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Management in Practice

M5X02110 – Level 5

3: “It’s the economy, stupid!”

Analysing the
External Operating
Environment 1:
Economic



Last time.....



1. To examine demand, supply and markets

- identify a market and define the attributes of a perfect market
- analyse the factors that affect the demand for a good or service
- analyse the factors that affect the supply of a good or service
- understand the concept of equilibrium price
- analyse the factors that cause changes in equilibrium price
- relate price theory to real-world examples

2. To define money & the uses of money

Today's Objectives – To....



1. Define a PESTEL/PESTLE analysis
2. identify the key variables in the economy which affect leisure, events and tourism and hospitality organisations
3. identify and utilize information sources
4. analyse the impact of changes in economic variables on LET organisations
5. explain the interrelationship between key economic variables
6. understand and analyse the causes of change in the economic environment
7. understand and evaluate government economic policy and the significance of the budget
8. understand the global economic environment
9. utilise economic forecasts with due caution
10. conduct an opportunities and threats analysis

Assignment Tasks: case study

- Environmental analysis (PESTLE & SWOT)
- Performance Management Audit (systems, operating performance)
- Presentation and report = 5000 words



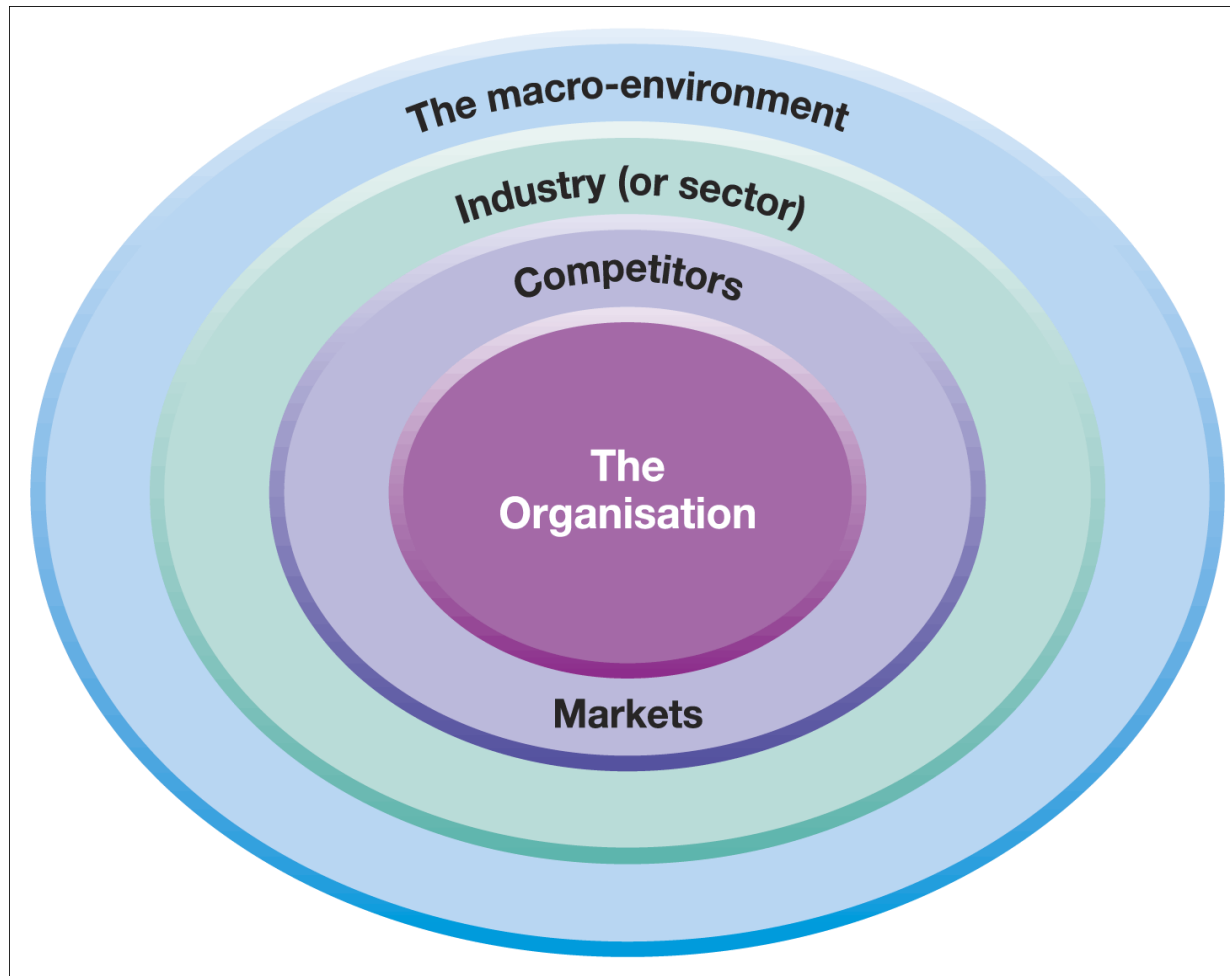
The economics of LET

- Scarcity and choice
- Demand, supply and markets
- Work vs. leisure
- Government intervention
- Economic impacts
- Growth and development
- Externalities and the environment

PESTEL/PESTLE

- Analyse the broad macro-environment of organisations in terms of political, economic, social, technological, environmental ('green') and legal factors *(PESTEL)*.
- Identify key drivers in this macro-environment and use these key drivers to construct alternative *scenarios* with regard to environmental change.

Layers of the business environment



Layers of the business environment

The PESTEL framework (1)



The PESTEL framework categorises environmental influences into six main types:

political,

social,

environmental

economic,

technological,

legal

Thus PESTEL provides a comprehensive list of influences on the possible success or failure of particular strategies.

https://youtu.be/_YhEpBvIO2M

The PESTEL framework (2)

- ***Political Factors:*** For example, Government policies, taxation changes, foreign trade regulations, political risk in foreign markets, changes in trade blocks (EU).
- ***Economic Factors:*** For example, business cycles, interest rates, personal disposable income, exchange rates, unemployment rates, GDP trends.
- ***Socio-cultural Factors:*** For example, population changes, income distribution, lifestyle changes, consumerism, changes in culture and fashion.

The PESTEL framework (3)

- ***Technological Factors:*** For example, new discoveries and technology developments, ICT innovations, rates of obsolescence, increased spending on R&D.
- ***Environmental ('Green') Factors:*** For example, environmental protection regulations, energy consumption, global warming, waste disposal and recycling.
- ***Legal Factors:*** For example, competition laws, health and safety laws, employment laws, licensing laws, etc

Key drivers of change

Key drivers for change:

- The environmental factors likely to have a high impact on the success or failure of strategy.
- For example, the birth rate is a key driver for those planning nursery education provision in the public sector.
- Typically key drivers vary by industry or sector.

Task (15m)

In groups, produce a PESTEL analysis of the restaurant industry

1. Political
2. Economic
3. Social
4. Technological
5. Environmental
6. Legal

Political

Economic

Social

Technological

Environmental

Legal

Using the PESTEL framework

- Apply *selectively* –identify specific factors which impact on the industry, market and organisation in question.
- Identify factors which are *important currently* but also consider which will become *more important in the next few years*.
- Use *data* to support the points and analyse trends using up to date information
- Identify *opportunities and threats* – the main point of the exercise!

Scenarios



Scenarios are detailed and plausible views of how the environment of an organisation might develop in the future based on key drivers of change about which there is a high level of uncertainty.

- Build on PESTEL analysis .
- Do not offer a single forecast of how the environment will change.
- An organisation should develop a few alternative scenarios (2–4) to analyse future strategic options.

Carrying out scenario analysis (1)

- Identify the most *relevant scope of the study* – the relevant product/market and time span.
- Identify *key drivers of change* – PESTEL factors that have the most impact in the future but have uncertain outcomes.
- For each key driver *select opposing outcomes* where each leads to very different consequences.

Carrying out scenario analysis (2)

- *Develop scenario 'stories'* - That is, coherent and plausible descriptions of the environment that result from opposing outcomes
- *Identify the impact of each scenario* on the organisation and evaluate future strategies in the light of the anticipated scenarios.
- *Scenario analysis is used* in industries with long planning horizons for example, the oil industry or airlines.

Industries, markets and sectors

An industry is a group of firms producing products and services that are essentially the same. For example, automobile industry and airline industry.

A market is a group of customers for specific products or services that are essentially the same (e.g. the market for luxury cars in Germany).

A sector is a broad industry group (or a group of markets) especially in the public sector (e.g. the health sector)





The Economic Environment

Where is everyone?



- What factors in the economic environment affect the demand for tourism/events/leisure/hospitality/recreation?

The Macroeconomic Environment

- Key macroeconomic issues
 - economic growth
 - unemployment
 - Inflation
 - balance of payments and exchange rates
 - balance of payments deficits and surpluses
 - exchange rate movements

The Macroeconomic Environment

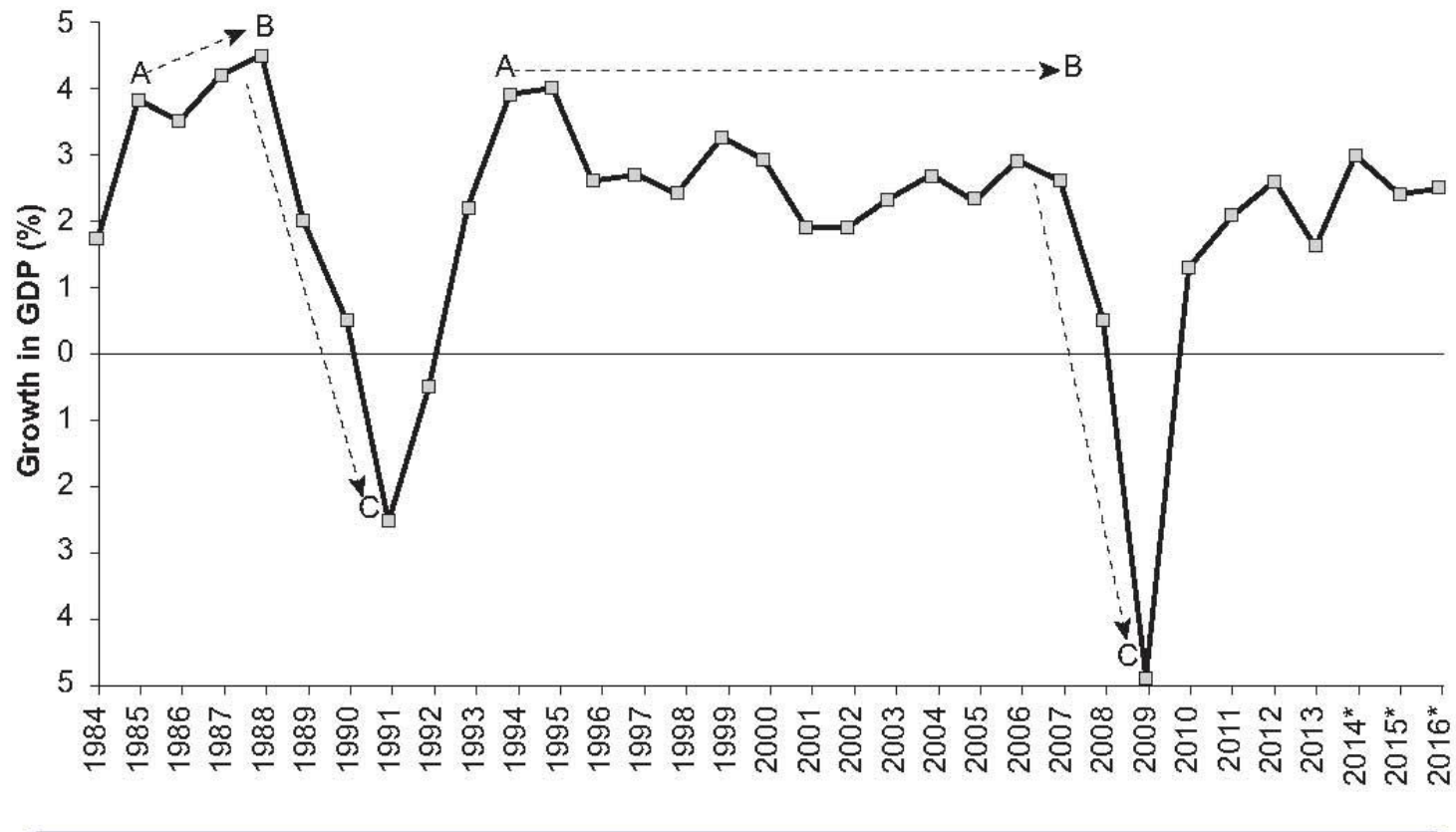
Task – what is/are:

- economic growth
- unemployment
- Inflation
- balance of payments and exchange rates
 - balance of payments deficits and surpluses
 - exchange rate movements

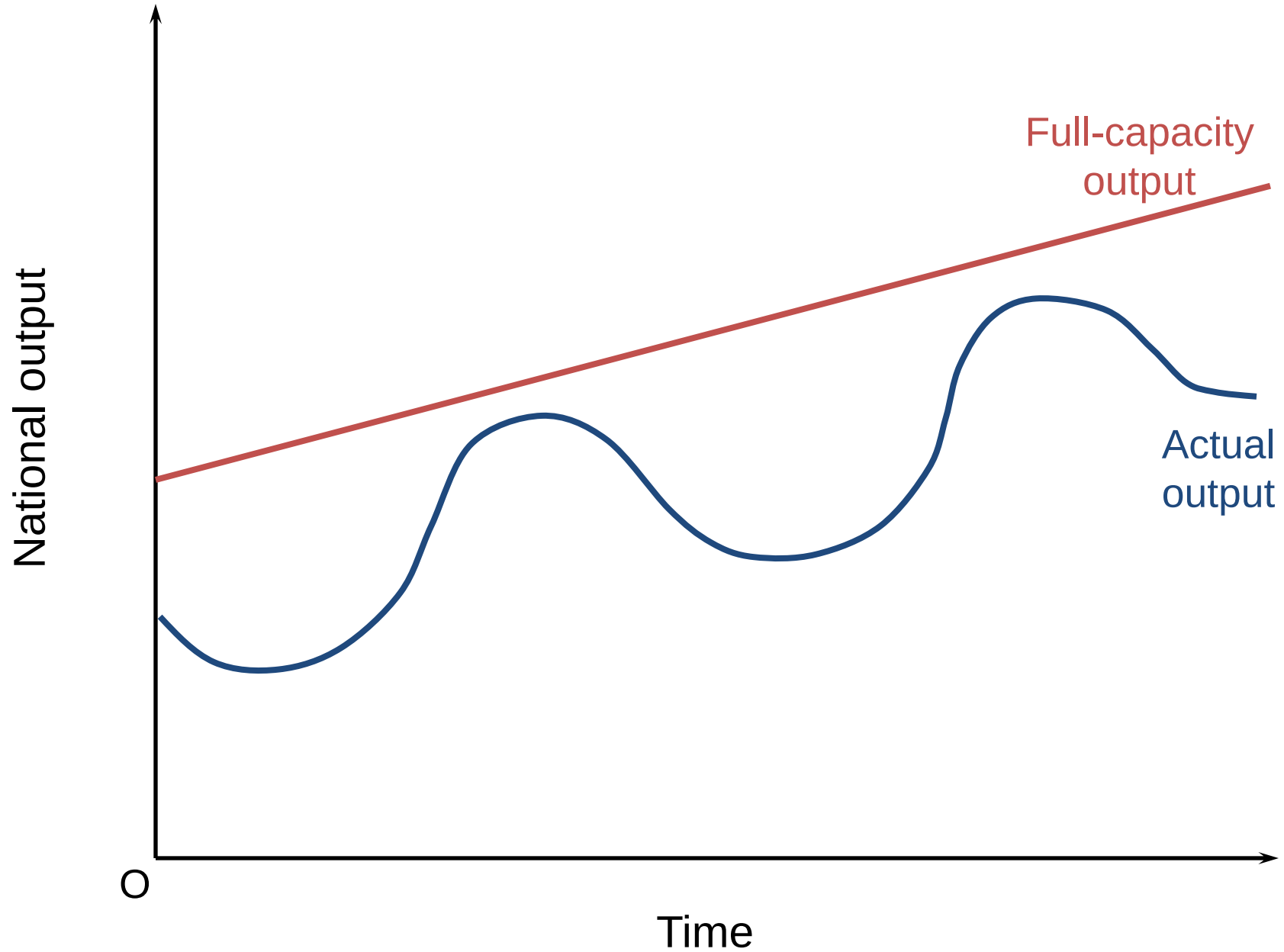
Economic Growth

- Growth in actual and potential output
- Economic growth and the business cycle
 - fluctuations in actual growth
 - the phases of the business cycle
 - the upturn
 - the expansion
 - the peaking out
 - the slowdown or recession

