U.P.Rajarshi Tandon Open
University, Allahabad

M.Com-303
Business Environment

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अनुवाद की स्थिति में

मूल लेखक	अनुवाद
मूल सम्पादक	भाषा सम्पादक
मूल परिमापक	परिमापक

सहयोगी टीम

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Block 1 : BUSINESS ENVIRONMENT

Block Introduction

This block comprises in four units. The first unit introduces the subject of business environment and its component. It also provides an overview of BE in India.

The second unit explains the concept of complexity and diversity of business environment in 21st century. It also explains the concept of business cycle.

The third unit deals with environment scanning and its various techniques.

The fourth unit refers to political environment. It also looks into the three political institutions : legislature, executive and judiciary.

UNIT 1 OVERVIEW OF BUSINESS ENVIRONMENT

Structure:

1.0 Objectives

1.1 Introduction

1.2 Meaning and Definition of business environment

1.3 Features of business environment

1.4 Importance of business environment

1.5 Components of business environment

1.5.1 Internal Environment

1.5.2 External Environment

1.5.2.1 Micro components of business environment

1.5.2.2 Macro components of business environment

1.6 Overview of business environment

1.7 Summary

1.8 Self Assessment Exercise

1.9 Further Readings

1.0 Objectives

After studying this lesson, you will be able to:

- explain the meaning of business environment;
- identify the features of business environment;
- describe the various components of business environment;
- understand importance of business environment

1.1 INTRODUCTION

Understanding the environment within which the business has to operate is very important for running a business unit successfully at any place. Because, the environmental factors influence almost every aspect of business, be it its nature, its location, the prices of products, the distribution system, or the personnel policies. Hence it is important to learn about the various components of the business environment, which consists of the economic aspect, the socio-cultural aspects, the

political framework, the legal aspects and the technological aspects etc. The success of every business depends on adapting itself to the environment within which it functions. For example, when there is a change in the government polices, the business has to make the necessary changes to adapt it into the new policies. Similarly, a change in the technology may render the existing products obsolete, as we had seen that the introduction of computer has replaced the typewriters; the colour television has made the black and white television out of fashion. Again a change in the fashion or customers' taste may shift the demand in the market for a particular product, e.g., the demand for jeans reduced the sale of other traditional wear. All these aspects are external factors that are beyond the control of the business. So the business units must have to adapt themselves to these changes in order to survive and succeed in business. Hence, it is very necessary to have a clear understanding of the concept of business environment and the nature of its various components.

1.2 Meaning and Definition of Business Environment

The term Business Environment is composed of two words- 'Business' & 'Environment'. The term business is understood and explained in different ways by different people. For some, business is an activity, for some it is a method of transacting, for others; it is a method of making money. People also argue that business is an organized activity to achieve certain pre determined goals or objectives. In simple terms, the state in which a person remains busy is known as business but in its economic sense business is referred to the activities like production, extraction or purchase or sales of goods and services that are performed for earning profit. Business may be understood as the organized efforts of an enterprise to supply consumers with goods and services for a profit. Businesses vary in size, as measured by the number of employees or by sales volume etc. But, all businesses share one common purpose that is to earn profits. The concept of business has undergone a vast change. From a producer driven activity, it has become a consumer centric phenomenon. On the other hand, the term environment refers to the totality of all the factors which are external to and beyond the control of individual business enterprises and their management. In another words,

environment means, all external and internal forces (factors) which affect the functioning of a particular place (atmosphere). Environment furnishes the macro context while the business firm is the micro unit. Thus, the environment of a business is its surrounding in which it operates. Business environment may be defined as the total surroundings, which have a direct bearing on the functioning of business. The business environment consists of all those internal and external factors which affect a firm's decision. The term business environment refers to the aggregate of all forces, factors and institutions which are internally affecting the business through management structure and policies as well as which are external to and beyond the control of individual business enterprises; but which influence their functioning. Business involves activities, which links an organization, a business is governed by the behavior of its employees, management or decision makers.

Business Environment may be defined as all those internal and external factors/components which impact the functioning / performance of a firm and/or its decision making, particularly strategies. Although the scope of the term business environment includes, in a broad sense, both internal and external factors impacting the business. In its common usage it often refers to the external factors.

The term 'business environment' connotes external forces, factors and institutions that are beyond the control of the business and they affect the functioning of a business enterprise. These include customers, competitors, suppliers, government, and the social, political, legal and technological factors etc. While some of these factors or forces may have direct influence over the business firm, others may operate indirectly. Thus, business environment may be defined as the total surroundings, which have a direct or indirect bearing on the functioning of business. It may also be defined as the set of external factors, such as economic factors, social factors, political and legal factors, demographic factors, and technical factors etc., which are uncontrollable in nature and affects the business decisions of a firm.

1.3 FEATURES OF BUSINESS ENVIRONMENT

On the basis of the above discussion the features of business environment can be summarized as follows:

- Business environment is the sum total of all factors external to the business firm and that greatly influences their functioning. It covers factors and forces like customers, competitors, suppliers, government, and the social, cultural, political, technological and legal conditions.
- Business environment is composed of internal as well as external factors both. Though generally we consider business environment as external environment but the internal environment of the organization is equally important as it helps to analyze the strengths and weaknesses of the business
- The business environment is dynamic in nature that means it is never static as it is constantly changing due to economic as well as non economic factors.
- The changes in business environment are unpredictable and uncertain. It is very difficult to predict the exact nature of future happenings and the changes in economic and social environment.
- Business Environment differs from place to place, region to region and country to country. Business environment is different for different business units. Though there may be certain macroeconomic or natural factors which may have a common impact on all units but the effect may be larger or smaller depending on the industry, size and efficiency or experience of the different business units. Political conditions in India differ from those in Pakistan. Taste and values cherished by people in India and China vary considerably.
- Business environment has both long term and short term impact. For example allowing FDI in retail may have a negative short term impact of reduction in profit or increase in competition but in long term it may force the domestic firms to be more efficient and productive thus increasing their profitability.

Thus we can conclude that business environment is complex, dynamic, uncertain and competitive.

1.4 IMPORTANCE OF BUSINESS ENVIRONMENT

There is a close and continuous interaction between the business

and its environment. This interaction helps in strengthening the business firm and using its resources more effectively. The business environment is multifaceted, uncertain, and dynamic in nature which has a far-reaching impact on the survival and growth of the business. Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in realm of business. To be more specific, proper understanding of various aspects of business environment such as social, political, legal and economic helps the business in the following ways:

- *First Mover Advantage:* Early identification of opportunities helps an enterprise to be the first to exploit them instead of losing them to competitors. For example, Maruti Udyog became the leader in the small car market because it was the first to recognize the need of small cars in India.
- *Threats Identification:* Identification of possible threats helps in taking corrective and improving measures to survive the competition. For instance; if an Indian firm finds that a foreign multinational is entering the Indian market, it can meet the threat by adopting measures like, by improving the quality of the product, reducing cost of the production, engaging in aggressive advertising, and so on. ITC has diversified itself identifying the threat to its core business of cigarette and tobacco.
- *Matching to Rapid Changes:* Now-a-days all types of enterprises are facing environment changes. In order to effectively cope with these significant changes, firms must understand and examine the environment and develop suitable course of action. For example, Bajaj Auto Ltd (BAL) has shutdown the production of its highest selling two wheeler scooters just to match the changing trends of motorbikes.
- *Performance Improvement:* The enterprises that continuously monitor their environment and adopt suitable business practices are the ones which not only improve their present performance but also continue to succeed in the market for a longer period. For example, Hero Moto Corp, (earlier Hero Honda Motor Ltd) is improving its performance by launching improved and modified

models just to keep itself ahead of Bajaj auto ltd and Honda Motor ltd.

- *Opening of New Growth Avenues:* The interaction with the environment leads to opening up new frontiers of growth for the business firms. It enables the business to identify the areas for growth and expansion of their activities. Most of the companies moved to Utrakhand when the state started a new industrial hub as SIDCUL and provided other relaxations.
- *Analyzing Competition:* It helps the firms to analyze the competitors' strategies and formulate their own strategies accordingly in order to cope with the rapidly increasing competition. Coke & Pepsi; Amar Ujala & Dainik Jagran always keep themselves vigilant against each other just to counter attack the competition.
- *Corporate Image Building:* Environmental understanding helps the business organizations in improving their image by showing their sensitivity to the environment within which they are working. For example, in view of the shortage of power, many companies have set up Captive Power Plants (CPP) in their factories to meet their own requirement of power and saving to loss of energy in transmission. Companies are also moving towards green marketing, water harvesting and non traditional sources of energy.

1.5 COMPONENTS OF BUSINESS ENVIRONMENT

On the basis of the extent of intimacy with the firm, business environment has two major components, the internal environment, i.e. components internal to the firm and the external environment, i.e. components external to the firm which have relevance to it. The following chart gives a summary of the various components of business environment:

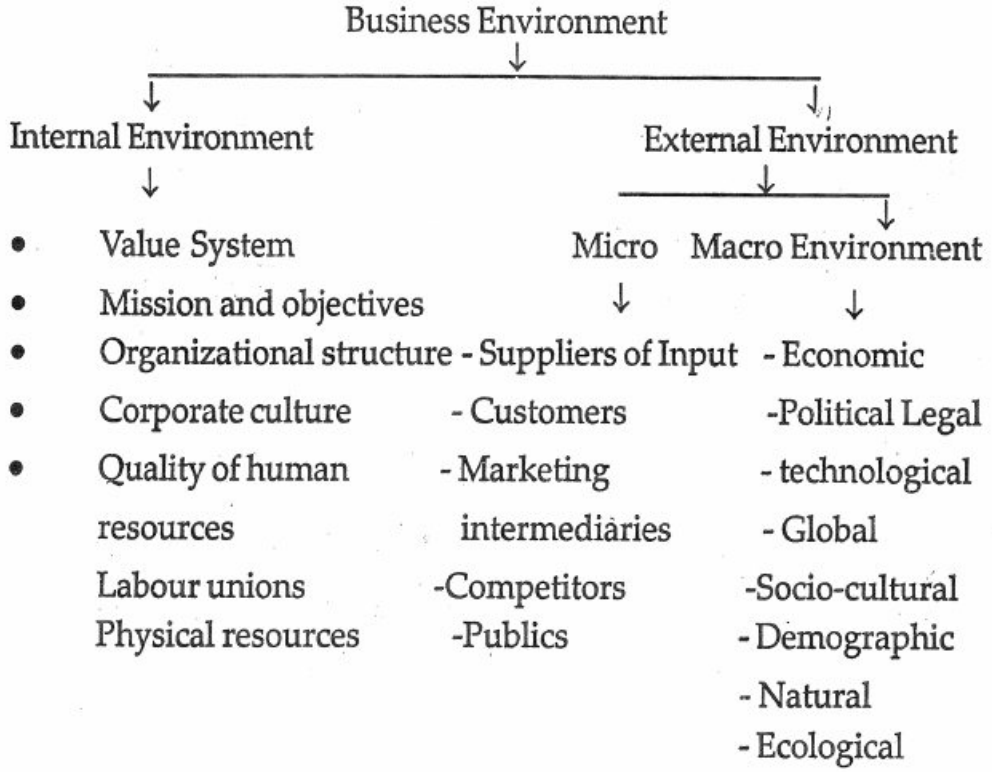


Fig.: Components of Business Environment

As shown in the figure, business environment has two major components-Internal environment and External environment. We can discuss these components in length as below:

1.5.1 INTERNAL ENVIRONMENT

Internal environment plays an important role in the strategic management. It consists of the resources and inherent competencies of the firm, the structure, process and the organization culture. Internal environment provides an overview of strengths and weaknesses of any organization. It helps in designing suitable strategies to cope with competition outside the firm. The internal components are generally regarded as controllable components because the company/firm has control over these components/factors; it can alter or modify these factors as its personnel, physical facilities, structure and even its objectives to suit the environment. The internal environment components determine the potential of a company to meet the external environment challenges. The internal environment of a business organization is constituted by the following:

- *Value System:* The values system of any organization plays an important role in deciding the behaviour and working

environment. It determines the course of action. It takes to achieve its objectives and goals while operating in fast changing external environment. The value system of the business organization influences its portfolio strategy, HRM, marketing strategy and corporate social responsibility (CSR). The value system and ethical standards are also considered by some of organization in the selection of suppliers and middlemen. The principles of right and wrong that are accepted by an individual or organization are what comprise value system.

- ***Vision, Mission and objectives***: The vision statement of any organization states where it wants its business to reach at. It is the future dream for its business to visualize its position in coming years. It should keep the business reaching for new heights. Example of vision statement: Disney states "to make people happy".

  An organization's mission is the purpose or reason of its existence. It tells what the company is providing to society, either a service like house cleaning or a product like mobile phones. A well said mission statement defines the fundamental and unique purpose that sets a company apart from other firms of its type. For example, ONGC Ltd has its mission statement, "To be world class Oil & Gas Company integrated in energy business with dominant Indian leadership and global presence". A mission statement describes what the organization is now; a vision statement describes what the organization would like to become.

  Objectives are the end results of planned activity. They state what is to be accomplished by when and should be quantified if possible. Vision, mission and objectives set the scope, direction, philosophy and pace of development.

- ***Organizational Structure:*** The organizational structure of the Board of Directors, extent of professionalization of management etc, are important factors influencing business decisions. Some management structure and styles delay decision making while some others facilitate quick decision making. The centralization & decentralization, delegation of authority and span of control also affect the business decision as the internal component of environment of any firm.

- *Corporate Culture:* Corporate culture can be viewed as a collection of beliefs, expectations and values learnt and shared by the organization's members and transmitted from one generation to other generation. It can be considered to reflect the values of the founders and mission of the firm. It has two distinct attributes-intensity and integration. Cultural intensity refers to the degree to which members of the unit accept norms, values or other cultural content associated with the unit. Cultural integration refers to the extent to which the units in an organization share common culture. Culture can strongly affect the organization's ability to shift its strategic directions.
- *Human Resource (Employees)*: The human resource is the important factor for any organization as it contributes to the strength and weakness of any organization. The human resource in any organization must have characteristics like skills, quality, high morale, commitment towards the work, attitude, etc. The involvement and initiative of the people in an organization at different levels may vary from organization to organization. The organizational culture and over all environment have bearing on them. It is an internal factor and an organization has absolute control on changing this factor as per the needs of the enterprise and other forces.
- *Labour Unions*: Labour unions also affect the organization's working efficiency. An organization should always take into consideration the welfare of its employees to avoid any shutdown of production on the demand of labour unions. Recently Maruti Udyog Ltd has faced severity of this internal component at its Manesar plant.
- *Physical Resources and Technological capabilities*: Facilities like production capacity, technology are among the factors which influences the competitiveness of the firm. The proper acquisition and working of the assets is indeed essential for efficient working of the organization. An organization invests money in plant and machinery because it expects a positive rate of return over cost in future. The revenue from the use of plant and machinery should be sufficient so as to cover the invested money, operating costs,

and generate enough profit to satisfy the organization. The availability of plant and machinery is dependent on technological development of the country and the government's approach towards foreign technical collaboration.

Apart from these, image of the corporate, R & D and competitive advantage are other internal components of business environment.

1.5.2 EXTERNAL ENVIRONMENT

The external environment of an organization comprises of all entities that exists outside its boundaries, but have significant influence over its growth and survival. External environment and its factors are generally regarded as uncontrollable as they are beyond the control of a company. As they are beyond the control of a company, its success will depend to a very large extent on its adaptability to the environment. The external environment can be divided in to Micro environment and Macro environment.

1.5.2.1 MICRO ENVIRONMENT (Task Environment/ Operating Environment)

The micro environment is also known as the task environment and operating environment because the micro environmental forces, though are external factors, still have a direct bearing on the operations of the firm. The micro environment consists of the factors in the company's immediate environment that affects the performance and working of the company. The micro environmental factors are more intimately linked with the company than the macro factors. The micro forces need not necessarily affect all the firms in a particular industry in the similar ways. Some of the micro factors may be particular to any given type of organization. For example, a firm which depends on a supplier may have a supplier environment which is entirely different from that of a firm whose supply source is different. Micro environmental factors/forces are discussed as below:

- *Suppliers:* They are the persons who provide the raw materials and required components to the company to carry out their manufacturing and production activities. A supplier's behaviour will directly impact the business it supplies. They must be reliable and business must have multiple suppliers i.e. they should not

depend upon only one supplier. For example, if a supplier provides a poor service, this could increase timescales or lower product quality. An increase in raw material prices will affect an organization's marketing mix strategy and may even force price increases. Close supplier relationships are an effective way to remain competitive and secure quality products.

Customers: Customers are regarded as the king of the market. Each individual may be a different from other one. There may be as many as type of customers. Success of every business depends upon the level of their customer's satisfaction. Organizations survive on the basis of meeting 'customer needs and wants' and providing benefits to their customers. Failure to do so will result in a failed business strategy. This includes offering customers the best quality products at reasonable prices.

Competitors: Competitors are also important factor in the micro environment and include companies with similar offerings for goods and services. (The name of the game in marketing a product is differentiation) Can the organization offer benefits that are better than those offered by competitors? Does the business have a unique selling point (USP)? Competitor analysis and monitoring is crucial if an organization is to maintain or improve its position within the market. If a business is unaware of its competitor's activities, they will find it very difficult to 'beat' them. The market can move very quickly, whether that is a change in trading conditions, consumer behaviour or technological developments. As a business, it is important to examine competitors' respons to the changes, so that firm can maximize the benefits. To remain competitive a company must consider who are their biggest competitors while considering its own size and position in the industry.

Public and Media: Any group that has an interest in or impact on the organization's ability to meet its goals is termed as public. For example, media, local citizens, ethnic groups, environmental groups, human rights activists and NGO etc. They may be the users or non users of the product. Positive media attention can 'make' an organization (or its products) and negative media

attention can 'break' an organization. Organizations need to manage the media so that it helps promote the positive things about the organization and conversely reduce the impact of a negative event on their reputation. Some organizations will even employ public relations (PR) consultants or 'gurus' to help them manage a particular event or incident. Consumer television programmes with a wide and more direct audience can also have a very powerful impact on the success of an organization. Some business recognizes this and uses media support for building their image and reputation. Similarly, local groups like students unions or ethnic groups may influence customer perception about various products. Citizen- action publics including environmental groups, human right activists or NGOs can question the action of a company and put them in the public spotlight.

- *Marketing Intermediaries:* They work as a link between business and final consumers. Marketing Intermediaries refers to resellers like wholesalers and retailers, physical distribution firms like transporters and warehouses, marketing service agencies like advertising agencies and financing firms like banks etc. These are the people or organizations that help the company promote, distribute and sell its products to final buyers. The resellers are those who hold and sell the company's products like any kirana store or showroom. Transporters carry company's product from factory to market through rail, road or pipeline. Warehouses store the stock of the company. Marketing service agencies like R&D firm which provides the valuable insights about the market trends like ORG Marg, advertising agency promotes company's products like O&M. The financing firms are those institutions that finance the company like banks and credit companies.

1.5.2.2 MACRO ENVIRONMENT (General Environment/ Remote environment)

Macro environment is also known as general environment and remote environment. Macro factors affect the general scenario of all the business units and are not specific to a particular company or business unit like micro environmental factors. Macro environment are generally more uncontrollable than micro environment factors. When the macro factors

become uncontrollable, the success of company depends upon its adaptability to the environment. This environment has a bearing on the strategies adopted by the firms and any changes in the areas of the macro environment are likely to have a far- reaching impact on their operations. The macro environment is primarily concerned with major issues and upcoming changes in the environment. We can summaries the macro environment factors in details one by one.

- *Economic Environment:* It is very complex and dynamic in nature that keeps on changing with the change in policies and political situations. Economic environment refers to the overall economic factors like economic system, economic structure, planning, economic policies, control and regulations etc. There is a close relationship between business and its economic environment. It obtains all inputs from economic environment and all its output is absorbed here with. The state of the economy is usually in flux. The current situation (specific to the industry) and any changes that may be forecast are important. The economy goes through a series of fluctuations associated with general booms and recessions in economic activity. In a boom nearly all business are benefited whereas recession is a case vice versa. Business is influenced by economic aspects like interest rates, wage rates etc. The survival and success of each and every business enterprise depends fully on its economic environment. The GDP indicates the growth scenario of any country. Companies take this into consideration before expanding or diversifying their business. The main factors that affect the economic environment are:
- *Economic Conditions:* The economic conditions of a country refer to a set of economic factors that have great influence on business organizations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market etc. All these help in improving the pace of economic growth.
- *Economic Policies:* All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are

- Industrial Policy
- Fiscal Policy & Monetary Policy
- Foreign Investment Policy
- Export –Import Policy (EXIM Policy)

The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business organization has to function strictly within the policy framework and respond to the changes therein.

- *Economic System*: The world economy is primarily governed by three types of economic systems, viz., (i) Capitalist economy; (ii) Socialist economy; and (iii) Mixed economy. The type of economic system influences greatly the choice of business.
- *Demographic Environment*: It is the component of the business environment concerned with the perspective of population. Demographics refer to the size, density, distribution and growth rate of population. All these factors have a bearing on the demand for various goods and services. For example, a country where population rate is high and children constitute a large section of population, and then, there will be more demand for such products. Similarly, the demand of the people of cities and towns are different than that of people of rural areas. The high rise of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skilled labour in certain areas motivates the firms to set up their units in such area. For example, the business units from America, Canada, Australia, Germany, UK, are coming to India due to easy availability of skilled manpower. Thus, a firm that keeps a watch on the changes on the demographic front and reads them accurately will find opportunities knocking at its doorsteps. ITC launched its unique and ambitious programme called e-chaupal, targeted at the rural market as 70% of Indian population lives in villages. Markets with growing population and income are growth markets. But the decline in the birth rates has affected the demand for baby products. Johnson &

Johnson have overcome this problem by repositioning their products like baby shampoo and baby soap, promoting them to the adult segment, particularly to the females.

Socio-cultural Environment: Societal values and lifestyles change over time, and the most important of these; directly or indirectly leave an impact on the business environment. For example, over the past generation, it has become acceptable for women to work; people are not retiring at 65; and people are more aware of the environment etc. The changes in culture and lifestyle may come from many sources: medical (smoking, healthy eating, exercises); science (global warming, going green'); economic (people working longer, women in the workforce); cultural diversity (music preferences, foods, living accommodations, medicine); and technologies (biodegradable plastic) are just a few examples.

These changes will be important to the industry and to the business. The social environment of business includes social factors like customs, traditions, values, beliefs, poverty, literacy, life expectancy rate etc. The social structure and the values that a society cherishes have a considerable influence on the functioning of business firms. For example, during festive seasons, there is an increase in the demand for new clothes, sweets, fruits, flower, etc. Due to increase in literacy rate, the consumers are becoming more conscious of the quality of the products. Due to change in family composition, more nuclear families with single child concepts have come up. This increases the demand for the different types of household goods. It may be noted that the consumption patterns, the dressing and living styles of people belonging to different social structures and culture vary significantly. The dressing sense and eating habits of south India is different from North India. We can also observe the differences in people's behavior due to different religion. Companies have to develop different set of offers to meet out these socio cultural differences. Coke advertises its product in various languages due to socio cultural environment. McDonald and KFC had to change their product portfolio when they launched their restaurant chain in India.

The value and beliefs associated with colour vary significantly between different cultures. Blue, considered feminine and warm

in Holland, is regarded as masculine and cold in Sweden. Green is favourite colour in the Muslim world; but in Malysia, it is associated with illness. White indicates death and mourning in China and Korea; but in some countries, it expresses happiness and is the colour of the wedding dress of the bride. Therefore, these social and cultural factors should be taken into consideration while promoting certain product, services or ideas

Technological Environment: Technology is understood as the systematic application of scientific or other organized knowledge to practical tasks. Technology changes fast and to keep the pace with the dynamics of business environment; organization must be on its toes to adapt to the changed technology in their system. The business in a country is greatly influenced by the technological development. The technology adopted by the industries determines the type and quality of goods and services produced. Technological environment influences the business in terms of investment in technology, consistent application of technology and the effects of technology on markets. Technological environment include the methods, techniques and approaches adopted for production of goods and services and its distribution. The varying technological environments affect the designing of products in different countries. Technology encompasses something more than computers. Technology comes in many forms such as medical devices, new plastics, and production techniques. We see the new offers of mobile phones regularly due to advancements in the technology day by day. The Bajaj Auto Ltd has observed this advancement in technology and it shut down its two wheeler scooter line and now focusing on motorcycles line only. Technological developments may increase the demand for some existing products. For example, voltage stabilizers help increase the sale of electrical appliances in markets characterized by frequent voltage fluctuations in power supply. However, the introduction of TVs, fridges with in-built voltage stabilizer adversely affects the demand for voltage stabilizers. Therefore, companies must keep in touch with technology advancement and amend their products and services accordingly.

Political and Legal Environment: It affects different business units extensively, as the business decisions are based on governn.ent policies and they have to change their policies too as per the government decisions. Political environment refers to three political institutions viz. legislature, executive and the judiciary in shaping, directing, developing and controlling business activities. The political environment of a country is influenced by the political organizations such as philosophy of political parties, ideology of government or party in power, nature and extent of bureaucracy influence of primary groups. The political environment of the country influences the business to a great extent. The political environment includes the political system, the government policies and their attitude towards the business community. All these aspects have a bearing on the strategies adopted by the business firms. The stability of the government also influences business and related activities to a great extent. It sends a signal of strength, confidence to various interest groups and investors. While hung parliament means an unstable and coalition government which signals poor decision making. For example, in our country UPA II could not pass the FDI bill from the parliament as it is a coalition government and does not has numbers to implement its decisions. Further, ideology of the political party also influences the business organization and its operations. Tata had to shift from West Bengal to Gujrat due to political disturbances raised by Trinmul Congress party. Reliance could not operate its Reliance Fresh stores in Uttar Pradesh during BSP government from 2007 to 2012 due to this political unfavourable environment.

Political changes are closely tied up with legal changes. Legal environment includes flexibility and adaptability of law and other legal rules governing the business. It may include the exact rulings and decision of the courts. These affect the business and its managers to a great extent. This refers to set of laws, regulations, which influence the business organizations and their operations. Every business organization has to obey, and work within the framework of law. Additionally, an industry may have specific

laws and regulations. For example, a pet store would deal with federal animal welfare and prohibited pet laws as wells as state laws concerning animal cruelty, housing, veterinary care and so on. In the same way tobacco companies have to print warning related to harm in consumption of cigarette and gutkha etc as per the legal issues. A stable political and legal environment is indispensable for business growth.

Natural & Ecological Environment: The natural environment includes geographical and ecological factors that influence the business operations. These factors include the availability of natural resources, weather and climatic condition, location aspect, topographical factors, etc. For example, sugar factories are set up only at those places where sugarcane can be grown. It is always considered better to establish manufacturing unit near the sources of input. Further, government's policies to maintain ecological balance, conservation of natural resources etc. put additional responsibility on the business sector. The ecology and physical environment plays a large part in many businesses, – especially for those which carry out production and manufacturing activities. In fact, business is affected on daily basis due to environmental and ecological changes. For example, the impact of climate change must be considered: water and fuel costs could change dramatically, if the world warms by only a couple of degrees.

Global Environment: The global environment refers to those global factors which are relevant to business such as the WTO principles and agreements; other internal conventions/ treaties / agreements/ declarations and protocols; economic and business conditions etc. Similarly, there are certain developments, like hike in crude oil price which have global impact. Indian fuel companies also increase or decrease fuel prices based on global change in price of crude oil. Globalisation and the increasing global business interdependence makes the fortunes of companies, sometimes even of national economies, dependent on the economic conditions in other countries. For example, recession in US economy in 2008 affected the economies of all major parts of the world. International political factors can also affect business, like war or political tension or uncertainties.

1.6 OVERVIEW OF BUSINESS ENVIRONMENT

Business environment in present era of economic liberalization, privatization and globalization is becoming increasingly complex, unstable and unpredictable. The environment is the resultant of a number of interacting and constantly changing social and economic forces and thus remains in a state of flux. Variations in the overall and sectoral rates of growth and frequent shifts in macro economic policies necessitated and triggered by social, economic or even political issues and problems demanding urgent attention keeps business environment in a state of continuous change. The changing environment creates challenges, opens up new opportunities and affects the strengths and weaknesses of various business segments.

Business environment for a firm is a multi-layered structure. It is possible that some layers are favourable and others adverse for it. These layers exhibit different characteristics. A layer produces effects, though in a limited manner, over the adjoining layers over a period of time. The closeness of interaction and relationship between the layers is different at different levels. For example, changes in global business environment may affect the domestic growth environment significantly, but the effect of the latter on policy environment may be slow. Some components like non economic environment are rigid and amenable to slow change due to the nature of their determinants. It is important for a business firm to comprehend the nature and structure of business environment and the factors causing change in it. At some stage a particular state of external environment may be favourable in varying degrees to certain segment of business while it may be adverse to others depending upon the nature of competitive situation, marketing mix of firms and managerial capabilities and the ability of the firm to adjust to environmental changes.

Business environment is becoming very complex day by day as some environmental issues such as deforestation, global warming, depletion of the ozone layer, pollution of land, air and water are no longer strictly the issues related to books and conferences. The leading politicians and managers around the world have picked up the environmental banner. The green marketing movement has been gaining momentum around the world. The businesses are challenged today to develop creative ways to make profits without unduly harming the

existing environment. Considering the variety of these sources of change in the environment, global managers are challenged to keep themselves abreast and adjust as necessary. Some companies like Daewoo, Hyundai, Maruti, Tata and Hero-Honda in India, with their pollution prevention programmes are leading the way. Indeed, cleaning up the environment promises to generate whole new classes of jobs in the future. Gone are the days when business was heavily protected and subsidized, licenses, quotas and restrictions were the order of the day. Now competition is the name of modern business. Businessmen always stand on the brink of a fear to eliminate from the market. They stand on their feet to cut down costs, to eliminate deficiencies and incessant improvements in the quality are order of the day. But by the competition, consumer is obviously benefited by the diverse openings of different competitors. According to Micheal Porter "aggressive home based suppliers and demanding local suppliers competing domestic rivals will keep each other honest in obtaining government support". Now a days competition is not only from rival firms but also from the ever improving technology. For example, type writers have been completely wiped out from the market by the computers. Traditional postage telegrams are at the verge of elimination by the increasing use of internet services. So, today's business is witnessing the manifolds competition which was not prevalent in the past.

Internationalization or globalization of business has become a subject of very serious discussion in the national economic policies and corporate board room. International trade is growing faster than world output and international investment is growing much faster than global trade. Globalization is a new phenomenon to India. We were for long time content in serving internal market which has been vast. Domestic production was insufficient to feed the vast market. We were compelled to import in order to supplement domestic production. We were also exporting to other countries, but our exports were composed of traditional commodities and the direction was mainly erstwhile communist block. Globalization did hardly exist during past five decades. There are other reasons too, which made us within the country's boundaries. For a long time, we did not have industries of the number and magnitude to think of globalization. Vibrant economy filled with robust industries is a pre-requisite for internalization. Secondly, for the past five decades, we followed an economic policy which did not encourage competitive spirit among our industrialists. In the name of self-reliance, import substitution,

swadheshi and economic sovereignty, we encouraged domestic industries to prosper, however inefficient they were. We gave those licenses, fixed quotas, imposed tariffs and offered subsidies generously. We put several restrictions on foreign companies desiring to enter Indian soil. This continued till 1990. In 1991, the new industrial policy paved the way for globalization in our economy.

1.7 SUMMARY

Business is an economic activity undertaken in a systematic manner with the intention of making profit which involves risk and it results in the production or exchange of goods or services. Business environment includes set of conditions or situation that affects business activities or decision making. These conditions are broadly classified into internal environment and external environment. Internal environment consists of factors which are within the control of the organization. Business ethics, Objective of the firm, Value system, Management structure, Physical assets, Technological resources, Financial resources, Stakeholders, Human resources etc. are part of the internal environment of business. External environment include factors which are outside the control of the business organization but it provide opportunities or pose threats. External environment is further classified into two categories micro environment and macro environment. Micro environment include factors which have a direct impact on the functioning of the organization. Micro environment consist of general public, competitors, customers, suppliers, trade union, marketing intermediaries (distributors, dealers, retailers) etc. Macro factors affect the general scenario of all the business units and are not specific to a particular company or business unit like micro environmental factors. Macro environment are generally more uncontrollable than micro environment factors. Macro environment factors include economic, demographic, technological, political, socio-cultural, natural, legal and international. Business environment is Complex, Dynamic and Multi-faceted and has a far- reaching impact. The interaction between the business and its environment helps in identifying the opportunities for and threats to the business. It opens up new frontiers of growth for the business firms. Environmental analysis makes the task of managers easier in dealing with business challenges. It helps the firms to analyze the competitors' strategies and formulate their own strategies accordingly keeping in mind its own strength and weakness.

1.8 SELF ASSESSMENT QUESTIONS

1. What is business environment?
2. Explain various components of business environment.
3. Discuss in brief, the Indian business environment.
4. What is the significance of studying business environment?

1.9 SUGGESTED READINGS

1. Cherrunilam Francis, Business Environment, Vikas Publishing House Private Limited. Place & Years
2. Bedi Suresh, Business Environment, Excel Books, Place & Years
3. Mittal Vivek, Business Environment, Excel Books, Place & Years
4. Kotler Philip & Armstrong Gary, Principles of Marketing, PHI, Place & Years

UNIT-2 ENVIRONMENTAL SCANNING

Structure:

2.0 Objective

2.1 Introduction

2.2 Meaning of environmental scanning

2.3 Need to scan the business environment

2.4 Factors to be considered for environmental scanning

2.5 Approaches to environmental scanning

2.6 Sources of information for environmental scanning

2.7 Methods and techniques of environmental scanning

- 2.7.1 Scanning societal environment
- 2.7.2 Scanning task environment: Industrial analysis

2.8 Scanning internal environment variables

- 2.8.1 Resource based analysis: VRIO framework
- 2.8.2 Value chain analysis
- 2.8.3 Scanning Functional resources

2.9 Summary

2.10 Self Assessment Questions

2.11 Suggested Reading

2.1 INTRODUCTION

As we had studied in previous unit that now a day companies are operating their business in a uncertain environment. What is environmental uncertainty? It is the degree of complexity plus the degree of change existing in an organization's external environment. On the one hand changing environment creates new opportunities to the companies while on the same time it destroys the old ones. This means only those companies can survive in this volatile business environment are a strategily fit between environment and their offers. The companies always search this strategic fit and it can be developed by continuous scanning of the environment. The environment scanning enables constant monitoring of various factors affecting the business. This unit

explains the need of environmental scanning and the different techniques of business environment scanning. Before discussing environment scanning in detail, first define scanning:

Defining Scanning

There are a number of ways to conceptualize scanning. Aguilar (1967) identified four types of scanning. **Undirected viewing** consists of reading a variety of publications for no specific purpose other than to be informed. **Conditioned viewing** consists of responding to this information in terms of assessing its relevance to the organization. **Informal searching** consists of actively seeking specific information but doing it in a relatively unstructured way. These activities are in contrast to **formal searching**, a proactive mode of scanning entailing formal methodologies for obtaining information for specific purposes.

Morrison, Renfro, and Boucher (1984) simplified Aguilar's four scanning types as either passive or active scanning. Passive scanning is what most of us do when we read journals and newspapers. We tend to read the same kinds of materials—our local newspaper, perhaps a national newspaper like The New York Times or The Wall Street Journal, or an industry newspaper like The Chronicle of Higher Education. However, the organizational consequences of passive scanning are that we do not systematically use the information as strategic information for planning, and we miss many ideas that signal changes in the environment.

Active scanning focuses attention on information resources that span the task and industry environments as well as the macro environment. Another way of looking at scanning was described by Fahey, King, and Narayanan (1981). They view scanning as irregular, periodic and continuous. **Irregular** systems are used on an ad hoc basis and tend to be crisis initiated. These systems are used when an organization needs information for planning assumptions and conducts a scan for that purpose only. **Periodic** systems are used when the planners periodically update a scan, perhaps in preparation for a new planning cycle. **Continuous** systems use the active scanning mode of data collection to systematically inform the strategic planning function of the organization. The rationale undergirding active scanning is that potentially relevant "data" are limited only by your conception of the environment. These data are inherently scattered, vague, and imprecise and come from a host of sources. Since early signals often show up in

unexpected places, your scanning must be ongoing, fully integrated within your institution, and sufficiently comprehensive to cover the environments important to your decision makers.

2.2 MEANING OF ENVIRONMENTAL SCANNING

Environmental scanning is an analysis and evaluation of internal conditions and external data and factors that affect the organization. It was originally a concept from the business management world by which businesses gathered information from the environment to give them a competitive advantage but now it is widely used by the public and private sectors as part of any planning or strategy. 'Environmental scanning is monitoring, evaluating and disseminating of information from the external and internal environments to key people within the corporation'. A corporation uses this tool to avoid surprises and to ensure its long term survival. Environmental scanning has positive relationship with the profits. Environmental scanning identifies changing trends and patterns which have impact on organization. The objective of environmental scanning is to alert decision makers to potentially significant external changes before they crystallize so that the decision makers have sufficient lead time to react to change. Environment scanning can be done on ad-hoc basis, periodic basis or continuous basis. It depends on nature of business and the nature of environmental factors. External environment scanning provides insights related to opportunities and threats while internal environment scanning provides insights related to strengths and weaknesses of any organization.

2.3 NEED TO SCAN THE BUSINESS ENVIRONMENT

Business environment of a country is never constant or static. It is always in a dynamic state and is affected by a number of factors. The various factors that affect or constitute business environment keep interacting with one another. This dynamic nature and uncertainty of business environment result into a desperate need of various organizations to scan the business environment on continuous basis. The changes in the business environment are not sudden but gradual. Many business organizations are able to predict or forecast the changes on the basis of their experience and continuous monitoring of various factors which help them in manipulation of their decisions in

comparison of their competitors. We may notice a few examples of environmental scanning as follows:

When it was found that the motorcycle was eating into the share of the scooter in the two-wheeler market, Bajaj which had been concentrating on the scooter realized the emerging threat and decided to introduce a motorcycle so that what its scooter would lose might be gained by its motorcycle. So Bajaj has noticed the changing trends in the two-wheeler segment and took appropriate decision and now Bajaj is the highest exporting company of two wheeler motorcycles in India. It could happen just because of business environment scanning.

We can quote another example to prove the need of environmental scanning. When Nirma launched the toilet soap with the strategy of low price and high promotion (penetration pricing), the HLL and Godrej realized the threat, and HLL launched Breeze and Godrej launched Vigil to counter the threat of Nirma. Scanning and monitoring of business environment is necessary to identify the emerging threats and to take measures to face them.

Apart from it, these are the other reasons which explain the need of business environment scanning:

1. Environmental scanning helps the mangers to reduce uncertainties in the business environment by estimating future trends.
2. Environmental scanning helps in narrowing down the alternatives which makes the managers more comfortable and accurate in taking business decisions.
3. Environmental scanning helps in effective utilization of resources.
4. Environmental scanning alerts the mangers for possible changes occurring in business environment and they can minimize the shocks.
5. Environmental scanning helps in converting threats in to opportunities by letting the mangers know about the danger signals in time. Appropriate action can be taken to counter the threats and strengths can be developed to convert threats in to opportunities.

2.4 FACTORS TO BE CONSIDERED FOR ENVIRONMENTAL SCANNING

The external environment in which an organization operates

business consists of a variety of factors. These factors are events, trends, issues and expectations of different interested groups. These factors are explained below:

- EVENTS are important and specific occurrences taking place in different environmental sectors.
- TRENDS are the general tendencies or the courses of action along which events take place.
- ISSUES are the current concerns that arise in response to events and trends.
- EXPECTATIONS are the demands made by interested group in the light of their concern for issues.

Take the example of the first public issue of shares of Reliance Industries in 1977. That was a specific event. The trend that started was the participation of public in equity investment in private sector companies. The issue that emerged was of the development of equity culture in India. The expectation by the general public that resulted was that the benefits would and profits would be received due to economic development in the corporate sector.

Environmental factors are a complex mix of the events, trends, issues and expectations that continually shape the business environment of the organization.

2.5 APPROACHES TO ENVIRONMENTAL SCANNING

There are three approaches which could be adopted for sorting out information for environmental scanning. These are suggested by KUBR. We can discuss these as below:

- ***Systematic Approach:*** Under this approach, information for environmental scanning is collected systematically. Information related to markets and customers, changes in legislation and regulations that have a direct impact on an organization's activities, government policy statements pertaining to the organization's business and industry etc. could be collected continuously to monitor changes and take the relevant factors into account.

- *Ad hoc Approach:* Using this approach, an organization may conduct special surveys and studies to deal with specific environmental issues from time to time. Such studies may be conducted, for instance, when an organization has to undertake special projects, evaluate existing strategies or devise new strategies.
- *Processed-form Approach:* In this approach, the organization uses information in a processed form, available from different sources both inside and outside the organization.

2.6 SOURCES OF INFORMATION FOR ENVIRONMENTAL SCANNING

The various sources of information used for collected for environmental scanning could be classified in different ways. There could be formal and informal sources. Then there could be written as well as verbal sources. In terms of origin, data sources could be external and internal. We can discuss some of the important types of sources of information as follows:

1. Documentary or secondary sources of information like different types of publications. These could be newspapers, magazines, journals, books, trade and industry association newsletters, government publications, annual reports of competitor companies, commercial databases etc. For example, Government information such as Census of India reports, five year plan reports, economic survey, export-import policies etc. Business Today, Business World magazines, The Economic Times, The Financial Express newspapers.
2. Mass media such as radio, television and Internet. For example, search engines as Google, Yahoo etc. websites of government of India, www.india.gov.in
3. Internal sources like company fields and documents, internal reports and memoranda, management information system, database, company employees and sales staff etc.
4. External agencies like customers, marketing intermediaries, suppliers, trade associations etc.
5. Formal studies done by employees, market research agencies, consultants and educational institutes.

6. Spying and surveillances through ex-employees of competitors, industrial espionage agencies.

The decision makers in the organization use the different sources of information as per their needs for environmental scanning. Government sources are more comprehensive and rich but are available after a considerable time period while private sources, though relevant and timely, are quite expensive to tap. Therefore whenever a particular source of information is to be used, it should be checked for its reliability, time frame, data collection method and analysis used.

2.7 TECHNIQUES OF SCANNING BUSINESS ENVIRONMENT

The range of methods and techniques available for environmental scanning is wide. There are formal and systematic techniques as well as intuitive methods available. Various authors have mentioned the methods and techniques used for environmental scanning. D. LeBell and O.J. Krasner outline nine groups of techniques: single variable extrapolation, theoretical limit envelopes, dynamic modes, mapping, multivariable interaction analysis, unstructured expert opinion, structured expert opinion, structured inexpert opinion and unstructured inexpert speculation.

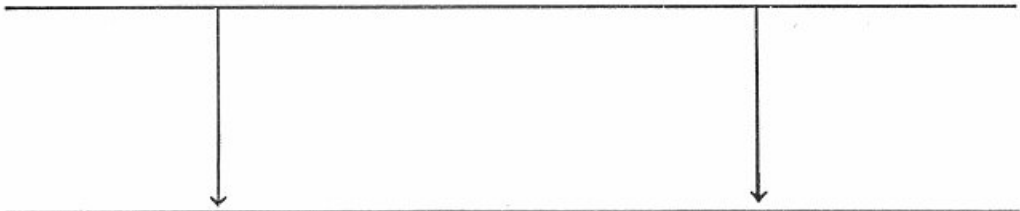
Fahey, King and Narayanan have included ten techniques in their survey of environmental scanning and forecasting in strategic planning. These are scenario writing, simulation, morphological analysis, PPBS, game theory, cross impact analysis, field anomaly relation, multiechelon coordination and other forecasting techniques.

Techniques based on artificial intelligence, neural network, data mining and a knowledge based system have been proposed too. Although many of the environmental techniques are based on statistical methods and using software in computer assisted environmental scanning but there are some which does not use statistics but uses intuition to predict what the future is most likely to be, like scenario-writing. Process based techniques for environmental scanning have been proposed from time to time. For instance a four step technique QUEST (Quick Environmental Scanning Technique).

Business environment scanning is very important for collecting relevant information for the decision making and strategy formation.

Apart from the different techniques discussed here there are techniques of environment scanning for external as well as internal environment. We can summarize these different techniques as follows:

SCANNING EXTERNAL ENVIRONMENT



SCANNING SOCIETAL ENVIRONMENT	SCANNING TASK ENVIRONMENT
Societal environment factors Analysis	Porter's Approach to Industry
	Analysis
Issues Priority Matrix	Strategic group Analysis
	Strategic types
	Forecasting

SCANNING INTERNAL ENVIRONMENT

Resource Based approach to Organizational analysis: VRIO Framework
Value Chain Analysis
Scanning Functional resources

2.7.1 SCANNING SOCIETAL ENVIRONMENT

The large numbers of factors in the societal environment affect a business organization very much. These factors become very important as they affect differently in different countries. Generally business organizations categorize the societal environment in any one geographic region and observe and analyze four important factors that do not directly touch on the short run activities of the organization but that can influence its long run decisions and business. These factors are shown in the given table as below like economic, technological, political-legal and sociocultural:

Economic	Technological	Political–Legal	Sociocultural
Economic development	Regulations on technology transfer	Form of government	Customs, norms, values
Per capita income	Energy availability/cost	Political ideology	Language
Climate	Natural resource availability	Tax laws	Demographics
GDP trends	Transportation network	Stability of government	Life expectancies
Monetary and fiscal policies	Skill level of workforce	Government attitude toward foreign companies	Social institutions
Unemployment levels	Patent-trademark protection	Regulations on foreign ownership of assets	Status symbols
Currency convertibility	Internet availability	Strength of opposition groups	Lifestyle
Wage levels	Telecommunication infrastructure	Trade regulations	Religious beliefs
Nature of competition		Protectionist sentiment	Attitudes toward foreigners
Membership in regional economic associations, e.g., EU, NAFTA, ASEAN		Foreign policies	Literacy level
Membership in World Trade Organization		Terrorist activity	Human rights
Outsourcing capability		Legal system	Environmentalism

- **Economic** factors that regulate the exchange of materials, money, energy and information.
- **Technological** factors that generate problem solving inventions.
- **Political-legal** factors that allocate power and provide constraining and protecting laws and regulations.
- **Sociocultural** factors regulate the value, mores and customs of society.

Trends in the economic part of the societal environment can have an impact on business activity. For example, an increase in interest rate means fewer sales of major home appliances. RBI (reserve bank of India) also announces its monetary policies time to time that affects the business organization's decisions.

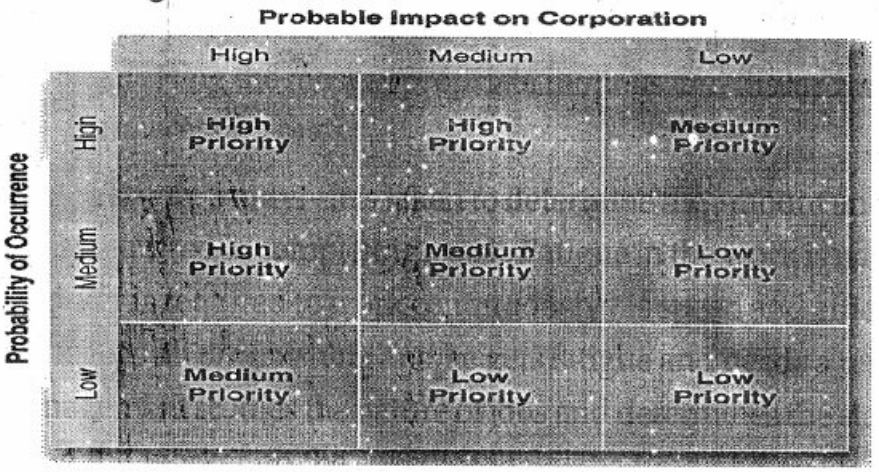
Changes in the technological part of the societal environment also have an impact on multiple industries. For example, improvements in computer microprocessors have not only led to the widespread use of home computers, but also to better automobile engine performance in terms of power and fuel economy through the use of microprocessors to monitor fuel injection.

Trends in the political-legal part of the societal environment have a significant impact on business. For example, changes in the law by the Government to allow private fuel retail outlets in 2002has led to the entry

of private sector enterprises like Reliance, Essar and Shell to enter the market and compete with the public sector giants like IOC, HPC and BPCL.

Demographic trends are the part of the sociocultural environment. Increasing environmental awareness, increasing diversity of workforce and markets, changing household composition and changing pace and location of life are the few sociocultural trends that are shaping our society and affecting the business decision making.

Another technique of identifying and analyzing developments in the external environment is to use the **issue priority matrix** which is shown as below in figure:



Issues priority matrix answer the question why do companies often respond differently to the same environmental changes? Generally no firm can successfully monitor all external factors. It differentiates these external factors in different choices as per their importance. The decision makers on the basis of their business and their own experiences try to understand which of the external factor is important for them and which is not. The technique of issue priority matrix to scan external factors is used in different steps as follows:

1. Identify a number of likely trends emerging in the societal and task environments. These are strategic environmental issues-those important trends that, if they occur, determine what the industry or the world will look in the near future.
2. Assess the probability of these trends actually occurring from low to high.
3. Attempt to ascertain the likely impact from low to high of each of these trends on the corporation being examined.

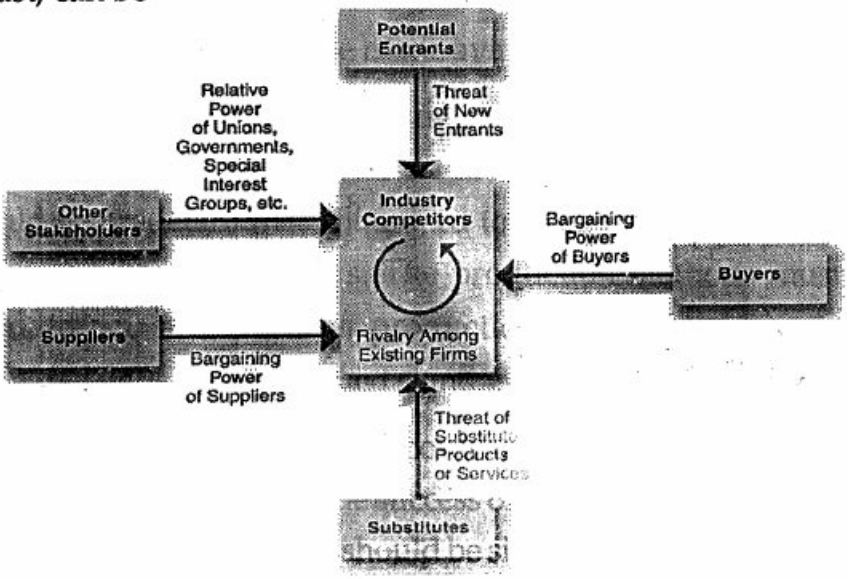
The issue priority matrix technique is used to help the managers deciding which external environmental factor should be merely scanned and should be at low priority or which should be monitored as import and strategic factor and should be at high priority.

2.7.2 SCANNING TASK ENVIRONMENT: INDUSTRY ANALYSIS

An industry is a group of firms producing a similar products or services, such as biscuits or financial services. An examination of the important stakeholder groups, such as suppliers and customers in a particular corporation's task environment is an important aspect of external environment scanning. We can use a few techniques for task environment as follows:

1. ***Porter's approach to scan task environment factors:*** According to Michel Porter, a business organization should be more concerned with the intensity of competition within its industry. The level of this intensity is determined by basic competitive forces which are shown in the figure as follows:

The collective strength of these forces determine the ultimate profit potential in the industry, where profit potential is measured in terms of long run return on investment capital. These forces as shown in the figure are threat of new entrants, rivalry among existing firms, threats of substitute products or services, bargaining power of buyers, bargaining power of suppliers and relative power of other stake holders. The stronger each of these forces, the more limited companies are in their ability to raise prices and earn greater profits. A high force can be regarded as a threat because it is likely to reduce profits. A low force, in contrast, can be



viewed as an opportunity because it may allow the company to earn greater profits.

- Risk of entry by potential competitors
- Bargaining power of suppliers
- Bargaining power of buyers
- Intensity of Rivalry among established firms
- Threat of substitutes

2. **Strategic groups within Industries Meaning:** Companies in an industry often differ significantly from each other with respect to the way they strategically position their products in the market in terms of such factors as the distribution channels they use, the market segments they serve, the quality of their products, technological leadership, customer service, pricing policy, advertising policy, and promotions. As a result of these differences, within most industries it is possible to observe groups of companies in which each company follows a business model that is similar to that pursued by other companies in the group. These different groups of companies are known as strategic groups.

3. **Proprietary group:** The companies in this proprietary strategic group are pursuing a high risk high return strategy. It is a high risk strategy because basic drug research is difficult and expensive. The risks are high because the failure rate in new drug development is very high.

4. **Generic group:** Low R&D spending, Production efficiency, as an emphasis on low prices characterizes the business models of companies in this strategic group. They are pursuing a low risk, low return strategy. It is low risk because they are investing millions of dollars in R&D. It is low return because they cannot charge high prices.

2.8 SCANNING INTERNAL ENVIRONMENTAL VARIABLES

The internal environment is also to be scanned to identify internal strategic factors-those critical strengths and weaknesses that are likely to determine if the firm will be able to take advantage of opportunities while avoiding threats. This is internal scanning is often known as

organizational analysis. We can use various methods for scanning the internal environmental variables. Some of them are VRIO framework, a resource based approach, value chain analysis and anlysing functional resources.

2.8.1 RESOURCE BASED ANALYSIS: VRIO FRAMEWOR

A resource is an asset, competency, process, skill or knowledge controlled by the corporation. A resource is strength if it provides a company with a competitive advantage. It is something the firm does or has the potential to do particularly well relative to the abilities of existing or potential competitors. A resource is weakness if it is something the corporation does poorly or does not have the capacity to do although its competitors have that capacity.

VRIO Framework: Barney and Hesterly describe the VRIO framework as a good tool to examine the internal environment of a firm. They state that VRIO "stands for four questions one must ask about a resource or capability to determine its competitive potential:

1. **The Question of Value:** Does a resource enable a firm to exploit an environmental opportunity, and/or neutralize an environmental threat?
2. **The Question of Rarity:** Is a resource currently controlled by only a small number of competing firms? [are the resources used to make the products/services or the products/services themselves rare?]
3. **The Question of Imitability:** do firms without a resource face a cost disadvantage in obtaining or developing it? [is what a firm is doing difficult to imitate?]
4. **The Question of Organization:** Are a firm's other policies and procedures organized to support the exploitation of its valuable, rare, and costly-to-imitate resources?"

Types of resources lead to a competitive advantage: 1) Tangible resources, 2) Intangible resources, 3) Organizational capabilities.

Tangible Resources	
Financial	• Firm's cash and cash equivalents • Firm's capacity to raise equity • Firm's borrowing capacity
Physical	• Modern plant and facilities

	• Favorable manufacturing locations
	• State-of-the-art machinery and equipment
Technological	• Trade secrets
	• Innovative production processes
	• Patents, copyrights, trademarks
Organizational	• Effective strategic planning process
	• Excellent evaluation and control systems

Intangible Resources

Human	• Experience and capabilities of employees
	• Trust
	• Managerial skills
	• Firm-specific practices and procedures
Innovation and Creativity	• Technical and scientific skills
	• Innovation capacities
Reputation	• Brand name
	• Reputation with customers for quality and reliability
	• Reputation with suppliers for fairness, non-zero-sum relationships

Organizational Capabilities

- Firm competences or skills the firm employs to transfer inputs to outputs
- Capacity to combine tangible and intangible resources, using firm processes to attain desired end.

Examples

- Outstanding customer service
- Excellent product development capabilities
- Innovativeness or products and services
- Ability to hire, motivate, and retain human capital

According to the VRIO framework, a supportive answer to each question relative to the firm being analyzed would indicate that the firm can sustain a competitive advantage. Below is an example of how to apply

the VRIO framework and the likely outcome for the firm under varying circumstances.

Applying the VRIO Framework—the value and rarity of a firm's resources		
If a firm's resources are:	⟶	The firm can expect:
Not valuable	⟶	Competitive Disadvantage
Valuable, but not rare	⟶	Competitive parity (equality)
Valuable and rare	⟶	Competitive advantage (At least temporarily)

Then, if there are high costs of imitation, the firm may enjoy a period of sustained competitive advantage. Costs of imitation increase due to some combination of the following: 1) **Unique Historical Conditions** (path dependence; first mover advantages), 2) **Causal Ambiguity** (links between resources and advantage foggy), 3) **Social Complexity** (social relationships not replicable), 4) **Patents** (double-edged sword since period of protection eventually runs out).

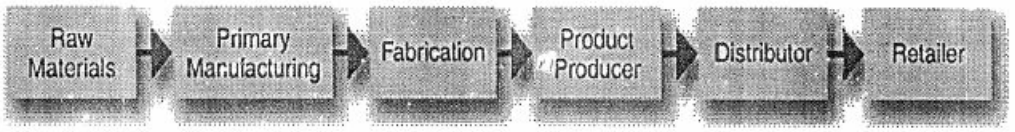
Applying the VRIO Framework, integrating the notion of Inimitability		
If a firm's resources are:		The firm can expect:
Valuable, rare, but *not* costly to imitate	⟶	Temporary competitive advantage
Valuable, rare, *and* costly imitate	⟶	Sustained competitive to advantage (if organized properly)

Organized properly deals with the firm's structure and control (governance mechanisms—compensation, reporting structures, management controls, relationships, etc). These must be aligned so as to give people ability and incentive to exploit the firm's resources.

Summary of VRIO, Competitive Implications, and Economic Implications					
Valuable?	Rare?	Costly to Imitate?	Organized Properly?	Competitive Implications	Economic Implications
No			No	Disadvantage	Below Normal
Yes	No		↑	Parity	Normal
Yes	Yes	No		Temporary Advantage	Above Normal (at least for some amount of time)
Yes	Yes	Yes	Yes	Sustained Advantage	Above Normal

2.8.2 VALUE CHAIN ANALYSIS

A value chain is a linked set of value creating activities beginning with basic raw materials coming from suppliers, moving on to a series of value added activities involved in producing and marketing a product or service, and ending with distributors getting the final goods into the hands of the ultimate consumer. For example a typical value chain for a manufactured product can be shown as below:

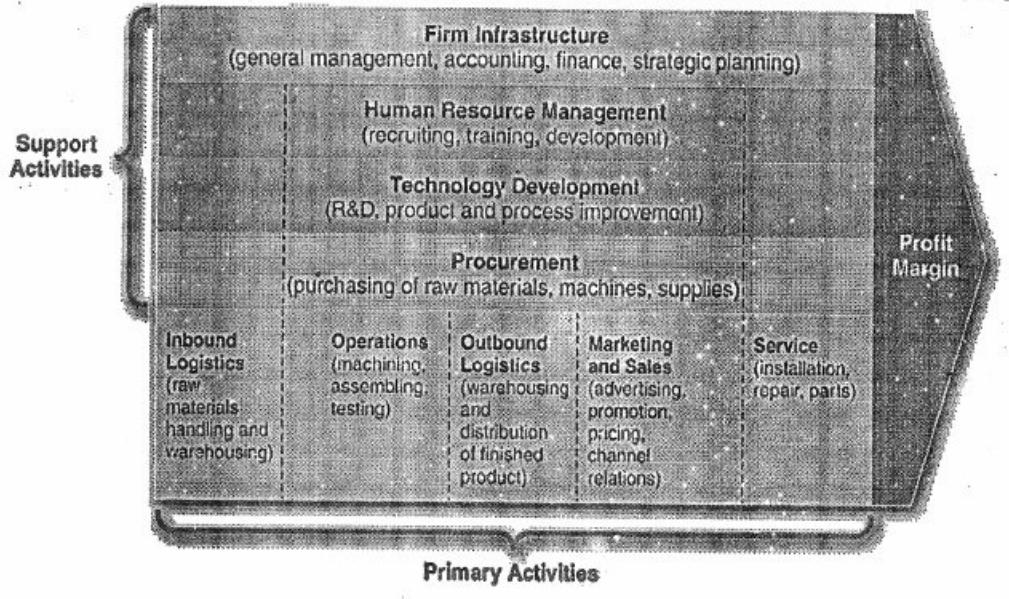


The focus of value chain analysis is to examine the corporation in the context of the overall chain of value creating activities, of which the firm may be only a small part.

The term 'Value Chain' was used by Michael Porter in his book "Competitive Advantage: Creating and Sustaining superior Performance". The value chain analysis describes the activities the organization performs and links them to the organizations competitive position. Value chain analysis describes the activities within and around an organization, and relates them to an analysis of the competitive strength of the organization. Therefore, it evaluates which value each particular activity adds to the organizations products or services. This idea was built upon the insight that an organization is more than a random compilation of machinery, equipment, people and money. Only if these things are arranged into

systems and systematic activates it will become possible to produce something for which customers are willing to pay a price. Porter argues that the ability to perform particular activities and to manage the linkages between these activities is a source of competitive advantage.

Porter distinguishes between primary activities and support activities. Primary activities are directly concerned with the creation or delivery of a product or service. They can be grouped into five main areas: inbound logistics, operations, outbound logistics, marketing and sales, and service. Each of these primary activities is linked to support activities which help to improve their effectiveness or efficiency. There are four main areas of support activities: procurement, technology development (including R&D), human resource management, and infrastructure (systems for planning, finance, quality, information management etc.). The basic model of Porters Value Chain is as follows:



The term 'Margin' implies that organizations realize a profit margin that depends on their ability to manage the linkages between all activities in the value chain. In other words, the organization is able to deliver a product / service for which the customer is willing to pay more than the sum of the costs of all activities in the value chain.

These linkages are crucial for corporate success. The linkages are flows of information, goods and services, as well as systems and processes for adjusting activities. Only if the Marketing & Sales function delivers sales forecasts for the next period to all other departments in time and in reliable accuracy, procurement will be able to order the necessary material for the correct date. And only if procurement does a

good job and forwards order information to inbound logistics, only than operations will be able to schedule production in a way that guarantees the delivery of products in a timely and effective manner – as pre-determined by marketing. In the result, the linkages are about seamless cooperation and information flow between the value chain activities. In most industries, it is rather unusual that a single company performs all activities from product design, production of components, and final assembly to delivery to the final user by itself. Most often, organizations are elements of a value system or supply chain. Hence, value chain analysis should cover the whole value system in which the organization operates.

Within the whole value system, there is only a certain value of profit margin available. This is the difference of the final price the customer pays and the sum of all costs incurred with the production and delivery of the product/service (e.g. raw material, energy etc.). It depends on the structure of the value system, how this margin spreads across the suppliers, producers, distributors, customers, and other elements of the value system. Each member of the system will use its market position and negotiating power to get a higher proportion of this margin. Nevertheless, members of a value system can cooperate to improve their efficiency and to reduce their costs in order to achieve a higher total margin to the benefit of all of them (e.g. by reducing stocks in a Just-In-Time system). A typical value chain analysis can be performed in the following steps:

- Analysis of own value chain – which costs are related to every single activity
- Analysis of customers' value chains – how does our product fit into their value chain
- Identification of potential cost advantages in comparison with competitors
- Identification of potential value added for the customer – how can our product add value to the customers value chain (e.g. lower costs or higher performance) – where does the customer see such potential

2.8.3 SCANNING FUNCTIONAL RESOURCES

Environment scanning is not complete without scanning the functional resources. Functional resources include not only financial,

physical, and human assets in each area, but also the ability of people in each area to formulate and implement the necessary functional objectives, strategies, and policies. The resources include the knowledge of analytical concepts and procedural techniques common to each area as well as the ability of the people in each area to use them effectively. If used properly these resources serve as strengths to carry out value added activities and support strategic decisions. In addition to the usual business functions of marketing, finance, R&D, operations, human resources and information systems, there are other resources like corporate structure and culture. Functional areas vary between organizations, depending upon the type of work carried out. For example, retailers do not need a production function. The main purpose of functional areas is to ensure that all important business activities are carried out efficiently. This is essential if the business is to achieve its aims and objectives. In addition, speciûc areas will be responsibility for supporting speciûc types of aims and objectives, for example: sales and marketing will be involved in achieving targets linked to developing new markets or increasing sales; human resources will be involved in arranging staff training activities and supporting the continuous professional development of all staff; finance will be expected to monitor and support aims and objectives linked to keeping costs low to improve profitability; production will be set targets relating to quality or meeting planned production schedules.

Although there is an almost infinite variety of structural forms but an organization has to understand which structure suits it best. The basic types of structure may be simple, functional, divisional and SBU. Corporate culture is the collection of beliefs, expectations and values learned and shared by a corporation's member and transmitted from one generation of employee to another. It gives a company a sense of identity. The marketing manager has to think who are our customers? What marketing mix is most competitive? The same questions are asked by the other departments like human resource, finance, supply chain and information system etc. The basic purpose of internal functional scanning is to know our strengths to take advantage of opportunities and to overcome on our threats by knowing our weaknesses. Therefore the resources should be utilized smartly so that their effectiveness can be ensured as competitive advantage for the organization

2.9 SUMMARY

Environmental scanning is one component of the global environmental analysis. Environmental monitoring, environmental forecasting and environmental assessment complete the global environmental analysis. The global environment refers to the macro environment which comprises industries, markets, companies, clients and competitors. Consequently, there exist corresponding analyses on the micro-level. Suppliers, customers and competitors representing the micro environment of a company are analyzed within the industry analysis. Environmental scanning can be defined as 'the study and interpretation of the political, economic, social and technological events and trends which influence a business, an industry or even a total market'. The goal of environmental scanning is to alert decision makers to potentially significant external changes before they crystallize so that decision makers have sufficient lead time to react to the change. Consequently, the scope of environmental scanning is broad.

Environmental scanning is the acquisition and use of information about events, trends, and relationships in an organization's external environment, the knowledge of which would assist management in planning the organization's future course of action. Organizations scan the environment in order to understand the external forces of change so that they may develop effective responses which secure or improve their position in the future. They scan in order to avoid surprises, identify threats and opportunities, gain competitive advantage, and improve long-term and short-term planning. To the extent that an organization's ability to adapt to its outside environment is dependent on knowing and interpreting the external changes that are taking place, environmental scanning constitutes a primary mode of organizational learning. Environmental scanning includes both looking at information (viewing) and looking for information (searching). It could range from a casual conversation at the lunch table or a chance observation of an angry customer, to a formal market research programme or a scenario planning exercise.

2.10 SELF ASSESSMENT QUESTIONS

1. Define environment scanning.
2. What are the various sources of environment scanning?

3. Explain value chain analysis.
4. Discuss Porter's Five Force Model to understand industry analysis.
5. What is the significance of resource based VRIO framework?

2.11 SUGGESTED READINGS

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UNIT 3 COMPLEXITIES & DIVERSITY OF BUSINESS ENVIRONMENT IN 21ST CENTUARY

Unit Structure:

3.0 Objectives
3.1 Introduction
3.2 Managing diversity in 21st century
3.2.1 Diversity at Indian workplace
3.2.2 Diversity at Market Place
3.3 Types of diversity & conflicts
3.4 Managing complexities in 21st century
3.5 Concept of business cycle
3.5.1 Features of business cycle
3.5.2 Phases of a business cycle
3.5.3 Causes of business cycle
3.5.4 Effects of business cycle
3.5.5 Theories of business cycle
3.5.5.1 Hawtreys's Monetary Theory
3.5.5.2 Schumpeter's Innovations Theory
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3.6 Government intervention to control business cycle
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3.8 Self Assessment Exercise
3.9 Further Readings

3.1 INTRODUCTION

India's economy is gradually being transformed by India's highly entrepreneurial and rapidly globalizing private sector. Indian firms are investing in infrastructure projects, growing their advanced manufacturing capabilities, and investing in new volume-based business models that tap into rising incomes and consumption in towns and rural economies across the country. In terms of long-range economic forecasts, major consulting firms project that more than 400 million people, a full 40 percent of the population, will enter India's middle class over the next 15

to 20 years. Given the expected dramatic increase in the size of the Indian middle class, the critical role played by India's private consumption is likely to endure, notwithstanding the Government of India's efforts to become more export-oriented. This "demographic dividend" of India's growing under-35 population is anticipated to be one of the key drivers of long-term growth, provided sufficient employment can be generated. India would like to be viewed as major economy and world power, but it is difficult to overlook that India is home to the largest number of poor people in the world, ranging from 300 million people to 800 million people. Poor infrastructure, high tariffs and slow pace of economic reforms present the biggest obstacles to foreign investment and growth.

