



# The Firm Value Chain Amidst a Changing Business Landscape: External Environment Considerations

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**Abstract:** This study has been undertaken to obtain a conceptual understanding of the potential linkages between the firm value chain and the external environment amidst a changing business landscape. The study primarily consists of a literature review concerning the latest developments among PESTEL factors and a mapping to areas most significantly impacted by such developments within the context of the firm value chain. Potential solutions are recommended for business practitioners to focus on whilst considerations for future research are also highlighted to empirically establish such linkages in the modern era.

**Index Terms – Firm value chain, PESTEL, external environment**

## I. INTRODUCTION

Organizations, whether operating locally or across borders, are often plagued with a variety of issues daily. The respective managers of these organizations must seek to understand not only the external environment that they operate in but how such environment interacts with internal components of the organization. By understanding the linkages between an organization's environment and its value chain, companies can react to developments in the environment more effectively. The value chain concept was designed for the purpose of manufacturing based entities as it represents an organizational supply chain network (Institute for Manufacturing, 2016; Acharyulu, Subbaiah, & Rao, 2015) Whilst the value chain can be thought of as applicable to other industries and need not be a strict linear process (Ensign, 2011), for the purposes of this paper, our analysis will be centered on a generic manufacturing based organization operating in a global context within the manufacturing industry.

## II. REVIEW OF LITERATURE

### 2.1 External Environment and the Value Chain

An organization's environment is typically defined as the elements that lie beyond an organization's boundary which may influence the organization itself (Daft, 2010). The PESTEL framework (i.e. Political, Economic, Social, Technological, Environmental and Legal factors) describes the relationship between firms and the external environment. The idea behind the framework is that an organization's strategy must create a fit between the external environment and the organization's own capabilities and is useful for strategic planning (Gupta, 2013; Koumparoulis, 2013). In recent years, this notion has been challenged to the fullest, especially with the advent of the Covid-19 pandemic, that has caused previously assumed knowledge on potential linkages between external environment forces and the firm value chain to be scrutinized.

Hence, given that the external environment interacts with an organization, exploring the impact of the environment on the value chain is crucial. The value chain represents a tool to understand what activities can be performed better to achieve competitive advantages (Porter, 1985), where advantages arise once value is unlocked along the value chain. An organization's interaction with its external environment influences its ability to generate value and by extension organizational performance (Njoroge, Ongeti, Kinuu, & Kasomi, 2016; Jones, 2013; Machuki & Aosa, 2011). Whilst not all PESTEL factors can be evaluated in full with respect to the firm value chain, certain recent developments have been changing the business landscape permanently. Exploring such potential linkages between external environment developments and the most impacted component of the value chain could yield valuable insights for business and management practitioners in their day to day activities.



**Figure 1:** Porter's Value Chain

From Fig 1, the value chain consists of two distinct components i.e., primary activities and support activities. In the manufacturing industry, primary activities represent inbound logistics, operations, marketing and sales, outbound logistics and services whilst support activities range from human resources to technology and procurement along with infrastructure. The organization's success is contingent on how skillfully it responds to changes in the environment (Kuznetsova, et al., 2017). Understanding the links between the value activities (and the environment) is vital as these links affect the performance of the organization's products or services (Kumar & Rajeev, 2016; Sutarmin & Jatmiko, 2016).

## 2.2 PESTEL and Impact on Selected Components in the Firm Value Chain

### 2.2.1 Political considerations

Political activities have a strong influence on individuals which in turn influence the pace and direction of development of an environment (Chitescu & Lixandru, 2016). Hence, any development in the political landscape may affect the value chain in various ways. Firms may be affected in terms of the primary activities associated with production or support activities that may indirectly impact their ability to produce output consistently. One crucial point of focus in recent years is the issue of costs associated with production and the importance of labor considerations. International political organizations have been working towards implementing fairer practices in relation to human resource management. The International Labour Organization ("ILO") introduced its Decent Work Agenda to advocate employers around the world to provide sufficient minimum wages, guaranteed rights and social protection access (International Labour Organization, 2020). Governments around the world have also committed to the reduction of inequalities through adoption of new wage policies (United Nations, 2015). Hence, the development of fairer employment regulations is an international agenda driven by political leaders.