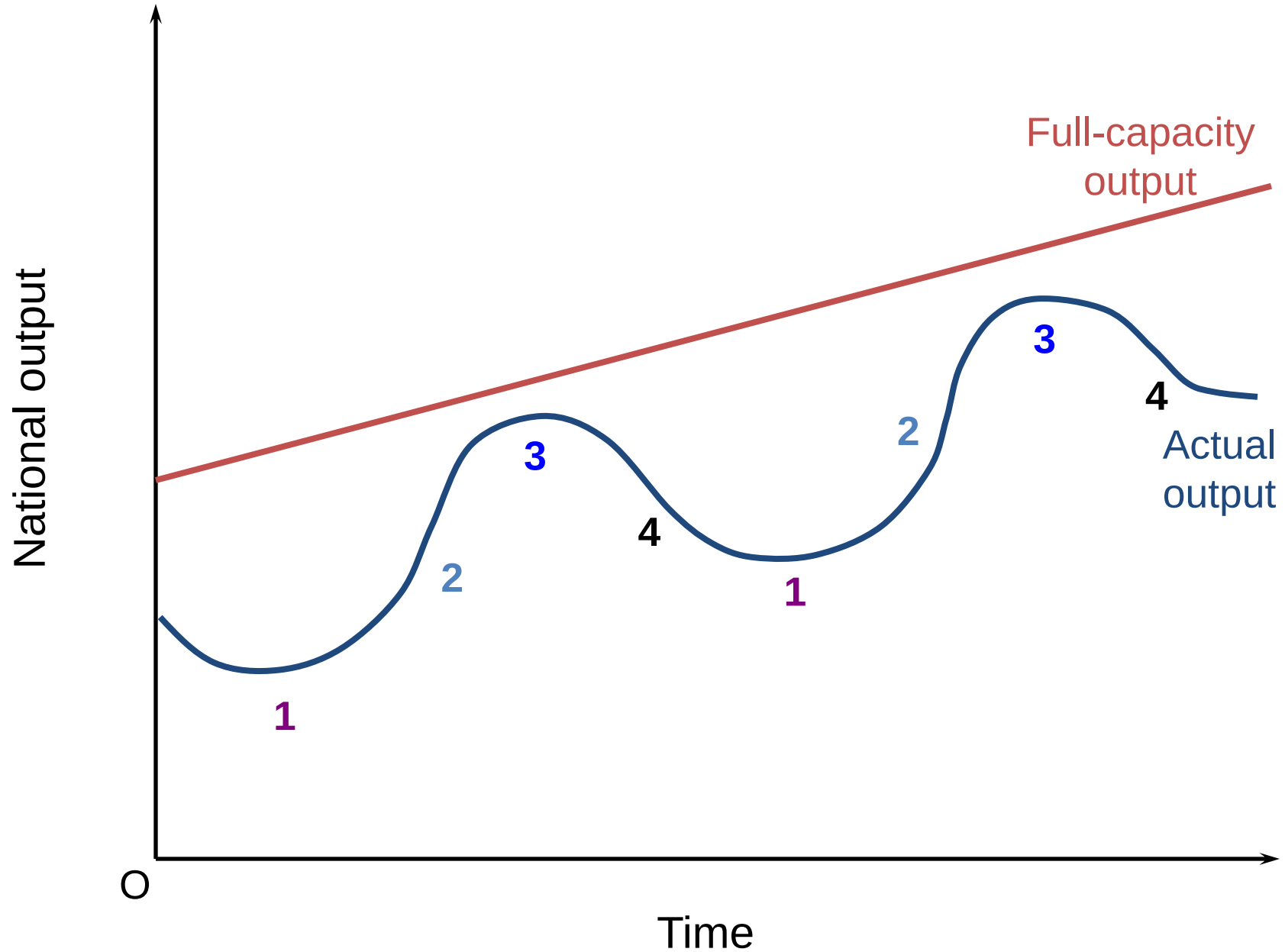
UK economic growth



The business cycle



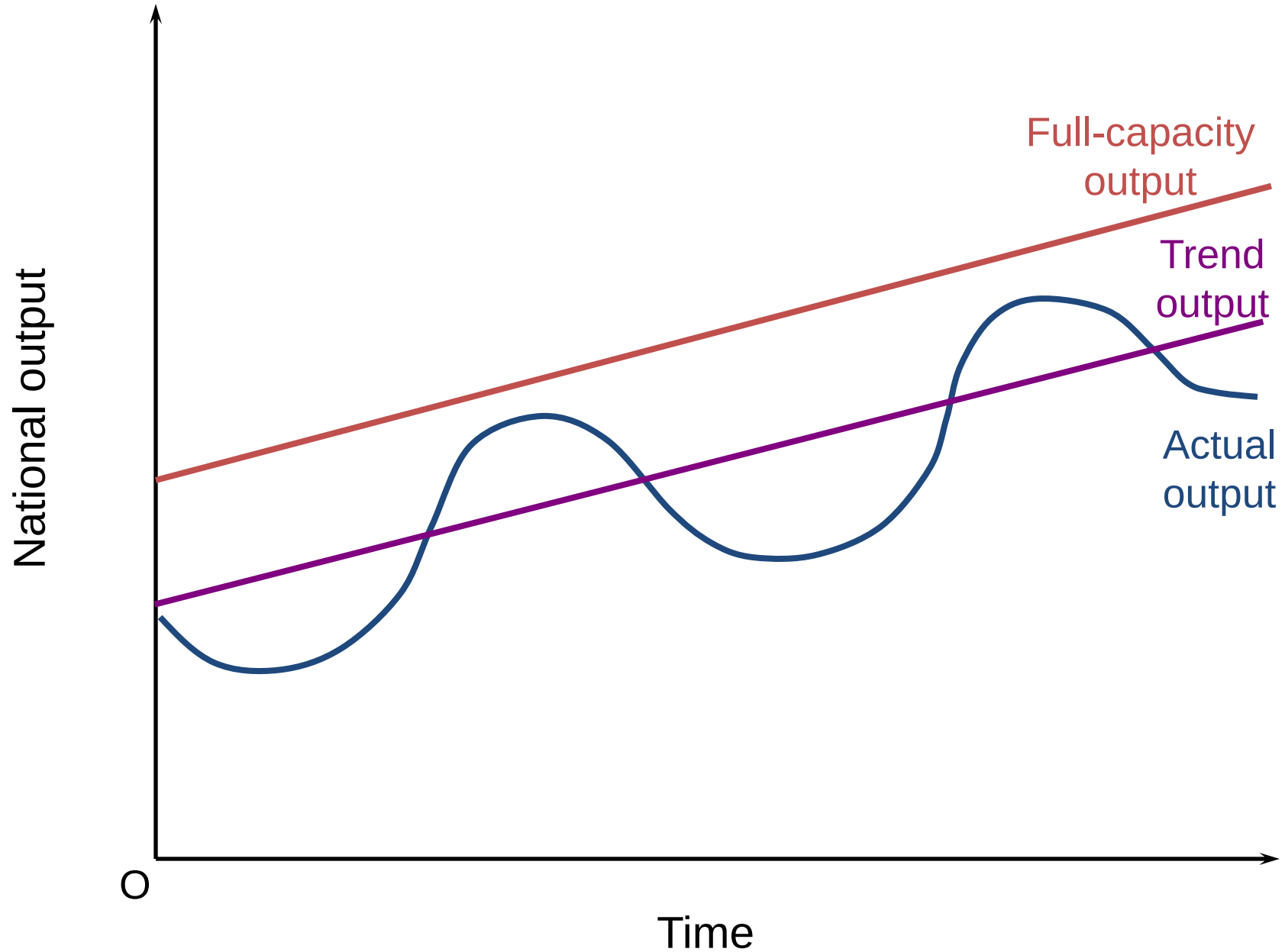
The business cycle



Economic Growth

- Growth in actual and potential output
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 - fluctuations in actual growth
 - the phases of the business cycle
 - the upturn
 - the expansion
 - the peaking out
 - the slowdown or recession
- long-term output trend

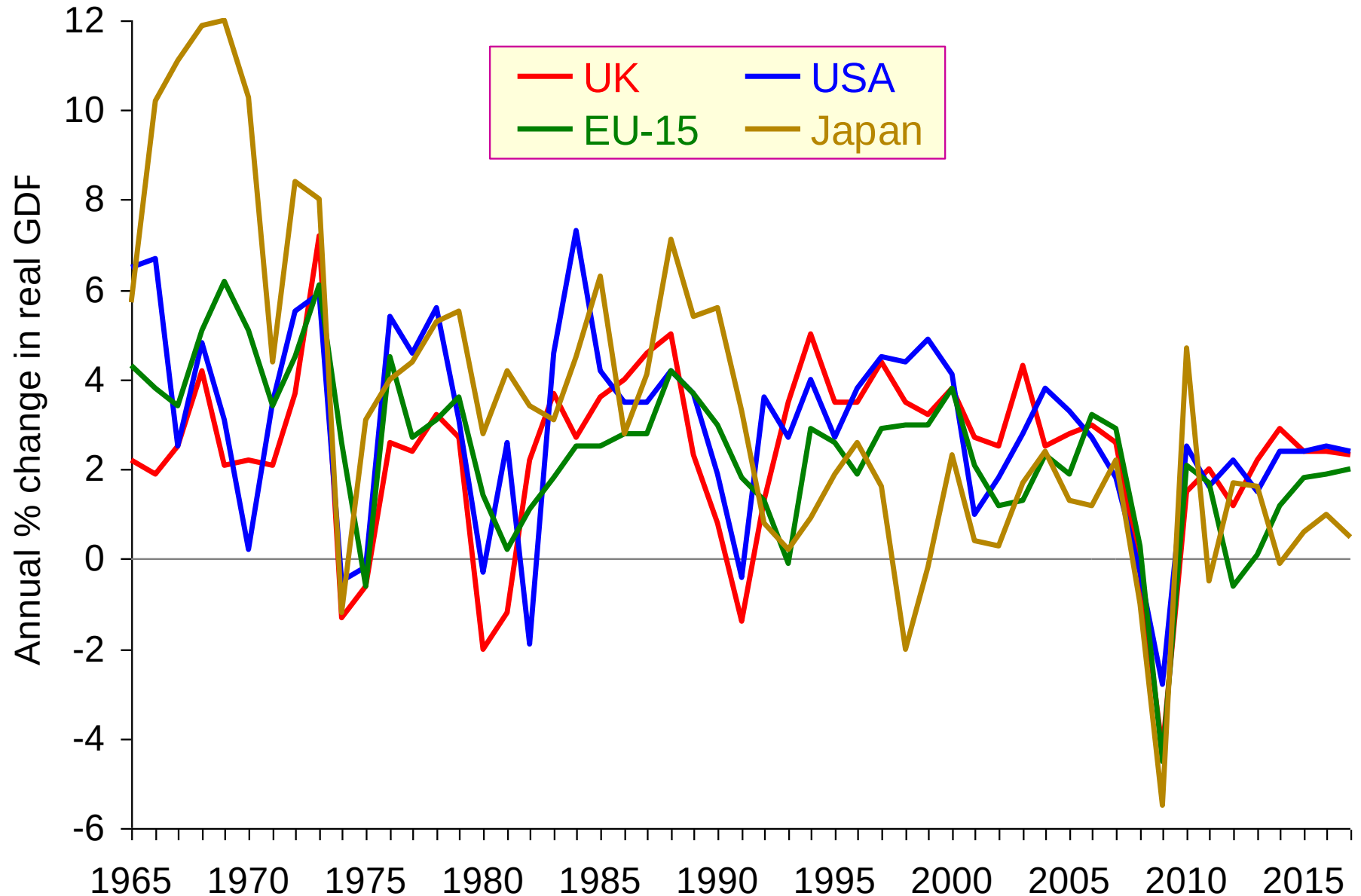
The business cycle



Economic Growth

- Economic growth and the business cycle
 - fluctuations in actual growth
 - the phases of the business cycle
 - the upturn
 - the expansion
 - the peaking out
 - the slowdown or recession
 - long-term output trend
- the business cycle in practice
 - ✦ the length of the phases
 - ✦ the magnitude of the phases

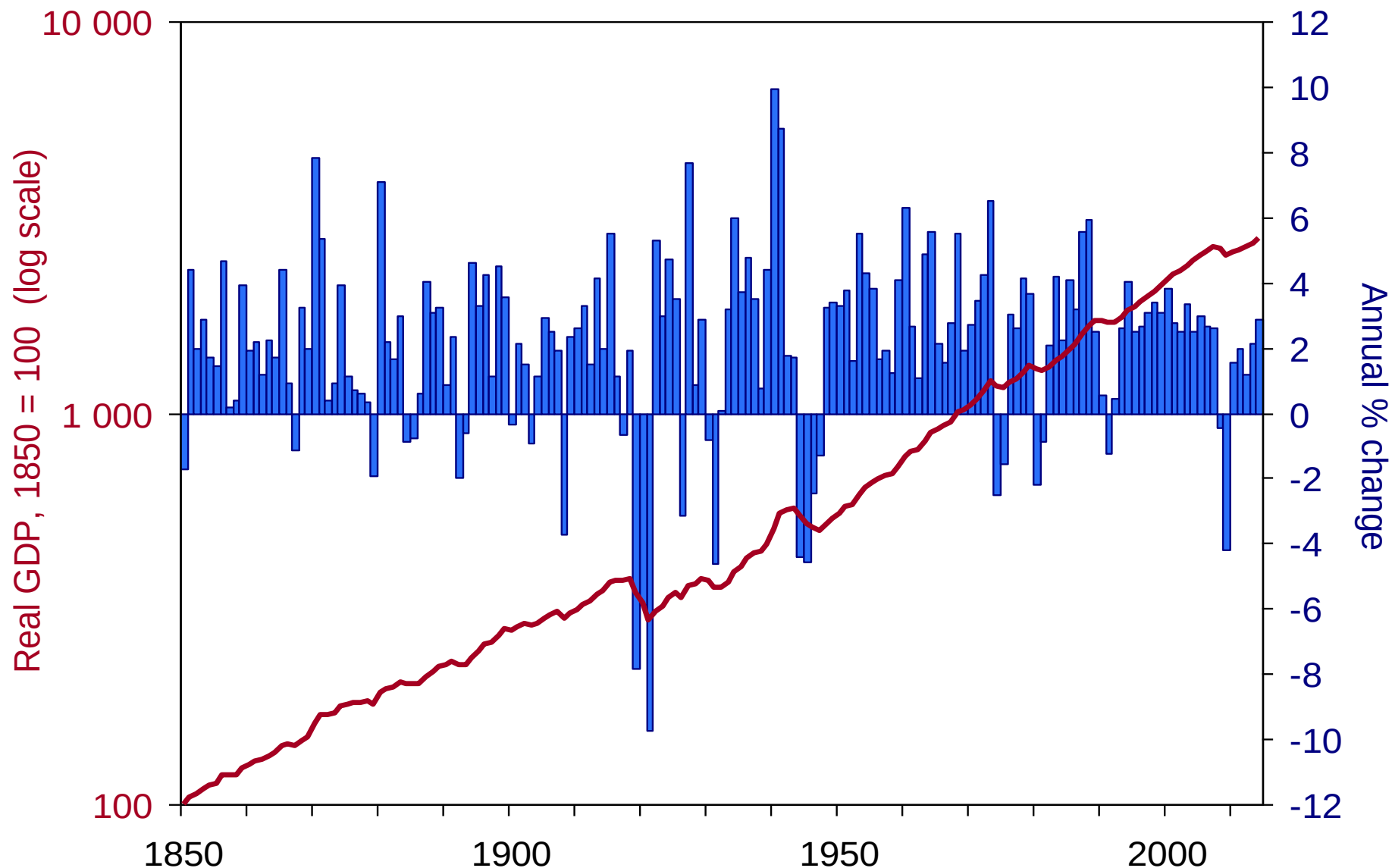
Growth rates in selected industrial countries



