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Professional Paper

BUSINESS ENVIRONMENT ANALYSIS AS A KEY STAGE IN THE PROCESS OF STRATEGIC MANAGEMENT

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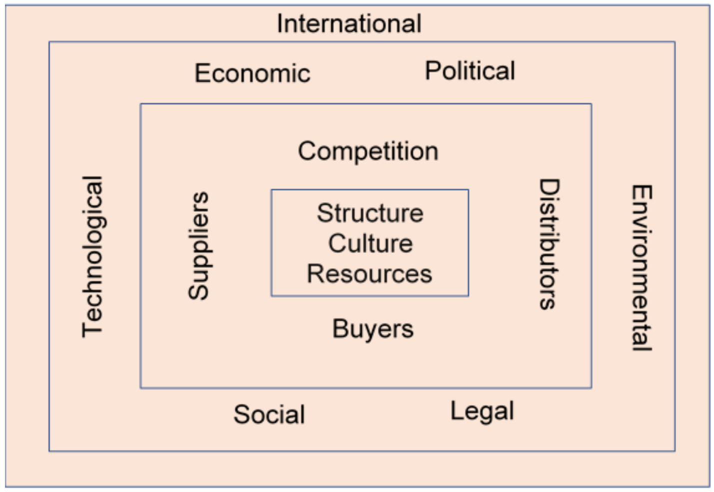
Abstract
As noted in all modes of strategic management, no author yet has failed in recognizing business environment analysis as a key state in the process of strategic management. Tens of techniques for analyzing the external and internal environment have been developed by companies, researchers, research centers and universities worldwide. Some of them more, and others less famous, these techniques provide a platform upon which other strategic and business analysis in general, can and should be constructed. If achieving and maintaining a competitive edge is the main focus of strategic management, strategies and management in general, then environment analysis is a key factor in finding ways to be flexible and adapt internal forces to external pressures and changes.
Keywords: environmental analysis, techniques, competitive advantage, strategic management

1. The very essentials of environment analysis

Business organizations do not exist and function in a vacuum. They are open systems constantly interacting with their environment, constantly being influenced by their environment, and trying to adapt in order to minimize the risks and utilize any chances, opportunities that might surface. Having this in mind, and the fact that all model of strategic management introduces environmental analysis as the basic step in the process of strategic management, the immense importance of evaluating the company's environment becomes even more expressed.

Organizations are part of an open system in which they are constantly interacting with other organizations and individuals – including their customers, suppliers, financiers and competitors. Furthermore, they are exposed to continuous change and uncertainty in the wider external environment. Environmental analysis, or developing an understanding of the business environment, is a critical early stage in the strategy process. (Winfield *et al, 2004, pp.339)*

The generally accepted approach is the one that classifies two broad types of environments, that is the external and the internal environment. The external environment in turn, includes the general environment and the industry environment while the main elements of the internal environment are considered to be structure, culture and resources.



Graph. 1 The environment

Strictly speaking, a company's macro-environment encompasses all of the relevant factors making up the broad environmental context in which a company operates; by relevant, we mean the factors are important enough that they should shape management's decisions regarding the company's long-term direction, objectives, strategy, and business model. The relevance of macro-environmental factors can be evaluated using PESTEL analysis, an acronym for the six principal components of the macro-environment: political factors, economic conditions in the firm's general environment, sociocultural forces, technological factors, environmental forces, and legal/ regulatory factors.(Gamble *et al, 2015, pp.38).*

Internal analysis is concerned with providing management with a detailed understanding of the business, how effective its current strategies are and how effectively it has deployed its resources in support of its strategies. In recent years the importance of internal analysis has been given greater emphasis because recent research has suggested that it is predominantly the actions of the business itself that determine its ability to outperform competitors. Internal analysis aims to provide the managers of a business with an understanding of its potential for competitive advantage and, equally, of those areas where it must take remedial action to ensure its survival (Campbell *et al, 2002, pp.31)*. The internal environment will be analyzed as part of the VRIO framework and the value chain analysis.

