

EVALUATION OF BUSINESS MACRO ENVIRONMENT: CASE OF ECONOMIC SLOWDOWN

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Abstract. Nowadays due to growing importance of competitiveness measurement (9) a lot of resources are invested in the issue-related researches. One of the major components of measuring competitiveness is evaluation of business macro environment (BME).

Three approaches are mainly used to evaluate the BME:

Analysis of key indicators (usually by segregating business environment in parts (4, 9), for instance, PESTEL analysis);

Business surveys (for instance, IFO Business Climate Index in Germany, Economic Sentiment Index in Latvia, etc.). However, this approach does not give a clear explanation of how entrepreneurs carry out the BME evaluation and what information they use.

More advanced (and rear) approach that combines results of the first two approaches and explains the gap between the evaluation results.

In the economic slowdown conditions the analysis of key indicators is still appropriate to employ (with some exceptions though), but reasonable changes take place in the BME evaluation undertaken by the entrepreneurs for the reason that general economic indicators become less important.

The most important information for the entrepreneurs to evaluate the BME in 2005-2006 was the average wages level in the country, but in the end of 2007 (in the beginning of the slowdown) - the overall employment situation.

Key words: business macro environment; methods of evaluating business macro environment; economic slowdown

Introduction

The evaluation of business macro environment has become crucial to making correct management decisions and forecasting the future situation in conditions of the current economic slowdown. The BME evaluation to be undertaken becomes more important at the scale of the Baltic because there is no previous experience of running businesses in the economic slowdown conditions within the region. After seven years of the rapid economic growth – in 2007, the GDP rose by 2 - 4% – in 2008², the GDP growth forecast accounts for 3-4% only. The Governments of the Baltic States need the BME to be more precise in order to support the economic activity in line with the current requirements. The BME assessment and forecasting development also strongly influence on the real-life management decision-making.

The research

This paper is a logical continuation of the previous study undertaken by the research team³. The research tasks were to find out, firstly, how the entrepreneurs undertake the BME evaluation; secondly, how the entrepreneurs make the BME evaluation in conditions of the economic slowdown; and thirdly, to identify directions for further research.

In order to find out how the entrepreneurs undertake the BME evaluation, a special survey (120-sample) was conducted⁴. To find out how the entrepreneurs make the BME evaluation in

² Prognoses (taking in to account 2 quarters of 2007), new prognoses at October 2008 estimated - 0%

³ In several periods, Jānis Vucāns, Aija Vucāne and Kristīne Guseva (in 2006) took part in the BME research (3, 4).

⁴ As just 120 businessmen from Kurzeme (Western part of Latvia) took part in polling, results can't be related to all businessmen in Latvia, but results are useful for formulating establishing tendencies

the economic slowdown conditions, representatives from different business areas were interviewed. The research was based on the primary information in part, whereas the secondary data (mainly statistical indicators) was used to describe the current economic situation.

Research limitations

The research limitations are primarily connected with the viability of widening the survey and interview samples taking into account the economy structure.

Results and discussion

The most widely used approaches to the BME evaluation are:

Analysis of indicators (4)

Business surveys

More advanced (and rear) approach that combines and compares results of the first two approaches

All these methods are widely used for the BME’s short-term forecasting development (macro econometrics methods widely employed to forecast the BME changes previously faced reasonable dissatisfaction at present (2)).

The indicators analysis remains very popular approach to evaluate the BME. This approach employs M. Porter’s PESTEL model; the idea behind it is to analyse all parts of the BME separately and then to elaborate the aggregated indicator for each of them as well as for the whole business microenvironments (6, 7).

In 2005-2006, we tried to compare the indicators analysis results of the BME evaluation with the results obtained by conducting business surveys (3). The analytical comparison showed that there is a considerable difference between the results obtained by the indicators analysis and the business surveys approaches to the BME evaluation.

The most widely used approach to the BME evaluation (as well as to evaluation of the countries’ competitiveness (8, 9)) is business surveys.

The most popular indices elaborated in the frames of this approach are the IFO Business Climate Index in Germany, Economic Sentiment Index in the Baltic States and others. The business surveys results are widely used for short-term forecasting of the BME development (they also influence on managerial decisions made by the entrepreneurs), but it is still unclear how the entrepreneurs make this evaluation, on what information it is based. The black box model illustrates the evaluation process of the kind (fig.1).