Problems with the country's roads, railroads, ports, airports, education, power grid, and telecommunications are among the toughest obstacles to India's economy growing to its full potential. India's ongoing urbanization, together with rising incomes, have resulted in heightened need for improved infrastructure, both to deliver public services and to sustain economic growth. India is seeking to invest $1 trillion in its infrastructure during the 12th Five-Year Plan (2012-2017) and is looking for private sector participation to fund half of this massive expansion through the Public-Private Partnership (PPP) model.

India has made very little progress in recent years on trade liberalization and in improving market access for U.S. goods and services. The Government of India (GOI) image was seriously dented in 2011, because of its failure to follow through on pro-reform measures. Import duties continue to be comparatively very high, and exporters and investors are faced with non-transparent and often unpredictable regulatory and tariff regimes. Foreign direct investment rules have been liberalized over time, but many restrictions remain in key sectors, especially in services. The World Bank ranks India among the world's more difficult business climates – 132 out of 183 economies in 2012 (improved from 139/182 in 2011), and next to last in enforcing contracts.

India has embarked on a policy of manufacturing indigenization, with implemented or proposed policies that either ban certain imported products from the market or require some domestic sourcing. In October 2011, the Indian government unveiled the National Manufacturing Policy which encourages government procurement practices that would discriminate against foreign companies. Indian ministries have begun

to announce policies that would mandate a certain percentage of domestic content for government contracts. In the last year India has introduced or proposed such requirements in solar energy technology, ICT, and electronic products.

Two long-standing market access concerns that remain stymied are: the flat ban on FDI in multi-brand retail and an increase of the FDI limit on insurance from 26 percent to 49 percent. However, in December 2011, the ruling coalition suspended implementation of its announced intention to open multi-brand retail to 51 percent. Even though the government has reaffirmed its commitment to opening up the multi-brand retail sector and pledged to continue consultations that would permit the rules to be changed, prospects for implementation remain uncertain. Near-term prospects for legislation that would relax insurance FDI rules are also uncertain.

Environmental threats, technology advancements and globalization will also affect the business environment in 21st century.

3.2 MANAGING DIVERSITY IN 21ST CENTURY

Today is not like yesterday and tomorrow will be different form today three things are being changed very rapidly. They are customer needs, competition and environment. Diversity in many ways is closely connected to another term that we see commonly used today, which is 'Change'. Managing diversity is an essential part of change management. If Indian companies have to thrive in today's changing global marketplace, it has to learn to manage diversity, both within the company and without.

The two Areas of Diversity at India Inc

Diversity exists in two key areas in an Indian Business Organization; the first is at the workplace and involves the employees of the company. The second is at the marketplace and involves the interaction of the company with three groups of stakeholders- the owners, the partners and the customers.

Reasons for Diversity at the Workplace

There are two reasons for increased levels of workplace diversity today:

1. India has witnessed significant demographic changes in the past twenty years; many people from traditionally agricultural communities

have now joined the ranks of the middle class. Also, large numbers of women are now being employed in traditionally male dominated areas

2. Many companies in India are proactively encouraging diversity within its ranks. Some of them have adopted best practices of corporations around the world.

Reason for Diversity at the Marketplace

The reason for the increasing levels of diversity at the market place can be summed up in one word – Globalization. Though a much maligned and overworked word, no other term captures so effectively the situation in the markets today. The challenge for Indian companies that cannot manage marketplace diversity effectively is enormous. This is true not only in global marketplace, but increasingly so in the Indian marketplace itself.

Advantages of Diversity

A company gains several advantages if it can effectively manage diversity. Some of these include the ability to spot new markets, reduction of costs, improved hiring quality, reduction in unintended biases, favorable publicity and creative advantages. In the Indian context, promoting and managing diversity, particularly at the work place would go a long way in promoting social progress and help bring down barriers created by differences in Language, Caste, Ethnicity and Religion

3.2.1 DIVERSITY IN THE INDIAN WORKPLACE

Managing workplace diversity is one of thorniest challenges for HR managers in India today. Gone are the days, when most people in the office looked the same, spoke in the same manner and had the same outlook in life. Now things are somewhat different and so are the challenges.

Kinds of Diversity at the Workplace

There are different kinds of diversity that one encounters at the workplace. These include diversity of Gender, Age, Psychology, Education, Language and Culture. We will look at how three of these, those of Gender, Ethnology & Psychology can be managed.

1. Managing Gender Diversity at India

The corporate workplace has traditionally been a male-dominated one. This has changed greatly in recent days in many of the business

sectors like Technology Services, Finance & Banking and Retail. One significant change now is that men and women are being employed in the same roles within a company, whereas earlier even in the most diverse of organizations, there was clear demarcation as to what was a 'woman's job' and what was not

The Challenges from Gender Diversity

This has brought with it a fresh set of challenges from the HR perspective. Gender Diversity is one of the reasons many HR policies fail; one man's bread is often another woman's poison. One sector that has been relatively successful in promoting Gender diversity is the IT Industry. Even here, the Gender ratio is skewed heavily in favor of men.

2. Managing Ethnological Diversity – An India specific Challenge

In a modern Indian workplace, there is a great deal of diversity when it comes to language, ethnicity & culture. There are 5 elements of Ethnological diversity that one can find in an Indian Workplace. Four of them are the identities of Language, Religion, Caste and Ethnicity. There is also a fifth element that we call 'inter-ethnological experience'; some employees may have mixed ethnicity or may speak more than one language fluently

The Challenges from Ethnological Diversity

The challenges an Indian company faces from Ethnological diversity could stem from differences in any of the 4 identities:

1. **Language**: People speaking different languages find it difficult to communicate effectively when working in a group
2. **Religion**: Animosity or ill-feeling could stem from religious differences
3. **Caste**: Caste divides could make its presence felt even in the most open and diverse of workplaces
4. **Ethnicity:** Misunderstandings can arise among employees because of perceived ethnic stereotypes.

Recommendations for Managing Existing Ethnological Diversity

The following are the recommendations for managing the existing diversity in a workplace:

1. Encourage the use of a common language in the workplace.
2. Cross-ethnological teams should be formed whenever possible.

3. Team building exercises should be an integral part of any team project.

4. A cross-ethnic mentoring scheme whereby a mentor from a different ethnic group is assigned to new recruits.

Influence of Community Ethos on Workplace Diversity Community Ethos plays a very significant role in determining the level of diversity at the work place. There are two ways that this can happen-

1. People from communities generally not associated with a certain occupation find it difficult to assess their chance of success in those jobs. A person who has seen a member of his family succeed at a trade or occupation is far more likely to take it up.

2. During job interviews, there is a possibility of recruiters making such community-occupation associations. An individual from a certain ethnic group is sometimes assumed to be better suited for a certain job if the recruiters are familiar with people from the same ethnic group who work in such roles.

3. Managing Psychological Diversity

Psychological Diversity is the least understood kind of diversity and consequently the most difficult to manage. Some of the acknowledged difficulties are:

1. In many sectors job roles are quite similar for large groups of people, and the inherent flexibility to accommodate for psychological diversity is missing.

2. Performance of a person in a particular role is the primary consideration for promotions in most companies. This would have been ideal, if it weren't for the fact that oftentimes skills required after such promotions are significantly different.

Recommendations to accommodate for Psychological Diversity:

1. The employee is given a role in deciding where he/she would work

2. An employee can be switched between roles to understand in which role he or she would be most comfortable.

3. A career growth path is defined for each of the roles in a project

4. De-linking pay rises from promotions. A person performing well in a business critical role should be rewarded for his work without 'promoting' him to a role in which he is unlikely to succeed.

5. Psychometric testing before Job/role assignment

3.2.2 DIVERSITY AT THE MARKET PLACE

Diversity can be understood in terms of three key market interactions. These interactions are between: A company and its owners, a company and its partners and a company and its customers. The first has assumed a great deal of significance in the wake of many changes in the corporate world. The second is the one that we in India are most familiar with. The third is probably the most significant, in terms of both the extent of diversity and the challenges involved.

Managing Diversity in Ownership

In the Indian context, two things are happening today. Firstly, many foreign companies are 'investing' or setting up shop in India. Secondly, many Indian companies have started setting up units in other countries. Some have even ventured to take over foreign companies.

Managing Diversity in Partnerships

Partners for a company may include among others, Vendors, dealers, distributors, Technology licensees & licensors. One of the most critical elements for managing diversity in partnerships is improving communication between the partners. Two broad areas where communication can be improved:

1. **Language & Form of communication:** Many partnerships encounter difficulties with the form of language used for communication. There are cases where use of certain expressions during semi-formal communication, particularly while using email were misunderstood by partners and strained the company-partner relationship.
2. **Media of communication:** This includes the development of systems; including IT applications that enable partners to quickly access relevant information.

Managing Customer Diversity

Diversity rears its head in many forms in a company's interaction with existing or potential customers. Sometimes the diversity is so overwhelming that a company can lose focus and fail to understand actual market requirements. There are two imperatives for Indian companies with regard to managing Customer Diversity in a diverse marketplace. These are 'Understanding cross-cultural sensitivities' and 'Building Customer Relationships'.

- **Understanding Cross-Cultural Sensitivities**

Understanding cultural sensitivities is the first lesson that an

Indian company has to take when expanding into diverse global markets. The cultural sensitivity may be with respect to Product & Service Quality or with respect to Marketing Strategy.

- **Product & Service Quality for a Diverse Market**

The elements of quality includes among other things functional quality, aesthetics and after sales support. A company venturing into a diverse market place should ensure that it has what it takes to provide what the market requires in terms of quality of products and services. For most products there is a trade-off between product quality and price. One of the key advantages that an Indian company has in the global market is the ability to provide products and services at a lower price. But in quality sensitive markets like Western Europe and North America, low prices may just not be enough. Indian companies sometimes find that they have to provide products or services of drastically improved quality if they have to survive.

- **Marketing Strategy**

The following things should be kept in mind when marketing a product in a diverse Marketplace.

1. Product names acceptable in certain countries may have negative connotations in others.
2. Slogans when translated sometimes have completely different meanings.
3. Certain methods of advertising products may be considered offensive in certain countries.
4. The primary way of advertisements may be different in different places. In some places, personal selling may be far more effective than using the media.

3.3 TYPES OF DIVERSITY & CONFLICTS

The range of what we call diversity is so extensive that understanding what we mean by it is vital. The definition frequently used as a starting point is "A characteristic of a group that refers to differences of one sort or another among group members." Diversity can be subdivided into three categories:

1. ***Social category diversity:*** visible demographic characteristics such as age, sex, ethnicity and race. This is what most people think of when they say diversity.

2. *Informational diversity*: educational level, organizational tenure and work experience, expertise of the individual.

3. *Goals and values diversity*: team and company goals and underlying work values. Low values/goals diversity means values similarity, i.e., sharing the same work ethic, similar approaches to dealing with people, sharing the same team goals and objectives, interpretation of vision, etc.

It is important for leaders to have a good grasp of the types of diversity they are dealing with as they compose and lead their teams. The implications for this are enormous because knowing what you're dealing with is a key to managing diversity well. Most of us are painfully aware that diversity often leads to conflict. The nature of diversity affects the type of conflict it might have, which in turn affects performance and morale. The way in which different types of diversity influence performance is not a simple story. Different forms of diversity produce different forms of conflict, which in turn affects performance, satisfaction, intent to remain and commitment.

When people with different cultural backgrounds and life experiences find themselves working together, clashes are bound to occur. However, there is "good" and "bad" conflict, just as there is clean and dirty fights. As with diversity, there are three types of conflict that affect the functioning and performance of teams. The conflict arises with all three types of diversity.

1. *Relationship conflict:* It is related to disagreements and incompatibilities among team members, such as different communication styles, political views, and personality styles.

2. *Task conflict*: Task conflict is based on issues about the task being performed, such as current hiring strategies or what to include in an annual report.

3. *Process conflict*: Process conflict means logistical and delegation issues, such as how a task should proceed, who is responsible for what, or how something should be delegated.

There is a direct relationship between diversity and conflict which as follows:

- Informational diversity will increase task conflicts in teams.
- Social category diversity will increase relationship conflicts.
- Values diversity will increase all three types of conflicts.
- Values and social category diversity will decrease team morale.

- Informational diversity will increase team performance when tasks are complex rather than routine.

3.4 MANAGING COMPLEXITY IN 21ST CENTURY

Coping with the complexity of today's business environment is not about predicting the future or reducing risk. It's about building the capacity, in yourself, your people, and the organization to adapt continuously and learn speedily, in order to maximize the chances of seizing fleeting opportunities. As business leaders, policy makers, the academic community, the media and an outraged public search the rubble of the global economic crisis for clues as to what went wrong, all fingers point to a common perpetrator, poor risk management. But while risk management, or lack thereof, played its part in the disintegration of the world financial system, we contend that another culprit played an even bigger role: complexity, and an inability to cope with it. The unpredictable, unstable, non-linear, and fast-paced nature of the complex interrelationships between nations, firms, and persons that shape the global economic landscape are at the root of today's risk-management challenges. In these turbulent times, the question becomes: How can business leaders effectively cope with complexity?

Complex environments, complex organizations

Complexity is one of the salient hallmarks of the 21st century. It's evident not only in business, but in every facet of the globalized world in which we live. Countries, economies, and people are more deeply and densely interconnected than at any time in history and these connections are proliferating at a faster pace than ever. Global travel and instant communications magnify the so called "butterfly effect," whereby a butterfly flapping its wings in Sao Paolo can trigger hurricanes in Shanghai, illustrating how a relatively small event in one part of the world, when amplified in a non-linear fashion, can have catastrophic consequences for another. For example, the recent eruption of an obscure, unpronounceable volcano in Iceland, a tiny nation with only 300,000 inhabitants, resulted in the closing of the entire European air space for six days, losses of approximately two billion USD for the airline industry, as well as billions of dollars in losses for the makers of urgent, perishable, and high-value goods, logistics firms, and tourism operators around the globe. There are four main drivers which are responsible for the complexity in the organizations:

- Diversity: From diversity in business models, management systems, and employees to diversity in customers, suppliers, and socio-political systems, leaders must respond to an ever-increasing variety of often-conflicting demands from multiple stakeholders. Investors may demand higher profits while communities demand more corporate social responsibility, just as customers demand lower prices while regulators demand more safety. Take Siemens AG, the global engineering powerhouse. It has operations in 190 countries and over 400,000 employees, and competes in businesses as diverse as energy, healthcare, telecommunications, transportation and financial services. The sheer diversity of Siemens increases the complexity of its operations on a massive scale and presents formidable challenges to its leadership, such as defining strategies, promoting common values, and integrating processes.

Interdependence: Globalization's deep web of connections has resulted in "small world" effects, shortening the standard six degrees of separation to one or two – local events can easily have global effects through "long-hops." The intertwining of organizations' value chains, corporate governance, and financial flows results in exposure to shocks at the periphery that can move to the centre of an organization in rapid succession.

Ambiguity: An overload of information, often with numerous, conflicting data points, makes it hard for business executives to glean insights that can be applied to decision-making judiciously. Coupled with increasing uncertainties and unknowns, causal relationships are difficult to pin down, making it even more problematic to assess the validity of a course of action.

Flux: The unrelenting pace of change that envelops companies, industries, and nations only adds fuel to the fire of complexity. Circumstances that are taken for granted today may become irrelevant tomorrow, often with no advance warning. Consider the case of the music industry. Within three years of its introduction, Apple's iPod music player gained an audience of 50 million users, a feat that took radio 38 years to achieve. The iTunes music store recently passed its 10 billionth download, and it has come to redefine the value chain of the industry.

With these four factors at play, as firms intensify the scale and scope of their operations in progressively more complex environments, business leaders in turn preside over progressively more complex

organizations. The internal complexity of an organization must equal the external complexity of its environment in order to be effective. The typical organizational application of this law has been to add multiple layers of hierarchy and specialization, with increasingly standardized systems and processes for efficient execution of planned strategies. The demands of competing in a complex landscape require structures and conditions that promote adaptability, learning and creative problem solving, as well as leadership that enables the distributed intelligence of the organization to flourish. Following are the measures how to enable organizations to survive and thrive in the increasingly complex business world.

Dealing with complexity through organizational learning and improvisation

Given the challenges described above, leaders need to build agile organizations where individuals deal well with ambiguity, reap the benefits of diversity and do so under the pressure of time with a keen awareness of the inter-dependencies in the network in which they operate. Needless to say, this is a very tall order. We look to the fields of organizational learning and improvisation for what it takes to build and lead organizations equipped to deal with complexity.

Some of the best insights come from improvising, where composition and creativity converge with execution, bringing practice and performance together in real time. Improvisation theory was born from work in jazz and theatre in an effort to identify the individual, group and organizational characteristics that provide for both discipline and freedom to take place simultaneously, in order for a goal to be reached in a novel way. We can learn a great deal from improvisation about flexibility and agility in the face of ambiguity and time pressure. Consider jazz musicians, who jam, or work collaboratively to co-create music in real time. This stands in contrast to the orchestral musician working from a musical score with a conductor ensuring the pieces fit together. The improvisers have learned to deal with diversity, ambiguity, interconnectedness and flux. In short, they are masters at dealing with complexity, and in being able to do so provide four key lessons that can be applied to business.

1. Understand the minimal structures on which you innovate.

Rather than operating with minimal structures, businesses often get bogged down with a great deal of outdated procedure, routine and

bureaucracy that burden organizations. The lessons for business are to understand the minimal structures that inform the strategy and the minimal structures that inform organizational processes.

Professors Don Sull of London Business School and Kathy Eisenhardt of Stanford Business School have suggested that these rules are focused on a few strategically important processes such as what markets to enter, what products to offer and with which partners to ally. These differ from company to company, as each organization has its own opportunity to maximize priorities. Several types of rules and examples of each are mentioned:

- *How-to-rules*- delineating the key features of how a process is performed, i.e. Dell splits a business unit responsibilities when a business has reached 1 billion in revenue
- *Boundary rules* – focus on which type of opportunities to pursue, i.e. Lego products must meet checklist of rules, must be fun, high quality, encourage creativity, approved by parents
- *Priority rules* – ranking of priorities, i.e. Intel allocates production capacity based on gross margin
- *Timing rules* – the pace at which to explore opportunities, i.e. product development cycle must be less than 18 months
- *Exit rules* – when to abandon opportunities, i.e. GE either number 1 or 2 in industry or divest.

Hence, the leader's job is no longer to set the strategy per se but to draw the boundaries within which evolving strategies are able to come forth. Setting simple strategic rules does not imply, however, that tensions in the strategy-making process are resolved. There are still trade-offs to be made as to how to allocate scarce resources. As well, leaders still need to know when to say "No" to emergent strategies that dilute the organization's uniqueness.

There are also simple rules about process, and often these relate to the values of the organization. Consider the point made by a WestJet executive who described the freedom of WestJetters (as WestJet employees are called) to resolve customer issues and to create a remarkable experience for the customer or guest. Flight attendants tend to be confronted with challenges for which there is no existing policy or rule (not yet anyway); if all the (potential) challenges and their associated policies are documented it would make for a lengthy manual. Instead,

flight attendants are encouraged to use their judgment in creating a remarkable experience for the guest; they are urged to take into consideration the company's core values. The executives are interested in the intent of the behavior demonstrated by the flight attendants in trying to resolve the challenge. If the challenge was handled properly by the flight attendant, that would be considered as great. If not, coaching will take place and an effort made see if there is (was) a better way to respond to the particular challenge.

2. Design a learning organization that can improvise

For many organizations, a focus on execution, and the resultant bias towards efficiency, has been the bedrock principle. If the creativity and adaptability required to deal with complexity are to be exercised and even maximized, the organization needs to have the capacity to learn and improvise.

There are several elements that have proven troubling for organizations in this regard. At the individual level, dealing with complexity means that individuals need a comfort level with ambiguity and a willingness to learn. As Guy Claxton, author of the book Live and Learn noted, one of the biggest barriers to learning is our resistance to let go of the 4C's – the desire to be consistent, comfortable, competent and confident. We add a fifth to the list – the desire for control. Protecting and preserving these five C's is a huge barrier to individual growth and development. Yet, developing a learning organization means more than having a bunch of capable individuals. It is clear that complexity dictates that the understanding and associated action is a shared endeavor, and that therefore there are critical group elements that underpin organizational learning capability. Many of these are embedded in the simple process rules of improvisers around listening, supporting one another, being accountable to one another and to the joint goal.

3. Build expertise and real-time communication

Improvisation research reveals that the greater the level of expertise, the better the improvisation. There is a caveat, however. Expertise actually drives out improvisation, since individuals and organizations tend to revert to old patterns rather than consider whether new approaches are required. Yet, when they do engage in improvisation, expertise is critical. Real-time communication is also essential. Real-time communication means that individuals have access to the right

information when they need it. One of Wal-Mart's strengths has been the use of information technology to help them understand customer needs, and get the products on the shelf when they need it. They know customers tend to buy more

Pop-Tarts in serious storms so they can track weather patterns and ship products to where they need to go. The ill-fated Apollo XIII mission, in which a sudden explosion of one of the oxygen tanks endangered the lives of three astronauts on board, forced Mission Control in Houston to improvise solutions with materials already on the spaceship, i.e. plastic bags, duct tape, etc. to deal with the ongoing challenges posed by this unanticipated event. At the same time, NASA ensured that it had the expertise in the room to solve the complex problem with unorthodox yet practical solutions.

CEMEX, one of the leading construction materials companies of the world, with over 50,000 employees, uses these principles to create order out of chaos in its home market, Mexico. Using the latest in information technology, including computers and GPS units in all their ready-mix delivery trucks, each truck operates as independently as possible – cruising Mexico's notoriously unpredictable roads as an autonomous agent, waiting for orders. There are no fixed schedules. Instead there is real-time data of customer orders, production schedules, traffic reports, even weather reports that allow operators to make decisions on the spot as to where to deploy resources. The objective of the drivers is to deliver within a twenty-minute time window; time window.

4. Distribute leadership

In most large organizations leadership is designated and respnsiblities are assigned by hierarchy - there are top, middle, and line managers, with prescribed roles at each level. Top level managers fulfill resource allocation duties, while middle managers are controllers, and operational managers, imlementers. Improvisation, on the other hand, teaches us that individuals take the lead at different times, though the lead is collectively owned. Clearly there is a top leadership role, namely to be the prime promoters of trust and purpose, while middle-level managers take on more of a coaching role and line managers become entrepreneurs. At each level there needs to be a sense that leadership is shared; that is, leadership is conferred on the individual with the critical skill set, know-how and capabilities for a specific challenge. Adopting this approach can be a difficult adjustment for leaders who have been

taught that their job is to manage and lead. After all, that's how they became successful leaders! Leaders need to acknowledge that they cannot know everything. In certain situations they serve their people better by listening and accepting their expertise. Leadership in this context, regardless of role, needs to act as an enabler of spontaneous action. Leaders need to serve as catalysts for bottom-up interaction by promoting empowerment at all levels. Hence, power is diffused through the system and blunt authority is pushed aside in favour of collective influence.

At West Jet, employees at all levels are urged to think alongside management about how to reduce costs and enhance guest satisfaction. For example, the ground crew noticed that the absence of external sight gauges to read the water level of the potable water tank that supplies the aircraft with water led the crew to always fill the tank, regardless of its destination. The extra water added weight, thereby increasing fuel burn and emissions. The crews' suggestion to install an external sight gauge allowed the crew to determine how much potable water was used on a specific flight or route, hence decreasing costs as well reducing emissions. In contrast, General Motors, once the most highly successful automotive company in the world, lauded its centralized leadership and tightly controlled processes as cornerstones of its success, not realizing that these practices were inhibiting its employees' capacity to learn and innovate in the fast-changing automotive business.

Thus, the insights gained from organizational learning and improvisation are good management practices in and of themselves, but in the face of complexity, learning and improvisation are paramount in dealing with the ambiguity, diversity, interconnectedness and flux.

3.5 BUSINESS CYCLE

Business cycle or trade cycle is the part of the capitalist system. It refers to the phenomenon of cyclical booms and depressions. In business cycle, there are wave like fluctuations in aggregate employment, income, output and price level. In greater detail, a business cycle is an interval of time that contains two phases, an expansion and contraction (recession), during which economic activity rises and falls. The period of increasing economic activity begins in a trough, which is a low point in economic activity, and culminates in a peak, a local zenith in economic activity. Correspondingly, a recession begins with a peak and ends in a

trough. According to Keynes, "Trade Cycle is composed of periods of good trade characterized by rising price and low unemployment percentage altering with periods of bad trade characterized by falling price and high unemployment percentage." In the simple words – Business Cycle is a fluctuation of the economy characterized by periods of prosperity followed by periods of depression.

3.5.1 COMPOSITION AND FEATURES OF BUSINESS CYCLES

Business cycles are successive periods of increasing or decreasing economic activity. They are also known as economic fluctuations, and they relate to changes in business conditions.

1. Cyclical fluctuations are wave like movements.
2. Fluctuations are recurrent in nature
3. They are nonperiodic or irregular. In other words, the peaks and troughs do not occur at regular intervals.
4. They occur in such aggregate variables as output, income, employment and prices.
5. These variables move at about the same time in the same directions but at different rates.
6. No two cycles are exactly the same or follow exactly the same course.
7. All business cycles have the following:
   - Two periods, i.e. contraction (downswing) and expansion (upswing).
   - Two turning points, i.e. trough and peak.
8. The upward and downward periods divide into the following phases:
   - prosperity phase (boom)
   - recession
   - depression
   - recovery
9. Business cycles are not seasonal fluctuations such as upswings in retail trade during Diwali and Christmas.
10. They are not secular trends such as long run growth or decline in economic activity.

11. Upswings and downswings are cumulative in their effects.

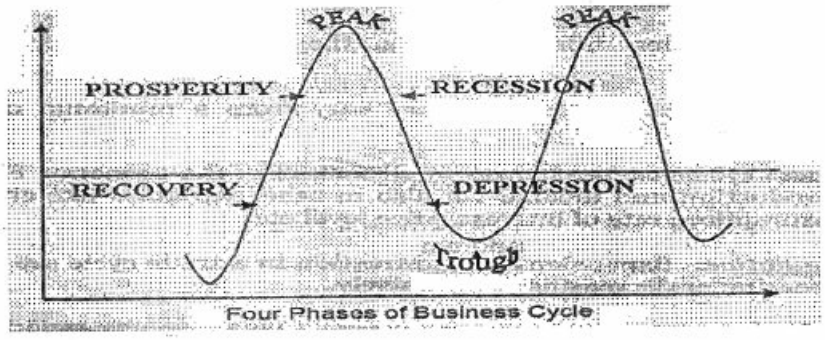
3.5.2 PHASES OF A BUSINESS CYCLE

A Typical cycle is generally divided into four phases:

1. Expansion or prosperity or the upswing
2. Recession or upper turning point
3. Contraction or depression or downswing
4. Revival or recovery or lower turning point

These phases are recurrent and uniform in the case of different cycles. But no phase has definite periodicity or time interval. As pointed out by Pigou, cycles may not be twins but they are of the same family, like families they have common characteristics that are capable of description. Starting at trough or low point, a cycle passes through a recovery and prosperity phase and reaches a trough. This is shown in following figure where straight line shows equilibrium:

3. Depression Phase



The four phases of a business cycle are briefly explained as follows:-

1. Prosperity Phase

When there is an expansion of output, income, employment, prices and profits, there is also a rise in the standard of living. This period is termed as Prosperity phase. The features of prosperity are:-

1. High level of output and trade.
2. High level of effective demand.
3. High level of income and employment.
4. Rising interest rates.
5. Inflation.
6. Large expansion of bank credit.
7. Overall business optimism.
8. A high level of MEC (Marginal efficiency of capital) and investment.

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Due to full employment of resources, the level of production is Maximum and there is a rise in GNP (Gross Natior.al Product). Due to a high level of economic activity, it causes a rise in prices and profits. There is an upswing in the economic activity and economy reaches its Peak. This is also called as a Boom Period.

2. Recession Phase

The turning point from prosperity to depression is termed as Recession Phase. During a recession period, the economic activities slow down. When demand starts falling, the overproduction and future investment plans are also given up. There is a steady decline in the output, income, employment, prices and profits. The businessmen lose confidence and become pessimistic (Negative). It reduces investment. The banks and the people try to get greater liquidity, so credit also contracts. Expansion of business stops, stock market falls. Orders are cancelled and people start losing their jobs. The increase in unemployment causes a sharp decline in income and aggregate demand. Generally, recession lasts for a short period.

3. Depression Phase

When there is a continuous decrease of output, income, employment, prices and profits, there is a fall in the standard of living and depression sets in. The features of depression are:-

1. Fall in volume of output and trade.

2. Fall in income and rise in unemployment.
3. Decline in consumption and demand.
4. Fall in interest rate.
5. Deflation.
6. Contraction of bank credit.
7. Overall business pessimism.
8. Fall in MEC (Marginal efficiency of capital) and investment.

In depression, there is under-utilization of resources and fall in GNP (Gross National Product). The aggregate economic activity is at the lowest, causing a decline in prices and profits until the economy reaches its Trough (low point).

4. **Recovery Phase**

The turning point from depression to expansion is termed as Recovery or Revival Phase. During the period of revival or recovery, there are expansions and rise in economic activities. When demand starts rising, production increases and this causes an increase in investment. There is a steady rise in output, income, employment, prices and profits. The businessmen gain confidence and become optimistic (Positive). This increases investments. The stimulation of investment brings about the revival or recovery of the economy. The banks expand credit, business expansion takes place and stock markets are activated. There is an increase in employment, production, income and aggregate demand, prices and profits start rising, and business expands. Revival slowly emerges into prosperity, and the business cycle is repeated. Thus we see that, during the expansionary or prosperity phase, there is inflation and during the contraction or depression phase, there is a deflation.

3.5.3 CAUSES OF BUSINESS CYCLE

1. **Interest rates:** Changes in the interest rate affect consumer spending and economic growth. For example, if the interest rate is cut, this reduces borrowing costs and therefore increases disposable income for consumers. This leads to higher spending and economic growth. However, if the Central Bank increases interest rates to reduce inflation, this will tend to reduce consumer spending and investment, leading to an economic downturn and recession.

2. **Consumer and business confidence:** People are easily influenced by external events. If there is a succession of bad economic news,

this tends to discourage people from spending and investing making a small downturn into a bigger recession. But, when the economy recovers this can cause a positive bandwagon effect. Economic growth encourages consumers to borrow and banks to lend. This causes higher economic growth. Confidence is an important factor in causing the business cycle.

3. **Multiplier Effect:** The multiplier effect states that a fall in injections may cause a bigger final fall in real GDP. For example, if the government cut public investment, there would be fall in aggregate demand and a rise in unemployment. However, those who lost their jobs would also spend less, leading to even lower demand in the economy. Alternatively, an injection could have a positive multiplier effect.

4. **Accelerator Effect:** This states that investment depends on the rate of change of economic growth. If the growth rate falls, firms reduce investment because they don't expect output to rise as quickly.

5. **Inventory cycle:** Some argue that there is a natural inventory cycle. For example, there are some 'luxury' goods we buy every five years or so. When the economy is doing well, people buy these luxury items causing faster economic growth. But, in a downturn, people delay buying luxury goods and so we get a bigger economic downturn.

In brief, There are two main reasons for the existence of business cycles: Exogenous and Endogenous.

A. **Exogenous causes:** Factors or events that influence the economy from outside the market system. These factors are weather conditions, shocks (e.g. 26/11 attack), structural changes (technology), etc.

B. **Endogenous causes:** Factors or events that influence the economy from inside the market system. These factors are consumer expenditure, production, over investment, competition and innovations etc.

3.5.4 EFFECT OF BUSINESS CYCLE

Economists measure the effects of the business cycle to first ascertain growth and expansion in a market. Full employment is common at the peak of many business cycles. At this point, economists believe

that an economy can stay constant so long as no artificial interaction occurs from outside forces. Inflation should also be constant as no growth occurs, which naturally promotes inflation. Essentially, a business cycle peak indicates that all resources in an economy have an efficient use by producers.

During a contraction, the effects of the business cycle can be much wider than the growth and peak stages. As the business cycle enters a contraction phase, unemployment may increase, wages can decrease, and consumer confidence will begin to fall. Companies need to pull back on their production output in order to match reduced consumer demand. Government actions may increase as regulatory agencies often attempt to stem the negative effects, but in many cases, contractions in a business cycle are often part of destructive capitalism.

Business cycles tend to go in circles as expansion, peak, contraction, and troughs occur. Their effects, therefore, repeat at each stage. Extreme cycles can affect global economies as an especially severe downturn can affect more than one economy. Therefore, one country's economy can force another country's economy into a contraction period due to the strong connection between the two.

3.5.5 THEORIES OF BUSINESS CYCLE

3.5.5.1 HAWTREYS'S MONETARY THEORY

According to Prof. R.G.Hawtrey, The trade cycle is a purely monetary phenomenon. IT is changes in the flow of monetary demand on the part of businessmen that lead to prosperity and depression in the economy. He argues that the non monetary factors like strikes, floods, earthquakes, droughts, wars etc may at best cause a partial depression, but not a general depression. In actuality, the cyclic fluctuations are caused by expansion and contraction of bank credit which, in turn, lead to variations in the flow of monetary demand on the part of producers and traders. Bank credit is the principal means in the present time. Credit is expanded or reduced by the banking system by lowering or raising the rate of interest or by purchasing or selling securities to merchants. This increases or decreases the flow of money in the economy and thus brings about prosperity or depression.

3.5.5.2 SCHUMPETER'S INNOVATION THEORY

The innovation theory of trade cycle is associated with the name of Joseph Schumpeter. According to Schumpeter, innovations in the

structure of an economy are the sources of economic fluctuations. Business cycles are the outcome of economic development in a capitalist society. He accepts that the cause of depression is prosperity. He says that it is the innovation which leads a change in the business cycle. According to him, an innovation may be a new product, a new method of production, opening up of new market, new source of raw material and new organization of new industry. He says that it is the introduction of a new product or the continuous improvement in the existing product that is the principal causes of business cycle.

3.5.5.3 KEYNES'S THEORY

The Keynesian theory of the business cycle is an integral part of his theory of income, output and employment. According to Keynes, "Trade Cycle is composed of periods of good trade characterized by rising price and low unemployment percentage altering with periods of bad trade characterized by falling price and high unemployment percentage." He says that trade cycle are periodic fluctuations of income, output and employment. According to him, the principal cause of depression and unemployment is the lack of aggregate demand. Revival can be brought about by raising aggregate demand which, in turn, can be raised by consumption and /or investment.

3.6 GOVERNMENT INTERVENTION TO CONTROL BUSINESS CYCLES

Business cycles and government policy

- Governments' primary aim with business cycles is to achieve the best possible growth rates.
- During periods of expansion income, output and employment increase.
- During periods of contraction income, output and employment decrease.

What can government do during these two periods?

1. **Fiscal policy:**
    - It's about government's budget, how it raises money and how it spends money.
    - When the economy is in an expansion, Government can increase taxation (leakage) and decrease expenditure (injection).

- When the economy is in a contraction, Government can increase expenditure and decrease taxation.

2. **Monetary policy:**

- It focuses on the money supply and interests rates, and is controlled by the Reserve Bank.
- When the economy is in a contraction, the central bank can increase the money supply by decreasing the interest rates.
- Instruments that Reserve bank can use:

  Interest rates

  Cash reserve requirements

  Open-market transaction

- Exchange rate policy (free-floating policy (supply and demand determine currency) or managed policy (central bank intervenes))
- It's best for Government to use its policies in combination with one another.

The new economic paradigm (smoothing of the cycles)

In the new economic paradigm, Government focuses less on fine-tuning and more on eliminating uncertainties with regard to fiscal and monetary policy. The new economic paradigm is embedded in demand-side policy and supply-side policy.

A. **Demand-side policy**

Traditional monetary and fiscal policies focus by their nature on aggregate demand. It will have an effect on: Inflation and Unemployment

B. Supply-side policy

It is possible for Government to arrange things in the economy in such a way that supply is more co-operative to changes in demand. Government does it by reducing production costs, improving the efficiency of inputs and improving the efficiency of markets.

3.7 SUMMARY

Diversity in many ways is closely connected to another term that we see commonly used today, which is 'Change'. Managing diversity is an essential part of change management. If Indian companies have to

thrive in today's changing global marketplace, it has to learn to manage diversity, both within the company and without.

Coping with the complexity of today's business environment is not about predicting the future or reducing risk. It's about building the capacity, in yourself, your people, and the organization to adapt continuously and learn speedily, in order to maximize the chances of seizing fleeting opportunities. As business leaders, policy makers, the academic community, the media and an outraged public search the rubble of the global economic crisis for clues as to what went wrong, all fingers point to a common perpetrator, poor risk management. But while risk management, or lack thereof, played its part in the disintegration of the world financial system, we contend that another culprit played an even bigger role: complexity, and an inability to cope with it.

Business cycle or trade cycle is the part of the capitalist system. It refers to the phenomenon of cyclical booms and depressions. In business cycle, there are wave like fluctuations in aggregate employment, income, output and price level. In greater detail, a business cycle is an interval of time that contains two phases, an expansion and contraction (recession), during which economic activity rises and falls. The period of increasing economic activity begins in a trough, which is a low point in economic activity, and culminates in a peak, a local zenith in economic activity. A Typical cycle is generally divided into four phases: Expansion or prosperity or the upswing, Recession or upper turning point, Contraction or depression or downswing, Revival or recovery or lower turning point. There are two main reasons for the existence of business cycles: Exogenous and Endogenous.

3.8 SELF ASSESSMENT QUESTIONS

1. Discuss complexity and diversity of business environment.
2. Explain various phases of business cycle.
3. What are the various theories of business cycle?
4. How can Government control business cycle?

3.9 SUGGESTED READINGS

1. Cherrunilam Francis, *Business Environment*, Vikas Publishing House Private Limited, Place & Years
2. Bedi Suresh, Business Environment, Excel Books, Place & Years
3. Mittal Vivek, Business Environment, Excel Books, Place & Years

4. Kotler Philip & Armstrong Gary, Principles of Marketing, PHI, Place & Years
5. Kazmi Azhar,Strategic Management & Business Policy ,Tata McGraw Hill, Place & Years
6. Wheelen & Hunger, Strategic Management and Business Policy, Pearson, Place & Years
7. Jhigan ML, Principles of Economics,Vrinda Publications Pvt Ltd, Place & Years

UNIT 4 POLITICAL ENVIRONMENT

Unit Structure:

4.0 Objecive
4.1 Introduction
4.2 Aspects of political environment which affect business
4.3 Three institutions of political environment
4.3.1 Legislation
4.3.1.1 Organization of legislature
4.3.1.2 Functions of legislature
4.3.2 Execution
4.3.2.1 Meaning & types of executive
4.3.2.2 Composition of executive
4.3.2.3 Functions of executive
4.3.3 Judiciary
4.3.3.1 Functions of judiciary
4.3.3.2 Understanding Indian judicial system
4.3.3.3 Jurisdiction & powers of the court
4.4 Summary
4.5 Self Assessment Exercise
4.6 Further Readings

4.0 Objectives

After studying this unit, you will be able to:

- Understand political environment;
- Define the three institutions of political environment;
- Describe the various functions of executive, legislation and judiciary.

4.1 INTRODUCTION

Political Environment affects different business units extensively, as the business decisions are based on government policies and they have to change their policies too as per the government decisions. Political environment refers to three political institutions viz. legislature, executive and the judiciary in shaping, directing, developing and controlling

business activities. The political environment of a country is influenced by the political organizations such as philosophy of political parties, ideology of government or party in power, nature and extent of bureaucracy influence of primary groups. The political environment of the country influences the business to a great extent. The political environment includes the political system, the government policies and their attitude towards the business community. All these aspects have a bearing on the strategies adopted by the business firms. The stability of the government also influences business and related activities to a great extent. It sends a signal of strength, confidence to various interest groups and investors. While hung parliament means an unstable and coalition government which signals poor decision making. For instance, business is subject to political risks if a war erupts in any country where we do business. Likewise, changes in government policies may either affect us positively or negatively. The prevailing political environment in any country directly affects the economic environment or performance. Take for example; Tata had to shift its plant from West Bengal to Gujarat because of this political environment. Reliance could not operate its store named 'Reliance Fresh' in UP in BSP government due to policies of government which were not supporting it. Another example can be quoted here of approval of FDI in retailing by UPA- II government, although it is yet to be decided to implement it. Therefore a business owner need to keep himself aware of the political climate in which he operates. Political changes can also create great opportunities for us as a business person and such chances can come our way if we keep our self knowledgeable about the political climate in which we do business. For example, last year Samajwadi Party won the elections in UP and when it formed the government, it announced free distribution of laptop and tablets to the students which is a good business opportunity for any manufacturer of laptops and tablets. This awareness enables us to run our business from an informed point of view so that we are not subjected to political risks.

4.2 ASPECTS OF POLITICAL ENVIRONMENT WHICH AFFECT BUSINESS

Some of the aspects of the political environment which affect our business are described as below:

1. Stability of Government:

It's important to **know** how **stable** the national government is and how stable it's likely to **be in** future depending on prevailing political circumstances. Political instability makes it **very** difficult to do business. An abrupt change in a political regime may make businessmen lose their property and hard earned money. The present coalition government of UPA –II in our country could not take decisions independently as it's not a stable government.

2. International relations:

How does government relate with other governments? Does home government maintain good relations with other foreign governments? For instance, for people who run online home businesses, there are countries where it's pretty difficult for one to set up an online payment system just because services provided by, say, PayPal or Click bank are not available in those countries. This makes it difficult to sell products or services online. A good political environment makes it possible to establish good relations with other foreign governments, which in turn creates directly or indirectly an attractive environment for new investors.

3. Government bureaucracy:

The political environment in which we do business may be slow to facilitate opening or conducting businesses in the country. Long processes may be required for investors or entrepreneurs, whereby they are subjected to fill in so many forms that actually discourage some of the potential entrepreneurs.

4.3 THREE INSTITUTIONS OF THE POLITICAL ENVIRONEMENT

Effective and efficient governance is the expectation of every civilized society. This role is performed by the government which is one of the four essential elements of the state. No state is possible without a government which not only provides security to the people. But also looks after their basic needs and ensures their socio-economic development. Thus, we can say that a government is a set of institutions that exercises control through legal devices and imposes penalties on those who break the law, for this purpose, social acceptance of the power of the government to control people must be accepted by the people voluntarily and recognized by them. A government normally functions by dividing its

functions between its organs, with each organ performing some specific functions. It primarily performs three main functions i.e. making of laws, enforcing the laws and adjudicating disputes.

There are three institutions of a government, the legislature which makes the laws, the executive which implements the laws and the judiciary which interprets the laws and decides the disputes. These institutions of the government are so well structured that they can perform their functions adequately. This system of dividing the powers in the three organs of the government is known as 'separation of the powers'. This tradition is very much familiar in the US. In our country we also have this system of separation of powers to enjoy the democracy. The three institutions of the government are independent of one other. The legislature should comprise of representative of people of India, since they perform most important function of making laws by which the people of our country are to be governed. Therefore wide representation of people should be ensured to get better results. The executive implement the laws, therefore it should be ensured that the executive should comprise of the efficient and competent people. The third institution, the judiciary interprets the laws and decides the disputes and cases according to the laws made by the legislature and implemented by the executive.

4.3.1 LEGISLATION

Legislature in the field of comparative politics is technically known as the rule making department. Most commonly, legislature is known by the name of parliament. A legislature is a kind of deliberative assembly with the power to pass, amend, and repeal laws. The law created by a legislature is called legislation or statutory law. In addition to enacting laws, legislatures usually have exclusive authority to raise or lower taxes and adopt the budget and other money bills. Legislatures are known by many names, the most common being parliament and congress, although these terms also have more specific meanings.

In parliamentary systems of government, the legislature is formally supreme and appoints a member from its house as the prime minister which acts as the executive. In a presidential system, according to the separation of powers doctrine, the legislature is considered an independent and coequal branch of government along with both the judiciary and the executive.

4.3.1.1 ORGANIZATION OF LEGISLATURE

The primary components of a legislature are one or more chambers or houses: assemblies that can debate and vote upon bills. Legislature may be organized in two ways:

- Unicameral
- Bicameral

Unicameral: A legislature with only one house is called unicameral. A unicameral legislature has only one chamber based upon popular representation and is responsible for the entire function of law-making. Unicameral legislatures exist in some countries such as New Zealand, Denmark, Finland, and China. It also exists in some of the Indian states like Punjab, Haryana, Orissa and Kerala.

Bicameral: A bicameral legislature possesses two separate chambers, usually described as an upper house and a lower house, which often differ in duties, powers, and the methods used for the selection of members. A bicameral legislature consists of two chambers: (a) the upper and (b) the lower chamber. The lower chamber is generally more popular in character and has a greater say in law-making. The lower houses are directly elected as in India, U.K., France, Germany, etc. Upper houses are also directly elected in some countries such as the Senate in the United States. In Britain, members of the upper house, the House o f Lords, are nominated. In India. the upper chamber, the Rajya Sabha, is indirectly elected. In a bicameral legislature, there is a lot of

party politics and the process of law-making is much more complex, since both the Houses have to give their assent to the bills.

In most parliamentary systems, the lower house is the more powerful house while the upper house is merely a chamber of advice or review. However, in presidential systems, the powers of the two houses are often similar or equal. In federations, it is typical for the upper house to represent the component states; the same applies to the supranational legislature of the European Union. For this purpose, the upper house may either contain the delegates of state governments, as is the case in the European Union and in Germany and was the case in the United States before 1913, or be elected according to a formula that grants equal representation to states with smaller populations, as is the case in Australia and the contemporary United States.

4.3.1.2 FUNCTIONS OF LEGISLATURE

Although the organization, nature and functions of the legislatures differ from country to country, their main functions are more or less the same. They may be classified as legislative, regulatory, financial, deliberative, judicial, constituent and electoral functions.

1. Legislative functions:

Law making is the foremost function of a legislature as it is the direct source of legislation. Law is regarded as the expression or the will of the people. The laws reflect the changing conditions of society and the new social environment. The policies of the government are put to executive though the laws made by legislature. The laws have to adjust themselves to the ever changing requirements of the society. Therefore besides making law, one of the major functions of the legislature is to amend and repeal them wherever they become obsolete or outdated. Laws are enacted according to prescribed procedure of the constitution. The law making powers of the legislatures are absolute. They are limited by the provisions of the constitution.

2. Regulatory Functions:

Under Parliamentary System of government the legislature exercises its immediate and direct control over the executive. The executive is under responsible and answerable to the legislature for all its actions. The legislature exercises its control by a) asking questions to the ministers to elicit important information relating to matters of administration and matters of public importance. Secondly b) it, can move adjournment motions or raise debates to point out specific lapses of the government and most importantly c) it can move no confidence motion. Though such a motion it can express its lack of confidence in the government, which if passed by the legislature forces the party in power to resign. These powers of the legislature regulate the working of the government to a large extent.

3. Financial Powers:

The legislature has very important powers in the field of finance. It acts as the guardian of national purse. It regulates the "income and expenditure of the government in respect of its various projects, administrative and welfare. People's money must be controlled and spent under the supervision and control of their representatives to prevent its misuse and wasteful expenditure.

4. Deliberative Functions:

The Legislature is a deliberative body, a forum where many persons represent numerous interests, various points of view of different sections of the community. This is a body which facilitates determination of policies and legislation through a process of debate and discussion. This discussion provides with opportunities to each member not only to present the view and perception of his party but also permits to mould his own views in light of the discussion made in the House over and above the various viewpoints presented in the House contribute to the growth of political consciousness of the people in general and educate the members of executive to find out the solutions to various problems in particular. Through this power the legislative acts as a link between the public and the government.

5. Judicial Function:

The legislature also exercises some judicial function. Certain countries have entrusted to their legislatures the function of trying high constitutional authorities like the head of the executive, members of judicially and other constitutional bodies through the motion of impeachment. In India the President, the judges of Supreme Court, the members of U.P.S.C, the Comptroller and Auditor General can be impeached by the Parliament after fulfilling certain constitutional formalities. In England the Upper House of the Parliament Acts as the highest court of appeal. Also in United States the President can be impeached by the Senate. Very often the legislatures appoint commissions of inquiry relating to trade, commerce, agriculture, industry etc.

6. Constitutional Functions:

The legislatures also have constitutional functions to perform. Most of the legislatures have been entrusted with the powers to amend the constitution. In India all amendment proposals can be initiated only in the legislature. So is the case with Britain and U.S.A. In all such cases the legislature exercises its constituent powers under a number of procedural restrictions.

7. Electoral Functions:

Many of the legislatures participate in electoral functions. The Indian Parliament takes part in the election of the President and Vice-President of India. It also elects some its members to various committees of the House. It elects its presiding and deputy presiding officers.

Relative Roles

As between the two Houses, the Lok Sabha has supremacy in financial matters. It is also the House to which the Council of Ministers drawn from both Houses is collectively responsible.

On the other hand, the Rajya Sabha has a special role in enabling Parliament to legislate on a State subject if it is necessary in the national interest. It has a similar power in regard to the creation of an All-India Service common to the Union and the States. In other respects, the Constitution proceeds on a theory of equality of status of the two Houses.

Disagreement between the two Houses on amendments to a Bill may be resolved by both the Houses meeting in a joint sitting where questions are decided by majority vote. However, this provision of joint sitting does not apply to Money Bills and Constitution Amendment Bills.

4.3.2 EXECUTION

4.3.2.1 MEANING & TYPES OF EXECUTIVES

The execution is the implementing arm of the government. The execution formulates and executes the various policies of the government. The dictionary meaning of the word 'execution' is the power to put important decisions into action i.e. to execute or to implement. According to J.W.Garner, the executive institution embraces all the functionaries and agencies of the state which have been formulated by the government as per its will and expressed in terms of laws, thus it comprehends entire governmental organization. Thus tax collectors, police, inspectors, supervisors, army officers, district and state officers are a part of the executive organization.

Though the term 'executive' is taken into broad as well as narrow terms but in the politics, its narrow sense is mostly applied. It is the executive head and his principal colleagues who run the machinery of the government, formulate national policies and check its proper implementation for the welfare of the people and the nation both. We can understand the different types of executives as shown in the following figure:

Executive	
Nominal	**Real**
Hereditary Elective	**Singular Plural**

The executives may be of two types- nominal executives and real executives. The nominal executive may be a monarch or an elected President. He is known as 'nominal' executive because he does not enjoy the real powers. He is just a constitutional head who perform some ceremonial functions. He enjoys little or no powers but the entire administrative work is done in his or her name. The monarch may assume office in hereditary succession as in U.K. or through direct or indirect election as in Malaysia. The system of hereditary succession is still prevailing in some of the countries as U.K., Nepal, Japan and Saudi Arabia. Wherever there is constitutional monarchy as in U.K., still the real power does not vest in monarch but in an elected constitutional government headed by the Prime minister and his team of ministers who collectively accountable to the legislature.

However there are some monarchs who enjoy the real powers. They are not the constitutional heads only but they enjoy absolute power and they may be categorized as the real executives. For example, monarchy in Jordan and Saudi Arabia fall in the category of absolute real executive.

The real executives may also be divided in to two categories- singular executive and plural executive. A singular executive is one that is headed by the single leader who does not share his powers with the others as in U.S.A. In USA the constitution vests all powers in a single person/leader that is known as President. While on the other hand, in case of plural executive the all powers are vested in a group of ministers. Its only example in today's world is found in Switzerland where authority of the government is shared by seven ministers (called Presidents) who are elected by legislature for four years. It is known as the Federal Council. One of the Presidents is formally designated as the President of the confederation who performs all the ceremonial function normally performed by the head of the state in any other country.

4.3.2.2 COMPOSITION OF EXECUTIVE

Another type of executive can be shown as given in the following table which shows the composition of the executive:

Executive			
Political (Non-permanent)		Non political (Permanent)	
Democratic		Totalitarian	Colonial
Parliamentary	Presidential Quasi-Parliamentary/ Quasi-Presidential		

The executive generally consists of two types of officials: the political executive and the non political executive. The political executive consists of President, Prime minister, Cabinet or Council of Ministers. The political executives are non permanent in nature as they may be changed over a period of time or before a period of time. The non political executive consists of those bureaucrats who are permanent in nature and enjoys the tenure of their working period regardless of which government comes to power. The political executive is directly elected by the people as in US where the Presidential type of government prevails, or he may be indirectly elected by the legislature as in the case of India and Great Britain. In China, President is elected by the National People's Congress and he is the head of the state and the highest ceremonial functionary of the state.

The political executive may be further divided into three categorize as shown in the figure, democratic, totalitarian and colonial. In democratic state, members are chosen by the people of that state and remain accountable to its constitution. For example, India, United States of America and Britain are the democratic country where government is elected by the people and it has to be accountable to its constitution and the parliament. In India, Government is elected by general public i.e. by everyone who is eligible to vote and a democracy is determined either directly or through elected representatives. A totalitarian state is a country with only one political party. People are forced to do what the government tells them and may also be prevented from leaving the country. In totalitarian state, government cannot be removed by the people or their elected representatives. In such countries, people have no freedom; they have no power to criticize the government

or conduct of government. Iraq was a totalitarian state till Saddam Husain ruled. In past, Germany headed by Hitler was also an example of totalitarian state. A colonial executive is one who acts under the authority of the colonial government.

The democratic model may be further divided into two parliamentary and presidential forms of government. In the parliamentary form of government, the cabinet runs the government under the leadership of prime minister. For example, In India, parliamentary form of government exists. Here, the political party which wins the majority in the lower house (LOK SABHA) elects its leader and then the President of India invites him to form the government. He is appointed as the Prime minister and then he decides his team of ministers in cabinet. This team of cabinet is accountable to Loksabha. Prime minister and his cabinet are collectively responsible to the legislature. United Kingdom also has the same form of government. In both these countries, the head of the state is a nominal executive in whose name governance is done by the cabinet. The President of India and the Queen of U.K. are nominal heads of state. The other format of democratic model is the Presidential form of government. For example, in the United States, the basis of executives- legislature relationship is separation of powers. The president is the real executive. He is neither the member of the legislature, nor removed by it. His term is fixed.

Apart from these two models of democratic government, there is another model that can be called as quasi-parliamentary or quasi-presidential as here the President is the real executive; the prime minister and his cabinet are under the control of president and at the same time, they are accountable to the parliament. This model exists in France. This model contains the features of both the parliamentary form and presidential form of governments.

4.3.2.3 FUNCTIONS OF EXECUTIVES

In the modern political system, distrust in executive dominance has been replaced by, a confidence in its leadership. Today, the classical theory of the three organs of government with equal powers needs restatement because the executive has now become the government in the real sense of the term. Among its many functions, the first and the foremost function of the executive is to run the administration of the country. The government has to ensure and maintain internal peace and order. The executive has also to conduct external relations, make treaties with foreign states, declare

war and conclude peace, mobilize troops. Proclaim emergency when required, re value or devaluate currency, fix prices of essential commodities and perform other activities relating to the well-being of the people of the state.

The executive has started another function of drafting laws. The executive takes considerable initiative in drafting and proposing laws to the legislature. For this purpose, the cabinet passes the ordinance when the house is not in session, as in India; Manmohan Singh led UPA-II government is trying to pass an ordinance related 'Food Security Bill' without taking legislature into confidence. The law making is the role of legislature but here government is trying to do it, although due to opposition of the alliance parties, it could not do so. Even in the USA where the separation of power prevails, the President manages to influence the legislature by sending his message. In its expanded function of making laws, executive generally drafts and fills the details in the bills passed by the legislature.

The executive also performs judicial functions. In all the states, the head of the state has the power to grant pardon or reprieve or amnesty to the offenders. This is called his 'Prerogative of Mercy'. The Head also appoints the judges of the various courts, appoints chairmen of various commissions like election commission etc.

The executive prepares the budget of the nation and present to the parliament for its approval. It is the executive who decides the tax structure in the country, the parliament only approves it. The executive also takes care of implementing these budgetary provisions in the country. The government has the officers to audit and check as watchdog for the collection of the taxes in the country.

The permanent executive i.e. the bureaucracy takes care of the decisions of cabinet. It ensures the implementation of these laws and cabinet decisions in the same spirit. They are involved at every stage of the decision-making process and maintain the continuity in administration. Generally the political executives depend upon the bureaucrats because of their technical expertise and knowledge.

As per the book titled, 'The Function of the Executives', written by Chester Barnard, the functions of executives can be narrated as determination of the objectives, the initiation of policy, the manipulation of means, controls over the instruments of action and

stimulation of action, and stimulation of coordinated action. The role of the government is increasing these days. In traditional sense, the role of any government has been to maintain law and order, provide social security, exercise control over public activities and protect the national from external aggression. But, in course of time, emphasis on planned economic development and various other circumstances such as increasing gap between rich and poor, monopoly like situation created by private sector, rise in inflation and concentration of national wealth in the hands of few, prompted the government to play an active role in promoting and regulating the business activity consequently. Thus, government has assumed four important roles in an economy as explained under:

- Regulatory Role.
- Promotional Role.
- Entrepreneurial Role.
- Planning Role.

One thing should be noted that these roles are not exclusive to each other. There may be circumstances when the government becomes active in more than one way to serve national or sectoral objectives. For instance, the regulatory and planning roles may be mutually complementary and so can be the entrepreneurial, planning and promotional roles. The implications of each role are as follows:-

(1) Regulatory Role:

In almost every country, government plays a regulatory role for the extent and development of industries with the least wastage of resources. Government regulation of the business may cover a broad spectrum extending from entry into a business to the final results. More specifically, government may regulate business activities using direct (discretionary) measures and/or indirect (non-discretionary) measures.

Direct Control: It refers to measures which are applicable at the discretion of administrative authorities. They can be applied selectively from firm to firm and industry to industry. Many developing countries like India, China and Brazil have instituted a

variety of controls over economy, including industrial licensing and price and distribution controls. The objectives of direct control include the prevention of the market structure from becoming monopolistic, the development of small and new entrepreneurs, balanced regional development, etc.

Indirect Control: Indirect control of government is usually exercised through fiscal and monetary incentives and disincentives (penalty). For example, a high import duty may discourage imports while on the other hand; fiscal and monetary incentives may encourage the development of export oriented industries.

Indirect regulations may consist of legislative measures or rules laid down whereby private activities are automatically regulated, whether and to what extent, the measures apply to business firms or individuals do not depend upon discretionary powers of the administration due to the specific content of legal provisions and rules. In short, the regulatory role of government may include:

(a) To regulate and monitor the conduct of business by laying down acts and standard of management, e.g. making provisions in law (Factory Act, 1948) for regulating working conditions, minimum remuneration and service rules.

(b) To lay down measures to control the disposal or accrual of income, e.g. ceiling on dividend distribution, levy of wealth tax, etc.

(c) To prescribe conditions under which private firm would be permitted to enter certain business areas or avail of public facilities and scarce resources. For instance, permitting entry into oil and gas exploration on issue of license and to set up economic zones like Special Economic Zone (SEZ), free trade zone (FTZ), export oriented units (EOUs), etc. and inviting particular business groups on long term lease and attractive subsidies.

(d) To monitor and regulate the relationship between different interest groups or segments in the economy so as to protect legal

rights or resolve disputes or prevent unhealthy concentration of economic power, e.g.

(a) Check on mergers, acquisitions and take-over.

(b) Check on inter-company investments.

(c) Emphasizing on corporate governance.

(d) Legal enactment to protect consumer rights, and

(e) Ceiling on purchase/acquisition of share by FIIs/NRTs.

On the other hand, legislative or administrative measures aimed at restricting or limiting private trade and industry come under the category of negative regulations. These negative regulations sometimes may include restrictions on rising up of capital from primary market through control of capital issues, raising taxes and duties, controlling supply of essential goods and services, imposing price ceiling and so on. Thus, it would not be correct to suggest that government regulations always have either positive or negative implications. Sometimes, even it happens that a measure taken by government may have both positive and negative implications. Thus, it is welcome by one group of businessmen and on the other hand, opposed by another group of business people. For example, any increase in import duty may restrict the profits of some domestic industries but it may be a welcome decision for producers and/or suppliers of competing products.

(2) Promotional Role:

In developed economies, government does not only regulate industrial labour and agricultural activities but actively assist and develop them. This role may not be quite surprising by people of developed economies but for a developing country like India, Chine and Korea, the promotional role of government is obviously of greater significance. If developing world has to become independent, the government will have to assure direct responsibility to build up and strengthen the necessary development of infra-structure, such as, road, power, transport, and means of communication, finance, marketing, institutions for training and

guidance and other promotional activities. The promotional role of government may include:

(a) Assistance for development of rural/backward/remote areas by way of setting up business zones, offering subsidies, tax concessions, allocating scarce resources, providing land, power, water at concessional rates, making available credit and finance at low interest and marketing and promoting through specialized organizations.

(b) Providing insurance cover to businesses and up-to-date information inputs for the development of priority sectors.

(c) To assist and promote industrial and commercial activities by assuming the responsibility to provide and strengthen road network, water and power supply, transport, communication network, availability of funds, setting up training and R&D houses and so on.

(d) Expansion of public sector.

(e) Establishment and operation of development banks.

(f) To promote sick units.

(g) Encouragement to small and medium scale enterprises (SMEs).

(h) Promoting sick and weak units.

(i) Balanced regional development.

(3) Entrepreneurial Role:

In many countries, the government also plays the entrepreneurial role which means the government itself becomes the entrepreneur. It then not only establishes business enterprises but operates, manages and controls the business operations. There are number of factors to justificate this role and may be found in developed and developing countries. These are mainly

(a) To promote balanced regional development.

(b) To provide employment.

(c) Socio-political factors.

(d) To prevent the exploitation of consumers by traders.

(e) Areas belonging to public welfare and safety where private sectors hesitate to invest due to low margin.

(f) To promote capital intensive industries involving huge investments which may not be an attractive option to private sector due to greater risk and low returns.

(g) To take over and manage private enterprises those offers huge employment but are not profitable in present.

Further, Indian industrial policy also reserves certain industries where private sector cannot enter. These industries basically belong to Defense products, Atomic energy, Atomic metal and so on. The reason for restricting entry of private sector is that these areas belong to a nation's security and strategic concerns.

(4) Planning Role:

The Planning role of the government has been closely related with its regulatory role. The Modern State is custodian of the welfare of society. The welfare government has the responsibility to fulfill the aspirations of the society by bringing about all-round prosperity. The basic idea in favour of Government's planning role was exclusive dependence on the market mechanism and freedom of private enterprise has not been conducive to rapid economic development. The ends i.e. the objectives to be achieved and the purpose to be served are many. In the pursuit of this task, the most important problem especially in the case of less developed countries is the scarcity of resources. The resources that are readily available are quite insufficient to meet all the ends. The resource constraints demanded that some of the purposes go unserved. This calls for the determination of the more urgent needs or national priorities and the optimal allocation of the available resources as best to sub-

serve the common man. This is also the basic principal of national planning.

However the need of this hour demands a proper check on leadership of the executives. The fate of the political system depends on the role of the political leaders who are said to be entrusted with three important functions, namely, founding, implementing and stabilizing a regime. What is thus needed is the imposition of proper checks on the authority of the executives. This will enable it to efficiently as well as properly perform the manifold functions entrusted to it which include the creation of a welfare service, the extension of social welfare to the whole population and the restoration of compassion.

4.3.3 JUDICIARY

Judiciary, also known as the rule-adjudication department of the government, in quite simple terms, may be defined as the third organ of government concerned with the job of doing justice. It interprets law and awards punishments for the violation of laws. The primary objective of any political system is to protect the rights of the individual, and this work is done by the judicial organ of the government.

4.3.3.1 FUNCTIONS OF JUDICIARY

The functions of the judiciary differ from one political system to another, but generally they are as follows:

- The first and the foremost function of the courts is the administration of justice. The courts hear and decide cases of all civil, criminal and constitutional nature. In countries having written constitutions, the courts are also entrusted with the power of interpreting the constitution. They act as the guardian of the constitution.
- Secondly, though legislation is the work of the legislatures, the courts also legislate in a different way. Where a law is silent, or

ambiguous, the courts decide what a law is and how it should prevail.

- Thirdly, the courts in a federal system of government also play the role of an independent and impartial umpire between the central and regional governments.
- Fourthly, the courts are important agencies of legitimizing the outputs of government. It is expected that the courts should keep themselves aware of the growing urges and aspirations of the people and should interpret the meaning of law dynamically in the light of obtaining situation. They should see that any law or executive action does not infringe upon the various rights of the people.
- Fifthly, the courts should also stabilize and support the existing political system. The behaviour of the courts must not be obstructive or destructive so that the smooth running of the political organization becomes a problem.
- The most controversial function of the courts lies in their power of judicial review under which they have the capacity to examine the validity of a legislative or administrative measure, and then declare it, either in part of full, 'intra vires or ultra vires of the constitution.' This power had its origin in the United States and also has its best form there. Its second best example can be found in India. Its weaker instances can be found in other countries also like Italy, Australia and South Africa.

4.3.3.2 UNDERSTANDING INDIAN JUDICIAL SYSTEM

The Indian Judicial System is one of the oldest legal systems in the world today. It is part of the inheritance India received from the British after more than 200 years of their Colonial rule, and the same is obvious from the many similarities the Indian legal system shares with the English Legal System. The frame work of the current legal system has been laid down by the Indian Constitution and the judicial system derives its powers from it.

The Constitution of India is the supreme law of the country, the fountain source of law in India. It came into effect on 26 January 1950 and is the world's longest written constitution. It not only laid the framework of Indian judicial system, but has also laid out the powers, duties, procedures and structure of the various branches of the Government at the Union and State levels. Moreover, it also has defined the fundamental rights & duties of the people and the directive principles which are the duties of the State. Inspite of India adopting the features of a federal system of government, the Constitution has provided for the setting up of a single integrated system of courts to administer both Union and State laws. The Supreme Court is the apex court of India, followed by the various High Courts at the state level which cater to one or more number of states. Below the High Courts exist the subordinate courts comprising of the District Courts at the district level and other lower courts.

An important feature of the Indian Judicial System is that it's a 'common law system'. In a common law system, law is developed by the judges through their decisions, orders, or judgments. These are also referred to as precedents. Unlike the British legal system which is entirely based on the common law system, where it had originated from, the Indian system incorporates the common law system along with the statutory law and the regulatory law.

Another important feature of the Indian Judicial system is that our system has been designed on the pattern of the adversarial system. This is to be expected since courts based on the common law system tend to follow the adversarial system of conducting proceedings instead of the inquisitorial system. In an adversarial system, there are two sides in every case and each side presents its arguments to a neutral iudge who would then give an order or a judgment based upon the merits of the case.

Indian judicial system has adopted features of other legal systems in such a way that they do not conflict with each other while benefitting the nation and the people. For example, the Supreme Court and the High Courts have the power of judicial review. This is a concept prevalent in the American legal system. According to the concept of judicial review, the legislative and executive actions are subject to the scrutiny of the judiciary and the judiciary can invalidate such actions if they are ultra vires of the Constitutional provisions. In other words, the laws made by the legislative and the rules made by the executive need to be in conformity with the Constitution of India.

4.3.3.3 JURISDICTION & POWERS OF THE COURTS

Supreme Court of India:

One of the most important powers of the Supreme Court of India is that any law declared or order/judgment passed by it is binding on all the courts within the territory of India. The jurisdiction and powers of the Supreme Court (SC) are defined under Articles 131 to 142 of the Indian Constitution. The jurisdiction includes original, writ, and appellate jurisdiction.

Original Jurisdiction refers to the power of the court to hear disputes when they arise for the first time. By exercising its power of Original jurisdiction the Supreme Court can hear disputes between,

- Government of India (GoI) and one or more States, or
- GoI & any State or States on one side and one or more States on the other, or
- Two or more States, if it involves a question - of law or fact - on which depends the existence or extent of a legal right.

