Contents

Preface to the Ninth Edition

Why study the business environment?

The business environment is our environment, it is the world we live in and all aspects of the business environment should be viewed in terms of people. Business ethics is about fairness in how a business operates; a business environmental policy is about how we pollute or preserve our own world; employment and unemployment are about people's ability to house and feed themselves. This is a book about all of us and how we interface with the world and each other, because businesses are just organisations of people and material things.

In reading about the business environment you are reading about your world. You are reading about why the prices of the things you buy might go up or down, or why at any given time it might be harder or easier for you to get a job. By understanding the things in this book that make up your world you will better understand how the world works, what changes mean and the implications they might have on your organisations (whether they are organisations that we work for, or the organisations that we have at home). In my own life, understanding the business environment has helped me make decisions about when and where and how to buy a home, and what and what not to invest in. Understanding the world allows us to make informed decisions.

Despite the global pandemic, Brexit, the Russian invasion of Ukraine and increased international trade tensions, the world keeps on turning. People continue to learn at home and at universities – and people continue to graduate and find jobs. It will be sensible for somebody going for an interview to carry out some research on the potential employer and understand how they might be affected by their business environment.

The first aim of this book is to set out the way things are in the world today. It will do this by breaking down everything outside of a business (and cover a little bit inside as well) into chapters organised in a logical way. In effect, what we mean by external and internal environments in a global context in which business operates today. The second part will cover aspects of the business environment as you might find them in a PESTLE analysis (Political, Economic, Social, Technological, Legal, Ethical/Ecological). The third part will cover firms and industries, as well as how government regulates business. The fourth part will consider the importance of markets as a concept, nationally and internationally. Finally, we will consider how the business environment feeds into strategy making for organisations.

The second aim of the book is to offer you examples and opportunities to apply what you have learned. The biggest change in this edition of the book has been the inclusion of specific chapters on the biggest contemporary events – namely the global Covid-19 pandemic and the retreat of some aspects of globalisation, including Brexit. These new chapters apply some of the content which are introduced elsewhere to give an all-round perspective on how factors influence one another, and convey the complexity of the business environment.

The context

With this edition, like the last, I feel I have to introduce some caveats at this point. A 600-page textbook takes a while to update. As I write this (in early 2022) the terms of Brexit arrangements are finalised, but the implications are still being worked out – particularly at the Irish/Northern Irish boarder. The tide appears to be turning with respect to Covid-19, with several viable vaccines, countries making progress with their distribution, and plans for how the developing world will be supported to ensure global protection. However, things change quickly. While I will address Brexit and Covid-19, the concepts set out here can be applied to many different contexts; the specific situations will change over the next two to five years but the concepts will persist. Further afield, when I started the last edition Russia was considered a friendly nation to Europe; when I started this edition things were a bit more icy between the two nations. Now things are very different and Ukraine has been invaded – with things in Ukraine looking increasingly like a proxy war. . . at any rate, the most significant conflict in Europe for 20 or more years.

The second caveat is with respect to data. I have updated data wherever possible – but in some circumstances there are simply no more updates. Sometimes data are reported in a different way, so continuity could not be maintained if the datasets were any more up to date, and in a few cases data had been collected by agencies which have changed or been disbanded. As a result, some of the datasets are not as up to date as I would have preferred, but they are sufficient to illustrate the points made in the book.

My authorship

This book is now in its ninth edition. Ian Worthington approached me to author this title in a more stable world (2015), a time when pandemic flu was hypothetical and before Brexit; a time when writing a book on the business environment seemed like a less troublesome undertaking!

I have quite a broad background in terms of my experience with the business environment, having worked for large and small private and public sector organisations. My first degree in business studies equipped me with most of my foundational business environment knowledge. Subsequently, I gained a master's degree in project management, and a doctorate in organisational behaviour. In most of my organisational work I have applied an actor–network theory perspective to how the world works. Actor–network theory considers all things related, nothing existing in isolation. This has proven a logical approach writing this book too; the environment is a world of many connections, some obvious and others less so. I hope through reading this book that you will come to understand the world in a similar way.

Thanks on behalf of Ian, Chris and myself to a dedicated team from Pearson for their work on this edition, particularly Archana Makhija, Supervising Producer for UK and Canada, for her support and encouragement through the development of this edition. And on behalf of myself, a big thanks to Ian and Chris, who handed over the updating of the title in the 8th edition. This remains their creation, but as the person responsible for updates I must insist that errors are *my* own.

Finally, take it from someone with a British PhD in Organisational Behavior: organisation is spelled with a Z in *English* English (it's in the *OED*). However, to appease my publishers, it will appear as *organisation* hereafter.

Ed Thompson

Part One

INTRODUCTION

1 Business organisations: the external environment

Business organisations differ in many ways, but they also have a common feature: the transformation of inputs into outputs; it is through this process that the value is created. This transformation process takes place against a background of external influences which affect the firm and its activities. This external environment is complex, volatile and interactive, but it cannot be ignored in any meaningful analysis of business activity.

Learning outcomes

Having read this chapter you should be able to:

- indicate the basic features of business activity
- portray the business organisation as a system interacting with its environment
- demonstrate the range and complexity of the external influences on business activity
- identify the central themes inherent in the study of the business environment

Key terms

Environmental change
External environment
General (or contextual) environment
Immediate (or operational) environment
Inputs
Open system
Outputs
PESTLE analysis
Transformation system

Introduction

Business activity is a fundamental and universal feature of human existence and yet the concept of 'business' is difficult to define with any degree of precision. Dictionary definitions tend to describe it as being concerned with buying and selling, or with trade and commerce, or the concern of profit-making organisations, and clearly all of these would come within the accepted view of business. Such a restricted view, however, would exclude large parts of the work of government and its agencies and the activities of non-profit-making organisations – a perspective it would be hard to sustain in a climate in which business methods, skills, attitudes and objectives have been vigorously adopted by these organisations. It is this broader view of business and its activities that is adopted below and that forms the focus of an investigation into the business environment.

The business organisation and its environment

A model of business activity

Most business activity takes place within an organisational context and even a cursory investigation of the business world reveals the wide variety of organisations involved, ranging from the small local supplier of a single good or service to the multi-billion-dollar international or multinational corporation producing and trading on a global scale. Given this rich organisational diversity, most observers of the business scene tend to differentiate between organisations in terms of their size, type of product and/or market, methods of finance, scale of operations, legal status, and so on. Nissan, for example, would be characterised as a major multinational car producer and distributor trading on world markets, while a local builder is likely to be seen as a small business operating at a local level with a limited market and relatively restricted turnover.

web link

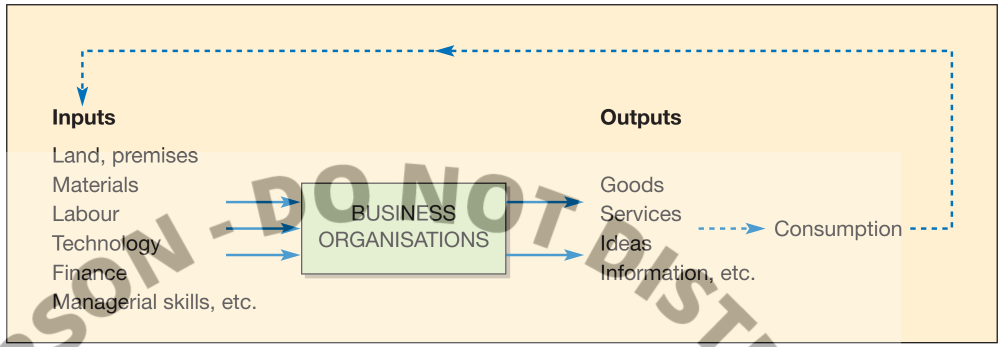
Further information on Nissan is available at *www.nissan-global.com*
The Nissan UK website address is *www.nissan.co.uk*

While such distinctions are both legitimate and informative, they can conceal the fact that all business organisations are ultimately involved in the same basic activity, namely the transformation of **inputs** (resources) into **outputs** (goods or services). This process is illustrated in Figure 1.1.

In essence, all organisations acquire resources – including labour, premises, technology, finance, materials – and transform these resources into the goods or services required by their customers. While the type, amount and combination of resources will vary according to the needs of each organisation and may also vary over time, the simple process described above is common to all types of business organisation and provides a useful starting point for investigating business activity and the environment in which it takes place.

A more detailed analysis of business resources and those internal aspects of organisations which help to transform inputs into output can be found in Chapters 2 and 8. The need, here, is simply to appreciate the idea of the firm as a **transformation system** and to recognise that in producing and selling output, most organisations hope to earn

Figure 1.1 The business organisation as a transformation system



sufficient revenue to allow them to maintain and replenish their resources, thus permitting them to produce further output which in turn produces further inputs. In short, inputs help to create output and output creates inputs. Moreover, the output of one organisation may represent an input for another, as in the case of the firm producing machinery, basic materials, information or ideas. This interrelationship between business organisations is just one example of the complex and integrated nature of business activity and it helps to highlight the fact that the fortunes of any single business organisation are invariably linked with those of another or others – a point clearly illustrated in many of the examples cited in the text.

The firm in its environment

The simple model of business activity described above is based on the systems approach to management (see Chapter 2). One of the benefits of this approach is that it stresses that organisations are entities made up of interrelated parts which are intertwined with the outside world – the **external environment** in systems language. This environment comprises a wide range of influences – economic, demographic, social, political, legal, technological, etc. – which affects business activity in a variety of ways and which can impinge not only on the transformation process itself, but also on the process of resource acquisition and on the creation and consumption of output. This idea of the firm in its environment is illustrated in Figure 1.2.

