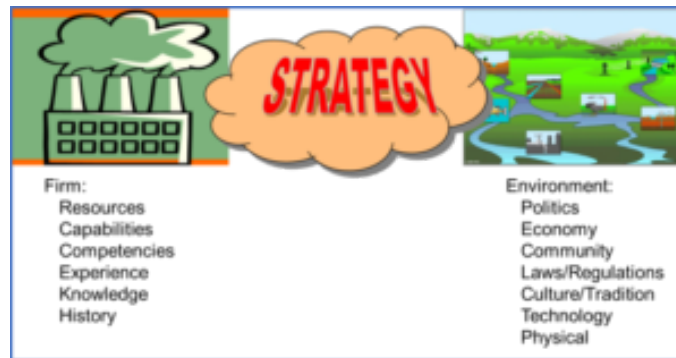


## 4.2: How Environment Affects Strategy

### Learning Outcomes

- Explain the key aspects of the environment that can affect strategy (e.g., stability, complexity, resource scarcity, and uncertainty).

We've talked about how organizations use strategy to integrate their functions and activities. Strategy also integrates the firm with its external environment. This means that the structure of the firm must align with external conditions. The problem this presents is that the environment constantly changes and the firm has little control over the changes. Strategy and structure must be flexible to adapt to changes in the environment.



Strategy integrates the organization with its external environment.

### Strategy and Change

To determine the appropriate strategic response to changes in the environment, managers must be able to understand the impact of the changes. There are four components that describe the nature of change in the environment: stability, complexity, resource scarcity, and uncertainty.

#### Stability

Stability refers to the rate at which change occurs. In a **stable environment**, change is slow. Managers have time to monitor and respond to changes in a deliberate manner. The grocery industry is relatively stable. A **dynamic environment** is changing rapidly. Managers must react quickly and organizations must be flexible to respond. Today's business environment is generally very dynamic. Technology, consumer tastes, laws and regulations, political leaders, and international conditions are all changing rapidly and dramatically. Failure to monitor and respond to changing conditions often results in a company's demise. Consider the Nokia example we introduced in an earlier section. Nokia was a market leader just a few years ago (2011). It didn't respond quickly to the emergence of smartphones and has now been acquired by Microsoft. Or we can look at the example of True Religion Jeans, a market leader in fashion jeans very recently. It did not respond to the shift in consumer taste to casual sportswear and the company has filed for bankruptcy.

#### Complexity

Complexity refers to the number of elements in the organization's environment and their connections. In a highly complex environment there are many variables that can affect the company. The variables are hard to identify and measure and are connected in ways that are hard to understand. Managers must monitor and respond to more sources of change, which makes it more difficult to make decisions. Complexity can be modeled with *chaos theory*, where small changes in one factor can produce a major change in another. For example, the failure of an Ohio power company to trim tree branches near its high-voltage lines lead to the biggest power blackout in US history, affecting more than 50 million people. Should GM, a global auto manufacturer, have anticipated that an increase in default rates on US home mortgages would begin a series of financial crises that would eventually lead to declaring bankruptcy?

#### Resource Scarcity

Resource scarcity refers to the availability of resources critical to a company or that are in high demand by other companies. Resource scarcity is usually the result of a shortage of supply, but it can also result from demand driving up prices. In conditions of

resource scarcity, a company may not be able to acquire the resources it needs to operate or grow. For example, lithium ion batteries are now used extensively in electronic devices, tools, and electric cars. But lithium supplies are in a severe shortage and new sources are slow to arise. Tesla, the US electric car manufacturer, will require about one-third of the available lithium to supply its new battery factory. Its ambitious growth plans could be jeopardized if new sources are not developed.

### Uncertainty

Instability, complexity, and resource scarcity all lead to uncertainty. Uncertainty refers to how predictable environmental conditions are. In an uncertain environment it is very difficult for managers to predict where and how change will occur. Instead, managers must make decisions based on assumptions rather than clear facts. Companies that “guess” right benefit from uncertainty and companies that guess wrong suffer. For example, in the 1990s when oil prices were around \$50 per barrel, there was no clear information to predict what would happen in the near future. Southwest Airlines bet that fuel prices would go up and hedged against oil price increases. Other airlines bet that prices would be stable or decline. When oil prices soared to more than \$100 per barrel, Southwest was able to remain profitable whereas other airlines lost more than \$6 billion.

#### ? Practice Question

<https://assessments.lumenlearning.co...essments/12187>

### Summary

Nothing stays the same. This simple fact underlies strategic management, which seeks to adapt to and benefit from change. However, in today’s environment, it is difficult for managers to identify and understand rapid or unexpected changes in the environment. Conditions of instability, complexity, resource scarcity, and uncertainty make it impossible for managers to anticipate change and make rational decisions. Instead, they must operate with incomplete data and base decisions on assumptions and best guesses. This makes good managers, who use their experience and training to guess right more often, even more important to organizations.

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