

Chapter 5

Analysing the macro-environment

Learning outcomes

- After reading this chapter you should be able to:
- explain the structure of the external environment that organisations face
- discuss the importance of the external environment in strategy formulation
- critically discuss and evaluate relevant macro-environmental factors and forces
- justify the importance of macro-environmental analysis for strategy formulation
- discuss and evaluate the merits of the PESTEL approach, the Issues Priority Matrix and Scenario Analysis in analysing the macro-environment.

Overview

- The primary focus of this chapter is on the macro environment and its importance in strategy formulation as part of an integrated strategic management process.
- The need for macro environmental analysis is demonstrated through discussion, evaluation and interpretation of identified macro environmental factors and forces.
- The approach to and methods of macro environmental analysis as part of strategic analysis in strategy formulation conclude this chapter.

5.1 Introduction

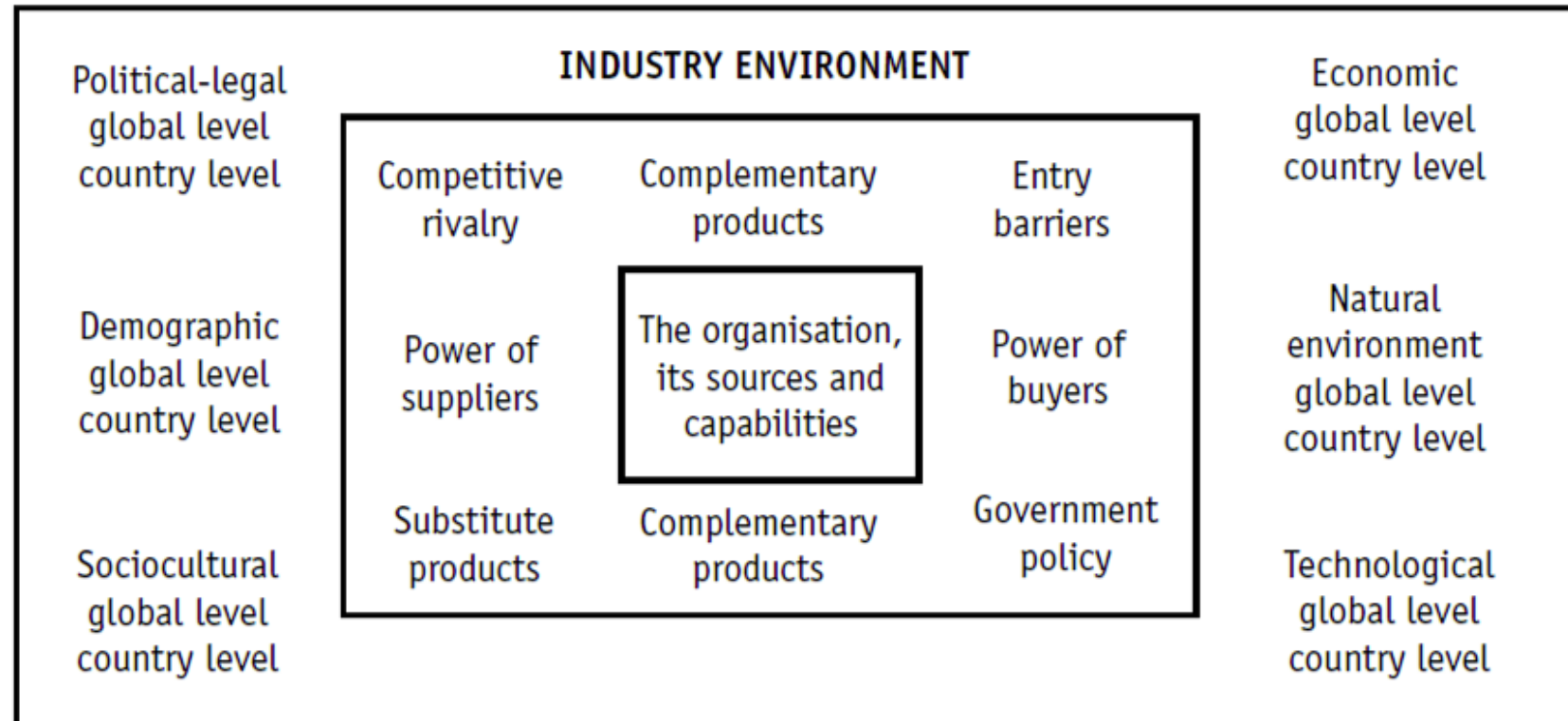
- The next phase of the strategic management process – strategic analysis – is covered in this chapter.
- Strategic analysis is an evaluation of both the external environment and the internal environment of the organisation.
- The approach to analysing the external environment as an integral step of the strategic management process focuses on two main components of the external business environment: the macro environment and the industry environment.