Figure 1.2 The firm in its environment

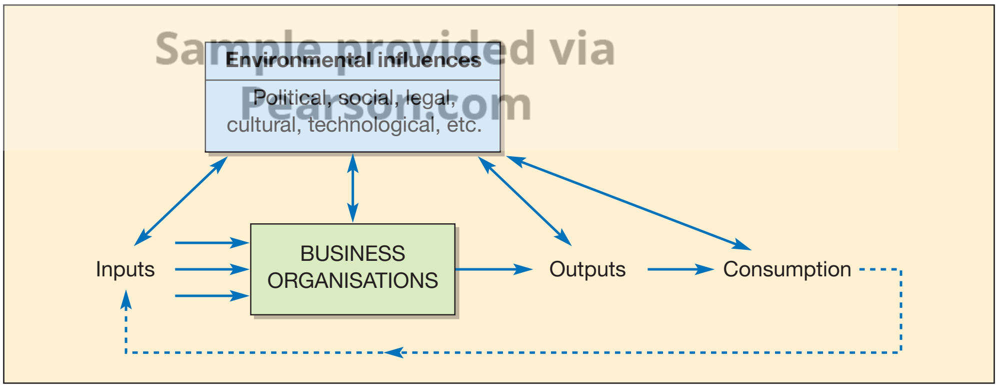
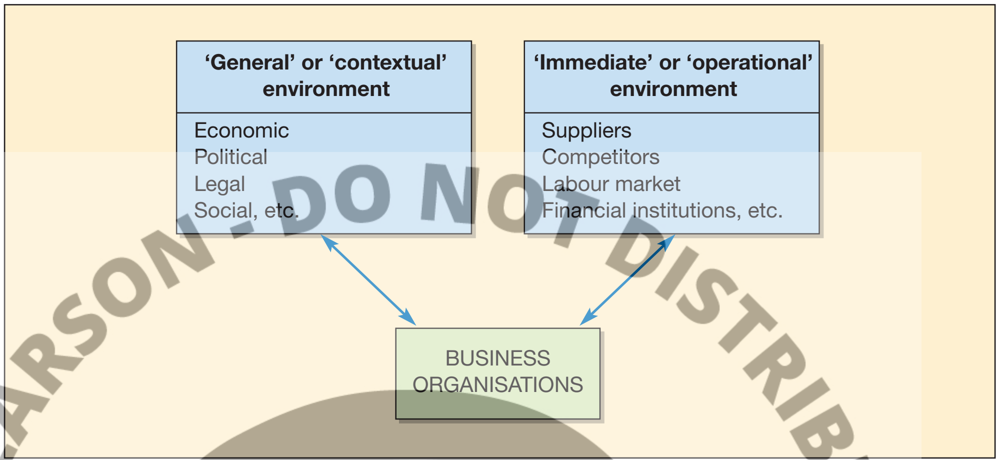


Figure 1.3 Two levels of environment

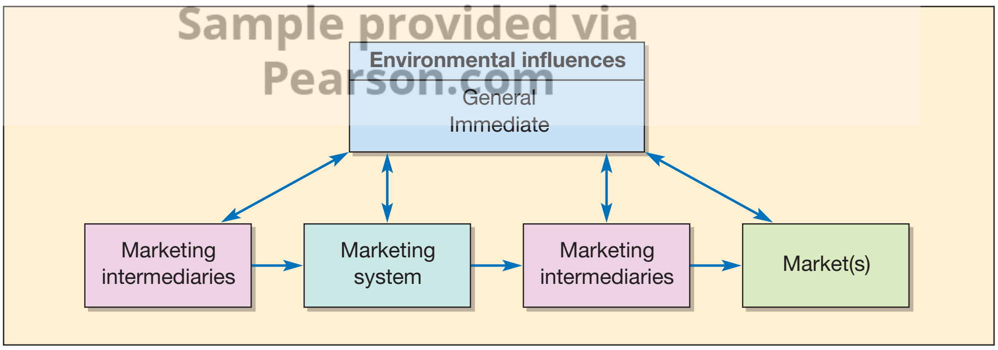


In examining the business environment, a useful distinction can be made between those external factors that tend to have a more immediate effect on the day-to-day operations of a firm and those that tend to have a more general influence. Figure 1.3 makes this distinction.

The **immediate (or operational) environment** for most firms includes suppliers, competitors, labour markets, financial institutions and customers, and may also include trade associations, trade unions and possibly a parent company. In contrast, the **general (or contextual) environment** comprises those macroenvironmental factors such as economic, political, socio-cultural, technological, legal and ethical influences on business which affect a wide variety of businesses and which can emanate not only from local and national sources, but also from international and supranational developments. Macroenvironmental factors might be thought of as factors so large that the business cannot change them.

This type of analysis can also be extended to the different functional areas of an organisation's activities, such as marketing or personnel or production or finance, as illustrated in Figure 1.4. Such an analysis can be seen to be useful in at least two ways. First, it emphasises the influence of external factors on specific activities within the firm and in doing so underlines the importance of the interface between the internal and external

Figure 1.4 Environmental influences on a firm's marketing system



environments. Second, by drawing attention to this interface, it highlights the fact that, while business organisations are often able to exercise some degree of control over their internal activities and processes, it is often very difficult, if not impossible, to control the external environment in which they operate.

The general or contextual environment

While the external factors referred to above form the subject matter of the rest of the book, it is useful at this point to gain an overview of the business environment by highlighting some of the key environmental influences on business activity. In keeping with the distinction made between general and more immediate influences, these are discussed separately below. In this section we examine what are frequently referred to as the 'PESTLE' factors (i.e. Political, Economic, Socio cultural, Technological, Legal and Ethical influences). A **PESTLE analysis** (or PEST analysis) can be used to analyse a firm's current and future environment as part of the strategic management process (see Chapter 19).

PESTLE examines factors external to the firm; these might represent opportunities or threats and later can be used in a SWOT analysis (whereas strengths and weaknesses are internal factors).

The political environment

A number of aspects of the political environment clearly impinge on business activity. These range from general questions concerning the nature of the political system and its institutions and processes (Chapter 5) to the more specific questions relating to government involvement in the working of the economy (Chapter 6) and its attempts to influence market structure and behaviour (Chapters 12, 16, 18).

Government activities, both directly and indirectly, influence business activity, and government can be seen as the biggest business enterprise at national or local level (Chapter 14). Given the trend towards the globalisation of markets (Chapters 4 and 17) and the existence of international trading organisations and blocs, international politico-economic influences on business activity represent one key feature of the business environment (Chapters 5, 8 and 17). Another is the influence of public, as well as political, opinion in areas such as environmental policy and corporate responsibility (Chapter 10).

The economic environment

The distinction made between the political and economic environment – and, for that matter, the legal environment – is somewhat arbitrary. Government, as indicated above, plays a major role in the economy at both national and local level (Chapters 6 and 14) and its activities help to influence both the demand and supply side (e.g. see Chapter 15). Nevertheless there are a number of other economic aspects related to business activity which are worthy of consideration. These include various structural aspects of both firms and markets (Chapters 11, 12, 13 and 16) and a comparison of economic theory and practice (e.g. Chapters 15, 16 and 17).

mini case The impact of regional economic conditions

For a company that trades in different markets across the world, macroeconomic conditions (see Chapter 6) in a particular part of its overall market can play a key role in determining its corporate sales and profitability. French carmaker PSA Peugeot Citroën, for instance, experienced a significant decline in sales in 2012 as demand fell in Southern Europe on the back of the recession in the eurozone. In response to the problem, the company announced significant job cuts aimed at reducing costs and looked to the French government for a series of multi-billion-euro loans to keep it afloat until trading conditions improved.

As the global economy slowed, steel industries have been heavily affected. After a period of rapid expansion (driven mostly by the growth of Chinese infrastructure and social development), China's economy has now started to slow as demand from more developed countries who consume Chinese-made products has fallen. This has led to a dramatic drop in the price of steel as it is no longer needed for building more factories and infrastructure. To support its own steel industry China has been selling steel at less than the cost European steelmakers can produce it. This is an example of the slowdown in European and American economies causing Chinese businesses to act more aggressively, which has eventually led to the collapse of large parts of the British steel industry such as the (Indian-owned) Tata steel works at Port Talbot near Cardiff in 2016.

Since market conditions can vary substantially in different locations, some businesses can experience significant variations in performance in different parts of their operations. US car giant Ford, for example, announced significant losses in Europe in 2012 alongside 'spectacular' results in its North American division. Like Chrysler and other competitors including GM, Ford was able to offset its European losses with stronger sales in the United States. It also posted pre-tax profits in its South American and Asian markets.

web link

Further information on the organisations mentioned in this mini case is available at *www.psa-peugeot-citroen.com*; *www.tatasteel.com*; *www.ford.com*; *www.chrysler.com*; *www.gm.com*

The social, cultural and demographic environment

Both demand and supply are influenced by social, cultural and demographic factors. Cultural factors, for example, may affect the type of products being produced or sold, the markets they are sold in, the price at which they are sold and a range of other variables. People are a key organisational resource and a fundamental part of the market for goods and services. Accordingly, socio-cultural influences and developments have an important effect on business operations, as do demographic changes (Chapters 7 and 8).

The technological environment

Technology is both an input and an output of business organisations as well as being an environmental influence on them. Investment in technology and innovation is frequently seen as a key to the success of an enterprise and has been used to explain differences in the relative competitiveness of different countries (Chapter 8). It has also been responsible for significant developments in the internal organisation of businesses in the markets for economic resources.

The legal environment

Businesses operate within a framework of law, which has a significant impact on various aspects of their existence. Laws usually govern, among other things, the status of the organisation (Chapter 11), its relationship with its customers and suppliers and certain internal procedures and activities (Chapter 9). They may also influence market structures and behaviour (e.g. Chapters 16 and 19). Since laws emanate from government (including supranational governments) and from the judgments of the courts, some understanding of the relevant institutions and processes is desirable (e.g. Chapters 5 and 9).

The ethical and ecological environment

Ethical considerations have become an increasingly important influence on business behaviour, particularly among the larger, more high-profile companies. One area where this has been manifest is in the demand for firms to act in a more socially responsible way and to consider the impact they might have on people, their communities and the natural environment (Chapter 10).

The immediate or operational environment

Resources and resource markets

An organisation's need for resources makes it dependent to a large degree on the suppliers of those resources, some of which operate in markets that are structured to a considerable extent (e.g. Chapter 8). Some aspects of the operation of resource markets or indeed the activities of an individual supplier can have a fundamental impact on an organisation's success and on the way in which it structures its internal procedures and processes. By the same token, the success of suppliers is often intimately connected with the decisions and/or fortunes of their customers. While some organisations may seek to gain an advantage in price, quality or delivery by purchasing resources from overseas, such a decision can engender a degree of uncertainty, particularly where exchange rates are free rather than fixed (Chapter 17). Equally, organisations may face uncertainty and change in the domestic markets for resources as a result of factors as varied as technological change, government intervention or public opinion (e.g. conservation issues).

Customers

Customers are vital to all organisations and the ability both to identify and to meet consumer needs is seen as one of the keys to organisational survival and prosperity – a point not overlooked by politicians, who are increasingly using business techniques to attract the support of the electorate. This idea of consumer sovereignty – where resources are allocated to produce output to satisfy customer demands – is a central tenet of the market economy (Chapter 6) and is part of a capitalist ideology whose influence has become all-pervasive in recent years, the idea being that companies competing is the most efficient way to organise society. Understanding the many factors affecting both individual and market demand, and the ways in which firms organise themselves to satisfy that demand, is a vital component of a business environment that is increasingly market led.

