

Organisational environment

[Environment](#), [Ecology](#)



2.1 The General Environment The General Environment 2.2 Scanning, Monitoring, and Forecasting Changes in the Environment Key Work Strategic decision making under conditions of uncertainty 2.3 Scenario Planning Key Work Strategic inflection points and their impact on strategy Tools and Techniques Undertaking scenario planning 2.4 PEST Analysis 2.5 SWOT Analysis 2.6 The General and the Competitive Environments Tools and Techniques Writing a PEST analysis ? Main Reference Schoemaker, P. J. H. (1995). Scenario planning: a tool for strategic thinking. Sloan Management Review, 36(2), 25.

Learning Objectives After completing this chapter you should be able to:

- Define what constitutes the general environment
- Evaluate the role of scanning and monitoring in detecting environmental trends
- Apply scenario planning to decision making in uncertain environments
- Evaluate PEST as a framework for analysing the macro-environment
- Explain the use of SWOT analysis
- Evaluate the relationship between the general and the competitive environment

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2 In the previous chapter we looked at what strategy is and introduced a number of different perspectives on strategy formulation. We addressed the importance of values in determining why an organization exists, and looked at how an organization's values, its vision, and its mission guide individuals' behaviour by signposting what is important to the organization. We explained the importance of an organization being willing to change the assumptions that underpin its theory of the business if it is to adapt to changes in its environment.

We also introduced a strategic management process which involves strategy analysis, strategy formulation, and strategy implementation. We noted that this essentially linear approach is useful for exposition but may not always accurately replicate decisions in the business world. With this caveat in mind we can start to evaluate some tools of analysis that can be used for strategy analysis. What happens in the general environment is important to an organization. This is because changes that take place in the general environment may point to trends that can substantially impact upon an organization's competitive environment.

These changes, sometimes called discontinuities, fractures, or tipping points, that fundamentally impact on the competitive environment will be considered in this chapter. The tools of analysis an organization can use to discern changes in its general environment will also be considered. This includes scenario planning, which will be assessed as an aid to organizational decision making in uncertain environments. The benefits and limitations of a PEST framework, which includes political, economic, social, and technological factors, will be addressed.

A SWOT analysis and its links with scenario planning and PEST analysis will be briefly discussed before being taken up in detail in a later chapter. The aim of the chapter is not simply to apply these techniques but, importantly, to understand their limitations. The chapter ends with a discussion of the links between the general and competitive environment. • Section 2. 1 defines the general environment and explains its importance to the competitive environment. • Section 2. evaluates the role of scanning and monitoring the general environment to try to discern discontinuities that

have the potential to disrupt an organization's competitive environment. • In Section 2. 3 we assess the role of scenario planning in helping organizations to deal with uncertainty in their environment. This section also includes how to undertake scenario planning. • Section 2. 4 evaluates PEST analysis as a tool for analysing the macro-environment. It shows how an organization can detect and monitor weak signals in the hope of recognizing the discontinuities or trends that shape the environment. • In Section 2. we explain the use of SWOT analysis with reference to the general and competitive environment. • The chapter concludes in Section 2. 6 with an evaluation of the relationship between the general and competitive environments. 9780199581610_035_063_CH02. indd 37 2/1/11 11: 03: 52 AM 38 part 2 Strategic Analysis 2. 1 The General Environment 2 The external environment facing the organization consists of both a general environment and a competitive environment. The competitive environment consists of the industry and markets in which an organization competes. The competitive environment is analysed in detail in Chapter 3.

The general environment, in contrast, is often referred to as the macro-environment. This is because changes that occur here will have an effect that transcends firms and specific industries. Figure 2. 1 shows the relationship between the general environment, the competitive environment, and the organization. It should be noted that, other things being equal, it is the competitive environment that has the most direct and immediate impact on the organization. The General Environment Political Economic The Competitive Environment Potential Entrants Power of Buyers The Organization Power of Suppliers Competitive Rivalry

Substitute Products/Services Social Technological figure 2. 1 The organization and its external environment That said, organizations must continually scan and monitor their general environment for signals, often weak or barely perceptible, which might indicate a change in their competitive environment. For example, firms in the industry that produced typewriters would have been unwise not to scan the general environment for signs of change, in this case technological change. The advent of micro-technologies was a 9780199581610_035_063_CH02. indd 9780199581610_035_063_CH02. indd 38 2/1/11 11: 03: 52 AM the general environment 2 lear threat to the typewriter industry, ushering in as it did the era of the word processor. It is easy to forget that individuals who relied upon the use of the typewriter were initially sceptical about learning how to use the new technology. Nowadays one is hard pushed to see typewriters in use. In order to scan and monitor their environment, firms require tools of analysis or models that will allow them to factor in the changes in the general environment and evaluate their impact. One such approach involves scanning the environment to detect signals that will act as a signpost for future changes in the organization's industry.

In addition, an organization must monitor its environment to discern patterns and trends that are beginning to form and try to forecast the future direction of these trends. Ginter and Duncan (1990) argue that macro-environmental analysis can act as an early-warning system by giving organizations time to anticipate opportunities and threats and develop appropriate responses. Therefore, the aim of macro-environmental analysis is to aid the organization

in discerning trends in the general environment which might impact upon its industry and markets.

The organization is then able to formulate a strategy and use its internal resources and capabilities to position itself to exploit opportunities as they arise. At the same time the strategy will be acting to mitigate the effects of any threats. However, as we shall see in Chapter 3, there is a belief that the pace of change in the macro-environment is increasing, and is becoming more turbulent and unpredictable. This uncertainty effectively shortens the lead time an organization has to anticipate and respond to changes in its environment.

39 2. Scanning, Monitoring, and Forecasting Changes in the Environment

The purpose of scanning and monitoring the general environment is to try to discern changes, however small, that have the potential to disrupt an organization's competitive environment. Once these changes are discerned, it is up to the organization to monitor them and see if they might become a trend that can affect its industry. Clearly, experience and intuition will be involved in trying to forecast where these changes will eventually manifest themselves, or indeed if they will have any impact at all.

