

Eighth Edition

# THE BUSINESS ENVIRONMENT

A Global Perspective

Ian Worthington, Chris Britton,  
Ed Thompson

# The Business Environment



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# The Business Environment: A Global Perspective

Eighth edition

Ian Worthington, Chris Britton and Ed Thompson

Leicester Business School, De Montfort University, Leicester



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For Lindsey, Tom and Georgina, for Rachael, Philip,  
Nick and Megan, and for Ramanjeet, Darshan, Sandra  
and David – with our love





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## Contributors

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## Preface to the eighth edition

### Why study the business environment?

The business environment is our environment, it is the world we live in and all aspects of the business environment should be viewed in terms of people. Business ethics is about fairness in how a business operates; a business environmental policy is about how we pollute or preserve our own world; employment and unemployment are about people's ability to house and feed themselves. This is a book about all of us and the world we live in, and the world businesses live in as well, because businesses are just organisations of people and material things.

In reading about the business environment you are reading about your world. You are reading about why the prices of the things you buy might go up or down, or why at any given time it might be harder or easier for you to get a job. By understanding the things in this book that make up your world you will better understand how this world works, what changes mean and the implications they might have on your organisations (whether they are organisations that we work for, or the organisations that we have at home). In my own life, understanding the business environment has helped me make decisions about when and where and how to buy a home, and what and what not to invest in. Understanding the world allows us to make informed decisions.

Many of my students aspire to work for firms in the financial sector trading internationally. Depending on the outcomes of Brexit, some firms are better to work for than others, some firms are more exposed to risk and some are more or less likely to pull out of the UK. It will be sensible for somebody going for an interview to carry out some research on the potential employer. You have to understand the business environment in order to make sense of what you are reading.

The first aim of this book is to set out the way things are in the world today. It will do this by breaking down everything outside of a business (and cover a little bit inside as well) into chapters organised in a logical way. In effect, what we mean by external and internal environments in a global context in which business operates today. The second part will cover aspects of the business environment as you might find them in a PESTLE analysis (Political, Economic, Social, Technological, Legal, Ethical/Ecological). The third part will cover firms and industries, as well as how government regulates business. The fourth part will consider the importance of markets as a concept, nationally and internationally. Finally, we will consider how the business environment feeds into strategy making for organisations.

The second aim of the book is to offer you examples and opportunities to apply what you have learned. This edition has doubled the number of case studies from the previous edition to present applied knowledge. The business environment is not always simple, and some of these case studies illustrate how counter-intuitive some interactions between parts of it can be.

## My authorship

This book is now in its eighth edition, the previous seven having been written by Ian Worthington and Chris Britton. Ian approached me to author this edition in a more stable world (2015), a time of majority government and before Brexit, a time when writing a book on the business environment seemed like a less troublesome undertaking!

I have quite a broad background in terms of my experience with the business environment, having worked for large and small private and public sector organisations. My first degree in business studies equipped me with most of my foundational business environment knowledge. Subsequently I gained a master's degree in project management, and a doctorate in organisational behaviour. In most of my organisational work I have applied an actor-network theory perspective to how the world works. Actor-network theory considers all things related, nothing existing in isolation. This has proven a logical approach writing this book too; the environment is a world of many connections, some obvious and others less so. I hope through reading this book that you will come to understand the world in a similar way.

## New to this edition

With this edition I have attempted to increase the number of case studies, sometimes updating, sometimes replacing and sometimes supplementing what was in the seventh edition. I have tried to incorporate a greater range of industries in case studies (from the service and hospitality sectors in particular), as well as a wider international perspective. International content has been increased where possible too, but the level of detail in terms of British legislation and companies was worth maintaining as well.