Competitors

Competition – both direct and indirect – is an important part of the context in which many firms operate and is a factor equally applicable to the input as well as the output side of business. The effects of competition, whether from domestic organisations or from overseas firms (see Chapter 17, for example), are significant at the macro as well as the micro level and its influence can be seen in the changing structures of many advanced industrial economies (Chapter 13). How firms respond to these competitive challenges (e.g. Chapter 12) and the attitudes of governments to anti-competitive practices (Chapter 19) is a legitimate area of concern for students of business.

Analysing the business environment

In a subject as all-encompassing as the business environment it is possible to identify numerous approaches to the organisation of the material. One obvious solution would be to examine the various factors mentioned above, devoting separate chapters to each of the environmental influences and discussing their impact on business organisations. While this solution has much to recommend it – not least of which is its simplicity – the approach adopted below is based on the grouping of environmental influences into three main areas, in the belief that this helps to focus attention on key aspects of the business world, notably contexts, firms and their markets.

mini case Fresh but not so easy

A recurring theme in this and previous editions of the book is the need for businesses to monitor and, where necessary, respond to changes in the business environment. Equally important is the requirement for a firm to understand the needs of the customers in the markets in which it currently operates or in which it wishes to expand its operations as a means of growing the organisation. Even some of the world's largest and most sophisticated companies can sometimes get this wrong.

Take the very well documented case of Tesco PLC's foray into the US grocery retailing market with the launch of its Fresh & Easy stores in 2007–8. Initially established in a number of states on the US west coast, the experiment was aimed at providing a low-risk method of entry into a large and lucrative market, with the focus on providing fresh produce at low prices in competition with existing retailers such as Trader Joe's and Walmart. As a preliminary step, the company sent some of its senior executives to the United States to live with American families for several months in order to understand their shopping habits and product preferences. It also ran a high-profile promotional campaign to support its plans to open up 1,000 stores in California and neighbouring states before launching the brand on the east coast.

Tesco's hope that it would be able to break even in two years quickly evaporated and the company was forced to pump hundreds of millions of pounds into the venture to keep it afloat. Apart from the rather unfortunate coincidence of the launch of its brand with the sub-prime crisis and subsequent recession in the United States, retail analysts have pointed to some fundamental errors in understanding the preferences of US consumers. Mistakes are said to have included an unclear image; cold and antiseptic stores; the introduction of self-pay checkouts; using cling film on fresh products; an over-emphasis on ready meals; an unwillingness to embrace the 'coupon culture' that is an important part of the US shopping experience; and problems in ensuring high-quality produce. Some consumers also apparently complained that the name Fresh & Easy reminded them of a deodorant or a sanitary product.

By the time of its withdrawal from the US market in September 2013, Tesco had reputedly lost more than £1.8 billion. On the positive side, Tesco has made ventures into other markets. Trent Hypermarket, owned jointly by Tesco and Tata was formed in 2015 and after a mixed time during the pandemic was making around £4 million a month in profit by the second quarter of 2022.

web link Tesco's website address is: *www.tesco.com*

Following a basic introduction to the idea of the 'business environment', in Part Two consideration is given to the political, economic, social, cultural, demographic, legal, ethical and ecological contexts within which businesses function. In addition to examining the influence of political and economic systems, institutions and processes on the conduct of business, this section focuses on the macroeconomic environment and on those broad social influences that affect both consumers and organisations alike. The legal system and the influence of law in a number of critical areas of business activity are also a primary concern and one which has links with Part Three.

In Part Three, attention is focused on three central structural aspects: legal structure, size structure and industrial structure. The chapter on legal structure examines the impact of different legal definitions on a firm's operations and considers possible variations in organisational goals based on legal and other influences. The focus then shifts to how differences in size can affect the organisation (e.g. access to capital, economies of scale) and to an examination of how changes in scale and/or direction can occur, including the role of government in assisting small business development and growth. One of the consequences of changes in the component elements of the economy is the effect on the overall structure of industry and commerce – a subject which helps to highlight the impact of international competition on the economic structure of many advanced industrial economies. Since government is a key actor in the economy, the section concludes with an analysis of government involvement in business and in particular its influence on the supply as well as the demand side of the economy at both national and local levels.

In Part Four, the aim is to compare theory with practice by examining issues such as pricing, market structure and foreign trade. The analysis of price theory illustrates the degree to which the theoretical models of economists shed light on the operation of business in the 'real' world. Similarly, by analysing basic models of market structure, it is possible to gain an understanding of the effects of competition on a firm's behaviour and to appreciate the significance of both price and non-price decisions in the operation of markets.

The analysis continues with an examination of external markets and the role of government in influencing both the structure and the operation of the marketplace. The chapter on international markets looks at the theoretical basis of trade and the development of overseas markets in practice, particularly in the context of recent institutional, economic and financial developments (e.g. the Single Market, globalisation, the euro). The section concludes with an investigation of the rationale for government intervention in markets and a review of government action in three areas, namely privatisation and deregulation, competition policy and the operation of the labour market.

To emphasise the international dimension of the study of the business environment, each chapter of the book concludes with a relevant national and international cases which draw together some of the key themes discussed in the previous chapters. By examining specific issues and/or organisations, the aim is to highlight linkages between the material discussed in the text and to provide an appreciation of some of the ways in which business activity reaches well beyond national boundaries.

The concluding chapter in the book stresses the continuing need for organisations to monitor change in the business environment and examines a number of frameworks through which such an analysis can take place. In seeking to make sense of their environment, businesses need access to a wide range of information, much of which is available from published material, including government sources. Some of the major types of information available to students of business and to business organisations – including statistical and other forms of information – are considered in the final part of this chapter.

Central themes

A number of themes run through the text and it is useful to draw attention to these at this point.

Interaction with the environment

Viewed as an **open system**, the business organisation is in constant interaction with its environment. Changes in the environment can cause changes in inputs, in the transformation process and in outputs, and these in turn may engender further changes in the organisation's environment. The internal and external environments should be seen as interrelated and interdependent, not as separate entities.

Interaction between environmental variables

In addition to the interaction between the internal and external environments, the various external influences affecting business organisations are frequently interrelated. Changes in interest rates, for example, may affect consumer confidence and this can have an important bearing on business activity. Subsequent attempts by government to influence the level of demand could exacerbate the situation and this may lead to changes in general economic conditions, causing further problems for firms. The combined effect of these factors could be to create a turbulent environment which could result in uncertainty in the minds of managers. Failure to respond to the challenges (or opportunities) presented by such changes could signal the demise of the organisation or at best a significant decline in its potential performance.

The complexity of the environment

The environmental factors identified above are only some of the potential variables faced by all organisations. These external influences are almost infinite in number and variety and no study could hope to consider them all. For students of business and for managers alike, the requirement is to recognise the complexity of the external environment and to pay greater attention to those influences which appear to be the most pertinent and pressing for the organisation in question, rather than to attempt to consider all possible contingencies.

Environmental volatility and change

The organisation's external environment is further complicated by the tendency towards **environmental change**. This volatility may be particularly prevalent in some areas (e.g. technology) or in some markets or in some types of industry or organisation. As indicated above, a highly volatile environment causes uncertainty for the organisation (or for its sub-units) and this makes decision-making more difficult.

Environmental uniqueness

Implicit in the remarks above is the notion that each organisation has to some degree a unique environment in which it operates and which will affect it in a unique way. Thus, while it is possible to make generalisations about the impact of the external environment on the firm, it is necessary to recognise the existence of this uniqueness and where appropriate to take into account exceptions to the general rule.

Different spatial levels of analysis

External influences operate at different spatial levels – local, regional, national, supranational, international/global – exemplified by the concept of LoNGPEST/LoNGPESTLE (see Chapter 19). There are few businesses, if any, today that could justifiably claim to be unaffected by influences outside their immediate market(s).

Two-way flow of influence

As a final point, it is important to recognise that the flow of influence between the organisation and its environment operates in both directions. The external environment influences firms, but by the same token firms can influence their environment, and this is an acceptable feature of business in a democratic society which is operating through a market-based economic system. This idea of democracy and its relationship with the market economy is considered in Chapters 5 and 6.

Synopsis

In the process of transforming inputs into output, business organisations operate in a multifaceted environment which affects and is affected by their activities. This environment tends to be complex and volatile and comprises influences which are of both a general and an immediate kind and which operate at different spatial levels.

Understanding this environment and its effects on business operations is vital to the study and practice of business.

Summary of key points

- Business activity is essentially concerned with transforming inputs into outputs for consumption purposes.
- All businesses operate within an external environment that shapes their operations and decisions.
- This environment comprises influences that are both operational and general.
- The operational environment of business is concerned with such factors as customers, suppliers, creditors and competitors.
- The general environment focuses on what are known as the PESTLE factors.
- In analysing a firm's external environment attention needs to be paid to the interaction between the different environmental variables, environmental complexity, volatility and change, and to the spatial influences.
- While all firms are affected by the environment in which they exist and operate, at times they help to shape that environment by their activities and behaviour.

case study — Facing the unexpected

In previous editions of the book we have stressed how the business environment can sometimes change dramatically and unexpectedly for the worse, using the September 11, 2001 attack on the World Trade Center in the United States as an example of what is known as an exogenous shock to the economic system.

Mercifully, events of this kind tend to be relatively rare, but when they occur they present a considerable challenge to the businesses and industries affected. The same is true when natural disasters occur, as the following examples illustrate.

2010 – the eruption of an Icelandic volcano sent a cloud of volcanic ash over large parts of Europe, resulting in the grounding of aircraft and weeks of disruption of air travel. Airlines in particular were badly affected and faced additional costs because of stranded passengers and cancelled flights. Beneficiaries included hoteliers who had to accommodate people unable to travel and alternative transport businesses (e.g. ferry operators).

2013 – sudden and devastating storms in the Burgundy and Bordeaux regions of France destroyed swathes of the French wine industry, resulting in a loss of jobs and income in the affected local communities, with a knock-on impact on local businesses. In China, a heatwave across the central and eastern parts of the country badly affected the farming industry and tempted the government to spend millions on artificial steps to trigger rain. In some areas power failures occurred as the demand for electricity soared as individuals and organisations turned on the air-conditioning. Much warmer conditions were also experienced in parts of Northern Europe, including the UK, resulting in increased sales of certain items (e.g. barbecues, sunscreen) and tempting many people to holiday at home. Other adverse natural events in 2013–14 included a super typhoon in the Philippines, extensive fires in parts of Australia, a major drought in California and severe storms and flooding in southern England, all of which had major effects on businesses and communities in the affected areas.

2015–16 – in 2015 terrorists armed with assault rifles and hand grenades attacked a beach resort in Tunisia. The British Foreign Office issued travel advice to avoid all but essential travel to the country, as did many other governments. The result was a 37 per cent fall in foreign spending in Tunisia, whose economy is 8 per cent dependent on tourism. In 2016 attacks on Brussels and Paris had an impact on tourism across Europe, with hotel occupancy in London down as a result.