We look at scanning, monitoring, and forecasting changes in the general environment below.

2. 2. 1 Scanning the Environment

It is often said that there are two certainties in life: death and taxes. However, a third certainty can be added: change. If the external environment facing organizations was

9780199581610_035_063_CH02. indd 9780199581610_035_063_CH02. indd 39 2/1/11 11: 03: 52 AM 2 40 discontinuities threats faced by organizations that have the potential to undermine the way they do business weak signals barely perceptible changes in the external environment whose impact has

yet to be felt 780199581610_035_063_CH02. indd 40 part 2 Strategic Analysis stable and simple to understand, then firms would be faced with an enviable situation of having relatively little change or, if change occurs, it would be easy to forecast based on historic trends. Some commodity markets exhibit a relative degree of stability, making predictions or extrapolations based on past data quite reliable. However, most environmental conditions facing organizations are complex, uncertain, and prone to change. They are complex because of the sheer volume of data that exists in the environment.

Therefore any analytical tool or framework can only extract and simplify a tiny proportion of this data. At the same time, any given source of data, for example economic data on the well-being of the economy, is ambiguous as it can be interpreted in a number of different ways. If past performance is no guarantee of what will occur in the future because of uneven changes and discontinuities then attempts at forecasting the future are fraught with uncertainty. Discontinuities refer to the threats faced by organizations and industries that have the potential to undermine the way they do business.

We have already mentioned the typewriter industry; other examples include Amazon. com and Dell, which have both taken advantage of the Internet to change the way established products are customized and delivered to end consumers. Fahey and Narayanan (1986, quoted by Mercer 1998) suggest three goals for an analysis of the general environment. First, the analysis should provide an understanding of current and potential changes taking place in the environment. Second, it should provide important intelligence for strategic decision makers.

Third, environmental analysis should facilitate and foster strategic thinking in organizations. For Fahey and Narayanan, scanning may reveal 'actual or imminent environmental change because it explicitly focuses on areas that the organization may have previously neglected' (see Mercer 1998). Scanning the environment as a general activity has been made far more cost effective with the advent of the Internet. Prior to the Internet, the view was that scanning was a costly activity which could only take account of a fraction of the information that existed in an organization's environment.

By redefining search costs, the Internet has changed the economics of undertaking scanning. At the same time it has provided an opportunity to access a wealth of data which requires time and effort to structure properly. Scanning, therefore, is an opportunity for the organization to detect weak signals in the general environment before these have coalesced into a discernible pattern which might affect its competitive environment. Weak signals refer to minor changes in the external environment that an organization's scanning of the environment may barely register. This is because their impact has yet to be felt.

The key for organizations is to be able to read these signals correctly and monitor them until they coalesce into a more clearly discernible pattern. However, there are errors that can follow when looking for patterns. The first is that the organization may fail to identify these signals. The second is that the organization may discern a pattern that is not there but is based on the assumptions and mental models that managers carry in their heads. We saw in Chapter 1 how senior management's reliance on its existing theory of the business can affect the success of the organization by blindsiding them to

changes /1/11 11: 03: 52 AM the general environment 41 taking place in the environment. Ansoff (1984) makes the point that the detection of weak signals requires senior management commitment and sensitivity on the part of the observers. This means that the organization must be diligent in continually scanning its macro-environment for weak signals. When it believes that it has discerned something significant occurring in its general environment, this broad scanning can turn into a more focused monitoring. 2

2. 2. 2 Monitoring the Environment

While scanning the environment may make organizations aware of weak signals, unless these are carefully monitored the resulting patterns will be missed. Monitoring can be seen as the activity that follows these initially disparate signals and tracks them as they grow into more clearly discernible patterns. Monitoring allows an organization to see how these general environment trends will impact on its competitive environment. Whereas scanning is a more broad-brush approach, monitoring uses a finer brush stroke.

However, the two are inseparable, since without an identification of weak signals in the general environment there is no focus for an organization's monitoring activities. One way in which an organization might monitor weak signals is to set thresholds such that any activity which occurs above the threshold will be monitored. This might include, for example, when an interest is shown by a major competitor in a particular social or technological change. This interest then becomes the threshold at which the organization itself starts to take an interest. 2. 2. 3 Forecasting Changes in the Environment

The purpose of scanning and monitoring the general environment is to aid the organization in developing viable forecasts of future trends before they become an unmitigated threat. This is particularly useful when dealing with discontinuities which themselves will usually evolve from weak signals that exist in the environment. The objective is to use this information to develop robust strategies that ensure a degree of competitive advantage. Van der Heijden (1996) identifies three main types of uncertainty. 1. Risks. This is where past performance of similar events allows us to estimate the probabilities of future outcomes. . Structural uncertainties. This is where an event is unique enough not to offer evidence of such probabilities. 3. Unknowables. This is where we cannot even imagine the event. Most managers are capable of dealing with the type of uncertainty that appears in the form of risks. Also, what is unknowable cannot, by definition, be forecast and 9780199581610_035_063_CH02. indd 9780199581610_035_063_CH02. indd 41 2/1/11 11: 03: 52 AM 42 structural uncertainties where no probable pattern of outcomes can be derived from previous experience part 2 Strategic Analysis herefore the organization must wait for the event to occur before it can react to it. This leaves structural uncertainties where no probable pattern of outcomes can be derived from previous experience. In such a situation, van der Heijden suggests scenario planning as a useful tool of analysis to help the organization make sense of an uncertain and dynamic environment that has little in the way of clear road maps. 2 For information on strategic decision making under conditions of uncertainty go to the Online Resource Centre and see the Key Work feature. www.oxfordtextbooks.co.uk/orc/henry2e/ . 3 Scenario Planning Schoemaker (1995) states that ‘

scenario planning is a disciplined method for imagining possible futures'. It is 'an internally consistent view of what the future might turn out to be' (Porter 1985, p. 446). The oil multinational Royal Dutch Shell has used scenario planning since the 1970s to help it generate and evaluate its strategic options. Scenario planning has given Shell a better success rate in its oil forecasts than its competitors, and it was the first oil company to see overcapacity in the tanker business and Europe's petrochemicals (Schoemaker 1995).