Given the fact that human resource activities in the value chain influence an organization's ability to generate competitive advantages (Alnidawi & Omran, 2016), political pressure and the implementation of minimum wages would adversely impact an organization's ability to generate value from its value activities. This is in line with the neoclassical theory of the labour market, which notes that any increases in production output would increase in tandem with units of labour and such relationship diminishes until such a time where any marginal increase in labour fails to increase production output (International Labour Organization, 2013). Naturally, as firms require less labour, wages would ultimately stabilize and the absence of regulations would mean wages levels would reach equilibrium (Sangkuhl, 2015). The demand for labour within an organization is driven by a firm's production plan (Fernández- Huerga & Garcia-Arias, 2019) and the implementation of a minimum wage policy could disrupt this relationship (Vitez, 2020). Therefore, increase in minimum wage policies around the world could mean that organizations would incur additional costs (Sabia, 2015) in striving to reach optimal production outputs.

These developments coupled with the general increase in the costs associated with production have also been severely impacted due to political developments caused by the Covid-19 pandemic. Movement restrictions which have come into place as a health measure to curb the spread of the virus have resulted in the reduction of available food sources, operational constraints and production restrictions that have caused adverse impacts on value chains throughout industries (Meester & Ooijens, 2020). Given that political developments around the world have resulted in a distrust towards scientific recommendations (McLaughlin, Mewhirter, & Sanders, 2021), firm value chains may be further exposed as political decisions would result in harsher operating conditions for production firms despite seemingly good intentions including from a human resource perspective.

### 2.2.2 Economic considerations

Developments in the economic landscape have a clear impact on the organizations value chain component. To date, global growth in GDP has been slowing in light of increased trade tensions and public health concerns. In 2019 global economic growth slowed to its slowest since the 2008-2009 financial crisis (Aljazeera, 2019). In 2020, the World Bank had estimated that growth would take place at a pace of 2.5% (World Bank Group, 2020), a noticeably slower rate. However, subsequent to the developments surrounding Covid-19 and the emergence of new variants, world GDP declined at an annualized rate of -3.4% to -7.6%, with the hope of an economic recovery in 2021 (Jackson, et al., 2021). Particularly for multinational organizations, slowing growth in the macroeconomic environment would impact the firm's ability to generate value as the value activities are driven economically (Porter, 1985). Along with slowing growth rates, the world economy is experiencing volatility. Stresses in key developing markets and geopolitical tensions continue to pressure economic activities, particularly in trade and manufacturing sectors (International Monetary Fund, 2020). As organization's incur costs for the generation of value within the value chain for its final products or services (Acharyulu, Subbaiah, & Rao, 2015), the increase of costs associated with planning for economic volatility could lead to lesser margins. These developments in the economic landscape will impact the firm infrastructure component this function within the multinational value chain is a set of formal systems (Johnson, Scholes, & Whittington, 2008) responsible for planning and

management, which are great sources for competitive advantages (Porter, 1985). It is noted that a strong firm infrastructure is essential for all primary functions (Tarver, 2019).

### 2.2.3 Social considerations

Social factors refer to cultural, demographic and social aspects of the external environment (Ho, 2014). In the past, developments to social norms were considered slow, often taking hundreds of years to materialize (Green, 2016). Social attitude and norms today are changing at a more rapid pace. Changes in society impact operations of multinational companies especially in areas such culture, language, religion, education levels, customer preferences and societal attitudes (Masovic, 2018). A firm's nature of goods or services is highly dependent on the changes in societal habits and attitudes, and this impacts organizational performance (Sharma & Singh, 2015). Globalization is also driving cultural diversity and is forcing businesses to make changes in enterprise functions (Parashar, 2018). In addition, culture is a business issue that drives the success of the business and shapes how work is performed in the organization (Kaplan, Dollar, Melian, Durme, & Wong, 2016).