5.2 Strategic relevance and structure of the external environment

- The strategic management process evolved as an innovative way of aligning an organisation's unique resources and capabilities to the ever-changing and increasingly competitive external environment in pursuance of its goals.
- To respond effectively to external challenges such as these, organisations need to know and understand their external and their internal environments to obtain the relevant information they need for effective strategy formulation.
- The interrelationships between the organisation and its external environments are illustrated in Figure 5.1 below.

5.2 Strategic relevance and structure of the external environment (cont.)

Figure 5.1 Interrelationships between the organisation and its external environments³



5.2 Strategic relevance and structure of the external environment (cont.)

Definition of external environment:

- The external environment includes everything outside an organisation at the global, country and industry levels that might affect the ability of the organisation to attain its goals.
- It includes factors beyond the control of the individual organisation, such as major global, regional and national political and economically-related events.
- It also includes new technological breakthroughs that influences its choice of strategic direction and actions.

5.2 Strategic relevance and structure of the external environment (cont.)

Definition of macro environment:

- The macro environment is part of the external environment, and includes political, legal, economic, sociocultural, demographic, technological, and natural environment forces at the global level and/or within a country.
- These forces, whether global or related to a specific country, originate beyond, and are usually irrespective of, any single organisation's operating situation.
- The macro environment is also referred to as the general environment or remote environment

5.3 Strategic importance of the macro-environment

- The macro-environmental factors tend to exert forces that have a major influence on industries, and hence on organisations operating within those industries.
- These macro-environmental forces will not affect all industries, and organisations in those industries, in the same way.
- The forces emanating from macro-environmental factors in the global environment and/or from individual countries, may have a profound impact on an organisation's strategic direction, competitiveness, profitability, and ultimately on its survival.
- Given an organisation's vision, mission and strategic intent, management should consider the potential advantages of opportunities identified by analysing the external and internal environments when developing and ultimately deciding on an appropriate strategy for the organisation.

5.3 Strategic importance of the macro-environment (cont.)

- It is evident that there is a clear link between the information obtained from the strategic analysis of the organisation's external (macro- and industry) and internal (micro) environments, and its ultimate choice of strategy that needs to align the organisation's internal resources, competencies and capabilities to the organisation's identified market needs in the external environment.

5.4 Factors and forces of the macro-environment

Categories of factors and forces:

- Political-legal
- Economic
- Sociocultural
- Demographic
- Technological
- Environmental

5.4 Factors and forces of the macro-environment (cont.)

Political-legal factors

- A strong relationship exists between the political and legal systems of a country.
- Political processes and legislation define the regulatory and legal parameters that influence industries and organisations.
- Political stability and effective legal systems in a country are therefore of major importance in business ventures and the formulation of strategies.

5.4 Factors and forces of the macro-environment (cont.)

Political-legal factors (cont.)

- Political-legal factors may either limit or benefit the organisations they influence.
- Potential effects of these factors and forces are major issues that require serious consideration in the evaluation of the macro-environment.
- Political constraints placed on organisations include trade policies, competition policy, tax programmes, labour legislation, anti-pollution and pricing policies, the regulation of e-commerce, and safety and security measures.

5.4 Factors and forces of the macro-environment (cont.)

Political-legal factors (cont.)

- Some political-legal actions serve to protect and benefit the business sector.
- An example is laws which protect patents and other forms of intellectual property, grants and subsidies for training and development of the workforce.
- Funding to encourage research and development in strategically important areas is another relevant example.

5.4 Factors and forces of the macro-environment (cont.)

Political-legal factors (cont.)

- Privatisation of state-owned enterprises (SOEs) has far-reaching consequences for the industries concerned.
- Deregulation of industry may also have beneficial effects.
- Industry-specific regulators (government agencies or statutory bodies) present a further example of a political-legal factor in the macroenvironment that has a direct impact on an industry.

5.4 Factors and forces of the macro-environment (cont.)

Political-legal factors (cont.)

- Industry-specific regulators are responsible for formulating, interpreting and implementing rules and regulations governing various elements of a specific industry.
- Analysis of the political-legal factors in the macro-environment should include an assessment of the potential for political risk.
- The purpose of examining political-legal factors is to create an awareness of their importance as regards the extent of political stability in a country, and a government's ability to create and nurture an enhancing business environment.

