



UNIT-1 The Business Environment

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Discuss what the Business Environment is
- ✓ Explore the social responsibility of businesses and business ethics

Unit 1

The Business Environment

There are certain conditions that need to be understood and fulfilled in order for a business to flourish in any environment. Be it for production or for the purchase or sales of goods and services, a business has to keep in mind the kind of environment in which it is working and adapt its way of working to that environment.

Just as the growth of a plant depends upon its environment, so does the growth of a successful business. The Business Environment in simple terms consists of the factors that need to be examined and followed in order to run a successful business with the aim of earning profits.

One can define Business Environment as all those external and internal factors that are highly important for the business's survival and that affect its course and function. The Business Environment for any region or country can be split into two aspects: **Internal and External**.



Fig: 1.1

- **Internal Aspects**

- Internal aspects are factors that are responsible for the smooth functioning of the enterprise, i.e. the workers responsible for the production, the machinery, the money and materials and, finally, the management. These factors are within the business's control and can be altered as per requirements.

- **External Aspects**

- These are factors or conditions that cannot be controlled or may sometimes even act as a threat to the survival of the enterprise. The external environment, again, is divided into two parts: **Micro and Macro**.
- **Micro Environment** is closer to the operation of a business. **It is important to build a fine working relationship with these factors.** The quality, the cost of production, and the success of the business depends on the relationship that has been developed with these factors.



Fig: 1.2

The factors in the Micro environment are as follows:

- a. **The suppliers**, who deliver the materials required for production. Dependence on just one supplier could create a threat to the smooth operation of a business.
 - b. **The customers**, who include all the various kinds of buyers, from the wholesalers and retailers to the government, etc. The success of any business depends mainly on the satisfaction of the customers.
 - c. **The middlemen**, who work as a link between the consumers and the business.
 - d. **Competitors**; it is essential to study the competitors of any business in any market and to keep introducing new ways to win the loyalty of new and existing customers.
 - e. **The public**, which includes the local media as well as the citizens or targets of the business, who may or may not be the users of the product.
- **Macro Environment** is usually less controllable than the micro environment. When a business successfully adapts itself to the factors in the Macro environment, it can survive in that environment. **These are the social, political, legal, technological, institutional and, of course, economic aspects of any society or culture.**

One needs to have a clear understanding of these factors to navigate the business through any sudden changes that may occur in any one of these factors. The macro environment can pose threats to the business and also create opportunities for it to successfully move forward.

The conditions in the macro environment might be affected by things such as a new government rule or law that requires a certain material's immediate discontinuation, a change in the standard of requirements, a change in tastes and, hence, the customer's needs and demands, or the introduction of a similar product by a competitor.

These factors are beyond the control of the individual and are completely external. These factors are:

Economic	Social
Political	Cultural
Legal	Technological
National	International

The economic factors are concerned with the economic conditions and laws of a particular country, while the **non-economic** factors have to do with recent developments in technology, changes in nature, or natural calamities.

The import and export laws of different countries and their foreign policies, the ideals of the current ruling political party, and the beliefs and customs of the people in the nation are also considered economic factors.

They need to be carefully studied and their developments monitored to avoid the risk of shocks. Needless to say, these factors are unpredictable and highly important.

While the conditions are basic and true for any environment, **the social aspects** also come into play. For example, the tastes of the people in one country will obviously differ from those of another. Their requirements and expectations will be different too.

Before even thinking of opening a business in any market, one must carefully study the needs and practices of the people of that particular society, and the current competition and work practices of suppliers, middlemen and agencies that are essential for the business.

A successful assessment of the workings of the society or the environment will then enable the business to learn about the various opportunities and areas where the business can expand and grow.

By understanding the culture, the business can shape its image in a way that will win over its prospective customers.

Thorough research and analysis will help the business present itself in a way that will please and attract the market, gaining customers from existing competitors. Without research, it is impossible to improve and remain one step ahead of the competition.

It will also help the firm understand its own positives and negatives or what might help its image and sales and harm its growth in the market. The firm might then work on developing a more customer-friendly front.

Types of Businesses and Their Ownership

A business is an organisation run by an individual or a group of individuals with a common interest in trading goods, ideas or services to customers to earn a profit. Businesses can be of various types depending on what they are trading or dealing with, or who runs them.

There are a few globally recognised business entities or systems. They are legally recognised by all countries. In addition, different countries have different laws for certain businesses. However, the following are the main types of globally recognised business.