Kahane (1992) reminds us that: In the oil industry, experts have sometimes been able to suggest, but rarely to predict, the key turning points in crude oil prices . . . The Shell approach to strategic planning is, instead of forecasts, to use scenarios, a set of stories about alternative futures. scenario a challenging, plausible, and internally consistent view of what the future might turn out to be tipping point an unexpected and unpredictable event that has a major impact on an organization's environment 9780199581610_035_063_CH02. ndd 42 These stories promote a discussion of possibilities beyond the most likely one and encourage the organization to consider 'what if' questions. Therefore, a scenario can be seen as a challenging, plausible, and internally consistent view of what the future might turn out to be. They are not forecasts in the sense that one is able to extrapolate using past data. However, they do deal with the future and provide a tool of analysis for the organization to structure the surfeit of information that is contained in the present.

In particular, scenarios help organizations recognize the weak signals that signpost changes in its environment. It is these weak signals which precede

environmental discontinuities, fractures, or strategic inflection points that help shape the competitive environment (Morgan 1988; Grove 1996). If an organization is to remain proactive in its competitive environment it must not allow the rules of the game to be changed to its detriment, that is, it must be capable of dealing with a tipping point (Gladwell 2000), an unexpected and unpredictable event that has a major impact on an organization's environment. /1/11 11: 03: 53 AM the general environment 43 For a discussion of strategic inflection points and their impact on strategy go to the Online Resource Centre and see the Key Work feature. www.oxfordtextbooks.co.uk/orc/henry2e/ 2 Strategic decisions are almost always fraught with ambiguity and uncertainty which create complexity for decision makers. As human beings we are subject to biases and imperfect reasoning about uncertainty, that is, as individuals we will tend to misread events that are unlikely and either ignore or overemphasize unlikely but significant events.

In an attempt to resolve these shortcomings, most companies will use some form of discounted cash flow coupled with sensitivity analysis when analysing risky strategic decisions (Gertner 2000). The problem with these quantitative approaches is that they imbue the decision making with a false sense of objectivity and can be misleading. For example, sensitivity analysis is seen as overly simplistic in that by varying one parameter at a time it fails to incorporate any links or correlations between them.

Scenario planning is an approach to decision making under conditions of uncertainty that helps to overcome many of the shortcomings of traditional decisionmaking methods; that is, scenario planning allows organizations to

change several variables at the same time without keeping other variables constant. Crucially, scenario planning helps to overcome some of the biases and imperfect reasoning that human beings make under conditions of uncertainty. Scenarios are a tool of analysis to help improve the decision-making process set against the background of a number of possible future environments.

They benefit the organization by readily helping managers think in a more systematic way. This allows individuals to more readily recognize change in their business environment instead of ignoring or rejecting it. Van der Heijden (1996), a former head of scenario planning at Shell, states that the benefits of scenario planning for Shell have been:

- More robust strategic decisions.
- Better thinking about the future by a 'stretching mental model'.
- Enhancing corporate perception and recognizing events as a pattern (the recognition and monitoring of weak signals until they coalesce into a pattern is clearly important here).

Improving communication throughout the company by providing a context for decisions.

- A means to provide leadership to the organization.

The process of scenario planning should have the objective of positively influencing the strategy of the organization. This requires that the scenarios devised should stretch the imagination of management while also remaining plausible. In order to achieve this, organizations must be prepared to invest resources in educating managers to help them make the best use of scenarios.

They need to recognize that developing scenarios takes time and is most effective when managers from different

Strategic Analysis 2 parts of the business interact. By constructing multiple scenarios, an organization can explore the consequences of uncertainty for its choice of strategies. Furthermore, an organization can formulate strategies knowing that the assumptions on which it competes, what Drucker (1995) refers to as its theory of the business, are surfaced and adequately assessed. See Case Study: Novacraft which highlights some of the difficulties of taking account of a changing environment).

case study 2. 1 Novacraft— Dealing with change Over the past five years Novacraft, which designs, develops and manages smartcards for travel and leisure-service providers, such as Transport for London, has enjoyed strong demand thanks to policies promoting public transport and Oyster-style integrated ticketing systems. But proposed public spending cuts and tough trading conditions in the travel industry make future investments more doubtful, according to Novacraft's managing director Debra Charles. Our market should be both emerging and growing, but there are economic barriers,' she admits. ' Organisations, especially in the public sector, have to make savings. Our competitors are financially stretched so they are selling cheap. We must innovate to find new clients as well as saving our existing customers money. ' Charles, who has a background in both technology and marketing, launched Novacraft in 1998 with money inherited from her parents. As the company's name suggests, she was inspired to start a firm that would use the web to develop new ways of working. I thought it would be great to create a transparent online database so that organisations could see what was happening with their money and their clients,' she remembers. Now, the Northampton-based firm manages more than 1m customer records for clients that issue pre-paid

travel tickets and other smart cards. Staff verify and process paper or online applications before loading the information onto a chip, producing plastic cards, processing payments and providing a help centre that answers cardholders' queries. Novacraft can also analyse records ranging from call notes to scanned documents to help clients understand their customers' habits.

One of Novacraft's highest profile contracts is to manage the concessionary Oyster cards for students, children and 16- and 17-year olds on behalf of Transport for London. As well as checking that applicants have given correct information about their age, address and place of education, the company's helpline deals with questions such as how to replace lost or stolen cards. The company also manages concessionary travel cards on behalf of the Scottish government and handles online applications for Young Persons, Family and Senior Railcards for the Association of Train Operating Companies.

