

1.5 - Understanding External Influences on a Business

Topic overview

In this topic students need to continue to relate the concepts to the contexts in which an enterprise and an entrepreneur will be operating. They must be aware how the local and national business environment might impact on a small business. Students must be aware of this topic's relationship with the other topics in this theme and how this might affect decision-making.

Section	Key things to learn
Business stakeholders	Main business stakeholders and their objectives How stakeholders impact and are impacted by business activity Stakeholder conflict
Technology and business	Different types of technology that businesses use How technology influences business activity
Legislation and business	Purposes and principles of consumer legislation Purposes and principles of employee legislation Impact on businesses of meeting and not meeting legislation requirements
The economy and business	How businesses are affected by the economy and changes to key economic variables
External influences	How businesses are subject to external change and how it influences their business activity

Business stakeholders

A stakeholder is anyone who has an interest in the activities and decision-making of a business.

Stakeholders include:

- Shareholders or business owners
- Managers and employees
- Customers
- Suppliers
- Banks and other finance providers
- Government
- Local community
- Competitors
- Pressure Groups

Various factors affect how many stakeholders a business has and the strength of their interest and influence on the business. These factors include:

The size and scale of the business: for example, a small, sole-trader service business will have relatively few stakeholders. Contrast this with a much larger, complex business like a national supermarket chain,

which has thousands of employees operating in numerous locations and is an important customer to hundreds of suppliers.

The nature of the good or service: some products are more likely to attract the attention of stakeholders. For example, a manufacturing business that has high levels of carbon emissions or waste packaging will be scrutinised much more closely than a simple service business. The local community will have a greater interest in a business that is a major local employer than in a one-man band.

Objectives of business stakeholders

The main objectives of each main stakeholder group will not always be the same as the objectives the business sets for itself. The objectives of the more important stakeholders to a business can be summarised as follows:

Stakeholder	Mainly interested in...
Shareholders/owners	• Good return on their investment • High level of profits and dividends • Success and growth of the business • Proper running of the business (if shareholders are not directly involved in the day-to-day running of the company)
Managers and employees	• Rewards, including maximising basic pay and other financial incentives • Job security and good working conditions • Promotion opportunities • Job satisfaction and status through high levels of motivation, interesting roles and responsibilities • Success of the business
Customers	• Value for money • Product quality that meets their specific needs • Appropriate levels of customer service
Suppliers	• Fair or high prices and prompt payments • Continued profitable trade with the business • Financial stability – can customers pay their bills?
Banks and other finance providers	• Profitability and cash-flow for the bank • Low risk that the business will not be able to repay finance provided • Growth in profits and value of the business
Government	• Prompt and correct collection and payment of taxes, for example VAT, income tax • Creating jobs, for example through businesses succeeding and growing • Compliance with business legislation, for example health and safety, minimum wage/national living wage compliance, consumer protection, fair trading, environmental protection
Local community	• Success of the business – particularly creating and retaining jobs • Compliance with local laws and regulations, for example noise, pollution
Competitors	• Profitability and success for their own business

Stakeholder	Mainly interested in...
	An increase in market share
Pressure Groups	- These could include trade unions and environmental groups - Best deal for their members, for example trade unions will push for higher wages, environmental groups will want safeguards to prevent business activity damaging the environment

How stakeholders are affected by business activity

Any activity of a business will affect some, if not all of its stakeholders. The impact will differ dependent on the particular stakeholder group. In many cases, the impact will be positive for some stakeholders and negative for others.

Example: If a business decides to relocate to a location that will be more convenient for customers, this will have different effects on different groups of stakeholders. Customers will benefit, the owners will also benefit, as the profits are likely to increase. Employees might lose their jobs or be forced to relocate, so the effect on them will be negative and one local community will lose, whilst the other local community gains in terms of job and therefore wealth creation.

It should be noted that the effect on stakeholders might be different in the short term and long term. A decrease in wages for workers might be negative in the short term, but might ensure that the business remains competitive and survives, which will mean that the workers' jobs will be preserved in the long term.

Impact of stakeholders on business activity

The behaviour of stakeholders will be influenced by their objectives, as previously described, and in turn, this will impact on the activities of the business.

Example: Employees want higher pay. This means they will negotiate with the managers to get a better deal, possibly threatening strike action if they do not get a pay rise. If they are successful, then this will increase the costs of the business. This may result in the business having to increase its prices to maintain its profit level. However, this might not be possible if there are competitors, so the profits earned by the owners or shareholders will decrease, as prices will need to stay the same in order for the business to remain competitive.