Table 1. Environmental influences (Thompson & Martin, 2015, pp.170)

Influence	Threats and opportunities
The economy	The strength of the economy influences the availability of credit and the willingness of people to borrow. This affects the level of demand. Interest rates and currency fluctuations affect both the cost and demand of imports and exports.
Capital markets	This includes shareholders, and their satisfaction with company success. Are they willing to buy more shares if offered them to increase equity funding? Would they willingly sell if someone bid for the organization? Also included are the banking system, and the cost and availability of loan capital.
Labor market	Changes in structure with an ageing population and more. Women seeking work Availability of skills, possibly in particular regions Influence of trade unions Contribution of government training schemes
Technology	Robotics in manufacturing in industries such as car assembly Computers for design and manufacturing Information technology such as electronic point of sale in retailing
Socio cultural environment	Pressure groups affecting demand or industry location Changing population – by age groups Changing tastes and values Regional movements
Government	Regional aid policies Special industry initiatives, e.g. where high technology is involved The legal environment is part of this, including the regulation of competition Restraints on car exhaust emissions (pollution control) and labelling requirements would be other examples
Suppliers	Availability and cost of supplies, possibly involving vertical integration and decisions concerning whether to make or buy-in essential components
Customers	Changes in preferences and purchasing power Changes in the distribution system
Competitors	Changes in competitive strategies Innovation
The media	Effects of good and bad publicity, drawing attention to companies, products and services
Source: John Thompson, Frank Martin: Strategic Management: Awareness and Change, Fifth edition, Thomson, 2005, pp. 170	

2. The very essentials of the common environment analysis techniques

2.1. Pestel

There are several models for microenvironment analysis, almost all building up from the PEST analysis, an analysis including political, economic, socio - cultural and technological factors. They include amongst others the PESTEL analysis that is the analysis of political, economic, socio-cultural technological, environmental, and legal factors and the PESTLE analysis that is the analysis of political, economic, socio-cultural technological, legal and environmental factors.

In fact, PEST analysis at its core is usually attributed to Francis Aguilar and his 1967 “Scanning the Business Environment” in which he introduced a framework of economic, technical, political and social factors (ETPS framework). In the years that followed much renaming of the framework were done, but PEST prevailed for some reason. During the last decade PESTEL and PESTLE variations of the framework have gained in significance. The PESTEL analysis includes six main components of the general environment, as presented in table 2.

Table 2. The Six Components of the Macro-Environment Included in a PESTEL Analysis (Gamble et al, 2015, pp.39-40)

Component	Description
Political factors	These factors include political policies and processes, including the extent to which a government intervenes in the economy. They include such matters as tax policy, fiscal policy, tariffs, the political climate, and the strength of institutions such as the federal banking system. Some political factors, such as bailouts, are industry-specific. Others, such as energy policy, affect certain types of industries (energy producers and heavy users of energy) more than others
Economic conditions	Economic conditions include the general economic climate and specific factors such as interest rates, exchange rates, the inflation rate, the unemployment rate, the rate of economic growth, trade deficits or surpluses, savings rates, and per capita domestic product. Economic factors also include conditions in the markets for stocks and bonds, which can affect consumer confidence and discretionary income. Some industries, such as construction, are particularly vulnerable to economic downturns but are positively affected by factors such as low interest rates. Others, such as discount retailing, may benefit when general economic conditions weaken, as consumers become more price-conscious.
Sociocultural forces	Sociocultural forces include the societal values, attitudes, cultural factors, and lifestyles that impact businesses, as well as demographic factors such as the population size, growth rate, and age distribution. Sociocultural forces vary by locale and change over time. An example is the trend toward healthier lifestyles, which can shift spending toward exercise equipment and health clubs and away from alcohol and snack foods. Population demographics can have large implications for industries such as health care, where costs and service needs vary with demographic factors such as age and income distribution.
Technological factors	Technological factors include the pace of technological change and technical developments that have the potential for wide-ranging effects on society, such as genetic engineering and nanotechnology. They include institutions involved in creating knowledge and controlling the use of technology, such as R&D consortia, university-sponsored technology incubators, patent and copyright laws, and government control over the Internet. Technological change can encourage the birth of new industries, such as those based on nanotechnology, and disrupt others, such as the recording industry.
Environmental forces	These include ecological and environmental forces such as weather, climate, climate change, and associated factors like water shortages. These factors can directly impact industries such as insurance, farming, energy production, and tourism. They may have an indirect but substantial effect on other industries such as transportation and utilities.
Legal and regulatory factors	These factors include the regulations and laws with which companies must comply such as consumer laws, labor laws, antitrust laws, and occupational health and safety regulation. Some factors, such as banking deregulation, are industry-specific. Others, such as minimum wage legislation, affect certain types of industries (low-wage, labor-intensive industries) more than others.