I feel I have to preface this edition with two caveats. The first is that, as I finish the manuscript, we are about six months into Brexit negotiations between the UK and EU. This means that there are lots of uncertainties on what is going to happen in terms of law, trade and immigration in particular. This is not so much a problem as one might think, as this book sets out concepts which are applied to contexts; the context will change over the next two to five years but the concepts will persist. The second is on data. I have updated data wherever possible – but in some circumstances there are simply no more updates. Sometimes data are reported in a different way, so continuity could not be maintained if the datasets were any more up to date, and in a few cases data had been collected by agencies which have been disbanded as a result of austerity. As a result, some of the datasets are not as up to date as I would have preferred, but they are sufficient to illustrate the points made in the book.

Thanks on behalf of Ian, Chris and myself to Vicky Tubb and Donna Goddard from Pearson for their work on this edition. And for the first time in a preface for this title I get to thank Ian and Chris for their overwhelming scholarly contribution on which I have developed. I feel as if I have moved into their house: redecorated, modernised and in places extended, but they built it. I hope that I have done it justice. This time, errors are *my* own.

Take it from someone with a British PhD in Organizational Behavior: organization is spelled with a Z in *English* English (it's in the *OED*).

*Ed Thompson*



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### Figures

Figure 7.7 adapted from *The UK R&D Landscape*, Centre for Business Research and UK-IRC (Huges, A. and Mina, A., March 2012) p. 13 ([www.cbr.cam.ac.uk/pdf/RDlandscapeReport.pdf](http://www.cbr.cam.ac.uk/pdf/RDlandscapeReport.pdf)); Figure 12.4 adapted from STAN Database for Structural Analysis from OECD.StatExtracts <http://stats.oecd.org/> (20 May 2014); Figure 14.13 adapted from Halifax Price Index, [www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com); Figure 15.3 adapted from Still, Sparkling and Fortified Wine – UK – September 2013, <http://oxygen.mintel.com/display/638252/>; Figure 16.9 adapted from Bank of England, [www.bankofengland.co.uk/](http://www.bankofengland.co.uk/); Figure 18.2 adapted from *The right game: use game theory to shape strategy*, Harvard Business Review, 73(4), pp. 57–71 (Brandenburger, A. and Nalebuff, B. 1995).

### Tables

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*Indicators 2010*, OECD Publishing. <http://dx.doi.org/10.1787/9789264084360-en>; Table 15.8 adapted from Adbrands.net, 2012. All rights reserved © Mind Advertising Ltd 1998–2018; Table 16.12 adapted from Financial Indicators – Stocks: Private sector debt, <http://stats.oecd.org/index.aspx?queryid=34814>. OECD. StatExtracts <http://stats.oecd.org/>.

## **Text**

Case study on page 360 adapted from Halifax Price Index, [www.lloydsbankinggroup.com](http://www.lloydsbankinggroup.com).



## Part One

# INTRODUCTION

- 1 Business organisations: the external environment**
- 2 Business organisations: the internal environment**
- 3 The global context of business**

International business in action: The global car industry and the changing business environment





# 1

## Business organisations: the external environment

Ian Worthington

Business organisations differ in many ways, but they also have a common feature: the transformation of inputs into outputs; it is through this process that the value is created. This transformation process takes place against a background of external influences which affect the firm and its activities. This external environment is complex, volatile and interactive, but it cannot be ignored in any meaningful analysis of business activity.

### Learning outcomes

Having read this chapter you should be able to:

- indicate the basic features of business activity
- portray the business organisation as a system interacting with its environment
- demonstrate the range and complexity of the external influences on business activity
- identify the central themes inherent in the study of the business environment

### Key terms

Environmental change  
External environment  
General (or contextual)  
environment

Immediate (or operational)  
environment  
Inputs  
Open system

Outputs  
PEST analysis  
PESTLE analysis  
Transformation system

## Introduction

Business activity is a fundamental and universal feature of human existence and yet the concept of ‘business’ is difficult to define with any degree of precision. Dictionary definitions tend to describe it as being concerned with buying and selling, or with trade and commerce, or the concern of profit-making organisations, and clearly all of these would come within the accepted view of business. Such a restricted view, however, would exclude large parts of the work of government and its agencies and the activities of non-profit-making organisations – a perspective it would be hard to sustain in a climate in which business methods, skills, attitudes and objectives have been vigorously adopted by these organisations. It is this broader view of business and its activities that is adopted below and that forms the focus of an investigation into the business environment.

