BUSINESS ENVIRONMENT

Business Environment

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CHAPTER 1

Introduction to Business Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Explain the concept of business environment
- Describe the nature and scope of business environment
- Describe the importance of business environment
- Explain the components of business environment
- Discuss the relationship between business environment and strategic management

1.1 INTRODUCTION

Business is an organisation or enterprise engaged in producing goods and services for profit motive. It is a collective effort where a firm is engaged in commercial, industrial or professional activities. The main aim of business is to satisfy the needs of customers. The success of every business depends on adapting itself to the environment within which it functions. For example, with changes in the government policies, the business needs to adapt itself with the new policies. Similarly, any technological advancement may render the existing products obsolete, such as the introduction of smartphones has replaced the telephone to a greater extent. Therefore, it is very important to have a clear understanding of the basic concept of business environment and the nature of its various components.

Business environment includes those external factors and institutions over which it does not have any direct control. These factors affect the functioning of an organisation directly or indirectly. These include customers, competitors, suppliers, government, and the social, political, legal and technological factors, etc.

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 affect the business decisions of a firm, is called business environment.

The relationship between business and its environment can be explained by following points:

- Business is affected by its environment and, in turn, to some extent, it will also influence the external factors. Similarly, economic environment influences socio-cultural environment and vice versa. Other environmental factors also have same relationship with each other.
- The environmental factors are constantly changing. Similarly, business is also dynamic.
- One business firm, by itself, may not be able to change its environment. But together with other businesses, it will be in a position to mould the environment in its favour.

In this chapter, you will study the concept of business environment, its components and how it is important for organisations. You will also study about relationship between business environment and strategic management.

1.2 CONCEPT OF BUSINESS ENVIRONMENT

In general sense, all businesses aim to achieve multiple objectives. A business manager identifies and sets some important objectives like survival, stability, growth, profitability and efficiency. Enterprise needs to balance these objectives. Profit is the biggest stimulus for the survival of the business and its future development. There is always a risk involved in business and profit is the reward for taking the risk. Business can be established, but it is difficult to survive in this competitive world where whole world is one market. So, it is important for business to scan the environment.

Environment refers to all external forces which affect the functioning of business. Environment factors are largely, if not totally, external and beyond the control of individual industrial enterprises and their managements. The surrounding in which business operates is called business environment.

The word 'Business Environment' has been defined by various authors as follows:

According to **Keith Davis**, *Business environment is the aggregate of all conditions, events and influences that surround and affect it*.

According to **Reinecke and Schoell**, *the environment of business consists of all those external things to which it is exposed and by which it may be influenced directly or indirectly*.

These definitions give a clear understanding of the business environment. We can say that business environment is a combination or mixture of complex, dynamic and uncontrollable external factors within which a business is to be operated.

The change in tastes and preferences of customers, introduction of new technologies, innovations, government policies, etc., all are parts of the business environment. Business needs to accept and adapt these changes promptly to survive in the market. So, it is necessary for the business to analyse the business environment.

1.2.1 NATURE OF BUSINESS ENVIRONMENT

The business environment of an organisation usually poses threats as well as opportunities. To grasp the opportunities and reduce the threat, it is important to know the nature of business environment. Following are some points which describe nature of business environment:

- **Internal and external environment**: Every business is surrounded by internal and external environment. Internal environment can be controlled by an organisation, like men, money, material, machine and method, whereas external environment is uncontrollable like political conditions, technologies, legal regulations, etc.
- **Dynamic and ever-changing:** Business environment keeps on changing frequently in terms of technologies, government rules and regulations, socio-economic conditions, etc., which make business dynamic.

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- **Complexity of the environment:** Business environment cannot be easily analysed because of too much complexity involved**.** Environment consists of a number of factors, events, conditions and influences, generating from different sources which impact business, thus, making the business complex**.**
- **Inter-relatedness:** Factors of business environment are related to each other. For example, change in political parties will result in changing the government rules, fiscal policies, market conditions, technology, etc. So, all the factors need to be scanned properly because these factors are inter-related to each other.
- **Uncertainty:** It is difficult to predict the changes going to take place in future because environment keeps on changing. These changes are uncontrollable. So, business can only try to combat from these challenges. For example, in case of fashion industries, changes take place so frequently, economy could collapse any time.
- **Impact:** Impact means the effect of environment on business. Business environment has both long-term and short-term impacts on business. For example, different firms may get influenced differently from change in monetary policy**.**
- **Inter-dependence:** A business firm and its environment are mutually interdependent. The economic status of a country affects the development of technology or it may change the lifestyle of people.

1.2.2 SCOPE OF BUSINESS ENVIRONMENT

The aspects which fall under business environment are as follows:

- **Internal and external environment:** Internal environment includes all those factors that are within an organisation and impart strength or cause weakness in business. For example, inefficient human resource, superior raw material, etc.

  External environment includes those factors which are beyond the control of business and are outside the organisation. They provide opportunities and pose threat to business. For example, change in political conditions, technological change, etc.
- **Specific and general environment:** Specific environment includes external forces that directly impact or influence organisations' decisions and actions and are directly relevant to the achievement of organisations' goals. The main forces that make up the specific environment are customers, suppliers, competitors and pressure groups.

  General environment includes the economic, political/legal, socio-cultural, demographic, technological and global conditions that affect organisations. External forces do not affect organisations to a great extent, but organisations must plan, organise, lead and control their activities taking into account these factors.
- **Micro environment and macro environment**: Micro environment impacts the working of a particular business. It has direct impact on business activities. It includes customers, suppliers, market intermediaries, competitors, etc. These factors are controllable to some extent.

Macro environment is general environment that impacts the working of all businesses. It is uncontrollable and influences indirectly. Political conditions, economy, technology, etc., come under macro environment.

- **Controllable and uncontrollable environment:** All those factors which are governed by business come under controllable environment. Internal factors are treated as controllable factors, like men, material, machine, money, etc.

  Uncontrollable factors are external and are beyond the control of business like technological change and law related change.

1.2.3 IMPORTANCE OF BUSINESS ENVIRONMENT

Following points describe the importance of business environment:

- **Identification of business opportunities:** Many opportunities are provided by business environment to the organisation. Scanning business environment would help business get the first mover advantage. If changes are analysed carefully, then they can be the reason for business success.
- **Optimum utilisation of resources:** Resources like raw material, machine, money, labour, etc., are input for business. All these inputs are provided by environment to the business firms for carrying out their activities and also expect something in return.
- **Identification of threat and early warning signal:** Business can recognise the threat by analysing the change taking place in the environment. For example, if any new multinational company is entering the Indian market, the manager of an Indian firm dealing with same product as that of the multinational company should take it as a warning signal. Before the MNC launches its product, the manager should implement measures, such as improving the quality of his product and heavy advertisement.
- **Coping with the rapid changes:** To efficiently cope with these changes, managers must understand the environment and should adopt appropriate courses of action at the right time. It helps management become more sensitive to ever-changing needs of customers. As a result, they are able to respond to such changes effectively.
- **Meeting competition:** This helps firms analyse competitors' strategies and formulate their strategies accordingly.
- **Identifying firm's strength and weakness:** Business environment helps identify the individual strength and weakness in view of the technological and global developments.
- **Assisting in planning and policy formulation:** Business environment brings both threats and opportunities to a business. Having a good understanding of the business environment can immensely help an organisation's management in their future planning and decision-making endeavours. For example, competition increases with the entry of new firms in the market.

  The management has to draft new plans and policies to deal with new competitors. Environmental awareness provides intellectual stimulation to planners in their decision making. They can make changes in their plans efficiently and effectively.

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SELF ASSESSMENT QUESTIONS

1. ____________________ is the aggregate of all conditions, events and influences that surround and affect it.
2. All those factors which are governed by business come under controllable environment. (True/False)
3. A business firm and its environment are mutually ____________________.

1.3 COMPONENTS OF BUSINESS ENVIRONMENT

The performance of an organisation is affected by the business environment. It has a far-reaching impact on its survival, profit and growth. There are certain forces inside and outside the organisation. These forces affect the business both in positive and negative ways.

Figure 1 displays components of business environment:

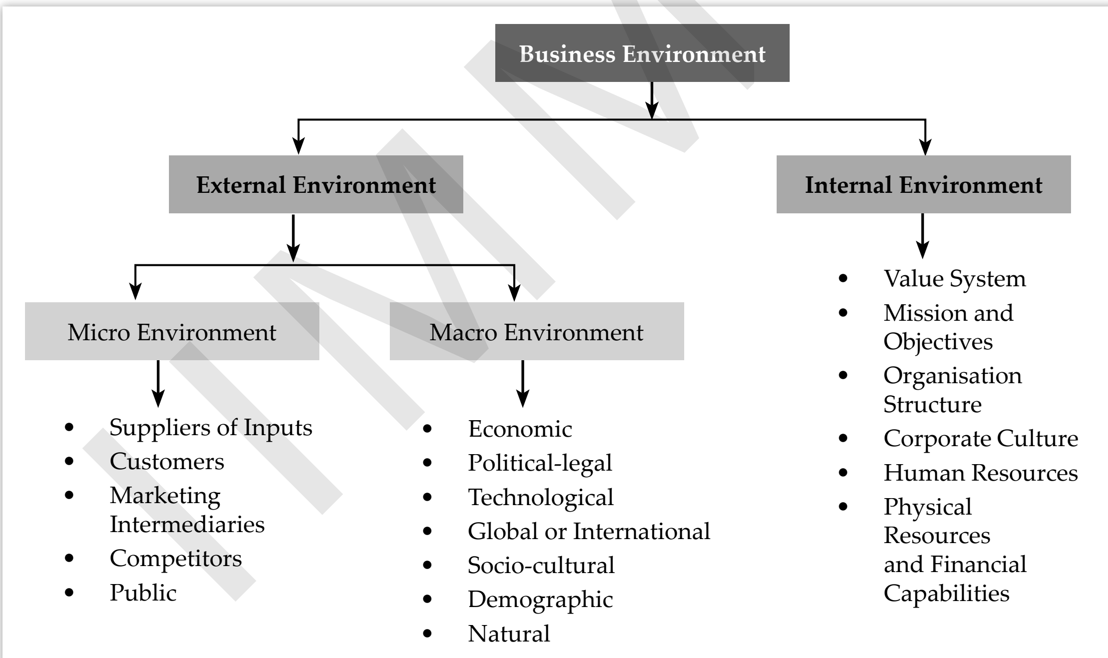

FIGURE 1: Components of Business Environment

Various components of business environment are as follows:

- **Internal environment:** These are those factors or conditions that exist within an organisation and affect its performance. These factors are controllable in nature and organisation can try to change or modify these factors. Organisation's resources like men, material, money, method and machine come under internal environment. Various internal factors are as follows:
  - **Value system:** The values are the ethical beliefs that guide the organisation in achieving its mission and objectives. It is framed by top-level managers like board of directors. The extent to which the value system is shared by all in the organisation is an important factor contributing to its success.

- **Mission and objectives:** The objective is the end towards which business activities are directed. All businesses focus on maximisation of profit. Mission is defined as the overall purpose or reason for its existence. A mission guides and influences an organisation's decisions and economic activities. An organisation can change or modify its mission and objective accordingly.
- **Organisation structure:** The organisational structure is the hierarchy in business that define roles, responsibilities and supervision. The composition of the board of directors, the professionalism of management, etc., come under organisation structure and are important factors influencing business decisions. For efficient working of a business organisation and to facilitate prompt decision making, the organisation structure should be conducive.
- **Corporate culture:** Shared values and belief in an organisation which determine its internal environment are called corporate culture. Organisation where there is strict supervision and control results in lack of flexibility and unsatisfied employees. The sets of values that help members understand what organisation stands for how it does work, what it considers, cultural values of business forces of business, and so on. It helps in direction of activities.
- **Human resources:** Human quality of a firm is an important factor of internal environment. Skills, qualities, capabilities, attitude, competencies and commitment of its employees, etc., could contribute to the strengths and weaknesses of an organisation. Organisations may find it difficult to carry out modernisation and redesigning because of resistance by its employees.
- **Physical resources and financial capabilities:** Physical resources, such as plant and equipment, facilities and financial capabilities of a firm determine its competitive strength which is an important factor for determining its efficiency and unit cost of production. Also research and development capabilities of a company determine its ability to introduce innovations which enhance the productivity of workers. Financial capabilities are company's source of fund generation.

○ **External environment:** These are those factors and the conditions which are outside the organisation and affect the performance of business. External factors are further divided into micro environment and macro environment which are as follows:

- **Micro environment:** Those factors which have direct impact on business. The various constituents under micro environment are as follows:
  - ✓ **Suppliers of inputs:** The suppliers of inputs are important factors in the external micro environment of a firm. Suppliers provide raw material and resources to the firm. A firm should have more than one supplier for proper inflow of inputs.
  - ✓ **Customers:** They are the buyers of firm's products and services. Customers are an important part of external micro environment because sales of a product or service are critical for a firm's survival and growth, so it is necessary to keep the customers satisfied.

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- ✓ **Marketing intermediaries:** Intermediaries play an essential role of selling and distributing its products to the final customers. Marketing intermediaries are an important link between a business firm and its ultimate customers. Retailers and wholesalers buy in bulk and sell business products and services to the ultimate consumer.
- ✓ **Competitors:** Competitors are the rivalry in business. Competition can based on pricing of products or based on competitive advertising. For example, organisations may sponsor some events to promote the sale of different varieties and models of their products. Business formulates strategies after analysing their competitor.
- ✓ **Public:** Public or groups, such as environmentalists, media groups, women's associations, consumer protection groups, are important factors in external micro environment. Public, according to **Philip Kotler**, *is any group that has an actual or potential interest in or impact on the company's ability to achieve its objective*.

- **Macro Environment:** These are the factors or conditions which are general to all businesses and are uncontrollable. Because of the uncontrollable nature of macro forces, a firm needs to adjust or adapt it to these external forces. These factors are as follows:
  - ✓ **Economic environment:** All those forces which have an economic impact on businesses are called economic environment. It includes agriculture, industrial production, infrastructure, and planning, basic economic philosophy, stages of economic development, trade cycles, national income, per capita income, savings, money, etc., For example, low per capital income will negatively impact business because people have less money to spend.
  - ✓ **Political-legal environment:** The activities of legislature, executive and judiciary play a vital role in shaping, directing, developing and controlling business activities. Rules and regulations, framed by the government, like licensing policy, polythene ban, etc., affect the business. Business growth can be achieved by using a stable and dynamic political-legal environment.
  - ✓ **Technological environment:** Systematic application of scientific or other organised knowledge to practical tasks or activities is called technology. As it is changing fast, businessmen should keep a close look on those technological changes for its adaptation in their business activities.
  - ✓ **Global or international environment:** The global environment is also important for shaping business activity. In the era of globalisation, whole world is a market. Business analyses international environment to cope up with the changes.
  - ✓ **Socio-cultural environment:** People's attitude towards work and wealth, lifestyle, ethical issues, role of family, marriage, religion and education and also social responsiveness of business affect the business.
  - ✓ **Demographic environment:** Population size and growth, life expectancy of the people, rural-urban distribution of population, the technological

skills and educational levels of labour force come under demographic environment. These features also affect the functioning of organisations.

- ✓ **Natural environment:** The natural environment plays an important role as it provides raw materials and energy for production in a firm. Natural environment consists of geographical and ecological factors a such as minerals and oil reserves, water and forest resources, weather and climatic conditions and port facilities. These are very important for many business activities. For example, in places where temperatures are high, the demand for coolers and air conditioners is high. Also, demand for clothes and building materials depends on weather and climatic conditions. Natural calamities like floods, droughts, earthquakes, etc., immensely affect business activities.

SELF ASSESSMENT QUESTIONS

4. ______________ and ______________ are the two types of external environment.
5. Which among the following comes under economic environment?
   a. Education
   b. Population size
   c. GDP
   d. Lifestyle
6. Marketing intermediaries are an important link between a business firm and its ultimate customers. (True/False)

ACTIVITY

Choose any company of your choice and note the internal and external factors affecting its business.

1.4 RELATION BETWEEN BUSINESS ENVIRONMENT AND STRATEGIC MANAGEMENT

The set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company objectives are called strategic management. Strategic decisions are based on what a manager forecasts rather than what he knows. Strategic decisions have complex implications for more areas of the firm. The characteristics of strategic management decisions vary with the level of strategic management activity.

- Strategic management helps in defining the objectives and policies for the business. To make strategy, a business needs to scan its environment.
- In formulating a strategy, the strategic decision makers must analyse internal as well as external conditions in the environment, which are described in the following sections:

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- The analysis of internal and external environment will help managers determine what goals and mission they can or should adopt, and the strategic options that are available.
- Strategic planning should be based on business environment analysis. The world today is changing at a rapid pace. So it is very important for companies to scan the business environment more clearly, and make up strategic planning that can match the changes.
- The environment is changing, and the strategy which is suitable for companies today may bring threat tomorrow. Strategy is effective only if it is flexible.

Self Assessment Questions

7. Strategic management does not help in defining the objectives and policies for the business. (True/False)
8. ____________________ are based on what a manager forecasts rather than what he knows.

1.5 SUMMARY

- Business environment is a combination or mixture of complex, dynamic and uncontrollable external factors within which a business is to be operated.
- Business environment is complex, uncertain, inter-related, dynamic and interdependent.
- Specific environment includes external forces that directly impact or influence organisations' decisions and actions and are directly relevant to the achievement of organisations' goals.
- General environment includes the broad economic, political/legal, socio-cultural, demographic, technological and global conditions.
- Business environment helps in identifying opportunities and threats.
- The components of business environment are: internal and external environment. External environment consists of micro and macro factors which affect the business.
- The set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company objectives are called strategic management.
- Strategic management helps in defining the objectives and policies for the business. To make a strategy, a business needs to scan its environment.

1.6 KEY WORDS

- **Opportunities:** The favourable conditions which can give a positive outcome.
- **Threats:** The unfavourable conditions which can give a negative outcome.
- **Globalisation:** An integration of economies, industries, markets, cultures and policy-making around the world.

- **Strategic management:** The set of decisions and actions that result in the formulation and implementation of plans designed to achieve an organisation's objectives.

1.7 CASE STUDY: TATA NANO–ENVIRONMENTAL ANALYSIS

In 1868, Tata Gamsi founded Tata group. It is the largest conglomerate in India and is owned by Tata sons. Tata Motors is a leader in manufacturing of commercial, passenger, military and electric vehicles. It is also the world's 4th largest truck and 2nd largest bus manufacturer by volume. In January 2008, Tata Motors introduced Tata Nano, dubbed as the 'People's Car' and also known as the world's cheapest car. The car was launched in March 2009 which created a significant impact in the Indian automobile market. Tata Motors Ltd. is one of the few companies which has its own R&D centres. It has established an engineering research centre at Pune (with a strength of around 3,500 personnel).

The main target group of customers for Tata Nano are the lower- and middle-income families in India, many of whom resisted purchasing four-wheelers mainly due to the price affordability and maintenance cost. Launching of Tata Nano gave an opportunity for these groups to purchase a car within their means.

During the initial launch, Tata Nano was priced at about rupees one lakh. In December 2008, the cost of the car increased significantly due to higher raw material costs.

Table A: Passenger Car Segments in India

Segment	Type	Length
A1	Mini	Up to 3400 mm
A2	Compact	3401-4000 mm
A3	Mid-size	4001-4500 mm
A4	Executive	4501-4700 mm
A5	Premium	4701-5000 mm
A6	Luxury	Above 5000 mm

Source: *SIAM*

Table B: Awards Tata Nano Received

Awards	Awarding Organisation	Year
Indian Car of the Year (ICOTY) Award.	Instituted by leading automotive magazines in India, in association with JK Tyre	2009
Business Standard Motoring Indian Car of the Year	Business Standard	2010
Good Design Award	Museum of Architecture and Design together with The European Centre for Architecture, Art, Design and Urban Studies	2010
Gold Prize in the Best New Product segment	Edison Awards	2010
Best Car Advertisement of the Year Award	Bloomberg, UTV, Autocar India Awards	2011

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Further, in 2013, Tata Nano was rated as the most trusted 4-wheeler brand by Brand Trust Report India Study.

Tata Motors was so confident about Nano that they thought this is going to be a massive success. But it failed and became one of the most disaster products in the history of marketing.

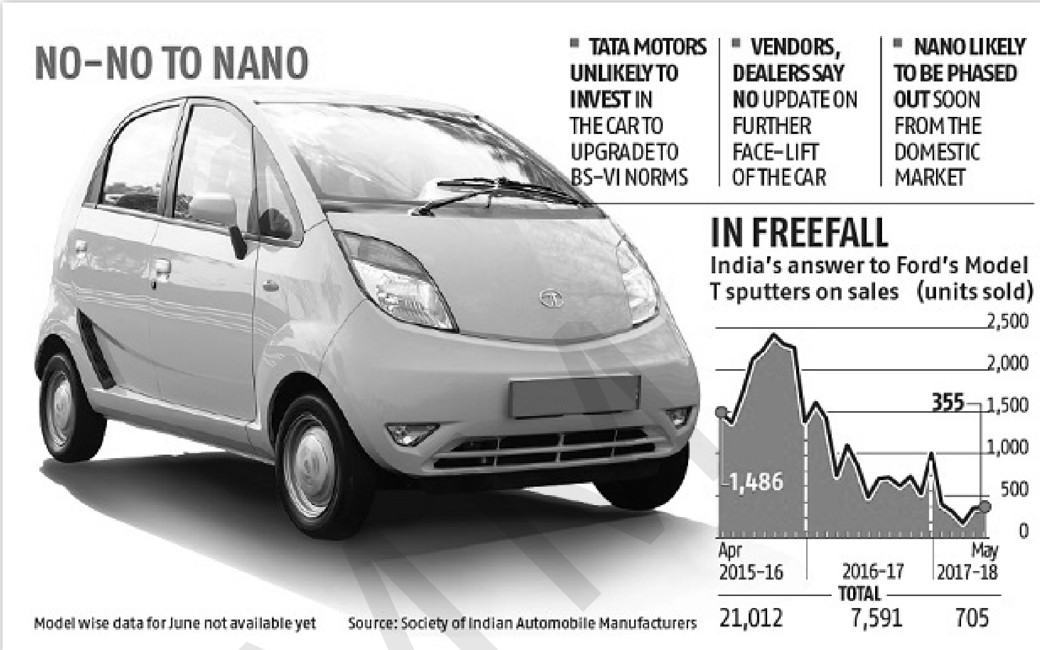

Figure A: TATA Nano sales

Table C: TATA Nano Sales Figure (2017–2018)

Month	Oct. 2017	Nov. 2017	Dec. 2017	Jan. 2018	Feb. 2018	Mar. 2018	Apr. 2018	May 2018	Jun. 2018
Tata Nano GenX	57	121	94	62	52	29	42	20	3

Tata Nano Failure Reasons

- Tata Nano projects itself as the cheapest car. Nobody wants to drive the cheapest car. Buying a car is related to social status and prestige in society.

  Ratan Tata says:

  "It (Nano) became termed as the cheapest car by the public and, i am sorry to say, by ourselves, not by me, but the company when it was marketing it. I think that is unfortunate."

- So many Nano cars catch fire. This created a complete buzz in media. Despite the low price, everyone hesitated to buy them because of the incidences of fire.
- After the announcement of Nano, the second-hand market of cars faces a drop in price by 15% to 20%. New cars like Alto 800, Maruti 800, Indica, etc., also have to reduce the price. People called it a Nano effect.

- The vision of Tata was an affordable car that could fit a family of four. But, in reality, it was not fitting an Indian family of 4 with ease.

Source: https://bking.in/tata-nano-failure-case-study/

QUESTIONS

1. What was the vision of Ratan Tata behind the launch of Nano project? How did he analyse the environment?

   (**Hint:** Low-income group people, safety, substitute for a bike.)

2. In spite of extensive research and development programme, Nano was a huge failure. Why?

   (**Hint:** Poor vision and mission, competition, quality, etc.)

1.8 EXERCISE

1. Describe the forces which affect individual enterprises directly and immediately in their day-to-day working.
2. Explain how the understanding of business environment helps the management in coping with the rapid change and identifying opportunities and threats.
3. ABC Pvt. Ltd. was operating its business in USA. The company started exporting its product to India with the introduction of New Industrial Policy in 1991. The company appointed retailers in India who had direct links with suppliers to replenish stocks when needed. Identify and explain the dimensions of business environment discussed above.
4. Strategic decisions are based on what a manager forecasts rather than what he knows. Explain the relationship between strategic management and business environment.

1.9 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Concept of Business Environment	1.	Business environment
	2.	True
	3.	interdependent
Components of Business Environment	4.	Micro environment; macro environment
	5.	c. GDP
	6.	True
Relation between Business Environment and Strategic Management	7.	False
	8.	Strategic decisions

1.10 SUGGESTED BOOKS AND E-REFERENCES

SUGGESTED BOOKS

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CHAPTER 2

Environmental Screening

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe the environmental screening
- Explain the importance of environmental screening
- Discuss the steps of business environmental analysis
- Describe the SWOT technique of business environmental analysis
- Explain the meaning of risk
- Explain how organisations assess risk

2.1 INTRODUCTION

In the previous chapter, you studied the concept of business environment. The chapter also discussed about the components of business environment. The relation between business environment and strategic environment have been described at the end of the chapter.

An organisation functions within a particular environment which is comprised of internal and external environments. The internal environment of an organisation includes its employees, its policies that exist in the organisation, its strategy, its mission, etc. The internal environment is responsible to reflect the common purpose of the organisation. The external environment includes government, regulating agencies, customers, suppliers, public at large, etc. They affect the business strategy of the organisation. Internal environment is managed internally by the keypersons of the organisation. Thus, it is important for a organisation to screen the external environment in detail to make a strategy that could work for it. SWOT technique is used to make a complete analysis of internal and external environment of an organisation.

In this chapter, you will study the meaning and importance of environmental screening. You will also study the business environment analysis and SWOT analysis in detail. Towards the end of the chapter, risks in business environment have been discussed.

2.2 MEANING AND IMPORTANCE OF ENVIRONMENTAL SCREENING

The term 'environment' means surroundings near you, which includes all components of environment like physical environment, social environment and governing environment. Physical environment consists of plants, land, water and all natural resources. Social environment consists of labourers, staff, management, suppliers, customers or all other human resources. Governing environment are rules, regulations and policies of the government. The term 'screening' means the process of evaluation or assessment of anything with the purpose of gathering data on any subject matter and coming to a conclusion.

Thus, you can conclude that environmental screening is a process in which an organisation makes assessment or analysis of all the components of the environment and screens their impact on its functioning, stability, growth and profits.

For an effective environmental screening, an organisation must follow the following steps:

1. **Defining the type of business:** First, the organisation should assess what type of business it is dealing in and later on decide how environment will impact it. The same environment affects the clothing business and food business differently.
2. **Defining the scope of project:** If screening is done for a particular project, then it is necessary to define the scope of the project. The scope will decide how environment will affect the project of the organisation.
3. **Defining the type of environment:** It is important to define what type of environment an organisation is working in. It is important to consider all types of components of environment, such as physical, social or governing, and how the business will be affected due to them.
4. **Preparing a report:** A detailed report should be made on how the organisation will be affected by the surrounding environment.
5. **Monitoring:** Environment is not a static thing. It keeps on changing its features and characteristics. For example, employees keep on changing their jobs, customers keep on changing their choices, government keeps on changing its policies, etc. Thus, environment and its impacts should also be constantly monitored.

If an effective environmental screening is done properly, then it gives following benefits:

- It gives the clear picture of what kind of environment the organisation is working in. Also, the organisation becomes aware of the features of different components of environment.
- Organisation gets the idea of opportunities and threats possible in the environment.
- Organisation is able to define the scope of its business, like how much the organisation can grow and to what extent it can raise its targets and profits.
- Organisation becomes aware of the existing and possible competitors.
- Continuous monitoring of environment makes an organisation aware of the upcoming dangers and updates for future challenges. This makes an organisation aware of its customers' choices, so that the organisation could further improve the quality of its products or services.

SELF ASSESSMENT QUESTIONS

1. ________ is the evaluation or assessment of something, such as plants, land and water which are the ________ components of environment.

2.3 BUSINESS ENVIRONMENTAL ANALYSIS

The environmental analysis process is not a universal process. It is rather a dynamic process which may change from one business to another. For example, the business process analysis would be different for the airline services to that of the beauty salon services.

A business manager plays a vital role in the analysis of business environment. He needs to thoroughly understand the availability of opportunities and possible threats. As per the analysis, an organisation needs to work on the available opportunities as per its strength and weakness.

Following are four basic components of business environment analysis:

- **Scanning:** The term 'scanning' means analysing all parts or components of anything in order to develop some features of that thing. Being the first component of the environmental analysis process, this analyses the environmental factors of an organisation. The purpose of scanning is as follows:
  - Scanning helps in identifying the possibilities of environmental changes which may affect the working of an organisation.
  - Understanding the present changes in the environment.

  Scanning is basically a non-structured activity. This is because the data in scanning is unlimited, but is ambiguous and imprecise in nature. So, it is difficult to distinguish what data is relevant or what is not. For the environmental analysis process, it is the basic challenge to extract the relevant data and make the best use of it.
- **Monitoring:** 'Monitoring' means keeping a constant eye or check on something. Thus, in environmental analysis, monitoring keeps a check on environmental changes from time to time. For example, employees keep on changing, natural resources keep on changing, and government and their policies keep on changing.

  Thus, after scanning, it is necessary to keep monitoring what sort of changes the concerned environment is facing and what impact it might cause on the normal functioning of the organisation. Constant monitoring ensures that business-persons are aware, and make responses towards the possible change in the business environment.
- **Forecasting:** Scanning and monitoring are steps on those aspects which have already happened and organisation cannot change them. These are sunk aspects, i.e., which have already taken place in the past and will not change in the future. But when an organisation is formulating a strategy for its operations, it might require future prospects and future orientation too. Forecasting is, thus, making any predictions about future and is, consequently, a part of business environment analysis. Forecasting can be done for any business-related project or aspect. For example, a forecasting can be made about whether a particular technology will arrive in the market or not, what would be the government's new policies regarding tax, whether customers would change their preferences or would they like the innovation in the products or services, etc. These kinds of questions are being attempted to be answered in forecasting. Scanning and monitoring are

comparatively easy tasks than forecasting. Forecasting is a complex task which requires brainstorming with which future predictions are being made. The scope of forecasting is more specific and clearer than monitoring and scanning. The results of monitoring and scanning are accurate as study of something present is done. But results of forecasting are contingent in future.

- **Assessing:** After scanning, monitoring and forecasting the business environment, organisation must make proper evaluation or assessment of collected data in the above-mentioned steps. The organisation also needs to analyse what impact it will create on functioning. Assessment will provide answer to the following questions:
  - What strategy needs to be made for the smooth functioning of the organisation?
  - What changes might an organisation want to bring in your current strategy?
  - What alternatives does an organisation have in case of negative changes in environment?
  - How will an organisation face the coming changes?

2.3.1 STEPS IN BUSINESS ENVIRONMENTAL ANALYSIS

Following steps need to be followed in the process of business environmental analysis:

A. Scanning all the required components
B. Grouping the scanned components
C. Observing the internal components
D. Monitoring the external components
E. Outlining variables for analysis
F. Usage of different techniques for analysis
G. Forecasting future outcomes
H. Formulating strategies
I. Execution of formulated strategies
J. Monitoring

Let us discuss the above-mentioned steps in detail:

A. **Scanning all the required components:** Environment of an organisation consists of various components. But, not all factors and aspects would be equally important or even important for the functioning of an organisation. A good strategist always distinguishes the relevant factors and scans them in detail. He/she looks for all the required components of environment and would study the relevant factors in detail. This way, he/she collects the required components and would present a scanned report.

B. **Grouping the scanned components:** In the first step, the required raw information is gathered. In this step, the collected components are to be grouped; for example, what is affecting the stability, what is affecting the sales, what is affecting the growth, etc. Grouping is made of all the collected information.

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C. **Observing the internal components:** After scanning and grouping the relevant components of external environment, the strategist looks at the internal components of the organisation. For example, how the employees are reacting to the environmental changes and how smooth an organisation is functioning as the external components change in the environment.

D. **Monitoring external components:** As an environment is not static in nature, it keeps on changing, for example, changing in government policies, changing in customer's preferences, changing in supplier's rates, etc. Thus, just one-time scanning is not a fruitful activity for the organisation. An organisation needs to constantly monitor and make aware of the upcoming changes.

E. **Outlining variables for analysis:** Variables are the components responsible for bringing a change in an external environment. Some variables are national minimum wage, GDP, tax policies, competitors' policies, customers' preferences, etc. A strategist must outline all such variables and study them from time to time, so that he could bring the necessary change in the functioning.

F. **Usage of different techniques for analysis:** Different techniques are being used for a proper environmental analysis, such as benchmarking, scenario building, network methods, etc. The term 'benchmarking' means setting the best standard as per the industry and then comparing company's performance with the set standards. Scenario building is presentation of overall picture of the system of the an organisation along with the affecting components. Network method is a complex process which is used to analyse the external environment of the organisation. This method helps in analysing the available opportunities in the market and studying possible threats. A network method also judges how internal strengths and weaknesses will be affected by the external environment. Essential data can be gathered through Delphi method, conceptualising, study and verifiable enquiry method.

G. **Forecasting future outcomes:** In a business environment analysis, it is necessary to make predictions for future outcomes. A good strategist will always make future predictions of how the environmental components may affect the functioning of the organisation. The assessment of past results can also be made in this step.

H. **Formulating strategies:** It is also one of the important steps of business environmental analysis. After the assessment of all the above environmental components, an organisation formulates the required strategies for the functioning. As you have already studied above, conduct the SWOT analysis before making an effective strategy. SWOT analysis means analysing the strengths, weaknesses, available opportunities and possible threats of the organisation. There are various ways of formulating or designing a strategy. Internal or core components are being recorded in Strategic Advantages Profiles (SAP). However, external components are being recorded in Environmental Threat and Opportunity Profile (ETOP). Both SAP and ETOP profiles can be compounded into SWOT profile. To evaluate internal and external components, External Factor Evaluation (EFE) matrix is being used by the strategists as a tool.

Let us discuss the above-mentioned tools in brief:

- **SAP:** It is a tool which is being used by strategists to examine internal components of the organisation, like strengths and weaknesses. The processes of both ETOP and SAP are much similar. Both have positive, neutral and negative signs. The five utilitarian areas in the majority of the associations leaned to distinguish their quality and shortcoming are human asset and corporate arranging, fund or bookkeeping, generation or activity, showcasing or conveyance and innovative work. Every one of these zones is important to give a reasonable image of the key position of the association.

- **ETOP:** It analyses the external components of the business environment. It is basically the study of factors that are responsible externally to affect the business functioning. It is essential to study the impact of external components which might create an impact on an organisation. Components can be both positive and negative or even neutral in nature. Thus, it becomes necessary to determine which aspects will create a positive impact and which will create a negative impact.

I. **Execution of formulated strategies:** After the above steps, a strategist implements and executes upon the formulated strategies. The strategist always evaluates how he had formulated the given strategy and how that can be effectively implemented. He/she also makes the required future predictions. This process is also often referred to the process of SWOT analysis

J. **Monitoring:** The strategist must keep monitoring the external environment. As an environment keeps on changing, thus, it is necessary to have a continuous look at the changes and bringing the required changes in the plan or strategy.

SELF ASSESSMENT QUESTIONS

2. What is the first component of business environment analysis?
3. Which component of business environment analysis involves evaluation?
4. What is the full form of SAP?
5. What is the full form of ETOP?

2.4 SWOT ANALYSIS

SWOT analysis refers to the analysis of both the internal and external environments of an organisation. In this term, S stands for Strengths and W stands for Weaknesses. Both these terms are internal components of an organisation. O stands for available Opportunities in the market and T stands for the possible Threats in the market. Both of these are the external components of the organisation.

Let us discuss these above-mentioned terms in detail:

- **Strengths:** The term 'strengths' basically means the things you are good at or your capabilities. In the organisational context, it means the core competencies or capabilities of an organisation for which it can gain strategic advantages from its competitors. Even if it does not gain any advantages over competitors, it refers to an organisation's capacities in which the organisation is having affirmative aspects. Strength is necessary for every organisation to gain competitive advantages. For example, some organisations have their employees as their strength and some organisations may have low cost of production as their strength.

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- **Weaknesses:** Weaknesses are exact opposites of Strengths. While strengths are competitive advantages, weaknesses are competitive disadvantages of an organisation. Weaknesses are responsible for downfall of an organisation. The term 'weakness' also refers to the things in which the organisation is not good. For example, an organisation might not have better marketing strategies in comparison to its competitors. Then, in such a case, marketing would be its weakness.
- **Opportunities:** The term 'opportunity' means a chance to grab on in a positive sense. This is actually a favourable condition or circumstances present in the external environment, which should be grabbed by the organisation, in order to increase its strengths and gaining competitive advantages. A company's strategist must be aware of the coming opportunity in the market, so that it could grab them on time and could raise revenues and profits; for example, sudden rise in demand of customers, new government policies in the favour of the organisation, emerging technologies, etc.
- **Threats:** The term 'threat' means exposing vulnerability of something which might create an adverse impact. In an external environment, if suddenly or even gradually some changes occur and those are not in favour of the organisation, then these are called threats to the organisation. For example, a changes in preferences of customers, and changes in government policies, which are not in favour of the organisation, are considered as threats to the organisation.

It is not necessary that an organisation has only its one single strength. An organisation might have one or more strengths at one time. More number of strengths would give an organisation more competitive advantages. An organisation might have one or more weaknesses which would degrade its competitive position in the market. The weakness of an organisation would factually hamper the growth of an organisation. The strengths and weaknesses of an organisation could be collectively determined and this combination would create a collective impact on the organisation and it is called a circumstance of synergistic effect. The concept of synergy says that if two things are merged together, then the resulting effect could be greater or lesser. This means when strengths and weaknesses of a company are understood together, then they could create a resulting strength or resulting weakness. This could be better understood as 'two plus two could be either five or three'.

The SWOT analysis is a tool to evaluate the strengths, weaknesses, opportunities and threats of an organisation. Every organisation must do this analysis very effectively, as all these areas are necessary to be understood in detail. A strategy would be formed on the basis of these elements only. Through SWOT analysis, a detailed study could be done about both internal and external factors of an organisation.

The SWOT analysis as a whole matches the organisation's strengths and weaknesses with the market's opportunities and threats. It is in the organisation's self-interest to use its strengths to exploit the available opportunities in the market. Further, an organisation must neutralise its weaknesses and avoid the possible threats in the external environment of the organisation. A four-cell matrix is being used to perform the SWOT analysis. In this matrix, the cells are referred to as strengths, weaknesses, opportunities and threats.

SELF ASSESSMENT QUESTIONS

6. In following options, what is an opportunity for a business?
   a. A business has poor marketing strategies
   b. A business has a goof labour force
   c. A business is exposed to a low demand for its products
   d. A business can have a high demands of its products in the coming future
7. Out of the following options, which one is strength of a business?
   a. A business has poor marketing strategies
   b. A business has a goof labour force
   c. A business is exposed to low demand of a product
   d. A business can have high demand of its product in the coming future

2.5 ASSESSING RISK IN A BUSINESS ENVIRONMENT

The term 'risk' means a situation or circumstance where there is an exposure to danger. Business risk, therefore, means when an organisation is exposed to danger or threat, which could lower its profits or which may hamper the achievement of its targets. Any threat which may harm the normal functioning of an organisation is known as business risk.

Any exposed risk could affect the organisation in the following ways:

- It could disrupt normal working
- It could create an adverse effect on sales or revenue
- It could defame the brand image
- It could create an adverse impact on growth

It is not factually correct every time to blame managers or staff for the risk. A risk to business occurs because of many reasons.

Following are the reasons which may cause a business risk:

- Preference of customers, their demand and sales
- Overall per unit cost to the company
- Existing competition in the market
- Economic climate
- Government policies, rules and regulations

Assessing risk means making an estimate of what level of risk is present in the given business situation. Thus, risk assessment is actually risk measurement. Following steps are to be taken to assess risk:

1. **Define the type of risk:** There are various types of risks that are present in the market, to which a business is exposed. The first step is to identify the types of risks that are present.

There are following types of risks present in the market:

- **Financial risks:** Financial risks are risks which affect the financial or monetary position of an organisation. Financial risks include credit risk, liquidity risk, asset-based risk, foreign investment risk, equity risk, currency risk, etc. In these types of risks, the organisation faces money crisis.
- **Marketing risks:** When an organisation fails to make a better marketing strategy for its products or services, it faces such types of risks. These include a failure of marketing of products or services, risk, risk related to product development, product pricing, product promotion, etc.
- **Operational risks:** When an organisation fails to properly operate its day-to-day functioning, it is known as operational risk. In these kinds of risks, employees are not able to work properly for the organisation. For example, risk of electricity cut off, risk of disruption in the Internet, etc.
- **Strategic risks:** When there is a failure in proper strategy making or when strategy is not updated as per the changes in the environment, such situation is known as strategic risk; for example, failure of management in adapting new technology, failure in meeting customers' demands, etc.
- **Workforce risks:** When the workforce of the organisation does not perform its duties well or does not work for the organisation, it is known as work-force risks; for example, strike of labourers, continuous absence of labourers or employees, etc.

2. **Estimate the likelihood of occurring:** After analysing all types of risks an organisation needs to estimate what are the fair chances of each risk occurring in the future. Various techniques like percentages or probability can be used to estimate the chances of occurrence of risk. For example, there are twenty-five percent chances that the demand is going to fall down in the coming time for the said project.
3. **Estimate the loss:** After identifying the risks, the organisation has to estimate the chances of its occurrence and the extent of loss it may cause to the organisation. For example, there are twenty-five percent chances that the demand may fall for the said project and, consequently, the organisation may suffer loss of revenue of one million rupees in one month of time.
4. **Decide whether or not to take the risk:** The organisation has come to a rough figure of how much loss it is going to suffer if the risk proves to be right. Organisation takes decision whether or not that risk is worthy to take. In the above example, there are seventy-five percent chances that the demand would not fall and if the demand rises, the organisation would have profit of ten million rupees in the coming month. So, considering all these factors, project is worthy to be taken.

Self Assessment Questions

8. ________ is a situation of exposure to danger
9. Failure to adapt to a new technology is ________ risk.