Corporations	Co-operatives
Partnerships	Sole Traders
Limited Liability Companies	

Corporations

A corporation is created under the laws of the state, but it has detached accountability; i.e. the leader and the corporation are treated as different entities, and the corporation is held accountable for its liabilities and achievements.

This means that the corporation is treated as an individual or a separate legal entity. A business that is recognised as a separate legal entity has some of the same rights as a person in a court of law.

It can enter into contracts, it can be held accountable for any loss or profit, and it can also be sued (like a person) by other companies or individuals and held accountable for any damages.

In such cases, it would use the name of the company rather than the members of its board or its shareholders. A corporation can also use its name to sue another corporation, management, state, or individual for any transgression perpetrated against it.

In most countries, a corporation can be created through registration. It has many types, but they are mainly used to conduct business. If a corporation fails for whatever reason, its shareholders or employees are not liable to pay any debts created by it.

There is a special area of law created for corporations called corporate law; specialist lawyers work in this area and handle cases on behalf of corporations.

Co-Operatives

A co-operative is a self-governed association of people who work for their own economic, social or cultural benefit. They can be non-profitable organisations run by various people for the benefit of their community (or for a cause) or by a group of people who use the organisation's services.

They are owned and managed by the people involved in the act of co-operation. The name comes from the same word which means to co-operate for a certain cause or a similar purpose.

A co-operative can be on a small scale, such as a building or housing co-operative, where the various owners of the houses or apartments of a certain area come together to work for the mutual benefit and betterment of their society, manage its funds, and take care of any repairs or problems that arise.

Alternatively, it can be on a larger scale such as workers' co-operatives, where the workers of a factory, or an enterprise or a group of enterprises with similar dealings come together to work for the benefit of the members; there are also cooperative banks that are mostly non-profit in nature.

Partnerships

A partnership is a type of business that is run by two or more individuals who have the same

goals and aims for the business. Partnerships are common among people around the world, but when a partnership is formed for economic purposes, it becomes a business partnership.

They can be temporary in nature between two or more organisations and even nations, who come together to work on one goal, or they can be permanent partnerships. Some partnerships (such as in law firms) add new partners to the agreement for fixed periods of time.

- **Sole Traders**

Sole traders or sole proprietorships are businesses run by one individual who is completely responsible for all liabilities and achievements. He/she owns every aspect of the business, is responsible for all the debts, and has the sole right to the profits.

Such businesses are owned by a single individual, although they may have people working under them. They may use an assumed or business name for trading purposes but it must be in accordance with the laws of the nation.

Some laws require the name of the owner to be printed on the various products, cards and buildings owned or distributed by the business.

- a) **Limited Liability Companies**

A limited liability company is a mixture of a corporation and a partnership. **In such a company, one partner or member of the business is not responsible for problems created by another.** The partners in this business type have the right to administer and manage the many dealings of the business directly.

However, limited liability companies have different rules and laws in different countries. Some countries require the companies to elect one general partner with unlimited liability. Every partner, as the term suggests, has limited liability regarding the losses and gains of the company.

Importance of Business Environment

There is a close and continuous interaction between the business and its environment. This interaction helps to strengthen the business firm and enables it to use its resources more effectively. As stated above, the business environment is multifaceted, complex and dynamic in nature, and it has a far-reaching impact on the survival and growth of the business. To be more specific, a proper understanding of the social, political, legal and economic environment helps the business in the following ways:

- a) **Determining Opportunities and Threats:** The relations between the business and its environment will identify opportunities for and threats to the business. This helps the business enterprise to meet its challenges successfully.
- b) **Giving Direction for Growth:** It enables the business to identify the areas for growth and expansion of its activities.

- c) **Continuous Learning:** Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in the business realm.
- d) **Image Building:** Environmental understanding helps business organisations to improve their image by showing their sensitivity to the environment in which they are working.
- e) **Meeting Competition:** It helps firms to analyse their competitors' strategies and formulate their own strategies accordingly.
- f) **Identifying Firm's Strength and Weakness:** The business environment helps firms identify individual strengths and weaknesses with regard to technological and global developments.

Types of Business Environment

1. Economic Environment

Various economic factors or conditions come into play and affect the workings and plans of a business. These factors or conditions are known as the **economic environment**. They come under the external factors of a business environment and are out of the business's control.