## The business organisation and its environment

### A model of business activity

Most business activity takes place within an organisational context and even a cursory investigation of the business world reveals the wide variety of organisations involved, ranging from the small local supplier of a single good or service to the multi-billion-dollar international or multinational corporation producing and trading on a global scale. Given this rich organisational diversity, most observers of the business scene tend to differentiate between organisations in terms of their size, type of product and/or market, methods of finance, scale of operations, legal status, and so on. Nissan, for example, would be characterised as a major multinational car producer and distributor trading on world markets, while a local builder is likely to be seen as a small business operating at a local level with a limited market and relatively restricted turnover.

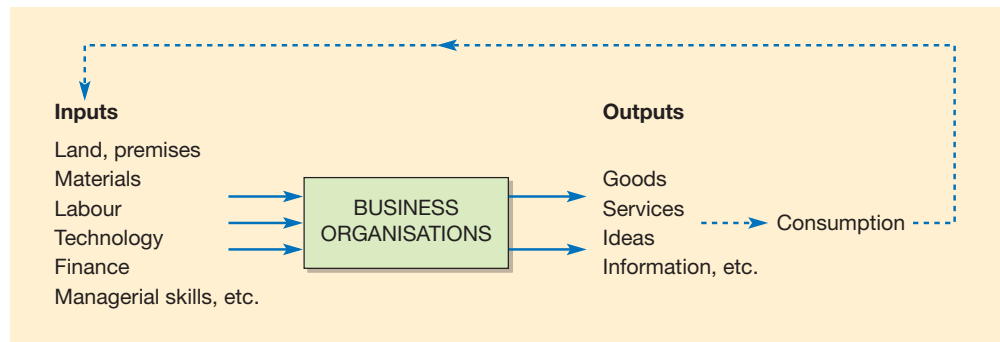


Further information on Nissan is available at [www.nissan-global.com](http://www.nissan-global.com)  
The Nissan UK website address is [www.nissan.co.uk](http://www.nissan.co.uk)

While such distinctions are both legitimate and informative, they can conceal the fact that all business organisations are ultimately involved in the same basic activity, namely the transformation of **inputs** (resources) into **outputs** (goods or services). This process is illustrated in Figure 1.1.

In essence, all organisations acquire resources – including labour, premises, technology, finance, materials – and transform these resources into the goods or services required by their customers. While the type, amount and combination of resources will vary according to the needs of each organisation and may also vary over time, the simple process described above is common to all types of business organisation and provides a useful starting point for investigating business activity and the environment in which it takes place.

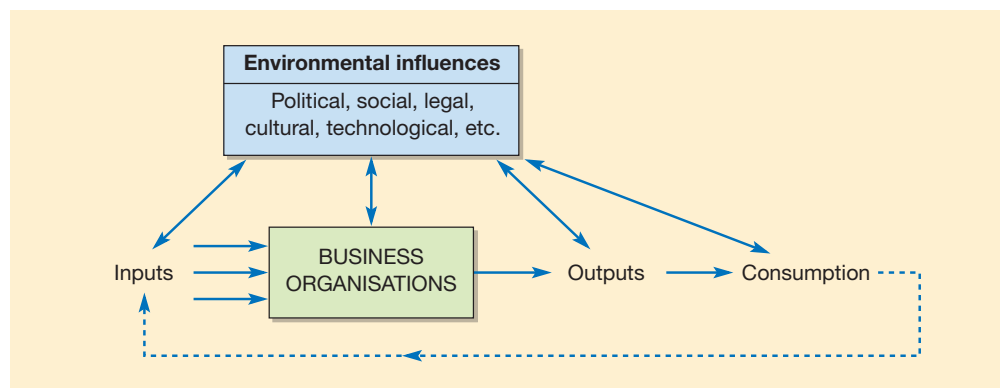
A more detailed analysis of business resources and those internal aspects of organisations which help to transform inputs into output can be found in Chapters 2 and 7 below. The need, here, is simply to appreciate the idea of the firm as a **transformation system** and to recognise that in producing and selling output, most organisations hope