Social developments bring attention once again to the human resource component. Without adapting to cultural and societal changes, a company would fail in its quest for value. The costs of hiring inappropriate employees are estimated at 30% of that individual's income (Cloke, 2019) and often these inadequate hiring decisions arise from a poor cultural fit (Bressler, 2014). The way organizations can manage this is to further understand future employees needs in talent acquisition through Maslow's Hierarchy. Through advancements in human resource management, partly enabled by technology, organizations can seek to better understand employees from the perspective of Maslow's higher level i.e. belonging, esteem and self-actualization (Wall Street Journal, 2014). Any attempt to move away from the hierarchy could negatively impact organizational culture, employee performance and management of human resources (Jerome, 2013). Therefore, given that the support activities (i.e. human resources) are linked to society's own infrastructure (Walsh, 2011), social developments could have an influence firm's human resource management component.

### 2.2.3 Technological considerations

Aside from the developments on the person, technological changes have also changed social constructs in recent years. The arrival of social media in the realm of business has fueled the need to rethink how social factors may impact a particular organization and its value chain. The concept of digitalization is fast changing marketing communications as traditional media is replaced by digital media as well as the internet becoming the main communication channel (Tankosic & Trifunovic, 2015). One such development, i.e., social media, is defined as an online platform that is utilized to build social networks, communicate data and share knowledge (Akram & Kumar, 2018). Such platforms are not only considered advancements in technology but are also impacting the societal norms and culture of human civilization. New social media technology has been known to influence humanity's ability to think independently, impacted social relationships, general well-being, brain activity and human identity (Zeitel-Bank & Tat, 2014). Hence, the development of social media technology has enabled ease of communication among individuals and businesses, increasing the impact of consumer-to-consumer communications in the marketplace (Pourkhani, Abdipour, Baher, & Moslehpour, 2019) and changed the way businesses are conducted globally through becoming an ideal medium for managing customer relationships (Agarwal, Kumar, & Pragya, 2016).

### 2.2.4 Environmental considerations and the impact on primary activities

Environmental considerations relating to the natural environment in which businesses operate in are increasingly impacting businesses. The risk of large climate change related events is a global concern especially to the private sector in light of the rising associated costs and threat to organizations' viability (Henderson, Reinert, Dekhtyar, & Amram, 2017). In the table below, severe changes in temperature, precipitation, drought severity, humidity, sea levels and intensity of storms have wide ranging impacts on human activities around the world.

Change to climate variable	Examples of impacts
Higher mean temperatures	<ul style="list-style-type: none"> <li>→ Increased evaporation and decreased water balance.</li> <li>→ Increased severity of droughts [see below].</li> <li>→ Reduced alpine winter snow cover.</li> <li>→ Reduced range of alpine ecosystems and species.</li> <li>→ Increased stress to coral reefs.</li> </ul>
Higher maximum temperatures, more hot days and more heat waves	<ul style="list-style-type: none"> <li>→ Increased incidence of death and serious illness, particularly in older age groups.</li> <li>→ Increased heat stress in livestock and wildlife.</li> <li>→ Increased risk of damage to some crops.</li> <li>→ Increased forest fire danger [frequency and intensity].</li> <li>→ Increased electric cooling demand and reduced energy supply reliability.</li> </ul>
Higher minimum temperatures, fewer cold days and frost days	<ul style="list-style-type: none"> <li>→ Decreased cold-related human morbidity and mortality.</li> <li>→ Decreased risk of damage to some crops and increased risk to others.</li> <li>→ Extended range and activity of some pest and disease vectors.</li> <li>→ Reduced heating energy demand.</li> </ul>
Decrease in precipitation	<ul style="list-style-type: none"> <li>→ Decreased average runoff, streamflow.</li> <li>→ Decreased water quality.</li> <li>→ Decreased water resources.</li> <li>→ Decrease in hydro-power potential.</li> <li>→ Impacts on rivers and wetland ecosystems.</li> </ul>
Increased severity of drought	<ul style="list-style-type: none"> <li>→ Decreased crop yields and rangeland productivity.</li> <li>→ Increased damage to foundations caused by ground shrinkage.</li> <li>→ Increased forest fire danger.</li> </ul>
Decreased relative humidity	<ul style="list-style-type: none"> <li>→ Increased forest fire danger.</li> <li>→ Increased comfort of living conditions at high temperatures.</li> </ul>
More intense rain	<ul style="list-style-type: none"> <li>→ Increased flood, landslide and mudslide damage.</li> <li>→ Increased flood runoff.</li> <li>→ Increased soil erosion.</li> <li>→ Increased pressure on disaster relief systems.</li> </ul>
Increased intensity of cyclones and storms	<ul style="list-style-type: none"> <li>→ Increased risk to human lives and health.</li> <li>→ Increased storm surge leading to coastal flooding, coastal erosion and damage to coastal infrastructure.</li> <li>→ Increased damage to coastal ecosystems.</li> </ul>
Increased mean sea level	<ul style="list-style-type: none"> <li>→ Salt water intrusion into ground water and coastal wetlands.</li> <li>→ Increased coastal flooding [particularly when combined with storm surge].</li> </ul>