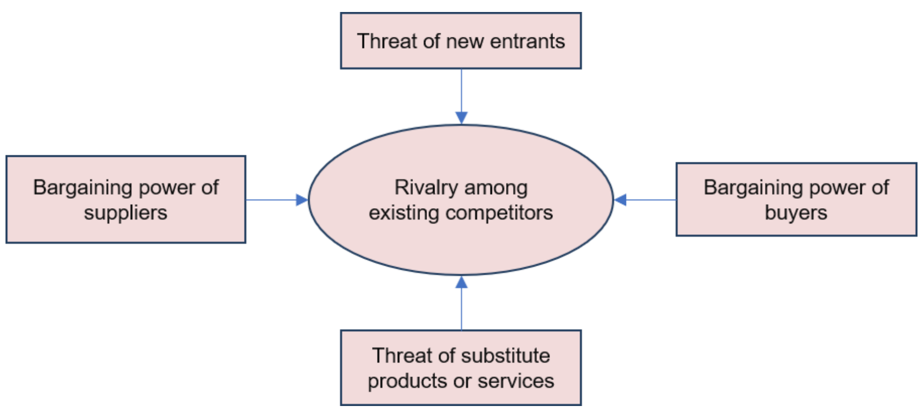
The PESTEL/PESTLE analysis has many advantages and disadvantages, tab.3.

Table 3. PESTEL advantages and disadvantages (Rastogi, Trivedi)

Advantages	Disadvantages
▪ The tool is simple and easy to understand and use. ▪ The tool helps understand the business environment better. ▪ The tool encourages the development of strategic thinking. ▪ The tool helps reduce the effect of future business threats. ▪ Can help an organisation to anticipate future difficulties and take action to avoid or minimize their effect. ▪ The tool enables projects to spot new opportunities and exploit them effectively.	▪ The tool allows users to over-simplify the data that is used. It is easily possible to miss important data. ▪ The tool needs to be updated regularly to be effective. ▪ The tool is most effective when users come from different perspectives and departments. ▪ The tool requires users to have access to data sources which could be time consuming and expensive. ▪ Much of the data used by the tool is on an assumption basis. ▪ The business environment is changing drastically. Thus, it is becoming increasingly difficult for projects to anticipate developments. ▪ Users must not succumb to "Paralysis by Analysis "where they gather too much information and forget the objective of this tool which is identification of potential threats so that proper action can be taken.

2.2. The five forces model

The five forces model introduced by Michael Porter introduces five forces affecting competition: industry rivalry, market entry, substitutability, suppliers and customers.



Graph. 2 The five forces model (Porter, 2008)

The threat of substitute products or services is a measure of the ease with which customers can find substitutes for an industry's products or services. If customers can easily find substitute products or services, the competition will be greater, and profits will be lower. If there are few or no substitutes, competition will be weaker and profits will be higher (Williams, 2011, pp.203).Substitutes limit the potential returns of an industry by placing a ceiling on the prices that firms in that industry can profitably charge. The more attractive the price/performance ratio of substitute products, the tighter the lid on an industry's profits. Identifying substitute products involves searching for other products or services that can perform the same function as the industry's offerings. This may lead a manager into businesses seemingly far removed from the industry. For example, the airline industry might not consider video cameras much of a threat. But as digital technology has improved and wireless and other forms of telecommunication have become more efficient, teleconferencing has become a viable substitute for business travel. That is, the rate of improvement in the price–performance relationship of the substitute product (or service) is high (Dess *et al, 2014, pp.53)*.