2.6 SUMMARY

- Environmental screening is a process in which an organisation makes an assessment or analysis of all the components of the environment and screens their impact on its functioning, stability, growth and profits.
- The environmental analysis process is not a universal process. It is a dynamic process which may change from one business to another.
- SWOT analysis refers to the analysis of both internal and external environments of an organisation. In this term, S stands for Strengths and W stands for Weaknesses. Both these terms are internal components of an organisation. O stands for available Opportunities of the market and T stands for possible Threats in the market. Both these are external components.
- Business risk means when an organisation is exposed to danger or threat which could lower its profits or which may hamper the achievement of target. Any threat which may harm the normal functioning of an organisation is known as business risk.
- Assessing risk means making an estimate of what level of risk is present in the given business situation. Thus, risk assessment is actually risk measurement.

2.7 KEY WORDS

- **Environment:** The surroundings around anything/ an organisation.
- **Screening:** The process of evaluation or assessment of anything.
- **Scanning:** The process of analysing all the parts of anything in order to develop its feature.
- **Monitoring:** The process of keeping a constant eye on something to check at on a regular basis.
- **Strengths:** The ability in which someone performs very well.
- **Weakness:** The inability due to which someone performs very badly.
- **Opportunity:** A chance available in a given situation.
- **Threat:** Threat means exposing vulnerability of something which might create an adverse impact.
- **Risk:** An exposure of something to a possible loss.

2.8 CASE STUDY: SWOT ANALYSIS OF APPLE INC.

SWOT analysis is basically an analysis of company or organisation's strengths, weaknesses, opportunities and threats. Here is a case study of Apple Inc. on SWOT analysis.

Apple had launched its new phone iPhone 7 in an event. It has also expanded its business boundary by launching Apple watch, and Bluetooth headphones, also known as AirPod.

Apple's Strengths

iPhones have created a unique brand identity for themselves. People are willingly ready to spend lakhs in the name of iPhone. The logo of Apple is a symbol of status these days. Moreover, Apple's product design is artistic, yet simple, rich and royal and creative too. Apple has customer faith and its brand value has worldwide recognition. Its brand value is so high that most of the Apple's products are often pre-ordered worldwide. Moreover, Apple utilises its image to sell a way of life of imagination, extravagance and smoothness. This is how it advertises its items: Not as a straightforward contraption, yet as a route into its designed and planned world. This is why, its revenues and, subsequently, its profit margin are too high in products like Mac Laptop, iPhone, iPad, etc.

Apple's Weaknesses

One of the greatest weaknesses of Apple is its high prices of products. Although its prices are high, but it restricts its buyers from upper middle class to high class. Usually, a PC can be bought for $200. On the contrary, Apple's Mac laptop costs around $1100-$1200+. If offered at a sale price, the sales reduce the price of the product by only $50-$100. Only the students are able to get the laptops at discounted prices. If we take globally, then there are a number of lower-class people who couldn't afford to buy Apple products. Apple ignores this class of customers. We can say that this is a great weakness of Apple Inc.

Apple's Opportunities

Apple has witnesses a potential advantage in teaming up with various solid and existing brands identified with its commercial centre. With its new AirPods, it has collaborated with Beats earphones to present the new remote Beats X close by its iPhone 7. Moreover, Nintendo is bringing another amusement, Mario Run, to iPhone — consolidating the Apple name with the notable diversion face of Nintendo. This is another incredible brand which could get gigantic numbers from its numerous fans all over the world.

Apple's present advancement can be derided, criticised or cheered. In any case, the business openings from working together with other expansive brands over the world will profit the Apple brand monstrously, insofar as it keeps on building up these business connections.

Apple's Threats

Ever since Apple Inc has entered in the market, its biggest threat is innovation. It keeps on producing the same kind of products. The regular customer might lose interest after some time. While Apple's structure is smooth and short-sighted, that is actually what makes it simple to imitate. Worldwide stores sell counterfeit renditions of iPhones and iPod contacts which, outwardly, look about indistinguishable. Furthermore, numerous individuals fall for the tricks of 'overly cheap Apple items' sold on the web. Another threat to Apple products is competition. Companies like Samsung have captured the market with the launch of the concept of androids in the market. Apple has heightened its competition by not providing earphones in its new model, iPhone 7. Moreover, android companies are providing the same facilities at much cheaper rates.

Source: *https://pestleanalysis.com/swot-analysis-case-study-of-apple/*

QUESTIONS

1. How did Apple expand its business boundaries?

   (**Hint:** iPhone 7, Bluetooth headphone, watches, etc.)

2. What were the threats to Apple Inc?

   (**Hint:** Innovation, competition, etc.)

2.9 EXERCISE

1. What is environmental screening?
2. What is importance of environmental screening?
3. What is business environment analysis?
4. State different steps in business environment analysis.
5. What is SWOT analysis?
6. What is risk assessment?

2.10 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Meaning and Importance of Environmental Screening	1.	Screening; physical
Business Environmental Analysis	2.	Scanning
	3.	Assessing
	4.	Strategic Advantages Profile
	5.	Environmental Threat and Opportunity Profile
SWOT Analysis	6.	d. A business can have a high demands of its products in the coming future
	7.	b. A business has a goof labour force
Assessing Risk in a Business Environment	8.	Risk
	9.	strategic

2.11 SUGGESTED BOOKS AND E-REFERENCES

SUGGESTED BOOKS

❍ *Organisations and the Business Environment*, written by David Campbell and Tom Craig. https://books.google.co.in/books?id=h-FHr6ExlQUC&printsec=fr

Notes

ontcover&dq=business+environment+analysis&hl=en&sa=X&ved=0ahUKEwiAnaO_iKjhAhXMbn0KHQZDD4QQ6AEINTAC#v=onepage&q=business%20environment%20analysis&f=false

- *SWOT Analysis*, written by Alan Sarsby, published by Leadership Library https://books.google.co.in/books?id=Yrp3DQAAQBAJ&printsec=frontcover&dq=swot+analysis&hl=en&sa=X&ved=0ahUKEwjlqtvYiajhAhWJSH0KHaaXDHwQ6AEIKjAA#v=onepage&q=swot%20analysis&f=false

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CHAPTER 3

Micro Business Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe the micro business environment and its importance
- Describe the various elements of micro business environment
- Explain the meaning of organisational appraisal
- Explain various methods of organisational appraisal
- Describe the various sources of information collection for organisational appraisal
- Describe the informational appraisal approaches
- Describe the factors affecting organisational appraisal approach

3.1 INTRODUCTION

In the previous chapter, you had studied meaning and importance of environmental screening. You had also studied about business environment analysis and its steps, SWOT analysis, and assessment of risk in business environment.

Every business functions in its unique and special environment. This environment encompasses certain factors which impact the operations and functioning of the business. Therefore, businesses cannot operate on their own without the external forces which are outside to its periphery. An environment of business includes all such forces and factors which influence the strategies, decisions and actions of the business. In other words, the environment determines the success of a business. So, all businesses must identify, evaluate or appraise, and respond to every opportunity and threat in their environments. Thus, in order to survive and grow, a business must continuously keep an eye on its environment and adjust itself accordingly.

According to **Glueck and Jauch**, "*The environment includes factors outside the firm which can lead to opportunities for or threats to the firm. Although there are many factors, the most important of the factors are socio-economic, technological, suppliers, competitors and government*."

According to **Barry M. Richman and Melvyn Copen**, "*Environmental factors or constraints are largely, if not totally, external and beyond the control of individual industrial enterprises and their managements. These are essentially the 'givers' within which firms and their managements must operate in a specific country and they vary, often greatly, from country to country.*"

In the present scenario, both external and internal forces which impact the business decisions and policies are regarded as an integral element of the business environment.

In this chapter, you will study about micro business environment, its significance and constituents. You will also study about organisational appraisal, its various methods, and informational appraisal approaches and factors affecting organisational appraisal approach.

3.2 CONCEPT OF MICRO BUSINESS ENVIRONMENT

Micro business environment refers to the factors that have a direct influence on company's overall performance. In other words, the most immediate environment of the company is constituted by these factors. These factors encompass public, consumers, marketing intermediaries, competitors, suppliers, general public and shareholders. These factors are influenced by the macro business elements of the environment.

In contrast to the macro factors, the micro environmental business factors are more intricately associated to the company. Different industries are influenced by the micro factors in different ways. Thus, an organisation might take into consideration the micro factors which are related to a specific business activity. For example, the micro business environment of a restaurant might be its manpower, raw material suppliers, customers, other restaurants, etc.

3.2.1 SIGNIFICANCE OF MICRO BUSINESS ENVIRONMENT

Micro environment can be considered as the first pillar for setting up an organisation. Components of micro environment are utilised to carry out all the marketing plans, strategies and objectives. It is, hence, the executive wing of business in which practical execution of concepts, thoughts and ideas are performed. By depending on the responses of these constituents, a business either moves in the forward direction or may move back.

Moreover, it guides and directs the future promotion and communication policies of an organisation. With all of these characteristics, micro environment of an organisation plays a crucial role in identifying the current potential and assessing the organisation's future.

Micro environment encompasses factors of availability and usage of resources that affect businesses and individuals. A manager or executive of an organisation should have knowledge of the core microeconomic factors that influence the business. This will not only assist in planning and preparation, but also in the long-term development of business strategy.

3.2.2 CONSTITUENTS OF MICRO BUSINESS ENVIRONMENT

Various constituents of micro business environment are as follows:

- **Customers:** Customers are vital elements of a business environment. The primary motive of a business is to gain the attention of customers in order to retain them. This helps the organisation acquire profitability and long-term survival. Therefore, business enterprises must carefully identify and analyse the needs and wants of their customers and fulfil them in an effective manner in order to gain loyal customers. The interest of customers cannot be neglected by any business as this might cause adverse effects on business. So, business organisations must make changes in their products and services as per the changing tastes and preferences of customers. Hence, customers prove to be the central focus of a business environment.

Notes

- **Suppliers:** The business strategy gets influenced by actions of suppliers, as they provide the raw materials for the process of production. For example, the production time and the sales will be affected due to delayed production process if the services of the suppliers are not timely and reasonable.
- **Marketing intermediaries:** A company channelises and distributes its products from the manufacturing units to the market and customers with the help of dealers and distributors. Marketing intermediaries represent the company. They play an active role in delivering and distributing the products to the end user. They also ensure that products and inventories are adequately available in stores, retails or other access points. This is essential for business organisation and its success. For example, consumers can buy a household item from the nearest retail shop or outlet. They can also buy items from shopping malls, supermarkets or purchase stuff online. Hence, it becomes the primary responsibility of the management to make sure that the products and items are adequately available in all their stores and outlets so that customers do not have to go home empty-handed and purchase the product that they need.
- **Competitors:** Competitors of a firm or company can have a direct influence on the strategies of the business. The organisation must possess the knowledge of performing a competitive analysis and gain advantage over its competitors thereafter. Hence, the unique selling point (USP) of the competitors as well as the value-added services offered by them must be known to the organisation. The organisation should also know how to differentiate itself from its competitors. The focus of the company should be to offer value and something which the competitors do not offer.
- **General public:** Companies must pay attention to a very vital component of micro environment, i.e., the general public, for its long-term survival. However, all the customers of a particular region would not purchase the company's product, but the existence of the company in that region will be dependent on how the people perceive the product, the company's image or brand. For example, free sample products are offered by companies and they also organise and arrange press releases, media and seminars, and so on. Organisations also engage themselves in community development, environment and public service programs by developing sanitation units, etc. This helps the organisations acquire goodwill and gain the trust and faith of their customers as well as the general public including social groups, consumer protection activists, media, environmentalists, etc.
- **Employees:** An organisation can attain its objectives and goals with the help of skilled employees. This is because employees who are experienced and skilled possess the necessary expertise to assist the organisation in achieving success. Such employees are developed through timely and regular training and development programs and sessions. These programs and sessions help in attaining the goals and objectives of the organisation efficiently and effectively.
- **Shareholders:** Shareholders are not just investors who invest in the company. In a way, they are the actual owners of the company since they own the shares of the company. This implies that shareholders have a right to know about the activities and operations of the company. A return on investment will also be demanded

by the shareholders. Hence, it is the responsibility of the organisation to generate profits and distribute them among the shareholders. Wealth for the shareholders has to be created by the organisation. Regular and timely dividends will also have to be paid to maintain their interest. Therefore, the perfect balance between the benefits to the shareholders and the health of the company has to be determined by the organisation.

SELF ASSESSMENT QUESTIONS

1. Which of the following is an important constituent of micro business environment?
   a. Customers
   b. Employees
   c. Shareholders
   d. All of these
2. Which micro business element provides raw materials for the process of production?
   a. General public
   b. Suppliers
   c. Competitors
   d. Marketing intermediaries

3.3 MEANING OF ORGANISATIONAL APPRAISAL

Organisational appraisal or internal analysis is normally performed to resolve a problem or an issue within the organisation or to manage an emergency within the organisation. For example, poor maintenance of production machinery and equipment results in defects in the finished products. This problem can be solved with proper maintenance and servicing of the machinery and equipment. Analysis of internal business condition is also important for designing an appropriate strategy. Organisational appraisal is performed by the strategic decision makers in order to get a practical outlook of the company profile, which, in turn, provides a clear explanation of the strengths and weaknesses of the company.

3.3.1 ORGANISATIONAL APPRAISAL METHODS

Strategists should remember to select only those techniques that match the needs of organisation from every aspect during the process of analysing the environment. Among the several methods for organisational appraisal, some of the important methods are given as follows:

- **Value chain analysis:** Under the resource analysis or value chain approach, physical quantities are transformed into monetary units. This analysis is performed in order to evaluate the amount of resources that are utilised for the economic objective and have emerged from various likely actions. It is the resource analyst's responsibility to evaluate not only the economic cost, but also ensure that the manpower and resources utilised are important for the process and are needed at that particular period of time. Besides this, resource analysis is also helpful in assessing the strengths and weaknesses of the organisation. This assists the organisation to devise strategies for enhancing its strengths and overcome its weaknesses.

All business processes are a combination of several allied activities starting from the inception of a concept of product to sales and service associated with the product offering. At every stage of this chain of activities, a value is added to the offering of the company, making it better than earlier stages. This chain of activities is known as 'value chain'. Value chain is a related series of activities which creates or adds value to the organisation. Basically, a company's value chain consists of two major processes known as primary activities and the relevant support or secondary activities. The primary activities are those activities which emphasise on generating values for its customers and the relevant support activities help and improve the performance of primary activities.

- **Balanced scorecard:** Balanced scorecard was introduced by **Robert Kaplan** and **David Norton** in the early 19^{th} century as a method of evaluating the performance. It helps assess the performance of the organisation from various viewpoints. The reason behind such views is that managers are greatly identifying the need of assessing other aspects of organisational performance for measuring their value-creating activities. Lately, the balanced scorecard has adopted a new approach. According to this approach, it is a broad mechanism of evaluating the performance which provides a balance between non-conventional operational methods and financial methods. In the last few years, balance scorecard has managed to establish itself as the best approach for strategic control. It serves as a basis for the firms to validate the financial and strategic controls, they have launched for their performance evaluation. It is regarded the most appropriate for business-level strategies and is also applicable to corporate-level strategies.
- **Historical analysis:** Historical analysis assists in removing several issues associated with the rules of the industry as it examines the ratio and changes brought in the organisation over a time period (in case there is an absence of chief strategic shift in the industry and the organisation has not entered into a new industry). It helps in resolving the issues related to ratio calculation in several ways. The drawback involved in computing the historical ratio is that there is no external validation. For example, a company might have kept its account receivable collection period to 90 days for many years and has considered it as suitable, if there is no external validation that other organisations have boosted it up to a period of thirty days. Historical analysis offers a way to compare the firm's performance and assists in identifying its strengths and weaknesses over the years. It serves as an important tool to study the rise or fall in the organisation's performance, depending on its earlier performance records. It is a standard presentation of the balance sheet involved in designing the description about profit and loss in the organisation's annual report. Those areas which have regularly shown progress depict the strengths and vice versa. It is possible to correctly evaluate the constant progress in the firm with the help of historical analysis.
- **Benchmarking:** One of the biggest ways to identify the assets and competencies of the organisation is to compare it with the current or present (or potential) rivals

and competitors. Various organisations existing in the similar industry generally have diverse marketing skills, integrity, managerial ability, brand images, technical expertise, operating sites and services, financial assets, etc. These different and diverse internal resources can become the relative strengths (or weaknesses) of the organisation depending upon the strategy that it chooses. While choosing a strategy, managers need to emphasise on comparing the important internal resources of the organisation with that of the rivals or competitors, thus segregating its own major strengths and weaknesses. Benchmarking is the process which encompasses comparing the performance standards and business processes of an organisation with those which are the best practices in the same industry or are the best standards in other industries. Generally, aspects which are evaluated are cost, quality and time. With the help of the benchmarking process, the organisation is able to recognise the best performing organisations in the same industry, or those with the similar procedures in the other industries; and can compare their (target firm) outcomes and processes with that of its own. Thus, this allows them to determine the reasons behind the good performance of the target firms and major secrets behind their success.

- **Key factor rating:** Key factor rating is performed on the basis of carefully studying the important factors which might influence the performance (marketing, financial, operations and human resource capabilities) and assessing on the whole competence of the organisation on the basis of the data gathered. The important factors which influence the organisation's functioning are taken into consideration under this method. A number of discussions, sequential meetings and surveys assist in collecting information about the important factors. With a perspective to rate the important factors, answers to questions in all the areas of function are examined carefully. Mathematical models are utilised to study the relative effect of all the factors (conducive or not conducive) on a particular result. Some of the basic questions which a strategist can utilise as a guide are related with the vital elements of the internal environment. The information which was gathered by the key factor rating can assist the strategist to draw brief estimation and conclusion about the situation of the internal environment of the organisation.

- **Industry standards:** Industry standards are popularly accepted to calculate the value of the financial ratios of the organisation, yet sometimes they might be misleading. Normally, several matters are taken into consideration while making use of industry standards. Firstly, the organisation which is being analysed is, in reality, the actual member of the industry for which the standards are devised. For example, a lot of work has been done to formulate the industrial standards for the educational institutions, yet in the category of educational institutions, there are several sub-categories, like private, government, medical, rural, urban, engineering, aided, etc. For example, for the purpose of offering grants/aids or regulation, there is a possibility that the standards of one institute are different from that of another institute. As the information offered usually by the publication is the major source of industrial standards, it is very significant to utilise that ratio for the industry which is being analysed and industrial standards are computed in somewhat similar ways. Some ratios are computed by only a single method without any issue, while others can be computed by various legitimate methods, which might result in certain variations in the outcomes.

3.3.2 SOURCES OF INFORMATION COLLECTION FOR ORGANISATIONAL APPRAISAL

The information sources for organisational appraisal can be in written format or verbal. The collection of sources depends on the firm's information capability. Sources of information may be classified as internal or external. Internal data is collected from within the organisation to make decisions for effective operations and processes. This information is crucial to find out whether the strategies that the organisation is presently following are effective or if changes or modifications should be made. The internal sources of information include:

- **Accounting resources:** A vast amount of internal information is offered by the accounting resources. A marketing researcher can make use of such information.
- **Sales force report:** Information pertaining to the sales of the product is offered by the sales force report.
- **Internal experts:** The heads of various departments of an organisation are the internal experts. These individuals can give insights regarding the way a particular task or an activity should be performed.
- **Miscellaneous reports:** Operational reports offer such type of information.

The external sources of information are majorly required when a firm attempts to perform a comparative analysis.

These sources include:

- **Government publications:** A vast amount of information is provided by the government sources. However, many internet websites also contain such information. Data is generated by a variety of government agencies. They are:
  - **Registrar General of India:** Demographic data is generated by this government body. Data covers details regarding gender, age, income, occupation, and so on.
  - **Central Statistical Organisation:** Statistics regarding national accounts is published by this governmental body. It encompasses details like growth rate, national income, and so on. The annual survey of industries is also published by this organisation.
  - **Director General of Commercial Intelligence:** The operations of this office are carried out from Kolkata. Information pertaining to exports and imports, i.e., foreign trade is offered by this body.
  - **Ministry of Commerce and Industries:** Information regarding wholesale price index is offered by this ministry. It operates through the office of economic advisor. The statistics offered by this body pertains to various sectors, such as food, fuel, power, etc. All India Consumer Price Index is also offered by this ministry.
  - **Planning Commission:** The basic statistics about the Indian economy is offered by the commission.
  - **Reserve Bank of India:** Data regarding savings and investments is offered by the RBI. Various financial reports and currency are also furnished by RBI.

- **Labour Bureau:** Data regarding employment and jobs is offered by this bureau.
- **National Sample Survey:** Ministry of Planning carries out the National Sample Survey. Through this survey, statistics regarding demographics, agriculture, economy, society, etc., is acquired.
- **Department of Economic Affairs:** Data pertaining to income, consumption, expenses, investments and foreign trade is provided by this department.
- **State Statistical Abstract:** Data regarding activities of state like education, occupation, etc., is offered by this body.

❍ **Non-government publications:** Publications of various trade and industry associations come under this body. It includes:
- Various mills, such as textile mills, woollen mills, etc.
- Small Industries Development Board of India
- Confederation of Indian Industry (CII)
- Export Promotion Council
- Several press media associations
- Several chambers of commerce
- The Indian Cotton Mill Association
- The Bombay Stock Exchange

❍ **Syndicate services:** Some organisations offer these services. Such organisations collect and tabulate information regarding marketing on a regular basis. They do so for their clients who are subscribers for such syndicate services. Therefore, the information which is appropriate for the subscriber is offered under the syndicate services. Information regarding households as well as institutions is offered under such services. Three techniques of data collection are utilised for collecting data from households, viz., survey, electronic scanner services and mail diary panel.

3.3.3 INFORMATIONAL APPRAISAL APPROACHES

Various approaches regarding organisational appraisal are given as follows:

❍ **Systematic approach:** Under the systematic approach, information regarding organisational appraisal is gathered in a systematic manner. A wide variety of information pertaining to policy statements of the government regarding the firm's industry and business, target customers and markets, amendments in regulations and laws which influence the activities of the firm directly can be easily gathered. However, it becomes essential to regularly update such information for operational tasks as well as strategic management.

❍ **Ad hoc approach:** Under this approach, various special surveys, researches and studies can be carried out by an organisation for the purpose of handling the diverse issues of the environment every now and then. These researches and surveys can be carried out under occasions when the firm needs to take up any special project, formulate new strategies or measure the effectiveness of the current strategy.

Any alterations or unanticipated turn of events can be looked into regarding their influence on the firm.

- **Processed form approach:** Processed information, available from within and outside the firm, can be utilised by any firm if it wants to follow this approach. Information provided by several private agencies or government bodies is a form of processed secondary data which can also be used by firms and companies.

3.3.4 FACTORS AFFECTING ORGANISATIONAL APPRAISAL APPROACH

Organisational appraisal is affected by the following factors:

- **Ability of strategists:** This refers to the skill and expertise of the strategist to assess the influences and forces influencing the firm.
- **Organisational size:** Size of the organisation influences the quality of appraisal in the organisation. Smaller organisations are easier to analyse as compared to the larger ones.
- **Traits of internal environment:** This encompasses the characteristics of people, teams and organisational politics. The appraisal process may suffer if no co-ordination exists between the teams. Hence, at last, it can be said that appraisal of the organisation is essential for the organisation's growth.
- **Satisfaction with success:** At times, successful firms become satisfied with their success and are not able to improve their performance further and, hence, neglect the process of appraisal.
- **Lack of strategic planning:** Certain firms are not able to think in a strategic manner and, hence, fail to focus on important constituents of the external and internal environment. Planning is considered as a routine or regular activity in such firms. Every organisation should have an overall view of its complete environment and appraise it in an effective manner in order to identify the factors affecting it either in a negative or a positive manner.

SELF ASSESSMENT QUESTIONS

3. Which of the following is an internal information source for organisational appraisal?
   a. Government publications
   b. Syndicate services
   c. Salesforce reports
   d. Non-government publications
4. Which is an organisational appraisal method?
   a. Industry standards
   b. Balanced scorecard
   c. Benchmarking
   d. All of these

3.4 SUMMARY

- Micro environment refers to the factors which directly influence the performance of the company.
- Micro environment plays a very crucial role in identifying the true potential of the organisation and deciding its future course of actions and strategies.
- Components of micro business environment include customers, suppliers, competitors, marketing intermediaries, general public, employees and shareholders.
- Organisational appraisal or internal analysis is performed to obtain a practical view of the company profile, which, in turn, provides a clear description of the strengths and weaknesses of the firm.
- Some methods of organisational appraisal include benchmarking, key factor rating, balanced scorecard, industry standards, etc.
- Sources of information collection for organisation appraisal include internal as well as external sources of data.

3.5 KEY WORDS

- **Ad hoc approach:** An approach that is developed for a particular or single use. It is the exact opposite of a systematic approach which can be generalised and adopted in various scenarios.
- **Benchmarking:** A systematic process of comparison of the organisational processes and performances with those of the best organisations in the industry to create new standards or to improve processes.
- **Micro business environment:** An environment comprised of various micro factors that affect business strategy, decision making and performance of an organisation.
- **Value chain analysis:** A strategic tool used by organisations to evaluate their internal activities.

3.6 CASE STUDY: COCA-COLA'S MICRO ENVIRONMENT

The marketing department of Coca-Cola develops core strategies for company brands to make sure that all communication is consistent in all the markets. With a combined effort, the Coca-Cola system attempts to maximise its resources for profitable growth and market leadership. The marketing departments are responsible for product's advertisement, marketing and promotion. If all these departments perform their duty effectively, then the objectives of the Coca-Cola Company will be met. Coca-Cola agreed to swap some brands and buy a 17% stake in Monster Beverage Corp. for about $2.15 billion, increasing its bet on the rapid growth of the energy-drink market. Under the agreement, the two companies will share their production, marketing and distribution.

Marketing intermediaries aid the company in promoting, selling and distributing its goods to the end customers. Intermediaries encompass marketing agencies, distribution firms and resellers. For example, in a deal, Coke joined hands with a

US-based company Wendy that it will provide coke to all the fast food chains located in the US. In this case, Wendy is an important example of intermediary for coke.

Suppliers offer raw materials and resources that are required by the firms to produce goods and services. For example, bottling partners is a company-owned entity, namely Hindustan Coca Cola Beverages Ltd. Suppliers always play a crucial role in the operations of every firm.

Customers of coke differ massively in terms of age. From kids to youngsters, youngsters to elders and elders to older people, coke has always captured high customer attention for decades. For example, with the help of market survey, Coke finds that one million US population drinks coke with breakfast every single day. This is how coke has been favourite drink of customers for centuries. Recent survey shows that coke is the only product in the world of which more than 85% of the population is well aware. All companies have to keep updated study of their customers. In case of coke, the company has always maintained excellent customer retention.

Coca Cola's annual Stakeholder Panel is particularly insightful with members of the Panel drawn from NGOs, academia, investors, trade associations, suppliers and other technical experts. The Panel's scope is to identify emerging risks and opportunities, and to encourage company demonstrate ever-greater leadership and innovation.

Source: *https://www.slideshare.net/TannuBhatnagar/marketing-management-38228513*

QUESTIONS

1. What are the micro business environment components of Cola-Cola as in the case mentioned above?

   (**Hint:** Marketing intermediaries, suppliers, customers, stakeholders.)

2. How has Coca-Cola maintained its customer base?

   (**Hint:** Coke finds through market survey that one million of the US population drinks coke with breakfast everyday. This is how coke has been a favourite drink of customers for centuries.)

3.7 EXERCISE

1. Write a detailed note on micro business environment and its significance.
2. What are the various constituents of micro business environment?
3. What do you mean by organisational appraisal? Also state various organisational appraisal approaches.
4. Explain the factors affecting organisational appraisal.
5. Discuss various methods of organisational appraisal in detail.
6. Give a description on the sources of information collection for organisational appraisal.

7. Write short notes on the following terms:
   i. Value chain analysis
   ii. Benchmarking
   iii. Balanced scorecard
   iv. Key factor rating
   v. Processed form approach
   vi. Ad hoc approach
   vii. Systematic approach
   viii. Syndicate services

3.8 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Concept of Micro Business Environment	1.	d. All of these
	2.	b. Suppliers
Meaning of Organisational Appraisal	3.	c. Salesforce reports
	4.	d. All of these

3.9 SUGGESTED BOOKS AND E-REFERENCES

SUGGESTED BOOKS

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CHAPTER 4

Macro Business Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe the concept of macro business environment
- Explain the significance of macro business environment
- Identify the constituents of macro business environment
- Identify the factors affecting the macro business environment

4.1 INTRODUCTION

In the previous chapter, you had studied the concept of the micro business environment. Its important constituents include employees, customers, markets, etc. You had also studied various methods of organisational appraisal and their importance.

Macro business environment consists of those factors which are beyond control. Some examples include the September 11 terrorist attacks, financial crisis in 2008-2009, the EU sovereign debt crisis of 2009-2011, and US-China trade war and the Brexit impact of 2019. The unpredictability of these factors makes them more threatening to businesses. These factors also trigger a chain of uncontrollable events which accentuate the damage. For example, concerned about the loss of manufacturing jobs, the Trump administration increased duties for the goods imported from China. This invoked a tit-for-tat response from China as it increased duties on US goods, particularly on politically impacting agricultural products. Positive impacts of the macro business environment also occur in the same manner. For example, as crude oil prices drop, the average consumer in India starts spending more on retail products due to more cash savings. The increased consumer spending on retail outlets increases demand for other consumer products.

In this chapter, you will study about the concept of macro business environment, its significance, constituents, as well as impacting factors.

4.2 CONCEPT OF MACRO BUSINESS ENVIRONMENT

All organisations, whether big or small, are part of the business environment. The business environment surrounds them and forms the context in which they have to operate. Two major types of business environments are given as follows:

- **Macro business environment:** This is the general environment that affects the operations of all the business entities that operate in an economy. It affects its business enterprises indirectly and distantly.
- **Micro business environment:** This is the immediate environment in which a particular organisation operates. Thus, it only affects that organisation directly and regularly.

4.2.1 SIGNIFICANCE OF MACRO BUSINESS ENVIRONMENT

No business organisation functions in a vacuum. It makes decisions within an environment of customers, competitors, suppliers, distributors, political factors, social framework and legislation. Managers can easily control some of these environmental factors, whereas others cannot be controlled. Therefore, they must accommodate these uncontrollable factors in their decision-making process.

Significance of Macro Business Environment on Family Businesses in India

In 1947, when India became independent, almost all private businesses were family-owned. Some business houses, such as the Tatas, the Birlas, the Mafatlals and the Walchands were major players. Post independence, the Indian economy observed significant developments and changes in the macro business environment, including high tariff rates, import restriction, foreign exchange regulation, creation of public sector monopolies, and nationalisation of banking and insurance sectors. Despite these restrictions and regulations, family-owned businesses in India continued to retain a majority control on the private business sector.

In 1990, the government was compelled to liberalise the Indian economy due to the balance of payments crisis. A large scale of economic reforms transformed the structure, operations, investment and competitiveness of businesses in India. Several sectors, which were reserved for public entities, opened up for private players. These included telecommunication, power generation and distribution, mining, and airlines. The rules and norms for the entry of foreign multinational companies to set up businesses in India were relaxed. This resulted in growth in the Indian economy. In 10 years, the GDP growth rate increased from 5.6% (in 1990) to 7.4% (in 2000) as shown in Table 1:

Table 1: India's GDP Growth Rate from 1990 to 2015 (%)

	1950-80	1981-90	1991-2000	2001-10	2011-15
GDP growth	3.5	5.6	6.2	7.4	6.7

Source: *1950-2000: Das, Gurucharan. [2007]. "India: How a rich nation become poor and will be rich again", https://grucharandas.org/rich-nation-poor, accessed on April 10, 2017; 2001-2015: Data Source- World Development Indicators, http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?contextural=default&end=2015&locations=IN&start=1961&view=chart,accessed on April 10, 2017, averages calculated by the authors.*

While business houses, such as Tatas, Birlas, Ambanis (Reliance), Bajajs and Mahindras were able to reinvent themselves, other major players, such as Thapars, Mafatlals, Shrirams (DCM) and Shahs (Mukund) sank. New business houses, such as Adanis, Dr. Reddy's, Mittals (Bharti) and Shangvis (Sun Pharma) emerged.

30 years after liberalisation, many business houses are newly facing existential crisis in the digital economy.

4.2.2 CONSTITUENTS OF MACRO BUSINESS ENVIRONMENT

The macro environment consists of political, economic, socio-cultural, technological, legal and environmental factors. These factors can be easily remembered as PESTLE. Let us discuss these factors in detail:

- **Political and legal environment:** All business organisations are affected by the political forces shaping the country. These forces determine the laws and regulations within which businesses have to operate. Therefore, managers must

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analyse the major political and legal forces influencing their market, organisation and industry. Some examples of political forces are:

- **Patent legislation:** Intellectual property, patent and copyright laws have significant influence in high-tech industries and pharmaceuticals. Governments establish the rules about what may or may not be patented. The patent (and copyright) laws are often a matter of high-profile litigation and settlement.
- **Taxation:** Governments impose general tax as well as selective tax on companies' specific products to manage demand and raise revenue. For example, many state governments in India have a high tax on tobacco and liquors.
- **Safety regulations:** Governments expect products to confirm to specified safety regulations.
- **Labour law:** Governments set and change labour laws after ratification from the Parliament. Different countries have different labour laws. In India, the labour laws are quite restrictive, whereas the US has relaxed labour laws.
- **Consumer protection law:** Governments enact laws to protect consumers. For example, the government introduced the Real Estate Regulatory Authority (RERA) Act in 2013 to protect home-buyers and boost investments in the real estate sector.
- **Bankruptcy law:** In 2016, the Indian government introduced the Insolvency and Bankruptcy Code (IBC) to create a single law for insolvency and bankruptcy of businesses. Since then, there has been a significant rise of cases in the IBC Code.

A change in the central or local government can make substantial changes in the law policy. For example, left-wing governments in India [such as coalition governments formed with the support of Communist Party of India (CPI) or Communist Party of India (Marxist) (CPI (M))] traditionally increase the number of laws and regulations on businesses, whereas the right-wing governments (such as those formed by or in coalition with the Bharatiya Janata Party (BJP) tend to reduce restrictions on businesses. The laws are enforced by specialist bodies such as the Securities and Exchange Board of India (SEBI).

In India, laws are created through three sources:

- Legislation from the Parliament
- Laws decided by the Supreme Court based on the Constitution of India
- Local laws passed by the state governments

The Supreme Court makes laws when a law is unclear and the judges need to clarify matters by referring to other cases.

- **Economic environment:** Most economies follow a cycle of growth for 7-8 years followed by a recession of 7-8 years. Companies have to carefully scrutinise the economic environment particularly in periods of recession. In recession, consumers are likely to delay the purchase of major items due to employment insecurity. By the same token, business organisations reduce their capital expenditure on new factories or equipment. They will borrow less, as they are not confident about their ability to repay. All these factors will dampen the demand even further. In most cases, recession periods last for a few months to a year. However, in 2008, the mortgage sub-prime crisis created a worldwide recession in which many economies were able to recover only after about five years.

- **Socio-cultural environment:** This environment is made up of:
  - **Demographic forces:** These are the factors that determine the structure of a population, such as age, income distribution and ethnicity.
  - **Cultural forces:** These are the differences in beliefs, behaviours and customs among different people.
  - **Social responsibility and ethics:** These include the ethical beliefs of people as in how businesses should operate socially and ethically.
  - **Consumerism:** This is the tectonic shift from business organisations to consumers.

  Figure 1 illustrates the relationship between these factors:

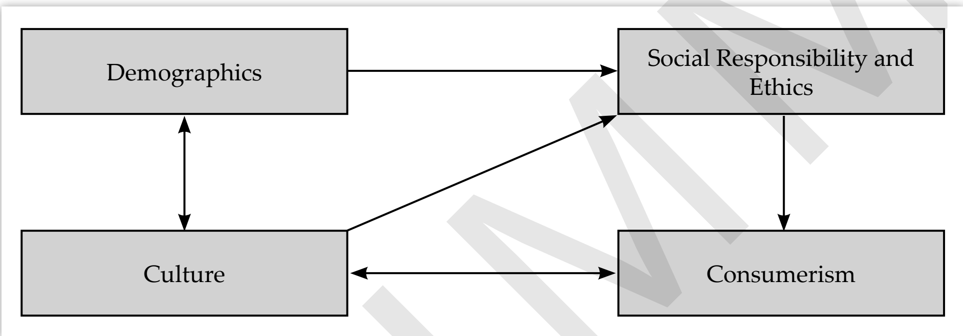

Figure 1: Socio-cultural Factors

Source: *https://uk.sagepub.com/sites/default/files/upm-binaries/58888_blythe_pandp_chapter_2_the_marketing_environment.pdf*

The socio-cultural environment determines the value system of a society. It includes factors such as:

- Purchase and consumption behaviour
- Ethical values and beliefs
- Literacy and education
- Consumer tastes and preferences
- Human relationships
- Language and norms in society
- Social customs and traditions
- Family structure
- Changing life style patterns

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All these factors have far-reaching impacts on organisations, as they determine the work culture, labour mobility, etc. Even when people of different cultures use the same product, their consumption behaviour, conditions of use, purpose or perception of the product may differ. Some examples of different cultural perceptions of the same product/message/item are given as follows:

- While Vicks Vaporub ointment is used for cold and pain in India, it is used as a mosquito repellent in some tropical countries.
- The slogan 'sticks like crazy' of 3Ms is translated as 'sticks foolishly' in Japanese.
- Blue is a feminine and warm colour in Holland, but masculine and cold in Sweden.
- Green is a preferred colour in the Muslim nations, but it represents illness in Malaysia.
- Red is a popular colour in Russia, but it represents disaster in Africa.
- White is the colour of death and mourning in China and Korea, but it is popularly used in bridal dress in the western countries, as it is a symbol of purity for them.

❍ **Technological environment:** To understand the impact of technological environment, read the story of Blackberry demise. The company went from owning 50% share of the smartphone market in 2007 to less than 1% in 2012. And, all this was because of its ignorance to the iPhone's mass appealing concepts, such as performance and ease of use. New technologies have a tremendous capacity to make and destroy businesses. Technological innovation is a pervasive factor that cannot be ignored. IT giants in India today are facing a severe reduction in profit margins because of artificial intelligence and automation. It has been predicted that in 20 years, thousands of jobs will cease to exist, as robots will be doing them. Business managers have to analyse technological developments and adapt their organisations accordingly. For example, robots may take over a lot of jobs today. However, there will also be new sorts of jobs that will be created for which skilled people will be needed.

❍ **Natural and global environment:** Ecological or natural forces, such as weather and climate, are relevant to business. For example, an umbrella might be a staple necessity in Mumbai, but it is not a requirement in the desert city of Dubai. The different types of marketing mix are prepared for different geographical conditions. For example, industries with high requirement of raw materials such as steel and cement plants are located near the raw material sources. Topological factors may also impact demand. For example, jeeps and sports utility vehicles (SUVs) are in greater demand in hilly areas than sedans or hatchbacks. Recently, environmental factors have assumed tremendous importance due to rising pollution, global warming and changing weather patterns.

The global environment refers to factors that are relevant to the internal business environment. These factors include:

- World Trade Organization (WTO) agreements
- International conventions

- Business treaties among countries
- International agreements
- Rise in oil prices

SELF ASSESSMENT QUESTIONS

1. The business environment can be divided into:
   a. National and local environment
   b. Macro and micro environment
   c. Financial and non-financial environment
   d. Domestic and international environment
2. Macro business environment is beyond the control of a business. (True/False)
3. The constituents of macro business environment are commonly known as __________.

4.3 FACTORS AFFECTING MACRO BUSINESS ENVIRONMENT

Although macro business environment trends are cyclic in nature, it is important to analyse them closely. Otherwise, businesses run the risk of finding themselves in the middle of a downward spiral caused due to an out-of-control factor. Therefore, managers should be aware of the global headwinds that may impact the economy of their country, workforce or industry, and take appropriate actions to adapt to them proactively.

Business environment of an organisation is managed by environment scanning. It is the process of collecting and using information about occasions, patterns, trends, and relationships within an organisation's micro and macro business environment. It helps to identify the threats and opportunities in the environment and formulate strategies accordingly. One approach of macro environment scanning is PESTLE analysis. There are various versions of PESTLE analysis. You can select any suitable version depending on your context. Some of the versions of PESTLE analysis are as follows:

- **PESTLE/PESTEL:** Analysis of political, economic, socio-cultural, technological, legal, environmental factors
- **PEST:** Analysis of political, economic, socio-cultural, and technological factors
- **PESTLIED:** Analysis of political, economic, socio-cultural, technological, legal, international, environmental, demographic factors
- **STEEPLE:** Analysis of social/demographic, technological, economic, environmental, political, legal and ethical factors
- **SLEPT:** Analysis of socio-cultural, legal, economic, political, technological factors

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- **LONGEPESTLE:** Local, national and global versions of PESTLE (most suitable for environment scanning in multinational organisations)
- **PESTELI:** PESTEL + Industry analysis

The result of PESTLE analysis is to evaluate the 'big picture' surrounding an organisation and the potential of new markets. Doing business in markets under the influence of negative forces becomes quite difficult. Figure 2 illustrates the process of conducting PESTLE analysis:

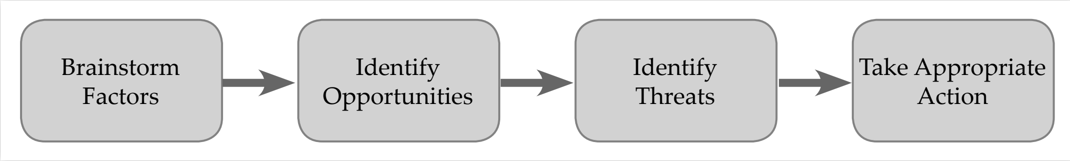

FIGURE 2: PESTLE Analysis

1. **Brainstorm factors:** Consider political, economic, socio-cultural, technological, legal and environment factors.

   a. **Political factors:**

   - ✓ When are the next national or state elections? How could their results change the government policy?
   - ✓ Who is tipped to win elections? What are their views on business policies or any other policies that impact your organisation/industry?
   - ✓ How much established are the property rights?
   - ✓ What is the level of corruption and/or organised crime? What are the political steps to counter them?
   - ✓ How will business regulation and planned changes impact your organisation?
   - ✓ Is the political parties' trend toward more regulation or deregulation?
   - ✓ How does the government approach corporate policy, corporate social responsibility (CSR), environment issues and consumer protection laws?

   b. **Economic factors:**

   - ✓ What is the state of the current economy? Is it stable? Is it growing or declining?
   - ✓ What is the status of key exchange rates? Are they stable or fluctuating?
   - ✓ Is the customers' level of disposable income increasing or decreasing? What will be the trend in the next few years?
   - ✓ What is the rate of unemployment? Will it be easy to create jobs? Will there be sufficient skilled manpower?
   - ✓ Do businesses and individuals have easy access to credit?
   - ✓ What is the cash flow situation of businesses?
   - ✓ What are the impacts of globalisation or free trade economy?