Notes: 2015 and 2016 based on forecasts; EU-15 = the member countries of the European Union prior to 1 May 2004

Source: Based on data in [AMECO Database](#) (European Commission, DGECFIN)

Output and economic growth in the UK since 1850



Note: Growth is the annual growth in constant-price GDP

Sources: 1850–1948 based on data from Bank of England available at <http://www.bankofengland.co.uk/publications/quarterlybulletin/threecenturiesofdata.xls>; from 1949 based on data from *Quarterly National Accounts* series [IHY](#) and [YBEZ](#) (National Statistics)

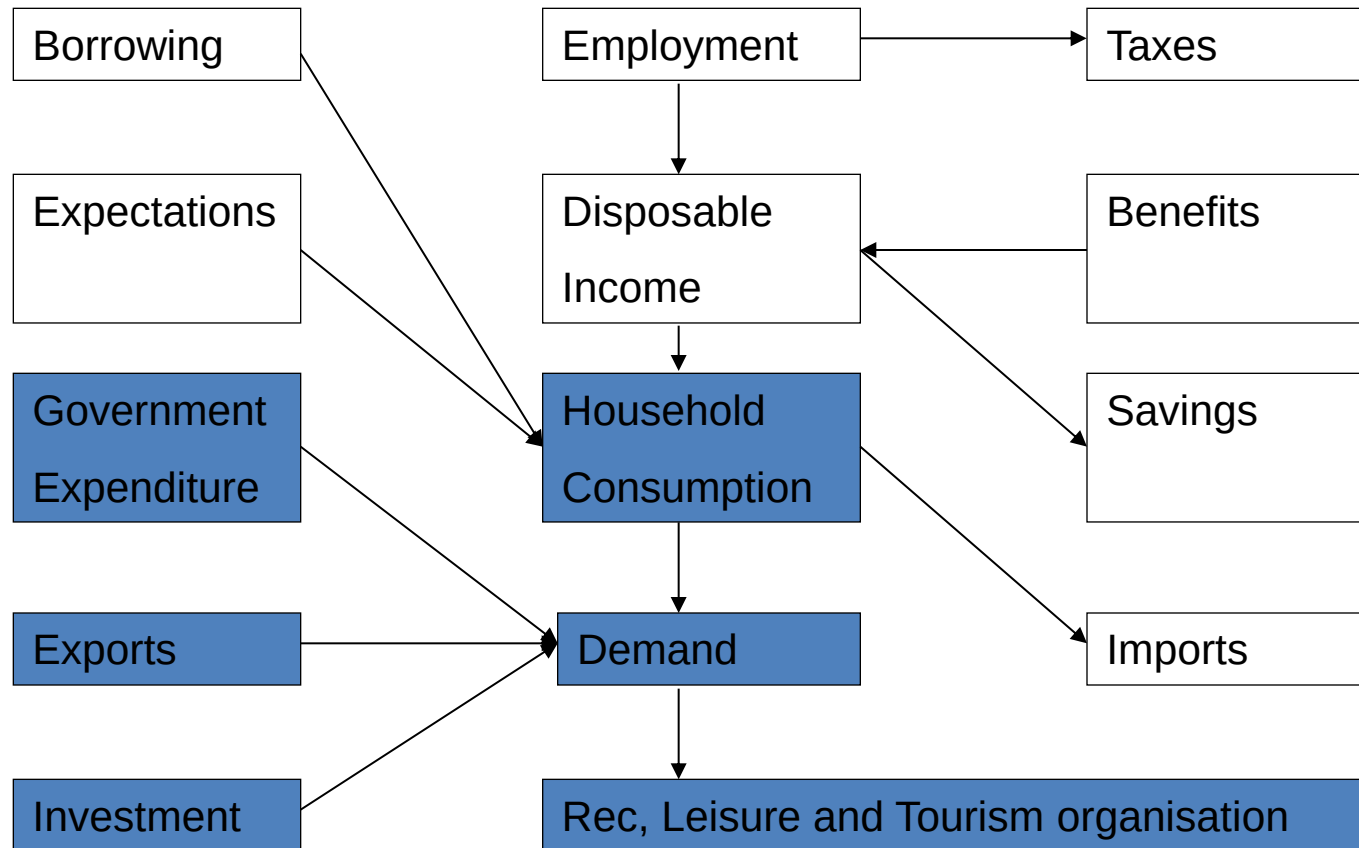
Economic Growth

- Policies to achieve growth
 - demand-side policies
 - supply-side policies
 - the twin roles of investment

What are the key variables?

- The economic environment affects organisations in the LET sector in two main ways:
 - changes in the economic environment can affect the **demand** for an organisation's products
 - changes may affect an organisation's **costs**
 - additionally, background factors such as share and property prices may affect organisations

The economic environment and demand



The economic environment and demand

- The key macroeconomic factors affecting demand for recreation leisure and tourism industries are:
 - household consumption
 - export and import demand
 - government expenditure
 - investment

Household consumption

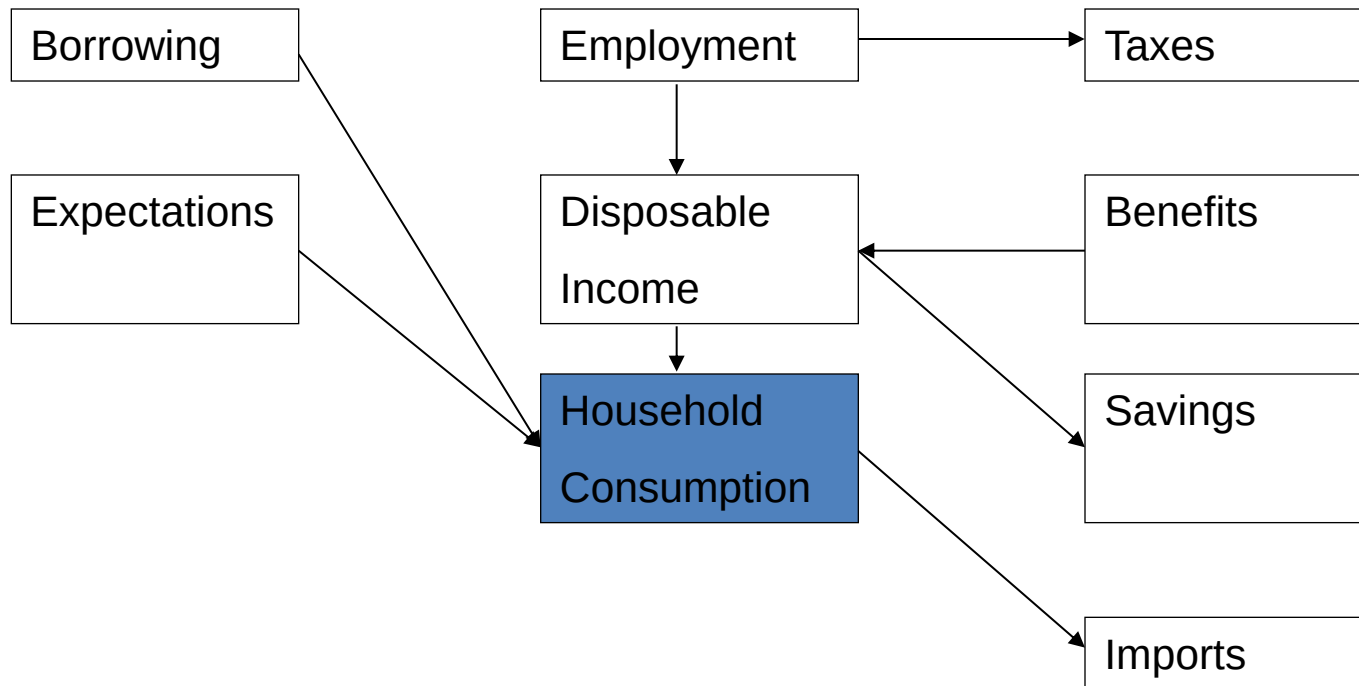
- Defined as
 - the total expenditure on goods and services for immediate consumption
 - current price measurement includes inflationary element
 - constant price measurement has had the inflationary element removed and is therefore a more useful guide
 - $\text{real household consumption} = \text{money household consumption} - \text{inflation}$

US changes in real GDP and household consumption

	2006	2007	2008	2009	2010	2011	2012
Real GDP	2.4	2.3	-2.8	-0.2	2.7	1.7	1.6
Consumption	3.3	1.8	-1.9	-0.2	3.1	1.5	2.0

Source: US Treasury Office of Economic Policy (<http://www.ustreas.gov>).

What determines the level of household consumption?



What determines the level of household consumption?

- Real household's disposable income
- Employment and wages
- Taxes and benefits
- Borrowing and savings and interest rates
- Expectations (of the future)

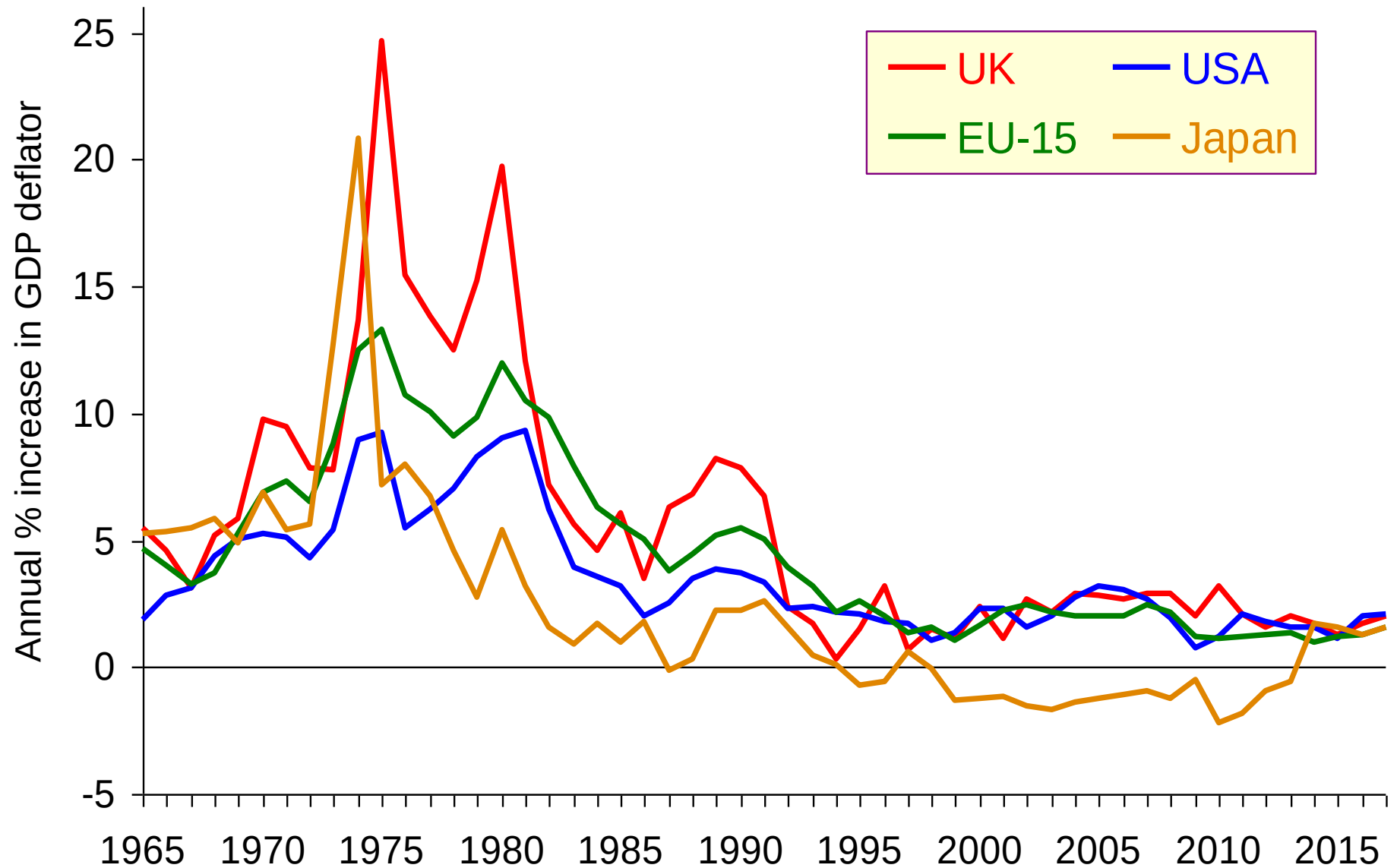
Real household's disposable income

- Real income = money income – inflation
- Real household's disposable income =
real household's income – taxes +
benefits

Inflation

- Defining inflation
 - rising price levels
 - Consumer Prices Index (CPI)
 - Retail Prices Index (RPI)

Inflation rates in selected industrial countries



Notes: (i) Based on the annual rate of increase in the GDP deflator; (ii) Figures from 2014 based on forecasts; (iii) EU-15 = the member countries of the European Union prior to 1 May 2004.

Source: Based on data in [AMECO Database](#) Database (European Commission, DGECFIN)

Inflation

- The costs of inflation
 - redistribution
 - uncertainty
 - balance of payments
 - resources used to cope with inflation

Q In a period of rapid inflation which of the following would be the least desirable store of wealth?

