shareholders or owners are those who invest their money in the business. **They should be provided with a fair return on their investment.**
- b. Responsibility towards the Employees:** A business enterprise must ensure a fair wage or salary to the workers based on the nature of work involved and the prevailing rates in the market. The working conditions must be good in respect of safety, medical facilities, canteen, housing, leave and retirement benefits. etc. They should also be paid reasonable amount of bonus based on the business earnings. Preferably, there should also be a provision for their participation in management
- c. Responsibility towards the Consumers:** A business enterprise must supply quality goods and services to the consumers at reasonable prices. It should avoid adulteration, poor packaging, misleading and dishonest advertising, and ensure proper arrangement for attending to customer complaints and grievances.

Responsibility towards the Government: A business enterprise must follow the guidelines of the government while setting up the business. It should conduct the business in a lawful manner; pay the taxes honestly and on time. It should not indulge in any corrupt practices or unlawful activities.

- d. Responsibility towards the Community:** Every business is a part and parcel of its community. So it should contribute towards the general welfare of the community. It should preserve and promote social and cultural values, generate employment opportunity, and contribute towards the progress of the society. It must take every step to protect the physical and ecological environment of the society. It should contribute to the community development programmes like public health care, sports, cultural programmes.



Fig: 1.4

Business Ethics

The word 'Ethics' originally came from the Greek word 'ethos' meaning character, conduct and activities of the people based on moral principles. It is concerned with what is right and what is wrong in human behaviour on the basis of standard behaviour or conduct accepted by the society.



Fig: 1.5

Honesty, truthfulness, compassion, sympathy, feeling of brotherhood, etc. are considered ethical. Similarly, ethics from business point of view or business ethics are the moral principles, which guide the behaviour of businessmen or business activities in relation to the society. It provides certain code of conduct to carry on the business in a morally justified manner. Running the business without adopting unfair practices, being honest and truthful about quality of goods, charging fair prices, abiding to laws, paying taxes, duties and fees to the government honestly are some of the ethical behaviour of business.

Further Reading:

- ✓ *Business in Context: An Introduction to Business and Its Environment (By David Needle)*
- ✓ *Introduction to Global Business: Understanding the International Environment and Global Business Functions (By Antonio Arreola-Risa)*