External Influences on Business Activity

A2 Business

External Influences

External influence is anything outside the business that has direct effect on a business.

1. Government Rules / Regulations
2. Laws – Consumer Laws, Employment Laws, Environmental Laws
3. Economic Factors – macroeconomic policies of governments affect business in both positive and negative ways
4. Political Factors
5. Technological Factors
6. Demographic Factors

Government Rules / Regulation

- Advertisement of cigarettes is prohibited in Pakistan and many other countries
- During COVID lockdown schools cannot operate as usual.

Consumer Laws

Any laws made by the governments to protect consumer rights.

- ***Trade Description Act***: states that product description should be accurate information about the product, its features and any risks associated with use of that product.
- ***Consumer Protection Law:*** the product sold should be a good fit for

its intended use.

- ***Sale of Goods Act:*** The product should not be defective and so on.

Employment Law

- Employment Laws are made to ensure protection of employees' rights.

1. ***Health and Safety Laws:*** all laws that ensure safe and healthy work environment.
2. ***No discrimination act:*** it is illegal for businesses to discriminate against their employees on the basis of things like gender, race, ethnicity etc

3. Employment Contract: it is an official document that lists the rights and responsibilities of employees in any organization. In case of conflict between employer and employee it serve as the guiding document to decide which party has more justified claim.

Health & Safety Laws

- Laws concerning safety of employees at workplace. For instance providing safety equipment to employees, not forcing your employees to work beyond the maximum working hours.
- Law concerning health insurance.

No Discrimination Act

- Discrimination is defined as evident deliberate attempt to provide someone unfair advantage or to exclude someone from some opportunity.
- Now with this law it is illegal for businesses to discriminate.

Employment Contract

- Employment contract is an official document that lists the details of employee’s employment.
- In case of dispute between employer and employee the court decides on the basis of information provided in the employment contract.

Environmental Law

- Environmental laws ensure that companies do not engage in environmentally harmful activities.

Political Factors

- Any political factor that affects businesses like protests, political lockdowns etc.
- But these factors are not very common or frequent so businesses are not very much concerned about these.

Technological Factors

- Any technological advancements that affect businesses and the way they operate.
- ***CAM:*** Computer Aided Manufacturing – software used to control and operate machines
- ***CAD:*** Computer Aided Design – software used to design products eg 3D printer.
- ***Bar code scanner:*** is commonly used by departmental stores to know the product being sold and to charge consumers accordingly. • ***Debit and Credit card payments:*** payments can be made through debit and

credit cards.

How these external factors affect businesses?

- Technological factors help save cost due to reduced demand for labor.
- Much less error and more reliability.
- If machines / capital is too expensive then businesses will be careful with making so much financial commitment.
- Technology require upgradation and its requires maintenance cost and these factors need to be taken into consideration to make more informed decisions.
- Technology allows businesses to access markets that were previously not

available like ecommerce has made selling to far off places possible and convenient. Some of these technological advances are creating new opportunities for businesses.

How can these external factors be a challenge?

- Some of these technological advancements have put local businesses in competition with foreign businesses causes the small local businesses to lose in the process.

Demographic Factors

- Demographic factors refers to socioeconomic changes taking place in a country like population distribution, age distributional, occupational distribution etc.
- Population Distribution: is how the country’s population is spread over different areas / cities etc.
- Age Distribution: how the country’s population is divided in different age brackets. It shows if a country’s population is young or ageing.
- Occupational Distribution: what percentage of country’s population is involved in different occupations and sectors of economy like primary, secondary or tertiary etc.

Economic Factors

• Any economic factor that affects businesses in some way eg inflation, economic growth / GDP, exchange rate, macroeconomic policies. • Any ***change in macroeconomic variable*** can have an effect on businesses like higher inflation, lower interest rates, higher economic growth rate etc. • Macroeconomic Variables

1. GDP
2. Inflation
3. Unemployment
4. Exchange Rate
5. Balance Of Payments

Macroeconomic Policies

- Macroeconomic Policies are country level economic policies that are intended to achieve specific economic objectives.

1. Fiscal Policy

2. Monetary Policy

3. Supply Side Policies

GDP

- It is the total value of all goods and services produced in an economy during certain time period.
- Economic Growth: is the percentage change in economic activity.
- Higher levels of economic activity (as measured by GDP) results in higher incomes of consumers and so result in higher demand for goods and services.

Income Elasticity of Demand

- A formula that calculates the percentage change in quantity demanded of a product following a given change in income of consumers.

- By how much the demand for a product change given a change in consumers' income.
- ***Pro-cyclical*** – any business for which the demand of its products are directly related to the level of economic activity.
- ***Counter – Cyclical*** – any business for which the demand of its products is higher when level of economic activity is low.

Types of Goods

- Normal Good: any product for which the demand increases due to increase in consumers' income. Iphone, Samsung

- Inferior Good: any product for which the demand decreases due to increase in consumers’ income. Huawei, Oppo

Inflation

- Inflation is the increase in general price level.
- Consumers lose from inflation due to decrease in their purchasing power.
- Producers gain since inflation help them earn higher profit margins

which incentives producers to invest more in the economy resulting in creation of more jobs and higher economic activity.

- Low and stable rate of inflation is desirable where as high rate of inflation should be avoided.

Why is low and stable rate of inflation desirable?