In 2017 the Manchester Arena was bombed during a concert which had local and national effects on how show security was managed.

In 2020–21 Covid-19 radically changed business across a wide range of sectors.

While there is little a business can do to protect itself totally against events of this kind, many larger firms, especially multinationals, tend to put in place contingency plans to manage unexpected crises, whether they are caused by human or natural events. A business continuity plan (BCP) can help an organisation to respond quickly and effectively to a negative situation and hopefully to survive the experience and learn from it. Smaller firms on the whole tend to lack the financial and human resources needed to adopt such resilience measures and some may not survive an adverse change in the external environment. For other organisations such a change may bring with it business opportunities, an unexpected though possibly welcome gain from an event that has a negative impact on other firms.

Case study questions

1 Can you think of any other examples of major unanticipated events in your own country (or areas of your own country) that have had a serious adverse effect on its firms and/or industries?

2 Can you think of any businesses that may have benefited commercially from this event or these events?

Review and discussion questions

1 In what senses could a college or university be described as a business organisation? How would you characterise its 'inputs' and 'outputs'?

2 Taking examples from a range of quality newspapers, illustrate ways in which business organisations are affected by their external environment.

3 Give examples of the ways in which business organisations can affect the external environment in which they operate.

Assignments

1 Assume you are a trainee in a firm of management consultants. As part of your induction process you have been asked to collect a file of information on an organisation of your choice. This file should contain information not only on the structure of the organisation and its products but also on the key external influences that have affected its operations in recent years.

2 For a firm or industry of your choice, undertake a PESTLE analysis indicating the likely major environmental influences to be faced by the firm/industry in the next five to ten years.

Further reading

Daniels, J. D., Radebough, L. H. and Sullivan, D. P., *International Business: Environments and Operations*, 14th edition, Prentice Hall, 2012.

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Worthington, I., Britton, C. and Rees, A., *Economics for Business: Blending Theory and Practice*, 2nd edition, Financial Times/Prentice Hall, 2004, Chapter 1.

2 Business organisations: the internal environment

The systems approach to the study of business organisations stresses the interaction between a firm's internal and external environments. Key aspects of the internal context of business include the organisation's structure and functions and the way they are configured in pursuit of specified organisational objectives. If the enterprise is to remain successful, constant attention needs to be paid to balancing the different influences on the organisation and to the requirement to adapt to new external circumstances. This responsibility lies essentially with the organisation's management, which has the task of blending people, technologies, structures and environments.

Learning outcomes

Having read this chapter you should be able to:

- outline the broad approaches to organisation and management, paying particular attention to the systems approach
- identify alternative organisational structures used by business organisations
- discuss major aspects of the functional management of firms
- illustrate the interaction between a firm's internal and external environments

Key terms

Bureaucracy
Classical theories of organisation
Contingency approach
Divisional structure
Downsizing
Formal structures
Functional organisation
Functional specialisation
Hierarchy of needs
Holding company
Human relations approach
Human resource management
Management
Marketing
Marketing concept
Marketing mix
Matrix structure
Organisation chart
Private sector
Profit centre
Project team
Public sector
Re-engineering
Scientific management
Sub-systems
Systems approach
Theory X and Theory Y
Theory Z
Virtual organisation
Voluntary (or third) sector

Introduction

Under the systems approach to understanding business activity presented in Chapter 1, the organisation lies at the heart of the transformation process and tends to be seen as a kind of 'black box' which contains a multitude of elements – including structures, processes, people, resources and technologies – that brings about the transformation of inputs into outputs (see below). While the study of the business environment rightly focuses on the external context of business organisations, it is important to recognise that firms also have an internal environment that both shapes and is shaped by the external context in which they operate and make decisions. This notion of the interplay between an organisation's internal and external environments is a theme that runs through many of the chapters in this book.

As students of business and management will be aware, the internal features of business organisations have received considerable attention from scholars researching these fields, and a large number of texts have been devoted to this aspect of business studies. In the discussion below, the aim is to focus on three areas of the internal organisation that relate directly to a study of the business environment: approaches to understanding organisations, organisational structures, and key functions within the enterprise. Further insight into these aspects and into management and organisational behaviour generally can be gained by consulting the many specialist books in this field, a number of which are mentioned at the end of this chapter. Issues relating to a firm's legal structure are examined in detail in Chapter 11.

A central theme running through any analysis of the internal environment is the idea of **management**, which has been subjected to a wide variety of definitions. As used in this context, management is seen both as a system of roles fulfilled by individuals who manage the organisation (e.g. entrepreneur, resource manager, coordinator, leader, motivator, organiser) and as a process that enables an organisation to achieve its objectives. The essential point is that management should be seen as a function of organisations, rather than as a controlling element, and its task is to enable the organisation to identify and achieve its objectives and to adapt to change. Managers need to integrate the various influences on the organisation – including people, technology, systems and the environment – in a manner best designed to meet the needs of the enterprise at the time in question and be prepared to institute change as and when circumstances dictate.

The concept of the organisation: an initial comment

According to Stoner and Freeman (1992: 4), an organisation can be defined as two or more people who work together in a structured way to achieve a specific goal or set of goals. Defined in this way, the term covers a vast array of structures in the:

- **private sector** – that part of the economy where ownership and control of the organisation is in the hands of private individuals or groups and where profit-seeking is a central goal;
- **public sector** – that part of the economy under the control of government and its agencies and where the state establishes and runs the different types of organisation on behalf of its citizens and for their general well-being;

- **voluntary (or third) sector** – comprising those organisations, including charities, voluntary bodies and community businesses, that are not-for-profit enterprises and non-governmental.

Leaving aside the blurring of definitions of these three generic sectors that has occurred over recent years (e.g. where third-sector organisations are commissioned to deliver public services), the concept of the 'business organisation' as used in this text covers enterprises of all types and in all sectors. In this book the concept also encapsulates those organisations where the objectives are set by one individual who both owns and controls the business and has no other employees (i.e. sole traders with zero staff).

Despite coming in a wide variety of shapes, forms and sizes, business organisations share a number of common features. Mullins (2013) identifies four such features:

- people (i.e. employees);
- objectives (i.e. what the organisation is set up to achieve);
- structure (i.e. the organisational framework through which the objectives are pursued and efforts are coordinated);
- management (i.e. the directing and controlling aspect of the enterprise).

To these we could add the idea of resources (including finance) and technologies. We also need to recognise the existence of an external environment that faces all types of enterprise. This is, after all, a fundamental feature of the systems approach to understanding business organisations and how they operate.

Understanding the nature of organisations: theories of organisation and management

To gain an insight into the principles that are felt to underlie the process of management, it is useful to undertake a brief examination of organisational theories. These theories or approaches – some of which date back to the late nineteenth century – represent the views of both practising managers and academics as to the factors that determine organisational effectiveness and the influences on individuals and groups within the work environment. Broadly speaking, these approaches can be broken down into three main categories: the classical approach, the human relations approach and the systems approach. Since the last of these encompasses the model presented in Chapter 1, particular attention is paid to this perspective.

The classical approach

Classical theories of organisation and management mostly date from the first half of the twentieth century and are associated with the work of writers such as Taylor, Fayol, Urwick and Brech. In essence, the classicists viewed organisations as **formal structures** established to achieve a particular number of objectives under the direction of management, the emphasis being on purpose, structure, hierarchy and common principles. By identifying a set of guidelines to assist managers in the design of the organisational structure, the proponents of the classical view believed that organisations would be able to achieve their objectives more effectively. Fayol, for example, identified 14 principles which included the division of work, the scalar chain, centralisation and the unity of command – features which also found expression in Weber's notion of 'bureaucracy'. Urwick's rules or principles similarly emphasised aspects of organisation structure and operations – such as specialisation, coordination, authority, responsibility and the span of control – and were presented essentially as a code of good management practice.

Within the classical approach special attention is often given to two important sub-groupings, known as **scientific management** and **bureaucracy**. The former is associated with the pioneering work of F. W. Taylor (1856–1915), who believed that scientific methods could be attached to the design of work so that productivity could be increased. For Taylor, the systematic analysis of jobs (e.g. using some form of work study technique) was seen as the key to finding the best way to perform a particular task and thereby achieving significant productivity gains from individuals, which would earn them increased financial rewards. In Taylor's view, the responsibility for the institution of a scientific approach lay with management, under whose control and direction the workers would operate to the mutual benefit of all concerned.

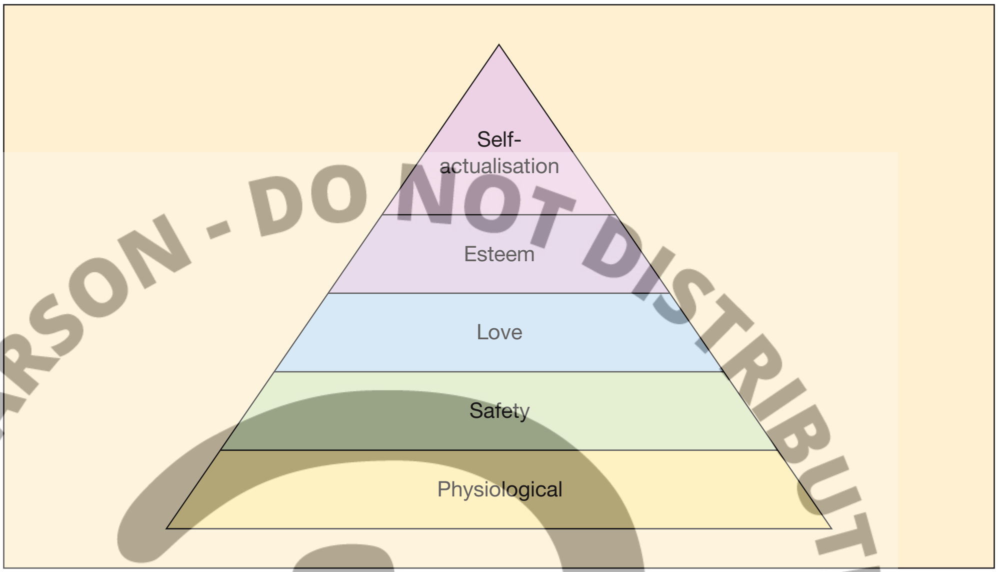
The second sub-group, bureaucracy, draws heavily on the work of Max Weber (1864–1920), whose studies of authority structures highlighted the importance of 'office' and 'rules' in the operation of organisations. According to Weber, bureaucracy – with its system of rules and procedures, specified spheres of competence, hierarchical organisation of offices, appointment based on merit, high level of specialisation and impersonality – possessed a degree of technical superiority over other forms of organisation, and this explained why an increasing number of enterprises were becoming bureaucratic in structure. Despite Weber's analysis appearing somewhat dated nowadays, bureaucratic organisation remains a key feature of many enterprises throughout the world and is clearly linked to increasing organisational size and complexity. Bureaucracy is often seen as something which restricts organisations from making internal changes or taking advantage of opportunities, leading to ineffectiveness. Modern defenders of bureaucracy (Du Gay, 2000) argue that bureaucratic systems are fair, treating situations and individuals rationally and equally. Notwithstanding the many valid criticisms of Weber's work, it is difficult to imagine how it could be otherwise.

