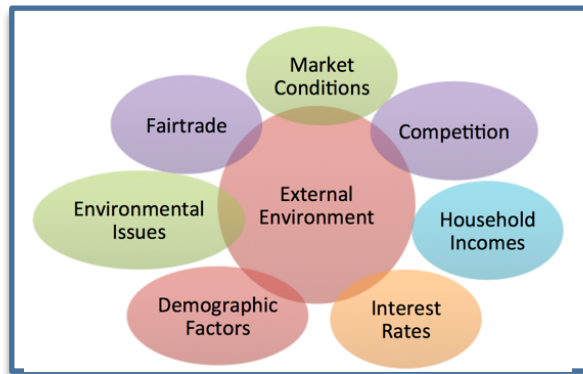


External Environment (Introduction)

3.1 What is Business?

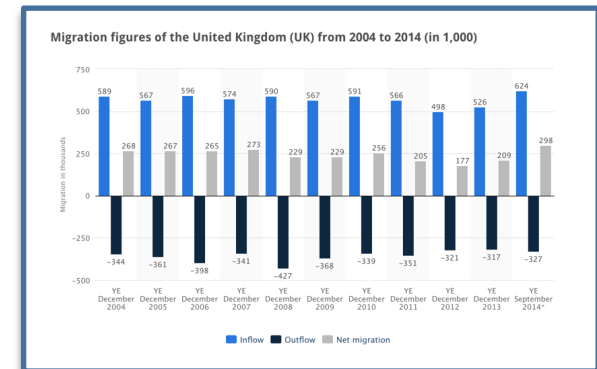


GDP

- Measure of the value of output (activity) in the economy
- Value used to assess changes in economic growth

DEMAND

- How much of a good or service a consumer wants – and is able to pay for
- For a business, demand turns into revenues (sales)



What you need to know

- What is the external environment
- Effects of changes in the external environment
- Overview of:
 - Market conditions
 - Incomes
 - Interest rates
 - Demographic factors
 - Environmental issues

External Environment Links Closely With



Introduction

- Businesses must take into account the external environment in which they operate, in order to make effective decisions.
- Most businesses are unlikely to have much control (if any) over this environment
- Businesses need to monitor their environment constantly, in order to react to any changes that occur
- The most competitive businesses will anticipate change, rather than react to it.

PESTLE Analysis provides a useful way to analyse the external environment

P

POLITICAL

E

ECONOMIC

S

SOCIAL

T

TECHNOLOGICAL

L

LEGAL

E

ETHICAL / ENVIRONMENTAL

Examples of PESTLE Factors: Political



Competition policy

Industry regulation

Govt. spending & tax policies

Business policy & incentives

Examples of PESTLE Factors: Economic



Interest rates

Consumer spending & income

Exchange rates

Economic growth (GDP)

