3.7.4. ANALYSING THE EXTERNAL ENVIRONMENT: POLITICAL & LEGAL CHANGE

POLITICAL ENVIRONMENT	Local, national or international authorities to: • Encourage enterprise • The regulation of markets • The country's infrastructure • Issues relating to the environment • International trade.
POLICIES AFFECTING ENTERPRISE	This can be assessed by how well an economy is supporting self employment. Decisions and actions by government can encourage or discourage business start ups e.g. lockdown hurt small businesses at the expense of large companies.
FINANCIAL SUPPORT FOR ENTERPRISE	New enterprise allowance Start up loans Enterprise Finance Guarantee Ensuring sufficient small, local banks are available to support small, local businesses. This has proven very successful in Germany.
NON FINANCIAL SUPPORT FOR ENTERPRISE	Reducing the number of regulations for business Tax breaks for small businesses Supporting innovation through helping researchers The government offering a range of schemes to help entrepreneurs
THE ROLE OF REGULATORS	Regulations may relate to a number of aspects that affect businesses including: • Regulations to create fair and free competition • Regulation of banking & financial services • Regulation of privatised monopolies • Self regulation by businesses.

REGULATION TO CREATE FREE & FAIR COMPETITION	• Imposing windfall taxes • Controlling prices • Restricting rates of return on capital
REGULATION OF HIGH PROFILE INDUSTRIES	Prudential Regulation Authority The Financial Conduct Authority
REGULATION OF PRIVATE UTILITIES	State Owned Enterprises were effectively turned into privately run monopolies. Consequently they needed regulation to ensure they offer a competitive service. e.g. OfWAT for Water, OfGEM for Gas & Electricity.
IMPACT OF REGULATION	May increase costs, may ensure lower prices and avoid exploitation. But equally regulators can be 'captured' by large firms, making regulators ineffective.

THE UK'S INFRASTRUCTURE

INFRASTRUCTURE	Roads, rail, air and telephone networks.
BENEFITS OF GOOD INFRASTRUCTURE	Business activities can be conducted more quickly and efficiently if travel times are reduced and telecommunications are more effective. Better globally connected.
INFRASTRUCTURE OPPORTUNITIES & THREATS	Beneficial for engineering firms to be engaged in infrastructure improvements & the need for continued maintenance. However, improved infrastructure may pose threats traditional transportation methods. E.g HS2, may make other rail networks less viable.
THE NATURAL ENVIRONMENT	Protecting the environment may mean certain industries cannot grow. E.g. House builders, road builders and firms in the fracking industry.

INTERNATIONAL TRADE

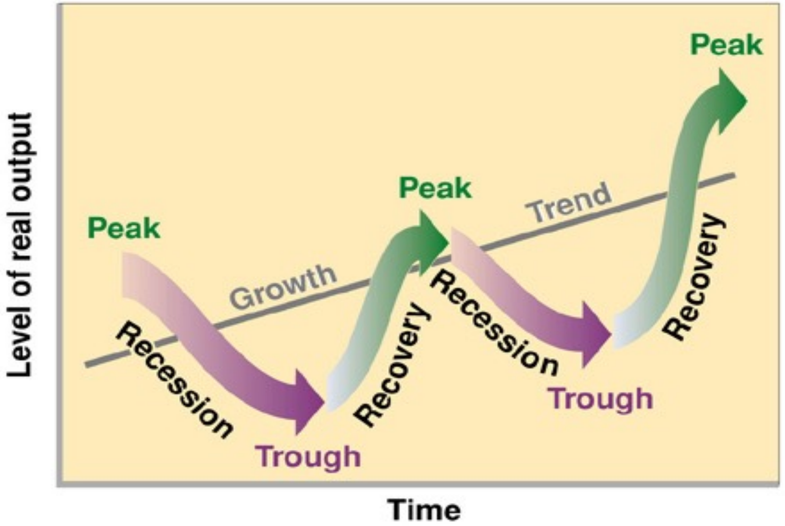
BENEFITS OF INTERNATIONAL TRADE	Promotes UK exports to overseas buyers Improves the country's balance of trade. Trade can help to ensure that British businesses are competitive Offers choice to customers. But it has contributed to much structural unemployment in the UK.