Figure 3 displays Porter's Diamond model which is a useful tool to align organisation's strategy to the economic environment of the country.

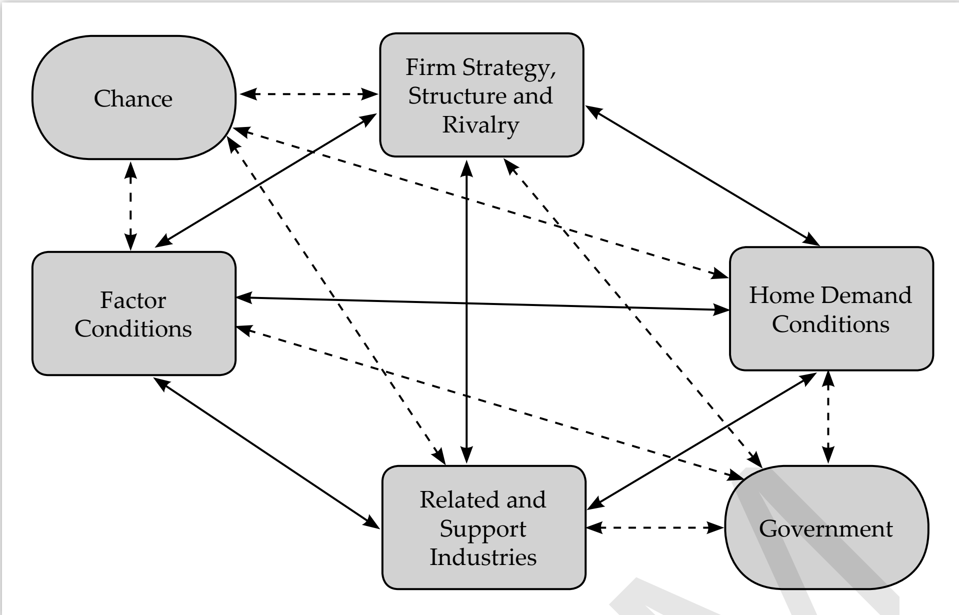

FIGURE 3: Porter's Diamond Model

Source: *https://www.toolshero.com/strategy/porter-diamond-model/*

Porter's Diamond model resembles a diamond. It offers a structure that can help a country to understand its competitive position internationally. Porter has introduced a new term called clusters, which are groups of interrelated organisations, suppliers, industries and institutions in a specific location. He suggested that the sustained competitive advantage of a country is an outcome of the following four inter-related factors and activities within these clusters:

1. **Firm strategy, structure and rivalry:** Direct competition compels companies to increase productivity and innovation.
2. **Home demand conditions:** The more the demand in an economy, the greater is the pressure for companies to innovate and improve competitiveness.
3. **Related and support industries:** When the upstream and/or downstream industries are located in close proximity of an organisation, it leads to an unobstructed exchange of ideas and innovation.
4. **Factor conditions:** Skilled labour, capital and infrastructure are the most important factors of production. If an organisation invests wisely in these factors of production, it leads to sustained competitive advantage.

c. **Socio-cultural factors:**

- ✓ What is the age profile and growth rate of the population?
- ✓ Will there be any generational shifts that may impact your business?
- ✓ What is the level of health, education and social mobility in the society? How are these levels changing?

- ✓ What are the job market trends? What is the attitude of the population towards work?
- ✓ What social attitudes and customs can impact your business?
- ✓ What are the religious beliefs and lifestyle choices of the population?

To understand values in a society, you can use the following tools:

- ✓ **Competing values framework:** Figure 4 shows a framework developed by Robert Quinn and Kim Cameron, is a useful tool to identify organisation's values.

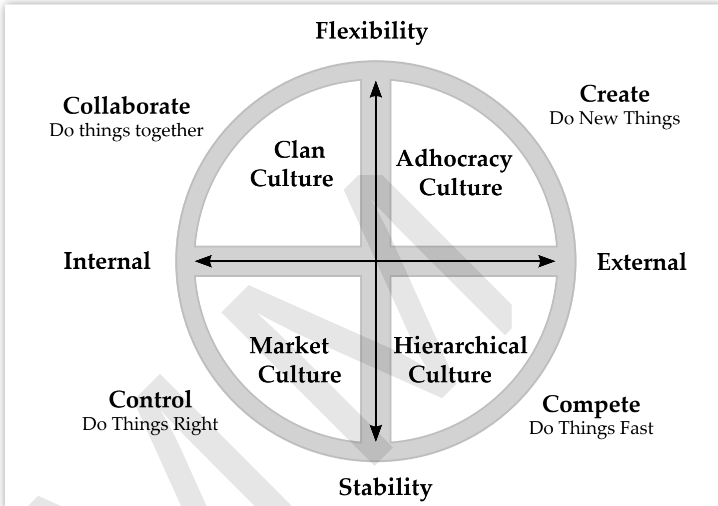

FIGURE 4: Competing Values Framework

Source: *https://www.toolshero.com/leadership/competing-values-framework/*

There are four corporate cultures given as follows:

- ♦ **Clan culture:** It is highly flexible and internally focussed. The company resembles a large family. The leaders are perceived as mentors or father figures. Loyalty, relationships and morality are valued. Most start-ups or family businesses follow this culture.
- ♦ **Hierarchical culture:** These are formal, structured, controlling and internally focussed organisations. Government agencies are a typical example. Employees follow procedures religiously. All work processes are efficiently organised to manage control systems. Formal rules and policies are followed. The hierarchy is maintained. The focus is on reliable supply, tight deadlines and low costs.
- ♦ **Market culture:** This culture focusses on results and achievement of objectives. It observes a high degree of control and is externally focussed. Competition and goal orientation are valued among employees. Examples of such organisations include banks and insurance companies. Outwardly, they profile themselves market leaders, but inside they are ruthless competitors.
- ♦ **Adhocracy culture:** These organisations focus on innovation. They are highly flexible and externally focussed. Marketing and advertising

agencies follow this culture. Employees are encouraged to achieve creative outcomes and are allowed considerable freedom to take risks.

- ✓ **Hofstede's cultural dimensions:** Hofstede proposed six dimensions to explain cultural differences among people:
  - ♦ **Power distance index (PDI):** This refers to the acceptable degree of inequality in a society. A high PDI means that people accept an unequal distribution of power, whereas a low PDI means that the power is shared in society. For example, Malaysia is a high PDI country where team members wait for the directions of their manager to start a task.
  - ♦ **Individualism vs. Collectivism:** In an individual society, people take less responsibility for other individual's actions. In a collectivist society, people are loyal to their communities, and the community, in turn, will defend their interests. For example, Panama is a collectivist society. Businesses that focus on benefits to the community are valued.
  - ♦ **Masculinity vs. Femininity:** In masculine societies, assertiveness and demonstration of success are valued. In feminine societies, modesty and good relationships are valued. For example, Japan is a highly masculine society where feelings of pride and ego are seen as status symbols. Money and achievement are valued over good relationships. On the other hand, Sweden is a feminine society, where there is more focus on the quality of life.
  - ♦ **Uncertainty avoidance index (UAI):** This refers to the ability of people to cope with anxiety. For example, Greece has a high UAI. People attempt to avoid uncertainty and try to make their life as predictable as possible. In Singapore (low UAI), people are more open to change or innovation.
  - ♦ **Long vs. Short-term orientation:** Countries with a long-term orientation are practical, modest and economical. Countries with short-term orientation focus on principles, consistency, truth and religion/ nationalism. For example, the US is a short-term orientation country, as people value short-term gains and quick results. They also have a strong sense of nationalism and social standards.
  - ♦ **Indulgence vs. Restraint:** Countries that are high on indulgence promote individual drives and emotions, such as having fun. Countries that exhibit restraint focus on suppressing immediate gratification and have strict social norms to regulate people's conduct and behaviour. For example, Russia has a restrained culture.

d. **Technological factors:**

- ✓ What are the new technologies that the business should be using?
- ✓ Are there potentially any technologies being developed that could severely impact the business or industry?
- ✓ Does any competitor(s) have access to new, path-breaking technologies?

- ✓ What are the focussed areas of research among governments and educational institutions? How can you leverage them?
- ✓ Does any technology require you to change infrastructure to adjust work patterns?
- ✓ Can you leverage any existing technological hubs?

e. **Legislative factors:**

- ✓ What are the employment laws in the country (such as minimum wage, benefits, etc.)?
- ✓ What are the health and safety regulations that must be considered?
- ✓ What are the environmental regulation laws of the land?
- ✓ What data laws and copyright protection laws concern your business?

f. **Environmental factors:**

- ✓ What sustainable environmental practices are applicable?
- ✓ What is the status of ethical sourcing in the land? How can you adopt it for your business?
- ✓ How can you reduce your carbon footprint in the business?
- ✓ What data handling and user privacy practices can you incorporate in the business?

2. **Identify opportunities:** After identifying the relevant macro environment factors, identify the opportunities that these factors could open up for you. For example, you can analyse whether any of these factors enable you to develop new products or enter new markets or make processes more efficient.
3. **Identify threats:** You should also analyse which of these factors pose any threats. This will help you to forecast changes that could disrupt your business. For example, if a core customer base of your business is aging, then you should analyse whether you can open up to other demographics. If your product is under threat due to new technology on the horizon, then you can evaluate how you can leverage that technology to improve your product.
4. **Take action:** Finally, take suitable actions to exploit opportunities in your business plan, and manage or remove risks.

Self Assessment Questions

4. Which of the following is not a political factor impacting the macro business environment?

   a. Change in the central government

   b. Civil unrest

   c. Threat of war

   d. Cost of production

5. Which of the following elements is not a part of Porter's Diamond Model?
   a. Factor conditions
   b. Firm strategy, structure and rivalry
   c. Home demand conditions
   d. Government

4.4 SUMMARY

- All organisations are part of the business environment.
- The business environment consists of a macro business environment and a micro business environment.
- Macro business environment is the general environment that affects the operations of all business entities in an economy. It cannot be controlled.
- Micro business environment is the immediate, specific environment in which an organisation operates. It can be controlled.
- The macro business environment consists of the political, economic, socio-cultural, technological, legal and natural environments.
- Business environment of an organisation is managed by environment scanning. It is the process of collecting and using information about occasions, patterns, trends and relationships within an organisation's micro and macro business environment.
- PESTLE analysis is used for macro environment scanning. It identifies the potential opportunities and threats arising from factors affecting the macro business environment.

4.5 KEY WORDS

- **Gross Domestic Product:** The value of all the goods and services produced in a country within a specific period of time.
- **Patent:** A government authority/license bestowing a right/title for a specified period.
- **Ethics:** Moral principles of an individual that suggest the concept of right and wrong.

4.6 CASE STUDY: APPLE PESTLE ANALYSIS

Apple is one of the world's most recognisable and prominent brands. Founded by Steve Jobs and Steve Wozniak, the company has introduced revolutionary products in personal computing and smartphones. Today, it is the world's largest mobile phone manufacturer with 1,23,000 employees (in 2017), with a revenue of $215.49 billion (as of 2018). The company's CEO is Timothy Donald 'Tim' Cook. Its main competitors are Samsung, Google, Cisco, HP and Lenovo. The main products of the company are iPhone, iPod, iPad, Mac, Apple TV and iOS applications.

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This case study conducts the PESTLE analysis to reveal the macro business environment factors that affect the company externally. The data is collected from various published sources and from Apple's case studies.

PESTLE Analysis of Apple

Political Factors

The larger revenue share of the company is from outside the US ($113.8 billion) as compared to within the US ($68.8 billion). Thus, the company's position is highly vulnerable to any political disturbance in these countries. Some political disturbances which affected Apple's business are as follows:

- **Suicide cases against Foxconn:** Foxconn, a Taiwanese company, is a major supplier of Apple. In May 2010, the company was held responsible for the suicide of two employees. Lawsuits were filed against the company for forcing employees to work for long hours. In another case, 16 workers were injured in an explosion in a supplier's facility.
- **Political turbulence in China:** Apple highly depends on the cheap labour of China. However, the political unrest in China, which erupts from time to time, may disrupt its manufacturing facilities.
- **Higher tariffs on China:** The Trump administration has imposed tariffs of $250 billion on Chinese goods. China responded by imposing a tariff of $110 billion on US goods. Although no tariffs are imposed on iPhones, there is a cause to worry as China may retaliate in ways that could harm Apple. The growing nationalism in China can also lead to reduced market share for its products in China.

Economic Factors

Due to its premium pricing policies, Apple is more vulnerable to recession and other economic crises. Some economic crises which affected Apple's growth are as follows:

- **Global recession:** Apple had a slow growth in 2013-14 due to the global recession, as shown in the following table A:

TABLE A: Decrease in Sales Growth Due to Global Recession

Country	2011-12	2012-13
US	50%	9%
Europe	31%	4%
China	78%	13%

- **Europe's economic troubles:** Europe's declining economy decreased revenue of Apple by 16% in 2012 (3rd quarter), as compared to 2011 Q3.
- **Inflation in the US:** Apple is particularly vulnerable to the rising inflation in the US, as it has large cash reserves.
- **Rising labour cost:** The rising labour cost in China is bad news for the company.
- **Strong Dollar**: The exchange rates are increasing due to increase in the value of the US dollar. The increased exchange rates impact Apple products, as the increased

difference between the US $ and other currencies (e.g., Euro and Yuan) will make it more expensive for Apple to do business in Europe and China.

Socio-cultural Factors

Some of the socio-cultural factors which might affect Apple's operations are as follows:

- **High-status lifestyle:** Apple products are regarded as symbols of social status due to their premium prices.
- **Increased consumer spending in third-world countries:** In the coming years, Apple is likely to witness a growing market for its products in Africa and other third world countries.
- **Ethical concerns of manufacturing in China:** Some critics have pointed out the moral obligation of Apple to create job opportunities in the US as against manufacturing in China.
- **Brand acquisition:** To fulfil its customer's needs, Apple has made some major acquisitions and alliances with Sony, Motorola, Phillips and AT&T. The social background of these brands affects Apple's operations.
- **Increased usage of smartphones:** The increasing popularity of mobile devices and social media will increase the demand for Apple devices.

Technological Factors

Apple has reinvented itself with time and thus, has the potential to keep growing as a major technology company. Some of the technological changes which Apple made in order to increase its business are as follows:

- **Advantage of 760 China Mobile Subscribers:** In 2013, Apple disclosed a deal with China Mobile to introduce iPhone to the Chinese market, which was dominated by low-cost Android smartphones. This deal gave Apple advantage to enter China in a major way through China Mobile's 760 subscribers. Under this deal, iPhone 5 and iPhone 5S were available at China Mobile and Apple retail stores in China.
- **Evaluating customers:** In 2015, Apple reportedly spent $8.07 billion for R&D (3% of the company's net revenues) to evaluate the customer's mindset.
- **Preferences to screen size:** Apple has realised that its customers prefer larger screens and thus, has unveiled gradually larger size versions in iPhone 6, iPhone 7, iPhone 8 and iPhone X.
- **Competition:** Apple's competitors, Samsung and Google, are also offering similar products and services as Apple. Google took less than a year to build the payment app Google Pay just as Apple Pay. Thus, their ability to replicate Apple's products has considerably increased the risk for Apple brand.
- **Limited market:** Apple has limited markets and restricted customer bases where it can launch its new products.
- **Cybercrimes:** The increasing number of cyber threats and crimes has made Apple systems vulnerable and less secure for consumers. The damaged reputation makes the brand more vulnerable.

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Legal Factors

Apple is vulnerable to several legal factors as follows:

- **Domestic legal problems:** In the US, Apple is grappling with bans on imports for its products.
- **Apple Pay:** With Apple Pay, Apple entered the highly regulated financial sector. As a result, the company could face a potentially high level of litigation.
- **Breach of IP laws:** Apple's brands are covered by intellectual property (IP) laws. Its products and services are vulnerable to piracy and litigation.
- **Entry into the automobile sector:** Apple has invested $6.04 billion for R&D on the manufacturing of electric vehicles. However, the company is facing tremendous pressure to return the money to its shareholders. A lawsuit has also been filed. Thus, Tim Cook has announced that the company will start production of electric vehicles by 2020.

Environmental Factors

Apple's revenues can be impacted by various environmental factors as follows:

- **Disposal of used/non-working electronic devices:** Discarding of junk devices has become a massive problem for Apple, as the effective disposal of lithium batteries is a costly venture. Otherwise, it is a major environmental issue.
- **Pollution in China:** The pollution and environmental side effects in Apple's factories in China have raised environmental concerns. To minimise the environmental issues, Apple has to pay a large amount of money.
- **Greenhouse effect:** China's initiative to reduce greenhouse gases and limit fossil fuels could potentially increase the manufacturing costs for Apple.
- **Global warming:** Due to an increase in global warming, Apple might face the issues in trans-oceanic shipping.
- **Rising electricity costs:** Apple's vulnerability to rising electricity costs due to high reliance on data centres and other Internet infrastructure are also a risk.

Results

Opportunities: The PESTLE analysis identifies various business growth opportunities for Apple. It is recommended that Apple is increasing its market penetration in Africa and other developing countries, which would help it to meet the threat of its low-priced rivals. Apart from China, Apple should look for other facilities where it can gradually shift its manufacturing base. Also, Apple could offer more variety of product base and services. Apple should also strategically plan to lower its carbon footprint and emissions, and continue to strengthen its brand value.

Threats: The PESTLE analysis has also revealed the various threats to Apple. A recommendation is for the company to calmly ride out the US-China trade war by adopting a neutral stance on the conflict. It should take steps to ensure that its suppliers follow the norms of health and safety and workers' concerns. It should improvise its processes and technologies to lower manufacturing cost, so that it can increasingly offer second-hand/used devices for developing nations at competitive prices. It should also take steps to prevent the rising threat of cybercrime.

Conclusion

On the basis of PESTLE analysis, it has been forecasted that Apple would dominate the electronic device industry in the next 5 years. This is mainly attributed to the company's impressive ability to adapt to a challenging environment. Its innovative products continue to give the company a competitive advantage.

Source: *https://myassignmenthelp.com/case-study/apple-swot-&-pestle-analysis.html*

QUESTIONS

1. What political factors affected Apple?

   (**Hint:** Suicide cases against the supplier in Taiwan, political unrest in China, US-China trade war.)

2. What socio-cultural factors impacted Apple?

   (**Hint:** High aspiration lifestyles, rising disposable income in the developing countries, ethical concerns, the social background of acquired companies, increased usage of smartphones.)

4.7 EXERCISE

1. What is the macro business environment? Why is it important to a business?
2. What are the constituents of a macro business environment?
3. What factors impact the macro business environment? Illustrate with an example.
4. Briefly describe Porter's Diamond model and Hofstede's cultural dimensions.

4.8 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Concept of Macro Business Environment	1.	b. Macro and micro environment
	2.	True
	3.	PESTLE (Political, Economic, Socio-cultural, Technological, Legal and Environmental)
Factors Affecting Macro Business Environment	4.	d. Cost of production
	5.	d. Government

4.9 SUGGESTED BOOKS AND E-REFERENCES

SUGGESTED BOOKS

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CHAPTER 5

Political Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Discuss the political environment of India
- Describe the environmental perspective of the public sector
- Explain the importance and role of government in the private sector
- Discuss the public sector reforms and performance

5.1 INTRODUCTION

In the previous chapter, you studied about the concept of the macro business environment, its significance and constituents. The chapter also discussed the factors which affect the macro business environment.

Business units are affected by the political environment through various means. Thus, it is essential to have a stable political environment for the growth of the business. Political stability, relation with other countries, Centre-State relations, the views of the opposition parties, etc. are the major elements of the political environment. Therefore, the stability and efficiency of political environment lead to business growth. Long-term plans are difficult to formulate while there is lack of proper political environment. Also, the business is drastically affected by the unstable government. Likewise, business is also influenced by the relations of the government with other countries. Friendly relations with other countries provide a favourable environment for foreign trade.

In this chapter, you will study about the political environment of India and the environmental perspective of the public sector. You will also study the intervention of government in the private sector. The reforms and performance of the public sector have been described at the end of this chapter.

5.2 POLITICAL ENVIRONMENT OF INDIA

A political system, including kingship, democratic, socialist, etc., as well as political openness to the market forces is referred to as political environment of a country. Business activities in a country are widely affected by its political environment.

The Directive Principles of the State Policy and Fundamental Rights as per the provisions of the Constitution of India and execution of those provisions by the state machinery have a significant effect on the business environment. The government is also mutually working with several private firms and various multilateral companies in order to attain this objective.

There are some major elements of the political environment with respect to business, namely Political System, Political Processes, Stability of Political Structure and Centre-State Relations. Now, let us discuss briefly the above-mentioned elements of the political environment:

- **Political System:** The Constitution of India governs the Indian political system. It was stimulated by Pandit Jawaharlal Nehru on 9 December, 1946 and was later implemented by the Constituent Assembly in January 1947. It came into existence on 26th January 1950. The Constitution of India is not the creation of political revolution, but the study of the prominent people who made an exertion to mend upon the prevailing system.

The head of the Indian Union is President of India and has to perform an act in accordance with the advice of the council of ministers and the Prime Minister of India.

Parliament is the supreme legislative body of the Indian Union. It consists of two houses:

a. **Lok Sabha:** It is also known as House of People, and members of Lok Sabha are elected by direct election for a time period of maximum five years.

b. **Rajya Sabha:** It is also known as Council of States, and members of Rajya Sabha are indirectly chosen. The elected members of legislative assemblies of state are the members of Rajya Sabha.

The president of India also nominates some members, and one-third members retire every year.

States have:

a. Legislative assemblies or Vidhan Sabha.

b. Legislative councils or Vidhan Parishad (not all states have Vidhan Parishad).

Union Territories have Administrators who are directly appointed by the President whereas local Government in urban areas has elected municipal bodies.

- **Political Processes:** The creation and functioning of political parties at national and state levels are governed by Election Commission of India which is an independent authority. Election Commission has the right to register political parties. Further, the state or government cannot prefer only one religion as against others. In the 42^{nd} Constitutional Amendment, the term 'Secular' was added in the Preamble to the Constitution in 1976, which means giving equal reassurance to all religions.

  Moreover, during elections, the issues which are of personal benefit are focussed more by the national leaders and occasionally takes up issues, such as alleviation of poverty, rural upliftment, problems of backward classes, etc. It is important to focus on problems of the constituency of leaders during the election campaign. This has led to no individual party having a clear majority which not only leads to instability in politics, but also impacts the growth of the business as well as the nation.

- **Stability of the Political Structure:** It is necessary to have a balance between executive, legislation and judiciary in order to achieve a stable political structure. In India, executive power at centre and state lees with ministries, departments, secretariats and offices. The President appoints Comptroller and Auditor General (CAG). CAG is responsible to report on account of Union and States to the President and respective Governors.

  Moreover, local leadership sometimes leads to political instability as an outcome of their ulterior interests.

- **Centre-State Relations:** A threefold distribution of power, namely Union List, State List and Concurrent List is provided by the Constitution of India to evade conflict between Union and federating states. Policy-making on the subjects mentioned in Union List lies with only Central government whereas policy making on the subjects mentioned in the State list is the responsibility of only state government. But policy-making on subjects mentioned in Concurrent List lies with both centre and state governments. The President's rule can be imposed under Article 356 which also provides for the dissolution of state assembly in the situation of failure of constitutional machinery in the states.

  The Constitution also specifies Centre-State relations with respect to:

  - Distribution of financial powers between the Centre and states
  - Mechanism of resource transfer from the Centre to states

SELF ASSESSMENT QUESTIONS

1. The Parliament of India consists of ___________ and ______________.
2. The power of making policies under ____________ lies with both the Central and state governments.

5.3 DIFFERENT ECONOMIC SYSTEMS AND THE ROLE OF THE GOVERNMENT

Due to the failure of the free market mechanism, the intervention of government became indispensable for the growth of an economy. Now, the question arises of determining the extent of government intervention in regulating and managing economic activities. This remains a debatable issue among various economists. This is because of the reason that the government intervention is also not able to eradicate the economic problems of a nation completely. Different economists have given different viewpoints for the role of the government in an economy.

According to Colin Clark, *"the role of government must be held at a ceiling of 25 percent of the national income."*

According to Samuelson, *"there are no rules concerning the proper role of government that can be established by a priori reasoning."*

From the aforementioned viewpoints, it can be concluded that the accurate and exact percentage or amount of government intervention in an economy is hard to decide and calls for an issue of collective social choice. The extent of the role of government differs in different economies. An economic system is a way through which economic resources are owned and distributed. On the basis of the ownership and distribution of resources, the economic system can be grouped into three categories namely capitalist economy, socialist economy and mixed economy.

A **capitalist economy** refers to an economy that works on the principle of the free market mechanism. It is also termed as laissez faire system. In a capitalist economy, the role of government is very limited. The main functions of government, as given by Adam Smith, are to maintain law and order in a country, make national defense stronger, and regulate the money supply. According to Smith, the market system administers various economic functions. However, over a period of time, the functions of government in an economy have increased. In a capitalist economy, the main responsibilities performed by the government are as follows:

- Developing and sustaining the free market mechanism system
- Eliminating any kind of restrictions on the working of a free competitive market
- Increasing the effectiveness of the free competitive market system through various measures

In the view of Meade, following are the responsibilities of a government in a capitalist economy:

- Regulating and controlling various economic situations, such as inflation and deflation, by formulating and implementing various fiscal and monetary measures
- Controlling the power of monopolistic and large corporations to elude various economic problems, such as unemployment and inequitable distribution of resources
- Possessing the ownership of public utilities, such as railways, education, medical care, water, and electricity, which are required by an economy as a whole
- Prohibiting discrimination among individuals and providing them equal educational and job opportunities
- Limiting restrictive trade practices and power of trade unions
- Maintaining law and order, administering justice, and safeguarding the freedom of individuals in an economy
- Supporting private ventures in an economy
- Creating a central planning body that helps in the development of an economy on a larger scale
- Handling problems to the environment, extinction of natural resources, and growth of population

Therefore, we can conclude that the major role of government in a capitalist economy is to control and encourage the free market mechanism. In addition, the government should encourage private ventures for safeguarding the future of an economy.

In a **socialist economy**, the function of government is entirely different from the function of government in a capitalist economy. In a capitalist economy, the government acts as a regulatory and complementary body. On the other hand, in a socialist economy, the government plays a comprehensive role in almost all economic activities, such as production, distribution, and consumption, of a nation. In a socialist economy, not only the ownership of private property is allowed to a limited amount, but the concept of the free market mechanism is also eliminated. The private ownership of resources, in a socialist economy, is changed by state ownership. In addition, in a socialist economy, the government plans and regulates all the economic activities centrally at a state level. Moreover, the decisions related to production, allocation of resources, employment, pricing, and consumption,

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are completely dependent on the government or its central planning authority. In a socialist economy, an individual's decisions are totally dependent on the limit decided by the government. For example, individuals are given the freedom of choice, but it is subject to the limitations of policy framework of the socialist economy. The countries in which the socialist economy is adopted are China, Yugoslavia, Czechoslovakia, and Poland.

The objective of the government in a socialist economy is the same as in the capitalist economy, such as growth, efficiency, and maintaining justice. However, the ways adopted by the socialist economy to achieve those objectives are different from the capitalist economy. For example, in the capitalist economy, the main force of motivation is the private profit, whereas, in the social economy, the encouraging factor is the social welfare. The socialist way of managing an economy facilitates the elimination of various evil activities of the capitalist economy, such as labor exploitation, unemployment, and inequality in the society. This is only the classical view of the socialist economy. However, over a passage of time, the scope of socialist economy has also been reduced due to various reasons, such as prohibition of profits from private ventures, inadequate utilisation of resources, and restrictions on economic development as noted by Union of Soviet Socialist Republics (USSR).

Mixed economy refers to an economy that comprises the features of both, the socialist economy and capitalist economy. This implies that working of a mixed economy is based on the principles of the free market mechanism and centrally planned economic system. In a mixed economy, the private sector is encouraged to work on the principle of the free market mechanism under a political and economic policy outline decided by the government. On the other hand, the public sector, in a mixed economy, is involved in the growth and development of public utilities, which is based on the principle of socialist economy. In a mixed economy, the public sector comprises certain industries, businesses, and activities that are completely owned, managed, and operated by the government. Moreover, in a mixed economy, certain laws have been enacted by the government to restrict the entry of private entrepreneurs in industries reserved for the public sector. Apart from this, the government also strives hard for the expansion of the public sector by nationalising various private ventures. For example, in India, the government has nationalised several private banks, which has resulted in the expansion of the public sector. Besides working for the growth and development of the public sector, the government, in a mixed economy, controls the activities of the private sector by implementing various monetary and fiscal policies.

It should be noted here that a free market mechanism is actually a form of a mixed economy. This is because of the reason that in a free market mechanism, both the private and public sectors exist simultaneously. However, the public sector in a free market mechanism economy is different from the public sector of the mixed economy. In free market mechanism economy, the public sector is responsible to maintain law and order in a country, make national defense stronger, and regulate money supply. On the other hand, the public sector of a mixed economy is involved in almost all economic activities, such as production, distribution, and consumption. For example, the public sector of an economy, such as India, is based on the socialist pattern of society.

SELF ASSESSMENT QUESTIONS

3. The working of a mixed economy is based on the principles of the _________ and centrally planned economic system.

5.4 PUBLIC SECTOR—AN ENVIRONMENTAL PERSPECTIVE

Public sectors are those industrial sectors which are controlled and regulated either by central government or state governments or both. Thus, it can be said that the public sectors comprise the government owned corporations. Central or state government holds the majority of public shares of these Public Sector Undertakings (PSUs) which are not less than 51%.

Before 1947, there were only a few sectors, which were controlled by the states including ports, railways, telegraphs, postal services, etc. Industrial policy was formed after independence, which favoured the concept of large PSUs. Also, a roadmap for the business sector in India was constructed as a part of 1956 industrial policy, envisioning the view of a self-reliant economic growth. In the Indian economy, a strategic role was assigned to the public sectors through the Industrial Policy Resolution of 1956.

There are various types or forms of public enterprises including:

i. Departmental undertakings such as Railways, Defence, etc.
ii. Statutory Corporations such as LIC, the Indian Airlines Corporations, etc.
iii. Government Companies such as Heavy Electricals Ltd., HMT Ltd., etc.
iv. Holding Company such as Steel Authority of India Ltd.

Following are the major objectives of Public sectors:

- To encourage prompt economic development through construction and development of Infrastructure
- To create financial resources for development
- To generate employment opportunities
- To encourage redistribution of wealth and income
- To promote balanced regional growth
- To promote exports and import substitution
- To encourage Supplemental Security Incomes (SSIs)

SELF ASSESSMENT QUESTIONS

4. Government shares in PSUs can be less than or more than 51%. (True/False)
5. Which of the following is/are not the type of PSUs?
   a. Departmental undertakings
   b. Ministry Undertaking
   c. Statutory Corporations
   d. Holding Company

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5.5 GOVERNMENT INTERVENTION IN THE PRIVATE SECTOR

The development and growth of a company is widely depended on the government of the country. It works for social welfare and makes optimal distribution of resources in order to achieve economic growth. Although, the role of government should be restricted in an economy as per the views of classical economists. Moreover, they proposed that the economy changes independently without any governing unit. Although, these situations are not valid in this practical world. For instance, the economy could not be restored itself at the time of the Great Depression of 1930s. Apart from this, the free-market mechanism can fail due to various other reasons such as:

- **Inequitable distribution of goods and job opportunities:** It is one of the main reasons behind the failure of the free-market mechanism. As proposed by Slither, there are two basic necessities of an economy that are essential to be fulfilled in the free-market mechanism. Initially, the goods should be offered to those people in an economy who seeks maximum pleasure by consuming those goods. Thereafter, people with greater efficiency should be given the job of producing goods as they can perform the task with greater efficiency. According to economics, the marginal utility of each good should be equal for all consumers while distributing the goods in an economy. Whereas the marginal productivity of each factor of production should remain equal while allocating resources to each industry. Although, according to Slither, the goods and resources are not distributed in such a manner in the free-market mechanism. Here, individual those are capable of paying maximum prices are offered goods regardless of the marginal utility derived from those goods. Thus, the theory of the relationship between the ability to purchase goods and satisfaction derived by consuming that good is not justified here. Also, the satisfaction level of poor varies with that of rich for the same product. For instance, an ordinary clothing of a rich man can be a delight for a poor as the buying power of a poor is far less than a buying power of a rich person and he/she is incapable of purchasing the apparel that belongs to the rich person.

  Likewise, jobs are not given in a manner that an individual is able to perform them with no extra efforts in the free-market mechanism. Also, the wages of people do not depend on their productivity in the free-market mechanism. Numerous unproductive labourers in an economy are paid more salary than the productive ones, such as politicians, bureaucrats and commission brokers.

- **Existence of perfect competition:** Another drawback of the free-market mechanism is the existence of perfect competition. Although, perfect competition plays a significant role in efficient and proper working of an economy in free-market mechanism. Increase in production cost in every market, non-existence of public goods, exclusion principle of consumption, mobilisation of factors of production and perfect knowledge of buyers and sellers are the major other aspects for the efficient functioning of an economy under the free-market mechanism. Although, practically no perfect competition exists in the real world. Also, perfect competition is not only the factor affecting the efficient functioning of the economic system. For instance, the improper balance between social and private costs also act as an obstacle for the proper functioning of the economy even under perfect competition.

- **Judgment of individuals:** It is believed that people are always the best evaluator of their needs, preferences and tastes in the free-market mechanism. Thus, the decision regarding the choice of individuals is also the most appropriate. Although, there are some factors such as prejudices, habits, impulses and comparison between alternatives, etc. that influence the buying behaviour of individual, especially in case of consumer goods. Therefore, the decision made by individuals are not restricted to their own choices but are also influenced by various other factors. Thus, individual's decision cannot be considered always as the best.
- **Emphasis on profit:** In a free-market mechanism, profit is considered as the prime motive for private entrepreneurs. Thus, it is not suitable to make an investment in those industries which are not fruitful, regardless of whether the industry has a significance role in the economic development of the nation or not. On the other hand, maximisation of profit in present monopolistic and oligopolistic markets are leading to underutilisation of resources which eventually leads to a decrease in productivity as well as employment.
- **Low priority for public utilities:** The failure of the free market is mainly due to this factor. There are few public utilities which are of significant nature for all people in an economy irrespective to whether they are rich or poor such as water, medical care, electricity and education. Besides these, there are some other facilities which also add up in the development of an economy of a country such as transport and communication which are referred to as socio-economic infrastructure. Although, these sectors incur huge starting cost and few returns due to which private companies are not willing to invest in these sectors. Apart from these, public utilities are consumed mutually under which the principle of exclusion in pricing is not applied. If the private sector would have owned and governed public utilities, it may have been possibility that only the individuals from the high-income class group would be able to afford such utilities. And eventually, it would have been led to inequitable distribution of resources among people.
- **Growth of monopolies:** The failure of the free-market mechanism is widely affected by the growth of monopolies. As discussed earlier, perfect competition widely influences on free-market mechanism. There should be parity among all competitors in perfect competition. Though, practically, it is not possible as efficiency among competitors cannot be equal, thus, it leads to the state of imperfect competition. It is evident that imperfectly competitive markets can certainly not be perfectly competitive which concludes in the growth of oligopolistic and monopolistic competition. Various economic problems, such as low employment, low production and high prices rises are due to the evolution of private monopolies.

All the above-mentioned aspects are the reason behind the failure of the free-market mechanism in an economy.

For instance, in a free-market, the objective of proper allocation of goods, optimum utilisation of scarce resources, etc., is not attained. Instead it leads to the growth of improper distribution of income, private monopolies and increase in poverty and unemployment. Though, the growth of the economy can be seen through free-market mechanism, but was unable to retain and withstand such growth. Therefore, in such a situation, the intervention of government plays a significant role in the growth of an economy.

Self Assessment Questions

6. The development and growth of a company is widely depended on the ____________ of the country.
7. Which of the following is not a reason behind the failure of the free-market mechanism?
   a. Existence of perfect Competition
   b. Judgment of individuals
   c. Emphasis on profit
   d. High priority for public utilities

5.6 PUBLIC SECTOR REFORMS AND PERFORMANCE

There are various strategic roles of the public sector in the Indian economy, which are as follows:

- Development of defence industries
- Capital formation
- Development of power projects
- Balanced economic growth
- Development of infrastructure
- Strong industrial base
- Development of basic and key industries such as iron and steel, cement, etc.
- Economies of scale
- Development of banking and insurance
- Balanced regional development
- Removal of regional disparities
- Import substitution
- Export promotion
- Saving in foreign exchange
- Diversity of projects
- Optimal allocation and utilisation of resources
- Expansion of employment opportunities
- Source of revenue to the government

Some of the issues and drawbacks of the Indian public sector are as follows:

- Mounting losses
- Delay in completion of the projects
- Over-capitalisation
- Price policy of public enterprises
- Increase in costs of construction
- Faulty planning and controls
- Political factors influence the decision about location
- Under-utilisation of capacity
- Inefficient management
- Unfavourable input-output ratio
- Shortage of raw materials and power
- Use of manpower resources in excess of actual requirements
- Labour problem resulting in strikes and lockouts
- Higher capital intensity -- low employment generation

Some of the remedies/measures that can be taken for boosting the performance of the Indian public sector are as follows:

- Reduction in unproductive expenditure
- Utilisation of installed capacity
- Better utilisation of manpower and materials
- Proper planning and control
- Improvement of efficiency of management
- Suitable price policy
- Making them autonomous
- Improvement of industrial relations
- Motivation of staff and workers

SELF ASSESSMENT QUESTIONS

8. Development of defence industries and infrastructure is the major role of public sector. (True/False)
9. Which of the following is not a key role of the public sector.
   a. Development of Power projects
   b. Balanced Economic Growth
   c. Economies of Scale
   d. Mounting Losses

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5.7 SUMMARY

- A political system, including kingship, democratic, socialist, etc., as well as political openness to the market forces is referred to as the political environment of a country.
- The major elements of the political environment are Political System, Political Processes, Stability of Political Structure and Centre-State Relations.
- On the basis of the ownership and distribution of resources, the economic system can be grouped into three categories, namely capitalist economy, socialist economy and mixed economy.
- Parliament is the supreme legislative body of Indian Union which comprises of Lok Sabha and Rajya Sabha.
- Public sectors comprise the government-owned corporations in which Central or state governments hold the majority of public shares which should not be less than 51%.
- The free-market mechanism can fail due to various other reasons, therefore, in such a situation, the intervention of a government plays a significant role in the growth of an economy.
- Various reasons behind the failure of the free-market mechanism can be inequitable distribution of goods and job opportunities, the existence of perfect competition, judgement of individuals, emphasis on profit, low priority for public utilities, growth of monopolies, etc.
- There are various strategic roles of the public sector in the Indian economy, such as development of defence industries, capital formation, development of power projects, etc.

5.8 KEY WORDS

- **Preamble:** The introductory statement contained within any statute or deed. This statement explains the purpose, aims and philosophy behind the concerned statute.
- **Public sector:** The part or sector of an economy that is controlled and regulated by the state.
- **Statutory corporations:** A corporation created by the state whose nature varies according to the jurisdiction.
- **Perfect competition:** A market in which there are a number of buyers as well as sellers in the market.
- **Economies of Scale:** The cost savings that occur to an organisation as a result of its scale of operations.

5.9 CASE STUDY: ROLE OF GOVERNMENT IN BUSINESS ENVIRONMENT

Provisions by which politically associated firms get economic favours are very common nowadays, but little is known of the effects or form of influence in business-government affairs. Not much is known about the firm-level political influence or its significance. What characterises the bargain between governments and influential firms? How do influential firms pay governments, in exchange for any benefits they receive? Recent firm-level analyses have examined various determinants of political influence, and how these connections influence market valuation while some have detailed the networks through which the benefits accrue. Still others, finally, have explained how ''systems'' of influence come into being, and why they endure. Much less is identified, however, of how these political connections influence decisions within firms or of the strings that may come along with political influence.

A general model in which influence entails firms to offer goods of political value in return for economic privileges. An investigation on both the characteristics that define political influence among firms in developing countries and the effects of that influence on company performance and behaviour. An argument that political influence develops the business environment for selected firms through industrial or quasi-industrial policies, but restricts their ability to fire workers.

Under such conditions, if political influence primarily sinks fixed costs over variable costs, then favoured firms will be less favoured to invest and their output will ache, even if they earn more profits than non-influential firms. Depending on the World Bank's Enterprise reviews of approximately 8000 firms in 40 developing countries, and control for a number of prejudices present in the data. Our viewpoint is that influential firms benefit from lower managerial and monitoring barriers (including bribe taxes), superior pricing power, and easier entree to credit. But these firms also deliver politically valuable benefits to occupants through bloated payrolls and greater tax payments. At last, these firms are worse-performing than their non-influential foils. The results highlight a potential channel by which cronyism leads to obstinate underdevelopment.

QUESTIONS

1. Discuss the role of politics in the above case.

   (**Hint:** Political Environment)

2. Discuss the role of government in a business environment.

   (**Hint:** Government intervention in the private sector)

5.10 EXERCISE

1. Write a short note on political environment.
2. Elaborate the main element of political environment of India.
3. What do you understand by the public sector? Also state its objectives.
4. Discuss the significance of government in the private sector.
5. Discuss the role of the public sector in India.

