

PEST Analysis

Introduction-

The global environment of today is much different than it was even 10 years ago. While companies used to struggle to get any kind of information about new markets, today they are drowning in information. To stay afloat, companies may turn to what is known as a PEST analysis. PEST stands for the political, economic, socio-cultural, and technological aspects of a business environment. In a PEST analysis we audit these factors to gain insights about the company's environment. Just as Porter's 5 forces helps us evaluate the attractiveness of a specific industry, PEST analysis helps us evaluate the attractiveness of the larger global environment in which that industry operates. Let's explore these factors in depth.

Political Factors-

First, *political factors* refer to laws, property rights, patents, political stability, and so forth. Laws can drastically impact the nature of the business environment. Consider recent laws requiring a certain percentage of electricity to come from renewable sources. These laws have increased demand for wind turbines, solar panels and other renewable energy sources.

In some business environments property rights are poorly protected by governments. Those with political power can seize property with few repercussions and governments may be unlikely to enforce patents, trademarks and so forth. Times of civil unrest and political instability make the business environment particularly uncertain and risky.

Economic Factors-

Economic factors refer to market and trade cycles, currency fluctuations, specific industry changes, customer preferences, and country economic growth forecasts. For example, China's economy has grown dramatically in recent years and this growth has led to new market opportunities. China's 1.3 billion people represent a massive, largely untapped consumer market for global companies. Today more cars are sold in China than in Europe.

Socio-cultural Factors-

Socio-cultural factors refer to national culture and values, religion, language, human rights, and population demographics. Socio-cultural factors are sometimes radically different in different countries. Firms that compete globally must understand differences among consumers in each country they serve. For example, Chinese culture promotes the well-being of the group over the individual, which results in a strong norm of open information sharing. This leads to more widespread acceptance

of product knockoffs and software piracy than we typically see in western cultures.

Understanding local cultures helps companies plan for the unique preferences and practices of local employees and consumers. In some countries, night shifts are taboo. In other countries, employers are expected to provide employees with meals and transportation. In India, for example, companies often give cash bonuses on wedding anniversaries and dating allowances for unmarried employees due to the cultural importance of marriage. These are practices that may not be obvious to non-native managers.

Demographic trends may also be important because they indicate potential changes in the workforce and/or consumer preferences. Companies that need highly educated employees, for example, may need to pay close attention to local educational trends. Similarly, companies selling automobiles may carefully consider socio-cultural trends in transportation. Thailand may look attractive to auto makers due to the population size, but an increasing focus on motorcycles may indicate low potential growth rates for automobiles.

Technological Factors-

Technological factors refer to the maturity of manufacturing equipment, information systems, technology platforms, and consumer access to technology. Technological advances in some countries have led to increases in service sector jobs and decreases in manufacturing jobs. Companies are increasingly turning to sophisticated machinery that requires fewer workers to produce the same amount of product. Consider one textile factory in Bangladesh where it is more cost effective to purchase high-tech threading equipment to spin thread than to hire hundreds of people to do the work by hand, even with a very low wage rate.

Advancement in information systems and technology platforms have also increased the rate of global technology adoption. Continuous advancements in internet technologies increasingly allow companies to spread common technology platforms at very low costs. These common platforms makes work less specific to particular companies and countries.

Technological advancements have also empowered individuals to compete with large companies. Guru.com, for example, has developed an online marketplace where individuals can offer various services and compete for business throughout the world. If you need to develop a new website you can easily find qualified developers who may live in Manila, Mumbai, Manhattan, or Munich.

Benefits of a PEST Analysis-

Now, let's talk about what a PEST analysis does for you. It can help you (1) spot business opportunities with advanced warning of potential threats, (2) implement appropriate practices for local cultures and avoid problematic practices, and (3) break free of old assumptions about how managers should run organizations.

For example, Rolls Royce conducted an extensive PEST analysis before it set up operations in Vietnam. Managers believed that Vietnam presented a strong market opportunity because of its tremendous economic growth, increased political freedom, more outward openness to cultural differences, and technological advancements. Vietnam's economy was growing at higher rates than other countries without the same market saturation such as the US, UK and other European markets.

While the analysis showed many growth opportunities, it also revealed many threats. For example, bribery was a common practice in Vietnam but against Rolls Royce's company policy and ethical standards. Additionally, many Vietnamese were concerned that foreign companies were only coming to make money and send it back to company headquarters without investing in Vietnam. To avoid this perception Rolls Royce focused on building local skills and sustaining the local natural environment.

Key Steps-

As illustrated by Rolls Royce, there are three key steps to a PEST analysis. First, determine the relevant environmental factors to assess. For example, are intellectual property laws relevant to your business in that country? An accounting firm opening an office in France probably doesn't need to spend any time or energy understanding French IP laws but probably needs to be very aware of whether France has adopted International Financial Reporting Standards (IFRS).

Second, evaluate how the relevant factors affect your company's international operations. What exactly does it mean for our strategy and operations in France if they have adopted the IFRS standards? It may not affect us in hiring local accountants as they will be trained in the standards of their country but it may affect coordination across countries and how much we can leverage the work of our accountants across borders.

Third, develop the appropriate strategy and appropriate management practices in the appropriate locations for the appropriate employees. If other European Union countries adopt the IFRS then it might make sense to have your France office as part of a regional group of offices within the EU so that projects and knowledge can be leveraged across borders. Such an approach might help win contracts with companies seeking consistency across their regional operations.

Conclusion and Summary-

In summary, a PEST analysis entails scanning different business environments to understand long-term trends and how they might impact a company. You may not be able to change these environmental factors, but it is important to understand what they are so you can take advantage of opportunities and steer clear of threats in the different local environments where you have operations.