

5 Impact of external influences

Definition

An external influence is a factor beyond a firm's control that can affect its performance. Examples include: changes in consumer tastes, laws and regulations and economic factors such as the level of spending in the economy as a whole.

Linked to: Corporate objectives, Ch 1; Corporate strategy, Ch 2; The competitive environment, Ch 6; Growth, Ch 7; Corporate influences, Ch 15; Causes and effects of change, Ch 22

5.1 The impact of external influences on firms

Some external influences have a favourable effect on firms. The holiday company Saga specialises in providing trips targeted at the elderly. So an ageing population will enlarge Saga's target market, giving the company a good opportunity to increase its revenue and profit.

Other external influences can have adverse effects on firms. In 2015, it emerged that rising temperatures in the North Sea were causing problems for stocks of haddock. This staple of fish and chip shops in the north of England will probably see a sharp rise in price. Bad news for chippies, but perhaps good news for competitors such as Chinese and Indian takeaways.

It can be helpful to analyse external factors under the overall heading PESTLE, which stands for:

- Political
- Economic
- Social
- Technological
- Legal
- Environmental

5.2 Political factors

Despite the fuss made by businesspeople in the lead-up to elections, politics is rarely a huge influence on business success or failure. In 2010–2015, the coalition government cut corporation tax from 28 to 20 per cent, to the applause of the business community. The result was negligible: research and development spending fell; spending on training fell, though there was a small rise in investment spending. More significant was a hike in dividend payments to shareholders which pushed share prices up. In other words the actions of politicians did little to improve the real economy: jobs, innovation and economic growth.

The same could not be said of a political move to withdraw Britain from the European Union. That would be very serious. At the time of writing, Jaguar Land Rover has been complaining about the lack of UK-based 'Tier 1' suppliers of car components. With UK car production having been buoyant lately, it is possible to see German and Japanese, perhaps even Chinese, component suppliers building factories in Britain, perhaps close to Nissan's huge factory in the North-East. But not if there's a threat that the UK might withdraw from the European Union. That would create too much uncertainty for an overseas company – even a Chinese one. (Figure 5.1 shows the promising trend in UK car production for export in the period 2004 to 2014.)

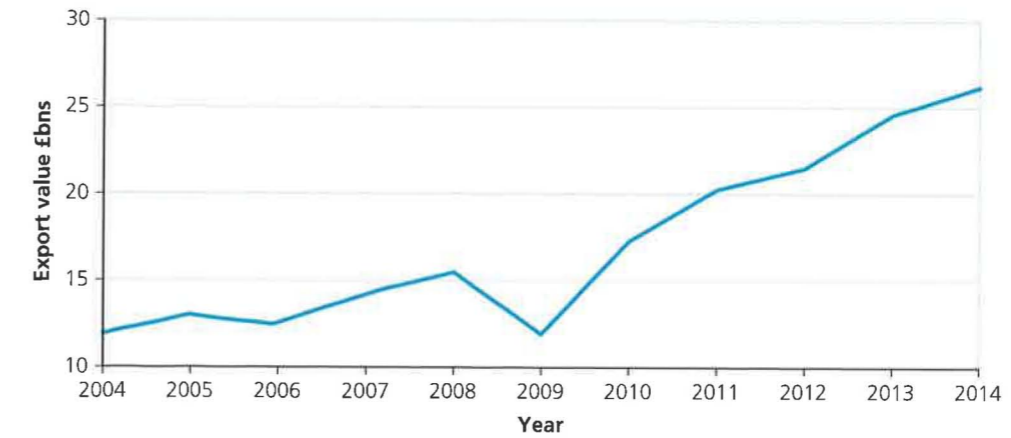


Figure 5.1 UK car exports (by value) (source: Society of Motor Manufacturers & Traders using figures from ONS)

5.3 Economic factors

Of all the economic factors that can affect a business, none is more important than the path of economic activity, as measured by the GDP: the Gross Domestic Product. Shown below in Figure 5.2, it is clear that the 2008/2009 recession was a dramatic event in the economy – and therefore business too. Particularly in the early part of the recession, there were dramatic falls in sales of luxury cars, posh holidays and champagne. Even the UK housing market took a huge hit, with prices falling 16.5 per cent nationally in the year from January–March 2008 to 2009. (This was nothing compared with Dubai, where property prices fell by 40 per cent in a year.)

Sales of most items are linked in some way to GDP and therefore people's real incomes. For Aldi and Lidl, the grinding economic woes between 2008 and 2014 meant

a glorious boom in demand. Families had to take more care of their pennies – and they did.