5.4 Factors and forces of the macro-environment (cont.)

Economic factors

- The national economy of a country has an impact on industries, business and non-profit sectors, consumers and society in general.
- There are four important factors in the economic environment of a country: growth rate of the economy; level of interest rates; currency exchange rates; and price inflation.

5.4 Factors and forces of the macro-environment (cont.)

Sociocultural factors

- Changing social values, beliefs, attitudes, traditions, lifestyles and other culture-related elements of a nation, society or a group affect an industry, and therefore, the organisations within that industry where these changes could create opportunities or threats.
- Changing sociocultural factors affect the strategies of organisations as they have to create new products for emerging markets, or adapt existing products to avoid their becoming obsolete.
- These factors also have an effect on market size and industry competitiveness.

5.4 Factors and forces of the macro-environment (cont.)

Sociocultural factors (cont.)

- Changing social trends:
 - single parent families
 - increasing number of women in the workplace
 - changing demographics in education
 - dual-income families
 - emphasis on health and wellness
 - age distribution of population
 - impact of HIV/Aids.
- Economic growth results from productive activities by organisations in a country.
- Changing economic conditions can influence the timing and relative success of particular strategies.

5.4 Factors and forces of the macro-environment (cont.)

Demographic factors

- Demographic criteria or variables include:
 - age
 - life expectancy
 - gender
 - race
 - religion
 - sexual orientation
 - social class
 - level of education
 - family size and orientation
 - group rather than individual orientation

5.4 Factors and forces of the macro-environment (cont.)

Technological factors

- Technological change can be both creative and disruptive.
- Technological breakthroughs may have far-reaching consequences for specific industries and the organisations within those industries.
- New technological products may present unique opportunities for an organisation, or entirely new products may render an existing product obsolete.
- Emergence and growth of the Internet and the use of technological devices have revolutionised the way business is done.

5.4 Factors and forces of the macro-environment (cont.)

Table 5.1 Growth in Internet users (millions), 2005–2010e30

WORLD INTERNET USAGE AND POPULATION STATISTICS						
WORLD REGIONS	POPULATION (2009 EST.)	INTERNET USERS DEC. 31, 2000	INTERNET USERS LATEST DATA	PENETRATION (% POPULATION)	GROWTH 2000-2009	USERS % OF TABLE
Africa	991,002,342	4,514,400	86,217,900	8.7 %	1,809.8 %	4.8 %
Asia	3,808,070,503	114,304,000	764,435,900	20.1 %	568.8 %	42.4 %
Europe	803,850,858	105,096,093	425,773,571	53.0 %	305.1 %	23.6 %
Middle East	202,687,005	3,284,800	58,309,546	28.8 %	1,675.1 %	3.2 %
North America	340,831,831	108,096,800	259,561,000	76.2 %	140.1 %	14.4 %
Latin America/ Caribbean	586,662,468	18,068,919	186,922,050	31.9 %	934.5 %	10.4 %
Oceania / Australia	34,700,201	7,620,480	21,110,490	60.8 %	177.0 %	1.2 %
WORLD TOTAL	6,767,805,208	360,985,492	1,802,330,457	26.6 %	399.3 %	100.0 %

Notes:

(1) Population numbers are based on data from the United States Census Bureau.

(2) The most recent usage information comes mainly from data published by Nielsen-Online, the International Telecommunications Union, GfK, local Regulators and other reliable sources.

SOURCE: Reprinted by permission of Internet World Stats, 2010.

Available: <http://www.internetworldstats.com/stats1.htm> [7 May 2010].

5.4.7 Factors related to the natural environment

- An important factor in the macro-environment is the delicate and often sensitive relationship between business and the ecology.
- The term ecology refers to the interaction between human beings and other living things and the air, soil and water in the natural environment that support them.
- Threats to the life-supporting ecology caused predominantly by human, industrial and commercial activities in a society are commonly known as pollution.
- Global climate changes are accelerated by humanity's activities.
- A change in atmospheric radiation, owing in part to ozone depletion, causes global warming.
- This is caused by solar radiation which is normally absorbed into the atmosphere, reaching the earth's surface, heating the soil, water and air.