780199581610_035_063_CH02. indd 44 2/1/11 11: 03: 53 AM the general environment 2 ' In the past, clients might have used several different firms to produce cards, provide databases and integrate systems, but we have all that under one roof,' explains Charles, whose chief rivals are major systems integrators such as Accenture and Logica. ' We have been successful in getting big companies on board through the tender process because we have invested in hiring and training the right people and really thinking about what the customer needs. We even self-impose penalty clauses. '

As a result, Novacraft made a substantial profit last year on a turnover of ? 6m, up from ? 4. 9m in 2007. The company has 96 employees, which rises to approximately 200 when extra staff are brought in to the call centre during

the busy start to the academic year. Finding new clients by maximizing the range and quality of service is a key challenge for Novacroft. As Charles points out, in the aftermath of the bank bail-outs, pledges such as transport secretary Lord Adonis's promise to consider incentives for train operating companies that introduce smart ticketing look far from secure. Can we really assume that these statements are facts or that money is ringfenced? ' she says. ' The real certainty is that the government and train operating companies have to save money. ' In recent months Novacroft has worked on scenario planning to consider how the company might react to changing demand. The company prides itself on a ' foxy' approach to market conditions, moving nimbly and using all its available tools to tackle future trends. ' We spent 14 hours in a hotel room thinking about what we know, what we don't know and studying the rules of the game and our competition. Understandably, Charles is reluctant to reveal her conclusions, but she is very confident that the exercise was worthwhile. ' We have created a massive opportunity that's totally outside what our competitors are thinking about. ' Some diversification into products such as money cards is likely, while building databases that clients can outsource to India is another possibility. Improving efficiency to keep prices competitive for cash-strapped public sector organisations is another priority. Since March, Charles has introduced a series of lean management techniques that have cut costs by more than ? 80, 000 while maintaining service standards. For example, a study of customer service queries revealed that the number of calls processed by the help centre could be cut by improving online information. The company is also reaping the benefits of investing around ? 40, 000 in

staff leadership training over the past three months, she says. Charles believes that, despite the slowdown, Novacraft could achieve a turnover of up to ? 20m within the next five years. ' We stand for innovation, service delivery and value for money—and that's always attractive. ' 45

Source: ' Smart ticketing business Novacraft is looking to play its cards right' Daily Telegraph, 14 August 2009 9780199581610_035_063_CH02. indd 45 2/1/11 11: 03: 53 AM 46 part 2 Strategic Analysis Questions 1. In what ways might scenario planning help Novacraft to remain competitive? 2. What remedies might Novacraft pursue to reduce its reliance on public sector finance? 2 3. Comment on Debra Charles's confidence in Novacraft's business model. 2. 3. 1 Undertaking Scenario Planning1 Scenario planning is relevant to almost any situation in which a decision maker needs to understand how the future of his or her industry or strategic business unit might develop. It divides our knowledge into two areas: (1) things we think we know something about, and (2) things we consider uncertain or unknowable. The first area is based on the past and continuity. For example, an organization can make fairly safe assumptions about the direction of a country's demographic profile. The uncertain elements include such things as future oil prices, interest rates, and the outcomes of political elections. Even here it is not necessary to account for every possible outcome, since simplifying the outcome is fine for scenario planning.

Therefore, an organization might simply categorize future interest rates as high, medium, or low, rather than trying to work out every possible permutation. Also, as scenarios highlight possible futures but not specific strategy formulations, outside opinions such as those of consultants can be

included in the process. A process for developing scenarios is as follows. 1. Define the scope. This involves setting the time frame and the scope of analysis. The time frame can be determined by factors such as product life cycles and rate of technological change. The scope of analysis may include products, markets, and geographical areas.

Once the time frame is set, the question becomes: What knowledge would the organization benefit most from in that timescale? 2. Identify the major stakeholders. Those who can affect and are affected by the organization's decisions. The organization needs to know their current levels of interests and power, and how these have changed over time. 3. Identify basic trends. Which political, economic, social, technological, and industry factors will have the most impact on the issues identified in Step 1? The impact of these trends on current strategy can be listed as positive, negative, or uncertain. . Identify key uncertainties. Which events that have an uncertain outcome will most affect the issues the organization is concerned with? Here again the 9780199581610_035_063_CH02. indd 46 2/1/11 11: 03: 53 AM the general environment 47 organization might consider political, economic, social, and technological factors, in addition to industry factors. For example, what will characterize future consumer trends? An organization should develop possible outcomes for each of these uncertainties. These should be limited to keep the analysis simple. 2 5. Construct initial scenario themes.

Once trends and uncertainties are developed, the organization has the basic building blocks for scenario planning. It can then identify extreme world views by juxtaposing all positive elements in one scenario and the negative elements in another broad scenario. 6. Check for consistency and

plausibility. This involves checking to see if the trends identified are compatible with the chosen time frame. If they are not, then remove all the trends that do not fit the time frame. Do the scenarios combine outcomes of uncertainty that actually go together?

In other words, ensure that inconsistent outcomes are not put in a scenario, such as having full employment and zero inflation together. Lastly, have major stakeholders been placed in a position they will not tolerate or cannot change? In this case, the scenario described will probably change into another one. The key then is to identify this ultimate scenario. 7. Develop learning scenarios. Here the role is to develop relevant themes for the organization around which possible outcomes and trends can be organized. The scenarios can be given a name or title to reflect that they tell a story.

This also helps individuals to remember the scenarios. At this stage the scenarios are useful for research and further learning within the organization rather than decision making. 8. Identify research needs. At this stage, further research may be required to understand uncertainties and trends more fully. This is because organizations are knowledgeable about their own competitive environment but less knowledgeable about other industries. Therefore, the organization may need to study changes, in technology for instance, which have yet to impact its industry but may ultimately do so. . Develop quantitative models. Once further research has been gained, the organization may wish to revisit the internal consistency of the scenarios and decide whether it might benefit from formalizing some interactions in a quantitative model. 10. Evolve towards decision scenarios. The ultimate aim of this process is to move the organization towards scenarios that can be

used to test its strategy formulation and help it generate new ideas. At this point it is helpful to double check Steps 1-8 to see if the scenarios take account of the issues facing the organization.