Examples of PESTLE Factors: Social



Demographic change

Impact of pressure groups

Consumer tastes & fashions

Changing lifestyles

Examples of PESTLE Factors: Technological



Disruptive technologies

Adoption of mobile tech

New production processes

Big data and dynamic pricing

Examples of PESTLE Factors: Legal



Employment Law

Minimum / Living Wage

Health & Safety Laws

Environmental legislation

Examples of PESTLE Factors: Ethical & Environmental



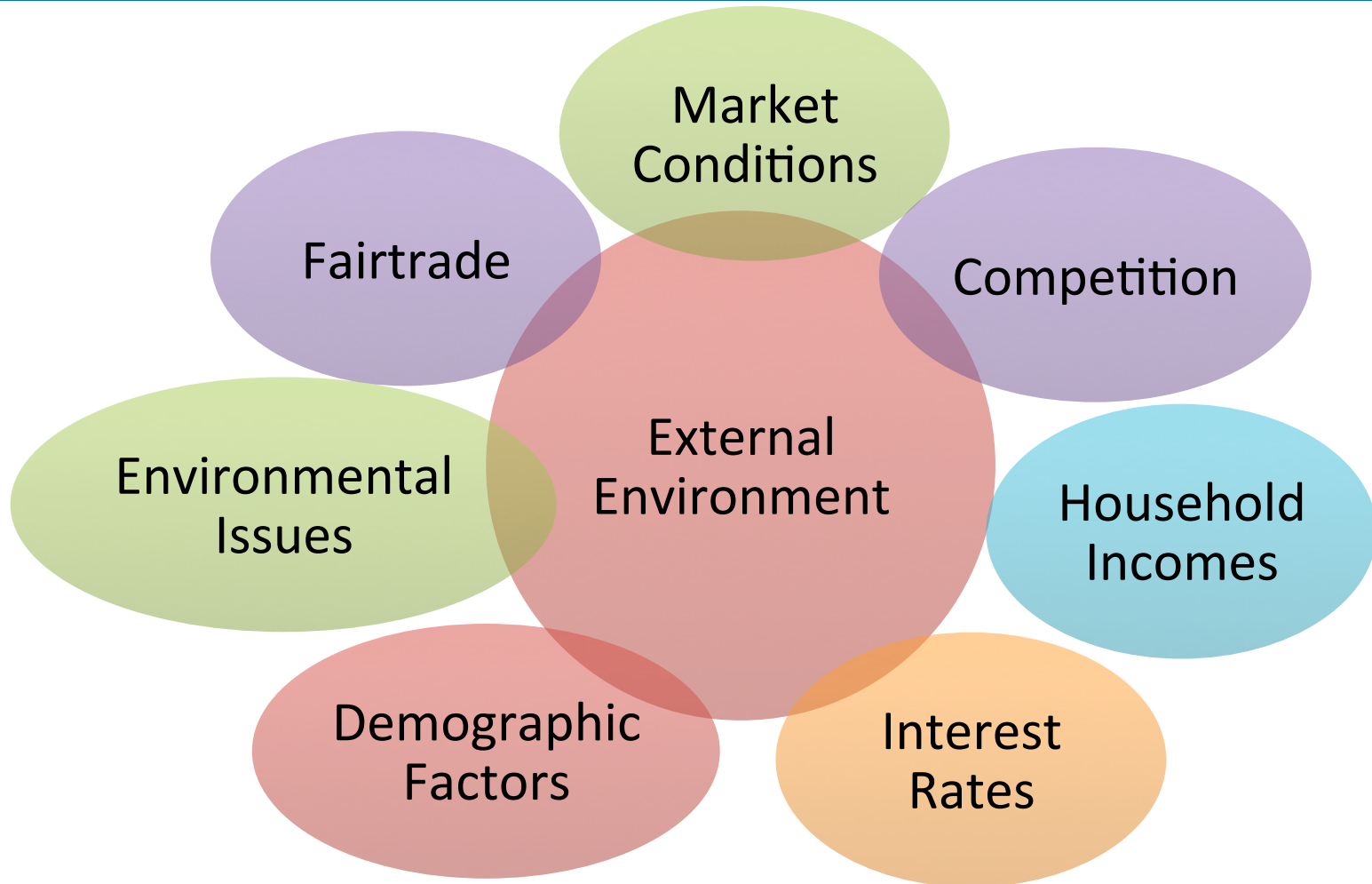
Sustainability

Tax practices

Ethical sourcing (supply chain)

Pollution & Carbon Emissions

Some Specific Features of the External Environment

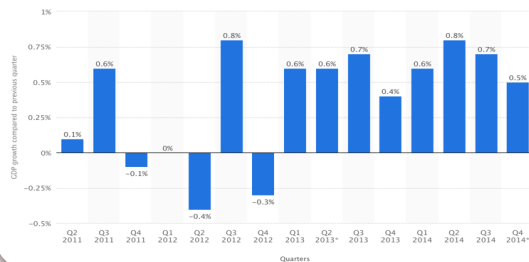


Market Conditions: Two Key Indicators

INDICATOR	OVERVIEW
Economic growth (GDP)	<p>The level of demand in most markets is influenced by the rate of economic growth</p> <p>Economies vary in terms of their “normal” long-term growth rate. A mature economy like the UK has a long-term growth rate of around 2-3%</p> <p>GDP growth will vary depending on the state of the economic cycle</p>
Market demand	<p>The size and growth rate of a market is a key indicator of market conditions</p> <p>A fast-growing market will encourage new entrants as well as benefit existing competitors</p> <p>A slow-growing or declining market makes market conditions much tougher, with competitors fighting for their share of weak demand</p>

What are GDP and Demand?

United Kingdom: Quarterly growth of the real gross domestic product (GDP) from 2nd quarter 2011 to 4th quarter 2014 (compared to the previous quarter)