THE LEGAL ENVIRONMENT	
LAW	A framework of rules governing the way in which our society operates.
COMPETITION LAW	Intended to protect businesses and consumers from the effects of anti competitive practices. This applies to three key areas: 1. Cartel activity – price and output fixing 2. Abuse of a dominant market position 3. Other anti-competitive practices e.g. agreements with suppliers not to sell below a given price.
MERGERS & TAKEOVERS	Competition and Markets Authority will seek to assess whether mergers and takeovers are in the public interest.
KEY UK COMPETITION LAWS	Competition Act 1998, Enterprise act 2002, Enterprise & regulatory reform act 2013, EU competition policy
LAWS RELATING TO THE LABOUR MARKET	Those that relate to individual employees. E.g. minimum wage, equalities act. Those that apply to groups of people such as trade unions. E.g. Employment Act, Trade Union Act
HEALTH & SAFETY LEGISLATION	Designed to prevent accidents in the workplace, and has developed steadily over the last thirty years.
ENVIRONMENTAL LEGISLATION	Protects the environment from firms polluting the natural environment. Examples of legislation include: The Environmental Protection Act & the Environment Act.
EU & INTERNATIONAL LAWS	These laws have to be enacted into national laws among the 28 member states of the EU.
LEGAL ENVIRONMENT & DECISION MAKING	Legislation has the ability to affect many businesses and could the impact upon the decisions made by the business. This will depend upon: • The nature of the law & which businesses will be affected • The type of business, its size and corporate objectives.

3.7.6. ANALYSING THE EXTERNAL ENVIRONMENT TO ASSESS OPPORTUNITIES & THREATS: ECONOMIC CHANGE

THE BUSINESS CYCLE: The regular patterns of ups and downs in demand and output within an economy.

GDP	The total value of goods & services produced in an economy.
Causes of changes in the business cycle	• Changes in business & consumer confidence • Period of stock building then de-stocking • Consumer spending and the impact of borrowing and repayment. • Confidence in the banking sector.
Growth Stage Characteristics	• Incomes will be rising • Unemployment will be low • Inflation may be increasing due to **DEMAND-PULL**. • **CONTRACTIONARY FISCAL** & **MONETARY POLICY** needed? • **INCOME ELASTIC NORMAL** goods will be more popular • Consumers less **PRICE SENSITIVE**.
Recession Stage Characteristics	• Incomes falling • **Cyclical** & **search unemployment** increase • Inflation is likely to be low • **EXPANSIONARY** FISCAL & MONETARY POLICY. • **INCOME INELASTIC INFERIOR** goods more popular • Consumers more **PRICE SENSITIVE**
Trend rate of growth	The long run average rate for a country over a period of time.



EXCHANGE RATES

Represent the price of one currency against another. They directly influence the price of IMPORTS & EXPORTS. **W£IDEC/SPICED. APPRECIATION represents the rise in the price of a currency. DEPRECIATION the fall in price of a currency.**

Types of Exchange Rates	FLOATING – Rely entirely upon supply and demand to determine the price. Used by MEDCs. FIXED - Policy makers intervene to fix the value of the currency at a given level. Used by LEDCs.
Reasons for changes in an Exchange Rate	Demand & supply for the currency. Potential for future economic growth. Changes in domestic interest rates.
Price Elasticity of Demand & the Exchange Rate	Exchange rates directly impact the price of IMPORTS & EXPORTS. IF goods are price elastic – demand is very price sensitive. If goods are price inelastic – demand is price insensitive.
Main problems caused by Exchange Rates	Transaction costs in converting currencies, Exchange rate fluctuation risks. They can also cause cost push INFLATION due to W£IDEC.
Managing Exchange Rate risk	Monitor & try to anticipate exchange rate risk Use 'what if' sensitivity analysis to analyse implications of different exchange rates. Use currency options to provide certainty – an 'option' to buy at a given price in future. Use foreign bank accounts to reduce currency transactions Capitalise on low exchange rates via outsourcing or FDI via purchases of foreign firms Inward FDI into UK cheaper due to £'s depreciation. UK PLCs vulnerable to foreign takeover?