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5.11 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Political Environment of India	1.	Lok Sabha; Rajya Sabha
	2.	concurrent list
Different Economic Systems and the Role of the Government	3.	free market mechanism
Public Sector—An Environmental Perspective	4.	False
	5.	b. Ministry Undertaking
Government Intervention in the Private Sector	6.	government
	7.	d. High priority for public utilities
Public Sector Reforms and Performance	8.	True
	9.	d. Mounting Losses

5.12 SUGGESTED BOOKS AND E-REFERENCES

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CHAPTER 6

Economic Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe the Indian economic environment
- Explain the different kinds of economic systems
- Discuss the various economic policies
- Describe the current inflationary position of India and its impact on businesses
- Discuss the various economic legislations
- Describe the economic transition in India

6.1 INTRODUCTION

Economic environment of a country encompasses external factors which have a significant effect on the creation and dissemination of wealth. The demand and supply of a firm are directly influenced by such economic factors. From the financial point of view, it also justifies the viability of a country regarding the carrying out of business practices.

The economic environment of a firm comprises various external factors like economic conditions, economic system and economic policies. A country's economic condition can be explained in the form of the income distribution, per capita income, economic nature, economic resources, and so on.

Demand is a very important element of the economic environment. The demand for products of a firm is influenced by the confidence or insecurities of consumers and their buying ability. Hence, the economic environment has a crucial role to play in the decision making of a business.

The economic system acts as the basis for determining the degree of private business. There are several types of economic system followed across nations. Some nations have free market economies or capitalist economies whereas some have centrally planned economy or socialist economy. There are also some countries which follow the mixed economy, i.e., carrying characteristics of both capitalist and socialist economies.

In this chapter, you will study about the Indian economic environment, kinds of economic systems and economic policies. The chapter also discusses the current inflationary position and its impact on the business sector and economic legislations. The economic transition in India has been discussed at the end of this chapter.

6.2 INDIAN ECONOMIC ENVIRONMENT

India can be regarded as the fastest developing economy in the world and over the next 10-15 years, it is believed to become one of the top three global economic superpowers, because of its robust democracy and relationships with the world. In 2017-18, the GDP of India increased by 7.2 per cent, whereas in 2018-19, it increased by 7 per cent. With more than 4750 start-ups based on technology, India is still the third largest start-up base in the world.

As per research conducted by Thought Arbitrage Research Institute and ASSOCHAM, by 2020, the labour force of India is estimated to reach 160-170 million.

According to RBI, as of March 15, 2019, the foreign exchange reserves of India were US$ 405.64 billion.

By FY27, the GDP of India is estimated to touch US$ 6 trillion and because of the favourable reforms, demographics, globalisation and digitisation, India is set to attain an upper-middle income status.

By 2019, the revenue receipts of India are expected to reach US$385412 billion. This is due to the reforms like GST and demonetisation and measures to boost the infrastructure.

Self Assessment Questions

1. ____________ environment of a country encompasses external factors which have a significant effect on the creation and dissemination of wealth.
   a. Political
   b. Economic
   c. Socio-cultural
   d. None of these
2. A country's economic condition can be explained in the form of
   a. Income distribution
   b. Economic resources
   c. Per capita income
   d. All of these

6.3 KINDS OF ECONOMIC SYSTEMS

An economic system can be referred to as a system that encompasses the methods of production, distribution and exchange of goods and services (excluding their consumption). The different economic systems differ on the basis of means of establishment of ownership.

6.3.1 CAPITALIST ECONOMY

Capitalism is an economic system in which the industries, trade and production means are completely owned by private bodies. This type of economy is also known as a **capitalist economy** or a **free-market economy**. This type of economy involves no governmental interference. There are many developing as well as developed nations which follow the capitalist economy system such as Germany, U.S., etc.

The production task of a capitalist economy is completely controlled by firms and industries. The market mechanism, decision-making process, the means of production carried out for the supply of products in the market are owned by private organisations.

In the words of **Karl Marx**, "*Capitalism is a particular mode of organisation of production which is characterised by wage slavery, production of profit, and creation of surplus value*".

As per **Louks and Hoots,** *"Capitalism is a system of the economic organisation featured by the private ownership and the use for private profit of man-made and nature made capital."*

In a free-market economy, there is no ownership of government as all the activities of production are owned by private bodies. The productive activities are not controlled or planned by anyone instead they are decided by the demand and supply of products and the price mechanism. In this type of economy, the consumers are sovereign. If the demand for products exceeds the supply, then prices increase and producers raise their level of production. On the other hand, if the supply of products exceeds the demand, then the prices of products decrease and producers reduce their level of production.

Features of Capitalism

Capitalism can be explained as the economy which utilises its capital optimally in the process of production. Technically, in capitalism, capital and goods are privately owned by businesses or individuals. Capitalism has the following features:

- **Private property:** The setting up of private property acts as the basis of economic life in the modern world. Therefore, private property is regarded as the *terra ferma* of capitalism. In capitalism, it is a fundamental right of all the individuals to be the owner of private property.
- **Large scale production:** Industrial revolution gave a boost to capitalism along with the commencement of large-scale production. The installation of large plants and the division of labour resulted in increased levels of production. As a result, high production led to proper capital utilisation and a huge amount of profits.
- **Profit institution:** Profit institution is a significant characteristic of capitalism. Here, capitalists earn profits by making investments. Therefore, the process of production is oriented towards profit.
- **Competition:** A capitalist economy has to face strong competition in the market. This results from the artificial rise in the demand and reduction in the supply. Therefore, competition is regarded as an indivisible constituent of a capitalist economy.
- **Price mechanism:** In capitalism, the prices of goods and services are decided by their demand and supply. Production cost is not taken into consideration while setting the prices of goods and services.
- **Wage institution:** Workers are exploited under the system of capitalism. The rates of wages of workers are largely bargained. Here, the capitalist tries to extract maximum possible output from the workers and pays very less wages in return.
- **Money and credit:** Credit institutions sanction loan to capitalists for the purposes of investment. Capitalists establish their business and generate profit on the basis of credit. It further assists the capitalists in the expansion of their property.
- **Business organisation:** Presence of large business organisations with widespread business structures is another characteristic of a capitalist economy. Therefore, an enormous industrial infrastructure can be set up by combining a huge amount of funds from them and similarly from other shareholders too.

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- **Market Economy:** The process of production, distribution and exchange under a capitalist economy is governed by the market forces. There is interference of government over such activities. The economy of the market is greatly dependent on the law of demand and supply. Hence, it is also referred to as a free or liberalised economy.

6.3.2 SOCIALIST ECONOMY

Socialism is an economic system where ownership and regulation are under the government. All the activities of production and other functions like allocation of resources, consumption, distribution of income, investment pattern, etc., are under the direction and control of the government. It is also referred to as the socialist or command economy. In contrast to capitalism, socialism ensures public welfare and equality among people.

The communist countries are the origin of socialist economies. In these nations, the common interest of the entire community was preferred over the interest of the individuals. After the 1980s, the number of communist nations started to reduce. But there are still some democratic nations which are presently run by governments which are socialist-inclined. They have adopted some components of a command economy. For example, India and France both function under the planning system of the government.

In socialism, enterprises which are owned by the government have limited access to incentives for cost control since they cannot go past their policies of the business. This is against the socialist economy's objective which makes sure resource mobilisation for the society's welfare. Under socialism, private firms are restricted and no incentives are offered for their efforts to cater to the needs of the consumers. Therefore, command economies are not innovative and dynamic which may bring the economy to a standstill.

In the words of **Leftwitch**, *"In socialism the role of the state is central. It owns the means of production and directs economic activity."*

As per **H.D. Dickinson**, *"Socialism is an economic organisation of society in which the material means of production are owned by the whole community and operated by the organs representative of and responsible to the community according to a general economic plan, all members of the community being entitled to benefit from the results of such socialised production on the basis of equal right."*

Features of Socialism

The salient features of a socialist economy are as follows:

- **Social ownership:** In socialism, there is no private ownership since all the production means such as banks, railways, mines, factories, farms, etc., belong to the society. A person can only possess a private property by way of consumer goods, furniture, residence, and so on.
- **Social welfare:** Social welfare is one of the crucial objectives of socialism. This is achieved through proper resource utilisation and catering to the society's needs

and wants. It takes care of the economy's benefits as a whole instead of the needs of some individuals. Unlike a capitalist economy, where means of production is profit oriented, in socialism, productive resources are utilised in order to produce goods and services for the purpose of attaining social welfare. Here, the production of necessary goods is given more significance instead of the luxury goods.

- **Central planning:** Under socialism, all the activities of production and their associated goals and plans are designed by the Central Planning Authority. As per these plans, various programmes and objectives are implemented by the government.
- **Equality of income and opportunity:** Socialism strives to remove or reduce disparities in income and wealth and offers equal opportunity to every individual. Social ownership and production for the welfare of the society and community abolish unequal distribution of wealth and income. It also offers equal opportunity to every person by way of professional training, free education, and so on. However, it is not possible to have absolute equality since capabilities differ from person to person.
- **Classless society:** Contrary to capitalism, socialism is a classless society, where there is no division of society into classes like labour class or elite class, etc. Here, all the activities of production are carried out by the community as a whole and, therefore class-conflict is very less likely to happen.

6.3.3 MIXED ECONOMY

Mixed economy combines the characteristics of both capitalism and socialism. It is the aggregate of both public and private ownership. A mixed economy offers private enterprises the freedom to function and develop but also permits government interference in matters for maintaining economic objectives. The combination of government interference and private sector varies from one nation to another. India is a mixed economy and comprises all the relevant characteristics of capitalism and socialism for the regulation and control of the economy.

The decisions pertaining to economic planning and resources allocation is undertaken by the Central Government. The economy's overall growth and development depend upon the achievement of its goals through collaborative efforts of both the private and public firms. In a mixed economy, some areas are operated by private firms, whereas some areas are reserved for the public firms. Also, there are few areas, where both private and public sectors work in a collaborative way.

As per **Samuelson,** *"Mixed economy is that economy in which both public and private institutions exercise economic control."*

In the words of **Pickersgill,** *"The primary difference between the mixed economy and market socialism is the relatively greater importance of individual decision making, private property and the reliance on market-determined prices to guide the allocation of resources. The mixed economy differs from competitive capitalism with respect to the share of collective decision making in the economy."*

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Features of Mixed Economy

The main features of a mixed economy are as follows:

- **Co-existence of the public and private sector:** In a mixed economy, both public and private sectors operate independently but strive to achieve a single objective. Public sectors operate for the society's welfare while the private sector is oriented towards earning profits. Therefore, the government has devised several economic policies in order to regulate and govern the economic activities of the private sector. Such policies include monetary policy, fiscal policy, taxation policy, etc.
- **Individual freedom:** Government imposes restrictions for ensuring the welfare of the society. Hence, manufacturers have to abide by these rules and regulations. For example, the government might put restrictions on the production of harmful and hazardous goods. However, individuals are free to buy any product. Therefore, despite all sorts of government control, people have the freedom to purchase and choose the occupation or profession of their own choice.
- **Economic welfare:** The primary purpose of a mixed economy is to ensure economic welfare. This can be brought about by reducing regional imbalances and by offering opportunities for employment. The government has taken several steps towards society's upliftment. The monetary and fiscal policies are designed to govern and control the economic activities of the private sector.
- **Economic planning:** The Central Government devises economic plans and direct the functions of both the public and private firms in view of that. The public sector activities are directly regulated by the government whereas different incentives and subsidies are offered to the private sector for functioning as per the economic objectives.
- **Price mechanism:** Price system of the economy is regulated by the price policy framed by the government. For offering commodities at economical rates to the weaker sections of the society, the government provides financial and economic aid to the producers. It offers subsidies to the target groups and also provides material inputs below the market price or free of cost to various firms. Therefore, under a mixed economy, people avail an enormous amount of benefits and support from the government.
- **Free and controlled economic development:** Mixed economy is regarded as the best alternative to the socialist and capitalist economies. It attempts to eliminate all the issues and drawbacks associated with the sustainable growth and development of the economy. It gives freedom of occupation and choice as well as controls and governs the economic activities.
- **Government intervention:** Under the mixed economy, the government can interfere in order to stabilise the economy, particularly during a crisis. For example, during the global crisis of 2008, the governments of the United States and other nations intervened into the affairs of the economy for controlling and managing the effect of the crisis.

Self Assessment Questions

3. In which economic system, the industries, trade and production means are completely owned by private bodies?

   a. Socialism b. Capitalism

   c. Mixed d. None of these

4. __________ economy is that economy in which both public and private institutions exercise economic control.

   a. Mixed b. Capitalism

   c. Socialism d. All of these

6.4 ECONOMIC POLICIES

For giving a boost to the development of the country and eliminating the issues of the economy (such as poverty, lack of infrastructure, low industrial production, and so forth). India embarked on the path of economic reforms in the year 1991. Economic policy enables the government to formulate and take various actions for the economy's welfare. These actions involve designing yearly budgets, framing tax rates and other plans. In a business environment, such economic policies influence the nature of ownership, labour markets, industrial relations and the other related aspects.

Both the internal and external factors influence the formulation of the economic policy of the nation. The political beliefs and philosophy of the various political parties come under the internal factors, whereas, the several international institutions such as World Bank, International Monetary Fund (IMF), credit rating agencies come under the external factors. By formulating the economic policy, a broad approach was taken to achieve a notable position in the world economy. The economic reforms of 1991 transformed the prevailing economic mind-set of India. The protectionism image was eliminated and the nation became liberal. The doors were opened to foreign investors and they were permitted to invest in Indian firms and organisations. Huge amounts of funds flowed into the Indian economy by way of FDI and portfolio investments. For enjoying the full benefits from such economic policies, some level of consistency between economic policies and the type of trade was maintained. However, while the new economic policies were formulated, the old ones were also kept in mind. This was done with the objective of keeping developmental targets in mind.

6.4.1 FISCAL POLICY

Fiscal policy implies the policy of the government regarding expenditure and tax. It is a form of economic policy which regulates and controls the management of public debt, borrowings, expenditure and tax system within a country. The prime emphasis of fiscal policy is on the currency flow in a specific economy.

The process of flow of money is initiated by the private sector which is normally transferred to the government. The government makes use of these funds for the

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economy's welfare. Private sector uses the tax system as a medium to channelise funds to the government and these funds then return to the economy by the way of public expenditure. Management of public debt is another important aspect in fiscal policy. Loans from the government, payment of interests and retirement of matured debts, all come under the purview of public debt management. Hence, fiscal policy is considered to be very crucial for the economy of India.

The role of fiscal policy varies as per the country's requirements. Developed countries make use of fiscal policy as an instrument to increase the level of employment and maintain stability in the economy. On the other hand, underdeveloped countries make use of fiscal policy to give a boost to economic growth.

As per **Buehler**, *"By fiscal policy is meant the use of public finance or expenditure, taxes, borrowing and financial administration to further our national economic objective."*

In the words of **Arthur Smithies**, *"Fiscal policy is a policy under which government uses its expenditure and revenue programmes to produce desirable effects and avoid undesirable effects on the national income, production and employment."*

6.4.2 MONETARY POLICY

Monetary policy is referred to as the policy of Central Bank (RBI, in the context of India) of an economy in which the cost, availability and the usage of money are controlled and regulated by using monetary methods in order to achieve predetermined goals and objectives. It uses several tools to set the level of aggregate demand for goods and services or to assess the patterns and trends in the economic sectors.

The extent of economic activities and the supply and demand of flow of credit are influenced by the variations in the economy. These variations occur because of the amendments made in the monetary policy. Consecutively the monetary policy changes because of the varying availability and cost of credits. This change makes an impact on the asset pattern of commercial banks and financial institutions.

In the words of **Paul Einzig**, *"Monetary policy is the attitude of the political authority towards the monetary system of the community under its control."*

As per Johnson, *"Monetary policy is defined as policy employing central bank's control of the supply of money as an instrument for achieving the objectives of general economic policy."*

The role of monetary policy is crucial in the economic development of a nation. Over the years, the requirement for monetary control has been realised extensively. It not only regulates the extent of supply and demand of currency but also controls the functioning of currency, deposits, credit and foreign exchange of the country.

SELF ASSESSMENT QUESTIONS

5. _________ policy implies the policy of the government regarding expenditure and tax.

   a. Monetary b. Fiscal

   c. Industrial d. All of these

6. Which policy is defined as policy employing central bank's control of the supply of money as an instrument for achieving the objectives of general economic policy?

   a. Fiscal b. Monetary

   c. Industrial d. None of these

6.5 CURRENT INFLATIONARY POSITION AND ITS IMPACT ON THE BUSINESS SECTOR

In February 2019, the Indian consumer prices increased by 2.57 per cent annually, following a downwardly revised 1.97 percent increase in January and higher than the expectations of the market of 2.43 per cent. As prices of food dropped, this was the highest rate of inflation in four months. RBI (Reserve Bank of India), in its meeting in February 2019, lowered its predictions of inflation to 2.8 per cent for the period of January-March 2019. It also highlighted a deflation in food products and a drop-in inflation of fuel. From 2012 until 2019, India's inflation rate was at an average of 6.22 per cent; lowest being at 1.54 percent in June, 2017 and highest being at 12.17 per cent in November 2013. Impact of inflation on the business sector is as follows:

- **Reduced demand for products and services:** In the situations of high inflation, both savings and investments are negatively influenced in a negative manner. Because of low demand of goods and services, most of the businesses get adversely affected. Many customers tend to shift towards the Internet marketing, as the prices of goods and services are comparatively cheaper on the websites. The services provided by the business portals also get affected in a negative manner because of a reduction in demand for goods and services. Many industries in India are also affected negatively due to the reduction in demand in various sectors like consumer durable goods and automobiles, etc., which results due to price rise because of inflation.

- **Increased product price:** There are primarily two key factors responsive to the cost-push inflation. First is the high price of raw materials and second is the increase in the rate of wages. In fact, the rise in prices in any of the production factors like land, labour, material or technology can lead to a price rise of the products. Profit margins of businesses get affected whenever the production or operation cost is increased. The increased costs of operations are transferred to the customers by way of increased prices which gives rise to cost-push inflation.

- **Market bubbles:** When the central bank maintains the rate of inflation in the economy within limits artificially, different forms of market bubbles are created. Conventionally, easy credit and increased supply of money are related to low rates of interest. It creates speculations and market bubbles in the economy.

- **Economic downturn:** Sometimes, downturns in the economy are resulted due to the combined effect of high prices and economic bubbles. Bursting of such bubbles takes place when some remedial measures are taken. The impact of such situations is mostly realised by small businesses and workers. The employment

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industry faces the worst of high inflation rates. It leads to an increased rate of unemployment and also decreases consumer spending.

- **Reduced purchasing power:** The reduction in the purchasing power of currency and its depreciation are the two key and immediate outcomes of inflation. It is the retired individuals with limited or fixed incomes who are affected the worst by depreciation as the purchasing power of their money gets substantially reduced. However, individuals who are not dependent on a fixed income are less affected since they can counteract the depreciation by raising their fees.

SELF ASSESSMENT QUESTIONS

7. Which of the following options the impact of inflation on the business sector?
   a. Reduced purchasing power
   b. Economic downturn
   c. Increased product price
   d. All of the above
8. From 2012 until 2019, India's inflation rate was at an average of _______ per cent.
   a. 8.97 b. 7.25
   c. 6.22 d. 4.9

6.6 ECONOMIC LEGISLATIONS

Socio-economic issues such as unethical trade practices, exploitation of labour and growth of monopolies are always present in an economy. The principal reasons behind these problems are conflicts between the government and private sector regarding social and private interests and social responsibilities which are normally discarded by private business organisations. Therefore, some laws and acts called the economic legislations are formulated by the governments to manage them. Following are some economic legislations formulated by the Indian government for private business organisations:

6.6.1 MONOPOLIES AND RESTRICTIVE TRADE PRACTICES (MRTP) ACT

Various new and large business organisations have entered the Indian trade market after independence. The level of competition was not extreme hence, they tried to establish their monopoly. The intentions of those business organisations were not hidden from the eyes of the Indian government. Hence, the MRTP bill was passed for protecting the consumers' interest, which eventually resulted in the emergence of Monopolies and Restrictive Trade Practices Act of 1969. This law empowered the MRTP commission to close down all those firms and organisations which attempted to hinder or get in the way of healthy competition.

The MRTP bill was passed to safeguard the rights of consumers and check any kind of monopoly or alliance which might prove harmful for the interests of the consumers. Its purpose is to curb the practice of build-up of wealth in a few hands, which can be harmful to the consumers. It also curbs the monopoly and unfair practices of the trade.

Following are the main objectives of the MRTP Act:

- To regulate and control the build-up of financial power
- To curb monopoly and dominant practices of trade until they prove to be helpful for the people
- To restrict unfair trade practices

6.6.2 FOREIGN EXCHANGE REGULATION ACT (FERA), 1973

In 1973, Foreign Exchange regulation Act (FERA) was passed. It put very strict regulations on some specific form of payments, securities and dealings that had a negative effect on the export and import of currency and foreign exchange. The FERA bill was framed in order to regulate foreign exchange and payments. From January 1, 1974, FERA was brought into effect.

At the time when the foreign exchange reserves in India were low, the FERA was introduced. The foreign exchange became rare. Hence, FERA assumed that the Indian Government was the rightful owner of all the foreign exchange earned by the residents of India. Therefore, it had to be accumulated and given to the RBI (Reserve Bank of India). The transactions restricted by the RBI were mainly not allowed under FERA. The objectives of FERA are as follows:

- To regulate the foreign payments
- To regulate the transactions in securities and foreign exchange
- To conserve foreign exchange for India

6.6.3 FOREIGN EXCHANGE MANAGEMENT ACT (FEMA), 1999

In 1999, Foreign Exchange Management Act (FEMA) was brought to replace Foreign Exchange Regulation Act (FERA), 1973. The purpose of FERA was to regulate the conducting of the business of Indian companies in foreign markets and foreign companies in the Indian market. FEMA was bought into effect from January 1, 2000. This act applies to every office, branch or agency in India and also to the foreign offices and branches of people who are the Indian residents.

FEMA was framed by the Indian Government and is directly associated with the foreign direct investment in the economy. FEMA has a crucial role to play in facilitating external payment and trade.

Hence, FEMA is an Act of the Parliament of India *"to consolidate and amend the law relating to the foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India."* The main Objectives of FEMA are as follows:

- To amend and consolidate FERA
- To assist in external payments and trade
- To facilitate the systematic development of the Indian foreign exchange market

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SELF ASSESSMENT QUESTIONS

9. What replaced the Foreign Exchange Regulation Act (FERA) in 1999?
   a. MRTP Act
   b. FEMA
   c. Competition Act
   d. Goods and Sales Tax
10. Which of the following is an objective of the MRTP Act?
    a. To regulate and control the build-up of financial power
    b. To curb monopoly and dominant practices of trade until they prove to be helpful for the people
    c. To restrict unfair trade practices
    d. All of these

6.7 ECONOMIC TRANSITION IN INDIA

India has been the concept of a mixed economy since the beginning of the 1950s. This means that the Indian economy is a mixture of both socialism and capitalism. During that time, many international donors and top development economists praised this approach of India. The mixed economy made way for a highly controlled private sector, import substitution and a huge public sector. The result was actually 'mixed' since it resulted in both the slow growth of socialism and the disparities of capitalism. India is a mixed economy due to the presence of the following factors:

1. **Coexistence of public and private sectors:** India transformed into a mixed economy because of the coexistence of public sector and huge private sectors. Such coexistence has been possible because of the industrial policies framed by the Government of India. Public sector runs some basic and heavy industries. However, the scope of private sector has widened with the liberalisation of the Indian economy.
2. **Planned development:** During independence, the industrial sector of India was poor. The Indian economy became weak because of the long period of stagnation under the rule of British Raj. Therefore, five-years plans were formulated as per the Directive Principles of State Policy in order to boost the rural economy and provide a basis for the development of the industrial sector.
3. **Planned objectives:** The concept of the five-year plan was introduced in India in 1951. These plans had the following basic objectives:
   - Growth of the economy
   - Modernisation
   - Social justice
   - Self-reliance
   - Poverty elimination
   - Employment opportunities
   - Fulfilment of basic needs such as food, shelter, clothing, etc.

In 2015, the concept of five-year plan was dissolved and NITI Ayog was established. It became operational from 1st January 2015. The NITI Ayog is a think-tank which works as a strategic advisory authority for the central and state governments. NITI Ayog provides strategic and technical advice with respect to various policy areas.

4. **Role of public sector:** The public sector had a crucial role to play in India's development. The speed of economic growth was boosted by the public sector. Moreover, it tried to eliminate the inequality in the wealth and income. Public sector works for the following areas:
   - Infrastructure development
   - Spreading the industries in various remote and backward areas
   - Setting up of basic and heavy industries
   - Marketing and trading activities along with international trade.
5. **Private sector:** Private sector encompasses the organized industry along with small scale industries, agriculture, housing, construction and trade. Almost three-fourth of the economy is employed under the private sector. The MRTP Act and the Industries Development and Regulation Act have been established to control the private sector.

SELF ASSESSMENT QUESTIONS

11. Which type of economy does India follow?
    a. Mixed   b. Socialism
    c. Capitalism   d. None of these
12. Both the public and private sectors exist in India. (True or False)

6.8 SUMMARY

- The economic environment of a firm comprises various external factors like economic conditions, economic system and economic policies.
- Economic policy enables the government to formulate and take various actions for the economy's welfare.
- Socio-economic issues such as unethical trade practices, exploitation of labour and growth of monopolies are always present in an economy. Therefore, some laws and acts called the economic legislations are formulated by the governments to manage them.

6.9 KEY WORDS

- **Economic environment:** The external factors which have a significant effect on the creation and dissemination of the wealth of a nation.
- **Monetary policy:** The policy of Central Bank of an economy in which the cost, availability and the usage of money are controlled and regulated by using monetary methods in order to achieve predetermined goals and objectives.

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- **Foreign Exchange Management Act (FEMA):** FEMA was bought into effect from January 1, 2000. This act applies to every office, branch or agency in India and also to the foreign offices and branches of people who are the Indian residents.
- **Fiscal policy:** The policy of the government regarding expenditure and tax
- **Capitalist economy:** An economic system in which the industries, trade and production means are completely owned by private bodies.
- **Socialist economy:** An economic system where the ownership and regulation are under the government. All the activities of production and other functions like allocation of resources, consumption, distribution of income, investment pattern, etc., are under the direction and control of the government.

6.10 CASE STUDY: INFLATION AND THE INDIAN ECONOMY

Inflation is the rise in prices which occurs when the demand for goods and services exceeds their available supply. In simpler terms, inflation is a situation where too much money chases too few goods.

In India, the Wholesale Price Index (WPI), which was the main measure of the inflation rate consisted of three main components - primary articles, which included food articles, constituting 22% of the index; fuel, constituting 14% of the index; and manufactured goods, which accounted for the remaining 64% of the index.

For purposes of analysis and to measure more accurately the price levels for different sections of society and as well for different regions, the RBI also kept track of consumer price indices.

The average annual GDP growth in the 2000s was about 6% and during the second quarter (July-September) of fiscal 2006-2007, the growth rate was as high as 9.2%. All this growth was bound to lead to higher demand for goods. However, the growth in the supply of goods, especially food articles such as wheat and pulses, did not keep pace with the growth in demand. As a result, the prices of food articles increased. According to Subir Gokarn, Executive Director and Chief Economist, CRISIL, 'The inflationary pressures have been particularly acute this time due to the supply side constraints (of food articles) which are a combination of temporary and structural factors'.

To control inflation, the RBI announced some measures late 2006 and early 2007. These measures included increasing repo rates, the Cash Reserve Ratio (CRR) and reducing the rate of interest on cash deposited by banks with the RBI. With the increase in the repo rates and bank rates, banks had to pay a higher interest rate for the money they borrowed from the RBI. Consequently, the banks increased the rate at which they lent to their customers. The increase in the CRR reduced the money supply in the system because banks now had to keep more money as reserves. The RBI again increased the CRR to 5.5% (an increase of 50 basis points) in December 2006. On January 31, 2007, the RBI increased the repo rate by 25 basis points to 7.5%.

In 2006-07, all the measures that were taken by the RBI and the government to control the inflation were based on the traditional and time-tested measures to curb inflation. However, some economists argued that the steps taken by the government to control inflation were not enough.

It was opined by various economic analysts that the RBI could have handled the inflation without changing with the interest rates. The analysts held that changing the interest rates may slow the pace of economic growth. Some of the analysts also explained that high inflation is considered as an indication of economic mismanagement and high inflation that continues to exist for a long period of time affects the confidence of investors. However, the inflation rate in emerging economies was usually higher than developed economies (Refer to Exhibit VI for inflation rates in some developed and developing countries).

Source: *http://www.icmrindia.org/casestudies/catalogue/Economics/The%20Indian%20Economy-Dealing%20with%20Inflation-Case%20Study.htm*

QUESTIONS

1. Explain the concept of inflation in the Indian context.

   (**Hint:** Inflation is normally associated with high prices, declining purchasing power.)

2. Give out the ways of curbing inflation.

   (**Hint:** Monetary measures and fiscal measures.)

6.11 EXERCISE

1. Write a note on India's inflationary position and its impact on the business sector.
2. What are the different kinds of economic systems? Explain them.
3. What is meant by economic policies? Explain monetary policy and fiscal policy.
4. Give a detailed description of economic transition in India.
5. Write short notes on:
   i. MRTP Act
   ii. Capitalist economy
   iii. Mixed economy
   iv. Socialist economy

6.12 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Indian Economic Environment	1.	a. Economic
	2.	d. All of these
Kinds of Economic Systems	3.	b. Capitalism
	4	a. Mixed
Economic Policies	5.	b. Fiscal
	6.	b. Monetary

Topic	Q. No.	Answer
Current Inflationary Position and its Impact on the Business Sector	7.	d. All of these
	8.	c. 6.22
Economic Legislations	9.	b. FEMA
	10.	d. All of these
Economic Transition in India	11.	a. Mixed
	12.	True

6.13 SUGGESTED BOOKS AND E-REFERENCES

SUGGESTED BOOKS

- Saleem, Shaikh. *Business Environment 3rd Edition*. Pearson Education
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CHAPTER 7

Legal Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe an overview of the legal environment
- Explain the acts influencing the legal environment of business
- Discuss the laws protecting consumers, society and public interest
- Explain the intellectual property regime
- Describe the legislation for unfair trade practices

7.1 INTRODUCTION

In the previous chapter, you have studied about the concept of Indian economic environment, kinds of economic systems and economic policy. The chapter also discussed about the current inflationary position and its impact on the business sector. Economic legislations and economic transition have been also described at the end of the chapter.

Martin Luther King once said, *"Morality cannot be legislated, but behaviour can be regulated. Judicial decrees may not change the heart, but they can restrain the heartless."* As a future business manager and a leader, you must have a good understanding of the law and legal risks involved in making and influencing business decisions. This will help you not only to gain a competitive advantage but also avoid legal pitfalls. The Indian legislation has several acts and amendments to protect consumer rights, resolve disputes, protect Intellectual Property rights, and prohibit unfair trade practices. Gaining an in-depth understanding of these laws would require an in-depth analysis.

However, this chapter provides concise and relevant information about the legislation and laws affecting businesses in India. You will also learn about the legal provisions describing agreements and contracts, consumer protection rights, IP and trademarks, and unfair trade practices and monopolies.

7.2 WHAT IS LEGAL ENVIRONMENT?

The legal environment in business is a code of conduct that defines the boundaries of business within a legal jurisdiction. The law has been meant to mean different things at different periods. Given below are some definitions:

- **Traditionalist approach:** Legal traditionalists define law as a body of principles and rules that courts use during dispute resolution. As per them, no matter how much society changes its beliefs, the basic concepts of right and wrong will remain intact.
- **Environmental approach:** Law is a tool used to control society. Thus, it must always demonstrate the moral constructs of the society through the execution of rules and regulations. This environmental approach is wider than the traditional viewpoint.

- **Social jurisprudence approach:** Law is shaped by the society and its means of enforcement. It is a way to provide a systematic, predictable system of social order, change and legal reform.

Thus, the main objectives of the law are as follows:

- Maintain peace
- Deliver justice
- Provide equality and uniformity
- Protect individual rights
- Protect minorities against injustice
- Maintain social control
- Maintain law and order
- Resolve disputes
- Provide systematic social change and legal reform

Before you learn about the different categories of the law, you should have an idea about the terms right and duty. A **right** is the ability of an individual, as provided by the law, to demand someone else to perform or stop in a certain activity. A **duty** is a commitment of an individual to perform or refrain from a certain activity. Right and duty are correlated in that an individual cannot have a right without having a corresponding duty to another person.

The main categories of law are:

- **Substantive law vs. Procedural law:** Substantive law includes all the laws that define and regulate legal rights and duties. If a rule states that promises are enforced only if a party gets something of value from the other party, then it is the part of the substantive law. For example, business contracts are substantive law. But what happens if a contract is violated? Then, procedural law comes into play. Procedural law is used to enforce the rights established by the substantive law. It answers questions such as:
  - How should a lawsuit be filed?
  - What papers should be filed?
  - Which court should be attended?
  - What witnesses are required?
- **Civil law vs. Criminal law:** Civil law includes all the laws that define the duties of individuals or legal entities, such as corporations or companies. Violations of civil law include employment violation, contract breach, product liability and copyright infringement. Criminal law, on the other hand, is an act proscribed by the law to protect the public at large. Criminal violations include when individuals in positions of authority to commit crime against other individuals, the company, or the consumer. Examples include fraud, bribery, insider trading, embezzlement, cybercrime, public corruption, identity theft, consumer fraud and forgery.

There are three main sources of law:

- **Customs:** Customs refer to the set practices or unwritten rules that have become a society's norm. These were the primary sources of law in ancient societies. Some customs still prevail as an important source of law. For example, Saptapadi or 'seven steps' is the most important rite of a Hindu marriage ceremony, when the newly-wed couple takes seven steps around the fire. This custom of Saptapadi is incorporated in Section 7 of the Hindu Marriage Act, 1955. Customs can be divided into two classes:
  - **Customs without sanction:** These customs are not mandatory and are followed due to public opinion.
  - **Customs with sanction:** These customs are mandatory and enforced by the state. These include:
    - ✓ **Legal custom:** This custom's authority is absolute. It is recognised and enforced by a court of law. These may be general (throughout a state) or local (restricted to a part of the state).
    - ✓ **Conventional custom:** These are enforced on parties on account of an agreement. For example, an agreement between a landlord and a tenant about the payment of rent is a conventional custom bound by the rent agreement.
- **Judicial precedent:** This includes the previously decided judgements of the High Courts and the Supreme Court of India, which judges are obliged to follow. It is a legacy from the British-India legal system.
- **Legislation:** This is the most important and modern source of the law. It includes the laws enacted and recognised by the state. There are two main types of legislation:
  - **Supreme legislation:** This includes laws directly enacted by the Indian Parliament. The powers of the Parliament are regulated and controlled by the Constitution of India.
  - **Subordinate legislation:** This includes laws that are made by any subordinate authority of the supreme legislation. It is further divided into:
    - ✓ **Autonomous law:** This is the law enacted by a group of individuals legally recognised as an autonomous body, such as universities or incorporated companies.
    - ✓ **Judicial rules:** Under the Constitution of India, the Supreme Court and the High Courts have the power to make rules for their administrative procedures.
    - ✓ **Local laws:** Laws enacted by local bodies like Panchayats or Municipal Corporations are recognised as local laws under the 73rd and 74th amendments.
    - ✓ **Laws made by the executive:** In India, there are three organs of the state: the legislature, the executive, and the judiciary. Each has specific functions. The legislature (the Indian Parliament) is responsible for making law within the Constitution of India. The executive (the Indian government)

is responsible to implement the laws enacted by the Parliament. However, the Indian Parliament delegates some of its law-making powers to the executive (delegated legislation), as it is not possible for it to go through all the details of the law.

SELF ASSESSMENT QUESTIONS

1. Which approach defines law as a 'means to provide a systematic, predictable system of social order, change and legal reform'?
   a. Modern approach
   b. Social jurisprudence approach
   c. Environmental approach
   d. Traditional approach
2. Consumer fraud is a violation under:
   a. Criminal law
   b. Civil law
   c. Colonial law
   d. Procedural law

7.3 ACTS INFLUENCING THE LEGAL ENVIRONMENT OF BUSINESS

The legal environment of business in India mainly comprises the legal policy, framework and laws in which businesses have to operate. These laws are enacted to protect the interests of both the producers and the customers. Let us discuss the main acts:

- **Indian Contract Act, 1872:** This act is applicable to entire India, except Jammu and Kashmir. This act ensures that the rights and duties arising out of a contract are honoured and that legal remedies are available to the parties bound by the contract. It defines a contract and an agreement, as follows:
  - **Contract:** An agreement between two or more persons/parties subject to certain terms and conditions for legal consideration.

    Thus, Contract = Agreement + Enforceability

    Example: 'A' offers to sell his house to 'B' for a specified amount. 'B' accepts to purchase the house. Here, 'A' offers an agreement. When 'B' accepts the offer, it becomes a contract.
  - **Agreement:** An offer that must satisfy the following three conditions:
    - ✓ There must be at least two parties.
    - ✓ There must be an offer (proposal) from one party to another.
    - ✓ There must be an acceptance from the other party/person.

    Thus, Agreement = Offer + Acceptance

    Table 1 lists the main differences between a contract and an agreement:

TABLE 1: Contract vs. Agreement

Contract	Agreement
It originates from an agreement.	It originates from the consent of parties.
It is always legal and enforceable by law.	It may be illegal, so may not be enforceable.

Notes

Contract	Agreement
Every contract is an agreement.	Every agreement is not a contract. For example, 'A' hires 'B' to kill 'C'. Then, it is an agreement, but not a contract, as it is not legal to kill a person and, thus, not enforceable by law.

- **Sale of Goods Act, 1930:** This act enforces the contracts relating to the sale of goods. It also applies to entire India, except the State of Jammu and Kashmir. The contract for the sale of goods is subject to the law relating to the Indian Contract Act. Its features include as follows:
  - Transfer of ownership
  - Delivery of moveable goods
  - Rights and duties of both the buyers and the sellers
  - Measures against breach of contract
  - Terms and conditions under the contract for sale

  To become effective a contract of sale, there must be a buyer and a seller. The buyer purchases/agrees to purchase goods from the seller, who sells/agrees to sell them. Goods must be moveable or transferrable from the seller to the buyer. Transfer of immovable property is not regulated under this act. Price is a necessary factor for all transactions of sale. If there is no price, then the transfer of goods is not a sale. The price normally means money, which can be paid fully in cash or partly paid/ partly promised to be paid in the future.
- **Indian Partnership Act, 1932:** According to this act, a relationship between two or more individuals where they agree to split the profits of a business is called a partnership. The business may either be run by them directly or by one/more person(s) acting on their behalf. This act is also applicable to the whole of India, except Jammu and Kashmir. The partners must be the age of majority as per the law, of sound mind and qualified for contracting. They can be an individual, firms, a Hindu Undivided Family (HUF), a company, or trustees. The maximum number of partners in a firm should be 20. The essential features of partnership are as follows:
  - **Agreement:** This defines the relationship between partners. If the only proprietor of a firm dies, then although his/her heirs inherit the firm, they do not become partners. This is because there is no agreement between them.
  - **Profit sharing:** The partners may agree to share profits, but not losses. Sharing of losses is not necessary to form a partnership.
  - **Business:** This may include every trade, occupation, or professions that are continued with a profit motive.
  - **Relation between partners:** The partner that conducts the business of the partnership is called:
    - ✓ **A principal:** He is called so because he acts for himself.
    - ✓ **An agent:** He is called so because he acts for the rest of the partners too.

- **Duties of a partner:** A partner conducts the business of the firm in good faith, renders true accounts, indemnifies for loss caused due to fraud, indemnifies the firm for wilful neglect of a partner and conducts duties carried out by the contract.
- **Rights of a partner:** A partner can participate in the conduct and management of the business, express the viewpoints in business matters, access all the records and account books of the firm, share the profits, and earn interest on advance payments. In case he incurs any expenses or losses on behalf of the firm, then he has the right to be indemnified by the firm against that amount.

❍ **Companies Act, 2013:** This act defines the incorporation, dissolution and running of companies in India. It was enforced on September 12, 2013 and includes a few amendments to the previous Companies Act, 1956. The new act has fewer sections (470) than the previous act (658). It empowers shareholders and focuses on corporate governance. Some of its features are as follows:

- **Class action suits for shareholders:** This is done to make shareholders and other stakeholders more informed about their rights.
- **More power for shareholders:** Now, approvals from shareholders are required for various key transactions.
- **Women empowerment:** At least one Director on the Board (for a specific class of companies) should be a woman.
- **Corporate Social Responsibility (CSR):** A certain class of companies must spend a specific amount of money each year on CSR activities.
- **National Company Law Tribunal:** The National Company Law Tribunal and the National Company Law Appellate Tribunal replace the Company Law Board and Board for Industrial and Financial Reconstruction.
- **Fast track mergers:** The procedure for mergers and acquisitions for a certain class of companies has been simplified and fast-tracked.
- **Cross-border mergers:** Now a foreign company can merge with an Indian company and vice versa with prior permission of the RBI.
- **Prohibition on forward dealings and insider trading:** Directors and key managers are forbidden from purchasing call and put options of shares of the company, if they have access to price-sensitive information.
- **Increase in number of shareholders:** The maximum number of shareholders in a private company is now 200 (from 50).
- **One-Person Company (OPC):** A new form of private company called one-person company can be formed under the new act. It may have only one director and one shareholder.