GDP

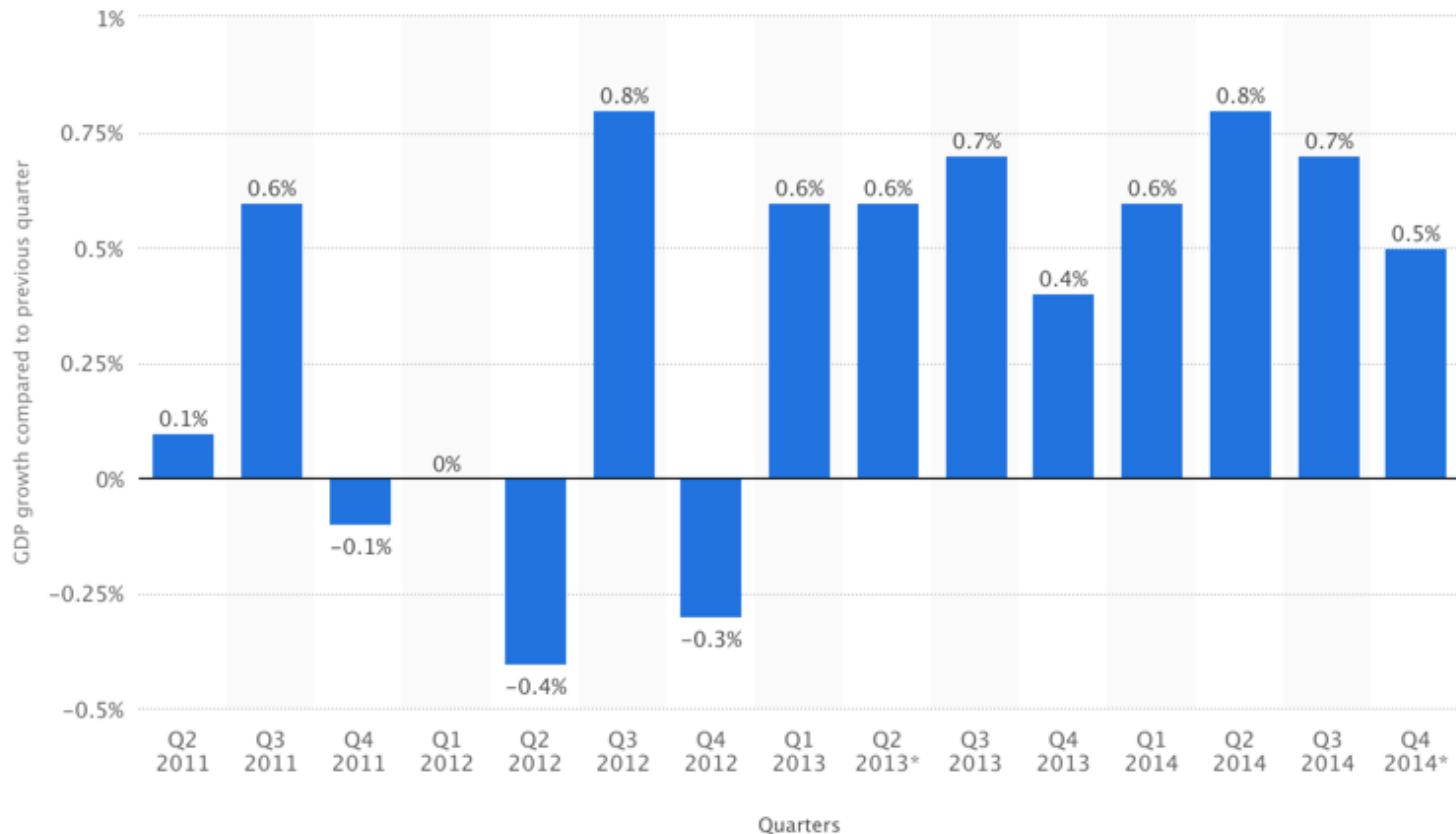
- Measure of the value of output (activity) in the economy
- Value used to assess changes in economic growth

DEMAND

- How much of a good or service a consumer wants – and is able to pay for
- For a business, demand turns into revenues (sales)

The Value of GDP Fluctuates as the Level of Activity in the Economy Changes

United Kingdom: Quarterly growth of the real gross domestic product (GDP) from 2nd quarter 2011 to 4th quarter 2014 (compared to the previous quarter)



Competition: Key Issues Which Make the External Environment Tougher

Competitors with significant market share or faster growth than the market

Influence of disruptive technologies – increasing risk of new competitors

Consolidation of a market which creates more powerful competitors (e.g. takeovers)