5.4.7 Factors related to the natural environment (cont.)

- There is a debate as to the extent to which human activity intensified the likelihood of natural forces.
- In this regard, natural events include acts of God for example earthquakes, landslides, avalanches, floods, tidal waves, droughts, freezes and volcanic eruptions.
- There are two observations about natural events:
 - Their impact upon business activity can be very powerful and, in almost all cases, the events are difficult to predict or avoid.
 - The risk of certain natural events occurring varies by geographical location.

5.4.8 Factors related to the global environment

- Globalisation has been facilitated by declining barriers to international trade and investment, and by advances in technology, especially in communications and transportation technologies.
- To compete internationally, organisations need to develop and adopt international competitive strategies, as discussed in Chapter 11.
- Forces in the global environment do not affect macro environmental and industry factors in all countries in exactly the same way and to the same extent.
- Domestic organisations must analyse the potential effects of possible global forces in addition to their analysis of the macro environment in their home country.

5.5 Analysis of the macro-environment

- As forces in the external environment change, the organisation needs to know how to change, or adapt, its strategy to remain competitive.
- An organisation needs to scan the external environment (both macro- and industry environments) continuously to identify emerging opportunities and threats.
- Managers who developed a keen awareness of, and are alert to, actual and potential macro-environmental changes and are able to predict the possible impact of these changes on their industries and markets with a high degree of certainty, can be regarded as a source of competitive advantage.
- According to Lynch, the environmental forces that organisations face can be assessed by means of the following two measures:
 - changeability
 - predictability.

Figure 5.2 Analysing the dynamics of the macro-environment

	ENVIRONMENTAL TURBULENCE	REPETITIVE	EXPANDING	CHANGING	DISCONTINUOUS	SURPRISING
Changeability	<i>Complexity</i>	National	National	Regional Techno- logical	Regional Socio- political	Global Economic
	<i>Familiarity of events</i>	Familiar	Extra- polable		Discon- tinuous Familiar	Discon- tinuous Novel
Predictability	<i>Rapidity of change</i>	Slower than response		Comparable to response		Faster than response
	<i>Visibility of future</i>	Recurring	Fore- castable	Predictable	Partially predictable	Unpredict- able surprises
	Turbulence level					

5.5.3 Guidelines for macro-environmental analysis

- Guidelines for macro environmental analysis – nine basic stages proposed by Lynch, some relating to all organisations; others to specific industries and organisations:
 - environmental basics
 - consideration of degree of turbulence
 - background factors
 - analysis of stages of market growth
 - factors specific to industry
 - factors specific to balance of power
 - factors specific to co-operation
 - factors specific to immediate competitors
 - customer analysis

5.5.4 Conducting macro-environmental analysis

- Conducting macro environmental analysis – three basic techniques:
 - PESTEL analysis
 - issues priority matrix
 - scenario analysis

PESTEL APPROACH

- Macro-environmental factors and forces could present both opportunities and threats, and organisations use information from macro-environmental analysis to develop strategies that would minimise the effects of threats and capitalise on opportunities.
- Table 5.4 is an example of relevant macro-environmental influences specific to an airline in the commercial airline industry identified under the six PESTEL analysis categories of factors.

5.5.4 Conducting macro-environmental analysis (cont.)

- PESTEL analysis:
 - **P**olitical
 - **E**conomic
 - **S**ociocultural
 - **T**echnological
 - **E**cological
 - **L**egal

Table 5.4 PESTEL – example summary of macro-environmental opportunities and threats

Political

Government support for national carriers
Security controls
International airline treaties

Economic

Interest and inflation rate levels
Economic growth rate
Fuel prices

Socio-cultural

Increase in travel by the elderly
Increase in tourist and student air travel
Multilingual cabin crews

Technological

Fuel-efficient engines and airframes
High- technology optical security equipment
Teleconferencing for business class passengers

Ecological (natural environment)

Air pollution controls
Energy consumption controls
Noise pollution controls

Legal

Preferential airport rights for some airlines
Restriction on airline mergers
Increase in domestic air safety regulations

5.5.4.2 The Issues Priority Matrix

- Organisations often respond differently to the same environmental changes because of differences in the ability of managers to recognize, and understand, external strategic issues and factors.
- Few organisations can successfully monitor all of the important external factors.
- Even though managers agree that strategic importance determines what variables are consistently tracked, they sometimes miss, or choose to ignore, crucial new developments.