SELF ASSESSMENT QUESTIONS

3. Which Act defines the relationship between two or more individuals who agree to share the profits of a business?

   a. Companies Act, 2013

   b. Sale of Goods Act, 1930

   c. Indian Partnership Act, 1932
   d. Indian Contract Act, 1872
4. What is a key feature of the Companies Act, 2013?
   a. More Sections (658) than the Companies Act, 1956 (470)
   b. Maximum number of shareholders is 50
   c. Maximum number of partners is 20
   d. One-person Company

7.4 LAWS PROTECTING CONSUMERS, SOCIETY AND PUBLIC INTEREST

Consumers are vulnerable to unscrupulous business practices. They may be exploited through high prices, defective goods, deficient services, misleading advertisements, hazardous products, black marketing, cybercrimes, etc. The government is responsible for protecting the interests and rights of consumers by setting appropriate policies, legal structure and administrative framework. In 1986, the government enacted the Consumer Protection Act, 1986, to establish a legal framework for protecting the rights and interests, and to provide socio-economic justice to the consumers. Its main objectives are as follows:

- Protect consumers' interest
- Promote free competition in markets
- Prohibit anti-competitive practices and abuse of dominant position
- Ensure free trade

The Consumer Protection Act prescribes establishment of three tier quasi-judicial bodies to redress consumer-related disputes, give relief and award compensation to the aggrieved party. These quasi-judicial consumer disputes redressal bodies include:

- **District Forums:** This is composed of a President and two members (one member is a woman).
  - **Maximum term for office:** 5 years or up to the age of 65 years, whichever is earlier.
  - **Minimum educational qualification**: Graduation.
  - **Maximum amount of adjudication**: INR 20 lakhs.
- **State Commissions:** These are headed by the retired High Court judges.
  - **Maximum amount of adjudication:** INR 1 crore.
- **National Commission:** This is headed by a retired Supreme Court judge.
  - **Maximum amount of adjudication:** Above INR 1 crore.

The proceedings before these bodies are regulated according to the principles of natural justice. A complaint can be filed against any of the following cases:

- A trader adopts an unfair or a restrictive trade practice.
- The goods purchased/agreed to be purchased from a trader are defective.
- The services hired or availed of from a trader are inadequate.
- The trader has charged a higher price for the goods than the price fixed by or in force for the time being or displayed on the package.
- The trader has sold goods hazardous to life and safety while flouting the law to display information about the contents, manner and effect of the use of such goods.

The fee structure for filing of complaints is shown in Table 2:

Table 2: Fee Structure for Filing of Complaints

Value of Goods or Services and Compensation Claimed	Fee Structure for Filing of Complaints
Up to INR 1 lakh	INR 100
INR 1 lakh - 5 lakhs	INR 200
INR 5 lakhs - 10 lakhs	INR 400
INR 10 lakhs - 20 lakhs	INR 500
INR 20 lakhs - 50 lakhs	INR 2000
INR 50 lakhs - 1 crore	INR 4000

Note that a complaint cannot be filed if:

- The complainant does not come under the gambit of 'consumer' under the Consumer Protection Act, 1986.
- If the complaint is on behalf of the general public (unidentifiable consumers).

The District Forum, State Commissions and National Commission must decide a complaint at the most within 3 months from the date of notice received by the opposite party, if there is no requirement for any commodity testing/analysis for the complaint. If the complaint requires analysis or testing, then it must be decided within 5 months.

The appeals can be filed within 30 days against the order of quasi-judicial body. An appeal against the order of the National Commission can also be referred to the Supreme Court within 30 days. However, the Supreme Court will not entertain any appeal by a person who needs to pay any amount in terms of an order of the National Commission, unless that person deposits 50% of that amount or INR 50,000, whichever is less. Similarly, there is a requirement for depositing INR 35,000 and INR 25,000 in appeals against order of State Commissions and District Forums, respectively.

Self Assessment Questions

5. In which year was the Consumer Protection Act enacted?

    a. 1930   b. 1932

    c. 1986   d. 2013

NOTES

6. Who presides over the National Commission?
   a. The Chief Justice of India b. District Magistrate
   c. Retired High Court judge d. Retired Supreme Court judge

7.5 INTELLECTUAL PROPERTY REGIME

With globalisation and free trade, Intellectual Property (IP) has assumed significant place in the legal space of India. On January 1, 1995, India signed the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) mandated by the World Trade Organization (WTO). TRIPS is the most significant multi-country agreement on IP. TRIPS-compliance is a necessary requirement for statutes, enforcement provisions, and dispute resolution methods related to IP protection.

Under the TRIPS-Agreement, India is obliged to protect trademarks, inter alia, protect distinguishing marks, recognise service marks, periodically renew registration and abolish compulsory licensing of trademarks. The brand names, trade names and trademarks must have minimum standards of protection and efficient procedures for enforcement.

India has various laws that deal with protection of IP. These are as follows:

- **The Trade Marks Act, 1999:** After a wide review and resulting repeal, the old Indian Trade and Merchandise Act, 1958 was replaced by the new Trade Marks Act, 1999, which conforms to TRIPS. This act provides, inter alia, for:
  - Registration of service marks
  - Filing of multiclass applications
  - Increasing the registration terms of a trademark to 10 years
  - Recognition of the concept of 'well-known trademark'
  - Protection of domain names

  Section 135 of the act provides legal remedies against both infringement and passing off trademarks.

  - **Infringement**: If a person uses an identical/similar/deceptively similar mark to a registered trademark without the permission of the registered proprietor of the trademark, then it is called trademark infringement.
  - **Passing off**: Suppose party A has a registered trademark. Party B misrepresents as being the owner of this trademark or having some relationship with party A such that it damages the goodwill of party A, then it is called passing off.

  The above actions are cognisable offences and can invite civil and criminal actions. In case of a criminal action for infringement or passing off, the punishment is jail for a term of 6 months to 3 years and a fine of INR 50,000 to 2 lakhs.

- **The Patents Act, 1970 (as amended in 2005):** The patent law in India is governed by the provisions of the Patents Act, 1970, as amended by the Patents (Amendment)

Act, 2005, and Patents Act Rules, 2006. This act provides for the definition of the invention, which is compliant with the provisions of TRIPS. The criteria for patentability are novelty, inventive step, and industrial applicability.

- **The Indian Copyright Act, 1957:** The India Copyright Act, 1957, as amended several times and the Indian Copyright Rules, 1958, protects the interests of creators of IP in the form of literary, dramatic, musical, and artistic works and cinematograph films and sound recordings, against:
  - Reproduction of work
  - Issuing copies of work to the public
  - Performing the work in the public
  - Communicating the work to the public
  - Making any translation or adaptation of the work

  A copyright lasts for 60 years, following the death of the author or the date of publication, depending upon the work type. However, to protect the interests of the public at large, a copyright can be used for research, review, reporting, judicial, amateur performance and education purposes.

  Infringement of copyright is a punishable offense with minimum jail time of 6 months and a fine of at least INR 50,000. In case of multiple violations, the minimum imprisonment is 1 year and a fine of at least INR 1 lakh.
- **The Information Technology Act, 2000:** This act has been established to deal with e-commerce and cybercrime in India. It was enacted to deliver and facilitate lawful electronic, digital and online transactions, and reduce cybercrime. It focuses on privacy issues and information security. Its objectives are as follows:
  - Give legal recognition to all electronic transactions and digital signatures
  - Facilitate e-filing of documents
  - Promote electronic storage of data
  - Facilitate e-transfer of funds
  - Facilitate electronic book keeping of accounts

SELF ASSESSMENT QUESTIONS

7. India is obliged to protect trademarks under which agreement of WTO?
   a. TRIPS b. GATT
   c. GATS d. SCM
8. A music composer can protect his new composition under which Act?
   a. Trade Marks Act, 1999
   b. Indian Copyright Act, 1957
   c. Patents Act, 1970
   d. Information Technology Act, 2000

7.6 LEGISLATION FOR UNFAIR TRADE PRACTICES

There are two main legislations to deal with unfair trade practices:

- Consumer Protection Act, 1986
- Competition Act, 2002

You have already studied about the Consumer Protection Act in a previous section of this chapter. **Section 2(1)(r)** of this Act defines unfair trade practice as any practice that:

- Makes a statement (oral/written/visible) which falsely represents:
  - That the goods or services are of a particular standard or quality or grade
  - That second-hand, renovated, or old goods are new goods
  - That goods or services have specific sponsorship, performance, characteristics, or benefits
- Gives any false, untested warranty/guarantee of a product
- Misleads the public on a warranty or guarantee of the goods/services
- Gives false or misleading facts damaging the reputation of the goods/services/ trades of another person
- Offers a false gift or prize with the goods/services without the intention of honouring them

The concept of unfair trade practice was also described in the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969. This act has now been replaced by the Competition Act, 2002. **Section 36 A** of the previous MRTP Act defined unfair trade practice as a practice to promote the sale, use, or supply of any goods or for the provision of any services using unfair methods or deceptive practices.

Such unfair/deceptive practices may include:

- Oral, written, or visible misrepresentation about the standard, quality, usefulness and the price of goods/services
- False warranty/guarantee of goods/services
- False advertising
- False gifts, prizes and offers in sale

Although the Competition Act, 2002 does not define unfair trade practices, it derives their meaning from the previous MRTP Act. Section 3 of the Competition Act restricts businesses from entering into anti-competitive agreements. These anti-competitive agreements include any agreement:

- Regarding production, distribution, or the control of goods or services, which damages the free competition within India
- That fixes the purchase or sale prices
- That restricts production, supply, markets, technical development, investment, or the provision of services

- That fixes the sharing of the market
- That causes bid rigging or collusive bidding

Section 4 of the Competition Act deals with the abuse of a dominant position. A business abuses its dominant position in the following cases:

- Unfair/discriminatory purchase of goods/services
- Unfair/discriminatory pricing
- Limited or restricted production of goods or services
- Denial of market access
- Uses its dominant position in one relevant market to enter into/protect other relevant market

Along with the enactment of the Competition Act, 2002, the government established a statutory body called the Competition Commission of India (CCI) to ensure that there are no unfair trade practices in the market.

The functions of the CCI are follows:

- Ensure fair competition and consumer benefits in markets
- Cooperate with other regulating authorities to ensure compliance with the Competition Act
- Advocate competition by educating ministries, state governments, regulators and other authorities about its benefits to the economy

SELF ASSESSMENT QUESTIONS

9. Which of the following is an unfair trade practice?
   a. Sale of a new dress at a price higher than the 3-month old stock
   b. Wearing down of the battery of a new mobile phone within one month
   c. Sale of a geyser with ISI mark after approval from that authority
   d. Online price of a shirt at INR 500 along with a delivery charge of INR 600, with the condition that the delivery charge may apply
10. To stop a new departmental store from doing business, a supermarket chain started selling its products at a much lower price. This trade practice is called:
   a. Competitive pricing
   b. Hoarding
   c. Abuse of dominant position
   d. Price fixing

7.7 SUMMARY

- Law is established to maintain peace, deliver justice, provide equality, protect individual rights, maintain social control and resolve disputes.

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- The main categories of law are substantive and procedural law, and civil and criminal law.
- There are three main sources of law: custom, judicial precedent and legislation.
- The main acts influencing the legal environment of business in India are the Indian Contract Act, 1872; Sale of Goods Act, 1930; Indian Partnership Act, 1932; and Companies Act, 2013.
- The Consumer Protection Act, 1986, establishes a legal framework for protecting the rights and interests, and to provide socio-economic justice to the consumers.
- The IP rights are protected through the Trade Marks Act, 1999; the Patents Act, 1970; the Indian Copyright Act, 1957; and the Information Technology Act, 2000.
- There are two main legislation for dealing with unfair trade practices: Consumer Protection Act, 1986 and Competition Act, 2002.

7.8 KEY WORDS

- **Bid rigging:** Any agreement between enterprises producing/trading identical or similar goods or services to manipulate the process for bidding.
- **Predatory pricing:** A situation where an enterprise in a dominant position exposes itself to loss on purpose or forfeits profit in the short term to foreclose an existing/potential competitor(s) in the market.
- **Hindu Undivided Family (HUF):** A family of members who are descended from a common ancestor, including wives and unmarried daughters.

7.9 CASE STUDY: CONSUMER PROTECTION ACT, 1986

The purpose of the National Consumer Disputes Redressal Commission (NCDRC) is to provide cost-effective, quick redressal of consumer disputes. This case study describes a case filed/disposed of relating to the protection of consumer rights.

In 2012, Jagannath Hirav and Baby Hirav booked a flat on the 60th floor of a luxury project named Lodha Dioro at New Cuffe Parade in Wadala, Mumbai. However, their Mumbai-based builder Lodha Crown Buildmart Private Limited did not deliver the flat as promised. Therefore, the couple filed a complaint against the builder under the Consumer Protection Act, 1986.

They alleged that they had booked a 3 BHK flat on the 60th floor of the proposed building for a price of INR 4,45,68,432 and paid a sum of INR 14 lakhs separately for two parking spaces.

In 2013, the Mumbai Metropolitan Region Development Authority (MMRDA) granted commencement certificate to the proposed building project for only ground-plus-53 floors and not 60 floors. According to the complaint, the builder demanded additional payment for the 60th floor despite MMRDA's non-permission to construct beyond 55 floors.

In 2015, the builder cancelled the allotted flat of the couple due to non-payment of extra charges. Consequently, the couple went to the Consumer Protection court and filed a complaint to seek refund of the deposited amount and compensation for the damages. In their complaint, they alleged that Lodha did not inform them on reduction in the number of floors and kept demanding a balance amount as per the agreement for a flat on the 60th floor. In this way, the builder misrepresented and suppressed the true and material facts in the registered agreement.

In defence, the builder alleged that the couple were traders who had booked the flat only for reselling purposes, and therefore cannot be regarded as 'consumer' as per the Consumer Protection Act, 1986. The builder also offered to refund the deposited amount or offer a new flat in the same building (on the 50th floor). However, the couple refused the offer.

Subsequently, it was revealed that the builder did not have the permission to build even beyond 45 floors due to height restriction by the Airports Authority of India (AAI).

Result

The National Commission heard the complaint and keeping all the points in mind passed an order in favour of the homebuyer couple. It directed the builder to refund INR 2.52 crore along with 9% interest per annum. It also held the directors of Lodha Crown Buildmart Private Limited, Ramandas Pandey and Pranav Goel, liable to pay the amount.

Source: *https://www.consumer-voice.org/real-estate/damage-for-duping-consumers-by-builders/*

QUESTIONS

1. Why did the National Commission pass the order in favour of the home buyer? Explain in your own words the points in favour of the judgement.

   (**Hint:** It judged that the builder had duped the customer after misrepresenting the facts and was practising unfair trade practices.)

2. Why did the National Commission dismiss the plea by the builder that the couple was not a 'consumer'?

   (**Hint:** Section 2(d) of the Consumer Protection Act, 1986 defines a 'consumer'. Explore the definition.)

7.10 EXERCISE

1. What do you mean by legal environment? Define law and list its objectives.
2. What are the main categories of law?
3. What are the main sources of law?
4. Describe the main acts that affect the legal environment of business.
5. What is the difference between an agreement and a contract?
6. Explain the provisions of the Consumer Protection Act, 1986.
7. Explain the laws enacted to protect IP rights.
8. What are the laws to prevent unfair trade practices? How do they define unfair trade practices?

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7.11 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
What is Legal Environment?	1.	b. Social jurisprudence approach
	2.	a. Criminal law
Acts Influencing the Legal Environment of Business	3.	c. Indian Partnership Act, 1932
	4.	d. One-person Company
Laws Protecting Consumers, Society and Public Interest	5.	c. 1986
	6.	d. Retired Supreme Court judge
Intellectual Property Regime	7.	a. TRIPS
	8.	b. Indian Copyright Act, 1957
Legislation for Unfair Trade Practices	9.	b. Wearing down of the battery of a new mobile phone within one month
	10.	c. Abuse of dominant position

7.12 SUGGESTED BOOKS AND E-REFERENCES

SUGGESTED BOOKS

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CHAPTER 8

Socio-Cultural Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Discuss the socio-cultural environment
- Explain the concept of corporate governance
- Discuss the corporate social responsibilities of a business and its importance
- Describe social audits

8.1 INTRODUCTION

The socio-cultural environment includes social customs, values, codes of conduct, beliefs, traditions, etc. Every business is influenced by the socio-cultural environment; therefore, it is essential to examine the environment and make strategies accordingly. Education level of people, values and attitude, work ethics, family structure define social cultural environment. Social practice, beliefs and associated factors are helpful for promotion of the certain products, services or ideas; the success of marketing depends on a large extent, on the success in terms of changing social attitude or value systems.

Business failures and dissatisfaction with the way many corporate functions have led to the global realisation of the need of a proper system for corporate governance. Corporate governance refers to a process of balancing between the organisation, its stakeholders' interest to achieve organisation goals and the social goals. The governance framework is there to encourage and boost the efficient and effective use of scarce resources and equally to require accountability and transparency for the stewardship of those resources. The motive is to protect the interest of individuals, corporations and society. The business firm functions and acts in such a way that it will accomplish social gains along with the traditional economic gains in which the business firm is interested. The concept of social responsibility is based on the idea that a business functions in the society and uses the physical and human resources of the society for its operations, and hence it is under the obligation to serve the society. The concept of social responsibility is also based on the idea that anything good done by a business firm for the society is good for the business itself in the long run.

This chapter begins with the description of socio-cultural environment. Further, it clears the concept of corporate governance and its need. It also illustrates the guidelines for good corporate governance. Next, the chapter discusses the Corporate Social Responsibilities and its evolution in India. Towards the end, the chapter explains social audit and its uses.

8.2 MEANING OF SOCIO-CULTURAL ENVIRONMENT

Culture is a very crucial part of any business. There should be a proper understanding of the cultural dimensions for taking key business decisions. According to **E.B. Tylor**, "*Culture of civilisation is that complex whole which includes knowledge, belief, art, morals, law, customs and other capabilities and habits acquired by man as a member of society.*"

Customs, traditions, values, beliefs, practices, behaviour, poverty, literacy, etc., that exist within a population comes under socio-cultural Environment. The social values and structure that society admires have a significant impact on the functioning of a business. For example, during Diwali, there is a huge 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. In addition, there has been a significant increase in consumerism. All these factors have led to tremendous increase in the demand for the different types of household goods. The consumption patterns, the dressing and living styles of people belonging to different social structures and culture vary significantly. This leads to generation of demands for different kinds of products.

The behaviour and attitudes of individuals and their relationships determine socio-cultural environment. Factors responsible for the creation of a socio-cultural environment include beliefs, values, norms and traditions of the society. These factors determine how individuals and organisations should be interrelated. These factors affect the business to a large extent. For example, the demand for goods and services is highly affected by the factors, such as customs, values, norms, preferences, etc., of the customers

The important socio-cultural factors that have a major impact on the operation of a business are as follows:

- **Culture:** According to the definition by **House, Javidan et al.**, "*culture is defined as shared motives values, beliefs, identities, and interpretations or meaning of significant events that result from common experiences of members of collectives and are transmitted across age generations*."

  The culture that exists within a society or community has an overwhelming impact on any business. It has been an established fact that the culture drives people's behaviour, innovation and customer service.

- **Language:** Because of diversity, people in different state, countries use different languages to communicate. An organisation operating in different states or countries should have its business communication designed in a way that can be comprehended by the local audience. English is accepted as a universal business language.

- **Religion:** Religion even determines the way people think of work. As a result, religion influences enterprise and its operations. Many companies adapt their working processes according to a religion of a given state or countries in terms of the holidays, working hours, food habits, a way of dressing, etc.

- **Social systems:** The way individual interacts and socialises with other individuals in the society is called Social system. It includes family systems, marriage, caste system, etc. Social systems influence the consumption habit of people. For example, with an increasing number of families, the demand for fast foods and ready to cook foods has increased.

- **Level of education:** Education is about teaching, learning skills and knowledge. Education changes the lifestyle of people, their thoughts and the way of doing work. The level of education changes state-wise. However, in many countries,

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the level of education has a tendency to increase. The education level and level of literacy of population of a given country are indicators of the quality of their potential workforce.

- **Customer preferences:** With the spread of global communication and facilitated travel opportunities, certain social behaviours are getting similar globally. Today, people around the world watch the same movies, listen to the same music, play the same video games and use the same Internet websites. Apparently, the taste and habits of the population are becoming the same. This social trend is called global convergence.
- **Social institutions:** Social institutions such as family, economics, religion, education and state define the collective modes of behaviour. They prescribe a way of doing things. Secondary institutions are derived from primary institutions. The secondary institutions derived from family such as marriages, divorces, monogamy, polygamy, etc. The secondary institutions of education are school, college, university, etc. The secondary institutions of state are interest groups, party system, democracy, etc.
- **Population growth rate:** The increases in the number of individuals in a population. The rise in demand for food ultimately depletes natural resources needed by everyone for living.

SELF ASSESSMENT QUESTIONS

1. The way an individual interacts and socialises with other individuals in the society is called ___________.
2. The behaviour and attitudes of individuals and their relationships determine the socio-cultural environment. (True/False)
3. The needs, tastes and habits become identical at a global level. This social trend is called ______________________.

8.3 CONCEPT OF CORPORATE GOVERNANCE

The term governance has been derived from the word *gubernare*, which means to rule or steer. It is a relatively new discipline of management that focuses on the regulation and control of an organisation. Corporate governance deals with looking after complete governance of various organisations with respect to financial disclosures, transparency, legal practices, organisational structure and social welfare.

The discipline of corporate governance is worth exploring because it includes various organisational aspects such as executive compensation, financial scandals, and shareholder activism.

According to **OECD**, "*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 other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance*."

Corporate governance can be defined as systematic process, practice and guidelines which make sure that an organisation is governed in best interest of its stakeholders and the social groups. Also, it brings clarity, fairness and accountability in operation of the organisation. Corporate governance helps in achieving various organisational objectives as well as social goals as follows:

- Prompt decision making and releasing useful and relevant information
- Full discloser and clarity in operations
- Adherence to the laws
- Promoting shareholders interest

8.3.1 NEED FOR CORPORATE GOVERNANCE

- It helps in giving complete independence to the management and board so that they can take major business decision without any pressure and biasness.
- It also helps in bringing new ideas into business and operation.
- It helps in attracting sources of fund by taking domestic and foreign investor into confidence. Corporate governance focuses on building a long-term shareholders' value.
- It is needed to gain the trust and confidence of domestic and foreign investors.
- It helps in operational performance of an organisation by the following ways:
  - Improving strategic thinking at the top through induction of independent directors who bring in experience and new ideas
  - Rationalising the management and constant monitoring of risk that a firm faces globally
  - Improving the decision-making process of the organisation
  - Assuring the integrity of financial reports, etc.
- It reduces perceived risks, consequently reduces cost of capital and enables board of directors to take quick and better decisions which ultimately improves bottom line of the corporate.
- It minimises the probable risks, as a result cost of capital decreases and enables board of directors to take prompt and better decisions which consequently improves the bottom line of the corporate.
- It ensures long-term survival and build up stakeholders' relationship.
- It attracts investors because of it the credential of an organisation are good.
- It ensures commitment to values and ethical conduct of business.

8.3.2 CORPORATE GOVERNANCE GUIDELINES

- **Clear identification of role and powers:** Proper and clear communication of powers, roles, responsibilities and accountability of the Board, CEO and the Chairman of the board is the important requirement of good corporate governance.

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- **Laws should be clear and specific.** All the rules and laws of regulatory framework should be clearly specified. This is must for effective corporate governance.
- **Code of conduct:** It is important that an organisation's code of conduct is communicated to all stakeholders and is clearly understood by them.
- **Board independence:** For sound corporate governance, an independent board is essential. It means that the board is capable of analysing the performance of managers with an objective perspective. A complete independent board is needed for the organisation so the members of board members reflect their effectiveness in dealings with other organisation.
- **Board skills:** The board must possess the necessary blend of qualities, skills, knowledge and experience so as to make quality contribution. It includes operational or technical expertise, financial skills, legal skills as well as knowledge of government and regulatory requirements.
- **Management environment:** A transparent, responsible, and objective-oriented framework should be established. This type of management environment implements robust business and operational planning, establishes clear communication system, making opportunities in a manner that the human resources engage with as per their skill-sets.

8.3.3 CORPORATE GOVERNANCE IN INDIA

India's first code of corporate governance was released in 1998, by the confederation of Indian Industry (CII). In India, the CII, Ministry of Corporate Affairs (MCA) and the Securities and exchange board of India (SEBI) are the part of corporate governance administration. In February 2000, SEBI followed the recommendations given in Kumar Mangalam Birla committee report and entrenched the first formal and official framework of corporate governance for all the listed companies (Clause 49). One more committee was set up under the chairmanship of Mr. N.R. Narayana Murthy to review Clause 49. This committee gave recommendations on the matter related to audit committees, audit reports, independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct, and financial disclosures.

In 2002, the MCA appointed Naresh Chandra committee on corporate audit and governance for investigating different corporate governance issues. The committee highlighted the aspects like financial and non-financial disclosures, independent auditing and board oversight of management. National foundation for corporate governance was set up by the MCA as a not-for-profit trust in association with CII, ICAI and ICSI to review the importance of good corporate governance practices and to facilitate good corporate governance in India.

Following laws and agreements ensure the implementation of good corporate governance:

- **The Companies Act, 2013:** This act includes laws relating to board constitution, board meetings, board processes, independent directors, general meetings, audit committees, related party transactions, disclosure requirements in financial statements, etc.

- **Securities and Exchange Board of India (SEBI) guidelines:** SEBI is a regulatory authority having jurisdiction over listed companies and which issues regulations, rules and guidelines to the companies to ensure the protection of investors interests.
- **Standard Listing Agreement of Stock Exchanges:** For companies whose shares are listed on the stock exchanges.
- **Accounting Standards issued by the Institute of Chartered Accountants of India (ICAI):** ICAI is an autonomous body, which issues accounting standards providing guidelines for disclosures of financial information. Section 129 of the New Companies Act provides that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under Section 133 of the New Companies Act. It is further provided that items contained in such financial statements shall be in accordance with the accounting standards.
- **Secretarial Standards issued by the Institute of Company Secretaries of India (ICSI):** ICSI is an autonomous body, which issues secretarial standards in terms of the provisions of the New Companies Act. So far, the ICSI has issued Secretarial Standard on "Meetings of the Board of Directors" (SS-1) and Secretarial Standards on "General Meetings" (SS-2). These Secretarial Standards have come into force w.e.f. July 1, 2015. Section 118(10) of the New Companies Act provide that every company (other than one-person company) shall observe Secretarial Standards specified as such by the ICSI with respect to general and board meetings.

Self Assessment Questions

4. __________________ is about promoting corporate fairness, transparency and accountability.
5. The organisational framework for corporate governance initiatives in India consists of:
   a. Ministry of Corporate Affairs (MCA)
   b. Confederation of Indian Industry (CII)
   c. Securities and Exchange Board of India (SEBI)
   d. All of these

8.4 CORPORATE SOCIAL RESPONSIBILITY OF BUSINESS AND ITS IMPORTANCE

All the activities a business does over and above the statutory requirement comes under Corporate Social Responsibility (CSR). CSR depicts that the business has moral responsibilities towards the society. According to **Archie B. Caroll**, *"Corporate Social Responsibility is the entire range of obligations business has to society."* He has derived four models of CSR. They are as follows:

- **Economic:** Since the firm is primarily an economic entity, its activities should contribute to the prosperity of the economy.
- **Legal:** A company is legally bound in many aspects and it is ought to obey the law of the land.

- **Ethical:** These are certain standards which the society expects the business to do though they are not demanded by the law. Example Avoiding corruption and unfair trade practices.
- **Discretionary:** These are the voluntary contributions of the business to the social affluence like participation in the community development programmes.

The Ministry of Corporate Affairs has notified Section 135 and Schedule VII of the Companies Act, 2013, as well as the provisions of the Companies (Corporate Social Responsibility Policy (CSR)) Rules, 2014, to come into effect from April 1, 2014. Every company, private limited or public limited, which either has a net worth of ₹ 500 crores or a turnover of ₹ 1,000 crores or net profit of ₹ 5 crores, needs to spend at least 2% of its average net profit for the immediately preceding three financial years on CSR activities. The CSR activities should not be undertaken in the normal course of business and must be with respect to any of the activities mentioned in Schedule VII of the 2013 Act. Contribution to any political party is not considered to be a CSR activity, and only in India CSR activities would be considered for computing expenditure.

8.4.1 COMPONENTS OF CSR

The social responsibility of an organisation refers to such decisions and activities which provide for the welfare of the society as a whole along with the earning of profit for the organisation. Following are the components of social responsibility:

- **Towards owners of enterprise:** The responsibilities of business enterprises towards their owners are:
  - Payment should be at regular basis at fair rate of dividend
  - Increase the present net value of the organisation with the help of a productive management system
  - Making the full participation of the owners in the operation of the organisation
  - Establishing the effective communication system to send a detailed and indiscriminate reports on operation of the organisation.
  - Financial doubts should be clarified in a manner so that there is no room for doubt.
  - Owners/chairman of the organisation available for the directors or top management for discussing or getting information relating to the operation of the organisation.
- **Towards workers:** Some of the responsibilities of a business enterprise towards its workers are:
  - Fair salary process, security for job, medical facility with family of workers, bonus, etc. are to maintained
  - Appraisal process is done in trustworthy manner.
  - A fair-minded opportunity process should be set up within the organisation. This helps workers and employee to enhance their skills and quality.

- Participative in management, decision making, etc., are to be promoted in the organisation.
- Facilitating better work environment and social security
- Implementing occupational hazards policy in an effective manner
- Trade union leadership policy should be encouraged
- Management manages human resources so attitude towards employee/workers should be professional as well as humane

❍ **Towards consumers:** The responsibilities of business enterprise towards consumers of its products are:

- Ensuring availability of products in the right quantity, at the right place and at the right time
- Supplying products of high quality
- Charging reasonable prices for its products
- Using correct measures
- Providing good after sales services
- Avoiding restrictive trade practices and other undesirable methods to exploit the consumers
- Encouraging the formation of associations of consumers and consumers' advisory councils and maintaining close links with them
- Developing appropriate products and services for satisfying the needs of the consumers
- Taking such measures which would promote consumer satisfaction and welfare

❍ **Towards the society:** The obligations of a business to the society are:

- Adopting a set of methods to use resources in optimised manner.
- Providing sustainability and economic growth for the society.
- Facilitating opportunity and amenities such as sports event, eco-friendly goods and water sanitation program for the society.
- Maintaining natural resources through initiatives like waste management, air pollution control system, renewable energy system, etc.
- Contributing in social welfare programmes by conducting sanitation programs in villages and urban slums, facilitating medical care for senior citizens, women and children, making awareness for skill development, etc.
- Improving quality of life of the people at large by capacity building, creating employment and providing opportunity to making wealth.

❍ **Towards the government:** The obligations of business enterprise to the government are:

- Strictly observing the provisions of the various laws and enactments

- Paying taxes and other dues to the government regularly and honestly
- Extending full support to the government in its efforts to solve national problems such as unemployment, food, inflation, regional imbalance in economic development, etc.

❍ **Towards the weaker section of society:** The obligations of business enterprise to the weaker section of the society are:

- Providing vocational training like cookery, tailoring, selling techniques for their economic growth
- Donating funds to various voluntary agencies and NGOs, which are participated in population and family welfare, literacy and education, development of women and children of the schedule cast and schedule tribes.

8.4.2 IMPORTANCE OF CSR

❍ **Optimum utilisation of resources:** Resources are limited in nature. By following social responsibilities, an organisation is expected to use resources in a justified way. Resources are to be used for the productions of those goods and services which are not detrimental to the interest of the society. Organisation is not expected to produce unnecessary and unwanted goods. Production of such goods not only reduces national resources, but also encourages people to spend on unnecessary consumption.

❍ **Producing goods and services efficiently and contributing to the economic well-being of society:** Organisations are expected to produce goods without wastage. Organisations are expected to practice business process reengineering. This helps the organisation to identify new and improved ways of doing improvement in the product. Product safety is also taken care of. All these factors contribute to the economic well-being of the society.

❍ **Providing public amenities and avoiding the conditions of slums and congestion:** Organisations are expected to protect the surrounding environment. It cannot handover this responsibility to the government. If healthy environment exists, the organisation takes initiative to avoid slums and congestion and pollution of surroundings.

❍ Maintain environmental ecology and adopting anti-pollution measures.

SELF ASSESSMENT QUESTIONS

6. CSR depicts that the business has moral ________________ towards the society.
7. Paying taxes and other dues to the government regularly and honestly do not come under CSR. (True/False)

8.5 SOCIAL AUDITS

Social audit is a set process of reviewing the organisation performances, code of conduct, and its CSR work report and initiatives. Social audits making transparencies in work-culture of the organisation and its performances. Social audits reduce wrong practices, wastages, and improves the way of working of the organisation.

The customers may protest violently, seek justice through courts and press the government to put an end to such unlawful operations.

The main purpose of social audit is to improve the local governance of an organisation, Strengthen the accountability, and maintain transparency among shareholders. An annual statement is prepared that shows the information regarding the organisation shareholders, various social projects, initiatives taken up for the benefits of employees.

The process of social audit involves the following four steps:

1. Find circumstances leading to the commencement of the social audit programme.
2. List goals of the social programme.
3. State how the organisation is going to meet such goals.
4. Quantitatively evaluate what is actually done as against what has been planned.

8.5.1 USES OF SOCIAL AUDITING

Following are the uses of social auditing:

- To indemnify the requirements in accurate manner and helps in making an environmental-oriented work culture within the organisation.
- To make sure transparency in financial and accounting report.
- To facilitate free from harassment and equal opportunity organisational system.

To ensure the utilisation of funds as per the requirement.

Self Assessment Questions

8. ______________ is a process of measuring and understanding, reporting and ultimately improving an organisation's social and ethical performance.
9. Which of the following options reflects the main purpose of social audit ?
   a. Improve the local governance
   b. Strengthen the accountability
   c. Maintain transparency
   d. All of these

8.6 SUMMARY

- Customs, traditions, values, beliefs, practices, behaviour, literacy, etc. that exist within a population comes under socio-cultural Environment.
- Corporate governance is process by which and organisation set the rules to govern in the interest of its stakeholders and the people at large.
- Corporate Governance is needed to gain the trust and confidence of domestic and foreign investors, protecting shareholder's interest, etc. for effective decision making and transparency.

- Clear identification of powers, roles, responsibilities and accountability of the Board, unambiguous legislative and regulatory framework, adherence to code of conduct by each member, etc. are some guidelines for corporate governance.
- The Ministry of Corporate Affairs (MCA), CII and SEBI introduced the framework of corporate governance for the companies in India.
- The social responsibility of an organisation refers to the activities to provide for the welfare for the people at large along with the earning of profit for the firm.
- Social audit is a set process of reviewing the organisation performances, code of conduct, and its CSR work report and initiatives.

8.7 KEY WORDS

- **Transparency:** It is the discloser of all the relevant information to the stakeholders or interest group**.**
- **Responsibility:** It is the duty or obligation to complete a given task.
- **Accountability:** It is the duty of an individual or organisation to account for its activities.
- **Unambiguous:** Describing something clearly so that it is not open to more than one interpretation or meaning.

8.8 CASE STUDY: COCA-COLA-CSR STRATEGY

One of the country's leading beverage companies is Coca-Cola India, offering a wide range of rejuvenate beverage alternatives to consumers. In 1993, the Company re-entered to establish portfolio of its beverage brands like Coca-Cola Zero, Coca-Cola, Diet Coke, Thums Up, Fanta, Fanta Green Mango, Limca, Sprite, Sprite Zero, VIO Flavored Milk, Maaza, Minute Maid range of juices, Georgia and Georgia Gold range of hot and cold tea and coffee options, Kinley and Bonaqua packaged drinking water, Kinley Club Soda and BURN energy drink.

Coca-Cola noticed that CSR had to be an essential part of its corporate agenda. As per the company, it was familiar with the environmental, social and economic aftermath caused by a business of its scale and, therefore, it had decided to execute initiatives to upgrade the quality of life of its customers, the personnel and society at large.

However, the company received strong criticism from environmental experts and activist who accused it with lower groundwater resources in the areas in which its bottling plants were established, thereby affecting the subsistence of the poor farmers, disposing toxic and dangerous waste materials near its bottling facilities, and dumping waste water into the agricultural lands of farmers. Due to its unethical practices, Coca-Cola get the notorious tag in the world business.

Coca-Cola taking initiatives like rainwater harvesting, restoring ground water resources, sustainable development like recycling process of waste materials. It also outlined the plan for water neutrality for India. Its critics also appraised its initiatives project like 'green' and 'environment-friendly' business operation in India and spent millions of dollars on this project. This case study revealed the challenges to prepare and implement its CSR strategy in India.

Source: *http://www.icmrindia.org/casestudies/catalogue/Business%20Ethics/BECG093.htm*

QUESTIONS

1. Analyse the issues and disagreement faced by Coca-Cola with regard to its sustainability initiatives in India.

   (**Hint:** Disposing toxic material, lower water level, adversely affecting lives of the poor farmers.)

2. Examine the CSR strategy endorsed by Coca-Cola India.

   (**Hint:** rainwater harvesting, restoring groundwater resources, sustainable packaging, recycling, etc.)

8.9 EXERCISE

1. Socio-cultural factors have a major impact on the operation of a business. Explain this statement with one example.
2. What do you mean by the term 'Corporate Governance'? How will you differentiate Corporate Governance from Corporate Social Responsibilities?
3. In what ways is social auditing useful for the organisations? What are the steps involved in social auditing?
4. Describe the social obligations of business towards its customers and society. Explain the importance of corporate social responsibilities.

8.10 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Meaning of Socio-Cultural Environment	1.	social system
	2.	True
	3.	global convergence
Concept of Corporate Governance	4.	Corporate governance
	5.	d. All of these
Corporate Social Responsibility of Business and its Importance	6.	responsibilities
	7.	False
Social Audits	8.	Social audit
	9.	d. All of these

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8.11 SUGGESTED BOOKS AND E-REFERENCES

SUGGESTED BOOKS

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CHAPTER 9

Business Environment of Service Sector

Table of Contents

LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe an overview of the service sector
- Explain the banking reforms and challenges
- Discuss the industrialisation trends and industrial policy environment for the SME sector
- Examine the emerging service sectors of the Indian economy

9.1 INTRODUCTION

In the previous chapter, you have studied the meaning of socio-cultural environment and the concept of corporate governance. The chapter explained the concept of Corporate Social Responsibility of business and its importance. Towards the end, you studied about social audits.

When it comes to India's growth story, the service sector is a key driver. Its contribution was 57.12% to India's gross value (at current prices) in the first half 2018-19. The net service exports were $ 38.95 billion. The service sector in India encompasses a wide range of activities including trade, software development, hotels and restaurants, transport, storage, communication, financing, insurance, real estate, business services, community, social and personal services, and construction services, etc.

In this chapter, you will learn about the business environment of the service sector. You will also learn about banking reforms and challenges, current industrialisation trends and industrial policy environment for the Small and Medium Enterprises (SMEs) and emerging service sectors in the Indian economy.

9.2 UNDERSTANDING SERVICE SECTOR

The service sector is the producer of services (intangible goods) instead of goods. It includes various types of services are as follows:

- Information technology sevices
- Transportation services
- Financial services
- Investment services
- Waste management services
- Healthcare services
- Entertainment services
- Education services

The service sector is also called the third tier or tertiary sector in an economy. **Allan Fisher, Colin Clark, and Jean Fourastié** proposed three sectors of an economy. They are as follows:

- **Primary sector/tier:** It includes extraction of raw materials, mining, fishing and agriculture produce, forestry and other tangible goods.
- **Secondary sector/tier:** It includes manufacturing tangible products such as such as cars, clothes, fuels, etc.
- **Tertiary sector/tier:** It includes services such as consultancy, software development, transportation, etc.

As an economy, its focus shifts from the primary tier, through the secondary tier, to the tertiary tier. Developing countries with low per capita income achieve the main part of their national income through the primary tier. Countries in a more advanced stage of development achieve their income mostly in the second tier. However, highly advanced countries with a high per capita income rely on the tertiary (services) tier as the major contributor to the economy.

According to the CIA World Factbook released in 2018, the largest countries by tertiary output are presented in Table 1:

Table 1: Largest Countries by Tertiary Output

Rank	Country (Economy)	Services GDP	% of Total GDP
1	United States	15,526,720	80.2%
2	China	6,232,680	52.2%
3	Japan	3,384,612	69.3%
4	Germany	2,530,836	69.3%
5	United Kingdom	2,062,260	80.4%
6	France	2,005,925	77.9%
7	Brazil	1,514,968	72.8%
8	India	1,499,985	61.5%
9	Italy	1,419,619	73.9%
10	Canada	1,151,280	70.2%

Source: *http://statisticstimes.com/economy/countries-by-gdp-sector-composition.php*

The service sector contributes maximum to the business sector of an economy. Businesses in this sector constitute 'knowledge economy,' or the ability to gain a competitive edge by understanding customer's needs and meeting those needs quickly and cost-effectively.

9.2.1 IMPORTANCE OF SERVICE SECTOR IN INDIA

According to Table 1, India ranks eighth in the top 10 service producers' countries in the world. The Gross Domestic Product (GDP) amount by the services in India was

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$ 1,499,985, as of 2017. Some reasons why the service sector is important to India's growth story are given below:

- **Contribution to GDP:** The expansion of the service sector was largely responsible for India's economic growth since the 1990s, where exports played a major role. After 1996-97, the share of services in GDP increased significantly. From just 1.9% in 186-87, it increased to 6.8% in 2006-07. Today, the service sector accounts for more than half of the country's GDP. Table 2 illustrates this trend more clearly:

Table 2: Share of Services in India's GDP Over the Years

	1950 - 51	2013 – 14
Share of total services, excluding construction to India's GDP	28.5%	51.3%
Share of total services, excluding construction to India's GDP at factor cost (at current prices)	30.5%	55.7%
Share of transport, communication and trade in India's GDP (at constant prices)	11%	18.6%
Share of community and personal services to GDP (at constant prices)	8.5%	12.9%
Share of finance insurance, real estate, and business services	9%	19.8%

- **Support to agriculture and manufacturing:** The service sector achieved the Compound Annual Growth Rate (CAGR) of 10.3% for the period 2004-5 to 2011-12. This rate was higher than the CAGR of India's GDP achieved during the same period, which was 8.6%. In other words, the service sector increased at a higher rate than both the agriculture and industry sectors, which was only 6.6%. Significantly, this growth was due to the growth of public services, information technology and financial services. Today, India is a service-oriented economy. It skipped the traditional growth models of manufacturing growth stage and directly jumped from the agricultural growth to the services growth stage. This growth in the service sector will help the agriculture and the industry sectors in the following ways:

  - **Support to agriculture:** Services will expand agriculture by providing better network, transportation and credit facilities to farmers.
  - **Support to industrialisation:** Services such as transport, communication, electricity and banking will boost industrialisation in the country.