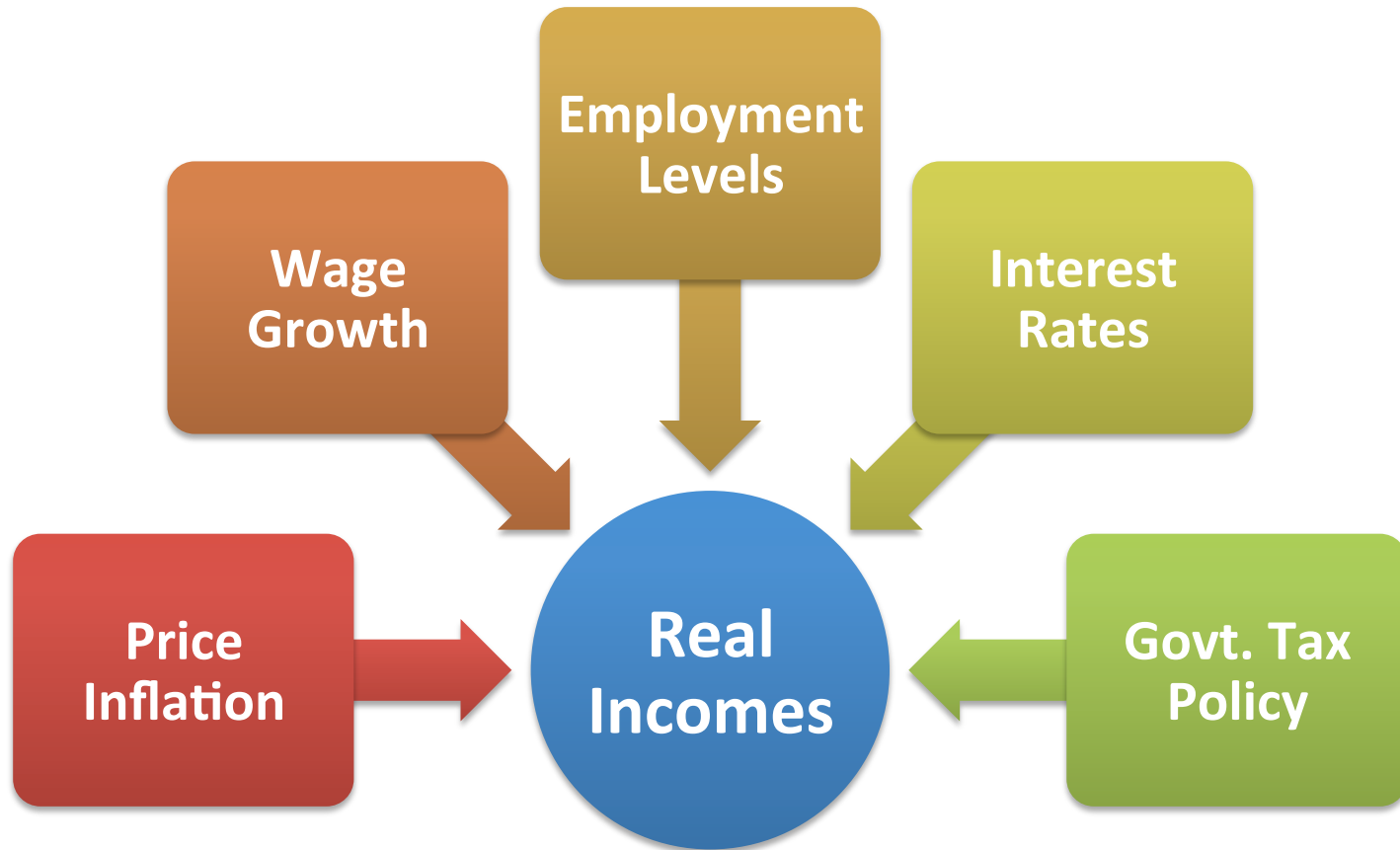
Spare or surplus capacity in the market / industry which reduces industry profits and makes price wars more likely

Investment in innovation & new product development by close competitors

What are Real Incomes?

Real incomes measure the amount of disposable income available to consumers (e.g. households & individuals)

Key Factors That Affect Real Incomes



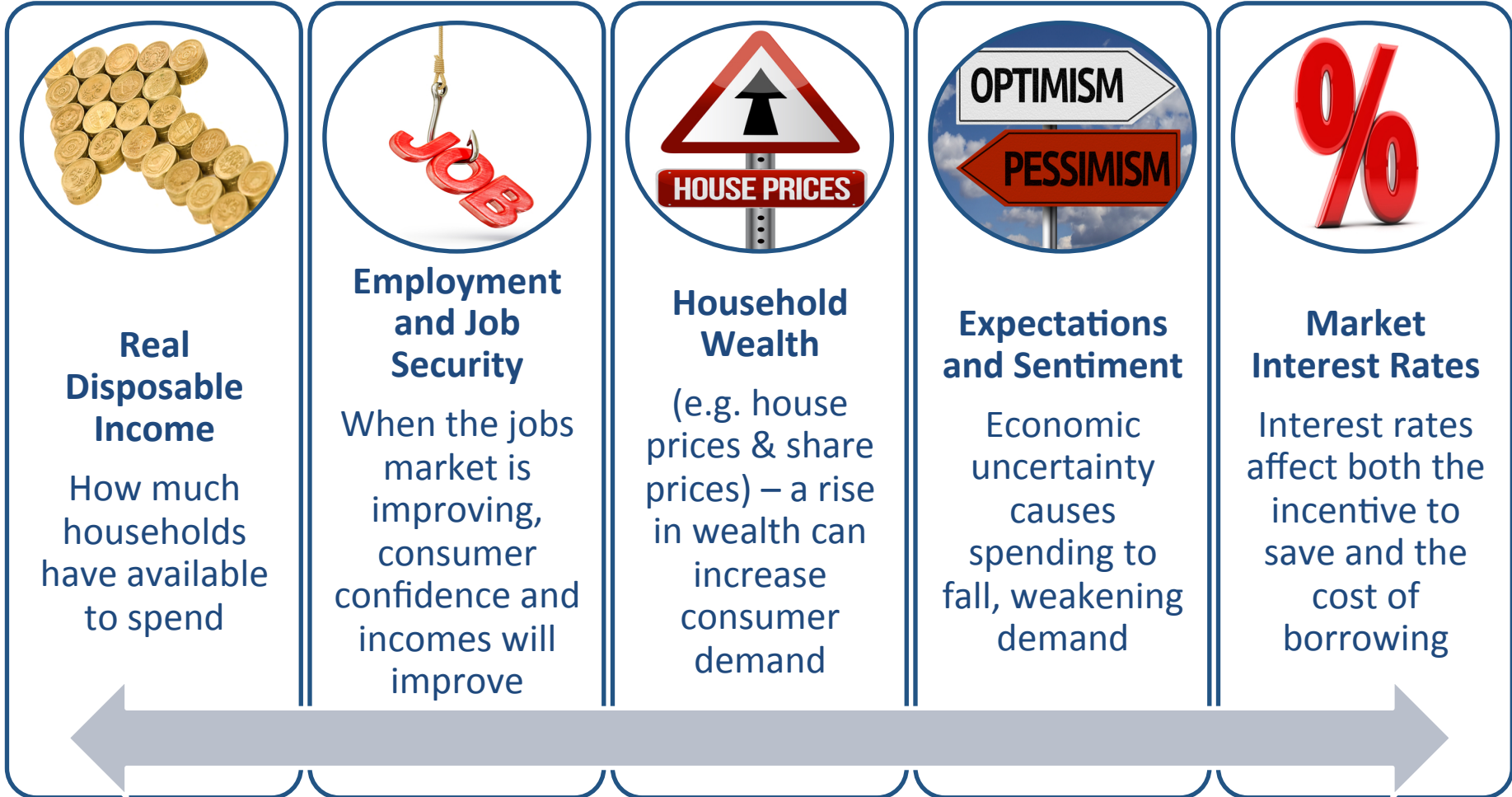
There are Large Differences in Household Disposable Incomes by Region in the UK