All stakeholders can impact business activity. If suppliers insist on immediate payment, this will make the business's cash-flow more difficult to manage. If the owners want short-term profits, they may prefer a high price strategy rather than a low price, high growth option.

Why might the objectives of stakeholders be in conflict?

Many business objectives are shared by a broad range of stakeholders.

For example, an objective for a business start-up of achieving survival would be supported by nearly all the stakeholders. Other than its competitors, it is unlikely to be in anyone's interest for a business to fail.

However, once a business becomes better established and larger, then potential conflicts begin to arise. Let's look at two examples in a little detail:

Business expansion versus higher short-term profit:

An objective of increasing the size and scale of a business might be supported by managers, employees, suppliers and the local community – largely for the extra jobs and sales that expansion would bring.

However, an expansion is often associated with increased costs in the short-term, for example extra marketing spending, new locations opened, more production capacity added. This might result in lower overall profits in the short-term, which may cause conflict with the business shareholders or owners, who may want high profits and high rewards for being a shareholder in the form of dividend payments now and therefore would not be prepared to wait for rewards.

However in the longer-term, most business owners will be in support of expansion, particularly if it increases the overall value of the business.

Job losses versus keeping jobs

This was a big issue for many businesses during the recent economic downturn. In order to reduce costs and not spend cash, business managers made some staff redundant or introduced other measures like short-time working to reduce wage costs. This will have been supported by business owners and managers.

However, it created a potential conflict with stakeholders such as employees (who were directly affected), the local community (affected by local job losses) and suppliers (which suffered from a reduction in business).

Here are some other potential causes of conflicts between stakeholders:

- “Short-term” thinking by managers who want to maximise profits today, may discourage important long-term investment in the business which would increase owners profits in the long run
- Investing in new machinery to achieve better efficiency to raise profits for the owners, may result in job losses
- Extending products into mass markets to increase sales and profits for shareholders may result in lower quality standards for consumers

Technology and business

In recent years there has been a revolution in how businesses can benefit from new technology. The invention and widespread use of computers and mobile phones has allowed massive changes to the way businesses operate and how they communicate. It has also redefined markets for many businesses and how they conduct their buying and selling operations. **Digital technology** is an overall term used to include all aspects of computer use and can be applied to most areas of human life from its use in education and health, to its use by government and business.

E-commerce

Businesses have been using computers for over thirty years. Originally computers were used mainly for the storage of data and the production of documents, but as technology has developed, the amount of uses for **information and communication technology** (ICT) has increased to include stock control and production technologies, such as computer aided design (CAD) and computer aided manufacturing (CAM).

The revolution in the use of computers has taken place since the invention of the worldwide web, which has allowed computers to be linked both nationally and internationally. Combined with the use and availability of mobile phones and smart phones, this has created a new digital world where businesses, customers and employees can all benefit from cheap and affordable technologies.

In the last twenty years, the buying and selling of goods through **e-commerce** has grown rapidly. This has included auction sites and internet retailers, as well as high street retailers developing internet sites. There have been many benefits of e-commerce to its users, but one of the most important is it allows access to wider markets.

The table highlights the advantages and disadvantages of e-commerce.

	Advantages	Disadvantages
Businesses	☑ Can sell products and services 24 hours a day, 7 days a week ☑ Costs can be reduced, as no need for retail premises ☑ Market can be expanded on a national and international basis ☑ Quality will be improved, as businesses will be under constant scrutiny, as customers can easily compare one business's products to another through reviewing online feedback; only the best value for money goods and services will be chosen resulting in an increase in efficiency ☑ Processing of orders is fast and delivery can be quick and in line with customer expectations; delivery can also be tracked ☑ Data recording and analysis is easily achieved; can help with targeted promotional activity ☑ Pure play or e-tailers can locate in less expensive areas of the country, where land is not of a premium price	☒ No personal contact with customers, so more difficult to influence sales on an individual basis ☒ ICT systems have to be established, maintained and updated which can add to costs and lead to customer frustration if unreliable ☒ Distribution costs can increase rapidly through increased geographical spread of sales ☒ Increased competition, as businesses can make products available on an international basis ☒ Not all customers have internet access; some customers are afraid of fraud and therefore will not trade electronically ☒ Providing a good customer service, including return of products purchased, can be expensive
Customers	☑ Allows customers to shop from the comfort of their own home at a time when it is convenient ☑ Cheaper prices and better quality due to competition ☑ Availability can be checked, which means no wasted journeys to shops ☑ Choice is increased, as products can be selected from anywhere in the world ☑ Product details and reviews are	☒ Customers cannot see or try goods before purchasing them; returning goods can be inconvenient or expensive ☒ Possibility of personal details being used for fraud or for unwanted advertising ☒ Delays in delivery compared to high street shopping, where goods are available immediately