  The growth of the service sector will also help to generate more employment and raise overall productivity.

- **Boost exports:** The growth in services was largely associated with the surge in the exports. India's share of services in total exports (38%) is much higher than in countries such as China, Mexico, and Brazil, and is close to ratios in the US and the UK.

The ratio is presented in Figure 1:

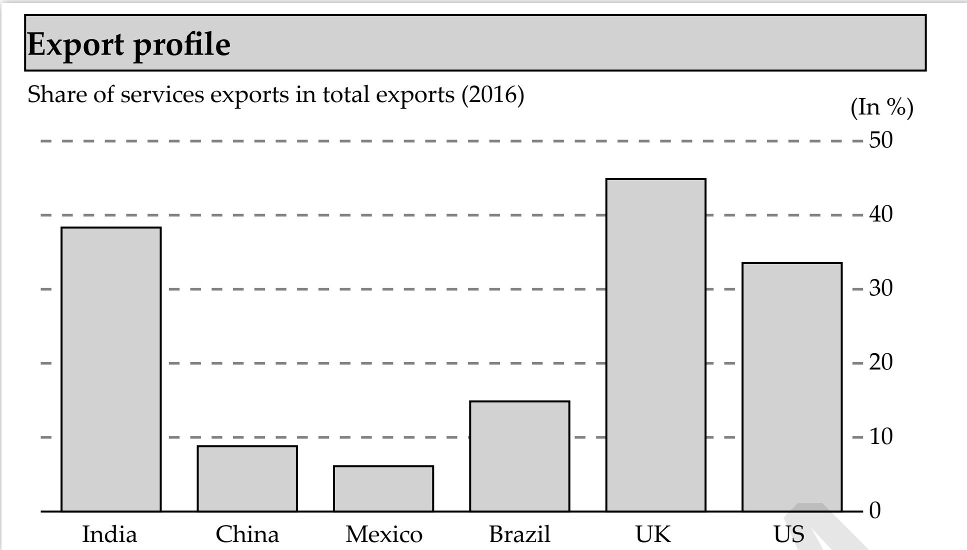

FIGURE 1: Export Profile

Source: *https://www.thehindubusinessline.com/opinion/columns/c-p-chandrasekhar/indias-services-sector-boom-has-failed-on-the-jobs-front/article25540761.ece*

- **Employment generation:** Agriculture is still the dominant employer in India, but the service sector is quickly taking over. From 1999-00 to 2009-10, employment in the service sector increased by 25% as shown in Figure 2:

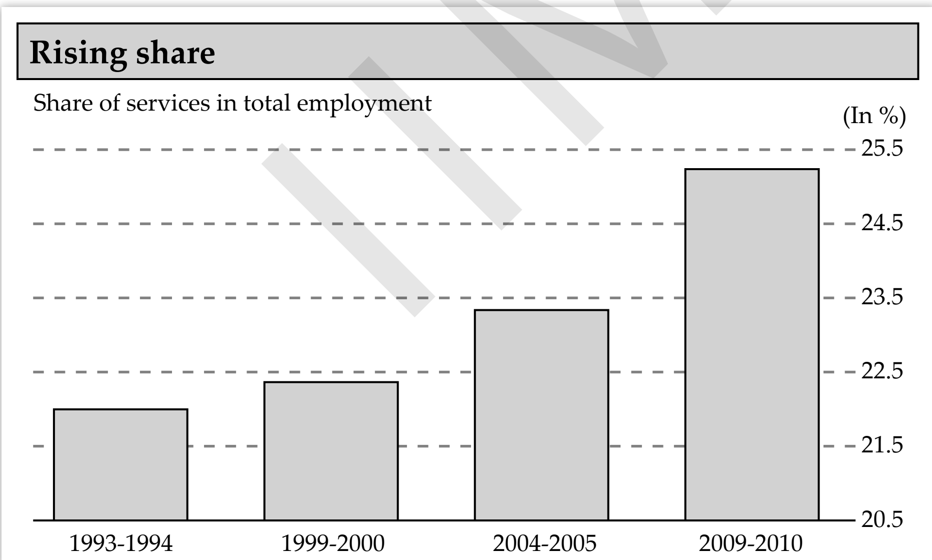

FIGURE 2: Share of Services in Total Employment

Source: *https://www.thehindubusinessline.com/opinion/columns/c-p-chandrasekhar/indias-services-sector-boom-has-failed-on-the-jobs-front/article25540761.ece*

This rise was particularly observed in the construction sector. The total employment in the construction sector increased from 17 million in 2000 to 50 million in 2011-12 (double from 2004-05). Thus, the share of the construction sector in total employment increased from 4.4% in 1999 – 2000 to 10.5% in 2011 – 12.

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According to the National Sample Survey Organisation (NSSO) report on Employment and Unemployment Situation in India in 2009-10, for every 1000 people employed in rural India, the share of employment is as shown in Table 3:

TABLE 3: Share of Employment Over Three Sectors of Economy

Total Number of People Employed	People Employed in Agriculture	People Employed in Manufacturing	People Employed in Services
Rural India			
1000	679	80	241
Urban India			
1000	75	242	683

Studies further indicate that the employment growth of the service sector in both rural and urban areas is steadily moving from low-income jobs to high-income jobs.

- **Contribution towards human development:** The service sector provides valuable services towards human development, such as health services, education, IT and IT Enabled Services (ITES), skill development, health tourism, sports, and cultural services. These services help to empower and improve the quality of life of the public at large.
- **Contribution towards Foreign Direct Investment (FDI):** A modest growth of the service sector has streamlined the flow of FDI into India. The combined FDI share of financial and non-financial services, computer hardware and software, telecommunication and real estate was 40.5% of cumulative FDI equity during April 2000 – December 2012. If the construction sector is also included, then the FDI inflows increase to 47%.
- **Contribution towards infrastructure development:** The service sector plays a key role in developing, expanding and managing transportation and communication infrastructure. The transport, storage and communication contributed 7.1% (at current prices) to the GDP in 2011-12.
- **Contribution towards IT and ITES growth:** The IT and ITES industries have four key parts:
  - IT services
  - Business Process Outsourcing (BPO)
  - Engineering services, and Research and Development (R&D)
  - Software products

  Over the year, this industry has generated considerable revenue and employment in the Indian economy. According to NASSCOM, the IT-BPM sector (excluding hardware) revenues of India were $ 167 billion in 2018. The sector is projected to create 1 lakh IT jobs in 2019-20.
- **Development of social services:** The service sector also plays a significant role in the development and expansion of some social services, such as sports and cultural services. These are core sectors of job creation and a vehicle of cultural identity. They promote valuable social services and enrich the society.

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9.2.2 TRENDS IN SERVICE SECTOR GROWTH

According to a report by IBEF, the service sector is poised for strong growth in the coming years. Some key trends are as follows:

- It has grown at a CAGR of 6.25% from 2012-2019 (at current prices) to reach $ 1,294.41 billion.
- It will continue to be a major employment provider. As of 2018, it provided direct employment to 34.49% of India's population.
- It will continue to contribute significantly to the total exports of India. In 2017, India was the 8th largest exporter of commercial services. In the first half 2018-19, the exports of services amounted to $ 38.95 billion.
- It will continue as a major contributor of FDI inflows in India. In the period of April 2000-December 2018, the service sector received FDI inflows of $ 70.91.
- The key performers in the service sector are as follows:
  - **Aviation:** From 2011 to 2017, the air passenger traffic in India quadrupled from 59.87 million to 117 million passengers.
  - **Tourism:** The earnings in the tourism in 2017 were $ 27.7 billion, which was an increase of 20.8% on a year-on-year basis.
  - **IT-BPM:** Revenues from the IT-BPM industry increased by 8.38% year-on-year from $ 167 in 2018 to $ 181 billion in the first quarter of 2019.

SELF ASSESSMENT QUESTIONS

1. The services sector is called ____________ of an economy.

   a. primary tier   b. secondary tier

   c. tertiary tier   d. quarterly tier

2. Which sector is the biggest employment generator in India as of 2018?

   a. Services   b. Manufacturing

   c. Agriculture   d. Construction

9.3 BANKING REFORMS AND CHALLENGES

India's financial sector is dominated by the banking industry. It has several structural weaknesses, which cannot be removed without radical reforms.

Indian banks have around $ 150 billion in non-performing assets (NPAs) or about 15% of total loans. Public sector banks hold a majority of these NPAs. In early 2018, the government injected a package of $ 14 billion followed by $ 6.8 billion in early 2019 to help the banks. To improve recovery rates, the government has also implemented several key amendments to the bankruptcy code. However, these reforms are not sufficient, as they do not resolve structural challenges such as:

- High level of government involvement in the financial sector
- Inadequate financial inclusion of a large scale of population

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- Wasteful misallocation of capital
- Poor governance

These problems arise because there are two competing forces in the country, which are difficult to reconcile. Out of a straight line, the Indian state needs compliant banks to lend to favoured sectors and finance the government by purchasing bonds. On the other hand, there are capital requirements of businesses and consumer requirements for basic banking.

Let us discuss the structural problems in the banking sector of India.

- **High level of state ownership:** The public sector banks own about 70% of deposits and 50% of loans. Although they are listed on the stock market with minority shareholders, these banks are mostly used as the tools of the government policy. The top appointments in banks are politically influenced. Ministers decide capital allocations after evaluating their impact on the fiscal deficit and other funding priorities.
- **Distorted financial system:** About 25% of loan share is through private banks. Due to the existence of public banks, private banks choose to operate in commercially profitable segments. As a result, public banks have to bear most of the cost of servicing remote areas and unprofitable accounts. This has led to artificially-high valuations for some private sector banks.
- **Liquidity risks:** The deposit base of private banks is not adequate to finance lending growth. Their high loan-to-deposit ratios make their liquidity vulnerable in wholesale money markets.
- **Financial exclusion:** There are still around 190 million people in India who have no bank account.
- **Constrained credit:** To improve the capital ratios of banks, the Reserve Bank has imposed a Prompt Corrective Action Plan. As a result, more than half of the public sector banks cannot expand lending, which hurts small borrowers, such as farmers.
- **Misallocation of capital:** The government prefers public sector banks to grant loans to its business backers and state-owned enterprises, which become NPAs in the downturn of the economic cycle. Multiple governments have been unwilling to deal with bad debts, which ties up their capital.
- **Shadow banking:** It is a term used to describe the non-bank financial intermediaries which provide financial services, such as loans and other services to individuals or business entities. This type of banking is usually related to risky investments, pawnshop and peer-to-peer lending. Shadow banking is widespread in India. As of March 2019, its share in the total loan share is 25%. Just as banks, these institutions use short term borrowings to finance long-term loans. However, for funding, they rely on volatile money markets and interbank loans, which increase their risk. On September 2018, IL&FS, an infrastructure finance group, defaulted on short-term lending and required a bailout. The exposure of Indian banks to shadow banks is also threateningly high, as they have lent about $70 billion to shadow banks (40% of the banking sector's capital).

- **Corruption and governance:** Since 2018, banking frauds amounting to more than \$2.5 billion have come to the public's attention. This includes the \$2 billion case of the Punjab National Bank by companies associated with the celebrity jeweller Nirav Modi and his uncle Mehul Choksi. The private sector banks are also not doing well. The CEOs of several reputed private banks have exited in questionable conduct. For example, Chanda Kochhar, the former CEO of ICICI Bank (a large private sector bank), resigned on October 2018 on charges of having a conflict of interest. She has been accused of granting loans from the ICICI Bank to a company founded by her husband.

The above challenges require some structural reforms to the banking sector. The reforms are as follows:

- **Full privatisation of public sector banks:** This will allow banks to operate autonomously without any interference from the government. The government will benefit, as it will get cash funds and will be able to remove future capital claims on the budget.
- **Consolidation of the banking industry:** The consolidation of the banking industry will help to remove poorly managed lenders.
- **Reform of shadow banks:** There must be an amendment in the law to reduce regulatory arbitrage of shadow banks. They must meet the requisite standards of capital requirement to the letter and the spirit.
- **Improvement in financial inclusion:** To bring in financial inclusivity, commercial financial groups and private banks may be given subsidies to operate in low-profit sectors. Public banks may be roped in to provide limited services to target sectors.

However, the above reforms are difficult to implement due to the following issues:

- Resistance from all political parties to privatise banks
- Protest from trade unions and employees against deregulation due to fear of job loss and a more competitive employment environment
- Pressure from the government on the RBI to lower interest rates on lending and recognise NPAs

Self Assessment Questions

3. Which of the following is a structural weakness in the Indian banking sector?

   a. Deregulation of banks
   b. Existence of only state-sponsored banks
   c. Financial inclusion
   d. Shadow banks

4. Due to lowering performance and asset quality, the RBI asked the board of a bank to reconsider the fourth 3-year term given to its CEO. Which bank was that and who was the CEO?

   a. Chanda Kochhar, ICICI Bank
   b. Shikha Sharma, Axis Bank
   c. Rana Kapoor, Yes Bank
   d. Usha Ananthasubramanian, PNB Bank

9.4 CURRENT INDUSTRIALISATION TRENDS AND INDUSTRIAL POLICY ENVIRONMENT FOR THE SME SECTOR

After the agriculture sector, the Small and Medium Enterprises (SMEs) are the second largest employment generators in India. According to the National Sample Survey (NSS), the sector has created 11 crores jobs in the rural and urban areas of the country in 2015-16. The sector contributes around 31% to India's GDP.

Figure 3 shows the contribution of SMEs in the national economy at current prices:

Year	SME GVA	Growth (%)	Total GVA	Share of SME in GVA (%)	Total GDP	Share of MSME in GDP (%)
2011-2012	2583263	-	8106946	31.86	8736329	29.57
2012-13	2977623	15.27	9202692	32.36	9944013	29.94
2013-14	3343009	12.27	10363153	32.26	11233522	29.76
2014-15	3658196	9.43	11481794	31.86	12445128	29.39
2015-16	3936788	7.62	12458642	31.60	13682035	28.77

Figure 3: The Contribution of SMEs in the National Economy

Source: *MSME Annual Report (http://ficci.in/spdocument/23035/Key-to-SME-Growth.pdf*

The share of SMEs in the overall exports stands at 45% and in manufacturing output at 34%.

Section 7 of the MSMED Act, 2006 has identified three classes of SMEs:

- **Micro enterprise:** A unit producing goods or rendering services with the maximum annual turnover of INR 5 crores.
- **Small enterprise:** A unit producing goods or rendering services with an annual turnover of INR 5 crores-75 crores.
- **Medium enterprise:** A unit producing goods or rendering services with an annual turnover of INR 75 crores-250 crores.

The contribution of MSMEs to the total industrial sector is more than 80%. They employ about 117 million people. They contribute more than 40% to industrial output and exports. However, there is still a considerable unidentified potential in this sector, which needs to be tapped.

A majority of MSMEs in India do not have access to structured finance from banks. This could be because more than 50% of MSMEs in India are rural enterprises in low-income states. Therefore, they are a priority sector to focus on for inclusive economic growth and poverty alleviation.

To allocate funds to MSMEs, alternative sources of financing have been proposed. They are as follows:

- **Factoring mechanism:** Factoring mechanism involves the selling of accounts receivable (borrowers) to a third party (factor) at a discounted rate. This arrangement is very useful for companies who have inadequate working capital and cash flow problems. The company pays cash against the credit sales of the customer and obtains the right to receive future payments on those invoices from the debtors. In February 2012, The Factoring Regulation Act was enacted to promote and regulate the factoring business in India. However, much still needs to be done to raise its awareness.

- **Private equity:** Private Equity (PE) investment is another way to raise capital for MSMEs. This method is not only easier than the public issue, but also requires minimum regulation. Currently, PE investments in India are tilted towards larger businesses; they still have to gain a foothold on small business investments. Although venture capital funds and angel investors have shown interest in MSMEs, much still needs to be done. The regulatory authority has taken a crucial step in the listing of companies on the MSME exchange. But the market for public issues of MSMEs is in a nascent stage and there is a lack of underwriters to support their PE investments. Another challenge is that MSMEs balance sheets are under pressure due to heavy reliance on debt. They need to shift their focus from debt to equity capital mix to grow in a healthier way. This alternative funding method will improve their balance sheets, increase their capacity to bear the volatile business environment, and make them more flexible in determining the return on investment.
- **Crowdfunding:** It is also known as democratised funding, this is a web-based tool that involves raising capital from various lenders through a social platform. This concept is also in nascent stage in India, whereas it is a major source of raising capital in the US, UK, and China. SEBI is considering a framework to promote, streamline and regulate crowd funding in India.
- **Peer to Peer (P2P) lending:** This is a popular form of crowdfunding where interested investors and borrowers with matching requirements connect to fund a venture, without involving a formal financial institution. It does not require collaterals and offers affordable rates of interest, which are lower than of the banks. This scheme allows investors with extra cash to fund lucrative ventures. However, in India, this funding concept is at its nascent stage and unregulated.
- **Fin-tech start-ups:** These act as intermediaries between banks/NBFCs and borrowers. The charge a processing fee from both for a transaction. As against traditional credit rating agencies, fin-techs arrive at more holistic credit scores, which help the MSME to build a good credit history. As a result, their loan applications are processed more quickly.

The aim of the 'Make in India' campaign is to transform India as a manufacturing hub by promoting exports and FDIs, raising industrial productivity, and improving the ease of doing business. This is expected to create 100 million jobs by 2022 and increase the share of manufacturing sector to 25% in the national GDP. There are two main groups of industries that can be leveraged here:

- Open up and enhance India's traditional unskilled labour-intensive manufacturing products such as clothing, footwear and toys.
- Become a major player as the final assembly line for high-end product manufacturing, such as cars, electronics and electrical goods.

The emerging opportunities for the SMEs in the coming years include:

- Going digital and embracing the e-commerce trend to gain a competitive edge
- Adopting social media, mobile phones and cloud technology to open up new opportunities for revenue growth and operational efficiency

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- Taking benefits from government initiatives such as 'Make in India', 'Startup India', and 'Skill India' to promote entrepreneurial culture
- Taking advantage of fin-tech firms to get accessible and affordable funds for business

SELF ASSESSMENT QUESTIONS

5. Which of the following is a small enterprise as per Section 7 of the MSMED Act, 2006?
   a. A unit with the minimum annual turnover of INR 5 crores
   b. A unit with the maximum annual turnover of INR 5 crores
   c. A unit with the annual turnover of INR 5 crores-75 crores
   d. A unit with the annual turnover of INR 75 crores-250 crores
6. Which funding method involves the selling of accounts receivables to a third party at a discounted rate?
   a. Factoring mechanism b. Crowdfunding
   c. Private equity investment d. P2P lending

9.5 EMERGING SERVICE SECTORS OF THE INDIAN ECONOMY

There are several service sectors within the Indian economy that are expected to rapidly grow quite large in the near future. These emerging sectors are as follows:

- **Food processing:** The food processing sector received FDI of about $ 7.54 billion from April 2000-March 2017. According to the Confederation of Indian Industry (CII), this sector will attract up to $ 33 billion FDI over the next decade and employ about 9 million person-days. Key initiatives to boost this sector include:
  - 100% FDI in marketing and e-commerce of food products through automatic routing
  - Research in the fertiliser sector with international cooperation
  - Enhancement and development of skills in food and food processing industry
  - Adoption of international food safety and quality assurance mechanisms
  - Good Manufacturing Practices (GMP) and Good Hygiene Practices (GHP)
- **Healthcare:** The growth in the healthcare market is estimated to be INR 8.6 trillion by 2022. The average growth of medical tourism in the country is 22%-25%. By 2025, the government will increase health expenditure to 2.5% of the country's GDP. The government's Pradhan Mantri Jan Arogya Yojana (PMJAY) provides health insurance of INR 5 lakhs to more than 100 million families every year. Ayushman Bharat National Health Protection Mission is the world's largest government funded health scheme. The diversified healthcare sector provides opportunities for both public and private players. More and more companies are now getting Abbreviated New Drug Application (ANDA) approvals.
- **Retail:** The retail market is likely to increase by 60% to achieve $ 1.1 trillion by 2020 due to rising disposable incomes, quality of life and digital connectivity. India's e-commerce market is phenomenally growing due to robust investment, rapidly

increasing Internet users, increasing disposable income, entry of foreign players and positive demographics. By 2021, the retail market is expected to be shared as follows: traditional retail (75%), organised retail (18%) and e-commerce retail (7%).

- **Education and training:** India has the world's largest population in the age of 5 – 24 years. This provides a great opportunity for the education sector, which is forecasted to reach $ 10.1 billion in 2019. India is the second largest eLearning market after the US. By 2021, the eLearning is expected to reach $ 1.96 billion. Due to the need for developing skill in the growing economy, education infrastructure development has assumed considerable significance. The availability of English-speaking, technology-educated talent and a strong legal and Intellectual Property (IP) protection framework boost the network.
- **Tourism and Hospitality:** The Indian tourism and hospitality industry is an emerging sector that has the potential to provide a large scale of employment and generate massive FOREX capital. The rising disposable income is a strong contributor to the growth of domestic and international tourism. During 2018, foreign tourist arrivals (FTAs) grew by 5.2% year-on-year, and stood at 10.56 million. The sector contributed 8% share in employment generation in 2018, employing around 41.6 million people in 2018. It is estimated that by 2028, about 52.3 million jobs will be created in this sector. International hotel chains are increasing their footprint in the country, while debt-ridden domestic hotel chains are consolidating to improve their profitability.

SELF ASSESSMENT QUESTIONS

7. How much FDI is proposed for marketing of food products?

   a. 25%   b. 50%

   c. 80%   d. 100%

8. The world's largest centrally funded health scheme is _____________.

9.6 SUMMARY

- The service sector is the tertiary sector in an economy, after agriculture (primary sector) and manufacturing (secondary sector).
- The service sector is the prime contributor to the economy of highly advanced countries with a high per capita income.
- The service sector contributes to GDP growth, expands agriculture, supports industrialisation, increases exports, generates a large-scale employment, contributes towards human and infrastructure development, increases FDI inflows, contributes to IT and ITES growth, and develops social services.
- India is the eighth largest service sector country in the world. In the coming years, the service sector in the country is forecasted to rise exponentially in various sectors, spurred by government initiatives, infrastructure development, rising incomes of the middle class, and increasing digital connectivity.
- India's financial sector is controlled by public sector (majority share) and private sector banks, as well as NBFCs (shadow banks). The sector is riddled with various structural weaknesses that need to be resolved firmly to ensure strong economic growth and avoid financial crisis.

- After the agriculture sector, the SMEs are the second largest employment generators. Primarily based in rural areas, the SMEs have received considerable government interest in the form of schemes and funding to ensure that they continue to contribute to the national GDP. However, they still face a considerable problem in procuring funding and capital. Several new initiatives such as crowdfunding and fin-tech start-ups have now eased their funding options, but they still need to be taken up on a larger scale.
- The emerging services in India, which are poised for a strong growth in the near future, are food processing, healthcare, retail, education and training, and tourism and hospitality.

9.7 KEY WORDS

- **Service:** The intangible equivalent of a tangible goods.
- **Service provision:** An economic activity that facilitates a change in the tangible or intangible assets of customers.
- **Gross Domestic Product (GDP):** The total monetary value of all the goods and services produced by an economy in a year.

9.8 CASE STUDY: SHADOW BANKING CRISIS

On September 6, 2018, India's credit markets were spooked when news of a default by Infrastructure Leasing and Financial Services (IL&FS) was flashed on television channels and newspapers. And they were right to fear that—the IL&FS had a massive INR 91,000 crores debt and there was no near end at sight. This case study explores the causes of this financial crisis, which threatens to engulf India's banks and lending institutions.

IL&FS was founded in 1987 by three financial institutions: Central Bank of India, Housing Development Finance Corporation (HDFC), and Unit Trust of India (UTI). The aim was to establish a firm that would provide loans for major infrastructure projects. A few years later, Life Insurance Corporation India, Orix Corporation Japan and Abu Dhabi Investment Authority (ADIA) became its largest shareholders. The current shareholders in the company are as follows:

- LIC – 25.3%
- Orix – 23%
- ADIA – 12.5%
- IL&FS staff – 12%
- HDFC – 9%
- Central Bank of India – 7.6%
- SBI – 6.4%

The main reasons for its failure were:

- **Complex company structure:** A prime reason for IL&FS's default was its complex organisation structure. The parent IL&FS owned 69 companies. 135 companies were indirect subsidiaries, 6 companies were joint ventures, and 4 were associate companies. As a result, it was extremely difficult to audit and monitor the company's books.

- **Source and use of funds:** The parent IL&FS company ran up a debt of INR 91,000 crores on the back of 'a debt Ponzi scheme', with just INR 9.83 crores of equity capital. The parent company would raise debt, which would then be put as equity in each subsidiary. The subsidiary would then use that equity, which was listed as debt on the parent company, to raise more debt. This pyramid debt structure was effective for more than a decade, but when infrastructure projects were being delayed due to sluggish approvals and environmental clearances, their problems surfaced. Infrastructure financing is long-term, lasting for 15 – 20 years. Such long-term funds are available through public sector banks. However, in 2014, when public sector banks started to withdraw funding from infrastructure projects due to increase in NPAs, developers were left with scarce options of funding. The projects were stalled due to lack of funds or got delayed due to environmental clearances. This created an imbalance in IL&FS' balance sheet. The company had to pay off short-term money in the form of interest for long-term loans, which created a cash flow problem.
- **Lack of regulation:** The role of the board, particularly independent directors, was also questioned. For years, they knew that the company had a serious asset-liability mismatch, yet none of them raised an alarm. Even if some of the independent directors had raised concerns, it was not sufficient to avert the crisis.
- **Ethical issue:** Despite the problem with the company's balance sheets, the credit rating agencies kept on giving the investment grade to IL&FS, which raises doubts over their credit evaluation process.

Results

The IL&FS crisis encompasses the entire banking and credit sector of India, ranging from premium banks like SBI and HDFC to LIC. As of now, the government of India has stepped in and taken over the board. It has appointed a new board led by Uday Kotak, the vice-chairman of Kotak Mahindra Bank, to prepare a resolution plan. The solution is being awaited.

Conclusion

The IL&FS crisis brings to the fore three key questions regarding the banking sector in India:

1 What measures could have been taken to avoid the IL&FS default?

2 How will this crisis impact the infrastructure financing in India?

3. How does the banking industry evaluate credit risk in future?

Source: *https://www.xamnation.com/nbfc-crisis-case-study-on-ilfs/*
http://www.forbesindia.com/article/boardroom/ilfs-the-debt-pyramid/51489/1

QUESTIONS

1. The IL&FS crisis is being compared with the Satyam scandal. Read about the two cases and compare the points.

   (**Hint:** Both cases raise concerns over the source of funding, lack of regulation and ethical issues in the Indian corporate system.)

NOTES

2. What are the possible impacts of IL&FS crisis? What are the solutions?

   (**Hint:** Loss of investor confidence, widened fiscal deficit, increased litigation of similar cases in National Company Law Tribunal (NCLT), credit crunch for infrastructure financing, writing up off a large amount plunging the entire banking industry into crisis.)

9.9 EXERCISE

1. Describe the importance of service sector in India.
2. Discuss a few important trends that effect the service sector.
3. Elaborate various banking reforms and challenges.
4. Explain the current industrialisation trends.
5. Describe the Industrial Policy Environment for the SME sector.
6. Explain the various service sectors of the Indian Economy.

9.10 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Understanding Service Sector	1.	c. tertiary tier
	2.	c. Agriculture
Banking Reforms and Challenges	3.	d. Shadow banks
	4.	b. Shikha Sharma, Axis Bank
Current Industrialisation Trends and Industrial Policy Environment for the SME Sector	5.	c. A unit with the annual turnover of INR 5 crores-75 crores
	6.	a. Factoring mechanism
Emerging Service Sectors of Indian Economy	7.	d. 100%
	8.	Ayushman Bharat National Health Protection Mission

9.11 SUGGESTED BOOKS AND E-REFERENCES

SUGGESTED BOOKS

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CHAPTER 10

Global Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe globalisation and its impact on the Indian industry
- Identify the effects of globalisation
- Identify various modes of entries in international market
- Identify various types of international trade strategies
- Describe the environment for foreign trade and investment
- Describe the exchange rate movements and their impact
- Identify different trends and challenges of globalisation
- Identify the trends related to the balance of payments

10.1 INTRODUCTION

In the previous chapter, you studied about the business environment of the service sector. You studied about the importance of service sector in India. The chapter discussed about the banking reforms and challenges. The later section of the chapter described the emerging service sectors in Indian context.

No matter wherever you are in the world, you are touched by globalisation. You may like it or hate it, but you cannot ignore it. Streets of New York or Old Delhi, you will find most of the people in denims. McDonald's is one of the most recognised brands in the world today, serving more than 119 countries. For the first time in the history of mankind, people-to-people exchange has spread to such a vast global level. On one end, they are working together in multinational corporations (MNCs) for shared goals, and on the other end, they are exchanging their culture and viewpoints on social media platforms.

If globalisation has brought people and cultures together, then it has also touched some raw nerves. The free migration of workers have generated a feeling of protectionism among countries and started anti-immigrant movements in the US and Europe. Farmers in India feel threatened by the invasion of MNCs who are bringing in genetically modified products and patents over 'local' plants and seeds. People in the US want to ban 'illegal' immigrants from having access to public services.

There are myriad arguments for and against globalisation, but one thing is certain. Globalisation is here to stay because technologically, we've come too far and simply cannot remain isolated. Therefore, it is crucial that you understand the aspects and impacts of globalisation so that you can leverage it effectively for your business. This chapter describes the concept of globalisation and its impacts, modes of entries in the international market, types of international trade strategies, and the environment for foreign trade and investment. You will also learn about exchange rate movements and their impacts, globalisation trends and challenges, and balance of payment trends.

10.2 GLOBALISATION AND ITS IMPACT ON THE INDIAN INDUSTRY

Globalisation is defined as the rise in economic interdependencies on a global scale. It is an ongoing process that opens world markets and amalgamates societies and cultures. It dismantles the trade barriers between countries and increases the interchange of goods and services across nations. The main aspects of globalisation are:

- Alignment of local economies with global economies through free trade
- Foreign direct investment (FDI) flows
- Flow of capital
- Technological advancement
- Easier global communication
- Large-scale migration
- Sharing of cultural values
- Competitive advantage through easy access to low cost materials and labour
- Investment opportunities

Globalisation of the Indian economy started in 1991 after the Indian government took a series of economic reforms to resolve the severe balance of payment crisis. The Gulf War had just ended. India had to pay a massive import oil bill while the collections from exports were meagre. The total trade deficit was INR 17,369 crore. Making the crisis even more serious, India had made high-cost external commercial borrowings and non-resident deposits on which it was going to default. As a major policy change, the government of India initiated a new economic reform called **Liberalisation, Privatisation, and Globalisation (LPG)**. The purpose of the LPG reform was to make the economy more efficient, fast growing, and globally competitive. The government introduced the following measures:

- **Devaluation:** To maintain the equilibrium of the Balance of Payments (BOP), the Indian currency was devalued by 18-19% in the international forex market.
- **Disinvestment:** Most of the private sector enterprises were sold to private bidders to generate revenue, make enterprises more efficient, and offload the government's burden.
- **Dismantling:** The industrial licensing 'raj' was dismantled. At present, only five industries are under the compulsory licensing policy due to environmental safety and strategic conditions. These are:
  - Distilleries of alcoholic drinks
  - Tobacco products manufacturing units
  - Electronic aerospace and defence production units
  - Industrial explosives units
  - Hazardous chemicals, such as:
    - ✓ Hydrocyanic acid and its derivatives

✓ Phosgene and its derivatives

✓ Isocyanates and diisocyanates of hydrocarbons

- **FDI:** Investment from foreign companies was allowed across a wide range of industries, through an automatic route.
- **Non-resident Indian (NRI) scheme:** The NRI and overseas corporate bodies (having more than 60% stake by NRIs) were offered concessions and facilities for FDI.

Almost 30 years from LPG reforms, the Indian economy stands tall in the global map. From a potential defaulter, globalisation has made India the world's seventh largest economy by GDP. On the other hand, it has generated the highest level of income inequalities in the Indian population. Let's consider both the positive and negative effects of globalisation on the Indian economy:

The following are some of the positive effects of globalisation on the Indian economy:

- **Growth of GDP:** In 1980-90, the GDP of India was just 5.6%. In 1993-2001, the GDP increased to more than 7%, and has mostly stayed at that level on a year-to-year basis. The current estimate of GDP stands at 7% for 2018-19.
- **Increase in FOREX reserves:** In 2001, the Reserve Bank of India (RBI) had forex reserves of $39 billion. By March 2019, they have increased to $ 402 billion, as shown in Figure 1:

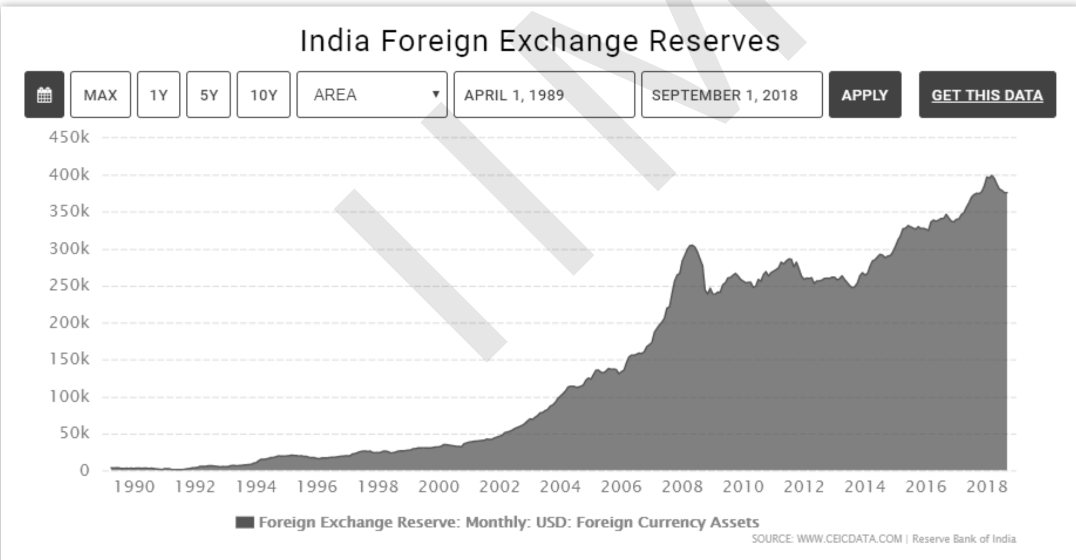

FIGURE 1: Growth of FOREX Reserves in India

- **FDI inflows:** From 1991 to 2006, the cumulative FDI inflows were $43.39 billion. The following industries were the top gainers:
  - Computer software (18%)
  - Services (13%)
  - Telecom (10%)
  - Transportation (9%)

- **Global outsourcing:** The availability of cost-effective, highly skilled, English speaking, and technologically proficient local talent has made India a top destination for the global outsourcing business. In 2017, India's share was 52% in the global outsourcing market.
- **Market capitalisation:** India is today the eighth largest country by market capitalisation. India's market capital is $2.12 trillion, which is larger than that of Germany's $2.08 trillion. The world's top capital markets as of March 2019 are:
  1. US: $30.17 trillion
  2. China: $7.16 trillion
  3. Japan: $5.73 trillion
  4. Hong Kong: $5.53 trillion
  5. UK: $3.27 trillion
  6. France: $2.43 trillion
  7. Canada: $2.15 trillion
  8. India: $2.12 trillion
  9. Germany: $2.08 trillion
  10. South Korea: $1.45 trillion
- **Billionaires rising:** As per the Forbes list 2018, India has the third largest number of billionaires after the US and China. As of 2018, there are 131 billionaires in India with assets worth more than the public sector undertakings in India.

The following are some of the negative effects of globalisation on the Indian economy:

- **Exploitation of child labour:** India has the largest number of child labourers in the world. As per official records, there are more than 12 million child workers in India. Some non-government organisations (NGOs) claim that the actual figure is up to 60 million. The main causes of child labour are poverty and lack of financial security. After LPG reforms, the child labour has drastically increased, as the role of the public sector was reduced. Since private sectors operate only for profit, the general financial insecurity has increased.
- **Neglected agriculture sector:** Agriculture is the primary pillar of Indian economy. About 58% of Indian population rely on it for their livelihood. The LPG reforms have boosted the manufacturing and services sector, but have neglected the agricultural sector. Farmers' suicides due to debt burden are issues of grave concern. The lack of public investment and the presence of intermediaries between sellers and consumers are the two main issues for their debt burden.
- **Job insecurity:** LPG reforms have dwindled public sector jobs, which offered more security and benefits than private sector jobs. Due to this job insecurity, there is a huge imbalance where the skilled people are more but jobs are less. A single government job for a peon invites millions of applicants, and some of them are even qualified engineers and MBAs. The social insecurity has also increased the rates of crime and fraud across India.

- **Poverty and unemployment:** The gap between the rich (haves) and the poor (have nots) has increased significantly. As of 2012, 22% of its population was below the poverty line. Malnutrition, child labour, and crimes have increased. A large section of Indian youth is unemployed and survives on subsistence wages.

SELF ASSESSMENT QUESTIONS

1. Which period in India received the first thrust of globalisation?
   a. 1973-74 b. 1990-91
   c. 2002-03 d. 2014-15
2. What does LPG mean in terms of economy?
3. Which of the following is a benefit of globalisation to India?
   a. Forex reserves increase b. Decrease in child labour
   c. Green revolution d. Job security

10.3 EFFECTS OF GLOBALISATION

Globalisation has brought in several positive and negative effects. Let's explore them.

Positive Effects of Globalisation

The following are some of the positive effects of globalisation:

- **Global market:** Globalisation enables easier access to cheaper raw materials and labour. It also enables easier access to international markets. This promotes industrial growth. Competitive companies gain the ability to acquire other businesses to grow inorganically. They develop strategic partnerships with local players to capture a larger market share.
- **Cross-cultural exchange:** Culture refers to the values and beliefs of a certain group of people that shape their behaviour. Globalisation has spread the American culture across the planet. Before globalisation, women were not encouraged to work in several countries; even if they were, they would do traditional jobs such as teaching or nursing. With globalisation, the number of women workers joining the workforce in non-traditional sectors has increased. Another example is that like the US, most countries have started to understand the value of time.
- **Foreign trade:** Globalisation has expanded foreign trade across the world. Popular brands from the US and Western Europe can be seen anywhere in the world. This has boosted exports for developed countries and created jobs in developing countries. World Trade Organisation (WTO) has emerged as a powerful organisation with far-reaching influences on international trade policies, taxes, and tariffs. More and more countries are depending on trade, foreign investments, and global financial markets.
- **Competition:** Globalisation has increased global competition among companies. Companies are investing in Research & Development (R&D) to develop more

innovative products. More and more young people are confident of setting their own ventures and becoming entrepreneurs.

- **Foreign investment:** Companies and institutions in developed countries prefer to invest in profitable business ventures in developing nations, instead of banks, as it enables them to earn good profits without any efforts. However, defaults in economies in third-world countries make them a risky investment.
- **Advanced technology:** A positive impact of globalisation is the rapid advancement in technology and global communication. The phenomenal expansion of smartphones and their reach to the person at the lowest level of income in developing countries have led to the rapid development of start-ups, which are effectively planning and implementing venture to bring benefits to the public directly.
- **Legal effects:** Globalisation has made people aware about basic human rights. Consequently, causes such as environmental protection, rights of workers, and women empowerment have amassed global appeal and movement. Due to international courts of justice and increased coordination among countries, it has now become convenient to apprehend and extradite loan defaulters and criminals in hiding. Countries are also cooperating to curb global terrorism and block funds of organisations supporting terrorist movements.
- **Culture:** Globalisation has brought together cultures of the world. It is due to the globalisation only that the Indian food has become popular worldwide and Barbie has become the most popular doll in the world. Films, music, books, and other art forms have spread easily through people-to-people exchange via social media platforms. Global tourism has increased impressively, with all countries big or small welcoming people from across the world to visit their countries.
- **Poverty eradication:** Before globalisation, several resource-rich, developing countries did not know how to use their resources. Most of their population was uneducated and employed in agriculture or mining. They lacked the infrastructure to transport raw materials and goods. After globalisation, developing countries learned from foreign investors on how to leverage their resources efficiently. Local populations realised the benefits of education and they started sending their children regularly to schools to make them employable. The living standard of families improved. Suddenly, a lot of people had more disposable income than ever before in their lives. Although there still needs to be done in terms of poverty alleviation, particularly in reducing the gap between the rich and the poor, globalisation has contributed significantly to raising a large section of population above the poverty line.
- **Employment situation:** Globalisation has provided jobs to people in developing nations. Through outsourcing, millions of people in India got jobs and this alleviated a large section of world population from poverty.
- **Education:** Globalisation has increased access to higher education in foreign countries. Now, more and more students are availing student loans to study in the prestigious universities in foreign countries to make them employable for high paying jobs.

Negative Effects of Globalisation

The following are some of the negative effects of globalisation:

- **Terrorism:** After globalisation, terrorism has also increased due to the easy movement of people across countries. After 9/11 attacks, airports around the world beefed up their security. Now, it has become a common practice for normal citizens to be body screened at railways, airports, hotels, markets, or convention centres.
- **Job insecurity:** When companies decided to shift their manufacturing bases to low-cost countries, many local people lost their jobs. In countries such as India, public sector enterprises dwindled after globalisation. Private companies work for the profit motive and thus seek cheap labour. As a result, they short charge their employees by expecting them to work for more hours and have a quick hire and fire policy.
- **Price fluctuation:** Industries cut their production costs by moving their factories to countries of cheap labour and then sell their goods at different prices in the world markets. For example, to compete with Chinese products, which are offered at lower costs, many companies in the US were forced to slash their prices to retain their customers.
- **Currency fluctuation:** The US dollar is the currency of doing international trade. Therefore, local currencies in developing countries fluctuate relative to the dollar price.
- **Spread of fast foods chain and fast fashion:** Fast food brands such as McDonald's, KFC, Domino's, and Dunkin Donuts have changed the food habits of people worldwide. Their food is cheap and tasty, but high in fat, sugar, and salt. This has increased the obesity levels among the world population to alarming degree. Fast fashion companies like H&M and Zara offer fashionable clothes at very cheap prices. They are able to offer these low-priced dresses because they get most of their manufacturing done in cheap labour countries, where workers work for long hours in hazardous conditions. The Rana Plaza accident in Bangladesh is one such example.

