Organization’s External Environment

The external environment of an organization comprises of all the entities that exist outside its boundary, but have significant influence on its growth and survival. An organization has little or no control over its environment but needs to constantly monitor and adapt to these external changes, a proactive or reactive response leads to significantly different outcome.

The Environmental Domain

The domain consists of all the entities of the environment that interacts with the organization. Although the domain can be large, it is important to focus on the ones that have the highest significance. The common external factors that influence the organization are discussed below.

- **Competition**: It comprises of the related industries with similar products or services, their geographic locations and markets.
  - **Related Industries**: It is important to know all the competitors, their organizational size and skills pool, their competitive advantages, their marketing strategies, offshore development etc.
  - **Global context**: Due to increasingly broad world economy, it is important to watch the competition across the oceans, competitive products launched from abroad, changing socio-political situations, and home grown entrepreneurs.
- **Customers**: They are the end-users of the product and services, the most critical aspect of the environment.
  - **Preference changes**: Customers likes and dislikes changes rapidly, people live in a tight social system that create and encourage trends. It is important to anticipate changes in user’s product requirements, emerging technologies that can change how the products are used etc.
  - **Demographical changes**: These include the social, economical and cultural changes like population age, ethnicity, education level and economic class. Such changes affect the customer preference and the mass market trends.
- **Resources**: An organization depends upon availability of certain external resources for its operations and productivity.
  - **Skilled Workers**: These include undergraduate students, related university courses, training schools and labor market. The availability of adequately skilled employees at various levels in the organization can change dramatically over the period of time. Once the demand for certain skill drops, so does the supply, in a long run it adversely
affect the organization since it becomes hard to obtain highly skilled new workers. Similarly, as the competition grows, they compete for the same skill set in the market creating a high temporary demand.

**Raw Materials:** Every organization uses certain raw materials to manufacture its product or service, any disruption in its supply, changes in cost of materials etc can have an adverse effect. The raw material definition includes sub parts that are contracted to be manufactured by others, projects that are send overseas for production, the leased space the organization uses or the transportation of its goods.

**Finance:** It provides operational support; it includes savings or available cash, credit lines to fund new ventures, venture capitals, the stock markets and investors. It is particularly noteworthy in the organizations that operate on thin margins or new startups since they have little support to raise capitals.

**Technology:** It includes the science and technology required for the production, the technical tools that are used in the manufacturing or the technology of the product itself in case of high-tech industry. Internet, social network, advances in semiconductors and communication technologies have revolutionized how organizations operate in current era.

**Laws and Regulations:** All organizations have to abide by the legal system, new laws and regulations are constantly added due to the political or social changes. Compliance can result in additional cost, developing new technology, additional taxes or legal fees; one such example is lowered carbon emission requirements.

**Environmental Uncertainty**

*The rate at which the external domain can possibly change defines the environmental uncertainty; put differently, it’s a measure of how many factors change during a single planning period.* Not all factors impact the day to day operations and thus needs to be weighed differently. Higher level of uncertainty entails that organizational leaders have a complex environment to deal with, it test their visionary and decision making capability in absence of clear data.

A framework of environmental uncertainty can be formulated by determining the complexity and stability of the environment.

- **Complexity of Environment:** It’s a measure of number of domain elements that influence the organization’s operation. Not all domain factors might have considerable impact, one company might have very few competitors with little market share while another might be threatened by new players.

- **Stability of Environment:** It is the frequency at which the domain elements change and how predictable are the changes. Domain is considered to be stable if only few elements change in a predictable fashion. It is considered unstable if the domain elements are dynamic and shift abruptly, and it is hard to anticipate the changes. Competitors marketing strategies or alliances, price wars, sudden change in political climate are some unpredictable factors that add to the domain’s instability.

**Environmental Intelligence**

*Environmental intelligence gathering is a process of constantly scanning the environmental domain for changes.* Its purpose is to detect the changes, gather vital information, perform methodical analysis and present its reports to the top executives in the organization. There are two channels of obtaining environmental domain changes that are mentioned below.

- **External Linkage:** Organizations are an open system and are tightly bounded to its external environment. Almost every functional unit has either direct or indirect linkage
with the environment and it receives tips and information about the related changes. Sales & marketing can provide information about the competition’s new product, road-map and pricing, R&D about the emerging technologies, HR about skilled resources, laws and regulations. Similarly procurement dept can detect changes in suppliers and finance about availability of credit, economic outlook etc. Some organizations create an additional functional unit that acts as a bridge between other units, it systemically collects and compiles the competitive information that is used by top executives in strategic planning and decision making.

**External Consultants**: Organizations can also use specialized external services in field of competitive intelligence and strategic planning. These services utilize various tools like survey & questionnaires, systemic scanning of public information and the web and use various statistical techniques to analyze the collected data. These consultants work with the internal functional units as well the external environment to obtain their information, thus can potentially provide unbiased recommendations which are sometimes hard to obtain internally.

**Adapting to External Environment**

In order to survive and prosper, the organization has to adapt itself to the ecological system that surrounds itself. It is important to utilize the environmental intelligence to determine the uncertainty and take appropriate actions for the well being of the organization.

- **Forecasting and Planning**: Environmental uncertainty should be used to predict the future course of the environment and plan appropriately to reduce its adverse impact. A planned organization is better prepared against the unstable environment and can respond quickly and coherently.
- **Organization Design or Reorganization**: The internal design of the organization is directly influenced by the stability and uncertainty of the external environment (also see “Organization Design”). The two structural dimensions, hierarchical vs. horizontal are both dependent upon the environmental instability, when the environment is stable, hierarchical structure provides essential control and efficiency. Since not every functional area will have similar uncertainty, organizations need to adjust the extent to which they need coordination vs. control in internal structure of each unit.
- **Reduce Resource Dependence**: As mentioned earlier, an organization depends upon external resources, but it can find ways to control some aspect of it. One method is to forge inter-organizational alliances where it shares the scarce resource, collaborate with another to control cost and minimize risk while giving up some of its autonomy. Inter-organizational linkage can be in form of acquisition of similar organization, contracts and joint ventures with competition. Another approach is to keep extra resources at an additional cost, having more than necessary workers and raw materials provides a cushioning effect to slight changes and thereby minimizes risk.

**Controlling the External Environment**

- **Shifting Core Competencies**: An Organization can change its core business to an emerging product and thereby lead the change in the domain for other competitors. By leading a change, it creates a new customer base, monopolizes the market and keeps the competitors out. However such drastic step can only be initiated by a visionary leader who has the support of all the stakeholders, board members and the investors.
- **Advertisements**: These are effective means of influencing the customer taste and opinion; and it provides an edge over the competition.
- **Political Lobbying**: Political lobbying and activities are ways influencing the government policies and regulations in favor of the organization or sometimes against the competitors. Lobbying for “Green” legislation is a good strategic advantage over competition for firms that had anticipated it and have the technology to deliver it.