	Advantages	Disadvantages
	available, including from other customers ☑ No hard sell from employees; customers are free to choose and buy products that best suit them	☒ Potential customers, with no internet access, may lose out on choice
Communities	☑ Growth of new job opportunities in providing e-sales centres, distribution outlets and transport networks ☑ Increased sales in associated industries, such as technology and communication ☑ Local and national economic benefits from businesses who are successful; individuals with higher disposable incomes, due to now being in employment, will spend this income in other businesses, creating a multiplier effect	☒ Loss of traditional retailers from high street shopping areas and retail parks, due to an increase in competition ☒ Increase in products from other countries that have cheaper costs, resulting in the loss of direct and indirect jobs from an economy

Social media

Most businesses will now either be using, or at least be aware of, Twitter and Facebook. Social media provides an unrivalled number of direct contacts for communication – said to be 2 to 3 billion potential customers worldwide. It is also not expensive to set up and to operate at a basic level. Most social media sites allow data collection of users.

Marketing and promotion in particular, can be considerably expanded through the use of social media, although small and new businesses may find it hard to establish a following just using a Facebook page. There are an enormous number of similar businesses using similar methods. Social media is often linked to the business website, but provides a more up to date “newsy” type of information or blogs.

Other areas of the business can also benefit, for example the business may well link some recruitment strategies to social media options and sites such as LinkedIn can provide a CV sharing platform.

Digital communication

Digital communication is now in widespread use throughout the world. This includes all devices such as mobile phones, tablets, fax machines and video conferencing equipment. It has enormous applications. Digital communication can also happen through social media platforms.

The use of digital communication and digital technology can be applied to all **stakeholders**. Some specific examples are as follows:

- Customers – ordering, invoicing or sending bills, customer service, advertising
- Suppliers – ordering, payments, product information
- Employees – payslips, job information, booking holidays, checking hours to be worked

- Shareholders – annual reports, dividend information and payments

In addition, e-mail could be used for communication to all stakeholders, to share relevant information that is appropriate to the individual stakeholder needs.

Specific advantages and disadvantages of using digital communication to a business are listed in the table:

Advantages	Disadvantages
☒ Cheap to operate and widely used. Messages and data can be transmitted quickly and is increasingly possible throughout the world	☒ May be unreliable and no guarantee that messages will be received or accessed by the person intended to receive them
☒ Data and messages can be stored electronically, so saves cost of storage. Can be saved digitally and backed up using cloud storage	☒ Can lead to communication overload, as more messages are created and more information is received and sent. Important messages and emails may be lost or delayed
☒ Possible to produce translated versions using online applications	☒ Equipment may not work and not all places will be connected
☒ Teleconferencing and videoconferencing are possible, which can produce considerable time and cost savings	☒ Environmental and health concerns over electronic transmission
☒ High quality advertising and marketing messages are possible through high definition graphic and video images	☒ Lack of leisure time, as employees expected to be available longer hours and when on holiday
	☒ Constant training requirement for staff to understand how to use digital communication efficiently

Payment systems

Technology has been used by businesses for a long time. The paying of staff directly into their individual bank accounts has been used well before the internet was developed. The use of the internet has accelerated the use of e-payments, to such an extent that in many countries it has overtaken the use of cash within the country. This does however, vary considerably between different countries.

One of the first uses of internet payment systems was for businesses to pay suppliers through direct banking payments, either on a one off or regular basis. Similarly businesses can collect payments from customers in a similar way. Methods such as standing orders, direct debits, debit cards and credit cards, now represent the “normal” way for many businesses to collect payments from customers, with contactless pay being the most recent development.

The growth of e-commerce has been linked to the use of electronic payment and firms, such as PayPal, have developed to make this process easier and safer. Mobile payments are also now becoming used on a much wider basis and Apple Pay and Android Pay are examples of a new level of customer friendly applications to set up and make payments.