The Supreme Court has also been conferred the power to issue directions or order or writs under Article 32 of the Constitution for

the enforcement of any of the rights provided under Part III of the Constitution, including the Fundamental Rights. This is referred to as the Writ jurisdiction of the Supreme Court. The writ jurisdiction of the Apex court under Article 32 is part of its original jurisdiction.

Appellate jurisdiction refers to the power of the Apex court to hear appeals against any judgment, decree or final order (or sentence) of a High Court in a constitutional, civil or criminal case, where exists a substantial question of interpretation of

- the constitution, or
- a law of general importance in case of a death sentence awarded in criminal matters.

However, an additional requirement is that the concerned High Court (HC) under Article 134A has to certify that the case in question is fit for an appeal to the SC. The jurisdiction of SC also encompasses matters which fell within the jurisdiction of the Federal Court under any law just before the commencement of the Indian Constitution.

The Supreme Court can also grant special leave to appeal against any judgment, decree, determination, sentence or order passed by any court or tribunal in the territory of India in any matter. The exception to this rule is the orders, judgments etc passed by any court or tribunal constituted by or under any law relating to the Armed Forces. Apart from the original, appellate and writ jurisdiction, the Supreme Court also has special advisory jurisdiction regarding matters referred to it by the President if India under Article 143 of the Constitution. The Apex court also has the power and authority to review any order or judgment passed by it as well as transfer cases from one High Court to

another or from the District Court of one state to the District Court of another State.

High Courts of India:

The High Courts of India are the supreme judicial authority at the State level. There are currently 21 High Courts in the country and of these the oldest High Court of India is the Kolkata High Court, which was established in the year 1862. Their powers and jurisdiction are similar to that of the Apex court, but with a few differences –

- Any law declared or orders/judgments passed by them are not binding on the other High Courts (HCs) of the country or the subordinate courts which fall under the purview of the other HCs unless the other High Courts choose to follow such law or order or judgment.
- Their territorial jurisdiction is varied.

The High Courts are the appellate authority for a State or group of States and get a lot of matters in appeal from the subordinate courts. They have the power to issue writs, just like the Apex court, under Article 226 of the Constitution, but with one difference. While the Supreme Court has the power to issue writs to enforce only the rights provided under Part III of the Constitution, the High Courts can issue writs for enforcement of the rights under Part III as well as "for any other purpose".

Just like in the case of the Supreme Court, the writ jurisdiction of the High Court is also part of their Original jurisdiction, since all writ petitions are filed directly before the High Court. Apart from writ petitions, any civil or criminal case which does not fall within the purview or ambit of the subordinate courts of a State, due to lack of pecuniary or territorial jurisdiction, can be heard by the High Court of that State. Also certain other matters or issues may be heard by the High Court as part of its original jurisdiction, if the law lay down by

the legislature provides for it. For example, the company law cases fall within the original jurisdiction of the High Court.

Therefore, the High Courts' work primarily consists of appeals from the lower courts as well as the writ petitions filed before it under Article 226. The territorial jurisdiction of a High Court, as mentioned earlier, is varied. Both the Supreme Court and the High Courts are courts of record and have all the powers associated with such a court including the power to punish for contempt of itself.

The Subordinate Courts:

The District Courts are at the top of all the subordinate or lower courts. They are however under the administrative control of the High Court of the State to which the district court belongs to.

Their jurisdiction is confined to the districts they are responsible for, which could be just one or more than one. The original jurisdiction of the District Courts in civil matters is confined by not just the territorial limitations, but by pecuniary limitations as well. The pecuniary limitations are laid down by the legislature and if the amount in dispute in a matter is way above the pecuniary jurisdiction of the District Court, then the matter will be heard by the concerned High Court of that State. In case of criminal matters, the jurisdiction of the courts is laid down by the legislature. The decisions of the District Courts are of course subject to the appellate jurisdiction of the High Courts. Apart from these judicial bodies who enforce the laws and rules laid down by the legislature and executive and also interpret them (the Supreme Court & High Courts), there are numerous quasi judicial bodies who are involved in dispute resolutions. These quasi judicial bodies are the Tribunals and Regulators. Tribunals are constituted as per relevant statutory provisions and are seen as an alternative forum for redressal of grievances and adjudication of disputes other than the Courts.

Some of the important tribunals are, Central Administrative Tribunal (CAT), Telecom Disputes Settlement Appellate Tribunal (TDSAT), Competition Appellate Tribunal (COMPAT), Armed Forces Tribunal (AFT), Debt Recovery Tribunal (DRT), etc.

The kinds of cases the tribunals hear are limited to their specific area. That is TDSAT can hear only matters related to telecom disputes and not matters of armed forces personnel. So the area of operation of these tribunals are marked out at the beginning itself by the statute under which its constituted. The same hold true for the various Regulators like – TRAI, DERC, etc. They regulate the activities of companies which fall under their purview as per the statute. Thus, the Indian Judicial System is a mix of the Courts and the Tribunals & Regulators, and all these entities working together as part of an integrated system for the benefit of the nation.

4.4 SUMMARY

Political Environment affects different business units extensively, as the business decisions are based on government policies and they have to change their policies too as per the government decisions. Political environment refers to three political institutions viz. legislature, executive and the judiciary in shaping, directing, developing and controlling business activities. The political environment of a country is influenced by the political organizations such as philosophy of political parties, ideology of government or party in power, nature and extent of bureaucracy influence of primary groups. The political environment of the country influences the business to a great extent. There are three institutions of a government, the legislature which makes the laws, the executive which implements the laws and the judiciary which interprets the laws and decides the disputes. These institutions of the government are so well structured that they can perform their functions adequately. This system of dividing the powers

in the three organs of the government is known as 'separation of the powers'.

A legislature is a kind of deliberative assembly with the power to pass, amend, and repeal laws. The law created by a legislature is called legislation or statutory law. In addition to enacting laws, legislatures usually have exclusive authority to raise or lower taxes and adopt the budget and other money bills. Legislatures are known by many names, the most common being parliament and congress, although these terms also have more specific meanings.

The execution is the implementing arm of the government. The execution formulates and executes the various policies of the government. The dictionary meaning of the word 'execution' is the power to put important decisions into action i.e. to execute or to implement.

Judiciary, also known as the rule-adjudication department of the government, in quite simple terms, may be defined as the third organ of government concerned with the job of doing justice. It interprets law and awards punishments for the violation of laws. The primary objective of any political system is to protect the rights of the individual, and this work is done by the judicial organ of the government.

4.5 SELF ASSESSMENT QUESTIONS

1. What are the aspects of political environment which affect business?
2. Explain the three institutions of political environment.
3. Discuss Indian legislative and judicial system.

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परिमापक

अनुवाद की स्थिति में

मूल लेखक	अनुवाद
मूल सम्पादक	भाषा सम्पादक
मूल परिमापक	परिमापक

सहयोगी टीम

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Block 2 : BUSINESS ENVIRONMENT

Block Introduction

This block comprises of four units.

The fifth unit introduces the subject of economic environment and the concept of economic system. It also provides an overview of economic system in India.

The sixth unit explains the Strategies & evaluation of current five year plan, New Industrial Policy & New Industrial Licensing.

The seventh unit deals with new economic policies and emerging economic effects of recession on business and their remedies.

The eighth unit refers to legal environment of business. It also looks into the different company regulatory legislation in India like FEMA and competition law. This unit throws light on EXIM policy of India too.

UNIT 5 ECONOMIC ENVIRONMENT

Unit Structure:

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5.5 Further readings

5.0 Objectives

After studying this unit, you will be able to:

- Explain the meaning of economic environment;
- Identify the economic systems;
- Describe the various types of economic systems;
- Understand merits & demerits of capitalism, socialism and mixed economy system.

5.1 ECONOMIC ENVIRONMENT

It is very complex and dynamic in nature that keeps on changing with the change in policies and political situations. Economic environment refers to the overall economic factors like economic system, economic structure, planning, economic policies, control and regulations etc. There is a close relationship between business and its economic environment. It obtains all inputs from economic environment and all its output is absorbed here with. The state of the economy is usually in flux. The current situation (specific to the industry) and any changes that may be forecast are important. The economy goes through a series of fluctuations associated with general booms and recessions in economic activity. In a boom nearly all business are benefited whereas recession is a case vice versa. Business is influenced by economic aspects like interest rates, wage rates etc. The survival and success of each and every business enterprise depends fully on its economic environment. The GDP indicates the growth scenario of any country. Companies take this into consideration before expanding or diversifying their business. The main factors that affect the economic environment are:

Economic Conditions: The economic conditions of a country refer to a set of economic factors that have great influence on business organizations and their operations. These include gross domestic product, per capita income, markets for goods and services, availability of capital, foreign exchange reserve, growth of foreign trade, strength of capital market etc. All these help in improving the pace of economic growth.

Economic Policies: All business activities and operations are directly influenced by the economic policies framed by the government from time to time. Some of the important economic policies are

- **Industrial Policy:** The Industrial policy of the government covers all those principles, policies, rules, regulations and procedures, which direct and control the industrial enterprises of the country and shape the pattern of industrial development.
- **Fiscal Policy** : It includes government policy in respect of public expenditure, taxation and public debt.
- **Monetary Policy:** It includes all those activities and interventions that aim at smooth supply of credit to the business and a boost to trade and industry.

Foreign Investment Policy: This policy aims at regulating the inflow of foreign investment in various sectors for speeding up industrial development and take advantage of the modern technology.

Export –Import Policy (EXIM Policy): It aims at increasing exports and bridge the gap between expert and import. Through this policy, the government announces various duties/levies. The focus now-a-days lies on removing barriers and controls and lowering the custom duties.

The government keeps on changing these policies from time to time in view of the developments taking place in the economic scenario, political expediency and the changing requirement. Every business organization has to function strictly within the policy framework and respond to the changes therein.

Economic System: The world economy is primarily governed by three types of economic systems, viz., (i) Capitalist economy; (ii) Socialist economy; and (iii) Mixed economy. The type of economic system influences greatly the choice of business.

5.2 ECONOMIC SYSTEM

The term economic system refers to the mode of production and the distribution of goods and services within which economic activity takes place. In a broader sense, it refers to the way different economic elements (individual workers and managers, productive organizations such as factories and firms and government agencies) are linked together to form an organic whole.

According to Landauer, "An economic system is the sum total of devices by which preferences among the alternative purposes of economic activity are determined and individual activities are coordinated for the achievement of those purposes."

The Economic system also refers to how the different economic elements will solve the central problem of an economy i.e. to answer three vital questions:

- What to produce?
- How to produce?
- For whom to produce?

The first question 'what to produce' depends on what is wanted. But all wants cannot be satisfied. This is because a country may not be gifted with all the necessary resources to produce all the goods. Hence, depending upon the resources, a country would decide what it could produce. Then there is a problem of prioritizing the available resources among the goods to be produced. Resources should not be used for the production of unwarranted goods. The production of goods, which are harmful to human beings, like narcotic drugs, should be prevented. Hence, considering the availability of resources, the economic system should opt to produce only goods and services that would satisfy the wants of human beings and increase social welfare. In this context it becomes necessary to weigh the individual requirements and the national requirements for goods and services.

The second question 'how to produce' addresses issues relating to selection of right strategy, technology and investment. For example, a country like India, with very huge population cannot prefer capital intensive technology, as that would lead to more unemployment of human resources. Similarly, while selecting the technology, a country should weigh a number of considerations like relevance of technology, cost of technology, support in case of failures, consequences of the technology used etc. Another vital aspect is the investment that a country has to make while selecting the strategy and the technology and whatever the available funds, should be invested in sophisticated research and development or meeting the basic needs of the people.

'For whom to produce' implies to resource utilization. The country as a whole should be benefited not a few segments only. The aspect deals with equitable distribution of goods and services produced in the economy. The distribution of national products would differ from country to country depending upon the economic system in place.

The way in which the above three questions are answered depends on the economic system which function in a country. The role of government and private organization depends on the economic system being followed. There are three main economic systems, capitalism, socialism and mixed economy.

5.2.1 CAPITALISM

Capitalism is an economic system based on the principles of free market, open competition, profit motive and private ownership of the

means of production. Capitalism encourages private investment and business, compared to a government-controlled economy. The objective of such a system is to maximize private gains. In such a system the market forces determine the resource allocation and price. All factors of production are privately managed and owned by individuals. The raw materials, the machines, the firms, and the factories are owned and managed by individuals who are at liberty to dispose of them within the prevalent laws of the country. Individuals have the right to choose any occupation, and to buy or sell any number of goods and services. Price mechanism is the nucleus of the capitalistic society. Investors in these private companies (i.e. shareholders) also own the firms and are known as capitalists.

According to Wright, "Capitalism is a system in which, an average, much of the greater portion of economic life and particularly of net new investment is carried on by private (i.e. non-government) units under conditions of active and substantially free competition and avowedly at the least, under the incentive of hope for profit." In the words of Loucks, "capitalism is a system of economic organization featured by private ownership and use for private profit of man-made and nature-made capital."

5.2.1.1 FEATURES OF CAPITALISM

The features of capitalism are discussed as below:

1. **Profit Motive:** All economic activities are guided by the motive of earning profit. The entrepreneurs choose to produce goods and services which yield greater profit. It is totally profit motive driven and there is no consideration for social justice. The profit motive is synonymous with the desire for personal gains.
2. **Right to Private Property:** In capitalism individuals are free to own, use and dispose of productive factors such as land, plant, machinery capital, etc. Private property is a legal right.
3. **Competition:** Competition is one of the most important features of a capitalist economy. It implies the large number of buyers and sellers. Due to a large number of competing firms, an individual firm cannot control the market. Profit motive induces new firms to enter the market there by increasing competition.
4. **Limited Role of Government:** The government does not interfere with the day to day functioning of the economy. Its main job is to

maintain law and order, ensures the country's security and enacts law necessary for public welfare. Pure capitalism rests on laissez-faire policy of the state i.e. no government intervention at all in business.

5. **Role of Price Mechanism:** The major role of bringing about equilibrium in the market is played by the price mechanism. Through this mechanism, the demand and supply forces interact in the market and an equilibrium is achieved due to bidding up of prices in case of excess demand and bidding down of prices in case of excess supply.

6. **Consumer Sovereignty:** People are free to spend their incomes as they like. Every consumer is free to buy from any seller and consume any commodity in any quantity. In fact, the tastes and preferences of consumers direct production in a free market economy. This is known as the principle of consumer sovereignty.

7. **Freedom of choice of Occupation:** People have the freedom of choice of occupation as the decision of 'what to produce' and 'how to produce' is taken by private entrepreneurs and individuals and free to choose their professions.

8. **OTHERS:** In addition to the above important features of a capitalist economy there are other features also:

- Based on individualism.
- Interdependence of entrepreneurs.
- Birth of big business houses due to large profits and individual ownership.
- Existence of consumer sovereignty and up to certain extent the consumer's decision may influence the economic activities.
- It provides occupational freedom and freedom to judge.
- Capital has prime importance among the sources of production.
- The Government has very limited role. The state considers means for providing better living for the people.
- It does not give any importance to economic quality and therefore, the community consists of different categories of people viz. rich, medium or poor.

5.2.1.2 VARIANTS OF CAPITALISM

There are many variants of capitalism in existence. All these forms of capitalism are based on production for profit, at least a moderate degree of market allocation and capital accumulation. The dominant forms of capitalism are listed below:

1. **Laissez-Faire/ Pure Capitalism:** The phrase laissez-faire is French and literally means 'let do', but it broadly implies, 'let it be' or 'leave it alone'. In economics, laissez-faire is an environment in which transactions between private parties are free from state intervention, including restrictive regulations, taxes, tariffs and enforced monopolies.

   Pure or free market capitalism consists of a free price system where supply and demand are allowed to reach their point of equilibrium without intervention by government. Productive enterprises are privately owned, and the role of the government is limited to protecting property rights.

   A laissez-faire or pure capitalist system is one within which all markets are unregulated by any parties other than market participants. In the purest form, the government play neutral role in its administration and legislation of economic activity. Free markets contrast sharply with controlled markets, in which governments more actively regulate prices and supplies, directly or indirectly, which according to free market theory causes markets to be less efficient.

2. **Social/ Mixed Capitalism:** A Social market economy is a normally free market system where government intervention in price formation is kept to a minimum but the state provides significant social security, unemployment benefits and recognition of labour rights through national collective bargaining laws. The social market is based on private ownership of businesses.

   The social market economy seeks a middle path between socialism and laissez-faire economic liberalism, combining private enterprise with government regulation to establish fair competition, maintaining a high rate of economic growth, price stability, low unemployment, good working conditions, social welfare and public services.

3. **State Capitalism:** The term state capitalism has various meanings, but it is usually described as commercial (profit-seeking)

economic activity undertaken by the government with management of the productive forces in a capitalist manner, even if the state is socialist for namesake. State capitalism is usually characterized by the dominance or existence of a significant number of state owned business enterprises. Examples include corporatized government agencies and state that own controlling shares of publicly-listed corporations, effectively acting as a large capitalist and shareholder itself.

State capitalism has also come to refer to an economic system where the means of production are owned privately but the state has considerable control over the allocation of credit and investment. Alternatively, state capitalism may be used to describe a system where the state intervenes in the economy to protect and advance the interests of large scale businesses. This practice is often claimed to be in contrast with the ideals of both socialism and laissez-faire capitalism.

State capitalism can be thought as a social system combining capitalism-the wage system of producing and appropriating surplus value-with ownership or control by the government. By that definition, a state capitalist country is one where the government controls the economy and essentially acts as a single huge corporation, extracting the surplus value from the workforce in order to invest it in further production. Workers are exploited in such economies and government operates with the profit motive instead of social welfare.

4. **Corporate Capitalism:** Corporate capitalism is a free or mixed market characterized by the dominance of hierarchical, bureaucratic corporations, which are legally required to pursue profit. A large proportion of the economy and labour market falls within corporate control. In the developed world, corporations dominate the market, constituting fifty percent or more of all business. Those businesses which are not corporations contain the same bureaucratic structure of corporations, but there is usually a sole owner or group of owners who are liable to bankruptcy and criminal charges relating to their business. Corporations have limited liability and remain less regulated and accountable than sole proprietorship.

Corporations are usually called public entities when their shares are listed and traded on the stock market. This is done as a way of raising capital to finance the investments of the corporation. The shareholders appoint the executives of the corporation, who are the ones running the corporation via a hierarchical chain of power, where the major investor decisions are made at the top, and have effects on those beneath them.

Corporate capitalism has been criticized for the amount of power and influence corporations and large business interest groups have over government policy, including the policies of regulatory agencies and influencing political campaigns. Many social scientists have criticized corporations for failing to act in the interests of people, and their existence seems to circumvent the principles of democracy, which assumes equal power relations between individuals in a society.

5.2.1.3 MERITS OF CAPITALISM

The merits of capitalism can be discussed as below:

1. **Efficient Utilization of Resources:** Under capitalism, the scarce resources of the country are used most economically and with minimum waste. Every business firm wants to minimize costs so that it can compete in the market. In order to minimize costs producers attempt to utilize factors of production in the best possible manner. Under capitalism, producers undertake the production of only those goods which appear to yield maximum profits in anticipation of demand. This leads to optimum use of resources.

2. **Increase in Production:** Arthur Young wrote "The magic of property turns sand into gold." This observation of Young holds good in a free enterprise economy where every farmer, trader or industrialist can hold property and use it in any way he likes. He brings improvement in production and increases productivity because the property belongs to him. This leads to increase in income, saving and investment, and to progress.

3. **Quality Product at Low Costs:** The twin freedoms of consumers and producers leads to the production of quality products, and lowering of costs and prices. Thus the society as a whole stands to gain under capitalism.

4. **Progress and Prosperity:** The presence of competition under capitalism leads to increase in efficiency, encourage producers to innovate and thereby brings progress and prosperity in the country. As pointed out by Seligman. "If competition in biology leads only indirectly to progress, competition in economics is the very secret of progress."

5. **Maximum Welfare:** The automatic working of the price mechanism under capitalism brings efficiency in the production and distribution of goods and services without any central plan, and promotes the maximum welfare of the community.

6. **Flexible System:** A capitalist economy operates automatically through the price mechanism. If there are shortages or surpluses in the economy, they are corrected automatically by the forces of demand and supply. As such, capitalism is a highly flexible system which can adapt itself to changing economic conditions. That is why it has survived many depressions, recessions and booms.

5.2.1.4 DEMERITS OF CAPITALISM

The countries which have become independent after 1950s, adopted mostly the socialistic economic system because of the demerits of the capitalist economic system. Human welfare aspect has completely disappeared in the capitalist system and it has created disparity in income and wealth. H.D. Kickinson writes, "Capitalism ... is fundamentally blind, purposeless, irrational and is incapable of satisfying many of the urgent human needs." Some of the important demerits of capitalism are:

(1) **Leads to Monopoly:** Competition which is regarded as the very basis of capitalism contains within itself the tendency to destroy competition and leads to monopoly. It is the profit motive under capitalism which leads to cut throat competition and ultimately to the formation of trusts, cartels, and combinations. This brings about a reduction in the number of firms actually engaged in production. As a result, small firms are eliminated in this process.

(2) **Inequalities:** The institution of private property creates inequalities of income and wealth under capitalism. The price mechanism through competition brings huge profits to big producers, the landlords, the entrepreneurs and the traders who accumulates vast

amount of wealth. While the rich roll in wealth and luxury, the poor live in poverty and squalor.

(3) **Economic Instability:** It is difficult to establish a balance between the demand and supply. There will be trade boom or recession or the frequent fluctuations in prices. All the decisions relating to production are taken by the capitalist and due to wrong estimates of future requirements; imbalance in production is generally found. Due to fluctuations in prices industrial and other economic activities become unstable and this will have adverse impact on the economic development and expansion.

(4) **Inefficient Production:** The capitalist always produces with motive of profit only. He always produces goods for use by higher income class of the community so that maximum profits can be obtained. Goods and services are not produced by keeping in vie the interests and wants of the common man, but with the motiv of capitalist's profits.

(5) **Class Conflicts:** The capitalist economy divides the community into two parts; on the first side the top capitalists and on the other side labour class which depends on the capitalists to fill their stomach. Since the production resources are controlled by the capitalists they exploit the labour from their reasonable reward.

(6) **Unemployment:** In a capitalist economy full employment situation cannot be brought due to lack of central economic planning. With the result, optimum use of resources cannot be possible. This brings the situation of unemployment.

(7) **Monopoly and Exploitation:** The establishment of large-scale business, improvement in technology, motive of maximization of profits, formation of combinations and acute competition are the reasons for creation of monopoly and exploitation of customers.

(8) **Neglect of National Interest:** They are mainly oriented towards self-interest of maximization of profits for which they compete with each other. They neglect the social interests. They do not undertake their activities keeping in view the national interest.

5.4.1 SOCIALISM

Socialism is the philosophy of the Government and economic

system based on the belief in the worth of each individual. The basic philosophy of socialism is the provision of certain goods and services to all individuals in the nation. As a movement, socialism seeks to create more opportunity for the under-privileged classes and to end inequality based on birth so that society can be rebuilt on the foundation of co-operation instead of competition, incentive or profit. Under this economic system, the Government representing the society determines what goods shall be produced and how they shall be produced.

The ultimate goal of socialist economy is to replace the private ownership of means of production by social ownership and control. In a democratically-managed socialist economy individuals are free to choose their own occupations though it encourages them to choose certain types of work and discourages them from pursuing others.

The socialist system was first introduced in Union of Soviet Socialist Republics (USSR). Under this system the Government holds the ownership of the sources of production as well as in all the economic activities. In this system the production is owned by the people collectively through their government. There are no private landlords and factory owners. All business is conducted by the State and all profits go to the state treasury.

According to Samuelson, "the important essentials of Socialism are that all the great industries and the land should be publicly or collectively owned and that they should be conducted for the common good instead of private profit."

In the words of Webbs, "A Socialized industry is one in which the national instruments of production are owned by public authority or voluntary associations and operated not with a view to profit by sale to other people, but for the direct service of those whom the authority or association represents."

5.2.2.1 CHARACTERISTICS OF SOCIALISM

The important characteristics of socialism are as follows:

(1) **Role of the state:** The role of the state will be more comprehensive and it influences every field of public life. The state accumulates the sources of production. It determines the fields of different business and executes them according to priorities.

(2) **Central Planning:** As per H.D. Dickinson, Central economic planning means, "the making of major economic decisions - What

and how much is to be produced, how, when and where it is to be produced, and to whom this to be allocated - by the conscious decision of determinate authority, on the basis of comprehensive survey of the economic system as a whole." The sources of production are distributed on the basis of definite planning. The central planning duty is given to the control of any authority.

(3) **Social ownership of the means of Production**: In a socialist economy, the means of productions are not with the capitalists. The state holds the ownership of the means of production and they are utilized for the benefit of the society. The state takes steps to uplift the standard of living of the people.

(4) **Economic and Social Quality**: The socialist economy makes equal distribution of income and opportunities without consideration of family, caste and rights of property.

(5) **Goal of Social Welfare:** The object of economic activity is not limited to profits but mainly oriented to Social welfare. The State produces according to the consumption needs of the citizens.

(6) **Freedom of Consumption and Production:** The consumers have freedom of choice to select from. In addition to this, the production is made according to the needs and wants of people. The workers have freedom to change the enterprise for betterment. R.L. Hall writes "The Socialist economy involves the abandonment of free choice to the individuals, as fundamental liberty, consumption and production must fit into the central planning".

(7) **Labour as Trustees and Employee:** The role of workers is like a trustee and employee. They are given participation in management. All their ideas, suggestions and views are incorporated in the management decision.

(8) **OTHERS:**

- The market mechanism takes the shape of active and controlled price mechanism.
- The dignity of the worker is not in the form of a factor of production, but it has good relations with the means of production.
- Socialist economy has well planned and rationalized objects. It works for the welfare of the people.

- Distribution according to functions.
- Private ownership on all items of consumption.

5.2.2.2 MERITS OF SOCIALISM

1. **Maximum use of National Resources:** Because of central economic planning, the state uses the means of production for optimum welfare of the society.
2. **No Cyclical Fluctuations:** In a socialist economy all type of cyclical fluctuations and uncertainties in business disappear as the economic activities are not guided by the profit element. The economy proceeds towards the situation of full employment.
3. **Production Planning:** The main object of socialist economy is to serve for the real demands and to fulfill the real needs of the people. For this purpose it arranges of planned production.
4. **Possibilities of Investment and Development:** In socialist economy, the economic process and procedures are on rolled and without minimizing consumption needs the rate of investment is increased. According to Earnest Mandel, the following sources of investments are found in socialist economy:

- by utilizing maximum capacity of production leading to capital investment;
- by restricting the use of luxury items as well as controlling unnecessary expenses;
- by minimizing distribution expenses, such as expenses on advertising, salesmanship etc.;
- by adopting rationalization for increasing the production and thereby increasing investments;
- by using the creative powers of employees in production.

5. **Goal Oriented Economy:** It is an arrangement based on human objectives. It is the system in which human welfare is undertaken by human beings. It is an effort to increase and maintain human status and dignity, whereas the capitalist economy is based on exploitation of people. Dickinson writes, "Capitalism ... .is fundamentally blind, purposeless, irrational and is incapable of satisfying many of the most urgent human needs."
6. **End to the Exploitation:** There comes to end the exploitation of consumers and workers. In socialist economy the community is not

divided as exploits and exploiters. The parasite category disappears from the society.

5.2.2.3 DEMERITS OF SOCIALISM

The important demerits are:

1. **Lack of Rational Calculation of Costs:** It is of the view of well-known writers that in socialist economic system, there is lack of national calculation of costs in production process. It becomes impossible for efficient production and distribution of resources in the absence of rational calculation of costs. The main reason is the State Ownership in the sources of production.

2. **Bureaucratic Tendency:** It is an important drawback of the socialist system that it becomes victim of bureaucratic attitude as it creates inefficiency. In the management of government business, the bureaucrats do not take any personal interest and encourage red tapism in the functioning.

3. **Increase Government Powers:** The government holds supreme powers in economic and political fields. All powers are concentrated in the hands of government as it holds ownership in physical assets in the country and sole control and management in the industrial activities. The consumers have limited freedom, limited autonomy to entrepreneurs and the freedom to undertake any industrial activity.

5.2.3 MIXED ECONOMY

Mixed Economy is neither pure capitalism nor pure socialism but a mixture of the two system. In this system we find characteristics of both capitalism and socialism. Mixed economy is operated by both, private enterprise and public enterprise. That is private enterprise is not permitted to function freely and controlled through price mechanism. On the other side, the government intervenes to control and regulate private enterprise in several ways. It has been realized that a free functioning of private enterprise results in several types of problems.

According to J.W. Grove, "One of the pre-suppositions of a mixed economy is that private firms are less free to control major decisions about production and consumption than they would be under capitalist-free enterprise, and that public industry is free from government restrains than it would be under centrally directed socialist enterprise."

The term mixed economy is used to describe economic systems which stray from the ideals of either the market, or various planned economies, and "mix" with elements of each other. A mixed economy aims at blending together the best control socialist or communist economy with the best of free enterprise in a capitalist economy. The overall planning and allocation of resources is decided by the Central Government and the planning Commission. Private enterprises and public enterprises are allowed to function so as to contribute towards the development of the economy.

5.2.3.1 CHARACTERISTICS OF MIXED ECONOMY

The important characteristics of mixed economy are as follows:

1. **Co-existence of the Public and Private Sectors:** The important characteristic of mixed economy is that in this economy both private sector and public sector function together. The heavy industries such as defense equipment, atomic energy, heavy engineering industries etc., come under the control of public sector. On the other hand, the consumer goods, small and cottage industries, agriculture, etc., are assigned to the private sector. The government helps the private sector by providing several facilities, of their development.

2. **Economic Welfare:** It is the most important criterion of the success of a mixed economy. Public Sector seeks to avoid regional inequalities, provides large employment opportunities and often its price policy is guided by considerations of economic welfare rather than by profit motive. Private activities are influenced through monetary and fiscal policies to make them contribute to economic welfare of the society at large level.

3. **Economic Planning:** In mixed economy, the Government adopts the instrument of economic planning. This is necessary for the public sector enterprises which have to work according to some plan and to achieve certain pre-determined objectives. In the same way, the Private Sector cannot be left to develop in its own way. To ensure a coordinated and fast economic development the programmes of both the sector are drawn in such a way that growth in one complements the growth in the other.

4. **Free and Controlled Economic Development:** The mixed Economic System considered to be more appropriate to remove the demerits of the capitalist and communist economic systems. Encouragement is given to free economic activities and at the same time steps are also taken to control economic activities.

5.2.3.2 MERITS OF MIXED ECONOMY

The merits of mixed economic system are discussed below:

1. **Adequate Freedom**: Mixed economy also permits adequate freedom to different economic units:

(a) Consumers are free to dispose of their incomes in a manner they want, although the government does try to influence these decisions through monetary, fiscal and commercial policies.

(b) Factors of production are free to choose their own occupations although again the Government may strive to create conditions favourable for the growth of chosen occupations.

(c) Private initiative is always encouraged to find its best possible use.

2. **Maximum Welfare**: In mixed economic system, the state makes efforts to provide maximum welfare to workers and other citizens. The government makes provision for the employees for housing, education, minimum wages, good working conditions, etc.

3. **Modern Technology**: In mixed economy, the modern technology and capital saving method is used, with the result large-scale production and profit could be possible. Reserve fund is created to meet any undesired situation in future. It produces more at the time of trade boom and utilizes the reserve capital when there is recession.

4. **Best allocation of Resources:** The resources are utilized in the best possible manner in the Mixed Economic System. The Central Government makes economic planning for optimum use of the resources. Thus shortage is avoided; productive efficiency increases, and cyclical fluctuations are eliminated.

5.2.3.3 DEMERITS OF MIXED ECONOMY

The major disadvantages of mixed economy are:

1. **Low Inflow of Foreign Capital**: Because of the government policy and the fear of nationalization there is less possibility of inflow of foreign capital which is very essential of the development of private sector.

2. Inefficiency of Public Sector: In comparison to private sector, public sector efficiency is lacking and corruption, discrimination and red-tapism are the evils spread in the public sector.

3. Maximum Control on Private Sector: On one side, opportunity is given to private sector for development, on the other side stringent controlling is exercised by the government to regulate the functioning of private enterprises. This has an adverse impact on the development of private sector.

4. **Fear of Nationalization:** The private entrepreneurs are much worried about the government policy to nationalize private enterprises in certain situations.

5. Problem of Concentration of Economic Power: Although it is said that the mixed sector minimizes economic concentration but in practice the private-entrepreneurs take the advantage of government policy and accumulate wealth since both the private and public sectors co-exist, the government will not be in a position to impose any stringent steps to prevent economic concentration.

6. Presence of Imbalance in the economy: The mixed economy cannot provide faster development as the government simply wants to maintain a balance between the private and public sectors. The policies of the government are not so clear or it facilitates to give any direction with the result, there exists non-clarity of objectives and presence of imbalance in the economy.

5.2.3.4 MIXED ECONOMY IN INDIA

Mixed economic system was introduced in Indian together with the announcement of Industrial Policy Resolution in 1948. This was the first industrial policy of India after Independence. Entire Industrial Sector has been divided into four categories, such as:

(1) Industries under the management of government.

(2) Industries controlled by the government.

(3) Industries under the regulation and control of the government.

(4) Industries under the private sector.

It is the combination of Capitalist and Socialist economy. India had adopted a mixed economy after independence with the intention of procuring the advantages of both and avoiding their disadvantages. The productive activities are divided between the government (Public Sector) and the people (Private Sector). Normally the basic industries, the Capital Goods Industries, The Heavy Industries are placed in to the public sector and the light and consumer goods industries in the Private Sector. The

activities of the public sector are guided by the welfare motive whereas the activities of the private sector are guided by profit motive. They balance each other. This ensures earning a profit and also a high level of public welfare. The public sectors are completely directed by the government whereas the private sectors are indirectly controlled by the government.

A mixed economy today in India resembles a capitalist economy with certain modifications. It is not a complete different economic system. The state tries to change the structure of the capitalist economy so as to make it more appropriate for model economy situations.

In India almost the entire agricultural sector is under private ownership. In the non agricultural sector, 3/4th of the industries are in the private sector. The wholesale and retail trade is mostly in the private sector and transport is also largely in the private sector except the railways transport.

The role of the public sector is supportive. The public sector is expected to build the infrastructure which is used by the private sector. The public sector also develops the basic and capital goods industries. Their products are used by the private sector but even in this field we are fast moving towards privatization. The state intervenes in any productive activity with the intention of making it more community friendly. If it is found that the private sector is cornering the stocks of a commodity and exploiting the consumers, the state setup its own units to produce the commodity and augment its supply. This is helpful in arresting the rise in the price of the commodity.

The public sector mainly specialized in the production of public utilities such as local transport, supply of cooking gas, supply of water and such other commodities which enter into the budget of the common man. The government also undertakes purchase and sale of necessaries of life so as to protect the vulnerable sections of the community against an excessive rise in prices. India has adopted mixed economy system due to following characteristics of Indian economy:

1. Efforts to establish a welfare state.
2. All the basic industries of national importance are reserved for public sector.
3. Inclusion of four economic-areas in the economy, viz., public sector, private sector, joint sector and the cooperative sector.

4. Public sector enterprises are complementary to such other and cooperative.
5. Social and Labour welfare orientation of public sector.
6. Efforts are made regularly to faster economic development of the country.
7. Appropriate control over the private and MRTP companies by the government.
8. Government control on raw materials and consumption goods by the government through pricing and distribution.
9. Presence of the features of capitalist and socialist system of economies.
10. Small and cottage industries are given equal importance along with the large-scale industries.
11. Efforts to transform a structure of agriculture, and mining, along with the industrial growth.

Thus a mixed economy is a need of a developing economy like India in the initial stages. But as the economy develops the private sector rise into prominence and the mixed economy is knowingly or unknowingly transformed in to a market regulated economy.

5.3 SUMMARY

The term economic system refers to the mode of production and the distribution of goods and services within which economic activity takes place. The world economy is primarily governed by three types of economic systems, viz., (i) Capitalist economy; (ii) Socialist economy; and (iii) Mixed economy. In Capitalism system capital is owned and invested by individuals and private-owned institutions to earn profit. The fruit of the economic activity naturally goes to the individuals who invest their capital individuals who invest their capital individually or correctively. The most fundamental feature of capitalism is the right of the individuals to own tangible and intangible private property. This right is expected to provide the incentive to initiate and continue the economic activity. The system is marked by little or no interference by the Government in business run by private individuals or institutions. This enables individuals to choose what goods to produce, in what quantity to produce and in which markets to sell. Individual consumers also enjoy the choice of the goods

they want to consume from among the alternative varieties available. This generates competition among producers and sellers to secure maximum share of market and among buyers to secure the goods of their choice to satisfy their individual wants. Competition is also generated among workers, firms and companies. It is expected that competition and free enterprise would encourage business units to improve quality of goods and services and adjust their production to meet the needs of consumers with almost efficiency. The profit motive is the basic incentive for work under this system. People are motivated to earn profit so that they can increase their capital and wealth. Since capitalism is based on economic individualism, it does not guarantee that each individual will share equally in the benefits arising out of the working of the economy. Individuals commanding more wealth will have the advantage over the less wealthy. Originally capitalism was based on the assumption that competition would automatically eliminate inefficiency in individuals and institution. However, the growth of monopolies in capitalist economies has belied such expectations and there are many cases where large but relatively less efficient organizations could drive out the smaller units.

In short, capitalism is a system in which individuals are free to own property and business enterprises to compete freely in the market a d determine their own future. In the modern capitalist economy, the restraints on these freedoms have come to be imposed to ensure that the society is not held to ransom by a few powerful capitalists

In socialism, production and distribution of goods and services are largely owned by the government and very few economic activities are carried out by the private players. The motive of this economy is welfare of the society. The price of the product is fixed by the government under expert advice irrespective of the cost of production. Socialism is the philosophy of the Government and economic system based on the belief in the worth of each individual. The basic philosophy of socialism is the provision of certain goods and services to all individuals in the nation. Under this economic system, the Government representing the society determines what goods shall be produced and how they shall be produced. The ultimate goal of socialist economy is to replace the private ownership of means of production by social ownership and control.

In a mixed economy, private enterprise is permitted to function and flourish subject to control and restrictions by the Government. The

extent of Government control over business and its interference in economic activity varies from country to country. But a mixed economy aims at blending together the best control socialist or communist economy with the best of free enterprise in a capitalist economy. India has adopted the mixed economy system. The overall planning and allocation of resources is decided by the Central Government and the planning Commission. Private enterprises and public enterprises are allowed to function so as to contribute towards the development of the economy. The overall objective of the economic system in India is to achieve economic growth with distributed justice. Certain areas of economic activity are left open to private enterprise, certain others are reserved for the public enterprise while in some areas both the sectors may compete or collaborate. Thus, there is a combination of the features of capitalism and socialism.

5.4 SELF ASSESSMENT EXERCISE

1. Define economic environment of business.
2. Discuss advantages and disadvantages of capitalism and mixed economy.
3. What are the salient features of Indian mixed economy?

5.5 SUGGESTED READINGS

1. Cherrunilam Francis, Business Environment, Vikas Publishing House Private Limited, Place & Years.
2. Bedi Suresh, Business Environment, Excel Books, Place & Years.
3. Mittal Vivek, Business Environment, Excel Books, Place & Years.
4. Shukla M. B., Fundamentals of Business Environment, Taxmann's Publication Private Limited, Place & Years.

UNIT 6 INDUSTRIAL POLICY

Objectives:

After studying this unit, you will be able to:

- Analyze the current five year plan
- Understand the new industrial policy and its objectives
- Explain the new licensing policy and delicenced areas

Structure:

6.1 Introduction

6.2 Strategies and evaluation of current five year plan

6.3 New industrial policy

6.4 New licensing policy

6.5 Summary

6.6 Self Assessment Question

6.7 Suggested readings

6.1 INTRODUCTION

For most seven decades the strategy for India's Industrial development had been to place strong emphasis on three pillars: dominant role for public sector, focus on basis and heavy industries and government regulations and control over the private sector. After the adoption of the Constitution and the socio-economic goals, the industrial policy was comprehensively revised and adopted in 1956. To meet new challenges, from time to time, it was modified through statements in 1973, 1977 and 1980. It was only in 1991 when the market reforms were undertaken and a number of economic policy reforms were made to change the role of government from that of regulation to one development.

The government of India is trying to give a strong and diversified industrial base and develop it as a major industrial nation of the world. The goals and objectives set out for the nation are quite important one. These include the rapid agricultural and industrial development of our country, rapid expansion of opportunities for gainful employment, progressive reduction of social and economic disparities, removal of

poverty and attainment of self-reliance remain as valid today as at the time. Any industrial policy must contribute to the realization of these goals and objectives at an accelerated pace. The statement of industrial policy is the prevailing environment at the time of the formulation. The statements announced from time to time also represent a renewed initiative towards consolidating the gains of national reconstruction available during the course of its implementation.

6.2 STRATEGIES AND EVALUATION OF CURRENT FIVE YEAR PLAN

The current five year plan is implemented for the period of 2012-2017. This is 12th five year plan. This plan was announced by Prime Minister Manmohan Singh on September 15, 2012. The Union Cabinet on 4 October 2012 approved the 12th five-year plan with its aim to renew Indian economy and use the funds from government in improving the facilities of education, sanitation and health. This plan has seen a three-fold increase in the budget constraints when compared to that of the 11th five-year plan. The plan would infuse a huge fund of 47.7 lakh crore rupees and this will help to accomplish the economic growth to an average level of 8.2 percent. The plan aims towards achieving a growth of 4 percent in agriculture and to reduce poverty by 10 percentage points, by 2017. The Planning Commission outlined three economic scenarios depending on the level of policy action and implementation - Strong Inclusive Growth, Insufficient Growth and Policy Logjam. The current fiscal deficit is too high which is attracting adverse comments from analysts. It is pegged at 2.9% of the GDP in the 12th Five-Year Plan. The fiscal deficit can be brought down mainly through Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII) flows.

The Eleventh Plan period ended with notable achievements. The average growth rate was 7.9 percent. This was lower than the 9 percent target, but better than the 7.6 percent achieved in the Tenth Plan. Since the period saw two-global crises - one in 2008 and another in 2011 - the 7.9 percent growth is commendable. There was also progress in inclusiveness. Poverty declined twice as fast between 2004-05 and 2009-10 than it did in the previous ten years. Agriculture grew at 3.3 percent per year in the Eleventh Plan, much faster than the 2.4 percent observed in the Tenth Plan. The latest NSSO data also establish that the growth rate of rural consumption per capita in the period 2004-05 to 2011-12

was twice as high as in the previous period 1993-94 to 2004-05. These are positive features, but it should be recognized that the Twelfth Plan started in a year when the world economy is experiencing difficulties and economy has also slowed down. Growth decelerated to 6.5 percent in 2011-12, and was only 5.5 percent in the first quarter of 2012-13.

As the Plan document points out that the objective is not just growth of GDP, but growth that is inclusive and also sustainable. The SC/STs, OBCs, and the Minorities must all participate fully in the growth process. The Plan has many elements designed to ensure this. The most important area for immediate action is to speed up the pace of implementation of infrastructure projects. This is critical for removing supply bottlenecks which constrain growth in other sectors, and also for boosting investor sentiment to raise the overall rate of investment. The infrastructure ministries must set ambitious goals for their sectors over the Twelfth Plan and strive to achieve them.

Constraints are many. Power projects are held up due to lack of fuel supply. Coal projects are being delayed because of environmental clearances and forest clearances. Port projects have slowed down because of security clearances. Many of infrastructure sectors face financing difficulties which call for some creative solutions.

There is a need to put in place new empowered mechanisms to overcome bottlenecks. The Investment Tracking System, the monitoring of large PSU investments, the process to speed up security and other clearances are all part of the effort at de-bottlenecking. Many problems require that central government should work in closer cooperation with state governments to achieve common goals.

Turning to the longer term policy agenda, the Plan can be seen as consisting of three broad components. One is the set of Government programmes aimed at achieving specific sectoral objectives. The Plan contains ambitious programmes in health, education, water resource management, infrastructure development, and a number of programmes aimed at inclusiveness, most notably the MGNREGA, the PMGSY, the IWDP and the National Rural Livelihoods Mission. Considerable resources are being allocated for these programmes. The need is to pay much greater attention to whether they are also delivering results on the ground, especially for the SCs/STs and the weaker

sections. For this, there is a need for better monitoring and concurrent evaluation and also a willingness to be flexible in programme design.

The second component relates to macro-economic balance. The Plan envisages a substantial acceleration of growth. This is critically dependent on raising the rate of investment in the economy. The investment environment is therefore critical. High investments must be supported by much higher levels of domestic savings. The macro policies must therefore encourage savings, especially long term savings. One of the key elements in this process must be the reversal of the decline in government savings in recent years, which is reflected in the sharp increase in the fiscal deficit. Because export performance is likely to be weak, a high growth, high investment strategy will require financing a current account deficit of about 2.9 per cent of GDP. This must be financed mainly through FDI and FH flows, so that reliance on external debt is limited.

The third key component of the Plan is the set of policies which can improve performance in individual sectors. Numerous policy deficiencies in individual sectors need to be addressed and are discussed at length in the Plan. A few key sector priorities are as follows in the 12th plan:

- Health, education, and skill development are key sectors which enhance human capability and can contribute hugely to the objective of inclusive growth. They must be given high priority in the Twelfth Plan. These are sectors where additional public resources are needed but there is also need to ensure greater efficiency in delivery through system reforms.

- Agricultural growth must be accelerated to about 4 percent. This can be done by resorting to better technology and better seeds combined with more effective water management. Most of the growth will come from perishables (horticulture, dairy, fisheries) where post-harvest logistics are important. The plan makes many recommendations for States to follow to modernise agriculture.

- Manufacturing must grow much faster than it has, to generate the employment growth we need. The plan outlines a multi-pronged strategy for faster growth in manufacturing, especially for MSMEs which are much more employment generating.

- Infrastructure development increases the competitiveness of Indian producers, especially small and medium industries that rely heavily on

general infrastructure. It is also critical for opening up remote areas by improving connectivity. Infrastructure development needs a combination of public investment and PPP.

- Energy is a difficult area where our policy needs a comprehensive review. We are energy deficient and our import dependence is increasing. It is vital for our energy security that we increase domestic production and also increase energy efficiency. Rational energy pricing is therefore critical. The Plan points out that our energy prices are out of line with world prices. This is true not just in petroleum products, but also natural gas, coal and therefore also electricity. India cannot achieve energy efficiency, or increase domestic production without aligning our prices with global trends. The increase in diesel prices effected recently is a step in the right direction.

- Water is another area where problems of scarcity and the challenges of effective natural resource management are likely to expand in the years ahead. We do not really have an institutional and legal framework in which water can be efficiently managed.

- Urbanisation is a new challenge which we must address through a combination of additional resources and reforms.

The central message of the Plan is to emphasise the role of policies, the Plan for the first time presents alternative scenarios.

Scenario one is called "Strong Inclusive growth" and presents what is possible if the numerous policy actions outlined in the Plan are substantially implemented. One can expect a number of virtuous cycles to start operating, leading to positive results on both growth and inclusion. This is the scenario Government should aim for.

Scenario two is called "insufficient action". It describes a state of partial action on policies with weak implementation. The virtuous cycles that reinforce growth in Scenario-I will not kick in, and growth can easily slow down to 6 to 6.5 percent. Inclusiveness will also suffer. This is where Government will end up if it slip in implementation, and make only half-hearted efforts.

Scenario three is called "policy logjam". It reflects a situation where for one reason or another, most of the policies needed to achieve Scenario 1 are not taken. If this continues for any length of time, vicious cycles begin to set in and growth could easily collapse to 5 percent per year, with very poor outcomes on inclusion.

6.3 NEW INDUSTRIAL POLICY 1991

The Government of India announced the New Industrial Policy on 24th July, 1991. The industrial Policy Statement of 1991 stated that "the Government will continue to pursue a sound policy framework encompassing encouragement of entrepreneurship, development of indigenous technology through investment in research and development, bringing in new technology, dismantling of the regulatory system, development of the capital markets and increased competitiveness for the benefit of common man". It further added that "the spread of industrialization to backward areas of the country will be actively promoted through appropriate incentives, institutions and infrastructure investments".

Objectives of the Policy: Main objectives of the industrial policy statement 1991 are as follows:

1. to maintain a sustained growth in productivity;
2. to enhance gainful employment;
3. to achieve optimal utilization of human resources;
4. to attain international competitiveness; and
5. to transform India into a major partner and player in the global arena.

Policy Focus: Important points of policy focus are as follows:

1. Deregulating Indian industry;
2. Allowing the industry freedom and flexibility in responding to market forces; and
3. Providing a policy regime that facilitates and fosters growth of Indian industry.

Features of Industrial Policy Statement, 1991: Salient features and initiatives of the industrial policy statement, 1991 are as follows:

A. Industrial Licensing Policy

1. Industrial licensing will be abolished for all projects except for a short list of industries related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons, and items of elitist consumption (list attached as Annex II). Industries reserved for the small scale sector will continue to be so reserved.

2. Areas where security and strategic concerns predominate will continue to be reserved for the public sector (list attached as Annex I).

3. In projects where imported capital goods are required, automatic clearance will be given:

(a) in cases where foreign exchange availability is ensured through foreign equity, or

(b) if the CIF value of imported capital goods required is less than 25 % of total value (net of taxes) of plant and equipment, up to a maximum value of Rs.2 crore. In view of the current difficult foreign exchange situation, this scheme (i.e. (iii) b) will come into force from April, 1992.

In other cases, imports of capital goods will require clearance from the Secretariat for Industrial Approvals (SIA) in the Department of Industrial Development according to availability of foreign exchange resources.

4. In locations other than cities of more than 1 million populations, there will be no requirement of obtaining industrial approvals from the Central Government except for industries subject to compulsory licencing. In respect of cities with population greater than 1 million, industries other than those of a non polluting nature such as electronics computer software and printing will be located outside 25 kms. of the periphery, except in prior designated industrial areas. A flexible location policy would be adopted in respect of such cities (with population greater than 1 million) which require industrial re-generation. Zoning and Land Use Regulation and Environmental Legislation will continue to regulate industrial locations. Appropriate incentives and the design of investments in infrastructure development will be used to promote the dispersal of industry particularly to rural and backward areas and to reduce congestion in cities.

5. The system of phased manufacturing programmes run on an administrative case by case basis will be applicable to new projects. Existing projects with such programmes will continue to be governed by them.

6. Existing units will be provided a new broad banding facility to enable them to produce any article without additional investment.
7. The exemption from licencing will apply to all substantial expansions of existing units.
8. The mandatory convertibility clause will no longer be applicable for term loans from the financial institutions for new projects.

Procedural consequences

9. All existing registration schemes (Delicensed Registration, Exempted Industries Registration, DGTD registration) will be abolished.
10. Entrepreneurs will henceforth only be required to file an information memorandum on new projects and substantial expansions.
11. The lists notified in the Indian Trade Classification (Harmonised System)

List of Industries in which Industrial Licensing will be compulsory

1. Coal and Lignite.
2. Petroleum (other than crude) and its distillation products.
3. Distillation and brewing of alcoholic drinks.
4. Sugar.
5. Animal fats and oils.
6. Cigars and cigarettes of tobacco and manufactured tobacco substitutes.
7. Asbestos and asbestos-based products.
8. Plywood, decorative veneers, and other wood based products such as particle board, medium density fiber board, and blackboard.
9. Raw hides and skins, leather, chamois leather and patent leather.
10. Tanned or dressed fur skins.
11. Motorcars.
12. Paper and Newsprint except bagasse-based units.
13. Electronic aerospace and defense equipment; All types.
14. Industrial explosives, including detonating fuse, safety fuse, gunpowder, nitrocellulose and matches.
15. Hazardous chemicals.

16. Drugs and Pharmaceuticals (according to Drug Policy).
17. Entertainment electronics (YCRs, colour TYs, C.D. Players, Tape Recorders).
18. White Goods (Domestic Refrigerators, Domestic Dish washing machines, Programmable Domestic Washing Machines, Microwave ovens, Air conditioners).

Note: The compulsory licensing provisions would not apply in respect of the small-scale units taking up the manufacture of any of the above items reserved for exclusive manufacture in small scale sector.

B. Foreign Investment

1. Approval will be given for direct foreign investment up to 51 per cent foreign equity in high priority industries (Annex ill). There shall be no bottlenecks of any kind in this process. Such clearance will be available if foreign equity covers the foreign exchange requirement for imported capital goods. C nsequential amendments to the Foreign Exchange Regulation Act (1973) shall be carried out.
2. While the import of components, raw materials and intermediate goods, and payment of know-how fees and royalties will be governed by the general policy applicable to other domestic units, the payment of dividends would be monitored through the Reserve Bank of India so as to ensure that outflows on account of dividend payments are balanced by export earnings over a period of time.
3. Other foreign equity proposals, including proposals involving 51% foreign equity which do not meet the criteria under (1) above, will continue to need prior clearance. Foreign equity proposals need not necessarily be accompanied by foreign technology agreements.
4. To provide access to international markets, majority foreign equity holding up to 51% equity will be allowed for trading companies primarily engaged in export activities. While the thrust would be on export activities, such trading houses shall be at par with domestic trading and export houses in accordance with the Import Export Policy.
5. A special Empowered Board would be constituted to negotiate with a number of large international firms and approve direct

foreign investment in select areas. This would be a special programme to attract substantial investment that would provide access to high technology and world markets. The investment programmes of such firms would be considered in totality, free from predetermined parameters or procedures.

C. Foreign Technology Agreements

1. Automatic permission will be given for foreign technology agreements in high priority industries (Annex III) up to a lump sum payment of Rs. 1 crore, 5% royalty for domestic sales and 8% for exports, subject to total payment of 8% of sales over a10 year period from date of agreement or 7 years from commencement of production. The prescribed royalty rates are net of taxes and will be calculated according to standard procedures.
2. In respect of industries other than those in Annex III, automatic permission will be given subject to the same guidelines as above if no free foreign exchange is required for any payments.
3. All other proposals will need specific approval under the general procedures in force.
4. No permission will be necessary for hiring of foreign technicians, foreign testing of indigenously developed technologies. Payment may be made from blanket permits or free foreign exchange according to RBI guidelines.

D. Public Sector Policy

1. Portfolio of public sector investments will be reviewed with a view to focus the public sector on strategic, high-tech and essential infrastructure. Whereas some reservation for the public sector is being retained there would be no bar for areas of exclusivity to be opened up to the private sector selectively. Similarly the public sector will also be allowed entry in areas not reserved for it.
2. Public enterprises which are chronically sick and which are unlikely to be turned around will, for the formulation of revival/ rehabilitation schemes, be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar high level institutions created for the purpose. A social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages.

3. In order to raise resources and encourage wider public participation, a part of the government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers.
4. Boards of public sector companies would be made more professional and given greater powers.
5. There will be a greater thrust on performance improvement through the Memorandum of Understanding (MoU) systems through which managements would be granted greater autonomy and will be held accountable. Technical expertise on the part of the Government would be upgraded to make the MoU negotiations and implementation more effective.
6. To facilitate a fuller discussion on performance, the MoU signed between Government and the public enterprise would be placed in Parliament. While focusing on major management issues, this would also help place matters on day-to-day operations of public enterprises in their correct perspective.

Proposed List of Industries to be reserved for the Public Sector

- Arms and ammunition and allied items of defence equipment, Defence aircraft and warships.
- Atomic Energy.
- Coal and lignite.
- Mineral oils.
- Mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond.
- Mining of copper, lead, zinc, tin, molybdenum and wolfram.
- Minerals specified in the Schedule to the Atomic Energy (Control of Production and Use) Order, 1953.
- Railway transport.

E. MRTP Act

1. The MRTP act will be amended to remove the threshold limits of assets in respect of MRTP companies and dominant undertakings. This eliminates the requirement of prior approval of central government for establishment of new undertakings, expansion of undertakings, mergers, amalgamation and takeover and appointment of directors under circumstances.

2. Emphasis will placed on controlling and regulating monopolistic, restrictive and unfair trade practices. Simultaneously, the newly empowered MRTP commission will be authorized to initiate investigations on complaints received from individual consumers or classes of consumers in regard to monopolistic, restrictive and unfair trade practices.

3. Necessary comprehensive amendments will be made in the MRTP Act in this regard and for enabling the MRTP commission to exercise compensatory powers.

FURTHER REFORMS INITIATIVES IN INDUSTRIAL POLICY

Important initiative taken by the Government of India with regard to industrial statement, 1991 are as follows:

1. A substantial modification of Industrial Licensing Policy was deemed necessary with a view to ease restraints on capacity creation; respond to emerging domestic and global opportunities by improving productivity. Accordingly, the Policy Statement included the abolition of industrial licencing for most industries, barring a handful of industries for reasons of security and strategic concerns, social and environmental issues. Compulsory licencing was required only in respect of 18 industries. These included, inter alia, coal and lignite, distillation and brewing of alcoholic drinks, cigars and cigarettes, drugs and pharmaceuticals, white goods, hazardous chemicals. The small scale sector continued to be reserved. Norms for setting up industries (except for industries subject to compulsory licencing) in cities with more than one million populations were further liberalized.

2. Recognising the complementarily of domestic and foreign investment, foreign direct investment was accorded a significant role in policy announcements of1991. Foreign direct investment (FDI) up to 51 per cent foreign equity in high priority industries requiring large investments and advanced technology was permitted. Foreign equity up to 51 per cent was also allowed in trading companies primarily engaged in export activities. These important initiatives were expected to provide a boost to investment besides enabling access to high technology and marketing expertise of foreign companies.

3. With a view to inject technological dynamism in the Indian industry, the government provided automatic approval for technological agreements related to high priority industries and eased procedures for hiring of foreign technical expertise.

4. Major initiatives towards restructuring of public sector units (PSUs) were initiated in view of their low productivity, over staffing, lack of technological upgradation and low rate of return. In order to raise resources and ensure wider public participation PSUs, it was decided to offer its shareholding stake to mutual funds, financial institutions, general public and workers. Similarly, in order to revive and rehabilitate chronically sick PSUs, it was decided to refer them to the Board for Industrial and Financial Reconstruction (BIFR). The Policy also provided for greater managerial autonomy to the Boards of PSUs.

5. The Industrial Policy Statement of 1991 recognized that the Government's interventions in investment decisions of large companies through MRTP Act had proved to be deleterious for industrial growth. Accordingly, pre-entry scrutiny of investment decisions of MRTP companies was abolished. The thrust of policy was more on controlling unfair and restrictive trade practices. The provisions restricting mergers, amalgamations and takeovers were also repealed.

Present Policy Measures: Some of the important policy measures announced and procedural simplifications undertaken to pursue the above objectives are as under:

1. Liberalization of Industrial Licencing Policy: The list of items covered under compulsory licencing under the Industries (Development & Regulation) Act, 1951 is reviewed on an ongoing basis. Drugs and Pharmaceutical have been removed from the list of items requiring compulsory licencing vide Notification No. S.O.1386 (E) dated 23.9.2005. At present, only five industries are under compulsory licencing mainly on account of environmental, safety and strategic considerations. They are:

- Distillation and brewing of alcoholic drinks.
- Cigars and cigarettes of tobacco and manufactured tobacco substitutes.
- Electronic Aerospace and defence equipments all types.

- Industrial explosives including detonating fuses, safety fuses, gunpowder, nitrocellulose and matches.
- Specified Hazardous chemicals i.e. (a) Hydrocyanic acid and its erivatives, (b) Phosgene and its derivatives and (c) Isocyanates & diisocyanates of hydrocarbon, not elsewhere specified (example Methyl isocyanate).

Similarly, from 8 industries reserved for the public sector in 1991, there are only following 3 industries reserved for public sector at present:

- Atomic energy.
- The substances specified in the schedule to the notification of the Government of India in the Department of Atomic Energy number S.O. 212(E), dated the 15th March, 1995.
- Railway transport.

2. **Industrial Entrepreneurs' Memorandum (IEM)**: Industries not covered under compulsory licencing are to file an Industrial Entrepreneurs' Memorandum (IEM) with the Secretariat for Industrial Assistance (SIA). No industrial approval is required for such exempted industries. Amendments are also allowed to IEMs filed w.e.f. 1.7.1998.

3. **Liberalization of the Locational Policy**: A significant development, discarding regulatory measures, has been a recent decision of the Government to do away with the locational stipulation in setting up of industries in cities with population of one million and above as per 1991 census. Entrepreneurs are now free to select the location for setting up industry. Necessary amendments to this effect have been made in Notification No. 477(E) dated 25.7.1991 with the issue of Notification No. 2054(E) dated 14.8.2008, issued under the provisions of the IDRA 1951. However Zoning and land use regulations as well as environmental legislations continue to regulate industrial locations.

4. **Policy for Small Scale Industries:** Though reservation of items exclusively for the Small scale sector forms an important focus of the industrial policy, review for dereservation of such items is also undertaken by the Government at periodic intervals, in order to enhance competitiveness of such products in the domestic/ global markets. Review of reserved items is thus a continuous process. During the last 5 years, more than 600 items have been dereserved.

At present 21 items are reserved for manufacture in the small scale sector. All undertakings other than the small scale industrial undertakings engaged in the manufacture of items reserved for manufacture in the small scale sector are required to obtain an industrial licence and undertake an export obligation of 5096 of the annual production. This condition of licencing is, however, not applicable to those undertakings operating under 100% Export oriented Undertakings Scheme, the Export Processing Zone (EPZ) or the Special Economic Zone Schemes (SEZs).

At present, the SSI is defined under the Micro, Small & Medium Enterprises (MSMED) Act, 2006 which has categorized SSEs (Small scale enterprises) as having the value of investment in plant machinery between Rs. 2 crore and Rs. 5 crore. In tune with the provisions of the MSMED Act, 2006 and policy of liberalization, the provision of restricting equity participation by non-SSI undertakings in SSI undertakings upto 24% has been removed by way of rescinding Notification No. S.O. 857(E) dated 10.12.1997 vide Notification No. S.O. 563(E) dated 27.2.2009.

5. **Non-Resident Indians Scheme:** The general policy and facilities for Foreign Direct Investment as available to foreign investors/ company are fully applicable to NRIs as well. In addition, Government has extended some concessions specially for NRIs and overseas corporate bodies having more than 60% stake by the NRIs. These inter alia includes (i) NRI/OCB investment in the real estate and housing sectors up to 100% and (ii) NRI/ OCB investment in domestic airlines sector up to 100%. NRI/OCBs are also allowed to invest up to 100% equity on non-repatriation basis in all activities except for a small negative list. Apart from this, NRI/ OCBs are also allowed to invest on repatriation/non-repatriation under the portfolio investment scheme.

6. Electronic Hardware Technology Park (EHTP)/ Software Technology Park (STP) Scheme: For building up strong electronics industry and with a view to enhancing export, two schemes viz. Electronic Hardware Technology Park (EHTP) and Software Technology Park (STP) are in operation. Under EHTP /STP scheme, the inputs are allowed to be procured free of duties.

The Directors of STPs have powers to approved fresh STP /EHTP proposals and also grand post-approval amendment in respect of EHTP /STP projects as have been given to the Development Commissioners of Export Processing Zones in the case of Export Oriented Units. All other application for setting up projects under these schemes, are considered by the Inter Ministerial Standing Committee (IMSC) Chaired by Secretary (Information Technology)

7. Policy for Foreign Direct Investment (FDI): Promotion of foreign direct investment forms an integral part of India's economic policies. The role of foreign direct investment in accelerating economic growth is by way of infusion of capital, technology and modern management practices. The Department has put in place a liberal and transparent foreign investment regime where most activities are opened to foreign investment on automatic route without any limit on the extent of foreign ownership.

The latest updates related to FDI norms are also an integrated with objectives set for growth and liberalization by India's new industrial policy. Foreign Direct Investment (FDI) in India is subject to certain Rules and Regulations and is subject to predefined limits ('Limits') in various sectors which range from 20% to 100%. There are also some sectors in which FDI is prohibited. The FDI Limits are reviewed by the Government from time to time and as and when the need is felt and FDI is allowed in new sectors where the limits of investment in the existing sectors are modified accordingly. In order to revise the FDI Limits to attract more foreign investment in India, the Union Government constituted a committee named, Arvind Mayaram Committee headed by the Economic Affairs Secretary. On, 16th July, 2013, the Government approved the recommendations given by the Arvind Mayaram Committee to increase FDI limits in 12 sectors out of the proposed 20 sectors, including crucial ones such as defense and telecom.

Some of the important changes made in the Existing FDI Limits are provided below:

- FDI Limit in Telecom Sector is increased from 74 per cent to 100 percent, out of which up to 49 per cent will be allowed under automatic route and the remaining through Foreign Investment Promotion Board (FIPB) approval. A similar dispensation would be allowed for asset reconstruction companies and tea plantations.

- FDI in 4 sectors i.e. gas refineries, commodity exchanges, power trading and stock exchanges have been allowed via the automatic route. In case of PSU oil refineries, commodity exchanges, power exchanges, stock exchanges and clearing corporations, FDI will be allowed up to 49 per cent under automatic route as against current routing of the investment through FIPB.
- FDI in single brand retail is to be allowed up to 49 percent under the automatic route and beyond that shall be through FIPB.
- In credit information firms, 74 per cent FDI under automatic route will be allowed.
- In respect of courier services, FDI of up to 100 per cent will be allowed under automatic route. Earlier, similar amount of investment was allowed through FIPB route.
- FDI cap in defense sector remained unchanged at 26%, however higher limits of foreign investment in state-of-the-art manufacturing would be considered by the Cabinet Committee on Security (CCS). Technically, the decision leaves it open for CCS to even allow 100% foreign investment in what the defence ministry will define as "state-of-the-art" segments with safeguards built in to ensure that the technology and equipment are not shared with other countries.
- In the contentious insurance sector, it was decided to raise the sectoral FDI cap from 26 per cent to 49 per cent under automatic route under which companies investing do not require prior government approval. A Bill to raise FDI cap in this sector is pending in the Rajya Sabha.

Some of the sectors in which FDI limits were expected to be increased but did not were civil aviation, airport, media, multi-brand retail and brown field (existing firms) pharmaceuticals. Tabular representations of the key changes proposed under the FDI Limits are as follows:

Sector/Activity	Before the proposal		After the proposal	
	% of FDI /Equity	Entry Route	% of FDI / Equity	Entry Route
Defense Sector	26%	Government Route	No Change	Higher limits of foreign

				investment in "stateof-the-art" manufac-turing would be considered by the CCS
Insurance Sector Telecom Services Automatic up to	26% 74%	Automatic Route 49% Government route beyond 49% and up to 74%	49% 100%	Automatic up to 49% Govern ment route beyond 49% and up to 100%
Tea Plantation	100%	Government Route	100%	Automatic up to 49%Govern ment route beyond 49% & up to 100%
Asset Reconstruc tion Company	- 74% of paid-up capital of ARC (FDI +FII)	Government Route	100%	Automatic up to 49% Gover -nment route beyond 49% & upto 100%
Petroleum & natural Gas Commodity Exchanges	49% 49% (FDI & FII) + [Investment by Registered FII under Portfolio Investment Scheme (PIS) will be limited to 23% and	Government Route Government Route (For FDI)	49% 49%	Automatic Route Automatic Route

	Investment under FDI Scheme limited to 26%]			
Power Exchanges	49% (FDI & FII) FDI limit of 26 per cent and an FII limit of 23 per cent of the paidup capital	Government Route (For FDI)	49%	Automatic Route
Stock Exchanges/ Clearing Corporations	49% (FDI &FII) FDI limit of 26 per cent and an FII limit of 23 per cent of the paid-up capital	Government Route(For FDI)	49%	Automatic Route
Credit Information Companies	49% (FDI & FII)	Government Route	74%	Automatic Route
Courier Services	100%	Government Route	100%	Automatic Route
Single Brand product retail trading	100%	Government Route	100%	Automatic up to 49% Government route beyond 49% & up to 100%

6.4 NEW INDUSTRIAL LICENCING POLICY 1991

A licence is an approved letter issued by the government to an industrial undertaking for the production of specified goods. Industrial Licenses are regulated under the Industries (Development & Regulation)

Act, 1951. It was enacted for the successful operation of industrial policy in the country. Industrial Licence is granted by the Government of India in the Secretariat for Industrial Approvals (SIA) on the recommendation of the Licensing Committee. Licencing system is an important and efficient part of this Act. The Act empowered the central government to regulate the establishment and working of industrial undertaking in the country.

