

**P**EST has many variations — maybe you know it as SLEEPT or PESTLE. Ultimately though, what matters, regardless of which term you use, is what the letters mean and what is involved in a PEST analysis.

### External influences

PEST is a model that helps businesses to analyse what impact, both now and in the future, the external environment could have on them. This analysis should look at both the opportunities and threats presented by any possible external influences that have been identified.

External influences are those factors that affect a business, but are beyond its direct control and so are difficult for a business to plan for and manage. Some unforeseen events, such as the recent SARS virus, are almost impossible to plan for, though contingency planning may help (see Box 1).

Even where a business can exercise some degree of control over its external environment this control may be limited. A business might be able to lobby the government to limit the impact of new laws, but struggle to block the law entirely. Clearly the size of business is important here. A large multinational is likely to have a greater degree of influence over its external environment than your local fish and chip shop.

The uncertainty of the external environment and the difficulties this presents are what make the business environment so challenging. Businesses that are prepared for the challenges and can react effectively to change are often the most successful.

### What impact?

#### Political

This examines the effects that government activity can have on business through

taxation, political objectives and legislation. Possible impacts include:

- changes to employment law (the working time directive, minimum wage etc.)
- changes to environmental laws affecting business location or pollution levels
- the potential impact of adopting the euro
- changes in attitude towards private sector involvement in the provision of public services

Political influences can have a direct effect on businesses and consumers. A policy of increased taxation, for instance, might result in reduced consumer demand (due to a rise in income tax), which in turn may reduce sales and profits. Profits may be further squeezed by an increase in corporation tax.

#### Legal

The 'L' in SLEEPT and PESTLE is often used to consider the impact of the **legal** environment on businesses in more detail. For instance, the planned introduction of a law covering corporate manslaughter would increase the burden of responsibility on company directors.

#### Economic

This considers how the current or forecast economic climate might impact on a business. It looks at how, for instance, changes in the purchasing power of customers might affect sales. Other possible economic considerations include:

- how current and forecast economic growth might affect investment decisions
- the impact of interest rate changes on consumer spending and a firm's debt burden
- forecast exchange rate changes and the impact on international trade
- the impact of inflation on costs

#### Social

Significant social and lifestyle trends can

### Box 1 Contingency planning

Contingency planning is the consideration of 'what if' scenarios. A business will draw up plans to deal with, often unlikely, situations that would severely harm its operations. Large businesses use complex computer models to investigate the likely impact of any situation.

Contingency plans might include:

- the possible impact of a fire at an office or store
- the threat of a product health/safety scare, e.g. the ban, in April 2003, on the popular 'Yo-Ball' toy
- the failure of a sole supplier, e.g. the case of Land Rover when the failure of its chassis supplier caused production problems
- an unusually high period of staff absence
- a sudden increase in demand

have a major impact on business activities. Social factors include the demographic and cultural aspects of the external environment. They may affect customer spending patterns, market size and market growth. The organic food market, for example, grew at 40% a year from 1999 to 2002 in the wake of food scares and concern about genetic modification. Sales of organic foods are forecast to exceed \$1bn by 2005.

Other social factors include:

- consumer attitudes to business practices — over recent years there has been increasing media concern about ethically questionable business practices
- the work–leisure time balance has created a market for ready meals and fast food which, coupled with a move to healthier eating, has encouraged McDonald's, for instance, to launch a range of salads
- the age distribution of a population — the UK has an ageing population, presenting opportunities for companies such as SAGA, which specialise in products/services for the over 50s

### Environmental

The extra 'E' in PESTLE or SLEEPT represents **environmental** and is used to examine possible environmental changes or concerns that may affect a business in more detail. This may be the impact (or possible impact) on business activity of various environmental pressure groups, or how changes in the environment, such as global warming, might affect sales.

### Technical

Technological change can be both rapid and expensive. Consider, for example, the speed with which the internet has become an almost essential business tool. New technologies present businesses with both opportunities and threats. Businesses may need to embrace them quickly in order to remain competitive.