There are many advantages to a business of having technology based payment systems. These include:

- ☒ Lower costs
- ☒ Quicker receipt of money
- ☒ Happy customers who find it convenient
- ☒ No need for cash to be kept or used

Electronic payment does however have its critics, normally on the basis of security. There have been well publicised examples of fraudulent use of banking details and this concern is still the main reason why some customers will not use digital payment systems. Disadvantages can therefore be summarised as follows:

- ☒ Cost of buying and using payment systems
- ☒ Customers resistance to use of payment systems
- ☒ Not all customers may have access to required technology
- ☒ Risk of fraud

How businesses are affected by the use of technology

Every business area can make use of digital technology. Ignoring the pace of change is not an option even if in the short run it may be disruptive and expensive, as competitors which do use the technology will become more efficient. Those businesses that continue to use old technology will be left behind and may not survive. For a small business lack of knowledge, awareness or finance in this area can be a real problem.

Some examples of how technology influences and is used in business activity are:

Sales – the use of e-commerce, whilst providing many benefits, has also brought a constant need for businesses to keep up to date with payment methods and consumer preferences. This will be expensive and time consuming to entrepreneurs who are generally very busy.

Costs – financial recording is now predominantly computer based, with various software packages available. Digital applications are also used for electronic billing and payments. Many firms will also use programmes for financial modelling and monitoring linked to **management information systems** which are used to provide this data to managers and owners. Software packages are available that are suitable for small businesses, but they are often expensive.

Marketing mix – Digital technology can be used directly in terms of e-commerce and websites. Marketing also makes other widespread use of computers in terms of product design, advertising, social media and its use of customer databases, which is often linked to market research. Setting up, managing and developing technology based promotion are all possible for a small business. However, there is a need for entrepreneurs to understand its benefits and afford its costs.

There will be other uses of digital technology within even a small business and production, human resources and the organisation of administration will all make considerable use of the opportunities that it provides.

Legislation and Business

Governments introduce legislation in many areas of the economy. This is done to control businesses that otherwise might put profits before looking after its customers or treating its employees fairly. It also ensures a fair system, as all businesses in the UK have to meet the same requirements.

Consumer Laws

Consumer Rights Act 2015

This law provides consumers with significant protection when it comes to dealing with businesses. All start-up and small businesses, as well as larger businesses, have to ensure that they comply with this legislation. The Consumer Rights Act covers product quality, returning goods, repairs and replacements, digital content and delivery rights.

The main requirements include that:

Goods must fit their description

- E.g. organic wine really must be organic
- Businesses need to take care with descriptions – avoid inaccurate claims

Goods and services must be of satisfactory quality

- The test is whether a “reasonable person” finds them to be satisfactory
- Goods must work and have no significant defects

Goods are fit for the purpose specified

- E.g. a watch should tell the time
- Businesses should take care when explaining what a product can be used for

The Trade Descriptions Act 1968

The Trade Descriptions Act makes it an offence for a trader to make false or misleading statements about goods or services. It carries criminal penalties and is enforced by Trading Standards Officers, making it an offence for a trader to:

- apply a false trade description to any goods
- supply or offer to supply any goods to which a false description has been applied
- make false statements about the provision of any services, facilities or accommodation

The Consumer Rights Act and the Trade Descriptions Act are the two main two acts that exist to protect consumers. However, consumer protection under the law goes much further. For example:

- Businesses may not use **unfair commercial practices**, for example misleading advertising or pressurised selling.
- Customers have a right to return and be provided with a full refund if goods/services do not comply with the law.
- Services must be completed at a reasonable price and by the time stated. The customer can request that unsatisfactory work be repaired or carried out again at no cost.

- Since October 2008, consumers buying from home or at work have the right to a “cooling off period”. This means if a customer orders a product, such as a mobile phone, by phone or online, he/she has 14 days to decide whether he/she wants to keep it or not.

Effects on business

There will be costs that businesses will need to pay, for example in terms of increased quality control, to make sure that they obey consumer law. There will however, be many benefits to a business of ensuring that they do comply with these laws, such as gaining an improved reputation in the marketplace, which could lead to an increase in sales, and avoiding bad publicity.

Breaking any of these laws can lead to a business incurring costs of repair and replacement, increased administration costs, as well as gaining a bad name in the market. It can also lead to very high fines for the business, which can run into millions of pounds.