A. Vintage wine

B. Property

C. Money

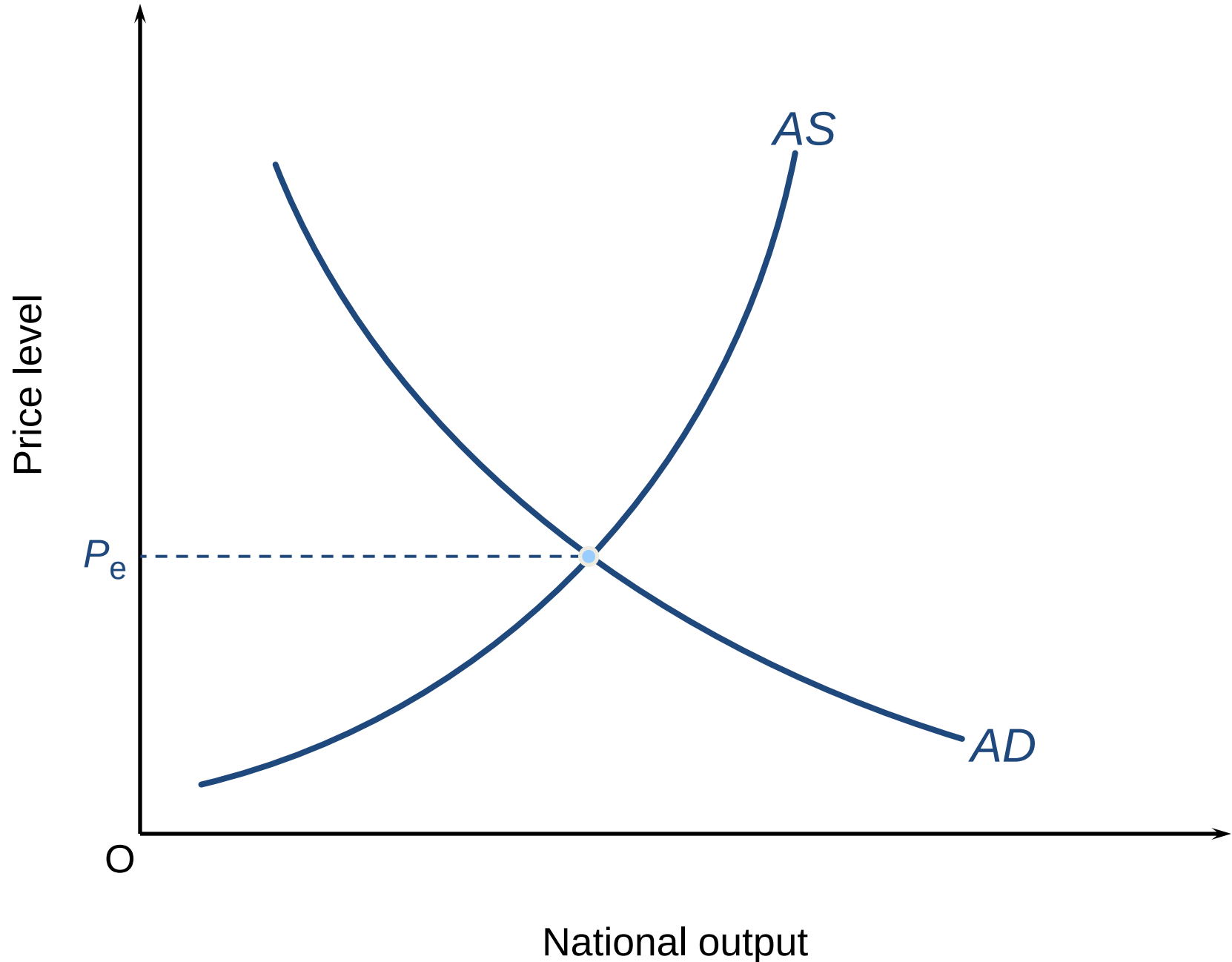
D. Land

E. Stocks and shares

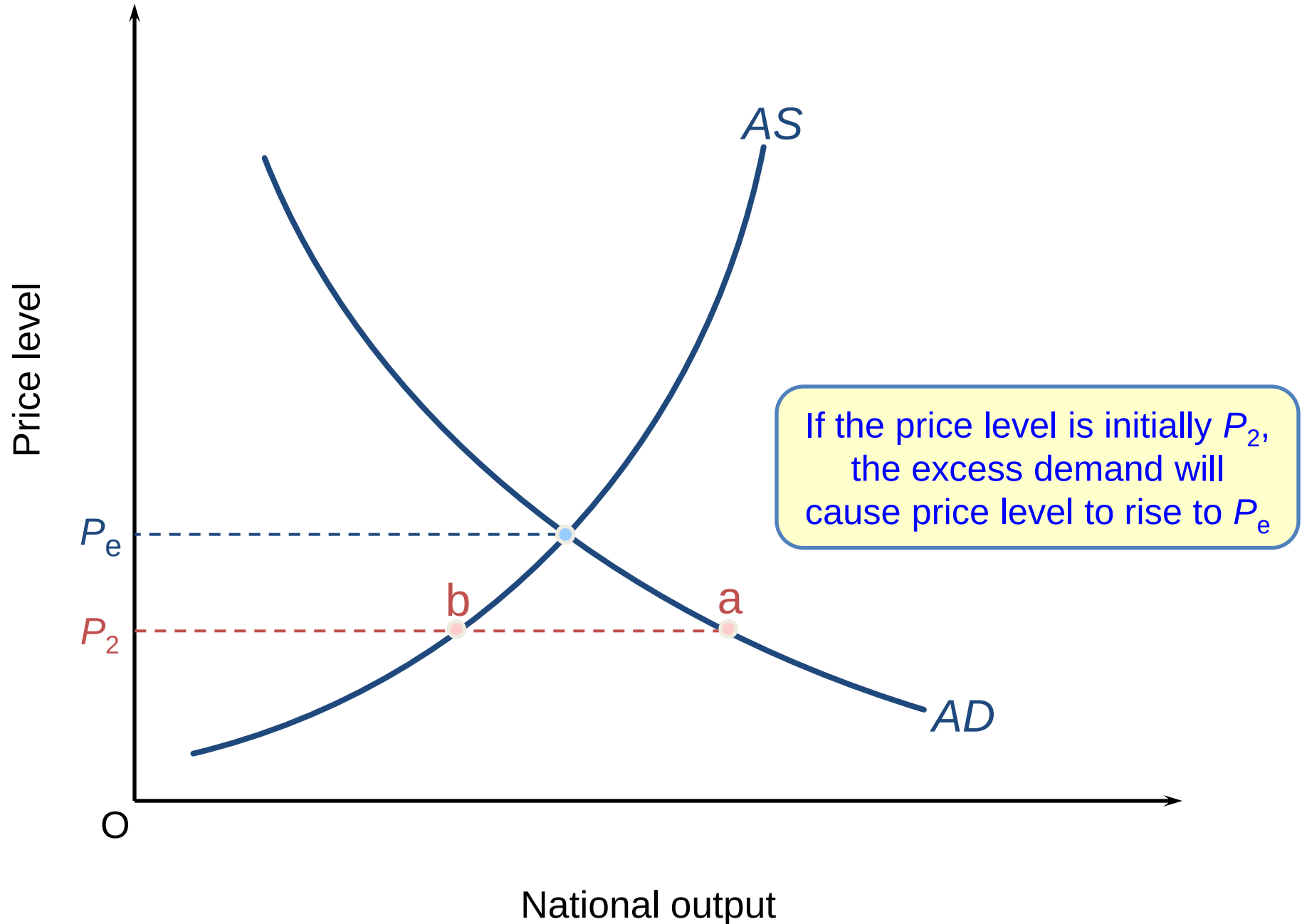
Inflation

- Inflation in practice

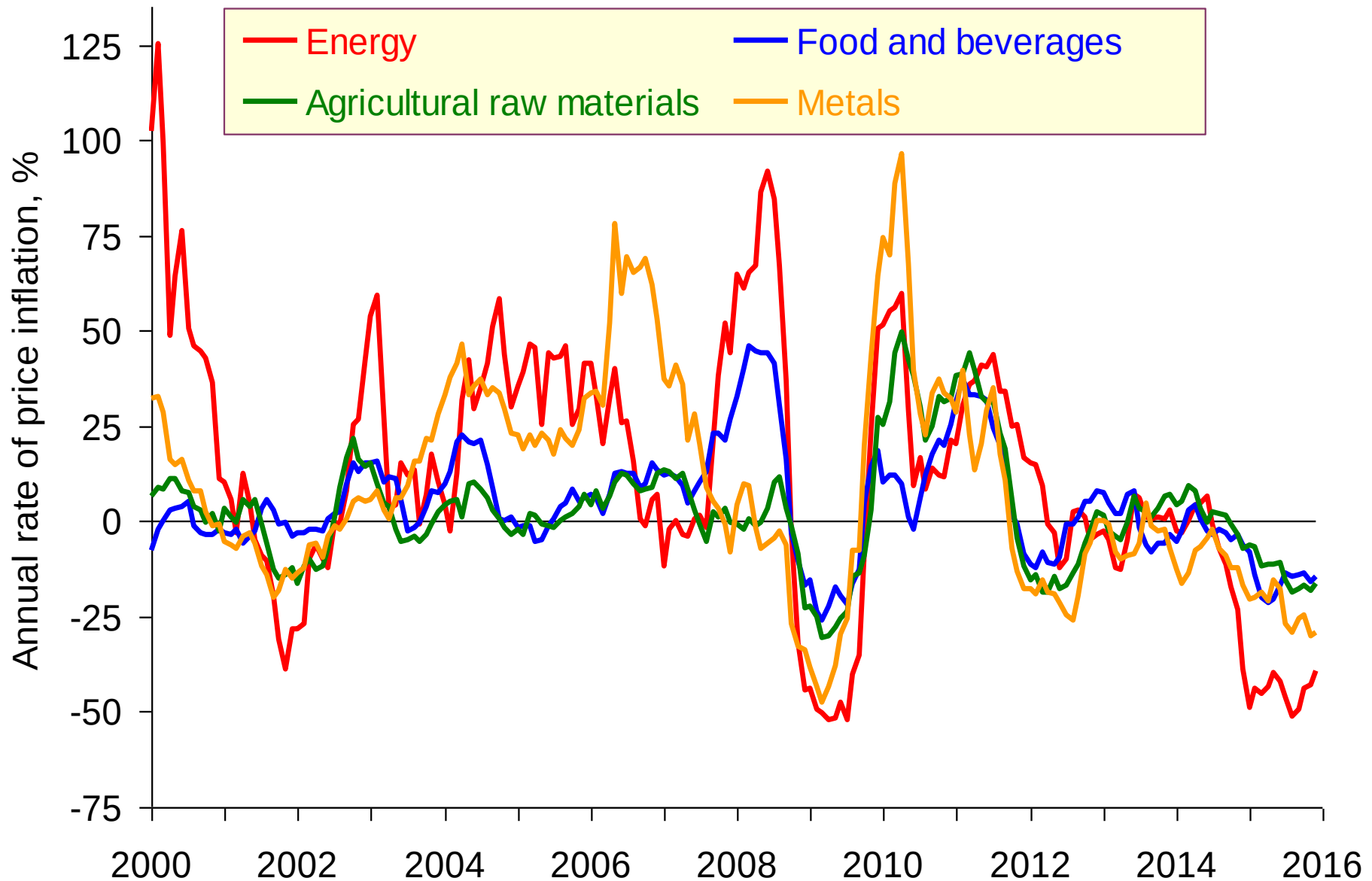
Aggregate demand and aggregate supply



Aggregate demand and aggregate supply



Commodity price inflation



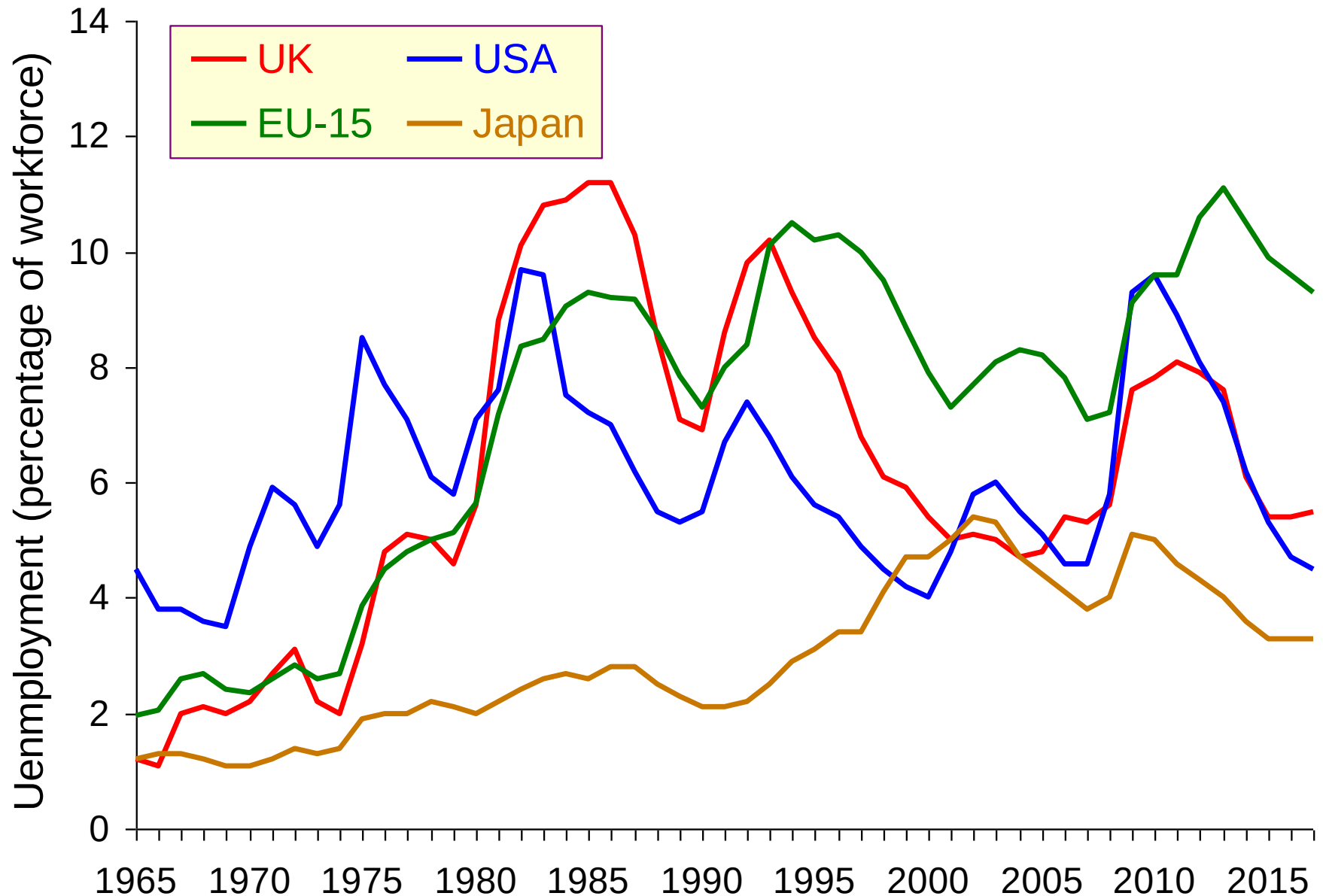
Employment and wages

- The change in the income component of real household's income is determined by the level of employment and the amount of wages and salaries earned.
- As the level of employment in the economy grows, so generally does the level of income.

Unemployment

- The meaning of ‘unemployment’
 - defining the unemployment rate
 - claimant unemployment
 - do claimant statistics give a true picture of unemployment?
 - standardised unemployment (ILO/OECD)
 - use of labour force surveys