If the scenarios are useful to the organization, they might have the following characteristics: (1) they address the concerns of individuals in the organization; (2) the scenarios are internally consistent; (3) they describe fundamentally different futures 9780199581610_035_063_CH02. indd 9780199581610_035_063_CH02. indd 47 2/1/11 11: 03: 54 AM 48 part 2 Strategic Analysis 2 as opposed to being variations on a particular theme; and (4) each scenario describes an equilibrium state that can exist for a considerable period of time as opposed to being merely short-lived.

In summary: scenario planning attempts to capture the richness and range of possibilities, stimulating decision makers to consider changes they would otherwise ignore . . . organizing . . . into narratives that are easier to grasp and use than great volumes of data. Above all . . . scenarios are aimed at challenging the prevailing mind-set. (Schoemaker 1995, p. 27) It is perhaps worth reiterating that scenarios are not intended to predict the future. They are designed to help managers deal with a highly uncertain and dynamic environment.

They may be aimed at the general or competitive environment (for a discussion of why scenario analysis should be applied at the industry level see Porter (1985)). Porter, whilst recognizing the value of multiple scenarios for an organization's choice of strategy when considering scenario planning at the macro-level, argues, ' Macroscenarios, despite their relevance, are too general to be sufficient for developing strategy in a particular industry'

(Porter 1985, p. 447). Whether this statement is accepted may depend more on the industry being addressed rather than scenario planning per se.

Scenarios encourage management to ‘think the unthinkable’, to question and surface assumptions they hold about the environment, and to be prepared to view events from a radically different perspective. Scenarios are a tool of analysis that examines the impact of uncertainty on organizations and industries by explicitly identifying some of the key uncertainties—the scenario variables. For scenarios to be effective, they must encourage the creation of robust strategies that match the organization’s limited resources with the endless challenges in the external environment.

To do this, scenario planning must ensure that as many as possible of the long-term opportunities and threats facing the organization are identified and addressed. For more information on how to undertake scenario planning go to the Online Resource Centre and see the Tools and Techniques feature. www.oxfordtextbooks.co.uk/orc/henry2e/ 2. 4 PEST Analysis A useful tool when scanning the general environment is PEST analysis. This refers to political, economic, social, and technological factors. It is worth noting that some commentators include legal and environmental factors separately, preferring to extend the acronym to PESTLE.

However, the legal element of the acronym can be 9780199581610_035_063_CH02. indd 48 2/1/11 11: 03: 54 AM the general environment 2 subsumed within the political factor. In addition, the use of the last E (which refers to environmental factors) is often meant to signify the effects of our lifestyles on our environment, such as the use of fossil fuels

and their impact upon climate change. In this respect it can be captured within the 'social' factor, or indeed within all four factors in one form or another.

Therefore, it is not important whether we use PEST (or STEP) or PESTLE, but to understand how this framework can be used and to be aware of its limitations. As long as the choice of acronym is clearly defined we have a consistent approach. What will PEST do for the organization? PEST analysis is simply another tool to help the organization detect and monitor those weak signals in the hope of recognizing the discontinuities or fractures shaping the environment. PEST analysis can be used to help detect trends in the external environment that will ultimately find their way into the competitive environment.

It provides a link between the general and competitive environments in that weak signals in the general environment can become key forces for change in the competitive environment. Although we will deal with each factor in turn, it should be noted that interrelationships between the factors exist. For example, a social trend of healthier eating and consumers' increasing distaste for factory farming (the crowding of animals and fowl in confined spaces prior to their sale for human consumption) may signal to supermarkets a change in consumer behaviour and spending patterns.

4. 1 Political Factors The political factor of PEST deals with the effects of government policy. Inasmuch as government policy is worked out through legislation, it encompasses all legal elements of this analysis. This includes items such as government stability, taxation policy, and government regulation. Government stability is not a major issue in Western economies. However, where multinational corporations operate across international

borders, the stability of governments and political systems in those countries needs to be taken into account.

These corporations need to be assured that there will not be any sudden and detrimental changes that might jeopardize the substantial investments they will have made. The safety of their personnel operating in these countries will be paramount, as will the existence of an infrastructure which allows the efficient transfer of goods and services as well as financial assets. For instance, a government policy of deregulation or privatization has the effect of opening up markets to competition.

Previously comfortable industries feel the chill wind of change, and organizations within the industry are forced to innovate and cut costs to remain competitive. This is because new entrants will often enter a market with lower cost curves and more innovative products and services owing to a better use of technology and a clearer understanding of consumer needs. To avoid being surprised, companies need to be scanning their environment for signs of change in government policy which might impact on their industry.

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corporate socialresponsibilityecognition that organizations need to take account of the social and ethical impact of their business decisions on the wider environment in which they compete part 2 Strategic Analysis An air or sea disaster which costs human lives may prompt tighter government regulations in the areas ofhealthand safety, particularly where an investigation shows that the disaster could have been avoided. Companies operating within these industries should not be waiting to react to the outcome but should have worked out the ramifications of government

involvement and be positioning themselves to take advantage of government regulation.

The reduction in carbon dioxide emissions and new fuel consumption standards for cars came about as a result of intergovernmental regulations. This, in turn, was a result of widespread concern by consumers and environmental groups about climate change due to increased levels of 'greenhouse gases' in the atmosphere. This highlights the links between social trends and political change. Government regulation need not be something for companies to fear.