The threat of new entry in the market depends on the presence and intensity of certain entry barriers, such as (Johnson *et al, 2005, pp.81, 82)*:

- Economies of scale. In some industries, economies of scale are extremely important: for example, in the production of automobiles, in distribution (e.g. brewing) or in sales and marketing (e.g. advertising costs for fast-moving consumer goods).
- The capital requirement of entry. The capital cost of entry will vary according to technology and scale.
- Access to supply or distribution channels. In many industries manufacturers have had control over supply and/or distribution channels. Sometimes this has been through direct ownership (vertical integration); sometimes just customer or supplier loyalty.
- Customer or supplier loyalty. It is difficult for a competitor to break into an industry if there are one or more established operators that know the industry well and have good relationships with the key buyers and suppliers.
- Experience. Early entrants into an industry gain experience sooner than others. This can give them advantage in terms of cost and/or customer/supplier loyalty.
- Expected retaliation. If an organisation considering entering an industry believes that the retaliation of an existing firm will be so great as to prevent entry, or mean that entry would be too costly, this is also a barrier.
- Legislation or government action. Legal restraints on competition vary from patent protection, to regulation of markets (e.g. pharmaceuticals and insurance), through to direct government action.
- Differentiation. By differentiation is meant the provision of a product or service regarded by the user as higher perceived value than the competition.

Table 4. Bargaining power of byers and suppliers according to Porter (Porter, 2008)

Bargaining power of buyers	Bargaining power of suppliers
▪ It concentrates or purchases large volumes relative to supplier sales. ▪ The products purchased represent a significant fraction of the buyer's costs or purchases. ▪ The products it purchases are standard or undifferentiated. ▪ It faces few switching costs. ▪ It earns low profits creating the incentive to lower purchasing costs. ▪ It poses a threat of backward integration whereby the buyer places pressure on suppliers by suggesting that they will create the product or perform the service in-house. ▪ The products being bought are unimportant [have little to do with] to the quality of the buyer's products or services. ▪ The buyer has full information, giving it greater negotiating leverage.	▪ It is dominated by only a few companies and is more concentrated than the industry in which it sells. ▪ It does not contend with substitute products. ▪ The industry of the buyer is not an important customer of the supplier. ▪ The supplier's product is critical to the buyer's business. ▪ The supplier's group's products are differentiated or have high switching costs. ▪ The supplier (or supplier group) poses a threat of forward integration, meaning it can potentially enter the buyer's business.

Byers become more powerful as contrasted to the organization, in particular (Barney & Hesterly, 2012, pp.46, 47):

- First, if a firm has only one buyer, or a small number of buyers, these buyers can be very threatening.
- Second, if the products or services that are being sold to buyers are standard and not differentiated, then the threat of buyers can be greater.
- Third, buyers are likely to be more of a threat when the supplies they purchase are a significant portion of the costs of their final products. In this context, buyers are likely to be very concerned about the costs of their supplies and constantly on the lookout for cheaper alternatives.
- Fourth, buyers are likely to be more of threat when they are not earning significant economic profits. In these circumstances, buyers are likely to be very sensitive to costs and insist on the lowest possible cost and the highest possible quality from suppliers.
- Finally, buyers are more of a threat to firms in an industry when they have the ability to vertically integrate backward. In this case, buyers become both buyers and rivals and lock in a certain percentage of an industry's sales.

Competitive rivalry becomes more intense in the following cases:

- Numerous or equally balanced competitors. Slow industry growth necessitating the need to maintain or expand market share. High fixed or storage costs pressuring firms to fill available capacity.
- Lack of differentiation or switching costs where products or services are viewed as commodities.
- Capacity increased in large increments requiring economies of scale. Can be disruptive to the industry’s supply/demand balance and creates the risk of overcapacity and price cutting.
- Diverse competitors, such as foreign entrants or sole proprietor businesses that are indifferent to subnormal rates of return on invested capital, cause rivalry. Foreign firms may “dump” product on a market and smaller owner-operator firms managing a “life-style” company simply don’t need the return rate required of larger established firms.
- High strategic stakes where market presence and market share rivalry create the potential to sacrifice profitability.

2.3. The VRIO framework

As noted earlier, structure, culture and resources are the three main elements of the internal environment. Since structure and culture will be addresses later on in this text, resources will be analyzed in this part. In fact,, the VRIO model has to do with organizational resources in terms of their specifics.

When it comes to resources it should be noted that the resources category is quite broad since In fact, it includes everything that gets spent in the production process. Their importance is quite obvious having in mind those resources include almost everything starting from the physical assets and up to the available human resources of an organization. In general resources are classified into tangible and intangible resources, tab. 5.