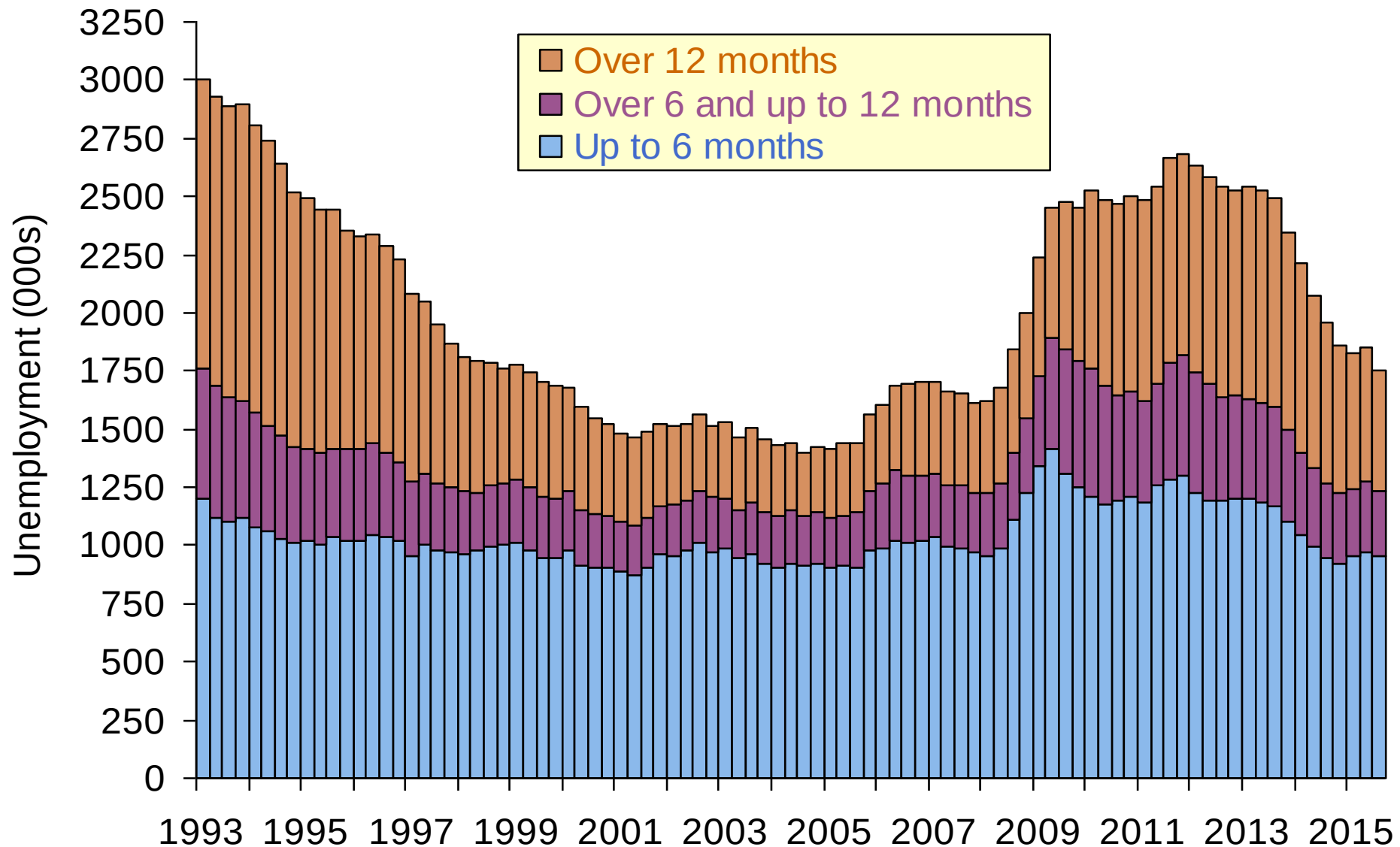
Standardised unemployment rates



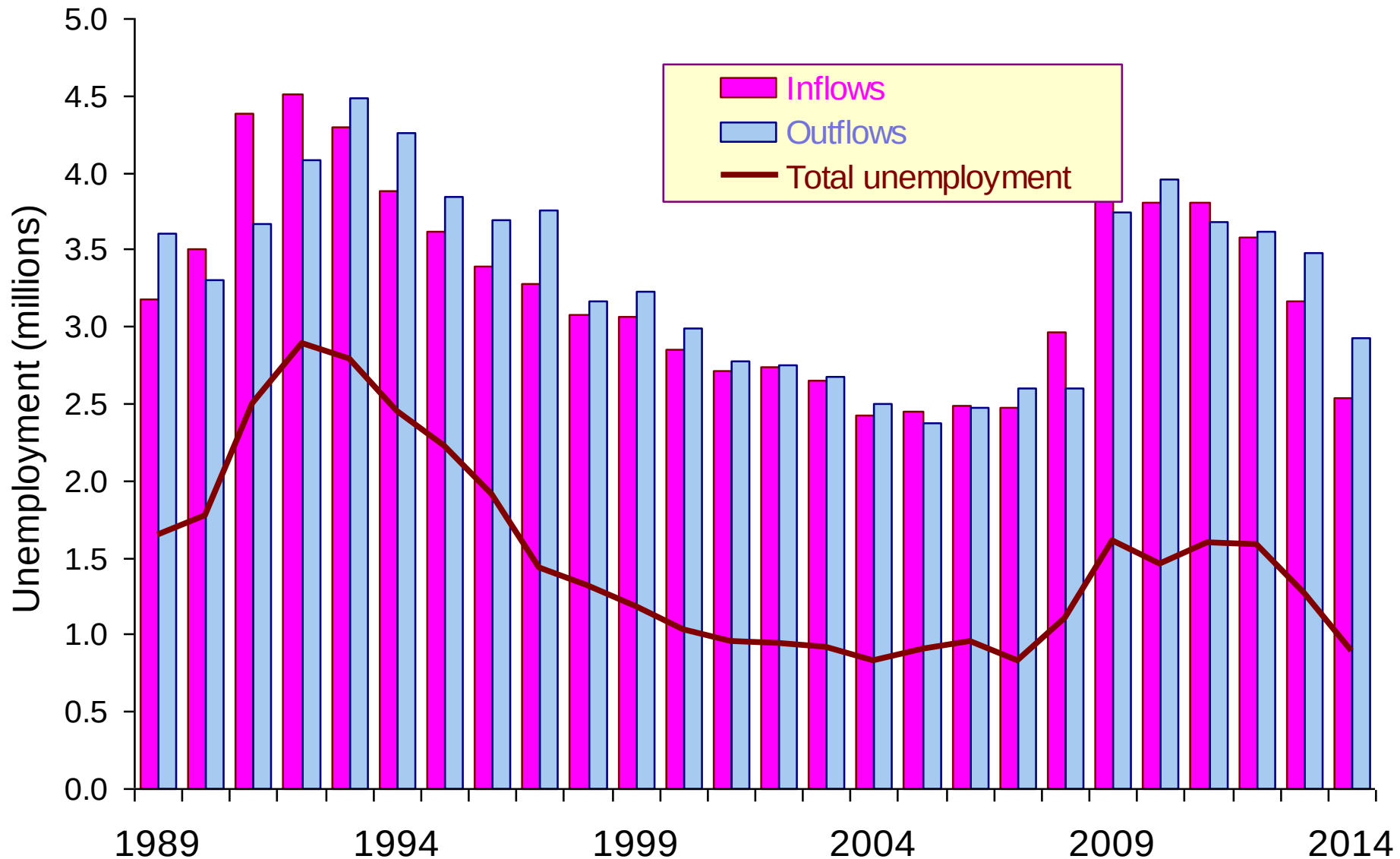
Notes: Figures from 2014 based on forecasts; EU-15 = the member countries of the European Union prior to 1 May 2004

Source: Based on data in [AMECO Database](#) (European Commission, DGECFIN)

UK unemployment by duration



UK claimant unemployment: total stock and annual flows



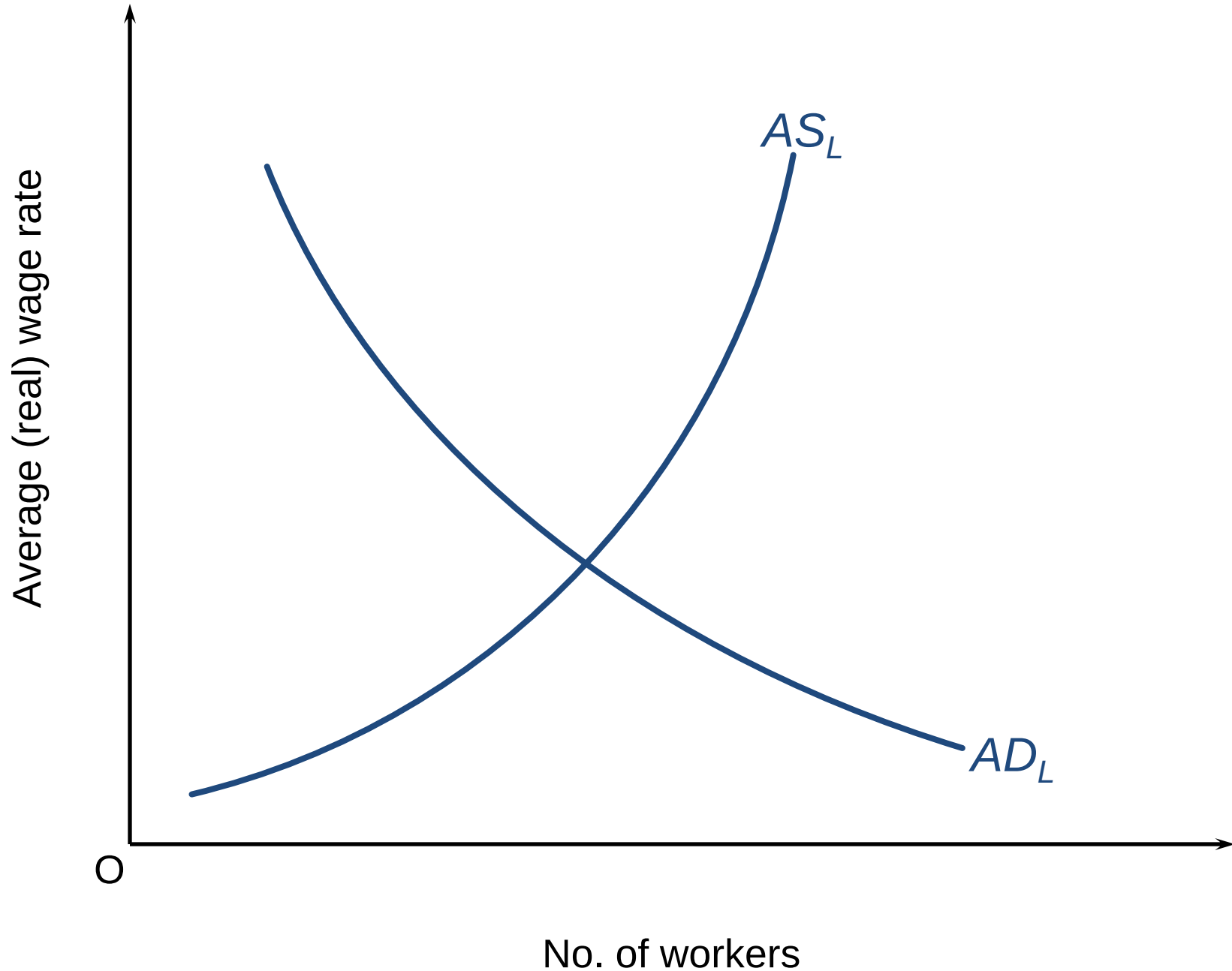
Unemployment

- The costs of unemployment
 - to the unemployed themselves
 - to family and friends
 - to society at large

Unemployment

- Unemployment and the labour market
 - the aggregate demand and supply of labour

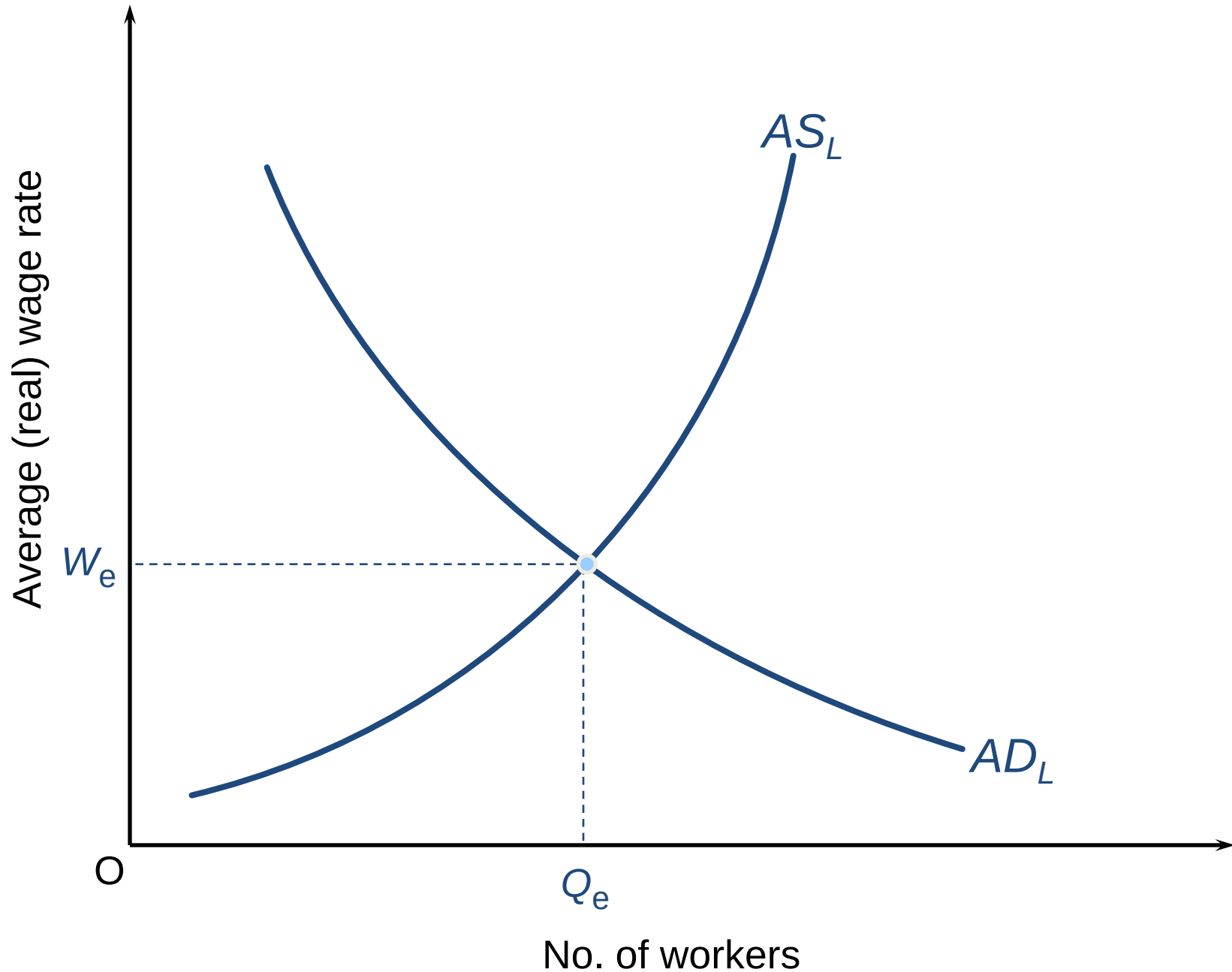
Aggregate demand and supply of labour



Unemployment

- Unemployment and the labour market
 - the aggregate demand and supply of labour
 - equilibrium in the model

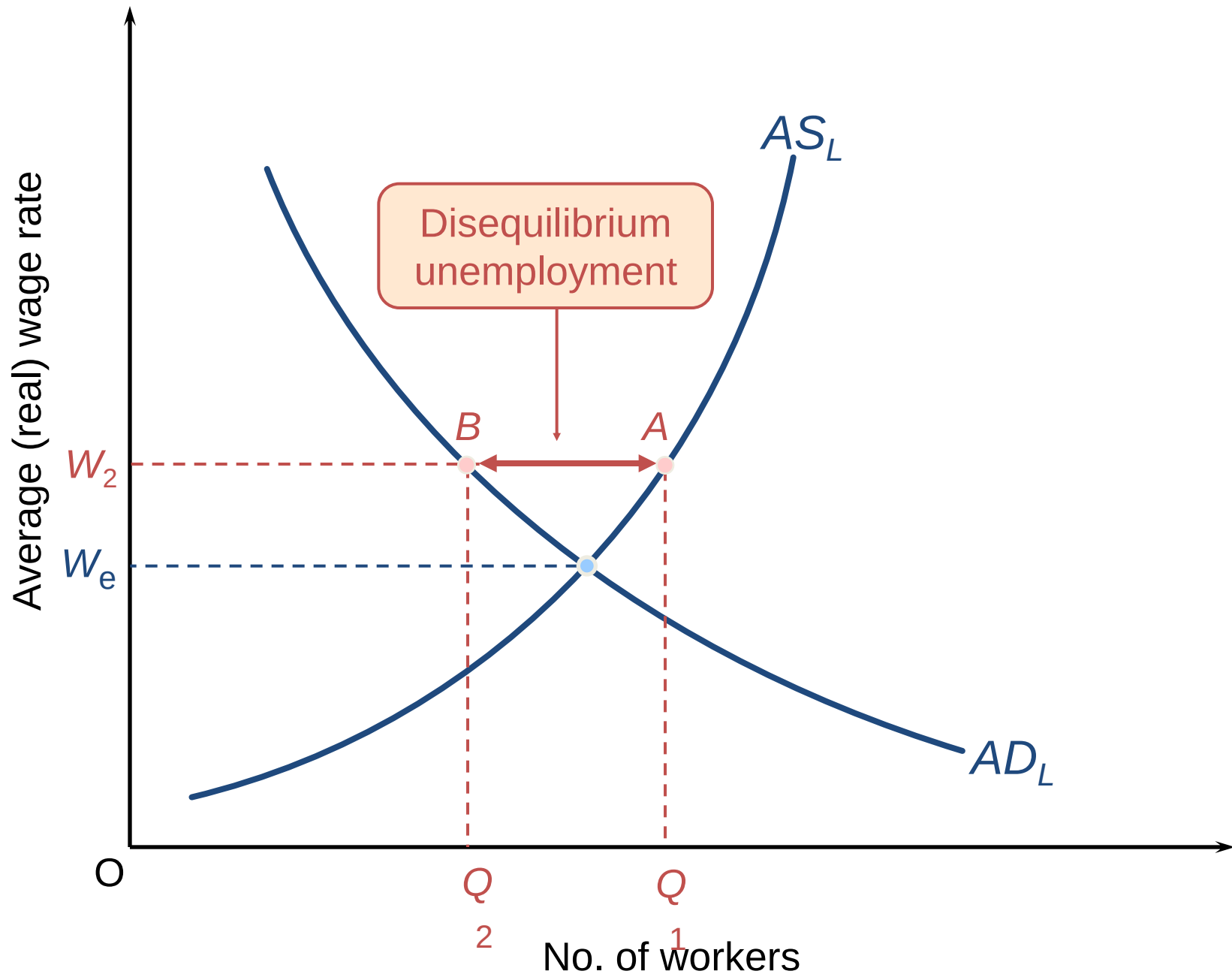
Aggregate demand and supply of labour



Unemployment

- Unemployment and the labour market
 - the aggregate demand and supply of labour
 - equilibrium in the model
 - disequilibrium unemployment

Disequilibrium unemployment



Unemployment

- Types of disequilibrium unemployment
 - real-wage unemployment
 - demand-deficient (cyclical) unemployment
 - growth in the labour supply
- Types of equilibrium unemployment
 - frictional (search) unemployment
 - structural unemployment
 - changing pattern of demand
 - technological unemployment
 - regional unemployment
 - seasonal unemployment

Unemployment in OECD countries

Country	2007	2008	2009	2010	2011	2012	2013
Australia	4.379	4.234	5.560	5.213	5.081	5.220	5.653
Iceland	2.292	2.983	7.233	7.558	7.050	6.025	5.392
US	4.617	5.775	9.267	9.617	8.950	8.067	7.375
UK	5.275	5.617	7.550	7.800	8.075	7.925	7.558
Japan	3.842	3.992	5.067	5.050	4.583	3.842	3.992
Spain	8.225	11.267	17.867	19.883	21.408	24.792	26.117
Ireland	4.683	6.400	12.033	13.900	14.658	14.717	13.092

Source: OECD (<http://stats.oecd.org>).

