

The external environment

A business converts inputs into outputs in order to make a profit. However, the business does not exist in a vacuum, it exists within an external environment consisting of the actions of other players who are outside the business. The external environment consists of:

- * competitors
- * the economic system
- * the social system
- * the monetary system
- * the political/legal system
- * the environmental system.

Competitors actions affect the ability of the business to make profits, because competitors will continually seek to gain an advantage over each other, by differentiating their product and service, and by seeking to provide better value for money.

The economic system is the organisation of the economy to allocate scarce resources. The economy tends to go through periods of faster and slower growth. Businesses prosper when the economy is booming and living standards are rising.

The social system is the fabric of ideas, attitudes and behavior patterns that are involved in human relationships. In particular businesses are influenced by consumer attitudes and behaviours which depend on such factors as the age structure of the population, and the nature of work and leisure.

The monetary system facilitates business exchange. Monetary activity is based around earning, spending, saving and borrowing. Money has been likened to the oil that lubricates the wheels of commerce. Monetary activity involves businesses in a web of relationships involving financial institutions (e.g. banks and building societies), creditors, debtors, customers and suppliers. A key monetary influence for business is the interest rate. Higher interest rates increase business costs and act as a break on spending in the economy.

The political/legal system creates the rules and frameworks within which business operates. Government policy supports and encourages some business activities e.g. enterprise, while discouraging others e.g the creation of pollution.

The environmental system is the natural system in which life takes place. Increasingly businesses have become aware of the relationship between their economic activity i.e. making goods and services for profits and the effects that this has on the environmental system.