Gross Household Disposable Income, £ per head in 2013	
United Kingdom (total)	17,559
North East	14,927
North West	15,412
Yorkshire and The Humber	15,252
East Midlands	15,893
West Midlands	15,551
East of England	18,523
London	22,516
South East	19,898
South West	17,693
Wales	15,413
Scotland	17,039
Northern Ireland	14,347

In 2013 **London** had the highest income per head, where the average person had £22,516 available to save or spend.

Northern Ireland had the lowest, with the average person having £14,347

Household Incomes are Just One (Important) Factor that Affect Consumer Spending (Demand)



Interest Rates

An interest rate is the **reward for saving** and the **cost of borrowing** expressed as a percentage of the money saved or borrowed

The Bank of England Base Rate has Been Very Low and Stable for Many Years



SOURCE: WWW.TRADINGECONOMICS.COM | BANK OF ENGLAND

However, there Are Many Different Interest Rates Operating in the Economy

- Interest rates on savings in bank and other accounts
- Borrowing interest rates
 - Mortgage interest rates (housing loans)
 - Credit card interest rates and pay-day loans
 - Interest rates on government and corporate bonds
- The Bank of England uses **policy interest rates** to help regulate the economy and meet **economic policy objectives**

Interest Rates Are a Key Factor Influencing the Amount of Business Investment



What Happens When Interest Rates Fall?

Cost of servicing loans / debt is reduced – boosting spending power

Consumer confidence should increase leading to more spending

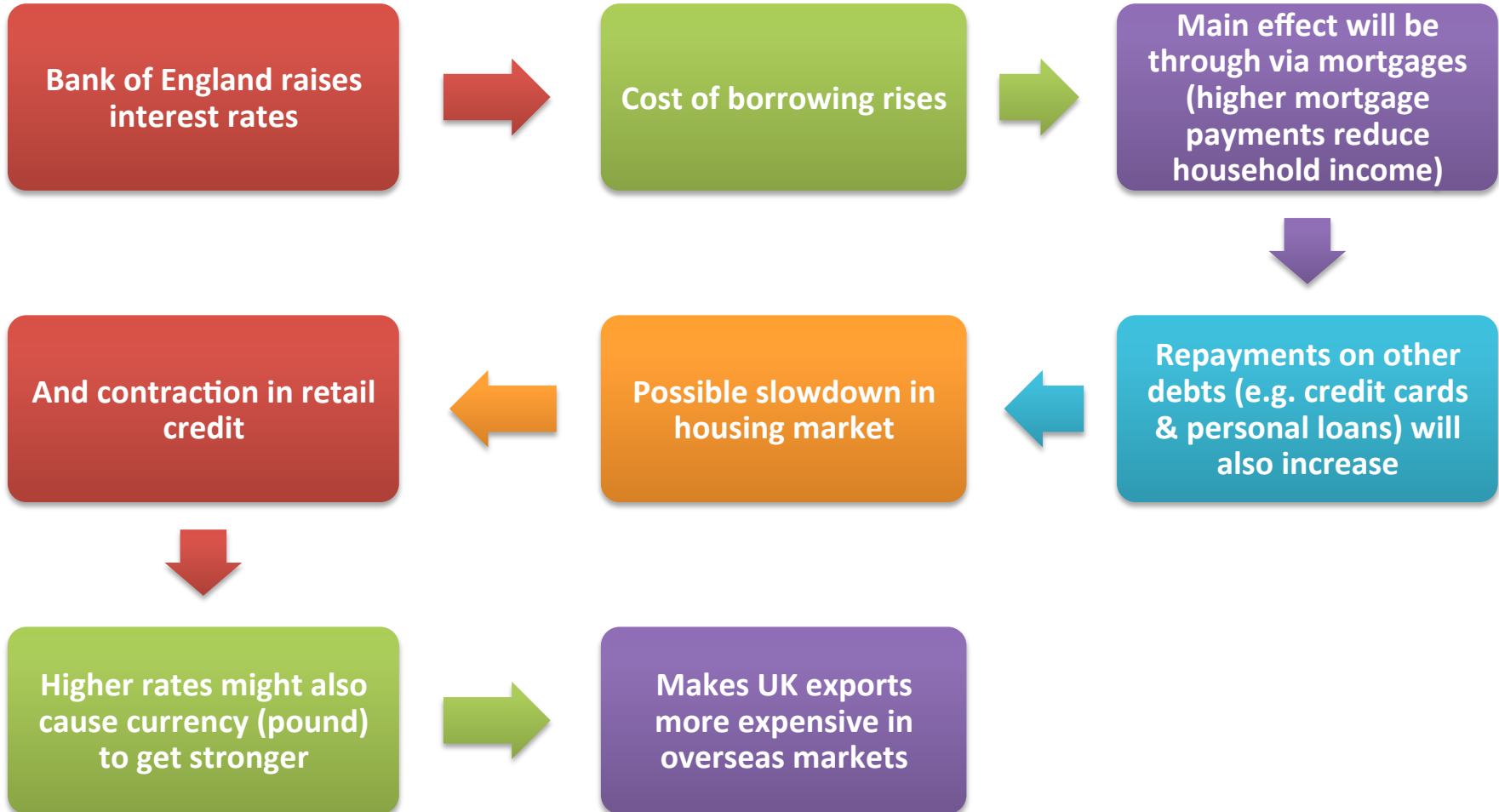
Effective disposable income rises – lower mortgage costs