Assignment Tasks:

- Environmental analysis (PESTLE & SWOT)
- Performance Management Audit (systems, operating performance)
- Presentations and report = 5000 words



PESTLE

- Economic factors
- Political factors

Taxes and benefits

- Changes in taxes and benefits can cause significant changes to the disposable element of disposable income.

Country	Corporate rate of income tax (%)	Personal rate of income tax (%)	National sales tax (%)
Australia	30	17–45	10 (GST)
China	25	3–45	17
Denmark	25	38–65	25
Hong Kong	16.5	2–17	–
Monaco	33.33	0	19.6
Russia	20	13	18
Saudi Arabia	20	20	–
Singapore	17	3.5–20	7 (GST)
Spain	30	24–52	21
UK	23	0–45	20
USA	15–35	0–40	–

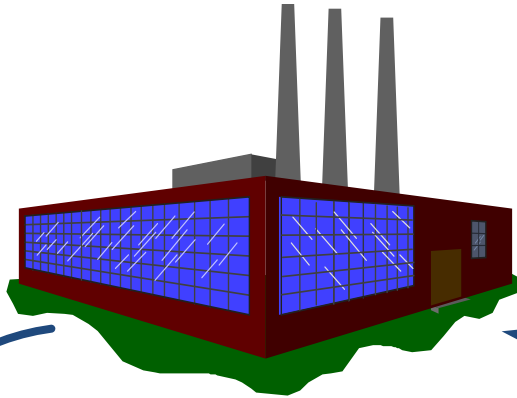
Source: Worldwide Tax (www.worldwide-tax.com).

- Table: Tax rates 2014

The Circular Flow of Income

- The inner flow

The circular flow of income



Firms

Consumption of
domestically
produced goods
and services (C_d)

Factor
payments

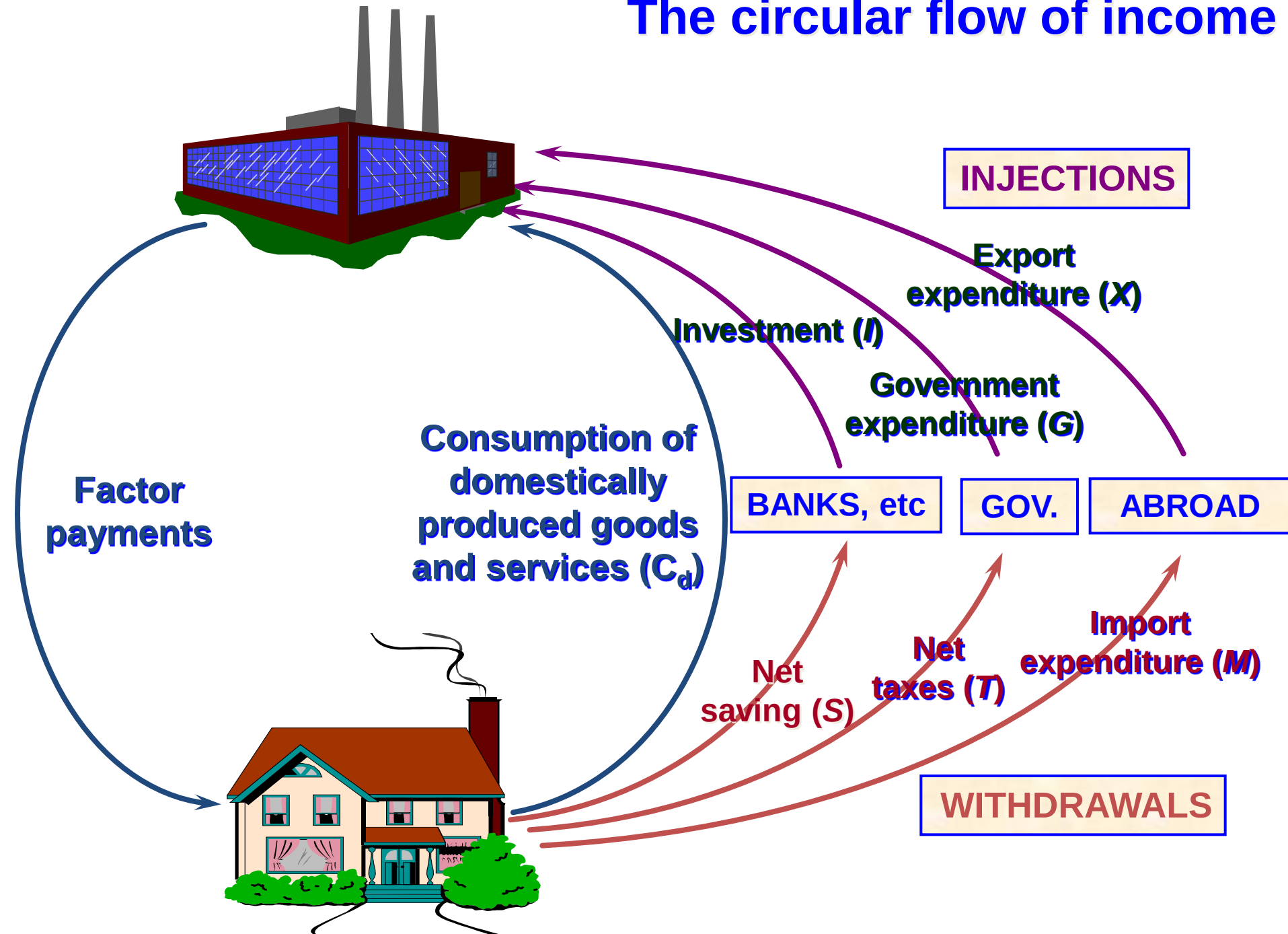


Households

The Circular Flow of Income

- Withdrawals
 - net saving (S)
 - net taxes (T)
 - import expenditure (M)
- Injections
 - investment (I)
 - government expenditure (G)
 - export expenditure (X)

The circular flow of income



Borrowing, saving and interest rates

- Borrowing enables households to spend in excess of their current disposable income. The level of borrowing depends on several factors, including:
 - the ease of obtaining credit
 - future income
 - interest rates
- UK base rates:

Year (October)	Base rate (%)	Year (October)	Base rate (%)	Year (October)	Base rate (%)
1987	9.50	1996	6.00	2005	4.50
1988	12.00	1997	7.00	2006	4.75
1989	15.00	1998	7.25	2007	5.75
1990	14.00	1999	5.25	2008	4.50
1991	10.50	2000	6.00	2009	0.50
1992	8.00	2001	4.50	2010	0.50
1993	6.00	2002	4.00	2011	0.50
1994	5.75	2003	3.50	2012	0.50
1995	6.75	2004	4.75	2013	0.50
				2014	0.50

Expectations

- Expectations (or business confidence) refers to the degree of optimism or pessimism with which consumers and business people view the future.
- Expectations tend to be influenced by
 - recent experience
 - the mass media
 - asset prices (particularly property prices) and
 - the level of unemployment.

Export and import demand

- Some household consumption is spent on imports. For the LET sector this can be a significant amount.
 - the demand for imports is affected by overseas costs, quality and uniqueness and the exchange rate.
 - Now more expensive due to falling £
- On the other hand, some demand for the goods and services of domestic firms arises from overseas customers in the form of exports.
 - the demand for exports is similarly affected by relative costs, quality and uniqueness, the exchange rate and the prosperity of overseas economies.

Government expenditure

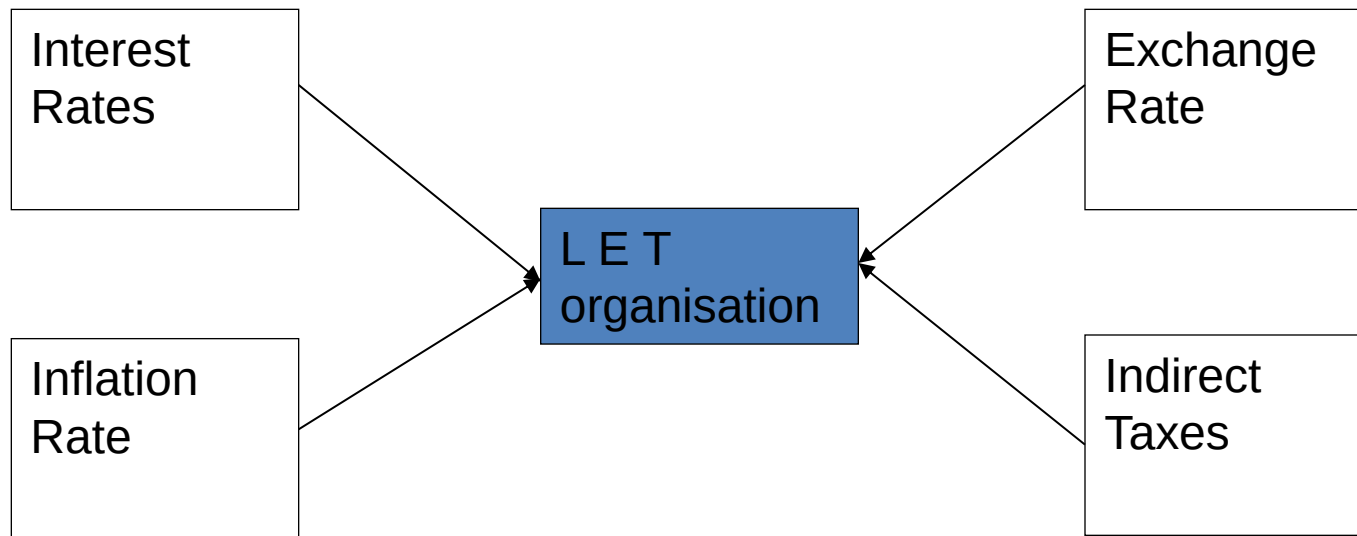
- LET organisations which are sensitive to changes in government expenditure are those which depend upon government for their income.
- Examples of these include arts organisations, including museums, community sports organisations and national and local tourist marketing organisations.
- The level and detail of government expenditure tend to reflect two things:
 - the state of government finance
 - the political party in power.

- Does your case study organisation rely on the government for part of their funding?
- How has this changed over time?
- Is this a risk at a time of public expenditure cuts?

Investment

- Some organisations do not supply goods and services to consumers, but specialise in supplying capital goods to other firms.
- For example, the aircraft manufacturer Boeing, selling to airlines and tour operators, finds demand for its products is sensitive to the level of investment in the economy.

The economic environment and costs



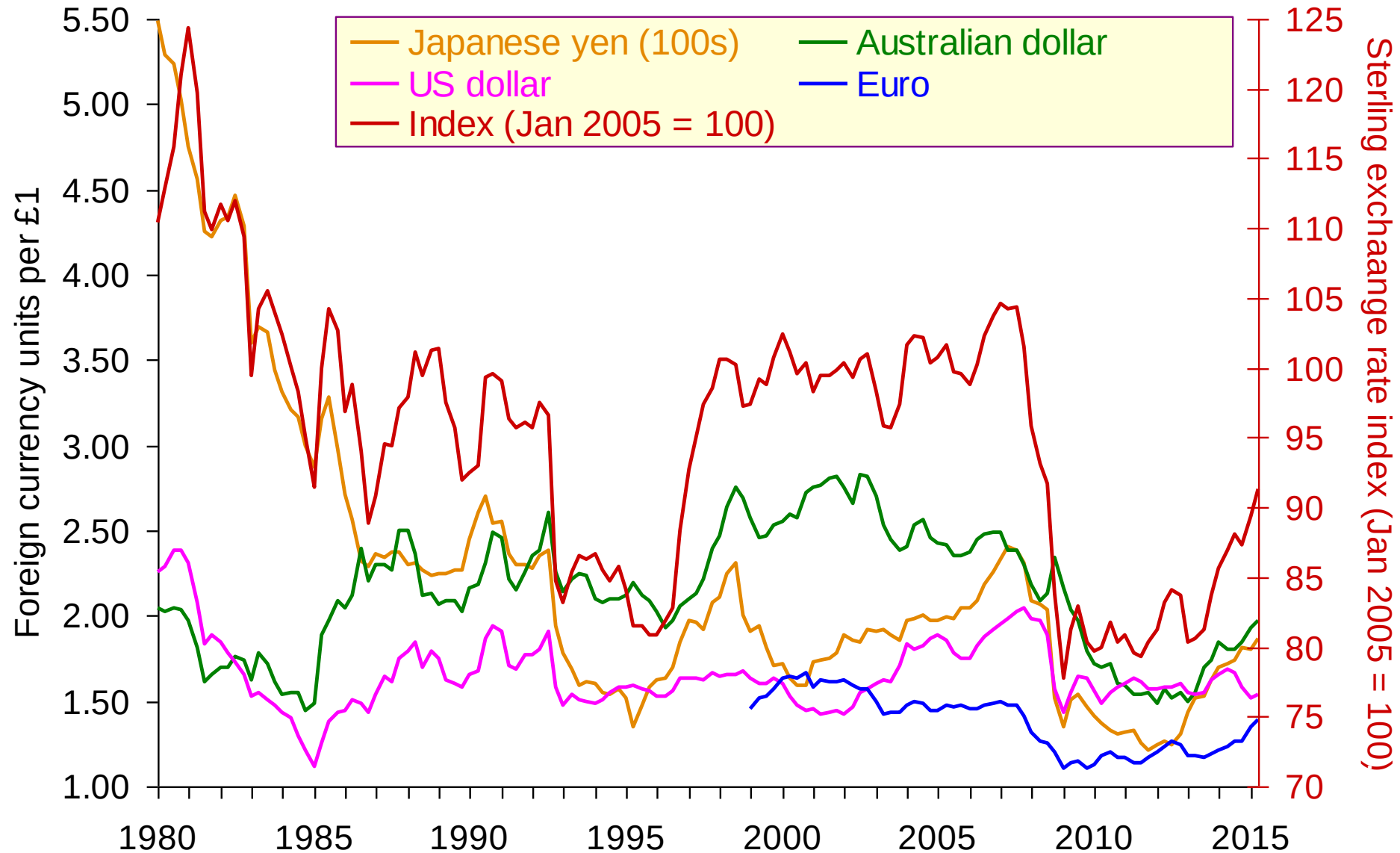
The economic environment and costs

- The key macroeconomic factors affecting costs of recreation, leisure and tourism goods and services are:
 - interest rates
 - inflation
 - the exchange rate
 - indirect taxes