Self Assessment Questions

4. Globalisation has:
   a. Lowered the standard of education in the developing countries
   b. Made the American culture unpopular
   c. Made local companies less competitive
   d. Removed poverty to some level
5. Globalisation has provided jobs and raised the job security in India. (True/False)

Notes

10.4 MODE OF ENTRIES IN INTERNATIONAL MARKET

A company can enter a new global market through various modes of entry including:

- **Exporting:** It is a traditional mode of entry where a company sells its goods/ services in a foreign land, without establishing its operations there. Exporting can be:
  - **Direct exporting:** In this approach, a company directly exports its products/ services to an international market. This enables the company to have greater control on its marketing and operations. For example, the Austrian energy drink Red Bull entered India via the direct exporting route.
  - **Indirect exporting:** In this approach, a company employs an agency in the foreign country to handle its product or service. For example, the US chewing gum company Wrigley entered the Indian market by using the distribution outlets of Parrys, a local confectionary company.

  Table 1 lists the favourable conditions, benefits, and drawbacks of exporting:

  Table 1: Conditions, Benefits and Drawbacks of Exporting

Favourable Conditions for Exporting	Benefits	Drawbacks
Little product adaptation required in the foreign market	Distribution of surplus	High cost of starting up in case of direct exports
Close proximity of distribution channels to the plant	Cheap, maximum economy of scale due to use of existing facilities	Less control on distribution of products
High production costs in the foreign market	Quick market access	High cost due to the involvement of intermediaries
Liberal policies for import	Control over market selection	High tariffs and trade barriers increase costs
Political risk in foreign land	Safe as it minimises risk and investment	Difficulty in product customisation

- **Licensing**: In this mode of entry, a company (foreign licensor) sells a right to a local manufacturer (licensee) to produce its product or service. The foreign licensor invests its own capital in the venture. The licensee pays a fee to get the royalty from the foreign licensor to use its trademark, business system, and format. For example, Walt Disney Corporation used the licensing mode to enter India.

  Table 2 lists the favourable conditions, benefits, and drawbacks of licensing:

  Table 2: Conditions, Benefits and Drawbacks of Licensing

Favourable Conditions for Licensing	Benefits	Drawbacks
Barriers to importing and investment	Minimum risk of investment	Knowledge spillover

Favourable Conditions for Licensing	Benefits	Drawbacks
Legal protection is available in foreign market	Cost-effective and high return on investment (ROI)	Loss of goodwill due to poor quality maintained by the licensee
Low sales potential in foreign market	Ability to avoid trade barriers	Threat of the licensee becoming a future competitor
Huge cultural gap	Quick access to foreign markets	Less control over manufacturing of products or use of asset by the licensee
Lower capability of the licensee to become a competitor	Utilises the expertise of licensee	Limited license period

- **Franchising:** In this approach, a company (franchiser) sells the right to use its trademark and sell its products or services to a semi-independent local business (franchisee). The franchisee bears the cost and risks of establishing the operations in the foreign market. For example, McDonald's and KFC entered Indian market through franchising.

  Table 3 lists the conditions, benefits, and drawbacks of franchising:

  Table 3: Conditions, Benefits, and Drawbacks of Franchising

Favourable conditions for franchising	Benefits	Drawbacks
The franchisee has good local knowledge.	Safer than other modes of entry	Lack of quality control
Legal protection is available in foreign market	Ability to avoid trade barriers	Lower ROI as franchisor only receives a royalty and not the entire profit
	Quick access to foreign markets	Threat of the franchisee becoming a future competitor

- **Joint venture:** In a joint venture (JV), a company establishes a new company in a foreign market in collaboration with a local partner. The reasons could be to:
  - Enter into a foreign market
  - Share risks and rewards in a specific proportion
  - Share technology
  - Develop a product jointly as partners
  - Conform to regulations by the local government

  For example, Singapore Airlines entered the Indian market in a joint venture with the Tata Group, as it was not possible for them to enter India as a wholly owned

Notes

subsidiary. Table 4 lists the favourable conditions, benefits, and drawbacks of a joint venture:

Table 4: Conditions, Benefits, and Drawbacks of Joint Venture

Favourable Conditions of Joint Venture	Benefits	Drawbacks
Barriers to importing and government restrictions on foreign ownership	Overcomes ownership and cultural barriers	Difficult to manage conflicts
Huge cultural gap	Optimum use of resources of two companies	Dilution of control
Impossibility of fair pricing of assets	Less investment needed	Riskier venture than exporting, licensing, and franchising
High sales potential	Useful learning experience	Less protection of trade and technology secrets
Political risk	Technological capability	Costly venture
Availability of good local partners		Vulnerable to political and cultural backlash

- **Mergers and acquisitions:** A merger is a process where two or more companies combine into a single entity to accumulate their mutual assets and liabilities. The merger enables them to:
  - Achieve economies of scale
  - Avail tax benefits
  - Get synergy and diversify products/services

  After a merger, the merging entities lose their previous identities and assume the identity of the newly formed entity.

  Acquisition, on the other hand, is the process where a company acquires controlling shares of another company. The acquired company does not lose its identity after an acquisition. The acquisition may be a friendly acquisition (such as Walmart acquiring Flipkart) or a hostile takeover (such as L&T Infotech acquiring Mindtree).
- **Strategic alliance:** In a strategic alliance, two or more companies formalise an agreement to share their risks and resources in order to achieve a common set of objectives, while assuming their independent identities. The strategic alliance enables them to:
  - Expand production capacity
  - Increase market share for a product or service
  - Develop core technologies
  - Use brand image and market knowledge of both entities

  For example, Motorola formed a strategic alliance with Toshiba to enter Japanese cellular phone market.

- **Foreign direct investment (FDI):** In FDI, a company enters a foreign market by investing in that country, either through the acquisition of a local entity or by setting up a new entity. This mode of entry is subject to the local government's policies and regulations. For example, LG and Samsung entered India through FDI route. Table 5 lists the favourable conditions, benefits, and drawbacks of FDI:

TABLE 5: Conditions, Benefits, and Drawbacks of FDI

Favourable Conditions of FDI	Benefits	Drawbacks
Barriers to importing and licensing	High degree of control over operations	High requirement of resources
Small cultural gap	Ability to serve customers better	High commitment necessary
Impossibility of assets to be fairly priced	Ability to meet competitors' challenges better	Restrictive government policies
Low political risk	Possibility of introducing changes anytime	Lower ROI
High sales potential	Easy mode of entry	Higher risk than other modes
	Better utilisation of specialised skills	Difficulty to manage local resources
	Minimum knowledge spill over	

- **Outsourcing:** This is a method by which a company can reduce its costs and focus on core operations by transferring a part of work to low-cost suppliers in a foreign land. It involves both domestic and foreign contracting as well as offshoring (relocation of a business function to another country).

  Table 6 lists the benefits and drawbacks of outsourcing:

TABLE 6: Benefits and Drawbacks of Outsourcing

Benefits	Drawbacks
Quick operations	Risk of data privacy breach
Gaining the ability to focus on core operations, as supporting functions are outsourced	Hidden costs
Sharing of risks	Lack of customer focus
Drastic cutting of costs	

- **Contract manufacturing:** In this process, a foreign company hires a local manufacturer to produce a product or a part of the product. It is a cost-effective mode of production while utilising local skills and expertise. The foreign firm retains the control to market and sell the product.

  Table 7 lists the benefits and drawbacks of contract manufacturing:

TABLE 7: Benefits and Drawbacks of Contract Manufacturing

Benefits	Drawbacks
Cost-effective production	Difficulty in maintaining quality standards

Notes

Benefits	Drawbacks
Small and medium enterprise (SME) development	Risks to local manufacturers
Retain of control over the product and/or process	

- **Turnkey projects:** In these projects, a foreign organisation takes the responsibility of setting up a new organisation on behalf of a client organisation. The client will pay the contractor company for planning the infrastructure, constructing new facilities, and training of staff. After the project is complete, the contractor hands over the new organisation to the client for initiating the actual operations. For example, a Singapore based company takes a contract from the Indian government to set up a smart city project. Such projects depend on various factors, such as the local government's policies, competition, and resource availability.

Self Assessment Questions

6. Which of the following is not a mode of entry in an international market?
   a. Licensing
   b. Importing
   c. Strategic alliance
   d. Joint venture
7. Which mode of entry enables a company to have the highest degree of control over operations in a foreign market?
   a. Franchising
   b. Strategic alliance
   c. FDI
   d. Turnkey projects

10.5 TYPES OF INTERNATIONAL TRADE STRATEGIES

Companies adopt three types of international trade strategies to guide their way across foreign markets:

- **Multi-domestic strategy**: In this strategy, a company focuses on providing specific, tailor-made products and services in response to local demands within each foreign market. For example, the MTV channel customises its programs according to the regions in which they are being broadcasted. Similarly, Heinz offers a no-garlic, no-onion version of its signature ketchup for Indian customers.
- **Global strategy**: This strategy is the opposite of multi-domestic strategy. Here, a company focuses on being efficient. Its aim is to achieve economies of scale by offering the same products/services in each foreign market, with a few modifications. For example, Microsoft offers the same programs worldwide albeit with minor modifications to match local languages.

- **Transnational strategy:** This strategy is mid-way between the multidomestic and the global approach. It focuses on being efficient as well as adjusting to local preferences. For example, McDonald's and KFC use the same business format and efficient processes in their worldwide restaurants, but they adjust their products to suit local tastes. McDonald's in France offers wine to customers, as wine is a staple part of the French diet.

SELF ASSESSMENT QUESTIONS

8. What international trade strategy is adopted by Intel?
   a. Global
   b. Multi-domestic
   c. Transnational
   d. Local
9. Which international trade strategy is most responsive to local preferences and tastes?
   a. Local
   b. Global
   c. Multi-domestic
   d. Transnational

10.6 ENVIRONMENT FOR FOREIGN TRADE AND INVESTMENT

A favourable environment must be developed and sustained for FDI. Factors to consider include:

- **Clear investment policy and regulations:** The FDI policy should be transparent, protective of investors' property, and non-discriminatory. There should be minimum discriminatory restrictions. Whatever restrictions are there, they should be transparent and clear. They should be periodically evaluated to determine their cost-benefit ratio. The process of screening investment proposals should be transparent and efficient.
- **Good law enforcement:** Good laws must be developed and enforced to protect intellectual property (IP), enforce contracts, and resolve disputes. The host country should also have adequate, timely, and effective methods of registering property ownership. Finally, the domestic legal system should have sufficient capacity to take up litigation and dispute related matters and settle them on a timely manner.
- **Sustainable environment:** As important as it is to attract foreign trade and investment, it is equally important to sustain them in the long run and use it for the country's development. This can be done by promoting innovation and export growth through special economic zones (SEZs) and industrial parks. There should be a single window with a single-point authority. It is also important to follow up with investors after they have established facilities and troubleshoot their problems. There should be coordination among authorities for export promotion,

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business registration, or land allocation for businesses. Their performance should be frequently evaluated.

- **Incentive planning:** Most countries use tax incentives to attract FDI, without paying attention to whether FDI inflows are proportionally increasing as a result of these incentives. These incentives should be carefully planned so that any chances of corruption are avoided. The governments should also promote linkages between foreign players and domestic players.
- **Infrastructure development:** Infrastructure is a major reason for attracting FDI. There should be a clear and fair policy for both public and private providers of infrastructure services. Private players should be encouraged to play a greater role in infrastructure development, as they are more efficient than public units. The regulatory framework for infrastructure investment should be transparent and have enough safety provisions to address risky long-term investments.
- **Synergy between trade and investment:** To promote both exports and improve FDI inflows, countries should coordinate and align their trade and investment strategies. The common structural bottlenecks should be removed. The export sectors and destination markets should be diversified. Investments should be made for developing and enhancing human resource skills. Excess red tape for investors should be removed. The supply of labour should be aligned with demand and forecasted for long-term by focusing on a few key market areas that offer long term potential.
- **Responsible business conduct:** Finally, there should be strong, regulatory and institutional frameworks to foster responsible business conduct among businesses.

SELF ASSESSMENT QUESTIONS

10. Which step will help promote FDI inflow in a country?
    a. Long judicial proceedings
    b. Less red-tapism
    c. Preferential policies for specific countries
    d. Multiple windows with multiple authorities for approval
11. Fuzzy tax incentives may mostly lead to:
    a. IP rights violation
    b. Crony capitalism
    c. Data theft
    d. Corruption

10.7 EXCHANGE RATE MOVEMENTS AND THEIR IMPACT

Suppose you need to travel to New York. Before you travel, you go to a forex dealer to get the US currency and pay a specific amount of Indian rupees in exchange. The exchange rate is the rate at which the Indian rupees will exchange for the US dollar.

The exchange rate of currency changes daily depending on various factors. Before you learn about these factors, you should realise the importance of the exchange rate movements on a country's foreign trade.

Table 8 illustrates this relationship:

TABLE 8: Effect of Currency Value on Country's Imports, Exports & Balance of Trade

Currency value	Effect on imports	Effect on exports
High, e.g., US Dollar, GBP Sterling, Euro	Less expensive for the country	More expensive in foreign markets
Low, e.g., INR	More expensive for the country	Cheaper in foreign markets

The difference between the value of imports and that of exports in a given period determines the company's balance of trade. A higher exchange rate for a country deteriorates its balance of trade, while a lower exchange rate improves it.

The factors determining the exchange rate between countries are:

- **Differences in inflation:** If a country has a steadily lower inflation rate, then its currency will have a higher value. This will increase the purchasing power of the currency with respect to other currencies. For example, Japan has a consistently lower rate of inflation and thus the Japanese Yen has a higher purchasing power.
- **Differences in interest rates:** You may have heard about the Reserve Bank of India (RBI) changing the interest rates to control inflation. These changes in interest rates lower the value of INR. When the Fed keeps the interest rates high in the US, lenders get better returns. Thus, higher interest rates attract investment and raise the value of the dollar.
- **Current account deficits:** India and the US are trading partners. The balance of trade between India and the US is called the current account. This current account will include all the payments between India and the US for goods, services, interests, and dividends. If there is a deficit in the current account, then it means that India is spending more on foreign trade with the US than it is earning. In other words, India needs more US dollars that it receives through exports, and it supplies more Indian rupees than the US demands for its products. This extra demand for the US dollar lowers the value of INR, until domestic goods are cheap enough for the US citizens and foreign assets are too expensive for the Indians.
- **Public debt:** To stimulate the Indian economy, sometimes the Indian government offers a stimulus package to provide large-scale deficit financing for public sector projects. However, this may not generate an adequate response from foreign investors if the public deficit and debt are high. This is because the inflation rate will be very high due to debt. If inflation is high, then the debt will be eventually paid off with cheaper US dollars. In the worst case scenario, the Indian government has also printed money to pay part of a large debt. However, this increase in the money supply also causes inflation. If the government is still not able to pay its deficit, then it must increase the supply of securities for sale to foreign investors to lower their prices. However, if the risk of defaulting is evident, then foreign investors will not purchase securities too. Therefore, the debt rating of a country by rating agencies such as Moody's or Standard & Poor's is a key factor in determining the exchange rate.

- **Terms of trade:** This is a ratio of a country's exports prices and its imports prices. If the country's exports prices increase at a greater rate than that of its imports, then the terms of trade are favourable. This means that the country's exports are in greater demand, which increases the revenue generated from them. This, in turn, will increase the demand for that country's currency and increase its exchange rate. On the other hand, if the country's imports prices increase at a greater rate than that of its exports, then its currency's value will decline.
- **Political stability and economic performance:** Foreign investors are likely to invest more in politically stable countries with good economic performance. If there is political chaos, such as in Venezuela, then the investors will lose confidence in its currency and the value of the currency will reach the bottom. As of 2018, Venezuela is grappling with hyperinflation of 1,000,000% (IMF report).

In conclusion, the exchange rate of a country determines its purchasing power, interest, rates, inflation, and capital gains from domestic securities. Let's understand the impacts of exchange rate movements:

- **Impact on inflation:** The exchange rate movement affects inflation by:
  - Changing the prices of imported goods and services. This directly raises the consumer price index. For example, a reduction in the exchange rate will generally increase the price of imported goods.
  - Changing the price of commodities, such as oil. A weaker INR will increase the price of crude oil, as it is traded in the dollar.
  - Changing the growth of exports. For example, if the exchange rate of INR is high, then it increases the prices of exports. On the other hand, if the INR weakens, then the Indian exports become cheaper.
- **Impact on unemployment:** Rise in the exchange rate will reduce net exports and increase the demand for imports. If the demand and output are low, then businesses will try to control their costs. To do so, they may cut jobs. Some job losses are temporary. However, if imports are permanently higher than exports, then job losses will be more permanent in nature.
- **Impact on recession:** Sometimes when an economy is in recession, its currency is depreciated (its value is decreased in the free market) to stimulate demand, increase output, and create jobs. This will improve the balance of trade by driving higher export sales and widening of output in industries (particularly exporters). This effect is called the supply chain effect.

  A cheaper currency has some downsides also. For one thing, investors may lose confidence in a weakened currency and may take away their capital (capital flight). This will make it tough for the government to finance budget deficits and trade deficits. The cost of imports will be higher than the revenues from exports. This may cause inflationary risks.
- **Impact on balance of payments adjustments:** A short-term depreciation may not be beneficial to improve the BOP because of the low price elasticity of demand for imports and exports in the short term. In the beginning, there will not be any change in the number of imports as their contracts have already been signed. However, the demand for exports will be inelastic with the exchange rate movement. The

net earnings from exports may be inadequate to compensate for higher spending on imports. This may further deteriorate the BOP. This phenomenon is called the J curve effect, as shown in Figure 2:

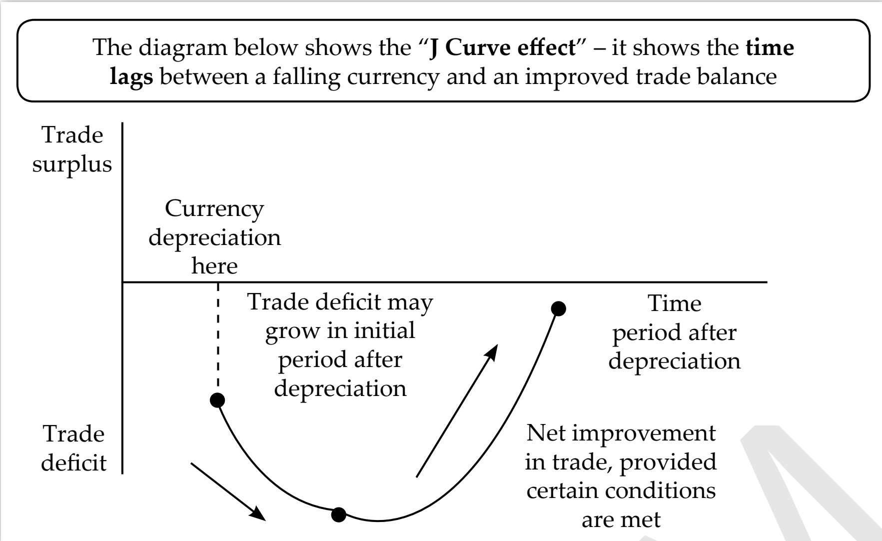

Figure 2: J Curve Effect

Source: *https://www.tutor2u.net/economics/reference/exchange-rates-macroeconomic-effects-of-currency-fluctuations*

With time, the trade balance will improve because the elasticity of demand for imports and exports is more than one. This effect is called the Marshall-Lerner condition.

Self Assessment Questions

12. Which factor will raise the exchange rate value of the INR relative to the US Dollar?
    a. Inflation in India is high at 10%
    b. The country is running trade surplus
    c. The RBI has lowered the interest rates
    d. The export prices are increasing at a higher rate than the imports prices
13. Which of the following is a benefit of a weaker currency?
    a. Improved balance of trade
    b. Capital flight
    c. Higher cost of imports
    d. Higher agricultural output

10.8 GLOBALISATION TRENDS AND CHALLENGES

Globalisation has significantly affected people and communities around the world. With technology advancements and increased mobility, globalisation has enabled several economies to touch new heights, but in the process, it has irreversibly

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impacted societies and natural environment. Over the last 30 years, the world has undergone massive transformation. From $ 50 trillion in 2000, the world GDP has grown to $ 75 trillion in 2016. The gap between the rich and the poor has increased tremendously. In 2017, 82% of the global wealth goes to the richest 1% people in the world (Oxfam report).

If globalisation has to sustain its momentum, then it has to overcome such challenges. In general, there are three major trends:

- **Shifts in production and labour markets:** This trend explains how changes in production, such as through outsourcing and mechanisation, have impacted the labour markets globally and resulted in job losses. This trend is related with the increasing gap between rich and poor.
- **Quick technology advancements:** This trend refers to the rapid technology advancements in IT, communication, and artificial intelligence. Although these technologies will pave way for sustainable development, there is a threat for countries that cannot afford them of being left out.
- **Climate change:** Economic activity, changes in lifestyle, and growing urbanisation have adversely affected the natural environment. The climate change problem needs to be addressed globally.

There are three main challenges to globalisation:

- **Job mobility:** The largescale shifting of jobs, particularly manufacturing jobs, from developed countries to developing countries has made globalisation highly unpopular politically and culturally. Lower-skilled workers in developed countries who lose their jobs often find it difficult to find alternative employment, which compensates them equally. This also adds a burden on the social welfare system of those countries. Due to fewer jobs, less tax is collected, which is required for funding the social welfare systems.
- **Dominance of the West:** Western Europe and the US continue to dominate the international order, despite the rise of China and BRICS. For instance, the heads of the IMF and the World Bank are either from the US or from the European Union (EU). However, if western values are forcibly imposed, they may lead to disastrous results, such as the fall of Arab leaders during the Arab Spring who were propped up by the Western countries.
- **Cultural identity loss:** Although globalisation has made it easier for people to share cultural values, it has also led to the destruction of traditional values in various societies. The American culture has emerged as a dominant culture with young people around the world copying their lifestyles, food preferences, and consumer behaviour. This has shifted the savings balance of several societies, which have been traditionally frugal and conservative.

SELF ASSESSMENT QUESTIONS

14. Which of the following is a mega-trend of globalisation?
    a. Shifts in the production and labour market
    b. Easy access to foreign culture

c. Improved lifestyle

d. Cheaper goods and services

15. Samantha Nash in the US lost her job in a car-manufacturing plant because her company shifted the plant to Mexico. Which globalisation challenge is this?

a. Shift in technology b. Job mobility

c. Eroding cultural value d. Climate change

10.9 BALANCE OF PAYMENTS TRENDS

The Balance of Payments (BOP) is a statement that summarises all the international transactions conducted by the residents of a country, involving:

- Goods, services and income
- Financial claims on and liabilities to the rest of the world
- One-sided transactions or transfers (such as gifts)

The BOP helps to determine how much financial capital has flown out of a country and how much capital has come inside. It is prepared on a quarterly and annual basis in the domestic currency of the country. It has the following four components:

- **Current account:** This includes all imports and exports of goods and services, income receipts and payments from investments, and one-sided transfers of foreign aid. In a current account, if the amount of debits (imports) is more than the credits (exports), then the country is in a trade deficit. In a contrary situation (imports>exports), the country is running a trade surplus.
- **Capital account:** This account determines the net difference between the sales of assets of a country to foreign investors and the country's purchase of foreign assets. It includes FDI, portfolio and other investments.
- **Official reserves account:** This account includes gold, foreign currencies, and special drawing rights (SDRs). SDRs are reserve positions with the IMF.
- **Statistical discrepancy:** This includes the entries made to balance omissions and inaccurate transactions in the BOP.

The BOP is recorded in a double entry system, where all transactions are debit or credit transactions, as illustrated in Table 9:

TABLE 9: Debit and Credit Transactions In BOP

Debit (= Payments to foreigners)	Credit-Receipts of payments from foreigners)
Imports of goods	Exports of goods
Transportation and travel expenses	Transportation and travel receipts
Income paid on investments of foreigners	Income received from investments made in foreign lands
Gifts to foreign residents	Gifts received from foreign residents or non-resident domestic people

Notes

Debit (= Payments to foreigners)	Credit-Receipts of payments from foreigners)
Aid given by the country to foreign nations	Aid received from foreign governments
Overseas investments by residents	

For each credit transaction in the BOP, there must be a balancing debit transaction, and vice versa (double entry system condition). Thus, the current and capital accounts must sum to be 0 for maintaining equilibrium in the BOP. However, the BOP's equilibrium can be disturbed due to the following factors:

- **Economic factors:** Imbalance between exports and imports, huge development expenditure, etc.
- **Political factors:** Restrictive imports policy, such as anti-dumping duty
- **Social factors:** Changes in lifestyles and consumer tastes, which imbalance imports and exports

To restore the equilibrium of the BOP, the following measures should be taken:

- Promotion of exports by granting sufficient rewards to manufacturer and exporters
- Discouraging imports through import substitution and reasonable tariffs
- Reducing inflation
- Controlling the exchange rates by asking all exporters to surrender their FOREX to the central bank and then rationing the FOREX to licensed importers
- Devaluating the domestic currency in case of the fixed exchange rate
- Depreciating the domestic currency in the free market system

Figure 3 displays India's BOP in Q3 of 2017-18:

Table 1: Major Items of India's Balance of Payments

(US$ Billion)

	October-December 2017 P			October-December 2016			April-December 2017-18 P			April-December 2016-17		
	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net
A. Current Account	150.1	163.6	-13.5	130.2	138.1	-8.0	435.6	471.3	-35.6	382.8	394.6	-11.8
1. Goods	77.5	121.6	-44.1	68.8	102.0	-33.3	226.8	345.6	-118.9	202.8	285.5	-82.7
of which:												
POL	9.9	29.2	-19.3	8.1	21.8	-13.7	26.5	75.8	-49.2	22.5	61.3	-38.8
2. Services	50.0	29.0	20.9	42.1	24.4	17.8	143.3	85.7	57.6	122.4	72.6	49.8
3. Primary Income	4.9	11.3	-6.4	4.0	10.4	-6.4	14.3	34.9	-20.6	11.8	32.5	-20.7
4. Secondary Income	17.7	1.6	16.1	15.3	1.4	13.9	51.3	5.1	46.3	45.8	4.0	41.8
B. Capital Account and Financial Account	168.8	156.2	12.6	138.7	131.4	7.3	470.9	437.0	33.9	406.8	395.0	11.8
of which:												
Change in Reserve (Increase (-)/Decrease (+))	0.0	9.4	-9.4	1.2	0.0	1.2	0.0	30.3	-30.3	1.2	15.5	-14.2
C. Errors & Omissions (-) (A+B)	0.8		0.8	0.7		0.7	1.8		1.8	0.0	0.01	-0.01

P: Preliminary

Note: Total of subcomponents may not tally with the aggregate due to rounding off.

Figure 3: BOP in Q3 of 2017-18

Source: *https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=43403*

The main trends of BOP are:

- Increase in the current account deficit (CAD) (from $ 8 billion in Q3 2016-17 to $ 13.5 billion in 2018-19)

- Increase in the trade deficit ($44.1 billion) due to the higher value of imports of goods than exports
- Increase in the net services receipts ($17.8 billion in Q3 2016-17 to $20.9 billion in Q3 3017-18) due to an increase in net earnings from software services and travel receipts
- Increase in private transfer receipts and remittances by Indians employed overseas ($17.6 billion)
- Decrease in the net FDI in the financial account ($ 9.7 billion in Q3 2016-17 to $ 4.3 billion in Q3 2017-18)
- Net inflow in portfolio investment ($ 5.3 billion in Q3 of 2017-18) due to net purchases in both debt and equity markets, relative to net outflow ($11.3 billion) in Q3 last year
- Net receipts of NRI deposits ($ 3.1 billion in Q3 of 2017-18) relative to net repayments ($18.5 billion) in Q3 last year
- Increase of $ 9.4 billion in FOREX reserves compared to depletion of $ 1.2 billion in Q3 of 2016-17

Self Assessment Questions

16. The BOP summarises all the ____________ transactions of the residents of a country.
    a. Personal
    b. Public
    c. Commercial
    d. International
17. Which component of BOP determines the net difference between the sales of a country's assets and the country's purchase of foreign assets?
    a. Current account
    b. Capital account
    c. Official reserves account
    d. Statistical discrepancy

10.10 SUMMARY

- Globalisation is the rise in economic interdependencies in the world. It is an ongoing process of increasing openness of world markets and amalgamation of societies and cultures.
- Globalisation started in India after LPG reforms in 1990-91. It has been responsible for the growth of the GDP, rise in FOREX reserves, increased FDI inflows, global outsourcing opportunities, increased market capitalisation, and rise of billionaires. However, it has also led to rising cases of child labour, less agricultural output, farmers' suicides, job insecurity, and poverty and unemployment.
- Globalisation has created a global market, facilitated cross-cultural exchange, promoted foreign trade and fair competition, increased FDI, advanced technology usage, brought in awareness of legal rights, alleviated poverty, increased jobs in developing countries, and promoted education. On the flip side, it has also led

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to the rise of terrorism, job insecurity, price and currency fluctuation, and rise in obesity.

- The various modes of entries in international markets are exporting, licensing, franchising, joint venture, mergers and acquisitions, strategic alliance, FDI, outsourcing, contract manufacturing, and turnkey projects.
- There are three types of international trade strategies: Multidomestic, global, and transnational.
- The environment for foreign trade and investment requires a clear investment policy and transparent regulations, good law development and enforcement, carefully planned incentives, infrastructure, synergy between trade and investment, and responsible business conduct.
- The exchange rate depends on the differences in inflation and interest rates, current account deficits, public debt, terms of trade, political stability, and economic performance.
- The three major trends in globalisation are shifts in production and labour markets, quick technology movements, and climate change.
- The challenges to globalisation are job mobility, dominance of the West, and cultural identity loss.
- The BOP provides the economic transactions of a country with the rest of the world over a specified period. It is a double entry system made up of the current account, capital account, official reserves account, and statistical discrepancy.

10.11 KEY WORDS

- **Poverty line:** The estimated smallest amount of money that a person or a family needs to secure the basic necessities of life. In India, a person or family qualifies for a below poverty line (BPL) list, if his/their annual income is about INR 27000.
- **Purchasing power:** The amount of goods or services that one unit of a currency can purchase.
- **Capital asset:** An asset with more than one year of useful life. Examples include property, cars, stocks, bonds, and art collectibles.
- **Capital gain:** The increase in the monetary value of a capital asset relative to its purchasing power.
- **Inflation:** The economic trend where the prices continuously rise and the purchasing power of the currency depletes.
- **Devaluation:** The process of reducing the exchange rate of domestic currency in order to make domestic goods cheaper to foreigners. It is only done if the exchange rate system is fixed. It may increase inflation within the country.
- **Depreciation:** The process of dropping the purchasing power of the domestic currency in a free market system where the demand for FOREX is more than the supply of FOREX of the country.

10.12 CASE STUDY: ENTRY OF HUAWEI INTO INDIA

This case study explores the globalisation strategy used by Huawei, the world's second largest telecommunication company, to enter into the Indian market.

Problem

Huawei is a Chinese business-to-business (B2B) company that rapidly expanded into the global market since 1997. Before that, its name was literally unheard of outside China. In 2000, the company decided to enter into the Indian market. However, it faced various challenges:

- **Crowded space:** The telecommunication space was crowded with various domestic and international players. In such a space, the company had to make a distinctive brand for itself as a reliable partner.
- **Politically charged history:** Ever since the Sino-Indian wars in 1962, India and China had maintained a cool distance. Clashes between the two troops in the disputed northern border were not unheard of. In such a scenario, the Indians regarded the Chinese company with scepticism.
- **Cultural perception:** For most Indians, the Communist Republic of China was a closed country. Although neighbours, the people-to-people exchange between the two Asian giants was very rare. One reason could be attributed to the language difference; Chinese were mostly non-English speakers, whereas most of India used English as their business language. Therefore, Huawei found it difficult to establish trustworthy relations with the Indian businesses community.
- **Quality perception:** In India, Chinese products were perceived to be of inferior quality. This was a negative factor for Huawei.

Solution

To overcome these challenges, Huawei decided to invest some time to understand the Indian market better. The company implemented the following steps:

- Established R&D centres and service centres in the country.
- Allocated 90% jobs locally to the Indians—a fact that worked very favourably in building a good reputation of the company among the Indians.
- Set up two production plants in Chennai.
- Conducted skill based workshops for Indians with Huawei staff to make them aware about the international standards. This also helped the company to clarify the cultural misconceptions the Indians had about the Chinese.
- Sourced most of its components locally, which made them not only cheaper but also helped the local companies to achieve international quality standards. Again, the Huawei staff helped the local companies in skill and technology enhancement.
- Promoted consumer products such as smartphones by establishing strategic partnerships with local media channels.

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- Advertised Huawei smartphones as aspirational products to remove the perception of low quality of Chinese products.
- Fostered a strong brand culture.
- Set up rewards and recognition programs for R&D talent.
- Promoted Indian employees to managerial positions.

Conclusion

There is a misconception among strategy formulators and marketers that the two Asian giants, India and China, share a similar culture, which is not the case. For companies on both sides to enter into each other's market, it is important to study the market comprehensively before entering into it.

The Chinese company Huawei found it as difficult to break the cultural barriers in the Indian market as the Western companies do. Huawei was able to successfully overcome these barriers by:

- Establishing itself as a trustworthy brand
- Building relationships with the local businesses and personnel
- Committing a long-term, sustainable relationship that would boost India's economy and create jobs for locals
- Providing superior quality consumer products

Source: *https://www.ft.com/content/a7c4d656-fe89-11e1-8028-00144feabdc0*

QUESTIONS

1. What were the challenges faced by Huawei while entering the Indian market? Compare those challenges with the challenges that the company faced while entering another market, such as Europe or Africa.

   (**Hint:** Crowded telecom market, political differences, cultural differences, misconceptions about the company and its products, general scepticism about job creation, etc.)

2. What are the key learnings from the Huawei's entry into India?

   (**Hint:** Always study the foreign market with an open mind, never pre-assume anything particularly with respect to the company's image and the local culture, invest and commit to develop trustworthy relations, etc.)

10.13 EXERCISE

1. What do you mean by globalisation? What is its impact on the Indian industry?
2. What are the major effects of globalisation?
3. What are the different modes of entering an international market?
4. What are the different types of international strategies?

5. What environment is conducive to foreign trade and investment?
6. What do you mean by exchange rate movements? What is their impact?
7. What are the mega globalisation trends? What are the key challenges to globalisation?
8. Explain BOP. Illustrate the trends of BOP in India.

10.14 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Globalisation and its Impact on the Indian Industry	1.	b. 1990-91
	2.	Liberalisation, Privatisation, Globalisation
	3.	a. Forex reserves increase
Effects of Globalisation	4.	d. Removed poverty to some level
	5.	False
Mode of Entries in International Market	6.	b. Importing
	7.	c. FDI
Types of International Trade Strategies	8.	a. Global
	9.	c. Multi-domestic
Environment for Foreign Trade and Investment	10.	b. Less red-tapism
	11.	d. Corruption
Exchange Rate Movements and their Impact	12.	b. The country is running trade surplus
	13.	a. Improved balance of trade
Globalisation Trends and Challenges	14.	a. Shifts in the production and labour market
	15.	b. Job mobility
Balance of Payments Trends	16.	d. international
	17.	b. Capital account

10.15 SUGGESTED BOOKS AND E-REFERENCES

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CHAPTER 11

Business Ethics

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Explain business ethics and values
- Describe the advantages of ethical business
- Explain the concept of values in business
- Explain the concept of ethical dilemma
- Describe the impact of globalisation on business ethics
- Describe how business ethics can be a competitive advantage

11.1 INTRODUCTION

In today's times of cut-throat competition, organisations may not always play fair to achieve their goals. Big organisations tend to gobble up smaller companies and monopolise markets. However, their selfish behaviour may invite bad publicity and even legal actions.

In the Biblical tale of 'David and Goliath', everyone has a natural sympathy for David. So when it comes to any dispute between a large organisation (Goliath) and an estranged employee, a small competitor, or a customer (David), most people would sympathise with David. It may be possible that the organisation wins the civil action; however, the resulting damage to its reputation and goodwill will have far-reaching impacts. The worst part is that if an organisation's unethical practices are allowed to continue, then the organisation becomes morally corrupt and would refuse to take moral responsibility for any future misdeeds. Customers may shun its products, and people may not want to be associated with it as employees or suppliers. Therefore, it has become highly important for organisations to follow certain standards in their business operations. These standards are called business ethics. Business ethics help organisations to build customer loyalty, maintain employee satisfaction, create a congenial work environment, and improve the organisational value.

In this chapter, you will learn about the concept of business ethics and values, advantages of ethical business, the concept of values in business, and ethical dilemmas. You will also learn about the impact of globalisation on business ethics. The chapter also explains how business ethics can be a competitive advantage.

11.2 MEANING OF BUSINESS ETHICS AND VALUES

Ethics are a set of principles that help in differentiating between what is morally right and what is morally wrong. Business ethics and values are the moral principles that a business uses in daily transactions. They help to prevent ethical issues that may arise in the day-to-day running of operations, such as insider trading, corporate governance, bribery, discrimination, corporate social responsibility and fiduciary responsibilities.

Before we go any further, let's understand the difference between ethics and values. **Values** are those things that are valued by an organisation; for which the organisation stands for. The core values of an organisation are used to determine the organisation's vision and mission statements. For example, the mission statement of

Patagonia is: *"Build the best product, cause no unnecessary harm, use business to inspire and implement solutions to the environmental crisis."* This mission statement is built from two types of values:

- **Values that ensure market success:** Patagonia's values on developing safe and high-quality products
- **Values that do the general good:** Patagonia's values on preserving the natural environment and doing philanthropy

Business values are universally applicable to all individuals in an organisation, despite their individual inclination. Values represent what an organisation stands for. They should set the foundation of every individual member in the organisation. They describe an ideal set of criteria on the basis of which the organisation decides what is appropriate. Thus, values determine what is right and what is wrong.

Ethics deal with doing what is right or wrong. An ethical behaviour is about being consistent with right values in normal day-to-day transactions. For example, an organisation has a value to treat everyone fairly with dignity and respect. However, the organisation ignores sexual harassment cases that are reported to it. In this case, the organisation is doing ethically wrong behaviour.

Some of the features of business ethics are:

- **Based on moral values:** Business ethics are based on the guiding values related to the functioning of a business.
- **Relative:** Business ethics are not universally applicable to all situations; they deviate from one person to another. For example, ethics followed in Microsoft may be totally different from ethics followed in Apple.
- **Both objectives and means:** Business ethics segregate between fair and unfair. They ensure that the means opted for satisfying objectives are rational and justified.
- **Society oriented:** Business ethics emphasise that a business has a social responsibility to guard the interests of all its stakeholders.
- **More than law:** Business ethics cannot be enforced by law. They must be acknowledged as self-discipline.

Business ethics and values determine the reason why an organisation exists, what it stands for. Although many people argue that the sole aim of an organisation is to earn maximum profits for its shareholders, there are others who contend that value creation should be the main objective of an organisation. The debate may continue, but it is proven that business ethics and values help an organisation to generate goodwill among customers and stakeholders. The increased transparency and accountability brought in by ethical business practices ensure long-term sustenance of the business growth.

Some general business ethics are:

- **Same rules and regulations for everyone:** If the organisation's rules and regulations are fair and universally applicable to everyone, irrespective of their status or salary, then employees are highly motivated. For example, all members of an organisation should be punctual. Just because someone is a manager, he/she should not be allowed to come to office late even if his/her team is working on his/her behalf.

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- **Clear communication of policies to everyone:** The policies must be made transparent at all levels of the hierarchy.
- **Value employees:** The rules and regulations should be flexible to allow employees to have a good work/life balance. For instance, insisting an employee to attend office even if he/she has a medical emergency at home is unethical. Managers often lure employees with rewards or threaten them with job insecurity to pressurise them to work even when they are on vacation, during weekends, or for longer hours. This generates a considerable dissatisfaction among employees. Some companies even hold their employees' salaries when things are not going well. This practice should be avoided and employees' salaries must be cleared at the earliest.
- **Prepare policies that are employee-centric:** The Human Resource department should ensure that proper policies for staff are prepared and implemented. A holiday calendar should be prepared and employees should be allowed to enjoy the festivals with their families. The leave policy should be clear and fair. The culture to expect employees to work even on leaves should be discouraged, as it builds resentment among the staff, which does not benefit the work at all.
- **Evaluate employee fairly:** Everyone in an organisation gets cautious at the time of performance evaluation. Their performance will determine if their jobs are secure, get a promotion, or a salary hike. Some managers might expect flattery to get good grades. Although they will say that they never asked their staff for this type of behavior, but who does not like flattery? Ethical managers are those that evaluate an employee fairly on the basis of his/her performance without any bias.

SELF ASSESSMENT QUESTIONS

1. Business ethics are mostly founded on the basis of:
   a. Vision statement b. Organisational values
   c. Strategic objectives d. Organisational policies
2. Which statement is true about business ethics?
   a. They are not universally applicable.
   b. The end does not justify the means.
   c. They are obligatory by law.
   d. They are free from social obligations.

11.3 ADVANTAGES OF ETHICAL BUSINESS

Organisations that adopt ethical practices are able to survive for a long period in the market by delivering value to their stakeholders. Such an organisation engages in fair practices and fair competition in the best interest of consumers and society. An ethical business is able to:

- Satisfy basic human needs
- Cultivate a good public image
- Prevent business malpractices
- Improve customers' confidence

- Safeguard consumers' rights
- Protect stakeholders
- Gain a competitive edge
- Develop good industrial relations
- Give confidence to employees that they are working for a fair and ethical business
- Unite employees and leaders on common goals or mission
- Improve decision-making as decisions will be founded on values
- Sustain long-term growth

The following are examples of some companies that demonstrate a high standard of ethical behavior:

- **Google:** The company with the motto—"Don't be evil"—has donated more than $1 billion to renewable energy projects. It is an open supporter of free speech and is still banned in China due to this policy. To develop positive employee relations, it gives them free healthcare and free legal advice with discounted legal services.
- **Microsoft:** Founded by Bill Gates, who has established himself as one of the world's most generous philanthropist, Microsoft donates more than $1 billion annually to charities and non-profit organisations. To reduce the shortage of IT personnel in the US, Microsoft employees volunteer in local schools to promote computer science and technology among students. Microsoft gives 100% coverage on the health care premiums of its employees.
- **Intel:** Intel Foundation hosts programs to promote science and technology subjects among school students. It has established various donation funds to encourage girls and underprivileged minorities to study in science and technology subjects. To motivate its employees, the company reassigns each employee to a different field or area every 16 to 24 months so that they are able to explore new fields and do not remain stuck in the same jobs.
- **Nustar Energy:** In the field of oil companies, Nustar Energy is a shining beacon. Its employee programs have made the company a regular in the best places to work for lists. The company pays 100% of its employees' health insurance premium. It has a strict no-layoffs policy.
- **Salesforce.com:** This company has been regularly awarded for its philanthropy and good ethical behavior. Salesforce.com Foundation has donated millions of dollars in education programs. To encourage its employees to do charity work, it gives them 6 days off every year to contribute to any charity of their choice.