5.5.4.2 The Issues Priority Matrix (cont.)

- One way to identify, and analyze, critically important developments in the macro environment is to use an Issues Priority Matrix, described below, using the framework outlined in Figure 5.3:
- Identity a number of likely trends emerging in the macro- and industry environments.
- These are strategic environmental issues: those important trends that, if they happen, will determine how various industries might be affected and what they will look like.
- Assess the probability (from low to high) of these trends actually occurring.
- Attempt to ascertain the likely impact (from low to high) of each of these trends on the organisation.

Figure 5.3 Issues priority matrix

		Impact on organisation	
		High	Low
Probability of occurrence	High	HIGH PRIORITY	
	Low		LOW PRIORITY

The matrix is a 2x2 grid. The vertical axis is labeled 'Probability of occurrence' with 'High' at the top and 'Low' at the bottom. The horizontal axis is labeled 'Impact on organisation' with 'High' on the left and 'Low' on the right. The top-left cell (High Probability, High Impact) is shaded light gray and contains the text 'HIGH PRIORITY'. The bottom-right cell (Low Probability, Low Impact) is shaded medium gray and contains the text 'LOW PRIORITY'. The other two cells (top-right and bottom-left) are white. The middle cell (High Probability, Low Impact) is shaded medium gray and contains the text 'MEDIUM PRIORITY'.

5.5.4.3 The benefits of macro-environmental analysis

- Increases managerial awareness of environmental changes.
- Increases understanding of the context in which industries and markets function.
- Improves understanding of relevant multinational and global issues.
- Helps improve resource allocation decisions based on strategic priorities.
- Enables management to identify and reduce risk owing to greater awareness and understanding of potential environmental threats.
- Focuses attention on importance of actual and potential strategic change, particularly during environmental scanning process.
- Acts as early warning system which allows management to identify emerging opportunities and threats, and to devise appropriate and timely responses.

5.5.4.4 The limitations of macro-environmental analysis

Managers must:

- be aware of the limitations and inaccuracies of macro-environmental analysis
- understand the complexity of the environment in which they operate and the sources of information on which the analysis is based
- carry out the analysis continuously (because changes occur frequently)
- constantly seek to identify more appropriate sources of information and techniques for analysis
- use the information as one source of organisational learning (alongside other information gathering activities)
- use the information to inform future strategy.

5.5.4.5 Scenario analysis and planning

- Scenario analysis is the identification and structured investigation of possible future configurations of the wider business environment at both global and individual country levels through consideration of political-legal, economic, sociocultural, demographic, technological, and ecological factors.
- Scenario planning involves the development of ‘what if’ plans with regard to a range of possible alternative futures based on different strategic assumptions.
- Scenario planning is therefore essentially an innovative approach to encourage managers to be alert to, and to understand, the dynamic and complex nature of the external environment, to think strategically, and to generate a range of strategic options that could be pursued under different circumstances and varying envisaged environmental conditions.

5.5.5 Summary

- The macro-environment comprises external factors that affect all organisations.
- Changes in the macro environment are of extreme importance to organisations as these changes can influence market expansion or contraction, determine the level of competition within an industry, and could even lead to the creation of new industries or the demise of existing industries.
- These macro-environmental changes can be evaluated using PESTEL analysis to identify trends in political-legal, economic, socio-cultural, technological, ecological, and legal factors and forces.

5.5.5 Summary (cont.)

- Managers can create an issues priority matrix to classify environmental trends as low, medium or high in terms of probability of occurrence and their impact on an organisation.
- The issues priority matrix will highlight potential opportunities on which to capitalise, or potential threats to minimise, depending on the strategy which management chooses to pursue.
- Scenario analysis can be used to clarify issues which may impact on the future of the organisation (as identified in the PESTEL analysis).
- Macro environmental analysis should be a continuous process.

5.5.5 Summary (cont.)

- Managers need to be vigilant in identifying and observing changes in the macro-environment and adjusting an organisation's strategies accordingly.
- Managers need to look at all aspects of the environment, which may include factors that do not normally affect the organisation.
- It is critical for an organisation to be future-orientated and to anticipate environmental change.

DISCUSSION QUESTIONS

1. Why are macro-environmental factors and forces of strategic importance for business organisations?
2. Identify a recent political-legal, economic, socio-cultural or technological trend that significantly affected financial institutions, and discuss its implications for this sector.
3. Critically discuss the following statement: “Major opportunities and threats usually result from an interaction among key environmental trends rather than from a single external event or factor.” Do you agree with this statement? Explain your answer.
4. Identify a recent political-legal, economic, socio-cultural or technological trend or factor that significantly affected the mining industry, and discuss its importance and implications for this industry.