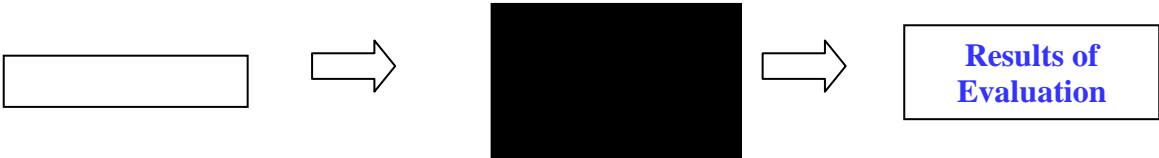


Fig.1. How do entrepreneurs evaluate the BME?

Therefore, it is necessary to conduct a further research on the process of the BME evaluation by the entrepreneurs.

After the entrepreneurs were asked whether the evaluation of the environmental business trends development was carried out in their enterprises, the results were somewhat unexpected.

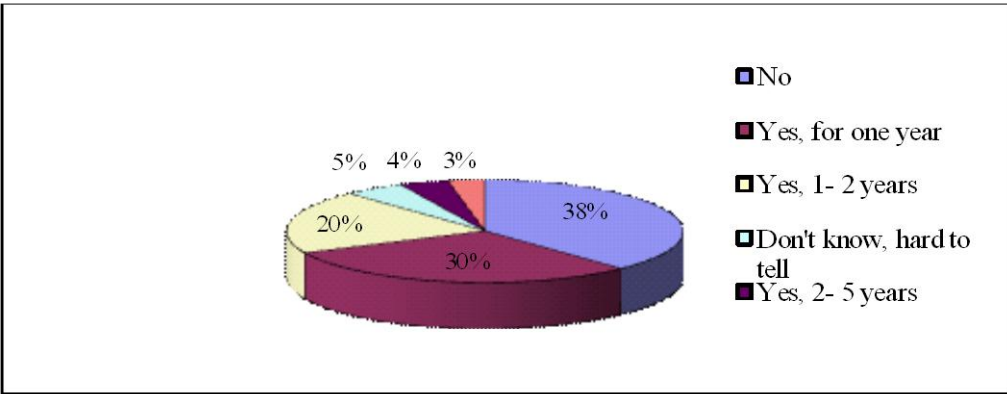


Fig.2. Has the evaluation of the business environment development trends been carried out at the enterprise?

A large part of the entrepreneurs (43%) does not make evaluation of the business environment at all⁵. In the time period from 2006 to 2007, the main sources of information used for the BME evaluation were the Internet databases. Papers published in the newspapers and journals carried an equal importance. The enterprise internal information and the industry associations' information were on the third and the fourth places, respectively. Therefore, it can be concluded – on the preliminary basis – that the information sources the entrepreneurs use to evaluate the BME are slightly untailed.

However, it is still unclear what kind of indicators the entrepreneurs employed to evaluate the BME. Taking into account the previous research results it is possible to make a preliminary conclusion that the indicators ranking used to evaluate the BME differ across countries.

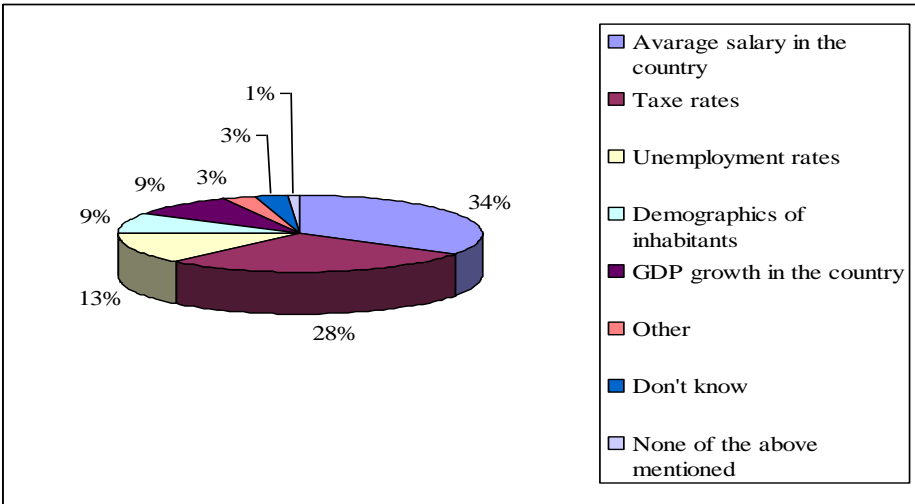


Fig.3. The most important external economic indicators taken into account while carrying out evaluation of the business environment

⁵ These results are not applicable for the Western Europe, i.e. the countries with a relatively long history of the market economy

In Latvia the entrepreneurs who undertake the BME evaluation and do further forecasting extensively use such indicators as the average salary, taxes and unemployment rates. The astonishing fact is a relative unimportance of the GDP growth indicator.