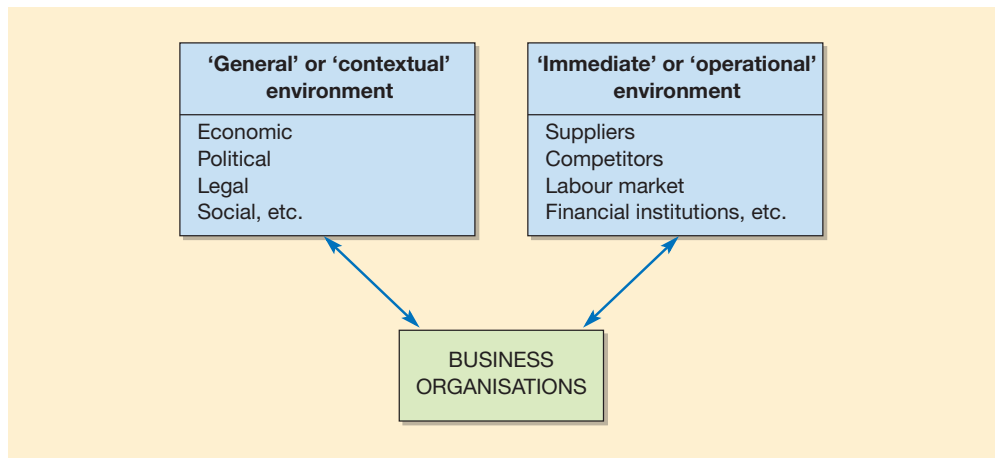
**Figure 1.1** The business organisation as a transformation system

to earn sufficient revenue to allow them to maintain and replenish their resources, thus permitting them to produce further output which in turn produces further inputs. In short, inputs help to create output and output creates inputs. Moreover, the output of one organisation may represent an input for another, as in the case of the firm producing machinery, basic materials, information or ideas. This interrelationship between business organisations is just one example of the complex and integrated nature of business activity and it helps to highlight the fact that the fortunes of any single business organisation are invariably linked with those of another or others – a point clearly illustrated in many of the examples cited in the text.

## The firm in its environment

The simple model of business activity described above is based on the systems approach to management (see Chapter 2). One of the benefits of this approach is that it stresses that organisations are entities made up of interrelated parts which are intertwined with the outside world – the **external environment** in systems language. This environment comprises a wide range of influences – economic, demographic, social, political, legal, technological, etc. – which affects business activity in a variety of ways and which can impinge not only on the transformation process itself, but also on the process of resource acquisition and on the creation and consumption of output. This idea of the firm in its environment is illustrated in Figure 1.2.

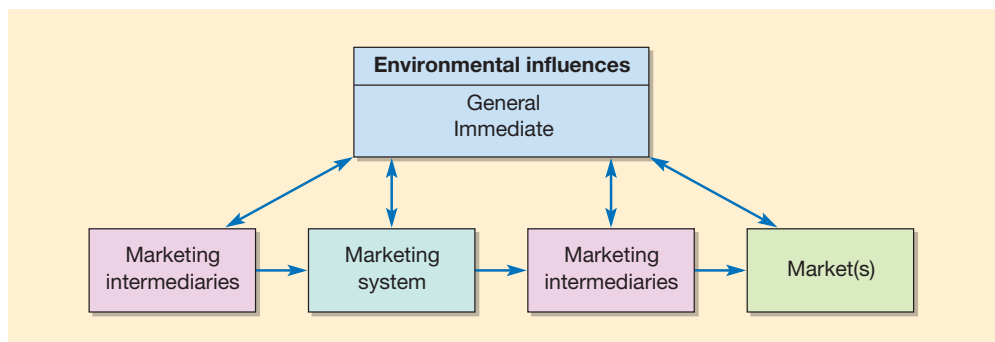
**Figure 1.2** The firm in its environment

**Figure 1.3** Two levels of environment

In examining the business environment, a useful distinction can be made between those external factors that tend to have a more immediate effect on the day-to-day operations of a firm and those that tend to have a more general influence. Figure 1.3 makes this distinction.