Business investment should be boosted e.g. prospect of rising demand

Housing market effects – more demand and higher property prices

Exchange rate and exports – cheaper currency will increase exports

What Might Happen When Interest Rates Start to Rise Again in the UK?

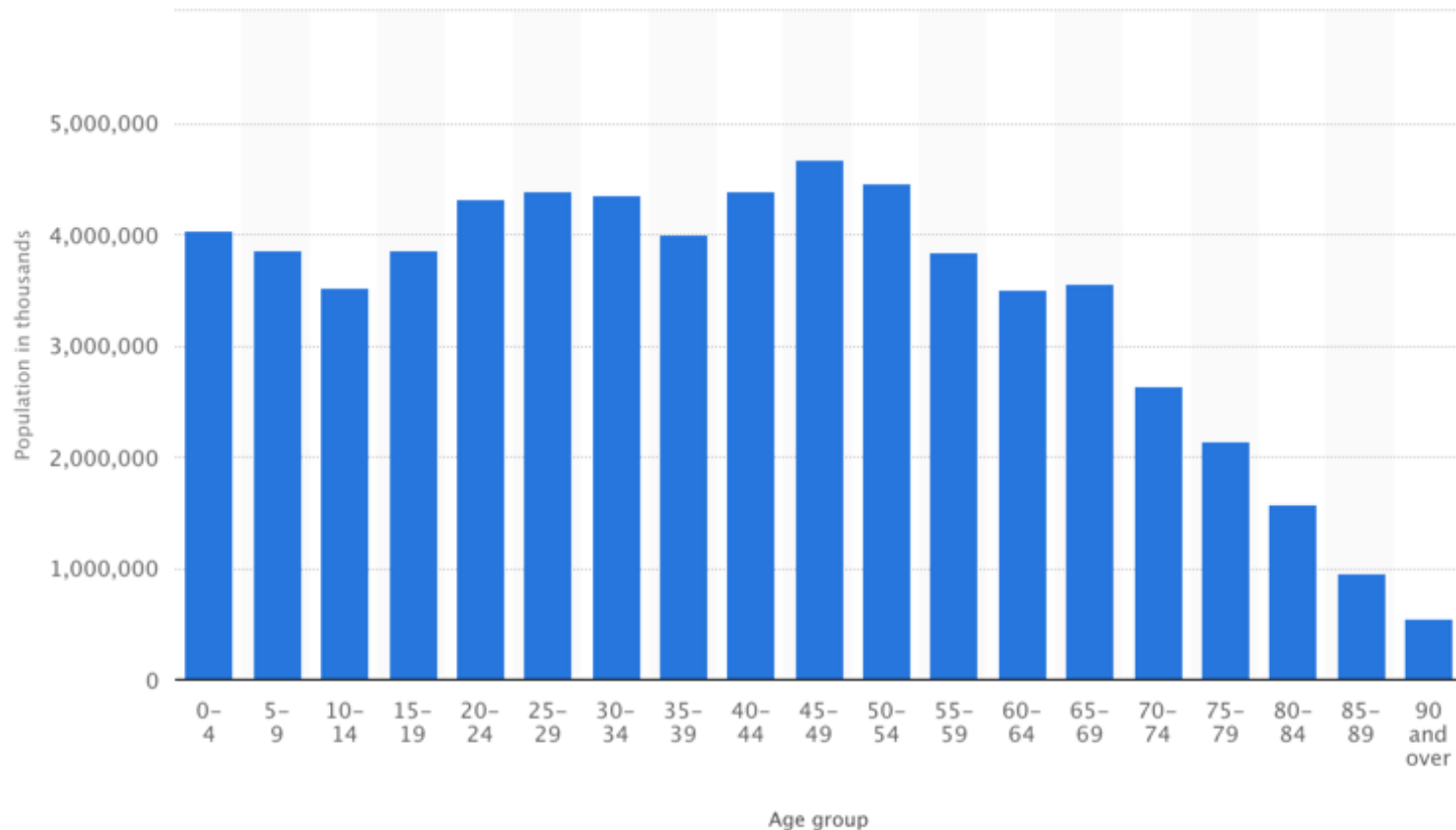