Exchange Rates

- The rate of exchange
 - individual rates of exchange
 - exchange rate index

Sterling exchange rates against selected currencies



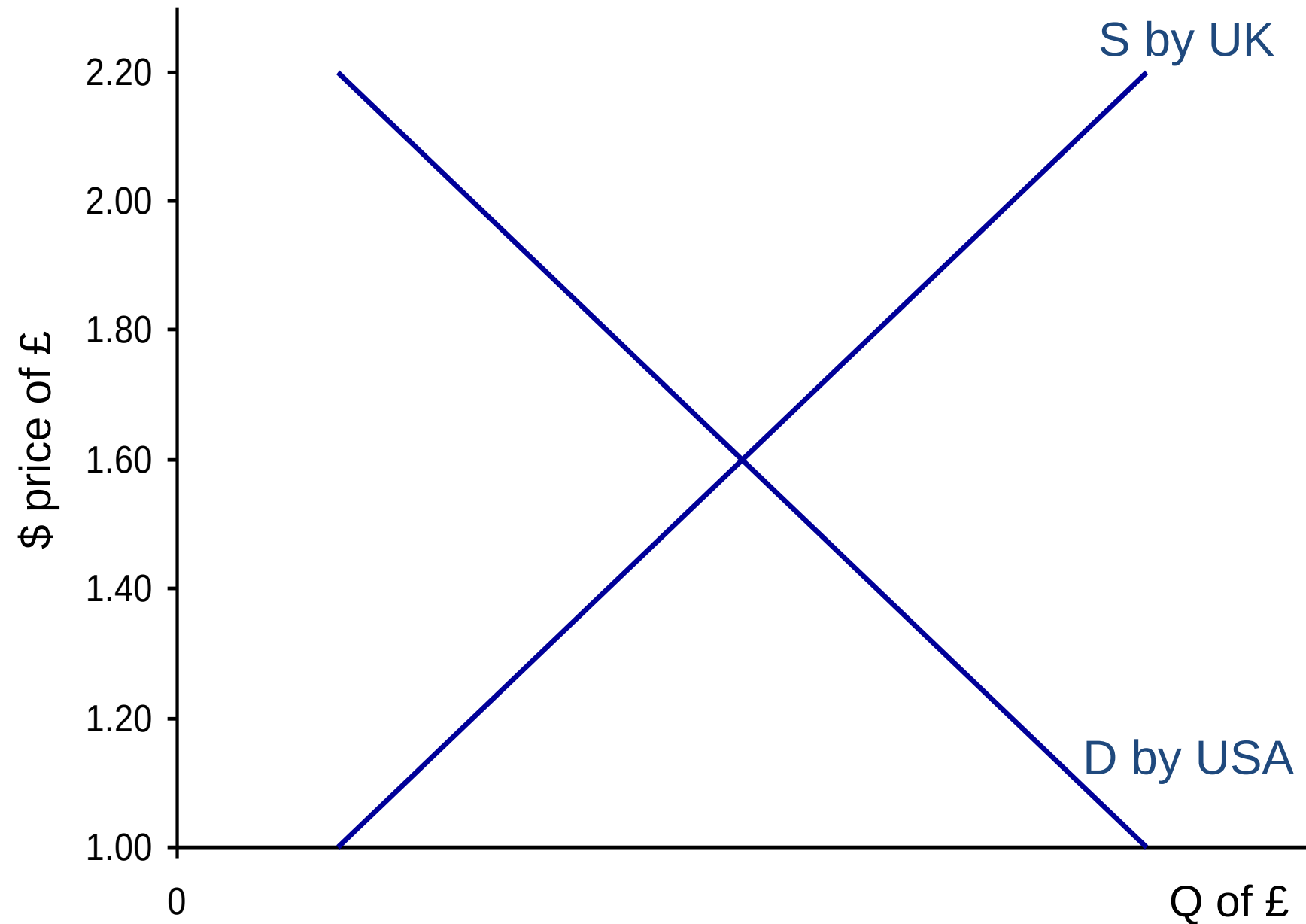
Note: The euro was introduced in 1999, with notes and coins circulating from 2001.

Source: Based on data in [UK Trade, Table 16](#) (National Statistics)

Determination of the rate of exchange



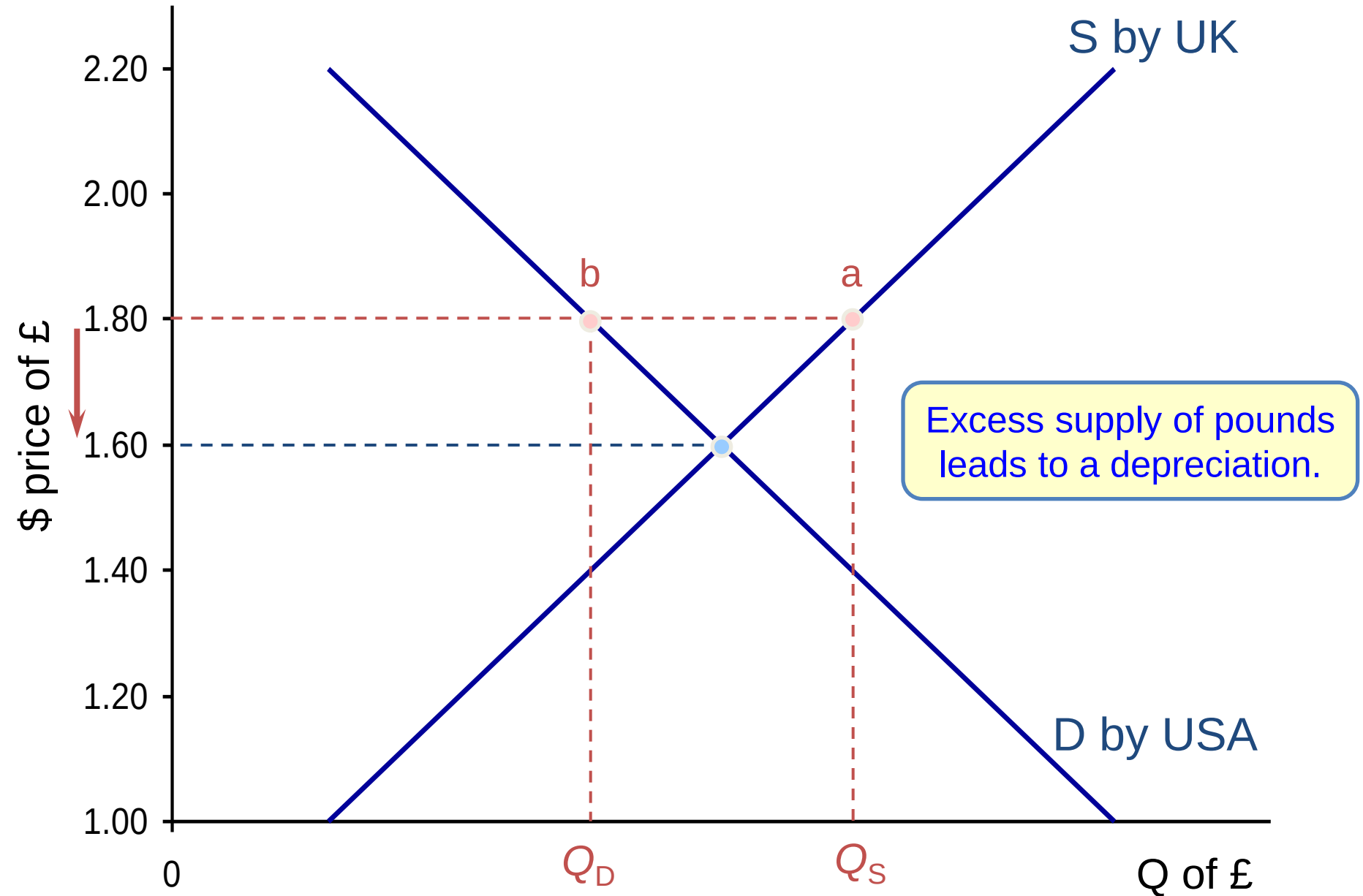
Determination of the rate of exchange



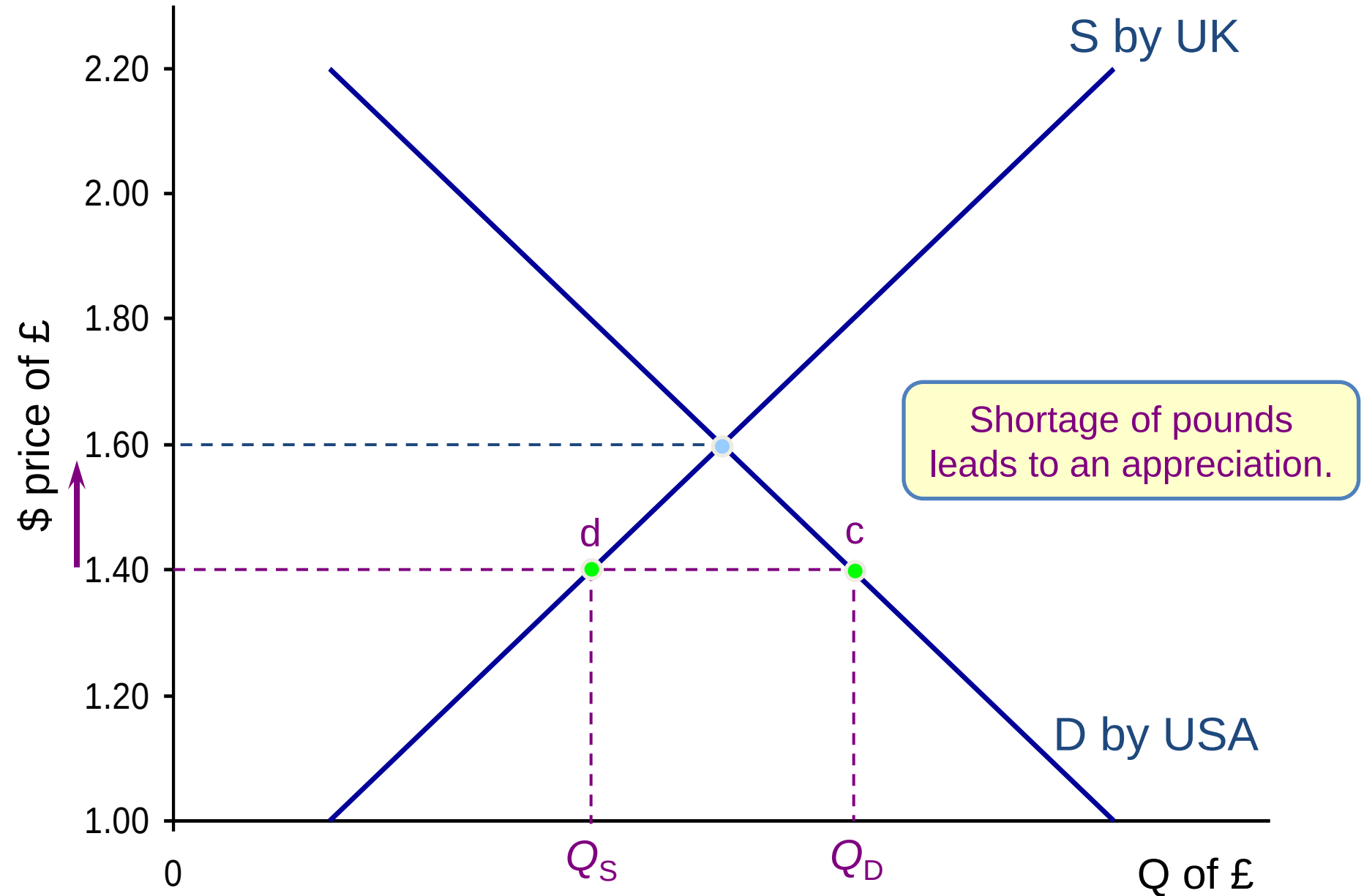
Exchange Rates

- Floating exchange rates
 - demand for a currency
 - why downward sloping
 - supply of a currency
 - why generally upward sloping
 - the equilibrium exchange rate