Name of the industrial undertaking, status, product to be manufactured, Production capacity and other conditions are included in the licence. Industrial licensing policy and procedure have also been liberalized from time to time. Over the years, keeping in view the changing, industrial scene in the country, the policy has undergone modifications. A full realization of the industrial potential of the country calls for a continuation of this process of change.

In order to achieve the objectives of the strategy for the industrial sector for 2010s and beyond it is necessary to make a number of changes in the system of industrial approvals. Major policy initiatives and procedural reforms are called for in order to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and challenges. The bedrock of any such package of measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgment. The attainment of technological dynamism and international competitiveness requires that enterprises must be enabled to swiftly respond to fast changing external conditions that have become characteristic of today's industrial world. Government policy and procedures must be geared to assist entrepreneurs in their efforts. This can be done only if the roles played by the government were to be changed from that of only exercising control to one of providing help and guidance by making essential procedures fully transparent and by eliminating delays.

The winds of change are quite important. The industrial licencing system has been gradually moving away from the concept of capacity licencing. The system of reservations for public sector undertakings has been evolving towards an ethos of greater flexibility and private sector enterprise has been gradually allowed to enter into many of these areas on a case by case basis. Further impetus must be provided to these changes which alone can push this country towards the attainment of its entrepreneurial and industrial potential. This calls for bold and imaginative decisions designed to remove restraints on capacity creation,

while at the same, ensuring that overriding national interests are not jeopardised.

In the above context, industrial licencing will henceforth be abolished for all industries, except those specified, irrespective of levels of investment. These specified industries (Annex-II), will continue to be subject to compulsory licencing for reasons related to security and strategic concerns, social reasons, problems related to safety and overriding environmental issues, manufacture of products of hazardous nature and articles of elitist consumption. The exemption from licencing will be particularly helpful to the many dynamic small and medium entrepreneurs who have been unnecessarily hampered by the licencing system. As a whole the Indian economy will benefit by becoming more competitive, more efficient and modern and will take its rightful place in the world of industrial progress. With progressive liberalization and deregulation of the economy the requirement of industrial licencing have been substantially reduced.

INDUSTRIAL LICENCING POLICY -1991

Industrial Licencing Policy is a part of the Industrial Policy Statement 1991. Salient features of the policy are as follows:

1. Industrial licensing will be abolished for all projects except for a short list of industries related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons, and items of elitist consumption (list attached as Annex II). Industries reserved for the small scale sector will continue to be so reserved.
2. Areas where security and strategic concerns predominate will continue to be reserved for the public sector (list attached as Annex I).
3. In projects where imported capital goods are required, automatic clearance will be given:
   (a) in cases where foreign exchange availability is ensured through foreign equity, or
   (b) if the CIF value of imported capital goods required is less than 25 % of total value (net of taxes) of plant and equipment, up to a maximum value of Rs.2 crore. In view of the current difficult foreign exchange situation, this scheme (i.e. (iii) b) will come into force from April, 1992.

In the other cases, imports of capital goods will require clearance from the Secretariat for Industrial Approvals (SIA) in the Department of Industrial Development according to availability of foreign exchange resources.

4. In locations other than cities of more than 1 million populations, there will be no requirement of obtaining industrial approvals from the Central Government except for industries subject to compulsory licencing. In respect of cities with population greater than 1 million, industries other than those of a non polluting nature such as electronics computer software and printing will be located outside 25 kms. of the periphery, except in prior designated industrial areas. A flexible location policy would be adopted in respect of such cities (with population greater than 1 million) which require industrial re-generation. Zoning and Land Use Regulation and Environmental Legislation will continue to regulate industrial locations. Appropriate incentives and the design of investments in infrastructure development will be used to promote the dispersal of industry particularly to rural and backward areas and to reduce congestion in cities.

5. The system of phased manufacturing programmes run on an administrative case by case basis will be applicable to new projects. Existing projects with such programmes will continue to be governed by them.

6. Existing units will be provided a new broad banding facility to enable them to produce any article without additional investment.

7. The exemption from licencing will apply to all substantial expansions of existing units.

8. The mandatory convertibility clause will no longer be applicable for term loans from the financial institutions for new projects.

Procedural consequences

9. All existing registration schemes (Delicensed Registration, Exempted Industries Registration, DGTD registration) will be abolished.

10. Entrepreneurs will henceforth only be required to file an information memorandum on new projects and substantial expansions.

11. The lists notified in the Indian Trade Classification (Harmonised System).

List of Industries in which Industrial Licencing will be compulsory

1. Coal and Lignite.
2. Petroleum (other than crude) and its distillation products.
3. Distillation and brewing of alcoholic drinks.
4. Sugar.
5. Animal fats and oils.
6. Cigars and cigarettes of tobacco and manufactured tobacco substitutes.
7. Asbestos and asbestos-based products.
8. Plywood, decorative veneers, and other wood based products such as particle board, medium density fiber board, and blackboard.
9. Raw hides and skins, leather, chamois leather and patent leather.
10. Tanned or dressed fur skins.
11. Motorcars.
12. Paper and Newsprint except bagasse-based units.
13. Electronic aerospace and defense equipment; All types.
14. Industrial explosives, including detonating fuse, safety fuse, gunpowder, nitrocellulose and matches.
15. Hazardous chemicals.
16. Drugs and Pharmaceuticals (according to Drug Policy).
17. Entertainment electronics (YCRs, colour TYs, C.D. Players, Tape Recorders).
18. White Goods (Domestic Refrigerators, Domestic Dish washing machines, Programmable Domestic Washing Machines, Microwave ovens, Air conditioners).

Note: The compulsory licensing provisions would not apply in respect of the small-scale units taking up the manufacture of any of the above items reserved for exclusive manufacture in small scale sector.

Present Policy Measures: Some of the important policy measures announced and procedural simplifications undertaken to pursue the above objectives are as under:

The list of items covered under compulsory licencing under the Industries (Development & Regulation) Act, 1951 is reviewed on an ongoing basis. Drugs and Pharmaceutical have been removed from the list of items requiring compulsory licencing vide Notification No.

S.O.1386 (E) dated 23.9.2005. At present, only five industries are under compulsory licencing mainly on account of environmental, safety and strategic considerations. They are:

- Distillation and brewing of alcoholic drinks.
- Cigars and cigarettes of tobacco and manufactured tobacco substitutes.
- Electronic Aerospace and defence equipment: all types.
- Industrial explosives including detonating fuses, safety fuses, gunpowder, nitrocellulose and matches.
- Specified Hazardous chemicals i.e. (a) Hydrocyanic acid and its erivatives, (b) Phosgene and its derivatives and (c) Isocyanates & diisocyanates of hydrocarbon, not elsewhere specified (example Methyl isocyanate).

Similarly, from 8 industries reserved for the public sector in 1991, there are only following 3 industries reserved for public sector at present:

- Atomic energy.
- The substances specified in the schedule to the notification of the Government of India in the Department of Atomic Energy number S.O. 212(E), dated the 15th March, 1995.
- Railway transport.

If private entrepreneurs are interested to establish their units in these three areas, they have to seek licence or approval from the Government of India.

In the new industrial policy, 1991 the Government has prepared a list of industries (Schedule II) for which industrial licencing is compulsory. For setting up a unit for the manufacture of any item listed in Schedule II, all entrepreneurs have to necessarily obtain an industrial licence irrespective of the category to which they belong and the investments involved.

SEZs/EPZs/EOUs are exempted from industrial licencing for projects manufacturing items reserved for Small Scale Industries.

Aspects of Licencing Policy: Important aspects of licencing policy are as follows:

1. Small-Scale Sector: An industrial undertaking is defined as a small-scale unit if the capital investment in plant and machinery does not exceed Rs 10 million. Small-scale units can get registered with the Directorate of

Industries/District Industries Centre of the State Government. Such units can manufacture any item, and are also free from locational restrictions. The Government has reserved certain items for exclusive manufacture in the small-scale sector. Manufacture of items reserved for small-scale sector. Non small-scale units can manufacture items reserved for the small-scale sector only after obtaining an industrial licence. In such cases, the non-small scale unit is required to undertake an obligation to export 50 per cent of the production of SSI reserved items.

2. **Locational Restrictions**: Industrial undertakings are free to select the location of their projects. Industrial Licence is required if the proposed location is within 25 KM of the standard Urban Area limits of 23 cities having population of 1 million as per 1991 census. These cities are Urban area limits of Greater Mumbai, Kolkata, Delhi, Chennai, Hyderabad, Bangalore, Ahmedabad, Pune, Kanpur, Nagpur, Lucknow, Surat, Jaipur, Kochi, Coimbatore, Vadodara, Indore, Patna, Madurai, Bhopal, Visakhapatnam, Varanasi and Municipal Corporation limits of Ludhiana. The Locational restriction does not apply:

1. If the unit were to be located in an area designated as an "industrial area" before the 25th July, 1991
2. In the case of Electronics, Computer software and Printing and any other industry, which may be notified in future as "non-polluting industry"?
3. The location of industrial units is subject to applicable local zoning and land use regulations and environmental regulations.

PROCEDURE FOR OBTAINING INDUSTRIAL LICENCE

Industrial License is granted by the Secretariat for Industrial Assistance (SIA) on the recommendation of the Licencing, Committee. Application in the prescribed form (Form FC-IL) accompanied with a crossed demand draft of Rs. 2500 may be submitted to the PR&C section in SIA. Decisions are usually taken within 4-6 weeks of filing the application.

3. Policy for Industries exempt from licencing - IEM: Industrial undertakings exempt from industrial licence are only required to file an Industrial Entrepreneur Memoranda (IEM) in Part 'A', in the prescribed format (Form IEM).

PROCEDURE FOR IEM

The Application in the prescribed form (Form IEM) can be filed with the PR&C section in SIA either in person or by post. The IEM should be submitted along with a crossed demand draft of Rs. 1000 for up to 10 items proposed to be manufactured for more than 10 items; an additional fee of Rs. 250 for up to 10 additional items needs to be paid. On filing the IEM, an acknowledgement containing the SIA Registration Number, for future reference, is issued. In case IEM is sent by post, the acknowledgement is sent by post & no further approval is required.

An IEM would stand cancelled if the proposal requires compulsory license. Upon commencement of commercial production, Industrial undertakings need to file information in Part 'B' of the IEM to PR&C Section in SIA. No fee is to be paid for filing Part B. All industrial undertakings whether or not exempt from compulsory industrial licencing, are statutorily required to submit monthly production return in the prescribed proforma every month. This should reach the Industrial Statistics Unit (ISU) of the Department positively by the 10th of the following month.

4. Carry on Business (COB) Licence: Small-scale units by virtue of their natural growth may exceed the investment limit prescribed for small-scale units. In such cases these units need to obtain a Carry-on-Business (COB) Licence based on the best production in the preceding three years. No export obligation is fixed on the capacity for which the COB licence is granted. However, on further expansion of its capacity beyond the capacity included in COB licence, the unit would need to obtain an industrial licence.

5. Environmental Clearances : Entrepreneurs are required to obtain Statutory clearances relating to Pollution Control and Environment as may be necessary, for setting up an industrial project for 31 categories of industries in terms of Notification S.O. 60(E) dated 27.1.1994 as amended from time to time, issued by the Ministry of Environment & Forests under The Environment (Protection) Act, 1986. This list includes petrochemical complexes, petroleum refineries, cement, thermal power plants, bulk drugs, fertilizers, dyes, paper, etc. However, if investment in the project is less than Rs. 1 billion, such Environmental clearance is not necessary, except in cases of pesticides, bulk drugs and pharmaceuticals, asbestos and asbestos products, integrated paint complexes, mining projects, tourism projects of certain parameters, tarred roads in Himalayan

areas, distilleries, dyes, foundries and electroplating industries. Setting up industries in certain locations considered ecologically fragile (e.g. Aravalli Range, coastal areas, Doon valley, Dahanu, etc.) are guided by separate guidelines issued by the Ministry of Environment and Forests.

Status of Industrial Licencing Policy & Procedure-1991-2010

The Government's liberalization and economic reforms programme aims at rapid and substantial economic growth, and integration with the global economy in a harmonized manner. The industrial policy reforms have reduced the industrial licensing requirements, removed restrictions on investment and expansion, and facilitated easy access to foreign technology and foreign direct investment.

LICENCING POLICY:

Under the Industries (Development & Regulation) Act, 1951, an industrial licence is required respect of the following:

- Items of manufacture falling under the list of compulsory licencing (only 5 industries are in the list).
- If a non-SSI unit intends to manufacture items reserved exclusively for the Small Scale Sector.
- In addition certain industries are reserved exclusively for the Public Sector (presently Atomic Energy and Railway Transport come under this category).

With progressive delicensing of industries, only 5 industries have been retained under compulsory licencing under the Industries (D&R) Act, 1951 viz.:

1. Distillation and brewing of alcoholic drinks;
2. Cigars and cigarettes of tobacco and manufactured tobacco substitutes;
3. Electronic aerospace and Defence equipment: all types;
4. Industrial explosives including detonating fuses, Safety Fuses, gunpowder, nitrocellulose and matches;
5. Hazardous chemicals: viz: (a) Hydrocyanic acid and its Derivatives; (b) Phosgene andit derivatives; (c) Isocyanates and diisocyanates of hydrocarbon, not elsewhere specified (example: Methyl Isocyanate).

At present there are 21 items which are exclusively reserved for manufacture in the small scale sector (SSI). Any non-SSI unit desirous of manufacturing these items needs an industrial licence which is issued with an obligation to export 50% of annual production.

LICENSING PROCEDURE

Direct Industrial Licences are granted by the Government, against applications except for those items which are exclusively reserved for the small scale sector, since November 2003. For cases involving SSI items, initially a Letter of Intent is issued to the applicant subject to certain conditions like obtaining pollution clearance. On fulfillment of conditions stipulated in the LOI, etc, Letter of Intent is converted into an Industrial Licence.

STATUS OF INVESTMENT IN LETTERS OF INTENT/INDUSTRIAL LICENCE ISSUED

During the period August 1991 to March 2010, 4451 Letters of Intent and Direct Industrial Licences have been issued with proposed investment of Rs.1,30,709 crore. During 2009-10 however, no LOI has been issued.

DELICENCED SECTOR

All Industrial undertakings exempt from obtaining an industrial licence are required to file an Industrial Entrepreneur Memorandum (IEM). An acknowledgement is issued immediately on receipt of Part 'A' of the IEM form and no further approval is required, under the Industries (D&R) Act, 1951. Immediately after commencement of commercial production, Part 'B' of the IEM has to be filed by the entrepreneur.

Filing an IEM is primarily for the purpose of collecting data about the delicenced sector on investment, employment and type of industrial activity. It is also for the purpose of conducting a limited post facto scrutiny of the unit, mainly to preclude them from manufacturing a compulsory licencable/SSI reserved item.

Number of Proposed Investment Proposed IEMs filed during the period August 1991 to March 2010 was 81084 cr. The total investment proposed was Rs. 6210539 cr. Number of persons to be employed in these projects would be 17634369 cr.

Thus, there was a positive impact of liberalisation in licencing policy in the industrial environment of the country.

6.5 SUMMARY

The government of India is trying to give a strong and diversified industrial base and develop it as a major industrial nation of the world. The goals and objectives set out for the nation are quite important one. These include the rapid agricultural and industrial development of our country, rapid expansion of opportunities for gainful employment, progressive reduction of social and economic disparities, removal of poverty and attainment of self-reliance remain as valid today as at the time. Any industrial policy must contribute to the realization of these goals and objectives at an accelerated pace. The statement of industrial policy is the prevailing environment at the time of the formulation. The statements announced from time to time also represent a renewed initiative towards consolidating the gains of national reconstruction available during the course of its implementation.

The prime objective of liberalization is the base in deciding current five year plan or new industrial policy. This is why the delicencing is also emerging in many sectors. Many sectors are opened for FDI also.

6.6 SELF ASSESSMENT QUESTIONS

1. Discuss the new industrial policy of India.
2. Discuss the role of FDI for the development of Indian industries.

6.7 SUGGESTED READINGS

1. Cherrunilam Francis, Business Environment, Vikas Publishing House Private Limited, Place & Years
2. Bedi Suresh, Business Environment, Excel Books, Place & Years
3. Mittal Vivek, Business Environment, Excel Books, Place & Years
4. Shukla M. B., Fundamentals of Business Environment, Taxmann's Publication Private Limited, Place & Years
5. India 2012 & India 2013, Place & Years
6. Economic Survey of India 2012 & 2013, Place & Years
7. The Economic Times, Place & Years

UNIT 7 ECONOMIC POLICY

Structures:

7.0 Objectives

7.1 Introduction

7.2 New economic policy

7.2.1 Liberalization

7.2.2 Privatization

7.2.3 Globalization

7.3 Recession and its meaning

7.3.1 Emerging effects of recession on business

7.3.2 Causes of recession

7.3.3 Remedies of recession

7.4 Summary

7.5 Self Assessment Question

7.6 Suggested readings

7.0 Objectives

After studying this lesson, you will be able to:

- Understand the new economic policy and its perspectives
- Identify the emerging economic effects of recession on business & remedies

7.1 INTRODUCTION

The economic environment of business in India has been changing at a fast rate mainly due to the changes in the economic policies of the government and also due to global integration. At the time of independence, the Indian economy was basically agrarian with a weak industrial base. To speed up the industrial growth and solve various economic problems, the government took several steps like state ownership on certain categories of industries, economic planning, reduced role of private sector, etc. The Government adopted several control measures on the functioning of private sector enterprises. All these efforts results in a mixed response. There was growth in net national product, per capita income and development of capital goods

sector and infrastructure. But rate of industrial growth was slow, inflation increased and government faced a serious foreign ex- change crisis during eighties. As a result, the government of India introduced a radical change in economic policies in 1991. This policy abolished industrial licensing in most of the cases, allowed private participation in most industries; disinvestment was carried out in many public sector industrial enterprises and opened up the economy considerably. Foreign Investment Promotion Board was set up to channel foreign capital investment in India.

7.2 NEW ECONOMIC POLICY

Why new economic policy:

- The Indian currency, the rupee, was inconvertible and high tariffs and import licensing prevented foreign goods reaching the market.
- India also operated a system of central planning for the economy, in which firms required licenses to invest and develop
- Restriction on Private Investment
- Socialism
- Mixed Economy
- Internal debt liability increased to 53% of GDP.

Features of Indian economy:

- Integration with world economy with dismantling of tariff wall.
- Protection of foreign direct investment.
- Upgrading the technology of production.
- Financial stability.
- Outward looking policies.
- Deregulation of domestic market.
- Correcting the disequilibrium in foreign exchange market through demand reduction.
- Reform in trade policy
- Reduction in fiscal deficit
- Dismantling of barrier to free flow of capital.
- Depreciation of exchange rate.

Components of New Economic Policy:

- Exchange rate.

- Trade and industrial policy.
- Policies concerning the public sector.
- Financial sector.
- Capital market.

Outcome of new Economic policy:

- Liberalization
- Privatization
- Globalization

7.2.1 LIBERALIZATION

Liberalization refers to the process of eliminating unnecessary controls and restrictions on the smooth functioning of business enterprises. It includes:

- Abolishing industrial licensing requirement in most of the industries
- Freedom in deciding the scale of business activities
- Freedom in fixing prices of goods and services
- Simplifying the procedure for imports and exports
- Reduction in tax rates
- Simplified policies to attract foreign capital and technology to India

Through this liberalization process, Indian Economy has opened up and started interacting with the world in a big way. This has resulted in easy entry of foreign business organizations in India. This has further resulted in stiff competition and efficiency. Ultimately, liberalization has helped us in achieving a high growth rate, easy availability of goods at competitive rates, a healthy and flourishing stock market, high foreign exchange reserve, low inflation rate, strong rupee, good industrial relations, etc.

7.2.2 PRIVATIZATION

Privatization, which has become a universal trend, means transfer of ownership and/or management of an enterprise from the public sector to the private sector.

It also means the withdrawal of the state from an industry or sector, partially or fully. Another dimension of privatization is opening up of an industry that has been reserved for the public sector to the private sector.

Privatization is an inevitable historical reaction to the indiscriminate expansion of the state sector and the associated problems. Even in the 'communist' countries it became a vital measure of economic rejuvenation.

The objects are:

- To improve the performance of PSUs so as to lessen the financial burden on taxpayers
- To increase the size and dynamism of the private sector, distributing ownership more widely in the population at large
- To encourage and to facilitate private sector investments, from both domestic and foreign sources
- To generate revenues for the state
- To reduce the administrative burden on the state
- Launching and sustaining the transformation of the economy from a command to a market model

The important routes of privatisation are:

- Divestiture, or privatization of ownership, through the sales of equity
- Denationalization or re privatisation
- Contracting - under which government contracts out services to other organizations that produce and deliver them
- Franchising- authorizing the delivery of certain services in designated geographical areas- is common in utilities and urban transport
- Government withdrawing from the provision of certain goods and services leaving then wholly or partly to the private sector
- Privatization of management, using leases and management contracts
- Liquidation, which can be either formal or informal. Formal liquidation involves the closure of an enterprise and the sale of its assets. Under informal liquidation, a firm retains its legal status even though some or all of its operations may be suspended

The benefits of privatization are as follows:

- It reduces the fiscal burden of the state by relieving it of the losses of the SOEs and reducing the size of the bureaucracy

- Privatization of SOEs enables the government to mop up funds
- Privatization helps the state to trim the size of the administrative machinery
- It enables the government to concentrate more on the essential state

The functions of privatization are as follows:

- Privatization helps accelerate the pace of economic developments as it attracts more resources from the private sector for development
- It may result in better management of the enterprises

  Privatization may also encourage entrepreneurship
- Privatization may increase the number of workers and common man who are shareholders. This could make the enterprises subject to more public vigilance

Due to the policy reforms announced in 1991, the expansion of public sector has literally come to a halt and the private sector registered fast growth in the post liberalised period.

The issues of privatisation include:

- reduction in the number of industries reserved for the public and the introduction of selective competition in the reserved area
- disinvestment of shares of selected public sector industrial enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership in business
- improvement in performance through an MOU system by which managements are to be granted greater autonomy but held accountable for specified results
- In India, as a result of these steps, the post liberalisation phase has witnessed a massive expansion of the private sector business in India

7.2.3 GLOBALIZATION

India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market.

Foreign investment by Indian firms was very insignificant. With the new economic policy ushered in 1991, there has, however, been change. Globalization has in fact become a buzzword with Indian firms now and many are expanding their overseas business by different strategies.

Globalization is the process of becoming a part of some system that operates all over the world or in many countries.

Globalization may be defined as "the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology".

Globalization may be considered at two levels viz. at the macro level (i.e., globalization of the world economy) and at the micro level (i.e., globalization of the business and the firm). Globalization of the world economy is achieved, quite obviously, by globalizing the national economies. Globalization of the economies and globalization of business are very much interdependent.

Reasons for Globalisation:

- The rapid shrinking of time and distance across the globe thanks to faster communication, speedier transportation, growing financial flows and rapid technological changes
- The domestic markets are no longer adequate rich. It is necessary to search of international markets and to set up overseas production facilities
- Companies may choose for going international to find political stability, which is relatively good in other countries
- To get technology and managerial know-how
- Companies often set up overseas plants to reduce high transportation costs
- Some companies set up plants overseas so as to be close to their raw materials supply and to the markets for their finished products
- Other developments also contribute to the increasing international of business.

- The US, Canada and Mexico have signed the North American Free Trade agreement (NAFTA), which will remove all barriers to trade among these countries
- The creation of the World Trade Organization (WTO) is stimulating increased cross-border trade

The following are the features of the current phase of globalization:

New markets:

- Growing global markets in services – banking, insurance, transport.
- New financial markets - deregulated, globally linked, working around the clock, with action at a distance in real time, with new instruments such as derivatives.
- Deregulation of anti - trust laws and proliferation of mergers and acquisitions.
- Global consumer markets with global brands

New Rules and Norms:

- Market economic policies spreading around the world, with greater privatization and liberalization than in earlier decades
- Widespread adoption of democracy as the choice of political regime
- Human rights conventions and instruments building up in both coverage and number of signatories and growing awareness among people around the world
- Consensus goals and action agenda for development
- Conventions and agreements on the global environment – biodiversity, ozone layer, disposal of hazardous wastes, desertification, climate change
- Multilateral agreements in trade, taking on such new agendas as environmental and social conditions
- New multilateral agreements- for services, intellectual property, communications – more binding on national governments than any previous agreements
- The multilateral agreements on investment under debate

7.3 RECESSION AND ITS MEANING

Different economists define a "recession" term in different ways but in general they all agree that a recession is general slowdown in overall

economic activity, lasting long enough and universal in its character. In case of a recession economical decline spreads across all country, distinguishing it from structural crisis in separate industries. More over true economic recession can only be confirmed if it lasts for a period of two or more consecutive quarters in order to nullify seasonal effects. Due to globalization of modern business recession easily crosses national borders and strikes whole regions or World economy entirely.

A recession becomes visible through decline of all major macroeconomic indicators: GDP (Gross Domestic Product) growth slow down or goes negative; production, investment spending, household incomes and spending decline while bankruptcies and the unemployment rate rise.

Being a part of natural business cycle a reception inevitably follows any economic boom. Usually a normal business cycle consists of four successive phases: expansion, boom, recession and crisis. Each phase is important for transition of a cycle. Not only different social and economic contradictions gain momentum during a recession and crisis but also a basis for future growth is build. Over long-term period, the highs and lows of business cycle form the trend, or average, economic growth rate.

Numerous factors that may cause a recession could be divided in two large groups – internal (endogenous) and external (exogenous). The last one is represented by various force majeure obstacles of catastrophic nature: wars, revolutions, natural disasters. Economy of agricultural countries may be influenced by climatic changes, crop failure etc. Economists working in the neoclassical tradition also consider State regulations, labor unions acts, business monopolies and technological shocks as exogenous factors of a recession. In most cases external factors explain all crises prior to The Great Depression in 1930s. The longest and deepest depression of the 20th century happened during period of political stability and was caused by structural crisis in USA.

Internal causes of a reception could be resolved to accumulation of fundamental contradictions in an economical system. For example, Asian financial crisis in 1997-1998, which lead to global recession, was caused by overheating of private sector. Excessive investments in real-estate and production did not earn acceptable return. Large scale corporations used political leverage to create so called "cronyism"

where resource allocation is based on personal relationship between managers rather than risk/return assessment. As a result foreign investors made risk valuation adjustment; overloaded private debt coupled with capital outflow sparked currency crisis.

World financial crises in 2008 and current recession are also caused by internal factors. It was triggered by The United States housing bubble – extensive lending of American banks into high-risk "subprime" and adjustable rate mortgages resulted in default rates overgrowth and downfall of banking sector financial indicators. Defaults and losses on other loan types also increased significantly as the crisis expanded from the housing market to other parts of the economy. Bankruptcy of several high rated investment banks started panic on the inter-bank loan and stock markets. Rapid growth of interbank interest rates and international liquidity crisis made serious impact on emerging markets, especially Russia and Ukraine. Soon recession became global leading to GDP fall, heightened unemployment and economic hardship in many countries.

Adequate government regulation may significantly reduce negative outcome of a recession. Experience of several last years is carefully examined by international organizations and institutes. As a result new approaches to elimination of existing global imbalances are formed. The OECD recommends to its member states to proceed with essential structure reforms in order to improve transparency and stability of financial system. Countries will also need to deal with too-big-to-fail problems associated with systemically important financial institutions, whose failures have exposed significant vulnerabilities in many countries during the crisis. Other tasks are to achieve better capital adequacy and liquidity standards; strengthen the quality of financial infrastructures; refining legal frameworks and to orient the investment inflows toward the longer term.

It is important to remember that any crisis is exposure of structural misfits and is intended to overcome them by the price of social and political shock. A recession shows "weak links" in economic system, destroys them and releases resources for new undertakings. Decline in business activity forces companies to follow strict financial discipline, abandon non-effective business practices, improve their productivity. It also opens a way for new ideas, technologies and business models.

Definition: Recession is a slowdown or a massive contraction in economic activities. A significant fall in spending generally leads to a recession. A temporary downturn in economic activity, usually indicated by two consecutive quarters of a falling GDP The official NBER definition of recession (which is used to date U.S. recessions) is: A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion. Expansion is the normal state of the economy; most recessions are brief and they have been rare in recent decades. The start and end dates are determined by the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER). It is a popular misconception that a recession is indicated simply by two consecutive quarters of declining GDP, which is true for most, but not all recession. NBER uses monthly data to date the start and ending months of recessions.

7.3.1 EMERGING EFFECTS OF RECESSION ON BUSINESS

Consumer Spending Might Go Down

As consumers tighten their purse strings and spend their money just on essential items, there could be a decrease in your sales, especially if you are dealing in non-essential items. Even if you do manage to maintain your sales, your profit margins could still come down. You might have to devise new and innovative methods to attract customers towards your business.

Competition Could Get Fierce

As the economic cycle enters into a recession, the competition will get fiercer since there will now be many competitors fighting over a smaller pie. But take heart, because this cycle will also result in your weaker competitors closing shop.

Your Business Will Become Unpredictable

The downside of this economic fluctuation is that your business will become unpredictable. At times, you will find that customers have vanished into thin air - while during other times, you might think that you experiencing a sales boom. It pays to have a cool and calm head during such fluctuating periods.

Interest Rates Might Come Down

During a recession, interest rates could come down; and in case you need to apply for a loan, then you may not be faced with high interest rates. The only problem is, since there will be a liquidity crunch in the monetary markets, you could have a tough time qualifying for a loan as lenders' qualifying standards go invariably higher.

You Could Get A Chance To Invest Outside Your Business.

A recession could induce the stock markets and property markets to fall drastically. This could offer you a chance to invest in stocks or property due to lower prices. And once the economy moves back into the boom cycle, then your investments will be worth quite a lot more.

Your Employees Could Demand Higher Salaries.

As inflation eats into the pockets of your employees, they could ask for higher salaries in order for them to maintain their lifestyles. You might then have to let go inefficient employees in order to maintain your payroll at the same level.

Falling Stocks and Slumping Dividends

As declining revenues show up on its quarterly earnings report, the manufacturer's stock price may decline. Dividends may also slump, or disappear entirely. Shareholders may become upset. They and the board of directors (B of D) may call for a new CEO and/or an entirely new senior management team. The manufacturer's advertising agency may be dumped and a new agency hired. The internal advertising and marketing departments may also face a personnel shakeup. When the manufacturer's stock falls and the dividends decline or stop, institutional investors who hold that stock may sell and reinvest the proceeds into better-performing stocks. This will further depress the company's stock price.

Credit Impairment and Bankruptcy

It is also impacted by the recession is the accounts receivables (AR). The customers of the company that owe it money may pay slowly, late, partially or not at all. Then, with reduced revenues, the affected company will pay its own bills more slowly, late, or in smaller increments than the original credit agreement required. Late or delinquent payments will reduce the valuation of the corporation's debt, bonds and ability to obtain financing. The company's ability to service its debt (pay interest on the money it has borrowed) may also be impaired, eventuating in defaults on

bonds and other debt, further damaging the firm's credit rating and preventing further borrowing.

Debt will have to be restructured and/or refinanced, meaning new terms will have to be agreed upon by creditors. If the company's debts cannot be serviced and cannot be repaid as agreed upon in the lending contract, then bankruptcy may ensue. The company will then be protected from its creditors as it undergoes reorganization, or it may go out of business completely.

Employee Lay-offs and Benefit Reductions

The business may cut employees, and more work will have to be done by fewer people. Productivity per employee may increase, but morale may suffer as hours become longer, work becomes harder, wage increases are stopped and fear of further layoffs persists. As the recession increases in severity and length, management and labor may meet and agree to mutual concessions, both to save the company and to save jobs. The concessions may include wage reductions and reduced benefits. If the company is a manufacturer, it may be forced to close plants and discontinue poorly performing brands.

Cuts to Quality of Goods and Services

Secondary aspects of the goods and services produced by the recession-impacted manufacturer may also suffer. In an attempt to further cut costs to improve its bottom line, the company may compromise the quality, and thus the desirability, of its products. This may manifest itself in a variety of ways and is a common reaction of many big businesses in a steep recession. Airlines, for example, may lower maintenance standards. They may install more seats per plane, further cramping the already squeezed-in passenger. Routes to marginally profitable or money-losing destinations may be cut, inconveniencing customers and damaging the economies of the cancelled destinations. Giant food purveyors may offer fewer products, for the same price, in the same size package in which the larger amount was previously sold. Quality may also be reduced. Coffee, for example, may be cut with lesser-quality beans, compromising flavor and driving away cost-conscious consumers with little brand loyalty who have noticed the change.

Reduced Consumer Access

As firms impacted by the recession spend less money on

advertising and marketing, big advertising agencies which bill millions of dollars per year will feel the squeeze. In turn, the decline in advertising expenditures will whittle away at the bottom lines of giant media companies in every division, be it print, broadcast or online. As the effects of a recession ripple through the economy, consumer confidence declines, perpetuating the recession as consumer spending drops.

7.3.2 CAUSES OF ECONOMIC RECESSION

Unemployment:

Unemployment is a serious problem. The numbers of unemployed people are increasing day by day. The high rates of unemployment people show depression every month. They don't have enough demand.

Borrower Start Defaulting

When borrowers are unable to pay back their loans on homes, vehicles, businesses and credit cards, then this could be another indication of a falling economy. This breaks the cycle of flow of money which results in recession.

Inflation

When prices of food, fuel and other utilities shoot up - and the government seems helpless to do anything - then it could be said that inflation is causing of a possible recession. Inflation is always in the root of recession in the developing countries.

Prices of Property and Stocks Come Down

When repossessed homes and stock prices come down in value, but nobody has the funds to buy them, then it can be truly said that the economy has been hit by a recession.

7.3.3 REMEDIES OF ECONOMIC RECESSION

Recessions Don't Last Forever

Recessions come and go and some are more severe and last longer than others. But history shows that recessions invariably end, and when they do, an economic recovery follows. What is required is an alternative model of the economic system and a fresh set of policy measures to bring it into existence. The neo-liberal model followed since 1991 has created economic, legal and administrative systems which have favoured a few 'billionaires' at the cost of ordinary urban workers and millions of farmers toiling on land in the countryside. Inequalities of the order that exist in India and the world cannot lead to sustainable development. The

unconscionable earnings in the luxury sectors like Bollywood and Cricket and the ostentatious style of living of a few cannot be allowed co-exist with the horrible conditions of slumdogs who have to live without minimum facilities like clean drinking water, sanitation and housing.

Inequalities in the field of education and health are also quite appalling. Private schools and colleges charging unconscionably high fees co-exist with substandard municipal schools which even the poor families do not want their children to attend. Public hospitals are in an appalling state while the luxury hospitals provide up-to-date medical treatment and facilities at a cost which only the rich can afford. The few other remedies are described as follows:

Promote the Exports

The government should promote export, trade and business process in order to reduce the deficit of acute and sharp balance of payment.

Reduce the Unemployment

The government should open new factories and industries at as many places as possible. Unemployment should be reduced at minimum level. It is necessary for the progress and prosperity of economical situation.

Reduce the Inflation

Increase in prices of foods, utilities and essential commodities must cause high depression for general public. The government should increase the production of different ways in order to stable the gap between the supply and demand.

Promote the Investors

The government should promote and appreciate the local and foreign investors in order to increase in investment and for the establishment of the financial position of the country.

Government of India has also adopted a lot of measures to avoid recession or downfall in economy. Some of the measures are reflected in its Foreign Trade policy for period 2009-2014. RBI as the main controller of the banks and capital, it also regulated the economy by different action plans. These are given as below:

New Foreign trade policy (2009-2014): Commerce and industry Minister Anand Sharma announced a no. of measures to get rid of recession in

its new foreign trade policy. Government has set a target of 15 % growth in its export in 2010-11.

- Government has increased duration of exemption of income tax by one year for export oriented units (EOU).
- Textile, leather and handicraft are the main areas to be focused as these are the most affected areas in recession.
- India is set to be the International Diamond center.
- The limit of ornaments and jewels which a company can take with it to exhibit in any international exhibition is up to 50 lac dollar which was earlier 20 lac dolor
- 26 new markets are included in 'Focus market Scheme'.

RBI plan of action: RBI has given the prescription for the growth of economy. This will ensure 6% and more of GDP. The main features of this plan:

- Reduce non plan expenditure.
- More liberal FDI policies to bring in technology and productivity.
- Introduce government funded schemes for potential entrepreneurs.
- Link petroleum product prices to international prices.
- Augument grain procurement for food security.
- CPI (urban) to be used for measuring inflation.

7.4 SUMMARY

The globalization of India has given rise to new opportunities but it has also brought with it new challenges and responsibilities. It means that the global economy can no longer be viewed from a spectator's standpoint. What happens there has large implications for India. Every time there is a major financial crisis anywhere in the world, there is need to take brace position. And, in turn, the rise and fall of India's growth rate has an impact on global growth and there is need for India to take this responsibility seriously. Recession is an opportunity to bring about a root-and-branch change in the economic policy and the economic system with the aim of not only eliminating the systemic defects in capitalism and the evils of insatiable greed and bubbles of prosperity which they gave rise to, but also by deliberately building public systems of education, health, transport, housing etc. free from corruption, entirely handled by

professionals and free from interference by self-serving politicians and parties and devising policies to support agriculture and promote agro-processing and village industries like handloom which provide employment to masses of people. 'Safety nets' attached to a basically iniquitous economic system will not do. The system itself needs to be made more equitable. Unfortunately neither the Congress nor the BJP nor the Left parties have taken the opportunity of the general elections to place before the people a comprehensive economic philosophy and policy measures and agenda of action to deal with the consequences of recession and other shortcomings of the present economic system. To maintain the budget and to improve the cash flows we should change our mindset and start budgeting our savings not our spending. Spend less than you earn, Debit not credit, Review expenditure heads and don't over speculate.

7.5 SELF ASSESSMENT QUESTIONS

1. Explain the new economic policy of India.
2. What do you mean by globalization, privatization and liberalization of economic policy?
3. What is the effect of recession on economy?
4. Discuss the role of RBI and Government in the time of recession.

7.6 SUGGESTED READINGS

1. Cherrunilam Francis, *Business Environment*, Vikas Publishing House Private Limited, Place & Years.
2. Bedi Suresh, *Business Environment*, Excel Books, Place & Years
3. Mittal Vivek, *Business Environment*, Excel Books, Place & Years
4. Shukla M. B., *Fundamentals of Business Environment*, Taxmann's Publication Private Limited, Place & Years
5. *India 2012 & India 2013*, Place & Years
6. *Economic Survey of India 2012 & 2013*, Place & Years
7. *The Economic Times*, Place & Years

Unit -8 LEGAL ENVIRONMENT

Structures:

8.0 Objectives

8.1 Introduction

8.2 Company regulatory legislation in India

8.3 EXIM Policy (2009-2014)

8.4 FEMA

8.5 Competition Law

8.6 Summary

8.7 Self Assessment Questions

8.8 Suggested readings

8.0 OBJECTIVES

After studying this lesson, you will be able to:

- Understand the legal environment and company regulatory legislation in India
- Understand the provisions made in latest exim policy for export and import
- Analyze the provisions of FEMA
- Learn the competition law and its impact on business

8.1 INTRODUCTION

The government, in every country, regulates the business according to its defined priorities. Legal system of a country is framed by the government. The laws which are passed by the government for business operation is called legal environment. In every country, the government regulates business activities. These regulations of government are considered as legal environment. In practice legal and regulatory goes hand in hand. The limits for business operations are decided by regulatory environment & this is also called legal environment. Legal environment in a country has a dominating position on all decisions of organization. As all business policies are highly influenced by government, the organization should have thorough knowledge of these policies because non-implementation of legal policies results in heavy fines, penalties &

punishment & therefore every organization must follow all these regulations.

8.2 COMPANY REGULATORY LEGISLATION IN INDIA

In India there are several Acts and legislations enacted by the Government of India for regulation of industries in the country. These enactments play a very important role in the country's overall progress and economic development. These legislations are amended from time to time in accordance with the changing circumstances and environment. The most important Act is the Companies Act, 1956 which relates to setting up and operation of companies in India. It empowers the Central Government to regulate the formation, financing, functioning and winding up of companies. It contains the mechanism regarding organisational, financial, and managerial and all the relevant aspects of a company. In order to provide the Central Government with the means to implement its industrial policies, several legislations have been enacted. The most important being the Industries (Development and Regulation) Act, 1951 (IDRA). The main objectives of the Act is to empower the Government to take necessary steps for the development of industries; to regulate the pattern and direction of industrial development; and to control the activities, performance and results of industrial undertakings in the public interest.

The bulk of the transactions in trade, commerce and industry are based on contracts. In India, the Indian Contract Act, 1872 is the governing legislation for contracts, which lays down the general principles relating to formation, performance and enforceability of contracts and the rules relating to certain special types of contracts like Indemnity and Guarantee; Bailment and Pledge; as well as Agency.

Another important aspect of legislations is the industrial relations, which involves various aspects of interactions between the employer and the employees; among the employees as well as between the employers. In such relations whenever there is a clash of interest, it may result in dissatisfaction for either of the parties involved and hence lead to industrial disputes or conflicts. The Industrial Disputes Act, 1947 is the main legislation for investigation and settlement of all industrial disputes. The Act enumerates the contingencies when a strike or lock-out can be lawfully resorted to, when they can be declared illegal

or unlawful, conditions for laying off, retrenching, discharging or dismissing a workman, circumstances under which an industrial unit can be closed down and several other matters related to industrial employees and employers. Trade unions are also an important part of an industrial set up. The legislation regulating these trade unions is the Indian Trade Unions Act, 1926. The Act deals with the registration of trade unions, their rights, their liabilities and responsibilities as well as ensures that their funds are utilised properly. It gives legal and corporate status to the registered trade unions. It also seeks to protect them from civil or criminal prosecution so that they could carry on their legitimate activities for the benefit of the working class. Employees are offered many protections by business laws in India, which is a member of the International Labor Organization. These include the Payment of Wages Act of 1936, the Industrial Employment Act of 1946, the Industrial Disputes Act of 1947, the Payment of Bonus Act of 1965 and the 1972 Payment of Gratuity Act.

In recent years business laws in India have expanded to include consumer protection. Consumer Dispute Redressal Forums at the local and national levels were mandated under the 1986 Consumer Protection Act. Foreign companies need to cognizant of the legal, financial and public relations impact of transgressing these laws. As a founding member of the World Trade Organization in 1995, business laws in India having to do with copyrights, patents, and trademarks were updated to meet the requirements or TRIPS, the trade related aspects of intellectual property rights. Indian companies and the government largely honor global IPs rights.

Following are some of the government Acts & government policies relating to legal or regulatory environment for business operations:-

- The Sale of Goods Act, 1930.
- Indian Companies Act, 1913.
- Income Tax Act, 1961.
- The Consumer Protection Act, 1986.
- The Weights & Measures Act, 1958.
- Environment Protection Act, 1986.
- Agricultural Policy.
- Industrial Policy.
- Foreign Investment Policy.

- Monetary Policy.
- The Factories Act, 1948.
- The Minimum Wages act, 1948.

8.3 EXIM POLICY

Indian EXIM Policy contains various policy related decisions taken by the government in the sphere of Foreign Trade, i.e., with respect to imports and exports from the country and more especially export promotion measures, policies and procedures related thereto. Trade Policy is prepared and announced by the Central Government (Ministry of Commerce). India's Export Import Policy also known as Foreign Trade Policy is regulated by the Foreign Trade Development and Regulation Act, 1992. DGFT (Director General of Foreign Trade) is the main governing body in matters related to Policy. The Foreign Trade (Development and Regulation) Act, in general, aims at developing export potential, improving export performance, encouraging foreign trade and creating favorable balance of payments position. The current policy covers the period 2009-2014. The Export Import Policy is updated every year on the 31st of March and the modifications, improvements and new schemes become effective from 1st April of every year. All types of changes or modifications related to the EXIM Policy is normally announced by the Union Minister of Commerce and Industry who coordinates with the Ministry of Finance, the Directorate General of Foreign Trade and its network of regional offices.

Export and import affect the balance of payment and the level of foreign exchange available with the central bank. Generally, to keep the effective control on the foreign trade is also necessary from the point of national autonomy and sovereignty. So, each and every country formulates its own foreign trade policy keeping in mind the position of the economy, political environment and economic necessities. With a view to continuously increasing percentage share of global trade and expanding employment opportunities, certain special initiatives have been identified for various sectors in the latest EXIM policy (Foreign Trade Policy) 2009-2014, which are as follows:

Higher Support for Market and Product Diversification

1. Incentive schemes under Chapter 3 have been expanded by way of addition of new products and markets.

2. 26 new markets have been added under Focus Market Scheme. These include 16 new markets in Latin America and 10 in Asia-Oceania.

3. The incentive available under Focus Market Scheme (FMS) has been raised from 2.5% to 3%.

4. The incentive available under Focus Product Scheme (FPS) has been raised from 1.25% to 2%.

5. A large number of products from various sectors have been included for benefits under FPS. These include, Engineering products (agricultural machinery, parts of trailers, sewing machines, hand tools, garden tools, musical instruments, clocks and watches, railway locomotives etc.), Plastic (value added products), Jute and Sisal products, Technical Textiles, Green Technology products (wind mills, wind turbines, electric operated vehicles etc.), Project goods, vegetable textiles and certain Electronic items.

6. Market Linked Focus Product Scheme (MLFPS) has been greatly expanded by inclusion of products classified under as many as 153 ITC (HS) Codes at 4 digit level. Some major products include; Pharmaceuticals, Synthetic textile fabrics, value added rubber products, value added plastic goods, textile made ups, knitted and crocheted fabrics, glass products, certain iron and steel products and certain articles of aluminum among others. Benefits to these products will be provided, if exports are made to 13 identified markets (Algeria, Egypt, Kenya, Nigeria, South Africa, Tanzania, Brazil, Mexico, Ukraine, Vietnam, Cambodia, Australia and New Zealand).

7. MLFPS benefits also extended for export to additional new markets for certain products. These products include auto components, motor cars, bicycle and its parts, and apparels among others.

8. A common simplified application form has been introduced for taking benefits under FPS, FMS, MLFPS and VKGUY.

9. Higher allocation for Market Development Assistance (MDA) and Market Access Initiative (MAI) schemes is being provided.

Technological Upgradation

10. To aid technological upgradation of our export sector, EPCG Scheme at Zero Duty has been introduced. This Scheme will be available

for engineering & electronic products, basic chemicals & pharmaceuticals, apparels & textiles, plastics, handicrafts, chemicals & allied products and leather & leather products (subject to exclusions of current beneficiaries under Technological Upgradation Fund Schemes (TUFS), administered by Ministry of Textiles and beneficiaries of Status Holder Incentive Scheme in that particular year). The scheme shall be in operation till 31.3.2011.

11. Jaipur, Srinagar and Anantnag have been recognised as 'Towns of Export Excellence' for handicrafts; Kanpur, Dewas and Ambur have been recognised as 'Towns of Export Excellence' for leather products; and Malihabad for horticultural products.

EPCG Scheme Relaxations

12. To increase the life of existing plant and machinery, export obligation on import of spares, moulds etc. under EPCG Scheme has been reduced to 50% of the normal specific export obligation.

13. Taking into account the decline in exports, the facility of Re-fixation of Annual Average Export Obligation for a particular financial year in which there is decline in exports from the country, has been extended for the 5 year Policy period 2009-14.

Support for Green products and products from North East

14. Focus Product Scheme benefit extended for export of 'green products'; and for exports of some products originating from the North East.

Status Holders

15. To accelerate exports and encourage technological upgradation, additional Duty Credit Scrips shall be given to Status Holders @ 1% of the FOB value of past exports. The duty credit scrips can be used for procurement of capital goods with Actual User condition. This facility shall be available for sectors of leather (excluding finished leather), textiles and jute, handicrafts, engineering (excluding Iron & steel & non-ferrous metals in primary and intermediate form, automobiles & two wheelers, nuclear reactors & parts, and ships, boats and floating structures), plastics and basic chemicals (excluding pharma products) [subject to exclusions of current beneficiaries under Technological

Upgradation Fund Schemes (TUFS)]. This facility shall be available upto 31.3.2011.

16. Transferability for the Duty Credit scrips being issued to Status Holders under paragraph 3.8.6 of FTP under VKGUY Scheme has been permitted. This is subject to the condition that transfer would be only to Status Holders and Scrips would be utilized for the procurement of Cold Chain equipment(s) only.

Stability/ continuity of the Foreign Trade Policy

17. To impart stability to the Policy regime, Duty Entitlement Passbook (DEPB) Scheme is extended beyond 31-12- 2009 till 31.12.2010.

18. Interest subvention of 2% for pre-shipment credit for 7 specified sectors has been extended till 31.3.2010 in the Budget 2009-10.

19. Income Tax exemption to 100% EOUs and to STPI units under Section 10B and 10A of Income Tax Act, has been extended for the financial year 2010-11 in the Budget 2009-10.

20. The adjustment assistance scheme initiated in December, 2008 to provide enhanced ECGC cover at 95%, to the adversely affected sectors, is continued till March, 2010.

Marine sector

21. Fisheries have been included in the sectors which are exempted from maintenance of average EO under EPCG Scheme, subject to the condition that Fishing Trawlers, boats, ships and other similar items shall not be allowed to be imported under this provision. This would provide a fillip to the marine sector which has been affected by the present downturn in exports.

22. Additional flexibility under Target Plus Scheme (TPS) / Duty Free Certificate of Entitlement (DFCE) Scheme for Status Holders has been given to Marine sector.

Gems & Jewellery Sector

23. To neutralize duty incidence on gold Jewellery exports, it has now been decided to allow Duty Drawback on such exports.

24. In an endeavour to make India a diamond international trading hub, it is planned to establish "Diamond Bourse (s)".

25. A new facility to allow import on consignment basis of cut & polished diamonds for the purpose of grading/ certification purposes has been introduced.

26. To promote export of Gems & Jewellery products, the value limits of personal carriage have been increased from US$ 2 million to US$ 5 million in case of participation in overseas exhibitions. The limit in case of personal carriage, as samples, for export promotion tours, has also been increased from US$ 0.1 million to US$ 1 million.

Agriculture Sector

27. To reduce transaction and handling costs, a single window system to facilitate export of perishable agricultural produce has been introduced. The system will involve creation of multi-functional nodal agencies to be accredited by APEDA.

Leather Sector

28. Leather sector shall be allowed re-export of unsold imported raw hides and skins and semi finished leather from public bonded ware houses, subject to payment of 50% of the applicable export duty.

29. Enhancement of FPS rate to 2%, would also significantly benefit the leather sector.

Tea

30. Minimum value addition under advance authorisation scheme for export of tea has been reduced from the existing 100% to 50%.

31. DTA sale limit of instant tea by EOU units has been increased from the existing 30% to 50%.

32. Export of tea has been covered under VKGUY Scheme benefits.

Pharmaceutical Sector

33. Export Obligation Period for advance authorizations issued with 6-APA as input has been increased from the existing 6 months to 36 months, as is available for other products.

34. Pharma sector extensively covered under MLFPS for countries in Africa and Latin America; some countries in Oceania and Far East.

Handloom Sector

35. To simplify claims under FPS, requirement of 'Handloom Mark for availing benefits under FPS has been removed.

EOUs

36. EOUs have been allowed to sell products manufactured by them

in DTA upto a limit of 90% instead of existing 75%, without changing the criteria of 'similar goods', within the overall entitlement of 50% for DTA sale.

37. To provide clarity to the customs field formations, DOR shall issue a clarification to enable procurement of spares beyond 5% by granite sector EOUs.

38. EOUs will now be allowed to procure finished goods for consolidation along with their manufactured goods, subject to certain safeguards.

39. During this period of downturn, Board of Approvals (BOA) to consider, extension of block period by one year for calculation of Net Foreign Exchange earnings of EOUs.

40. EOUs will now be allowed CENVAT Credit facility for the component of SAD and Education Cess on DTA sale.

Thrust to Value Added Manufacturing

41. To encourage Value Added Manufactured export, a minimum 15% value addition on imported inputs under Advance Authorization Scheme has now been prescribed.

42. Coverage of Project Exports and a large number of manufactured goods under FPS and MLFPS.

DEPB

43. DEPB rate shall also include factoring of custom duty component on fuel where fuel is allowed as a consumable in Standard Input-Output Norms.

Flexibility provided to exporters

44. Payment of customs duty for Export Obligation (EO) shortfall under Advance Authorisation / DFIA / EPCG Authorisation has been allowed by way of debit of Duty Credit scrips. Earlier the payment was allowed in cash only.

45. Import of restricted items, as replenishment, shall now be allowed against transferred DFIAs, in line with the erstwhile DFRC scheme.

46. Time limit of 60 days for re-import of exported gems and jewellery items, for participation in exhibitions has been extended to 90 days in case of USA.

47. Transit loss claims received from private approved insurance companies in India will now be allowed for the purpose of EO

fulfillment under Export Promotion schemes. At present, the facility has been limited to public sector general insurance companies only.

Waiver of Incentives Recovery, On RBI Specific Write off

48. In cases, where RBI specifically writes off the export proceeds realization, the incentives under the FTP shall now not be recovered from the exporters subject to certain conditions.

Simplification of Procedures

49. To facilitate duty free import of samples by exporters, number of samples/pieces has been increased from the existing 15 to 50. Customs clearance of such samples shall be based on declarations given by the importers with regard to the limit of value and quantity of samples.

50. To allow exemption for up to two stages from payment of excise duty in lieu of refund, in case of supply to an advance authorisation holder (against invalidation letter) by the domestic intermediate manufacturer. It would allow exemption for supplies made to a manufacturer, if such manufacturer in turn supplies the products to an ultimate exporter. At present, exemption is allowed up to one stage only.

51. Greater flexibility has been permitted to allow conversion of shipping bills from one Export Promotion scheme to other scheme. Customs shall now permit this conversion within three months, instead of the present limited period of only one month.

52. To reduce transaction costs, dispatch of imported goods directly from the Port to the site has been allowed under Advance Authorisation scheme for deemed supplies. At present, the duty free imported goods could be taken only to the manufacturing unit of the authorisation holder or its supporting manufacturer.

53. Disposal of manufacturing wastes/scrap will now be allowed after payment of applicable excise duty, even before fulfillment of export obligation under Advance Authorisation and EPCG Scheme.

54. Regional Authorities have now been authorised to issue licences for import of sports weapons by 'renowned shooters', on the basis of NOC from the Ministry of Sports & Youth Affairs. Now there will be no need to approach DGFT (Hqrs.) in such cases.

55. The procedure for issue of Free Sale Certificate has been simplified and the validity of the Certificate has been increased from 1 year to 2 years. This will solve the problems faced by the medical devices industry.

56. Automobile industry, having their own R&D establishment, would be allowed free import of reference fuels (petrol and diesel), upto a maximum of 5 KL per annum, which are not manufactured in India.

57. Acceding to the demand of trade & industry, the application and redemption forms under EPCG scheme have been simplified.

Reduction of Transaction Costs

58. No fee shall now be charged for grant of incentives under the Schemes in Chapter 3 of FTP. Further, for all other Authorisations/ licence applications, maximum applicable fee is being reduced to Rs. 100,000 from the existing Rs

1,50,000 (for manual applications) and Rs. 50,000 from the existing Rs.75,000 (for EDI applications).

59. To further EDI initiatives, Export Promotion Councils/ Commodity Boards have been advised to issue RCMC through a web based online system. It is expected that issuance of RCMC would become EDI enabled before the end of 2009.

60. Electronic Message Exchange between Customs and DGFT in respect of incentive schemes under Chapter 3 will become operational by 31.12.2009. This will obviate the need for verification of scrips by Customs facilitating faster clearances.

61. For EDI ports, with effect from December '09, double verification of shipping bills by customs for any of the DGFT schemes shall be dispensed with.

62. In cases, where the earlier authorization has been cancelled and a new authorization has been issued in lieu of the earlier authorization, application fee paid already for the cancelled authorisation will now be adjusted against the application fee for the new authorisation subject to payment of minimum fee of Rs. 200.

63. An Inter Ministerial Committee will be formed to redress/ resolve problems/issues of exporters.

64. An updated compilation of Standard Input Output Norms (SION) and ITC (HS) Classification of Export and Import Items has been published.

Directorate of Trade Remedy Measures

65. To enable support to Indian industry and exporters, especially the MSMEs, in availing their rights through trade remedy instruments, a Directorate of Trade Remedy Measures shall be set up.

8.4 FEMA

A system of exchange control was first time introduced through a series of rules under the Defense of India Act, 1939 on temporary basis. The foreign crises persisted for a long time and finally it got enacted in the statute under the title "Foreign Exchange Regulation Act, 1947". Subsequently, this act was replaced by the Foreign Exchange Regulation Act, 1973(FERA) which was came into force with effect from January 1, 1974 and regulating foreign exchange for more than 26 years under this Act.

In 1991 Government of India initiated the policy of economic liberalization. After this foreign investment in many sectors were permitted in India. In 1997, Tarapore committee on Capital Account Convertibility, constituted by the Reserve Bank of India, recommended change in the legislative framework governing foreign exchange transactions. Accordingly, the Foreign Exchange Regulation Act, 1973 was repealed and replaced by the new Foreign Exchange Management Act, 1999 (FEMA) with effect from June 01, 2000. Under FEMA the emphasis was on management of foreign exchange. Foreign Exchange Management Act or in short (FEMA) is an act that provides guidelines for the free flow of foreign exchange in India. It has brought a new management regime of foreign exchange consistent with the emerging frame work of the World Trade Organisation (WTO).

APPLICABILITY OF FEMA

The Foreign Exchange Management Act, 1999 was enacted to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and for promoting the orderly development and maintenance of foreign exchange market in India. FEMA extends to the whole of India. The Act also applies to all branches,

offices and agencies outside India owned or controlled by a person resident in India and also to any contravention committed there under outside India by any person to whom this Act is applies.

OVERALL STRUCTURE

The overall structure of Foreign Exchange Management Act, 1999 is covered by legislations, rules and regulations. These legislations, rules and regulations relating to Foreign Exchange Management Act, 1999, can be divided in to the followings:

1. FEMA contains 7 chapters divided into 49 sections (Supreme Legislation)
2. 5 sets of Rules made by Ministry under section 46 of FEMA. (Delegated legislations)
3. 23 sets of Regulations made by RBI under section 47 of FEMA. (Subordinate Legislations)
4. Master Circular issued by Reserve Bank of India every year.
5. Foreign Direct Investment (FDI) policy issued by Department of Industrial Policy and Promotion (DIPP) time to time.
6. Notifications and Circulars issued by Reserve Bank of India.
7. Enforcement Directorate.

FEMA contains 7 Chapters divided into 49 sections of which 12 sections cover operational part and the rest 37 sections deal with contraventions, penalties, adjudication, appeals, enforcement directions, etc. FEMA makes provisions for dealings in foreign exchanges. Broadly, all current account transactions are free. However, Central Government can impose reasonable restrictions by issuing rules. The capital account transactions will be regulated by RBI/Central Government for which necessary circulars/notifications will have to be issued under FEMA.

All chapters of FEMA divided into 49 sections. Besides the FEMA, there are 5 Rules and 23 regulations under the Act which help in implementation of the Act are classified here:

Chapter I: Preliminary (Section 1 &2)

Chapter II: Regulation and Managements of Foreign Exchange (Section 3 -9)

Chapter III: Authorised Person (Section 10-12)

Chapter IV: Contraventions and Penalties (Section 13-15)

Chapter V: Adjudication and Appeal (Section 16-35)

Chapter VI: Directorate of Enforcement (Section 36-38)

Chapter VII: Miscellaneous (Section 39-49)

The Rules made by Central Government under section 46 of FEMA are:

1. Foreign Exchange Management (Encashment of Draft, Cheque, Instruments and Payment of Interest) Rules, 2000
2. Foreign Exchange Management (Authentication of Documents) Rules, 2000
3. Foreign Exchange Management (Current Account Transaction) Rules, 2000
4. Foreign Exchange Management (Adjudications Proceedings and Appeal) Rules, 2000
5. Foreign Exchange Management (Compounding Proceedings) Rules, 2000

The Regulations made by Reserve Bank of India under section 47 of FEMA are:

1. Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2000
2. Foreign Exchange Management (Borrowing and Lending in Rupees) Regulations, 2000
3. Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000
4. Foreign Exchange Management (Deposit) Regulations, 2000
5. Foreign Exchange Management (Export and Import of Currency) Regulations, 2000
6. Foreign Exchange Management (Guarantees) Regulations, 2000
7. Foreign Exchange Management (Issue of Security in India by a Branch, Office or Agency of a Person Resident Outside India) Regulations, 2000
8. Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000
9. Foreign Exchange Management (Establishment in India of Branch or Office or Other Place of Business) Regulations, 2000
10. Foreign Exchange Management (Export of Goods and Service) Regulations, 2000

11. Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) Regulations, 2000
12. Foreign Exchange Management (Insurance) Regulations, 2000
13. Foreign Exchange Management (Investment in Firm or Proprietary Concern in India) Regulations, 2000
14. Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2000
15. Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000
16. Foreign Exchange Management (Possession and Retention of Foreign Currency) Regulations, 2000
17. Foreign Exchange Management (Realization, Repatriation and Surrender of Foreign Currency) Regulations, 2000
18. Foreign Exchange Management (Remittance of Assets) Regulations, 2000
19. Foreign Exchange Management (Transfer or Issue of Security by a Person resident Outside India) Regulations, 2000
20. Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000
21. Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004
22. Foreign Exchange Management (Offshore Banking Unit) Regulations, 2002
23. Foreign Exchange Management (Withdrawal of General Permission to Overseas Corporate Bodies (OCBs)) Regulations, 2003.

AUTHORITIES AND ENFORCEMENT MACHINARY

FEMA in itself is not an independent and isolated law. The provisions of FEMA are spread at different place and so there are regulatory bodies. Reserve Bank of India makes Regulations for FEMA and the Rules are made by Central Government. Authorities governing the enforcement of FEMA are:

1. Foreign Exchange Department of Reserve Bank of India.
2. Directorate of Enforcement, Department of Revenue, Ministry of Finance.

3. Capital Market Division, Department of Economic Affairs, Ministry of Finance.
4. Foreign Trade Division, Department of Economic Affairs, Ministry of Finance.

Machinery responsible for various aspect of FEMA is:

1. **Enforcement Directorate:** To investigate provisions of the Act, the Central Government, have established the Directorate of Enforcement with Directors and other officers as officers of the Enforcement.
2. **Adjudicating Authorities:** The Adjudicating Authorities will issue a notice to the person who has contravened the provisions of the Foreign Exchange Management Act, Rules, Regulations, Notifications or any directions issued by the RBI.
3. **Special Director (Appeals):** Any person aggrieved by an order made by the Adjudicating Authority, being an Assistant Director of Enforcement or a Deputy Director of Enforcement can prefer an appeal to the Special Director (Appeals.)
4. **Appellate Tribunal:** Any person aggrieved by an order made by the adjudicating Authority, or the Special Director (Appeals) can prefer an appeal to the Appellate Tribunal.

FEMA envisages that RBI shall have controlling role in management of foreign exchange. Since RBI cannot directly handle foreign exchange transactions, it authorizes "Authorised Persons" to deal in foreign exchange as per direction issued by RBI.RBI is empowered to issue direction to such "Authorised Persons". These Directions are issued through AP (DIR) Circulars. (AP stands for Authorised Person and DIR stand for Directions).

MAIN PROVISIONS OF THE ACT

- It permits only authorised person to deal in foreign exchange or foreign security. Such an authorised person, under the Act, means authorised dealer, money changer, off-shore banking unit or any other person for the time being authorised by Reserve Bank. The Act thus prohibits any person who:- · Deal in or transfer any foreign exchange or foreign security to any person not being an authorized person;
- Make any payment to or for the credit of any person resident outside India in any manner;

- Receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner;

- Enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person;
- is resident in India which acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India.
- The Act regulates two types of foreign exchange transactions, namely 'Capital Account Transactions' and 'Current Account Transactions'.

1. According to the Act, 'Capital account transaction' means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes the following transactions referred in the Act:-
   - Transfer or issue of any foreign security by a person resident in India;
   - Transfer or issue of any security by a person resident outside India;
   - Transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
   - Any borrowing or lending in rupees in whatever form or by whatever name called;
   - Any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
   - Deposits between persons resident in India and persons resident outside India;
   - Export, import or holding of currency or currency notes;
   - Transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;

- Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
- Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred-

(i) By a person resident in India and owed to a person resident outside India; or

(ii) By a person resident outside India.

2. It also defines the term 'current account transaction' as a transaction other than a capital account transaction and without prejudice to the generality of the foregoing such transaction includes:- (i) payments due in connection with foreign trade, other current business, services, and short-term banking and credit facilities in the ordinary course of business; (ii) payments due as interest on loans and as net income from investments; (iii) remittances for living expenses of parents, spouse and children residing abroad; and (iv) expenses in connection with foreign travel, education and medical care of parents, spouse and children.

* The Act has empowered the Reserve Bank of India (RBI) to specify, in consultation with the Central Government, the permissible capital account transactions and the limits upto which foreign exchange may be drawn for such transactions. But it shall not impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

- Any person may sell or draw foreign exchange if such sale or drawal is a current account transaction. Under the Act, Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed.
- Every exporter of goods shall:- (i) furnish to the Reserve Bank or to such other authority a declaration in such form and in such manner as may be specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable

at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India; (ii) furnish to the Reserve Bank such other information as may be required by it for the purpose of ensuring the realisation of the export proceeds by such exporter.

- The Reserve Bank may, at any time, cause an inspection to be made, by any officer specially authorised in writing by it in this behalf, of the business of any authorised person as may appear to it to be necessary or expedient for the purpose of:- (i) verifying the correctness of any statement, information or particulars furnished to the Reserve Bank; (ii) obtaining any information or particulars which such authorised person has failed to furnish on being called upon to do so; (iii) securing compliance with the provisions of this Act or of any rules, regulations, directions or orders made there under.

8.5 COMPETITION LAW

Competition Act 2002 has come into force to replace the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969. After the economic reforms of 1990, it was felt that MRTP has become obsolete pertaining to international economic developments relating to competition law and there was a need of law which curbs monopolies and promotes competition. In 1990s India saw substantial increases in the value and volume of international trade in goods and services, in foreign direct investments (FDI), and in cross border mergers and acquisitions (M&A). Over the period of time, trade barriers fell and restrictions on FDI were reduced. The Competition Act, 2002 has been enacted with the purpose of providing a competition law regime that meets and suits the demands of the changed economic scenario in India and abroad.

The Competition Act has repealed the Monopolies and Restrictive Trade Practices Act, 1969 and has dissolved the Monopolies and Restrictive Trade Practices Commission. The cases pending before the MRTP Commission are transferred to Competition Commission of India "**CCI**", barring those which are related to unfair trade practices and the same are proposed to be transferred to the National Commission constituted under the Consumer Protection Act, 1986.

HIGHLIGHTS OF COMPETITION ACT 2002

- It provides for the establishment of a Competition Commission of India "CCI" to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect interests of consumers and to ensure freedom of trade carried on by other participants in markets.
- CCI prohibits enterprises to enter into anti-competitive agreements, abusing their dominant position and forming combinations.
- **Scope of CCI -** CCI shall look into any alleged violations under the Act, (a) either on its own motion, or (b) on receipt of a complaint from any person, consumer or their trade association, or (c) on references made by the Central Government, State Governments or any statutory authority.
- **Exclusion of jurisdiction of civil courts—** No civil court has the jurisdiction to entertain any suit or proceeding which CCI is empowered by or under the Act to determine. Also, no injunction can be granted by any court or authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the Act.
- CCI is not bound by the procedure laid down by Code of Civil Procedure, 1908 and must only follow the principles of natural justice. CCI, thus, has the power to regulate its own procedure.
- If any party to such agreement is outside India; or if any enterprise abuses its dominant position is outside India; ora combination has taken place outside India; or any party to combination is outside India; or any other matter or practice or action arising out of such agreement or dominant position which causes an appreciable adverse effect on competition in the relevant market in India.
- **Powers of CCI—** CCI has the power to grant interim relief award compensation, impose penalty and to grant any other appropriate reliefto levy penalty for contravention of its orders, making of false statements or omission to furnish material information, etc.
- **Division of dominant enterprise—** CCI can recommend the Central Government division of a dominant enterprise to ensure that it does not abuse its position. On the recommendation, the

Central Government under Section28 may direct division of such an enterprise.

