ANALYSING THE BUSINESS ENVIRONMENT: THE BIG PICTURE

Timeframe:	12 hours
Learning outcome:	• Conduct an analysis of current environmental factors.
Multimedia:	• Law of Diminishing Marginal Utility. [Video clip] (Investopedia.com, 2013d)
Section overview:	Organisations form an important part of life as society depends on organisations, be they private or government-controlled, to meet their constantly changing needs. This module builds on the foundation laid during Strategic Management I (Fundamentals of Business Management), which dealt with the general management functions. We will differentiate between the different environments in which businesses find themselves and discuss the relevance of these environments for strategic planning.

The Big Picture

Strategic planning requires a thorough analysis of the environment in which the organisation conducts business. It is important to understand the different environments in which organisations conduct business. **Figure 1** briefly explains the business environment.

Figure 1: The Business Environment

(Marr, 2012)

The organisation can be divided into the internal and external environment. The internal environment refers to the events, entities and conditions within the organisation that influence the activities and choices of the organisation (BusinessDisctionary.com, 2013c). These factors include, but are not limited to, the leadership styles adopted by management, the organisational culture and the organisation's strategy (BusinessDisctionary.com, 2013c). The external environment of the organisation refers to the micro- and macroeconomic environments. **Table 1** overleaf gives examples illustrating the differences between micro- and macroeconomics.

Micro- and macroeconomics are defined as follows:

Macroeconomics: The field of economics that studies the behaviour of the aggregate economy. Macroeconomics examines economy-wide phenomena such as changes in unemployment, national income, rate of growth, gross domestic product, inflation and price levels.

(Investopedia, 2013b)

Microeconomics: The branch of economics that analyses the market behaviour of individual consumers and firms in an attempt to understand the decision-making process of firms and households. It is concerned with the interaction between individual buyers and sellers and the factors that influence the choices made by buyers and sellers. In particular, microeconomics focuses on patterns of supply and demand and the determination of price and output in individual markets (e.g. coffee industry).

(Investopedia, 2013c)

Table 1: Macro- and Microeconomics

Microeconomics is concerned with:	Macroeconomics is concerned with:
1. The production of maize	The total output of all goods and services in the economy
2. An entrepreneur's decision to export his/ her product	The total export of goods and services to other countries
3. The unemployment of an individual	The total supply of labour in the economy
4. The decisions of a local supermarket	The combined decisions of all firms in South Africa

(Van Baren, 2013)

Developing a strategic plan requires a thorough analysis of the complete business environment. The analysis of these environments will allow the strategic planner to evaluate their influence on the business, which will, in turn, influence the strategy of the business. In this section, we will look at the **macroeconomic** environment.

The Macroeconomic Environment

The macroeconomic environment describes the aspects of the business environment that cannot be controlled. This environment requires the study of the market system on a large scale. The macroeconomic environment considers all markets in the market system as well as the market system as a whole, which includes households, businesses and governments (Kroon, 1995: 54).

Economics: Definition

Economics studies how economic agents (households, businesses and governments) use their scarce resources to specialise in production and to exchange and consume goods and services according to the prevailing economic system.

(Dictionary.reference.com, 2013)

Economics is thus concerned with scarcity of goods and services.

Wants, needs and demands

We have already said that economics is concerned with scarcity of goods and services. Now we require a better understanding of wants, needs and demands (Bhasin, 2011). These issues are discussed in **Table 2**.

Table 2: Wants, Needs and Demands

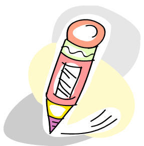
Wants	Needs	Demands
• Wants are human desires for goods and services. • Examples include luxury cars, exotic holidays, etc.	• Needs are necessities, the things that are essential for survival. • Needs include food, water, shelter and clothing.	• There is only a demand for a good or service if those who want to purchase it have the necessary means to do so.

(Adapted from: Bhasin, 2011)

We now need to clarify our understanding of scarce or limited resources. Generally, people have unlimited needs and wants but their resources are limited. Hence, choices have to be exercised to ensure that scarce resources result in a maximisation of output (Bhasin, 2011).

Scarcity, choice and opportunity cost

To understand what scarcity, choice and opportunity costs are, we need to review what resources are.



Resources are the land and natural resources, the labour and the capital assets (plants, equipment and inventories) that can be combined to produce goods and services.

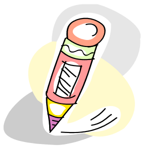
(Libberdale, 2003)

Scarcity exists when the amount of goods or resources offered is less than what users would want if it were freely available (Reilly, 2013). Scarcity has little to do with wealth or poverty as expensive designer watches may be just as scarce as canned vegetables. Scarcity affects everyone and sometimes requires that we make certain choices. Scarcity forces economic agents to make **choices**:

- Households must choose how to spend their limited income.
- Businesses must choose among combinations of scarce resources and among different goods to produce.
- Manufacturers must decide whether to use assembly-line workers or industrial robots.
- Governments must choose whether to spend more on [for example] security or education.