Employment Law

Equal pay and minimum wage laws

The basic rule for all businesses in the 2010 Equality Act UK is that:

Men and women are entitled to equal pay for work of equal value

... Looking at that rule in a little more detail:

- “Pay” includes everything in the employment contract - bonuses and pension contributions, as well as basic wages or salary
- Workers have the right to ask their employer for information to check equality – using the equal pay questionnaire
- If employees believe their pay is unequal, they can take the employer to an **employment tribunal**

Employees must be paid at least the national minimum wage (NMW) by law. Since April 2016, if staff members are aged 25 or over, they must be paid at least the national living wage (NLW). The NMW and NLW are reviewed and usually changed every year. The rates as at October 2016 and April 2017 are shown in the table:

Current rates					
These rates are for the National Living Wage and the National Minimum Wage. The rates change every April.					
Year	25 and over	21 to 24	18 to 20	Under 18	Apprentice
October 2016 (current rate)	£7.20	£6.95	£5.55	£4.00	£3.40
April 2017	£7.50	£7.05	£5.60	£4.05	£3.50

Source: <https://www.gov.uk/national-minimum-wage-rates>

Effects on business

The effect of wage legislation on many businesses is often that their wage costs will increase, although some businesses will choose to pay above these levels, to attract a higher calibre of staff. They may also choose to pay higher than the minimum levels to increase staff motivation and reduce labour turnover. This will reduce recruitment costs and increase productivity levels within the business.

Firms which do not pay minimum wages can face significant fines, as well as receiving bad publicity, which will make future recruitment more difficult and may reduce sales.

Discrimination

Discrimination is the **treatment in an unacceptable way of anyone who is termed to be different**. In the UK, it is illegal for an employer to discriminate against an employee on the basis of:

- Sex, including pregnancy and maternity
- Marital/civil partnership status
- A person's disability
- Race
- Age
- Sexual orientation
- Religion/belief
- Trade union membership or non-membership
- Status as a fixed-term or part-time worker

Discrimination laws apply in many areas of employing staff, for example:

- Recruitment
- Employee contract - terms and conditions
- Promotions and transfers
- Providing training
- Deciding which fringe benefits employees receive
- Employee dismissal

Employment rights

An employment right is something to which an employee is entitled, which is protected by law. Laws provide a variety of “rights” for employees, including:

- Reasonable notice before dismissal
- Right to redundancy
- Right to a written employment contract
- Right to request flexible working
- Right to be paid the national minimum or living wage
- Right to take time off for parenting

Health and Safety

The **Health and Safety at Work Act (1974)** gives employers the duty to ensure, as far as it is possible, the **health, safety and welfare** at work of all their employees.

The act requires for example:

- safe operation and maintenance of the working environment, plant and systems

- maintenance of safe access to and around the workplace
- safe use, handling and storage of dangerous substances
- adequate training of staff to ensure health and safety
- adequate welfare provisions for staff at work

In terms of health and safety, management must remember that it is not just concerned about protecting staff – health and safety applies to any person who comes into contact with the business. That means that proper health and safety needs to be provided to:

- Employees working at the business premises, from home, or at another site
- Visitors to the premises, such as customers or subcontractors
- Employees working at other premises where their business is working, such as on a construction site
- Members of the public - even if they are outside the business premises
- Anyone affected by the products the business designs, produces or supplies

For most start-up or small businesses, complying with health and safety does not pose too many problems, although the business will incur additional costs to ensure that it complies with the law properly. For example, there could be staff training costs on relevant health and safety matters, providing appropriate equipment and clothing to staff and lost management time spent checking that the business is obeying all aspects of the law. In some industries however, health and safety is really important, for example:

- Food processing (hygiene)
- Hotels (guest safety, hygiene)
- Chemical production (dangerous processes, waste disposal)
- Air travel (passenger safety)
- Tour operators (holidaymaker safety)

Effects on business of Health and Safety Law

Many businesses will often say that meeting health and safety requirements can be expensive and make them uncompetitive, especially if they face competition from firms in other countries where there are less health and safety requirements. However, failure to meet health and safety requirements can result in unlimited fines and imprisonment.

Businesses will also benefit from a **safe working environment**, as staff will stay working for the business and will be happy and more motivated in what they are doing. This will increase productivity levels. Businesses will also find it is easier to recruit new employees, if a vacancy arises.

The economy and business

Governments will all have well established economic policies designed to influence and control how the economy operates in their country. They will have aims such as low inflation, high employment, increased production and a balance in international trade. The policies used to achieve these objectives, which include **interest rates** and **taxation**, will all affect businesses both directly and indirectly through their effects on consumers and employees.