Table 5. Tangible and intangible resources (Gamble,205)

Tangible resources	Intangible resources
▪ Physical resources —state-of-the-art manufacturing plants and equipment, efficient distribution facilities, attractive real estate locations, or ownership of valuable natural resource deposits. ▪ Financial resources —cash and cash equivalents, marketable securities, and other financial assets such as a company's credit rating and borrowing capacity. ▪ Technological assets —patents, copyrights, superior production technology, and technologies that enable activities. ▪ Organizational resources —information and communication systems (servers, workstations, etc.), proven quality control systems, and strong network of distributors or retail dealers.	▪ Human assets and intellectual capital —an experienced and capable workforce, talented employees in key areas, collective learning embedded in the organization, or proven managerial know-how. ▪ Brand, image, and reputational assets —brand names, trademarks, product or company image, buyer loyalty, and reputation for quality, superior service. ▪ Relationships —alliances or joint ventures that provide access to technologies, specialized know-how, or geographic markets, and trust established with various partners. ▪ Company culture —the norms of behavior, business principles, and ingrained beliefs within the company.

The Danish economist and management theorists Birger Wernerfelt in a 1984 paper introduced the RBV (Resource based view of the company). In fact, he argues that (Wernerfelt, 1984):

- By a resource is meant anything which could be thought of as a strength or weakness of a given firm.
- If the production of a resource itself or of one of its critical inputs is controlled by a monopolistic group, it will, ceteris paribus, diminish the returns available to the users of the resource and nn equally bad situation can occur on the output side if the products resulting from use of the resource can be sold only in monopsonistic markets.
- In some cases, a holder of a resource is able to maintain a relative position vis-a-vis other holders and third persons, as long as these act rationally.
- An entry barrier without a resource position barrier leaves the firm vulnerable to diversifying entrants, whereas a resource position barrier without an entry barrier leaves the jirm unable to exploit the barrier.
- Most resources can be used in several products. As a result, a given resource position barrier will often have consequences for several products, each yielding part of the resulting return.
- The general attractiveness of a resource, understood as its capacity to support a resource position barrier, is only a necessary, not a sufficient, condition for a given firm to be interested in it etc.

Years later the RBV was evolved by Jay Barney into the VRIO framework. But, Barney argues that there are two main reasons that make the RBV view incomplete that is (Barney & Hesterly, 2015, pp.87).

- First, different firms may possess different bundles of resources and capabilities, even if they are competing in the same industry. This is the assumption of firm resource heterogeneity. Resource heterogeneity implies that for a given business activity, some firms may be more skilled in accomplishing this activity than other firms.
- Second, some of these resource and capability differences among firms may be long lasting because it may be very costly for firms without certain resources and capabilities to develop or acquire them. This is the assumption of resource immobility.

In fact, VRIO is an acronym for the main characteristics that resources should have that is: valuable, rare, difficult to imitate and organized.

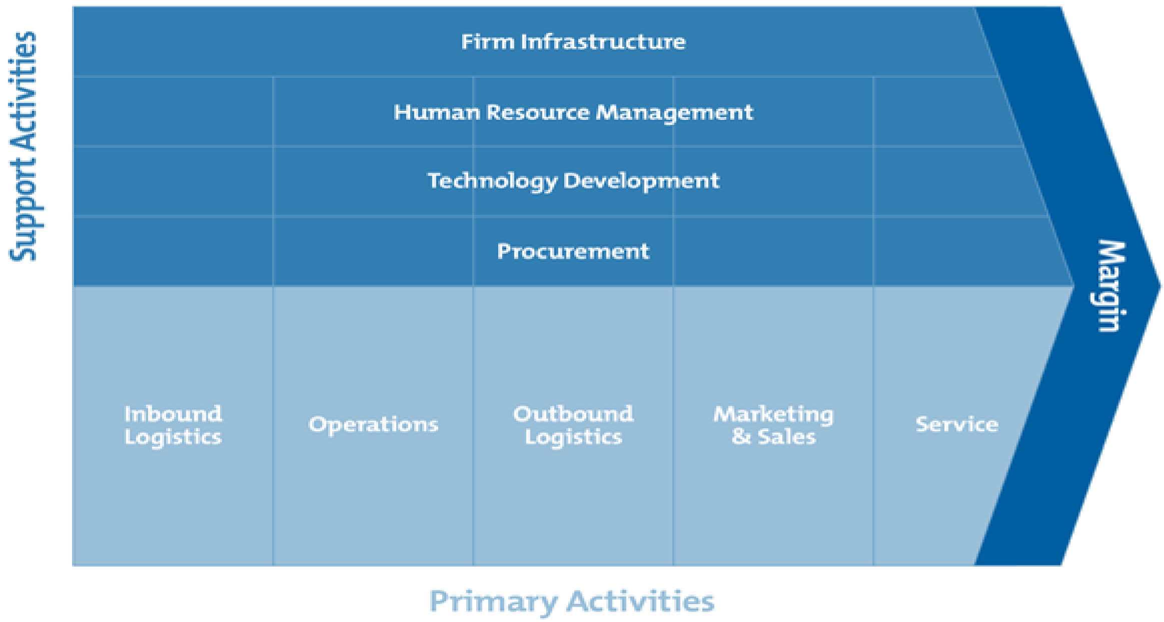
Table 6. The VRIO framework (is (Barney &Hesterly, 2015, pp.89-100).