Determination of the rate of exchange



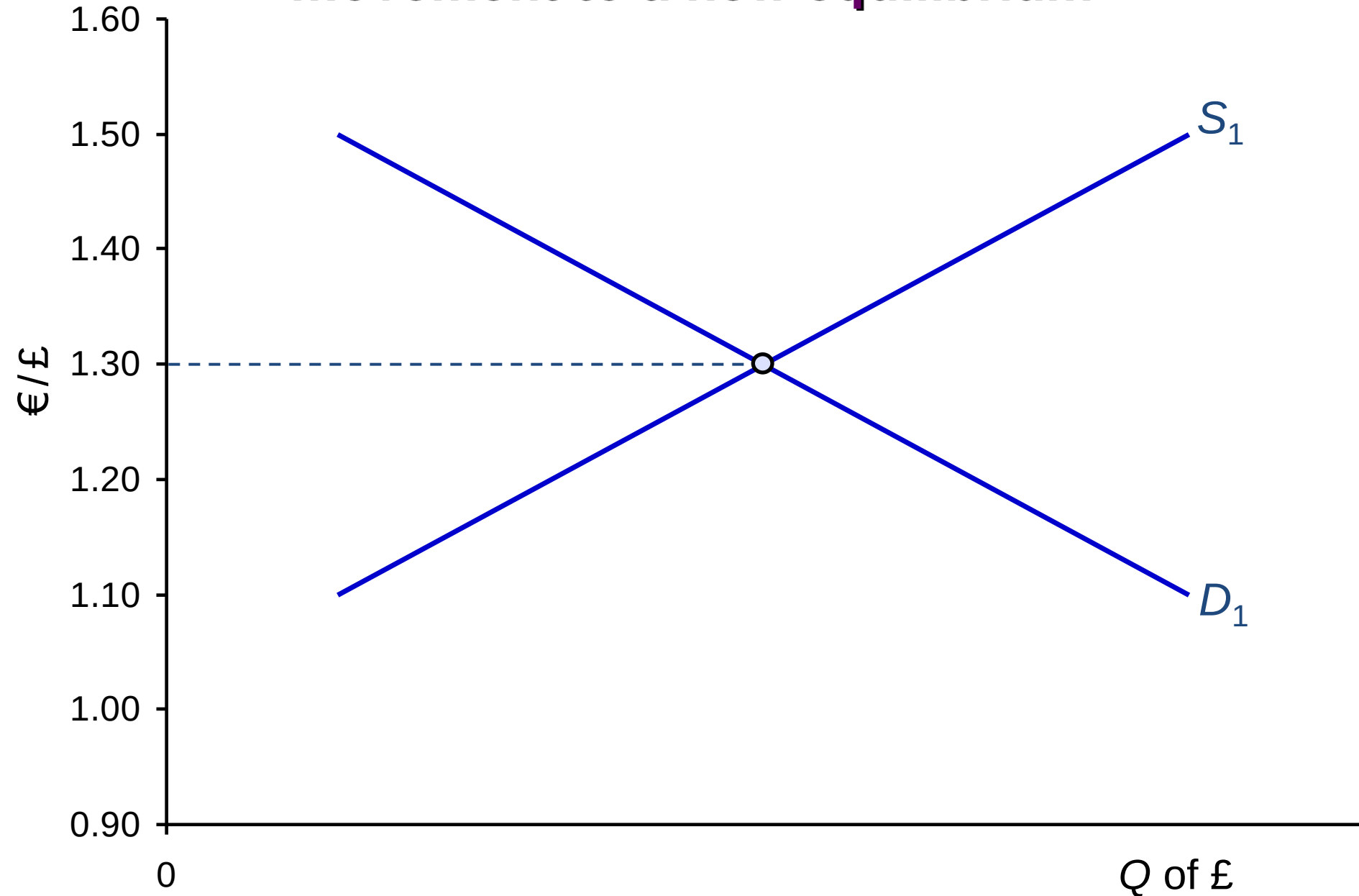
Determination of the rate of exchange



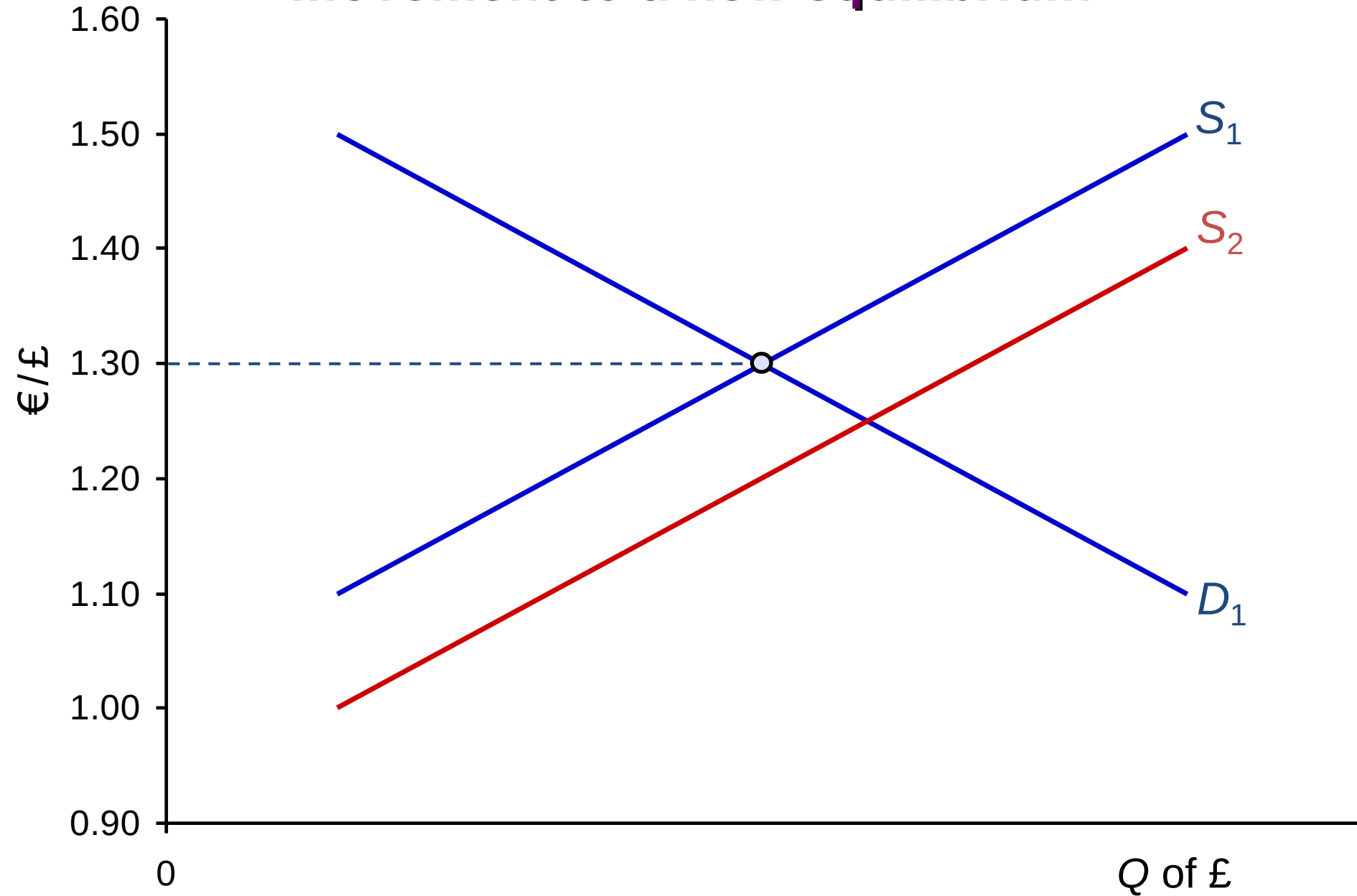
Exchange Rates

- Floating exchange rates (cont.)
 - shifts in currency demand and supply
 - changes in relative interest rates
 - differences in relative inflation rates
 - differences in relative growth rates
 - differences in relative investment prospects
 - speculation
 - appreciation and depreciation

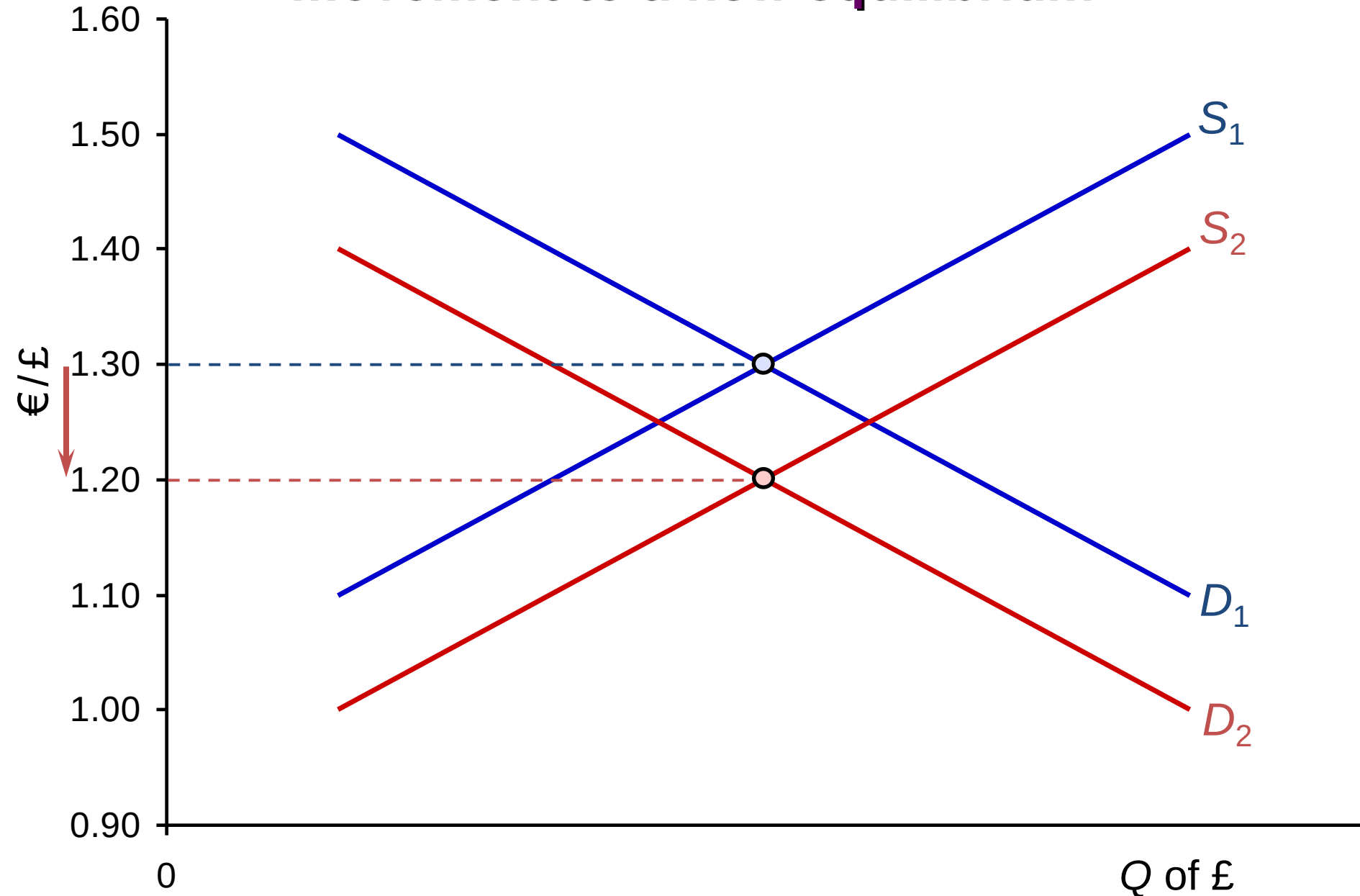
Floating exchange rates: movement to a new equilibrium



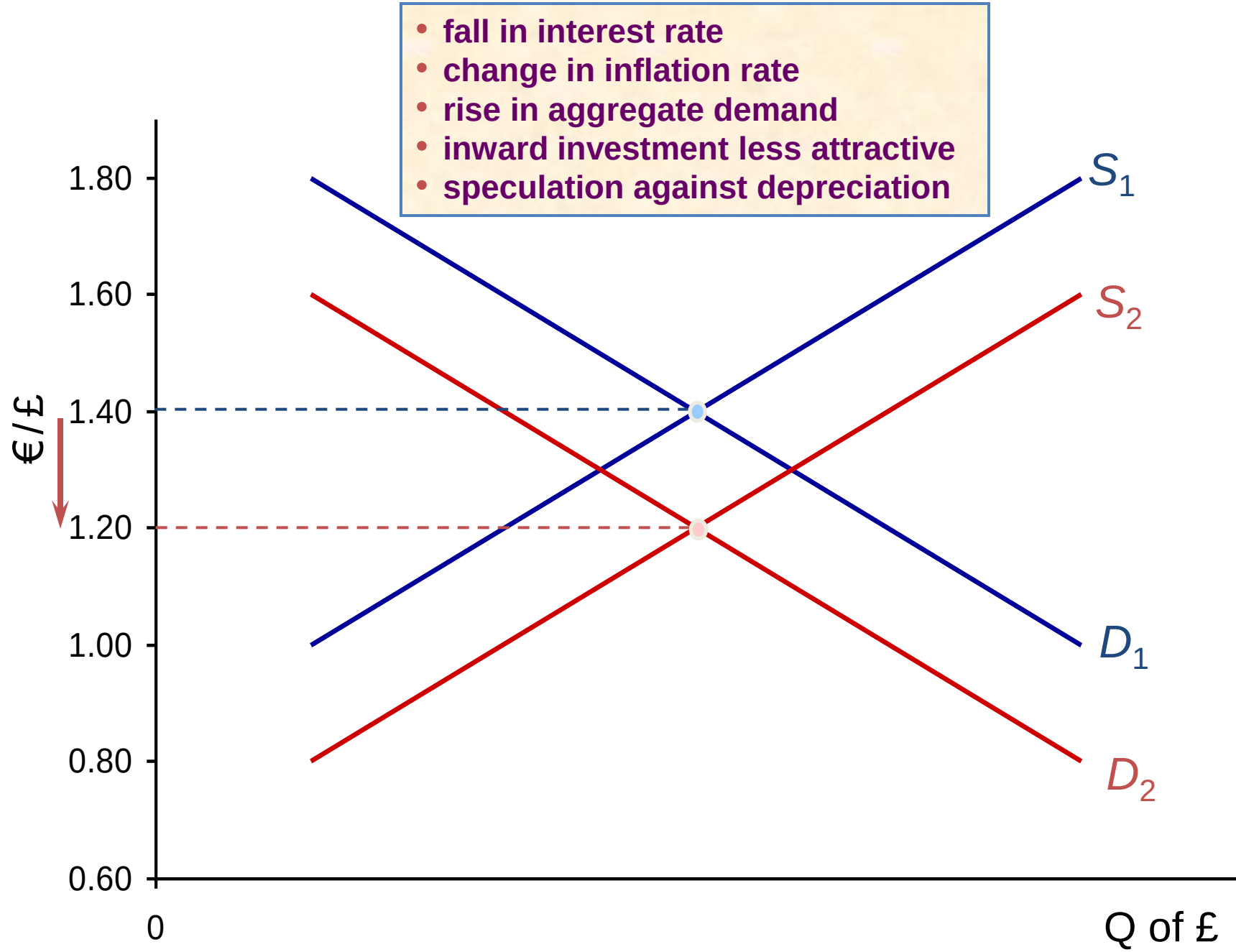
Floating exchange rates: movement to a new equilibrium



Floating exchange rates: movement to a new equilibrium



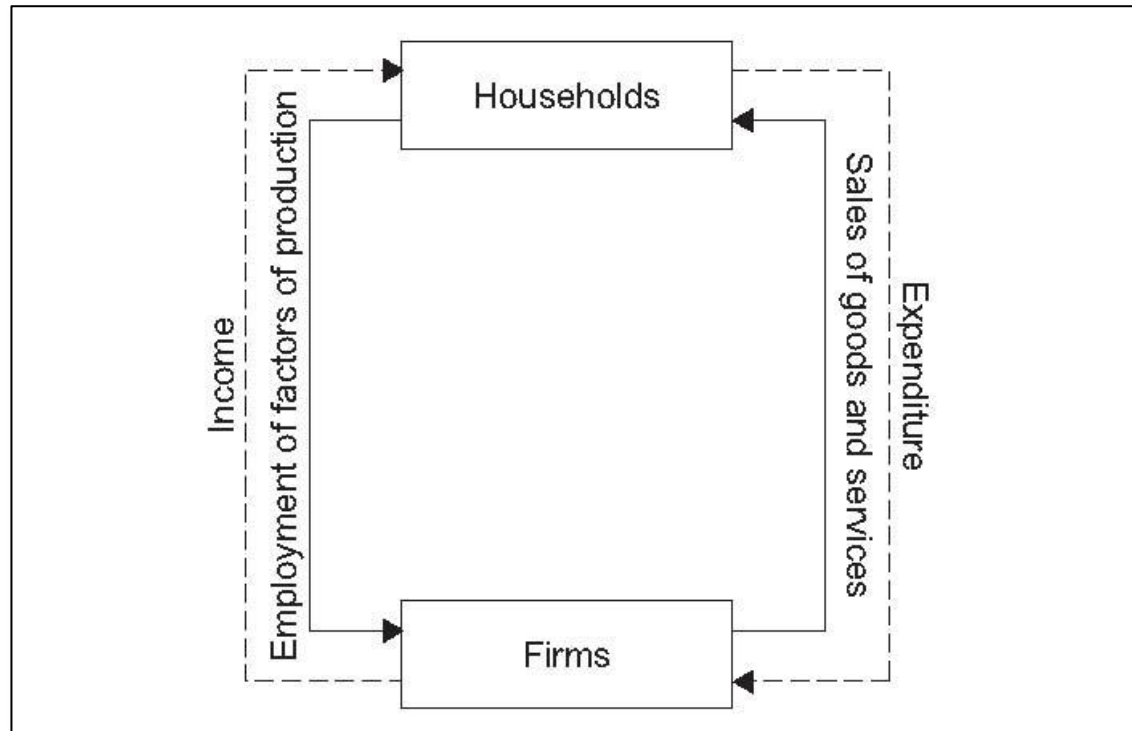
Causes of a depreciation (assume no changes abroad)



Economic cycles

	Upswing/boom	Downswing/recession
Unemployment	Falling	Rising
Profits	Rising	Falling
Household spending	Rising	Falling
Consumer borrowing	Rising	Falling
Imports	Rising	Falling
Inflation	Rising	Falling
Expectations	Optimistic	Pessimistic
Economic growth	High	Low/negative
Can lead to ...	Hyper-inflation	Recession

Cycles and the circular flow



Government policy

- Low inflation
- Low unemployment
- Balance between government spending and income over the medium term (balanced budget)
- Balance between overseas earnings and expenditure (balanced trade)
- Economic growth

Economic environment and government policy 1985–present: the case of the UK

- 1986–1988: boom
- 1989–1992: bust
- 1992–1994: a lucky escape
- 1994–2007: sustainable growth?
- 2007–2010: back to bust – the financial crisis and near-global recession
- 2010–2016: austerity
- The future

Opportunities and threats analysis

Environment	Opportunities	Threats
Competitive		
Threat of entrants		
Power of buyers		
Power of suppliers		
Threat of substitutes		
Competitive rivalry		
PEST		
Political		
Economic		
Sociocultural		
Technological		

Review of key terms 1

- Real household consumption
 - money household consumption – inflation
- Disposable income
 - income – direct taxes + government benefits
- Recession
 - two consecutive quarters of falling output
- Public sector net cash requirement =
 - government spending – taxes

Review of key terms 2

- GDP = gross domestic product
 - total value of output of an economy in a year
- Economic cycle
 - up and down movement of economic activity
- Fiscal policy
 - use of tax and government spending levels to influence the economy
- Monetary policy
 - use of interest rates to influence the economy

What are the implications of Brexit for the UK's LET sector?



Next :

Analysing the External Operating Environment 2: Political & Legal – Brexit & More



Brexit