Level of employment and unemployment

Governments will be aiming to have high employment (and low unemployment) in their economy, so there will be less people reliant on benefit payments. There are, however, advantages and disadvantages to businesses of high levels of employment. These are summarised in the table:

Advantages	Disadvantages
☑ Incomes will be higher, so spending on goods and services will increase, particularly on non-essential items ☑ Workers will be more motivated, as they have more job security, increasing productivity levels and efficiency	☒ Fewer workers will be available, resulting in new job vacancies being difficult to fill ☒ Wages and salaries are likely to increase, as fewer workers are available; new and existing workers can demand higher pay ☒ Increased staff turnover, as it easy for workers to move jobs, increasing recruitment and training costs

High unemployment will result in the reverse of the above points and may also cause workers' skills to be lost, particularly in industries using technology.

There will also be considerable regional variation within a country in terms of employment levels. This may encourage businesses to relocate to take advantage of the opportunities that this provides, directly through an increase in the amount of available labour or indirectly through government relocation grants and subsidies. Some businesses will benefit more than others, depending on whether their goods or services are targeted at consumers with high or low incomes.

Growth and consumer spending

An increase or decrease in consumer incomes will affect how much money consumers spend and what they spend their money on.

An **increase** in spending will mean that consumers will **purchase more goods and services**. Although this is an opportunity for local, domestic businesses, they will need to produce more or consumers will buy from other countries that may be quicker to expand production and fulfil customer needs more efficiently. If production cannot increase to meet customer demand, there is a possibility that increased consumer spending might lead to prices rising and inflation taking place. When a decrease in consumer spending occurs, the above effects are reversed.

When an increase or decrease in income levels happens, consumers will **purchase different goods and services**. For example, when there is an **increase** in income levels, businesses that produce luxury goods and services will do very well. Businesses that produce more basic products might see a decrease in demand, even though overall customer spending is increasing. This is because customers may switch from buying lower priced products, such as Tesco value beans to buying a branded product, such as Heinz beans. Demand for some products however, will remain near enough constant, despite changes in income levels. Examples of these products include bread, milk and eggs, as they are seen as necessity items.

Inflation

Inflation is a prolonged period of rising prices in an economy. The UK economy has had very low inflation for many years. If inflation were to increase this would mean that the prices of goods and services would increase and there would normally be corresponding increases in wage rates, so that consumers could afford the higher prices.

The effect of inflation on business can therefore be seen in two parts: costs and demand.

Increased costs – wage costs and the cost of materials will rise. This can prove difficult for businesses, as they will always want costs to reduce. It can lead to pay disputes with workers or a decrease in quality of materials purchased in order to save money.

Increased prices – the increased costs will be passed onto the customers. This may reduce **demand** as consumers find cheaper products from goods imported into the country. Some consumers will also not have an increase in their wages. The increased prices might also cause a fall in demand if they sell their products to other countries, which have lower or no inflation.

As well as the additional work involved in managing inflation, there is always the risk of a **wage – price spiral** where wage increases lead to price increases which lead to further wage increases and so on. The inflation rising out of control will damage most businesses in an economy.

Taxation

Taxation will affect businesses directly and indirectly. Firstly businesses will be taxed on their profits. This is known as income tax for a sole trader or partnership. A company pays corporation tax which affects all business with revenue of over £300,000 a year. The rate at which businesses are taxed has been reduced in recent years to encourage businesses to stay in the UK rather than moving to other countries, which may tax profits at lower rates.

Businesses will also be affected by taxes on consumer income and expenditure. Direct taxes on consumers include income tax. If this increases then consumers will have less money to spend, so businesses will suffer (see **consumer spending**). There are also indirect taxes that consumers pay on their spending, VAT being the most important. 20% is currently added to the price of most goods and services. Changes to VAT are used by the government to encourage or discourage consumer spending.