Question	**Short explanation**
Value	The question of value is: “Do resources and capabilities enable a firm to exploit an external opportunity or neutralize an external threat?” If a firm answers this question with a “yes,” then its resources and capabilities are valuable and can be considered strengths. If a firm answers this question with a “no,” its resources and capabilities are weaknesses. There is nothing inherently valuable about a firm’s resources and capabilities. Rather, they are only valuable to the extent that they enable a firm to enhance its competitive position. Sometimes, the same resources and capabilities can be strengths in one market and weaknesses in another.
Rarity	If a particular resource or capability is controlled by numerous competing firms, then that resource is unlikely to be a source of competitive advantage for any one of them. Instead, valuable but common (i.e., not rare) resources and capabilities are sources of competitive parity. Only when a resource is not controlled by numerous other firms is it likely to be a source of competitive advantage. These observations lead to the question of rarity: “How many competing firms already possess particular valuable resources and capabilities?”
Imitability	Valuable and rare organizational resources, however, can be sources of sustained competitive advantage only if firms that do not possess them face a cost disadvantage in obtaining or developing them, compared to firms that already possess them. These kinds of resources are imperfectly imitable. These observations lead to the question of imitability: “Do firms without a resource or capability face a cost disadvantage in obtaining or developing it compared to firms that already possess it?”
Organization	A firm’s potential for competitive advantage depends on the value, rarity, and imitability of its resources and capabilities. However, to fully realize this potential, a firm must be organized to exploit its resources and capabilities. These observations lead to the question of organization: “Is a firm organized to exploit the full competitive potential of its resources and capabilities?”

2.4. Value chain analysis

The value chain framework was provided by Michael Porter in his 1985 ‘Competitive Advantage: Creating and Sustaining Superior Performance”. In fact,, Porter introduces the idea that the competitive advantage stems from different types of activities performed by the company and therefore a new systematic way of analyzing such activities, that is the value chain, is needed. The value chain itself is a part of a larger stream that Porter names the value system.

The value chain breaks a firm down into nine activities. Five of these—inbound logistics, operations, outbound logistics, marketing (which includes distribution and sales), and service—are primary in the sense that they represent a flow of goods and services from inputs (inbound logistics) to the sale and service of final outputs (marketing and service). The remaining four activities—technology development (in products and processes), procurement, human resource management, and infrastructure (which includes the organization’s reporting structure and its accounting and control systems)—are secondary in that they support, or are found in, each of the primary activities (Walker & Madsen, 2016, pp.142).



Graph. 3 The value chain (Porter, 1985, pp.37

The value chain displays total value and consists of value activities and margin. Value activities are the physically and technologically distinct activities a firm performs. These are the building blocks by which a firm creates a product valuable to its buyers. Margin is the difference between total value and the collective cost of performing the value activities. Margin can be measured in a variety of ways. Every value activity employ purchased inputs, human resources (labor and management), and some form of technology to perform its function. Each value activity also uses and creates information, such as buyer data (order entry), performance parameters (testing), and product failure statistics. Value activities may also create financial assets such as inventory and accounts receivable, or liabilities such as accounts payable (Porter, 1985, pp.39).The value activities themselves are divided into primary and supportive activities.