(Adapted from: Reilly, 2013)

However, some choices come at a cost in that in order to get something, we might have to give something up (Parkin, Kohler, Lackey, Rhodes, Saayman, Schöer, Scholtz and Thompson, 2012:10). This brings us to the issue of opportunity cost.



The **opportunity cost** of something is the highest-valued alternative that we give up to get it.

(Parkin *et al*., 2012:10)

Every decision has an opportunity cost; for example, when consumers or businesses make the decision to purchase or produce particular goods, they are doing so at the expense of buying or producing something else.

The opportunity cost concept is critical in ensuring that there is efficient use of scarce economic resources. Thus, opportunity costs are not restricted to monetary or financial costs: the real costs of foregone output, lost time, pleasure or any other benefit that provides satisfaction or utility should also be considered opportunity costs.

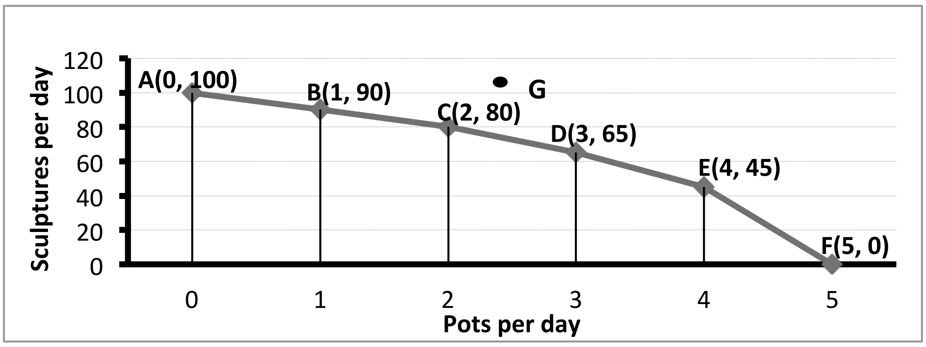
The Production Possibility Curve or Frontier (PPF) is used to illustrate the relationship between scarcity, choice and opportunity cost of economic decisions. Scarcity, choice and opportunity cost is best explained with the aid of what Mohr *et al*. (2009) calls the *production possibilities curve* as illustrated in the example below.

The Production Possibilities Curve

An entrepreneur manufactures ceramic pots, but also makes miniature sculptures from wood. If he devotes all his available time to make the pots he can produce 5 pots per day. Should he spend all his time to make the sculptures he can produce 100 sculptures per day? Sometimes he sells more pots than sculptures and would like to know what the best possible production output would be for a given scenario. This can be represented graphically as below.

The figure below assumes an economy that has a combination of two products that it can produce with the available factors of production. It explains where the economy attains efficiency with the limited resources allocated to the two products and the opportunity cost associated with the increase or decrease in one product and the other.

The Production Possibilities Curve



Notes:

- The graph represents a production possibilities curve;
- Point A means that the entrepreneur can produce maximum 100 sculptures per day if he does not produce any pots;
- Point F means that the entrepreneur can produce maximum 5 pots per day if he does not produce any sculptures;
- Point C means that the entrepreneur can produce maximum 2 pots and 80 sculptures per day;
- The opportunity cost of producing 80 sculptures is the difference of 3 pots that he cannot produce; He must forgone the 3 pots;
- The marked points merely represent some of the best possible production opportunities as any point on the curve is a possible production opportunity;
- The opportunity cost of each additional pot increases as we move along the production possibility curve;
- All points that fall outside the curve, e.g. point G, [are] unattainable, the product is thus scarce;
- Choice is illustrated by the need to choose among the available combinations along the curve;
- The production possibility curve is a useful way to illustrate scarcity, choice and opportunity cost;
- The negative slope of the curve represents opportunity cost as more of one product can be produced by sacrificing the other product;
- Opportunity cost therefore involves a trade-off between the goods.

(Mohr *et al.*, 2009)

Marginal analysis and marginal utility

Every economic entity bases its decision on the benefit/utility or satisfaction derived from the consumption of a good or service. Hence, any economic decision made by individuals (assuming they are rational) is theoretically intended to increase satisfaction. This implies that the more satisfaction derived from the consumption of a certain good, the more the consumer will buy and will be willing to pay for the good. Consumers derive different satisfaction levels from a variety of goods (Investopedia.com, 2013d).

Utility or satisfaction derived from the consumption of goods and services can be difficult and subjective to measure. However, the satisfaction derived from consuming an extra portion of the same good or service results in a decline in satisfaction. This concept is called marginal utility, which means that the satisfaction derived from an additional consumption of goods or services decreases (Investopedia.com, 2013d).