They are highly unpredictable and frequently change. The economic environment depends on factors such as economic conditions, economic systems, and the government's economic policies at the time.

a) Economic Conditions

The economic conditions of a nation largely affect the sales and, in turn, the success of a business. For example, people living a country that is struggling with recession are less likely to spend money on non-essential goods and services such as cars and vacations, etc. On the other hand, if the country is doing very well economically, the people of that nation are more likely to spend money on items of comfort and luxury. When starting a business in any country, it is important to first bear in mind the economic conditions and then assess whether the products offered by the business will be worth the people's money. The economic conditions will also affect the cost of production, depending on the prices of various materials in the market, the inflation level at the time, and the production quantity and quality. If the country's economy is prospering or booming, the business has a very good chance of succeeding.

b) Economic System

The economic system that a country follows (i.e. mixed, capitalist or socialist) is also an important factor as its rules and regulations will affect the workings and the market of the business in that

country.

For example, in a capitalist country where the aim is to earn profits, companies have the freedom to make their own decisions and the government will not interfere in those decisions. Meanwhile, in a socialist country there is heavy involvement by the government, even down to the occupations of its citizens.

c) Economic Policies

The government of every nation passes certain economic policies which depend on its ideology or philosophy. These policies are very important for every business. Businesses have no choice but to abide by the policies, which may or may not be in their favour. Among the economic policies, the industrial, fiscal, monetary, foreign investment and export- import policies are very important. Policies change according to the economic conditions, developments in the market, and the party's goals. Every country expects the businesses operating there to strictly adhere to these policies. These are important for regulating business. However, they can also work in businesses' favour.

Industrial policies are those policies which the government frames to control the country's industrialisation. Although every country naturally supports industrialisation, there are certain guidelines that businesses are expected to follow.

Fiscal policies are also known as budget policies. Every country works within the confines of a budget plan, and it requires the businesses operating there to follow certain rules and respect certain limits in terms of borrowing and spending. This policy also deals with the taxes that all businesses must pay.

Monetary policies are framed by the central banks of every country to control the rates of interest.

In addition, technological developments around the world are important for the economic environment. The world is striving to come up with inventions that will help cut the cost of production and increase its speed.

It is essential for businesses to embrace the latest developments in production. Otherwise, they may face higher costs of production and sales and lose ground in the market amongst their competitors.

It is also important to keep in mind the latest social trends in a particular environment. A product that is out of date will not do well in the market. It is advisable to stay ahead of the trends and times rather than to lag behind.

2. Non-Economic Environment

a) Political Environment

The political environment of a market depends upon the ruling political party or the government of the time. The changes in this field are completely dependent on the policies, ideologies and philosophies of the ruling party, its attitude to the business or the firm, and the longevity and

guarantee of its term or rule.

The political environment is one of the external macro environmental factors affecting business. Businesses must always monitor changes in governments and policies.

Foreign investors can flourish in a country where the ruling political party works in their favour but they will suffer greatly if it does not support business and imposes high tariffs and taxes on import quotas, etc. The political beliefs prevalent in a country and the strength and power of its governing party will affect the progress of a business.

The stability of the ruling party will also influence investors' decisions on whether to invest in a country or not. A ruling party that does not carry the trust of the people or appears too domineering will fail to earn the trust of interest groups and foreign investors as they will not want to become embroiled in any volatile situations that might arise in the future.



Fig: 1.3

Moreover, a party that is liberal and open to expanding and globalising the country will create a favourable environment for foreign business entities, while a political party that is wary of these processes will accomplish the opposite. Countries where most businesses have ties with political parties will suffer economically from strikes and protests by workers and unions. Poor and careless management will create problems for businesses.

As stated earlier, the type of government also affects the progress of a business. In a democracy, where people have the freedom to trade and create businesses as they wish, within the confines of

the law, it is easier to run a business and to conduct trade.

In dictatorial or totalitarian countries, however, where governments invariably interfere, businesses will find it difficult to flourish or enjoy a stable market.

Corrupt governments make it impossible for businesses to conduct their operations without paying bribes in various areas. They may create problems for businesses if they refuse. It is advisable for businesses to maintain an awareness of who might support or oppose their operations.

If they face opposition from opposition parties, they may experience difficulties in the event of that party taking office. It is not uncommon for big businesses to experience political problems, even if they have only moderately transgressed or done nothing wrong.

It is important to form favourable political relationships as these will open doors for that business in both the national and international markets in which that country deals. The business will face fewer risks and will gain more opportunities in a more stable business environment.

If a country is in a state of war, businesses will face far worse problems, especially foreign entities seeking to establish branches in another country.

b) Legal Environment

The legal environment comes under the external macro environmental factors that affect the growth of a business. The legal environments depend on the legal systems, which vary from country to country. Every business must obey these laws unconditionally. National domestic laws, the laws of foreign markets and the laws of business followed globally are the factors at play in the legal environment.