- Low and stable rate of inflation increase producers’ profit margins which incentivizes them to invest more and so generates more employment and economic activity.

Unemployment

- Anyone who is willing and able to work and is finding job but is unable to find one is known as unemployed.
- ***Types of Unemployment***: refers to the underlying reason why someone is unemployed.

1. ***Structural Unemployment***: is when the industry is ending because there is no more demand for that product like non-smart phones, etc.
2. ***Seasonal Unemployment:*** is when during certain seasons due to limited or no demand for the product the demand for labor is also low. Any industry for which there is only seasonal demand.

Types of Unemployment

- ***Frictional Unemployment***: it is when someone left their previous and are in the process of finding another one. It is when someone is between switching jobs.
- ***Casual Unemployment***: it applies to occupations that involve working on projects like actors, musicians, artists and therefore when they are not working on any particular project they are unemployed.
- ***Cyclical Unemployment***: when due to low economic activity meaning low demand for goods and services the demand for labor is also low.

For instance during the current pandemic a lot of businesses have laid off their worker.

Potential Strategies to Reduce Unemployment

- Cyclical Unemployment: governments will use expansionary fiscal and monetary policies to control this type of unemployment.
- Structural Unemployment: can be reduced through retraining of workers who lost their jobs and are looking for jobs in other industries.
- Casual and Frictional Unemployment: the government can reduce these types of unemployment by making more information available to job applicants.

- Seasonal Unemployment: government can create part type job opportunities who got seasonally unemployed.

Unemployment and Businesses

- Higher the unemployment lower the wage rate which means that businesses can hire people on lower wage rates during period of high unemployment.

Exchange Rate

- What is Exchange Rate?

Value of one currency in terms of another is known as exchange rate.

Effect of Depreciation on Local Businesses

- Depreciation is beneficial for local businesses since our products cost less in terms of foreign currency it is expected to increase the demand for our exports.
- More expensive imports and therefore the country's import expenditure will increase.

Effect of Appreciation on Local Businesses

- Expensive exports will reduce the demand for exports resulting in lower export revenue.

- Cheaper imports will allow businesses to import more quantities with lower expenditure.

Free Floating versus Fixed Exchange Rate

- Free Floating ER: is exchange rates are determined solely by market forces of demand and supply and ***there is no government intervention.***
- Fixed ER: it is when ***government actively controls exchange rate*** to either increase or decrease its value.

How can government artificially increase

the value of ER?

- To do that the central bank of the country like State bank of Pakistan will sell foreign currency like dollars, euros, pounds and buy local currency.

How can government artificially decrease the value of ER?

- This is achieved by selling the local currency and buying dollars etc.

Balance of Payments

- Is an official documents that records all of a country’s international trade transactions.
- If the value of exports is greater than the value of imports then it is known as Surplus on the balance of payments and if it is the opposite then it is known as deficit.

Trade Barriers

- Trade barriers are economic instruments used to restrict imports.
- Tariffs: is an indirect tax imposed on imports
- Quotas: is a limit on the quantity that can be imported in the country.

- Customs Duties: is another type of indirect tax imposed on imported products which discourage imports by making them expensive.

Macroeconomic Policies

- Fiscal Policy: deals with government revenue and expenditure to control the level of economic activity (GDP) of a country.

- Expansionary: it is when government reduce its taxes and increase its spending to achieve the objective of higher economic activity.

- Contractionary: it is when government increase the taxes and reduces its spending to achieve its objective of lower economic activity.

Macroeconomic Objectives

- These are country level objectives that economies wish to achieve.

1. High GDP
2. Low and Stable rate of Inflation
3. Low Unemployment
4. Stable Exchange Rate
5. Stable Balance of Payment

Macroeconomies Policies

- The strategies used to achieve economic objective are defined as policies:

1. Fiscal policy
2. Monetary Policy
3. Supply Side Policies

Fiscal Policy

- It deals with government taxes and government spending and is set through the use of annual budgets.

- Possible Options within Fiscal Policy

1. Expansionary: is reducing taxes and increasing government spending
2. Contractionary: is increasing taxes and reducing government spending.

How Fiscal Policy helps government achieves its objectives?

- Contractionary Policy is used to control inflation by increasing taxes which reduces consumers’ spending power.
- However the downside of this policy is that it can result in higher

unemployment.

Monetary Policy

- The central bank of a country sets its monetary policy which deals with interest rates.

- Expansionary: will reduce the interest rates – higher economic activity / employment but it can also result in higher inflation.
- Contractionary: will increase the interest rates – lower economic activity but it help control inflation

Objective of Expansionary Policy

- The objective of this policy is to generate more employment however on the downside it can result in higher inflation.

Supply Side Policies

- Any government strategy used to enhance a country's production potential is defined as Supply Side policies. Eg

1. Providing subsidies to businesses – increases their profits and so encourages them to produce more
2. Giving interest free loans especially to small business -

3. Providing industrial zones – are designated areas where government has provided subsidized utilities for businesses to set up their production plants.

4. Relaxing regulation for new businesses to register etc

5. Giving tax holidays – when businesses are exempt form paying taxes in the first few years of their operations.

Difference between Demand and Supply Side policies and which of the 2 is better?

- Demand side policies (Fiscal and Monetary policies) are easily implemented and take less time to have an effect on the economy.

- However demand side policies do not have permanent and long lasting effect on the economy.