Interest rates

In recent years, interest rates have been very low in the UK. Any change overall or in the direction of interest rates, can influence consumer and business behaviour considerably. An increase in interest rates may cause the following to happen:

Direct effects:

- Business loans will be more expensive. This will discourage investment and may mean businesses become less competitive or are reluctant to expand
- Costs may increase, as the cost of existing loans/overdrafts may be higher, dependent on the terms of the borrowing
- Businesses may choose to save money to earn the higher interest, rather than spend it

Indirect effects:

- Consumers will spend less, as it is more expensive for them to borrow money to fund expenditure
- Consumers will also spend less, as they will be more inclined to save more if interest rates are increasing
- Consumers may also spend less, as their costs on existing debts, such as loans and mortgages, may increase, meaning they have less disposable income to spend on other purchases, particularly non-essential goods and services, such as going to the cinema. Certain businesses will therefore see a drop in sales, revenue and therefore profit

- The exchange rate may increase, making the costs of goods sold by businesses to other countries more expensive

Exchange rates

Where businesses trade with other customers and suppliers in other countries, they will need to take into account the value of that country's currency. This **exchange rate** and changes to this exchange rate will affect the prices that have to be paid and the amount that can be earned from overseas trade.

Imports are goods and services that are purchased from other countries. These might be raw materials or finished products or services purchased by consumers. **Exports** are goods and services sold to businesses and consumers in other countries.

If the exchange rate changes so that the **currency appreciates**, then it will be worth more. This means that it will cost more for businesses located outside of the UK to buy the UK currency or pound sterling. It will also be cheaper for businesses located in the UK to buy another country's currency. This means that imports into the UK will be cheaper and exports will become more expensive.

As a result if a country's currency is appreciating then it is:

- **bad** for a business that exports, as its goods will become more expensive in the countries that it sells its goods in, so sales will decrease
- **good** for consumers, as prices of imports will decrease and they can get different and cheaper goods and services
- **good** if a business imports raw materials, as the business will be able to buy more of these raw materials for the same UK converted price. This will reduce business costs, which would give it more flexibility with pricing. This is very important if the business operates in a competitive market, as a reduction in prices could result in an increase in sales, which if costs are controlled could lead to an increase in profits
- **bad** for a local business that may not be able to compete against the cheap imports

If a **currency depreciates** then it will be worth less (devaluation) and be cheaper for other countries and businesses to buy. This is often seen as a disadvantage to a country, but in reality there are some businesses which will gain from this situation and others that will lose, which can be described as follows:

- **good** for a business that exports, as its goods will be cheaper so sales might increase
- **bad** for consumers, as prices of imports will increase, so they will have to spend more to get the same imported goods and services
- **bad** if a business imports raw materials, as it may increase its costs which might cancel out the benefits of cheaper export prices
- **good** for local businesses, as they will be able to compete better against cheaper imports

Fluctuations in exchange rates cause **uncertainty** in business and will impact on business decision-making. Since Brexit, the pound sterling has fallen in value, which has resulted in exports becoming cheaper, but imports becoming more expensive. Changes in the exchange rate such as this, might discourage businesses from trading internationally, as it will impact on the profits that a business makes.

These effects are often summarised using the word SPICED:

S	trong
P	ound
I	mports
C	heaper
E	xports
D	earer

The importance of external influences

External influences are very important for all businesses, but this is particularly so for a small or new business, as these influences, and changes to them, are outside the control of a business. Businesses will however, be affected by these factors and have to react to them. A good business will also be looking to the future and anticipating any changes and how they best should prepare for them. These changes can be local, national or international. For example, how will a business be affected if interest rates rise? Or if the large factory nearby closes? Or the minimum wage is increased significantly? Successful businesses are those businesses that are prepared and have a plan in place for these changes.

In order to summarise the way external influences can result in changes of business strategy and planning we can consider a few examples on a small independent hotel business:

External change	Impact on business	Reaction of business
Increase in income tax rates	☒ Business costs increase and consumer income decreases ☒ Reduced demand for goods and services, dependent on the nature of the product, for example there would be less demand for luxury goods In the example set, the business may see a drop in demand from wealthier customers, as they can no longer spend their income on short breaks, but must spend their income on their mortgage	• Short term price reductions to fill hotel • Some staff reductions to save costs • Advertisements in other countries as possible new markets
New anti-pollution law	All businesses need to recycle higher percentage of waste materials. ☒ Costs increased and profits decrease	• Room prices to customers increased, dependent on rivals • Other cost savings made in reducing staffing, less marketing and less training

External change	Impact on business	Reaction of business
Increase in e-shopping using mobile phones	☒ Drop in sales booked through reception and loss of sales to other hotels that were quick to adopt online bookings through mobile phones	• Investment in e-sales and a website which is compatible with smart phones • Daytime hotel reception staff made redundant • Price reductions for online bookings