Nonetheless, the indicators analysis still remains very useful.

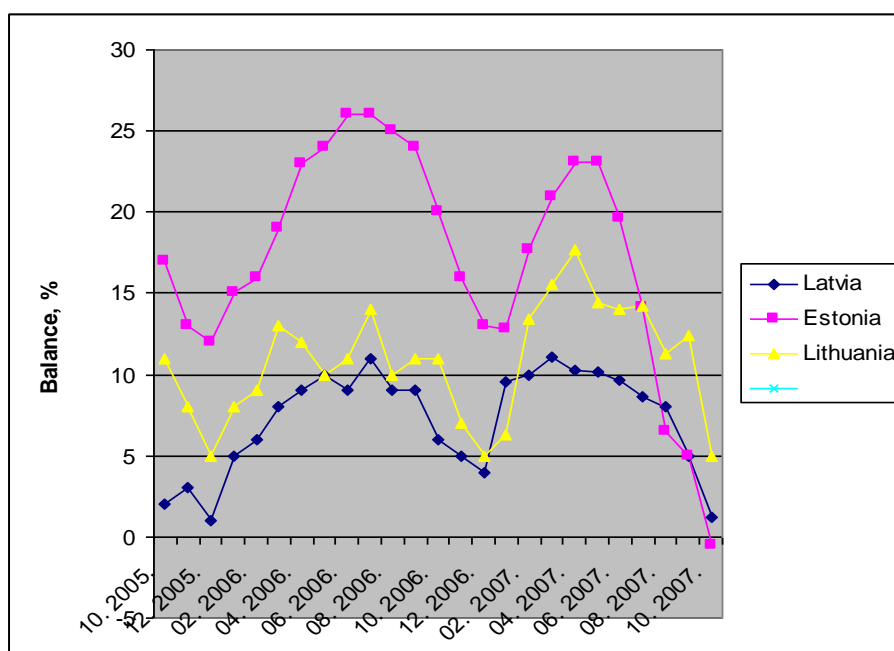


Fig.4. Economic Sentiment Index in Baltic States (1)

Figure 4 shows that the turning point of the Economic Sentiment Index for all the Baltic countries (Latvia, Estonia, Lithuania) is in July 2007 – the ESI starts decreasing tremendously and its level has reached the record minimum since October 2005.

From a theoretical viewpoint, the impact of such leading indicators as the durable goods consumption, the construction industry and building permits growth, etc., became more salient. However in the current situation of the economic slowdown the entrepreneurs are employing a variety of indicators to compare different phases of the economic development for evaluating the BME.

The interviews results show that in the economic slowdown conditions a key factor in evaluating the BME is a situation in respective industries. The average salary level is also significant, but to a lesser extent. All in all, the entrepreneurs evaluate the situation more pessimistically in comparison to the researchers and specialists from governmental institutions.

The explanation is tied with the fact that a large part of the researchers drew main conclusions based on the economic performance in 2006-2007, which was quite successful overall, but with a subsequent slowdown in the end of the period. On the other hand, the psychological factor is very important for the entrepreneurs (it potentially carries equal importance with the external environment (5)), thus, we must take it into account. The economic slowdown with the GDP growth plummeting from 10 % in 2007⁶ to the anticipated 3-4% in 2008 makes the evaluation of the BME pessimistic at present.

Main conclusions

1. From the entrepreneurial point of view, the rapid decrease of the economic development rate (in Latvia the GDP growth drops from 11% in 2007 to 3-4%

⁶ Centrālās statistikas pārvaldes datu bāze, <http://data.csb.gov.lv/Dialog/Saveshow.asp>

- (forecasted) in 2008). Therefore, the evaluation of the BME appears to be clearly pessimistic.
2. The largest part of the researchers uses the data of the previous years, when the economy was booming. Thus, the data analysis carried out in 2006-2007 cannot be applicable for forecasting the results of 2008-year of changing tendencies of economy.
 3. In conditions of the economic slowdown the entrepreneurs used the up-to-date information mainly, e.g. results of the particular industry performance (average salary level is still playing an important role), in evaluating the BME.

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