The fact that these companies are highly successful and profitable shows that being ethical in business is rewarding.

Self Assessment Questions

3. Which of the following is not an advantage of ethical business?
   a. Credibility
   b. Competitive edge
   c. Climate change
   d. Industrial relations

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4. Which of the following corporate examples demonstrates ethical business?
   a. Ben & Jerry's protest of Recombinant Bovine growth hormone in cows
   b. Apple's deliberate slowing down of older models with the release of a new version
   c. Equifax's selling of personal information of customers to financial institutions
   d. The forcible removal of a passenger on an overbooked United Airlines flight

11.4 VALUES IN BUSINESS

Values in business are the essential principles that guide the business in its day-to-day transactions. They establish what the business stands for and why it stands out. For example, if innovation is a core value for a business, then that organisation will invest heavily in Research & Development (R&D) for new product or service ideas. If a business's core value is agility, then that organisation will quickly adapt to change and seek opportunities to grow and retain their customer base.

Each business has its own core set of values, which may or may not be specifically stated. These values guide employees in achieving not only the organisation's objectives, but also their individual goals. They determine the company's mission statement. Examine how the given values closely match to what the company stands for:

- **Adobe:** Genuine, Exceptional, Innovative, Involved
- **Adidas:** Performance, Passion, Integrity, Diversity
- **American Express:** Customer commitment, Quality, Integrity, Teamwork, Respect for People, Good Citizenship, A Will to Win, Personal Accountability
- **Coca-Cola:** Leadership, Collaboration, Integrity, Accountability, Passion, Diversity, Quality
- **Facebook:** Focus on impact, Move fast, Be bold, Be open, Build social value
- **The Honest Company:** Create a culture of honesty, Make beauty, Outperform, Service matters, Sustain life, Be accessible, Pay it forward, Fun!
- **IKEA:** Humbleness and Willpower, Leadership by example, Daring to be different, Togetherness and Enthusiasm, Cost-consciousness, Constant desire for renewal, Accept and delegate responsibility
- **Procter & Gamble:** Integrity, Leadership, Ownership, Passion for winning, Trust
- **Tata:** Pioneering, Integrity, Excellence, Unity, Responsibility
- **Reliance:** Quality, Innovation, Ambition, Honesty, Integrity
- **Infosys:** Client value, Leadership by Example, Integrity and Transparency, Fairness, Excellence

Every business needs to identify its core values that guide it on the right path to achieve its goals. There are plenty of values to choose from; however, the following values are absolutely critical for any type of business:

- **Problem solver:** Problems are inevitable. A company ready to face problems and solve them will be successful.
- **Ambition:** Be the change that you want to see in the world.
- **Transparent:** Being honest, open, and direct saves a lot of time, effort, and money.
- **Empathetic:** Try to wear the shoes of the other person and understand his/her challenges. Evaluate how you can help them to overcome their challenges and achieve goals.
- **Adaptable:** Be accountable, accept responsibility, and reveal results transparently. Brushing things under the carpet will only cause the problems to simmer and resurface later in much worse shape.
- **Focussed:** Focus on one thing at a time to achieve it; instead of trying to accomplish too much at the same time.
- **Integrity:** Be honest and morally upright. This will benefit everyone, from stakeholders to consumers to employees.

SELF ASSESSMENT QUESTIONS

5. ____________ determine what a business stands for and guide its behaviour.
6. "We believe in the simple, not the complex." This statement reflects which company's core value?

   a. Disney
   b. Wipro
   c. Nestle
   d. Apple

11.5 ETHICAL DILEMMA

Despite ethical practices, there may be a moral crisis where there is no clear right way of dealing with a complicated situation. These gray areas constitute **ethical dilemmas**, which arise when an organisation needs to choose between two options, neither of which resolves the situation in an ethically acceptable fashion.

For example, an organisation was gearing up to launch a new product. The testing team found that a small sample size was defective and could be harmful. At this juncture, the product manager had to decide whether or not to hold off the product launch. On one hand, the defective sample size was small and not statistically significant. On the other hand, the company believed the long-term impact risk was high. If the defect was bigger than they thought, it could have created a huge loss of trust with their customers. Finally, the company decided to delay the product launch. Although it was not a popular decision at the time, it was the right decision for the business. The company based the decision on what would have created long-term value for the business instead of just gaining short-term win.

When facing an ethical dilemma, an organisation should consider:

- What should it do?
- What is right and what is ethical?

- What will be the consequences of its actions and decisions?
- Is the decision officially allowed?
- Is the decision impartial? Is it fair for all the concerned parties in short- as well as long-term?
- Is the decision a win-win situation for all the parties involved?
- What kinds of benefits or damages it may cause?
- Would the organisation be accountable if something goes wrong?
- How will the organisation protect itself in case of any legal complications?

A possible way to overcome the confusion surrounding an ethical dilemma is to take suggestions from other stakeholders. Professionals can deal with ethical dilemmas by implementing the following practices:

- Applying principled thinking, which results into ethical reasoning
- Using moral creativity to negotiate with stakeholders, who claim unethical interests
- Identifying self-moral values to set ethical and unethical standards

Most businesses develop an Ethics Policy to describe the different moral crises that may impact in business dealings and how employees should proceed in those cases. This policy not only states what the business considers as suitable actions, but also sends a message on what it holds dear.

SELF ASSESSMENT QUESTIONS

7. When an organisation needs to make a choice between two options, neither of which resolves the situation in an ethically acceptable fashion, such a situation is called an:
   a. Unethical practice b. Unethical value
   c. Ethical issue d. Ethical dilemma
8. What is mostly required to solve an ethical dilemma?
   a. Information b. Objectivity
   c. Teamwork d. Accuracy

11.6 IMPACT OF GLOBALISATION ON BUSINESS ETHICS

Globalisation opened the barriers to international trade and increased economic interdependencies between countries. With the growth in trade, it became imperative for businesses to deal fairly with their suppliers, customers, and employees. If globalisation opened more markets, provided access to cheap sources of materials and labour, and increased profits for developed countries, then it created new job opportunities, brought in multinational brands, introduced new business opportunities to local suppliers, and raised the standard of living for millions of people in developing nations.

In their pursuit of better margins and more market capitalisation, several companies have sacrificed their business ethics and values. Corruption, egotism, and pursuit of material wealth have increased. Consumerism and materialism have invaded all the societies, and ethics are the casualty in the process. There have been multiple corporate scandals involving large businesses where they have compromised their customers' sensitive information or misused their trust for profit. Employees have been short-charged as well. Thousands of manufacturing jobs were shifted from developed countries to developing countries with cheaper labour, without giving adequate compensation to the employees. The local suppliers in developing countries make workers work for long hours in sub-human conditions.

The agriculture sector has been largely ignored. The growing urbanisation uprooted societies, as people migrated from villages to cities for their livelihood. Infrastructure development has resulted in the destruction of natural habitats. The global warming has reached alarming levels. People in developed countries are protesting against the rising number of migrants, who are fleeing their countries for better livelihood. The social welfare schemes of developed countries are under strain. Thus, globalisation has impacted business ethics considerably. Let's explore some key points:

- **Environmental ethics:** Organisations must conduct business while acting responsibly towards environment conservation and using resources sustainably. The raw materials must be sourced from the environment responsibly, while ensuring that the ecological balance is maintained. However, in pursuit of greater productivity, some companies ignore the environment and treat it with carelessness. For example, in 2010, BP spilled about 4.9 million barrels of oil in the Gulf of Mexico. This was the largest ever oil disaster caused due to the company's negligence and misconduct.

  Another aspect of environmental ethics is related to waste management. For example, fossil fuels contribute to air pollution and global warming. In the big cities in China and India, the air pollution has reached hazardous levels. During the winter season, the high concentration of pollutants in the air cause breathing problems and other health related issues.

  Industrialisation and cutting down of forests are the main causes of environmental pollution. Urbanisation has led to the growth of air conditioners, cars, and other electrical products, which require a large number of natural resources and fossil fuels. Although companies are investing in green and renewable sources of energy, the speed at which the environment is being polluted is too quick to be controlled.

  In 2016, the Paris Agreement was ratified by 194 states and the EU to deal with greenhouse gas emissions. However, soon after coming to power, the Trump administration decided to withdraw from the agreement to prevent the US coal plants from shutting down. Thus, when it comes to environment, it is very difficult to build a consensus as political parties do not want to conserve the environment at the cost of jobs loss and lowered development. Therefore, it is important to educate the public about the far-reaching but imminent impacts of environmental pollution on their incomes, health, and lifestyle.

- **Child labour:** Globalisation has also compounded the problem of child labour. One reason could be that child labour is perceived differently in different countries. In the EU, it is considered unethical, whereas in Asian countries it is acceptable to a moderate degree as children from poor families work to contribute to family income. For instance, in Vietnam, the Nike factory employs children. However, the factory also provides them free education and food. Similarly, other businesses such as Gap, Walmart, and Primark employ children in their factories in developing countries. Many activists have called this practice as unethical

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and raised a big furore against the "exploitation of children." Some customers in developed countries even stopped buying products from these brands due to this unethical behaviour.

However, it is important to understand the context where these children are employed. Coming from economically backward families, these children work to survive and feed their families. Instead of judging, it would be more prudent to observe it from the Utilitarian theory of ethical conduct. According to this perspective, the conduct of companies should be to give maximum benefits to maximum number of people.

In conclusion, organisation can improve the climate for ethical behaviour by implementing the following steps:

- Encouraging ethical conduct among employees and managers
- Setting examples of ethical conduct in dealings with customers, suppliers, and employees, and with the natural environment and local communities
- Encouraging employees to report incidents of unethical behaviour and ensuring their privacy and protection from the backlash
- Developing policies to objectively evaluate cases of unethical behaviour and ensuring that they are assessed on the basis of the company's ethical policy and values
- Conducting training, seminars, and meetings to discuss actual situations so that employees become aware of potential ethical conflicts
- Communicating the code of ethics to all employees

SELF ASSESSMENT QUESTIONS

9. More than 20% of the Amazon rainforest is gone due to ranching and agriculture. This is mainly due to the lack of:

   a. Development　　b. Agricultural policy

   c. Environmental ethics　　d. Business ethics

10. In 2008, the BBC's Panorama program and The Observer newspaper uncovered which scandal regarding the fashion chain, Primark?

    a. Employing child workers in India

    b. Use of plastic bags

    c. Use of fur in clothes

    d. Emission of greenhouse gases

11.7 BUSINESS ETHICS AS A COMPETITIVE ADVANTAGE

It is important to incorporate business ethics as part of the corporate code and implement that as a corporate philosophy to gain a competitive edge for the organisation. Focusing on customers in targeted market segments helps companies gain a competitive advantage on the short-term basis only. For long-term sustainable competitive advantage, the core capabilities of the organisation should be cultivated by effectively managing its skills and assets. Business ethics also form a part of these intangible assets of the organisation that enable it to stand out from competitors.

In the rapidly evolving domestic and international markets, intangible assets have become increasingly important. As companies develop or acquire similar tangible assets, companies rely on their intangible assets to sustain their competitive advantage. Therefore, it has become essential for them to protect, utilise, and improve their unique intangible assets, such as business ethics.

When an organisation implements a value-creating strategy, which other companies cannot copy, then the company achieves a sustainable competitive advantage globally. For example, the leadership of Tata Consultancy Services (TCS) is successfully able to enhance the company's integrity capacity among customers, suppliers, and employees. As a result, TCS has emerged as the first 100 billion dollar company in India.

Companies that can demonstrate superior integrity are able to perceive the interdependent relationship of their multiple stakeholders and manage them responsibly. They demonstrate ethical awareness and effectively respond to ethical issues. To achieve organisational excellence, their leaders can and should be responsible for improving the integrity capacity (which is an intangible asset) of their organisations. The domestic and international markets are increasingly evaluating which organisations have demonstrated superior integrity and which are just paying lip-service.

Moreover, sustainable competitive advantage requires change. This means that organisations must tap the demand for business ethics, rather than ignore it. Business ethics involves building effective relations with stakeholders on the basis of integrity, trust, and mutual respect. Organisations must treat all its stakeholders as consulting parties rather than just mute spectators. This would enable organisations to effectively and sustainably improve their financial performance.

SELF ASSESSMENT QUESTIONS

11. Business ethics should be part of the __________ and ____________.
12. Business ethics constitute a tangible asset of a company. (True/False)

11.8 SUMMARY

- Business ethics and values are the principles or code of conduct that a business uses in daily transactions. They help to prevent ethical issues that may arise in day-to-day running of operations, such as insider trading, corporate governance, bribery, discrimination, corporate social responsibility and fiduciary responsibilities.
- Values of an organisation represent what the organisation stands for. They describe an ideal set of criteria on the basis of which the organisation decides what is appropriate.
- The core values of an organisation are used to determine the organisation's vision and mission statements. They guide the organisation in determining what is right and what is wrong.
- Business ethics deal with doing what is right or wrong. An ethical behaviour is about being consistent with right values in normal day-to-day transactions.
- Business ethics are based on values, are relative, are both objectives and means, have a social responsibility, and are not obligatory by law.

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- Some common business ethics are fairness to all, transparency, valuing of employees, employee ethics, and environmental ethics.
- Business ethics help an organisation to develop credibility, generate goodwill, improve the confidence of customers, prevent malpractices, protect customers' rights, gain a competitive advantage, develop good industrial relations, and satisfy basic human needs.
- Each business has its own core set of values, which may or may not be specifically stated. These values guide employees in achieving not only the organisation's objectives, but also their individual goals.
- Some critical values that a business should adopt are problem solver, ambition, transparency, empathy, adaptability, focus, and integrity.
- An organisation may face a moral crisis where there is no clear right way of dealing with a complicated situation. These gray areas constitute ethical dilemmas, which arise when an organisation needs to choose between two options, neither of which resolves the situation in an ethically acceptable fashion.
- When facing an ethical dilemma, organisations should apply principled thinking, use moral creativity, and identify self-moral value to set ethical standards.
- Globalisation has impacted business ethics by bringing in cut-throat competition and the desire to acquire more and more material things. In the rush to achieve increasing profit margins, companies have damaged the natural environment and traditional communities. Therefore, environmental ethics and child labour are some concerns that need to be resolved sensibly.
- Business ethics are part of intangible assets of a company, which enable the company to gain an advantage over its competitors.

11.9 KEY WORDS

- **Intangible asset:** An asset of a company that does not have a physical form but has a value to the company. They include patents, copyrights, goodwill, and ethics of a business.
- **Integrity:** The quality of being truthful and demonstrating a steady and inflexible devotion to strong moral and ethical principles and values.

11.10 CASE STUDY: JOHNSON & JOHNSON (J&J) TYLENOL CONTROVERSY

Source: *http://www.icmrindia.org/free%20resources/casestudies/Business%20Ethics/Johnson%20&%20 Johnson's-Tylenol%20Overdose%20Controversy.htm*

This case study explores the various ethical issues surrounding J&J's product Tylenol.

Background

Founded in 1886, J&J is a leading healthcare company and manufacturer of medical devices and pharmaceutical products. In 1956, it acquired McNeil Laboratories, which used to sell the painkiller Tylenol as an over-the-counter (OTC) drug. During the 1960s, the aggressive production of Tylenol made it the most popular drug as compared to other analgesics such as Aspirin and Ibuprofen.

In 1974, J&J acquired a healthcare company StimTech, which used to sell an innovative product called Transcutaneous Electronic Nerve Stimulator (TENS).

TENS was more effective than other analgesics as it would reduce pain by electronic means. However, TENS failed due to inadequate promotion by J&J. StimTech's founders sued J&J alleging that the company deliberately suppressed TENS as it was a potential competitor to Tylenol. J&J lost the lawsuit and had to pay $170 million in damages.

In 1975, J&J slashed Tylenol's price by one-third to beat a low-priced analgesic called Datril. The sales revenue of Tylenol in 1975 was $50 miilion which increased to $400 million in 1981. The sales revenues of Tylenol over the years is shown in Table A:

Table A: Tylenol's YOY Sales

Year	1975	1976	1977	1978	1979	1980	1981	1982	1983
Sales (in $ million)	50	80	110	150	200	280	400	210	70

Source: *Strategic Management, John A Pierce and Richard B Robinson*

The share of Tylenol in the US Analgesics Market is shown in the Table B:

Table B: Tylenol's Share in US Analgesics Market

Product	Tylenol	Anacin	Bayer	Excedrin	Bufferin	Anacin 3	Others
Market Share (in %)	37	13	11	10	9	3	17

Source: *Strategic Management, John A Pierce and Richard B Robinson*

Crisis

In 1982, a 12-year-old girl named Mary Kellerman of Chicago died after she took extra strength Tylenol capsules for headache. Subsequently, there were 6 more reported deaths within 2 days after consuming Tylenol. The news spread like a wild fire and created the nationwide panic. A hospital in Chicago received 700 distress calls in a single day. People started admitting themselves to hospitals fearing cyanide poisoning. In just 10 days, J&J received 1411 calls from customers.

Responding to the crisis, J&J sent alert messages to its consumers via the national media and the police against consuming any type of Tylenol product. The company recalled all the Tylenol bottles from the US retail stores, which were 31 million bottles worth more than $100 million. It temporarily closed the production, distribution, and advertising of Tylenol. This was followed by a warning from the Food and Drug Administration (FDA) of the US against taking Tylenol capsules.

Solution

J&J fully cooperated with the federal investigators to determine the cause of cyanide tampering. After testing of 8 million Tylenol capsules, it was revealed that in six different stores in Chicago, 75 capsules had been opened and filled with 65 mg of cyanide in eight different bottles. Although the tampering was local, the company decided to recall all Tylenol products at the national level. This decision led to a loss of $1.24 billion due to the damage of goodwill and brand value. The market share of J&J dropped from 37% in early 1982 to just 7% by late 1982.

To rebuild its image, J&J launched an aggressive promotional campaign. James E. Burke, then Chairman and CEO of J&J said, *"It will take time, it will take money, and it will be very difficult, but we consider it as a moral imperative, as well as good business, to restore Tylenol to its preeminent position."*

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By the end of 1982, J&J relaunched Tylenol in a new triple-tamper-resistant package. As a result, the company recaptured 32% of its previous 37% market share just 6 months after bottle tampering.

The company was lauded for its prompt action in recalling Tylenol products and giving priority to consumer safety over loss of revenue. The company's honest, open, and transparent communication with the public helped it to maintain its credibility and establish trust with the public. Instead of considering the financial loss, the company's CEO, James Burke, sent a team of scientists to investigate the source of tampering. Although the company's stock declined in the immediate aftermath of the crisis, it soon recovered due to the positive and honest communication by the company to the shareholders, customers, and general public.

According to a news report in Washington Post, it may have been tempting for the company to delink Tylenol from the reported deaths, citing illegal tampering. However, the company did not attempt any such thing. Instead, it honestly tried to find the cause of deaths taking all the moral responsibility. The company even put up a reward of 1 million dollars to trace the killer.

Aftermath

In 1986, when things were going well for Tylenol, another case of product tampering erupted. A woman in New York died after consuming Tylenol. This time also, J&J recalled all the Tylenol capsules. The company decided to discontinue the production of Tylenol capsules and replaced them with new solid caplets, which were relatively more tampering-proof. However, analysts criticised the company claiming that after the 1982 incident, it should have been more alert and proactive about product safety.

In the following years, J&J again faced a major crisis when some people died due to the overdose of Tylenol. In 1989, a 5-year-old girl died from its overdose. In early 1990s, a 14-month-old girl was given an overdose of infant Tylenol drops as per the paediatrician's advice. The infant drops were 3-and-a-half times stronger than the average dose of children's medicines. The infant girl survived after her liver tissue was transplanted but she had to consume immunosuppressant drugs for the rest of her life. In 1993, an alcoholic overdosed on Tylenol and had to be saved only through a liver transplant. There were several such incidents reported when people died or suffered from severe liver damage due to Tylenol's overdose.

The reason was attributed to acetaminophen, which was the main ingredient of Tylenol. Acetaminophen was used to relieve from mild and moderate pain in simple headaches, muscle aches, and mild arthritis. It was more effective than Aspirin or Ibuprofen, which would cause gastrointestinal ulcers. However, in large doses, it would damage the liver tissue.

The consumers gradually found out about the proper doses of Tylenol. They realised that even double the prescribed dose was dangerous to the liver. However, despite all the prescribed doses, the accidents could not be averted. Tylenol was marked as a 'Safe' alternative to Aspirin and it came in different flavours which the children liked. Therefore, the children would take one more spoon of Tylenol. Then, there were normal confusion when one parent did not know that the other parent had already given a dose to the child. Some parents were not even aware of the harmful effects of overdosing on Tylenol. It was also found that Tylenol was harmful if taken along with alcohol and other medicines on an empty stomach.

Despite these harmful side effects, Tylenol was promoted with the tag line "Nothing's Safer." As per the US FDA, it came only with the warning labels of alcohol-related risks. Despite the negative publicity and lawsuits, which cost the company millions of dollars, J&J refused to put explicit warnings in Tylenol labels. It just put in a cosmetic change to the label: "Not for use for children".

As per critics, the company resisted from putting any explicit warning labels, as it would have alerted people against using Tylenol and the sales would have dropped. In their defence, J&J claimed that they did not put a label linking the overdose of Tylenol with the liver failure because the "organ-specific" warning would have confused customers. The company said that it did not publicise the harmful effects of acetaminophen to prevent suicidal people from taking the drug overdose.

When the studies revealed Tylenol-related liver damages, J&J advised its sales reps to avoid discussing the issue with the doctors. Instead of suggesting concrete measures to prevent drug overdose, it suggested that the patients themselves keep a record for the doses they have taken. This was a recommendation in a patient education brochure given to the doctors.

In 1990-1997, the company faced at least 100 lawsuits over acetaminophen poisonings. J&J settled four cases out-of-court and put in the clause of remaining silent about the terms to the plaintiffs in their settlements.

Analysts felt that J&J did not properly take steps to make the public aware of the harmful effects of Tylenol to protect its high profit margins. The annual revenue of Tylenol was $1.3 billion in 1996, while acetaminophen was available at about half the price. A substantial part of that profit was spent on Tylenol promotion. The domestic advertisement budget for Tylenol in 1997 was $250 million, which was more than the ad budget spent by Coca-Cola on Coke.

Conclusion

J&J's response to Tylenol controversy in 1990s was in sharp contrast to their response a decade earlier, when the company had exhibited sincere and responsible business ethics. In 1982, under the stewardship of James Burke, the company had taken personal responsibility for public safety. However, in the 1990s, the company sacrificed business ethics for profit. According to the American Association of Poison Control Centers, there were 100 deaths every year due to acetaminophen.

QUESTIONS

1. What was the reason of Tylenol-related deaths in 1982? Explain the ethical steps taken by J&J to avert that crisis.

   (**Hint:** Tampering of Tylenol capsules with cyanide.)

2. What was the reason of Tylenol-related deaths in 1990s? Explain how the company failed in business ethics.

   (**Hint:** The main ingredient Acetaminophen which caused liver damage in large doses.)

11.11 EXERCISE

1. What do you mean by business ethics and values? Explain the features of business ethics.

NOTES

2. What are the benefits of ethical business practices? Illustrate with a real-life example.
3. What are the values in business? List the common values used by the top businesses in India from different industries.
4. What is an ethical dilemma? Explain with an example. What should be considered while facing an ethical dilemma?
5. What is the impact of globalisation on business ethics? How can the climate for ethical behaviour be improved?
6. Explain the role of business ethics as a competitive advantage.

11.12 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
Meaning of Business Ethics and Values	1.	b. Organisational values
	2.	a. They are not universally applicable.
Advantages of Ethical Business	3.	c. Climate change
	4.	a. Ben & Jerry's protest of Recombinant Bovine growth hormone in cows
Values in Business	5.	Values
	6.	d. Apple
Ethical Dilemma	7.	d. Ethical dilemma
	8.	b. Objectivity
Impact of Globalisation on Business Ethics	9.	c. Environmental ethics
	10.	a. Employing child workers in India
Business Ethics as a Competitive Advantage	11.	corporate code; corporate philosophy
	12.	False

11.13 SUGGESTED BOOKS AND E-REFERENCES

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CHAPTER 12

Emerging Trends in India's Business Environment

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LEARNING OBJECTIVES

After studying this chapter, you will be able to:

- Describe the nature of business environment
- Discuss India's growth with respect to the world economy
- Know the factors which influence business environment
- Discuss the different macro/external factors of business environment
- New trends of business
- Business opportunity in the rural sector

12.1 INTRODUCTION

In the previous chapter, you have studied about business ethics and values. In this chapter, you will study about the emerging trends in India's business environment.

In the current fast-paced global economy, industries are facing demands like never before. Customers expect products that are more customised to their individual preferences and needs. However, factors like globalisation, rapid advancement of technology, pace of innovation, evolution of communication systems and flow of information have drastically changed the meaning of competitiveness across the world economy. Increasing competition requires that organisations continuously evolve and better themselves else they may face grave situations.

Organisations are constantly affected by various components such as socio-cultural, political, economic and international forces. The drastic changes in the production and consumption pattern have continuously been creating opportunities for business growth. India is also coping up with the world economy dynamics in a great manner. In the last decade, the technological and global factors have major impacts on the Indian economy. The flourishing trade across the world made it essential for every organisation to understand the global business environment and recent trends in the business environment. From the last few decades, business trends are changing rapidly. The basic purpose of any business is to create customers and for this they must have to screen out the threats in the market and convert them into opportunities.

In this chapter, you will study about India's competitiveness in the World economy, external influences on India's business environment, competitive trends in business environment and business opportunities in the rural sector.

12.2 INDIA'S COMPETITIVENESS IN THE WORLD ECONOMY

For an economy, competitiveness refers to its ability to provide products and services in a more effective and efficient manner than its competitors. When a country is able to maintain or enhance its share of trade in the global economy without protection or subsidies, it means that the country is highly competitive. When an organisation is able to succeed in its home country or in the nearby country, it is usually a result of optimal transportation costs. On the contrary, if an organisation is able to truly trade with far-off countries, it is usually a result of superior productivity or technology. Truly competitive organisations gain competitive advantage using superior productivity. The competitiveness of a country is dependent upon the competitiveness of its domestic organisations.

The competitiveness of any country with respect to other countries of the world can be estimated using various ad-hoc or customised measures. However, the Global Competitiveness Report published by the World Economic Forum (WEF) is used as the internationally accepted measure of global competitiveness. WEF evaluates the competitive landscape of 137 countries on the grounds of economic and productive factors. The top three positions are attained by the United States, Switzerland and Singapore, respectively. India has earned the 58th position in the WEF and is considered as the leader among the South Asian economies because of its market size and innovation. Indian economy should improve its health, skills and education sector in order to accelerate its position in the list. With rapid expansion in the service industry and globalisation, India has gained the status of the fastest growing economy in the world.

SELF ASSESSMENT QUESTIONS

1. India has earned _____ position in the WEF.
   a. 28th b. 58th
   c. 15th d. None of these
2. _____________ refers to its ability to provide products and services in a more effective and efficient manner than its competitors.

12.3 EXTERNAL INFLUENCES ON INDIA'S BUSINESS ENVIRONMENT

Business Environment is comprised of various factors such as demographic factors, economic factors etc. Each and every factor affect the business environment directly or indirectly. In order to sustain in the competitive environment, every organisation has to identify, learn, change and adapt the new business trends and policies so as to keep up with the dynamic business environment.

Business environment has some internal and external factors that influence the smooth working of business. According to Barry M. Richman and Melvyn Copen *"Environment factor or constraint largely if not totally, external and beyond the control of individual industrial enterprises and their management. These are essentially the 'givers' within which firms and their management must operate in a specific country and the vary, often greatly, country to country."*

Business environment can be categorised into two types; Micro Environment and Macro environment. Micro environment consist of employees, suppliers, customers, competitors and the local community. On other hand, macro environment included all the external factors such as economic, demographic, political, etc.

Environment must be scanned to determine the threat and opportunities for the business. It is the process of gathering all the information regarding organisation's environment, analysing and predicting the impact of environment changes. It helps an organisation in achieving its objectives and goals by making informed decisions.

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External factors which influence an organisation working is beyond the direct influence and control of the organisation. External factors include individuals, group, agencies, events and conditions. To understand the impact of external influences on business environment we must go through with the factors given below:

- **Economic Factors:** The economic environment includes economic status of the country i.e. manpower market, money market, supply market, and so on. It influences the supply of raw material, their cost and quality. The purchasing power of the company depend on the income, price of the product or services, credit availability. Strategist must analyse, understand, scan, monitor and forecast key economic factors that are:
  - Level of disposable income
  - Global Movement of labours
  - Import & Export
  - Inflation Rates
  - Income distribution
  - Demands of Product
  - Interest Rate
  - Tax Rate
  - Government Budget
  - Consumption Pattern
- **Technological Environment:** Technology is the most important factor which affects the business environment. Technology has changed the communication and system via internet and telecommunication. It has been changing the business trends and creating new business opportunities both in domestic and international market. Technological innovations help to adopt new ways of performing business tasks. E-Trading, e-retailing are a few emerging trends in today's competitive business environment.
- **Demographic Factors:** The term Demographic factor consist of age, gender, income, education, population, employment. Demography refers to the characteristics of the population. India has younger population in the comparison of other country. Multinational companies are interested in India just because of its population size. India is having approximately 16% of world's population, our country holds great potential in all over the world in terms of man power.

  Business organisation screened out the different demographic factors, which has direct influence on business environment, they need to understand the following issue:
  - Population size has great impact on business environment. As increase and decrease in birth rate affect the demand and supply pattern. Indian market size is larger than other countries which provide massive growth opportunities for business within the domestic market.

- Geographic dispersal has direct impact on business. Population who shifted from one state to other state or non-metro city to metro city can affect the organisation's strategic competitiveness.
- Ethnic group has an implication for the organisation. Change in ethnic group has direct influence on organisation's potential customer and existing workforce.
- Distribution of income is important because changes in income will affect the consumption and saving patterns. Income distribution determines the market possibilities.

❍ **Global Environments:** In the present time organisation must screen out the global environment as it is rapidly changing. Migration of people from one region to other and from one country to other country, affects the operation of the organisation. Now Indian companies are going global in order to explore the opportunities in global market. Modes of entry, currency valuation etc. should be taken into consideration in order to know the global business environment.

❍ **Legal Environment:** Every organisation has to fulfil legal obligations and government rules and regulations. If legal compliance is not executed timely, it hampers the smooth functioning of the organisation. It is important to know the requirement of licensing, income tax compliance etc in order function as per the country's laws and regulation.

Self Assessment Questions

3. In order to sustain in the competitive environment, every organisation has to identify, learn, change and adapt the new business trends and policies so as to keep up with the dynamic business environment. (True/False)
4. ____________ refers to the characteristics of the population.

12.4 COMPETITIVE TRENDS IN BUSINESS ENVIRONMENT

Here, we will discuss the emerging trends of business environment. The competitive trends in the business environment and economic environment take place in a number of areas and are dependent on one another. Nowadays, the workforce is diversified, competition has intensified and technology has dramatically accelerated the scope and speed of different tasks. All organisations, whether small or large, have to function properly while meeting these changing and competitive challenges. The major competitive trends in the business environment are as follows:

❍ **Globalisation:** One of the major changes in the business environment is the globalisation of business. Over the number of years, business organisations have become global in character and are crossing their national boundaries in the pursuit of expanding business opportunities. As businesses go global, the economic and environmental changes of countries other than the home country in which a company carries out its operations, affect the performance levels and business decisions of firms. Moreover, the transformation of the manufacturing economy into rapidly growing service economy has posed challenges in respect of the need for expert knowledge and skills of employees and their improved job performance.

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- **Business Process Outsourcing (BPO):** One of the emerging trends in business is the procurement of goods or services from an outside manufacturer or service provider. Organisations have nowadays adopted a new strategy of outsourcing which has increasingly resulted in the reorganisation of supply chain. Outsourcing refers to the process of delegating non-core jobs or business processes from the internal production to an outside party. It is generally adopted by businesses so as to focus on their core competencies, achieve efficiency and cost effectiveness.
- **Revolution in Information Technology:** Information Technology (IT) creates competition in the business world and one can easily get information related to anything from anywhere. Through the digitisation of information and rise in technology innovations, more and more business enterprises are fruitfully leveraging the benefits offered by digital tools to improve their future business prospects. Organisations must update their technologies to ensure continuous business development and to secure their stake in the marketplace.
- **Removal of trade and tariff barriers:** With the liberalisation of trade, barriers or restrictions on the free exchange of goods and services between nations have taken place easily. Such tariff barriers comprise of duties, surcharges, licence regulations and quotas. The reduced regulation results in reduction in costs for countries which often trade with other countries or nations. This ultimately promotes free trade and lowers the consumer costs since imports are subjected to lower fees and increase in competition.
- **Changes in customer needs and habits:** Customers are the kings of all businesses as their satisfaction leads to optimum profits or sales. However, customers' needs and habits are changing rapidly. Nowadays, orgnaisations find it difficult to determine as to which products can fulfil the needs or demands of the customers. Businesses are hugely impacted by varied tastes and diversified requirements of customers. Identification of customers' demands and findings out ways to satisfy their specifications or priorities is a complex task faced by business enterprises.

SELF ASSESSMENT QUESTIONS

5. Trade liberalisation resulted in free exchange of goods and services between nations. (True/False)
6. ____________ refers to the process of delegating non-core jobs or business processes from the internal production to an outside party.

12.5 BUSINESS OPPORTUNITIES IN THE RURAL SECTOR

Business in rural areas has an important role to play in the development of Indian the economy. Taking into consideration the fact that about 70 per cent of the Indian population recognise rural India its home, adequate funding and support can provide a thriving entrepreneurial atmosphere in the rural sector. However, it is known that rural India as compared to the mainstream population is economically poor, younger, geographically isolated, isolated from the markets, culturally rooted in tradition, less flexible economically and facing depopulation.

With a young population that is rising to leadership and technology driving growth and innovation, there are several business opportunities in multiple sectors.

It is a way easier to start a business in rural areas because the business can be started with less initial capital and the overhead expenses are comparatively low. And secondly, it is easier to organise a business in a rural area where people know each other. The government is also providing funds and schemes to enhance the business opportunity in rural areas. There are some businesses that can be started in rural areas. Here, we will discuss the important business opportunities in rural areas:

- **Fertilisation and seed store:** Fertilisers are extensively being used to improve per hectare production of crops that can be used for food and industrial applications. This business can be started in rural areas.
- **Organic farming:** A local farming business can be started which adopts strictly organic methods to cultivate vegetables, fruits, sauces and local delicacies. This business would be a success, as people would come from different areas to buy organic products. For this type of business, one can sell produce, which are officially labelled organic or still organic with no label.
- **Selling fresh eggs:** Starting a poultry business or rearing does not need a lot of lands. However, state laws need to be checked to see if the requirements are to be met without difficulty.
- **Jute bags making:** It is the best eco-friendly business opportunity. Jute is also called golden fibre which is grown by farmers of rural areas and is bio-degradable along with a high cash value. Purchase raw jute from the farmers and start a business, then it will bring profit to them as well as you.
- **Waste management:** Tons of waste is generated in rural and urban areas. The disposed waste is a conglomerated form of organic as well as non-organic waste. utilising scores of wastes and transforming it into a usable product is a good deed as well as a business in rural areas.
- **Development of solar project:** Solar energy is finding important applications in this field. If India starts using solar power as an alternative source of energy, it can lead to positive social and economic gains.
- **Tea gardening:** Tea gardening is a good choice for people who are passionate about tea. This business does not require a huge tract of land for planting tea shrubs. In fact, tea gardening can be done in balconies. For this choice, the soil needs to be fully drained and sandy.
- **Beekeeping:** Beekeeping is an area of investment that has not been explored fully and it is a beneficial and high return business because it requires less time and money. Also, the infrastructure investments are minimum. This can be initiated by individuals or groups.
- **Fish farming:** In India, fish farming is one of the most profitable and successful businesses. Due to increasing population, the demand and therefore the price of fish has been increasing. Therefore, fish farming is one of the most sought after business.
- **Dairy enterprises:** Rural areas are more suitable for setting up a dairy farming business. In India, the majority of the dairy farmers raise animals using traditional methods. It does not require highly skilled labour. This business can easily set up small scale dairy farm with family members.

Notes

Self Assessment Questions

7. Smaller capital and lower ____________ is required to start business.
8. Starting a poultry business or rearing needs a lot of land. (True/False)

12.6 SUMMARY

- In the last decade's technological and global factors has the major impact on the Indian economy. World trade has been flourishing that is why it is essential for every organisation to understand the global business environment and recent trends in business environment.
- For an economy, competitiveness refers to its ability to provide products and services in a more effective and efficient manner than its competing countries.
- India has earned the 58th position in the WEF and it is considered as the leader among the South Asian economies because of its market size and innovation.
- Business environment can be categorised into two types; Micro Environment and Macro environment. Micro environment consist of employees, suppliers, customers, competitors and the local community. On other hand, macro environment included all the external factors such as economic, demographic, political etc.
- Today, the workforce is diversified, competition has intensified and technology has dramatically accelerated the scope and speed of different tasks. All companies, whether small or large, have to function properly while meeting these changing and competitive challenges in business environment.
- The major competitive trends in business environment are globalization, business process outsourcing, revolution in information technology, removal of trade and tariff barriers, and changes in customer needs and habits.
- Business in rural areas has an important role to play in the development of Indian the economy.
- Taking into consideration the fact that about 70 per cent of the Indian population recognise rural India its home, adequate funding and support can provide a thriving entrepreneurial atmosphere in the rural sector.

12.7 KEY WORDS

- **Tariff:** A form or tax or duty that is imposed on some particular classes of imports and exports.
- **Disposable Income:** The amount of income that every household has for savings and spending after paying income tax.
- **E-retailing:** The sale of goods and services using an electronic B2C platform using the internet.
- **E-trading:** The process of selling and purchasing of financial products over the internet.

12.8 CASE STUDY: FMCG COMPANIES' BUSINESS OPPORTUNITIES IN RURAL MARKETS GOING AHEAD OF URBAN MARKETS

NOTES

Changing patterns of lifestyle and consumption habits in the rural sector are replacing traditional livelihoods and setting the platforms for undergoing transformations in the coming future. With abundant budget allocation of Indian Government to water and electricity resources in rural areas and by raising Minimum Support Price in relation to agricultural produce, agricultural income is likely to increase and multiply in size.

The rural business sector is contributing to about 40% of the overall sales figures. Giant FMCG companies such as Hindustan Unilever and ITC have gone beyond their marginal expectations in terms sales revenue owing to growth in rural business and exceedingly increasing rural customers. During the third quarter of September 2018, ITC's sales rose by 15.4 percent and that of Hindustan Unilever rose by 10 percent. In the past few years, the upward trend in rural sales and agricultural business has become the driving force of future business growth potential of FMCG companies in India.

The growth roadmap of ITC and Hindustan Unilever has been on the surge due to their rural segment sales growth. Hindustan Unilever has its operations spread across foods solutions, beauty care and home care range of products. Because of the rising lifestyle aspirations of youth in rural India, Hindustan Unilever's beauty care and home care products were widely sold in rural and semi-rural regions. In fact, growth of rural sector is moving ahead of the urban sector counterparts. Therefore, the managers of Hindustan Unilever are of the perception that rural business has the potential to reach heights in future. Just like Hindustan Unilever, ITC also operates heavily into agricultural, paper, cigarettes and FMCG products which in turn reaches out to rural markets. ITC's management has noticed stable demand in business environment of rural markets.

With rise in rural business opportunities, the challenges faced by rural managers are also increasing. Rural managers should possess entrepreneurship skills and knowledge about agri-business culture, rural livelihoods, rural-urban interdependence, water and nutrition management issues and value chain processes. Experts in rural management and development are in high demand because of the enhancement in rural business opportunities. Many degree and diploma programmes are also provided by reputed management institutions across India to standardise and conceptualise educational requirements of prospective rural managers.

Source: *Rural growth for FMCG companies inching ahead of urban markets. (2019). Retrieved from https://www.moneycontrol.com/news/business/companies/rural-growth-for-fmcg-companies-inching-ahead-of-urban-markets-3136321.html*

QUESTIONS

1. What insights were observed in respect of ITC and Hindustan Unilever sales in rural sector?

   (**Hint:** ITC and Hindustan Unilever have been on the surge due to their immense growth in rural sector sales. For them, the growth of rural sector is moving ahead of the urban sector counterparts.)

NOTES

2. Are rural managers required to possess some specific skills?

   (**Hint:** Due to an increase in business opportunities in the rural sector, the challenges faced by rural managers are also increasing. They need to acquire requisite skills related to rural management and development.)

12.9 EXERCISE

1. What do you mean by business environment?
2. What are the major external factors which influence business environment?
3. What are the different business opportunities in rural areas?
4. Discuss in brief some of the emerging trends in business environment.

12.10 ANSWERS FOR SELF ASSESSMENT QUESTIONS

Topic	Q. No.	Answer
India's Competitiveness in the World Economy	1.	b. 58th
	2.	Competitiveness
External Influences on India's Business Environment	3.	True
	4.	Demography
Competitive Trends in Business Environment	5.	True
	6.	Outsourcing
Business Opportunities in the Rural Sector	7.	overhead
	8.	False

12.11 SUGGESTED BOOKS AND E-REFERENCES

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