The human relations approach

Whereas the classical approach focuses largely on structure and on the formal organisation, the **human relations approach** to management emphasises the importance of people in the work situation and the influence of social and psychological factors in shaping organisational behaviour. Human relations theorists have primarily been concerned with issues such as individual motivation, leadership, communications and group dynamics, and have stressed the significance of the informal pattern of relationships that exists within the formal structure. The factors influencing human behaviour have accordingly been portrayed as a key to achieving greater organisational effectiveness, thus elevating the 'management of people' to a prime position in the determination of managerial strategies.

The early work in this field is associated with Elton Mayo (1880–1949) and with the famous Hawthorne Experiments, conducted in the United States at the Western Electric Company between 1924 and 1932. These experiments showed that individuals at work were members of informal (i.e. unofficial) as well as formal groups and that group

Figure 2.1 A hierarchy of needs



influences were fundamental to explaining individual behaviour. Later work by writers such as Maslow, McGregor, Argyris, Likert and Herzberg continued to stress the importance of the human factor in determining organisational effectiveness, but tended to adopt a more psychological orientation, as exemplified by Maslow's **hierarchy of needs** and McGregor's **Theory X and Theory Y**. Maslow's central proposition was that individuals seek to satisfy specific groups of needs, ranging from basic physiological requirements (e.g. food, sleep, sex), through safety, love and esteem, to self-actualisation (i.e. self-fulfilment), progressing systematically up the hierarchy as each lower-level need is satisfied (see Figure 2.1). To McGregor, individuals at work were seen by management as either inherently lazy (Theory X) or committed to the organisation's objectives and often actively seeking responsibility (Theory Y). These perceptions consequently provided the basis for different styles of management, which ranged from the coercive to the supportive.

McGregor's concern with management styles is reflected in later studies, including Ouichi's notion of **Theory Z**. According to Ouichi, one of the key factors in the success of Japanese manufacturing industries was their approach to the management of people. Theory Z organisations were those that offered workers long-term (often lifetime) employment, a share in decision-making, opportunities for training, development and promotion, and a number of other advantages which gave them a positive orientation towards the organisation. For Ouichi, the key to organisational effectiveness lay in the development of a Japanese-style Theory Z environment, adapted to western requirements.

The systems approach

More recent approaches to organisation and management have helped to integrate previous work on structures, people and technology, by portraying organisations as socio-technical systems interacting with their environment. Under this approach – which became popular in the 1960s – organisations were seen as complex systems of people, tasks and technologies that were part of and interacted with a larger environment, comprising a wide range of influences (see Chapter 1). This environment was frequently subject to fluctuations, which on occasions could become turbulent (i.e. involving rapid and often unpredictable change). For organisations to survive and prosper, adaptation to environmental demands was seen as a necessary requirement and one that was central to the process of management.

The essence of the **systems approach** has been described in Chapter 1 but is worth repeating here. Organisations, including those involved in business, are open systems, interacting with their environment as they convert inputs into output.

Inputs include people, finance, materials and information, provided by the environment in which the organisation exists and operates. Output comprises such items as goods and services, information, ideas and waste, discharged into the environment for consumption by 'end' or 'intermediate' users and in some cases representing inputs used by other organisations.

Systems invariably comprise a number of **sub-systems** through which the process of conversion or transformation occurs. Business organisations, for example, usually have sub-systems that deal with activities such as production, marketing, accounting and human resource management, and each of these in turn may involve smaller sub-systems (e.g. sales, quality control, training) which collectively constitute the whole. Just as the organisation as a system interacts with its environment, so do the sub-systems and their component elements, which also interact with each other. In the case of the latter, the boundary between sub-systems is usually known as an 'interface'.

While the obvious complexities of the systems approach need not be discussed, it is important to emphasise that most modern views of organisations draw heavily on the work in this area, paying particular attention to the interactions between people, technology, structure and environment and to the key role of management in directing the organisation's activities towards the achievement of its goals. Broadly speaking, management is seen as a critical sub-system within the total organisation, responsible for the coordination of the other sub-systems and for ensuring that internal and external relationships are managed effectively. As changes occur in one part of the system, these will induce changes elsewhere and this will require a management response that will have implications for the organisation and for its sub- systems. Such changes may be either the cause or effect of changes in the relationship between the organisation and its environment, and the requirement for managers is to adapt to the new conditions without reducing the organisation's effectiveness.

Given the complex nature of organisations and the environments in which they operate, a number of writers have suggested a **contingency approach** to organisational design and management (e.g. Lawrence and Lorsch, Woodward, Perrow, Burns and Stalker). In essence, this approach argues that there is no single form of organisation best suited to all situations and that the most appropriate organisational structure and system of management is dependent upon the contingencies of the situation (e.g. size, technology, environment) for each organisation. In some cases a bureaucratic structure might be the best way to operate, while in others much looser and more organic methods of organisation might be more effective. In short, issues of organisational design and management depend on choosing the best combination in the light of the relevant situational variables; this might mean different structures and styles coexisting within different parts of an organisation.

Other theoretical approaches

To complement these traditional approaches to understanding the nature of organisations, Mullins (2013) highlights the contribution of theories of decision-making and social action. Decision-making theory, he suggests, can be seen as a sub-division of the systems approach in which the focus of attention is on the process of managerial decision-making and how information is gathered, processed and used in deciding how to act. The organisation in effect is seen as an information-processing network and successful management is concerned with making choices and resolving conflicts, often against a background of a changing internal and external environment.

Social action approaches emphasise the need to view the organisation from the standpoint of the individual employees or actors, each of whom has their own goals and interpretation of their work situation and whose behaviour is guided by their view of what work means to them and the satisfaction they are seeking. Organisations are portrayed as arenas in which individuals with different views and expectations interact. Conflicts of interest are regarded as a normal feature of human behaviour and an inevitable part of organisational life.

Organisational structures

Apart from the very simplest form of enterprise in which one individual carries out all tasks and responsibilities, business organisations are characterised by a division of labour which allows employees to specialise in particular roles and to occupy designated positions in pursuit of the organisation's objectives. The resulting pattern of relationships between individuals and roles constitutes what is known as the organisation's structure and represents the means by which the purpose and work of the enterprise are carried out. It also provides a framework through which communications can occur and within which the processes of management can be applied.

Responsibility for establishing the formal structure of the organisation lies with management and a variety of options is available. Whatever form is chosen, the basic need is to identify a structure that will best sustain the success of the enterprise and will permit the achievement of a number of important objectives. Through its structure an organisation should be able to:

- achieve efficiency in the utilisation of resources;
- provide opportunities for monitoring organisational performance;
- ensure the accountability of individuals;
- guarantee coordination between the different parts of the enterprise;
- provide an efficient and effective means of organisational communication;
- create job satisfaction, including opportunities for progression;
- adapt to changing circumstances brought about by internal or external developments.

In short, structure is not an end in itself but a means to an end and should ideally reflect the needs of the organisation within its existing context and taking into account its future requirements.

mini case 'Into the Dragon's Den'

As the chapter illustrates, the structure of an organisation is a means by which an enterprise can achieve its objectives. As the environment in which a business operates changes, a firm should be willing to adapt the structure to meet the new circumstances. This might mean moving beyond the traditional models discussed below, in an effort to improve performance.

The global pharmaceutical giant GlaxoSmithKline (GSK) illustrates this idea of an evolving organisational structure. In July 2008, GSK announced that in future its scientists would have to pitch their ideas for new drugs to a development board, based essentially on the lines of *Dragons' Den*, a popular UK television programme where would-be entrepreneurs seek to gain backing for their ideas from a group of financiers. The board would include two venture capitalists and would be a mixture of executives from inside the company and GSK outsiders, the plan being to stimulate innovation by requiring smaller teams of scientists to pitch three-year business plans to the new drug discovery investment board in an effort to secure funding for new drug treatments.

web link You can access the website for GSK at *www.gsk.com*

The essence of structure is the division of work between individuals and the formal organisational relationships that are created between them. These relationships will be reflected not only in individual job descriptions but also in the overall **organisation chart**, which designates the formal pattern of role relationships, and the interactions between roles and the individuals occupying those roles. Individual authority relationships can be classified as line, staff, functional and lateral and arise from the defined pattern of responsibilities, as follows:

- *Line relationships* occur when authority flows vertically downwards through the structure from superior to subordinate (e.g. managers–section leader–staff).
- *Staff relationships* are created when senior personnel appoint assistants who normally have no authority over other staff but act as an extension of their superior.
- *Functional relationships* are those between specialists (or advisers) and line managers and their subordinates (e.g. when a specialist provides a common service throughout the organisation but has no authority over the users of the service). The personnel or computing function may be one such service that creates a functional relationship. (Note that specialists have line relationships with their own subordinates.)
- *Lateral relationships* exist across the organisation, particularly between individuals occupying equivalent positions within different departments or sections (e.g. committees, heads of departments, section leaders).

With regard to the division of work and the grouping of organisational activities, this can occur in a variety of ways. These include:

- *by function or major purpose*, associated particularly with departmental structures;

- *by product or service*, where individuals responsible for a particular product or service are grouped together;
- *by location*, based on geographical criteria;
- *by common processes* (e.g. particular skills or methods of operation);
- *by client group* (e.g. children, the disabled, the elderly).

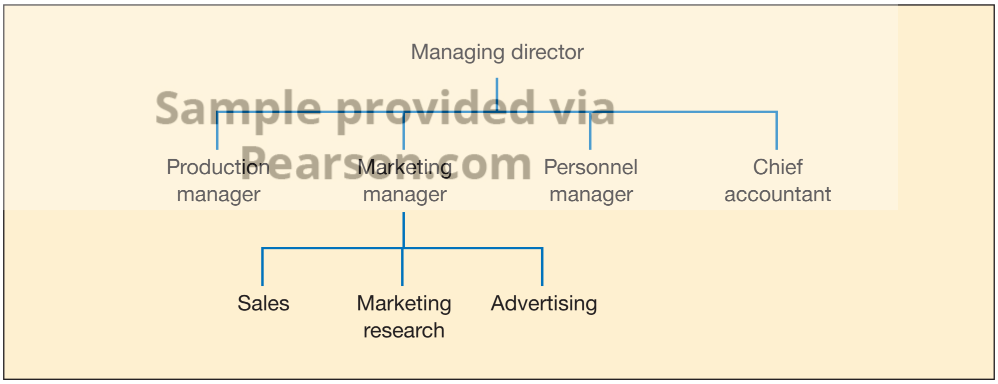
In some organisations a particular method of grouping will predominate, in others there will tend to be a variety of types, and each has its own particular advantages and disadvantages. In the next sections, we examine five popular methods of grouping activities in business organisations. Students should attempt to discover what types of structure exist within their own educational institution and the logic (if any) that underlies the choices made.