Porter and van der Linde (1995) point out that environmental regulations, such as reducing pollution, may act to spur competitive companies on to innovate and reduce costs to counter the increased costs of regulation. While the US car makers fought new fuel consumption standards in the vain hope that they would go away, the Japanese and German car makers developed lighter and more fuel-efficient cars. The companies that reap the competitive benefits will be the early movers: 'the companies that see the opportunity first and embrace innovation-based solutions' (Porter and van der Linde 1995).

To do this, managers need to develop a new mindset which recognizes environmental improvement as a competitive opportunity rather than a threat. There is evidence across the Anglo-American economies of the UK and the US that some organizations are beginning to recognize that good business can involve corporate social responsibility (CSR). For example, the world's leading media company, Time Warner, produced its first comprehensive report on its corporate social responsibility activities in 2006.

It states: Corporate social responsibility is not an afterthought at our company. It is central to what we do.

That's because Time Warner cannot be a great company unless we are a good company . . . It's simply good business to do so. (Time Warner 2006) In the US the Sarbanes-Oxley Act 2002 resulted from the corporate collapse of Enron, WorldCom, and Tyco. There was widespread concern that boardroom executives (including non-executives) and the accountancy profession had failed to safeguard shareholders' interest, and in the case of Enron had actively operated to pervert that interest. Internal auditors were seen as ineffectual and often completely unaware of what powerful executives were doing.

This legislation can work to the advantage of companies that are proactive in their response to it. For example, shareholders will be more confident in investing in a company which can show that it already has stringent ethical guidelines in place and that any breach of those guidelines will be taken seriously. The Building Society Act 1986 allowed building societies in the UK to offer current accounts and financial services that were previously the preserve of banks. This had 9780199581610_035_063_CH02. indd 50 2/1/11 11: 03: 54 AM the general environment 51 ar-reaching effects on the financial services sector, intensifying competition for customers and leading to consolidation within the industry. A player within the industry would have been wise to conduct some form of PEST analysis in order to determine the effects of these politically driven changes within the industry and on their organization. 2. 4. 2 Economic Factors 2 Key economic indicators include interest rates, disposable income, unemployment rates, retail price index

(inflation), gross domestic product (GDP), and exchange rates. However, economic data can be notoriously fickle and ambiguous.

In addition, an economic indicator can never provide a complete picture (even of the subset of data it purports to track), but rather provides a snapshot and simplification of complex economic phenomena. This makes scanning and monitoring the general environment for signs of economic shifts which might impact an organization's industry a little difficult. The strengthening of an economy will generally benefit industries, but the extent of its effect will vary according to which economic factors are most affected. For example, the construction industry and manufacturing are most susceptible to increases in the rate of interest.

Manufacturing organizations which export goods abroad will be scanning the general environment for signs of an appreciation in exchange rates, the effect of which will be to make it harder for them to sell their goods abroad but relatively easier for importers to sell their goods in the domestic market. In order to remain competitive, manufacturers exporting abroad will need to make efficiency gains and innovate so that they can offset the unfavourable exchange rate with a reduction in price or increase in quality. strategy focus

PEST Analysis— The Construction Industry

The construction industry worldwide is renowned for operating on narrow profit margins. Any sudden and prolonged rises in interest rates can have a profound effect on industry profitability. The key for players in this industry is to borrow funds at an interest rate which allows building projects to be completed successfully, on budget, and on time. Where there is slippage of large-scale construction projects, as was seen with the Channel Tunnel, this

immediately brings into doubt their financial viability. Any delay inevitably increases the final project cost.

Investors will be acutely aware that their investment in a project has an opportunity cost, that is, their money might be better invested elsewhere. If interest rates begin to climb this 9780199581610_035_063_CH02. indd 9780199581610_035_063_CH02. indd 51 2/1/11 11: 03: 54 AM part 2 Strategic Analysis Construction firms already scanning and monitoring their environment can anticipate economic trends and prepare for them. © iStockphoto. com/David Newton 2 52 exacerbates the situation, as investors will demand a greater return. The consortium of banks financing loans will want to rearrange the interest rates on offer to reflect the increased risk and changing economic conditions. UK and US banks are known for their preference for short-term financing and unwillingness to invest in the equity of construction projects, in contrast with their Japanese counterparts. This makes the monitoring of data and detecting any changes in the environment of great importance. Investment banks will readily pick up any adverse change in the economic fundamentals of a project. Therefore, the organization must not only be aware of these changes but also have contingent plans in place for dealing with them.

It also helps if the organization is aware of the interrelationships between economic variables—that a rise in inflation will probably cause the monetary authorities to consider increasing interest rates. They can then work through the ramifications of such changes on their projects. If one of the government's political priorities is to manage the economy, we can see a relationship between economic and political factors. Construction firms

already scanning and monitoring their environment will be expecting these trends and therefore be prepared.

Central bankers, such as the chairman of the US Federal Reserve Bank and the Governor of the Bank of England, are faced with a number of dilemmas. For instance, the economic data they will be tracking and monitoring will contain conflicting views. This forces them to use their judgement to look for similar patterns that have occurred in the past as a basis on which they can make decisions. This is not all that they have to contend with. The balance of economic data being monitored may lead them to believe that the economy is overheating. Their response may be a quarter-point increase in interest rates.

However, the time it takes to implement the interest rate rise and for this to impact on the economy may take a further six months. In that time it is conceivable that more recent economic data will point to the economy actually slowing down. Therefore, the effect of the rise in interest rates will be to accelerate 9780199581610_035_063_CH02. indd 52 2/1/11 11: 03: 55 AM the general environment 53 the likelihood of an economic downturn. This reinforces the need for sombre and intelligent judgement when using PEST analysis. 2. 4. 3 Social Factors 2

Social factors include cultural changes within the environment and are often referred to as socio-cultural. In the UK, increasing consumer concern with genetically modified food (GMF) and lobbying from consumer groups forced the government to scale down its introduction of genetically modified crops. Clearly, such social trends are of great importance to companies which research and produce genetically modified products. Many have been caught

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unawares by the strength of consumer response and find that they must first allay consumer fears if their products are to be fully accepted.