Examples of the impact of technological change include:

- communications technology that made possible the move of some British Airways call centres to countries such as India, thus saving on labour costs
- e-mail, the internet and wireless communications that are all having a part to play in a shift towards teleworking, a trend that presents businesses with the opportunity to save a great deal of money on office space

### What next?

Once a business has considered the various elements of PEST, it uses this analysis to inform its strategy. If the PEST analysis suggests, for instance, that economic conditions are likely to be particularly difficult over the next few years, a business might choose to delay expansion plans or to launch products that may appeal to cash-strapped consumers. Where PEST analysis yields information about a new technology, a business may choose to increase its budget for research and development.

If a business has identified possible threats that may be unlikely, but could be potentially severe, PEST analysis can be used as a basis for contingency planning (see Box 1).

### The value of PEST

PEST analysis is particularly useful for new businesses or businesses launching new products. It provides a simple model within which the impacts of the complex environment can be organised. Analysis of these impacts should lead to more informed business decisions. Updating their PEST analysis should be something that businesses do on a regular basis as part of their overall strategic analysis. Is the current strategy working? How relevant is it to today's markets?

One risk with PEST analysis is of oversimplifying a complex, perhaps unpredictable, external environment. Are all external influences really covered? What about the many events that cannot be predicted or planned for?

A full PEST analysis is an extremely costly process. Obtaining all the relevant data through primary and secondary research could run to many thousands of pounds. As a result, PEST analysis may be based on relatively weak data and hunches, which reduces its value as a true analytical tool.

As with all business tools, you must be critical when considering the usefulness of PEST analysis. Developing a critical eye in relation to both business activity and business models is an extremely useful skill.

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### Answers to A–Z of AS marketing and finance on p. 10

**A**dverse; **B**oston matrix; **C**ost plus; **D**istribution; **E**lasticity; **F**actoring; **G**ap; **H**unch; **I**ncome; **J**unk; **K**elloggs; **L**easing; **M**arket size; **N**egative; **O**verdrafts; **P**redatory; **Q**uantitative; **R**esponse; **S**afety; **T**otal costs; **U**nique; **V**ariable; **W**orking; **eX**ternal; **Y**outh; **Z**ero.

### Answers to AS revision crossword on p. 26

**Across:** 1. productivity, 8. constraints, 11. excess, 12. Enic, 13. Nortel, 14. tastes, 16. local, 17. serve, 19. ICI, 20. strategic, 21. his, 23. COD, 25. red, 26. objectives.  
**Down:** 1. paternalistic, 2. decentralise, 3. consult, 4. interest rate, 5. IPA, 6. yen, 7. diseconomies, 9. OS, 10. ideas, 15. energy, 17. stripe, 18. niches, 22. id, 24. do, 25. re.

### Answers to A2 strategy brainteasers on p. 32

- 1 (a) market  
(b) product  
(c) diversification  
(d) penetration
- 2 (a) Entrepreneur  
(b) Threats  
(c) Horizontal  
(d) Inflation  
(e) China  
(f) Strategy  
Word: ETHICS
- 3 (a) Payback, ARR or NPV (or IRR)  
(b) Backward (upstream) or forward (downstream)  
(c) Poland, Hungary, Czech Republic  
(d) Oil, armaments, aerospace (aircraft and engines), cars, food and drink (also electronic equipment, notably computers)
- 4 (a)  $(£12m \times 0.7) + (£6m \times 0.3) = £10.2m - £1m = £9.2m$ .  
This outweighs £8m from the 'Do nothing' option (of allowing the initial success to go ahead unchanged). So yes, it should launch the follow-up product.  
(b) Robots:  $(£4 \times 0.8) + (£2m \times 0.2) = £3.6m - £2m = £1.6m$   
New product:  $(£9.2 \times 0.4) + (£0.5 \times 0.6) = £3.98m - £2m = £1.98m$   
So launch the new product and, if successful, launch the follow-up.  
(c) It should have a 'Do nothing' line in case both the options yield a negative Net Expected Value.  
(d) That the new product launch has a 0.6 (60%) chance of losing the firm £1.5m (£2m out, £0.5m in); can the business afford to lose £1.5m? It should also consider the basis of the estimates, especially the probabilities (e.g. why is the follow-up product so likely to succeed compared with the initial new product?)