Demographic Factors

Demography is concerned with the size and composition of a population. Changes in population dynamics occur slowly but can be significant for businesses

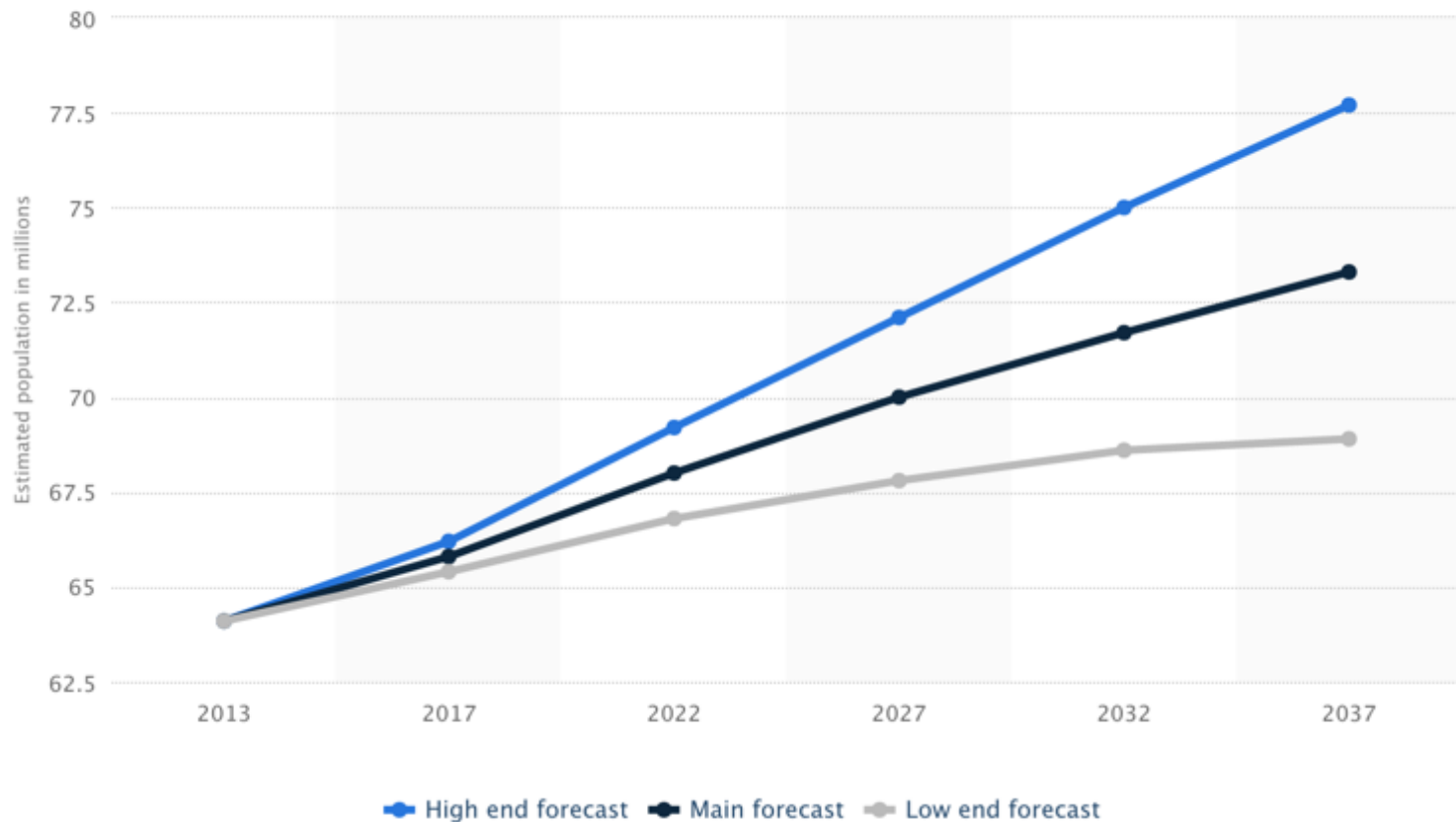
Population of the UK By Age Group

Population of the United Kingdom in 2014, by age group (in 1,000)