**Figure 2:** Environmental Impacts Arising from Climate Change (Department of the Environment and Heritage, 2006)

What is clear is that wide range of sectors of the economy are impacted by environmental factors, where the overall impacts are set to grow significantly leading to some industries experiencing devastating adverse impacts (Winn, Kirchgeorg, Griffiths, Linnenluecke, & Günther, 2011). The question is that how changes in the natural environment are set to impact a multinational organization's value chain components.

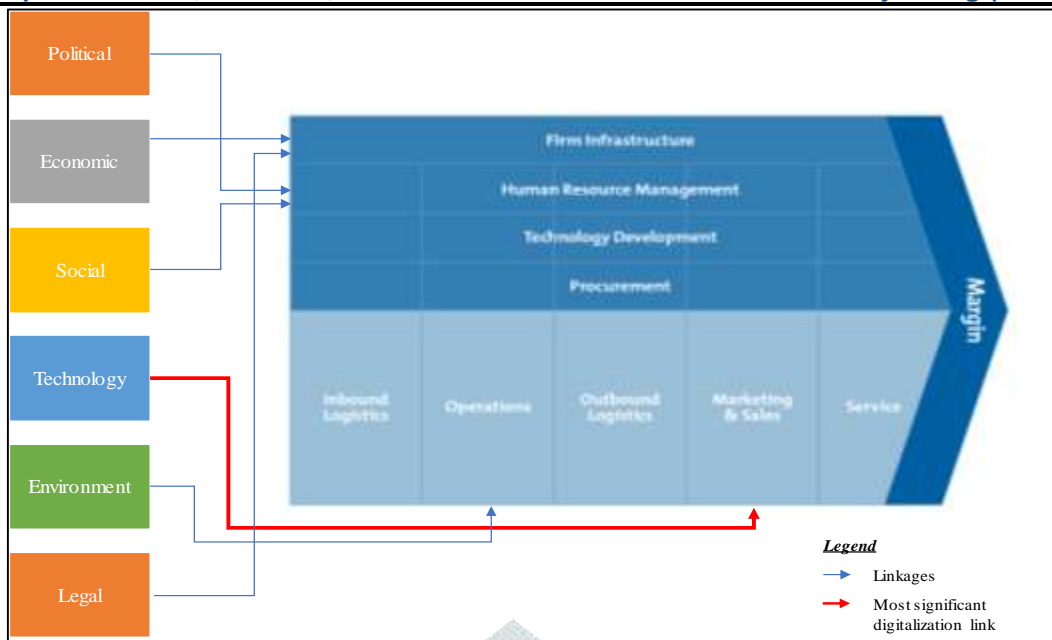
### 2.2.5 Legal considerations and the firm's infrastructure

Regulatory changes influences investors and entrepreneurs and affects the organization's ability to operate. This ranges from access to credit, taxation, business registration and property rights protection (MarketLinks, n.d.). As firms develop, more intellectual property and protection costs are incurred to preserve value generated. Specifically for intellectual property, legal departments often fail in taking effective action to protect the firm and risk the organization's livelihood altogether (Gillai, Rammohan, & Lee, 2014). It is also argued that legal structures and mechanisms are vital to the creation, geography and structure of global value chains (The IGLP Law and Global Production Working Group, 2016).

