

Introduction to the External Environment

Introduction

A business does not function in a vacuum. It has to act and react to what happens outside the factory and office walls. These factors that happen outside the business are known as **external factors or influences**. These will affect the main internal functions of the business and possibly the objectives of the business and its strategies.

Main Factors

The main factor that affects most business is the **degree of competition** – how fiercely other businesses compete with the products that another business makes.

The other factors that can affect the business are:

- ▶ **Social** – how consumers, households and communities behave and their beliefs. For instance, changes in attitude towards health, or a greater number of pensioners in a population.
- ▶ **Legal** – the way in which legislation in society affects the business. E.g. changes in employment laws on working hours.
- ▶ **Economic** – how the economy affects a business in terms of taxation, government spending, general demand, interest rates, exchange rates and European and global economic factors.
- ▶ **Political** – how changes in government policy might affect the business e.g. a decision to subsidise building new houses in an area could be good for a local brick works.
- ▶ **Technological** – how the rapid pace of change in production processes and product innovation affect a business.
- ▶ **Ethical** – what is regarded as morally right or wrong for a business to do. For instance should it trade with countries which have a poor record on human rights.

Changing External Environment

Markets are changing all the time. It does depend on the type of product the business produces, however a business needs to react or lose customers.

Some of the main reasons why markets change rapidly:

- ▶ Customers develop new needs and wants.
- ▶ New competitors enter a market.
- ▶ New technologies mean that new products can be made.
- ▶ A world or countrywide event happens e.g. Gulf War or foot and mouth disease.
- ▶ Government introduces new legislation e.g. increases minimum wage.

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Business and Competition

Though a business does not want competition from other businesses, inevitably most will face a degree of competition.

The amount and type of competition depends on the market the business operates in:

- ▶ **Many small rival businesses** – e.g. a shopping mall or city centre arcade – close rivalry.
- ▶ **A few large rival firms** – e.g. washing powder or Coke and Pepsi.
- ▶ **A rapidly changing market** – e.g. where the technology is being developed very quickly – the mobile phone market.

A business could react to an increase in competition (e.g. a launch of rival product) in the following ways:

- ▶ **Cut prices** (but can reduce profits)
- ▶ **Improve quality** (but increases costs)
- ▶ **Spend more on promotion** (e.g. do more advertising, increase brand loyalty; but costs money)
- ▶ **Cut costs**, e.g. use cheaper materials, make some workers redundant

Social Environment and Responsibility

Social change is when the people in the community adjust their attitudes to way they live. Businesses will need to adjust their products to meet these changes, e.g. taking sugar out of children's drinks, because parents feel their children are having too much sugar in their diets.

The business also needs to be aware of their social responsibilities. These are the way they act towards the different parts of society that they come into contact with.

Legislation covers a number of the areas of responsibility that a business has with its customers, employees and other businesses.

It is also important to consider the effects a business can have on the local community. These are known as the **social benefits** and **social costs**.

A social benefit is where a business action leads to benefits above and beyond the direct benefits to the business and/or customer. For example, the building of an attractive new factory provides employment opportunities to the local community.

A social cost is where the action has the reverse effect – there are costs imposed on the rest of society, for instance pollution.

These extra benefits and costs are distinguished from the private benefits and costs directly attributable to the business. These extra cost and benefits are known as externalities – external costs and benefits.

Governments encourage social benefits through the use of subsidies and grants (e.g. regional assistance for undeveloped areas). They also discourage social costs with fines, taxes and legislation.

Pressure groups (see below) will also discourage social costs.

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