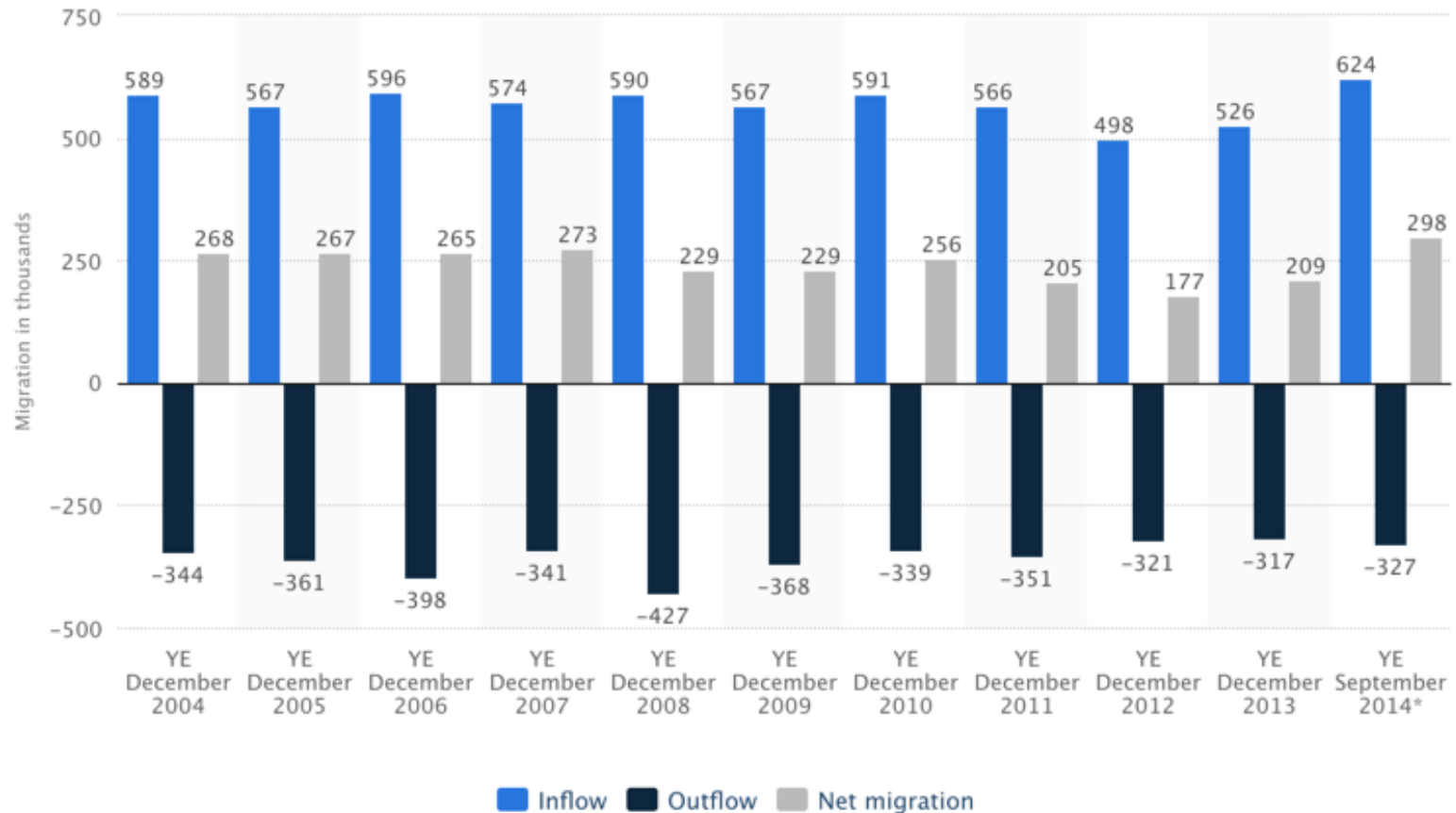
The Population of the UK is Forecast to Grow Significantly

National population forecast in the United Kingdom (UK) from 2013 to 2037 with high and low variants (in millions)



The UK Has Experienced a Large Net Immigration over Recent Years

Migration figures of the United Kingdom (UK) from 2004 to 2014 (in 1,000)



Some Key Business Implications of UK's Changing Population

Demographic Change	Implication Examples
Ageing population	Greater demand for services to support older people (e.g. healthcare) Increasing disposable incomes of older people reflected in higher demand for goods and services (e.g. holidays)
Continued high net immigration	Higher costs of (but greater demand for) public services (e.g. education, health, housing) Increase in size of labour force – potentially keeping wage rates low

Business is Inextricably Linked with the Environment



Key Environmental Issues for Business

- Sustainability
- A “green” supply chain
- Minimising packaging
- Promoting environmental policies
- Complying with environmental laws
- Carbon emissions
- Waste disposal

Some Business Benefits of Environmental Friendly Actions

- Lower raw material costs & waste disposal charges
- Longer life of assets that are recycled or repaired
- Trading opportunities with organisations that will only use environmentally-friendly suppliers
- Improved customer goodwill

What Businesses Need to Look At

- Use of raw materials, water and other **resources (inputs)**
- **Energy use** and its impact on climate change
- **Waste and pollution** produced by the business
- The **impact** the business has on employees and the local, wider and international community

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