Apart from these laws, new and flourishing businesses must also follow other laws that governments of certain nations (or global unions) pass from time to time. These can affect everything from the packaging to the contents of a product and its advertising.

In most cases, businesses enter into contracts containing the written terms of the agreements conducted with the nation. Laws and regulations also form the way in which businesses are created in a nation. They define how they will work, how they will progress, and to whom they will be accountable.

Some countries have no strict laws on copyrighting and the legal ownership and distribution of goods and services, while others have very strict laws.

Countries with effective and efficient legal systems will attract foreign investors and groups, whereas those with inconsistent and corrupt legal systems will deter many investors.

Aspiring entrepreneurs will find it difficult or easy to startup businesses, depending on the country's registration laws. Any business that offends the sentiments of the people of the nation is likely to face charges or penalties.

The terms of the contract signed by a business must be followed to the letter and the same can be enforced by the courts. Contracts must, of course, be ethical and fair to all parties involved, and business contracts must be in writing.

It is essential to keep in mind the business laws in every country, as well as the other laws in force in that country. A business that wishes to work on a legal basis must account for every action it takes and every contract it enters into. It is also important to monitor the activities of the competition.

If a business enters into a contract with the state or another company, it must research the benefits and the terms of the contract. The legal environment is one of the essential areas on which to concentrate when starting up or working in any business.

c) Social Environment

The social environment accounts for the behaviour of society. A proper analysis of the way the society of a particular region or country works would help a business bloom in those parts.

A knowledge and understanding of everything that constitutes a society - its people, castes, religion, attitudes of the people concerning various aspects of the world, their values, their beliefs, and the life expectancy of the people of that region - will help the business to create a favourable image amongst the people.

In turn, the locals will invest in the business, buy the products, and support the business. For example, in a country peopled mainly by vegetarians, it would be difficult for restaurant chains to open businesses and make profits with a completely non-vegetarian menu. They would have to add some vegetarian items to their menu in order to compete in the market.

Every society is part of a culture that celebrates various festivals. Even if the business originates from a foreign country, it is advisable to create certain activities that show its support for the festival, perhaps by giving discounts during the festival or creating products suitable for the occasion.

This will bring it closer to the customers in the market. A business cannot operate with callous disregard for what might offend the sentiments of a society.

Even if certain aspects are not written in the laws of a nation, and are even considered legal, it is advisable to delve deeper into people's thinking and introduce ways of working around the restrictions of certain practices.

In societies where nature is considered sacred, any business that cuts down trees, pollutes the air by emitting toxic fumes from its factories, uses certain materials that could harm the environment, produces too much waste, or uses animals skins or meat in its products will face opposition from pressure groups and may even have to cease trading.

It will also create problems for society, rather than helping it grow. A business can only flourish if it helps society flourish too. It is the responsibility of all entrepreneurs to manage their businesses in

such a way that they will not harm any aspect of society.

Otherwise, the government or authorities of that nation or region could impose taxes, penalties, or laws on such an enterprise. On the other hand, if a business benefits society, it will create more opportunities to progress. The individual aspects of society must also be researched and the ways in which they function thoroughly understood.

For example, in societies where parents exercise strict control over their children and do not allow them to use certain products until they reach an appropriate age, or where families believe in frugal spending and not overindulging themselves with unnecessary products, or where families live together with their parents and siblings or follow the nuclear family lifestyle, a businessman must analyse the needs of these families, which will in turn help him make the right decisions to boost his sales. The rate of literacy and the teachings of educational institutions and parents and grandparents will affect the future for many generations in society, influencing their outlook on certain products and thereby increasing or decreasing sales.

Religion is another major influence on people's choices. If religion prohibits or condemns the use of certain materials and products, or the consumption of certain foods and drinks, it will be difficult for a business to sell such products or increase its sales.

Moreover, the use of materials that are prohibited or considered taboo by a religion will also be banned by law or rejected by the people, who will refuse to use the goods.