Functional organisation

The functional approach to organisation is depicted in Figure 2.2. As its name indicates, in this type of structure activities are clustered together by common purpose or function. All marketing activities, for example, are grouped together as a common function, typically within a marketing department. Similarly, other areas of activity, such as production, finance, personnel and research and development, have their own specialised sections or departments, responsible for all the tasks required of that function.

Apart from its obvious simplicity, the **functional organisation** structure allows individuals to be grouped together on the basis of their specialisms and technical expertise, and this can facilitate the development of the function they offer as well as providing a recognised path for promotion and career development. On the downside, functional specialisation, particularly through departments, is likely to create sectional interests which may operate to the disadvantage of the organisation as a whole, particularly where inequalities in resource allocation between functions become a cause for inter-function rivalry. It could also be argued that this form of structure is most suited to single-product firms and that it becomes less appropriate as organisations diversify their products and/or markets. In such circumstances, the tendency will be for businesses to look for the benefits that can arise from specialisation by product or from the divisionalisation of the enterprise.

Figure 2.2 A functional organisation structure



Organisation by product or service

In this case the division of work and the grouping of activities are dictated by the product or service provided (see Figure 2.3), such that each group responsible for a particular part of the output of the organisation may have its own specialist in the different functional areas (e.g. marketing, finance, personnel). One advantage of this type of structure is that it allows an organisation to offer a diversified range of products, as exemplified by the different services available in National Health Service hospitals (e.g. maternity, orthopaedic, geriatric, and so forth). Its main disadvantage is the danger that the separate units or divisions within the enterprise may attempt to become too autonomous, even at the expense of other parts of the organisation, and this can present management with problems of coordination and control.

The divisional structure

As firms diversify their products and/or markets – often as a result of merger or takeover – a structure is needed to coordinate and control the different parts of the organisation. This structure is likely to be the divisional (or multi-divisional) company.

A **divisional structure** is formed when an organisation is split up into a number of self-contained business units, each of which operates as a profit centre. This may occur on the basis of product or market or a combination of the two, with each unit tending to operate along functional or product lines, but with certain key functions (e.g. finance, personnel, corporate planning) provided centrally, usually at company headquarters (see Figure 2.4).

The main benefit of the multi-divisional company is that it allows each part of what can be a very diverse organisation to operate semi-independently in producing and marketing its products, thus permitting each division to design its offering to suit local market conditions – a factor of prime importance where the firm operates on a multinational basis. The dual existence of divisional **profit centres** and a central unit responsible for establishing strategy at a global level can, however, be a source of considerable tension, particularly where the needs and aims of the centre appear to conflict with operations at the local level or to impose burdens seen to be unreasonable by divisional managers (e.g. the allocation of central overhead costs).

Much the same kind of arguments apply to the **holding company**, though this tends to be a much looser structure for managing diverse organisations, favoured by both UK

Figure 2.3 A product-based structure

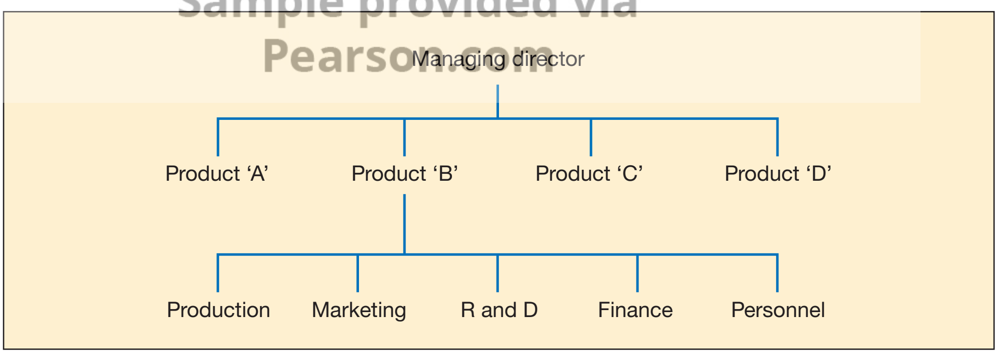
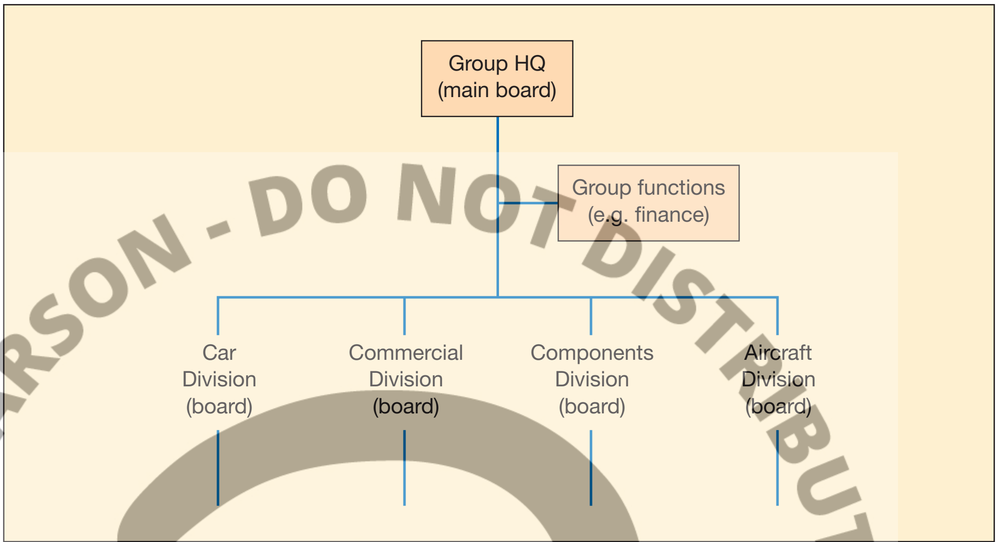


Figure 2.4 A divisional structure



and Japanese companies. Under this arrangement, the different elements of the organisation (usually companies) are coordinated and controlled by a parent body, which may be just a financial entity established to maintain or gain control of other trading companies. Holding companies are associated with the growth of firms by acquisition, which gives rise to a high degree of product or market diversification. They are also a popular means of operating a multinational organisation.

mini case Mergers and competition

In 2016 a £10.25 billion proposed acquisition was halted by the European Commission: Hutchinson-owned Three had planned to buy Telefónica-owned network provider O2, both one of four mobile network operators in the UK (the others being EE and Vodaphone). O2 and Three argued that combining their businesses to form one large company would mean that they were better able to compete with larger providers such as Sky and BT.

The European Commission argued that an O2–Three merger would change the structure of the market to leave only three competing businesses operating all of the networks in the UK (other smaller companies, such as Giffgaff, Sky Mobile and Tesco Mobile, only use the network run by the four network operators). The Commission argued that this would result in less competition and higher prices for customers across the sector.

O2 was originally formed between BT and Securicor, before being sold in 2005 to Telefónica, a Spanish company that also owns companies in Germany, Spain, France, Brazil, Columbia, the United States, and elsewhere. Mobile phone companies change hands quite frequently with relatively little difficulty. This is because business models and cultures are relatively similar. Consider which parts of the mobile phone company you encounter on a daily basis, and how long it would take to notice if your provider was sold to an international holding company.

web link For information on the proposed merger see, for example, *www.FT.com*

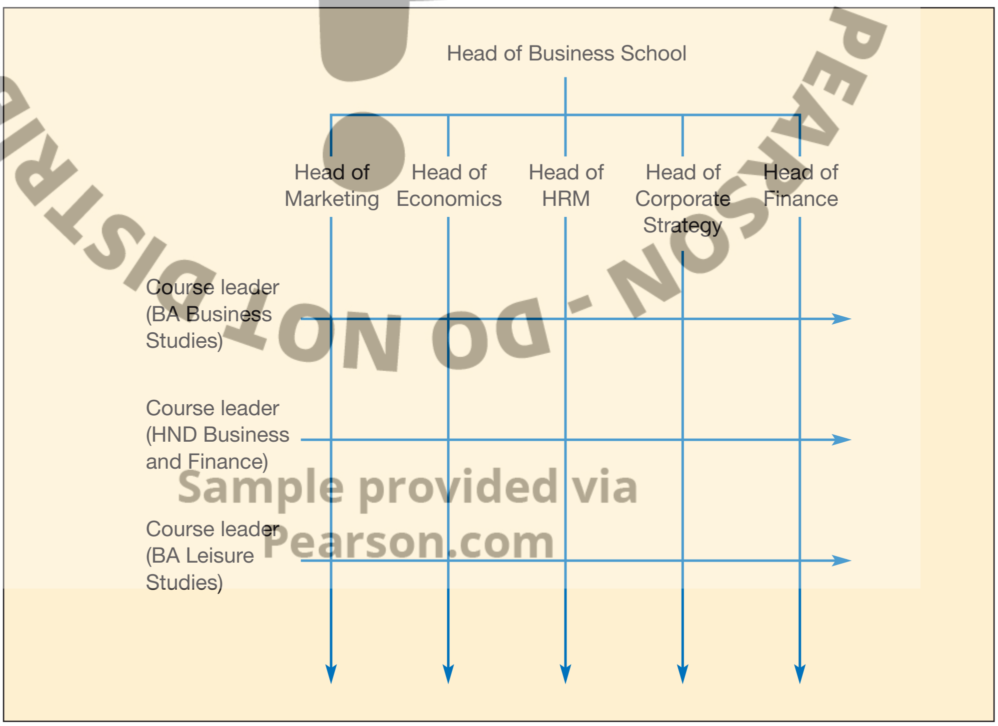
Matrix structures

A **matrix structure** is an arrangement for combining functional specialisation (e.g. through departments) with structures built around products, projects or programmes (see Figure 2.5). The resulting grid (or matrix) has a two-way flow of authority and responsibility. Within the functional elements, the flow is vertically down the line from superior to subordinate and this creates a degree of stability and certainty for the individuals located within the department or unit.