Indeed, the frozen food retailer Iceland was one of the first retailers to state emphatically that none of the food products it stocks contains genetically modified ingredients. In doing so Iceland had accurately read a change in social trends and recognized that it would influence consumer spending patterns. Other supermarkets were quick to follow. strategy focus Demographic Changes Courtesy of Johnson & Johnson The US and Western Europe face an ageing population with attendant problems for pension fund provisions. As the base of the working population continues to shrink, while advances in medical science and healthier eating ensure that people continue to live longer, companies are faced with shortfalls in the pension fund provisions they make for employee retirement. One solution is to encourage employees to take out personal pension plans that will supplement any state provision. Another solution being considered by governments is for employees to consider working for longer. In this way they can build up their pension fund to an acceptable level and avoid any shortfall. In response to a falling birth rate, companies like Johnson & Johnson, involved with the provision of baby-care products,

In response to a falling birth rate, companies have effectively targeted these like Johnson & Johnson have targeted their products at an adult female baby products at an adult female audience. 9780199581610_035_063_CH02. indd 53 2/1/11 11: 03: 56 AM 54 part 2 Strategic Analysis 2 audience. For example, their baby lotion is now marketed as being kind and gentle to women's skin, as well as that of babies. This represents a response to

changes in the general environment that directly affect their industry. Retail organizations in the US and Europe are increasingly responding to the changing demographics of an ageing population by employing older personnel. They recognize that retired employees possess a wealth of experience and respect for others that can be used to add value when serving customers.

2. 4. 4 Technological Factors

Without doubt some of the major changes taking place in the general environment that are impacting the competitive environment are technological. One merely has to think about how Amazon and Dell have used the Internet to change traditional retailing within their respective industries. For instance, for a small retailer operating in a remote location, the financial outlay of marketing its product to customers nationwide would prove prohibitive.

However, with the advent of the Internet, a retailer can access these consumers with a basic web page advertising its wares worldwide. It is interesting to note that small family businesses find their goods being demanded far outside their national borders because of awareness of their products through the Internet. Technological factors include the rates of obsolescence, that is, the speed with which new technological discoveries supersede established technologies. The rate of change in technology and innovations has the effect of causing new industries to emerge and also changes the ways in which existing industries compete.

Technological advances include the Internet, the use of sophisticated software (increasingly being used in the design and testing of automobiles), genetic engineering (see Section 2. 4. 3), and nanotechnology. The rapid rate of change of technology has changed the dynamics of industries such as

newspaper publishing, banking, financial services, and insurance. This has allowed new entrants to enter the market at a lower cost base than incumbents, thereby offering more competitively priced products and services and gaining market share in the process.

Direct Line insurance in the UK cuts out the insurance broker (intermediate) by providing insurance quotations direct to the consumer over the telephone. This allowed it to gain rapid market share and eventually become the market leader. It changed the rules of the insurance industry, forcing incumbent players to follow suit or face a loss in market share. As the insurance industry becomes increasingly commoditized, differentiation becomes harder to achieve as organizations compete on price. Direct Line's first-mover advantage is being eroded, as competing firms such as Norwich Union prove capable of competing on a price basis.

780199581610_035_063_CH02. indd 54 2/1/11 11: 03: 57 AM the general environment 2 First Direct, a subsidiary of HSBC, pioneered the use of telephone banking in the UK. At the time competitors were slow to follow suit, but, once it was established, all players offered a telephone banking option. The same is true of Internet banking. Telephone and Internet banking provide obvious consumer benefits as the financial cost of undertaking transactions within a bank branch is far in excess of the same transaction undertaken by telephone or online.

In fact, when the transaction is undertaken online the cost falls substantially. Therefore, organizations must be prepared to innovate and adopt new technologies if they wish to remain competitive. The Internet has been compared to the Industrial Revolution in terms of the changes it has brought

about. The pace of change of technology is increasing. Its unpredictability is increasing. Markets are becoming increasingly turbulent. This makes it important to try to detect the weak signals which grow into discernible patterns that have the potential to change how industries operate.

Moreover, if tipping points are unexpected, we need to change our thinking via the use of scenario planning to expect the unexpected. Organizations may not be able to predict these events but they will be in a stronger competitive position to respond to them once they have occurred. While the impact of technological change and changing consumer preferences continues to challenge the business model of traditional high street retailers such as the UK's WH Smith, such changes are not exclusively the preserve of the private sector.

Organizations in the public sector also face changes, often socio-political in nature, and here too an understanding of PEST analysis can benefit the organization. (See Case Study: Radical Change in the NHS, which highlights some of the important factors driving change within the National Health Service). 55 case study 2. 2 Radical Change in the NHS Senior officials have set 'aggressive' targets to reduce the number of patients referred to specialists, or treated in Accident and Emergency departments, while GPs will be asked to cut down on the amount of time spent in consultations.

The plans are being issued as senior managers warned that the NHS is about to face the greatest financial pressures since its inception. They fear that when the current spending round ends in 2011, the impact of an anticipated real-terms freeze or cuts—coming as the demands on the NHS of an ageing population increase—will be devastating. The NHS Confederation, which
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represents NHS managers, will tell this week's Labour Party conference that the impending challenge is so great that hospital closures and job cuts must be enforced across the country. 9780199581610_035_063_CH02. indd 55
2/1/11 11: 03: 57 AM iStockphoto. com/Sturti part 2 Strategic Analysis 2 56
The National Health Service It comes as two leading think tanks predict a future funding gap of between ? 20bn and ? 40bn within six years of 2011. Regional health authorities have ordered hospitals and primary care trusts to draw up plans for cuts worth billions. In London, NHS trusts have been told to divert more than half of A&E patients, and those seeing specialists, to cheaper ' polyclinics' run by groups of GPs. Meanwhile, family doctors will be asked to speed up their consultations, reducing the average time per patient from 12 minutes to eight.