INFLATION

A sustained general rise in prices, which is measured by the Consumer Price Index. The Bank of England targets a 2% rate of CPI inflation.

CAUSES OF INFLATION

Demand-pull	Often occurs at times of low unemployment – This can therefore be closely related to the business cycle. When there is **excess demand**, producers can raise their prices and achieve bigger **profit margins.**
Cost-push	**Cost-push inflation** occurs when firms respond to **rising costs** by increasing prices in order to **protect their profit margins**.

IMPACTS OF INFLATION

Real Incomes	At times of high inflation, REAL WAGES will decline. This is because inflation will be higher than wage growth. Consumers will become more PRICE SENSITIVE & demand for INFERIOR GOODS may increase.
Real debts	Higher inflation erodes the REAL VALUE of debts. This is due to money received now being worth more than money paid back in the future. Inflation will mean that future money is less valuable. It may be cheaper to use debt as a source of finance.
Rising costs & prices	Input costs could rise & this would REDUCE PROFIT MARGINS. These costs could be passed on to consumers in the form of higher prices.

POLICY RESPONSES TO INFLATION

Contractionary Monetary Policy	Increase interest rates to reduce consumption, investment & borrowing. This will also promote higher levels of savings.
Contractionary fiscal policy	Increasing taxation to reduce disposable incomes or by reducing government spending.

FISCAL POLICY

Involves the use of GOVERNMENT SPENDING & TAXATION which can influence the level of demand, output & jobs. Can be used to change the pattern of spending on goods & services.
Can help to achieve a redistribution of income & wealth.

Direct Taxation	Placed upon income, wealth and profit. E.g. income tax, inheritance tax & corporation tax. Income tax in the UK is progressive i.e. 10%, 20%, 40%, 45%.
Indirect Taxation	Indirect taxes are taxes on spending. E.g. include duties on fuel, cigarettes & alcohol & VAT. Many indirect taxes are regressive in nature.
Impact of Taxation on Consumers & Businesses	Directly influences the level of DISPOSABLE INCOME & the level of RETAINED PROFITS businesses can invest. This may influence consumer & R&D spending. Furthermore, with lower taxes more people may re-join the labour market. INCOME ELASTICITY OF DEMAND is relevant here!
Government Spending	Regional economic impact of infrastructure investment, providing Public goods such as National Defence & Merit goods e.g. NHS, schools.
Impact of Government Spending	Can create jobs in area of need & incentivise businesses to locate in particular areas. By providing good education the quality of the future workforce is much improved.
THE FISCAL BUDGET	The UK government runs a persistent fiscal deficit meaning the spend more than they receive in taxation. The difference is funded by borrowing.

MONETARY POLICY

Involves changing the supply of money in an economy conducted by the Bank of England. The most usual method is via changes in the interest rate. The main objective of monetary policy is price stability or **LOW INFLATION**.

Interest rates	The cost of borrowing & the reward for saving.
Impact of changes in monetary policy	• Changes to the availability of credit for businesses & consumers • Influence business investment/ expansion and the level of sales • Low Interest rates will benefit those on variable rate mortgages & vice-versa. This will influence **DISPOSABLE INCOME** & the **INCOME ELASTICITY OF DEMAND** of these consumers. They may be less **PRICE SENSITIVE** when interest rates are low • Interest rates also influence the exchange rate, thus impacting upon the price of goods in foreign markets. To what extent exports & imports are effected will depend upon the **PRICE ELASTICITY OF DEMAND**.
Markets most vulnerable to changes in Monetary Policy	The car industry – many cars are bought on finance. The housing market – less demand for homes when interest rates are higher & vice-versa Household appliances – often benefit when the housing market is buoyant Home improvement businesses – That allow people to buy kitchens/ bathrooms on credit.