Simultaneously, as a member of a project group or product team, an individual is normally answerable horizontally to the project manager whose responsibility is to oversee the successful completion of the project, which in some cases may be of very limited duration.

Matrix structures offer various advantages, most notably flexibility, opportunities for staff development, an enhanced sense of ownership of a project or programme, customer orientation and the coordination of information and expertise. On the negative side, difficulties can include problems of coordination and control, conflicting loyalties for staff and uncertain lines of authority. It is not uncommon in an organisation designed on matrix lines for project or programme leaders to be unsure of their authority over the staff from the contributing departments. Nor is it unknown for functional managers to withdraw their cooperation and/or support for projects located outside their immediate sphere of influence.

Figure 2.5 A matrix structure in a business school



Project teams

Despite its flexibility, the matrix often has a degree of permanence; in contrast, the **project team** is essentially a temporary structure established as a means of carrying out a particular task, often in a highly unstable environment. Once the task is complete, the team is disbanded and individuals return to their usual departments or are assigned to a new project.

Fashioned around technical expertise rather than managerial rank, and often operating closely with clients, project teams are increasingly common in high-technology firms, construction companies and some types of service industry, especially management consultancies and advertising. Rather than being a replacement for the existing structure, they operate alongside it and utilise in-house staff (and, in some cases, outside specialists) on a project-by-project basis. While this can present logistical and scheduling problems and may involve some duplication of resources, it can assist an organisation in adapting to change and uncertainty and in providing products to the customer's specifications. Project teams tend to be at their most effective when objectives and tasks are well defined, when the client is clear as to the desired outcome and when the team is chosen with care.

The virtual organisation

As indicated above, traditional organisations have structures that are designed to facilitate the transformation of inputs into output. Increasingly, as the business environment changes, relationships both within and between organisations have needed to become more flexible and this has given rise to such developments as the growth in teleworking and the establishment of dynamic broker/agent networks involving considerable outsourcing of sub-tasks to 'agents' (e.g. manufacturing, distribution) by the core organisation (the 'broker'). It is fair to say that this demand for greater flexibility has been driven partly by the market and partly by cost considerations, and the process of change has been facilitated by relatively rapid developments in information technology. One area currently exciting the interest of writers on management and organisation is the concept of the **virtual organisation**, arguably the ultimate form of organisational flexibility (see Chapter 12 for a further discussion of the concept in the context of networking).

The term virtual organisation or firm signifies an extremely loose web of essentially freelance businesses or individuals who organise themselves to produce a specific customer product (e.g. an individual holiday package with particular features unique to the customer). Without any permanent structure or hierarchy this so-called firm can constantly change its shape and, despite existing across space and time, tends to appear edgeless, with its inputs, outputs and employees increasingly dispersed across the linked world of information systems. Given modern forms of communication, opportunities exist for the creation of totally electronic-based organisations trading in expertise and information with no real-world physical identity. This stands in stark contrast to the traditional view of the firm as an arrangement which adds value by transforming basic economic inputs (e.g. land, labour, capital) into physical outputs or services.

Structural change

Internal change is an important feature of the modern business organisation. In order to remain competitive and meet stakeholder needs, a firm may have to find ways to restructure its organisation as the environment in which it operates changes.

Solutions can range from a partial or wholesale shift in the organisation's structural form to strategies for reducing the overall size and shape of the company (e.g. **downsizing**) or a radical redesign of business processes (e.g. **re-engineering**).

Whereas business re-engineering normally connotes a root-and-branch reform of the way in which the business operates, downsizing essentially involves shrinking the organisation to make it leaner and fitter and hopefully more flexible in its response to the marketplace. For some companies this means little more than reducing the size of the workforce through natural wastage and/or redundancies, as and when opportunities arise; for others it involves delayering the organisation by removing a tier, or tiers, of management, thus effectively flattening the organisation's hierarchy and helping it to reduce its unit costs of production.

In its most systematic and long-term form, downsizing can be used as a vehicle for cultural change through which an organisation's employees are encouraged to embrace notions of continuous improvement and innovation, and to accept that structural reform is a permanent and natural state of affairs. Under this approach, retraining and reskilling become vital tools in implementing the chosen strategy and in shaping the organisation to meet the demands of its changing environment. The danger is, however, that a firm may become too concerned with restructuring as a cure for all its problems, when the real cause of its difficulties lies in its marketplace. Cutting the number of employees, in such a situation, is unlikely to make unattractive products attractive, nor is it likely to boost morale within the organisation.

Aspects of functional management

Most organisational structures reflect a degree of **functional specialisation**, with individuals occupying roles in departments, units or sections which have titles such as Production, Finance, Marketing, Personnel, and Research and Development. These functional areas of the internal organisation, and the individuals who are allocated to them, are central to the process of transforming organisational inputs into output. The management of these functions and of the relationships between them will be a key factor in the success of the enterprise and in its ability to respond to external demands for change.

The interdependence of the internal functions can be demonstrated by a simple example. Providing goods and services to meet the market's needs often involves research and development, which necessitates a financial input, usually from the capital market or the organisation's own resources. It also requires, as do all the other functions, the recruitment of staff of the right quality, a task which is more often than not the responsibility of the personnel or human resources department. If research and development activities lead to a good idea which the marketing department is able to sell, then the production department is required to produce it in the right quantities, to the right specifications and at the time the market needs it.

This depends not only on internal scheduling procedures within the production department, but also on having the right kinds of materials supplied on time by the purchasing department, an appropriate system of quality control and work monitoring, machinery that is working and regularly serviced, the finished items packed, despatched and delivered, and a multitude of other activities, all operating towards the same end.

The extent to which all of these requirements can be met simultaneously depends on internal factors, many of which are controllable, and also on a host of external influences, the majority of which tend to be beyond the organisation's control. To demonstrate this interface between the internal and external environments, two key areas of functional management are discussed briefly below – marketing and human resource management. An examination of the other functions within the organisation would yield similar findings.

Human resource management (HRM)

People are the key organisational resource; without them organisations would not exist or function. All businesses need to plan for and manage the people they employ if they are to use this resource effectively and efficiently in pursuit of their objectives. In modern and forward-looking organisations this implies a proactive approach to the management of people that goes beyond the bounds of traditional personnel management and involves the establishment of systems for planning, monitoring, appraisal and evaluation, training and development, and integrating the internal needs of the organisation with the external demands of the marketplace. Such an approach is associated with the idea of **human resource management**.

As in other areas of management, HRM involves a wide variety of activities related to the formulation and implementation of appropriate organisational policies, the provision of opportunities for monitoring, evaluation and change, and the application of resources to the fulfilment of organisational ends. Key aspects of 'people management' include:

- recruitment and selection;
- working conditions;
- training and career development;
- job evaluation;
- employee relations;
- human resource planning;
- legal aspects of employment.

In most, if not all, cases these will be affected by both internal and external influences (e.g. size of the firm, management style, competition, economic and political developments), some of which will vary over time as well as between organisations.

The provision of these activities within an organisation can occur in a variety of ways and to different degrees of sophistication. Some very small firms may have little in the way of a recognisable HRM function, being concerned primarily with questions of hiring and firing, pay and other working conditions, but not with notions of career development, staff appraisal or job enrichment. In contrast, very large companies may have a specialist HRM or personnel department, often organised on functional lines and responsible for the formulation and implementation of personnel policies throughout the organisation. Such centralisation provides not only some economies of scale, but also a degree of standardisation and consistency across departments. To allow for flexibility, centralised systems are often combined with an element of decentralisation which permits individual departments or sections to exercise some influence in matters such as the recruitment and selection of staff, working conditions, training and career development.

To illustrate how the different aspects of HRM are influenced by external factors, one part of this function – recruitment and selection of staff – has been chosen. This is the activity within the organisation that seeks to ensure that it has the right quantity and quality of labour in the right place and at the right time to meet its requirements at all levels. To achieve this aim, the organisation initially needs to consider a large number of factors, including possible changes in the demand for labour, the need for new skills and likely labour turnover, before the processes of recruitment and selection can begin. These aspects in turn will be conditioned by a variety of factors such as changes in the demand for the product, the introduction of new technology, and social, economic and demographic changes, some of which may not be anticipated or expected by strategic planners.

Once recruitment and selection are ready to begin, a further raft of influences will impinge upon the process, some of which emanate from external sources. In drawing up a job specification, for example, attention will normally need to be paid to the state of the local labour market, including skill availability, competition from other employers, wage rates in comparable jobs and/or organisations, and socio-demographic trends. If the quality of labour required is in short supply, an organisation may find itself having to offer improved pay and working conditions simply to attract a sufficient number of applicants to fill the vacancies on offer.

Equally, in fashioning its job advertisements and drawing up the material it sends out to potential applicants, a firm will need to pay due attention to the needs of current legislation in areas such as equal opportunities, race discrimination and employment protection, if it is not to infringe the law.

Among the other external factors that the enterprise may need to take into consideration in recruiting and selecting staff will be:

- the relative cost and effectiveness of the different advertising media at reaching people with the desired skills;
- existing relationships with external sources of recruitment (e.g. job centres, schools, colleges, universities);
- commitments to the local community;
- relationships with employee organisations (e.g. trade unions, staff associations);
- opportunities for staff training and development in training and educational institutions.

Ideally, it should also pay some attention to possible future changes in the technology of the workplace, in order to recruit individuals either with appropriate skills or who can be retrained relatively easily with a minimum amount of disruption and expense to the organisation.

The marketing function

The processes of HRM are a good illustration of the interactions between a firm's internal and external environments. An even better example is provided by an examination of its marketing activities, which are directed primarily, though not exclusively, towards what is happening outside the organisation.

Like 'management', the term **marketing** has been defined in a wide variety of ways, ranging from Kotler's essentially economic notion of an activity directed at satisfying human needs and wants through exchange processes, to the more managerial definitions associated with bodies such as the Chartered Institute of Marketing. A common thread running through many of these definitions is the idea that marketing is concerned with meeting the needs of the consumer in a way that is profitable to the enterprise. Hence, strategic marketing management is normally characterised as the process of ensuring a good fit between the opportunities afforded by the marketplace and the abilities and resources of an organisation operating in it.

web link

Information about the Chartered Institute of Marketing is available at *www.cim.co.uk*

This notion of marketing as an integrative function within the organisation – linking the needs of the consumer with the various functional areas of the firm – is central to modern definitions of the term and lies at the heart of what is known as the **marketing concept**. This is the idea that the customer is of prime importance to the organisation and that the most significant managerial task in any enterprise is first to identify the needs and wants of the consumer and then to ensure that its operations are geared to meeting those requirements profitably. Though it would be true to say that not all organisations subscribe to this view, it is generally accepted that the successful businesses are predominantly those with a customer rather than a production or sales orientation. Equally, the evidence suggests that the need to adopt such a customer-centred approach applies not only to private sector trading organisations, but also increasingly to public sector enterprises and to bodies not established for the pursuit of profits but for other purposes (e.g. charities, political parties, trade unions).