- **Extent of penalty**— For abusing its dominant position or entering in anticompetitive agreements, CCI can levy penalty to the extent of 10 per cent of the average of the turnover for the preceding three financial years. The penalty is higher in case of such abuses by cartels and penalty can be equivalent to three times of the amount of profits made out of such agreement by the cartel or ten per cent of the average turnover of the cartel for the preceding three financial years.
- **Appeal from CCI.**—Any person aggrieved by any decision or order of CCI may file an appeal to the Supreme Court within 60 days from the date of the communication of the decision or order.

IMPORTANT PROVISIONS OF THE ACT

Section 3 Anti-competitive agreements-

(1) No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India.

(2) Any agreement entered into in contravention of the provisions contained in sub-section (1) shall be void.

(3) Any agreement entered into between enterprises or associations of enterprises or persons or associations of persons or between any person and enterprise or practice carried on, or decision taken by, any association of enterprises or association of persons, including cartels, engaged in identical or similar trade of goods or provision of services, which-

(a) directly or indirectly determines purchase or sale prices;

(b) limits or controls production, supply, markets, technical development, investment or provision of services;

(c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way;

(d) directly or indirectly results in bid rigging or collusive bidding, shall be presumed to have an appreciable adverse effect on competition: Provided that nothing contained in this sub-section shall apply to any agreement entered into by way of joint ventures if such agreement increases efficiency in production, supply, distribution, storage, acquisition or control of goods or provision of services.

(4) Any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including-

(a) tie-in arrangement;

(b) exclusive supply agreement;

(c) exclusive distribution agreement;

(d) refusal to deal;

(e) resale price maintenance, shall be an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition in India.

(5) Nothing contained in this section shall restrict-

(i) the right of any person to restrain any infringement of, or to impose reasonable conditions, as may be necessary for protecting any of his rights which have been or may be conferred upon him under-

(a) the Copyright Act, 1957 (14 of 1957)

(b) the Patents Act, 1970 (39 of 1970)

(c) the Trade and Merchandise Marks Act, 1958 (43 of 1958) or the Trade Marks Act, 1999 (47of 1999)

(d) the Geographical Indications of Goods (Registration and Protection) Act, 1999 (48 of 1999)

(e) the Designs Act, 2000 (16 of 2000)

(f) the Semi-conductor Integrated Circuits Layout- Design Act, 2000 (37of 2000)

(ii) the right of any person to export goods from India to the extent to which the agreement relates exclusively to the production,

supply, distribution or control of goods or provision of services for such export. Prohibition of abuse of dominant position

Section 4. Abuse of dominant position-

(1) No enterprise shall abuse its dominant position.

(2) There shall be an abuse of dominant position under sub-section (1), if an enterprise,-

(a) directly or indirectly, imposes unfair or discriminatory-

(i) condition in purchase or sale of goods or service; or

(b) limits or restricts-

(i) production of goods or provision of services or market therefore; or

(ii) technical or scientific development relating to goods or services to the prejudice of consumers; or

(c) indulges in practice or practices resulting in denial of market access; or

(d) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or

(e) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

Section 5. Combination-

The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises, if—

(a) any acquisition where—

(i) the parties to the acquisition, being the acquirer and the enterprise, whose control, shares, voting rights or assets have been acquired or are being acquired jointly have,—

(A) either, in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen nundred crores in India; or

(ii) the group, to which the enterprise whose control, shares, assets or voting rights have been acquired or are being acquired, would belong after the acquisition, jointly have or would jointly have, -

(A) either, in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores; or

(B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India; or

(b) acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, if -

(i) The enterprise over which control has been acquired along with the enterprise over Which the acquirer already has direct or indirect control jointly have, -

(A) either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores, or

(B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or

(ii) the group, to which enterprise whose control has been acquired, or is being acquired, would belong after the acquisition, jointly have or would enjoy have,-

(A) either in India, the assets of the value of more than rupees four thousand crores or turnover more than rupees twelve thousand crores, or

(B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India;

(c) any merger or amalgamation in which—

(i) the enterprise remaining after merger or the enterprise created as a result of the amalgamation, as the case may be, have,— (A) either in India, the assets of the value of more than rupees one thousand crores or turnover more than rupees three thousand crores; or (B) in India or outside India, in aggregate, the assets of the value of more than five hundred million US dollars, Including at least rupees five hundred crores in India, or turnover more than fifteen hundred million US dollars, including at least rupees fifteen hundred crores in India; or

(ii) the group, to which the enterprise remaining after the merger or the enterprise created as a result of the amalgamation, would belong after the Merger or the amalgamation, as the case may be, have or would have,— (A) either in India, the assets of the value of more than rupees four-thousand crores or turnover more than rupees twelve thousand crores; or (B) in India or outside India, in aggregate, the assets of the value of more than two billion US dollars, including at least rupees five hundred crores in India, or turnover more than six billion US dollars, including at least rupees fifteen hundred crores in India;

Section 6. Regulation of combinations-

(1) No person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

(2) Subject to the provisions contained in sub-section (1), any person or enterprise, who or which proposes to enter into a combination, may, at his or its option, give notice to the Commission, in the form as may be specified, and the fee which may be terminated, by regulations, disclosing the details of the proposed combination, within seven days of-

(a) approval of the proposal relating to merger or amalgamation, referred to in clause (c) of section 5, by the board of directors of the enterprises concerned with such merger or amalgamation, as the case may be;

(b) execution of any agreement or other document for acquisition referred to in clause (a) of section 5 or acquiring of control referred to in clause (b) of that section.

(3) The Commission shall, after receipt of notice under subsection (2), deal with such notice in accordance with the provisions contained in sections 29, 30 and 31.

(4) The provisions of this section shall not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement.

(5) The public financial institution, foreign institutional investor, bank or venture capital fund, referred to in subsection (4), shall, within seven days from the date of the acquisition, file, in the form as may be specified by regulations, with the Commission the details of the acquisition including the details of control, the circumstances for exercise of such control and the consequences of default arising out of such loan agreement or investment agreement, as the case may be.

Section 18.

Duties of Commission- Subject to the provisions of this Act, it shall be the duty of the Commission to eliminate practices having adverse effect on competition, promote and sustain competition, protect the interests of consumers and ensure freedom of trade carried on by other participants, in markets in India:

Provided that the Commission may, for the purpose of discharging its duties or performing its functions under this Act, enter into any memorandum or arrangement with the prior approval of the Central Government, with any agency of any foreign country.

WHAT IS AN ANTI-COMPETITIVE AGREEMENT?

An anti-competitive agreement is an agreement having appreciable adverse effect on competition. Anti-competitive agreements include, but are not limited to:-

- Agreement to limit production and/or supply;
- Agreement to allocate markets;
- Agreement to fix price;
- Bid rigging or collusive bidding;
- Conditional purchase/sale (tie-in-arrangement);
- Exclusive supply/distribution arrangement;
- Resale price maintenance; and

- Refusal to deal.

WHAT CONSTITUTES ABUSE OF DOMINANCE?

Dominance refers to a position of strength which enables an enterprise to operate independently of competitive forces or to affect its competitors or consumer or the market in its favour. Abuse of dominant position impedes fair competition between firms, exploits consumers and makes it difficult for the other players to compete with the dominant undertaking on merit. Abuse of dominant position includes imposing unfair conditions or price, predatory pricing, limiting production /market or technical development, creating barriers to entry, applying dissimilar conditions to similar transactions, denying market access and using dominant position in one market to gain advantages in another market.

WHEN MAY THE COMMISSION INITIATE INQUIRY?

- On Its own on the basis of information and knowledge in its possession, or
- On receipt of an information, or
- On receipt of a reference from the Central Government or a State Government or a statutory authority.

WHO CAN PROVIDE INFORMATION?

- Any person, consumer, consumer association or trade association can provide information relating to anticompetitive agreements and abuse of dominant position.
- A person includes an individual, Hindu undivided family (HUF), company, firm, association of persons (AOP), body of individuals (BOI), statutory corporation statutory authority, artificial judicial person, local authority and body incorporated outside India.
- A consumer is a person who buys products (goods and services) for personal use or for other purposes.
- Intermediate customers can also provide information.

CAN COMMISSION INITIATE INQUIRY SUO-MOTO?

Yes, the Commission can initiate inquiry on its own on the basis of information or knowledge in its possession; or On receipt of information or reference, if the Commission is of the opinion that there is a prima facie case, it shall direct the Director General, appointed under the Act, to investigate the matter and report his findings to the Commission.

TYPES OF ORDERS BY COMMISSION

- During the course of inquiry, the Commission can pass interim order restraining a party from continuing with anti-competitive

agreement or abuse of dominant position.

- The Commission can impose a penalty of not more than 10% of the average turnover of the last 3 preceding financial years of the enterprise. In case of a cartel, the Commission can impose on each member of the cartel, a penalty of up to 3 times its profit for each year of the continuance of such agreement or upto 10% of its turnover for each year of continuance of such agreement, whichever is higher.
- After the inquiry, the Commission may direct a delinquent enterprise to discontinue and not to re-enter anti-competitive agreement or abuse its dominant position (cease and desist order). The Commission may also direct modification of such agreement.
- The Commission may direct division of enterprise in case it enjoys dominant position.

8.6 SUMMARY

Legal environment includes flexibility and adaptability of law and other legal rules governing the business. It may include the exact rulings and decision of the courts. These affect the business and its managers to a great extent. This refers to set of laws, regulations, which influence the business organizations and their operations. Every business organization has to obey, and work within the framework of law. Additionally, an industry may have specific laws and regulations. For example, a pet store would deal with federal animal welfare and prohibited pet laws as wells as state laws concerning animal cruelty, housing, veterinary care and so on. In the same way tobacco companies have to print warning related to harm in consumption of cigarette and A new Companies Bill 2012 is proposed and passed by both the houses of parliament and it will replace the Companies Act 1956. The political system always affects the legal environment as the government changes the legal implementations are also affected. Therefore a stable government is also required in the centre to amend the legal issues and to implement them for the betterment of the economy and the industry.

8.7 SELF ASSESSMENT QUESTION

1. Discuss the various provisions of FEMA.
2. Explain new EXIM policy of India.
3. Explain the provisions of Competition law.

8.8 SUGGESTED READINGS

1. Cherrunilam Francis, *Business Environment*, Vikas Publishing House Private Limited, Place & Years
2. Bedi Suresh, Business Environment, Excel Books, Place & Years
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अनुवाद की स्थिति में

मूल लेखक	अनुवाद
मूल सम्पादक	भाषा सम्पादक
मूल परिमापक	परिमापक

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Block 3 : BUSINESS ENVIRONMENT

Block Introduction

This block comprises in four units. The unit Nine introduces the subject of business environment and its component. It also provides an overview of BE in India.

The unit ten explains the concept of complexity and diversity of business environment in 21st century. It also explains the concept of business cycle.

The unit eleven deals with environment scanning and its various techniques.

The unit Twelve refers to political environment. It also looks into the three political institutions : legislature, executive and judiciary.

UNIT 9 PUBLIC SECTOR IN INDIA

Structure:

9.1 Introduction

9.2 Objectives

9.3 Meaning and Concept and Characteristics of Public Sector

9.4 Evolution of Public Sector in India.

9.5 Need of Public Sector in India.

9.6 Philosophy of Public Sector in India.

9.7 Objectives of Public Sector in India.

9.8 Summary

9.9 Key Words

9.10 Self Assessment Questions

9.11 Suggested Readings

9.1 Introduction

Indian economy is known as mixed economy where there is coexistence of the Public, Private, Joint and Cooperative Sector. The policy on the public Sector has been guided by the Industrial Policy Resolutions 1956 & 1991, which gave the public sector a strategic role in the economy. At the time of India's independence in 1947, there were various problems confronting the country which needed to be tackled in a planned and systematic manner. Therefore if the country was to speed up its economic growth and maintain it in the long run at a steady level, a big push as required. As such, state's intervention in all the sector of the economy, was in evitable because private sector had neither the necessary resources in terms of funds, managerial and scientific skill, nor the will to undertake risks involved in large long gestation investments. Among the imperatives were removal of property, better distribution of income, expansion of employment opportunities, removal of regional imbalances, accelerated growth of agricultural and industrial production, better utilization of natural resources and a wider ownership of economic power to prevent its concentration in a few hands.

As the Bureau of Public Enterprises has rightly observed. The PUBLIC sector born as the outcome of conscious policy of the

Government to speed up the industrialisation of the country with a view to give added inputs to economic growth as well as to advice certain socio-economic goals as enunciated in the industrial policy resolutions of the government.

9.2 OBJECTIVES

After Studding this unit you will be able to:

- Understand the concept and meaning of Public Sector
- Understand the need and significance of Public Sector in India.
- Understand the Philosophy of Public Sector in India
- Identify the objectives of establishing Public Sector in India
- Explain the characteristics of Public Sector in India.

9.3 MEANING CONCEPT AND CHARACTERISTICS OF PUBLIC SECTOR

In simple terms a Public Sector enterprise is an industrial, commercial or other economic activity owned and managed by the Central or State Govt. or Jointly by both.

Definitions:

1. **A L HANSON:** "Public Enterprise means State ownership and operation of Industrial, agricultural, financial and commercial undertaking".

2. **ENCYCLOPEDIA BRITANICA:** "The term usually refers to Govt. ownership and active operation of agencies engaged in supplying the public, the goods and services which alternatively might be supplied by privately owned profit motivated firms".

3. **S S KHERA :** "By Public Enterprise is meant the industrial, commercial and economic activities carried on by the Central Govt. or by a State Govt. or Jointly by the Central Govt. and a State Govt. and in each case either solely or in association with private enterprise, so longar it is managed by a self contained management".

On the basis of above it may be concluded that public sector enterprises are the business and industrial enterprises which are owned managed and controlled by central or state govt.

CHARACTERISTICS OF PUBLIC SECTOR

The main features and characteristics of public sector are as

follows:

(a) **Government Control and Management :** Public enterprises are managed by the government or the public authority.

(b) **Government Ownership :** The public enterprises should either be wholly or Partially owned by the government.

(c) **Public Purpose :** The public interest in various forms and shape provides an under-current for all its strategic decisions.

(d) **Constituent of Political and Administrative Structure:** The public enterprises at present are considered as constituent of political and administrative structure.

(e) **Public Accountability :** They are accountable to the public through parliament.

(f) **Wide Coverage of Activities :** The public enterprises are not established for a specific line of activity or manufacture.

(g) **Autonomous Functioning :** Public enterprises are provided sufficient autonomy to manage their affairs in their own fashion.

9.4 EVOLUTION OF THE PUBLIC SECTOR

The public sector entered in a big way in the economic sphere of the country in post-independence development. Prior to 1947, public sector investment was limited to the railways, the post and telegraphs department, the ordinance factories and a few state managed factories like the quinine factories, salt factories etc. It was the Industrial Policy Resolution of the Government of India in 1948 which brought the public sector into limelight. It declares that a dynamic national policy must be directed to a continuous increase in production by all possible means, side-by-side with measures to secure its equitable distribution. The problem of State participation in industry and the conditions in which private enterprise should be allowed to operate must be judged in this context. Since then the expansion of the public sector has been very rapid.

The basic idea that in the economic development of the country the public sector would play a predominant role took root with the adoption of a socialist pattern of society in the second plan. In the Industrial Policy Statement of 1956 it was emphasised that public enterprise was designed to control the 'commanding heights' of the economy. But in recent years the trends towards increasing liberalisation are very much in evidence in India

and one gets the impression that private sector is designed to play an important role in the economy in the coming era.

Public sector in the industrial field has expanded rapidly since Independence. In 1951 there were only 5 non-departmental public undertakings with an investment of Rs. 29 crore. On March 31, 1993, the number of public enterprises had risen to 245 with total capital employed therein amounting to Rs. 146,971 crore.

9.5 NEED FOR PUBLIC SECTOR

1. Socialist Pattern of Society: The public sector was meant to socialize the means of mass production and benefit the masses, as is typically the case in a socialistic pattern of society. The commanding heights of the economy - the core sector comprising investment. production, distribution and consumption - were State owned, so as to promote national development as opposed to considerations of private profit. In such a situation, the so-called Public - Sector needs to expand rapidly, cover areas where the private sector is unwilling of unable to participate, and play a dominant role in shaping the economy. Some of these areas are power, communications, mass transportation, information and broadcasting, mines and defence production. Initially the public sector took the lead in developing basic and capital goods industries, laying the foundations for national growth unhindered by narrow considerations of profit as would arguably be seen in *a laissez faire* economy dominated by private enterprise, where motives of personal profit would presumably supersede national priorities. In time, however, some of these monoplistic establishments exhausted their early dynamism and metamorphosed into compliment, inefficient, cash-strapped, over-staffed, over-unionized islands of mediocrity that generated aught but huge losses-dinosaurs that had run out of time and relevance.

2. Socio-Economic Objectives: Reduction of inequalities of wealth and income is the most important socio-economic objective, going hand in hand with the need to eliminate poverty and establish an egalitarian society by redistributing wealth and earning potential equitably. Another important objective of a socialistic stem is to help the underprivileged realise their dormant potential by liberating them from economic serfdom and to give them all opportunity to attain social justice. Although rarely declared in so many words. the giant public sector organizations were also meant to serve this purpose by providing upliftment to these

neglected sectors, by means of reserving a certain percentage of jobs for weaker sections of society including the physically challenged. Nationalized banks rendered yeoman service by extending confessional loans under the 'Differential Rates of Interest' scheme, that allowed cheap finance to reach District Consultative Committee sponsored beneficiaries drawn from such sections of the local populace-something a purely profit driven banking system would never dream of undertaking.

3. **Balanced Regional Development:** One of the major goals of planning is to try and correct regional disparities by spreading the benefits of economic development as evenly as possible across the country. It is vital for humane as well as for security reasons to ensure that the fruits of prosperity percolate throughout the nation, for civil unrest is usually born of discontent with a system of wealth distribution that serves but to defeat the very purpose of adopting a socialistic type of governance. This is particularly true of the sensitive north and north-eastern States, many of whom are economically under-developed and hence vulnerable to ideologies incompatible with our peaceful, non-violent, democratic system of governance run on socialist principles. Industrial development of these areas is a top priority; Bhilai, Rourkela and Durgapur are well known examples. but more such success stories arc needed, and quickly.

4. **Need for Rapid Economic Development:** The need of the hour is rapid economic development. The private sector has neither the desire nor the resources to undertake the massive programme of industrialisation. Hence dependence on the private sector will only slow down m the economic development. Expansion of public enterprise will speed up the rate of economic growth.

5. **Pattern of Resource Allocation:** The main reason for the expansion of the public sector lies in the pattern of resource allocation decided upon under the plans. In the first Plan, the major emphasis was on agriculture but in the second Plan the emphasis was shifted to basic and capital goods industries. During the first plan period, the private sector was dominant in the field *of* industrial activities. But with changed emphasis it was inevitable that the public sector must grow not only absolutely but also relatively to the private sector.

6. **Building Infrastructure:** infrastructure provides certain basic facilities for rapid economic growth. In the economic infrastructure,

there are facilities like power, it irrigation, transport and communication, banking, training etc. Social infrastructure includes education. health. sanitation, drinking water facilities etc. The development of infrastructure is not possible through efforts of private individuals since its benefits go to society as a whole and not to individuals. It is therefore mainly the responsibility of the State. The infrastructure has accounted for 95.1 per cent of the public outlays in the first Plan and nearly 75 per cent in the subsequent plans.

9.6 PHILOSOPHY OF PUBLIC SECTOR IN INDIA

The modern India is the creation of Pt. Nehru's model of economic growth who referred to India as a socialist economy. Socialism was primarily thought of Mahatma Gandhi and congress ideology.

The Indian National Congress had traditionally expressed its socio-economic aspirations in radical terms. The 1929 Lahore Resolution had declared that in order to remove poverty and misery of the Indian people and to ameliorate the conditions of the masses, it was essential to make revolutionary changes in the present economic and social structures of society and to remove gross inequalities. The Subsequent Karachi Resolution declared that the State shall own or control key industries and services, mineral resources, railways, waterways, shipping and other means of public transport.

The objectives of establishing new enterprises and reasons for nationalising some existing ones are varied and often different from case to case and from time to time. Perhaps the only generalisation possible in this regard is that public enterprise for us is more a matter of necessity than of choice. It is not so much the ideology as the compulsion of the situation which has led to the -growth of public enterprise in India.

A brief statement about the need and role of public enterprise in India is contained in the statement of former Prime Minister Indira Gandhi that we advocate a public sector for three reasons to gain control of the commanding heights of the economy: to promote critical development in terms of social gain or strategic value rather than primarily on considerations of profit; and to provide commercial surpluses with which to finance further economic development.

Socialism is largely a misnomer in the case of India, except for Government ownership in industry and commerce. India is still primarily

an agricultural country and the distribution of income depends mainly on the distribution of agricultural property. Although there have been some attempts to distribute land to the peasants, land remains unequally distributed and there is evidence that the range of income inequality has been reduced. The tax system continues to be regressive, direct taxes are rarely levied on land and high urban income taxes are marked by evasion. The pre-tax income distribution figures sum up the failure to establish a more equitable distribution of income. In 1960, the buttom 10 per cent of families accounted for less than one per cent of all income, while the top 10 per cent for over one-third. This income distribution is less equitable than in industrialised capitalist countries. Rather than seeking to achieve 'Socialist' objectives through income redistribuiton, the architects of modern India economy emphasied State ownership in industry. The feeling was that socialism could be achieved through State control of Indistry which would serve as a surrogate for social change.

Public enterprises are expected to be the principal agents for rapid economic and social transformation by developing infrastructure and the core sector and by closing the gaps in the industrial structure. Its dominant position in the financial field is intended to control and guide the private sector, wherever necessary. Lastly, the economic growth through public enterprise will ensure social justice.

In developing countries, public enterprises are largely a necessity and not a matter of choice. In India, though the Congress government was clearly committed to expanding the public sector, it did not go into areas where private enterprise was operating. Nationalisation of the existing enterprises has been generally resorted to where the public interest was involved or where it was imperative to put the industry on sound footing and regulation and control were not found sufficiently effective. The vast majority of public enterprises is in areas which were hitherto untouched or unexplored by the private sector.

9.7 OBJECTIVES OF PUBLIC SECTOR IN INDIA

The Public Sector enterprises were promoted as an instrument for implementation of the government's socio-economic policies, had a multitude of objectives set for them, viz:

1. To promote rapid economic development by filling gaps in the industrial structure.

2. To promote infrastructural facilities for the growth of the economy.
3. To earn return on investment and thus generate resources for economic development.
4. To promote redistribution of income and wealth.
5. To create employment opportunities.
6. To promote balanced regional development.
7. To assist the development of small scale and ancillary industries.
8. To exercise social control and regulation through public finance institutions.
9. To attain self-reliance in different technologies.
10. To eliminate dependence on foreign aid and foreign technology.
11. To promote export and reduce imports to ease the pressure on balance of payment.

9.8 SUMMARY

Thus unit deals with Public Sector, its objectives and philosophy. The public sector enterprises include all government activities including public industrial or commercial enterprises. Since 1991 the Govt's policy towards public sector is changed. The philosophy behind establishment of Public Sector in India is dominated by the thinking of Mahatma Gandhi, Nehru and the Indian National Congress. They were the strong supporter of socialistic economy in India. Basically the Public Sector in India have the objectives of promoting rapid economic development, growth of infrastructural facility, creation of employment, balance regional development, to promote exports and reduce imports, social and public control on business and economic activities, development of small industry etc.

9.9 KEY WORDS

PUBLIC SECTOR – Any Activity, owned, Controlled and Managed by the Government (Central, State, Local)

AUTONOMY- Autonomy in managing and running the concern is needed to ensure a high degree of efficiency.

ACCOUNTABILITY – Since Public Sector is using Public funds and they are meant to work for social goods it is necessary that the independence of the management most be subjected to the accountability constraint.

9.10 SELF ASSESSMENT QUESTIONS

1. Explain the meaning, concept and characteristics of public sector.
2. Discuss the philosophy behind establishment of Public enterprises in India.
3. State the need and significance of Public Sector in India.
4. Discuss the objectives of Public Sector in India.

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UNIT-10 PERFORMANCE & PROBLMS OF PUBLIC SECTOR, DISINVESTMENT, PRIVATISATION, JOINT AND COOPERATIVE SECTOR IN INDIA

Structure:

10.1 Introduction

10.2 Objectives

10.3 Performance of Public Sector in India

10.4 Problem and Constraints of Public Sector in India

10.5 Disinvestment & Privatisation in India

10.6 Joint Sector in India

10.7 Cooperative Sector in India

10.8 Summary

10.9 Key Words

10.10 Self Assessment Question

10.11 Suggested Readings

10.1 INTRODUCTION

The Indian Economy which is also known as mixed economy is characterised by the co-existence of Public, Private, Joint and Cooperative Sectors. The pattern of economic, social and industrial development of India has been highly influenced by the roles of these sectors given by the industrial policy resolutions 1956 & 1991.

To accelerate the economic and social development the political ideology of India gave the public sector a dominant role in the industrial development of the country.

In a mixed economy, the private sector, also, has an significant role to play. According to the Industrial policy resolutions, 1956 & 1991, it is expected that in the context of the country's expanding economy the private sector will have the opportunity to develop and expand.

The heavy financial burden imposed by the PSUs and growing public discontent against them due to their inefficiency, indifferent, lack of concern for the customer needs, corruption & nepotism in management

led to privatisation in not only in India but world wide. Even in the communist countries privatisation became a vital measure of economic rejuvenation. Disinvestment is one of the method of privatisation.

The Dutta committee report on joint section made the joint sector popular after 1969. It conceived the idea of public private ownership as joint sector.

In India, the cooperative sector has been assigned an significant role in the development of the nation. The basic objective behind cooperative sector are prevention of concentration of economic power, wider dispersal of ownership, active involvement of people in economic development of the nation.

10.2 OBJECTIVES OF THE UNIT

The objectives of this unit are to explain the

- Performance of Public Sector in India.
- Problem and constraint faced by the Public Sector in India.
- Concept of Disinvestment and Privatisation, its objective and methods.
- Concept and role of Joint Sectior in India.
- Concept and significance of cooperative Sectior in India.

10.3 PERFORMANCE OF PUBLIC SECTOR IN INDIA

The Public Sector Enterprises have over the years grown in terms of number, turnover, no of people employed, share in net domestic product, share in capital formation, share in foreign exchange earnings etc but in terms of profitability, efficiency utilization, professional management and innovation they are far behind and facing many problems. In order to improve the performance of public sector government took a policy initiative by introducing the concept of memorandum of understanding. Bureau of Public Enterprise established in 1965 as an nodal agency to provide managerial advisory and performance monitoring services to PSUs.

The industrial policy statement announced by the Government in July 1991 envisaged disinvestment of a part of Govt. holding in selected enterprises in order to provide market discipline and to improve

performance of PSUs. Two more development to improve performance of PSUs are giving importance to private sector to increase competitiveness and withdrawal of budgetary support to PSUs are important.

The evaluation of the performance of public sector is rather difficult. Public Sector enterprises should be evaluated in terms of social cost-benefits rather than commercial profitability alone.

The performance of the public sector can be made on the following grounds:

1. *The share of the Public sector in the net domestic product* has been steadily increasing. The public sector accounts for one-fourth of the total income of the economy. The compound rate of annual growth of the public sector was 6 percent whereas that of the private sector was only 2.8 per cent.

2. ***Relative efficiency of investmen:*** If we evaluate the in the public enterprises against the performance of private enterprises, we find that private enterprises are, on an average, 2.5 times more profitable than public enterprises. For every hundred rupees invested, the private enterprise yields a return of Rs. 11.40. while the same amount in the public enterprise yields only Rs. 4.70. We must not forget that public enterprises are mostly concentrated in basic, core and heavy industries where the rate of return is very low and also in sick enterprises taken over by the Government, such as the National Textile Corporation and Coal India Limited.

   The economic efficiency of a public sector industry should be considered in terms of the transformation of the industrial structure, modernisation, higher labour productivity on a countrywide scale etc. The fact is that a higher proportion of the value produced by the public sector industries is realised outside this sector and it is therefore very difficult to estimate the efficiency of public sector enterprises in terms of costs and profitability.

   B.H. Dholakia advocates the adoption of the total factor productivity criterion to judge the efficiency of public sector enterprises. The criterion examines the contribution made by the enterprise to the country's net national product in terms of rent, wages and salaries, interest and profit. Adopting this criterion Dholakia finds that over

the period 1967-68 to 1975-76, the overall economic efficiency of the public enterprises increased at a rate of 2.44 percentage points per annum whereas that of private sector enterprises could increase by only 0.59 percentage points per annum.

3. *Share in Capital Formation:* Public sector has played an important role in capital formation. The share of the public sector in the total gross fixed capital formation in the country was 41 per cent during the first and second Plans and 49 per cent during the third Plan. It was reduced to 42 per cent in the Fourth Plan and 40 per cent in the Fifth Plan. But it again rose to 47 per cent in the Sixth Plan and 48 per cent in the Seventh Plan.

It should be pointed out that investment in tile private sector producing luxury goods should be evaluated lower than the similar type of investment in the public sector which is engaged in the production of basic goods and infrastructural services to the economy. Considering this, capital formation in the public sector is very significant for a developing economy like India.

4. *Public Sector Enterprises and Employment:* In India the organised sector is very small as it provides 10 percent of the total employment in the economy and about 90 percent is provided by the unorganised sector. The workers employed in the public sector constitute only 7 percent of, he total labour force in the country and those employed in the organised private sector are 3 percent, The number of persons employed in the public sector enterprises stood at 23.05 lakh as on March 31, 1991. The public sector is a model employer which provides the workers better wines and other facilities compared to the private sector. The public sector enterprises have also spent huge amounts for the development of townships around industries.

5. *Public Sector and Foreign Exchange Earnings* Foreign exchange earnings of public enterprises have been substantial and they have also helped in saving foreign exchange through their efforts as import substitution. Capital goods and industrial machinery which were imported about three decades ago are now being manufactured in the country itself. This has saved valuable foreign exchange. Public sector export earnings went up from Rs. 2143 crore in 1980-81 to Rs. 6366 crore in 1989-90. In addition to

actual exports by manufacturing units foreign exchange is also earned from services rendered by air corporations and shipping companies etc.

6. *Financial Performance:* The value of sales of public sector enterprises is an indicator of their contribution to the flow of goods and services in the economy. The total turnover of public enterprises amounts to Rs. 1,18,355 crore in 1990-91. Public enterprises contribute to national exchequer in the form of interest on government loans. income tax and excise duty. In 1990-91 Central Government units generated about Rs. 11.3 72 crore of resources; it contributed about Rs. 1,400 crore towards tax and Rs. 4, 100 crore towards interest.

As far as net profit after tax is concerned, the position was unsatisfactory up to 1980--81. However, the situation improved and public sector made impressive profits. In 1981--82 net profit after tax was Rs. 445 crore which went up to 3,789 crore in 1989-90 but fell to Rs. 2,368 crore in 1990-91.

10.4 PROBLEMS AND CONSTRAINTS OF PUBLIC SECTOR IN INDIA

It is a fact that public sector enterprises contributed less to industrial progress than what was expected of them. These enterprises suffer from a number of shortcomings such as over--capitalisation, underutilisation of plant, bureaucratic and irresponsible management, political interference and wrong personnel policies and overstaffing.

Underutilization of installed capacity is an important cause for the low level profitability in public sector enterprises. Nearly 40 per cent of public enterprises showed capacity utilisation of less than 75 per cent and 20 per cent enterprises worked at even lower than 50 per cent rate of capacity utilisation. Unutilised capacities means higher overhead charges which reduce the rate of profit.

There is over-regulation of Government undertakings which is not good for any business enterprise.

The *Estimate Comittee* on public sector undertakings of the parliament has pointed out several defect in its functioning from time to time. Of the various factors, the following are the particulars to mention:

1. **Lack of Clear Cut Objective :** It might be accused of not pursuing one specific objective whereas at another time, it stresses for another objective. In such a critical situation, the enterprise could not simultaneously attain a high degree of efficiency.

2. **Under-utilisation of Production Capacity :** The public sector enterprises are not working at their full installed capacity. During 1999-2000, 13% Public sector enterprises operated in the capacity utilisation range of 50% to 75% about 29% functioned below 50% utilisation of rated capacity and the remaining 58% had recorded capacity utilisation of more than 75%. This also restricts the flow of goods and services in the economy.

3. **Over-capitalisation :** Public sector projects are charged with over-capitalisation. In other words, the input-output ratio obtaining in many projects was unfavourable. The *study team* found several undertakings, viz., Heavy Engineering Corporation, Hindustan Aeronautics, Fertilizers Corpora-tion (Trombay Projects), etc. over-capitalised.

4. **Long Gestation Period :** Public enterprises involve long gestation period. Many plants take years to be completed. As a result, estimated cost tends to rise over time, while production is realised after a gap of several years. Long gestation period reduces profitability of investment.

5. **Monopolistic Position :** Most of the public sector enterprises enjoy monopolist position in their respective spheres of operation. They work in areas of production that are exclusively reserved for them. Absence of any competition from rivals thus makes them lethargic and inefficient.

6 **Over-regulation and Political Intervention :** Another problem is **over-regulation.** Parliament and the Government constantly keep too close a watch on the heads of PEs. depriving them of even the minimum independence in running their business. (The set of guidelines issued by Bureau of Public Enterprises are in two volumes and run into 1,100 pages).

7. **Over-staffing :** Most of the pub-lic sector enterprises are over-staffed. They have become the favourite place for providing employment by the Government and politicians. Excessive staff

with not much work to do, only adds to cost and inefficiency of these enterprises.

8. **Labour Troubles :** In many public enterprises serious troubles have occurred continuously. Trade union leaders have almost wrecked some enter-prises like the steel plant of Durgapur. Public enterprises have a special obliga-tion to follow labour policies which are conducive to securing and keeping a competent and contented working force at reasonable cost.

9. **Operational and Managerial Inadequacies :** The public sector enterprises in India are also suffering from operational and managerial inadequacies and inefficiencies leading to huge wastages and leakages of funds in their day today activities.

10. **Absence of Appropriate Pricing Policy :** A balanced and proper price policy is based on a policy of profit. There has been considerable confusion and difference of opinion in India on this question. It is asserted that government undertakings should not bother about getting profits, they should give greater importance to provision of welfare to the community. Public sector enterprises in India have failed because their pricing policies are not rational.

11. **High Expense Ratio :** The expense ratio (*L e.*, net sales turnover/ cost) has also been very high, causing surpluses of enterprises to remain on the low side or even leading to losses. In the case of certain enterprises, the expense ratio has been as high as 100 percent and even more.

12. **Heavy Social Costs :** These enterprises have incurred heavy social costs on the construction, maintenance and administration of townships in which these enterprises are located. These costs are an integral part of the total cost of enterprises. Besides, such expenses as on education, labour welfare, etc., also go to swell the total costs.

13. **Bureaucratic Delays :** Another problem being faced is that public enterprises faces bureaucratic specially in sanctioning of the funds from the Ministry of Finance. This delay causes escalation of costs and inefficiency.

14. **Research and Development :** There is great need to pay more attention to research and development which so far appears to have received less attention by the PSUs in India.

10.5 DISINVESTMENTS & PRIVATISATION

Disinvestment is one of the method of Privatisation. It refers to selling of an investment. Disinvestment implies selling of Government equity shares of Public Sector Units in the Market. It is a concrete step to wards privatisation, it is a step towards liberalization of our economy. The process of disinvestment was started in our country in the year 1992.

The word privatisation first made its appearance way back in the late 60's. Peter F. Drucker first used this word in his famous book 'The Age of Discontinuity' in 1969. Ten year later British Prime Minister Mrs. Margrat gave practical shape to privatisation. Later, a number of countries fell in line with Great Britain in the move towards disinvestment.

The basic objective of privatisation every where is to improve performance of Public Sector enterprises so as to lessen the financial burden on tax payments. The other objectives are increasing the scope and size of Private Sector, encouraging and facilitating private sector investment from both domestic and foreign sources, generating revenues for the Govt. reducing administrative burden on the Govt. etc.

Privatisation and disinvestment are not the same. Privatisation implies a change in ownership, resulting in a change in management. The privatisation of public sector enterprises will occur only when the Govt. sells more than 51 percent of its ownership to private entrepreneurs. Disinvestment on the other hand, has a much wider connotation as it could either involves dilution of government state to a level that results in a transfer of management or could also be limited to such a level as would permit govt. to retain central over the organisation.

The Indian economy had virtually embraced bankruptcy during 1981-91. In 1991 there were 236 operating Public Sector undertakings of which 123 were profit making. The top 20 profit making PSUs counted for 80 percent of the profits, implying that less than 10 percent of the PSUs were responsible for 80 percent of profits. The overall return on investment (ROI) of PSUs for the year 1990-91 was just near 2 percent. The basic charges against PSU for their poor performance are:

(1) Low rate of return on Investment.

(2) Over staff, bureaucratization, wastage of seavce resources,

(3) Declining contribution to national savings.

With the launching of the new economic policy, the Govt. appointed the Krishnamurthy Committee in 1991 and C Rangrajan Committee in 1992 to recommend disinvestment. In 1996 the G K Ramkrishna Commission recommended 58 PSUs for disinvestment. In 1999 Govt. set up a new department of disinvestment for systematic disinvestment programme.

The disinvestment programme started in 1991-92 but the disinvestment carried out so far has been half hearted. The disinvestment process of the Govt. has not really been successful both in terms of realisation of proceeds from disinvestment and achieving the targets for that purpose. There is need for a comprehensive strategy for disinvestments.

The world economists have adopted privatisation as a tool of new economic prosperity. It is expected that the new liberal era of industrialisation will open a new chapter in the field of productivity, efficiency, cost consciousness, competitiveness and management. The participation of the private sector in the development process is not an option, it is an essential requirement of development. Earlier private enterprises which had financial difficulties were taken over by the Government in most of the countries. Now the policy has completely changed. Public enterprises which had financial difficulties are transferred to a private agency. Government policy in India as in other countries is undergoing a sea change both on account of shifts on ideological account as well as basic economic considerations. Moreover, international lending agencies have increasingly brought in the privatisation of public enterprises as a condition for their project lending in several countries. It is evident from the World Bank report which has supported privatisation of public sectors steel industry and World Bank experts have suggested that privatisation is essential to attain productivity and efficiency. Many countries are moving away from nationalisation out of sheer economic compulsions, viz., the widespread failure of the public sector enterprises, higher pressure on government budgets, particularly due to the subsidising of the public sector white elephants and various other macro-economic problems. The public sector has lost its dynamism and according to some, it is now more a drag on development that an engine of growth.

Objectives of Privatisation

1. Improvement in the economic-performance of Public Sector assets
2. Depoliticalisation of economic decision regarding public sector.
3. Reduction in public outlays, taxes and borrowing.
4. Promotion of popular capitalism through wider ownership
5. Promotion of equity to private sector.

PRIVATISATION WORLD WIDE:

Worldwide experience of privatisation started during the 80s with a view to increasing efficiency and competitiveness of industry, means of earning money for Government, reduce budgetary deficit, widen share of ownership of economic assets and eliminate political interferences. Mrs. Thatcher in UK and Ronald Reagan in USA had championed the cause of privatisation.

In the former Soviet Union, Mikhail Gorbachev introduced Glasnost and Perestroika (restructuring) which include a massive decentralisation of economic management and decision-making, setting up of prices through competition, allowing private enterprise in selected areas and soon. France denationalised banking and insurance sectors and some profit making industries. Similar experiments with privatisation also started in Italy, Spain, Sweden, German Netherlands, Ireland, Austria and Japan-.

In the less developed countries privatisation has been pursued mainly because of fiscal problems like budget deficit through a variety of ways such as total or partial denationalisation, closure or liquidation of perpetually loss-making enterprises, transfer of management, selling through auction etc. Signals of privatisation process in India began with certain loosening of controls in the area of industrial licensing, liberalisation of import control policy, reduction in income and corporate tax rates and the long-term fiscal policy since 1985.

India's development strategy failed to exploit the advantages inherent in the economy. Instead, through planning it created high cost inefficient industries of less than economic scale and sheltered them from foreign competition. Self-reliance was perverted into self-sufficiency. The softness of the budget constraint of the bloated public sector and bureaucracy is at the heart of the problem. The socio-political

system was unable to distribute assets. The instruments of industrial and import licensing policy have not succeeded in reducing inequalities. Even though tax revenue as a share of GDP has risen, the revenue has been increasingly squandered. The deficit reflects the growth of subsidies of various kinds and the soft budget constraints of the public sector.

Many observers argue that the solution to industrial sickness in the public sector is privatisation. But privatisation is not the real solution. Bagaram Tulpule has rightly observed that closing down PSUs will involve heavy financial as well as other costs. Closure of these will take away the jobs of over four lakh employees.

The Government of India has ruled out any overmight handing over of such PSUs to the private sector. It would be better if the management of ailing PSUs comes out with credible revival packages. The Government would take a pragmatic approach to decide the fate of these undertakings.

The present trend indicates that public enterprises require a radical restructuring and reorientation. Privatisation has transformed itself from rhetoric to reality in both developed and developing countries. In the present day situation it is an accomplished fact and not a rigmarole. It is a reform that necessitates redistribution of income and usually a change in employment patterns.

10.6 THE JOINT SECTOR

The radical shift in Government policy has brought the concept of the joint sector into sharp focus. It is nothing but a form of partnership between the public sector and the private sector.

Concept: Although the Joint Sector concept was conceived by the authors of the 1956 Industrial Policy Resolution, it was really the brainchild of the industrial Licensing Policy Enquiry Committee, popularly known as the Dutta Committee. Besides the public and the private sectors, there was a need for a new sector-a joint sector-for the harmonious industrial development of the economy. The joint sector is envisaged as something in between the public and the private sector and in which the state could actively participate in management, control and decision-making. It is claimed that the joint sector scheme has the advantages of both the public and the private sectors and at the same time avoids the evils of both sectors and thus fulfils the basic socio-economic objectives of the country. Moreover, it offers an avenue of growth when all other gates to growth

seem to have been closed. The concept of a joint sector is basically an extension of the idea of mixed economy in which the public and private sector units are separate and function independently but are nevertheless part of a national plan. It is a compromise between total nationalisation and complete private autonomy. In the joint sector, the relationship between the representatives of the private and public sectors is much closer as they have to work together within the same unit. The joint sector was recommended for units where a large proportion of the cost of a new project was to be met by public financial institutions either directly or through their support.

There are three different concepts of joint sector: First, financial institutions can exercise the right to convert debt into equity and appoint directors on company boards. Secondly, Government may appoint directors on company boards through the exercise of powers granted by the Monopolies and Restrictive Trade Practices Act to check malpractices. This need not involve share participation and must not be confused with the joint sector. The third form is the real joint sector where the Government directly, or through its agencies is a co-shareholder in an enterprise. The Government in this case plays a promotional and entrepreneurial role and is an active majority partner.

Features of joint sector: In a memorandum submitted to the Government. JRD Tata suggested a slightly different definition of the joint sector. "A joint sector enterprise is intended to be a form of partnership between the private sector and the Government in which the State participation of capital will not be less than 26 per cent, the day-to-day management will normally be in the hands of the private sector partner, and control and supervision will be exercised by a board of directors on which government is adequately represented".

The Dutta Committee advocated conversion of some of the private sector units into joint sector enterprises as an important means of curbing the concentration of economic power in certain private groups. A number of new industrial projects had been established in the private sector with the help of funds provided by public financial institutions but the latter had not asked for a voice in the management. It was strange that huge private industrial empires should be built up with funds provided by public institutions without knowing how the money was actually spent. The Dutta Committee asked the Government to enunciate a new industrial policy whereby this anomaly could be rectified.

There was a change in the industrial policy without there being a change in the 1956 Policy Resolution. The Government announced the new industrial policy in February 1970. The joint sector concept as suggested by the Dutta Committee, was accepted in principle. It was laid down that while sanctioning loans or subscribing to debentures, public financial institutions should in future have the option to convert them into equity within a specified period of time. Specific guidelines had been laid down. In case the aggregate loans granted were below Rs. 25 lakh, the financial institutions are not to insert any convertibility clause in the agreement. If the loans granted were between Rs. 25 lakh and Rs. 50 lakh, it is optional for the financial institutions to insert a convertibility clause in the agreement. Once convertibility was agreed to, the undertaking is required to appoint representatives of the lending institutions as directors on company board.

It is not difficult to understand the logic behind the joint sector. As had been emphasised by the then Prime Minister, the old concepts of exclusive private ownership and private profit do not fit in with today's social values and priorities. An open society requires an open corporate structure; the joint sector provides this openness without taking away the advantages of private enterprise and initiative. The joint sector is a departure from exclusive private ownership but it should be welcomed in preference to outright nationalisation.

The joint sector experiment has been viewed with misgivings by many industrialists. It has been assailed as 'nationalisation by the backdoor'. But others have welcomed it on the ground that it is preferable to wholesale nationalisation of existing private undertakings. There is one serious objection to the joint sector. The concept is based on mutual trust and confidence, yet the idea originated because the private sector could not be trusted enough to grow on its own. Thus, conceived in mistrust, the marriage might be a disastrous failure.

The joint sector was evolved to check the concentration of economic power of private groups. But some think it is not necessary to check the concentration of economic power as the existing Monopolies and Restrictive Trade Practices Act was adequate for the purpose.

10.7 THE CO-OPERATIVE SECTOR

The co-operative sector has emerged as an important sector in our

economic environment. Co-operatives, inspired by the principle of self-help, are of great importance for the poor people of India. Co-operatives consist of persons of small means. Unable to face cut-throat market competition, these people get together and organise themselves into co-operatives. Thus poor individuals, through co-operative, acquire strength to perform tasks which they would not be able to do otherwise.

The co-operative idea took a concrete shape in India for the first time in 1904 when the Co-operative Credit Societies Act-a measure designed to combat rural indebtedness and provide for registration of credit societies-was passed. Later in 1912, the Co-operative Societies Act also provided for registration of non-credit societies as well as federations of co-operatives. Since then the co-operative movement has made noticeable progress, specially in agricultural credit, marketing and processing of agricultural produce, supply of farm inputs and distribution of consumer goods. An idea of the growth of co-operative movement in India can be had from the fact that there were as many as 3.50 lakh co-operative societies of all types with the total membership of about 16 crores and total working capital of about Rs. 62,500 crore as on June 30. 1990. Other distinguishing feature of the co-operative scene is that it is largely village-based. The Government's emphasis on institutionalisation of distribution of inputs to farmers and marketing of their agricultural produce through co-operatives owned by them has helped in strengthening co-operative sector in the rural areas.

By June 1989 there were 93.000 Primary Agricultural Credit Societies operating in the rural areas. Membership of these societies comprised of 9.20 crore persons. Co-operatives occupy an important place in the field of village and small industries and handloom weaving. As on June 30. 1989, there were 53,786 industrial co-operatives with a membership of 43.76 lakh. The National Federation of Industrial Co-operatives was set up in 1966 with a view to assisting the marketing of products of the member societies.

The total number of co-operative spinning mills installed was 10,948 in the growers' sector and 61 in the weavers' sector with a capacity of about 29.13 lakh spindles which was about I 1 per cent *of* total spindlage in the country.

Functional co-operatives for programmes like dairy, fishery and poultry mainly extended help to the weaker sections, as such co-

operatives provide increased employment and income opportunities to different sections like small and marginal farmers and fishermen. The National Co-operative Development Corporation (NCDC) also gives financial assistance to various types of co-operatives.

Co-operative societies is a state subject under the Constitution. However, such co-operative societies having their objects not confined to one State, and come under the jurisdiction of Central Government. The Multi-State Co-operative Societies Act, 1984 came into operation from September 16, 1985. At present, there are 182 Multi-State Co-operative Societies in the country.

A major development after Independence has been the emergence of the National Co-operative Federations which added a new dimension to the co-operative infrastructure. With the National Co-operative Union of India at the apex, other National Level Co-operative Federations established in the country are: National Agricultural Co-operative Marketing Federation, National Federation of State Co-operative Banks, National Federation of Co-operative Sugar Factories, National Co-operative Agriculture and Rural Development Banks' Federation, National Co-operative Consumers' Federation, National Federation *of* Industrial Co-operatives, All India Federation *of* Co-operative Spinning Mills, National Co-operative Housing Federation, National Co-operative Dairy Federation, National Federation of Urban Co-operative Banks and Credit Societies, National Federation of Fishermen's Co-operatives, National Federation of Labour Co-operatives and National Co-operative Tobacco Grower's Federation.

10.8 SUMMARY

India is a mixed economy. Public, private, Joint and cooperative Sector Coexist here, all these have their own specific role to play in the economy. Public Sector, as per our political ideology, was given preference after independence and played a very vital role in the infrastructural development of the country. Till 1980 PSUs were playing dominant role but during 80's the performance of PSUs declined not only in India but would wide.

Private Sector has also played a significant role in the growth of Indian Economy and after worldwide liberlization programme it has gaind momentum all over world.

The joint Sector and Cooperative Sector are also important because of their specific charactersitics and role for Indian economy.

10.9 KEWWORLDS

Private Sector: Enterprises owned by private person.

Joint Sector: It is a form of partnership beteen the private sector and Government.

Cooperative Sector : It is a type of enterprise which is managed by cooperative society.

Privatisation: Privatisation is a modern name in business and economies. It mean transfer of ownership from Govt to Private hands.

10.10 SUGGESTED ASSESSMENT QUESTION

1. Describe the growth and performance of Public Sector in India.
2. Discuss main problems and constraints faced by Public Sector in India.
3. What is disinvestment? How for disinvestment is successful as a mode of privatisation in India?
4. What is Joint Sector. Discuss its features featms and role in Indian Economy.

10.11 SUGGESTED READINGS

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15. Whats cooperative Sector. Discuss different fields of business where cooperatives have been successful.

UNIT-11 SOCIAL ENVIRONMENT: SOCIAL RESPONSIBILITY OF BUSINESS, COPRA 1986

Structure:

11.1 Introduction

11.2 Objectives

11.3 Social Environment

11.4 Social Responsibility of Business

11.5 Consumer Protection Act. (COPRA) 1986

11.6 Summary

11.7 Key Words

11.8 Self Assessment Questions

11.9 Suggested Readings

11.1 INTRODUCTION

In this unit you will have an understanding of various dimensions of the social environment of business. Specifically we shall discuss the evalving social factors and changes value system in the Indian Social Set up, viewpoints on the question of business assuming social responsibilities and the consumer protection Act (COPRA) 1986 issues attracting serious attention in modern times. Business including trade and industry today happen to be integral parts of the social system. Over ages, the complexion of society has changed in many ways, and so have the nature and forms of business enterprises.

Business must have a social purpose, business concerns must discharge social responsibility and social obligations and have social commitment. Otherwise, business cannot enjoy social sanction. This makes necessary for us to understand the serial environment of business. No business can survive and grow without social harmony. Different countries, over different time periods attain social harmony and order of different forms. Through different ways and means. Thus the social environment differs over space, time and methods. From the stand point of description and analysis, it is important to begin by identifying the critical elements of any environment. In brief we can say that business, like weather, is with us every day. It enhances the well being of the society, at the same time it is deeply influenced by

social elements. In order to discharge social responsibilities properly, it is necessary to understand the social environment of business. Social environment includes values, culture, tradition conventions, social institution and social pressure etc. The family, caste system, joint family system child marriage and inheritance are important social institutions.

11.2 OBJECTIVES OF THE UNIT

After studying this unit, you would be able to:

- Understand the social environment of Business.
- Identify the critical elements of Social Environment.
- Describe the Social Responsibility of business
- Understand the consumer protection Act 1986 and its provisions.

11.3 SOCIAL ENVIRONMENT

Business oganisation basically a social organisation. As such, business must have a social purpose Business Concerns must discharge social responsibility, social obligations and social commitment. Otherwise, business cannot enjoy social sanction. This makes it necessary for us to understand the social environment of business.

A business manager lives and operates in this environment, the manager who takes decision cannot neglect the social factors. A host of factors like social value belief tradition, and conventions, social attitudes, social institutes, class structure, social groups constitute the social environment. Successful business managers cannot afford to neglect there factors.

Majar Socio-cultural Variables : Different socio-cultural elements arc active is the environment which exercise their impact on the business. They can be enumerated as given below:

- Social institutions and systems.
- Social values and attitudes
- Education and culture
- Role and responsibility of Government
- Social groups and movements
- Socio-economic order
- Social problems and prospects

Their interaction with the business can be explained as given below:

1. **Social Institutions and Systems** develop through history, culture and heritage. The caste system, the joint family system the child marriage, the patriarchal family : all these are examples of social institution and systems. In our society of recent past, the caste system ensured a very simple occupational division of labour. The place of individual was very clearly defined in the social hierarchy of the joint family system where decision-making was centralised in the head of the family who commanded respect by way of age and experience. The position of women and children was also defined by the then social set-up.

2. Social Values and Attitudes: Social values and attitudes also play major role in this context. In India today, most of the age-old social institutions are dying Cast. It is because the social values and attitudes are changing very fast. The Western values of individualism have caught up our imagination. Indian women do not any longer remain satisfied as housewives. Business does not remain confined any more within a given community or caste. Customs, traditions and conventions are no longer rigid, but flexible. The society's view towards authorities, responsibility and delegation; the society's attitude towards business as a profession; view towards achievement and work; view towards ownership and management—all have very definite implications for sociological environment of business.

3. **Education and Culture :** Education and culture are also an important ingredient of sociological environment. In this category we may list : attitudes towards education; need for business education; education match with skill requirement of industry and manpower utillisation; role of' business schools and executive development programmes; education vs. training, correlation between formal literacy and the level of culture; spread of' education and its impact on business ethics; material progress and business morality; business culture and the organisation culture.

4. **Role of Government :** The Government is the apex social institution and particularly in a democracy, the Government has a very responsible function of maintaining social order and harmony in view of the interests of the majority. It is the Government which has to make sure that social progress is not handicapped by the tyranny of the

majority, otherwise social tensions will mount even under democracy and certainly, business cannot grow under social tension. In India, the Government being a Welfare State is trying its hard to balance the level of achievement and aspirations at society level. Government removes social tension and frustrations.

5. **Social Groups and Movements :** In a society, individuals form groups on the basis of caste, creed, religion, language, trade and profession, and similar other factors. Social groups and the social movement that they engineer is a very crucial and critical variable of non-economic environment. Some of these groups have direct business interests. Thus, consumerism, trade-unonism, co-operative movement, professional management, shareholders' association : all pose chal-lenges for business operation.

6. **Socio-economic Order :** In our vast country-India we have plural society. Ours is a land of variety of food, dress, language, religion and culture. On the other hand, *we* have dual *economy* with traditional (subsistence or unorganised) sector coexisting with modern (commercialised or organised) sector; technological dualism in India is very pronounced-the bullock carts play on the road and the Airbus flies through the sky. All these make a very unique socio--economic order for India today. And from time to lime, this social order gets disturbed and modified, hopefully for the better, through social movements and social policy formulation on subjects like science and technology, ecology and forestry, family planning, animal husbandry, etc.

7. **Social Problems and Prospects :** These both arc offshoots of a changing socio-economic order. When consequent to industrialisation and socio-economic development in many developing countries, we observe that the death rate falls faster than the birth rate, and this results in explosive population growth. This results in growing unemployment and poverty, poor housing and sanitation, urban congestion, pollution and increasing incidence of anti-social activities. The economists, therefore, suggest that we should always attempt *a social cost-benefit analysis* of industrial development. As the society moves from "pre-industrial" towards "post-industrial" stages of development, social benefits must outweigh social costs, otherwise, the emerging new social order will prove unstable. In India, we have been facing population problem since the dawn of industrial development and it has been nullifying our efforts of development on a stable basis.

11.3 SOCIAL RESPONSIBILITY OF BUSINESS

A business enterprise, in modern times *is* not only regarded as an economic institution but also as a social institution. It is expected to behave as a good neighbour which should take part in the betterment of the community and fulfilling its responsibility as a responsible citizen in a democracy. Business is, therefore, responsible not only for economic results but also for making social contribution. When the very existence of a business organisation depends (on society, it should not ignore its responsibility towards the society.

Definition of Social Responsibility

According to Bowen, social responsibility is an "obligation to pursue those policies to make those decisions or to follow those lines of action which are desirable in terms of objectives and values of our society".

It is clear from the above definition that the social responsibility involves the working of an individual or a group in such a way that it does not infringe or impinge the legitimate interests of all others associated with this. Koontz and O'Donnell are also of the view that social responsibility is the personal obligation of everyone, as he acts in his own interest to assure that the rights and legitimate interests of all others are not impinged.

George A. Steiner has defined social responsibility from three points of views : the conceptual, the impact of the responsibility on profits, and specific social programme. The conceptual social responsibilities refer to the businessman's decisions and actions taken for reasons at least partially beyond the firm's direct economic or technical interests. Corporate social programmes include product safety, advertising, consumer services, general community services and improving employee satisfaction. A company may take socially responsible actions which serve to improve short-range profits.

Thus, social responsibility involves an intelligent and objective concern for the welfare of society which, on the one hand, limits or prevents individual and corporate behaviour from being destructive and, on the other, leads in the direction of positive contributions, wherever feasible, to the betterment of human resources in different ways as desired by the society.

Justification for Social Responsibility

As stated earlier also, every business organisation operates in an environment with which it interacts. No organisation can survive in the absence of environment. It has to draw its inputs like manpower, money, machines, material, etc. from its environment. After converting the inputs into output, the organisation sells it to the various segments of society that are the important components of the environment. Thus, for its very existence, a business organisation depends on the society both for the procurement of required input and disposal of its output. When this is the case, it becomes obligatory on the part of business also to do its best for the welfare of the various sections of the society.

There are no two opinions that making reasonable amount of profits is necessary for the survival and growth of business. There is also no controversy over the fact that the business should take care of the interests of customers. But alongwith these two basic objectives, the business should pay due attention to the long-term welfare of the society. Today, it is expected of the business to take on itself the responsibility for serving and safeguarding the social interests as one of its important objectives. Business can significantly assist the development of backward are-as, agriculture, weaker sections of the society, social welfare and can also lead towards community development. With enormous resources at their disposal, the business organisations, specially the bigger ones, can ecidedly play an important role towards social welfare and thus can be the pace-setters.

Social Responsibility of Business towards Diverse Groups (interest groups) of Society

There are various interest groups in the society which may affect the function-ing of a business organistaion. Such interest groups may be identified as:

(i) Shareholders.

(II) Customers

(iii) Employees

(iv) Government

(v) Suppliers, creditors and others

(vi) Society in general

The business has responsibility towards all such interest groups

as follows:

(1) Responsibility towards Shareholders

The shareholders take great risk in making investment in a business. Therefore, a business organisation is responsible to safeguard the interest of shareholders who are its owners. This can be done by :

(i) Ensuring a fair return on the investment made by shareholders, which is possible when the enterprise earns adequate profit.

(ii) Keeping the shareholders informed about the functioning of the functioning of the organisation.

(iii) Strengthening and consolidating the position of enterprise.

(iv) Generating adequate funds and reserves for re-investment and also for declaring reasonable dividend during a lean period.

(v) Building up the company's financial independence.,

(vi) Keeping up the prices of shares.

(vii) Improving the public image of the company.

(2) Responsibility towards Customers :

Customers are the foundation of business. It is they who keep a business organisation in existence. It is basically to meet the wants of consumers that the society entrusts wealth reducing resources to a business organisation. It therefore becomes obligatory on the part of a business organisation to create and serve customers through:

(i) Supplying goods and services at fair and reasonable prices.

(ii) Ensuring good quality of such goods and services.

(iii) Ensuring adequate and regular supply of such goods and service,

(iv) Ensuring after-sales services.

(v) Ensuring only genuine advertisements and that too in accordance to public morals and culture.

(vi) Redressing the grievances of customers, if there are any.

(vii) Ensuring adequate research and development to improve quality and reduce cost of product-on of goods and service

(viii) Informing about adverse effects, if any, of the goods and services being sold by the organisation.

Responsibility towards customers assumes added significance in case of Shortage economies' like India.

(3) Responsibility towards Employees:

A business organisation can run effectively only when the morale of its employees is high and their needs are fully met. Hence, the management owes responsibility towards its employees which it can discharge in the following manner:

(i) Fair wages to employees.

(ii) Adequate training and development facilities.

(iii) Reasonable opportunities for promotion.

(iv) Good working and living conditions.

(v) Adequate welfare facilities and amenities.

(vi) Adequate social security treasures.

(vii) Workers' participation in management.

(viii) Recognition of their personality.

(ix) Appreciation for good work and conduct.

(x) Progressive and healthy personnel policies and programmes.

Needless to mention that a contented labour force is a real asset of an organisation.

(4) Responsibility towards Government:

Government provides a number of infra-structure facilities and a conducive environment to business organisation for their proper functioning. Therefore, the management of a business organisation can also discharge its responsibility towards the government in the following manner:

(i) By abiding with all relevant government legislation.

(ii) By maintaining fair trade policies and practices.

(iii) By paying all duties and taxes due from it.

(iv) By avoiding political favours.

(v) By not giving any bribe etc. to any government official etc.

(5) Responsibility Towards Suppliers, Creditors and others:

The functioning of a business enterprise is also affected by the suppliers, creditors and other interest groups with whom the business has to interact. Hence, management owes a responsibility towards such interest groups. This can be performed in the following manner :

(i) Prompt payment to suppliers.

(ii) Prompt payment of interest to lenders.

(iii) Furnishing of accurate information to creditors, financial institutions and suppliers.

(iv) Proper liason with all interest groups.

Discharging of the responsibility towards suppliers and creditors etc. boosts the public image of the enterprise.

(6) Responsibility towards the Society in General

A business enterprise exists and functions in the society. It is an integral part of our social system which facilitates its functioning. Hence, it owes a special responsibility towards the society in general which can be discharged in the following way :

(i) By extending general amenities to society.

(ii) By assisting in improving the standard of living of the people of the community.

(iii) By avoiding pollution of the environment.

(iv) By avoiding wasteful expenditure.

(v) By establishing socially desirable standards.

(vi) By keeping in view the social norms, conventions, traditions and customs while forming its policies and programmes.

(vii) by adopting some village(s) for its/their social and economic develop-ment.

Thus, no business enterprise, specially the big ones, should ignore its social responsibility, if it has to function effectively. The enterprise should be so managed as to make possible every thing likely to strengthen the society and lead to its betterment and prosperity.

11.4 CONSUMER PROTECTION ACT (COPRA 1986)

In a country like India where a large percentage of masses are illiterate and poorly informed, and have limited purchasing power and where growth for social justice is the guiding principles of national planning. The Government has a significant role in safeguarding by interests of the consumer is the need of hour.

Consumer Protection Act: There has been a tradition of exploitation of consumers in India due to shortages and the sellers' markets. The consumers as buyers always had a poor bargaining power. Traders often

follow unfair and unethical practices. In spite of many legislations, they have failed to provide any effective protection to consumers due to lack of proper implementation. The service section is no exception to unethical practices.

To provide protection to consumers, as already pointed out, a number of legislations have been passed including Sale of Goods Act, 1930, Essential Commodities Act, 1955, Prevention of Food Adulteration Act, 1954, Prevention of Black Marketing and Maintenance of Supplies of Essential Commodities Act, 1980, Standards of Weights and Measures Act, 1956, Agricultural Products Grading and Marketing Act, 1937, Indian Standards Institution Certification Act, 1952, MRTP Act, 1969 etc. MRTP Act acquired the elements of consumer protection legislation with the amendments in 1984 when unfair trade practices were brought in its fold. In spite of these changes in the MRTP Act, the need was felt for a more comprehensive consumer protection legislation. As a result, the Consumer Protection Act, 1986 was born. It is described as a unique legislation of its kind in India to offer protection to consumers. The main objective of the Act was to provide better protection to consumers unlike other laws which were punitive or preventive in nature. This Act will provide simple, speedy and inexpensive redressal to consumers' grievances.

Other salient features of the Act are:

(i) It applies to all goods and services unless specifically exempted by the Central Government.

(ii) It covers all sectors, public, private and cooperative.

(iii) It confers certain rights on consumers.

(iv) It envisages the setting up of consumer protection councils at the central, state and district levels whose main objectives are to promote and protect the rights of consumers.

(v) The provisions of this Act are in addition to the provisions of any other Act. "Consumer" under the Act means any of the following persons:

(vi) One who buys any goods for a consideration which has been paid or promised or partly paid and partly promised or under any system of deferred payment.

(vii) One who hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised or under any system of deferred payment.

In addition, the Act is understood to include the following persons as consumers:

(i) Those allotted plots or houses by a housing and development authority.

(ii) Patients receiving medical treatment in a government hospital.

(iii) Patients getting treatment at a private nursing home.

(iv) Persons selling/purchasing of shares to/from a share broker.

(v) User of services (like electricity, telephone, etc.) from public/ private utility bodies.

Rights of Consumers: For the first time in the history of consumer legislation in India, The Consumer Protection Act, 1986, extends statutory recognition to the rights of consumers. **The Act recognises the** following six rights of consumers:

1. *Right to safety, i.e.,* the right to be protected against the marketing of goods and services which are hazardous to life and property.

2. *Right to be informed, i.e.,* the right to be informed about the quality, quantity, potency, purity, standard and price of goods and services, as the case may be, so as to protect the consumer against unfair trade practices.

3. *Right to choose, i.e.,* the right of access to a variety of goods and services at competitive prices. In case of monopolies, such as railways, telephones etc. it means right to be assured of satisfactory quality and service at a fair price.

4. *Right to he heard, i.e.,* the consumers' interests will receive due considerations at appropriate forum. It also includes the right to be represented in various forums formed to consider consumers' welfare..

5. *Right to seek rederessal i.e.* the right to seek redressal against unfair practices or restrictive trade practices or unscrupulous exploitation of consumers. It also includes the right to a fair settlement of the genuine grievances of consumers.

6. *Right to consumer education, i.e.,* the right to acquire the knowledge and skill to be an informed consumer.

What are the complaints that may be lodged?

A compaint may relate to one or more of the following.

(i) that an unfair trade practice or restrictive trade practice has been adopted by any trader;

(ii) that the goods bought by him or agreed to be bought by him stiffer from one or more defects;

(iii) that the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;

(iv) that a trader has charged for goods mentioned in the complaint a price in excess of the price fixed by or under any law for the time being in force or displayed on the goods or on any package containing such goods;

(v) that goods which will be hazardous to life and safety when used are being offered for sale to the public in contravention of the provisions of any law for the time being in force requiring traders to display information in regard to the contents, manner and effect of the use of such goods.

Consumer Disputes and Redressal Agencies:

The Act provides a three-tier quasi-judicial machinery at the district, state and national levels. The following redressal agencies have been established at various levels:

(i) District Forum: A District Forum is set up by the State Government for each district. Each District Forum is headed by a District Judge with two other members. The District Forums have jurisdiction to entertain complaints where the value of the goods or services and the compensation claimed does not exceed Rs 5 lakh.

(ii) State Commission: A State Commission is set up by the State Government for the respective state. The State Commission is headed by a judge of a High Court and two other members. The State Commission has jurisdiction to entertain complaints where the value of goods or services and compensation claimed exceeds Rs 5 lakh but less than 20 lakh. The State Commission also hears appeals against the orders of the District Forums within the State.

(iii) National Commission: A National Commission is set up by the central Government. It is headed by a judge of the Supreme Court and consists of four other members. The national commission has jurisdiction to hear complaints where the value of goods or services and compensation, if any claimed exceed Rs. 20 lakh. It also hears appeals against the order of any state commission.