The primary activities include (Porter, 1985, pp.39-40):

- Inbound Logistics. Activities associated with receiving, storing, and disseminating inputs to the product, such as material handling, warehousing, inventory control, vehicle scheduling, and returns to suppliers.
- Operations. Activities associated with transforming inputs into the final product form, such as machining, packaging, assembly, equipment maintenance, testing, printing, and facility operations.
- Outbound Logistics. Activities associated with collecting, storing, and physically distributing the product to buyers, such as finished goods warehousing, material handling, delivery vehicle operation, order processing, and scheduling.
- Marketing and Sales. Activities associated with providing a means by which buyers can purchase the product and inducing them to do so, such as advertising, promotion, sales force, quoting, channel selection, channel relations, and pricing.
- Service. Activities associated with providing service to enhance or maintain the value of the product, such as installation, repair, training, parts supply, and product adjustment

The support activities in the value chain include the following (Porter, 1985, pp.40-43):

- Procurement. Procurement refers to the function of purchasing inputs used in the firm's value chain, not to the purchased inputs themselves. Purchased inputs include raw materials, supplies, and other consumable items as well as assets such as machinery, laboratory equipment, office equipment, and buildings.
- Technology Development. Technology development consists of a range of activities that can be broadly grouped into efforts to improve the product and the process.
- Human Resource Management. Human resource management consists of activities involved in the recruiting, hiring, training, development, and compensation of all types of personnel. Human resource management supports both individual primary and support activities (e.g., hiring of engineers) and the entire value chain (e.g., labor negotiations). Human resource management affects competitive advantage in any firm, through its role in determining the skills and motivation of employees and the cost of hiring and training. In some industries it holds the key to competitive advantage.
- Firm Infrastructure. Firm infrastructure consists of a number of activities including general management, planning, finance, accounting, legal, government affairs, and quality management. Infrastructure, unlike other support activities, usually supports the entire chain and not individual activities.

Three steps should be considered when analyzing the corporate value chain (Wheelen *et al, 2015, pp.170)*:

- Examine each product line's value chain in terms of the various activities involved in producing that product or service: Which activities can be considered strengths (core competencies) or weaknesses (core deficiencies)? Do any of the strengths provide competitive advantage and can they thus be labeled distinctive competencies?
- Examine the "linkages" within each product line's value chain: Linkages are the connections between the way one value activity (for example, marketing) is performed and the cost of performance of another activity (for example, quality control).
- Examine the potential synergies among the value chains of different product lines or business units: Each value element, such as advertising or manufacturing, has an inherent economy of scale in which activities are conducted at their lowest possible cost per unit of output. If a particular product is not being produced at a high enough level to reach economies of scale in distribution, another product could be used to share the same distribution channel.

3. Conclusions

As researchers of strategies and strategic management are aware, environment analysis is among the main elements in all management models in general and strategic management models in particular. This does not come as a surprise having in mind the turbulences in the external environment, the entanglement of environmental factors, their changing nature and the permanent pressures on the company to adapt its internal environment and processes to such pressures coming from the external environment. Perhaps the main idea behind striving in an ever changing environment is the creation and sustenance of a competitive advantage, which in turn requires that companies build adequate capacities to seize opportunities that emerge in the external environment and do as much as possible to avoid or at least minimize the consequences deriving from threats in the external environment and internal weaknesses. Aside from this, environmental scanning is a must first step in strategy formulation and then a must in every stage of strategy implementation and evaluation.

The paper has provided an analysis of the essentials of some of the most widely used techniques and modes for external and internal environment analysis. Although aware of the importance and the widespread usage of the SWOT analysis, the authors have intentionally not included this framework in the paper due to the fact that it is as several research activities proven the only technique for environmental analysis that companies are widely accustomed to in the Republic of North Macedonia in general and the Polog region in particular (Zeqiri & Aziri, 2014 and Aziri, 2020).

The main goal of the paper has been to provide an analysis of the four tools for environmental analysis in hope of raising the awareness of their existence and potential benefits from their implementation among the managerial and ownership structures in the Republic of North Macedonia in general and the Polog region in particular.

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