When viewed from a customer perspective, marketing can be seen to comprise a range of activities that goes beyond the simple production of an item for sale. These activities include:

- identifying the needs of consumers (e.g. through market research);
- designing different 'offerings' to meet the needs of different types of customers (e.g. through market segmentation and positioning);
- choosing products, prices, promotional techniques and distribution channels that are appropriate to a particular market (i.e. designing a 'marketing mix' strategy);
- undertaking market and product planning;
- deciding on brand names, types of packages and methods of communicating the product to the customer;
- creating a marketing information system.

As already indicated, in carrying out these activities the firm is brought into contact with a range of external influences of both an immediate and an indirect kind. This external marketing environment can have a fundamental impact on the degree to which the firm is able to develop and maintain successful transactions with its customers and hence on its profitability and chances of survival.

To illustrate how a firm's marketing effort can be influenced by external factors, the following brief discussion focuses on 'pricing', which is one of the key elements of the **marketing mix**: that is, the set of controllable variables that a business can use to influence the buyer's response, namely product, price, promotion and place – the 4Ps. Of all the mix elements, price is the only one that generates revenue, while the others result in expenditure. It is therefore a prime determinant of a firm's turnover and profitability and can have a considerable influence on the demand for its products and frequently for those of its competitors (see Chapter 15).

web link

There are lots of useful websites discussing the idea of the 'marketing mix'. Try typing the term into Google.

Leaving aside the broader question of a firm's pricing goals and the fact that prices will tend to vary according to the stage a product has reached in its life cycle, price determination can be said to be influenced by a number of factors. Of these, the costs of production, the prices charged by one's competitors and the price sensitivity of consumers tend to be the most significant.

In the case of cost-based pricing, this occurs when a firm determines its price based on the cost of buying or producing the product and adding a profit margin or 'mark- up' to arrive at the final selling price. Such an approach tends to be common among smaller enterprises and retailers (e.g. builders, corner shops) where costs are often easier to estimate and where likely consumer reactions are given less attention than the need to make an adequate return on the effort involved. The essential point about this form of price determination is that many of the firm's costs are influenced by external organisations – including the suppliers of materials, components and energy – and hence pricing will often vary according to changes in the prices of inputs. Only larger organisations, or a group of small businesses operating together, will generally be able to exercise some influence over input prices and even then not all costs will be controllable by the enterprise.

Organisations that take an essentially cost-based approach to pricing will sometimes be influenced by the prices charged by competitors – particularly in markets where considerable competition exists and where the products are largely homogeneous and a buyer's market is evident (e.g. builders during a recession). The competitive approach to pricing, however, is also found in markets where only a few large firms operate and where the need to increase or maintain market share can give rise to virtually identical prices and to fierce non-price competition between the market leaders (see Chapter 16). In the UK, for instance, a big cross-Channel ferry operator will normally provide the service to customers at the same price as its rivals, differentiating its offering in terms of additional benefits (e.g. on-board entertainment) rather than price. Where this is the case, the external demands of the market rather than costs constitute the primary influence on a firm's decisions, and changes in market conditions (e.g. the actual or potential entry of new firms; changes in a competitor's prices; economic recession) will tend to be reflected in price changes.

This idea of market factors influencing pricing decisions also applies to situations where firms fix their prices according to the actual or anticipated reactions of consumers to the price charged for a product – known in economics as the price elasticity of demand (see Chapter 15). In this case, the customer rather than a firm's competitors is the chief influence on price determination, although the two are often interrelated in that consumers are usually more price sensitive in markets where some choice exists. Differential levels of price sensitivity between consumers of a product normally arise when a market has distinct segments based on factors such as differences in income or age or location. In such cases a firm will often fix its prices according to the segment of the market it is serving, a process known as 'price discrimination' and one that is familiar to students and older people claiming concessionary fares on public transport.

While the above discussion has been oversimplified and does not take into account factors such as the price of other products in an organisation's product portfolio (e.g. different models of car), it illustrates quite clearly how even one of the so-called controllable variables in a firm's marketing mix is subject to a range of external influences that is often beyond its ability to control. The same argument applies to the other elements of the marketing function, and students could usefully add to their understanding of the internal/external interface by examining how the external environment impinges upon such marketing activities as promotion, distribution or market research.

Synopsis

The internal dimension of business organisations constitutes an extensive field of study and one to which students of business devote a considerable amount of time. In seeking to illustrate how a firm's internal organisation is influenced by its external environment, emphasis has been placed on a selected number of aspects of a firm's internal operations. Of these, its structure and functions were seen to provide a good illustration of the interface between the internal and external environments.

Appreciating the existence of this interface is facilitated by adopting a systems approach to organisational analysis.

Summary of key points

- Management is a key aspect of the internal environment of the business organisation.
- Theories of organisation and management fall broadly into three categories: classical theories, human relations approaches, systems approaches.
- The systems view of organisations depicts businesses as open systems interacting with their external environment as they convert inputs into outputs.
- The external environment of the organisation affects all aspects of the business, including its structures, functions and processes.
- To carry out their tasks, businesses can structure themselves in a variety of ways, including functionally, by product/service, by divisions, in a matrix format or via project teams. Each has its advantages and disadvantages.
- Structural change tends to be a feature of large modern organisations.

- Within the organisation, the different business functions such as marketing, production, HRM, purchasing, and so on are influenced by external factors of both a general and operational kind.
- An examination of the marketing and HRM functions reveals the importance of the wide range of external influences that can impinge upon these day-to-day areas of organisational work.
- Investigations of other functional areas within the organisation would produce a similar picture.

case study Reshuffle at Microsoft

When an organisation's fortunes appear to change for the worse, there is always a temptation to seek a remedy through a change in senior personnel and/or in the overall structure of the enterprise (e.g. leading professional football teams in Europe seem to change managers fairly regularly when results go badly). Whether this is invariably a good idea is open to question. Supporters see it as a way of revitalising the business by bringing in new faces with new ideas, of challenging existing ways of thinking and working; critics frequently portray it as 'rearranging the deckchairs on the *Titanic*', a failure to address the fundamental problem(s) facing the organisation. Time will tell which of these two viewpoints applies to the global business examined in this case study.

In 2013, faced with a demonstrable shift in consumer demand away from PCs and towards tablets, smartphones and touch devices – where it was struggling to compete with companies such as Apple and Google – Microsoft Chief Executive Steve Ballmer announced a major reorganisation of the business. Aimed at promoting faster innovation and a much sharper focus on meeting consumer needs, Ballmer heralded the demise of the divisional approach favoured by his predecessor (Bill Gates), which was evidently seen as creating a hierarchical structure of competing businesses, each with its own strategy and with separate finance and marketing teams. The centrepiece of the 2013 arrangements was the organisation of the business on the basis of function. Instead of divisions, Microsoft operated via a number of functional groupings, including engineering, marketing, finance, advanced strategy and research, and business development and evangelism. In what is likely to prove an important change, the engineering division will be split into four major areas or groupings: operating systems, devices and studios, applications and services, cloud and enterprise. Responsibility for running the main functions within the new organisation will be vested in a reshuffled senior executive team.

Commenting in 2013, the *Guardian* suggested that they were reminiscent of the reorganisation undertaken by its rival Apple the previous year. This, it suggested, had been designed to encourage even greater collaboration between various aspects of the business: the world-class hardware, its software and its services teams.

This was the most major reorganisation in Microsoft's long history. The company seems to reconsider how it organizes employees every year, with changes implemented each July. Microsoft announced two reorganisations in 2017, first of its cloud, enterprise and artificial intelligence sections, and most recently of its sales divisions. Much of the change is driven by slower than expected sales of hardware such as tablets and PCs, and greater than expected sales of cloud computing services based at its own data centres, such as Azure. In 2020 and 2021, both reorganisations refocused the companies deployment of resources to support cloud services and sales. In particular Microsoft Azure, its cloud services platform, has been both an engine of growth and a source of demand for more staff.

Existing structure can sometimes be an aid and sometimes an obstacle to a firm achieving its strategic objectives. Where the latter is the case, a partial or even radical restructuring of the organisation may be a necessary condition for putting the business on the right track. As this series of reorganisations has shown, arrangements need constant review to make sure that businesses are able to suit the needs and demands of the market.

Case study questions

1 What are thought to be the main advantages of restructuring an organisation that is facing problems?

2 Why is a decision to restructure an organisation unlikely to prove a 'sufficient condition' for its future success?

case study Thomas Cook expansion

The travel agent Thomas Cook announced a deal with the Chinese company Fosun in 2015. In return for 5 per cent of its company, Thomas Cook would take control of Club Méditerranée (Club Med) from the Fosun Group, operating its hotels directly rather than just profiting from selling bookings at the destination. The new partnership has also enabled Thomas Cook to draw on the knowledge of its new partners to develop opportunities in the Chinese market, as well as access to the other company's assets.

Thomas Cook plans to develop further partnerships to gain access to more resorts, destinations and markets with other regional operators. It may also be able to get further funding from new investing partners. By bringing together companies in these sorts of deals Thomas Cook can profit as both a seller and a provider of services.

Case study questions

1 What factors might Thomas Cook look for in new potential partners, and can you identify any likely collaborators in this market?

2 How might a large company's structure have to adapt to incorporate an acquired chain, as happened with Thomas Cook and Club Med?

Review and discussion questions

1 In the systems approach to organisations, reference is made to 'feedback'. What is meant by this term and how can feedback influence the process of transforming 'inputs' into 'output'?

2 Should a firm's internal structure be influenced by considerations of management or by the market it serves? Are the two incompatible?

3 Examine ways in which a firm's external environment can influence one of the following functional areas: finance or production or research and development.

4 Describe the structure of an organisation with which you are familiar (e.g. through employment or work experience), indicating why the organisation is structured in the way it is. Are there any alternative forms of structure the organisation could adopt?

Assignments

1 As a student on a business-related course, you have decided to get some practical experience of the business world by running a small venture with a number of colleagues which you hope will also earn you enough income to support you during your time at college or university. Your idea involves printing and selling customised T-shirts throughout the institution and possibly to a wider market. Design an appropriate organisational structure which you feel will help you achieve your objectives, indicating your rationale for choosing such a structure and the formal pattern of relationships between individuals.

2 In self-selecting groups of three or four, identify an organisation that you feel has a bureaucratic structure. Produce a report indicating:

(a) those features of the organisation's structure, management and operations that best fit the idea of bureaucracy;

(b) the practical consequences of these features for the working of the organisation.

Give examples to support your comments.

Further reading

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