11.6 SUMMARY

Business is a social activity. The social environment includes a host of factors like social values, cultures, belifs, tradition social institution, class structure, social group process or social dynamics etc.

Social responsibility of business isconcernedwith the functions, Programmes and Policies of an Enterprise for the welfare of the various section of society. The critical elements of social environment are : social institutions and systems, social values and attitudes, education and culture, social groups and movements. The socio- economic order, social problems and prospects etc.

The consumer movement witness the enactment of consumer protection Act 1986 against the exploitation of consumer from business community.

The business has therefore to be run in a socially responsible manner. This is necessary if the business has to sensitive and grow in the long run.

11.7 KEY WORDS

Social Environment : A subset of the environment consisting of and affected by social factors such as social institution and systems, social structues and formations, social values and attitudes, educational and cultural influences etc.

Social Responsibility: Consideration of the impact of the firm's action on society.

Copra 1986 : Consumer Protection Act, 1986.

11.8 SELF ASSESSMENT QUESTION

1. What is social environment of Business?
2. Discuss the elements of social environment.
3. Discuss the responsibilities of business. Give arguments for and against.
4. What are the different rights of the consumer under the COPRA 1986.
5. Identify the need of social responsibilities of business.
6. Business must be run in a socially responsible manner." comment.

11.9 SUGGESTED READINGS

Framcis Chermilam - Business Environment, Himalaya Publishing House, Place & Years

George Steiner - Business and society, Macmilan, Place & Years

Tandon B B - Indian Economy. Tata Mcgraw Hill, Place & Years

Kirshna Suri - Environment Politics, Sage India, Place & Years

Nadkarni MV - The Emerging challenges, Sage India, Place & Years

Das Gupta and Sen Gupta – Government and Business, Vikash Publishing House.

B. Ghosh - Business Environment, Vikash Publishing House Consumer Protection Act, 1986, Place & Years

UNIT-12 BUSINESS ETHICS,

Structure:

12.1 Introduction
12.2 Objectives
12.3 Business Ethics
12.4 Cross Cultural Environment
12.5 The Environment Protection Act
12.6 Summary
12.7 Key Words
12.8 Self Assessment Questions
12.9 Suggested Readings.

12.1 INTRODUCTION

Ethics concerns attempts to distinguish 'right' from 'wrong', 'good' from 'bad' and what constitutes a desirable conduct in a particular set of social circumstances. In the field of business ethics, there is variety of theories, approaches and philosophies.

The term 'culture' includes values, norms, artifacts and accepted behaviour of people that a society may have developed over time.

Every human activity affects the environment, but the inventions that followed the Industrial Revolution and world War II have done more damage than all the preceding ages put together.

In this unit we will learn the meaning, nature & importance of business ethics. The impact of cross cultural environment of business is also a topic of discussion and lastly we will discuss the preventive and regulatory efforts to save environment and ecology.

12.2 OBJECTIVES OF THE UNIT

After reading this unit you will be able to

- Understand about the meaning, characteristics, principles and importance of business ethics.
- Understand the cross cultural business environment.
- Understand the environmental pollution, its preventive and regulatory provisions under EP Act 1986.

12.3 BUSINESS ETHICS

Business ethics become an increasingly fashionable field of study in the 1990's. This represented a reaction to the excesses of the 1980's to the central emphasis on individual financial gain and display of wealth. Business ethics is a growing and developing discipline. It may rightly be called an American subject in the sense that the most recent work on the subject has been carried out in the U.S. The term 'business ethics' refers to the system of moral principles and rules of conduct applied to business. Ethics refers to the code of conduct that guides an individual in dealing with others. Ethics,' as a science, seeks to determine the 'summum bonum' of human life. It passes judgments of value upon human actions with special reference to moral ideal. Judgments of facts are judgments of what is, judgments of value are judgments of what ought to be.

The word 'ethics' is derived from the Greek word 'ethos' which refers to character. Ethics is concerned with personal conduct and moral duty and also concerns human relations with respect to right and wrong. With the development of human activities in the society ethical codes have been devised on the basis of mental and spiritual satisfaction. What is right and what is wrong, what is good and what is bad, what is true and what is false, answers to such questions eventually led the philosophers to devise the concept of ethics. It may be noted that ethics is concerned with morals and philosophy. In the words of Philip Wheelwright, "Ethics is that branch of philosophy which is the systematic study of selective choice, of the standards of right and wrong by which it may ultimately be directed." According to eter F Drucker, "There is only one ethics, one set of rules of morality, one code, that of individual behaviour in which the same rules apply to everyone alike."

Definitions

According to Peter F Drucker, "Ethics deals with the right actions of individulas."

According to Thomas M. Garrett, "Business ethics is concerned primarily with the relationship of business goals and techniques to specifically human ends."

In the words of Rogene A. Buchholz, "Business ethics refers to right or wrong behaviour in business decisions."

From the above definitions it is clear that business ethics comprises the principles, practices and philosophies that guide the business people in their day-to-day business decisions. Business ethics relates to the behaviour of a businessman in a business situation.

The important characteristics of business ethics are as follows:

(1) **As a Guide.** Business ethics constitutes the guiding principles of business functions. With the help of business ethics, businessmen can learn about the process, situation, environment and conditions of the business.

(2) **Goals and Means.** Business ethics is that branch of the business environment in which we can study about the goals and means for the national selection of sacred objects and their fulfilment. It (business ethics) accepts the principles of 'pure good inspires pure means' and 'means justify the end'.

(3) **Art and Science.** Business ethics is concerned with the principles of business behaviour, standards, moral values etc. With the study of business ethics, we can show the difference between good and evil, proper and improper actions of business. For these activities in business, business ethics is known as an ideal science. It is an art because it emphasizes practical use of behavioural standards, techniques and principles.

(4) **Good Intention.** The inner approach of business ethics is related with good wishes, good opinions and good expectations. There is no doubt that business ethics is a moral science which shows difference between good and evil, right and wrong actions of business.

(5) **Study of Human Aspect.** Business ethics studies all those activities which are concerned with human aspect. It is the primary function of the business ethics to provide information to customers, government, society etc.

(6) **Different from Social Responsibility.** Social responsibility is concerned with the functions, programmes and policies of an enterprise, whereas the business ethics is related with the conduct and behaviour of businessmen. But, in practice, social responsibility of business and its policies are influenced by business ethics.

(7) **Theology-Based.** Business ethics plays a dynamic role on the basis of theology. The development of business ethics is possible on the

basis of theological principles, such as, service, human welfare, sincerity, good behaviour etc.

(8) Develops Personal Dignity. Personal dignity can develop with the principles of ethics. A number of problems of ethics may arise on account of not giving dignity to individual. The business decisions should be aimed at giving dignity to employees, shareholders, distributors etc.

(9) Traditional Concept. Business is a traditional concept. It has its origin with the development of human civilization.

(10) Not Related to Emotions. Business ethics is not concerned with emotions but is based on reality and social customs. As a matter of fact, business ethics is developed after testing the requirements of business environment, social customs and traditions.

(11) Universal Philosophy. Business ethics is a universal philosophy. Wherever there are business activities and functions, there it would become essential to consider the questions relating to business ethics.

(12) Different from Social Morality. Business ethics is different from social morality. It does not accept the customs and traditions of the society. But, where the customs and traditions are practically followed, they are accepted as principles of business ethics.

From the above discussions it is clear that business should be conducted according to certain self-recognised moral standards. Ethics is an indirect governing force behind every human conduct, may it be that of an individual or of an organisation. It is an art and science for maintaining harmonious relationship with society, its various groups and institutions as well as reorganising the moral responsibility for the rightness or wrongness of business conduct.

Principles of Business Ethics

The principles of business ethics are generally associated with the names like J. S. Mill, Herbert Spencer, Plato, Thomas Garrett, Cantt, Woodrow Wilson etc. The principles of business ethics are as follows :

(1) Principle of Publicity. This principle was developed by W. Wilson. This principle explains that anything that is being done or is to be done, should be brought to the knowledge of everyone. When any decision is in the knowledge of all concerned, no one gets any opportunity to do unethical act.

(2) Principle of Proportional Judgement. This principle explains that one should make proper judgement before doing anything so that other

people do not suffer from any loss by the conduct of business. A proper judgement is said to be present where ends and means equal or exceed bad effects.

(3) **Principle of Autonomy.** This principle explains that there should be autonomy in the conduct of business. One should not be bound to act under any force of legal provisions, but he or she should act voluntarily on principle of autonomy.

(4) **Principle of Human Dignity.** This principle was developed by Prof. Sturdivant. In his analysis, he stated that man should not be treated as a factor of production, but his satisfaction should be a basic objective of business.

(5) **Principle of Cooperation.** This principle enjoins on us to cooperate with others in doing good work. It prohibits cooperation with those who do evil or with those who do not deserve.

(6) **Principle of Universal Value.** Under this principle it is necessary to the conduct of business that it should be based on universal values. The businessman should act with sincerity, mutual good and confidence. All his (businessman's) acts in' business should be based on the principles of ethics.

(7) **Principle of Sacredness.** This is an important principle of business ethics. This principle emphasises that the means and techniques adopted to secure the business ends must be sacred. A good end may not be obtained by a wrong means, even if it gives benefit to-the people. It may be noted that the object of business should not be against the interest of the people. The businessmen should not use improper, illegal methods and policies for the achievement of objectives.

(8) **Principle of Exemplary Conduct.** For establishing good quality of ethics, the officers or managers should present exemplary conduct before their subordinate staff. Speaking simply, by quoting examples alone, the subordinate staff cannot be motivated towards ethical behavicur.

(9) **Principle of Expectations.** This principle explains that the businessmen should give proper attention to those who have reasonable expectations from the business and are affected by the decisions of business. It is the duty of the businessmen to give priority to the expectations of customers.

(10) Principle of Consciousness. This principle explains that businessmen should give importance to their inner voice coming out from their sub-conscious mind. The businessmen should not play the game of business like cricket, chess, badminton etc. Every business decision should be weighed on the merits of voice from their inner mind.

On the basis of the above principles it may be said that business ethics deals with morality in the business environment. It has been rightly observed that business ethics refers to the system of moral principles and rules of conduct applied to business.

Nature and Scope of Business Ethics:

The nature and scope of business ethics is dynamic. It is because the ethical standards and issues are based on the exiting social, economic and political systems which are dynamic in nature. The ethical attitude in business comes from the fact that a company is in a sense a social system, and as such, reflects social values. The nature and scope of business ethics may be discussed under the following heads :

(1) Relating to Objectives of Business. The scope of business ethics is basically related to all matters which are concerned with business objects. It is essential for the businessmen to consider ethical values in setting business objectives. All the social, economic, national and human objectives must be decided on the basis of business ethics.

(2) Relating to Customers. There are a lot of issues relating to customers which are to be considered on ethical grounds. These issues include purity and safety, misleading advertising and publicity, pricing of goods, quality and price of the products, consumer education, protection of consumer's rights etc.

(3) Relating to Owners of Business. The investors play an important role in business activity. The investors may be known as the owners of business. Although there are a number of rules and regulations for safeguarding the interest of the investors, there is need to consider the matter according to ethical principles. The issues relating to owners of business are as follows :

(a) New issues of shares and debentures and priority of allotment.

(b) Investment of capital in profitable projects.

(c) Notices of meetings to all members of the company.

(d) Declaration of dividends.

(e) Notice of information to every member of the progress of business.

(4) Relation to Government. For the success of business activities, it is necessary to coordinate between government and business. A number of ethical issues are needed to regulate and control the relationship between government and business. The following issues are to be considered on ethical grounds :

(a) Proper assessment of taxes.

(b) Maintaining proper accounts books.

(c) Formation of business.

(d) Payment of taxes to government in proper time.

(e) Implementation of government policies and decisions.

(5) Relating to Employees. Business has moral responsibility towards its employees. There are a number of provisions regulating the conditions of work, wages, appointments, transfers, promotions and labour welfare. In all these issues ethical and moral standards must be applied.

(6) Relating to Creditors. There are a number of issues relating to creditors which need attention on ethical grounds. These issues are:

(a) Repayment of loans in time.

(b) Payment of interest to creditor in proper time.

(c) Following the terms and conditions of loans.

(d) Proper utilisation of loans.

(7) Relating to National Interest. The business should give top priority to national interest. The following issues should be considered:

(a) Industrial policy and lisensing policy.

(b) International co-operation.

(c) Export policy matters.

(d) Providing of employment.

(e) Balanced development of the country.

(f) Optimum use of resources.

(g) Priority to national schemes or projects.

To conclude, it is clear that the scope of ethics is dynamic. The areas of business where the human behaviour, individual respect and satisfaction are involved, need consideration on ethical grounds.

Importance of Business Ethics:

Good ethics promotes good business" -this type of approach has

been given by Raymond Baumhart, Brener and Molander, Storm and Ruch. According to them, business can develop on a long-term basis on ethical grounds only. The Importance of Business ethics can be discussed as follows:

(1) Perpetual Succession. Ethical behaviour of business leads to perpetual succession of success. The business may develop in the shadow of ethics. The well-known authorities state that a person who does hard work becomes ethical and always succeeds in his effort.

(2) Initiative for other People. When some businessmen follow the ethical principles in the conduct of business, others may follow the same principles. Prof. Learned has stated that a businessman who follows the ethical principles in the conduct of business motivates other people to follow the same ethical principles.

(3) Protects Society. Ethics is important because government cannot do everything to protect society. Where law fails, ethics can succeed. An ethically oriented management takes a number of measures to prevent pollution and protect workers' health even before being mandated by law.

(4) Satisfaction of Subconscious. The well-known experts have considered that good ethics can promote good business as the ethical behaviour gives satisfaction to their subconscious mind. There is no doubt that a number of businessmen first behave like individuals and then work for satisfaction to their subconscious mind.

(5) Releases from Worries. A businessman who believes in the ethical principles in the conduct of business, releases himself from worries. That businessman need not worry' about the security of his property as he gets legal protection.

(6) Ethics and Profit. Ethics and profit go together. A businessman who is inspired by ethical conduct, may take profit. The value-driven businessmen are sure to be successful in the long run, though in the short run, the businessmen may lose money.

12.4 CROSS CULTURAL ENVIRONMENT

From the above descriptions, it is clear that ethical conduct of business increases the goodwill of business and the businessmen. It is believed that nobody likes to deal with a mischievous businessman. In the words of Prof. Robert Day, "Good ethics is sound business insurance."

The cultural environment refers to the influence exercised by certain

social factors which are beyond the company's gate. Such factors include, among others, attitude of people to work, attitude to wealth, family, marriage, religion, education, ethics etc.

The interface between business and culture is brought out in the following paras:

Culture Creates People:

The concept of culture is of great significance to business because it is the culture which generally determines the ethos of people. It trains people along particular lines, tending to put a personality stamp upon them. Thus we have Indians, Japanise, Americans, Germans, Britishers and so on.

When people with different cultural backgrounds promote, own and manage organisations, organisations themselves tend to acquire distrinct culture. Thus the culture of the Tata group of companies is different from that of the enterprises owned by Birlas.

Culture Determines Goods and Services:

Culture broadly determines the type of goods and business a business should produce. The type of food people eat, the clothes they wear, the beverages they drink and the building materials they use to construct vary from culture to culture and from time to time within the same culture. Business should realise these cultural differences and bring out product, accordingly.

People's Attitude to Business:

Attitude of people towards business is largely determined by their culture. Business system are a product of belief, morals and customs of the society in which they exist. Indeed, their very existence depends upon social philosophies which conduct and support various kinds of business actions.

Attitude to Work:

How a worker looks at his work in a factory depends on his culture. Motivation, marale and other related aspects of human resource management are based on the worker's attitude to his work. Attitude to leisure vary from country to country. Higher incomes may produce more work or more spare time.

Caste System:

Our society was stratified in to four major castes viz. Brahmins were priests, Kshatriyas were rulers, vaishyas traders and farmers and

Sudras the lowest among the four castes, took to manual labour.

Ambitious or Complement:

An individual's ambitious to grow or remain complacent depends on his cultural ethos. An ambitious individual is highly motivated, is wealth acquisitive, has strong urge to excel, is prepared to change organisations and even take risks. economy becomes vibrant if a large proportion of population comprises ambitious people.

Education:

The close interface of business and higher education is a new development, centuries ago, each had a somewhat hands off attitude towards the other. A relatively small intellectual elite maintained their seclusion in University halls, educating a few selected students to become intellectual social leaders of their nation. Education was not for masses who laboured in factories, fields and stores. University education had little interest in business and businessman had little interest in education. Industrial societies of today are knowledge oriented and educated, and education is considered as one of the social overheads that has been accorded due priority among the developmental activities. Education benefits business. Business in turn has responded and started supporting education. This support is manifested in the starting and maintaining of educational institutions, sponsoring employees for quality education and bearing the cost of the education of employees children.

Family:

Basic to all types of social organisations is the family the institutions which concerns itself with love, marriage, reproduction, socialisation and the various statuses and roles involved in kinship organisation. Little wonder that the family is referred to as a remarkable institution.

Religion

Religion is an important element of culture. It governs people's attitude towards human activities, their moral values and ethics. In India, the prejudice against business, perceived to he concerned with 'making money' as a way of life, originated with religion. It has changed substantially over time. Honesty, truthfulness; and sympathy for people in distress are certain fundamental values which go with religion and arc still cherished by people. However, while religion as a social force hits provided strong emotional bonds among people, religious orthodoxy has made people sectarian in outlook, dogmatic and intolerant of others' views.

The Indian society includes people who follow different religions. Within particular religious communities, there are different sects and Cults. People practice religious rites according to their own faith. Their beliefs, habits and customs as also values reflect their religion in many ways. In this context, secularism is regarded as a valued aspect of Indian culture. It refers to the idea that the state, moral principles, education, etc. should be independent of religion. The Constitution of India has laid down that while people will be free to pursue their own religion, the state will be independent of any religion: India is thus declared as a secular state. While people follow their own religious practices in their private and social life, that does not affect their work life.

The importance of secularism will be appreciated if we examine its beneficial effects. First, there is no discrimination expected to he made between people of different religious faiths in public life related with education, employment and official work. Second, common problems may he approached unitedly by people of various religions and faith. Business in India is free from any bias towards customers on religious grounds except in the case of food products. Moreover, since the basic values and morals of all religions are the same, unity among people can be sustained on common grounds.

Values

Values constitute another important element of culture. People in every society "have basic convictions that certain modes of conduct or goals are desirable. These are known as values. Value system represents a set of values with priority ordering based on their relative importance. It prompts individuals and groups to distinguish between what is right and what is wrong, what "ought to be" and what "ought not to be".

Values may be classified into different types to identify their relative importance in the social context. Thus we may distinguish between 'theoretical values' (truth and rationality), 'economic values' (material gain and practicability), 'social values', (love of people, equality), 'political values' (acquisition of power), 'religious values' (morality, righteous conduct), and 'utilitarian values' (maximum good for the maximum number): The priority accorded to particular values may differ depending on the culture and tradition of societies, or it may differ between interest groups within a society.

Thus values which predominate in western societies differ from those that prevail in Asian countries. However, values are not necessarily static. Religious values predominated in the western world in the Middle Ages. A complete reversal has taken place through the intervening centuries. Acquisition of, money and wealth (economic values) considered vices in the Middle Ages became major virtues in the era of capitalism. This has happened also in the underdeveloped countries at a later stage. During the last fifty years since independence, people in India have imbibed modern western values, particularly in urban areas. Emphasis has been and is shifting from religious and social values to economic and political values.

The above discussion proves that business should participate in cultural affairs. Business should justify its involvement because of the better quality of life in society. The term 'culture' includes values, norms, artifacts and accepted behaviour pattern of' people that a society may have developed over time. Culture is also defined as the totality of behaviour that human beings in any society learn from their elders and pass on to the younger generation. In the sense culture may he regarded as the learned responses of a particular society.

The cultural change which has taken place and is still continuing in our country has been caused by the advancement of science and technology, growth of large-scale industries and improvement in the systems of transport and communication within and across the borders of India. Industrial development has created demand for varied types of goods and services, changed people's tastes and preferences, which in turn have influenced their habits and customs.

12.5 THE ENVIRONMENT PROTECTION ACT

Any human activity affects the environment, but the inventions that followed the Industrial evolution and World War II have done more damage to the ecosphere than all the preceding ages put together. The need to enhance food production and feed the world's hungry millions has led to the production of chemical weedicides and pesticides that give with one hand what they take away with the other, mortally wounding the environment. The relentless pressure to energize greater numbers of engines of locomotion, production and mass destruction has unleashed a vast range of new, often non-biodegradable substances- liquid, gaseous or solid - that have sullied the environment practically to the point of no

return. The endless wants of a rapacious consumerist society have brought forth inventions that further sully the environment and poison all living things with radioactive and carcinogenic materials. Toxic substances circulating in the earth's air, water and soil mean that no one can hope to escape the effects of global environmental pollution that have destroyed entire eco-systems, ravaged geographies, and - by cutting an ever-widening hole in the ozone layer that blocks lethal ultra-violet radiation-are ensuring that our days as a species appear to be numbered.

What we need is development without destruction of our environment

There are two basic reasons for progressive pollution. The first reason is the increase in population. Second is the increase in material well-being of the people. In fact, a major determinant of the level of pollution has been the amount people love had to spend for manufactured products. The by products of these manefactual goods our the pollutants.

Thus continuing degradation of water, air and land is due to rapid population growth and unsound development practices which do not provide for environmental protection. Pollution of air and water has become a greater menance to life than ever armaments and nuclear weapons. Industrialisation is the direct cause of air and water pollution in human environment.

Preventive Measures:

The strategy of prevention consists of raising public awareness, strict enforcement of laws, statutory assessment of environmental impact of projects and efforts to regenerate the productivity of ecosystems. The raising of public awareness is effective in some cases in refraining people from harmful activities, once they are convinced of the dangers. Strict laws, rigorously implemented, can prevent environmental destruction through stringent, punitive measures making an undesirable action very expensive for the offender. Statutory environmental impact assessment of all projects and activities before their implementation can prevent degradation through obligation on the executing agencies to undertake compensatory measures. Destruction can also be prevented by regenerating nature and increasing the productivity of the ecosystems.

The strategy of regulation is best applicable where projects have come up. It requires that:

(i) a detailed report should be prepared identifying the sources of pollution by the project or activity and indicating in a realistic and time-bound manner the measures required to be taken;

(ii) a similar report should be prepared about domestic and agricultural pollution, especially from pesticides, locating sources and suggesting remedial measures,

(iii) functioning of the Central and State Pollution Control Boards should be strengthened and be made more open;

(iv) comprehensive and realistic standards should be formulated for environmental pollution and for procedures and standards for assessing environmental damage;

(v) Industries should be made to recognise, if necessary by a dialogue with the governments the cost on economy of environmental effects and be Persuaded to show greater leadership and responsibility by controlling pollution through built-in measures;

(vi) public participation in prevention and control of pollution and environmental degradation should be facilitated by providing necessary technical help and by the governments setting up appropriate machineries for speedy response to investigation and disposal of public complaints;

(vii) for encouraging public vigilance, incentives should be offered for reporting instances of violation of laws relating to pollution, forests, wildlife and other environmental issues; and

(viii) the regulatory functions of the Government should be decentralized, especially in relation to pollution with essential training and equipment being provided to representatives of communities.

Regulatory Action

In India there are about 30 major enactments related to protection of environment now being administered by the Central and State Governments. Prominent among these are: the Water (Prevention and Control of Pollution) Act, 1974; the Air (Prevention and Control of Pollution) Act, 1981; the Factories Act, 1948 and the Insecticides Act. These are implemented through several organisations like Central and State Pollution Control Boards, Chief Inspectors of Factories and Insecticides, Inspectors of Agriculture Departments. Despite this, industrial accidents have led to widespread concern regarding danger to environment from

hazardous substances. Existing laws to cover such hazards do not provide a clear focus of authority to prevent damages. Taking this into account the government has enacted the Environment (Protection) Act, 1986, to focus on environmental issues in the country and to overcome difficulties in the existing Acts.

This Act was brought into force from November, 1986. Its salient features are:

(a) conferring powers on the government to *(i)* take a!1 necessary measures for protecting quality of environment, *(ii)* co-ordinate actions of States, officers and other authorities under this Act, *(iii)* plan and execute a nationwide programme for prevention, control and abatment of environmental pollution, (iv) lay down standards for discharge of environmental pollutants, (v) empower any person to enter, inspect, take samples and test, (vi) establish or recognise environmental laboratories, *(vii)* appoint or recognise government analysts, *(viii)* lay down standards for quality of environment, (ix) restrict areas in which any industries, operations or processes may not be carried out subject to certain safeguards, (x) lay down safeguards for prevention of accidents and take remedial measures in case of such accidents, *(xi)* lay down procedures and safeguards for handling hazardous substances, *(xii)* constitute an authority for exercising powers, *(xiii)* issue directions to any person, officer or authority including the power to direct closure, prohibition or regulation of any industry, operation or process, (xiv) require any person, officer or authority to furnish any prescribed information and (xv) delegate powers to any officer of a state or authority;

(b) it confers powers on persons to complain to courts regarding any violation of the provisions of the Act, after a notice of 60 days to the prescribed authorities;

(c) the Act makes it obligatory for the person incharge of a place to inform the prescribed authoritics regarding any accidental discharge of any pollutant in excess of prescribed standards. The concerned authorities, on receipt of such information, shall take remedial measures to prevent or mitigate Pollution caused by such accidents and expenses incurred by the authorities in respect of remedial measures are recoverable with interest from the polluter;

(d) it prescribes stringent penalties for violation of the provisions of the Act; and

(e) jurisdiction of civil courts is barred under the Act.

A comprehensive Environment (Protection) Act came into being in 1986 to remedy the lacunae noticed in the earlier laws and to serve as a single legislation on the subject. The Air (Prevention and Control of Pollution) Act, 1981 and the Water (Prevention and Control of Pollution) Act, 1974 were amended to bring their provisions at par with those of the Environment (Protection) Act, 1986 and to give more powers to the implementing agencies.

The Constitution of India requires every citizen to protect and improve the natural environment including forests, lakes, rivers and wildlife and to have compassion for living creatures. The Directive Principles of State Policy contained in the Constitution direct the state to endeavour to protect and improve the environment and to safeguard the forests and wildlife of the country.

The Environmental Protection Act, 1986, came into effect ;n November, 1986 and is in addition to the two allied acts, Water (Prevention and Control of Pollution) Act, 1974 and Air (Prevention and Control of Pollution) Act, 1981.

The objective of the Act is to provide for the protection and improvement of the environment and matters connected therewith. The law covers not only land and water or air but all aspects of the environment.

Environment includes (i) water, air and land and (ii) the inter-relationship which exists among and between water, air and land and human beings, other living creatures, plants, micro-organisms and property. Environment pollutants means any solid, liquid or gaseous substance present in such concentration as may be injurious to the environment. Environment pollution means the presence in the environment of any environment pollutant.

Under the Act, the Central Government has general powers to take measures for protecting and improving the quality of the environment, and preventing, controlling and obtaining environmental pollution. It can constitute the necessary authorities to whom it can delegate the required powers. Further, it has powers to appoint officers with such designation as it thinks fit for the purpose of the Act. It can make rules to regulate environmental pollution. The Govt. can call for information from any

person, officer, State Government or other authority to furnish information etc. in relation to its functions under the Act.

Environment Audit Report: As a result of the introduction of Rule 14 in the Environment (Protection) Rules, 1992, every person carrying on an industry, operation, or process requiring consent under Section 25 of the Water (Prevention and Control of Pollution) Act, 1974 or under Section 21 of the Air (Prevention and Control of Pollution) Act, 1981 or both or authorisation under the Hazardous Wastes (Management and Handling) Rules, 1989, issued under the Environment (Protection) Act, 1986 is required to submit an Environment Audit Report to the concerned State Pollution Control Board every year.

Conclusion

Dr. Einstein said, all our technological progress-our very civilization-is like the axe in 'he hand of the pathological criminal. So like pathological criminals we have mercilessly destroyed the forest and converted fertile land into desert.

Just as it is realised that exploitation of the people must end so too we must recognise that the exploitation of nature and specially of forests must end. We must evolve programmes by which forests cannot only co-exist but are enlarged side by side with the growth of agriculture and the industry and three together should help our people to raise their standard of living.

In 1980, Mrs. Gandhi said, "The preservation of our environment is our collective concern. Any deterioration of the environment threatens the present and future well-being of both our country and our people. The maintenance of ecological balance should be such a part of the development process as the working of our national resources. If we plan only on the basis of the exploitation of our existing resources and give no thought to their conservation and renewal we shall negate the concept of development itself. We have to plan for tomorrow and true development consists of building our capital measured not only in financial and physical terms but also in terms of nature".

In a developing country like India, the pollution is mainly due to poverty arising from lack of resources to ensure a decent standard of living for the majority of people. The population explosion and mad rush of people from village to urban areas resulting in overcrowding of cities, rapid industrialisation and urbanisation have led to an increase in

environment pollutant load that poses a serious public health problem. We are going too fast towards total industrialisation without taking proper precautions and safety measures. This is evident from the industrial disaster at Bhopal's Union Carbide plant.

The problem of industrial pollution is becoming a serious one in India. We need industrialisation but that must not be at the cost of environment. As regards noise pollution the authorities take little notice of it. Noise is not getting the attention it deserves and legislation to control noise sources is virtually absent.

According to historian Arnold T'oynbee, though the present chapter of civilisation had a western beginning, if it has to Survive and not destroy itself, it will have to have an Indian ending.

12.6 SUMMARY

Ethics refers to the code of conduct that guides an individual in dealing with others. The word ethics is derived from greek word 'ethos' which refers to character. Business ethics comprises the principles, practices and philosophies that guide business people in their day to day business decisions.

Business ethics are based on some principles. These ethics are made of moral principles and rules of conduct. Good ethics principles and rules of conduct. Good ethics promotes good business. The scope of ethics is dynamic. Ethical conduct of business increases the goodwill of business and the businessman.

The cultural environment refers to the influence exercised by a number of social factors which are beyond the company's gate. Such factors include attitude to wealth, family, marriage, education, religion, knowledge, custom, beliefs, art etc. These cultural factors influence business greatly.

The environment pollution of to day threatened by commercial exploitation, growing population demands and industrial wastes. The earth's "Garden of Eden' with its flora and fauna, its rivers and oceans, grass land and wetlands are fighting for survival.

Any human activity affects the environment but the industrial revolution and world was II have done more damage to the ecosphere. The strategy of prevention consists of raising public awareness, strict enforcement of laws, statutory assessment of environmental impact of

projects and efforts to regenerate the productivity of ecosystems. The environment protection act, 1986 come into effect in November, 1986. The law covers not only land and water or air but all aspects of the environment.

12.7 KEY WORDS

ETHICS- The word 'ethics' is derived from Greek word 'ethos' which refer to character.

BUSINESS ETHICS- Comprises the principles, practices and philosophies that guide business people.

CULTURE- Include the attitude of people towards wealth, family, marriage, religion, knowledge, belief etc.

EPA 1986 – Environment Protection Act, 1986.

12.8 SELF ASSESSMENT QUESTIONS

1. What do you understand by business ethics? Explain its characteristics.
2. Discuss the main principles of business ethics.
3. "Good ethics promotes good business". Explain this statement and discuss the importance of business ethics.
4. What do you understand by Cross cultural environment of business? Discuss.
5. Discuss the influence of cultural elements on business.
6. What are the different types of pollution? What preventive measures would you suggest to regenerate the ecosystem.
7. Describe briefly the basic provision of Environment Protection Act. 1986.

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M.Com-303
Business Environment

Block 4

Unit 13 5
Technological Environment : Impact on Technology on Business

Unit 14 17
Technological Policy, Import of Technology, Problems in Technology Transfer

Unit 15 29
International Environment : Emergence of Globalization, Control of FDI

Unit 16 39
Benefits and Problems from MNCs, WTO, its Role and Functions

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परिमापक

अनुवाद की स्थिति में

मूल लेखक	अनुवाद
मूल सम्पादक	भाषा सम्पादक
मूल परिमापक	परिमापक

सहयोगी टीम

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उत्तर प्रदेश राजर्षि टण्डन मुक्त विश्वविद्यालय, इलाहाबाद सर्वाधिकार सुरक्षित। इस पाठ्यसामग्री का कोई भी अंश उत्तर प्रदेश राजर्षि टण्डन मुक्त विश्वविद्यालय की लिखित अनुमति लिए बिना मिमियोग्राफ अथवा किसी अन्य साधन से पुनः प्रस्तुत करने की अनुमति नहीं है।

Block 4 : Introduction

Block Introduction

This block comprises of four units, Unit Thirteen deals with technological environment and its impact on technology.

Unit fourteen deals with technological policy, import of technology, problem in technology transfer. It highlights the issues related with all these factors.

Unit fifteen highlights international environment. Emergence of globalisation, its impact and control of FDI.

Unit sixteen comprises of MNCS and its advantages and problems WTO its role and its function.

UNIT-13 TECHNOLOGICAL ENVIRONMENT IMPACT OF TECHNOLOGY ON BUSINESS

Structure:

13.1 Introduction

13.2 Objectives

13.3 Technological Environment

13.4 Impact of Technology on Business

13.5 Summary

13.6 Key Words

13.7 Self Assessment Question

13.8 Suggested Readings

13.1 INTRODUCTION

In the earlier units you learnt about all other components of macro environment, technological environment exerts considerable influence on business. This unit is devoted to a detailed discussion of the technological environment and its impact on business.

Technology is the most dramatic force shaping the destiny of the people all over the world. Some of the technological inventions, the man feels, are wonders, some others are horrors, and yet other have mixed blessings.

J.K. Galbraith defines technology as a systematic application of scientific or other organised knowledge to practical tasks. During the last 150 years, technology has developed beyond anybody's comprehension. Science and technology enabled man to conquer distances, save lives, generate, preserve and distribute energy, discover new materials and substitutes to existing ones, introduce machines to do the work of human beings, substitute mental work with computers, control birth rate, provide him self with lot of leisure and comfort.

13.2 OBJECTIVES OF THE UNIT

After reading this unit you will be able to:

- Understand the technological environment.
- Understand the rule of technological environment.

Explain the impact of Technological Environment on business.

13.3 TECHNOLOGICAL ENVIRONMENT

Technology includes the tools – both machines and ways of thinking available to solve problems and promote progress between and among societies. According to United Nations Conference on trade and Development's (UNCTAD) Draft the types of Technology Code, Technology should be described as", systematic knowledge for manufacture of a product, for the application of a process or for the rendering of a service and does not extend transactions involving mere sale or lease of goods.

Technology in one of the important determinants of success of a firm as well as the economic and social development of a nation. Technology includes not only knowledge or methods that are necessary to carry on or to improve the existing production and distribution of goods and services, but also entrepreneurial expertise and professional know-how. Technology is one of the eight factors considered by the World Economic Forum to evaluate the global competitiveness of nations. The 1999 Global Competitiveness Report of the Forum, which continued to increase its focus on information technology as a new source of competitiveness, observes that there are at least three aspects to this. First, e-mail, second, the internet and third – emerging area of e-commerce. Technical innovations are very important factor that provides competitive advantage and, consequently, determines success.

Science and Technology has made a phenomenal impact the world over n shaping the life style of the common man. If India has to go ahead, science and technology must play a pivotal role in all the important tasks of nation's development, hence, the development in the field of science and Technology as an effective tool of growth, as an strategy. In order to derive maximum output from meagre resources the science and technology must be brought into the mainstream of economic, agricultural, industrial and services sectors. Today India spends one percent of its GNP on science and technology. Pt. Jawahar Lal Nehru made conscious efforts to modernize the scientific infrastructure in the country by setting up a number of R&D centres through universities and national laboratories.

In the new economic order the main cause of economic backwardness is the low level of technological advancement. Technology can play an important role in the economic development of the country. It

is an important instrument to get rid of socio-economic and political backwardness. The tasks of technological change in developing economies is difficult because the social set-up in developing pre-industrial economies is not conducive to technological improvements on any significant scale. It has been observed that the absence of technological change retards the economic development of the economy. The U. N. experts observed that, "Unless special effort is made, the process of technological development in the underdeveloped countries will be relatively slow and the gap in technology will continue to grow wider as the cumulative scientific progress of developed countries accelerates."

Technology is considered as the basic factor in the process of economic development. In business environment, technological change means the technical knowledge used in the production of capital and machinery. The modern changes in technology lead to increase in the productivity of labour, capital and other production factors. The technology is the powerful means of wresting power from nature in all possible ways. Technology strengthens the faculties of men and enables them to harness gigantic physical forces of nature.

In the words of Frankel, "Technological change is not a mere improvement in the technical know-how. It means much more than, this. It should be preceded by sociological change also, a willingness and desire on the part of community to modify their social, political and administrative institutions so as to make them fit with new techniques of production and faster tempo of economic activity".

According to Dr. H. Bhabha, "What the developed countries have and the underdeveloped lack is modem science and economy based-on modern technology. The problem of the developing underdeveloped countries is, therefore, the problem of establishing modern science in them and transferring their economies to one based on modern science and technology".

Role of Technology in the Economic Development of a Country:

Technological advancement and economic development are related to each other. The level of technology is an important determinant of economic development. In an economy the high rate of growth can be achieved through high level of technology. Prof. Schumpeter has observed that innovation or technological progress is only the determinant of economic progress. Kindleberge observes that major part of the increased productivity is due to technological changes.

Robert Solow estimated that technological change accounted for about 75 per cent of growth of the U. S. economy, after showing for growth in the labour force and capital stock. In real sense, the technology can be considered as primary source in economic development and the changes in technology contribute in the development of developing economies.

Role of Technology:

Every industry and country is concerned with technology. It is technology alone, which can solve many problems. The role of technology in the economic development of a country can be discussed in the following heads :

(1) Quicker Rate of Growth:

When technology is available new machinery can be set up. The economy proceeds on the path of industrialization. The rate of growth is both faster as well as quicker. The result of all this is that economy is in a position to become self-sufficient very quickly.

(2) Inflation is Checked:

Capital-intensive technique means spending more and more capital in the economy. When more money is available in the economy and gets circulated, then adverse effect is that the economy cannot bear it.

Therefore, inflation can be seen on the economy. But on the other hand, when there is labour-intensive technique of production, then no capital comes in the economy and the country is not faced with the problem of inflation.

(3) Bulk Production Possible:

With the help of capital-intensive production it becomes possible to produce goods in bulk, with which both national as well as global needs can be met.

(4) Encouragement to Small and Cottage Industries:

If labour-intensive techniques are adopted in the economy, then small and cottage industries will receive encouragement for the betterment of the nation as a whole.

(5) Proper Use of Raw Material:

Each nation has some raw material locally available to it. If new techniques are adopted, then the raw material is very usefully utilised, e.g. cotton can be used for manufacture of cloth at village level with labour-intensive techniques.

(6) Quick Results Available:

With the help of labour-intensive techniques, there is no gap between investment and production. The labour begins to work with the available skill and society gets the product. The society does not feel the need and necessity of getting the people trained from abroad.

From the above discussions it is clear that technology is the heart of economic development. But technology must suit local needs and to make an impact on the lives of common men, must give constant thought to even small improvements which could make better use of existing materials and methods of work.

13.4 IMPACT OF TECHNOLOGY ON BUSINESS

The inter ace between business and technology can be explained under the following heads :

(1) Technology Reaches through Business

Business is an institution through which people expect new techniques to be converted into goods and services. The managerial staff of the business organisations pool the necessary resources and work: on the new discoveries to convert them into useful products. Society depends on business to keep the stream of discovery flowing into useful goods and services for human beings. There is no doubt that economic prosperity of a country depends on technology. Fifty two percent of economic growth, of USA, France, UK and Japan has come from techn-i-cz1 progress achieved in these countries.

(2) Increased Productivity:

The primary role of technology is to increase productivity in terms of both quality and quantity. This is the main reason why most technology is adopted. In an organisation, the objective may be quantitative and qualitative in terms of maximum production at lower cost. As a result of productivity improvements, real wages of employees tend to rise and prices of some products decline.

(3) More Spent on Research and Development:

The investment in Research and Development (R and D) has increased from a paltry Rs. 20 crore in the First Five Year Plan to about Rs. 20, 000 crore in the Eleventh Five Year Plan. Presently, there are 214 universities, 400 national laboratories and 1,300 in-house R and D centres in the industrial sector. Several science and technology departments have been set up in the areas of environment, non-conventional energy

resources, bi-technology industrial research, defence, health, agriculture and electronics.

- An important question arises. Why does business spend much more money on discovering new technologies? The following reasons are responsible for investing :

(a) declining growth in base business;

(b) dramatic development in new technologies;

(c) development of international competition; and,

(d) vitality of the venture markets.

(4) Fast Changing Technology:

The changing global and national scenario is bound to make greater demands on science and technology. Our government policy for science and technology planning has to be geared to face this demand. Government policy framework would continue to encompass encouragement of entrepreneurship; development of indigenous technology through investment in R and D, bringing in fast changing technology.

From the above discussions it may be said that development technology has a large impact on business, but in the technological race between different economies, the developing economies lag far behind, consequently they are dependent on the developed industrial world for technology required to accelerate development process.

5. Growth and Decline of Products and Organisations:

A new technology may spawn a major industry but it may also destroy an existing one. Transistors, for example, hurt the vacuum-tube industry and xerography hurt the carbon-paper business. Television hurt ra-dios and movies and synthetic fibers reduced demand for cotton fabrics. It is for this reason that Schumpeter saw technology as a force for 'creative destruction.' And it is precisely for the same reason that the saying, "Today's growth product is tomorrow's earthen pot", becomes relevant. Products, like mortals, have life-cycles. A typical product, today, is subject to a cycle : introduction, growth, maturity, decline, and abandonment.

6. New Expectations of Consumers:

Technology has contributed to the emergence of affluent societies. Affluent citizens want more of many things than more of same things. New varieties of products, superior in quality, free from pollution, more safe and more comfortable, are to be produced and supplied to the affluent

sections. This calls for a massive investment in R & D. One important compulsion for in-vesting in technological advances in Japan is its customer's high expectations regarding design sophistication, quality, delivery schedules and prices.

7. Employment Tend to Become More Intellectual:

With the advancement of technology, employment tends to become more in-tellectual or upgraded. A job hitherto handled by an illiterate and unskilled worker now requires the services of an educated and competent worker A clerical post in an office now demands the services of an expert in computers

Introduction of new technology dislocates some workers un-less they are well-equipped to work on new machines. This makes it obligatory on the part of business to retrain its employees and to rehabilitate those displaced and untrainable. Equal is the re-sponsibility of the government to provide training and educational facilities to its citizens. Government and businessmen should boldly demonstrate and convince the people that economic growth is more an insurance against unemployment than opposition to technological advancement.

But for those who pick up and acquaint themselves with new technology, the job will be rewarding: The new job will be more challenging and rewarding. Working class, in general stands to gain through increased productivity, reduced prices and increased real wages- all by-products of technological advancement.

Along with upgrading jobs, technology has its impact on hu-man relations. Technology lays down the requirements for much of the human interaction in organisations. The arrangement of a production set-up determines who will be near whom. The work flow determines who needs to talk to whom. And since interac-tion and activity affect sentiments, technology indirectly deter-mines what individuals in large groups will feel and think about one another and about their work situation .

8. Problem of Technological Infrastructure :

With the advancement of technology only jobs become more intellectual, even the incumbents tend to become highly professionalised and knowledgeable. An organisation which has adopted the latest technology is flush with scientists, engineers, college graduates and highly skilled work-ers on its pay roll. Though such an organisation can boast of a progressive and modern outlook of its personnel complement, the problems such an enterprise has to face on this account are seri-ous,

to say the least. Motivation of such employees, for instance, is a difficult task.

The presence of technicians is not confined to the precincts of an industrial establishment, the influence goes beyond and cov-ers the entire gamut of society. The social values change to pro-ductivity, rationality, and efficiency when society gets dominated by technicians. Social institutions may be reconstructed or even eliminated. Family, for instance, might prove an anachronism as family loyalties might well interfere with rationality and effi-ciency. Procreative functions might be according to the laws of eugenics, breaking the age-old barriers of inbreeding. Education could be made a purely pragmatic institution, devoted to scien-tific and technical disciplines. Most significant is the fact that scientists and technicians are and will continue to be the key-men in our civilisation.

9. Need for Multi Purpose Professionals in Business:

Technical professionals who assume reins of administration, need to be qualified in management education in addition to the proficiency they have acquired in chosen fields of specialisation. Today's business needs bioprofessional and multiprofessional managers. To fill up a factory manager's post, for instance, the desired quali-fication stipulated is a degree in engineering and M.B.A. from a recognised institution. The need for managers well-versed in dif-ferent fields of knowledge is greatly felt now than ever before. Technological advancement has made the business more complex and its management more demanding.

10. Strict Rules and Regulation and Stiff Opposition:

The impact of technological advancement is the ever-increas-ing regulation imposed on business by the government of the land and stiff opposition from the public. Government has the powers to investigate and ban products that are directly harmful or hurt the sentiments of a section of society. Import of animal tallow has been banned by the Government of India because the alleged mixture of tallow with vanaspati oil hurt the feelings of Hindus. Continuous struggle launched by the FMRAI (Federation of Medi-cal Representatives of India) produced gainful results like ban-ning of the sale of harmful drugs and banning of sales promotion and advertisement of infant formula through the mass media.

Technological advancement is inviting opposition from those who fear that new innovations are a threat to ecology, privacy, simplicity and even the human race. These people oppose con-struction of high-rise buildings, location of plants that eject harm-ful effluent, and setting up

of hydroelectric plants. As the pro-duction proceeds becomes more complex and products assume greater sophistication, public have to be assured of their (products) safety, their minimal propensity to cause pollution, and their least threat to happiness and well-being of the human race.

The public must be enlightened that technology is not always unidirectional in its effects. It can be corrective as well as cura-tive. Technology has created antibiotics which give rise to side effects. The same technology has also shown remedial measures for the side effects. Again, technology causes pollution, but it can also be used to check pollution caused by it and by human beings. Technology does contribute to urban light, but it can also be used to beautify the city and make it more comfortable and enjoyable for the people to live in.

11. Complexity of System:

New Technology has resulted in complexity. Modern machines work better and faster, no doubt. But if they fail, they need services of experts

to repair. They fail often because of their complexity. A machine or a system is composed of several hundred components. All parts must work in tandem to accomplish a de-sired task. Reliable performance of each part, therefore, assumes greater significance.

Also there is interdependence of system failure of power supply, for example, will cause dry water taps, closed petrol bunks, suspended elevators between floors, dark streets, dark houses, dead TVs, closed retail establishments and so on. A localised prob-lem in a power house balloon into a regional problem affecting thousands of people. It is possible that technology might eventu-ally lead to simplicity and small independent operational units. Such a possibility still remains a distant dream. Meanwhile, more complexity in work and product systems is expected. Manage-ment is, therefore, under pressure to keep the whole system work-ing all the time.

12. Massive Need for Investment:

Modern technology necessitates massive investment of money on acquiring or discovering of new ideas and their adoption; edu-cating, training and maintaining of the managers and the man-aged and on several other related areas. In fact, today's technol-ogy is characterised by its insatiable demand for capital. Busi-ness organisations should not

only raise huge funds, exploiting all ways and means, the mobilised funds must be judiciously em-ployed for gainful purposes. This calls for honest and efficient financial management. Qualified and competent people must be appointed to assume responsibility for financial management and should be given due place in the hierarchy of organisation.

13. Change in Social Life:

The most striking influence of technology is found on society. Practically every area of social life and the life of every individual has been in some sense changed by the development in technology. However, two major modes of technological influence on social life may be noticed. Firstly, there is the change in so-cial life which results from a change in a technological process. Thus, an invention may destroy the economic basis of a city; dis-place thousands of workers; yet the same invention may result in the creation of a new city somewhere else and create even more jobs than it originally destroyed. Technological changes of this sort create a constant turmoil in society, with socially uprooted, mobile populations drifting about in search of new centres of employment. Sometimes, this drifting may result in a new geo-graphical distribution of population; an example is provided by the constant drift of population centres of electronic or aerospace industries."

Besides uprooting population, technology directly changes the patterns of their social life, for instance the family, the sensitive recorder of all types of change, alters with technological develop-ment. An invention may open new employment opportunities to women, radically change hours spent at work and in the family, increase available leisure time, open jobs to youth, and deny them to middle aged or old workers. Technological development may basically change the stratification system of a community. Skilled jobs, carrying great prestige, may be destroyed. Jobs may be opened to members of discriminated against and low-ranking or racial groups. Technological advancement tends to smoothen out social differences. Industrial technology tends to iron out differences between sexes and between parents and children in a family.

13.5 SUMMARY

Technology is the most dramatic force shaping the destiny of the people all over the world. Some of the technological inventions, the man feels, are wonders, some others are horrors, and yet other have mixed blessings.

J.K. Galbraith defines technology as a systematic application of

scientific or other organised knowledge to practical tasks. During the last 150 years, technology has developed beyond anybody's comprehension. Science and technology enabled man to conquer distances, save lives, generate, preserve and distribute energy, discover new materials and substitutes to existing ones, introduce machines to do the work of human beings, substitute mental work with computers, control birth rate, provide him self with lot of leisure and comfort.

According to United Nations Conference on trade and Development's (UNCTAD) Draft the types of Technology Code, Technology should be described as", systematic knowledge for manufacture of a product, for the application of a process or for the rendering of a service and does not extend transactions involving mere sale or lease of goods.

Technology is considered as the basic factor in the process of economic development. In business environment, technological change means the technical knowledge used in the production of capital and machinery. The modern changes in technology lead to increase in the productivity of labour, capital and other production factors.

Technological advancement and economic development are related to each other. The level of technology is an important determinant of economic development. In an economy the high rate of growth can be achieved through high level of technology. Prof. Schumpeter has observed that innovation or technological progress is only the determinant of economic progress.

Impact of Technology on Business : Increased Productivity, R&D, New Employment, Consumer Satisfaction, New Products, Need of Multipurpose Professionals, Complexity of System, Need of Heavy Investments, Change in Social Life etc.

13.6 KEY WORDS

Technology : Means Scientific knowledge for the manufacture of a product or rendering a service.

Transfer of Technology : Means adopting and absorbing newer technologies.

Appropriate Technology: Whether it will suit our condition or not.

13.7 SELF ASSESSMENT QUESTION

1. What do you mean by Technological Environment?
2. Discuss the role of Technology in the Economic Development of a

Country.

3. Discuss the Impact of Technology on Business.

4. Write Short note on R & D in India.

5. Briefly discuss the impact of Technology on Society.

13.8 SUGGESTED READINGS

The Economic Survey : Govt. of India Publication, New Delhi, Place & Years

Bhatia HL, International Economics, Vikas Publishing House, New Delhi, Place & Years

Mukherjee's and Indrani, Constitution of India, World Press, Kolkata, Place & Years

Eleventh Five year plan, Govt. of India Publication, New Delhi, Place & Years

Jagdish Bhagwati and Padma Desai, India Planning for Industrialisation (London)

Xavier M.J., Marketing in the New Millenium, Vikas Publishing House, New Delhi.

UNIT-14 TECHNOLOGICAL POLICY, IMPORT OF TECHNOLOGY, APPROPRIATE TECHNOLOGY & PROBLEM IN TECHNOLOGY TRANSFER

Structure:

14.1 Introduction

14.2 Objectives

14.3 Technological Policy

14.4 Import of Technology

14.5 Appropriate Technology

14.6 Problem in Technology Transfer

14.7 Summary

14.8 Key Words

14.9 Self Assessment Question

14.10 Suggested Readings

14.1 INTRODUCTION

In this unit you will have an understanding about the Governments Technological Policy, how the Govt. import technology, which are the appropriate technology among various options for the country and what are the problem in transfer of technology from other country.

Technology Policy of the Government is a very important element of the technological environment that is why a government may favour or disfavour certain types of technologies. Government's policy towards foreign technology is also a critical factor. Some labour abundant countries have a preference for labour intensive technology, mechanisation and automation may be opposed in such countries. Such a situation may adversely affect the business. In countries like India, the over emphasis on indigenous technology had led to high costs and distorted developments.

14.2 OBJECTIVES OF THE UNIT

After going through this unit you will be able to:

- Understand the technological policy of the country.

- Understand the way the technology is being imported in the country.
- Explain the appropriate technology for the country.
- Understand and short out the problems in transfer of technology.

14.3 TECHNOLOGICAL POLICY

India, like any other third world country, attained political independence after prolonged colonial rule and exploitation. The country entered the modern world in a state of economic back-wardness and poverty of a large section of people. It is obvious that technology must attend to the basic problems of food, cloth-ing, health and housing of people. At the same time rapid indus-trial development through latest technology is necessary to catch up with the advanced countries.

When India gained her independence after two hundred years of British rule, she was a country devastated by exploitation and neglect. While some basic infrastructure had been installed, there was little else to show for the harrowing experience she had undergone. Since the objective of a colonial power is to prop up a dominion for the primary purpose of transferring assets to the home country, India showed all the symptoms of economic hemorrhage, social and intellectual stagnation, and a collective psyche shattered by humiliating inequality and gross deprivation.

Thus, from the very midnight immortalized by Jawaharlal Nehru in his 'Freedom at Midnight' speech, the new leaders of the infant nation traumatized by Partition, tried to visualize the great future that was the country's birthright. Well they knew the trials and tribulations that lay in wait for them along the path, but the blueprint for a resurgent India was etched firmly in their minds. Being visionaries cast in the mould of men like Benjamm Franklin, they knew that progress on all fronts would be impossible without heroic efforts to foster a scientific spirit among their countrymen, and harness technology for the all-round progress of the newborn nation...

On March 4, 1958, the Scientific Policy Resolution was adopted by the Government of India, under the direct inspiration of Jawaharlal Nehru himself. It promoted the role of science and technology as being critical to India's future success on economic, defence and other fronts. The main objectives of the Policy were:

1. To foster, promote, cultivate and susta in both pure as well as applied research across technological disciplines.

2. To create the conditions necessary to educate, train, recognize and, finally, utilize qualified personnel to achieve rapid and self sustaining progress across a variety of scientific frontiers.

3. To ensure that the benefits conferred by science and technology were transferred to the people of India

In achieving the above objectives, the government acknowledged the importance of-

(i) Cultivating a scientific temper among the people of the country, by Methodically approaching the issue through creating teaching, training and research institutions across the length and breadth of the country, and

(iii) Ensuring that the benefits were equitably proliferated across as broad a canvas as possible, so that

(iv) The benefits percolated down to grassroots level and benefited all citizens of the country, and

(v) Strengthened the national resolve to catch up with the rest of the world.

Thus, the main aims of the Technological Policy were:

1. To attain self Sufficiency and adequate competence in routine as well as strategic areas by maximizing use of indigenous resources.

2. To provide maximum thrust to the economy by creating a new class of technology based business and industry, as opposed to traditional industries such as sugar mills, textile mills, etc.

3. To widen the employment base and provide fresh avenues for employment for the youth and experienced persons languishing for outlets for their skills.

4. To ensure a judicious balance between technology based and manual industries, so as not to disturb the livelihood of weaker sections.

5. To develop import substitution technologies, particularly those with potential for producing exportable goods.

6. To enhance productivity and quality through better, more modern technology.

7. To achieve significant energy savings, particularly that derived from non-replenishable sources.

8. To ensure ecological balance and harmony with nature while benefiting from technology.

9. To recycle industrial waste and tap by-products to the maximum extent possible.

In order to maximize returns from the investments in science and technology, it is necessary that policies covering S & T, Industry, Finance and Agriculture must be meaningfully intermeshed. The recent Industrial Policy has reserved very few industries for the public sector, reduced the sectors where industrial licensing was earlier necessary, liberalised the procedures relating to technology acquisition and investment, removed the restrictions on large companies and redefined the goals of the public sector undertakings. For this, the technology development must take place in a competitive environment and the policy for industrial research and development should be appropriately reoriented. In the formulation of future policy for the industrial R&D, the spirit and guidelines of the New Industrial Policy must be followed. In consonance with the agricultural policy, S&T inputs must be able to provide the ever increasing food requirements of our growing population. The S&T agencies would be directed not only to develop capabilities in their specialised areas but also to interact with the various developmental sectors, industries, institutions set up by the farmers and those providing services to promote the utilisation of their expertise. National laboratories under the S&T agencies should make their facilities available to the scientists from the agricultural and industrial sectors and provide services to the university system and evolve collaborative programmes with them. The socio-economic sectors therefore must lay a greater emphasis on the S&T content in their programmes and place their crucial demands on the S&T agencies.

14.4 IMPORT OF TECHNOLOGY

Rather than spend huge sums of money and valuable time in research which may not yield the desired results, Indian firms interested in taking a quantum jump in production quality, introducing new, high-tech products or using vastly improved processes prefer to take the import route. However, developed countries rarely part with their latest technology; foreign firms prefer to extend the life cycle of their outmoded technologies by selling or licensing them to developing economies (for whom it may be a vast improvement over what they then have) rather than parting with their current secrets. Hence, the question remains whether the technology available is the right choice for the country's level of development, especially because transplanted technology is not always the best answer. This leaves only one alternative, i.e., trying to develop

the technology in-house where possible, and that too without infringing patents, etc.

For example, the two-wheeler technology available in India is far behind what is in vogue in developed countries. Perhaps Suzuki-Maruti is one of the rare cases where the latest models like *Swift* are being produced here and launched globally, that too because India is a preferred low-cost production base. Hyundai Motor Company of South Korea has also declared that it intends developing India as a global supplier of their cars and components, but this means that the technology essentially remains with in the company for an appreciably long time before it gradually percolates into the mainstream. Usually, self interest is the sole motive for parting with technology, and it comes at a price that not all are willing to pay.

Even fairly new technology is obtained, there is always the problem of training Indian personnel to handle it, quite apart from the problem of ensuring the requisite quality and safety standards that go with the new methods. Suitable raw materials, parts, components and sub-assemblies have to be ensured by, again, training and developing vendors. All this entails considerable training, knowledge upgradation efforts and even some backward integration. When Maruti-Suzuki first started, they went through all these phases, and till today, the quality is overseen by the Japanese collaborators. This is because Indian firms are usually so far behind technologically that they are slow in adapting themselves to the new versions. Accepting and absorbing foreign technology needs a radical change in attitudes to work and quality, and this itself is a major task.

Besides, merely paying the royalty for licensing a technology or buying it outright is only a small part of the technology import picture. Even if we assume that there are companies in developed economies that are willing to part with their technology, the problem remains of obtaining the Indian government's approval to the terms and conditions under which the technology will be allowed to be imported. Clearance for the payment to the foreign principals in foreign currency introduces a whole new set of RBI and other statutory restrictions. Only when all these hurdles are cleared can the foreign technology reach Indian shores.

14.5 APPROPRIATE TECHNOLOGY

When different technologies are available, it needs to be ensured that the chosen is the most appropriate for the country. The technology suitable in one environment may not be appropriate in different

environment. Even when a technology is sought to be imported, it has to be seen whether it will suit Indian conditions. The heat, dust, humidity and other climatic conditions obtaining in India are obvious points of difference, as are the knowledge levels and attitudes of the persons abroad who might have successfully used the technology. Indians have a different outlook on life, and it takes time for Indian labour to imbibe the attitudinal changes that often go with the new systems, e.g., the Japanese concept of *kaizen* or small, cumulative improvements, or even Toyota's 'autonomatic' quality system where individual workers are empowered to levels that Indian labour has yet to experience. Moreover, it could he possible that raw materials and other inputs the user countries take for granted might be scarce or even non-existent in India. The condition of our roads, transport bottlenecks, lack of adequate cold chains and other infrastructural inadequacies and burcaucratic bottlenecks could make a huge difference to the efficiency with which the new technologies function in India.

In fact, like any life-form transplanted on alien soil, it needs to acclimatize or adapt to the changed conditions. It must be seen whether any such adaptation is necessary, and if so, whether it is feasible. Labour is cheap and abundant in India, whereas it is just the opposite abroad, and so the imported technology is usually capital intensive, not labour intensive generally just the reverse of what often suits our local conditions. Besides, the Indian economy is unlikely to be identical to that of the exporting country; the purchasing power of the average Indian is far less than his western counterpart, and the imported technology may push up the price of the finished products beyond his capacity to pay. Hence, the financial aspect is also crucial when it comes to making a decision to import a particular technology, far beyond the 'mere' cost of the technology itself.

14.6 PROBLEM OF TECHNOLOGY TRANSFER

The economic development of a country depends upon the technology existing in that country. In the new economic environment, technological change in developing or less developed countries is a difficult task and it needs special effort on the part of people and the government, Prof. Nurkse observes that, "It is much easier to adopt superior consumption habits than improved production methods. Hence, fashions in consumption can spread more quickly than techniques of production. But despite these difficulties the process of technological change is initiated in these, countries. It is essential to identify those

branches of economy which are in most need of technological change. Then the appropriate technology must be chosen."

Problems of Transfer of Technology:

The main problems of transfer of technology are :

(a) The less developed countries have divergent conditions like economic environment, social structure, education system etc. which call for different methods of transfer of technology.

(b) Import of technology is not-easy because developed countries are not willing to lend it. In fact, these countries view India as a potential rival. The technology, the developed countries are willing to lend is limited in scope and is aimed at exploiting India's dynamic cooperative advantages in order to feed the markets in which developed countries are interested.

(c) The less developed countries have a problem of intermediate technology.

(d) Modern technology is extremely capital-intensive which is not suitable for labour-abundant and capital-poor less developed countries.

(e) A typical manager is obsessed with issues of productivity. With productivity mind-set, a typical manager is not able to focus attention on new technology.

(f) The less developed countries are inadequate in human skilled resources who fail to make use of modern sophisticated imported technology.

(g) A typical manager is opposed to new technology. He does not encourage new technology. It is clear that new technology is expensive and risky.

(h) For transfer of technology there is an urgent need of managerial skill but less developed countries have shortage of managerial skill, thus, a great hurdle in the path of transformation

(i) The less developed countries have dearth of infrastructure like power, energy etc.

(j) In less developed countries, the shortage of foreign exchange creates greatest constraint in the path of technological transformation.

Measures to Prevent:

The main suggestions are :

(a) The less developed countries should design their industrial licensing policy in such a way that it may not hamper transfer of technology.

(b) Multinational corporations have an important role in the dissemination of modern technology. Such corporations should design technology based on indigenous materials.

(c) The international financial agencies like World Bank, International Monetary Fund, Asian Development Bank etc. should come forward and encourage foreign technology which is suitable to less developed countries.

(d) The policy of protection and import substitution may be better for the efficiency of productions.

(e) In less developed countries, there must be special advisory and extension service with a view to promoting the use of modern technology in small and cottage industries.

Transfer of technology for the betterment of less developed countries faces a number of problems. The developed countries should come forward and create an atmosphere by providing economic initiatives. In the words of Prof. Schumpeter, "Intermediate technology would be vastly superior in the productivity to their traditional technology while at the same time being vastly cheaper and simpler than highly sophisticated and enormously capital-intensive technology of the west."

In any society economic growth would be possible only through the introduction of improved technical inputs into the process of economic transformation. In the last few decades it has become quite clear that no economic development would be possible without higher technical input available in the-society. Our planners have pointed out that capital must be created and selective capital be invested in growth for development of the economy if the country wants to achieve a desired rate of growth. The importance of capital cannot be denied, but capital by itself will not be able to bring about the change which we are looking for. Capital can only be a means for facilitating input of technology. The economic growth of Japan, Korea and Taiwan presents clear examples that the input technology and the improved grade of technology have been responsible for their progress. In spite of more than Ten Five-Year Plans, we have not been able to grow at the desired rate nor are we in a position to produce and compete with Japan and Korea as we have not been able to bring in and use the latest technology. Hence, we can conclude that capital and money alone cannot make us move faster towards our desired goal; instead it is the application of latest technology which is needed.

Science produces knowledge, technology helps to produce wealth. Technology gives its owner temporary advantage over his competitors. That is why the owner of technology protects his technique from others through registration as patent and charges money from those who want to use it. The acquisition of technology from external sources is known as technology transfer.

Technology may be considered as improving something already being done, satisfying a long pending need and creating the possibility of a new need. There may be invention or innovation in this process. In its early stage of development technical change in a country is mainly the result of advanced technology imported from industrially and technologically advanced countries. That is to say technical progress is an agent of technology transfer. Technical change is defined as a shift in the production function whereas factor accumulation is identified with a movement along the function. There are two distinct components of technological progress. One are the elements that are 'embodied' in the original machinery and equipments and the second are the `disembodied' components which are subsequently added by innovation in the recipient country in the fields of production, management, marketing, raw materials etc. known as technology transfer. There is evidence to show that the rate of technological progress can be stepped up by the disembodied component, even with existing technology.

The scope of technology may be explained as a resource which comprises knowledge, skills and means for using and controlling the factors of production to produce, maintain, and distribute goods and services for which there is an economic and social demand. Under this broad definition various **sources of technology transfer** can be grouped under the following categories:

1. Projects-Foreign direct investment; turn-key construction and co-production.
2. *Trade*-Sale of equipment, tools and end-products.
3. *Contractors and Development*-Licensing of patents, trademarks, management and equipment, maintenance, risk contracts for oil drilling.
4. *Research and Development*- Location of R&D operations in foreign countries; joint R&D projects.
5. *Personnel* Exchanges- Development assistance under bilateral and multilateral aid programmes, international executive corps, employment of foreign technicians,

6. *Publications*- Professional and scientific literature, technical publications.

7. *Conferences-Professional* and scientific meetings, academic preferences, to-chemical societies, and, trade associations.

8. *Teaching and Training*- Foreign study in regular undergraduate and graduate programmes, training programmes of United Nations and other international agencies, internal training programmes of business firms etc.

9. *Others*- Transfers through international tender invitations, acquisition of companies, Government-to-Government agreements etc.

The great majority of developing countries including India are poor and suffer from over-population and consequent higher rates of unemployment. The technology of advanced countries by definition is capital-intensive, whereas the technology required in most developing countries has to be employment-intensive. This is, therefore, the basic contradiction. The transfer of capital-intensive technology into developing countries is likely to worsen the employment position as such technology would deny the unemployed the gains of economic growth through the adoption of capital-intensive techniques. The extremists, therefore, argue for an almost total rejection *of* transferring western technology to Indian conditions and advocate for the adoption of Gandhian or Maoist patterns of economic development in which emphasis is not on maximisation of income but on the maximisation of employment. Those who are of moderate views are *of* the opinion that the transference *of* western technology may not be feasible in to, yet there are certain areas like the generation of power where capital-intensive technology may pay desired dividends. Both the views ascertain that import of technology needs careful handling. The priorities of national planning and the choice of technologies both have to be optimized. An appropriate technology that will maximize employment and at the same time provide to the consumers products at reasonable prices has yet to be evolved.

Sometimes it is argued that developed countries must evolve appropriate technology suitable to the environment of developing countries and should not transfer their highly sophisticated technologies.

Advanced industrialised countries are trying to sell their technology to less developed countries. This is being done either by establishing multinational companies or through technical collaboration with leading companies. This is transfer of technology. It should be selective and its

application should be according to the conditions prevailing in the developing country concerned.

METHODS OF TECHNOLOGY TRANSFER:

Transfer of technology can be achieved:

(i) by improving and updating technologies,

(ii) by adopting and absorbing newer technologies,

(iii) by innovating and improving the technology imported,

(iv) by better using technology in production,

(v) by producing new kinds of products,

(vi) through improved systems and improved organisations and the effective use of technology.

INTERNATIONAL TECHNOLOGY TRANSFER

International Transfer of technology has played a great role in:

(a) the economic development of a developing country, like India and Pakistan.

(b) the Dissemination of technology from one developed country to another. For example, from USA to Japan or UK to USA etc.

(c) offering economic aid from UN to a developing country like Nepal, Sri Lanka etc.