## III. DISCUSSION AND ANALYSIS

The review of literature and various analysis reports from world bodies on how the external environment has impacted several value chain components has shown that any changes and trends in the environment may either improve or adversely affect value chain components. Conceptually, such developments in the external environment appear to have a direct impact on firm value chain activities. How organizations are able to manage such linkages and improve upon them would be key in determining whether the organization of the future succeeds or fails.

Through the observations in literature, linkages between the identified developments in the external environment have been mapped to the firm value chain components for greater clarity. Fig 3 shows a diagrammatic representation of the potential linkages identified for each PESTEL factor. In terms of political considerations, the arguments on labor and its impact on human resource management remain the obvious connection. Any potential developments in the political landscape that impact labor policies (such as the push by international players for a minimum wage policy) could result in human resource management activities of a typical production company being highly affected.



**Figure 3:** Linkages between the external environment, value chain and digitalization (author's diagram)

From a firm infrastructure standpoint, in order to prepare for volatility in the economy, planning teams may adopt risk management frameworks in line with prospect theory to reduce potential losses to the multinational organization. Prospect theory argues that from a behavioural perspective, individuals would be risk tolerant when presented with potential gains and would take more risks if it resulted in higher utility (Evans & Evans, 2018; Levy, 1992; Khaneman & Tversky, 1979) Risk management however is concerned with risk identification and minimization including that of market risks (Calatayud & Ketterer, 2016). Given this propensity to seek higher utility where organizations lack it, the firm infrastructure component would be the most impacted as organizations would incur more costs associated with planning and risk management ensure firm value creation is preserved.

How organizations position themselves operationally could also be impacted by the increased usage of social media in day to day business. This is a multifaceted point as social media is a synthesis of two points of consideration i.e., between the social and technological factors. One such observation is that the advent of the social media age has resulted marketing and sales (in terms of primary activities) being severely impacted. Social media has now become an important marketing tool for companies around the world, as it is used for marketing campaigns and reaching a wider range of consumers (Ali, Shabbir, Rauf, & Hussain, 2016). This is because social media is significant in advertising products to customers (Ohajionu & Mathews, 2015) and enhances customer communication (Ezeife, 2017; Jackson & Ahuja, 2016). As such, businesses now must implement social media technologies in the way they sell goods to customers to remain competitive (Andzulis, Panagopoulos, & Rapp, 2013). Social media is replacing how organizations are communicating, ensuring marketing efforts are more targeted and personalized (Shwetha & Shubha, n.d.). Digitized marketing efforts also include social media marketing, which are helping businesses grow (Standberry, 2019). Specifically for manufacturers, digitalization in this area could be of great use, as social media would help manufacturers in creating brand awareness, gain web traffic, run targeted ads, build customer relationships and obtain customer insights (WebFX, 2020). Further, product information obtained from other consumers through social media creates more trust compared to manufacturer information (Paquette, 2013) and this may help manufacturers increase the reputation of their products.

From an environmental standpoint, the primary focus would be on creating operational practices within the operations component of the value chain that are sustainable to reduce negative impacts on the environment. To do this, global organizations may adopt carbon efficient and smart technologies in production, increasing the usage of renewable energy and producing environmentally positive products and services (Shrestha, 2014).

#### IV. CONCLUSION

In short, global developments in certain areas such as changes in labor policies, economic growth and the convergence between social and technological developments in the form of social media usage are necessitating firms to relook at the impact between external environmental factors and individual components in the firm value chain. This paper has highlighted that potential linkages can be identified between PESTEL factors and firm value chain components conceptually. Whilst conceptually, such linkages are known and have been established through literature, further investigation is needed to solidify our understanding on how PESTEL factors continue to impact the firm value chain amidst the backdrop of digitalization and the new normal created by the spread of the Covid-19 virus..

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