The instructions drawn up by NHS London, and seen by The Sunday Telegraph, order trusts to demonstrate that they can deliver an ' aggressive scenario' in response to funding pressures. Under its ' affordability assumptions', already-controversial plans to reduce the number of patients treated in hospital are given more demanding targets in an attempt to cut costs. Sixty per cent of activity which now takes place in A&E departments should happen in community clinics within five years, the document says, along with 55 per cent of outpatient treatment.

Thirty per cent of outpatient appointments will be stopped altogether. Managers say not all appointments are necessary, though many doctors argue it is impossible to know in advance which patients do not need to be seen. The number of diagnostic tests carried out will be cut by 15 per cent, while the amount of surgery will be reduced by seven per cent. Although the

' polyclinic' model, to reduce demand on hospitals, is supposed to shift more treatment into the community, GPs will be told to reduce their average appointment time by one third, from 12 minutes to eight.

Senior managers in other regions, who will draw up their own plans later this year, said rural communities faced particular pressures, with small maternity and district general hospitals likely to struggle in the funding crisis. In a speech tonight to the Labour Party conference in Brighton, the NHS Confederation will warn that the service across the country faces unprecedented difficulties, which require ' bold and decisive measures'. Its policy director Nigel Edwards told The Sunday Telegraph: ' The NHS has never experienced a financial challenge of this magnitude or duration in its history. 9780199581610_035_063_CH02. indd 56 2/1/11 11: 03: 57 AM the general environment 9780199581610_035_063_CH02. indd 57 2 He said improving the operation of the NHS, and treating more patients earlier in primary care, would not be enough to balance the books. Delegates will be told: ' Savings only start to become available when we can shut entire buildings, sites and reduce staffing numbers. ' The organisation, which represents NHS managers, will also call for ' uncomfortable decisions' to be made to limit staff pay. Under a three-year deal already agreed, nurses will receive a rise of 2. 5 per cent in April. Sir Robert Naylor, chief executive of University College Hospital in London, said pay should be frozen for NHS staff after that point. If it was not, every one per cent pay rise could cost 10, 000 job cuts, he said. The chief executive said that while he supported plans to treat more patients in the community, he was concerned that PCTs were planning to cut back on hospital services before alternatives were put in

place. ‘ The investment in those services has to come first or where do the patients go? he said, criticising ‘ oversimplified’ analyses which failed to take account of increasing public demand. Dr Laurence Buckman, chairman of the British Medical Association’s GP committee, described the plans as ‘ desperate and inadequately thought through’. Dr Buckman, who works as a GP in London, said targets to reduce outpatient appointments by 30 per cent would put patients at particular risk. He said: ‘ All this means is that those people who are refused a referral to a specialist will be forced to go privately, or go nowhere. This will be difficult for doctors, but patients will be the real victims. While some specialist referrals turn out to be unnecessary, GPs only asked for a specialist opinion when they needed it, Dr Buckman said. A study by the King’s Fund and the Institute for Fiscal Studies forecasts a funding gap of between ? 20bn and ? 40bn by 2017, if funding for the NHS receives no increase, or gets a real-terms freeze which only keeps pace with inflation. Sue Slipman, director of the Foundation Trust Network, which represents the best hospitals, warned of an ‘ Armageddon scenario’ which could unfold without decisive action on pay, and terms and conditions.

She said: ‘ There is a trade-off between saving jobs, and pay increases, and in the current climate, protecting jobs needs to be a priority. ’ Katherine Murphy, from the Patients Association, accused NHS managers of wasting billions on management and repeated organisational restructuring during the boom years of record investment. She said there was no evidence that plans to shift patients into the community would provide safe care. ‘ Elderly patients often require intensive support which often means lots of staff, in

hospitals. The need is only going to get greater—these plans look like madness,' she said.

A spokesman for NHS London said its documents provided planning scenarios, rather than forecasts, to cope with a changing economic environment. He said 57 2/1/11 11: 03: 58 AM 58 part 2 Strategic Analysis the NHS was investing heavily to ensure care was provided in the most appropriate setting. Source: ' Plans for swingeing hospital cuts as NHS on brink of Armageddon' Sunday Telegraph, 26 Sep 2009 2 Questions 1. Outline the PEST factors driving change within the NHS. 2. Which PEST factors do you consider to be the most important, and why? 3.

How can an analysis of PEST factors help the government and NHS chief executives to resolve the crisis in the health service? 2. 4. 5 Limitations of PEST Analysis The economic example illustrates some of the limitations of dealing with macroenvironmental analysis. First, PEST analysis is not simply writing a ' shopping list'—the use of disparate bullet points without any consideration of their wider ramifications. In listing the economic factors, for example, one must clearly draw out the implications of each factor on the organization's environment.

In addition, the rate of change of PEST factors in the general environment and their increasing unpredictability act to limit the use of PEST analysis. Some have argued that the competitive environment is the only true arena for the organization to analyse since it is the competitive environment that has the greatest impact on a firm's markets and products (Porter 1985, particularly Chapter 13). Whilst there is agreement that the competitive environment has the greatest effect on an organization's ability to achieve

competitive advantage, it would be unwise to refrain from analysing the general environment.

For information on how to write a PEST analysis go to the Online Resource Centre and see the Tools and Techniques feature. www.oxfordtextbooks.co.uk/orc/henry2e/

2. 5 SWOT Analysis SWOT analysis refers to strengths, weaknesses, opportunities, and threats. Strengths and weaknesses refer to the organization's internal environment over which the firm has control. Strengths are areas where the organization excels in comparison with its competitors, while weaknesses are areas where the organization is at a disadvantage compared to its competitors.

9780199581610_035_063_CH02. indd 58 2/1/11 11: 03: 58 AM the general environment 2 competitors, while weaknesses are areas where the orga