Such international transfer of technology is usually large in size and volume involving billions of dollars, a long period of time usually five to ten years, hundreds of manpower, large number of contractors and sub-contractors under the main contractor, a consortium consisting of three to 15 companies offering the complex know-how, a main consultant aided by a large number of co-consultants etc. This is usually in the fields of Iron & Steel, Aluminium, Fertilisers, Dams and Barrages, Agriculture, Civil Engineering and Architecture for Civil 'Engineering and Architecture for Stadium, Residential Complexes, Railway Terminus, Airports, Water Supply stations etc. Many such projects are financed by the World Bank. International Monetary Fund or large aids from UN or organisations like Aid-India consortium.

14.7 SUMMARY

Realising the important role technology can play in the development of science the Government of India in 1983 introduced Technology Policy Statement the basic objective of which was to ensure

absorption and adaptation of imported technology appropriate to national priorities and availability of resources. Technological developments have been revolutionizing the business. They facilitate not only the introduction of new products but also tremendous improvement in the operational efficiency of business. The Government's technological policy creates very important technological environment. Restriction on foreign technology, scale of operations, type of technology etc very adversely affected the Indian business in the past.

14.8 KEY WORDS

Technology : Means Scientific knowledge for the manufacture of a product or rendering a service.

Transfer of Technology : Means adopting and absorbing newer technologies.

Appropriate Technology: Whether it will suit our condition or not.

14.9 SELF ASSESSMENT QUESTION

1. Describe the technological policy of the Government.
2. What is Technology Transfer?
3. Explain methods of Technology Transfer.
4. Identify the problems of Technology Transfer.
5. What would be the most appropriate technology for India? Discuss.
6. What do you mean by import of Technology?

14.10 SUGGESTED READINGS

The Economic Survey : Govt. of India Publication, New Delhi, Place & Years

Bhatia HL, International Economics, Vikas Publishing House, New Delhi, Place & Years

Mukherjee's and Indrani, Constitution of India, world Press, Kolkata, Place & Years

Eleventh Five year plan, Govt. of India Publication, New Delhi, Place & Years

Jagdish Bhagwati and Padma Desai, India Planning for Industrialisation (London), Place & Years

Xavier M.J., Marketing in the New Millenium, Vikas Publishing House, New Delhi, Place & Years

UNIT-15 INTERNATIONAL ENVIRONMENT, EMERGENCE OF GLOBALISATION, CONTROL OF FOREIGN DIRECT INVESTMENT

Structure:

15.1 Introduction

15.2 Objectives

15.3 International Environment

15.4 Emergence of Globalisation

15.5 Foreign Direct Investment

15.6 Control of Foreign Direct Investment

15.7 Summary

15.8 Key Words

15.9 Self Assessment Question

15.10 Suggested Readings

15.1 INTRODUCTION

A competitive business is an essential feature for global business. In Various economics the nature of business competition is different. With the emergence of globalisation there is tremendous changes in international business environment. It is a fact that business environment varies from place to place and from time to time. The United State's business environment is entirely different from Indian System, values, cultural factors socio-economic background and so on. On the account of their higher productivity and marketing success of US business system. On the other hand we find individualism, one-man decision making, collective coercion of the management by trade unions and so on in business environment of India. It means that international environment contrasts are most decisive factor in international business environment. There is a lot of difference between the business environment of developed and developing countries.

15.2 OBJECTIVES

After going through this unit you will be able to:

- Understand the meaning and nature of International Environment.
- Understand the meaning and emergence of Globalization.

- Explain the need and importance of Foreign Direct Investments.
- Explain the control measures of Foreign Direct Investment in India.

15.3 INTERNATIONAL ENVIRONMENT

The business environment in developing countries like India, differ substantially from that the developed market economies. The business organisations which operate in the global market must consider the environmental differences before they formulate policies. This is the reason why business managers must have the global approach. Their business operational strategies and business policies must consider the different economic system in the marked.

The rapid internationalisation and globalisation of business took place during 1990s. The entire global market is passing through a transition period. Today conducting and managing international business is a crucial venture worldwide due to variation in social, cultural, economic and political factors from one country to another. Now the international business operators must have accurate and timely information to enter into international market. The market segmentation pricing policy, size of production, are other factors to be kept in mind while formulating international business policies. The role of world Bank, IMF, WTO, FDI policy etc are also playing a vital role in framing international business environment these days.

15.4 EMERGENCE OF GLOBALISATION

Globalization is the process of becoming a part of some system that operates all over the world or in many countries. Globalization can be defined, simply as an expansion of economic activities across political boundaries of nation states. More importantly, perhaps, it refers to a process of deepening economic integration, increasing economic openness and growing economic interdependence between countries in the world economy. It is associated not only with a phenomenal spread and volume of cross border economic transaction, but also with an organization of economic activities which straddles national boundaries. The term 'Globalization' has been extensively used in modern discussion of industrial policies and also national economic policies, besides in business circles. Generally, the term 'globalization' is considered as a synonym for the term 'internationalization'. Strictly speaking, it is not so. Business with one or more foreign countries amounts to internationalism, whereas globalization means adopting a global outlook for the business and

business strategies are aimed at enhancing global competitiveness. Companies, which have adopted global outlook "stop thinking of themselves as national marketers, but start thinking themselves as global marketers." In these companies, the management and the staff are given training in planning business all the world over, competing it International markets throughout the globe. Executives are trained in worldwide operations and not mere domestic market or a few market outside the country.

Agricultural societies see industrialisation as the main vehicle for improving their living standards, even though initially industry relied largely on foreign trade. Industry is severely handicapped if it is deprived of the ability to trade widely. The division of labour is united by the size of the market. !t is the key to increased productivity. The World Development Report, 1987 stated that progress of small countries depended upon their ability to trade relatively freely with the rest of the world. On the other hand, economies with large domestic market, trade-led specialisation, economies of scale and competition to keep the managers alert. The volume of trade since 1970 has multiplied ten times. The world trade scene is at present marked by two opposing trends. On the one hand, there is a growing trend towards free trade. Quantitative trade restrictions are being gradually removed. More and more items like agriculture and free services are being sought to he brought under multilateral trade agreements. Custom duties have also been drastically reduced over the Years. On the other hand, regional trade blocks have been formed. A regional trade block is a trade arrangement which discriminates between countries within the block and those which arc outside it, and hence restricts the growth of trade and prosperity.

MEANING OF GLOBALISATION

Globalization is the integration of international markets for goods and services, technology, finance and to some extent labour. It is the integration of the country with the world economy. World is perceived as global village. A country will be able to supply anything to or buy anything g from anybody in, the world. Globalization implies the linkage of a nation's market with the global market. Technology is an important factor, which has facilitated the globalization process. Globalization has made markets highly competitive and there is thus, globalization is the process of becoming a part of some system that operates all over the world or in many countries a remarkable growth of new service products.

GLOBALISATION IN INDIA

In 1991, India had unprecedented balance of payments crisis. The finances of the Central, as well as State Governments had reached a - situation of near bankruptcy. India's increased reliance on high cost external commercial borrowings and NRI deposits further accentuated this problem. With the downgrading of India's credit rating by some international agencies, combined with political uncertainties at home, there was heavy flight of capital out of India. Since India lost its credit worthiness in the international market, the government mortgaged 40 tonnes of to Gold Bank of England.

In spite of adopting several restrictive measures in the import sector and also drawing 1.8 billion dollars from the Contingency Compensatory Financing Facility (CCEF) in January 1991, foreign exchange reserves declined to 1.1 billion dollar in June 1991, an amount barely sufficient for just two weeks of imports into the country. Default on debt servicing appeared imminent, and this could be avoided only if credit were made available by these institutions, but with a condition of adopting 'Stabilization, and Structural adjustment Programme' which included stabilization, domestic liberalization and external liberalization. Under these circumstances, the new government in July 1991 presented its budget with a series of policy changes, which underlined globalization, liberalization and privatization. This has come to be called as India's New Economic Policy. The policies are farther strengthened when India signed the Dunkel Draft in 1994. From this, it is evident that the adoption of the policy of globalization was not out of selection of a policy, but it was a matter of compulsion, both voluntary and involuntary.

15.5 FOREIGN DIRECT INVESTMENT

Every where in the world, including the developed countries governments are vying with each other to attract foreign capital. The belief that foreign capital plays a constructive role in a country's economic development, it has become even stronger since mid-1980. The experience of South East Asian Countries (1986-1995) has especially confirmed this belief and has led to a progressive reduction in regulations and restraints that could have inhibited the inflow of foreign capital

NEED FOR FOREIGN DIRECT INVESTMENT (FDI):

The need for FDI arises because of the following reasons. In most developing countries like India, domestic capital is inadequate for the purpose of economic growth. FDI is typically seen as a way of filling in

gaps between the domestically available supplies of savings, foreign exchange, government revenue and the planned investment necessary to achieve developmental targets. To give an example of this 'savings-investment' gap, let us suppose that planned rate of growth output per annum is 7 percent and the capital-output ratio is 3 percent, then the rate of saving required is 21 percent. If the saving that can be domestically mobilized is 16 percent there is a shortfall or a savings gap of 5 percent. Thus the foremost contribution of foreign capital to national development is its role in filling the resource gap between targeted investment and locally mobilized savings. Foreign capital is needed to fill the gap between the targeted foreign exchange requirements and those derived from net export earnings plus net public foreign aid. This is generally called the foreign exchange or trade gap.

An inflow of private FDI helps in removing deficit in the balance of payments over time if the foreign owned enterprise can generate a net positive flow of export earnings.

The third gap that the FDI and specifically, foreign investment helps to fill is that between governmental tax revenue and the locally raised taxes. By taxing the profits of the foreign enterprises the governments of developing countries are able to mobilize funds for projects (like energy, infrastructure) that are badly needed for economic development.

FDI meets the gap in management, entrepreneurship, technology and skill. The package of these much-needed resources is transferred to the local country through training programmes and the process of 'learning by doing. Further foreign companies bring with them sophisticated technological knowledge about production processes while transferring modern machinery equipment to the Capital poor developing countries. In fact in this era of globalization, there is a great belief that foreign capital transforms the productive structures of the developing *economics* leading to high rates of growth. Besides the above, foreign capital, by creating new productive assets, contributes to the generation of employment a prime need of a country like India.

FORMS OF FOREIGN INVESTMENT:

Foreign Capital can be obtained in the form of foreign investment or non-concesional assistance or concessional assistance.

1. **Foreign investment** includes Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). FP1' includes the amounts raised by Indian corporate through Euro Equities, Global Depository Receipts (GDR's), and American Depository Receipts (ADR's).

2. **Non-Concessional Assistance** mainly includes External Commercial Borrowings (ECB's), loans from governments of other countries/multilateral agencies on market terms and deposits obtained from Non-Resident Indians (NRIs).

3. **Concessional Assistance** includes grants and loans obtained at low rates of interest with long maturity periods. Such assistance is generally provided on a bilateral basis or through multilateral agencies like the World Bank, International Monetary Fund (IMF), and International Development Association (IDA) etc. Loans have to be repaid generally in terms of foreign currency but in certain cases the donor may allow the recipient country to repay in terms of its own currency. Grants do not carry any obligation of repayment and are mostly made available to meet some temporary crisis. Foreign Aid can also be received in terms of direct supplies of agricultural commodities or industrial raw materials to overcome temporary shortages in the economy. Foreign Aid may also be given in the form of technical assistance.

15.6 CONTROL OF FDI IN INDIA

The Government announced in 1991, a list of industries in which Foreign Direct Investment would be automatically allowed *tip* to 51 percent. (Foreign Equity) These industries ranged from the capital goods and metallurgical sector to the entertainment, electronic, food processing and service sectors with significant export potential. Hotels and tourist-related areas were also allowed foreign equity holdings by international trading companies of up to 51 percent.

In order to accelerate the progress of the power sector, 100 per cent foreign equity participation was allowed for setting up power plants. Such equity participation allowed free repatriation of profits and other incentives.

During 1992 - 93, several additional measures were taken to encourage investment flows:

The dividend balancing condition earlier applicable to foreign investment up to 51 per cent equity was no longer to be applied except for consumer goods industries.

Existing companies with foreign equity could raise it to 51 per cent subject to certain prescribed guidelines. FDI was also allowed in exploration, production and refining of oil and marketing of gas. Captive coalmines could also be owned and run by private investors in power.

Non-Resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) predominantly owned by them were permitted to invest up to 100 percent equity in high priority industries with reparability of capital and income. NRI investment up to 100 per cent was also allowed in export houses, hospitals, export oriented units, sick industries, hotels and tourism related industries and without the right of repatriation in the previously excluded areas of real estate, housing and infrastructure.

The restriction prohibiting the use of foreign brand name or trademark for approval for foreign investment and foreign technology agreements was removed.

Disinvestments of equity by foreign investors no longer needed to be at prices determined by the RBI.

The Foreign Exchange Regulations Act (FER A) 1973 was substantially liberalized in 1991-93. All restrictions on FERA companies in the matter of borrowing funds or raising deposits in India as well as taking over or creating any interest in business in Indian companies were removed. Indian companies and Indian nationals were allowed to start joint ventures abroad. FERA companies were also exempted from restrictions on the establishment of branches, liaison offices, and acquisition of company in India carrying on business in trade, commerce or industry excepting agriculture and plantations. Companies with more than 40 percent of foreign equity were also now treated on par with fully Indian-owned companies. Now of course, Foreign Exchange Management Act (FEMA) has replaced FERA.

The Indian corporate sector has also been encouraged to access global capital markets through the GDR mechanism as described below:

1. Foreign Investors can invest in Indian companies through the GDR route without any lock-in period.
2. These receipts can be listed on any of the overseas stock exchanges and denominated in any convertible foreign currency. However, the underlying shares would be denominated in Indian rupees.
3 Private placement with United States (US), investors is also permissible in accordance with the US Securities Act.
4. Short-term capital gains are taxable at the rate of 65 percent along with business income long-term capital gains (computed on holdings for more than 12 months) are taxable at the rate of 10 percent.

The Guidelines for Euro issues were liberalized in June 1996 so as to give the market a free play in judging the quality of issues and the

number of issues that can be floated in a year. The conditions relating to end-use of GDR proceeds have been relaxed significantly. Investment in the stock market and real estate is not. however permitted out of GDR proceeds.

In August 1999, a Foreign Investment Implementation Authority (FIIA) was established within the Ministry of Industry in order to ensure that approvals for Foreign Investments (including NRI investments) are quickly translated into actual investment inflows and that proposals frutify into proceeds.

The Insurance Regulatory and Development Authority (IRDA) Act was passed by parliament in December 1999. The Act, which seeks to promote private sector participation in the insurance sector, permits foreign equity shares in domestic private insurance companies up to maximum of 26 percent of the total paid-up capital.

In 2000-2001, further steps were taken:

Foreign Direct Investment (FDI) up to 100 percent was permitted in E-commerce subject to specific conditions.

The dividend balancing condition for *FDI* in twenty-two consumer goods industries was removed.

FDI under the automatic route was permitted up to 100 percent for all manufacturing activities in Special Economic Zones (SEZs) except certain activities.

100 percent FDI was also allowed (with certain conditions) in telecommunications sector, for Internet service providers, infrastructure providers, providing dark fiber, electronic mail and voice mail.

In March 2003, the Union Cabinet decided to set a cap of 26 percent on foreign investment in news channels that seek to uplink from India, putting television news and the print media on par. Until now, there was no separate up linking policy for news and current events channels. Other measures adopted during 2002-03 for encouraging greater FDI inflows included permission for 100 percent FDI in development of integrated townships regional urban infrastructure, and permission to foreign firms to pay royalty on brand name \ trademark as a percentage of net sales in case of technology transfer.

Sources of Foreign Direct Investment

The largest source of FDI to India over the period of 1991-2000 has been the USA and its share in total FDI approved has been 22 per cent. The second position was occupied by Mauritius with its share in FDI during

that period of 12 per cent. However, it should be noted here that Mauritius based investments are nothing but US invest invests. They are routed through Mauritius because of tax advantages. Since the tax rates prevailing in Mauritius are amongst the lowest in the world, many MNCs prefer to route their investments to India through Mauritius.

Prior to 90s, India had to depend on a few developed Western countries for capital. During the 90s a number of other countries took interest in investing in India. These included countries like Italy, Australia, South Korea, Singapore, Malaysia etc. Many other countries like Israel, Thailand, Saudi Arabia, South Africa whose names did not appear in the FDI list prior to 1901, have increased their share over the years.

15.7 SUMMARY

The rapid internationalisation and globalisation of business took place during 1990s. The entire global market is passing through a transition period. Today conducting and managing international business is a crucial venture worldwide due to variation in social, cultural, economic and political factors from one country to another. Now the international business operators must have accurate and timely information to enter into international market. The market segmentation pricing policy, size of production, are other factors to be kept in mind while formulating international business policies. The role of world Bank, IMF, WTO, FDI policy etc are also playing a vital role in framing international business environment these days.

The term 'Globalization' has been extensively used in modern discussion of industrial policies and also national economic policies, besides in business circles. Generally, the term 'globalization' is considered as a synonym for the term 'internationalization'. Strictly speaking, it is not so. Business with one or more foreign countries amounts to internationalism, whereas globalization means adopting a global outlook for the business and business strategies are aimed at enhancing global competitiveness. Companies, which have adopted global outlook "stop thinking of themselves as national marketers, but start in another words, globalization is the process of becoming a part by some system that operates all over the world or in many countries, thinking themselves as global marketers."

Every where in the world, including the developed countries governments are vying with each other to attract foreign capital. The belief that foreign capital plays a constructive role in a country's

economic development, it has become even stronger since mid-1980. The experience of South East Asian Countries (1986-1995) has especially confirmed this belief and has led to a progressive reduction in regulations and restraints that could have inhibited the inflow of foreign capital.

Foreign Capital can be obtained in the form of FDI, FPI, GDRs, ADRs, ECBs etc.

Control on FDI in India was further amended in 1991 with FEMA, IRDA, FIIA and liberlised upto 100 percent with certain conditions from time to time.

15.8 KEY WORDS

Globalization:		Expansion of economic activities across political boundaries of nation states.
FDI	-	Foreign Direct Investments.
FPI	-	Foreign Portfolio Investments.
GDRs	-	Global Depositary Receipts.
ADRs	-	American Depository Receipts.
ECBs	-	External Concessional Bassousings
OCBs	-	Over Seas Corporate Bodies
NRIs	-	Non Resident Indians
FEMA	-	Foreign Exchange Management Act.

15.9 SELF ASSESSMENT TEST QUESTIONS

1. What do you mean by Globalization?
2. Describe the Government's Policy towards.
3. Discuss the Cause and effect of Globalization in India.
4. Why Foreign Capital is needed? Discuss various sources of foreign capital.
5. Discuss the significance and method of control of F.D.I. in India.

15.10 SUGGESTED READINGS

B. Ghosh : Business Environment, New Book Stall, Kolkata.

Dunning and Handani (Edited): New Globalisation and Developing Country.

Dutta and Sundaram, Indian Economy, S. Chand & Co. Delhi.

H.L. Bhatia, International Economics, Vikas Publishing House, Delhi.

UNIT-16 BENEFITS AND PROBLEMS FROM MNCs, W.T.O. ITS ROLE AND FUNCTIONS

Structure:

16.1 Introduction
16.2 Objectives
16.3 Multinational Corporation Concept and Features
16.4 Benefits from MNCs
16.5 Problems from MNCs
16.6 WTO
16.7 Role of WTO
16.8 Functions of WTO
16.9 Summary
16.10 Key Words
16.11 Self Assessment Question
16.12 Suggested Readings

16.1 INTRODUCTION

Multinational Corporations are huge business organisations which extend their business operations beyond the country of origin through a network of industries and marketing operations. They are multi process and multi product enterprises. The few examples of MNCs are: Sony of Japan, IBM of USA, Siemens of Germany, Videocon and ITC of India. There are more than 40,000 MNCs, with more than 2,50,000 overseas subsidiaries. The top 300 MNCs Control over 25 percent of the world economy. The MNCs are such business units which operate simultaneously in different countries of the world. All business operations are carried out in different countries, with the strategic head quarters is any part of the world. Earlier only American based multinationals ruled the world; but today, many Japanese, Korean, European and Indian multinational companies have spread their wings in many parts of the world.

The reasons for the growth of MNCs are many but with advancement of Globalisation and Liberlisation policy of so many

developing countries after 1990 the MNCs are now indispensable business partner. A few reasons are: non transferable knowledge in the form of patent, desire to exploiting reputations, protecting secrecy, avoiding tariffs, product life cycle theory and strategic alliance and investment of available capital.

16.2 OBJECTIVES OF THE UNIT

After reading this unit your will be able to:

- Understand the meaning and features of MNCs.
- Explain the advantages of MNCs.
- Understand the problems and disadvantages of MNCs.
- Understand the role and functions of W.T.O.

16.3 MULTINATIONAL CORPORATION: CONCEPT & FEATURES

Meaning: An Multinational Corporation is one which undertakes foreign direct investment, i.e. it owns or controls income generation, assets in more than one country, and in so doing produces goods or services outside its country of origin, i.e. thus, a multinational corporation a company that manages, owns and controls production or service facilities in several foreign countries engages in international production.

Definition: There is no universally accepted definition of the term multinational corporation. Different authorities define the term differently.

(1) *As ILO Report says,* "The essential nature of the multinational enterprises lies in the fact that its Managerial Headquarters are located in one country *(home country)* while the enterprise carries out operations in a number of other countries as well *(host countries)*"

(2) *Lonard Gomes* obviously said, what is meant is, "A corporation that controls production facilities in more than one county, such facilities having been acquired through the process of foreign-direct investment. Firms that participate in international business, however large they may be, solely by exporting or by hunting technology are not Multinational enterprises."

(3) The *United Nations* defines MNCs as. "Enterprises which control assets-factories, mines, sales offices and the like in two or more countries."

(4) *In India, the Foreign Exchange Regulation Act, 1973 (FERA)* provides a specific definition of multinational corporation as follows :

"A corporation incorporated in a foreign country or territory shall be deem ed to be m ultin ationalcorp oration ifsu ch corp oration: (a) is a subsidiary or a branch or has place of business in two or more countries or territories. (b) carries on business or othezvise operations in two or more countries or territories."

A "multinational corporation" is also referred to 'as an *international, transactional* or *global corporation.* Actually, for an enlarging business firm, multinational is a beginning step, as it gradually becomes transnational and then turns into a global corporation.

FEATURES OF MULTINATIONAL CORPORATIONS:

Main features of multinational corporations are as under:

1. **Giant Size:** MNCs are predominantly large-sized and exercise a great degree of economic dominance. The assets and sales of MNCs run into billions of dollars and they also make supernormal profits.

2. **International Operations :** The control of such institutions resides in the hands of a single institution but its interests and operations sprawal across national boundaries. It operates through a / parent corporation in the home country.

3. **Transfer of Resources:** MNCs facilitates the collective transfer of resources between countries. There is a package of transfer in the form of equipment, raw materials, finished products, labour, technical know-how and financial investment.

4. **Varied Activities :** MNCs perform varied functions. One of their functions is concerned with services. These corporations transfer capital and techniques. Regarding knowledge of sale of goods, foreign trade, packing etc. They provide research and development services. Other activities are related to production etc.

5. **Oligopolistic Structure :** Through the process of merger and takeover etc. in course of time a MNC acquires awes one power. This coupled with its giant size make it oligopolistic in character.

6. Spontaneous Evolution:: MNCs usually grow in a spontaneous and unconscious manner. There is no need of any pre-planning. Many firms gradually assume international character. Several factors contribute the spread and development of multinational corporation, Viz., difference in wage rate in different. countries, favourable trade conditions etc.

7. Other Features : A large part of the capital assets of the parent company is owned *by* the citizens of the company's home country.

The absolute majority of the members of the Board of Directors are citizens of the home country.

Decisions on new investment and the local objectives are taken by the parent company.

16.4 BENEFITS OF MULTI NATIONAL CORPORATIONS

The MNCs have a revolutionary effect on the international economy. It is only due to this reason that the MNCs have affected the traditional form of capital flows and international trade for many economies. In the present world, they constitute a powerful force in the world economic system.

According to the *ILO Report,* "For some, the multinational companies are an invaluable dynamic force and instrument for wider distribution of capital technology and employment; for others they are monsters, which our present institutions, national or international cannot adequately control, a law to themselves with no reasonable concept, that the public interest or social policy can accept."

Benefits from MNCs can be studied under heads :

(I) *Benefits to the host countries* and *(II) Benefits to the home countries.*

(I) Benefits to the Host Countries: To the host countries MNCs are likely to bring the following benefits :

1. Transfer of Capital : The MNCs have played significant role to help the developing countries to obtain capital from the advanced countries of the world. Therefore, they transfer capital from countries where it is abundent to the countries where it is scarce.

2 Raising the Rate of Investment: MNCs raise the rate of investment in the host country. This brings about rapid indus-trial growth and is

followed by greater opportunities for employment in different sectors of the economy.

3. **Use of Modern Techniques:** MNCs not only provides finance but also managerial administrative and technical per-sonnel, new technology; research and innovations in products and techniques of production which are in short supply in LDCs. They tend to increase the pace of development.

4. **Linkage Effects :** The UDCs do not have a sufficient degree of linkage with other industries. The MNCs usually produce 'linkage effects' in the host country. They also help in the creation of 'linked industries'. Such linkages may be either forward or backward.

5. **Expansion of International Trade :** MNCs facilitate the expansion of international trade and bring out greater economic co-operation between the developed and developing countries by functioning as links between them.

6. **Effects on Balance of Payment :** investment by MNCs in the developing countries improves their balance of payment by increasing exports and providing access to required inputs.

7. **Increasing Employment :** All round diversification by MNCs increases employment and income and helps to raise living standards in LDCs.

8. **Risk Undertaking :** They undertake great risk in investing their funds in LDCs in the face of imperfect infrastructural facilities like power, transport, skilled labour, etc., low market demand and short supply of inputs.

9. **Development of .Human Resource Capital :** Still another point in favour of MNCs is that they are helpful to the development of human resource capital. They serve as carriers of knowledge and experience in different spheres. Thus, they provide sophisticated technology and improved skill and knowledge to under developed countries.

(II) Benefits to the Home Countries : The following benefits are likely to accrue to home countries

(1) Inflow of income from overseas profits, royalties, licensing fee and management contracts.

(2) Export of components and finished goods *for* assembly or distribution in foreign markets.

(3) Technology and management expertise acquired from competing in global markets.

(4) Acquisition of raw materials from abroad, often from a steadier supply and at lower prices that can not be found domestically.

(5) Job and career opportunities at home and abroad in connection with overseas operations.

16.5 PROBLEMS OF MULTINATIONAL CORPORATION

As is the case with many other activities, there are several problems of MNCs that may accompany the benefits brought to home and host countries. Some of the drawbacks are as follows :

1. **Interference in the Economic Sovereignty of the Host Country :** Since MNCs are economically powerful, they can evade or undermine national economic autonomy and political control. This poses the risk that they may threaten the political sovereignty of the host country.

2. **Drainage of Resources :** The main objective of the MNCs is to earn maximum profit. To achieve this objective they invest their capital in under-developed countries. According to *one* estimate, 300 *MNCs of* America received about $ 40 billion as profit from under-developed countries.

3. **Capital Intensive Technology :** The MNCs use modern capital intensive technology which is inappro-priate to the conditions in underdeve-loped countries. In countries where labour is in abundance and unemployment widespread, such labour saving technology is inappropriate because it does not offer many jobs.

4. **Economic Inequality :** 'MNCs have not adhered to the goal of economic equality in the following way :

(i) income gap among people also get widened as MNCs pay more salaries and perks to their employees.

(ii) These corporations give more importance to the production of luxury goods than the production of mass consumption goods.

(iii) Regional inequality has aggravated *as* MNCs set-up industries in advanced regions and not in backward regions.

5. **Effect on the Balance of Payments:** MNCs can have an unfavourable effect on the balance of payment of a country. Their presence results in a

large drain on the scarce foreign exchange resources of developing country.

6. **Neglect of Research and Development :** Although MNCs could have played a catalytic role in the promotion of research and development in the developing economies, their performance in this connection is far from satisfactory. Their expenditure on scientific research is negligible.

7. **Pre-Empting Savings:** MNCs are pre-empting local savings by overpricing the imports and underpricing the exports of LDCs. In cases where there is competition from local entrepreneurs, the MNCs undercut them by charging low prices for their products. As a result, the local firms are squeezed out of the business.

8. **Exploitation of Labour :** MNCs establish ventures in UDC to exploit the cheap labour available them. Therefore they are interested in maintaining a gap between the wages prevailing in their home country and the host country.

9. **Cultural Loss :** The most serious threat faced by the host country is the loss of their cultural moorings in the name of globalisation the MNCs *usher in* their own dress and fond habits which are simply grabbed by the youth c' the host countries.

10. **Unfair Trade Practices :** The MNCs also uses unfair trade practices. For instance to save the corporate tax they over invoice the Imports and under invoice the exports.

11. **Distortions in Consumption Pattern :** The MNCs may also lead to distortions in consumption patterns. By the massive, aggressive and sustained publicity, they can create demands and evolve market for their products. They have resources to spend and the art to attract customers. Thus, the worldwide network of MNC's in eatables like KFC, soft drinks like Pepsi and Coca Cola, Junk food outlets etc., are all examples of how the MNC's have created a taste for their products and ensured wider markets for sale.

12. **Depletion of Natural Resources :** The transnational corporations cause fast depletion of some of the non-renewable natural resources in the host country. They have also been accused of the following environmental problems : polluting the environment; not paying compensation for the environ-mental damages; causing harmful

damages to the local living conditions; and, paying little regard to the risks of accidents causing major environmental catastrophes.

13. **Encouraged Demonstration Effect :** The MNCs made heavy expenditure on advertisement and publicity It resulted in wasteful expen-diture whose burden is ultimately to be borne by customers.

14. **Creation of Monopolies :** The MNC's may create their monopolies in the markets and eliminate local competitors.

15. **Evasion of Taxes :** The MNC's may manipulate their accounts to evade the taxes in the host country.

16. **Against the National Interest :** The Multinational Corporations have instances of acting against the interests of the local economy. Many such instances can be quoted :

(i) Ship-owning companies (and indeed, their countries) like Bergesen (Norway) and (Greece) regularly violate international and national laws and dump their hazardous wastes at ship-breaking yards in India, Pakistan, China, Turkey and Bangladesh

(ii) In Kodaikanal (India), Hindustan Lever a subsidiary of Unilever Plc, an Anglo-Dutch multinational dumped mercury waste from its thermometer factory in the surrounding forests and on an innocent local community.

(iii) In Bhopal (India) more than 8,000 people died in the first three days after 40 tonnes of lethal gas spilled out from Union Carbide's Pesticide factory in December 1984.

Despite all these problems and disadvantages the developing countries are inviting the MNCs to gain some advantages at least and to be in true with expanding global economy.

16.6 WORLD TRADE ORGANISATION

On January 1, 1995, the first and most powerful world trade regulating agency, namely World Trade Organisation (WTO) came into existence, India. is one of its 132 founding members. The WTO is the umbrella organization responsible for overseeing the implementation of all agreements that have been negotiated just before it came into existence. It is also responsible for the settlement of disputes among its members. Finally, periodic review of the trade policies would also be initiated under the auspices of WTO.

Before the WTO came into existence international trade in merchandise was guided by the rules and provisions of the GATT. The GATT rules, however, could not absorb the complexities of world trade, which had been growing steadily since the Bretton Woods days, both in terms of commodity coverage and the nature of regulators applied by the regional trade blocks. Moreover, the GATT umbrella did not cover trade ill services. The headquarter of WTO is located at Geneva (Switzerland). Upto June, 2014 160 countries were the members 04 WTO.

16.7 ROLE OF WORLD TRADE ORGANISATION

The world trade organization (WTO) deals wirh the global rules of trade between nations. It main function is to ensure that trade flows as smoothly, predictably and freely as possible. The avowed goal of the WTO is to create a fair and equitable, rule based Multilateral trade system. The most appealing aspect is that the new multilateral trade regime would be transparent and non-discriminatory. For the world trading community as a whole, every initiative on trade liberalisation should ensure rewards in the form of large and expanding markets and greater trade flows for all participating members. All quantitative restrictions (quotas, import licensing etc.) would be replaced by tariff so as to make the process more transparent and open to international public scrutiny; all reductions and adjustments in tariffs would be effected through negotiations and are to be notified to the WTO. Then all kinds of subsidies would be reduced in due course by the developed Countries that the developing economies under their sheer comparative cost advantage could gain larger access to the markets in the developed world.

The two most significant principles of WTO agreements are the Most Favoured Nation and the National Treatment Clause. Under the former, no discrimination is to be exercised among member countries; any trade concession offered by one member to mother must he offered to all members. Under the latter, imported products and domestic products are to be accorded the same treatment; moreover, besides import duty, no extra tax other than one also levied on domestic products is to be imposed. Foreign companies investors and Government must feel assured that trade barriers would not be raised arbitrarily by any trading partner, Lastly, the new trade regime should work to a greater advantage of the less developed countries; they must be given more time

to adjust, greater flexibility and some special privileges.

On a broad plane, the canvas of WTO agreements is spread over three compartments; goods, services and intellectual property rights. First, trade in goods of all descriptions (agricultural or industrial) is to be governed under GATT reformulations. Second, trade in services of all kinds is to he regulated under General Agreement on Trade in Services. Third, trade related aspects of Intellectual Property Rights would set out the terms and conditions for the international flow of intellectual property.

Evaluation- The new trading system of WTO seems to give undue emphasis on private sector and competition and fails to recognise the strategic role which the state plays in promoting the right kind of development with emphasis on equity and social infrastructure. Overemphasis on competition seems to have eroded the concept of public good and thereby provided a partial view of development process.

One of the objectives of trade negotiations under the GATT is providing a freer trading environment for the movement of goods and services. This objective is based on the assumption that free trade is an optimal modality for global welfare. But free trade does not necessarily imply fair trade. Given the differences in the initial conditions, total free trade seems to aggravate the gap between the rich and the poor countries. The new trading system under WTO fails to recognise this adverse impact of liberalisation of trade on the norms of fairness.

16.8 FUNCTIONS OF WORLD TRADE ORGANISATION

The new World Trade Organisation (WTO) which replaced the General Agreements in Tariff's and Trade *(GATT)* came into effect from 1st January, 1995, with the backing of at least 85 founding member including India. The WTO now comes as the third economic pillar of worldwide dimensions alongwilh the World Bank and the IMF.

As many as 77 of the 125 countries which signed the Uruguay Round trade accord in April 1994 at a conference in Marrakesh have officially notified GATT that they would join the WTO.

The new trade body-WTO with powers to settle trade disputes between nations and to widen the principle of free trade to sectors such as services and agriculture, covers more areas than GATT, whose rules had been in operation for the last 50 years. The WTO envisages the

reduction of tariffs by more than one-third and is concerned with further opening of markets. It is expected that the world trade would be stimulated in the long run as a result of the coming, into being of the new trade body-WTO. According to an estimate made by the GATT, in 2005 turnover through international trade could be as high as $510 billion annually.

Like GATT, the WTO agreement will regulate the commodities trade, but in addition it will also deal with services across borders like insurance and tourism. The new WTO conditions also protect intellectual properly like patents, copyrights and brands. Agriculture and textiles are completely covered by the WTO agreements. The highest WTO body is a ministerial conference which will meet at least once in two years.

The WTO has been entrusted with the following functions:

1. The WTO would facilitate proper implementation of multinational trade agreements.
2. It will review trade policies undertaken by the member countries.
3. It will act as a forum for the negotiation of disputes among, the member countries over trade related problems.
4. The WTO will work in cooperation with the IMF and the World Bank.

Organization Structure

December in the WTO are made by the entire membership this is typically by consensus. The world trade organization is top level decision-making body is the ministerial conference which meets at least once every two years.

WTO Ministrial Conference

Conference	Year	Place
First	9-13 Dec, 1996	Singapore
Second	18-20 May, 1998	Geneva (Switzerland)
Third	30 Nov,-03 Dec, 1999	Seattle (USA)
Forth	9-13 Nov, 2001	Doha (Qatar)
Fifth	10-14 Sept, 2003	Cancun (Mexico)
Sixth	13-18 Dec, 2005	Hong Kong, (China)
Seventh	30 Nov,-02 Dec. 2009	Geneva (Switzerland)
Eight	15-17 December,2011	Geneva (Switzerland)

Ninth	03-07 December, 2013	Bali (Indonesia)
Tenth	15-18 December, 2015 (Beheld)	Nairobi (Kenya)

General council, many other councils and bodies are also important of structure of world trade organization.

WTO AND INDIA:

India is committed to WTO on following points:-

1. *Tariff Lines*: WTO, India has bound about 67 per cent of its tariffs lines whereas prior to the Uruguay Round only 6 percent of the tariff lines were bound. For non-agricultural goods with it few exceptions, ceiling bindings of 40 per cent advalorem on finished goods and 25 per cent on intermediate goods, machinery and equipment have been undertaken. The phased reduction to these bound levels is being undertaken over the period March 1995 to the year 2005. In textiles where reduction will be achieved over a period of 10 years, India has reserved the right to revert to duty levels prevailing in 1990, if the integration process, envisaged Under the Agreement on Textiles, does not materialise in full. Under the Agreement of Agriculture, India's bound rate ranges from 100 to 300 per cent.

2. *Quantitative Restrictions:* Quantitative restrictions on imports maintained on balance of payments grounds were notified to WTO in 1997 for 2714 tariff lines at the eight digit level. In view of the improvements in India's balance of payments, the Committee on Balance of Payments Restrictions had asked India for a phase out for the quantitative restrictions. An agreement between USA and India was reached which envisaged the phasing out of all quantitive restrictions by India by April 2001 In line with this agreement, India removed quantitative restrictions on 714 items in the EXIM Policy announced on March 31, 2000 and on the remaining 715 items in the EXIM Policy announced on March, 2001.

3. *TRIPs (Trade-related Intellectual Property Rights):* The ruling of the two WTO Dispute Settlement Panels following the complaints made by the USA and the European Union that India had failed to meet its commitments under Article 70.8 and Article 70.9 made it obligatory for the Government of India to make appropriate amendments to the Patents Act, 1970 by April 1999. "The Patents (Amendment) Act, 1999 was passed by Parliament in March 1999 to provide for Exclusive Marketing Rights.

In respect of plant varieties, a decision has been taken to put in place *a suigeneris* system as it is perceived to be in our national interest.

As far as copyrights and related rights are concerned, the Copyright Act, 1957, as amended in 1994 takes care of our interests and meets the requirements of the TRIPs Agreement except in the case of terms of protection of' performers' rights, A Bill to increase this term to 50 years was passed by Parliament in December 1999.

4. ***TRIMs (Agreement on Trade-related Investment Measures):*** Under the TRIMs agreement, developing countries have a transition period of five years up to December 31, 1999 during which they can continue to maintain measures consistent with the Agreement provided these are duly notified. The Government of India notified two TRIMS viz., that related to local content requirements in the production of' certain pharmaceutical products and dividend balancing requirement in the case of investment in 22 categories consumer items.

5. ***GATS:***. Under the General Agreement on Trade in Services (GATS), India has commitments in 33 activities. Foreign service providers will enter these activities. According to the Government of India, the choice of the activities has been guided by considerations of national benefit.

6. ***Customs Valuation Rules:*** India's legislation on Customs Valuation Rules, 1998, has been amended to bring it in conformity with the provisions of the WTO Agreement on implementations of Article VII of GATT 1994 and the Customs Valuation Agreement.

16.9 SUMMARY

Multinational Corporations are huge business organisations which extend their business operations beyond the country of origin through a network of industries and marketing operations. They are multi process and multi product enterprises.

The reasons for the growth of MNCs are many but with advancement of Globalisation and Liberlisation policy of so many developing countries after 1990 the MNCs are now indispensable business partner. A few reasons are: non transferable knowledge in the form of patent, desire to exploiting reputations, protecting secrecy, avoiding tariffs, product life cycle theory and strategic alliance and investment of available capital.

16.10 KEY WORDS

WTO - World Trade Organisation

GATT- General Agreement on Tariff and Trade.

MNCs- Multinational Corporations.

UDCs- Underdeveloped Countries.

LDCs - Less Developed Countries.

TRIPs - Trade Related Intellectual property Rights.

TRIMs- Trade Related Investment Measures.

GATs - General Agreement on Trade in Services.

16.11 SELF ASSESSMENT QUESTIONS

1. What is MNCs? Discuss.
2. Discuss the features of MNCs.
3. Discuss the benefits of MNCs.
4. Briefly explain the problem of MNCs.
5. What is WTO?
6. Discuss the role & Functions of WTO.

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Business Environment

Block 5

Unit 17 5
Meaning and Need of Corporate Restructuring

Unit 18 23
Objectives and Procedures of Corporate Restructuring

Unit 19 39
Corporate Governance

Unit 20 54
Benefits of Corporate Governance & Its Present State in India

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2. Prof. Geetika, HOD, SoMS, MNNIT, Allahabad
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परिमापक

अनुवाद की स्थिति में

मूल लेखक	अनुवाद
मूल सम्पादक	भाषा सम्पादक
मूल परिमापक	परिमापक

सहयोगी टीम

संयोजक Dr. Gaurav Sankalp, SoMS, UPRTOU, Allahabad.

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Block 5 : Quantitative Techniques for Business Decisions

Block Introduction

Block five comprises of four units. Unit Seventeen deals with corporate restructuring its meaning and needs . Unit Eighteen deals with objective and procesudure of corporate restructuring . Unit nineteen deals with corporate Governance, its needs, benefits and impact. Unit twenty deals with bebefits of corporate governance and its present state in India.

UNIT 17: MEANING AND NEED OF CORPORATE RESTRUCTURING

UNIT FRAMEWORK

17.1 Objective

17.2 Introduction

17.3 Concept of Corporate Structure

17.4 Meaning of Corporate Restructuring

17.5 Need and Scope of Corporate Restructuring

17.6 Corporate Restructuring- Historical Background from Indian Perspective

17.7 Types of Corporate Restructuring Tools

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17.9 Self-Assessment Questions

17.10 Suggested Readings

17.1 Objectives

After studding this unit you will be able to.

- Meaning of Corporate Restructuring
- Need & Scope of Corporate restructuring
- Historical Background
- Various Modes of Restructuring
- Emerging Trends
- How to structure a restructuring

17.2 INTRODUCTION

This lesson would help you in understanding the concept of corporate restructuring, available tools, historical background & emerging trends in restructuring strategies etc., the role of professionals like company secretaries in the process of restructuring right from the strategy development and pre diligence stage till the post integration stage.Youwill also be known that types of corporate structure tools by studying this unit.

The speed of business dynamic demands the business organizations are not only to revamp their internal business strategies like effective market expansion, increased customer base, product diversification, innovation etc.But also expects the corporates to devise

inorganic business strategies like mergers, acquisitions, takeovers etc., that results in faster pace of growth, effective utilization of resources, fulfillment of increasing expectations of stakeholders. These restructuring strategies work positively for the business both during the time of business prosperity and recession.

With Indian corporate houses showing sustained growth over the last decade, many have shown an interest in growing globally by choosing to acquire or merge with other companies outside India. One such example would be the acquisition of Britain's Corus by Tata an Indian conglomerate by way of a leveraged buy-out. The Tatas also acquired Jaguar and Land Rover in a significant cross border transaction. Whereas both transactions involved the acquisition of assets in a foreign jurisdiction, Indian domestic law also governed both transactions.

Whether a merger or an acquisition is that of an Indian entity or it is an Indian entity acquiring a foreign entity, such a transaction would be governed by Indian domestic law. In the sections, which follow, we touch up on different laws with a view to educate the reader of the broader areas of law, which would be of significance. Mergers and acquisitions are methods by which distinct businesses may combine. Joint ventures are another way for two businesses to work together to achieve growth as partners in progress, though a joint venture is more of a contractual arrangement between two or more businesses.

17.3 CONCEPT OF CORPORATE STRUCTURE

There are primarily two ways of growth of business organization, i.e. organic and inorganic growth.

Organic growth is through internal strategies, which may relate to business or financial restructuring withinthe organization that results in enhanced customer base, higher sales, increased revenue, without resulting in change of corporate entity.

Inorganic growth provides an organization with an avenue for attaining accelerated growth enabling it to skipfew steps on the growth ladder. Restructuring through mergers, amalgamations etc. constitute one of the most important methods for securing inorganic growth.

Growth can be Organic or Inorganic

A company is said to be growing organically when the growth is through the internal sources withoutchange in the corporate entity.

Organic growth can be through capital restructuring or business restructuring.

Inorganic growth is the rate of growth of business by increasing output and business reach by acquiring new businesses by way of mergers, acquisitions and take-overs and other corporate restructuring Strategies that may create a change in the corporate entity.

The business environment is rapidly changing with respect to technology, competition, products, people, geographical area, markets, and customers. It is not enough if companies keep pace with these changes but are expected to beat competition and innovate in order to continuously maximize shareholder value. Inorganic growth strategies like mergers, acquisitions, take overs and spin offs are regarded as important engines that help companies to enter new markets, expand customer base, cut competition, consolidate and grow in size quickly, employ new technology with respect to products, people and processes. Thus, the inorganic growth strategies are regarded as fast track corporate restructuring strategies for growth.

17.4 MEANING OF CORPORATE RESTRUCTURING

The term Corporate Restructuring is a wide & varied term. It has no legal definition, as the term has not been defined in any legal legislation. Hence, neither it has clear and precise meaning nor can it be defined with precision. Etymologically the term "Restructuring", means 'giving new structure or rebuild or rearrange'.

In this perspective, 'Corporate Restructuring' is defined as a process of rearranging the organizational or business structure of the company for increased efficiency and profitable growth. Simply stated, Corporate Restructuring is a comprehensive process by which a company can consolidate or rearrange its organizational set up or business operations and strengthen its position so as to achieve its short-term or /and long term objectives and establish itself as a synergetic, dynamic, continuing as well as successful independent corporate entity in the competitive environment.

In the words of Hon'ble Justice D.Y. Chandrachud "Corporate Restructuring" is the means that can be employed to meet challenges which confronts businesses. To conclude, it is a process undertaken by a business / corporate / any other such entity whether proprietorship or partnership for bringing about changes for better and to make the

business competitive.

Notes:

- Corporate Restructuring could be undertaken by any business entity whether it is proprietorship, partnership, or company.
- Conglomerates are being formed by combining business where synergies are not achieved, demergers are done take place.

17.5 NEED AND SCOPE OF CORPORATE RESTRUCTURING

Need of Corporate Restructuring:

The various needs of undertaking the scheme of corporate restructuring in this modern competitive business / corporate world are discussed briefly as follows:-

- To expand the business or operations of the company
- To focus on its core strength
- Cost reduction by deriving the benefits of economies of scale.
- To obtain tax advantages by merging a loss-making company with a profit-making company
- To have access to better technology
- To improve the debt-equity ratio
- To have a better market share
- To overcome significant problems in a company
- To become globally competitive
- To eliminate competition between the companies
- To focus on core strengths, operational synergy, and efficient allocation of managerial capabilities and infrastructure
- Consolidation and economies of scale by expansion and diversion to exploit the extended domestic and international markets
- Revival and rehabilitation of sick unit by adjusting the losses of such sick units with profits of healthy company
- Acquiring the constant supply of raw materials and access to scientific research and technological development
- Capital restructuring by appropriate mix up of loans and equity capital to reduce cost of servicing and to increase return on capital employed

- Improve the corporate performances to bring it at par with competitors.

Competition drives technological development. Competition from within a country is different from cross-country competition. Innovations and inventions do not take place merely because human beings would like to be creative or simply because human beings tend to get bored with existing facilities. Innovations and inventions do happen out of necessity to meet the challenges of competition. Cost cutting and value addition are two mantras that are highlighted in a highly competitive world. Money flow into the stream of production in order to be able to face competition and deliver the best possible goods at the convenience and affordability of the consumers. Global Competition drives people to think big and it makes them fit to face global challenges. In other words, global competition drives enterprises and entrepreneurs to become fit globally. Thus, competitive forces play an important role. In order to become a competitive force, Corporate Restructuring exercise could be taken up. In addition, in order to drive competitive forces, Corporate Restructuring exercise could be taken up.

Scope of Corporate Restructuring:

The scope of Corporate Restructuring encompasses enhancing economy (cost reduction) and improving efficiency (profitability). When a company wants to grow or survive in a competitive environment, it needs to restructure itself and focus on its competitive advantage. The survival and growth of companies in this environment depends on their ability to pool all their resources and put them to optimum use. A larger company, resulting from merger of smaller ones, can achieve economies of scale. If the size is bigger, it enjoys a higher corporate status. The status allows it to leverage the same to its own advantage by beingable to raise larger funds at lower costs. Reducing the cost of capital translates into profits. Availability offunds allows the enterprise to grow in all levels and thereby become more and more competitive. Some of the scope of Corporate Restructure are as follows:

- Scope of restructuring encompasses enhancing economy (Cost Reduction) and improving efficiency (Profitability)
- Cost cutting and value addition are the two mantras that get highlighted in a highly competitive world
- In every restructuring exercise the common objectives is to eliminate the disadvantages and combine the advantages at all

level

- Restructuring is concerned arranging the business activities of the corporate as a whole.
- Reducing cost of capital translate into profits
- The term amalgamation and merger are synonymous in the Companies Act, 1956.

17.6 CORPORATE RESTRUCTURING- HISTORICAL BACKGROUND FROM INDIAN PERSPECTIVE

In earlier years, India was a highly regulated economy. Though Government participation was overwhelming, the economy was controlled in a centralized way by Government participation and intervention. In other words, economy was closed, as economic forces such as demand and supply were not allowed to have a full-fledged liberty to rule the market. There was no scope of realignments and everything was controlled. In such a scenario, the scope and mode of Corporate Restructuring were very limited due to restrictive government policies and rigid regulatory framework.

Consequent upon the raid of DCM Limited and EscortsLimited launched by Swaraj Paul, the role of the financial institutions became quite important. In fact, Swaraj Paul's bids were a fore runner and constituted a 'watershed' in the corporate history of India. The Swaraj Paul episode also gave rise to acompletely new trend. Financially strong entrepreneurs made their presence felt as industrialists – Ram Prasad Goenka, M.R.Chabria, Sudarshan Birla, Srichand Hinduja, Vijay Mallya and Dhirubhai Ambani and were instrumental in corporatere structuring.

These restrictions remained in vogue, practically, for over two decades. These, however, proved incompatible with the economic system in keeping pace with the global economic developments if the objective of faster economic growth were to be achieved. The Government had to review its entire policy framework and under the economic liberalization, measures removed the above restrictions by omitting the relevant sections and provisions.

The real opening up of the economy started with the Industrial Policy, 1991 whereby 'continuity with change' was emphasized and main thrust was on relaxations in industrial licensing, foreign investments, and transfer of foreign technology etc. With the economic liberalization,

globalization and opening up of economies, the Indian corporate sector started restructuring to meet the opportunities and challenges of competition.Forinstance, amendments were made in MRTP Act, within all restrictive sections discouraging growth of industrial sector.

The economic and liberalization reforms, have transformed the business scenario all over the world. The most significant development has been the integration of national economy with 'market-oriented globalized economy'. The multilateral trade agenda and the World Trade Organization (WTO) have been facilitating easy and free flow of technology, capital and expertise across the globe. A restructuring wave is sweeping the corporate sector the world over, taking within its fold both big and small entities, comprising old economy businesses, conglomerates and new economy companies and even the infrastructure and service sector. From banking to oil exploration and telecommunication to power generation, petrochemicals to aviation, companies are coming together as never before. Not only this new industries like those that e-commerce and biotechnology have been exploding and old industries are being transformed.

1. **Present Scenario:**

Today, a restructuring wave is sweeping the corporate sector over the world, taking within its fold both big and small entities, comprising old economy businesses conglomerates and new economy companies and even the infrastructure and service sector. Mergers, amalgamations, acquisitions, consolidation and takeovers have become an integral part of new economic paradigm. Conglomerates are being formed to combine businesses and where synergies are not achieved, Demergers have become the order of the day. With the increasing competition and the economy, heading towards globalization, the corporate restructuring activities are expected to occur at a muchlarger scale than at any time in the past, and are stated to pay amajor role in achieving the competitive edge for India in international market place.

The process of restructuring through mergers and amalgamations has been a regular feature in the developed and free economy nations like Japan, USA and European countries with special reference to UK where hundreds of mergers take place every

year. The mergers and take overs of multinational corporate houses across the borders has become a normal phenomenon.

2. **Global Scenario:**

The sweeping wave of economic reforms and liberalization, has transformed the business scenario all over the world. The most significant development has been the integration of national economies with 'Market-oriented Globalized Economy'. The multilateral trade agenda and the World Trade Organization (WTO) have been facilitating easy and free flow of technology, capital and expertise across the globe.

Globalization gives the consumer many choices – technologies are changing, established brands are being challenged by value for money products, the movement of goods across countriesis on the rise and entry barriers are being reduced. As markets consolidate into fewer and larger entities, economies become more concentrated. In this international scenario, there is aheavy accent on the quality, range, cost and reliability of product and services. Companies all over the world have been reshapingand repositioning themselves to meet the challenges and seizethe opportunities thrown open by globalization. The managementstrategy in turbulent times is to focus on corecompetencies selling loss making companies and acquiringthose, which can contribute to profit and growth of the group.The underlying objective is to achieve and sustain superiorperformance. In fact, most companies in the world are mergingto achieve an economic size as a means of survival and growthin the competitive economy. There has been a substantialincrease in quantum of funds flowing across nations in searchof restructuring and takeover candidates. UK has been themost important foreign investor in USA in recent years with British companies. In telecom, the biggest deals include AT & TTCI, SBC-Ameritech etc. There have been huge oil sector mergers, the biggest being Exxon-Mobile, BP-Amoco and Total-Petrofina. It is estimated that one-in-four US workers have been affected by the wave of mergers and acquisition activity. In the Japanese context, mergers and acquisitions are less relevant as they believe in alliances and joint ventures than mergers and acquisitions. In addition, research has shown that Japanese are least preferred merger partner/acquirer. The reasonbeing - incompatible on language.

3. **National Scenario:**

The unleashing of Indian economy has opened up lucrative and dependable opportunities to business community as a whole. The absence of strict regulations about the size and volume of business encouraged the enterprises to opt for mergers and amalgamations to produce on a massive scale, reduce costs of production, make prices internationally competitive etc. Today Indian economy is passing through recession. In such a situation, corporates, which are capable of restructuring can contribute towards economic revival and growth. Despite the sluggish economic scenario in India, merger and amalgamation deals have been on the increase. The obvious reason is - as the size of the market shrinks, it becomes extremely difficult for all the companies to survive, unless they cut costs and maintain prices. In such a situation, merger eliminates duplication of administrative and marketing expenses. The other important reason is that it prevents price war in a shrinking market. Companies, by merging, reduce the number of competitors and increase their market share.

In the words of Justice Dhananjaya Y. Chandrachud , Corporate restructuring is one of the means that can be employed to meet the challenges, which confront business.

4. **Organizational Restructuring Exercise:**

Many firms have begun organizational exercises for restructuring in recent years to cope with heightened competition. The common elements in most organizational restructuring and performance enhancement programmes are described below,

Regrouping of business: firms are regrouping the existing businesses into a few compact strategic business units, whichare often referred to as profit centers. For example L&T hasbeen advised by Mckinsey Consultants to regroup its twelvebusinesses into five compact divisions

Decentralization: to promote a quicker organizational response to dynamic environmental developments, companies are resorting to decentralization, de-layering, and delegation aimed at empowering people down the line. For example, Hindustan lever Ltd., has embarked on an initiative to reduce

5. **Portfolio Restructurings:**

Mergers, asset purchases, and takeovers lead to expansion in some

way or the other. They are based on the principle of synergy which says 2 +2=5 !

Portfolio restructuring, on the other hand, involves some kind of contraction through a Divestiture or a De-merger is based on the principle of "synergy" which says 5 -3 = 3!

17.7 TYPES OF CORPORATE RESTRUCTURING TOOLS

Corporate restructuring is for various reasons and in numerous ways. The bottom line usually is Corporate Restructuring to increase profits and improve efficiency. In India, the concept has caught on like wildfire, with a merger or two reported frequently. The process of restructuring through mergers and amalgamations has been a regular feature in the developed and free economy nations like USA and European countries, more particularly in the UK, where hundreds of mergers take place every year. Corporate Restructuring normally occurs following new acquisitions, buyouts, takeovers, other forms of new ownership or the threat or filing of bankruptcy, according to the thinking managers. The Experts reports that Restructuring involve major changes in a corporation's equity base, such as converting outstanding shares to common stock or a reverse split combining a company's outstanding shares into fewer shares. Various types of corporate restructuring strategies include:

1. **Mergers and Amalgamations:**

The term 'merger' is not defined under the Companies Act, 1956 (the '**Companies Act**'), the Income Tax Act, 1961 (the '**ITA**') or any other Indian law. Simply put, a merger is a combination of two or more distinct entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but to achieve several other benefits such as, economies of scale, acquisition of cutting edge technologies, obtaining access into sectors / markets with established players etc. Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity.

Very often, the two expressions "merger" and "amalgamation" are used synonymously. However, there is, in fact, a difference. Merger generally refers to a circumstance in which the assets and liabilities of a company (merging company) are vested in another company (the merged company). The merging entity loses its identity and

its shareholders become shareholders of the merged company. On the other hand, an amalgamation is an arrangement, whereby the assets and liabilities of two or more companies (amalgamating companies) become vested in another company (the amalgamated company). The amalgamating companies all lose their identity and emerge as the amalgamated company; though in certain transaction structures the amalgamated company may or may not be one of the original companies. The shareholders of the amalgamating companies become shareholders of the amalgamated company.

While the Companies Act does not define a merger or amalgamation, Sections 390 to 394 of the Companies Act deal with the analogous concept of schemes of arrangement or compromise between a company, it shareholders and/or its creditors. A merger of a company 'A' with another company 'B' would involve two schemes of arrangements, one between A and its shareholders and the other between B and its shareholders.

Mergers may be of several types, depending on the requirements of the merging entities

i) **Horizontal Merger:**

It also referred to as a 'horizontal integration', this kind of merger takes place between entities engaged in competing businesses which are at the same stage of the industrial process. A horizontal merger takes a company a step closer towards monopoly by eliminating a competitor and establishing a stronger presence in the market. The other benefits of this form of merger are the advantages of economies of scale and economies of scope.

ii) **Vertical Merger:**

It is a merger, which takes place upon the combination of two companies, which are operating, in the same industry but at different stages of production or distribution system. For example, the merger of a company engaged in the construction business with a company engaged in production of brick or steel would lead to vertical integration. Companies stand to gain because of lower transaction costs and synchronization of demand and supply. Moreover, vertical integration helps a company

move towards greater independence and self-sufficiency. The downside of a vertical merger involves large investments in technology in order to compete effectively.

iii) **Congeneric Merger:**

It is the type of merger, where two companies are in the same or relatedindustries but do not offer the same products, but related products and may share similar distribution channels, providing synergies for the merger. The potential benefit from these mergersis high because these transactions offer opportunities to diversify around a common case of strategic resources.

iv) **Conglomerate Merger:**

These mergers involve firms engaged in unrelated type of activities i.e. the business of two companies are not related to each other horizontally or vertically. In a pure conglomerate, there are no important common factors between the companies in production, marketing, research and development and technology. Conglomerate mergers are merger of different kinds of businesses under one flagship company. The principal reason for a conglomerate merger is utilization of financial resources, enlargement of debt capacity, and increase in the value of outstanding shares by increased advantage and earnings per share, and by lowering the average cost of capital. A merger with a diverse business also helps the company to foray into varied businesses without having to incur large start-up costs normally associated with a new business.

v) **Cash Merger:**

In a typical merger, the merged entity combines the assets of the two companies and grants the shareholders of each original company shares in the new company based on the relative valuations of the two original companies. However, in the case of a 'cash merger', also known as a 'cash-out merger', the shareholders of one entity receives cash in place of shares in the merged entity. This is a common practice in cases where the shareholders of one of the merging entities do not want to be a part of the merged entity.

vi) **Triangular Merger:**

A triangular merger is often resorted to for regulatory and tax reasons. As the name suggests, it is a tripartite arrangement in which the target merges with a subsidiary of the acquirer. Based on which entity is the survivor after such merger, a triangular merger may be forward (when the target merges into the subsidiary and the subsidiary survives), or reverse (when the subsidiary merges into the target and the target survives).

2. **Demerger:**

The act of splitting off a part of an existing company to become a new company, which operates completely separately from the original company. Shareholders of the original company are usually given an equivalent stake of ownership in the new company. A demerger is often done to help each of the segments operate more smoothly, as they can now focus on a more specific task. This facilitates the restructuring or sale of the sick business, without affecting the assets of the healthy business. Conversely, a demerger may also be undertaken for situating a lucrative business in a separate entity. A demerger, may be completed through a court process under the Merger Provisions, but could also be structured in a manner to avoid attracting the Merger Provisions.

3. **Reverse Merger:**

Reverse merger is the opportunity for the unlisted companies to become public listed company, withoutopting for Initial Public offer (IPO).In this process, the private company acquires the majority shares of publiccompany, with its own name.With a reverse merger, the private company shareholders receive most of the shares of the public company and control of the Board. A reverse merger is a quick way of going public with the time table being only a couple of weeks. The reason a reverse merger is so quick is that the public company has already completed all the necessary paper work and reviews in order to become public.

4. **Disinvestment:**

Disinvestment means the action of an organization or government selling or liquidating an asset orsubsidiary. It is also known as

"divestiture".A Divestiture is the sale of part of a company to a third party. Assets, product lines, subsidiaries, or divisions are sold for cash, securities, or some combination thereof. The buyers are typically other corporations or, increasingly, investor groups together with the current managers of the divested operation.

Reasons:

- Dismantling conglomerates
- Restructuring activity
- Adding value by selling into a better fit
- Large additional investment required
- Harvesting past investments successfully
- Discarding unwanted business divisions

5. Takeover/Acquisition:

An acquisition or takeover is the purchase by one company of controlling interest in the share capital, or all or substantially all of the assets and/or liabilities, of another company. A takeover may be friendly or hostile, depending on the offered company's approach, and may be affected through agreements between the offered and the majority shareholders, purchase of shares from the open market, or by making an offer for acquisition of the offeree shares to the entire body of shareholders.

i) Friendly takeover:

Also commonly referred to as 'negotiated takeover', a friendly takeover involves an acquisition of the target company through negotiations between the existing promoters and prospective investors. This kind of takeover is resorted to further some common objectives of both the parties.

ii) Hostile takeover:

A hostile takeover can happen by way of any of the following actions: if the board rejects the offer, but the bidder continues to pursue it or the bidder makes the offer without informing the board beforehand. The acquisition of one company (called the target company) by another (called the acquirer) that is accomplished not by coming to an agreement with the target company's management, but by going directly to the company's shareholders or fighting to replace management in order to get the acquisition approved. A

hostile takeover can be accomplished through either a tender offer or a proxy fight.

iii) **Leveraged Buyouts (LBO):**

A leveraged Buyout or "Bootstrap" transaction occurs when a financial sponsor gains control of a majority of a target company's equity with borrowed money or debt. A LBO is essentially a strategy involving the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition. Often, the assets of the company being acquired are used as collateral for the loans in addition to the assets of the company.

iv) **Bailout Takeovers:**

Another form of takeover is a 'bail out takeover' in which a profit making company acquires a sick company. This kind of takeover is usually pursuant to a scheme of reconstruction/rehabilitation with the approval of lender banks/financial institutions. One of the primary motives for a profit making company to acquire a sick/loss making company would be to set off the losses of the sick company against the profits of the acquirer, thereby reducing the tax payable by the acquirer. This would be true in the case of a merger between such companies as well.

6. **Joint Venture (JV):**

A joint venture is an entity formed by two or more companies to undertake financial activity together. The parties agree to contribute equity to form a new entity and share the revenues, expenses, and control of the company. It may be Project based joint venture or Functional based joint venture.

i) **Project based Joint venture:**

The joint venture entered into by the companies in order to achieve aspecific task is known as project based joint venture.

ii) **Functional based Joint venture:**

The joint venture entered into by the companies in order to achieve mutual benefit is known as functional based joint venture.

7. Strategic Alliance:

A partnership with another business in which you combine efforts in a business effort involving anything from getting a better price for goods by buying bulk together, to seeking business together, with each of you providing part of the product. The basic idea behind alliances is to minimize risk while maximising your advantage.

In other words, an agreement between two or more parties to collaborate with each other, in order to achieve certain objectives while continuing to remain independent organizations is called strategic alliance.

8. Franchising:

Franchising may be defined as an arrangement where one party (franchiser) grants another party (franchisee) the right to use trade name as well as certain business systems and process, to produce andmarket goods or services according to certain specifications.The franchisee usually pays a one-time franchisee fee plus a percentage of sales revenue as royalty andgains.

9. Slump Sale:

Slump sale means the transfer of one or more undertaking because of the sale of lump sum consideration without values being assigned to the individual assets and liabilities in such sales. If a company sells ordisposes of the whole or substantially the whole of its undertaking for a predetermined lump sum consideration, then it results in a slump sale.

10. Employee Stock Option Plan (ESOP):

ESO plans are allows employees can buy company's stock after certain length of employment or they can buy share at any time. Some corporations have policies to compensate employees with company's shares instead of other monetary benefits. This will increase the accountability and commitment of employee with his work and organizational growth. At the same time, accumulation of shares to employee's hands also weakens the power of top management.

11. Sell-Offs:

A sell-off, also known as a divestiture, is the outright sale of a company subsidiary. Normally, sell-offs are done because the subsidiary does not fit into the parent company's core strategy. The

market may be undervaluing the combined businesses due to a lack of synergy between the parent and subsidiary. As a result, management and the board decide that the subsidiary is better off under different ownership.

12. **Equity Carve-Outs:**

More and more companies are using equity carve-outs to boost shareholder value. A parent firm makes a subsidiary public through an initial public offering (IPO) of shares, amounting to a partial sell-off. A new publicly listed company is created, but the parent keeps a controlling stake in the newly traded subsidiary

13. **Spinoffs:**

A spinoff occurs when a subsidiary becomes an independent entity. The parent firm distributes shares of the subsidiary to its shareholders through a stock dividend. Since this transaction is a dividend distribution, no cash is generated. Thus, spinoffs are unlikely to be used when a firm needs to finance growth or deals. Like the carve-out, the subsidiary becomes a separate legal entity with a distinct management and board.

17.8 SUMMARY

Growth of organization may be organic/inorganic growth. Growth in the factors of production is organicgrowth, whereas corporate restructuring initiatives lead to inorganic growth, which is relatively faster. Restructuring may be financial restructuring, technological, market and organizational restructuring. Financial restructuring of a company involves a rearrangement of its financial structure to make the company's finances more balanced.The most commonly applied tools of corporate restructuring are amalgamation, merger, demerger, acquisition, joint venture, disinvestments etc.

The restructuring usually takes place when a business is struggling and losing money. A third party will be brought in to assess the way that the business is being run, and then make recommendations based on what they found that will help make the business run more efficiently. A strong corporate restructuring firm will have experts in a wide variety of areas that can examine all aspects of a business to help find solutions. A good corporate restructuring firm will not just identify problems of where money is being lost, but also offer solutions that a company can implement in order to solve those problems. They will

also help a company through the process of restructuring by developing forecasts of what to expect and making sure the company is able to secure the capital available to make those changes. Corporate restructuring can help restore, preserve and enhance the value of an organization.

17.9 SELF-ASSESSMENT QUESTIONS

1. What are different types of corporategrowth strategies?
2. Briefly discuss the scope and need of Corporate Restructuring.
3. Discuss the different types of corporaterestructuring tools.
4. Discuss the global scenario of corporate restructuring.
5. Explain the strategic allianceof corporaterestructuring.
6. Discuss about differentacquisitions ofcorporaterestructuring.
7. Write a brief note on the role of professionals in corporate restructuring strategies.
8. Restructuring is just not a strategic plan. Discuss.