PROTECTIONISM

Occurs when countries place restrictions on imports into the economy. This can involve higher tariffs (a tax on imports) or quotas and embargoes. Other forms of protectionism can be less obvious, such as domestic subsidies to give industries unfair advantages.

EXAMPLES OF PROTECTIONISM	**Tariffs** – A tax on imports. **Quotas** – A physical limits on the quantity of imports **Embargoes** – This is a total ban on a good, this may be done to stop dangerous substances **Subsidies** – If a gov't subsidises domestic production this gives them an unfair advantage over competitors. This is quite common. **Administrative barriers** Making it more difficult to trade, e.g. imposing minimum environmental standards. These are sometimes known as non-tariff barriers.
ARGUMENTS FOR PROTECTIONISM	1. Infant Industry argument -protect new industries against free trade 2. Diversify the economy – tariffs and protectionism can help develop new industries to give more diversity to economy 3. Raise revenue for government. 4. Low cost competition. 5. Improve **CURRENT ACCOUNT** position. 6. Protect certain key industries from international competition to try and safeguard jobs.
ARGUMENTS AGAINST PROTECTIONISM	1. Protectionism leads to retaliation and therefore higher import prices and higher consumer prices. May also flout **WTO** rules. 2. Higher prices lead to lower overall demand causing job losses in other industries 3. Protectionism can encourage inefficient firms to stay in business. Protectionism can keep smaller national firms which can't benefit from the same economies of scale. 4. Benefits of Free Trade
EVALUATION	1. Higher costs of imports, are domestic substitutes available? 2. May mean final goods are more expensive in export markets – price elasticity of demand?

GLOBALISATION

Process enabling financial and investment markets to operate internationally, largely as a result of deregulation and improved communications.

Speed of Globalisation	This has generally been accelerating due to improvements in technology, containerisation, integration of communist countries & removal of trade restrictions.
Examples of Globalisation	Expansion of trade into international markets, Foreign Direct Investment, Internationalisation of products & services, **Outsourcing** & **offshoring**.
Alternative means of going global	License technology & other IP, Joint Ventures, Franchising, Takeover of foreign business, Offshoring & outsourcing production.

BENEFITS

- Opportunities for trade and investment,
- Access to cheaper goods & services – higher living standards,
- Access to cheaper factors of production
- Bigger export markets – economies of scale,
- More intense competition – drives innovation & efficiency,
- Has lifted hundreds of millions of people out of absolute poverty,
- Falling cost and rising speed of global communications.

DRAWBACKS

- Risks of increased structural unemployment,
- Globalisation may lead to rising income inequality,
- Impact on the environment – e.g. Co2,
- Loss of cultural diversity- uniformity of brands,
- Large trade account deficits as a result of imported consumer goods.
- Intensity of competition due to LEDC rival firms in home & foreign markets.
- Difficulties in understanding foreign market culture.

GROWTH OF TRADING BLOCS E.G. EU/ NAFTA

A single market with a standardised system of laws that apply in all member states.
It allows free movement of people, goods, services and capital.

Arguments in favour

- Major trading partners
- Source of inward investment
- EU businesses encourages British businesses to be efficient
- A market to export to with over 500m people
- Access the most suitable factors of production
- Expanding population.

Arguments against

- Trade deficit of £62b with the EU
- Structural unemployment in our manufacturing sectors
- Profit reducing regulations, lower business start ups
- Distorts trade & imposes damaging tariff escalation
- Fosters interests of larger firms

EMERGING MARKETS

Describes countries in the process of rapid growth and industrialisation. E.g. the MINT nations, China & India.

Key reasons for targeting Emerging Markets	Stronger economic growth, Slowing sales in domestic markets (saturation), Government support to expand overseas, Shareholder pressure to grow revenues & profits through expansion.
How to expand into Emerging Markets	Exporting direct to customers, selling via overseas agents or distributors, opening an overseas operation, joint venture or buying a business overseas.
Key International Risks	Cultural differences, Language issues, Legislation, Currency fluctuations, Domestic & foreign competition.