Among other economic factors of importance, it is important to consider:

- the exchange rate, and its effect on the international competitiveness of our businesses, especially manufacturers
- the inflation rate, with its possible impact on the value of people's money savings and on their real wages (if incomes rise by 3 per cent but inflation rises by 4 per cent people are 1 per cent worse off in real terms – and therefore buy fewer items)
- the rate of unemployment, within which the figure for youth unemployment (under-25s) is perhaps the most concerning. Table 5.1 shows the sometimes extraordinarily high rates in certain countries.

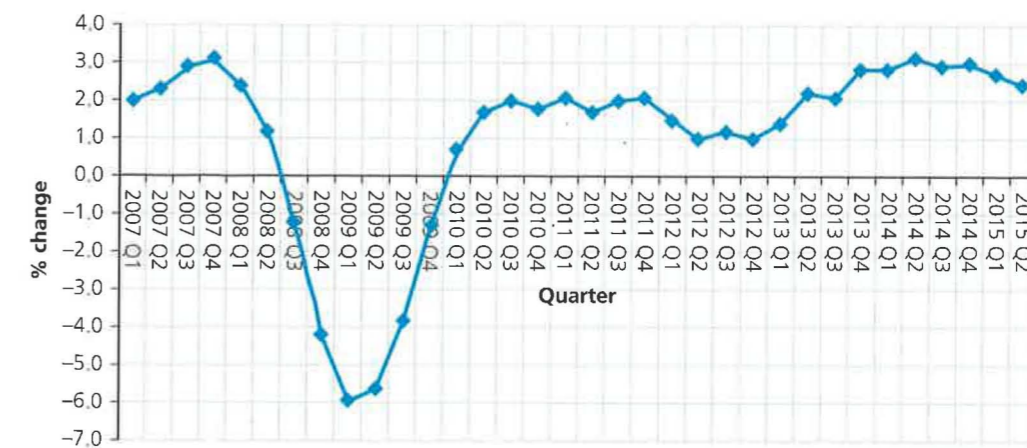


Figure 5.2 Changes in UK economic growth, 2007–2015 (source: ONS October 2015)

Level	Adult unemployment %	Youth unemployment %	Ratio of youth to adult unemployment
United Kingdom	6.1	16.1	2.64 times
France	10.3	24.6	2.39 times
Germany	5.0	7.4	1.48 times
Greece	26.5	51.1	1.93 times

Table 5.1 Unemployment data for selected countries, 4th quarter 2014 (source: Calculation based on Eurostat data)

5.4 Social factors

Among the key social factors are changes in social attitudes and behaviour. Sales of manufactured cigarettes in the UK began in 1871 and peaked in 1973. Since then they have fallen by more than two-thirds. Although legal and economic (tax/price) factors have played an important part in that decline, another factor has been a real social change from a 1960/1970s 'you're-a-bit-of-an-outsider-if-you-don't-smoke' type of attitude to the modern view that smoking is an outsider activity. That social change has been a consequence of numerous health reports about the dangers of active and passive smoking.

Although the changes in smoking seem to have been rational, some other social forces seem less so. Dramatic switches in diet from low-cal to low-fat to low-carb are little to do with the conflicting medical evidence. Producers simply have to weather different storms. Then there can be extraordinary crazes such as Loom Bands (2013) and *Frozen* (2014) in which a fad becomes a storm – until it blows out suddenly.

5.5 Technological factors

Although it feels like we are in the grips of the greatest ever technological revolution, it's important to keep some perspective. An online and super-connected life is very different from 20 years ago, but nothing like as different as before and after transport links (railways, then the car) or before and after electricity. IT was supposed to have brought about a productivity revolution, but there's no evidence of it in the growth rates of America, Japan, Germany or the UK.

So 'technological revolution' doesn't just refer to IT. It refers to any new, **disruptive** force that changes the way

an industry or a sector works. The success of the Land Rover Evoque owes a great deal to its innovative use of aluminium instead of steel. The vehicle that looks like it should be towing tractors actually is nippy and fun to drive because it's nothing like as heavy as most 4 × 4s. And its lightness gives it far greater fuel and emissions efficiency. This has been great for the company and for skilled workers in the Midlands and North-West where Land Rover manufactures them.

Despite this, it would be daft to ignore the importance of IT as a major category within technological factors. In the department store sector, John Lewis has shone and Marks & Spencer wilted in a world of online shopping. And in the grocery sector Morrisons has been the big loser. And that's without even considering the huge new business opportunities for apps, games and social media.

'I'm a technological optimist in that I do believe that technology will provide solutions that will allow the world in 2050 to support 9 billion people at an acceptable standard of living.'

