

## The Environment

The environment is what gives organisations their means for survival. The environment of an organisation can be categorised into three layers:

### **1. MACRO ENVIRONMENT:**

The widest layer and consists of broad environmental factors that impact to a greater or lesser extent on almost all organisations. The PESTEL framework can be used to analyse the environment, and so can Scenario Analysis.

- The **PESTEL Framework** highlights six environmental factors which impact an organisation, and which may influence a business strategy:
  - P – Politics*: politics highlights the role of the state and other political forces. This may include government policies, taxation changes, trade regulations, political risk in foreign markets etc.
  - E – Economics*: refers to the macro-economic factors such as exchange rates, business cycles and economic growth. It is important for a business to understand how its markets are affected by the prosperity of the economy as a whole.
  - S – Social*: includes changing cultures and demographics. This may include the impact of the aging population as well as changing cultural attitudes and ethics, income distribution, lifestyle changes, consumerism and changes in fashions and trends.
  - T – Technological*: refers to influences such as the internet which has a major impact on retailing, as well as manufacturing technologies etc.
  - E – Ecological*: stands specifically for 'green' environmental issues such as pollution, waste and climate change. Environmental regulations can impose additional costs, but can also bring new business opportunities.
  - L – Legal*: embraces legislative and regulatory constraints or changes.

To apply the PESTEL framework most affectively, managers should look at the 'key drivers of change', which are the environmental factors that are likely to have a high impact on the success or failure of a strategy. Key drivers will be different for all industries. For example, retailers are concerned with social changes such as trends and customer behaviour as well as disposable income, while also being concerned with technological advances such as the internet which will drive change in the way in which retailers conduct their business.

Without a clear sense of the key drivers for change, decisions will not be made which will prevent effective action.

Three concepts are useful for focusing on change while at the same time avoiding too much detail:

1. *Megatrends*: are large-scale changes that are slow to form but influence many other activities over decades to come. A mega trend typically shapes other trends. For example, the mega trend towards the aging population influences other trends in social care, retail spending and housing.
2. *Inflexion Points*: are moments when trends shift in direction such as sharply upwards or downwards
3. *Weak Signals*: are advanced signs of future trends and are particularly helpful in identifying inflexion points.

- **Scenario Analyses** are carried out to allow for different possibilities and help prevent managers from closing their minds to alternatives. Thus, scenarios offer plausible alternative views of how the business environment might develop in the future. The point is not to predict, but to encourage managers to be aware of a range of possible futures. Five basic Steps are used to carry out a scenario analysis:

1. *Defining the Scenario Scope*: scope refers to the subject of the scenario analysis and the time span.
2. *Identifying the key drivers for change*: here, PESTEL analysis can be utilised to uncover issues likely to have a major impact upon the future of the industry or market. Scenario Analysis also looks at uncertainty and mutual independence when analysing the key drivers for change, so that opposing outcomes can also emerge.
3. *Developing Scenario Stories*: having selected opposing key drivers for change, scenario stories need to be created that incorporate both the key drivers and other factors.
4. *Identifying impacts of each scenario*: allows the organisation to see the impact of the scenario and evaluate future strategies to handle each impact
5. *Establish Early Warning Systems*: identify indicators that might give an early warning of the way that the environment is changing and monitor such indicators.