17.10 Suggested Readings

1. Bhandari,M.C.:Guide to Company Law Procedures, LexisNexis ButterworthsWadhwa Nagpur
2. ICSI: Handbook on Mergers Amalgamations and takeovers
3. Sampath,K. R.: Mergers/Amalgamations, Takeovers, Joint Ventures, LLPs and Corporate Restructure, Snow White Publications
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UNIT 18: OBJECTIVES AND PROCEDURES OF CORPORATE RESTRUCTURING

UNIT FRAMEWORK

18.1 Objective

18.2 Introduction

18.3 Process for Corporate Restructuring

18.4 Objectives of Corporate Restructuring

18.5 Financial Restructuring

18.6 Need for Financial Restructuring

18.7 Emerging Trends

18.8 Corporate Restructuring – Regulations and Regulators – A Bird's Eye View

18.9 Expanding Role of Professionals in Corporate Restructuring Process

18.10 Summary

18.11 Self-Assessment Questions

18.12 Suggested Readings

18.1 Objective

After studding this unit you will be able to:

- Process for Corporate Restructuring
- Objectives of Corporate Restructuring
- Financial Restructuring
- Need for Financial Restructuring
- Emerging Trends
- Corporate Restructuring – Regulations and Regulators – A Bird's Eye View

18.2 INTRODUCTION

This unit would help you in understanding the concept of corporate restructuring, procedures of corporate restructuring, Regulations and Regulators of corporate restructuring, emerging trends in restructuring strategies etc. You will also be known thatexpanding role of professionals in corporate restructuring processby studying this unit.

The concentrated competition, prompt technological change, foremost corporate accounting scandals, and growingstock market volatility have increased the burden on executives to deliver superior performance andvalue for their stakeholders. In the modern "winner takes all" economy, companies that fail to meetthis challenge will face the certain loss of their independence, if not extinction.

Corporate restructuring has enabled thousands of organizations around the world to respondmore quickly and effectively to new opportunities and unexpected pressures, thereby reestablishingtheir competitive advantage. It has had an equally profound impact on the many more thousandsof suppliers, customers, and competitors that do business with restructured firms.The failure of many successful companies like the one witnessed by Enron Ltd., raised manydoubts about maintainability of consistent corporate success. It is also felt; past success is noguarantee for future success.

Corporate Restructuring, apart from creating value in unsettled period's arms corporates withfinancial strategies to reposition and revitalize their firms amidst unprecedented turmoil in theglobal financial and product markets.Corporate restructuring and improved corporate governance are essential parts of economic reformprograms under way in many countries.Corporate Restructuring is a non-recurring exercise for an organisation but it has a lasting impact on the business and other concerned agencies due to its numerous considerations and immense advantages viz., improved corporate performance, better corporate governance etc.

The purpose of this study material is to provide an in-depth understanding of all aspects and intricacies of law and practical issues affecting and arising out of Corporate Restructuring, exhaustively with key concepts, legislative aspects and procedures.The various changes made upto January 31, 2015 have been included in the study material. However, it may so happen that some developments might have taken place during the printing of the study material and its supply to the students.Corporate Restructuring may have a single objective or multiple objectives; amongst them, there must be a dominant objective in addition to other important objectives for a successful corporate restructuring.

Hence, Corporate Restructuring is a comprehensive process by which a company can consolidate its business operations and strengthen its position for achieving its short-term and long-term corporate objectives.

Corporate Restructuring is vital for the survival of a company in a competitive environment.

18.3 PROCESS FOR CORPORATE RESTRUCTURING

While looking at the concept of corporate restructuring, there is process to make it successful in achieving its stated objectives. For that, a company must understand the objectives, which are to be achieved and put forward the options or their opinions to achieve them. On selecting the appropriate option, a company can execute the same.

Corporate Restructuring as a Business Strategy

Corporate restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Restructuring may involve major layoffs or bankruptcy, though restructuring is usually designed to minimize the impact on employees, if possible. Restructuring may involve the company's sale or a merger with another company. Companies use restructuring as a business strategy to ensure their long-term viability. Shareholders or creditors might force a restructuring if they observe the company's current business strategies as insufficient to prevent a loss on their investments. The nature of these threats can vary, but common catalysts for restructuring involve a loss of market share, the reduction of profit margins or declines in the power of their corporate brand. Other motivators of restructuring include the inability to retain talented professionals and major changes to the market place that directly affect the corporation's business model.

Corporate restructuring is the process of significantly changing a company's business model, management team or financial structure to address challenges and increase shareholder value. Corporate restructuring is an inorganic growth strategy.

18.4 OBJECTIVES OF CORPORATE RESTRUCTURING

Today, corporate restructuring has become common to the corporate sector in order to grow and survive in the present ongoing corporate environment for increased efficiency and profitable growth. It is mainly concerned with reorganizing, restructuring, or rearranging the organizational or business activities of the company as a whole in the form of Merger, Amalgamation or Takeover or Joint Venture etc., to

achieve certain predetermined objectives at corporate level. Some of such corporate objectives are as follows:-

- Growth and technology
- Government policy and economic stability
- To reduce dependency on others
- Orderly redirection of the firm's activities
- Deploying the firm's surplus funds from one business to another for profitable growth
- Exploiting the inter dependence among the present and perspective business within corporate portfolio
- Risk reduction and development of core competencies

Therefore, when the corporate enterprises consider the scheme of restructuring their business activities they have to take a wholesome view of the business activities to introduce a scheme of restructuring at all level in a phase manner. It also aims at improving the competitive position of an individual business, maximizing its contribution to the corporate level objectives and exploiting the strategic assets accumulated by a business to enhance the competitive advantage. Thus, restructuring would help bringing an edge over competitors.

Global enterprises may be motivated to reorganize their worldwide tax and legal structure for a variety of reasons. For example.

- To fully realize the value anticipated from a strategic mergeror acquisition, a global enterprise must quickly reorganizeand integrate its combined business operations from a taxand legal perspective.
- On the other hand, a fully integrated global enterprise maybe forced to quickly realign its worldwide structure in orderto effect a strategic spin-off or disposition of business operations that the management no longer deems desirable or essential.
- Finally, a global enterprise may wish to reorganize its worldwide structure to accommodate a down-sizing or transformation of its existing business operations or simply to generate tax and legal efficiencies that will contribute to itsoverall earnings per share.

Whatever the objective, to be truly successful, a global reorganization must be structured in a manner that not only,

- Optimizes the ultimate tax position of the enterprise,

- But also addresses a multitude of legal issues that arise as aresult of the restructuring.

1. Business Failure and Reorganization

Business failure occurs due to different reasons. While few firmsfail within first year or two of life, few others grow, mature andfail much later. The failure can occur in a number of ways andalso from different reasons.

Business failure can be considered from,

- Economic and,
- Financial view point.

2. Why Business Firms Fail

Let us try to understand the different reasons why corporate often fail

- An imbalance of skills within the top echelon.
- A chief executive who dominates a firms operations without regard for the inputs of peers
- An inactive board of directors. The board of Directors lack of interest in the financial position of the company may lead to insolvency.
- A deficient finance function within the firm's management.
- The absence of responsibility for the chief executive officer.
- Apart from the above mistakes the firm usually is vulnerable to several mistakes,
- Management may be negligent in developing effective accounting system
- The company may be unresponsive to change
- Management may be inclined to undertake an investment project that is disproportionately large relative to firm size. If the project fails the probability of insolvency is greatly increased.
- Finally the management may rely heavily on debt financing that even a minor problem can place the firm in a dangerous position.

3. Symptoms of Bankruptcy or Failure

Having understood the causes for a firm's sickness, the next important question is – is it possible to with reasonable accuracypredict a firm's failure using some modeling technique.

Research shows that as a company enters the final stage prior tofailure - a pattern may develop in terms of - changing financialratios which prove to be useful indicators of an impendingdisaster.

4. Corporate Restructuring.... an Example

PQR Limited has surplus funds but it is not able to consider any viable projects. Whereas MNO Limited has identified viable projects but has no money to fund the cost of the project. The merger of PQR Limited and MNO Limited is a mutually beneficial option and would result in positive synergies of both the Companies.

5. Needs for Undertaking a Corporate Restructuring Exercise:

Corporate Restructuring aims at different things at different times for different companies and the single common objective in every restructuring exercise is to eliminate the disadvantages and combine the advantages. The various needs for undertaking a Corporate Restructuring exercise are as follows:

i) To focus on core strengths, operational synergy and efficient allocation of managerial capabilities and infrastructure.

ii) Consolidation and economies of scale by expansion and diversion to exploit extended domestic and global markets.

iii) Revival and rehabilitation of a sick unit by adjusting losses of the sick unit with profits of a healthy company.

iv) Acquiring constant supply of raw materials and access to scientific research and technological developments.

v) Capital restructuring by appropriate mix of loan and equity funds to reduce the cost of servicing and improve return on capital employed.

vi) Improve corporate performance to bring it at par with competitors by adopting the radical changes brought out by information technology.

Planning, formulation and execution of various restructuring strategies

Corporate restructuring strategies depends on the nature of business, type of diversification required and results in profit maximization through pooling of resources in effective manner, utilization of idle resources, effective management of competition etc.

Planning the type of restructuring requires detailed business study, expected business demand, available resources; utilized/ idle portion of resources, competitor analysis, environmental impact etc. The bottom line is that the right restructuring strategy provides optimum synergy for the organizations involved in the restructuring process.

It involves examination of various aspects before and after the restructuring process.

Important aspects to be considered, while planning or implementing corporate restructuring strategies

The restructuring process requires various aspects to be considered before, during and after the restructuring. They are

a. Valuation & Funding
b. Legal and procedural issues
c. Taxation and Stamp duty aspects
d. Accounting aspects
e. Competition aspects
f. Human and Cultural synergies

Based on the analysis of various aspects, a right type of strategy is chosen.

18.5 FINANCIAL RESTRUCTURING

The sources of capital of the company are divided into two categories viz. Debt and equity. A company is required to balance between its debt and equity in its capital structure and the funding of the resulting deficit. The targets a company sets in striking this balance are influenced by business conditions, which seldom remain constant.

Financial restructuring of a company involves rearrangement of its financial structure to make the company's finances more balanced. Reduction of Capital, reorganization of capital through consolidation, sub-division etc., are various forms of financial restructuring. As regards buy back of securities, listed companies have to comply with SEBI (Buy-back of Securities) Regulation, 1998, Private Limited Company, and Unlisted Public Limited Company (Buy back of Securities) Rules 1999 in addition to Section 77A of the Companies Act.

Broadly speaking, the financial structure of a company comprises its

i) paid up equity and preference share capital;

ii) various reserves;

iii) all borrowings in the form of –

a) long-term loans from financial institutions;

b) working capital from banks including loans through commercial papers;

c) debentures;

d) bonds;

e) credits from suppliers;

f) trade deposits;

g) public deposits;

h) deposits/loans from directors, their relatives and business associates;

i) deposits from shareholders;

j) Global Depository Receipts, American Depository Receipts and Foreign Currency Convertible Bonds;

k) Funds rose through any other loan instrument.

A company may require any one or more of the above keeping in view its financial requirements at a particular point of time. A dynamic Board should constantly review the financial structure of the company and effect financial restructuring and reorganization whenever the need arises.

18.6 NEED FOR FINANCIAL RESTRUCTURING

A company is required to balance between its debt and equity in its capital structure and the funding of the resulting deficit. When, during the lifetime of a company, any of the following situations arise, the Board of Directors of a company is compelled to think and decide on the company's restructuring:

i) Necessity for injecting more working capital to meet the market demand for the company's products or services;

ii) When the company is unable to meet its current commitments;

iii) When the company is unable to obtain further credit from suppliers of raw materials, consumable stores, bought-out components etc. and from other parties like those doing job work for the company;

iv) When the company is unable to utilize its full production capacity for lack of liquid funds;

Financial restructuring of a company involves rearrangement of its financial structure to make the company's finances more balanced.

A. Restructuring of Under-Capitalized Company

i) An under-capitalized company may restructure its capital by taking one or more of the following corrective steps:

ii) injecting more capital whenever required either by resorting to rights issue/preferential issue or additional public issue.

iii) resorting to additional borrowings from financial institutions, banks, other companies etc.

iv) issuing debentures, bonds, etc. or

v) inviting and accepting fixed deposits from directors, their relatives, business associates and public.

B. Restructuring of Over-Capitalized Company

If a company is over-capitalized, its capital also requires restructuring by taking following corrective measures:

i) Buy-back of own shares

ii) Paying back surplus share capital to shareholders

iii) Repaying loans to financial institutions, banks, etc.

iv) Repaying fixed deposits to public, etc.

v) Redeeming debentures, bonds, etc.

18.7 EMERGING TRENDS

- **Doing Deals Successfully in India – A Survey by KPMG India and Merger Market in 2014:**

In order to present a composite view of effective practices that have emerged from inbound investors' experience conducting M&A in India. KPMG in India and merger market in the year 2014, shortlisted a number of successful deals based on their size and prominence in the Indian marketplace.

They conducted interviews with key M&A Heads or equivalent from International companies involved in these transactions over the course of 2014. The report represents a summary of these conversations and the learnings that have emerged from these transactions.

Almost all participants acknowledged that India was an important part of their overall global expansion strategy, and mostly, participants have been pleased with the success of their respective deals despite the fact that some are still in the process of completing integration.

The key insights that emerged are as follows:

a) *Acquirers come to India for its domestic market and the innovation capabilities of its companies:*

The primary attraction for acquirers when investing in India is the potential of its domestic market and the opportunity to use India as a springboard to access some of the regional South Asian, Middle East and even African markets. Participants also cited capabilities for innovation that Indian companies have built over the last two decades, especially to serve low cost value conscious consumers in the emerging markets as a key reason behind doing deals in India.

b) *Investable targets are hard (but not impossible) to find*

Given India's size, its federal regulatory structure and socio-political diversity, most businesses take a regional approach to market growth in the country, and as a result, few truly national players exist. Having said that, many of the regional markets these businesses serve have the potential of being as large as or even larger than national markets in other countries.

Coverage and availability of information on domestic companies in India is still patchy, making secondary market scans difficult. And while auction processes are prevalent, many deals are done based on local relationships and a deep understanding of the regional operations of potential targets. In fact, for many of the successful acquisitions and partnerships highlighted in this report, acquirers were in India building relationships well before their transactions materialized either by forming an Indian subsidiary or by maintaining trading relationships.

Even once a potential deal is on the table it can take time for a seller to furnish historical financials and realistic forecasts that link back to past performance. Most acquirers tended to take an independent view of a target's growth prospects while factoring in the right level of investment support post deal.

c) *It takes time and effort to get to know the family*

Managing the relationship with the promoter (seller) can be of paramount importance for a successful deal. Promoters are also typically involved in direct management of the business, and selling would mean losing regular income, personal status and an important family asset. Furthermore, promoter-led businesses

often have more than one decision maker and depending on family history, internal politics often become part of the M&A process. For International Companies looking to acquire in India, it means spending considerable months to get to know and understand the promoters and the family well, before starting a transaction conversation.

d) *The process can seem long and complicated (because it often is)*

The deal process in India can initially seem long even when there is no competitive bidding process. Finding issues with compliance, tax or historical financial performance is common during diligence and these may seem like deal breakers at first.

To manage these challenges, acquirers preferred to implement transaction structures that allow buyers to leave liabilities behind with the sellers where possible, while ensuring sufficient engagement from promoters to ensure a smooth transition post deal. Participants also highlighted the need to build a business forecast bottom up, seeking independent verification of future contract commitments and an assessment of the dependence on promoter relationships for continuity of business.

Respondents to this study also highlighted the fact that sellers in India are often inexperienced in the M&A process and can start the process without adequate preparation. Where possible, buyers should request involvement of professional advisors on the sell side and ask for a well-managed process including electronic data rooms, verified financial information, explanation of discrepancies with published results, etc., at the start of the process.

e) *The hard work begins once the deal is done*

Most participants had a small base in India prior to the acquisition and hence integration of local domestic operations with the target was not really a big challenge. Key focus during the integration revolved around navigating cultural differences, managing employee expectations from an international acquirer and alignment of management styles. Their approach was cautious, with over half the respondents spending between 1-3 years to complete the integration activities. In almost all the cases, integration was a distinct project led by teams based locally and with significant senior management involvement.

Reflecting on the overall success of the transaction, most respondents felt that they were mostly happy with the overall outcome of the deal and with the quality of management that they had acquired because of the transaction.

18.8 CORPORATE RESTRUCTURING– REGULATIONS AND REGULATORS – A BIRD'S EYE VIEW

PARTICULARS	LEGISLATIONS/ RULES	REGULATORS	DETAILS
Corporate Restructuring • Mergers, • Amalgamations, • Acquisitions, • Demergers, • Revival restructuring etc.	• The Companies Act, 1956 • The Companies (Court) Rules • Sick Industrial Companies (Special Provisions) Act;1985 · SEBI (SAST) Regulations,2011 · Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 · FEMA, 1999 · The Income Tax Act, 1961 · Indian Stamp Act, 1899 · Listing Agreement	•High Court •Board of Industrial and Financial Reconstruction · Debt Recovery Tribunal (DRT) · Registrar or Companies Ministry of Corporate Affairs · Stock Exchanges · Reserve Bank of India · Income tax authorities	• Application to HighCourt to call for a meeting of members/ creditors under Section 391 of the Companies Act Approval of Scheme by High court · Filing of necessary forms under the Companies(Court) Rules, 1959 · Filing of necessary forms such as e-form 23, e-form 21 with Registrar of Companies .· Periodical intimations/filings to Stock exchanges. · Pre/post facto approval as

applicable from RBI in respect of issue of shares to non-residents, in the course of amalgamation/ merger. • DRT to pursue recovery of debts with respect to banks and financial institutions. • Application to Income Tax Authorities for exemption with respect to condition regarding forward or set-off of accumulated loss and unabsorbed depreciation Compliance with open offer requirements under SEBI(SAST) Regulations.

18.9 EXPANDING ROLE OF PROFESSIONALS IN CORPORATE RESTRUCTURING PROCESS

The restructuring process does not only involve strategic decision making based on the market study, competitor analysis, forecasting of synergies on various respects, mutual benefits, expected social impact etc., but also the technical and legal aspects such as valuation of organizations involved in restructuring process, swap ratio of shares.If any, legal and procedural aspects with regulators such as Registrar of Companies, High Court etc., optimum tax benefits after merger, human and cultural integration, stamp duty cost involved etc.

It involves a team of professionals including business experts, Company Secretaries, Chartered Accountants, HR professionals, etc., who have a role to play in various stages of restructuring process. The Company Secretaries being the vital link between the management and stakeholders are involved in the restructuring process through out as co-coordinator, in addition to their responsibility for legal and regulatory compliances.

The restructuring deals are increasing day by day to be in line with business dynamics and international demands. It necessitates the expanded role of professionals in terms of maximum quality in optimum time.

The Companies Act, 2013 and Corporate Restructuring:

The Companies Act, 2013 has brought various provisions towards revamping corporate restructuring process in India. It includes constitution of National Company Law Tribunal, simplification of merger process, cross border mergers, protection of minority interest etc. The provisions inter-alia include:

i) **National Company Law Tribunal:**

A dedicated forum to facilitate speedy processes.

ii) **Fast track merger:**

A provision proposing speedy mergers between certain companies, viz., small private companies and holding and wholly-owned subsidiaries.

iii) **Cross-border mergers:**

Merger between Indian companies and foreign companies with prior approval of the RBI is permissible.

iv) **Purchase of minority of shareholding:**

Majority shareholders who have, inter-alia, acquired majority stake (at least 90%) through amalgamation, share exchange, conversion etc. to compulsorily notify their intention to buy-out minority shareholders.

v) **Registered valuer:**

Prescribed registered valuers will undertake valuation in certain cases specified under the Bill in respect of property, shares, debentures, etc.

18.10 SUMMARY

The regulatory framework for corporate restructuring includes, The Companies Act, 1956, SEBI (SAST) Regulations; 2011, Listing agreement, Indian Stamp Act, 1899, Companies (Court) Rules; etc.The restructuring process over the years has expanded the role of professionals in the restructuring process at various stages.The Companies Act, 2013 has provided several provisions for revamping the corporate restructuring process in India.

The concentrated competition, prompt technological change, foremost corporate accounting scandals, and growingstock market volatility have increased the burden on executives to deliver superior performance andvalue for their stakeholders. In the modern "winner takes all" economy, companies that fail to meetthis challenge will face the certain loss of their independence, if not extinction.

Corporate restructuring has enabled thousands of organizations around the world to respondmore quickly and effectively to new opportunities and unexpected pressures, thereby reestablishingtheir competitive advantage. It has had an equally profound impact on the many more thousandsof suppliers, customers, and competitors that do business with restructured firms.

18.11 SELF-ASSESSMENT QUESTIONS

1. What are different objectives of corporate growth strategies?
2. Briefly discuss the process of Corporate Restructuring.
3. Discuss the different types of corporate restructuringprocedures.
4. Briefly explain the need of financial restructuring and highlight reasons in the context of over capitalized and under capitalized companies.
5. Discuss the global scenario of corporate restructuring.
6. Explain the national and present scenario of corporate restructuring.
7. Discuss differentregulations and regulatorsofcorporate restructuring procedures.
8. Write a brief note on the role of professionals in corporate restructuring strategies.

18.12 Suggested Reading

1. Ramaiya: Guide to Companies Act, LexisNexis Butterworths, Wadhwa, Nagpur
2. Bhandari,M.C.: Guide to Company Law Procedures, LexisNexis Butterworths Wadhwa Nagpur
3. ICSI: Handbook on Mergers Amalgamations and takeovers
4. Ramanujam, S.: Mergers et.al; Tata McGraw Hill Publishing Company Ltd, New Delhi
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UNIT 19: CORPORATE GOVERNANCE

UNIT FRAMEWORK

19.1 Objective
19.2 Introduction
19.3 Meaning, Definition and Concept of Corporate Governance
19.4 Objectives and Principles of Corporate Governance
19.5 History & Need of Corporate Governance
19.6 Evolution of Corporate Governance in India
19.7 Corporate Governance Committees
19.8 Other Committees
19.9 Summary
19.10 Self-Assessment Questions
19.11 Suggested Readings

19.1 Objective

After reading this unit, you will be able to describe the following:

- Meaning, Definition and Concept of Corporate Governance:
- Objectives and Principles of Corporate Governance:
- History & Need of Corporate Governance:
- Evolution of Corporate Governance in India:
- Corporate Governance Committees:

19.2 INTRODUCTION

In this unit Corporate Governance means, its type, various committees of Corporate Governance, objectives & principles of Corporate Governance will learn. You will understand the history & need of Corporate Governance. This unit will also know you that evolution of Corporate Governance in India and the suggestions given by the Corporate Governance Committees.

Corporate Governance is the set of policies that created for deciding a company's performance and direction. It is an overview of rules and regulations for the people in-charge of an incorporated firm. They are the ones who agree to take responsibility towards the shareholders.Corporate governance is a broad term is today's business environment. The legal outfits of corporate governance can be customized to fit the meticulous choice of each wearer.

Corporate governance is concerned with set of principles, ethics, values, morals, rules regulations, etc. Corporate governance establishes a system whereby directors are entrusted with duties and responsibilities in relation to the direction of the company's affairs.

The term "governance" means control i.e. controlling a company, an organization etc. or a company & corporate governance is governing or controlling the corporate bodies i.e. ethics, values, principles, morals. For corporate governance to be good, the manager needs to meet its responsibilities towards its owners (shareholders), creditors, employees, customers, government and the society. Corporate governance helps in establishing a system where a director is showered with duties and responsibilities of the affairs of the company.

Corporate Governance has a broad scope. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral, as well as ethical environment.

19.3 MEANING, DEFINITION AND CONCEPT OF CORPORATE GOVERNANCE

Meaning of Corporate Governance:

Corporate governance refers to the set of systems, principles and processes by which a company is governed. They provide the guidelines as to how the company can be directed or controlled such that it can fulfil its goals and objectives in a manner that adds to the value of the company and is beneficial for all stakeholders in the long term. Stakeholders in this case would include everyone ranging from the board of directors, management, shareholders to customers, employees and society. The management of the company hence assumes the role of a trustee for all the others.

In nutshell, meaning of Corporate Governance can be split up as follows:-

- Rights and equitable treatment of shareholders
- Interests of other stakeholders
- Role and responsibilities of the board
- Integrity and ethical behaviour
- Disclosure and transparency

Definitions of Corporate Governance:

1. **Cadbury Committee (U.K.), 1992** has defined corporate governance as such: *"Corporate governance is the system by which companies*

are directed and controlled. It encompasses the entire mechanics of the functioning of a company and attempts to put in place a system of checks and balances between the shareholders, directors, employees, auditor and the management."

2. OECD principles of corporate governance (1999) have defined corporate governance as such: *"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides this; it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance."*

3. The Institute of Company Secretaries of India has defined corporate governance as such: *"Corporate Governance is the application of best Management practices, Compliance of law in true letter and spirit and adherence to ethical standards for Effective Management and distribution of wealth and discharge of social Responsibility for sustainable development of all stakeholders".*

4. N. R. Narayana Murthy, Committee on Corporate Governance (SEBI) has defined corporate governance as such: *"Corporate Governance is the acceptance by management of the inalienable rights of the shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the Management of the Company."*

Corporate Governance is the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with its all stakeholders (financiers, customers, management, employees, government, and the community).

The corporate governance framework consists of

1. explicit and implicit contracts between the company and the stakeholders for distribution of responsibilities, rights, and rewards,
2. procedures for reconciling the sometimes conflicting interests of stakeholders in accordance with their duties, privileges, and roles, and

3. procedures for proper supervision, control, and information-flows to serve as a system of checks-and-balances.

Concept of Corporate Governance:

Corporate Governance may be defined as a set of systems, processes and principles, which ensure that a company is governed in the best interest of all stakeholders. It is the system by which companies are directed and controlled. It is about promoting corporate fairness, transparency and accountability. In other words, 'good corporate governance' is simply 'good business'. It ensures:

- Adequate disclosures and effective decision making to achieve corporate objectives;
- Transparency in business transactions;
- Statutory and legal compliances;
- Protection of shareholder interests;
- Commitment to values and ethical conduct of business.

Features of good Corporate Governance:

1. Clear Strategy
2. Effective Risk Management
3. Discipline
4. Fairness
5. Accountability
6. Transparency
7. Social Responsibility
8. Self-Evaluation

In other words, corporate governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It deals with conducting the affairs of a company such that there is fairness to all stakeholders and that its actions benefit the greatest number of stakeholders. In this regard, the management needs to prevent asymmetry of benefits between various sections of shareholders, especially between the owner-managers and the rest of the shareholders.

It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company. Ethical dilemmas arise from conflicting interests of the parties involved. In this regard, managers make decisions

based on a set of principles influenced by the values, context and culture of the organization. Ethical leadership is good for business as the organization is seen to conduct its business in line with the expectations of all stakeholders.

19.4 OBJECTIVES AND PRINCIPLES OF CORPORATE GOVERNANCE

Objectives of Corporate Governance:

The aim of "Good Corporate Governance" is to ensure commitment of the board in managing the company in a transparent manner for maximizing long-term value of the company for its shareholders and all other partners. It integrates all the participants involved in a process, which is economic, and at the same time social.

The fundamental objective of corporate governance is to enhance shareholders' value and protect the interests of other stakeholders by improving the corporate performance and accountability. Hence it harmonizes the need for a company to strike a balance at all times between the need to enhance shareholders' wealth whilst not in any way being detrimental to the interests of the other stakeholders in the company. Further, its objective is to generate an environment of trust and confidence amongst those having competing and conflicting interests.

It is integral to the very existence of a company and strengthens investor's confidence by ensuring company's commitment to higher growth and profits. Broadly, it seeks to achieve the following objectives:

- A properly structured board capable of taking independent and objective decisions is in place at the helm of affairs;
- The board is balance as regards the representation of adequate number of non-executive and independent directors who will take care of their interests and well-being of all the stakeholders;
- The board adopts transparent procedures and practices and arrives at decisions on the strength of adequate information;
- The board has an effective machinery to subserve the concerns of stakeholders;
- The board keeps the shareholders informed of relevant developments impacting the company;
- The board effectively and regularly monitors the functioning of the management team;

- The board remains in effective control of the affairs of the company at all times.

The overall endeavour of the board should be to take the organisation forward to maximize long-term value and shareholders' wealth.

Principles Underlying Corporate Governance:

Corporate governance is based on principles such as conducting the business with all integrity and fairness, being transparent with regard to all transactions, making all the necessary disclosures and decisions, complying with all the laws of the land, accountability and responsibility towards the stakeholders and commitment to conducting business in an ethical manner. Another point, which is highlighted in the SEBI report on corporate governance, is the need for those in control to be able to distinguish between what are personal and corporate funds while managing a company.

19.5 HISTORY & NEED OF CORPORATE GOVERNANCE

There have been several major corporate governance initiatives launched in India since the mid-1990s. The first was by the Confederation of Indian Industry (CII), India's largest industry and business association, which came up with the first voluntary code of corporate governance in 1998. The second was by the SEBI, now enshrined as Clause 49 of the listing agreement. The third was the Naresh Chandra Committee, which submitted its report in 2002. The fourth was again by SEBI — the Narayana Murthy Committee, which also submitted its report in 2002. Based on some of the recommendation of this committee, SEBI revised Clause 49 of the listing agreement in August 2003.

Subsequently, SEBI withdrew the revised Clause 49 in December 2003, and currently, the original Clause 49 is in force. More recently, in December 2009, the Ministry of Corporate Affairs (MCA) published a new set of "Corporate Governance Voluntary Guidelines 2009", designed to encourage companies to adopt better practices in the running of boards and board committees, the appointment and rotation of external auditors, and creating a whistle blowing mechanism.

The report of Cadbury Committee on the financial aspects of corporate Governance in the U.K. has given rise to the debate of Corporate Governance in India.Unfortunately, corporate governance often becomes

the centre of discussion only after the exposure of a large scams-such asHarshad Mehta's scame, Ketan Parekh's scame, Ramalingam Raju's scame.

Need for corporate governance arises due to separation of management from the ownership. For a firm success, it needs to concentrate on both economic and social aspect. It needs to be fair with producers, shareholders, customers etc. It has various responsibilities towards employees, customers, communities and at last towards governance and it needs to serve its responsibilities at the best at all aspects.

The "corporate governance concept" dwells in India from the Arthshastra time instead of CEO at that time there were kings and subjects. Today, corporate and shareholders replace them but the principles remain same, unchanged i.e. good governance.

20th century witnessed the glossy of Indian Economy due to liberalization, globalization, and privatization. Indian economy for the first time here was together with world economy for product, capital and labour market and which resulted into world of capitalization, corporate culture, business ethics, whichwas found important for the existence of corporation in the world market place.

19.6 EVOLUTION OF CORPORATE GOVERNANCE IN INDIA

The Indian ethos of Corporate Governance is as articulated by Mahatma Gandhi in his writings. He believed that management is a trustee of shareholders capital and business is a trustee of all resources, including the environment. The primary goal of management as the trustees is to protect the interest of the owners and not to exploit resources for short-term profits. In India, the initiative on corporate governance was not a result of any major corporate scandal, like Enron, World Com, etc. It started as a self-regulatory move from the industry rather than the rule of law (Prof. Uday Salunkhe, Prof. P.S. Rao, and Prof. Anitha Sehgal,2011).

The need for Corporate Governance has become highlighted by the scams brought high almost as an annual feature ever since the liberalization of the economy in 1991, To cite a few HarshadMetha, ketan Parikh scam, UTI scam, the vanishing company scam, the Bhansali scam and so on (Omkar Goswami, 2002).

Lessons should be learning from the countries like USA and UK where companies exposed to lot of hardships and failures due to misgovernance and unethical business practices. The Errors issue was examined by number of committees at different levels in the U.S and at the end of all these examinations, they came with a better model. In the Indian corporate scenario, it is imperative to induct good global standards so that at least the scope for scams should be minimized. The single most important development in the field of Corporate Governance and Investor protection in India has been the establishment of the Securities and Exchange Board of India in 1992.

In addition, its gradual empowerment since the time it was established primarily to regulate and monitor stock trading, it has played a crucial role in establishing the basic minimum ground rules of corporate conduct in the country. The concerns about Corporate Governance stemming from the several corporate scandals, coupled with a perceived need to open up to the forces of competition and globalization, gave rise to several investigations into ways to fix the Corporate Governance situation in India.

One of the first such endeavours was the confederation of Indian Industry (CII) code for Desirable Corporate Governance, developed by a committee chaired by Rahul Bajaj, this committee was formed in 1996 and submitted its code in April 1998. Later the Securities and Exchange Board of India (SEBI) constituted two committees to look into the issue of Corporate Governance. The first was chaired by KumarMangalam Birla, which submitted its report in early 2000, and the second by Narayana Murthy, which submitted its report three years later.

These two committees have been Instrumental in bringing about for reaching changes in Corporate Governance in India through the formulation of clause 49 of listing Agreements. Concurrent with the Initiatives by the SEBI, the Department of Company Affairs, the Ministry of Finance of the Government of India also began contemplating improvements in Corporate Governance.

These efforts include the establishment of a study group to operationalize the Birla Committee recommendations in 2000, the Naresh Chandra Committee on Corporate Audit and Governance in 2002, and the expert committee on Corporate Law (The J.J.Irani Committee) in late 2004. All these efforts were aimed at reforming the existing Companies Act of 1956 still forms the backbone of corporate law in India. Now

Companies Act, 2013 is more logical and incorporated all changes, which were minimally required.

19.7 CORPORATE GOVERNANCE COMMITTEES

The main committees, known by the names of the individuals who chaired them are discussed hereunder:

a) Cadbury committee on Corporate Governance, 1992:

The stated objectives of the Cadbury Committee was "To help raise the standards of corporate governance and the level of confidence in financial reporting and auditing by setting out clearly what it sees as the respective responsibilities of those involved and what it believes his expected of them".

The committee investigated the accountability of the board of directors to shareholders and to society. It submitted its report and associated "Code of Best Practices" in 1992 wherein it spelt out the methods of governance needed to achieve a balance between the essential power of the board of directors and their proper accountability. Its recommendations were not mandatory. The Cadbury code of best practices had 19 recommendations. The recommendations are in the nature of guidelines relating to the board of directors, non-executive directors, executive directors and those on reporting and control.

The stress in the Cadbury committee report is on the crucial role of the board and the need for it to observe the Code of Best Practices. Its important recommendations include the setting up of an audit committee with independent members.

b) The Paul Ruthman Committee

The committee was constituted later to deal with the said controversial point of Cadbury Report. It watered down the proposal on the grounds of practicality. It restricted the reporting requirement to internal financials controls only as against "the effectiveness of the company's system of internal control" as stipulated by the Code of Best Practices contained in the Cadbury Report.

The final report submitted by the Committee chaired by Ron Hampel had some important and progressive elements, notably the extension of director's responsibilities to "all relevant control objectives including business risk assessment and minimizing the risk of fraud."

c) The Greenbury Committee

This committee was setup in January 1995 to identify good

practices by the Confederation of British Industry (CBI), in determining directors' remuneration and to prepare a code of such practices for use by public limited companies of United Kingdom.

The committee aimed to provide an answer to the general concerns about the accountability by the proper allocation of responsibility for determining directors' remuneration, the proper reporting to shareholders and greater transparency in the process.

The committee produced the Greenbury**Code of Best Practice**, whichwas divided into the four sections:

- Remmuneration Committee,
- Disclosures,
- Remuneration Policy and
- Service Contracts and Compensation.

The Greenbury committee recommended that UK companies should implement the code as set out fully practicable, that they should make annual compliance statements, and that investor institutions should use their power to ensure that the best practice is followed.

d) The Hampel Committee

The Hampel committee was setup in November 1995 to promote high standards on Corporate Governance both, to protect investors and preserve and enhance the standing of companies listed on the London Stock Exchange.

The committee developed further the Cadbury report. In addition, it made the following recommendations.

i. The auditors should report on internal control privately to the directors.

ii. The directors maintain and review all controls.

iii. Companies should time to time review their need for internal audit function and control.

It also introduced the combined code that consolidated the recommendation of earlier corporate governance reports (Cadbury Committee and Greenbury Committee).

e) The Combined Code

The combined code was subsequently derived from Ron Hampel Committee's Final Report, Cadbury Report and the Greenbury Report. The combined code is appended to the listing rules of the London Stock

Exchange. As such, compliance of the code is mandatory for all listed companies in UK.

The stipulations contained in the Combined Code require, among other things, that the boards should maintain a sound system of internal control to safeguard shareholder's investments and the company's assets. The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal control covering all controls, including financial, operational and compliance and risk management, and report to shareholders that they have done so.

f) The Turnbull Committee

The Turnbull Committee was set up by the Institute of Chartered Accountants in England and Wales (ICAEW) in 1999 to provide guidance to assist companies in implementing the requirements of the Combined Code relating to internal control.

The committee provided guidance to assist companies in implementing the requirements of the Combined Code relating to internal control. It recommended that where companies do not have an internal audit function, the board should consider the need for carrying out an internal audit annually.

The committee also recommended that board of directors confirm the existence of procedures for evaluation and managing key risks.

Corporate Governance is constantly evolving to reflect the current corporate economic and legal environment. To be effective, corporate governance practices need to be tailor to particular needs, objectives and risk management structure of an organization.

19.8 OTHER COMMITTEES

1. World Bank on Corporate Governance:

The World Bank, involved in sustainable development was one of the earliest economic organizations to study the issue of corporate governance and suggest certain guidelines. The World Bank report on corporate governance recognizes the complexity of the concept and focuses on the principles such as transparency, accountability, fairness and responsibility that are universal in their applications.

Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the

efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible, the interests of individuals, organizations and society.

The foundation of any corporate governance is disclosure. Openness is the basis of public confidence in the corporate system and funds will flow to those centers of economic activity, which inspire trust. This report points the way to establishment of trust and the encouragement of enterprise. It marks an important milestone in the development of corporate governance.

2. Organization for Economic Co-operation and Development (OECD) Principles

Organization for Economic Co-operation and Development (OECD) was one of the earliest non-governmental organizations to work on and spell out principles and practices that should govern corporate in their goal to attain long-term shareholder value.

The OECD wastrendsetters as the Code of Best practices are associated with Cadbury report. The OECD principles in summary include the following elements.

i. The rights of shareholders
ii. Equitable treatment of shareholders
iii. Role of stakeholders in corporate governance
iv. Disclosure and Transparency
v. Responsibilities of the board

The OECD guidelines are somewhat general and both the Anglo-American system and Continental European (or German) system would be quite consistent with it.

3. Sarbanes- Oxley Act, 2002

The Sarbanes-Oxley Act (SOX) is a sincere attempt to address all the issues associated with corporate failure to achieve quality governance and to restore investor's confidence. The Act was formulated to protect investors by improving the accuracy and reliability of corporate disclosures, made precious to the securities laws and for other purposes. The act contains a number of provisions that dramatically change the reporting and corporate director's governance obligations of public companies, the directors and officers. The important provisions in the SOX Act are briefly given below.

i. **Establishment of Public Company Accounting Oversight Board (PCAOB):** SOX creates a new board consisting of five members of whom two will be certified public accountants. All accounting firms have to get registered with the board. The board will make regular inspection of firms. The board will report to SEC. The report will be ultimately forwarded to Congress.

ii. **Audit Committee:** The SOX provides for new improved audit committee. The committee is responsible for appointment, fixing fees and oversight of the work of independent auditors. The registered public accounting firms should report directly to audit committee on all critical accounting policies.

iii. **Conflict of Interest:** The public accounting firms should not perform any audit services for a publically traded company.

iv. **Audit Partner Rotation:** The act provides for mandatory rotation of lead audit or coordinating partner and the partner-reviewing audit once every 5 years.

v. **Improper influence on conduct of Audits:** According to act, it is unlawful for any executive or director of the firm to take any action to fraudulently influence, coerce or manipulate an audit.

vi. **Prohibition of non-audit services:** Under SOX act, auditors are prohibited from providing non-audit services concurrently with audit financial review services.

vii. **CEOs and CFOs are required to affirm the financials:** CEOs and CFOs are required to certify the reports filed with the Securities and Exchange Commission (SEC).

viii. **Loans to Directors:** The act prohibits US and foreign companies with Securities traded within US from making or arranging from third parties any type of personal loan to directors.

ix. **Attorneys:** The attorneys dealing with publicly traded companies are required to report evidence of material violation of securities law or breach of fiduciary duty or similar violations by the company or any agent of the company to Chief Counsel or CEO and if CEO does not respond then to the audit committee or the Board of Directors.

x. **Securities Analysts:** The SOX has provision under which brokers and dealers of securities should not retaliate or threaten to retaliate an analyst employed by broker or dealer for any adverse, negative or unfavorable research report on a public company. The act further

provides for disclosure of conflict of interest by the securities analysts and brokers or dealers.

xi. **Penalties:** The penalties are also prescribed under SOX act for any wrongdoing. The penalties are very stiff.

The Act also provides for studies to be conducted by Securities and Exchange Commission or the Government Accounting Office in the following area:

a. Auditor's Rotation

b. Off balance Sheet Transactions

c. Consolidation of Accounting firms & its impact on industry

d. Role of Credit Rating Industry

e. Role of Investment Bank and Financial Advisers.

The most important aspect of SOX is that it makes it clear that company's senior officers are accountable and responsible for the corporate culture they create and mustbe faithful to the same rules they set out for other employees. The CEO for example, must be responsible for the company's disclosure, controls and financial reporting.

19.9 SUMMARY

The concept of corporate governance hinges on total transparency, integrity and accountability of the management and the board of directors. The importance of Corporate Governance lies in its contribution both to business prosperity and to accountability.

In the age of globalization, global competition, good corporate governance helps as a great tool for corporate bodies. It existed from Vedic times as the Highest standards in ArthaShastra to today's set of ethics, principles, rules, regulations, values, morals, thinking, laws etc. as good corporate governance.

Corporate Governance is a means not an end, corporate excellence should be the end. Once the good Corporate Governance will be achieved, the Indian corporate body will shine to outshine the whole world.

19.10 SELF-ASSESSMENT QUESTIONS

1. What do you understand by Corporate Governance?
2. Explain the features of a good Corporate Governance.
3. What are the objectives of Corporate Governance?
4. Discuss the emergence of Corporate Governance as a concept.

5. Why has it become necessary for different industrial owners to have a good Corporate Governance? Discuss.
6. Discuss the evolution of Corporate Governance in India?
7. What are the main provisions of SOX act?
8. What is Greenbury committee produced code of best practice?

19.11 SUGGESTED READINGS

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UNIT 20: BENEFITS OF CORPORATE GOVERNANCE & ITS PRESENT STATE IN INDIA

UNIT FRAMEWORK

20.1 Objective
20.2 Introduction
20.3 Benefits of Corporate Governance
20.4 Perspectives of Corporate Governance
20.5 Important Issues in Corporate Governance
20.6 Recommendations of Various Committees on Corporate Governance in India
20.7 Regulatory Mechanisms of Corporate Governance
20.8 Systemic Problems of Corporate Governance
20.9 Summary
20.10 Self-Assessment Questions
20.11 Suggested Readings

20.1 Objective

After reading this unit, you will be able to describe the following:

- Benefits of Corporate Governance:
- Perspectives of Corporate Governance:
- Important Issues in Corporate Governance:
- Recommendations of Various Committees on Corporate Governance in India:
- Regulatory Mechanisms of Corporate Governance:
- Systemic Problems of Corporate Governance:

20.2 INTRODUCTION

In this unitbenefit ofCorporate Governance,perspectives of Corporate Governance,and important issues in Corporate Governancewill learn. You will understand the recommendations of various committees on Corporate Governance in India. This unit will also know you that regulatory mechanisms of Corporate Governancein India and the suggestions given by the Corporate

Governance Committees.

For effective corporate governance, its policies need to be such that

the directors of the company should not abuse their power and instead should understand their duties and responsibilities towards the company and should act in the best interests of the company in the broadest sense.

The concept of 'corporate governance' is not an end; it is just a beginning towards growth of company for long-term prosperity. Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed. It means carrying the business as per the stakeholders' desires. It is actually conducted by the board of Directors and the concerned committees for the company's stakeholder's benefit. It is all about balancing individual and societal goals, as well as, economic and social goals.

20.3 BENEFITS OF CORPORATE GOVERNANCE

Corporate Governance is the interaction between various participants (shareholders, board of directors, and company's management) in shaping corporation's performance and the way it is proceeding towards. The relationship between the owners and the managers in an organization must be healthy and there should be no conflict between the two. The owners must see that individual's actual performance is according to the standard performance. These dimensions of corporate governance should not be overlooked.

Corporate Governance deals with the manner the providers of finance guarantee themselves of getting a fair return on their investment. Corporate Governance clearly distinguishes between the owners and the managers. The managers are the deciding authority. In modern corporations, the functions/ tasks of owners and managers should be clearly defined, rather, harmonizing.

Some of the benefits of the Corporate Governance are listed below:

1. Good corporate governance ensures corporate success and economic growth.
2. Strong corporate governance maintains investors' confidence, because of which, company can raise capital efficiently and effectively.
3. It lowers the capital cost.
4. There is a positive impact on the share price.
5. It provides proper inducement to the owners as well as managers to achieve objectives that are in interests of the shareholders and

the organization.

6. Good corporate governance also minimizes wastages, corruption, risks and mismanagement.
7. It helps in brand formation and development.
8. It ensures organization in managed in a manner that fits the best interests of all.

Corporate Governance deals with determining ways to take effective strategic decisions. It gives ultimate authority and complete responsibility to the Board of Directors. In today's market- oriented economy, the need for corporate governance arises. In addition. efficiency as well as globalization is significant factors urging corporate governance. Corporate Governance is essential to develop benefit to the stakeholders.

Corporate Governance ensures transparency, which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights.

20.4 PERSPECTIVES OF CORPORATE GOVERNANCE

Mainly we will deal with the perspectives of corporate governance from three points of view:

1. **Shareholders:** as providers of a risk capital have final control on resource allocation decisions.
2. **Organization:** have the main purpose is to control i.e. through skills, intelligence, innovation, ideas, professionalism etc. Therefore, here in this perspective, resource allocation decision should rest with them.
3. **Stakeholders:**here, it says that for long-term business, only shareholders value maximization should not be seen as sole goal but it should be for well-being of all groups with stake of long run of business and it should be goal of corporate governance.

20.5 IMPORTANT ISSUES IN CORPORATE GOVERNANCE

There are several important issues in corporate governance and they play a great role, all the issues are inter related, interdependent to deal with each other. Each issues connected with corporate governance have different priorities in each of the corporate bodies.

1. **Value based Corporate Culture:**

For any organization to run in effective way, it needs to have certain ethics, values. Long run business needs to have based corporate culture. Value based corporate culture is good practice for corporate governance. It is a set of beliefs, ethics, principles which are inviolable. It can be a motto i.e. A short phrase which is unique and helps in running organization, there can be vision i.e. dream to be fulfilled, mission and purpose, objective, goal, target.

2. **Holistic View:**

This holistic view is more or less godly, religious attitude, which helps in running organization. It is noteasier to adopt it, it needs special efforts and once adopted it leads to developing qualities of nobility, tolerance and empathy.

3. **Compliance with Laws:**

Those companies which really need progress, have high ethical values and need to run long run business they abide and comply with laws of Securities Exchange Board Of India (SEBI), Foreign Exchange Regulation Act, Competition Act 2002, Cyber Laws, Banking Laws, and Companies Act, 2013 etc.

4. **Disclosure, Transparency, and Accountability:**

Disclosure, transparency and accountability are important aspect for good governance. Timely and accurate information should be disclosed on the matters like the financial position, performance etc. Transparency is needed in order that government has faith in corporate bodies and consequently it has reduced corporate tax rates from 30% today as against 97% during the late 1970s. Transparency is needed towards corporate bodies so that due to tremendous competition in the market place the customers having choices do not shift to other corporate bodies.

5. **Corporate Governance and Human Resource Management:**

For any corporate body, the employees and staff are just like family. For a company to be perfect the role of Human Resource Management becomes very vital, they both are directly linked. Every individual should be treated with individual respect, his achievements should be recognized. Each individual staff and employee should be given best opportunities to prove their worth

and these can be done by Human Resource Department. Thus in Corporate Governance, Human Resource has a great role.

6. **Innovation:**

Every Corporate body needs to take risk of innovation i.e. innovation in products, in services and it plays a pivotal role in corporate governance.

7. **Necessity of Judicial Reform:**

There is necessity of judicial reform for a good economy and in today's changing time of globalization and liberalization. Our judicial system though having performed salutary role all these years, certainly are becoming obsolete and outdated over the years. The delay in judiciary is due to several interests involved in it. Then with changing scenario and fast growing competition, the judiciary needs to bring reforms accordingly. It needs to speedily resolve disputes in cost effective manner.

8. **Globalization helping Indian Companies to become global giants based on good governance:**

In today's age of competition and due to globalization, our several Indian Corporate bodies are becoming global giants, which are possible only due to good corporate governance.

9. **Lessons from Corporate Failure:**

Every story has a moral to learn from, every failure has success to learn from, in the same way, corporate body have certain policies which if goes as a failure they need to learn from it. Failure can be both internal as well as external whatever it may be, in good governance, corporate bodies need to learn from their failures and need to move to the path of success.

20.6 RECOMMENDATIONS OF VARIOUS COMMITTEES ON CORPORATE GOVERNANCE IN INDIA

1. CII CODE RECOMMENDATIONS (1997)

(a) Board of Directors

1. No need for German style two-tiered board.
2. For a listed company with turnover exceeding Rs. 100 crores, if the Chairman I also the MD, at least half of the board should be Independent directors, else at least 30%.

3. No single person should hold directorships in more than 10 listed companies.
4. Non-executive directors should be competent and active and have clearly defined Responsibilities like in the Audit Committee.
5. Directors should be paid a commission not exceeding 1% (3%) of net profits for a company with (out) an MD over and above sitting fees. Stock options may be considered too.
6. Attendance record of directors should be made explicit at the time of re-appointment. Those with less than 50% attendance should not be reappointed.
7. Key information that must be presented to the board is listed in the code.

(b) Audit Committee

Listed companies with turnover over Rs. 100 crores or paid-up capital of Rs. 20 crores should have an audit committee of at least three members, all non-executive, competent and willing to work more than other non-executive directors, with clear terms of reference and access to all financial information in the company and should periodically interact with statutory auditors and internal auditors and assist the board in corporate accounting and reporting.Reduction in number of nominee directors. FIs should withdraw nominee directors from companies with individual FI shareholding below 5% or total FI holding below 10%.

(c) Disclosure and Transparency

1. Companies should inform their shareholders about the high and low monthly averages of their share prices and about share, performance and prospects of major business segments (exceeding 10% of turnover).
2. Consolidation of group accounts should be a) Companies should inform their shareholders about the high and low monthly averages of their share prices and about share, performance and prospects of major business segments (exceeding 10% of turnover).
3. Consolidation of group accounts should be optional and subject to FI s and IT department s assessment norms. If a company consolidates, no need to annex subsidiary accounts but the definition of "group" should include parent and subsidiaries.

4. Stock exchanges should require compliance certificate from CEOs and CFOs on company accounts
5. For companies with paid-up capital exceeding Rs. 20 crore, disclosure norms for domestic issues should be same as those for GDR issues.

(d) Creditors' Rights

1. FIs should rewrite loan covenants eliminating nominee directors except in case of serious and systematic debt default or provision of insufficient information.
2. In case of multiple credit ratings, they should all be reported in a format showing relative position of the company
3. Same disclosure norms for foreign and domestic creditors.
4. Companies defaulting on fixed deposits should not be permitted to accept further deposits and make inter-corporate loans or investments or declare dividends until the default is made good.

(2) BIRLA COMMITTEE (SEBI) RECOMMENDATIONS (2000)

(a) Board of Directors

1. At least 50% non-executive members
2. For a company with an executive Chairman, at least half of the board should be independent directors, else at least one-third.
3. Non-executive Chairman should have an office and be paid for job related expenses.
4. Maximum of 10 directorships and 5 chairmanships per person.

(b) Audit Committee

A board must have a qualified and independent audit committee, of minimum three members, all non-executive, majority and chair independent with at least one having financial and accounting knowledge. Its chairman should attend AGM to answer shareholder queries. The committee should confer with key executives as necessary and the company secretary should be he secretary of the committee. The committee should meet at least thrice a year - one before finalization of annual accounts and one necessarily every six months with the quorum being the higher of two members or one-third of members with at least two independent directors. It should have access to information from any employee and can investigate any legal/professional service as well as secure attendance of outside experts in meetings. It should act as the

bridge between the board, statutory auditors and internal auditors with far-ranging powers and responsibilities.

(c) Remuneration Committee

The remuneration committee should decide remuneration packages for executive directors. It should have at least threedirectors, all-nonexecutive and be chaired by an independent director. The board should decide on the remuneration of non-executive directors and all remuneration information should be disclosed in annual report. At least 4 board meetings a year with a maximum gap of 4 months between any 2 meetings. Minimum information available to boards stipulated.

(d) Disclosure and Transparency

1. Companies should provide consolidated accounts for subsidiaries where they have majority shareholding.
2. Disclosure list pertaining to "related party" transactions provided by committee till ICAI s norm is established.
3. A mandatory Management Discussion & Analysis segment of annual report that includes discussion of industry structure and development, opportunities, threats, outlook, risks etc. as well as financial and operational performance and managerial developments in HR/IR front.
4. Management should inform board of all potential conflict of interest situations.
5. On (re)appointment of directors, shareholders must be informed of their resume, expertise, and names of companies where they are directors.

(e) Shareholders' Rights

1. Quarterly results, presentation to analysts etc. should be communicated to investors, possibly over the Internet.
2. Half-yearly financial results and significant events reports be mailed to shareholders
3. A board committee headed by a nonexecutive director look into shareholder Complaints/grievance
4. Company should delegate share transfer power to a officer/ committee/registrar/share transfer agents. The delegated authority should attend to share transfer formalities at least once in a fortnight.

The Committee in its report observed that "the strong Corporate Governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection. It is the blood that fills the veins of transparent corporate disclosure and high quality accounting practices. It is the muscle that moves a viable and accessible financial reporting structure."

(3) NARAYANA MURTHY COMMITTEE (SEBI) RECOMMENDATIONS (2003)

(a) Board of Directors

1. Training of board members suggested.
2. There shall be no nominee directors. All directors to be elected by shareholders with same responsibilities and accountabilities.
3. Non-executive director compensation to be fixed by board and ratified by shareholders and reported. Stock options should be vested at least a year after their retirement. Independent directors should be treated the same way as non-executive directors.
4. The board should be informed every quarter of business risk and risk management strategies.

(b) Audit Committee

Should comprise entirely of "financially literate" non-executive members with at least one member having accounting or related financial management expertise. It should review a mandatory list of documents including information relating to subsidiary companies. "Whistle blowers" should have direct access to it and all employees be informed of such policy (and this should be affirmed annually by management). All "related party" transactions must be approved by audit committee. The committee should be responsible for the appointment, auditor.

1. Boards of subsidiaries should follow similar composition rules as that of parent and should have at least one independent director s of the parent company.
2. The Board report of a parent company should have access to minutes of board meeting in subsidiaries and should affirm reviewing its affairs.
3. Performance evaluation of non-executive directors by all his fellow Board members should inform are -appointment decision.
4. While independent and non-executive directors should enjoy some protection from civil and criminal litigation, they may be held

responsible of the legal compliance in the company's affairs.

5. Code of conduct for Board members, senior management, and annual affirmation of compliance to it

(c) Disclosure and Transparency

1. Management should explain and justify any deviation from accounting standards in financial statements.
2. Companies should move towards a regime of unqualified financial statements. Management should provide a clear description, followed by auditors' comments, of each material contingent liability and its risks.
3. CEO/CFO certification of knowledge, veracity and comprehensiveness of financial statements and directors reports and affirmation of maintaining proper internal control as well as appropriate disclosure to auditors and audit committee
4. Security analysts must disclose the relationship of their employers with the client company as well as their actual or intended shareholding in the client company.

Narayana Murthy committee to review the performance of Corporate Governance and to determine the role of companies in responding to rumour and other price sensitive information circulating in the market in order to enhance the transparency and integrity of the market. The Committee in its Report observed that "the effectiveness of a system of Corporate Governance cannot be legislated by law, nor can any system of Corporate Governance be static. In a dynamic environment, system of Corporate Governance needs to be continually evolved."

Based on the recommendations of the Committee, the SEBI had specified principles of Corporate Governance and introduced a new clause 49 in the Listing agreement of the Stock Exchanges in the year 2000. These principles of Corporate Governance were made applicable in a phased manner and all the listed companies with the paid up capital of Rs 3 crores and above or net worth of Rs 25 crores or more at any time in the history of the company, were covered as of March 31, 2003.

With a view to promote and raise the standards of Corporate Governance; SEBI on the basis of recommendations of the Committee and public comments received on the report and in exercise of powers conferred by Section 11(1) of the Securities and Exchange Board of India

Act, 1992 read with section 10 of the Securities Contracts (Regulation) Act 1956, revised the existing clause 49 of the Listing agreement vide its circular SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003.It clarified that some of the sub-clauses of the revised clause 49 shali be suitably modified or new clauses shall be added following the amendments to the Companies Act 1956 by the Companies (Amendment) Bill/Act 2003, so that the relevant provisions of the clauses on Corporate Governance in the Listing Agreement and the Companies Act remain harmonious with one another.

SUMMARY OF CLAUSE 49

Characteristic	Clause 49
Director Independence	**Requirement** – 50% independent directors if Chairman is executive director or 33% if Chairman is a nonexecutive. **Definition** – no material pecuniary relationship with company, not related to Board or one level below Board and no prior relationship with the Company for the last 3 years. ♦ Nominee Directors of Financial Institutions - considered independent.
Board Requirements & Limitations	♦ Meet 4 times a year (maximum 3 months between meetings) ♦ Limits on number of committees a director can be on (10), but only 5 for which director can be Chair of committee. ♦ Code of Conduct (Ethics) required.
Audit Committee Composition	♦ At least 3 directors (two-thirds must be independent). ♦ All financially literate. ♦ At least one having accounting or financial management experience.
Audit Committee Role & Powers	♦ Minimum 4 meetings/year (gap between meetings not exceed 4 months). ♦ Broad role – review statutory and internal auditors as well as internal audit function,

	obtain outside legal or other professional advice, and review whistleblower program if one exists amongst other things.
Disclosures	♦ Related party transactions, ♦ Accounting treatments and departures, ♦ Risk management, ♦ Annual report include discussion of internal controls adequacy, significant trends, risks, and opportunities, ♦ Proceeds from offerings, ♦ Compensation for directors (including nonexecutives and obtain shareholders approval), ♦ Details of compliance history for last 3 years. ♦ Corporate governance reports (and discloses adoption, if any, of mandatory and non-mandatory requirements).
Certifications	CEO & CFO: ♦ Financial statements ♦ Effectiveness of internal controls ♦ Inform audit committee of any significant changes in the above. ♦ Auditor or Company Secretary: ♦ Compliance with corporate governance
Subsidiary Companies	♦ At least one Independent director of Holding Company should sit as a director on Board of material non-listed Indian subsidiary. ♦ Significant transactions report to Holding Company Board (along with subsidiary board's minutes).
Other	Recommendations: ♦ Whistleblower policy is optional ♦ Independent directors loses status as "independent" if served 9 years at company ♦ Training board members ♦ Evaluate nonexecutive board performance.

In the Indian context, once clause 49 came into effect in 2005 end, the regulatory content for corporate governance changed significantly, additionally, with much greater inflow of foreign institutional investments (FII) into the Indian capital markets, there has been an increasing demand for transparency and disclosure from Indian firms to be in line with best practices in the developed world.

The new guidelines on corporate governance issued at the year of 2007 for the state owned enterprises in India are quite similar to the clause 49 requirements. These include guidelines with respect to role of the board of directors and management, audit committee, code of conduct and business ethics etc. These guidelines are voluntary however, the department of public enterprises may grade state owned enterprises on the basis of the compliance with the guidelines. While there is no denying that these guidelines promote the objective of good corporate governance however certain challenges remain. (Arun Balakrishnan, C&MD, HPCL). There is no denying the fact that clause 49 and the new guidelines provide an ideal for corporate governance. This is essential as the Indian economy and companies operate in an integrated international economy. However as is the case with any statute, it is quite often implementation which determines the effectiveness.

20.7 REGULATORY MECHANISMS OF CORPORATE GOVERNANCE

In our country, there are some major mechanisms to ensure corporate governance:

(1) Companies Act 2013

Companies in our country are regulated by the Companies Act, 1956, as amended up to date and now it is known as Companies Act, 2013. The companies Act is one of the biggest legislations with 658 sections and 14 schedules. The arms of the Act are quite long and touch every aspect of a company's insistence. But to ensure corporate governance, the Act confers legal rights to shareholders to

i) Vote on every resolution placed before an annual general meeting;

ii) To elect directors who are responsible for specifying objectives and laying down policies;

iii) Determine remuneration of directors and the CEO;

iv) Removal of directors and

v) Take active part in the annual general meetings.

(2) Securities Law

The primary securities law in our country is the SEBI Act. Since its setting up in 1992, the board has taken a number of initiatives towards investor protection. One such initiative is to mandate information disclosure both in prospectus and in annual accounts. While the companies Act itself mandates certain standards of information disclosure, SEBI Act has added substantially to these requirements in an attempt to make these documents more meaningful. The main objective of SEBI regulation is shareholder value maximization by putting corporate governance structures in place and through the reduction of information asymmetry between the managers and the investors of the company. Jensen (2000) also argues in favour of shareholder wealth maximization as the main objective function of any company.

(3) Reserve Bank of India (RBI)

The RBI, established in 1935, is the central bank of India and is entrusted with monetary stability, currency management, supervision of the financial, and payments systems. Its functions and focus have evolved in response to India's changing economic environment. It acts as the banker to the state and national governments, the lender of last resort and the controller of the country's money supply and foreign exchange. The RBI supervises the operations of all banks and NBFCs in the country. It is responsible for monetary policy, setting benchmark interest rates, managing the treasury operations (both borrowings and redemption) for the government and as custodian and controller of the foreign exchange reserves.

(4) Discipline of the Capital Market

Capital market itself has considerable impact on corporate governance. Here in lies the role the minority shareholders can play effectively. They can refuse to subscribe to the capital of a company in the primary market and in the secondary market; they can sell their shares, thus depressing the share prices. A depressed share price makes the company an attractive takeover target.

(5) Nominees on Company Boards

Development banks hold large blocks of shares in companies. These are equally big debt holders too. Being equity holders, these investors have their nominees in the boards of companies. These

nominees can effectively block resolutions, which may be detrimental to their interests. Unfortunately, the role of nominee directors has been passive, as has been pointed out by several committees including the Bhagwati Committee on takeovers and the OmkarGoswami committee on corporate governance.

(6) Statutory Audit

Statutory audit is yet another mechanism directed to ensure good corporate governance. Auditors are the conscious-keepers of shareholders, lenders and others who have financial stakes in companies. Auditing enhances the credibility of financial reports prepared by any enterprise. The auditing process ensures that financial statements are accurate and complete, thereby enhancing their reliability and usefulness for making investment decisions.

(7) Codes of Conduct

The mechanisms discussed till now are regulatory in approach. They are mandated by law and violations of any provision invite penal action. But legal rules alone cannot ensure good corporate governance. What is needed is self-regulation on the part of directors, besides of course, the mandatory provisions.

(8) Global Best Practices

A number of supranational organizations have drawn codes/ principles of corporate governance. The most well-known is perhaps the OECD principles of corporate governance of 1999. It is instructive to summarize the five basic pillars of OECD code, viz.,

i) Protecting the rights of shareholders;

ii) Ensuring equitable treatment of all shareholders including having an effective grievance redressed system;

iii) Recognizing the rights of stakeholders as established by law;

iv) Ensuring the timely and accurate disclosure regarding the corporation including the financial situation, performance, ownership and governance of the company; and

v) Ensuring the strategic guidance of the company, effective monitoring arrangement by the board and the board s responsibility to the company and the shareholder.While the OECD principles went a long way in emphasizing the basic tenets of corporate governance. (ShyamalaGopinath, 2004)

20.8 SYSTEMIC PROBLEMS OF CORPORATE GOVERNANCE

1. Demand for Information:

A barrier to shareholders using good information is the cost of processing it, especially to a small shareholder. The traditional answer to this problem is the efficient market hypothesis (in finance, the efficient market hypothesis (EMH) asserts that financial markets are efficient), which suggests that the shareholder will free ride on the judgments of larger professional investors.

2. Monitoring Costs:

In order to influence the directors, the shareholders must combine with others to form a significant voting group, which can pose a real threat of carrying resolutions or appointing directors at a general meeting.

3. Supply of Accounting Information:

Financial accounts form a crucial link in enabling providers of finance to monitor directors. Imperfections in the financial reporting process will cause imperfections in the effectiveness of corporate governance. This should ideally be corrected by the working of the external auditing process.

Above attempts made by the various regulating bodies shown a rising level of concern in the manner in which the corporate manage themselves and their geo political environment. As more and more multi nationals chip in to utilize cheap Indian labors – the regulating bodies will not have the only onus of task building, but will also have to ensure means to implement the regulations. Not only this, as more and more stakeholders make an attempt to maximize their profits, the investors (especially the smaller) will have to be wary of the crafty speculators who can ruin the market confidence and decimate them. Investor training therefore is an important area of immediate action. Organizations cannot create long-term value without having appropriate corporate governance policies in place, as the need of the hour is not only to manage earnings, but also to create value. It becomes of utmost importance especially for a country like India, as it comprises of the various odd sections of the society standing at juxtaposition to each other. Moreover, with the change in the context there is also a need to evolve the governance policies suiting the geo political, social and economic environment of that state.

In the last few years, the thinking on the topic in India has gradually crystallized into the development of norms for listed companies. The problem for private companies, that form a vast majority of Indian corporate entities, remains largely unaddressed. The agency problem is likely to be less marked there, as ownership and control are not generally separated. Minority shareholder exploitation, however, can very well be an important issue in many cases. The development of norms and guidelines are an important first step in a serious effort to improve corporate governance. The bigger challenge in India, however, lies in the proper implementation of those rules at the ground level. More and more it appears that outside agencies like analystsand stock markets (particularly foreign markets for companies making GDR issues) have the most influence on the actions of managers in the leading companies of the country. But their influence is restricted to the few top (albeit largest) companies. More needs to be done to ensure adequate corporate governance in the average Indian company. Even the most prudent norms can be hoodwinked in a system plagued with widespread corruption. Nevertheless, with industry organizations and chambers of commerce themselves pushing for an improved corporate governance system, the future of corporate governance in India promises to be distinctly better than the past.

20.9 SUMMARY

Corporate Governance is the interaction between various participants (shareholders, board of directors, and company's management) in shaping corporation's performance and the way it is proceeding towards. The relationship between the owners and the managers in an organization must be healthy and there should be no conflict between the two. The owners must see that individual's actual performance is according to the standard performance. These dimensions of corporate governance should not be overlooked.

Today, even law has a great role to play in successful and growing economy. Government and judiciary have enacted several laws and regulations like SEBI, FEMA, Cyber laws, Competition laws etc., and have brought several amendments and repeal the laws in order that they do not act as barrier for these corporate bodies and developing India.

Judiciary has also helped in great way by solving the corporate disputes in speedy way.

Corporate bodies have their aim, values, motto, and ethics etc., which guide them to the ladder of success. Big and small organizations have their magazines annual reports, which reflect their achievements, failure, their profit and loss, their current position in the market. A few companies have also shown awareness of environment protection, social responsibilities and the cause of upliftment and social development and they have deeply committed themselves to it.

20.10 SELF-ASSESSMENT QUESTIONS

1. What do you understand by benefits of Corporate Governance?
2. Explain the perspectives of Corporate Governance.
3. What are the important issues in Corporate Governance?
4. Discuss the recommendations of various committees on Corporate Governance in India.
5. What are the major recommendations of Kumara Mangalam Birla Committee Reports?
6. Discuss SEBI's role in the regards of Corporate Governance.
7. What are the regulatory mechanisms of Corporate Governance?
8. What are the systemic problems of Corporate Governance?

20.11 Suggested Readings

1. Securities and Exchange Board of India (2002) Report on SEBI Committee on Corporate Governance (under the chairmanship of Shri N R Narayanamurthy).
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9. Other Committee Reports.
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