Martin Rees, astronomer

5.6 Legal factors

Changes in the law can have a dramatic effect on a business. On 1 September 2014 a new European Union rule came in banning the sale of vacuum cleaners with more than 1,600 watts of power. Prior to this, media scare stories about low-power vacuums prompted a buying stampede with online sales rising by 400 per cent. The changes were especially helpful to James Dyson, whose design-led products had long offered plenty of cleaning power with relatively low-energy motors. So legal changes can affect total market sales and companies' market share statistics as well.

Because of the importance of legal factors, companies in Britain and (especially) the United States spend time and a great deal of money on lobbying parliament and government. Broadly, businesses want the minimum in the way of employment, health and safety, consumer protection and environmental legislation. Pressure groups such as the Confederation of British Industry (CBI) can put enormous pressure on governments that plan to intervene in the free market desired by firms. The introduction of the National Minimum Wage in 1998 was hugely controversial, with industry groups lobbying hard to prevent or postpone the legislation. In the event it proved a minor inconvenience.

Parliament has been intervening in business activity at least since 1833, when the Factory Act banned firms from employing children under the age of nine. Every intervention has been accompanied by warnings about competitiveness and 'freedom'. The fact that the European Union initiates quite a few laws to achieve common rules throughout Europe is seen by some as an important reason to leave the community.

5.7 Environmental factors

This category of external factors must be looked at from a short- and long-term point of view (and perhaps internationally as well, in a UK versus elsewhere comparison). Of all the topics in business, this is the one fraught with the greatest difficulty in establishing fact from opinion. In mid-nineteenth century Britain, average life expectancy was slightly below 40; today it's over 80. The amazing improvement is due to many things, but one is certainly the massive reduction in air and water pollution. Nineteenth-century public spending on water and sewage systems corrected much of the water problem, and the worst of the air pollution ended with the Clean Air Act of 1956. Yes, diesel exhaust emissions are a bad thing, but there's no excuse for making it sound as if environmental factors are a huge short-term problem in Britain.

Perhaps the most important short-term issue is particulate matter (specks in the air that can get into your lungs). Known as PM2.5, in 2014, the World Health Organization stated that in London it was five times the recommended level. New Delhi, in India, proved to be the world's most polluted city with a PM2.5 reading more than 30 times the recommended level (Beijing's is half that). Even New Delhi's though would be low compared with nineteenth-century Britain.

Then there is the long-term issue – global warming. This is the reason why European governments wrongly encouraged diesel over petrol engines – because diesel gives out less CO₂ per mile. Unfortunately it compensates by emitting far more nitric oxide and particulate matter. Theories relating to global warming have pushed governments to undertake other specific policy measures, such as the huge 35-year subsidy to be paid to the French/Chinese consortium that will build a new nuclear power plant at Hinkley Point. If the efforts prove inadequate and global warming continues, businesses will have to prepare for warmer winters and dust-bowl summers. Ice cream and soft drink producers are going to love it.

'Progressive companies regard global warming as an opportunity not a threat.'

Tom Delay, Chief Executive, the Carbon Trust

5.8 What can firms do about external influences?

Make the most of favourable external influences while they last

Luck can play an important role in determining whether a business flourishes or not, especially in the short run. However, over time good and bad luck has a habit of evening out. The key to success then is to make the most of any favourable external influence while it lasts. For example, the debt-fuelled consumer spending boom between 1997 and 2007 greatly assisted companies supplying luxury goods and services.

However, these firms should not have relied on this frothy boom for their success, because it was a factor over which they had no control. They should have made the best of the situation while it lasted, but also asked themselves a series of **'what if' questions**. In this case, 'What if interest rates were suddenly increased?' or 'How would we respond to a sudden drop in demand for our product if the commercial banks withdrew cheap and easy credit?'

Minimise the impact of unfavourable external influences

When faced with adverse external influences, successful firms make compensating internal changes to their business to offset the external constraint. Ryanair can do nothing about rising oil prices; however, it can attempt

to cut other costs within the business to compensate for the rising oil price. If Ryanair can improve its internal efficiency the impact of the adverse external influence can be minimised. Successful businesses try as far as it is possible to internalise external constraints.

‘The nine most terrifying words in the English language are “I’m from the government and I’m here to help”.’