The **immediate** (or **operational**) **environment** for most firms includes suppliers, competitors, labour markets, financial institutions and customers, and may also include trade associations, trade unions and possibly a parent company. In contrast, the **general** (or **contextual**) **environment** comprises those macroenvironmental factors such as economic, political, socio-cultural, technological, legal and ethical influences on business which affect a wide variety of businesses and which can emanate not only from local and national sources, but also from international and supranational developments. Macroenvironmental factors might be thought of as factors so large that the business cannot change them.

This type of analysis can also be extended to the different functional areas of an organisation's activities such as marketing or personnel or production or finance, as illustrated in Figure 1.4. Such an analysis can be seen to be useful in at least two ways. First, it emphasises the influence of external factors on specific activities within the firm and in doing so underlines the importance of the interface between the internal and external

**Figure 1.4** Environmental influences on a firm's marketing system

environments. Second, by drawing attention to this interface, it highlights the fact that, while business organisations are often able to exercise some degree of control over their internal activities and processes, it is often very difficult, if not impossible, to control the external environment in which they operate.

## The general or contextual environment

While the external factors referred to above form the subject matter of the rest of the book, it is useful at this point to gain an overview of the business environment by highlighting some of the key environmental influences on business activity. In keeping with the distinction made between general and more immediate influences, these are discussed separately below. In this section we examine what are frequently referred to as the 'PESTLE' factors (i.e. Political, Economic, Socio-cultural, Technological, Legal and Ethical influences). A **PESTLE analysis** (or **PEST analysis**) can be used to analyse a firm's current and future environment as part of the strategic management process (see Chapter 18). PESTLE examines factors external to the firm; these might represent opportunities or threats and later can be used in a SWOT analysis (whereas strengths and weaknesses are internal factors).

### The political environment

A number of aspects of the political environment clearly impinge on business activity. These range from general questions concerning the nature of the political system and its institutions and processes (Chapter 4) to the more specific questions relating to government involvement in the working of the economy (Chapter 5) and its attempts to influence market structure and behaviour (Chapters 11, 15, 17). Government activities, both directly and indirectly, influence business activity, and government can be seen as the biggest business enterprise at national or local level (Chapter 13). Given the trend towards the globalisation of markets (Chapters 3 and 16) and the existence of international trading organisations and blocs, international politico-economic influences on business activity represent one key feature of the business environment (Chapters 4, 7 and 16). Another is the influence of public, as well as political, opinion in areas such as environmental policy and corporate responsibility (Chapter 9).

### The economic environment

The distinction made between the political and economic environment – and, for that matter, the legal environment – is somewhat arbitrary. Government, as indicated above, plays a major role in the economy at both national and local level (Chapters 5 and 13) and its activities help to influence both the demand and supply side (e.g. see Chapter 14). Nevertheless there are a number of other economic aspects related to business activity which are worthy of consideration. These include various structural aspects of both firms and markets (Chapters 10, 11, 12 and 15) and a comparison of economic theory and practice (e.g. Chapters 14, 15 and 16).

## mini case The impact of regional economic conditions

For a company that trades in different markets across the world, macroeconomic conditions (see Chapter 5) in a particular part of its overall market can play a key role in determining its corporate sales and profitability. French carmaker PSA Peugeot Citroën, for instance, experienced a significant decline in sales in 2012 as demand fell in Southern Europe on the back of the recession in the eurozone. In response to the problem, the company announced significant job cuts aimed at reducing costs and looked to the French government for a series of multi-billion-euro loans to keep it afloat until trading conditions improved.