Therefore, even though most cultures do not have strong laws supporting or condemning the use of certain products, materials or methods, the consumption or practice of these will be negatively received in the market. Since the people in society are the potential and prospective customers of a business, research into the social environment is essential for any company.

d) Technological Environment

The technological environment includes the methods, techniques and approaches adopted for the production of goods and services and their distribution. The varying technological environments of different countries affect the design of products. For example, in the USA and many other countries electrical appliances are designed to operate with 110 volts. But when these items are made for certain other countries, they have to be adapted to operate with 220 volts. In the modern competitive age, the pace of technological change is very fast. Hence, in order to survive and grow in the market, a business has to adopt technological changes from time to time. It should be noted that scientific research for improvement and innovation in products and services is a regular activity in most large industrial organisations. Nowadays, in fact, no firm can afford to persist with outdated technologies.

e) Demographic Environment

This refers to the size, density, distribution and growth rate of the population. All these factors have a direct bearing on the demand for various goods and services. For example, in a country where the population rate is high and children constitute a large section of the population, there is more demand for baby products. Similarly, the demands of people in cities and towns are different from those of people in rural areas. The large growth in population indicates the easy availability of labour. This encourages business enterprises to use labour-intensive techniques of production. Moreover, the availability of skilled labour in certain areas motivates firms to set up units in such areas. For example, business units from America, Canada, Australia, Germany and the UK are being set up in some Asian countries due to the easy availability of skilled manpower.

f) Natural Environment

The natural environment includes geographical and ecological factors that influence business operations. These factors include the availability of natural resources, weather and climatic conditions, location aspects, topographical factors, etc. Business is greatly influenced by the nature of the natural environment. For example, sugar factories are set up only in those places where sugarcane can be grown. It is always considered better to establish a manufacturing unit near the sources of input. Further, government policies for maintaining ecological balance and conserving natural resources, etc, place additional responsibility on the business sector.

Social Responsibility of a Business

Every business enterprise is an integral part of society. It uses the resources of society for its growth. Hence, it is important that no business activity be injurious to the interests of society. However, it is observed that, in practice, there are a few socially undesirable aspects of business such as the pollution of the environment, non-payment of taxes, manufacturing and selling adulterated products, placing misleading advertisements, and so on.

This has resulted in the development of the concept of social responsibility of businesses, whereby the owners and managers of businesses are made aware of their responsibilities to the community and its customers, workers, etc.

The social responsibility of business refers to the obligation of business enterprises to adopt policies and plans of actions that are desirable in terms of the expectations, values, and interests of society. It ensures that the interests of different groups of the public are not adversely affected by the decisions and policies of businesses.

Social Responsibilities to Different Groups

The responsibilities of those who manage businesses cannot be limited to the owners. They have to take into account the expectations of other stakeholders such as the workers, the consumers, the government, and the community and public at large.

- a. Responsibility to the shareholders or owners:** The shareholders or owners are those who invest their money in the business. **They should be provided with a fair return on their investment.**
- b. Responsibility to the Employees:** A business enterprise must ensure it pays a fair wage or salary to the workers based on the nature of the work involved and the prevailing rates in the market. There must be good working conditions in respect of safety, medical facilities, canteen, housing, leave and retirement benefits, etc. The workers should also be paid reasonable bonuses based on the business's profits. Preferably, there should also be provision for their participation in management.
- c. Responsibility to the Consumers:** A business enterprise must supply quality goods and services to consumers at reasonable prices. It should avoid adulteration, poor packaging, and misleading and dishonest advertising; it should also ensure proper arrangements for attending to customer complaints and grievances.
- d. Responsibility to the Government:** A business enterprise must follow government guidelines while setting up the business. It should conduct the business in a lawful manner and pay taxes honestly and on time. It should not indulge in any corrupt practices or unlawful activities.
- e. Responsibility to the Community:** Every business is a part of the community where it is located. Hence, it should contribute to the general welfare of the community. It should preserve and promote social and cultural values, generate employment opportunities, and contribute towards the progress of society. It must take every step to protect the physical and ecological environment of the society. It should contribute to community development programmes such as public healthcare, sports, and cultural programmes.



Fig: 1.4

Business Ethics

The word 'Ethics' originally came from the Greek word 'ethos' meaning character, conduct and activities of the people based on moral principles. It is concerned with what is right and wrong in human behaviour on the basis of standard behaviour or conduct accepted by society.



Fig: 1.5

Honesty, truthfulness, compassion, sympathy, a sense of brotherhood, etc. are considered ethical. Similarly, ethics from a business point of view, or business ethics, are the moral principles that guide the behaviour of businessmen or business activities in relation to society. It provides a certain code of conduct to carry on the business in a morally justified manner. Running a business without adopting unfair practices, being honest and truthful about the quality of goods, charging fair prices, abiding by laws, and paying taxes, duties and fees to the government honestly are part of the ethical behaviour of businesses.

Further Reading:

- ✓ *Legal Environment of Business, A Managerial Approach: Theory to Practice* by Sean Melvin and Enrique Guerra-Pujol | Feb 9, 2017
- ✓ *Essentials of Business Law and the Legal Environment*, by Richard A. Mann and Barry S. Roberts | Jan 1, 2018