Ronald Reagan, former President, USA

Five whys and a how

Questions	Answers
Why might a change of government matter to UK companies?	It might mean a significant change in policies such as employment law, corporation tax rates and whether to stay in the European Union.
Why might a depreciation of the pound be welcomed by UK manufacturers?	Because their export sales would become more price competitive, while importers to the UK would find it harder to compete.
Why might a company such as Coca-Cola spend to finance academic research on a subject such as soft drinks and obesity?	The company would argue that it's part of its CSR practices; critics say that such research is directed at obscuring the evidence linking sugar and overweight.
Why, if new digital technologies are so powerful and efficient, has productivity growth slowed in the past ten years?	It's a bit of a mystery; some say the big productivity gains (and perhaps job losses) are still to come; others point out that IT and the internet are nothing like as fundamental as discovering engines or electricity.
Why do national leaders obsess about long-term global warming, yet do so little for short-term air quality (which is a killer)?	Another mystery; perhaps because it means <i>doing</i> something <i>now</i> , instead of setting ambitious long-term targets for governments in the future.
How might a company set about changing a proposed law that might damage its interests?	Lobbying is the start, which today means paying a 'consultancy' to get access to key government ministers or MPs; there will also be payments to public relations firms to get media coverage that favours your cause.

5.9 Impact of external influences – evaluation

The idea of PESTLE is that it provides a framework for analysing the context of a business – above all, to answer the question ‘Is the business really in charge of its destiny?’ City analysts hate it when a company blames poor performance on the weather or, still worse, on a factor that is external but predictable, such as a well-trailed piece of new legislation. If management knew a change was about to happen, why weren't they fully prepared?

In truth, though, there are external factors that appear to be manageable, but are not. A political swing to Jeremy Corbyn's Labour Party would create some panic among

the directors and shareholders of railway franchises. As was shown in Figure 5.2, a sudden economic downturn can happen – and inevitably causes havoc with company plans and budgets.

In the long run, a management will succeed if it shows that it's very largely in control of its destiny, and clever at coping with the remaining external factors that threaten to push it off course.

Key terms

Disruptive: technology would shift a whole sector towards a new way of doing things. This is very painful for those left behind.

‘What if’ questions: these are hypothetical (that is, they are used to test out different possibilities or theories).

5.10 Workbook

Revision questions

(30 marks; 30 minutes)

- 1 What is an external influence? (2)
- 2 Look again at the recession period shown in Figure 5.2. Briefly explain the probable effect of a sharp recession on:
 - a) an airline that focuses on long-haul flights such as Virgin Atlantic. (4)
 - b) a clothes retailer that focuses on value-for-money fashion clothes such as Primark. (4)
- 3 Based on your knowledge of economic trends over the past three months, explain how one economic factor may be having a positive impact upon UK firms. (4)
- 4 In 2015, the steelworks at Redcar was closed down, with 1,700 jobs lost. Outline three examples of the types of firms in and around Redcar that would be adversely affected by this decision. (6)
- 5 Record companies find it increasingly difficult to generate revenue because of file sharing sites that enable music lovers to illegally download music. What actions should record companies take to minimise this external constraint? (4)
- 6 Table 5.1 shows that youth unemployment is relatively high in the UK. Explain how that might affect two different businesses of your choice. (6)

Revision activities

Data response

Black day for retail?

So what was that all about? People fighting in store, queues of up to an hour online – yes, that's the new American novelty of 'Black Friday'. Probably a number of retail chains had severe doubts about joining in – but what can you do? Amazon.com sold 4 million items in the UK on Black Friday 2013 – a record number. And in 2014, the figure was 5.5 million, an amazing 37.5 per cent increase. Other growth figures were even more impressive, though perhaps from a lower base. John Lewis boasted a 307 per cent increase in online sales compared with last year – and Currys bettered that by saying their online sales rose fivefold.

Black Friday stems from the US tradition of 'Thanksgiving' on the last Thursday of November. After that, Christmas can start to take its commercial grip – hence the sales as a spur to shoppers to get going on Christmas presents. But in 2014, US shops reported a slight dip in Black Friday sales. It's a long-established event in America, whereas in Britain it's still a real novelty.

But will it help the retailers? Some argue that it's better to sell at 20 per cent off before Christmas than 50 per cent off in the January sales. That would be true if shops were so good at forecasting that they knew exactly what stock would be left unsold at Christmas. Furthermore, some experts are worried that: 'All Black Friday is likely to do is bring forward business from

December, reduce gross margins and undermine consumers' willingness to pay full price again before Christmas,' said retail analyst Nick Bubb.



Figure 5.3 Shoppers wrestle over goods on Black Friday

Questions (35 marks; 40 minutes)

- 1 The Black Friday phenomenon could be analysed using the acronym PESTLE. Explain which aspect of PESTLE was the most important factor. (5)
- 2 Assess the possible impact on stock management of having a day when online sales may be 307 per cent higher than you expect. (10)
- 3 Evaluate Nick Bubb's criticism of Black Friday from a business point of view. (20)