As the global economy slowed, steel industries have been heavily affected. After a period of rapid expansion (driven mostly by the growth of Chinese infrastructure and social development), China's economy has now started to slow as demand from more developed countries who consume Chinese-made products has fallen. This has led to a dramatic drop in the price of steel as it is no longer

needed for building more factories and infrastructure. To support its own steel industry China has been selling steel at less than the cost European steelmakers can produce it. This is an example of the slowdown in European and American economies causing Chinese businesses to act more aggressively, which has eventually led to the collapse of large parts of the British steel industry such as the (Indian-owned) Tata steel works at Port Talbot near Cardiff in 2016.

Since market conditions can vary substantially in different locations, some businesses can experience significant variations in performance in different parts of their operations. US car giant Ford, for example, announced significant losses in Europe in 2012 alongside 'spectacular' results in its North American division. Like Chrysler and other competitors including GM, Ford was able to offset its European losses with stronger sales in the United States. It also posted pre-tax profits in its South American and Asian markets.



Further information on the organisations mentioned in this mini case is available at [www.groupe-psa.com/fr](http://www.groupe-psa.com/fr); [www.tatasteel.com](http://www.tatasteel.com); [www.ford.com](http://www.ford.com); [www.chrysler.com](http://www.chrysler.com); [www.gm.com](http://www.gm.com)

## The social, cultural and demographic environment

Both demand and supply are influenced by social, cultural and demographic factors. Cultural factors, for example, may affect the type of products being produced or sold, the markets they are sold in, the price at which they are sold and a range of other variables. People are a key organisational resource and a fundamental part of the market for goods and services. Accordingly, socio-cultural influences and developments have an important effect on business operations, as do demographic changes (Chapters 6 and 7).

## The technological environment

Technology is both an input and an output of business organisations as well as being an environmental influence on them. Investment in technology and innovation is frequently seen as a key to the success of an enterprise and has been used to explain differences in the relative competitiveness of different countries (Chapter 7). It has also been responsible for significant developments in the internal organisation of businesses in the markets for economic resources.

## The legal environment

Businesses operate within a framework of law, which has a significant impact on various aspects of their existence. Laws usually govern, among other things, the status of the organisation (Chapter 10), its relationship with its customers and suppliers and certain internal procedures and activities (Chapter 8). They may also influence market structures and behaviour (e.g. Chapters 15 and 17). Since laws emanate from government (including supranational governments) and from the judgments of the courts, some understanding of the relevant institutions and processes is desirable (e.g. Chapters 4 and 8).

## The ethical and ecological environment

Ethical considerations have become an increasingly important influence on business behaviour, particularly among the larger, more high-profile companies. One area where this has been manifest is in the demand for firms to act in a more socially responsible way and to consider the impact they might have on people, their communities and the natural environment (Chapter 9).

# The immediate or operational environment

## Resources and resource markets

An organisation's need for resources makes it dependent to a large degree on the suppliers of those resources, some of which operate in markets that are structured to a considerable extent (e.g. Chapter 7). Some aspects of the operation of resource markets or indeed the activities of an individual supplier can have a fundamental impact on an organisation's success and on the way in which it structures its internal procedures and processes. By the same token, the success of suppliers is often intimately connected with the decisions and/or fortunes of their customers. While some organisations may seek to gain an advantage in price, quality or delivery by purchasing resources from overseas, such a decision can engender a degree of uncertainty, particularly where exchange rates are free rather than fixed (Chapter 16). Equally, organisations may face uncertainty and change in the domestic markets for resources as a result of factors as varied as technological change, government intervention or public opinion (e.g. conservation issues).

## Customers

Customers are vital to all organisations and the ability both to identify and to meet consumer needs is seen as one of the keys to organisational survival and prosperity – a point not overlooked by politicians, who are increasingly using business techniques to attract the support of the electorate. This idea of consumer sovereignty – where resources are allocated to produce output to satisfy customer demands – is a central tenet of the market economy (Chapter 5) and is part of a capitalist ideology whose influence has become all-pervasive in recent years, the idea being that companies competing is the